THE UNDERLYING MECHANISM OF RELATED PARTY TRANSACTIONS DISCLOSURE ACROSS COUNTRIES

Walaa Wahid ElKelish*

Abstract

This paper investigates the interrelationships between several external social institutions and related party transactions disclosure across 49 countries. A theoretical framework is proposed to encompass the interrelationships between cultural values, legal environment, government intervention in the economy, political environment, and related party transactions disclosure. Empirical results using path analysis showed the there are significant indirect effects of cultural values and gross national production per capita on related party transactions disclosure, whereby the legal environment and government intervention in the economy play intervention roles in this context. This investigation represents contribution towards the development of a comprehensive framework for related party transactions disclosure practices across countries.

Keywords: related party transactions disclosure, social institutions, cultural values, legal environment, government intervention, and political environment

*Assistant Professor of Accounting, Department of Accounting, Finance and Economics, College of Business Administration, University of Sharjah P.O Box 27272 Sharjah, United Arab Emirates
Tel: +971 50 6310588
Email: wwelkelish@yahoo.com

1. INTRODUCTION

There is growing interest in related party transactions disclosure especially after it was heavily blamed for some recent financial scandals such as the cases of Enron, WorldCom, and others (Rodrigues and Stegemoller, 2010; Cunningham, 2002; Barrett, 2002; Cox, 2003; Phan, 2007). Related party transactions disclosure is an important component of financial disclosure practices which can increase investor confidence and development in financial markets (Kohlbeck and Mayhew, 2010, Balasubramanian et al., 2009, Gordon et al., 2004, Djankov et al., 2008; La Porta et al., 2006). Related party transactions disclosure can be defined as the declaration of transfer of resources, services, or obligations between related parties that can possibly affect the financial position and profit and loss of the entity that is preparing the financial statements. Related parties may include relationships between a company and its affiliates, subsidiaries, executive officers, directors, shareholders and their immediate family members (See IAS 24, 2009; and SEC S-K and S-X, 2006).

The importance of these transactions stems from being a two sword economic tool which can be used to achieve efficiency and reduce transaction costs (Fan and Goyal, 2006, Fisman and Khanna, 2004), or to create private benefits for managers and/or controlling shareholders away from other shareholders, such as excessive compensation, transfer pricing, and excessive perquisites (Djankov et al., 2008). Several studies have highlighted the influence of firm specific characteristics and/or external social institutions on financial disclosure (See Debreceny and Rahman, 2005; Lopes and Rodrigues, 2007; Wang et al., 2008; Latridis, 2008; Eng and Mak, 2003; Chau and Gray, 2010; Ho and Wong, 2001; Archambault and Archambault, 2003; Hope, 2003; and Bushman et al., 2004). Other studies paid more specific attention to the impact of related party transactions on stock returns, earnings valuation, firms' performance, and firms' valuation (Cheung et al., 2006; Wenxia et al., 2010; Chen and Chien, 2007; Gordon et al., 2004; and Jian and Wong, 2010). This paper attempts to extend previous research by focusing on the determinants of related party transactions disclosure, and relates to the stream of studies which claims that differences in financial disclosure practices are due to external social institutions. Consequently, the main objective of this paper is to investigate the underlying inter-relationships between cultural values, legal environment, government intervention in the economy, political environment, and related party transactions disclosure across countries.

