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THE DETERMINANTS OF CORPORATE GOVERNANCE DISCLOSURE LEVEL IN THE INTEGRATED REPORTING CONTEXT

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Abstract

In recent years, the analysis of corporate governance aspects is becoming a central element for understanding corporate dynamics and represents a clear indicator of investor confidence in the decisions taken by the management and board of listed firms. For this reason, corporate governance disclosure is receiving more and more attention from both a professional and academic point of view. The advent of integrated reporting represents a new tool for disclosing information relating to corporate governance. The goal of this study is to investigate the factors that can influence the level of corporate governance disclosure within the integrated reports. The analysis, conducted on a sample of 73 international firms, shows a positive effect of the firm size, firm profitability and audit quality. To our knowledge, this is the first study that analyses corporate governance disclosure level in the integrated reporting context.

Keywords: *corporate governance; disclosure; integrated reporting; information quality*

Track: *Governance*

Word Count: 3.623

1. Introduction

In recent years, the analysis of corporate governance aspects is becoming a central element for understanding corporate dynamics and represents a clear indicator of investor confidence in the decisions taken by the management and board of listed firms. Since the early 1990s, the number of codes of corporate good governance has grown considerably to become an important criterion for assessing the level of transparency of companies and business compliance practices (Gandia, 2008).

The recent financial scandals that have hit European and US companies have clearly shown the need for firms to adopt recommendations (Ben-Amar & Boujenoui, 2006). In this regard, the regulatory agencies of various countries have set up special task forces in order to devise these recommendations and publish codes for best practices for corporate governance of listed firms (Aguilera & Cuervo-Cazurra, 2004; Broshko & Li, 2006; Collett & Hraskey, 2005; Cuervo-Cazurra & Aguilera, 2004; Li & Broshko, 2006). Therefore, as underlined in the Global Investor Opinion Survey, corporate governance represents an important criterion in investment decisions (McKinsey & Company, 2002). In fact, in their investment decisions, investors place greater trust in companies with good corporate governance (Gandia, 2008). In fact, the information relating to corporate governance allows investors to better determine the future performance of companies (Bhat et al., 2006). Therefore, in this perspective, the attention that capital markets devote to governance aspects should push companies to provide high quality information in order to increase their level of transparency (Ben-Amar & Boujenoui, 2006; Gandia, 2008).

The greater attention to information related to corporate governance is visible not only by the recent rules and regulations of world stock exchanges (Gandia, 2008), but also by the requirements of the entities that define international disclosure standards. In this regard, the International Integrated Reporting Council (IIRC) in the development of integrated reporting (IR) has provided an important focus on aspects related to corporate governance (Vitolla et al., 2019a; 2019b; 2019c; Raimo et al., 2019). It represents the last frontier of corporate disclosure and combines financial

and non-financial information in a single report (Vitolla et al., 2018; Vitolla & Raimo, 2018). Integrated reporting has also gained considerable importance from a professional point of view (IFAC, 2016; 2017; KPMG, 2016). With reference to corporate governance, integrated reporting aims to clearly show how it supports the company's ability to create value over time (IIRC, 2013). The corporate governance disclosure literature focused mainly on identifying the information that companies should provide and on the effects of this information (Gandia, 2008). An aspect not yet explored is represented by the analysis of factors capable of influencing the quality of corporate governance disclosure of companies. In this regard, the few studies in the literature have analysed the determinants of corporate governance information through a content analysis of annual reports and websites (Collett & Hrasky, 2005; Samaha et al., 2012; Gandia, 2008) or in alternative through the use of ratings (Ben-Amar & Boujenoui, 2006; Vander Bauwhede & Willekens, 2008). However, the absence of contributions aimed at analysing the corporate governance disclosure in the integrated reporting context is evident. This study aims to fill this important gap by investigating the factors that can influence the level of corporate governance disclosure contained in the integrated reports..

