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Board of directors and financial transparency and disclosure. Evidence from Italy

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Abstract

Purpose – *The purpose of this paper is to examine the link between board of directors' composition (independent directors' ratio, board size, CEO-duality) and financial transparency and disclosure (T&D).*

Design/methodology/approach – *The paper analyzes board composition and financial T&D of Italian listed companies using multiple linear regression analysis.*

Findings – *The results of this paper show a significant link between board composition and the level of financial T&D. In particular, the authors found a positive and significant relationship between the independent directors' ratio and the level of financial T&D and a negative relationship between board size and the level of financial T&D.*

Research limitations/implications – *While this paper focuses on a sample of 100 Italian listed companies, the authors acknowledge the importance of extending the results to other national context and to other type of firms (e.g. non-listed firms or SMEs). Moreover, while this paper concerns the amount of information disclosed by firms, it does not look at the quality or accuracy of disclosure.*

Practical implications – *This paper reveals the importance of evaluating the effectiveness of corporate governance mechanisms (such as board composition) in enhancing the level of financial T&D. Indeed, the authors provide some indications to firms to improve their internal governance mechanisms (e.g. the importance of high proportion of independent directors and of small- and medium-sized boards of directors).*

Originality/value – *This paper provides interesting insights to firms which are under pressure to improve the level of information to stakeholders. Moreover, has the level of information that is not legally required vary among companies and countries, the authors shed light on a context characterized by high level of ownership concentration, where firms can experience different types of conflict of interests.*

Keywords *Corporate governance, Board of directors, CEO duality, Independent directors, Board size, Financial transparency and disclosure*

Paper type *Research paper*

1. Introduction and motivation

In the wake of the global financial crisis and corporate scandals, firms are under pressure to improve the level of information to stakeholders. However, the level of information that is not legally required and that is disclosed can vary among companies and countries. Legal requirements do not always satisfy stakeholder demands, and there is a huge need for more information. Moreover, it seems clear that high-quality financial transparency reduces information asymmetries, increases overall transparency and is associated with positive capital market consequences such as lower cost of equity and debt capital (Francis *et al.*, 2004), higher market liquidity (Diamond and Verrecchia, 1991), better firm performance and higher competitiveness. Recent financial crisis and corporate scandals lead firms to improve substantially their financial transparency and disclosure (T&D). In fact, financial T&D are considered to be important mechanisms for aligning diverging interests (Bushman and Smith, 2001;

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Healy and Palepu, 2001; Hermanson, 2000; Healy *et al.*, 1999) to avoid opportunistic behaviors and mitigate agency problems (Fama and Jensen, 1983).

In contexts characterized by high ownership concentration, the issue of high-quality financial T&D becomes even more important to increase the level of protection of minority shareholders who are often exposed to high risk of expropriation by majority shareholders. This problem (e.g. in the Italian context) is commonly known as the agency problem II (Cascino *et al.*, 2010). When ownership is highly concentrated, the nature of the agency problem shifts away from manager–shareholder conflicts to conflicts between the controlling owner and minority shareholders (Fan and Wong, 2002; Berle and Means, 1932). In these contexts, T&D represents an important indicator of corporate governance quality (OECD, 1999).

Research on the determinants of voluntary disclosure initially focused on corporate characteristics such as company size (Depoers, 2000) and listing status (Meek *et al.*, 1995). However, recent research suggests that other factors may determine a firm's disclosure policy. Scholars are increasingly focusing their attention on the links between corporate governance mechanisms and the level of firms' T&D (Agyei-Mensah, 2016, Ho and Taylor, 2013). In this study, we seek to extend prior research by focusing on the link between corporate governance and disclosure. The focus is on the link between board of directors composition (independent directors ratio, board size and CEO-duality) and the level of T&D provided in the financial statements of Italian listed companies.

The board of directors has an important role in mitigating the conflicts of interests arising from agency problems (Jensen and Meckling, 1976). Indeed, the board of directors is regarded as a relevant mechanism in the oversight of managerial actions (Fama and Jensen, 1983). Researchers have examined the role played by certain practices aimed at enhancing the monitoring role of the board on the provision of voluntary information (Nagar *et al.*, 2003; Ho and Wong, 2001; Chen and Jaggi, 2000). It seems also important to highlight that in contexts characterized by concentrated ownership, like the Italian one, the board of directors becomes the main arena in which possible conflicting interests (majority shareholders, minorities, board members, top management team members, customers, etc.) may find balance. Thus, the exploration of boards' characteristics may shed new light on the factors that may enhance the level of financial T&D.