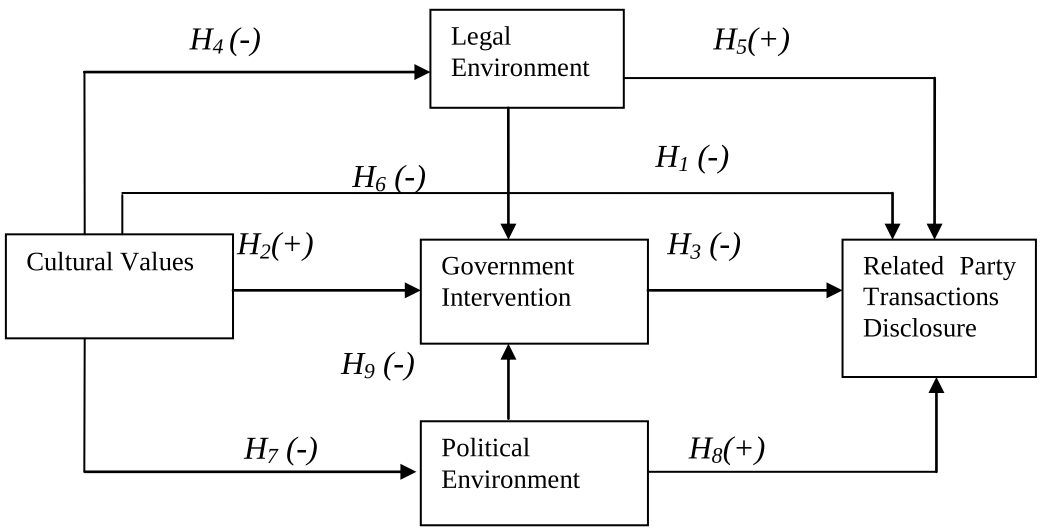
This paper adds to existing literature in two main ways: First, previous studies provided evidence on the direct effects of external social institutions on financial disclosure practices, however there is little done on the interrelationships between these institutions to explain financial disclosure. This study attempts for the first time to focus on the indirect effects of several external institutions on financial disclosure, in particular, the extent of related party transactions disclosure. The study of indirect effects can enrich our understanding of the potential impact of these institutions by focusing on their main interrelationships. Thus help improve reliability of financial reporting to provide more protection for shareholders' wealth as well as other corporate stakeholders. Second, the International Financial Reporting Standards have mandated new strengthened related party transactions disclosures requirements (IAS 24, 2009) as a vehicle to control and monitor these transactions; this study provides more understanding for the determinants of related party transactions disclosure which represent a building block for more effective implementation and enforcement of these international requirements across countries.

Empirical results show that there are significant indirect effects of cultural values and gross domestic production per capita on related party transactions disclosure, whereby the legal environment and government intervention in the economy act as intervention variables. These results proved to be robust after the addition of some explanatory control variables. The reminder of this paper unfolds as follows: Section two presents background and hypotheses development. Section three outlines the methodology and variables measurement. This is followed by section four which presents detailed results and discussions. Finally, section five concludes with a summary and suggestions for future research.

2. BACKGROUND AND HYPOTHESES

This paper proposes the following theoretical framework to highlight potential inter-relationships between external social institutions and related party transactions disclosure across countries (Figure 1).

Figure 1. The proposed theoretical framework for external social institution and related party transactions disclosure, and the hypothetical relationships (*H*), (+) positive relationship, (-) negative relationship



2.1 Cultural Values and Related Party Transactions Disclosure

In response to some financial scandals involving related party transactions a new body of regulations is under-going to rectify some deficiencies in accounting principles and rules governing these types of transactions (See IAS 24, 2009; SEC S-K and S-X, 2006; and Sarbanes-Oxley Act 402, 2002). Previous literature shows that the need for related party transactions disclosure is motivated by the potential conflict of interests between several stakeholders. Agency costs (Jensen and Meckling, 1976) may exist due to the potential misuse of related party transactions to expropriate wealth by management and/or controlling shareholders, and the potential misrepresentation of financial statements to increase or hide these transactions (Kohlbeck and Mayhew, 2010). To this extent, related party transactions disclosure can be used to control these transactions (Liu and Magnan, 2011; Kalyta and Magnan, 2008); and to signal to investor the effectiveness of the internal monitoring system to increase the reliability of financial reporting (Kohlbeck and Mayhew, 2004).

As for cultural values, it is asserted that they can influence the scope of institutional change through their impact on social norms and outcome behavior in a society (See North, 1990; Banfield, 1958; Greif, 2006; Casson, 1991, Landes, 1998, and Williamson, 2000). Consequently, several researchers tried to capture dominant cultural values using different models across countries (See Hofstede, 1980; Hall and Hall, 1990; Trompenaar and Turner, 1997). This paper utilizes the most recent cultural values model by Schwartz (1999), who derived seven Cultural value types, which can be summarized into three dimensions:

Embeddedness, Hierarchy, and Harmony. Interestingly, the cultural value of Embeddedness emphases the person as embedded in the group, maintenance of the status quo, propriety, and restraint of actions or inclinations that might disrupt group solidarity or the traditional order (Licht et al., 2007). The cultural value of Harmony deals with an attitude of submission and fitting with real world contingencies (Licht, 2001). While the cultural value of Hierarchy reflects the degree of acceptance of social inequality among members of a society (Dahl, 2004).