The remainder of this article is organized as follows: Section 2 analyses the background, Section 3 shows the study's hypotheses. Section 4 presents the methodology while Section 5 shows and discusses the results. The last section draws conclusions.

2. Background

The growing importance of corporate governance is demonstrated by the number of related contributions present in the literature in the field of accounting, management and finance (Bhagat & Black, 2002; Shleifer & Vishny, 1997). Corporate governance can be understood as a set of principles relating to the governance of firms and the way in which these principles are communicated externally (Gandia, 2008). Corporate governance disclosure studies focused primarily on the information that companies should disclose and on the effects of this information (López-Arceiz et al., 2019). Another part of the literature focused on the analysis of the media through which companies should disclose information related to corporate governance (Gandia, 2008; 2011). In fact, according to Bushman et al. (2004) corporate transparency depends on the channels and communication tools chosen by companies, which can hinder or facilitate the flow of information and therefore influence the availability of information from stakeholders. In relation to the different communication channels, past studies have focused on the information contained in the annual reports and websites (Collett & Hrasky, 2005; Samaha et al., 2012; Gandia, 2008). In this regard, Gandia (2008), making a comparison between the two channels, highlighted how companies that use internet as a communication tool present a higher quality corporate governance disclosure. In addition, the author added that the quality of corporate governance disclosure is influenced by the listing age, the presence of analysts, belonging to the communications sector and the visibility of companies.

The advent of integrated reporting provides companies with a new channel for communicating information related to corporate governance. It represents the last frontier of corporate disclosure and shows the interconnections between financial and non-financial information (Vitolla et al., 2019d). In this regard, the IIRC refers to six different types of capital: financial capital, manufactured capital, intellectual capital, human capital, social and relationship capital, and natural capital (Vitolla et al., 2019e). Among non-financial information, integrated reporting presents an important focus on intellectual capital (Vitolla et al., 2019f) and corporate governance, which in fact represents one of the eight content elements identified by the IIRC. The objective of an integrated report is, in fact, to show how an organization's corporate governance favours the creation of value in the short, medium and long term (IIRC, 2013). Therefore, for this purpose, an integrated report should show information relating to the structure of leadership, the components of corporate governance, the specific processes used to make decisions and the measures taken to influence and monitor corporate strategies (IIRC, 2013). In addition, an integrated report should represent the way in which ethics, culture and corporate values are reflected on the use of capital,

and the initiatives undertaken by governance to allow innovation (IIRC, 2013). Finally, it should provide information about the implementation of governance practices that go beyond legal obligations and about the link between remuneration and incentives (IIRC, 2013).

Despite the importance that the IIRC dedicates to aspects relating to corporate governance, in the literature there are no contributions aimed at analysing corporate governance information within the integrated reports. Therefore, this study aims to fill this gap by investigating the level of corporate governance disclosure contained in the integrated reports and by analysing some possible antecedents of this level.

3. Hypotheses development

Firm size: The empirical contributions in the literature show how the firm size represents a variable capable of explaining the political choices of disclosure, and specifically the quality and level of information provided voluntarily (Abdullah et al., 2015; Andrikopoulos et al., 2014; Bhasin et al., 2015; Bujaki & McConomy, 2002; Chow & Wong-Boren, 1987; Cooke, 1991; Depoers, 2000; Eng & Mak, 2003; Frías-Aceituno et al., 2014; Gul & Leung, 2004; Khan, 2010; Meek et al., 1995; Raffournier, 1995; Sharif & Rashid, 2014; Sierra-García et al., 2015). Larger companies are more likely to produce information and also incur lower costs due to economies of scale (Ben-Amar & Boujenoui, 2006; Gandia, 2008). Corporate governance disclosure is fundamental for this type of firms due to the complexity of corporate relationships (Gandia, 2008). A high level of information relating to corporate governance can reduce the monitoring costs of outside shareholders and information asymmetry that is higher in large companies (Eng & Mak, 2003). Furthermore, larger companies are subject to greater public pressure and therefore must provide more information (Marrone & Oliva, 2019; 2020; Vitolla et al., 2019c). The past contributions in the literature, in relation to corporate governance disclosure, have found a positive effect of the firm size on the amount of information provided by companies (Bujaki & McConomy, 2002). Therefore, in light of this, we introduce the following hypothesis:

H1: There is a positive association between the size of the firm and the corporate governance disclosure level.