The paper draws from an extension of agency theory perspective (Fama and Jensen, 1983; Jensen and Meckling, 1976). Indeed, we use a stakeholder theory perspective, which extends the agency assumptions taking into account the existence of multiple principles and agents that arises many agency problems. Thus, starting from the existence of conflicts of interest between the various stakeholders involved in the firm governance system (Fama and Jensen, 1983; Fama, 1980; Jensen and Meckling, 1976; Donaldson and Preston, 1995), it will be possible to identify cases where the dominant shareholder influences the reported earnings to maximize his interests (La Porta *et al.*, 2000). Therefore, financial T&D seem to be crucial to protect the interests of the various stakeholders involved in the business (Donaldson and Preston, 1995).

Hypotheses on the relationships between independent directors' ratio, board size, CEO duality and financial T&D are tested on a sample of 100 Italian listed firms (the sample is the top 100 Italian listed firms by market capitalization in 2007). This study has different contributions. First, it provides empirical evidence of a positive association between board independence and a direct measure of voluntary financial disclosure; second, it documents that the size of the board influence the level of T&D; and third, this demonstrates that CEO duality is not associated with the level of T&D. Additionally, the paper addresses the importance of studying the existing links between firms' governance structures and mechanisms and financial T&D also in context characterized by concentrated ownership. This links the importance of minorities' protection to the importance of good governance practices and high level of financial T&D.

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The paper is organized as follows: In Section 2, the theoretical framework and the hypotheses are presented. Section 3 describes the database and the methods. Results are presented in Section 4. Discussion and final remarks are presented in Sections 5 and 6.

2. Theoretical framework and hypotheses formulation

2.1 The need for more voluntary disclosure

The importance of the quality and effectiveness of financial reporting has received increasing attention from academics (Hope *et al.*, 2013; Bozzolan *et al.*, 2003; Eng and Mak, 2003; Leuz and Verrecchia, 2000; Chen and Jaggi, 2000) and regulatory and professional bodies (OECD, 2001; FASB, 2000). Investors, financial markets and other key stakeholders demand that companies voluntarily provide more comprehensive information about their long-term strategies and performance. The demand for enhanced disclosures has been pushed forward by the increasing popularity of the stakeholder approach that has resulted in a widespread realization that the interactions of a company are not limited to just shareholders (Donaldson and Preston, 1995). There are other stakeholder groups as well, who also have a right to be provided with information about how the activities of the company impact them. This is particularly true in context characterized by concentrated ownership (La Porta *et al.*, 1999), where the dominance of the main shareholder may substantially influence the level and the quality on financial T&D.

Most of the studies that have examined the voluntary disclosure practices of companies have analyzed voluntary disclosures as non-mandatory information that is made available to meet the information needs of the financial markets and investors (Healy and Palepu, 2001; Leuz and Verrecchia, 2000). Accordingly, these studies have investigated the relationship between voluntary disclosure and stock prices, as well as the company's cost of raising capital (Botosan, 1997). Existing research about voluntary disclosure practices in different national contexts shows a variety of approaches that companies have taken in addressing the information needs of various stakeholder groups. For example, Vandemaele *et al.* (2005) found that Swedish companies make more voluntary disclosures about intellectual capital than do companies from the UK and Holland. Similarly, studies conducted by Brennan (2001), and Bozzolan *et al.* (2003) found differences in the emphasis placed by Irish and Italian companies on disclosures regarding organizational, relational and human capital issues. While Brennan (2001) noted that there was little or no reporting of intellectual capital in Irish company annual reports, Bozzolan *et al.* (2003) found that disclosures by Italian companies mainly occur with regard to external structure – customers, distribution channels and business collaborations. Mechanisms of transparency, in the form of accounting, financial reporting and voluntary disclosures have also taken their place in corporate governance research. Again, traditionally, these have been researched from an agency theory perspective, whereby transparency in the form of disclosures to shareholders is an important mechanism for aligning shareholder and management interests (Bushman and Smith, 2001; Healy and Palepu, 2001; Healy *et al.*, 1999; Hermanson, 2000). The governance variables predicted to influence disclosure and transparency vary from external mechanisms in the form of legal systems for the country-level studies, to internal governance mechanisms relating to the board of directors, its committees, its independence, share ownership by directors and managers, ownership concentration among large shareholders and the quality of auditors.

Traditionally, accounting and finance research in corporate governance has focused on Anglo-Saxon stock markets, again reflecting the traditional dominance of agency theory. As a result, corporate governance research has started to focus on systems which do not fit the Anglo-Saxon, market-based mould. Indeed, most countries (e.g. Italy) have been shown to fall into the insider-dominated model of corporate governance, where companies tend to be owned and controlled by insiders such as founding families, the state, banks or other companies. A body of research has examined the factors determining different models of corporate governance, concluding that legal systems dictate stock market

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growth, according to the level of shareholder protection they provide (La Porta *et al.*, 1999, 1998).

2.2 Boards of directors' characteristics and financial T&D

Corporate governance has evolved and grown significantly in the past decade. Numerous countries have issued corporate governance codes and many recommendations aiming at achieving increased levels of T&D.

