Corporate Governance and Capital Market in Korea

Session 2. Empirical Analyses of Corporate Governance

Paper 2: Does Market React to Public Disclosure on Related Party Transactions in Korea?

By

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This is a preliminary draft prepared for the KDI Conference, “Corporate Governance and Capital Market in Korea” in Seoul on December 15~17, 2003.
Market reaction to public disclosure on equity investment in affiliated firms

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November 25, 2003
I. Introduction

Capital market monitoring is an important mechanism in reducing the agency costs of management in a firm where management is separated from ownership. It is believed that all relevant, material information on management actions and decisions that affect firm value would trigger market reaction once known to the public. Since market prices reflect market evaluation of management activities and decisions, value destroying activities will lower stock returns. With a lower return, the market punishes management decisions detrimental to the firm value. Therefore, the stock market can act as a pressure to the management once it has information. Because of this monitoring function however, firms and managers might not have sufficient incentive to inform their decisions and activities to the market. Therefore, it is necessary for a supervisory authority to require for firms to reveal such information so that information asymmetry is reduced and the interests of the investors are protected. That explains why (voluntary and mandatory) public disclosure is an important issue in strengthening the corporate governance system.

When an economy has been suffering from poor corporate governance, the importance of public disclosure would be even greater. Under a poor governance system, controlling shareholders are more likely to pursue their private interests at the cost of other shareholders than their counterparts under a properly working governance system. Some of the factors that contribute to poor corporate governance system include the lack of transparency in management and accounting information. This paper tries to evaluate whether and how the market is going to respond to the new information on controlling shareholders and managers’ activities in a country which introduced new disclosure system after suffering from poor governance system.

Using the information on related party transactions in Korean firms, we evaluate the role of public disclosure in corporate monitoring. Korea is a perfect case for our study. Many have argued that the Korean economic crisis in 1997 is deeply related to its structural weakness of the corporate and financial sectors. Since the occurrence of the crisis, many reform measures have been introduced in the economy including the
measures regarding the corporate governance system.\textsuperscript{1}

One of the reform measures introduced since the crisis is to change its disclosure requirement. The disclosure act has extended its coverage of events and information to report and strengthened its punishment to violating firms. It also introduced the fair disclosure clause. With strengthened accounting rules, and disclosure requirement, the capital market can provide investors with a chance to evaluate firm performance and reward or punish the firms accordingly. While much literature analyzes how the market reacts to the newly available information on firm performance such as earnings or dividend announcement, there is no literate on whether and how the market will respond to the new disclosure on related party transactions.

Using information on related party transactions that had occurred between 1996 and 2000, we have shown that the market responds quickly to the information. We specifically examined the effects of equity investment in affiliated firms. The analysis shows that the stock market responds negatively to a firm which engages in value destroying activities. This result suggests that the capital market can play a monitoring role when accurate information is provided.

The paper is organized as follows. First, we discuss regulations on public disclosure on corporate affairs in Korea. In the next section, we explain the importance of disclosure on transactions with the largest shareholders. Then, we show the empirical result on the market reaction to public disclosure on equity investment in affiliated firms followed by the conclusion and policy implications.

II. Background discussion on public disclosure in Korea

In Korea, the Securities and Exchange Act (SEA) and the Disclosure Regulation of the Korean Stock Exchange (KSE) regulate public disclosure on corporate affairs. The provisions of the SEA are mainly concerned with the disclosure both in the primary

\textsuperscript{1} See Joh (2001)
market and the secondary market, while the KSE Disclosure Regulation stipulates specific matters related to the disclosure in the secondary market only.

Corporations which plan to issue securities are required to submit registration statements to the Financial Supervisory Commission (FSC). In the secondary market, the listed corporations are obligated to submit financial statements to the FSC and the KSE on a periodic basis, and to make timely disclosure.

Until April 2000, all corporate disclosure was made in hard copies. Since then, an electronic disclosure system has been implemented. Under the electronic disclosure system, corporations now submit their disclosure documents in electronic forms via internet to the FSC and the KSE, so that they can be made easily accessible to the investing public.

A. Disclosure in the Primary Market

One of the main objectives of the disclosure in the primary market is to ensure that the investing public is properly informed of the issuers and the details of the securities to be issued. The securities registration statements and prospectus are the principal sources of information in the primary market.