Early writings by Gray (1988) theorized that cultural values influence the development of accounting systems, the regulations of the accounting profession and attitudes towards management and disclosure. In addition, several studies found significant relationships between cultural values and financial disclosure (See Archambault and Archambault, 2003; Hope, 2003; and Bushman et al., 2004). Based on the theoretical predictions by Gray (1988) and previous empirical evidence: Embeddedness (*EMBED*), Harmony (*HARMO*), and Hierarchy (*HIER*) cultural values (Schwartz, 1999) are usually associated with high secrecy and less concern about firm outside stakeholders, a need to limit information disclosure to avoid conflict and competition to preserve security, and more limitations on information disclosures to secure power inequalities in a society, respectively. Therefore, it can be hypothesized (H_1) that: *"Countries which are characterized by high cultural values of Embeddedness (H1A), Harmony (H1B), and Hierarchy (H1C) are usually associated with less related party transactions disclosure"* (Table 1).

Table 1. Predicted relationships between cultural values, external social institutions and related party transactions disclosure. (+) positive relation, (-) negative relation, N/A not available

	Related Party Transactions Disclosure	Government Intervention	Legal Environment	Political Environment
Cultural Values:				
Embeddedness	H1A (-)	H2A (+)	H4A (-)	H7A (-)
Harmony	H1B (-)	H2B (+)	H4B (-)	N/A
Hierarchy	H1C (-)	H2C (+)	N/A	H7C (-)

2.2 Cultural Values and Government Intervention in the Economy

Among other researchers, Dahl (2004) suggested that the cultural value of Embeddedness (Schwartz, 1999) is similar to the cultural value of Collectivism (Hofstede, 1980). It is argued that societies which are characterized by the cultural value of Collectivism are more likely to favor less competition and more government intervention in the economy (De-Jong and Semenov, 2002; Hofstede, 2001; Guiso et al., 2006). In these societies, more competition may raise public concern about the security provided by social and economic schemes (Rajan and Zingales, 2003). This implies a positive relationship between the cultural value of Embeddedness and government intervention in the economy.

It is argued that the cultural value of Harmony (Schwartz, 1999) is close to the cultural value of Uncertainty Avoidance (Hofstede, 1980), as they encourage accepting the surrounding social and natural environment rather than to try change it (Licht et al., 2007). High Uncertainty Avoidance societies usually prefer group decisions, consultative management, and less competition to limit uncertain future events (Hofstede, 2001; and De-Jong and Semenov, 2002). In this case, government intervention in the economy is viewed as a means to overcome long-term financial fluctuations (Rajan and Zingales, 2003). This implies a positive relationship between the cultural value of Harmony and government intervention in the economy.

Societies with the cultural value of Hierarchy (Schwartz, 1999), which is similar to the cultural value of Power Distance (Hofstede, 1980), usually lack trust and cooperation between their members as they perceive each other as potential threats (Hofstede, 2001). Hence, these societies usually prefer more concentration of power (De-Jong and Semenov, 2002), and more government ownership (Djankov et al., 2003). This implies more regulations and government intervention in the economy to emphasis role obligations within a legitimately unequal distribution of power. By contrast, Klashing (2008) found that societies with more equal distribution of power usually provide more protection for individual property rights, limit government intervention, and enjoy more government effectiveness. Therefore, it can be hypothized (H_2) that: *" Countries which are characterized by more cultural values of Embeddedness (H2A), Harmony (H2B), and Hierarchy (H2C) are usually associated with more government intervention in the economy"* (Table 2).

Table 2. Predicted relationships between related party transactions disclosure and external social institutions, (+) positive relation, (-) negative relation

	Government Intervention	Legal System	Political Environment
Related Party Transactions Disclosure *(RPTD)*	H3 (-)	H5 (+)	H8 (+)
Government Intervention		H6 (-)	H9 (-)

In the same context, Djankov et al. (2002) presented evidence that government intervention in the economy in the form of more entry regulations reflects the Public Choice theory (De Soto, 1990, and Stigler, 1971). This implies that more entry regulations across countries usually benefit specific interest groups away from any social welfare such as improved goods and services. In this case, controlling shareholders may manipulate related party transactions disclosure to hide expropriation of wealth (Cheung et al., 2009), and governments can adopt weak accounting standards and enforcement of rules to conceal economic information for special benefits (Bushman et al., 2004). Therefore, it can be hypothized (H_3) that: "Countries which are characterized by more government intervention in the economy are usually associated with less related party transactions disclosure" (Table 1).

