

The Influence of Blockholders, Bondholders and Families on the Venturers' Accounting Behavior

Simona Catuogno¹, Claudia Arena¹, Sara Saggese¹ & Fabrizia Sarto¹

¹ Department of Economics, Management, Institutions, University of Naples Federico II, Naples, Italy

Correspondence: Simona Catuogno, Department of Economics, Management, Institutions, University of Naples Federico II, Via Cinthia 26, 80126, Naples, Italy. Tel: 39-081-675-061. E-mail: simona.catuogno@unina.it

Received: April 22, 2016

Accepted: May 26, 2016

Online Published: July 18, 2016

doi:10.5539/ijbm.v11n8p31

URL: <http://dx.doi.org/10.5539/ijbm.v11n8p31>

Abstract

Relying on the opportunistic view of contracting theory, the paper explores the influence of blockholders, bondholders and families on the managerial accounting for interests in jointly controlled entities. In particular, it assumes that the equity method is an opportunistic accounting choice as it improves firm performance and induces managerial self-dealing rather than efficient contracting. The paper examines a sample of Italian listed companies holding interests in jointly controlled entities through a logistic regression analysis. Findings show that the family influence encourages the opportunistic choice of equity method, while the monitoring role played by blockholders and bondholders discourages the use of the performance-improving technique. The research contributes to the literature on contracting theory and corporate governance and has also practical implications for evaluating the appropriateness of IFRS 11.

Keywords: jointly controlled entities, equity method, contracting theory, managerial opportunism

1. Introduction

The accounting for jointly controlled entities (hereafter JCEs) has always been a debated issue for scholars, practitioners and regulators (Catuogno, Allini, & D'Ambrosio, 2015a). Even after the issuance of IFRS 11 "Joint Arrangements" (that removes the proportionate consolidation to increase comparability within IFRS and convergence with US GAAPs), the reporting of JCEs remains a controversial accounting topic as witnessed by the ongoing academic debate that does not support the IASB conclusions and brings to light the necessity of additional research (Lourenço, Fernandes, & Curto, 2012; Demerens, Manh, Delvaille, & Paré, 2014; Leitner-Hanetseder & Stockinger, 2014). A further proof on the relevance and timeliness of the JCEs' reporting is also provided by the IASB's intention to start a post-implementation review of IFRS 11 in 2016, so as to obtain information on unexpected costs or difficulties related with the transition towards the equity method.

On the basis of these premises, previous studies have investigated the determinants behind the accounting options for JCEs before the issuance of IFRS 11 (e.g. Lourenço & Curto, 2010; Giner & Veron, 2012; Catuogno et al., 2015a). Nevertheless, none of them has still questioned whether the choice of equity method may conceal managerial opportunistic behavior rather than efficient contracting when some corporate governance determinants occur. The paper builds on the opportunistic view of contracting theory and explores the effect of family influence and monitoring by blockholders and bondholders on managerial accounting behavior.

Recent empirical studies in the European setting confirm that the transition to the equity method would significantly improve the financial leverage and the profit margin (Lourenço et al., 2012; Demerens et al., 2014; Leitner-Hanetseder & Stockinger, 2014). Therefore, arguing that the equity method is a performance-improving accounting technique, the paper assumes that it can be considered as an opportunistic treatment that induces managerial self-dealing rather than efficient contracting (Davis & Largay III, 1999; Kothavala, 2003; Lourenço & Curto, 2010). Some distinctive features of the Italian institutional setting make particularly appealing the investigation of JCEs in Italy. First, a previous study has found a medium level of comparability among Italian consolidated financial statements in reporting the JCEs. Specifically, before the issuance of IFRS 11, almost half of the Italian venturers adopted the equity method, while the others employed the proportionate consolidation to account for JCEs (Catuogno & Allini, 2011). Second, an empirical investigation on the Italian setting has emphasized that the desire to achieve a greater informativeness of financial statements explains the adoption of the proportionate consolidation (Catuogno et al., 2015a). Third, Italy represents a peculiar setting in terms of

ownership and financial structure of firms. Indeed, it may be considered as representative of a family business environment in which family members play a relevant role in ownership, management and board composition (Zattoni, 1999). Moreover, in this country, debt contracts represent the main source of financing (Di Pietra, Gambovas, Raonic, & Riccaboni, 2008; Miller, Catuohhilli, & Corbetta, 2013). Lastly, a content analysis on the comment letters submitted to the IASB after the publication of the joint venture project “ED 9” by preparers, accounting professions, investors, national standard setters and market regulators, has pointed out that Italy strongly disapproved the withdrawn of proportionate consolidation. Indeed, according to the Italian respondents, on the one hand, the proportionate consolidation better represents the JCEs’ business; on the other hand, the equity method results in the omission of important elements from financial statements, such as indebtedness (Alexander, Delvaile, Demerens, Le Manh-Béna, & Saccon, 2012).

Relying on a logistic regression, this paper shows that the managerial opportunism drives the equity method choice. After controlling for a number of variables, the empirical results highlight that, while the growing family influence fosters the opportunistic selection of equity method, the monitoring role played by dominant shareholders and bondholders discourages the use of the performance-improving accounting technique.

The research has both theoretical and practical implications. In detail, the paper contributes to the contracting theory and the governance literature and addresses the general call for more research on the proper accounting for JCEs (Alexander et al., 2012; Demerens et al., 2014). In this sense, it provides a contribution to the international standard setting debate by offering evidence on the managerial opportunism in the adoption of equity method.

The remaining paper unfolds as follow. Section 2 provides the theoretical background. Section 3 formulates the research hypotheses. Section 4 describes the research sample and the variables. Section 5 shows the results. Section 6 concludes and suggests directions for future research.

2. Theoretical Background: Managerial Opportunism in Accounting Choices

The contracting theory assumes that managers select particular accounting procedures, either efficiently to attain corporate objectives (i.e. maximize firm value or minimize political exposure and agency costs) or opportunistically to manipulate earnings and reflect accounting numbers for their own benefit (Watts & Zimmerman, 1978; Holthausen, 1990).

The extent of efficiency and opportunism depends on the monitoring devices over managerial accounting discretion. In this sense, the efficient contracting view predicts that accounting practices evolve to mitigate contracting costs by addressing potential conflicts of interests between types of parties. Differently, the opportunistic view suggests that managers choose accounting policies for their own benefit which depends on debt covenants, political costs and bonus plans (Watts & Zimmerman, 1986; Holthausen, 1990).

