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# Corporate ownership structure and the informativeness of accounting earnings in East Asia<sup>☆</sup>

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## Abstract

This study examines the relations between earnings informativeness, measured by the earnings–return relation, and the ownership structure of 977 companies in seven East Asian economies. Our results are consistent with two complementary explanations. First, concentrated ownership and the associated pyramidal and cross-holding structures create agency conflicts between controlling owners and outside investors. Consequently, controlling owners are perceived to report accounting information for self-interested purposes, causing the reported earnings to lose credibility to outside investors. Second, concentrated ownership is associated with low earnings informativeness as ownership concentration prevents leakage

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## 1. Introduction

Public corporations in East Asia typically have low levels of transparency and disclosure quality. Some commentators and policy advisors believe that a closer adherence to international disclosure rules and the adoption of international accounting standards are essential for improving corporate transparency in the region (World Bank, 1998). Despite efforts to impose stricter reporting rules and standards, the general perception is that corporate transparency has been declining (Asian Wall Street Journal, 1999). While the new accounting rules may have increased the quantity of accounting information, investors have reservations about the quality of the reported numbers.<sup>1</sup> Therefore, it is important for regulators and policy makers to understand the causes of the low quality of reported accounting information in the region.

This paper focuses on the relations between corporate ownership structure and the quality of accounting information in seven East Asian economies excluding Japan. More specifically, we use the informativeness of accounting earnings to investors as a measure of the quality of accounting information. We develop two complementary arguments pertaining to the relations between ownership structure and earnings informativeness. The first argument is related to the entrenchment effect of ownership concentration (Morck et al., 1988). Corporate ownership is highly concentrated in East Asia. As the controlling owners are entrenched by their effective control of the firms, their decisions that deprive the rights of minority shareholders are often uncontestable in the weak legal systems in the region and by ineffective corporate governance mechanisms such as boards of directors and the market for corporate control (Shleifer and Vishny, 1997; La Porta et al., 1999; Johnson et al., 2000b). Moreover, due to the complicated pyramidal and cross-holding ownership structures typical in East Asian companies, a significant number of controlling owners in the region actually possess more control than their equity ownership indicates, which further exacerbates the entrenchment effect.<sup>2</sup> The

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<sup>1</sup>This view of low information quality was shared among business professionals at the recent World Bank Meeting. For example, a local lawyer from Thailand remarked that "the major difference (in accounting disclosure) between the past and today is that statements of accounts now carry more qualifications, not better information". See the report by Sender (1999).

<sup>2</sup>Claessens et al. (2002) report that the concentrated control and the divergence between ownership and control in public corporations in eight East Asian economies diminish firm value, indicating the economic significance of the agency problem associated with ownership structures. Consistent evidence is also found in several other studies. La Porta et al. (2002) examine over 300 firms from 27 wealthy economies and

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