2.3 Cultural Values and Legal Environment

Licht et al. (2005) presented evidence of a significant positive relationship between the cultural value of Individualism (Hofstede, 1980) and anti-director rights; and another significant negative relationship between the cultural value of Uncertainty Avoidance (Hofstede, 1980), and both anti-director rights and creditors' protection rights. Since investor protection is more dominant in common law countries than civil law countries (La Porta et al., 1998), it can be predicted that countries which are characterized by more group solidarity, cohesion, and uncertainty avoidance usually drift toward civil law system rather than common law system. The former system can provide more stability as it depends on legal codes and statutes which can only be modified through time consuming legislation processes. Therefore, it can be hypothized (H_4) that: *"Countries which are characterized by low cultural values of Embeddedness (H4A), and Harmony (H4B) are usually associated with common law system" (Table 1).*

In the same context, policymakers and regulators in common law regimes with high investor protection are expected to mandate and enforce more transparent corporate reporting practices than civil law countries (Bushman et al., 2004; La Porta et al., 1998; Ball et al., 2000; Archambault and Archambault, 2003, Doupnik and Salter, 1995; Jaggi and Low, 2000). More specifically, it is argued that common law countries usually demand more disclosure requirements and external approval on related party transactions compared to civil law countries (Djankov et al., 2008, Johnson et al., 2000). This strong investor protection orientation in common law countries is due to, among other reasons, the respect of individual rights in the English common law system (Bushman et al., 2004), and more freedom provided for judges to cope with changing economic conditions (De-Jong and Semenov, 2006). Therefore, it can be hypothized (H_5) that: *"Countries which are characterized by common law system are usually associated with more related party transactions disclosure"* (Table 2).

On another aspect, previous literature showed that countries with different legal systems usually have tendency towards different modes of social institutional design and control of business activities (See Djankov et al., 2003). For example, Doupnik and Salter (1995) showed that common law countries usually adopt microeconomic systems, while most civil law countries are usually macroeconomic. Business activities in microeconomic systems focus on the survival of individual companies, while macroeconomic systems focus on the national economy to serve public interest (Nobes, 1987). This implies that the former may favor a shareholder-oriented corporate governance model which encourage financial disclosure to satisfy the needs of several stakeholders (Ball et al., 2000), While the latter may favor codified regulations and government intervention in the economy. Therefore, it can be hypothized (H_6) that: *"Countries which are characterized by common law system are usually associated with low government intervention in the economy"* (Table 2).

2.4. Cultural Values and Political Environment

The relationship between cultural values and political environment was emphasized by Roe (2000) who argued that the common ideology in the

U.S.A. influences politicians to support legal rules that prevent ownership concentration. Empirical evidence by Licht et al. (2007) indicates that societies which are characterized by the cultural value of Autonomy (Schwartz, 1999) are likely to have more democratic accountability, with no impact found for the cultural value of Harmony. Also, Klashing (2008) showed that social systems based on individual preferences and equal distribution of power usually give individuals more democratic rights. Furthermore, Borooah and Paldam (2007) presented evidence that poverty, political, and cultural factors are main barriers to democracy across countries. Therefore, it can be hypothesized (H_7) that: *"Countries which are characterized by low cultural values of Embeddedness (H7A) and Hierarchy (H7C) are usually associated with more Democracy"* (Table 1).

In the same context, previous studies highlighted the importance of political environment on accounting adequacy, competition, ownership structure; and development and implementation of accounting rules (See Belkaoui, 1983; Roe, 2003; Watts, 1977; Watts and Zimmerman, 1986; Ball, 2006; and Goodrich, 1986). According to the Public Choice theory (De Soto, 1990, and Stigler, 1971) political pressures can limit information disclosure and/or exempt some firms from implementing certain reporting regulations, to protect private economic benefits from public checks and potential entrants (Leuz and Wysocki, 2008). Therefore, it can be hypothized (H_8) that: *"Countries which are characterized by more Democracy are usually associated with more related party transactions disclosure"* (Table 2).