Most empirical studies on accounting choices mainly focus on their effects on firm income and provide evidence on the incentives to choose income-increasing accounting methods related to leverage and bonus plans (Abdel-Khalik, 1985), as well as to choose income-decreasing accounting treatments related to political visibility and tax minimizing purposes (Karampinis & Hevas, 2013; Beuselinck & Deloof, 2014).

This paper builds on the opportunistic view of contracting theory as a focal point to support the discussion on the managerial choice for the accounting treatment of JCEs.

In this sense, before the debated issuance of IFRS 11 revised, the reporting of JCEs followed two accounting treatments allowed by IAS 31: the proportionate consolidation and the equity method. Under the former, the venturer’s proportionate share of the JCE assets, liabilities, revenues and expenses are added to its own items in the consolidated financial statements. Under the latter, JCEs are reported as a single line item investment in the statement of financial position, net income, changes in equity and statement of comprehensive income.

It is worth noting that accounting literature suggests that the proportionate consolidation is especially informative for a number of reasons. In particular, it provides a comprehensive view of the venturer financial position and its incumbent risks and rewards (Dieter & Wyatt, 1978). Moreover, it appears useful in predicting future returns on shareholders (Graham, King, & Morrill, 2003) and it is also relevant for explaining price volatility (Kothavala, 2003). Thereby, it offers relevant financial statement measures for bond risk premiums and bond ratings (Stoltzfus & Epps, 2005), avoiding the loss of relevant and forecasting information (Soonawalla, 2006; Bauman, 2007).

Differently, the equity method aggregation leaves out accounting numbers of joint venture, compared to the proportionate consolidation. Indeed, under the equity method, total assets and total liabilities are always lower, and the magnitude of the joint venture indebtedness is hidden. In addition, the leverage of the venture, as

reflected by the liabilities to equity, results in a lower percentage (Astami & Tower, 2006). The same effect occurs in the statement of comprehensive income, being revenues and expenses always lower. This phenomenon produces a higher profitability for the venturer, measured in terms of profit margin, as reflected by net income to revenues (Davis & Largay III, 1999; Kothavala, 2003; Lourenço & Curto, 2010).

On the basis of these theoretical assumptions, and arguing that the equity method is a performance-improving accounting technique, the paper assumes that this treatment can be considered opportunistic since it induces managerial self-dealing rather than efficient contracting.

Following the corporate governance literature (Zattoni, 1999), this paper explores the effect of family influence and monitoring role of both blockholders and bondholders on the managerial accounting behavior.

In general terms, controlling shareholders have the incentive to monitor managers and maximize shareholder value (Jensen & Meckling, 1976; Shleifer & Vishny, 1986). Nevertheless, especially in family firms, large blockholders manage the company they control and a problem of separation between ownership and control arises. Indeed, top managers are usually part of the controlling family and have the power to expropriate minority shareholders (La Porta, Lopez-De-Silanes, & Shleifer, 1999), showing an opportunistic behavior.

However, the above mentioned conflicts can be hampered or even mitigated when the company is financed by bond issuing. On the one hand, the presence of bondholders may provide incentives for managers to choose opportunistic accounting techniques aimed at improving firm financial position and creditworthiness. On the other hand, the managerial opportunistic use of the accounting treatment can be discouraged by the monitoring role of bondholders and the related market authorities.

3. Hypotheses Development

3.1 *The Influence of Blockholders*

There is considerable evidence that large shareholders play an active role in the corporate governance process (Shleifer & Vishny, 1997).

Literature suggests that managers of firms characterized by a dominant shareholder may experience less discretionary power (Dhaliwal, Salomon, & Dan Smith, 1982; La Porta et al., 1999; Ahmad-Zaluki, Campbell, & Goodacre, 2011). In this sense, ownership concentration is likely to reduce agency problems by increasing the level of internal monitoring. Indeed, ownership concentration over one or few investors leads to more efficient and direct supervision on managerial behavior and prevents opportunistic selection of accounting techniques for their personal benefits. Thereby, under this view, managers of blockholder-dominated firms are less likely to opportunistically choose accounting techniques that improve the firm profitability.

Scholars have tested the relationship between blockholder monitoring and managerial discretion but the empirical evidence is inconclusive. Whilst some studies find a negative correlation (Yeo, Tan, Ho, & Chen, 2002; Missonier-Piera, 2004; Astami & Tower, 2006), other research reports a non-significant association between blockholder monitoring and managerial discretion (Davidson, Goodwin-Stewart, & Kent, 2005; García-Meca & Sánchez-Ballesta, 2009; Waweru, Ntui, & Mangena, 2011).

This paper assumes that the presence of blockholders can be seen as an effective internal monitoring mechanism to constrain managerial discretionary use of equity method that opportunistically improves profitability and leverage ratios. Therefore, a negative relationship between blockholder monitoring and choice of equity method can be predicted by hypothesizing that:

HPI: The presence of blockholders reduces the likelihood of choosing the equity method for the accounting treatment of JCEs.

3.2 *The Influence of Families*

Controlling families are usually appointed to the board of directors or even fulfill a CEO position (Markarian, Pozza, & Prencipe, 2008). Families are a unique class of shareholders as they typically hold undiversified portfolios, show concern over firm and family reputation, and have substantially long term investment horizons. Family influence can occur via the extent of their ownership, governance and managerial involvement in the company (Astrachan, Klein, & Smyrnios, 2002). In spite of the growing attention to the effects of family ownership (Poutziouris, O'Sullivan, & Nicolescu, 1997; Chrisman, Chua, & Sharma, 2005), the research on their influence on accounting choices is still limited.

Two different sides of the optimal contracting view are often used to predict the managerial behavior in family firms. According to the alignment perspective, the family involvement is beneficial for companies as it mitigates the overall agency problems and reduces managerial incentives to report accounting information that deviate

from the underlying firm's economic performance (Jensen & Meckling, 1976; Fama & Jensen, 1983; Chrisman, Chua, & Litz, 2004; Salvato & Moores, 2010). Differently, the entrenchment perspective (Morck, Schleifer, & Vishny, 1988; Morck & Yeung, 2003) predicts that the family involvement has the potential to increase agency threats as dominant inside shareholders can expropriate the minorities' wealth through earnings management. This is especially true when governance mechanisms do not work properly (Catuogno, Saggese, Sarto, & Viganò, 2015b).

