VOLUNTARY DISCLOSURE AND FREE CASH FLOW IN FAMILY FRENCH FIRMS

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Abstract

This research investigates the governance role of voluntary disclosures especially in reducing agency problems measured by the level of free cash flow (FCF). In addition, it also shows the moderating effect of family ownership and governance mechanisms on this relation. Our research was conducted on a sample of 138 listed French firms between 2009 and 2013. To avoid the endogeneity problem caused by the voluntary disclosure variable we used the 2SLS regression method. The results show, on the one hand, that transparency provided by voluntary disclosures reduces the level of FCF and by the way agency problems. But family owners tend to accumulate FCF. On the other hand, the governance role of voluntary disclosure turns to be ineffective in family firms. This suggests a high risk of expropriation of minority shareholders by family ones. In addition, we demonstrate that governance mechanisms, especially board independence, gender diversity and audit committee independence, contribute to the strengthening of the governance role of voluntary disclosure.

Keywords: Voluntary Disclosure, Free Cash Flow, Family Ownership, Board Characteristics

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1. INTRODUCTION

All firms' activities generate cash. This cash can be accumulated for several reasons (Bates, Kahle, & Stulz, 2009): the transaction motive, the precautionary motive, the tax motive, and the agency motive. But since the last two decades, we assist in massive detention of cash: 1.64 trillion dollars for American firms and 380 million dollars for their French counterparts (Moody's Corporation, 2014). This massive detention of cash can be explained neither by transaction or precautionary motives nor by financial stability reasons. It should be noted that the continuous accumulation of such liquidity in the hands of managers is not without risk. In fact, in an agency situation, this excess of cash can be overinvested by managers in unnecessary projects or in negative net present value ones. It can be also diverted by managers to serve their own benefit or retained in the company and not distributed to shareholders. To counter these attitudes, several studies expose many solutions especially for large firms which generate lots of cash: good governance, the use of debt, sustained dividend distribution and investors' protection laws (Jensen, 1986; Dittmar, Mahrt-Smith, & Servaes, 2003; Kusnadi, 2005; Al-Najjar & Clark, 2017; Ozakan & Ozakan, 2004; Ben Moussa & Chichti, 2011).

In this study, we focus on an additional and new way to limit agency problems related to the cash excess in French companies: it is voluntary disclosure. Indeed, transparency is a goal sought by all global economies as regard to its benefits on the firm and on the financial market in general. Accounting information has essentially two functions. The pricing function is considered when accounting information impacts share prices, investment's risk estimation and strategies' formulation. But when accounting information alleviates governance structures and facilitates managers' control to push them to act in the interest of shareholders, we are considering the governing function of accounting information (Bushman & Smith, 2001). So, it is important to identify the impact of voluntary disclosures in reducing FCF considered as a proxy of the intensity of agency conflicts in the firm. It is also important to investigate the moderating effect of family ownership and governance mechanisms, essentially board independence, duality, gender diversity and audit committee independence, on this relation. Our sample is composed of 138 French listed firms. The period of the study is between 2009 and 2013. Empirical results highlight a negative association between voluntary disclosure and levels of FCF. This supports the idea that voluntary information reduces the informational gap between manager and shareholders (or minority and majority shareholders) which reduce agency conflicts in the firm. Results show also that family ownership has a positive impact on FCF. So, family members tend to accumulate cash to expropriate minority shareholders. Also, our results show that family ownership is an obstacle to the governing function of voluntary disclosure. The results relative to the moderating effect of governance mechanisms on FCF highlight that board independence, gender diversity and audit committee independence alleviate the governance function of voluntary disclosure by empowering the negative effect of these disclosures on the FCF.

The paper is organized into five sections. Section 1 presents the introduction. The literature review on voluntary disclosure, FCF and governance mechanism is developed in Section 2. This section presents also the hypothesis development. Section 3 is devoted to data and research design presentation. This section is followed by Section 4 with the exposure of the principal results and their discussion. Principal conclusions are presented in Section 5.