Previous studies have focused on unregulated disclosures, such as earnings forecasts and environmental and social disclosures. In this paper, we focus on financial T&D (voluntary disclosure). It seems important to underline that while compliance with the minimum disclosure requirements is mandatory, the amount of voluntary disclosure provided by companies can vary considerably (Deegan and Blomquist, 2006).

Currently, there is little empirical research that has successfully linked board characteristics significantly and positively to a direct measure of voluntary disclosure. In fact, the few studies in this area that use a direct measure of voluntary disclosure have provided counterintuitive and unexpected results. Despite of this, the association between a firm's governance mechanism (the board of directors) and its disclosure policies may shed new light on this interesting issue basing on the premise that well-governed firms use increased voluntary disclosure to mitigate their agency problems.

Corporate governance attributes examined in these studies include the independent directors ratio, the board size and CEO-duality (Malone *et al.*, 1993; Forker, 1992). As financial disclosure is subject to discretion, there is a need to align the information-disclosure tendencies of firms with the interests of all shareholders and stakeholders. In effect, even if the regulation of disclosure is effective, there is a need for a monitoring mechanism to ensure sufficient disclosure. Boards of directors are important mechanisms to enhance T&D (Collier and Zaman, 2005; Gendron and Be′dard, 2006; Turley and Zaman, 2007).

The board of directors, as an important internal component of corporate governance, receives its authority from shareholders who use their voting rights to elect board members. In fulfilling its legal responsibility, the board of directors should: perform vigilant oversight to be a fiduciary for all stakeholders in the corporation and act as an independent leader that takes initiatives that create shareholders/stakeholders value (Rezaee, 2002).

Arguably, boards controlled by the major shareholder may result in practices of collusion, among them, the expropriation of shareholder/minorities/stakeholders wealth. Therefore, codes of good governance include a number of recommendations, one of them being the appointment of non-executive directors, an inclusion designed to reduce agency conflicts (Gregory and Simmelkjaer, 2002; Fama, 1980). Even if it seems that the presence of non-executive directors is important to ensure high levels of financial T&D, in the existing literature, there are mixing and contrasting results on the relationship between independent directors and voluntary disclosure.

Ho and Wong (2001), using a direct measure of voluntary disclosure based on analyst perception, were unable to find a significant relationship between board independence and the level of voluntary disclosure. Eng and Mak's (2003) found a significant and negative association between the percentage of independent directors and a direct measure of non-mandatory disclosure. Gul and Leung (2004) document a significant negative association between a direct measure of voluntary disclosure and the percentage of "expert" non-executive directors. On the other hand, some studies provide empirical evidence supporting the role of non-executive directors in promoting higher transparency and better disclosure policies. Having a higher proportion of outside non-executive directors on the board would result in better monitoring of the activities by the board and limit opportunism (Fama and Jensen, 1983; Fama, 1980). Fama and Jensen (1983) argued that the larger the proportion of independent directors in the board, the more effective it will

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be in monitoring opportunism, with a positive effect on T&D. Chen and Jaggi (2000) found a positive association between the proportion of independent directors on the board and the extent of a firm's disclosure. The proportion of outside directors on corporate boards was also negatively associated with indicators that measured the (poor) quality of the information disclosed, such as the publication of fraudulent or defective financial statements (Beasley, 1996; Peasnell *et al.*, 2001), as well as measures of earnings management (Peasnell *et al.*, 2000).

Drawing from this contrasting debate, in this paper, we expect that the independent directors' ratio will be positively associated with voluntary disclosure. We base this hypothesis on the fact that the role of the board of directors is to monitor and control strategic decisions. Therefore, outside directors who are less aligned to management/shareholders' interests may be more inclined to encourage firms to disclose more information to outside investors and to the other stakeholders. Then, we expect that having more outside directors on the board will also result in high level of T&D. Hence, we hypothesize that:

H1. There is a positive and significant relationship between the independent directors' ratio and the level of financial T&D.

With respect to the size of the board, there are many studies relating this measure with some of the main firms' outcome. For example, according to Yermack (1996), oversized boards were supposed to lead to worse performance and firms with smaller boards are valued more highly by the market than are their counterparts with larger boards. Other scholars suggested that boards with fewer members may have a better working-style because smaller boards are more effective, active and dynamic than larger boards (Kim and Nofsinger, 2007). Cheng and Courtenay (2006) found that too large board actually has diminished monitoring capabilities. Eisenberg *et al.* (1998) concluded that there was a negative relationship between board size and profitability extends to small and midsize Finnish firms. John and Senbet (1998) suggested that limiting the size of the board might improve efficiency and improve corporate governance. However, Bhagat and Black (1999) found that the inverse correlation between board size and performance is not strongly related to performance measure.