The empirical evidence on this phenomenon is conflicting. Some authors document that family firms are less prone to managerial opportunism (Cascino, Pugliese, Mussolino, & Sansone, 2010; Prencipe, Bar-Yosef, Mazzola, & Pozza, 2011). Similarly, other studies report that the managerial opportunism decreases with managerial ownership, as proxy for family firms (Dhaliwal et al., 1982; Warfield, Wild & Wild, 1995) since the insider ownership implies the alignment of interests between managers and shareholders (Jensen & Meckling, 1976). Different conclusions are drawn by the studies providing evidence on the entrenchment effect of families (Gabrielsen, Gramlich, & Plenborg, 2002; Sánchez-Ballesta & García-Meca, 2007; Cornett, Marcus, & Tehranian, 2008; Yang, 2010; Gopalan & Jayaraman, 2012).

On the basis of the confounding results on the influence of families on accounting choices, a non-directional hypothesis can be formulated:

HP2: The family influence affects the likelihood of choosing the equity method for the accounting treatment of JCEs.

3.3 The Influence of Bondholders

Prior literature links financial debt and accounting policy choice because debt covenants are usually based on reported accounting numbers, and violations of debt covenants impose costs (Dhaliwal et al., 1982; Holtausen & Leftwich, 1983). In this sense, accounting decisions are influenced by the creditors' use of accounting data in their loan agreements and lending decisions. Thereby, managers aiming at reducing debt covenant costs and improving firm financial position may adopt the accounting methods that display favorable financial statements in terms of creditworthiness. Furthermore, managers may try to improve the firm's financial flexibility in order to prevent the reporting of a financial distress position. These considerations become more relevant when the firm uses bonds as financing solution.

Many scholars hypothesize that high contracting costs, in the form of bond covenant limitations on leverage (a typical public debt restriction), provide incentive for managers to choose accounting techniques aimed at avoiding constraints (Leftwich, 1981; Labelle, 1990; Beneish & Press, 1993). Indeed, the selection of accounting techniques that positively affect the company reported performance can decrease the probability of lending agreements violation as financial ratios are used in the definition of bond covenants (Thornton & Bryant, 1986; Demerjian, 2011).

However a political visibility argument, similar to that originally proposed by Watts and Zimmerman (1978), may also apply. In this perspective, firms issuing corporate bonds undergo the monitoring of the National authorities in charge of supervising the investors' safeguard and the financial market transparency as well as the market authority for listed companies. Indeed, regulatory agencies are likely to impose more stringent inspection on the managerial opportunism of firms using public debt. In this sense, venturers issuing bonds are more vulnerable to political pressure by market monitors and regulators. In particular, the monitoring role played by bondholders and related market authorities may discourage the managerial opportunistic use of the equity method that produces a cosmetic improvement in profitability and leverage ratios.

Taking into consideration both the contracting costs and the political visibility arguments, it can be hypothesized that:

HP3: The presence of external bondholders affects the likelihood of choosing the equity method for the accounting treatment of JCEs.

4. Method

4.1 Sample and Data Collection

To test the hypotheses, the paper relies on firms listed on the Italian Stock Exchange. A focus on Italian companies is timely because of the pervasiveness of blockholder dominated, family controlled and highly leveraged firms (Shleifer & Vishny, 1997; Linciano, Ciavarella, & Signoretti, 2014; Pagano, Panetta, & Zingales, 1996).

The sample consists of 257 firm-year observations of Italian listed companies that report interests in JCEs in

their financial statement for the fiscal year-ends between 2008 and 2012. The sample selection procedure is shown in Table 1, while Table 2 provides the industry composition and the distribution of firms using equity and proportionate accounting methods.

Table 1. Full sample composition

Firms	Total
Total listed Italian firms	1.469
Finance, Insurance, Real Estate	-388
Industrial firms	1.081
Firms holding interests in JCEs	308
Firms excluded	-52
Total sample	257

Table 2. Industry composition

Classification	Equity Method (%)	Proportionate Method (%)	Full Sample (%)
Agriculture, Forestry, Fishing	0	0	0
Mining	3.0	0.8	1.9
Construction	0.8	13.6	7.0
Manufacturing	64.4	40.8	52.9
Transportation, Communication, Electric, Gas, Sanitary Service	25.8	36.0	30.7
Wholesale Trade	3.0	0	1.6
Retail Trade	0.8	4.0	2.3
Finance, Insurance, Real Estate	0	0	0
Services	2.3	4.8	3.5
Public Administration	0	0	0
Total	100	100	100

Data is hand-collected from financial statements and corporate governance reports of each company.

4.2 Variables

The hypotheses are tested by a multiple regression analysis. In particular, the paper uses a logistic regression since it is especially appropriate when the response variable follows a binomial distribution (McCullagh & Nelder, 1989; Agresti, 2013), and applies a Generalized Linear Mixed Model (GLMM) with the logit function as link function (or mixed-effects logistic model) (Lee, Nelder & Pawitan, 2006). The Equation model is the following and it is applied controlling for year and industry as defined according to the SIC codes.

$$EQUITY_METHOD_{i,t} = \beta_0 + \beta_1 BLOCK_MON_{i,t} + \beta_2 FAM_INFLUENCE_{i,t} + \beta_3 BOND_HOLDER_{i,t} + \beta_4 JCE_TYPE_{i,t} + \beta_5 SIZE_{i,t} + \beta_6 LEV_{i,t} + \varepsilon_{i,t} \quad (1)$$

The variables are defined as follow.

The dependent variable represents the reporting method for the accounting interests in JCEs used by venturers in their annual financial statement. In line with the results of the literature review, the use of the equity method for reporting JCEs is assumed as a proxy for the managerial opportunism in accounting choice. Hence, EQUITY_METHOD is defined as a dummy variable that is equal to 1 if the venturer chooses to report interests in JCEs by the equity method and 0 if the venturer reports interests in JCEs by the proportionate consolidation method.

