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Cultural impact on Chinese corporate disclosure – a corporate governance perspective

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Abstract

Purpose – The purpose of this preliminary study is to explore the impact of changed cultural environment on the voluntary disclosure behaviour of Chinese listed companies.

Design/methodology/approach – A theoretical framework of the relationship between corporate disclosure and governance forms the basis of the research. A composite checklist of corporate disclosure was developed using relevant corporate governance indices and analyses were carried out on the 2003 financial reports of 120 Chinese listed companies. Six areas of voluntary disclosure of the sample companies were analysed and reported. These areas are: board structure and functioning, employees related issues, director remuneration, audit committee, related party transactions and stakeholder interest.

Findings – The results suggest that as China's cultural and social norms change, there was willingness of Chinese listed companies to provide voluntary information in addition to the disclosure requirements. Information relating to stakeholder interest and employees issues are found more frequently disclosed by listed companies than those which were regarded as sensitive. This is an exploratory study which shows that further research may provide more concrete evidence of the changing corporate disclosure environment in China.

Research limitations/implications – This study based on one year's results and as such has limitation in the interpretation of the results. Further research is necessary to demonstrate the impact of culture in corporate disclosure.

Practical implications – The results have practical implications for professional accountants and auditors to understand further the trend of voluntary disclosure in China. The paper provides some evidence of the changing scene of Chinese corporate governance practice.

Originality/value – This study fulfils a gap in prior research by examining the effect of cultural implications in corporate governance, in an emerging economy. The composite voluntary disclosure checklist will serve a good basis of measurement in corporate disclosure.

Keyword(s):

Corporate governance; Disclosure; Audit committees; Organizational culture; China.
Introduction

China currently is widely regarded as a new growth engine and an indispensable participant in global economy. Since Chinese government implemented the economic reform and opening door policy 26 years ago, its average annual economic growth has been four times that of developed countries in the same period and double that of developing countries (People's Daily Online, 2005a). As one of the fastest-growing economies in the world, China has attracted substantial amount of foreign direct investment (FDI) for years, especially post China's entry into World Trade Organization. The FDI into China reached an estimated 60.6 billion yuan in 2004, making it the world's top destination for capital inflows (People's Daily Online, 2005c). To maintain the confidence of the Chinese capital market and international investors, there is a high demand for transparency of corporate disclosure (Groom et al., 2004).

Transparency of corporate disclosure has become one of the essential components of corporate governance principles issued by organizations worldwide (OECD, 1999, 2003; ASX Recommendation, 2003). High profile corporate collapses such as Enron in the USA and HIH in Australia have highlighted the significance of corporate disclosure in playing a critical role as one of the external control mechanisms to solve the agency problem. Corporate governance, in respect of transparency, is the availability of firm-specific information to those outside publicly traded firms and it should go hand-in-hand with accountability. High level of disclosure transparency contributes to the establishment of confidence in capital markets and encourages a better flow of FDI into a country (Bushman and Smith, 2000; Groom et al., 2004).

The transparency of corporate disclosure made by Chinese publicly listed companies has always been an issue. Companies are criticised for lack of disclosure transparency and corporate scandals in recent years further strengthen this point of view. Falsification and fabrication of financial and governance information in China enable some listed companies to survive or obtain new injection of funds from the capital market (Shi and Weisert, 2002). International investors eye Chinese corporate reports with questioning as they experience difficulty in understanding the way that Chinese companies disclose information and their effectiveness (Leung et al., 2005).

Corporate disclosure is heavily influenced by environmental factors of a nation. Culture, defined by Hofstede (1980) as “a collective mental programming” has been identified as an important variable (Jaggi, 1975; Gray, 1988). Likewise, the traditional Chinese culture also has the potential to impact on their corporate disclosure environment (Chow et al., 1995; Bloom and Solotko, 2003). Based on an analysis of the authority for financial accounting systems, the role of accounting profession and accounting measurement and disclosure in China, Chow et al. conclude that the financial disclosure made by Chinese enterprises is secrecy in nature and they argue that the development of financial accounting would be constrained by the influence of Chinese traditional culture.

During the past 20 years, China has experienced dramatic changes in almost every aspect of societal life including political regime, legal system, social value and norms as a result of the economic reform implemented by Chinese government since late 1970s. Researchers have highlighted the need for further investigation into the significant change process that has occurred in Chinese corporate disclosure practices (Chow et al., 1995; Xiao, 1999; Liu, 2001; Leung et al.; 2005). This paper is inspired by the fact that the traditional culture in Chinese
society has undergone changes. The social norms and bounds are impacted by the surrounding environmental factors such as the transformation from a central planned to a market orientated economy, the emergence of the capital market in China, the booming in individual and institutional investments, the establishment of a financial accounting regulatory framework and corporate governance mechanism. Being a country that has experienced all these changes, China offers a unique research opportunity to examine the impact of changed cultural environment on the level corporate disclosure.

The aim of this paper is to investigate the impact of culture on the transparency of Chinese corporate disclosure. To fulfil the aim, the paper will identify different aspects of influence in the nature and extent of corporate information disclosed in companies' annual reports. This will be achieved by examining the cultural factors that could lead to changes in corporate disclosure in the Chinese context, from a corporate governance perspective and by investigating the voluntary corporate governance disclosure made by Chinese listed companies. Legitimacy theory and stakeholder theory are used to explore the relationship between the changed cultural environment and level of Chinese corporate disclosure. This study will contribute to the body of knowledge by filling the literature gap on the understanding of the relationship between modern Chinese culture and Chinese corporate disclosure. The output from the research will also extend the literature by contributing to the development of knowledge regarding the modern Chinese corporate disclosure environment.