2. LITERATURE REVIEW

2.1. Voluntary disclosure and FCF

FCF is defined by Jensen (1986) as "cash flow in excess of that required to fund all projects that have positive net present values when discounted at the relevant cost of capital" (p. 2). So, according to FCF hypothesis the presence of such cash flows is risky for the firms essentially those in bad investment horizons. Indeed, these FCF will be the source of intensive agency conflicts in the firm, especially in an information asymmetry context. Overinvestment is the first harmful decision that can be undertaken by a manager. In the presence of FCF, managers will use this excess of cash to invest it in order to promote their reputation and to be more entrenched

in the firm (Coeurderoy & Koulayom, 2007; Kusnadi, 2005; Couderc, 2006). It is called empire building. Richardson (2006) highlights that 20% of the FCF will be wasted by managers and 40% will be retained in the firm. These attitudes will alter the performance of the firm. Zhang Cao, Dickinson, and Kutan (2016) affirm that when FCF is abundant, the return on investment will be fewer than the cost of capital which is detrimental to shareholders' interests. The literature proposed many solutions to the problems caused by the presence of FCF in the firm: the distribution of dividend (Xiao, 2010) and indebtedness (Ben Moussa & Chichti, 2011; Kadioglu & Yilmaz, 2017; Nekhili, Wali Siala, & Chebbi Nekhii, 2009)

Managers can overinvest or divert the wealth of shareholders to serve their own interests only when governance mechanisms are inefficient. So, the presence of a good governance structure will limit these opportunistic attitudes (Dittmar et al., 2003; Al-Najjar & Clark, 2017). In this study, we are interested in the governance role of voluntary disclosures in reducing FCF and by the way overinvestment and wealth misappropriation. The relation between voluntary disclosure and FCF is not documented in the literature. So, to prove theoretically the impact of these disclosures in reducing the agency costs of FCF, we can highlight the impact of voluntary disclosure in increasing investment efficiency and its controlling function.

Overinvestment is an investment in negative net present value projects. These decisions are possible only in an information asymmetry context. So, transparency can reduce this problem by helping managers in identifying good investment opportunities (Gomariz & Sánchez-Ballesta, 2013). Beyer and Guttman (2012) underline the presence of two investments' intervals to which they associate two voluntary disclosure attitudes. If managers refrain from disclosing voluntary information in the investment period, they are necessarily overinvesting. Globally, Francis, Huang, Khurana, and Pereira (2009) proved that the growth rate of an economy is conditioned by its level of transparency. In addition, residual transparency improves resource allocation. Recently, Firmansyah and Triastie (2020) have demonstrated that corporate social responsibility disclosures, which are voluntary ones, can enhance investment efficiency if they are combined with other governance mechanisms.

On the other hand, transparency is a good controlling mechanism of managers' attitudes. Healy and Palepu (2001) highlight the monitoring effect of voluntary disclosure. It is the control exercised by shareholders and investors on managers' decisions to push them to act in the best interest of the firm. Several empirical studies have proved the effect of voluntary disclosure on the performance of the firm through its monitoring effect (Hope & Thomas, 2008; Bens & Monahan, 2004). So, we can formulate the following hypothesis:

H1: Voluntary disclosures reduce the level of FCF.

2.2. Governance mechanisms and FCF

The impact of good governance mechanisms on the level of FCF is largely debated in the literature but is far from consensus. Studies undertaken in the US proved that good governance devices are a signal that managers are well controlled which ensures

investors. So, managers can accumulate cash and will not be penalized by investors. This is due to the good protection of shareholders. In contrast, in France, investors are not as well protected as their American counterparts. So, the installation of governance mechanisms aims to control managers to reduce agency conflicts essentially overinvestment and empire building due to the presence of FCF.

2.2.1. Family ownership

The French context is characterized by the predominance of family firms. These firms suffer from specific agency conflicts (Type II). This conflict is between majority and minority shareholders (Basly, 2006). Family members, due to their participation in the management process can easily divert wealth from minority shareholders. Ali, Chen, and Radhakrishnan (2007) argue that family members dominate the firm thanks to their cash flow rights and their large representation on the board. So, they will pursue their own interests by engaging in related party contracts and the squeezing of minority shareholders.

Selective altruism, nepotism and the capture of management positions are specific agency conflicts that characterize family firms. On the other hand, family firms are generally funded by family members. These members have long term investment horizons. So, they will tend to accumulate cash to reinvest it rather than distributing it to shareholders (Basly, 2006).

So, we can formulate the following hypothesis:

H2a: Family ownership increases the levels of FCF.