BLOCK_MON is the dependent variable that proxies for the blockholders' influence. The international accounting literature generally considers the threshold of 10% or more of the voting rights as symptomatic of the presence of a controlling shareholder (Dhaliwal et al., 1982; Chen & Jaggi, 2001; Park & Shin, 2004). Since scholars report that, in Italian listed firms, the average and the median ownership concentration approximate to 51% of total voting rights (Zattoni, 1999; Cascino et al., 2010), the paper uses a more stringent threshold to define the dominant shareholder. The variable is a dummy that assumes value 1 if the ultimate shareholder owns more than 50% of the total voting rights and 0 otherwise.

FAM_INFLUENCE captures the family influence and is measured by the F-Pec score (Astrachan et al., 2002).

The primary advantage of this measure is grouping into a single index a series of dimensions suggested by the literature, namely the family ownership and the family involvement into the board of director and the top management team (Jaskiewicz, Gonzales, Mendez, & Schiereck, 2005; Caselli & Gatti, 2006; Giovannini, 2010).

BOND HOLDER is the proxy for the presence of bondholders and is measured as a dummy variable that assumes value 1 if the venturer reports own corporate bonds in its financial statement and 0 if no bonds are issued over the year.

In order to take into consideration the organizational aspects that affect the accounting choices, the model is applied controlling for the following variables: (i) JCE_TYPE, (ii) SIZE, (iii) LEV.

JCE_TYPE measures the type of JCEs. Similarly to Lourenço and Curto (2010), information on each JCE's business and the venturers' business are collected from their Notes to financial statement or from their website. When the business of the venturer is different from that of other venturers, the JCE is a case of heterogeneous cooperation and is therefore classified as a Link JCE. Differently, when the venturers undertake a similar business, the JCE is a case of homogeneous cooperation and is classified as a Scale JCE. Thereby, JCE_TYPE is defined as a dummy variable that assumes value 1 if the majority of JCEs is Scale and 0 if the majority of JCEs is Link.

Since the magnitude of political costs is related to firm dimension, the model is applied also controlling for firm size (SIZE) as measured by the logarithm of total sales (Patelli & Prencipe, 2007). Indeed, the visibility of large companies, especially in terms of available wealth, tends more easily to attract the attention of numerous stakeholders including politicians, regulatory bodies, customers, and competitors (Waweru et al., 2011). Consequently, managers of large politically sensitive firms are more inclined to make accounting choices so as to avoid or minimize political costs and political pressures (Missonier-Piera, 2004).

LEV is the proxy for indebtedness, measured by long-term financial liabilities to equity (Astami & Tower, 2006). In this sense, empirical studies show recurrent associations between accounting choices and firm leverage as a proxy for the proximity to violation and the debt covenant costs (Fields, Lys, & Vincent, 2001).

Table 3 provides the variable definition and the source of data.

Table 3. Variable definition

Variable	Definition	Source
EQUITY_METHOD	Dummy variable equals 1 if the venturer chooses to report interests in JCEs by the equity method; 0 otherwise	Financial Statement
BLOCK_MON	Dummy variable equals 1 if the ultimate shareholder owns more than 50% of the total voting rights; 0 otherwise	Financial Statement
FAM_INFLUENCE	F-Pec score	Corporate Governance Reports
BOND HOLDER	Dummy variable equals 1 if the venturer reports own corporate bonds in its financial statement; 0 otherwise	Financial Statement
JCE_TYPE	Dummy variable equals 1 if the majority of JCEs is Scale and 0 otherwise	Financial Statement
SIZE	Logarithm of total sales	Financial Statement
LEV	Long-term financial liabilities to equity	Financial Statement

5. Results

5.1 Descriptive Statistic

Table 4 shows the descriptive statistics while table 5 presents the correlation matrix among the numerical variables. It is worth noting that EQUITY_METHOD has a mean value of 0.491 and a standard deviation of 0.500. This means that the accounting treatment adopted by venturers is equally distributed across proportionate and equity method. Differently, BLOCK_MON has a mean value of 0.563 and a standard deviation of 0.496 as sample firms are characterized by a notable ownership concentration. FAM_INFLUENCE varies between 0 and 1.329 and presents a mean value of 0.408, while the variable BOND HOLDER has a mean value of 0.479 and a standard deviation equal to 0.501, suggesting that firms issuing bonds are approximately 48%.

Table 4. Descriptive statistics of numerical variables

	N	Min	Max	Mean	SD
EQUITY_METHOD	257	0.000	1	0.491	0.500
BLOCK_MON	257	0.000	1	0.563	0.496
FAM_INFLUENCE	257	0.000	1.329	0.408	0.423
BOND_HOLDER	257	0.000	1	0.479	0.501
JCE_TYPE	257	0.000	1	0.488	0.724
SIZE	257	-4.001	8.489	5.157	1.274
LEV	257	-6.24	14.811	0.876	1.487

Table 5. Correlation matrix

	1	2	3	4	5	6	7
1: EQUITY_METHOD	1						
2: BLOCK_MON	0.110	1					
3: FAM_INFLUENCE	-0.047	0.506	1				
4: BOND_HOLDER	0.382	-0.176	-0.138	1			
5: JCE_TYPE	0.413	0.077	0.077	-0.077	1		
6: SIZE	0.181	-0.166	-0.166	-0.166	0.083	1	
7: LEV	0.023	0.044	0.044	0.044	0.044	0.077	1

5.2 Regression Model

Table 6 shows the regression analysis using three different models. In particular, the model in column 1 includes the predictors and the firm level controls, while the model in column 2 adds the control for industry and JCE type. Finally, column 3 illustrates the full model.

Table 6. Results

Variables	Pred.	Column 1 EQUITY_METHOD	Column 2 EQUITY_METHOD	Column 3 EQUITY_METHOD
BLOCK_MON	-	-3.563** (1.606)	-3.001*** (1.119)	-2.908*** (1.113)
FAM_INFLUENCE	+	2.952* (1.764)	2.088** (1.025)	1.983** (1.007)
BOND_HOLDER	-	-5.921*** (1.463)	-3.640*** (1.081)	-3.429*** (1.108)
JCE_TYPE	+		6.446*** (1.099)	6.386*** (1.104)
SIZE	+	-0.337 (0.497)	-0.041 (0.391)	0.013 (0.399)
LEV	+	0.817 (0.666)	0.809 (0.526)	0.842 (0.541)
INTERCEPT		5.286 (2.778)	-0.579 (2.361)	-1.019 (2.514)
INDUSTRY		NO	YES	YES
YEAR		NO	NO	YES
Log-likelihood		-107.641	-79.076	-77.752
Deviance		215.280	158.153	155.506
Cox & Snell Pseudo R2		0.099	0.279	0.285
Random effects variance (Firm)		34.254	8.866	8.661
Random effects variance (Year)		0.000	0.000	0.000

Note. (***), (**) and (*) indicate significance at the 1%, 5% and 10% respectively.