The paper is structured as following: the next section, on culture and corporate disclosure, details the impact of societal cultural dimension on nations' disclosure practices; traditional Chinese culture and Chinese corporate disclosure; changed Chinese societal and corporate culture environment; theoretical framework and hypothesis development; the methodology section describes the sample selection and data used in empirical testing; the results of the tests are discussed in the result section; and the conclusion section concludes the study.

**Culture and corporate disclosure**

Early studies of the influence of national culture on financial accounting and reporting could be traced back to mid-1970s. Jaggi (1975) examines the impact of the cultural environment and individual value orientations on the reliability of financial information disclosures based upon Parsons and Shils' work, which classified value orientation of individuals into universalism and particularism. Universalism is featured by individual independence and impersonal relationship in respect of work structure among the most developed countries, and particularism is featured by worshiping family system in most developing countries. Jaggi hypotheses the reliability of financial disclosure is not expected to be high in developing countries unless legal disclosure standards are set. While this study represents the early awareness of the linkage between culture and disclosure practice, it lacks a cultural framework to support the approach to measure culture, also, it has no empirical result to test the hypothesis established. The literature on societal culture is quite fragmented until 1980, when Hofstede reports his study of work-related cultural values in more than 40 countries around the world. Based on an extensive empirical research conducted between 1960s and 1970s on 117,000 non-management IBM employees, he identifies four dimensions of societal culture (Hofstede, 1980):

1. large versus small power distance, the extent to which the members of a society accept that power in institutions and organisations is distributed unequally;
2. individualism versus collectivism, which stands for a preference for a loosely knit social framework in society wherein individuals are supposed to take care of themselves and their immediate families only versus a preference for a tightly knit social framework in which individuals can expect their relatives clan, or other in-group to look after them in exchange for unquestioning loyalty;
3. strong avoidance versus weak uncertainty avoidance is related to the degree to which the members of a society feel uncomfortable with uncertainty and ambiguity; and
4. masculinity versus femininity, which stands for a preference in society for achievement, heroism, assertiveness and material success versus a preference for relationships, modesty, caring for the weak and the quality of life.

Hofstede's cultural framework has been employed to guide the formation of several accounting and reporting theories, which significantly enrich the explanations about the different accounting practices and reporting systems among different countries (Gray, 1988; Perera, 1989; Gray and Vint, 1995; Zarsekei, 1996; Chanchani and Willett, 2004). Gray (1988) suggests that if Hofstede's cultural dimensions exist, then a link between societal values and accounting system can be established and the influence of culture can be assessed. Four sub-cultural accounting values including professionalism versus statutory control, uniformity versus flexibility, conservatism versus optimism and secrecy versus transparency are identified accordingly. Of these values, secrecy relates to the amount of disclosure. As secrecy increases, the amount of public disclosure decreases. Secrecy increases with uncertainty avoidance and power distance, and decreases with individualism and masculinity. Several subsequent studies are conducted to test Gray's accounting sub-culture model. In respect of the transparency/secrecy of corporate disclosure, Salter and Niswander (1995) find that only individualism is significantly related to secrecy, but not other cultural dimensions. Gray and Vint (1995) conclude that the cultural values most significantly related to the extent of information disclosure in practice are uncertainty avoidance and individualism. Findings of Zarsekei (1996) show that the secretiveness of a culture underlay disclosure practice of its business enterprises. Other studies extend the culture-disclosure research to institutional factors including national systems (political and legal systems, press), economic systems (economic development, inflation and capital markets), corporate systems (financial systems, ownership, exchanges listings, dividends, auditor and leverage) and operation systems (firm size, number of industries and foreign sales). Empirical evidences not only further strength the relationship between culture and disclosure practice of a nation, but also demonstrate that culture and other environmental factors which also influence the level of corporate disclosure are interactive with each other (Perera, 1989; Doupnik and Salter, 1993, 1995; Verma and Gray, 1997; Jaggi and Low, 2000; Hope, 2003; Archambault and Archambault, 2003; Chanchani and Willett, 2004).

**Corporate disclosure in China – prior research**

Corporate disclosure research on China attracted little attention until the end of 1980s owing to political, socio-economic, cultural and linguistic reasons (Zhou, 1988). Adopting Hofstede and Bond's (1988) cultural dimensions and Gray's (1988) accounting sub-culture model, Chow *et al.* (1995) fills the literature gap by exploring the cultural constraints on the implementation and development of accounting reforms in China. Chinese society, according to the survey conducted by Hofstede and Bond (1988), is featured with large power distance, strong uncertainty avoidance, long-term orientation, collectivism and femininity. Based upon the examination of several important phases of China accounting regulation development, some conventions, doctrines adopted by enterprises and the role played by accountants, Chow...
et al. suggest that China's accounting practice and disclosure should be classified as statutory control, uniform practices, a conservative measurement approach and secrecy in disclosure. Disclosure requirement is totally rely on government's prescription. Accessing accounting information, particularly in the public ownership sector is almost impossible. The implication is that transparency of corporate disclosure could hardly be achieved under the traditional Chinese cultural environment. Recent Chinese corporate disclosure researches indicate that there is a high level of mandatory disclosure requirement compliance among listed companies (Xiao, 1999). However, companies listed on the domestic stock exchanges are reluctant to disclose sensitive information such as related party transactions and new share subscription (Liu, 2001). In contrast, Chinese government owned enterprises listed on Stock Exchange of Hong Kong (SEHK) voluntarily disclose more strategic and financial information than other companies listed there (Ferguson et al., 2002).