We agree with consistent and prior studies basing their models on principles of cohesion of the groups suggesting the benefits of small-sized board (Bantel and Jackson, 1989). In fact, with dispersed opinions and non-cohesiveness in viewpoints, a board that is too large may actually have diminished monitoring capabilities. The results of Lipton and Lorsch (1992) and Jensen (1993) are consistent with this suggestion. Indeed, agency problems increase in large boards and directors are then less effective in monitoring managers. This is also suggested by codes of good governance that usually recommend limitations to the size of a board. By restricting the number of directors, it is believed that the exchange of ideas between board members will be enhanced, as well as flexibility in the decision-making process. Smaller boards are supposed to be more effective in monitoring the CEO and are tougher for the CEO or the chairman to manipulate (Jensen, 1993). It is important to show that the board size is affecting the board working-style and in turn the level of financial information provided. Accordingly, Vafeas (2000) has observed that investors place higher value on earnings information when provided by firms with smaller boards. Moreover, he indicates that smaller board size enhances the informativeness of earnings. These arguments lead us to hypothesize:

H2. There is a negative and significant relationship between board size and the level of financial T&D.

Concentrated decision-making power as a result of CEO-duality may constrain board independence and impair the boards oversight and governance roles including corporate disclosure policies (Worrell *et al.*, 1997; Carver, 1990; Fama and Jensen, 1983). This is because CEO-duality creates a strong individual power base, which could erode the

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boards' ability to exercise effective control. More specifically, CEO duality could constrain board independence and reduce its ability to execute its oversight and governance roles (Finkelstein and D'Aveni, 1994; Millstein, 1992).

Boards with CEO-duality are typically considered to be weaker monitors (Jensen, 1993), and firms that have one individual who serves as both CEO and chairperson are considered to be more managerially dominated (Molz, 1988). Firms characterized by this situation may, therefore, exhibit less disclosure transparency because the board is not in a position to demand greater transparency and the person who occupies both roles would tend to withhold unfavorable information to outsiders.

The empirical results concerning CEO-duality and financial reporting are somewhat mixed. Some studies show no relationship between CEO-duality and financial reporting quality (Agrawal and Chadha, 2005; Uzun *et al.*, 2004; Beasley, 1996). Similarly, Cheng and Courtenay (2006) show no relationship between CEO-duality and voluntary disclosure. On the other hand, some studies have identified a negative and significant relationship between CEO-duality and poor disclosure practices, suggesting that a dominant personality in both roles poses a threat to monitoring quality and is detrimental to the quality of disclosure (Forker, 1992). Moreover, Carcello and Nagy (2004a, 2004b) report a positive relationship between CEO duality and lower quality financial reporting using US samples, and Gul and Leung (2004) show that in Hong Kong, firms with CEO-duality voluntarily disclose less information than do firms where the CEO and chairperson positions are held by different people. Furthermore, Ho and Wong (2001) observed a negative relationship between corporate disclosure and the presence of a dominant personality on the firm's board.

Although extant evidence is somewhat mixed, in this study, we base our hypothesis on the assumption that firms characterized by CEO-duality have lower financial T&D. Separating the positions of CEO and chairman of the board arguably helps to improve the monitoring function of the board (Jensen, 1993). This dual role situation is quite common in some European countries (UK, France, Spain and Italy), but it may require a balance. Indeed, firms with CEO-duality are more likely to be associated with lower levels of voluntary disclosures, as the board is less likely to be effective in monitoring and ensuring a higher level of transparency. Such lower levels of transparency might be used to conceal fraud and incompetence. Hence, it is hypothesized that:

> *H3*. There is a negative and significant relationship between CEO-duality and the level of financial T&D.

3. Methods

3.1 Data collection and sample

Our sample consists of the 100 largest market cap firms listed in the Italian Stock Exchange. We extracted firm-specific variables from the AMADEUS database (firm size, industry type, ROA). Variables related to the corporate governance and disclosure were handily extracted in the 2007 annual reports and website of firms included in our sample (audit committee size, number of board meeting, independent directors ratio, CEO-duality, board size, ownership concentration, attributes included in the T&D index).

Table I provides the descriptive statistics for the variables used in the analysis. In particular, the value of T&D index ranges from a minimum of 6 to a maximum of 13, with an mean value of 9.26 (standard deviation equals 1.63).

Independent directors' ratio ranges from a minimum of 10.0 per cent to a maximum of 89.0 per cent (mean value 0.39 and standard deviation 0.18).

