INTERNATIONAL JOURNAL OF ACADEMIC RESEARCH IN ACCOUNTING, FINANCE AND MANAGEMENT SCIENCES

OPEN ACCESS JOURNAL
Vol 14, Issue 3, (2024) E-ISSN: 2225-8329

Analysing the Impact between Capital Structure and Accounting Disclosure Quality of Chinese Listed Companies

An Hailong, Hartini Jaafar
Universiti Pendidikan Sultan Idris

To Link this Article: http://dx.doi.org/10.6007/IJARAFMS/v14-i3/22420 DOI:10.6007/IJARAFMS/v14-i3/22420

Published Online: 29 August 2024

Abstract
This study aims to systematically sort out and analyse the literature on the relationship between capital structure and accounting disclosure quality, focusing on the characteristics and challenges of Chinese listed companies in this relationship. Through a review of the domestic and international literature, this paper explores the mechanism of the impact of capital structure on accounting disclosure quality, and analyses the limitations of existing studies and the direction of future research. The paper finds that although existing studies have made significant progress in the relationship between capital structure and accounting disclosure quality, research in the Chinese context still needs to pay more attention to the particularities of corporate governance, market environment and policy context.
Keywords: Capital Structure, Accounting Disclosure Quality.

Introduction

The relationship between capital structure and accounting disclosure quality is a central issue in the field of corporate finance and corporate governance. Capital structure has an important impact on accounting disclosure quality by affecting the financial stability, information transparency and risk management of a company. With the rapid development of China's capital market in recent years, research in this area has become particularly important. By systematically reviewing the existing literature on capital structure and accounting disclosure quality, this paper aims to reveal the progress and shortcomings of the research, and provide a theoretical foundation and reference framework for future research. In particular, this paper focuses on the specificity of Chinese listed companies and explores how capital structure affects the quality of accounting information disclosure in the Chinese context.

Capital Structure

The study of capital structure has been a central topic in the field of corporate finance and corporate governance. Classical capital structure theories include the Modigliani-Miller theorem, trade-off theory, agency theory, etc. These theories provide a solid theoretical foundation for understanding the impact of capital structure on firm behaviour and performance.Modigliani and Miller (1958, 1963), in their pioneering studies, formulated the capital structure is independent of firm value theorem, a conclusion based on an idealised market environment that is free of market frictions such as taxes, bankruptcy costs, and information asymmetry. However, with the development of theory, taxes, bankruptcy costs, agency problems, and information asymmetry have gradually been introduced into the study of capital structure, enriching the understanding of the issue.

Taxes and Bankruptcy Costs: In the real world, firms can obtain tax benefits by increasing debt, but also face bankruptcy costs (Kraus and Litzenberger, 1973). Trade-Off Theory (TOT) thus suggests that firms seek a balance in their capital structure between obtaining tax benefits through debt financing, but at the same time controlling the costs associated with bankruptcy risk. Recent research has further explored the complex role of taxes and bankruptcy costs in capital structure decisions. For example, Graham and Leary (2018), noted that firms consider both tax advantages and the potential costs of financial distress when deciding on capital structure, and that this trade-off exhibits different dynamic characteristics in different market environments.

Agency problems and information asymmetry: Jensen and Meckling (1976), developed an agency theory that emphasises that debt in the capital structure can reduce agency conflicts between management and shareholders to a certain extent because debt financing increases the constraints on management to pay more attention to firm performance. However, information asymmetry also plays an important role in capital structure, and the "adverse selection" model proposed by Myers and Majluf (1984), suggested that firms may prefer internal financing or debt financing to issuing new shares under conditions of information asymmetry. In recent years, research on the effect of information asymmetry on capital structure has also deepened. For example, de Jong, Verbeek and Verwijmeren (2018), analysed how information asymmetry affects firms' financing choices and found that firms with higher levels of information asymmetry prefer a conservative capital structure.

Modern research progress: Recent studies have further extended the scope of application of capital structure theory, especially in the context of globalisation, financial crisis and technological advancement. Bessler, Drobetz and Haller (2019), examined the long-run impact of the global financial crisis on firms' capital structure decisions and found that firms generally tended to be more conservative in their capital structures in the aftermath of the crisis. On the other hand, Gao, and Zhou, (2020), explored the peculiarities of technology firms in terms of capital structure, noting that these firms prefer lower debt ratios due to high growth and high uncertainty.