By looking at the model in column 3, the regression coefficient for BLOCK_MON is negative and significant (β

= -2.908), suggesting that the presence of blockholders reduces the use of the equity method. This result confirms the hypothesis *HP1* and is consistent with the role of large shareholders acting as monitor, suggesting less opportunity for accounting manipulation. Findings also confirm previous studies emphasizing that the ultimate shareholders have incentives to monitor managers and enough voting rights to oust them through takeovers (Yeo et al., 2002; Missonier-Piera, 2004; Astami & Tower, 2006; Giner & Veron, 2012).

Differently, the regression coefficient of *FAM_INFLUENCE* is positive and significant ($\beta = 1.983$), showing that the family influence increases the likelihood of choosing the equity method for the accounting treatment of JCEs. This result supports the hypothesis *HP2* and suggests that the growing family involvement in ownership and control reduces the capital market pressures on efficient contracting in the accounting choices. Thereby, the lack of market discipline leads executives to make opportunistic accounting treatments that reflect personal motives and increase their own wealth. In this sense, the research findings support the family entrenchment perspective, consistently with previous evidence (Sánchez-Ballesta & García-Meca, 2007; Cornett et al., 2008; Yang, 2010; Gopalan & Sudarshan, 2012).

Moreover, the regression coefficient of *BOND HOLDER* is negative and significant ($\beta = -3.429$), highlighting that the presence of external bond-holders reduces the likelihood of choosing the equity method for the accounting treatment of JCEs. Thereby, in line with previous research (Catuogno et al., 2015a), the hypothesis *HP3* is supported emphasizing that venturers issuing corporate bonds as a source of financing are more vulnerable to political scrutiny. In this regard, the research results provide evidence that the monitoring role played by bondholders discourages the opportunistic managerial use of the equity method that produces an improvement in profitability and leverage ratios.

As for the control variables, *JCE_TYPE* is significant with a positive coefficient, emphasizing that the type of JCE plays an important role in the management decision to report interests in JCEs (Mian & Smith, 1990; Lourenço & Curto, 2010). Finally, both leverage and firm size do not help explaining the managerial selection of the equity method. As for the former, findings reflect the existence of constraints that are not related to financial statement numbers but to private information due to the close relationship that may exist between Italian managers and lenders, especially banks (Ball, Li, & Shivakumar, 2015). As for the latter, the results are inconsistent with the political cost hypothesis to the extent that the firm's total sales do not explain the accounting policy choice for the Italian listed companies (Labelle, 1990; Missonier-Piera, 2004; Astami & Tower, 2006; Lourenço & Curto, 2010).

6. Conclusions and Directions for Future Research

Following the contracting theory and the corporate governance literature, the paper uses an ante IFRS 11 perspective in order to question the appropriateness of this accounting standard and investigate the determinants behind the choice of the equity method for the accounting of JCEs in Italy. The paper supposes that managers opportunistically adopt this treatment for their own benefit as it improves firm leverage and profitability. By applying a logistic model, the research considers the equity method as a baseline outcome category and controls for type of JCEs and sector.

Taken together, the empirical findings confirm that family influence, blockholders and bondholder monitoring all matter for choosing the equity method as the accounting treatment of JCEs. In particular, the research shows that the equity method is the opportunistic technique that may induce managerial self-dealing rather than efficient contracting. Indeed, the analysis highlights that the monitoring role played by blockholders and bondholders limits the managerial opportunism in the adoption of the equity method for the accounting of JCEs. Differently, the growing family influence fosters the entrenchment of controlling shareholders, leading to the selection of performance-improving accounting technique.

The paper provides several theoretical and practical contributions and addresses the ongoing international academic and standard setting debate by providing results that do not support the IASB decision to require merely the equity method.

First of all, it answers the general call for more research on the proper accounting for JCEs in order to assess the IASB decision to eliminate the proportionate consolidation and provide an accurate understanding of financial statement numbers for investor economic decisions. This is an important research topic since various stakeholders rely, to some extent, on publicly available accounting information for their decision-making. In this sense, paper findings suggest that requiring all ventures to report interests in JCEs using the equity method would encourage managerial opportunism.

Second, the paper adds knowledge to the literature on the determinants of accounting choice bringing evidence

on the extent to which Italian managers exercise discretion to improve their own wealth rather than mitigate the conflicting interests among contracting parties.

Third, the paper provides an original extension of the accounting choice literature by investigating the effect of family influence and both blockholder and bondholder monitoring besides the variables usually employed in the contracting theory.

With regard to the contributions for practitioners and policy makers, the paper addresses the international standard setting debate by providing results that witness the managerial opportunism in JCE reporting through the equity method. In particular, the research suggests that the accounting technique under examination is an additional tool in the hands of powerful managers to opportunistically increase their wealth, especially in the Italian family firms. These findings are of general interest for continental Europe and other countries with large family involvement.

In this sense, the present study is timely since it casts doubts on the appropriateness of the equity method and highlights the need for a future reconsideration of the IASB decision to withdraw the proportionate consolidation.

However, when drawing these conclusions, it is important to acknowledge that the paper results have certain limitations and potential caveats for future research. First, the study focuses only on one country, thereby further research might extend the analysis to different settings. Second, the paper does not provide empirical evidence on the increase in managerial wealth. Thus, there would be further research potential in empirically testing the managerial opportunism through the bonus plan hypothesis.