In addition, we are also interested in studying the moderating effect of family ownership on the relation between voluntary disclosures and FCF. Hirigoyen (2008) affirms that agency conflicts in family firms are essentially caused by information asymmetry. So, we think that family ownership constitutes an obstacle to the governing role of voluntary disclosure

H2b: Family ownership compromise the role of voluntary disclosure in reducing FCF.

2.2.2. Board independence

The presence of independent directors on the board is a guarantee of the good functioning of the board. Due to their independence, skills and professional experience, independent directors will properly control managers' actions in order to align the interests of the majority and minority shareholders (Haniffa & Cooke, 2002; Chen, 2008). Lee and Lee (2009) proved that the presence of independent directors minimize the level of cash and mitigate managerial entrenchment due to excess of cash.

H3a: Board independence decreases the levels of FCF.

In addition, several studies demonstrate the complementarity between governing devices, we think that the presence of independent directors will enhance the governing effect of voluntary disclosure. So, we can formulate the following hypothesis.

H3b: Board independence improve the role of voluntary disclosures in reducing the levels of FCF.

2.2.3. Duality

Good governance codes in France encourage the separation of top functions in the firm. Indeed, a CEO has considerable power in the firm essentially in strategies formulation (Gill & Shah, 2012). It will be easy for him/her to accumulate FCF to protect himself/herself and the managerial team against management errors. It is one of the entrenchment strategies undertaken by managers (Lee & Lee, 2009). Drobetz and Grüninger (2007) demonstrate that firms with a dualistic structure hold 30% more cash than non-dualistic ones.

H4a: Duality increases the levels of FCF.

H4b: Duality compromises the role of voluntary disclosure in reducing FCF.

2.2.4. Gender diversity

Female board members are recognised to be more careful due to their risk aversion (Arrondel, Masson, & Verger, 2004). They are also characterised by specific leadership attitudes (Adams & Ferrera, 2009). So, gender diversity on the board enhances its controlling function. In addition, women have a more ethical behaviour (Ford & Richardson, 1994). Then, they will resist any type of managerial decisions that aims to expropriate minority shareholders. In addition, Al-Rahahleh (2017) and Trinh, Cao, Dinh, and Nguyen (2020) demonstrated that the presence of women on the board of directors has a positive impact on corporate dividend policy. So, by enhancing dividend policy, gender diversity participates in reducing the FCF in the firm and by the way agency costs arising from the detention of such liquidity.

H5a: Gender diversity decreases the levels of FCF.

H5b: Gender diversity improves the role of voluntary disclosures in reducing the levels of FCF.

2.2.5. The independence of the audit committee

The principal function of the audit committee is the control of the quality of the accounting information produced by the firm. In addition, it guarantees the settlement of strong internal control mechanisms. Aldamen, Duncan, Kelly, McNamara, and Nagel (2011) demonstrate that this governing device is employed in strong agency conflict situations. The good analysis of accounting information provided by this type of committee to the board members helps them in enhancing controls and in formulating efficient strategies (Cai, Hillier, Tian, & Wu, 2015).

H6a: The independence of the audit committee decreases the levels of FCF.

H6b: The independence of the audit committee improves the role of voluntary disclosures in reducing the levels of FCF.

3. DATA AND RESEARCH DESIGN

Our sample is composed of French listed firms between 2009 and 2013. Financial companies are excluded from the sample because they require specific reporting obligations. We also exclude companies with incomplete data essentially those relative to voluntary disclosure. Our final sample is composed of 139 firms relative to different activity sectors.

The dependent variable: FCF is extracted from Thomson Database. This database uses the formula of Lehn and Poulsen (1989) (*FCF = INC – – TAX – INTEXP – PFDDIV – COMDIV*). We consider the logarithm of FCF. This function is only possible for the positive value of FCF. By adopting the Log function, we discard the negative value of FCF. These values are essentially caused by negative firm's results. So, the objective of the study is to investigate the role of voluntary disclosure in reducing agency conflicts caused by excess cash

which are essentially overinvestment and minority expropriation. These two risks are possible when FCF is positive.

The independent variable: voluntary disclosure is measured by a disclosure index thanks to a self-constructed list specific to the French context. To avoid endogeneity problems we use the 2SLS method.

