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Essays on corporate governance and audit quality within family business groups: evidence from Hong Kong

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Essays on Corporate Governance and Audit Quality within Family Business Groups: Evidence from Hong Kong

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ABSTRACT

This study consists of two essays. In the first essay, I examine the impact of board structure and auditor choice on the value transfer activities undertaken by controlling families within their family business groups. Using a sample of earnings announcements made by member firms affiliated to Hong Kong family business groups during the period 2002-2008, I find that the valuation implications of member firms' earnings announcement for stock prices of their nonannouncing group peers are reduced when announcing member firms have a board with a larger number of directors and/or a higher proportion of independent directors, but are reinforced when they have an executive director from their controlling families acting as board chairman. I also find that the intragroup valuation implications of member firms' earnings announcement are alleviated when announcing member firms and their nonannouncing counterparts are audited by different external auditors. My findings suggest that member firms' board with larger size, stronger independence, and leadership free from their controlling families, functions more effectively to protect corporate resources from being transferred to their group peers, and member firms hiring different external auditors than other member firms within the same family business groups also limits the ability of controlling families to transfer value between them.

In the second essay, I examine the impact of auditor composition within family business groups on audit quality provided by Big4 auditors to their member firm clients. Using a sample of member firms affiliated to family business groups in Hong Kong over the period 2003-2009, I find that member firms are allowed less discretion with respect to accounting accruals, indicated by smaller magnitude of abnormal accruals, in reporting earnings numbers if their Big4 auditors are not appointed to audit all member firms within their family business groups. Investors are found to pay a premium on earnings of member firms if their family business groups hire different Big4 auditors to audit different member firms, respectively. Additionally, I also find that family business groups with larger agency problems are more likely to hire different Big4 auditors to audit their member firms, and such preference for different Big4 auditors is mostly evident among family business groups whose member firms have high demand for additional equity capitals. My findings are consistent the conjecture that Big4 auditors are inclined to provide higher quality audits to their member firm clients in order to mitigate the additional audit risk and reputation concerns if they cannot audit all member firms within a family business group.

Keywords: family business groups; board structure; auditor composition; intragroup value transfer; audit quality

TABLE OF CONTENTS

DECLARATION .... **i**
ABSTRACT .... **ii**
ACKNOWLEGEMENTS .... **iii**
TABLE OF CONTENTS .... **iv**
Chapter one: Corporate Governance and Intragroup Value Transfers **1**
1.1 Introduction 1
1.2 Hypotheses development 7
1.2.1 Member firm's board structure and value transfer activities within family business groups 7
1.2.2 Auditor composition and value transfer activities within family business groups 11
1.3 Research design 13
1.3.1 Measuring stock price reactions of announcing and nonannouncing member firms 13
1.3.2 Investigating research questions 14
1.4 Sample selection and summary statistics 17
1.4.1 Data and sources 17
1.4.2 Summary statistics 18
1.5 Empirical results 20
1.6 Robustness checks 24
1.6.1 Ownership effect 24
1.6.2 The effect of auditor type 25
1.6.3 First announcing member firms and their nonannouncing member firms 26
1.6.4 The effect of better versus worse performing member firms 26
1.6.5 Self-selection issue 27
1.6.6 The impact of institutional change in board structure 31
1.6.7 Impact of overlapping estimation periods and different event windows 31
1.7 Conclusions 32
References **34**
Chapter two: Audit Quality and Auditor Composition within Family Business Groups **60**
2.1 Introduction 60
2.2 Hypotheses development 65
2.2.1 Audit quality and auditor composition within family business groups 65
2.2.2 Hypothesis of accrual quality 67
2.2.3 Hypothesis of perceived auditor quality 69
2.2.4 Hypothesis of auditor composition choice 69
2.3 Research design 71
2.3.1 Test of accrual quality 71
2.3.2 Test of perceived audit quality 74
2.3.3 Test of auditor composition choice 75

2.4 Sample selection 78
2.5 Empirical results 79
2.5.1 Results of accrual quality 79
2.5.2 Results of investor perceived audit quality 82
2.5.3 Results of family business group's auditor composition choice ...84
2.6 Conclusions 86
References **88**
CURRICULUM VITAE **110**