**Changed Chinese societal cultural dimensions**

The Chinese cultural environment has undergone some dramatic changes as a result of the economic reform and open-door policy, which have fundamentally changed the life of Chinese people during the last 20 years. Cultural environment changes, for the purpose of discussion of this paper, are broken down into Chinese societal culture changes and Chinese corporate culture changes. The following section will devote the discussion of Chinese societal culture and culture changes.

China is a country with more than 5,000 years civilization. Chinese sociologists suggest that the social structure of China was linked with the patriarchal clan system and blood relationships have intense ethical qualities. The moral standards and social norms of Chinese were heavily influenced by a well-known teacher, Confucius, who lived in the sixth and fifth century BC and created a philosophy which the Chinese people based their beliefs upon for hundreds of years to come. He took a view that achieving harmonization was for the best interest of each member lived in a good society. Influenced by Confucius' philosophy, traditional Chinese culture valued the mind more than material things. Although Chinese appreciated wealth, wealth would be meaningless if people could not live harmoniously and happily amongst one another. The essential component of Confucianism is that there should be less emphasis on questions of logic, epistemology and meta-physics than on moral problems and social philosophy. The traditional ethico-moral ideas of China are featured by a strong conservativeness and closed character (Liu, 1997).

The economic reform and the open-door policy have been a major impetus to Chinese economic development. Historical experience shows that economic development leads a transformation in ideology, modes of thinking and sense of value (Fu, 1997). Social scientists believe that there are four chief factors that cause a culture to change: changes in the environment, contact with other cultures, invention and the future development of the culture itself. The last three have proved to be the key factors in China's cultural change from old to new, as China began opening its doors to foreign relations and making scientific, technological and economic advances. Chen (1997) contends that collectivism, one ingredient of Chinese traditional values has been abandoned and individualism, as an emerging value, is accepted by people. The Chinese Communist Party has especially upheld collectivism for the last several decades and the advocacy of communist morality encourages people to devote themselves to the state and society. However, with the rapid development of Chinese market economics, idea of freedom, self-realization, self-determination and self-struggle have replaced collectivism as a result of the movement of liberation in both business area and
social life. For instance, rewarding for loyalty and conformity as well as group performance, one of the ingredients of collectivistic culture, has been replaced by performance-based rewarding for personal contributions, the character of individualistic culture, among many Chinese corporations these days. Individually, worship of money, wealth, power and individual success gradually become acceptable values among Chinese society and Chinese business community is driven by profitability and productivity, the vocabularies which are consistent with a highly masculine culture. Security of employment which is highly valued by feminine cultures, is not predominate situation in China now.

The evolution of corporate culture in China

China has a relatively short history of corporate culture (Tong, 2003). The evolution of corporate culture in China is motivated by the development of corporate governance structure, the establishment of financial reporting regulatory framework and increased awareness of corporate social responsibilities.

The development of corporate governance in China

As one of the important participants in the global economy, China has responded to the emphasis of corporate governance worldwide by establishing its own corporate governance principles for publicly listed companies. There was no notion of corporate governance in China until Chinese government allowed state-owned enterprises to become separate legal entities in 1987. As a consequence of enterprises reform, which aimed to “save” the heavy losses enterprise and facilitate the modernization of Chinese enterprise management system, some of the state-owned enterprises were transformed into listed companies via corporatization, raising funds from two stock exchanges officially opened in China since 1990. The agency relationship emerged in China, so did agency problems which exhibited some distinctive characteristics in the Chinese context and the ownership structure was widely regarded as one of the most substantial factors contributed to agency problems (Xu and Wang, 1997; Lu, 2002). To analysis the ownership structure of Chinese listed companies, considerations need to be given to the classification of shares and trading restriction imposed on different classes of shares in China. There is a concentration of ownership with the largest shareholder stake in a listed company averaging 45 per cent. More than 60 per cent of the listed companies' shares are non-tradable. The rationale is to ensure the “control” of the company to remain with the state-owned or state-controlled shareholders. Only one-third of total shares issued, owned by Chinese individual investors and overseas investors could be traded relatively freely on the capital market. There is a perception that some parent companies treat their listed companies as “An ATM” (Groom et al., 2004). The agency problem in the Chinese context is featured by the conflict between majority and minority shareholders (Xu and Wang, 1997).