Board size has a minimum value of six member and a maximum value of 20 members (mean value 9.95, SD 3.18). In our sample, there is CEO-duality in the 31.0 per cent of the cases. Firm size assumes a minimum value of 252 employees and a maximum value of

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Table I Descriptive statistics

Variables	Minimum	Maximum	Mean	SD
1. Firm size (number of employees)	252.00	77,371.00	8,279.93	15,688.59
2. Ownership concentration	2.50	74.29	43.33	17.06
3. Industry type (manufacturing vs service)	0.00	1.00	0.74	0.44
4. Return on asset (ROA)	−0.23	0.53	0.06	0.08
5. Audit committee size	2.00	5.00	3.13	0.63
6. Number board meetings	4.00	25.00	9.17	3.04
7. Board size	4.00	20.00	9.95	3.18
8. Independent directors ratio	0.10	0.89	0.39	0.18
9. CEO-duality	0.00	1.00	0.31	0.46
10. Financial T&D	6.00	13.00	9.16	1.63

Source: Our elaboration (2010)

77,371 (Mean 8,279.93; SD 15,688.59). The percentage of shares held by the major shareholder in our sample ranges from 2.5 to 74.29 per cent (Mean 43.33, SD 17.06). In 74 per cent of cases, firms are in the manufacturing sector. The mean ROA for our sample of firm is 6 per cent (SD 0.09). Audit committee size varies from a minimum two members to a maximum of five members (Mean 3.13, SD 0.63). Finally, the number of board meetings varies from a minimum of 4 meetings per year to a maximum of 25 meetings per year (Mean 9.17, SD 3.04).

3.2 Variables

3.2.1 Dependent variable. While prior studies have used indirect disclosure measures based on analysts' assessments of disclosure levels, Botosan (1997) points out that the use of such measures will bias the sample toward companies that are followed by analysts. Accordingly, many researchers have used self-constructed direct measures of disclosure. This study adopts a direct measure of voluntary disclosure based largely on these prior studies (Eng and Mak, 2003; Botosan, 1997; Hossain *et al.*, 1995; Meek *et al.*, 1995). This method is designed to capture the amount and level of detail of voluntary disclosure. While previous studies focus on financial and non-financial attributes of disclosure, we focus our attention on 13 financial attributes, listed as follows:

Financial attributes.

Financial attributes included in the financial T&D index:

- stocks performance, shareholder and investor return (dividends, trends, EPS, stock and debt ratings);
- management's presentation of measures adopted as critical success factors (milestone achievements, goals);
- non-mandatory analysis of profitability and financial structure (EBITDA, Cash Flow, ROI, ROE, Debts ratios, Pro-forma data);
- description of a total results by business/geographic units (percent of total, percent export);
- intangible assets monitor or intellectual capital statement (value of assets internally developed);
- economic profit and value-based management (economic value added);
- productivity (volumes/sales/value added by employee);
- litigations, legal actions and claims, included accounting litigations (expenses, number);
- R&D projects and expenditure (numbers, employees, percentage, trends);

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- market share, penetration and benchmarking with competitors;
- brands, license and trademarks (numbers, value creation, evaluation);
- cost accounting for suppliers; and
- cost accounting and cost saving by country, production line or project. Source – Our elaboration (2010)

It seems clear that the selection of voluntary items is based on subjective judgments. However, we reviewed recommendations from the following sources to arrive at the selection of a list of voluntary information items to be included in the T&D index:

- literature related to studies focusing on voluntary disclosure;
- academic literature concerning the Italian context;
- international financial institutions' recommendations; and
- other institutions' published works.

The inclusion of each attribute is scored on a binary basis as "yes" (included) or "no" (not included). Each "yes" answer is equal to 1 point and the overall T&D score for each firm is calculated as:

$$\textit{Financial T\&D} = \sum_{K} S_K$$

Where:

k = the attribute subscript, k = 1, . . ., 12.
Sk = the number of information items disclosed by the firm (coded as "yes").

3.2.2 Independent variables. The independent variables used in this study are: the independent directors' ratio, the board size and the CEO-duality.

The *independent directors' ratio* is measured through the ratio of independent directors to the total number of directors.

The *board size* is the number of board members.

CEO-duality is measured by a dummy variable coded "1" if the CEO is also the chairperson of the board and "0" if the positions are occupied by different people.

3.2.3 Control variables. The control variables used in this study are: firm size, ownership concentration, industry type, return on asset (ROA), audit committee size and number of board meetings.

Firm size is the number of employees measured in 2007. We controlled for firm size because large firms are likely to make more voluntary disclosures due to the greater demand for outside capital, lower average costs of collecting and disseminating information and greater demand for information by financial analysts (Hossain *et al.*, 1995). The existence of a significant positive relationship between firm size and disclosure was also suggested in many studies (Cheng and Courtenay, 2006; Arcay and Vazquez, 2005; Gul and Leung, 2004; Eng and Mak, 2003).

