Economia Aziendale Online

Business and Management Sciences
International Quarterly Review

BEYOND STAKEHOLDERS THEORY: FINANCIAL REPORTING AND VOLUNTARY DISCLOSURE IN ITALIAN SME ACCORDING TO A UNITARY PERSPECTIVE

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Pavia, Dicembre 2016
Vol. 7 - N. 4/2016

www.ea2000.it
www.economiaaziendale.it

Electronic ISSN 2038-5498
Reg. Trib. Pavia n. 685/2007 R.S.P.

Economia Aziendale Online VOL. 7. 4/2016: 285-304 *Refereed Paper*

www.ea2000.it
DOI: 10.13132/2038-5498/7.4.285-304

Beyond Stakeholders Theory: Financial reporting and voluntary disclosure in Italian SME according to a unitary perspective

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Abstract

In molti studi, la relazione tra l'informativa volontaria e due delle caratteristiche fondamentali delle aziende sono analizzate: la grandezza e lo stato della quotazione aziendale. Per questa ragione, le aziende di grandi dimensioni sono ampiamente investigate in letteratura, mentre le piccole medie imprese ricoprono un'attenzione minore. Per questo motivo, il presente articolo mira ad analizzare le condizioni sia specifiche del Paese che non, che possono influenzare la qualità della reportistica volontaria nelle piccole medie imprese italiane. L'obiettivo è quello di proporre un modello di analisi non ancora presente in Letteratura, che sia comprensivo dei diversi aspetti aziendali.

In most studies, the relationships between voluntary disclosure in financial reporting and two main characteristics of the firms are examined. One characteristic is the size of the company, and the other is the company's listing status. Thus, large and listed firms are extensively investigated in worldwide literature. Less attention is paid to small and medium sized entities which are more than the 90% of the firms both in developed and undeveloped countries. The paper aims to analyse main factors, both country-specific and not, influencing financial reporting quality and voluntary disclosure in Italian small and medium size entities. In particular, the paper offer a strategic point of view on the variables influencing voluntary disclosure and financial reporting quality in Italian context. Such variables and the set of cause-effect relationships connecting them are examined on the basis of mainstream literature approaches referring to corporate governance, information systems, internal auditing, accounting regulation, earnings management, and stakeholder theory, by reviewing empirical and theoretical literature. The focus is on the variables influencing corporate disclosure and financial reporting. A unified model is proposed according to Italian Business Economics Tradition.
The study is based on a theoretical basis. Future research aimed at examining, by surveys and case studies, relationships between the variables of the model needs, in order to explain and predict corporate financial disclosures in Italian small and medium sized entities, are planned. The comprehensive framework developed in this study for organizing and evaluating voluntary disclosures and financial reporting quality is an initial step in the direction of examining both phenomena from a strategic perspective. The paper proposes a model of analysis whose systematic structure is not yet developed in the literature.

Keywords: Corporate governance. Financial reporting. Voluntary disclosure. SME. Italian literature. Strategic perspective.

1 – Introduction

On the stakeholder perspective, the mandatory information disclosure cannot satisfy stakeholders diversified information needs. On one hand, voluntary disclosure can detail and deepen mandatory disclosure, improving the credibility and completeness of mandatory disclosure. On the other hand, it can complement and expand the mandatory disclosure, for the sake of realizing the more complete, diversified, and systematic information disclosure.

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In the last decade, many studies investigated the relationships between voluntary disclosure in financial reporting and the characteristics of the firms (such as the size of the company, the company's listing status, etc.). Thus, the adoption of voluntary *versus* mandatory disclosure by large and listed firms is extensively investigated in different countries. Less attention is paid to small and medium sized entities (SMEs). The aim of this paper is to propose a model focussed on the variables influencing SMEs corporate disclosure in Italy.

The Italian context is particularly suitable to address this issue as the characteristics of the Italian capitalism. The Italian corporate governance regime exhibits weak legal protection of creditors and shareholders, inefficient law enforcement, high ownership concentration, and an abundance of pyramidal groups (Di Pietra *et al.*, 2008). In this country a number of large companies are still controlled by one family and public companies are a rare case. Families use also a number of legal mechanisms – like pyramidal groups, syndicate agreements, and shares with limited voting rights – to separate ownership from control (Aganin and Volpin, 2003; Bianchi *et al.*, 2001; Faccio and Lang, 2002; La Porta *et al.*, 1999). Equity markets are underdeveloped (*i.e.* only few companies are listed on Stock Exchange). Unlisted SMEs represent, instead, over 99% of total companies in Italy, and 93% of the workforce is employed in them.

The paper is structured as follows: Section 1 introduces stakeholders' theory. Section 2 provides a brief overview of mainstream studies on financial reporting quality and voluntary disclosure around the world. Section 3 focuses on widely versus closely held firms in order to better present the Italian economic and institutional setting. Section 4 proposes a model for analysing financial reporting and voluntary disclosure in a systematic perspective; and, Section 5 discusses the limitations of the paper and the directions of future research.