References

- Abdel-Khalik, A. R. (1985). The effect of LIFO-switching and firm ownership on executives' pay. *Journal of Accounting Research*, 23(2), 427-447. <http://dx.doi.org/10.2307/2490819>
- Agresti, A. (2013). *Categorical data analysis* (3rd ed.). New Jersey: John Wiley & Sons.
- Ahmad-Zaluki, N. A., Campbell, K., & Goodacre, A. (2011). Earnings management in Malaysian IPOs: The East Asian crisis, ownership control, and post-IPO performance. *The International Journal of Accounting*, 46(2), 111-137. <http://dx.doi.org/10.1016/j.intacc.2011.04.001>
- Alexander, D., Delvaille, P., Demerens, F., Le Manh-Béna, A., & Saccon, C. (2012). *La consolidation des co-entreprises en IFRS: Etude de l'impact du changement de méthodes pour les sociétés européennes*. Paper presented at the 33ème Congrès de l'AFC. Retrieved from <https://halshs.archives-ouvertes.fr/hal-00935843>
- Astami, E. W., & Tower, G. (2006). Accounting-policy choice and firm characteristics in the Asia pacific region: An international empirical test of Costly Contracting Theory. *The International Journal of Accounting*, 41(1), 1-21. <http://dx.doi.org/10.1016/j.intacc.2005.12.004>
- Astrachan, J. H., Klein, S. B., & Smyrniotis, K. X. (2002). The F-PEC scale of family influence: A proposal for solving the family business definition problem. *Family Business Review*, 15(1), 45-58. <http://dx.doi.org/10.1111/j.1741-6248.2002.00045.x>
- Ball, R., Li, X., & Shivakumar, L. (2015). Internet appendix to “contractibility and transparency of financial statement information prepared under IFRS: Evidence from debt contracts around IFRS adoption. *Journal of Accounting Research*, forthcoming. <http://dx.doi.org/10.2139/ssrn.2587316>
- Bauman, M. (2007). Proportionate consolidation versus equity method: Additional evidence on the association with bond ratings. *International Review of Financial Analysis*, 16(5), 496-507. <http://dx.doi.org/10.1016/j.irfa.2007.06.005>
- Beneish, M. D., & Press, E. (1993). Costs of technical violation of accounting-based debt covenants. *The Accounting Review*, 68(2), 233-257. Retrieved from http://www.jstor.org/stable/248399?seq=1#page_scan_tab_contents
- Beuselinck, C., & Deloof, M. (2014). Earnings management in business groups: Tax incentives or expropriation concealment? *The International Journal of Accounting*, 49(1), 27-52. <http://dx.doi.org/10.1016/j.intacc.2014.01.008>
- Cascino, S., Pugliese, A., Mussolino, D., & Sansone, C. (2010). The influence of family ownership on the quality of accounting information. *Family Business Review*, 23(3), 246-65. <http://dx.doi.org/10.1177/0894486510374302>

- Caselli, S., & Gatti, S. (2006). *Long-run venture-backed IPO performance analysis of Italian familyowned firms: What role do closed-end funds play*. Venture capital: A European perspective. Amsterdam: Elsevier.
- Catuogno, S., & Allini, A. (2011). Multiple evaluation options & comparability: Equity investments in Italy and Spain. *Journal of Accounting, Management and Information System*, 10(2), 249-274. Retrieved from http://www.cig.ase.ro/articles/10_2_7.pdf
- Catuogno, S., Allini, A., & D'Ambrosio, A. (2015a). Information perspective and determinants of proportionate consolidation in Italy. An ante IFRS 11 analysis. *Rivista dei Dottori Commercialisti*, 4, 555-577. Retrieved from <http://hdl.handle.net/11588/610750>
- Catuogno, S., Saggese, S., Sarto, F., & Viganò, R. (2015b). Shedding light on the aim of stock options. A literature review. *Journal of Management & Governance*, 1-25. <http://dx.doi.org/10.1007/s10997-015-9318-0>
- Chen, C. J., & Jaggi, B. (2001). Association between independent non-executive directors, family control and financial disclosures in Hong Kong. *Journal of Accounting and Public Policy*, 19(4), 285-310. [http://dx.doi.org/10.1016/S0278-4254\(00\)00015-6](http://dx.doi.org/10.1016/S0278-4254(00)00015-6)
- Chrisman, J. J., Chua, J. H., & Litz, R. A. (2004). Comparing the agency costs of family and non-family firms: Conceptual issues and exploratory evidence. *Entrepreneurship Theory and Practice*, 28(4), 335-354. <http://dx.doi.org/10.1111/j.1540-6520.2004.00049.x>
- Chrisman, J. J., Chua, J. H., & Sharma, P. (2005). Trends and directions in the development of a strategic management theory of the family firm. *Entrepreneurship Theory and Practice*, 29(5), 555-576. <http://dx.doi.org/10.1111/j.1540-6520.2005.00098.x>
- Cornett, M. M., Marcus, A. J., & Tehranian, H. (2008). Corporate governance and pay-for-performance: The impact of earnings management. *Journal of Financial Economics*, 87(2), 357-373. <http://dx.doi.org/10.1016/j.jfineco.2007.03.003>
- Davidson, R., Goodwin-Stewart, J., & Kent, P. (2005). Internal governance structures and earnings management. *Accounting & Finance*, 45(2), 241-267. <http://dx.doi.org/10.1111/j.1467-629x.2004.00132.x>
- Davis, M. L., & Largay III, J. A. (1999). Financial reporting of "significant-influence" equity investments: Analysis and managerial issues. *Journal of Managerial Issues*, 11(3), 280-298. Retrieved from http://www.jstor.org/stable/40604272?seq=1#page_scan_tab_contents
- Demerens, F., Le Manh, A., Delvaillie, P., & Paré, J. L. (2014). An ex ante analysis of change in reporting methods: The example of joint ventures. *Association de Recherches et Publications en Management Gestion 2000*, 4(31), 65-89. <http://dx.doi.org/10.3917/g2000.314.0065>
- Demerjian, P. R. (2011). Accounting standards and debt covenants: Has the "balance sheet approach" led to a decline in the use of balance sheet covenants? *Journal of Accounting and Economics*, 52(2), 178-202. <http://dx.doi.org/10.1016/j.jacceco.2011.08.004>
- Dhaliwal, D. S., Salamon, G. L., & Dan Smith, E. (1982). The effect of owner versus management control on the choice of accounting methods. *Journal of Accounting and Economics*, 4(1), 41-53. [http://dx.doi.org/10.1016/0165-4101\(82\)90005-2](http://dx.doi.org/10.1016/0165-4101(82)90005-2)
- Di Pietra, R., Grambovas, C. A., Raonic, I., & Riccaboni, A. (2008). The effects of board size and 'busy' directors on the market value of Italian companies. *Journal of Management & Governance*, 12(1), 73-91. <http://dx.doi.org/10.1007/s10997-008-9044-y>
- Dieter, R., & Wyatt, A. R. (1978). Expanded equity method-alternative in accounting for investments in joint ventures. *Journal of Accountancy*, 6, 145-89. Retrieved from <http://search.proquest.com/openview/58bc2d8d97ab68a93398418ac82025d8/1?pq-origsite=gscholar&cbl=41064>
- Fama, E. F., & Jensen, M. C. (1983). Separation of ownership and control. *The Journal of Law and Economics*, 26(2), 301-325. <http://dx.doi.org/10.1086/467037>
- Fields, T. D., Lys, T. Z., & Vincent, L. (2001). Empirical research on accounting choice. *Journal of Accounting and Economics*, 31(1-3), 255-307. [http://dx.doi.org/10.1016/S0165-4101\(01\)00028-3](http://dx.doi.org/10.1016/S0165-4101(01)00028-3)
- Gabrielsen, G., Gramlich, J. D., & Plenborg, T. (2002). Managerial ownership, information content of earnings, and discretionary accruals in a non-US setting. *Journal of Business Finance & Accounting*, 29(7-8), 967-988. <http://dx.doi.org/10.1111/1468-5957.00457>