The first step was to estimate the fitted value of voluntary disclosure using this model.

$$DISV = \alpha_0 + \alpha_1 Famown_{it} + \alpha_2 Boardind_{it} + \alpha_3 Dual_{it} + \alpha_4 Divert_{it} + \alpha_5 Comind_{it} + \alpha_6 Size_{it} + \alpha_7 LEV_{it} + \alpha_8 ROE_{it} + \varepsilon_{it} \tag{1}$$

We then use this fitted value (*Divfit*) as an independent variable in FCF models.

Other independent variables are measured as follow: *Famown*: % of shares held by the founding family, *Boardind*: number of independent directors/total number of directors, *Dual*: 1 if CEO is in the same time chairman of the board and 0 otherwise, *Divert*: number of women on the

board/total number of directors on the board, *Comind*: number of independent director in the audit committee/total number of director in the audit committee. Control variables: *Size*: logarithm of total assets, *LEV*: total debt/total asset, *ROE*: net profit/total equity.

The global model is as follows:

$$FCF = \alpha_0 + \alpha_1 Divfit_{it} + \alpha_2 Famown_{it} + \alpha_3 Boardind_{it} + \alpha_4 Dual_{it} + \alpha_5 Divert_{it} + \alpha_6 Comind_{it} + \alpha_7 Divfit_{it} * Famown_{it} + \alpha_8 Divfit_{it} * Boardind_{it} + \alpha_9 Divfit_{it} * Dual_{it} + \alpha_{10} Divfit_{it} * Divert_{it} + \alpha_{11} Divfit_{it} * Comind_{it} + \alpha_{12} Size_{it} + \alpha_{13} LEV_{it} + \alpha_{14} ROA_{it} + \varepsilon_{it} \tag{2}$$

4. EMPIRICAL RESULTS

4.1. Descriptive statistics and correlation analysis

Table 1 reports the results of the descriptive statistics of the dependent and independent

variables. The mean value of FCF is 43,895 million euros. It is between 119949,930 million euros and -22,239 million euros. It constitutes 12.06% of the total assets. It constitutes a huge amount of liquidity and signals serious agency problems in these firms.

Table 1. Descriptive statistics

Variables	obs	Minimum	Maximum	Mean	Standard deviation
FCF (m. euro)	690	-22,239	119949,930	43,895	12,789
Famown	690	0	0,9364	0,2182	0,2730
Boardind	690	0	1	0,3635	0,2363
Dual	690	0	1	0,5652	0,4960
Divert	690	0	0,75	0,1337	0,1432
Comind	678	0	1	0,4333	0,3458
Control variables					
Size	690	3,7781	11,3774	8,6514	1,0598
LEV	690	0	0,6942	0,2094	0,1544
ROA	690	-33,629	22,92	-0,9817	17,9211

Note: FCF is the level of free cash flow extracted from the database, Famown: % of shares held by the founding family, Boardind: number of independent directors/total number of directors, Dual: 1 if CEO is in the same time chairman of the board and 0 otherwise, Divert: number of women on the board/total number of directors on the board, Comind: number of independent director in the audit committee/total number of director in the audit committee. Control variables: Size: logarithm of total assets, LEV: total debt/total asset, ROA: net profit/total assets.

4.2. Bivariate analysis

The correlation matrix, presented in Table A.1, shows the presence of significant correlations between some of our independent variables. The correlation coefficients between these variables are between 0.02 and 0.7. They are below the threshold of 0.8 announced by Gujarati (2004). To better assess the multicollinearity problem, we compute the variance inflation factor test (VIF). To assert the absence of multicollinearity between the variables of the model, the value of VIF must be less than 10 (Neter, Wasserman, & Kutner, 1989). The results shown in Table A.1 demonstrate that mean VIF is 1.83 which is well below 10. So, we can confirm that no serious multicollinearity problems exist. Thus,

the results of the regression analysis can be interpreted with a higher degree of confidence.