To regulate the capital market behaviour and protect the interest of individual shareholders, in 1992 China Securities Regulatory Commission (CSRC) was formed correspondently to the opening of Shanghai and Shenzhen Stock Exchanges in 1990 and 1991, respectively. The initial function of CSRC was to undertake stock exchanges administrative examination, approval of listing and share transferring. Nowadays, CSRC has changed its function to regulate the information disclosure, securities fraud and management of the listing process. It formulated a series of regulations on information disclosure with reference to international practices. In January 2002, following the footstep of the development of corporate governance worldwide, CSRC issued its own code of corporate governance for listed
companies in China to prescribe desired corporate governance structure. Chapter 7 of the
code gives special attention to information disclosure and transparency by addressing detailed
disclosure requirements to listed companies. In addition to financial information, companies
must disclose information regarding corporate governance and controlling shareholders'
interest. It is listed companies' responsibility to provide shareholders truthful, accurate,
complete and timely information as required by laws and regulations (Article 87). The code
itself does not give definition of transparency but companies are encouraged to voluntarily
disclose all other information that may have a material effect on the decision so shareholders
and ensure equal access to information for shareholders (Article 88). In terms of means of
information disclosure, CSRC takes on board the fact that the large number of individual
investors in China reside in diverse locations, it requires listed companies to make
information available not only at the company's premise, the stock exchange, the relevant
licensed brokers and their branches, but also publish the report using specified publication
and internet concurrently.

Development of financial reporting regulation

In line with the development of stock market and corporate governance, Chinese government
establishes regulatory framework for financial reporting and disclosure. Several important
promulgations are noteworthy. In 1985, the National People's Congress issued “The
Accounting Law” to specify the responsibilities of accountants, measurement processes,
principles of accounting transactions. The issuance of Accounting Regulation for
Experimental Listed Companies in 1992 by the Ministry of Finance (MOF) is seen as a
landmark of Chinese accounting system by abandoning the “fund system” adopted from
Soviet Union four decades ago. Effective on July 1993, the accounting standards for business
enterprises (ASBE) is regarded as the conceptual framework of financial reporting in China.
It firstly identifies the objective and users of financial reporting, qualitative characteristics of
information and definitions of the elements of financial statements. Served as a set of basic
accounting standards, ASBE represented the early effort made by Chinese government to
harmonize its accounting practices with international accounting standards. In 2000, the MOF
promulgated the accounting system for business enterprises (the “system”). All listed
companies are required to follow one unified new system. To complete the framework,
Chinese accounting standards are developed by the Chinese Accounting Standards
Committee. There are 16 accounting standards have been released with reference to the
international accounting standards issued by the International Accounting Standards Board.
The fundamental change in Chinese accounting and reporting led by the establishment of
financial accounting regulatory framework is the switching the emphasis of users of financial
accounting information. In the centralized planning economy, the government is the user.
Accounting is prescribed by the government, consistent with the tax law, using a uniform
chart of accounts. In the mixed market economy, external investors and creditors are the
primary users of financial accounting information (Bloom and Solotko, 2003). The objective
of Chinese financial accounting and reporting is to satisfy external users' information needs
which enable them to make efficient decision marking in relation to their investment
(Davidson et al., 1996).

Corporate social responsibility and accountability

There is a view that corporations are working in a social system, which affects and
meanwhile is affected by the achievement of corporations (Freeman, 1984). Previously,
Chinese state-owned enterprises (SOEs) only needed to be accountable to government
authorities. Since the separation of management from the private ownership, publicly listed companies should be accountable to external investors. Under the normative perspective of accountability model, information disclosure is responsibility driven instead of demand driven; it is corporations' obligation to provide information to stakeholders who have direct or indirect stake with corporations (Gray et al., 1996). This viewpoint has been adopted by CSRC when it establishes the corporate governance principle for listed companies in China as Chinese authority acknowledges that the unprecedented economic growth of China has brought consequent environmental and social issues (CSRC, 2002). In addition to financial information, Chinese investors and financial analysts need environmental information to evaluate overall corporation performance and estimate environmental and social risks (Guo, 2005). The promotional campaign of sustainable reports has begun in China (People's Daily Online, 2004a, b).

Above analysis have highlighted a fact that the relationship between changed cultural environment and the transparency of Chinese corporate disclosure needs to be re-defined as the finding of China culture-disclosure research, conducted a decade ago, does not possess the validity these days.

**Theoretical framework and hypotheses development**

To investigate the impact of culture on the transparency of Chinese corporate disclosure, voluntary disclosure made by Chinese listed companies in their annual reports is chosen as the area of interest. Voluntary disclosure is the disclosure in excess of requirements and they represent free choices on the part of company management to provide information deemed relevant to meet the needs of users of their annual reports (Meek et al., 1995). Listed companies are selected as they are more likely to attract the attention of investors who are interested and rely upon the quality of corporate disclosure to make investment decisions in China (Liu, 2005). The annual report is a significant element in the disclosure process (Todd and Sherman, 1991; Gray et al., 1995). Furthermore, the level of voluntary disclosure of annual reports is positively linked to the voluntary disclosure of quarterly and other published information. Also, companies would like to incorporate the information disclosed voluntarily beforehand through other sources into audited annual reports to increase its credibility (Lang and Lundholm, 1993). Therefore, in certain degree, the level of voluntary disclosure in annual reports mirrors a company's overall attitude towards information disclosure to the public.

