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Family Firms, Accounting Conservatism, and Information Asymmetry: Evidence from Japan

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ABSTRACT

This paper investigates accounting conservatism using a sample of family firms versus non-family firms in Japan. If CEOs of family firms opt to disclose bad news early, they will adopt a more conservative accounting reporting system. If shareholders and firm managers are more congruent and share similar values and are concerned with minority shareholders, firm managers may choose to disclose bad news early to face issues promptly and take necessary measures. Then, the quality of disclosure will be higher and information asymmetry of stocks will be lower. If CEOs from founding families or hired executive managers are under tight control of family management and have real authority, they may choose not to disclose bad news to minority shareholders, and information asymmetry will be higher. We investigate which of these two forces is dominant by investigating the relationship between income numbers, realized stock returns, and information asymmetry measures, given shares held by founding families and CEO either from founding families or not. The results reveal that family firms in Japan adopt a more conservative accounting reporting system for earnings and extraordinary losses, while the degree of information asymmetry of traded stocks remains higher. However, the shares held by founding families do not have explanatory power. We find evidence that the resolution of information asymmetry leads to conservative accounting choices by family firms.

Keywords: Family Firms, Loss Recognition, PIN Variables, Order Imbalances