Firm profitability: Past contributions in the literature have found a positive relationship between firm profitability and voluntary disclosure (Gandia, 2008). In this regard, Haniffa and Cooke (2005) showed that companies that generate high profit levels are very interested in providing information to highlight their performance to stakeholders (Malone et al. 1993; Siregar & Bachtiar, 2010; Udayasankar, 2008; Wallace et al., 1994). Furthermore, according to Singhvi and Desai (1971), greater levels of profitability persuade managers to provide more information in order to demonstrate the capacity of the firm to maximize shareholder value. Profitable firms will be more interested in disseminating information in order to promote a positive image of their performance (Sharif & Rashid, 2014). Finally, profitable firms may choose to publish higher-quality information in order to distinguish themselves from less-successful companies (Frías-Aceituno et al., 2014). In relation to corporate governance disclosure, companies characterized by high profitability levels could be incentivized to provide information in order to show the governance system to the audience (Ben-Amar & Boujenoui, 2006). Therefore, in light of this, we introduce the following hypothesis:

H2: There is a positive association between the profitability of the firm and the corporate governance disclosure level.

Audit quality: According to Jensen and Meckling (1976), external auditors represent an important corporate governance mechanism as they are in charge of providing a fair judgment on the quality of the information provided by the company (Al-Janadi et al., 2013; Barros et al., 2013; Francis et al., 1999). DeAngelo (1981) highlighted how auditor size represents a proxy for audit quality.

Larger audit firms are more likely to provide high quality services to preserve their reputation and avoid losing customers in case of misreporting (Barros et al, 2013). The direct consequence is that large audit firms do not accept pressures related to the disclosure of less accurate and detailed or incomplete information. In this regard, Titman and Trueman (1986) highlighted how the assumption of a large auditing firm signals to stakeholders the quality of the information provided. The contributions in the literature highlighted a positive impact of the size of the auditing firm on the level of voluntary disclosure (Craswell & Taylor, 1992; Debreceeny et al., 2002; Inchausti, 1997; Kelton & Yang, 2008; Xiao et al., 2004). Therefore, in light of this, we introduce the following hypothesis:

H3: There is a positive association between the audit quality of the firm and the corporate governance disclosure level.

4. Research methodology

4.1 Sample

The sample of this study is composed of 73 international companies that publish an integrated report. To download these documents, we used the IIRC website. Specifically, we used two different sections of the website: "Leading Practices" and "<IR> Reporters". The presence of the reports on the IIRC website ensures that they have been drawn up in compliance with the <IR> framework. In addition, the alternation of these two sources ensures an adequate level of balance for the sample. In fact, the "Leading Practices" section contains higher quality reports while the "<IR> Reporters" section presents a list of reports of presumed lower quality. The integrated reports analysed are all related to 2017. The selected companies belong to different countries and operate in different sectors. Normal tests were conducted which demonstrated normal data distribution.

4.2 Variables and model specification

The dependent variable of this study is represented by the corporate governance disclosure level (CGDL) contained in the integrated reports. In order to measure the level of information this study uses a visual content analysis. Through this technique, in fact, we have sought specific information related to corporate governance within the integrated reports. To this end, we first identified a series of items related to corporate governance. For the identification of these items we started with those identified by Gandia (2008). Based on this study, we classified the items into three categories: board of directors, ownership structure and good governance. In relation to the board of directors, we have identified 14 different items. With reference to the ownership structure, we identified 4 items. Finally, with reference to good governance we identified 6 items. Therefore, the total of the identified items is equal to 24. Through a visual content analysis, we verified the presence of these items in each integrated report. We assigned a score of 1 in case of presence of the single item and a score of 0 in case of absence. Therefore, in light of this, the corporate governance disclosure level can assume a maximum score of 24. Table 1 shows the corporate governance disclosure scoring model.