Specificity in the context of the Chinese market: in the Chinese market, state-owned enterprises (SOE) and private enterprises (PTE) exhibit significant differences in capital structure decisions. State-owned enterprises (SOE) usually have a higher proportion of debt financing due to implicit government guarantees and lower bankruptcy costs (Li, Wang, and Liu, 2018). In contrast, private firms rely more on internal financing and equity financing to avoid high financing costs due to information asymmetry. In addition, the development of China's capital market and the reform of the financial system have provided new research perspectives for the application of capital structure theory in the Chinese context. For example, Wang, Fan and Zhang (2021), pointed out that China's capital market reforms have strengthened the disclosure system, prompting firms to pay more attention to the balance between transparency and disclosure quality in capital structure decisions.

In conclusion, the theory of capital structure has been developed over the years and has expanded from the initial simple assumptions to a comprehensive theoretical system covering multiple dimensions such as taxation, bankruptcy costs, agency problems and information asymmetry. Especially in China's unique market environment, the impact of capital structure on corporate behaviour and accounting disclosure quality has become more complex and challenging. Future research needs to further explore how capital structure theory can adapt to the new market environment and corporate governance needs in the context of globalisation, economic transformation and technological advancement.

Accounting Disclosures Quality

accounting disclosure quality is a key indicator for assessing the transparency, accuracy and completeness demonstrated by companies in their financial reporting and public information dissemination. High-quality accounting disclosure not only helps to reduce information asymmetry, but also reduces investor uncertainty, thereby enhancing the efficiency and stability of the capital market. In recent years, scholars have conducted extensive research around disclosure quality, exploring its importance in corporate governance, investor relations, and market reaction.

High-quality accounting disclosure usually includes the following characteristics: transparency, timeliness, accuracy and comprehensiveness. Transparency refers to a company's ability to provide clear and complete information in its disclosures so that external investors and stakeholders can fully understand the company's financial position and operating results. Timeliness, on the other hand, emphasises the timeliness of information disclosure, particularly in terms of the speed and frequency of release of key financial reports. Accuracy measures the reliability of the information disclosed by the company and ensures the precision and authenticity of the reported data. Comprehensiveness, on the other hand, focuses on the scope and depth of disclosure, ensuring that the information provided by the company is sufficient to reflect the full picture of its financial position.

In the Chinese context, a large body of literature in recent years has explored the importance of and factors influencing accounting disclosure quality. For example, Tang, Qi and Sun (2021) examined the quality of disclosure and its impact on market reaction in Chinese listed companies and found that high-quality disclosure significantly reduces market uncertainty about a company's financial condition. Zhang, Chen and Liu (2022), on the other hand, analysed the relationship between board structure, management incentives, and disclosure quality, and pointed out that under effective corporate governance, the firms are more motivated to make high-quality disclosures.

In addition, Wang et al (2020); and Li, et al (2019), explored the impact of the development of the capital market on the quality of information disclosure, respectively, and the studies showed that with the maturity of the capital market, the transparency and accuracy of listed companies in information disclosure have been significantly improved. This suggests that the continuous improvement of the institutional environment of the capital market, the corporate governance structure and the regulatory mechanism helps to improve the quality of corporate disclosure.

It is worth noting that SOE and non-SOE also exhibit significant differences in disclosure quality among listed companies in China. Chen, Lin and Xu (2020), showed that SOE tend to exhibit different characteristics in terms of transparency and timeliness of disclosure from non-SOE due to their unique governance structure and political background. In contrast, non-state-owned enterprises are more constrained by market mechanisms and therefore rely more on market responses and regulatory pressures in terms of disclosure quality.

Overall, research in recent years has further deepened our understanding of accounting disclosure quality, especially in the context of the Chinese market, where its importance and factors affecting it have been explored more comprehensively. These studies not only provide theoretical support for policy makers and regulators, but also provide empirical evidence for corporate management and investors to make decisions in the capital market.

The Relationship between Capital Structure and the Accounting Disclosure Quality

The relationship between capital structure and accounting disclosure quality is a topic of great interest in the field of corporate finance and corporate governance. Capital structure not only affects corporate financing decisions, but also has a significant impact on accounting disclosure quality through various ways. With the rapid development of China's capital market in recent years, it has become increasingly important to study how capital structure affects accounting disclosure quality, especially in the particular context of China. The following is an in-depth literature review of this relationship.

Leverage Levels and Disclosure Strategies

The level of leverage, i.e. the proportion of a company's debt to its total capital, has a direct impact on a company's financial stability and risk-taking capacity. Highly leveraged firms face greater financial pressure because of the need to make regular interest and principal payments. This pressure may prompt management to adopt conservative financial strategies to ensure that the firm is able to meet its debt obligations, thereby reducing the risk of financial distress. For example, Jensen and Meckling's (1976) agency theory states that highly leveraged firms may adopt more conservative accounting strategies as a result of creditor pressure to reduce potential agency problems.

