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
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