1. Securities Registration Statement
Any corporation intending to make a public offering which is worth of 2 billion won or more is required to file a registration statement with the FSC (Financial Supervisory Commission). A registration statement contains a wide range of information about the issuer, including the company profile, a description of the public offerings, the use of proceeds, the business and financial status, the share ownership structure, and an auditor’s opinion on financial statements, etc. Registration statements submitted are kept for public perusal at such places as the issuing corporation, the FSS, the KSE and the subscription site.

2. Prospectus
Prospectus is prepared for the prospective purchasers’ perusal at the time of public offerings. A prospectus should include such facts as the effective date of the registration statement, the offering price, the subscription period, the public references and the matters pertaining to market making or price stabilization plans, etc. The information presented in the prospectus must be consistent with the information in securities registration statements.

B. Disclosure in the Secondary Market

Any listed corporation except financial institutions, firms under reorganization process or venture firms are obligated to make full and prompt disclosure on important corporate development. They can also disclose relevant information to public on a voluntary basis.

1. Periodic Disclosures

According to the SEA, listed corporations must file annual, semi-annual, and quarterly reports with the FSC and the KSE within 90 days, 45 days, and 45 days, respectively after the end of each reporting period, respectively.

A corporation is required to submit consolidated financial statements when it owns 50 percent or more of stakes in another corporation; or when it owns 30 percent or more of stakes in another corporation and acts as a controlling shareholder. Moreover, starting from 1999, the 30 largest business groups in terms of total assets are required to submit combined financial statements. Therefore, a listed corporation with an affiliation with any of those groups is required to file combined financial statements within 6 months after the end of a fiscal year.

2. Timely Disclosures

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2 Financial institutions that are not subject to the disclosure requirement includes Banks, securities companies, insurance companies, long-term credit banks, merchant banks, mutual savings banks, leasing firms which are pursuant to the specific acts.

3 New technology firms pursuant to the Act on Financial Assistance to New Technology Business
Listed corporations are required to report to the KSE important management actions without delay so that the KSE can release such information to the public through the Korean Investor’s Network for Disclosure (KIND) system. Corporations should disclose important corporate information on the day when it occurred, or within one day after it occurred, depending on the nature of information. When there are rumors or news that may influence the stock prices of listed corporations, the KSE makes an inquiry, asking the concerned corporation to confirm or refute the rumors or news. Listed corporations can also make disclosures on a voluntary basis.

For the effective functioning of the corporate disclosure system, the KSE requests each listed corporation to designate one of its directors as the disclosure officer who is responsible for the corporate disclosure.

   a) Information to be disclosed on the day of occurrence
   When a listed corporation encounters any of the following cases, the corporation should disclose the fact on the day it occurs:
   - Changes in corporate organization: reorganization, dissolution, M&As, etc.
   - Changes in capital: stock issuance, stock dividends, stock splits,
   - Changes in business circumstances: bankruptcy, dishonored checks, suspension of main business operation, etc.
   - CPA’s adverse opinion or disclaimer on financial statements
   - Lawsuits on the effect of issuance or rights of securities, etc.

   b) Information to be disclosed within one day after the occurrence
   - Significant changes in investments, contracts, business performance
   - Acquisition or disposition of fixed assets
   - Changes in controlling shareholders, affiliates or outside directors
   - transactions with the largest shareholders (to be discussed below)
   - Changes in business objectives, etc.

   c) Voluntary disclosures
Apart from the mandatory disclosure noted above, listed corporations can disclose other important information. When intending to disclose voluntarily any information that might be price-sensitive and important, listed corporations should provide the KSE with such information within one day after the day of occurrence. And listed corporations can disclose projected information such as the future business plans or financial prospects of the corporation to the KSE on a voluntary basis.

d) Disclosures upon inquiries
When a rumor or news that may significantly influence stock prices of a listed corporation is observed, the KSE requests the corporation to confirm whether the rumor or news is true or not. In addition, the KSE may request a listed corporation to disclose if it has any corporate information publicly unknown, when the price or the trading volume changes unusually without reasonable causes. Upon receiving the request from the KSE, the corporation should respond to it without delay.

3. Fair Disclosure

In order to ensure each and every investor a fair access to corporate information and to prevent unfair trading such as insider trading, listed corporations are prevented from offering undisclosed corporate information selectively to certain parties such as market professionals, analysts, reporters, etc. If they want to disclose some information, they must disclose the same information to the public.