- García-Meca, E., & Sánchez-Ballesta, J. P. (2009). Corporate Governance and Earnings Management: A Meta-Analysis. *Corporate Governance: An International Review*, 17(5), 594-610. <http://dx.doi.org/10.1111/j.1467-8683.2009.00753.x>
- Giner, B., & Veron, C. (2012). Determinantes de la discrecionalidad directiva en la elección del método contable de las participaciones en negocios consuntivos. *Revista Española De La Financiación Y Contabilidad*, 41(156), 589-614. <http://dx.doi.org/10.1080/02102412.2012.10779737>
- Giovannini, R. (2010). Corporate governance, family ownership and performance. *Journal of Management & Governance*, 14(2), 145-166. <http://dx.doi.org/10.1007/s10997-009-9093-x>
- Gopalan, R., & Jayaraman, S. (2012). Private control benefits and earnings management: Evidence from insider controlled firms. *Journal of Accounting Research*, 50(1), 117-157. <http://dx.doi.org/10.1111/j.1475-679X.2011.00431.x>
- Graham, R. C., King, R. D., & Morrill, C. K. (2003). Decision usefulness of alternative joint venture reporting methods. *Accounting Horizons*, 17(2), 123-137. <http://dx.doi.org/10.2308/acch.2003.17.2.123>
- Holthausen, R. W. (1990). Accounting method choice: Opportunistic behavior, efficient contracting, and information perspectives. *Journal of Accounting and Economics*, 12(1-3), 207-218. [http://dx.doi.org/10.1016/0165-4101\(90\)90047-8](http://dx.doi.org/10.1016/0165-4101(90)90047-8)
- Holthausen, R. W., & Leftwich, R. W. (1983). The economic consequences of accounting choice implications of costly contracting and monitoring. *Journal of Accounting and Economics*, 5, 77-117. [http://dx.doi.org/10.1016/0165-4101\(83\)90007-1](http://dx.doi.org/10.1016/0165-4101(83)90007-1)
- Jaskiewicz, P., Gonzalez, V. M., Menendez, S., & Schiereck, D. (2005). Long-run IPO performance analysis of German and Spanish family-owned businesses. *Family Business Review*, 18, 179-202. <http://dx.doi.org/10.1111/j.1741-6248.2005.00041.x>
- Jensen, M. C., & Meckling, W. (1976). Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of Financial Economics*, 3, 305-360. <http://dx.doi.org/10.1017/CBO9780511817410.023>
- Karpinis, N. I., & Hevas, D. L. (2013). Effects of IFRS adoption on tax-induced incentives for financial earnings management: Evidence from Greece. *The International Journal of Accounting*, 48(2), 218-247. [http://dx.doi.org/10.1016/0304-405X\(76\)90026-X](http://dx.doi.org/10.1016/0304-405X(76)90026-X)
- Kothavala, K. (2003). Proportional consolidation versus equity method: A risk measurement perspective on reporting interests on joint venture. *Journal of Accounting and Public Policy*, 22(6), 517-538. <http://dx.doi.org/10.1016/j.jaccpubpol.2003.10.001>
- La Porta, R., Lopez-De-Silanes, F., & Shleifer, A. (1999). Corporate ownership around the world. *Journal of Finance*, 54(2), 471-517. <http://dx.doi.org/10.1016/j.jaccpubpol.2003.10.001>
- Labelle, R. (1990). Bond covenants and changes in accounting policy: Canadian evidence. *Contemporary Accounting Research*, 6(2), 677-698. <http://dx.doi.org/10.1111/j.1911-3846.1990.tb00781.x>
- Lee, Y., Nelder, J. A., & Pawitan, Y. (2006). *Generalized linear models with random effects: Unified analysis via H-likelihood*. CRC Press. <http://dx.doi.org/10.1201/9781420011340>
- Leftwich, R. W., Watts, R. L., & Zimmerman, J. L. (1981). Voluntary corporate disclosure: The case of interim reporting. *Journal of Accounting Research*, 19, 50-77. <http://dx.doi.org/10.2307/2490984>
- Leitner-Hanetseder, S., & Stockinger, M. (2014). How does the elimination of the proportionate consolidation method for joint venture investments influence European companies? ACRN Proceedings in Finance and Risk Series 2013: Proceedings of the 13th FRAP Conference in Cambridge vol. 2, ACRN Publishing House. Retrieved from <http://www.acrn-journals.eu/resources/jfrp201401a.pdf>
- Lourenço, I. C., Fernandes, S., & Curto, J. D. (2012). How does the market view interests in jointly controlled entities? *Spanish Journal of Finance and Accounting*, 41(153), 119-142. <http://dx.doi.org/10.1080/02102412.2012.10779720>
- Lourenço, I., & Curto, J. (2010). Determinants of accounting choice between alternative reporting methods of interests in jointly controlled entities. *European Accounting Review*, 19(4), 739-773. <http://dx.doi.org/10.1080/09638181003687844>
- Markarian, G., Pozza, L., & Prencipe, A. (2008). Capitalization of R&D costs and earnings management: Evidence from Italian listed companies. *The International Journal of Accounting*, 43(3), 246-267.

