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Determinants and features of voluntary disclosure in the Chinese stock market

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ABSTRACT

This paper offers in-depth analysis of the determinants and features of voluntary disclosure based on information in the annual reports of 1066 Chinese firms listed on the Shanghai and Shenzhen Stock Exchanges. This extensive sample represents about 80% of all public companies in China. Our findings suggest that voluntary disclosure in China is positively related to firm size, leverage, assets-in-place, and return on equity and is negatively related to auditor type and the level of maturity or sophistication of the intermediary and legal environments. We also find some evidence to suggest a quadratic convex association between state ownership and voluntary disclosure. However, our analysis provides no evidence that extensive disclosure benefits public companies in China in the form of a lower cost of equity.

1. Introduction

Voluntary disclosure is a common way for a public company to disseminate company information not required by mandatory disclosure requirements to its investors and the general public. Earlier studies have suggested that this type of disclosure may benefit both investors and the public companies themselves in

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specific areas. For example, Diamond and Verrecchia (1991) and Kim and Verrecchia (1994) claim that voluntary disclosure can reduce information asymmetry between informed and uninformed investors. Moreover, empirical studies carried out by Barry and Brown (1986), Botosan (1997) and Piotroski (1999) demonstrate, among other things, that voluntary disclosure helps to reduce the cost of equity.

However, more recent studies have indicated that the abovementioned benefits may not hold for all stock markets. Using a dataset comprising 110 public companies with both A- and B-share listings in China, Wang et al. (2008) investigate the effects of voluntary disclosure and find no evidence that these companies benefited from that disclosure in the form of a lower cost of debt capital. Their analysis suggests that voluntary disclosure in the Chinese stock market exhibits determinants and characteristics that may be very different from those found in the stock markets of developed countries.

We intend to carry this line of thought further by investigating more closely the determinants and consequences of voluntary disclosure in the Chinese stock market using a much larger dataset – 1066 Chinese public companies – than that used in Wang et al. (2008). This extensive dataset represents about 80% of public companies listed on the Chinese stock exchanges that have a relatively complete historical record of annual reports.

Our investigation is motivated by two considerations. First, since their establishment in 1990 and 1991, respectively, the Shanghai and Shenzhen Stock Exchanges have become major global stock exchanges in terms of total capitalization, trading volume and the rapid pace of growth in the number and size of public companies. Also, a large individual investor population trades shares on both exchanges and China boasts an ever-increasing number of institutional investors. Further, foreign investors with Qualified Foreign Institutional Investor (QFII) status have also begun to invest directly in the Chinese stock market. Previous studies have found that both individual and institutional investors in China are less experienced and more restricted than their counterparts in developed countries such as the United States (Chen et al., 2004; Bailey et al., 2009; Deng and Xu, 2011), which may influence their understanding of financial reports and, in turn, affect the disclosure motivation of listed firms. The growing complexity of China's stock market calls for a better understanding of the key aspects involved, which will benefit investors, public companies, and regulators alike. Voluntary disclosure is one such key aspect, the effects of which concern all of these market players.

Second, China has a distinct political and geographical environment. As an emerging economy, China's capital market is not as efficient as those in developed countries, such as the United States. Moreover, the country's regulatory environment is less mature than those in developed countries, which have taken half a century or more to develop. Also different from more mature economies, the majority of listed companies on the Chinese stock exchanges are ultimately controlled by the central or local governments owing to the country's long history of a planned economy. These firms are called state-owned enterprises (SOEs). A large percentage of SOEs are in essential industries, rich in resources, and directly responsible to the government, and often enjoy rights and privileges unavailable to private companies. Consequently, they have different corporate governance mechanisms compared to firms listed in the United States, most of which are privately controlled (Xu and Wang, 1999; Qiang, 2003; Clarke, 2003; Wang et al., 2004). These corporate governance mechanisms result in the Chinese stock market having a number of distinct characteristics that in turn influence the determinants and consequences of voluntary disclosure by the public companies listed in China.

These two considerations suggest both the necessity and the particularity of an in-depth, thorough investigation aimed at reaching a better understanding of the nature and effects of voluntary disclosure in the Chinese stock market.

Some studies have been conducted in this and related areas. Ferguson et al. (2002) examine voluntary disclosures in the annual reports of SOEs listed on the Hong Kong Stock Exchange and conclude that these companies tend to disclose significantly more information than other companies listed on the same exchange. Using a dataset of the 300 largest public companies at that time, Xiao et al. (2004) analyzes the factors behind Chinese listed companies' voluntary adoption of Internet-based financial reporting and the extent of their disclosure. Wang et al. (2008) conduct a more focused study to test the determinants and consequences of voluntary disclosure in China using a relatively small sample comprising only firms issuing both A and B