In principle, deadline for fair disclosure is before providing the information to specific group and in case where fair disclosure information is provided by mistake, on the day of provision.

Information subject to Fair Disclosure includes the following.
- Future business and management plans
- Forecast of sales, profits
- Provisional business performance issued prior to the provision of annual reports
- Corporate information relating to timely disclosure

4. Unfaithful Disclosure

According to the KSE Disclosure Regulation, there are three types of unfaithful disclosure: non-compliance, reversals of disclosed information, and substantial modifications of disclosed information. In the case where a listed corporation is proved to have violated the provisions of the Disclosure Regulation, the KSE designates the corporation as an unfaithful disclosure corporation, and publicizes the event through its KIND system. When a firm receives prior notice, it can appeal to designation by filing a motion of objection within 7 days. Once the KSE receives an appeal, KSE should make the final decision within 12 days.

KSE can take disciplinary measures against Unfaithful Disclosure such as trading suspension, surveillance on the issue concerned, and/or notifies it to the FSC. Once designated as unfaithful disclosure firm, there is one-day trading suspension of the stock. In addition, when a listed firm is designated as an unfaithful disclosure corporation more than twice within a year, the stock of such corporation is classified as an administrative issue. If a corporation, within 6 months after having been designated as an administrative issue (AI) due to the violation of disclosure obligation, commits the same violation, the corporation is delisted from the KSE.

Upon receiving the notification from the KSE, the FSC may take such actions as restrictions on issuance of securities for a certain period of time, or recommendation for the dismissal of the responsible officers.

5. Disclosure on Transactions with the Largest Shareholder, etc.

The largest shareholder means the largest individual shareholder and persons with a special relationship, controlling institutional shareholder and an affiliate.
A listed corporation is required to disclose to the Exchange information on transaction with its largest shareholder, etc or on behalf of them when transaction is made or decided. The information should include contents such as the trading party (describing its relationship), transaction details (increase or decrease, and balance), etc. for each transaction, within one day of such occurrence. However, these provisions shall not apply to transactions standardized in accordance with an agreement form formulated by financial institutions:

- Advances of money, or lending of money or securities;
- Provision of real estate, movables, securities, or other property as collateral;
- Guarantee for pecuniary debts;
- Equity investment;
- Buying or selling of securities;
- Trading or leasing of real estate;
- Transferring or acquiring business.
- In addition to the items above, other transactions deemed necessary by the Exchange.

In addition to aforementioned transactions, a listed corporation is required to disclose to the Exchange information long term (one year or longer) large supply contracts with its largest shareholder, etc or on behalf of them. The listed corporation should disclose the contract contents at that time when such contract is made or decided, or when changes of the contents of such contract are made. The size of transactions specified in the contract should be equal or exceed the amount equivalent to 5/100 or more of the sales for the latest fiscal year. The corporation should declare such fact within one day of such occurrence except standardized transactions by financial institutions.

III. Why do we care about related party transactions?

As we have observed in the case of Enron collapse, the decision making agent or the controlling shareholders can arrange the transactions to benefit themselves at the cost of other shareholders. Powers (2002) who was the member of the Enron board of directors
and the special investigation committee showed how the Enron managers benefited themselves by engaging in transactions with special purpose entities.

In addition to some anecdotal evidence such as the Enron case, Johnson et al. (2000) argue that managers can engage in value destroying ‘tunneling’ activities. Some tunneling activities involve transactions with subsidiaries at the cost other stakeholders. They argue that such tunneling behavior is more likely to occur when directors and managers are subject to ‘duty of care’ rather than ‘duty of loyalty’. Moreover, when the court is conservative and its decision relies on “business judgment rule” in deciding whether managers actually engage in value-destroying activity or not, it is also easy for firm managers to engage in some activities at the cost of shareholders.

There are several methods for management to divert firm resources. Some of these include providing guarantee for debt taken by related parties, or selling and buying securities. According to Scharfstein and Stein (2000) and Scharfstein (1998) argue that internal capital market can be managed inefficiently. They argue that inefficient internal market is due to the agency problems of management. In fact, more capital is allocated to the divisions which are less efficiently managed than the market average, and less capital is allocated to more efficient divisions. While it is not clear whether the decision maker in a multi-divisional firm receives direct, personal, pecuniary benefits from such capital allocation, it is clear that such resource allocation will lower firm performance.