- <http://dx.doi.org/10.1016/j.intacc.2008.06.002>
- McCullagh, P., & Nelder, J. A. (1989). *Generalized linear models*. London: Chapman & Hall. [http://dx.doi.org/10.1016/0377-2217\(84\)90282-0](http://dx.doi.org/10.1016/0377-2217(84)90282-0)
- Mian, S., & Smith, C. (1990). Incentives for unconsolidated financial reporting. *Journal of Accounting and Economics*, 12(1-3), 141-171. [http://dx.doi.org/10.1016/0165-4101\(90\)90045-6](http://dx.doi.org/10.1016/0165-4101(90)90045-6)
- Miller, D, Catuohhilli, G., & Corbetta, G. (2013). Is family leadership always beneficial? *Strategic Management Journal*, 34(5), 553-571. <http://dx.doi.org/10.1002/smj.2024>
- Missonier-Piera, F. (2004). Economic determinants of multiple accounting method choices in a Swiss context. *Journal of International Financial Management & Accounting*, 15(2), 118-144. <http://dx.doi.org/10.1111/j.1467-646X.2004.00104.x>
- Morck, R., & Yeung, B. (2003). Agency problems in large family business groups. *Entrepreneurship Theory and Practice*, 27(4), 367-382. <http://dx.doi.org/10.1111/1540-8520.t01-1-00015>
- Morck, R., Shleifer, A., & Vishny, R. W. (1988). Management ownership and market valuation: An empirical analysis. *Journal of Financial Economics*, 20, 293-315. [http://dx.doi.org/10.1016/0304-405X\(88\)90048-7](http://dx.doi.org/10.1016/0304-405X(88)90048-7)
- Park, Y. W., & Shin, H. H. (2004). Board composition and earnings management in Canada. *Journal of Corporate Finance*, 10(3), 431-457. [http://dx.doi.org/10.1016/S0929-1199\(03\)00025-7](http://dx.doi.org/10.1016/S0929-1199(03)00025-7)
- Patelli, L., & Prencipe, A. (2007). The relationship between voluntary disclosure and independent directors in the presence of a dominant shareholder. *European Accounting Review*, 16(1), 5-33. <http://dx.doi.org/10.1080/09638180701265820>
- Poutziouris, P., O'Sullivan, K., & Nicolescu, L. (1997). The [re]-generation of family-business entrepreneurship in the Balkans. *Family Business Review*, 10(3), 239-261. <http://dx.doi.org/10.1111/j.1741-6248.1997.00239.x>
- Prencipe, A., Bar-Yosef, S., Mazzola, P., & Pozza, L. (2011). Income smoothing in family-controlled companies: Evidence from Italy. *Corporate Governance: An International Review*, 19(6), 529-546. <http://dx.doi.org/10.1111/j.1467-8683.2011.00856.x>
- Salvato, C., & Moores, K. (2010). Research on accounting in family firms: Past accomplishments and future challenges. *Family Business Review*, 23(3), 193-215. <http://dx.doi.org/10.1177/0894486510375069>
- Sánchez-Ballesta, J. P., & García-Meca, E. (2007). Ownership structure, discretionary accruals and the informativeness of earnings. *Corporate Governance: An International Review*, 15(4), 677-691. <http://dx.doi.org/10.1111/j.1467-8683.2007.00596.x>
- Shleifer, A., & Vishny, R. W. (1986). Large shareholders and corporate control. *The Journal of Political Economy*, 416-488. <http://dx.doi.org/10.1086/261385>
- Shleifer, A., & Vishny, R. W. (1997). A survey of corporate governance. *The Journal of Finance*, 52(2), 737-783. <http://dx.doi.org/10.1111/j.1540-6261.1997.tb04820.x>
- Soonawalla, K. (2006). Accounting for joint ventures and associates in Canada, UK, and US: Do US rules hide information? *Journal of Business Finance & Accounting*, 33(3-4), 395-417. <http://dx.doi.org/10.1111/j.1468-5957.2006.00609.x>
- Stoltzfus, R. L., & Epps, R. W. (2005). An empirical study of the value relevance of using proportionate consolidation accounting for investments in joint ventures. *Accounting Forum*, 29(2), 169-190. <http://dx.doi.org/10.1016/j.acefor.2004.10.001>
- Thornton, D. B., & Bryant, M. J. (1986). *GAAP vs. TAP in lending agreements: Canadian evidence*. Canada: Canadian Academic Accounting Association.
- Warfield, T. D., Wild, J. J., & Wild, K. L. (1995). Managerial ownership, accounting choices, and informativeness of earnings. *Journal of Accounting and Economics*, 20(1), 61-91. [http://dx.doi.org/10.1016/0165-4101\(94\)00393-J](http://dx.doi.org/10.1016/0165-4101(94)00393-J)
- Watts, R. L., & Zimmerman, J. L. (1978). Towards a positive theory of the determination of accounting standards. *The Accounting Review*, 53(1), 112-134. <http://www.jstor.org/stable/245729>
- Watts, R. L., & Zimmerman, J. L. (1986). *Positive accounting theory*. London: Prentice Hall International.
- Waweru, N. M., Ntui, P. P., & Mangena, M. (2011). Determinants of different accounting methods choice in

- Tanzania: A positive accounting theory approach. *Journal of Accounting in Emerging Economies*, 1(2), 144-159. <http://dx.doi.org/10.1108/20421161111138503>
- Yang, M. L. (2010). The impact of controlling families and family CEOs on earnings management. *Family Business Review*, 23, 266-279. <http://dx.doi.org/10.1177/0894486510374231>
- Yeo, G. H., Tan, P., Ho, K. W., & Chen, S. (2002). Corporate ownership structure and the informativeness of earnings. *Journal of Business, Finance & Accounting*, 29(7-8), 1023-1046. <http://dx.doi.org/10.1111/1468-5957.00460>
- Zattoni, A. (1999). The structure of corporate groups: The Italian case. *Corporate Governance: An International Review*, 7(1), 38-48. <http://dx.doi.org/10.1111/1467-8683.00127>

Copyrights

Copyright for this article is retained by the author(s), with first publication rights granted to the journal.

This is an open-access article distributed under the terms and conditions of the Creative Commons Attribution license (<http://creativecommons.org/licenses/by/3.0/>).