This paper adopts legitimacy theory and stakeholder theory to explain the voluntary disclosure behaviour of listed companies, seeking to explore the impact of changed cultural environment on this process. Legitimacy theory asserts that organisations continually seek to ensure that they operate within the bounds and norms of their respective societies and they attempt to ensure that their activities are perceived by outside parties as being “legitimate” (Deegan, 2000). Since mid-1990s' legitimacy theory has been frequently used to explain voluntary social and environmental disclosure made by corporations (Campbell et al., 2003; Deegan, 2002; Deegan et al., 2002; O'Donovan, 2002; O'Dwyer, 2003). Legitimacy theory is derived from the concept of organisational legitimacy, a condition or status which exists when an entity's value system is congruent with the value system of the large social system of which the entity is a part. When a disparity, actual or potential, exists between the two value systems, there is a threat to the entity's legitimacy (O'Donovan, 2002). Legitimacy threatening issues can be created by the media, regulatory or institutional pressures, evolving social awareness and or corporate/industry crises (Chalmers and Godfrey, 2004).
Management must be cognisant of legitimacy threatening issues and manage legitimacy. Voluntarily disclosing information related to their social and environmental performance and contribution has been seen as a means utilized by corporations to gain, maintain and repair legitimacy and legitimate their ongoing existence. To change corporation's activities or attempts to alter other's perceptions of its activities, there must be accompanied by disclosures. Otherwise, the intended audience will be unaware of what it is the corporation is doing or trying to achieve (O'Donovan, 2002).

Stakeholder theory defines stakeholder is any group or individual who can affect, or is affected by the achievement of the corporation's objectives (Freeman, 1984). The concept of stakeholder implies that in addition to shareholders, who have direct financial transactions with a corporation, parties such as creditors, suppliers, customers, government and local community also can have interest in a corporation's activities and behaviours. Gray et al. (1996) recommend that information (disclosure) is a major element that can be employed by the organisation to manage or manipulate the stakeholder in order to gain their support and approval, or to distract their opposition and disapproval. Therefore, voluntary disclosure has been seen as a mean of corporations to meet the stakeholder demands, especially in respect of the demand related to the provision of information about the social and environmental activities of the corporation.

Both legitimacy theory and stakeholder theory predict that organizations react to demands of diverse groups with responses aiming to legitimise their actions. Therefore, if voluntary disclosure behaviour of listed companies in China could be observed, then legitimacy theory could be used to explain why and stakeholder theory could be used to explain how as companies are anticipated to pay most attention to those legitimate stakeholder groups who have power and urgency. It is reasonable to assume that Chinese publicly listed companies will adopt voluntary disclosure to legitimate their behaviour and public investors' expectation has impact on the voluntary disclosure behaviour of Chinese listed companies (Figure 1).

Regulatory agencies can be seen as corporate disclosure interest groups. They legitimise their existence by developing and enforcing corporate disclosure rules and regulations that satisfy community information demands (Chalmers and Godfrey, 2004). In China, corporate disclosure environment has changed from one which the disclosures were completely not required to one where pressure was exerted on Chinese enterprises, especially on publicly listed companies. In order to maintain the confidence of capital market and continuously attract more FDI, the Chinese Security Regulatory Commission (CSRC) and the MOF, working as Chinese government regulatory agencies, devote to improve the transparency of overall capital market by gradually establishing a comprehensive disclosure framework for listed companies. To protect the interests of public investors, CSRC introduces average 20 major policies each year to address the stock issue system, trading and supervision on listed companies (People's Daily Online, 2005b). CSRC also publicly vows to improve the transparency of its own work to ensure the efficiency of capital market reforms and to curb corruption. It acknowledges that investors are expecting more disclosure on the policy-making process of regulators and stronger supervision on the transparency of the operation of listed companies. These regulators' self-promotional behaviour not only legitimises their own existence from domestic and international investors' perception, but also exerts pressure on “regulatees”, listed companies in this context, to legitimate their behaviour as well. Companies that failed to provide the capital market with timely, adequate and transparent information will face the severe consequence.
Individual investors emerged in Chinese society as a group in the beginning of 1990s when two stock exchanges were opened in Shanghai and Shenzhen. In only 14 years, China's capital market has developed into Asia's third biggest market, with more than 1,300 listed companies, 4 trillion yuan (US$483 billion) of market capitalization and more than 70 million individual personal share trading accounts (People's Daily Online, 2004a, b). Investors are certainly more concerned about the return of their investments to fill the dream of getting rich, although listed companies have been the biggest beneficiaries from the fast growth capital market. Previously, traders in Chinese stock exchanges had reputation of speculation, after a decade, traders are reported become more rational and mature investors. Quite a few financial scandals teach them lessons that the stock exchanges are not only a place where they can only make profit but also where they have to sustain the loss as well. Value-oriented investment ideology is more acceptable also due to the increasing number of institutional investors, which has changed the structure of investors in Chinese capital market. More and more shareholders start to use lawsuit mechanism to seek compensation from companies for their financial losses due to misleading financial disclosure (People's Daily Online, 2002). The overall investor community create a demand for transparency of corporate disclosure. It is predictable that individual shareholders will participate into the construction of corporate governance more actively.