Using the Korean M&A data, Bae, Kang and Kim (2002) showed that merger activities by large chaebols appear to lower firm value rather than enhance firm value, suggesting that tunneling occurred. Joh (2003) showed that before the Korea economic crisis in 1997, a firm’s equity investment in affiliated firms lowered the firm’s accounting income when firm size, industry factors, and capital structure has been controlled for. In short, empirical studies show that business transactions with related party can cause conflicts of interests.

In this paper, we specifically investigate the effects of firms’ equity investment in affiliated firms for the following reasons. Transactions that involve individual
controlling shareholders are difficult to analyze because the true identity of individual investors is difficult to find. Let us take an example. Suppose a firm issues securities to its selective investors through private offerings; some of the selected investors are family members of the controlling shareholders, and so are not. However, seemingly independent investors might not be independent in actuality. They might be current or former employees of the corporation or those of affiliated firms. They may have some indirect business transactions with the firm or the controlling shareholders, which make them not independent. They can use the newly acquired securities to protect the incumbent managers/controlling shareholders. Or, they might resell the acquired securities to the controlling shareholders. When small individual shareholders sell their securities, they do not have to report their transactions since they are not principal shareholders or family members of the largest shareholders. In brief, researchers do not know whether securities issued to non-controlling individual shareholders will be ultimately acquired by the controlling shareholders. Therefore, it is difficult for researchers to gauge the total effects of transactions involving the largest shareholders. On the other hand, it is relatively easy for a researcher to explore the effects of transactions with affiliated firms as the business relation among firms is publicly available and more reliable. In addition, firms are required to report their activities of selling and buying securities of other firms.

Equity investment in affiliated firms has been a central issue in policy debates regarding business groups in Korea. It has been criticized for several reasons. One, it exaggerates the true size of the business group. Suppose there are thee firms in a business group. Firm A invests in firm B. Firm B invests in firm C. Firm C can invest in firm A. When business groups were not required to report combined financial statements, they were believed to exaggerate the size of the business group. In an extreme case, part of assets held by firms A, B, C can be double or triple counted, and the sum of total asset size of all the firms with a business group affiliation is much larger than its true value net of overlapped equity. Two, it increases the discrepancy between control rights and ownership rights that the controlling shareholders face, as it increases the control rights. Joh (2003) shows that the discrepancy between control rights and ownership rights is larger in firms with group affiliation where equity investment in affiliated firms occur.
As a way of discouraging concentration of economic power, the KFTC regulated business groups’ equity investment by imposing a ceiling on it.\(^4\) When the regulation on equity investment was first introduced in 1987, the maximum amount of equity investment was set at the 40% of total asset. The ceiling was lowered to 25% in 1993 as the regulation became stricter.

Since the economic crisis, there have been several changes. While the government introduced measures that lower the ties and connections among firms in business groups, it abolished the regulation on equity investment. This policy change in equity investment was introduced with a regulation on debt structure. The government imposed a ceiling of 200 percent on debt equity ratio, as high debt equity ratio made firms vulnerable to negative economic shocks. The corporate sector reduced its high debt

\(^4\) See Lim and Joh (2003)
equity ratio mainly through equity issuance rather than through debt reduction. As the restriction on foreign ownership and M&A’s were all abolished, the corporate sector feared that much of seasoned equity issues would be eventually subscribed by foreigners or potential takeover raiders. In order to reduce a fear that the corporate sector would face a serious threat of takeovers, the government abolished the regulation on equity investment in February, 1998.

The abolishment resulted in a high increase in equity investment and interlocking ownership. As shown in the Table below, the total equity and equity investment has increased dramatically between 1998 and 2000. The government reintroduced the regulation in 1999, which were to be in effect in 2001. According to the regulation, firms with affiliation to the large business groups (designated by the KFTC) cannot invest more than 25% of equity to other firms. The KFTC regulation on equity investment has many exceptions. For example, investment by the holding firms to subsidiary is not subject to the rule. In addition, investment which is related to the purpose of restructuring, foreign investment, or cooperation with small and medium size firms are all exempt from such regulation. However, the government has faced a serious resistance from the corporate sector since the decision was made. It postponed the date of implementation of the regulation.