On another aspect, Djankov et al. (2002) found that countries with more political freedom have less regulation of entry even after controlling for per capita income. It is argued that the existence of Public Choice theory (De Soto, 1990, and Stigler, 1971) practices in some countries is due to the lack of a political control system to check on government performance, which gives rise to more entry regulations that contribute negatively on the social welfare and favor specific interest groups (Djankov et al., 2002). Therefore, it can be hypothized that (H_9): *"Countries which are characterized by more democracy are usually associated with low government intervention in the economy"* (Table 2).

3. METHODOLOGY AND VARIABLES MEASURMENT

The path analysis technique was implemented using multiple regression analyses (*OLS*) to test the proposed theoretical framework between external social institutions and related party transactions disclosure (Pedhazur, 1982; Davis, 1985; Pedhazur, and Schmelkin, 1991). A sample size of 49 countries is derived from the World Bank database (2007) which satisfied the data availability criteria on all study variables (See Appendix 1). Then, the statistical inference for total indirect effects are measured using: the *MEDTHREE* statistical technique by Hayes et al. (2010), which estimates the inference for indirect effects by generating percentile based bootstrap confidence intervals; and Sobel (1982).

The dependent related party transactions disclosure index (*RPTD*) is obtained from the World Bank (2007). The index represents the extent of related party transactions disclosure on five components: what corporate body can provide legally sufficient approval for the transaction; whether immediate disclosure of the transaction to the public is required; the regulator or the shareholders is required; whether disclosure in the annual report is required; whether disclosure by a buyer-seller member of the board of directors is required; and whether it is required that an external body, for example, an external auditor, review the transaction before it takes place. Data are collected using corporate surveys around the globe. The index ranges from 0 to 10, with higher values indicating greater disclosure and vice versa.

Several proxy variables were used to measure the external social institutions: cultural values, government intervention in the economy, legal environment, and political environment. Cultural values are represented by four dimensions: Embeddedness (*EMBED*), Harmony (*HARMO*), and Hierarchy (*HIER*) based on Schwartz (1999) cultural value model. Government intervention in the economy is represented by regulations to start business (*START*) composite rank for each country obtained from the World Bank (2007), which measures: number of procedures, time (days), cost (% of income per capita), and minimum capital (% of income per capita) required by a business to start operation as a legal entity. As for the legal environment, it is widely argued that the legal system is a principle variable that explains most of the variation in other legal factors such as: investor protection, judicial efficiency, and rule of law (Hope, 2003, Ball et al., 2000, Jøgensoen and Sabino, 2002). Therefore, two main legal systems (*LEG*): Common and Civil are chosen to represent the legal environment across countries, obtained from La Porta et al. (1998). Common law system usually depends on precedents from judicial decisions to resolve specific cases, while civil law system depends on statutes and comprehensive codes. A dummy variable score of (1) is used for Common law countries, while civil law countries are given a score of (0).

The political environment is represented by the Political Democracy index (*DEMO*) obtained from the Vision of Humanity (Institute of Economics and

Peace, 2007). It is a measure of the extent of political rights across countries, such as free and fair elections, existence of competitive parties, role and power of opposition parties, right to free speech, and freedom of the press. The measure is on a scale from 0 to 10, a value of (10) indicates more Democracy and vice versa.

Finally, two main explanatory control variables obtained from the World Bank (2007) are added to the analysis, which are: The natural logarithm of market capitalization (*LNCAP*) across countries in the fiscal year 2007 in US$. Previous empirical research showed that large firms usually provide more information to reduce agency costs (See Eng and Mak, 2003, Zarzeski, 1996, Archambault and Archambault, 2003, Bushman et al., 2004, Adhikari and Tondkar, 1992, Doupnik and Salter, 1995, Wenxia et al., 2010, Raffournier, 1995). This implies a positive relationship between market capitalization and *RPTD*. The natural logarithm of Gross National Income per Capita *(LNGNP/CAP)* expressed in current US$ is implemented to control for the level of general economic development across countries. It is argued that autocratic regimes are less likely to allocate resources in an efficient manner (Bushman et al., 2004). This implies a positive relationship between *LNGNP/CAP* and *DEMO*. By contrast, high regulatory intensity is expected to relate to lower per capita income, and more government intervention to serve specific interest groups (Djankov et al., 2002).

4. RESULTS AND DISCUSSIONS

Descriptive Statistics

The study variables in Table (3) show a sample of 49 countries with high variability among many of the scores across countries. The standard deviation ranges from (0.353) for *EMBED* to (46.77) for *START*.