Ownership concentration is the percentage of shares held by the major shareholder, and it is used as proxy for the ownership concentration. In firms with concentrated ownership, it is not possible to discuss board composition and independence without taking into account the ownership structure. To this respect, we expect that firms characterized by concentrated ownership differ, in terms of voluntary disclosure, from those characterized by widely ownership. McKinnon and Dalimunthe (1993) suggest that voluntary disclosure may be helpful in reducing conflicts between managers and shareholders that arise when a firm's shares are widely held. Furthermore, ownership dispersion may influence the supply of information. For example, Craswell and Taylor (1992) argue that increases in the separation of ownership and control are likely to be accompanied by additional disclosures

of information to third parties. Additionally, the ownership structure may have a significant impact on the adoption of rules of good governance which, in turn, will affect voluntary disclosure.

Industry type is a dummy variable, coded "1" when the company operates in a manufacturing sector and "0" when it operates in service sector. We control for the industry type because research in this area suggests that disclosure vary across industries (Meek *et al.*, 1995). This is also consistent with Meek *et al.* (1995), who suggested that manufacturing firms voluntarily disclose more information.

ROA is calculated as net income/total assets. ROA is a proxy of firm performance, which has been shown to be related to the level of disclosure (Nagar *et al.*, 2003; Skinner, 1994; Lang and Lundholm, 1993). *Audit committee size* is the number of member in the audit committee. The audit committee operates as a monitoring mechanism to improve the quality of information disclosed to external parties (Pincus *et al.*, 1989). We control for this variable because empirical evidence indicates that voluntary disclosure is positively related to the functioning and composition of the audit committee (Ho and Wong, 2001). Furthermore, other studies suggested that audit committees help to reduce the likelihood of accounting fraud (Peasnell *et al.*, 2001; Dechow *et al.*, 1996). *Number of board meetings* is the annual number of board meetings. According to previous studies, we use the number of board meetings as an indicator for board diligence (Carcello *et al.*, 2002). Furthermore, the level of disclosure is associated with more board meetings (Zhang *et al.*, 2007). Boards of directors need to be active to meet their corporate governance commitments, particularly in ensuring high-quality, transparent reporting in annual reports. Boards that meet frequently are more likely to perform their duties diligently and effectively, thereby enhancing their level of oversight (Vafeas, 1999; Lipton and Lorsch, 1992).

3.2.4 Multiple linear regression analysis. Multiple linear regression analysis was used to test the hypotheses. We used SPSS to run the regression analysis. The following model is estimated:

$$FINANC_T\&D = \beta_0 + \beta_1(\text{IND_DIR_Ratio}) + \beta_2(\text{BOARD_Size}) + \beta_3(\text{CEO_Duality}) + \varepsilon$$

We made a hierarchical analysis with two steps. In the first step, we run the regression including the control variables (Model I). In the second step (Model II), we run the regression including all the control variables and also entering the independent variable (independent directors' ratio, board size, CEO-duality).

4. Results

Table II presents correlations for the dependent, independent and control variables. Intercorrelations among independent variables were generally low, thereby minimizing the problem of unstable coefficients (because of collinearity) in the linear regression models. Moreover, multicollinearity has been diagnosed through analyses of correlation factors and

Table II Correlation matrix (100 firms)

Variables	*1*	*2*	*3*	*4*	*5*	*6*	*7*	*8*	*9*	*10*
1. Firm size (number of employees)	–									
2. Ownership concentration	0.27	–								
3. Industry type (manufacturing vs service)	0.01	0.15	–							
4. Return on asset (ROA)	0.03	0.20*	0.06	–						
5. Audit committee size	0.11	−0.20**	0.06	−0.14	–					
6. Number board meetings	0.02	−0.19*	−0.10	−0.17	0.13	–				
7. Board size	0.10	0.09	−0.03	0.12	−10	−0.09	–			
8. Independent directors ratio	0.02	−0.30**	0.08	0.17*	0.17*	0.19*	0.35**	–		
9. CEO-duality	−0.06	−11	0.01	0.07	0.06	−0.07	−0.07	−0.14	–	
10. Financial T&D	−0.07	−0.32*	−0.06	−19*	0.37*	0.09	−0.37**	0.32**	−0.08	–

Notes: **Correlation is significant at the 0.01 level (two-tailed); *correlation is significant at the 0.05 level (two-tailed)

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variable inflation factors (VIF), consistent with the study by Weisberg (1985). There are no multicollinearity issues.

The results of the regression analysis are presented in Table III. Two models are presented. Model I is the regression analysis only with the control variables. Model II includes the independent variables independent directors' ratio, board size and CEO-duality in addition to all the control variables.

Model I regressed the financial T&D on the control variables; the adjusted R^2 is 0.28. Model II regressed the financial T&D on the control variables and the independent variables; the adjusted R^2 is 0.47.

Board size is negatively and significantly related to the level of financial T&D ($p < 0.05$), supporting *H1*. *H2* is supported as well. Indeed, there is a negative and significant relationship between the independent directors' ratio the level of financial T&D ($p < 0.01$). We did not find relationships between CEO-duality and financial T&D; thus, *H3* is not supported.