The research evidence strongly indicates that the societal background of employees is very evident in the work environment: workers do not abandon their societal values and attitudes upon entering a working place (Hofstede, 1980). As part of Chinese society, the mindset of senior executives of Chinese enterprises would be impacted by the societal culture as well. Ralston et al. (1999) compare values held by old generation manager group in China who experienced the communist consolidation (1949-1965) and current generation manager group whose adolescence occurred during the great cultural revolution (1966-1976) to the new generation manager group who grew up mostly during the era of social reform (1977-present). The research findings suggest that the new generation managers scored much higher on values that are consistent with individualism, while scored lower on traditional Chinese values such as collectivism and Confucianism. One implication of the increased individualistic tendencies of these younger Chinese managers is that they are more likely to act independently, openly and take risks in the pursuit of profit even when these actions are in conflict with traditional ways. Authors recommend that the values of the new generation managers appear to be reflecting the consequence of government's “open-door” policy, the relative freedom Chinese people have and the greater exposure to western society and culture. Confronted with the societal pressure for transparent corporate disclosure, listed companies will have incentive to legitimise their behaviours in order to survive and be competitive in the capital market. Chinese companies' legitimacy behaviour can be evidenced by the study conducted by Ferguson et al. (2002). Owing to different political regime, legal and economic system, Hong Kong capital market is thought to be more mature than the capital market in Mainland China. Companies listed on the Hong Kong Stock Exchange are subject to a more comprehensive reporting regulatory framework. Chinese SOEs listed on the SEHK, interestingly, are found voluntarily and significantly disclose more strategic and financial information than other SEHK firms. Despite their status as relatively new entrants to competitive capital markets, the disclosure practices of the former SOEs appear quite sensitive to external investor's information demands and voluntary disclosure behaviour of SEHK listed SOEs is the effect of “showcasing” – to signal to international investing communities that mainland China firms are willing to increase transparency and act as a good corporate citizens among worldwide capital market (Ferguson et al., 2002). Presumably, in line of more disclosure regulations implemented in Chinese capital market and pressure from
both domestic and international investors, listed companies in China will exhibit similar behaviour as they behave in Hong Kong Stock Exchange.

Above discussion and anecdotal literature form the foundation of following research question:

*RQ1.* Could voluntary disclosure regarding to corporate governance be found from Chinese listed companies' annual reports as a result of changed cultural environment?

**Sampling and data collection**

To investigate culture impact on corporate disclosure, a pilot research has been conducted by collecting and examining 2003 financial year annual reports of 120 Chinese listed companies. The sample consists companies only issue A-shares, companies issue both A and B shares and companies issue A, B and H shares. A-shares could be only sold to Chinese investors, traded on Chinese stock exchanges in Chinese currency and financial reporting is under Chinese GAAP. B shares could be only sold to foreign investors, starting April 2001, to Chinese investors as well. This type of shares is tradeable on Chinese stock exchanges but in US dollars and financial reporting is subject to international accounting standards. Companies that issue H shares are listed on SEHK and this type of shares could be only traded in HK dollars. According to 2003 *Chinese Annual Report Handbook*, there are 1,243 companies listed on Shanghai and Shenzhen Stock Exchanges. All 1,243 companies are classified into 20 industries including miscellaneous. The percentage occupied in two stock exchanges by each industry is calculated by using the number of listed companies in each industry divided by the total number of companies listed. After excluding 41 companies which are classified as miscellaneous, the population of this study is 1,202 companies listed in two stock exchanges. Ten per cent of the population is chosen to be the sample, which covers 19 industries. The allocation of the number of sample companies for each industry is based on the proportion of each industry on stock exchanges. The general principle followed by sample selection is that the higher the percentage of an industry, the more companies are selected from this industry, however, subject to the availability of annual reports downloaded from CSRC's web site (for instance, if the annual report could not be downloaded from CSRC's web site due to technical difficulty, the annual report of the second largest company will be used). Once the total number of companies of each industry decided, the largest, medium and smallest companies are selected from each industry. The value of asset is used as the proxy of the size of the company. Table I displays the industry classification and component of sample.

**Corporate governance disclosure index**

Among corporate disclosure which is constituted by financial information disclosure and corporate governance information disclosure, corporate governance disclosure is chosen as the area of investigation. A voluntary corporate governance disclosure checklist has been developed in order to compare with the mandatory disclosure requirements to identify the voluntary disclosure items. The checklist is developed by reference to several important corporate governance principles and recommendations established by organizations including OECD, Australian Stock Exchange (ASX), HKSE in Hong Kong and CSRC in China. This checklist consists of 120 items of corporate governance related information which could be categorised into eight categories including: board structure and functioning; employees related issues; director remuneration; audit committee; related party transactions; controlling
shareholder's interests; stakeholder interest; and, compliance with relevant corporate governance principles. It is believed that above corporate disclosure items have captured a significant corporate governance disclosure that corporate management are expected to disclose in their annual reports in order to meet the information needs of different stakeholders. The items on the checklist are checked against the mandatory corporate disclosure requirements including the Code of corporate governance for listed companies in China (2002) (CSRC, 2002) and the format and content of publicly listed companies, No. 2 (2001) released by CSRC, in order to arrive at the voluntary disclosure index applicable to the sample companies. Among eight sections of the voluntary corporate governance information disclosure checklist, controlling shareholder's interests and compliance with relevant corporate governance principles are covered by the mandatory disclosure requirement, which leaves six sections constituting the content of the voluntary disclosure index. The voluntary disclosure index identified for this study could be found from the Appendix.