Table: Time trend of equity investment in top 30 chaebols  (unit: billion won)

<table>
<thead>
<tr>
<th></th>
<th>‘97.4</th>
<th>‘98.4</th>
<th>‘99.4</th>
<th>2000.4</th>
<th>2001.4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity investment(A) (annual growth rate t/t-1)</td>
<td>16.9</td>
<td>17.7</td>
<td>29.9</td>
<td>45.9</td>
<td>50.8</td>
</tr>
<tr>
<td>Total Equity(B) (annual growth rate t/t-1)</td>
<td>61.3</td>
<td>59.2</td>
<td>92.0</td>
<td>139.6</td>
<td>142.8</td>
</tr>
<tr>
<td>Equity investment/Equity(A/B)</td>
<td>27.5</td>
<td>29.8</td>
<td>32.5</td>
<td>32.9</td>
<td>35.6</td>
</tr>
</tbody>
</table>

Source: Korea Fair Trade Commission

5 for more discussion, see Lim and Joh (2003)
Table: Time trend of ownership (unit: %)

<table>
<thead>
<tr>
<th></th>
<th>'97.4</th>
<th>'98.4</th>
<th>'99.4</th>
<th>2000.4</th>
<th>2001.4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Largest shareholders</td>
<td>3.7</td>
<td>3.1</td>
<td>2.0</td>
<td>1.5</td>
<td>3.3</td>
</tr>
<tr>
<td>Families and relatives</td>
<td>4.8</td>
<td>4.8</td>
<td>3.4</td>
<td>3.0</td>
<td>2.3</td>
</tr>
<tr>
<td>Related firms</td>
<td>33.7</td>
<td>35.7</td>
<td>44.1</td>
<td>36.6</td>
<td>35.2</td>
</tr>
<tr>
<td>Stock repurchase</td>
<td>0.8</td>
<td>0.9</td>
<td>1.0</td>
<td>2.3</td>
<td>4.2</td>
</tr>
<tr>
<td>Total</td>
<td>43.0</td>
<td>44.5</td>
<td>50.5</td>
<td>43.4</td>
<td>45.0</td>
</tr>
</tbody>
</table>

Source: Korea Fair Trade Commission

IV. Empirical Study on equity investment in affiliated firms.

We investigate whether and how the market responds to public disclosure on related party transactions. Among the transactions with the largest shareholders subject to the disclosure, we review the effects of equity investment. We implemented an event study method. We examine whether and how the stock price return changes 10 days before and after the public disclosure on the equity investment.

From the Korean Investor’s Network for Disclosure (KIND) system, we collect information on the dates of related party transactions. We impose a restriction that any event in our sample is at least 100 days apart from the previous event date. This restriction reduces any lingering effects of previous events. We are able to isolate the effects of the current event. The final set has almost 246 cases between 1996 and March of 2000.

Equity investment produces a positive effect if the market believes that cash-rich firms invest money in profitable firms rather than wasting in negative-NPV projects. On the other hand, equity selling can send a signal to the market that either the firm is in need of money, or it can waste with an increase in its free cash flow. Therefore, the market might react positively to the information that a firm acquired stocks of other firms, and
negatively to the information that a firm sold stocks. Equity investment in un-affiliated firms might serve this purpose.

Equity investment in affiliated firms is a different story. Equity investment consolidates a business group’s internal capital market among affiliated firms. Equity investment in affiliated firms serves as interlocking ownership (cross-shareholding). With a high interlocking ownership stake, the incumbent controlling shareholders’ position is protected from external threat of takeovers. In addition, equity investment in affiliated firms can be used as a tunneling device. Imagine a firm sets the price of new issues at a higher price than the market valuation. While other investors do not participate in this offering, affiliated firms can purchase the overpriced stocks. In particular, equity investment from relatively well-functioning firm to relatively poorly performing firms is a channel to transfer money.

We have derived cumulative abnormal rate of return during the window periods of the event of equity investment. First, we estimated a market model using the price return information of 250 days for each firm. After deriving the systematic risk parameter (beta) and firm specific factor, we calculated the abnormal rate of return during the window period including the event. Cumulative average abnormal rate of return (CAR) is the sum of the average abnormal rate of return.

Since many reform measures were made after the economic crisis and the investors have learnt the problems associated with equity investment, we divide the data into two periods: one group consists of events that have occurred between 1996 and the end of 1998, the other group consists of events that have occurred since the beginning of 1999.