4.3. Results on the effect of voluntary disclosures on FCF

Results reported in Table A.2 demonstrate that voluntary disclosure has a negative and significant impact (1%) on FCF. These results prove that voluntary disclosures reduce the amounts of FCF available to managers. Consequently, by reducing FCF levels, voluntary disclosures contribute to minimizing the risks of the detention of such cash. These results are consistent with agency theory. By reducing an information gap between managers and shareholders, voluntary disclosures reduce agency

costs. In fact, agency costs arising from the massive detention of FCF are essentially overinvestment and shareholders expropriation. These entrenchment strategies are possible if managers set up an information asymmetry context. But, voluntary disclosures are an important mean of control of manager attitude. By the way, voluntary disclosure will impede managers from doing these entrenchment strategies. Finally, the manager will not tend to accumulate FCF in order to expropriate it. In addition, voluntary disclosures enhance investment efficiency. So, FCF will be necessary invested in good projects. In addition, our results support the idea that more transparent firms are more likely to collect external funds at reduced interest levels. So, managers of these firms do not need to accumulate FCF. Finally, transparency generated by voluntary disclosure helps the manager to rush the excess of cash toward good projects (with positive net present value).

4.4. Results of the effect of family ownership on FCF and its moderating effect

Results reported in Table A.2 relative to the Models 2 and 3 highlights a positive and significant relationship between family ownership and FCF. These results show that family members tend to accumulate cash in the firms and support agency theory, especially the expropriation hypothesis. Our results also support the idea of long-term horizons of family firms. They accumulate cash to reinvest it to extend firms for future generations. On the other hand, managers in family firms are always appointed from family members. These managers are supposed to stay in the firm for a long period. By the way, they aren't obsessed by rapid investments in order to preserve their posts. This type of manager has a long time to do investments (Basly, 2006). They will accumulate FCF for a long period to invest it when it is appropriate. In addition, the interaction term *Divfit * Famown* is negative but not significant. This means that family ownership is an obstacle for the governing function of voluntary disclosure. So voluntary disclosure only cannot solve agency conflicts in family firms. It should be associated with other governance mechanisms.

4.5. Results on the effect of board characteristics on FCF and their moderating effect

Table A.3 exposes the results of the effect of board characteristics on FCF levels. Gender diversity, board independence and audit committee independence are good governance devices. They reduce the levels of FCF which are sources of agency conflicts.

Interaction terms are also negative, significant, and more important. These results show that good governance mechanisms help voluntary disclosure in its governing function. They also show that voluntary disclosure, gender diversity, board independence and audit committee independence are complementary.

4.6. Robustness check

We conduct the robustness analysis to test the sensitivity of our results to changes in the measurement of variables or sensitivity to estimation methods. So, we change the measure of the dependent variable FCF. It is now measured by the level of FCF/total assets extracted from the database. It includes now the negative and positive values of FCF. The results of the regression are reported in Table A.4. Results remain unchanged proving that our results are robust.

5. CONCLUSION

The purpose of this study was to demonstrate the governance function of voluntary disclosure by reducing agency conflicts measured by FCF levels. Our results highlight that voluntary disclosure reduces the levels of FCF. This result supports the governance function of voluntary disclosures. In fact, voluntary disclosures are an efficient control mechanism of managers' attitude control. So, they limit FCF accumulation and their risk essentially overinvestment and shareholders' expropriation.

On the other hand, family firms tend to accumulate FCF which supports long term horizons of this type of firms. In addition, our results prove that family ownership is an obstacle for the control function of voluntary disclosure. This result supports the idea of agency conflicts between minority and majority shareholders (agency conflicts Type II) which is stressed by information asymmetry problems.

In addition, our results show that the presence of independent directors and women on the board in addition to the presence of an independent audit committee are good governance devices. Indeed, they reduce agency conflicts by reducing levels of FCF which can be overinvested or expropriated by managers. They also act which voluntary disclosure complementary.

Future studies can be undertaken in order to investigate the impact of voluntary disclosure on FCF in other contexts. Investor protection and shareholders activism should impact significantly this relation.