The content related to corporate governance disclosure of annual reports has been entirely examined. To carry out data analysis, the content of annual reports is compared with the voluntary disclosure index and coded in order to find whether particular voluntary disclosure item has been disclosed by certain companies. A score of 1 (0) is assigned to each item of information disclosed (not disclosed). The voluntary disclosure index is compiled based on the addition, and unweighted scoring approach of the disclosure items. Such an approach is based on the assumption that each item of information disclosure is equally important to users of annual reports in their decision-making process. This method is in line with the method adopted by Chau and Gray (2002) and Meek et al. (1995).

**Results and discussion**

A company is classified as a disclosing company if any voluntary corporate governance disclosure item in the voluntary disclosure index is found disclosed in its annual report. Although Chalmers (2001) argues that the potential bias introduced when dealing with voluntary disclosures is that of classifying a firm as non-disclosing when in fact it has nothing to disclose, the bias has minimal potential impact on the test result of this study as the items included in voluntary disclosure index are all directly or indirectly related to the “code of corporate governance for listed companies in China”, issued by CSRC. Some CSRC desired behaviour becomes explicit and mandatory disclosure items required; others are implicit and depending upon managers' discretion. For financial period ended 31 December 2003, of the 120 sample companies, 104 are identified as disclosing companies, representing 85 per cent of sample selected.

Given that there are significant portion of sample companies making voluntary disclosure, it is worth to examine the area of the disclosures and the quantity of the disclosure being made. Table II displays the average of the areas of voluntary disclosure made by sample companies. Average is calculated by using total voluntary disclosure item of each voluntary disclosure section to divide total disclosure made by disclosing companies for each section.

Among six sections which including board structure and functioning, employees related issues, director remunerations, audit committee, related party transaction and stakeholder interest, The most frequently disclosed area is stakeholder interest. As demonstrated by Table III, nearly 30 per cent of disclosing companies voluntarily disclosed the information regarding to their human resource policies, internal management structure and workplace
development initiatives. Of disclosing companies, 26 per cent disclosed their qualitative environmental protection programs. The finding is consistent to the conclusion made by Guo (2005). Although there is no formal standard or rule, listed companies in China would like to disclose some information regarding to their social and environmental performance. However, the content of disclosure is diverse and the information is featured by all positive actions or news.

Director remuneration, by all means, is an essential component of corporate governance information. Half of disclosing companies elaborated how and by whom the fees and other benefits of non-executive directors are determined. Of disclosing companies, 25 per cent mentioned to what extent director remuneration is related to director's performance, but the description in annual reports are found very general. A fact noteworthy is that establishing a remuneration committee is required by CSRC, however, only 24 per cent of disclosing companies briefly mentioned the role undertaken by their remuneration committee in the process of determining director remuneration. Some companies mentioned in annual reports that there was a plan to establish such committee during the next financial period.

By examining the breakdown of the disclosure frequency of specific items in the voluntary disclosure index, it is not difficult to find that the propensity of companies voluntarily to disclose broad structure and functioning and issues related to audit committee is low. Only two of 104 disclosing companies clearly indicated that the name of the directors considered by the board to constitute independent directors and the company's materiality thresholds. Audit committee, which is required by CSRC, has not been widely set up among sample companies. This could be one of the reasons led to the low-level audit committee disclosure.

There is no voluntary disclosure related to the related party transaction could be found from sample companies. The result supports the research finding of Liu (2002) which suggests that companies listed on the domestic stock exchanges are reluctant to disclose sensitive information such as related party transactions.

**Conclusion and limitation**

Empirical result shows that voluntary disclosure regarding to corporate governance could be found from Chinese listed companies' annual reports. Although this study only focuses on one-year data, the result does indicate the willingness of Chinese listed companies to provide information in addition to the disclosure items compulsorily required by Chinese governmental agencies. Information could assist listed companies to legitimate their social status such as information related stakeholder interest information and employees related issues are found more frequently disclosed by companies than sensitive information such as the related party transactions. Limited by the size of the empirical research, this study could not firmly demonstrate the impact of changed cultural environment on the level of Chinese corporate disclosure as the impact could be only investigated by a longitudinal study and qualitative research such as in-depth interview. Nevertheless, this study attempts to theoretically establish the relationship between changed Chinese cultural environment and Chinese corporate disclosure and voluntary corporate disclosure made in annual reports could be seen as the outcome of this relationship.
Figure 1 Theoretical framework
### Table I: Industry classification and component of sample