In order to show whether equity investment in affiliated firms yields effects different from those of equity investment in un-affiliated firms, we have included the CAR for investment in un-affiliated firms as well.
The figure above shows that equity investment in both affiliated firms and un-affiliated firms yield positive effects when we analyze the investment activities until the end of 1998. The market appears to evaluate the equity investment positively, and on average firms’ stock return has improved. The initial response to the disclosure is positive for both groups. Moreover, equity investment in affiliated firms yields a higher CAR than that in un-affiliated firms.

The figure above summarizes the analysis on the equity investment that has occurred since 1999. Equity investment in related firms and unrelated firms yield a quite opposite
effect. While investment in related firms yields a negative return while that in unrelated firms yields a positive return. The difference of CAR is 5% in 20 days. This result suggests that the market evaluates the equity investment in unrelated firms positively while it evaluates equity investment in related firms negatively.

Discussion

Since the 1997 economic crisis, the Korean government has discouraged transactions with related parties. Not only disclosure requirement, but also the government has investigated trading with related parties. When the terms of trading are different from the market price, such trading is considered unfair. The government has levied fines which amount up to 10% of gains. Our analysis shows that some of these transactions in fact lower firm value at the cost of minority shareholders.

KFTC Investigation on unfair intra-group trading

<table>
<thead>
<tr>
<th>Coverage of investigation</th>
<th>Time Period</th>
<th>Num. of providers</th>
<th>Num of recipients</th>
<th>Amount of transactions</th>
<th>Amount of subsidy</th>
<th>Amount of fines</th>
</tr>
</thead>
<tbody>
<tr>
<td>Top 5 chaebols</td>
<td>('98.5~6)</td>
<td>80</td>
<td>35</td>
<td>4,026.3</td>
<td>224.4</td>
<td>72.2</td>
</tr>
<tr>
<td>top 5 chaebols</td>
<td>('98.6~7)</td>
<td>33</td>
<td>21</td>
<td>1,492.7</td>
<td>546</td>
<td>20.9</td>
</tr>
<tr>
<td>top 5 chaebols</td>
<td>('99.5~7)</td>
<td>53</td>
<td>38</td>
<td>12,332.7</td>
<td>250.0</td>
<td>78.9</td>
</tr>
<tr>
<td>5 among top 6th-30th chaebols</td>
<td>('98.10~12)</td>
<td>35</td>
<td>45</td>
<td>2,483.7</td>
<td>693</td>
<td>14.2</td>
</tr>
<tr>
<td>8 state controlled enterprises</td>
<td>('99.3)</td>
<td>13</td>
<td>18</td>
<td>393.3</td>
<td>254</td>
<td>3.7</td>
</tr>
</tbody>
</table>

V. Conclusions and Policy implications

Using publicly disclosed information on equity investment, we have shown how the market responds to the news. The paper shows that the market responds negatively to
equity investment in affiliated firms while it responds positively to equity investment in non-affiliated firms. This result suggests that market participants believe that equity investment in affiliated firms reduce firm value rather than increasing firm value. This result is consistent with some argument that equity investment in affiliated firms by firms with affiliation with business group strengthened the position of controlling shareholders. Entrenched controlling shareholders are more likely to pursue private benefits and reduce firm value. This result implies that the market plays a monitoring role and stock market prices reflect the market evaluation on management decisions. This result shows that the stock market can ‘ultimately’ protect the investors when material information is disclosed properly. With a properly working disclosure system, investors punish management for the bad decisions that lower firm value and award management for the decisions that enhance firm value.

Equity investment in affiliated firms can occur at privately held firms as well as at publicly traded firms. Because public disclosure is not applicable to privately held firms or some financial institutions, it is difficult to protect shareholders of a privately held firm when the firm engages in value destroying transactions with firms under the influence of its largest shareholder. While privately held firms are on average much smaller than public firms, private firms are important in employment, and vitality of an economy. Protecting the minority shareholders and reducing agency costs in those firms would reduce its capital cost and improve firm performance. Therefore, it is also necessary to introduce disclosure requirement for large privately held firms.

Although the market responses triggered by the public disclosure requirement might not be sufficient to reduce management and controlling shareholders’ incentive to engage in value destroying activities, it still is an important device to monitor management decisions. Since the stock market responds to the information on equity investment, direct government intervention or government regulations on this issue might become less important especially for publicly traded firms.

Reference
Bae, Kang and Kim (2002)
Powers (2002)