Correlation Matrix

Pearson correlation coefficients (Table 4) showed several significant correlations between the study variables. The most notable of which include: significant correlations between related party transactions disclosure (*RPTD*), *HARMO*, *START, and LEG*, which are consistent with the study predictions (Table 1 and 2). The legal system (*LEG)* has significant correlations with *HARMO*, and *START*. The Political Democracy (*DEMO)* has significant correlations with all cultural values, and *START*. Finally, the cultural values of *EMBED, HARMO, and HIER* exhibit significant correlations with each others, which requires careful consideration of any potential multicollinarity using Variance Inflation Factors (*VIF*).

Path Analysis Results

Several multiple regression analyses (*OLS*) models were used to test the predicted relationships between the study variables. Path coefficients in model (1) (Table 5) showed that there is a significant negative relationship between the extent of regulation to start new business (*START*) and the legal system (*LEG*) at 5% level. Path coefficients are based on the standard coefficients (Beta) of the multiple regression models under consideration. This means that countries which are characterized by common law system usually have few regulations to start new business, which encourage new business entrants to the market place and hence more competition with less government intervention in the economy. This is consistent with the study predictions, especially the legal framework by La Porta et al. (1998), and provides support for hypothesis (*H7*).

Table 3. Descriptive Statistics for study variables

	N	Minimum	Maximum	Mean	S.D.
Related Party Transactions Disclosure (*RPTD*)	49	.00	10.0	6.24	2.83
Embeddedness (*EMBED*)	49	3.04	4.50	3.78	.353
Harmony (*HARMO*)	49	3.35	4.91	4.22	.372
Hierarchy (*HIER*)	49	1.41	3.63	2.25	.496
Regulations to Start business (*START*)	49	1.00	161	62.38	46.77
Legal system (*LEG*)	49	.00	1.00	.29	.46
Democracy (*DEMO*)	49	2.60	9.90	7.43	1.57
Market capitalization (*LNCAP*)	49	6.55	16.81	12.08	2.45
Gross National Production per Capita (*LNGNP/CAP*)	49	5.60	11.00	9.12	1.47

Table 4. Cross Correlation Matrix for study variables using Pearson correlation coefficients

P-values are in brackets. Related Party Transaction Disclosure (RPTD), Embeddedness (EMBED), Harmony (HARMO), Hierarchy (HIER), Regulations to start business (START), Legal system (LEG), Democracy (DEMO), Market capitalization (LNCAP), Gross National Production per Capita (LNGNP/CAP), (**) and (*) indicate correlation is significant at the 1% and 5% levels (2-tailed) respectively.

	RPTD	EMBED	HARMO	HIER	START	LEG	DEMO	LNCAP	LNGNP/ CAP
RPTD	1								
EMBED	.110 (.448)	1							
HARMO	-.395** (.004)	-.450** (.001)	1						
HIER	.234 (.102)	.568** (.000)	-.599** (.000)	1					
START	-.363** (.010)	.433** (.002)	-.071 (.626)	.295* (.038)	1				
LEG	.487** (.000)	.218 (.125)	-.619** (.000)	.237 (.093)	-.316* (.025)	1			
DEMO	-.161 (.275)	-.649** (.000)	.513** (.000)	-.695** (.000)	-.553** (.000)	-.089 (.541)	1		
LNCAP	.278 (.056)	-.526** (.000)	.115 (.431)	-.116 (.426)	-.373** (.009)	.063 (.667)	.286 (.051)	1	
LNGNP/ CAP	.068 (.639)	-.745** (.000)	.398** (.004)	-.677** (.000)	-.655** (.000)	-.065 (.653)	.766** (.000)	.573** (.000)	1

In addition, results showed that *LNGNP/CAP* plays a significant negative role at 1% level. This means that wealthy countries are more likely to encourage more competition and less government intervention in the economy, which is consistent with previous studies (Djankov et al., 2002). By contrast, the predicted hypotheses concerning the relationship between *START*, cultural values (H_1), and *DEMO* (H_8) are not supported. This may be due to the absence of some intermediating variables such as the legal environment as predicted in the study model. The overall model (1) has a significant *F-value* of (15.23) at 1% level, and R^2 of (0.69).