<table>
<thead>
<tr>
<th>Industry classification</th>
<th>Percentage of stock exchanges</th>
<th>Large</th>
<th>Medium</th>
<th>Small</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equipment</td>
<td>15.9</td>
<td>8</td>
<td>6</td>
<td>8</td>
<td>22</td>
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<tr>
<td>Petroleum and chemical</td>
<td>13.2</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>15</td>
</tr>
<tr>
<td>Metal</td>
<td>9.1</td>
<td>4</td>
<td>3</td>
<td>5</td>
<td>12</td>
</tr>
<tr>
<td>Medicine and biology medicine</td>
<td>6.6</td>
<td>4</td>
<td>1</td>
<td>3</td>
<td>8</td>
</tr>
<tr>
<td>Wholesale and retail</td>
<td>6.9</td>
<td>3</td>
<td>2</td>
<td>2</td>
<td>7</td>
</tr>
<tr>
<td>IT and telecom</td>
<td>6.8</td>
<td>3</td>
<td>2</td>
<td>1</td>
<td>6</td>
</tr>
<tr>
<td>Food and beverage</td>
<td>4.3</td>
<td>3</td>
<td>3</td>
<td>6</td>
<td></td>
</tr>
<tr>
<td>Power and raw material</td>
<td>4.2</td>
<td>3</td>
<td>3</td>
<td>6</td>
<td></td>
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<tr>
<td>Textile</td>
<td>4.6</td>
<td>3</td>
<td>3</td>
<td>6</td>
<td></td>
</tr>
<tr>
<td>Transport and storage</td>
<td>4.3</td>
<td>3</td>
<td>3</td>
<td>6</td>
<td></td>
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<tr>
<td>Real estate</td>
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<td>2</td>
<td>2</td>
<td>4</td>
<td></td>
</tr>
<tr>
<td>Electronic</td>
<td>3.3</td>
<td>2</td>
<td>2</td>
<td>4</td>
<td></td>
</tr>
<tr>
<td>Service</td>
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<td>2</td>
<td>1</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>Agriculture and pastoral</td>
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<td>2</td>
<td>1</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>Paper and printing</td>
<td>2.3</td>
<td>2</td>
<td>1</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>Construction</td>
<td>1.9</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>Mining</td>
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<td>1</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>Other manufacturer</td>
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<td>1</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>Finance and insurance</td>
<td>0.7</td>
<td>1</td>
<td>1</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>3.5</td>
<td>53</td>
<td>19</td>
<td>48</td>
<td>120</td>
</tr>
</tbody>
</table>

**Table I. Industry classification and component of sample**

### Table II: Areas of voluntary disclosure made by sample companies

<table>
<thead>
<tr>
<th>Areas of voluntary disclosure made by sample companies</th>
<th>Average</th>
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</thead>
<tbody>
<tr>
<td>Stakeholder interest</td>
<td>10.70</td>
</tr>
<tr>
<td>Director remuneration</td>
<td>7.92</td>
</tr>
<tr>
<td>Employees related issues</td>
<td>6.87</td>
</tr>
<tr>
<td>Board structure and functioning</td>
<td>3.54</td>
</tr>
<tr>
<td>Audit committee</td>
<td>2.17</td>
</tr>
<tr>
<td>Related party transactions</td>
<td>0.00</td>
</tr>
</tbody>
</table>

**Table II: Areas of voluntary disclosure made by sample companies**
Table III Disclosure frequencies of times in the voluntary disclosure index
Board structure and functioning

Educational qualifications (academic and professional) 1
Commercial experience of the non-executive directors 1
Commercial experience of the executive directors 1
The skills and expertise relevant to the position of directors held by each
director in office at the date of the annual report 1
The name of the directors considered by the board to constitute
independent directors and the company's materiality thresholds 1
Directors' interest in competing business 1
Statement of directors' responsibilities for the financial statements 1
A statement indicating whether any bankruptcy was filed by the
company, its executive officers, or members of the board of directors
within the previous ten years 1
A statement indicating whether any member of the board of directors or
executive officer of the company was convicted of fraud during the
previous ten years 1
A statement indicating whether the company violated any laws during the
previous ten years for which the company was found liable in an action
before a court or regulatory agency 1
The qualification of company secretary 1
The qualification of accountant 1
The full name and qualification of the compliance officer appointed 1

Employees

Details of the number of remuneration of employees, remuneration
policies, bonus and share option schemes 1
Amount spent in training 1
Nature of training 1
Policy on training 1
Categories of employees trained 1
Number of employees trained 1
Welfare information (general) 1
Safety policy 1
Data on accidents 1
Cost of safety measures 1
Policy on communication 1
Redundancy information (general) 1
Equal opportunity policy statement 1
Recruitment problems and related policy 1
Corporate culture development 1

Director remuneration

The aggregate of amounts paid during the financial year or receivable by
directors as an inducement to join or upon joining the company 1
The aggregate of compensation paid during the financial year or
receivable by directors or past directors for the loss of office as a director
of any member of the group or of any other office in connection with the
management of the affairs of any member of the group distinguishing
between contractual and other payments 1
How and by whom the fees and other benefits of non-executive directors
are determined 1
Analysis of directors remuneration – performance based compensation 1
Analysis of directors remuneration – non-performance based
compensation 1
Individual director of the aggregate value realized on the exercise of
options during the year together with an indication of the closing market
price of the shares at the balance sheet date 1
The role and functioning of the remuneration committee 1
Number of meetings during the year 1
The name of the members of the remuneration committee 1
Attendance of committee members at meetings of committee 1
Work undertaken by the remuneration committee during the year 1
Significant issues addressed during the year 1
The existence and terms of any schemes for retirement benefits, other than
statutory superannuation, for non-executive directors 1

Audit committee

Details of the names and qualifications of those appointed to the audit
committee 1
The role and function of the audit committee 1
Number of committee meetings 1
Attendance at committee meetings 1
Statement on independence 1
Report of work done 1

Related party transactions

Directors current accounts/loans to officers 1
Directors' interest in significant contracts 1
A statement of the interests (class and number of such securities) of each
director and CEO of the company in the equity or debt securities of the
company or any associated corporation 1
Table AI

Components of the voluntary disclosure index for corporate governance information

References


ASX Corporate Governance Council (2003), *Principles of Good Corporate Governance and Best Practice Recommendations*, Australian Stock Exchange Corporate Governance Council, Sydney, March.


Further Reading


Appendix

Table AI

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