The independent variables of this study are represented by firm size (SIZE), firm profitability (ROE) and audit quality (AUDQ). To measure the firm size (SIZE), we used the natural logarithm of the total assets. Firm profitability (ROE) was measured through return on equity. Finally, audit quality was measured through a dummy variable that equals to 1 if firm's report is certified by at least one "Big Four" accounting firm, and 0 otherwise.

We have also included some control variables. Specifically, we included: financial leverage (LEV), board size (BSIZE), environmental sensitivity (ESEN) and firm age (AGE). Financial leverage (LEV) was calculated as the ratio of the book value of debt over the book value of equity. Board size (BSIZE) was measured as the number of directors on the board. Environmental sensitivity (ESEN) is a dummy variable that assumes a score of 1 if the company operates in a highly polluting sector and 0 otherwise. Firm age (AGE) was measured as the number of years

from the establishment of the firm until the end of 2019.

To test the research hypotheses, this study uses a linear regression model. The following equation summarizes the analysis model:

$$CGDL = \beta_0 + \beta_1 SIZE + \beta_2 ROE + \beta_3 AUDQ + \beta_4 LEV + \beta_5 BSIZE + \beta_6 ESEN + \beta_7 AGE + \varepsilon$$

Table 1: – Corporate governance disclosure scoring model

Area	Total Score of the area
<p>BOARD OF DIRECTORS</p> <ol style="list-style-type: none"> 1) Board members 2) Board structure 3) Internal rules for organization and functioning 4) Functions and office of each director 5) Selection, de-selection and re-election procedures 6) Conduct rules for directors 7) Board's responsibility for the information disclosed to the markets 8) Relations between directors and major shareholders 9) Interests held by directors in share capital 10) Executive status and independence of directors 11) Independence conditions 12) Professional qualifications of independent directors 13) Offices held by any independent director in other companies 14) Directors' emoluments 	14
<p>OWNERSHIP STRUCTURE</p> <ol style="list-style-type: none"> 1) Breakdown of percentage interests in the firm owned by major shareholders 2) Agreements entered into by the company with its directors and senior executives 3) Operations between the company and major shareholders 4) Treasury stock held by the company and significant variations 	4
<p>GOOD GOVERNANCE</p> <ol style="list-style-type: none"> 1) Good governance criteria 2) Audit fees 3) Fees paid for non-audit services provided by audit firms 4) Disclosure of reports containing ethical principles (e.g. code of ethics or code of conduct) 5) Content of by-laws 6) Opinion of analysts and rating agencies 	6
CORPORATE GOVERNANCE DISCLOSURE LEVEL	24

5. Results

5.1 Descriptive statistics and correlation analysis

Table 2 shows the descriptive statistics and the correlation analysis. As far as the descriptive statistics are concerned, an interested datum is represented by the average value of the dependent variable represented by the corporate governance disclosure level (CGDL). It has a value of 10.21 which indicates, on average, a low level of corporate governance disclosure level within the integrated reports. As for the correlation matrix, the results show the absence of multicollinearity. In fact, the highest correlation coefficient is 0.437 for AUDQ and CGDL. However, harmful levels of multicollinearity should not exist until the correlation coefficient reaches ± 0.8 or ± 0.9 (Farrar & Glauber, 1967; Gujarati, 1995; Kennedy, 1999). Multicollinearity was also tested through variance inflation factor (VIF) analysis. The highest value is equal to 1.17. The effect of multicollinearity is not significant when the values are less than 10 (Myers, 1990). Therefore, in light of this, it is possible to say that multicollinearity does not represent a problem in the interpretation of the results.