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APPENDIX

Table A.1. Pearson correlation matrix

	Divfit	*Famown*	*Boardind*	*Dual*	*Divert*	*Comind*	*Size*	*LEV*	*ROA*
Divfit	1								
Famown	-0,4624*	1							
Boardind	0,6058*	-0,1569*	1						
Dual	-0,1846*	-0,0704	-0,2998*	1					
Divert	0,3107*	0,1008*	0,0572	-0,0288	1				
Comind	0,5769*	-0,2067*	0,5143*	-0,2024*	0,1115*	1			
Size	0,6503*	-0,2330*	0,3126*	-0,1041*	0,2204*	0,2488*	1		
LEV	0,3469*	-0,0569	0,1286	-0,1399*	-0,0121	0,0601	0,2824*	1	
ROA	-0,0314	-0,0629	0,863*	-0,493*	0,539*	-0,89*	0,234*	0,017	1
VIF	3,74	1,64	1,97	1,13	1,39	1,70	1,31	1,26	
Mean VIF	1,83								

Note: Divfit is the fitted value of voluntary disclosure, Famown: % of shares held by the founding family, Boardind: number of independent directors/total number of directors, Dual: 1 if CEO is in the same time chairman of the board and 0 otherwise, Divert: number of women on the board/total number of directors on the board, Comind: number of independent director in the audit committee/total number of director in the audit committee. Control variables: Size: logarithm of total assets, LEV: total debt/total asset, ROA: net profit/total assets.

Table A.2. Effect of voluntary disclosure and family ownership on FCF levels

	Model 1		*Model 2*		*Model 3*	
	Coef.	*P*	*Coef.*	*P*	*Coef.*	*P*
Divfit	-6,738	0,000***	-3,0125	0,002***	-2,848	0,005***
Famown			1,303	0,000***	1,585	0,086*
*Divfit * Famown*					-0,571	0,755
Size	0,626	0,000***	0,4218	0.000***	0,404	0,000***
LEV	0,259	0,378	-0,0957	0,746	0,034	0,905
ROA	-0,2236	0,383	-0,5964	0,113	-0,5988	0,112
Constante	-0,189	0,634	-0,577	0,134	-0,620	0,130
Wald chi2	69,01		127,81		127,95	
Prob > chi2	0,00		0,000		0,000	
Nbre D'obs.	637		637		637	

Note: Divfit is the fitted value of voluntary disclosure, Famown: % of shares held by the founding family, Size: logarithm of total assets, LEV: total debt/total asset, ROA: net profit/total assets.

Table A.3. Effect of voluntary disclosure and board characteristics on the levels of FCF

	Model 4	
Variables	*Coef.*	*P*
Divfit	-2,402	0,089*
Boardind	-2,358	0,065*
Dual	0,812	0,147
Divert	-3,258	0,065*
Comind	-2,423	0,012**
*Div * Boardind*	-4,712	0,046**
*Div * Dual*	-1,802	0,069**
*Div * Divert*	-5,473	0,084*
Div Comind*	-3,592	0,038**
Size	0,34	0,003***
LEV	0,213	0,506
Constante	0,296	0,589
Wald chi2	42,59	
Prob > chi2	0,000	
Nbre D'obs	637	

Note: Divfit is the fitted value of voluntary disclosure, Boardind: number of independent directors/total number of directors, Dual: 1 if CEO is in the same time chairman of the board and 0 otherwise, Divert: number of women on the board/total number of directors on the board, Comind: number of independent director in the audit committee/total number of director in the audit committee. Control variables: Size: logarithm of total assets, LEV: total debt/total asset.

Table A.4. Robustness check

Variables	Model 3		Model 4	
	Coef.	*P*	*Coef.*	*P*
Divfit	-0,8954	0,0211**	-2,005	0,045*
Famown	1,0235	0,08*		
*Divfit * Famown*	-0,523	0,3685		
Boardind			-0,987	0,043*
Dual			0,754	0,354
Divert			-2,569	0,087*
Comind			-0,265	0,023**
*Div * Boardind*			-1,895	0,032**
*Div * Dual*			-1,569	0,025**
*Div * Divert*			-0,5698	0,0879*
*Div * Comind*			-0,5984	0,078*
Size	0,5369	0,000***	-1,589	0,034**
LEV	0,009	0,869	0,569	0,075**
Constante	-0,659	0,269	0,369	0,605
Wald chi2	89,69		98,569	
Prob > chi2	0,000		0,000	
Nbre D'obs	637		637	

Note: Divfit is the fitted value of voluntary disclosure, Boardind: number of independent directors/total number of directors, Dual: 1 if CEO is in the same time chairman of the board and 0 otherwise, Divert: number of women on the board/total number of directors on the board, Comind: number of independent director in the audit committee/total number of director in the audit committee. Control variables: Size: logarithm of total assets, LEV: total debt/totalasset.