5. Discussion and findings

This study explores the extent and the determinants of voluntary disclosures in the annual reports of Italian largest listed firms. The disclosure of financial information in annual reports is a key area of accounting research, and more specifically, voluntary disclosure has received a great attention both from academics, regulatory and professional bodies.

This study sought to empirically investigate the association between corporate governance characteristics (boards of directors' characteristics) and financial T&D of the 100 largest Italian (in terms of market capitalization) listed firms in 2009. The results suggest that the level of T&D is positively and significantly related to the proportion of independent directors and negatively and significantly to the board size. Moreover, interesting relationships seem also to exist with ownership concentration and audit committee size.

H1 is thus supported, suggesting a positive and significant relationship between the independent directors' ratio and the level of financial T&D.

This is empirical evidence supporting the role of non-executive directors in promoting higher transparency and better disclosure policies to outside investors. This findings are in line with previous research on this relationship (Cheng and Courtenay, 2006; Leung *et al.*, 2005; Eng and Mak, 2003), especially with those studies indicating that the proportion of independent non-executive directors on board is positively related to the quality of financial disclosure (Ajinkya *et al.*, 2005; Forker, 1992). Furthermore, this is an interesting evidence for national contexts characterized by concentrated ownership (e.g. Italy) to focus the attention of formal governance mechanisms (such as the importance of independent directors) to increase the level of financial T&D and to reduce the risk of expropriation by majority shareholders.

Table III Regression analysis (100 Italian listed firms)

Independent and control variables	*Model I*	*Model II*
	Dependent variable Financial T&D	
Firm size (number of employees)	−0.06 (0.05)	−0.07 (0.05)
Ownership concentration	−0.11** (0.09)	−0.21** (0.14)
Industry type (manufacturing vs service)	−0.04 (0.33)	−0.10 (0.28)
Return on asset (ROA)	−0.07 (0.09)	−0.06 (0.10)
Audit committee size	0.46* (0.20)	0.49** (0.17)
Number board meetings	−0.03 (0.05)	−0.06 (0.03)
Board size		−11** (0.09)
Independent directors ratio		2.73*** (0.76)
CEO-duality		−0.08 (0.32)
Adjusted R^2	*0.28*	*0.47*
F-change	*7.17****	*10.03****

Notes: Standard errors are in parentheses; the levels of significance are; *< 0.1; **< 0.05; ***< 0.01

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Even if the result is interesting, it needs further discussion. Indeed, following traditional agency theory prescriptions (Jensen and Meckling, 1976), firms with more independent directors traditionally should have less agency problems. In fact, following the agency theory, independent directors may serve to primarily monitoring the management (Jensen and Meckling, 1976) to protect shareholders from management's conflict of interest (Fama and Jensen, 1983). However, recent corporate scandals have suggested that actual board independence is particularly difficult to be realized and this issue becomes more critical in context characterized by concentrated ownership (La Porta *et al.*, 1999). For example in the Italian context, characterized by a relatively high ownership concentration, there are multiple principals and agents that might be in several situations of conflict of interests, thus suggesting that a wider concept of independence should be considered. Hence, the independence of board members from the management is not enough to ensure actual independence. Even if the independent directors are independent from the management, we are not certain that they are independent from the controlling shareholders as well (Mallin, 2002).

We found support to *H2* as well. There is a negative relationship between board size and the level of financial T&D. This result is consistent with a large strand of literature. Indeed, restricting the number of directors, it is believed that the exchange of ideas between board members will be enhanced, as well as flexibility in the decision-making process. Prior studies have also investigated the relation between board size and disclosure finding similar results. It seems thus that the level of disclosure is associated with smaller board size (Zhang *et al.*, 2007).

We did not found support to *H3*, suggesting a negative relationship between CEO-duality and the level of financial T&D. This result is not consistent with the prior that found a significant negative relationship (Forker, 1992). A possible reason to this non-finding could be that a person who serves as both board chairman and CEO in Italian firms is likely to be a substantial shareholder, so it does not matter whether or not the two jobs are separated. However, our result seems to be consistent and in line with Arcay and Vazquez's (2005) findings, suggesting that in the Spanish context the existence of CEO-duality is not significantly associated with the provision of voluntary information. Therefore, further analysis on the inter-relationships between the impact of concentrated ownership and CEO-duality in countries like Italy and Spain may shed new light on the effective role that CEO-duality may have.