Table 5. Path analysis results using multiple regression analyses (*OLS*), Regulation to start business (START), Embeddedness (EMBED), Harmony (HARMO), Hierarchy (HIER), Legal system (LEG), Democracy (DEMO), Gross National Production per Capita (LNGNP/CAP)

(***), (**), and (*) indicate significant relationships at the 1%, 5%, and 10% levels (2-tailed) respectively. (VIF) Variance Inflation Factor

Model	Dependent variable	Independent variable	Study Hypotheses	Path coefficient	t-value	p-value	VIF	R^2
(1)	START	EMBED	H1A (+)	-.015	-.112	.911	2.35	.69
		HARMO	H1B (+)	-.024	-.153	.879	3.30	
		HIER	H1C (+)	-.220	-1.59	.118	2.52	
		DEMO	H8 (-)	-.115	-.750	.457	3.11	
		LEG	H7 (-)	-.302**	-2.33	.024	2.21	
		LNGNP/CAP		-.807***	-5.08	.000	3.33	
			F-value: 15.23*** at *p*-value: .00					
(2)	DEMO	EMBED	H3A (-)	-.138	-1.05	.298	2.26	.67
		HARMO	N/A	.100	.889	.379	1.66	
		HIER	H3C (-)	-.261*	-1.97	.055	2.30	
		LNGNP/CAP		.455***	3.258	.002	2.56	
			F-value: 22.13*** at *p*-value: .00					

The second multiple regression analysis model (2) (Table 5) showed that *DEMO* has a significant negative path coefficient with the cultural value of *HIER* at 10% level. This means that countries which are characterized by more *HIER* usually tend to prefer less *DEMO* to secure a legitimately unequal distribution of power, which is consistent with the study predictions, and provide support for hypothesis (*H3C*). In addition, *LNGNP/CAP* exhibited a strong positive relationship with *DEMO* at 1% level, which is consistent with previous studies (Bushman et al., 2004). By contrast, the predicted hypothesis for the relationship between *DEMO*, and the cultural value of *EMBED* (H3A) is not supported. The overall model (2) has a significant *F-value* of (22.13) at 1% level, and R^2 of (.67).

The third multiple regression model (3) (Table 6) showed that there is a significant negative association between the cultural value of *HARMO* and *LEG* at 1% level. This means that countries which are characterized by more *HARMO* tend to prefer civil law systems to protect themselves against any unexpected event in the future, which provide support for the study hypothesis (*H2B*). By contrast, there is no evidence to support the predicted relationship between *LEG* and the cultural value of *EMBED* (*H2A*). The overall model (3) showed a significant *F-value* of (9.59) at 1% level, and R^2 of (.46).

Table 6. Path analysis results using multiple regression analyses (*OLS*), Regulations to start business (START), Legal system (LEG), Democracy (DEMO), Gross National Production per Capita (LNGNP/CAP), Market capitalization (LNCAP)

(***), (**), and (*) indicate significant relationships at the 1%, 5%, and 10% levels (2-tailed) respectively. (VIF) Variance Inflation Factor

Model	Dependent variable	Independent variable	Study Hypotheses	Path coefficient	t-value	p-value	VIF	R^2
(3)	LEG	EMBED	H2A (-)	.047	.274	.786	2.43	.46
		HARMO	H2B (-)	.-.748***	-5.34	.000	1.63	
		HIER	N/A	-.059	-.343	.733	2.42	
		LNGNP/CAP		.228	1.23	.223	2.84	
		F-value: 9.59*** at *p*-value: .000						
(4)	RPTD	EMBED	H4A (-)	.171	.922	.363	2.45	.47
		HARMO	H4B (-)	-.135	-.607	.548	3.52	
		HIER	H4C (-)	-.090	-.440	.662	2.99	
		START	H5 (-)	-.482***	-2.88	.006	1.99	
		DEMO	H9 (+)	-.392*	-1.86	.071	3.16	
		LEG	H6 (+)	.180	.940	.353	2.60	
		LNCAP		.229	1.52	.136	1.61	
		F-value: 4.75*** at *p*-value: .000						

The last multiple regression analysis (*OLS*) results for model (4) (Table 6) showed that *RPTD* has a significant negative relationship with *START* at 1% level. This means that countries which are characterized by few regulations to start a new business encourage firms to disclosure more information about related party transactions, which is consistent with the Public Choice Theory (De Soto, 1990, Stigler, 1971), and provide support for study hypothesis (H_5). In addition, results showed that there is a significant negative relationship between *RPTD* and *DEMO* at 10% level, which is inconsistent with the study predictions and provide no support for hypothesis (H_9). This means that countries which are characterized by more *DEMO* usually provide less related party transactions disclosure. This is not surprising as previous empirical evidence on this issue is mixed (See Archambault and Archambault, 2003, and Belkaoui, 1983), and lacks a clean directional theoretical ground (Bushman et al., 2004).