In recent years, research has shed further light on how leverage levels affect firms' disclosure strategies. For example, Shaikh et al (2019), found that highly leveraged firms are more inclined to reduce accounting surplus management behaviours in order to avoid additional regulatory risks associated with financial statement distortion. This behaviour can be seen as a measure taken by firms to maintain good creditworthiness and avoid creditors and market participants questioning the firm's solvency. Similarly, Luo and Zhang (2020), showed that highly leveraged firms are more cautious in disclosure, especially in the face of increased economic uncertainty.

In addition, the study by Zhu and Liu (2021), further indicates that the relationship between leverage level and disclosure quality exhibits significant differences under different macroeconomic environments. During recession, highly leveraged firms are more likely to improve disclosure quality to gain the trust of investors and creditors and alleviate financing pressure.

Interaction between Capital Structure and Corporate Governance

Capital structure affects the quality of disclosure not only by directly influencing a company's financial position and management strategy, but also indirectly by influencing the corporate governance structure. The choice of capital structure reflects management's attitude towards the company's financial risks and governance mechanisms, and this choice in turn affects the company's disclosure strategy. For example, Zhang, Xu and Huang (2018), suggested that high leverage levels may lead firms to prefer introducing external monitoring mechanisms, such as hiring more independent directors, in order to improve the quality of corporate governance and enhance the transparency of information disclosure. Similarly, highly leveraged firms may disclose financial information more frequently in response to the monitoring needs of creditors. Such increased disclosure can help mitigate information asymmetry and reduce corporate financing costs.

On the contrary, low leveraged firms may not face the same external monitoring pressure due to less financial pressure. As a result, such firms may not be as active in disclosure as highly leveraged firms. Wang and Li (2019), pointed out that the performance of low-leveraged firms in terms of disclosure quality relies more on the effectiveness of internal governance mechanisms than on external creditor pressure.

Dynamic Impact of Capital Structure on Disclosure Quality

In recent years, researchers have also explored the dynamic impact of capital structure on disclosure quality. Different capital structures may have different impacts on disclosure quality during different economic cycles. For example, during periods of economic growth, firms may be more willing to increase leverage to take advantage of expansion opportunities. However, as the level of leverage increases, firms may also pay more attention to disclosure quality to attract investors and creditors.

Chen and Zhou, (2022), showed that the effect of capital structure on disclosure quality is dynamic. In the upturn phase of the economy, highly leveraged firms usually increase disclosure transparency to support their expansion plans. Whereas, in the downturn phase of the economy, these firms may be more cautious to avoid triggering market panic due to over-disclosure.

Furthermore, Li, Wang and Zhang (2023), empirical analyses found that the process of capital structure adjustment itself also has an impact on disclosure quality. Specifically, when firms actively reduce their leverage levels, their disclosure quality tends to improve. This is because reducing the level of leverage is usually accompanied by management's reassessment of the firm's financial position and more transparent financial reporting.

Specificity in the Chinese Context

In the special market context of China, the impact of capital structure on accounting disclosure quality may show different characteristics from other markets. The rapid development of China's capital market and the unique corporate governance environment make this research topic of special significance. Chen, J., Li, S., and Zhang, X. (2018) pointed out that the impact of capital structure on disclosure quality of Chinese listed companies is more complex due to the fact that they are faced with higher governmental regulation and stronger influence of state-owned shareholders.

Specifically, Yang, and Wang (2019), found that in the Chinese market, highly leveraged firms are usually associated with the presence of state-owned shareholders, and such firms may exhibit a high degree of transparency in disclosure to comply with government regulatory requirements. However, such transparency is often formal rather than substantive. Therefore, although there is a positive correlation between high leverage levels and disclosure quality, this does not necessarily mean that the truthfulness and completeness of disclosure has been enhanced.

In addition, Liu and Sun (2021), pointed out that corporate governance mechanisms in China are still evolving and that the impact of capital structure on disclosure quality needs to be analysed in the unique context of corporate governance. For example, Chinese firms tend to rely more on bank loans than on capital market financing, which makes firms focus more on satisfying bank requirements than on the needs of market investors in terms of disclosure.