The analysis also provides a number of additional interesting implications. Indeed, the impact of control variables on the level of financial T&D raised some important reflections. We found that ownership concentration has a positive influence on the level of financial T&D. The Italian context is indeed dominated by firms with a high level of ownership concentration. As the descriptive statistics shows, 43.33 per cent of the shares are in mean held by the major shareholder. The negative correlation between ownership concentration and the level of financial T&D is a result consistent with previous studies on voluntary disclosure. Indeed, McKinnon and Dalimunthe (1993); Mitchell *et al.* (1995) and Schadewitz and Blevins (1998) found an inverse relationship between ownership concentration and disclosure. Summa and Ben Ali (2006) come to the same opinion, outlined a negative and significant relation between the quality of disclosure and ownership concentration in the French context. Therefore, suggesting that voluntary disclosure might be more likely to be intensive in widely ownership contexts. Therefore, the higher the ownership concentration the higher the need for financial T&D.

In addition and according to Ho and Wong (2001), when a high proportion of the capital is held by a low number of shareholders, conflicts of interest are not between managers and shareholders, but between majority and minority shareholders. In such situation, managers have the incentive to behave against the interests of minority shareholders by reducing the quality of financial disclosure. Indeed, a better financial disclosure helps reducing conflicts of interests between shareholders and allows protecting these latter. Hence, in these

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contexts, high-quality financial T&D becomes even more important to increase the level of protection of minority shareholders who are often exposed to high risk of expropriation by majority shareholders. This problem (for example in the Italian context) is commonly known as the Agency Problem II (Cascino *et al.*, 2010). When ownership is highly concentrated, the nature of the agency problem shifts away from manager–shareholder conflicts to conflicts between the controlling owner and minority shareholders (Berle and Means, 1932; Fan and Wong, 2002). In these contexts, T&D represents an important indicator of corporate governance quality (OECD, 1999).

In addition, it is important to underline an important point. The Italian context is characterized by a majority of family-owned firms (Corbetta and Montemerlo, 1999). In our sample, there are many cases of family-owned firms; therefore, it is reasonable to argue that the level of financial T&D might be influenced by the owning family decision-making power. In fact, the family takes actively part to the management and direction of the firm also occupying top leadership positions (members of the board of directors or the top management team). This allows the owning family to manage all types of information to avoid conflicts with minorities or issues concerning the possibility to loose their controlling function. Therefore, family-controlled firms tend to provide less external information (Summa and Ben Ali, 2006).

The audit committee size is another important factor influencing the level of financial T&D. Our results suggest that the higher the audit committee size, the higher the level of financial T&D. This finding is also supported by previous studies. The audit committee operates as a monitoring mechanism to improve the quality of information conveyed to external parties (Pincus *et al.*, 1989) and oversees the preparation and communication of financial information to third parties to ensure that such data fulfils the requisites of clarity and the completeness of disclosure. Empirical evidence indicates that voluntary disclosure is positively related to the functioning of an audit committee (Ho and Wong, 2001). Furthermore, Peasnell *et al.* (2001), observed that audit committees help to reduce the likelihood of accounting fraud.

6. Conclusions, future research directions and limitations

The paper acknowledged the increased significance placed on voluntary disclosure and the importance of corporate governance to enhance the level of voluntary disclosure provided by the firms. This study makes several contributions to the theory and the practice. From a theoretical standpoint, the analysis first reveals a positive relationship between the independent directors' ratio and the level of financial T&D. Moreover, there is a negative relationship between board size and the level of financial T&D. It offers also important evidence, suggesting that ownership concentration and audit committee size impact on the level of financial T&D. Second, the study offers an interesting angle of analysis by focusing on the Italian context mainly characterized by a high level of ownership concentration. Indeed, stemming from this context might be useful to catch advancements to the agency theory prescriptions by suggesting that in these contexts, the level of financial T&D may be influenced by the existence of conflicts of interest between majority and minority shareholders. Third, by using a direct scoring methodology to catch the level of financial T&D, we avoid to use measures based on analysts' perceptions and bias related to this choice. Furthermore, we tried to summarize different attributes when considering the set of voluntary information that firms should have to reach high quality financial T&D.

The study also offers insights to policymakers and regulators to evaluate the effectiveness of corporate governance in enhancing the level of voluntary disclosure. Indeed, we provide some indications to firms to improve their internal governance mechanisms (e.g. the importance of high proportion of independent directors and of small- and medium-sized boards of directors).

This study also shows interesting future research directions.

While this study finds that voluntary governance codes have a significant effect on governance and disclosure practices, future studies could examine the relative size of the effects of mandatory regulations and voluntary codes. Moreover, a major focus on contingency factors and specificities of national context may help in contributing to advancement of the governance and accounting fields and practice.

Our study has also some limitations. The most important are the relatively small sample and the financial T&D measure. As for the sample, our analysis focus on the largest Italian listed companies. This may limit the reliability of our results to other national context and to other type of firms (e.g. non-listed firms or SMEs). To overcome this issue, similar studies can be also taken in the other European countries. Moreover, it could be of great interest extend that this study to non-listed firms to understand how the determinant of voluntary disclosure may change. With respect to the T&D measures, as noted above, the index concerns whether an item is disclosed, not the quality or accuracy of the disclosure.

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