In this matter, a further investigation points out to a possible intervention role for the legal system in this matter, for example a country like Switzerland which is characterized by high level of political democracy has a very low score of (0) on the extent of related party transactions disclosure due to its historic tradition of self-regulation provisions and stock exchange regulations on corporate governance, which is even substantially lower than the Organisation for Economic Co-operation and Development (*OECD)* average score of (5.9) (The World Bank, 2010). Comparatively, China enjoys a high score of (10) on the extent of related party transactions disclosure against a regional average score of (5.1) (The World Bank, 2010), despite its low score on the political democracy level. The high profile of China in terms of *RPTD* can be explained by the emergence of a new system of corporate governance as a result of company, legal, institutional and regulatory reforms, perhaps due to, among other reasons, the need to access international capital markets on better terms (See Doidge et al., 2007). This suggests that there may be some missing variables that mediate the relationship between the political environment and *RPTD* such as the legal institutions (See Perotti and Volpin, 2007); this is an issue that renders itself for more future research.

On another aspect, the results for model (4) (Table 6) showed no direct relationship between *LEG* and *RPTD*, which provides no support for hypothesis (*H6*). This also may be due to missing intermediary variables (i.e. company laws, securities law, administrative regulations and stock exchange listing rules). Similarly, the *LNCAP* showed no significant relationship with *RPTD*, which is inconsistent with previous studies. The overall regression model (4) showed a significant *F-value* of (4.75) at 1% level, and R^2 of (.47). Note that all the multiple regression models implemented in this study (Tables 5 and 6) showed no sign of multicollinarity, with Variance Inflation Factors (*VIF*) within the acceptable limit of 5 degrees as depicted by Studenmund (2006).

The overall results of the path analysis showed that there is a significant direct effect of *START* on *RPTD* with a total path coefficient of (-.482) at 1% level. In addition, there are two main indirect effects which involve: First, a link between *HARMO*, *LEG*, *START*, and *RPTD* with significant total indirect effect of (-.256) at 10% level using the *MEDTHREE* statistical inference technique by Hayes et al. (2010). The second link involves *LNGNP/CAP*, *START*, and *RPTD* with significant total indirect effect of (-1.28) at 1% level using the statistical inference technique by Sobel (1982).

5. CONCLUSION

Related party transactions disclosure is a major issue of concern for many corporate stakeholders due to its vital impact on shareholders' wealth and reliability of financial reporting. This paper extended previous literature by investigating indirect effects of several external social institutions on related party transactions disclosure. Most notably, empirical results show that there are significant indirect effects of cultural values and gross domestic production per capita on related party transactions disclosure, whereby the legal environment and government intervention in the economy act as intervention variables. This implies that countries which are characterized by high aversion towards uncertainty are likely to prefer civil law systems to reduce potential instability of future events, which in turn result in more government intervention in the economy in the form of more regulations to start new business, and consequently less corporate incentives towards related party transactions disclosure. Policymakers, regulators and accounting standard setters can encourage effective implementation and enforcement of international related party transactions disclosure requirements by mandating more risk management practices, allowing for a more flexible legal system to cope with the ever changing business environment, and lessen regulations to start new business. Further research is encouraged to include further elements of external social institutions and/or firm specific characteristics that mediate these relationships.

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APPENDIX 1

List of countries implemented in the study (World Bank, 2007)

Argentina	Hong Kong	Poland
Australia	Hungary	Portugal
Austria	India	Russia
Bolivia	Indonesia	Singapore
Brazil	Ireland	Slovakia
Canada	Israel	Slovenia
Chile	Italy	Spain
China	Japan	Sweden
Cyprus	Macedonia	Switzerland
Czech Republic	Malaysia	Taiwan
Denmark	Mexico	Turkey
Estonia	Namibia	United kingdom
Finland	Nepal	United states
France	Netherlands	Venezuela
Germany	New Zealand	Zimbabwe
Ghana	Norway	
Greece	Philippines	