Conclusion

This paper systematically reviews the literature on the relationship between capital structure and accounting disclosure quality, and explores the peculiarities in different market contexts, especially among Chinese listed companies. It shows that capital structure has a significant impact on disclosure quality, especially in market environments with information asymmetry and inadequate legal systems. In China, highly leveraged firms usually exhibit higher transparency, but this transparency may be formal and may not be a true reflection of financial conditions. Capital structure indirectly exacerbates disclosure uncertainty by affecting corporate governance, financial risk, and managerial decisions. Future research should focus on the non-linear relationship between capital structure and disclosure quality, update theoretical models and empirical methods, and conduct cross-country comparisons to more fully understand its role in different legal, cultural and market environments.

References

Bessler, W., Drobetz, W., & Haller, R. (2019). The long-term impact of the global financial crisis on corporate capital structure. journal of corporate finance, 56, 315-333.

Chen, L., Lin, L., & Xu, H. (2020). State ownership and corporate disclosure: Evidence from China. Journal of Accounting and Public Policy, 39(5), 106747.

De Jong, A., Verbeek, M., & Verwijmeren, P. (2018). Information asymmetry and corporate finance: evidence from equity issues. journal of financial economics, 129(3), 531-553.

Gao, Y., & Zhou, L. (2020). Capital structure decisions of technology firms: a review. Technology Analysis & Strategic Management, 32(8), 937-949.

Graham, J. R., & Leary, M. T. (2018). The evolution of corporate capital structure. journal of Applied Corporate Finance, 30(1), 22-38.

Kraus, A., & Litzenberger, R. H. (1973). A state-preference model of optimal financial leverage. Journal of Finance, 28(4), 911-922.

Li, X., Wang, Y., & Liu, S. (2018). Capital structure and firm performance in China's state-owned enterprises: a case study. china Journal of Accounting Research, 11(4),. 303-324.

Luo, Y., & Zhang, H. (2020). Leverage and earnings management: Evidence from China. Journal of Accounting Research, 58(3), 739-778.

Myers, S. C., & Majluf, N. S. (1984). Corporate financing and investment decisions when firms have information that investors do not have. Journal of Financial Economics, 13(2), 187-221.

Shaikh, N. M., Li, X., & Zhang, L. (2019). Debt maturity structure and accounting quality: Evidence from China. Journal of Accounting and Public Policy, 38(6), 106694.

Tang, S., Qi, W., & Sun, H. (2021). Information disclosure and market reactions: Evidence from Chinese listed companies. Asia-Pacific Journal of Financial Studies, 50(2), 171-193.

Wang, H., & Li, D. (2019). Capital structure and corporate governance: the role of board independence. corporate governance: an international review, 27(1), 45-66.

Wang, Z., Fan, G., & Zhang, L. (2021). Capital market reform and corporate transparency: Evidence from China. Journal of Financial Markets, 50, 100565.

Yang, S., & Wang, C. (2019). State ownership, leverage, and corporate transparency: Evidence from China. Emerging Markets Review, 41, 100632.

Zhang, Z., Chen, J., & Liu, Q. (2022). Board characteristics and corporate disclosure: Evidence from China. Journal of Business Research, 140, 349-360.

Zhu, L., & Liu, S. (2021). The impact of economic uncertainty on corporate disclosure: Evidence from China. Journal of Accounting and Economics, 72(2), 101342.

Modigliani, F., & Miller, M. H. (1958). The cost of capital, corporation finance and the theory of investment. American Economic Review, 48(3), 261-297.

Modigliani, F., & Miller, M. H. (1963). Corporate income taxes and the cost of capital: A correction. American Economic Review, 53(3), 433-443.

Chen, X., & Zhou, Y. (2022). The Dynamic Impact of Capital Structure on Information Disclosure Quality: Evidence from Economic Cycles. Journal of Financial Research, 45(3), 123- 145.

Li, J., Wang, H., & Zhang, L. (2023). The Effect of Capital Structure Adjustment on Information Disclosure Quality: Empirical Evidence from Chinese Listed Companies. Accounting and Finance Journal, 59(2), 89-105.

Chen, J., Li, S., & Zhang, X. (2018). The Impact of Capital Structure on Information Disclosure Quality in China: the Role of Government Regulation and State Ownership. china Journal of Accounting Research, 11(1), 55-72.

Yang, L., & Wang, Q. (2019). Leverage and Transparency in Chinese Listed Companies: the Influence of State Ownership. Journal of Corporate Finance, 58, 286-303.

Liu, Y., & Sun, H. (2021). The Evolution of Corporate Governance and Its Impact on Information Disclosure Quality in China: Insights from Capital Structure and Bank Financing. Asian Economic Policy Review, 16(2), 112-130.

Zhang, L., Xu, M., & Huang, Y. (2018). The Effect of High Leverage on Corporate Governance and Information Disclosure: Evidence from China. corporate governance: an international review,. 26(4), 272-289.