Table 2: Means, standard deviations, VIFs and correlations

Variables	Mean	S.D.	VIF	CGDL	SIZE	ROE	AUDQ	LEV	BSIZE	ESEN	AGE
CGDL	10.21	4.21		1							
SIZE	16.20	2.37	1.11	0.331 ***	1						
ROE	12.80	6.87	1.08	0.213 *	-0.126	1					
AUDQ	0.87	0.33	1.10	0.437 ***	0.156	0.168	1				
LEV	6.25	6.12	1.17	-0.139	0.027	-0.123	0.041	1			
BSIZE	10.82	3.58	1.13	-0.051	0.144	0.032	-0.042	0.084	1		
ESEN	0.43	0.49	1.16	0.092	0.047	0.059	-0.004	-0.350 ***	0.028	1	
AGE	52.79	49.92	1.12	0.084	-0.084	0.025	0.111	0.016	0.247 **	0.081	1

Note: $n = 73$. S.D. = Standard Deviation. *** = significant at the 1% level; ** = significant at the 5% level; * = significant at the 10% level.

5.2 Linear multiple regression results

We tested the hypotheses of this study through a linear regression model. The results support hypothesis 1 (H1). In fact, there is a positive relationship between firm size (SIZE) and corporate governance disclosure level (CGDL) at $p = 0.003$. This result shows how larger companies provide a greater level of information relating to corporate governance within the integrated reports. In addition, the results support hypothesis 2 (H2). In fact, they highlight a positive association between firm profitability (ROE) and corporate governance disclosure level (CGDL) at $p = 0.092$. This result underlines how the most profitable companies provide a greater level of information relating to corporate governance within the integrated reports. Finally, the results also support hypothesis 3 (H3). In fact, they highlight a positive association between audit quality (AUDQ) and corporate governance disclosure level (CGDL) at $p = 0.002$. This result underlines how the companies that have their report certified by at least one "Big Four" accounting firm provide a higher level of information relating to corporate governance.

Table 3: – Linear multiple regression results

Variables	Coefficient	Standard error	p-value
Cons	3.027	3.375	0.373
SIZE	0.575	0.189	0.003***
ROE	0.110	0.064	0.092*
AUDQ	4.416	1.355	0.002***
LEV	-0.087	0.755	0.252
BSIZE	-0.121	0.126	0.343
ESEN	0.154	0.920	0.867
AGE	0.008	0.009	0.379
N	73		
Adj. R ²	0.258		

*** = significant at the 1% level; ** = significant at the 5% level; * = significant at the 10% level

6. Conclusions

This study investigated the determinants of the corporate governance disclosure level contained in the integrated reports. The results first showed an average low level of corporate governance disclosure level within the integrated reports. Second, the results demonstrated a positive impact of firm size, firm profitability and audit quality. Large companies are more likely to produce information and also incur lower costs due to economies of scale. Furthermore, these companies are subject to greater pressure. These circumstances explain the positive impact of the firm size on the corporate governance disclosure level. As for profitable firms, they will be more interested in disseminating information in order to promote a positive image of their performance. Furthermore, profitable firms may choose to publish higher-quality information in order to distinguish themselves from less-successful companies. These circumstances explain the positive impact of firm profitability on corporate governance disclosure level. Finally, as regards audit quality, the reputation of the large accounting firms guarantees the quality of the information contained within the integrated reports. This circumstance explains the positive impact of audit quality on corporate governance disclosure level.

The results have important managerial implications. The managers of the largest and most profitable companies must increase the level of corporate governance disclosure in order to mitigate the pressures and show a good corporate image. In relation to audit quality, instead, managers should increase the quality of the audit in order to improve the level of information relating to corporate governance provided within the integrated reports.

This study is subject to a limitation related to the sample size. In fact, this study is based on a sample of only 73 companies. However, this limitation may represent a basis for future studies. In fact, future research will test the hypotheses of this study on a larger sample. In addition, future studies will be able to test the impact of other variables both at company level and at country level.

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