2 – Stakeholders theory and corporate social responsibility

The stakeholder perspective has become something which is inescapable if one wants to discuss and analyze corporate social responsibility. Stakeholder theory is considered as "a necessary process in the operationalisation of corporate social responsibility, as a complimentary rather than conflicting body of literature" (Matten *et al.*, 2003: 11). Furthermore, it can be said to exist a "stakeholder metanarrative" (Campbell *et al.*, 2003: 559) which underlies the corporate social responsibility debate. In fact, recent analysis of the extensive body of research on ethics and social responsibility issues show that an important number of the authors who devote themselves to these areas of study have mostly drawn on stakeholder theory (Garriga and Melé, 2004; Margolis and Walsh, 2003).

Stakeholder theory is based on the notion that beyond shareholders there are several agents with an interest in the actions and decisions of companies. Stakeholders are "groups and individuals who benefit from or are harmed by, and whose rights are violated or respected by, corporate actions" (Freeman, 1998: 174). In addition to shareholders, stakeholders include creditors, employees, customers, suppliers, and the communities at large. Stakeholder theory asserts that companies have a social responsibility that requires them to consider the interests of all parties affected by their actions. Management should not only consider its shareholders in the decision making process, but also anyone who is affected by business decisions. In contrast to the classical view, the stakeholder view holds that "the goal of any company is or should be the flourishing of the company and all its principal stakeholders" (Werhane and Freeman, 1999: 8). It is important to stress that shareholders are stakeholders and that dividing the world into the concerns of the two is "the logical equivalent of contrasting 'apples' with 'fruit'" (Freeman *et al.*, 2004: 365).

Many interesting typologies of stakeholders have been proposed. Clarkson's typology of stakeholders is the most widely cited and accepted. Clarkson (1995) distinguishes primary and secondary stakeholders. A *primary* stakeholder group is one without whose continuing participation the corporation cannot survive as a going concern. Primary stakeholder groups typically are comprised of shareholders and investors, employees, customers, and suppliers, together with what is defined as the public stakeholder group: the governments and communities that provide infrastructures and markets, whose laws and regulations must be obeyed, and to whom taxes and other obligations may be due. There is a high level of interdependence between the corporation and its primary stakeholder groups (Clarkson, 1995: 106). *Secondary* stakeholder groups are defined as those who influence or affect, or are influenced or affected by, the corporation, but they are not engaged in transactions with the corporation and are not essential for its survival. The media and a wide range of special interest groups are considered as secondary stakeholders under this definition. They have the capacity to mobilize public opinion in favour of, or in opposition to, a corporation's performance (Clarkson, 1995: 107).

Class of stakeholders can be identified by their possession or attributed possession of one, two, or all three of the following attributes: (1) the stakeholder's power to influence the firm; (2) the legitimacy of the stakeholder's relationship with the firm; and (3) the urgency of the stakeholder's claim on the firm. The manager's perception of a stakeholder's attribute is critical to the manager's view of stakeholder salience (Mitchell *et al.*, 1997: 854, 871).

Some of the problems with stakeholder theory lie in the difficulty of considering "mute" stakeholders (the natural environment) and "absent" stakeholders (such as future generations or potential victims) (Capron, 2003: 15). The difficulty of considering the natural environment as a stakeholder is real because the majority of the definitions of stakeholders usually treat them as groups or individuals, thereby excluding the natural environment as a matter of definition because it is not a human group or community as are, for example, employees or consumers (Buchholz, 2004: 130). Phillips and Reichart (2000) argue that only humans can be considered as organizational stakeholders and criticize attempts to give the natural environment stakeholder status.

One way of seeing the environment as a stakeholder is through the interests of future generations (Jacobs, 1997). However, it is impossible to ask the opinion of the natural environment or of future generations, and they cannot be members of a consultative committee. Thus, the problem is that only humans are capable of generating the necessary obligations for establishing stakeholder status and of the necessary volition in the acceptance of benefits of a mutually beneficial cooperative scheme (Phillips and Reichart, 2000: 191). However, if among the interests of legitimate stakeholders is a concern for the natural environment, it has to be taken into account. Moreover, the interests of the environment and future generations should contemplated by "being represented in decision-making structures, whether of companies or of society as a whole" (Jacobs, 1997: 26).

The incentive of firms to voluntarily disclose information has been of interest to both analytical and empirical researchers in accounting. Analytical research has examined issues such as how competition affects disclosure (Verrecchia, 1983; Darrough and Stoughton, 1990), and the use of disclosure as a signal of firm value (e.g., Hughes, 1986). Empirical research on voluntary disclosure has a much longer history, with a stream of studies documenting the impact of firm characteristics such as size, listing, leverage and managerial ownership on disclosure. Skinner (1994) finds that large negative earnings surprises are more often pre-empted by voluntary corporate disclosures. More recent research suggests that disclosure affects the cost of equity capital (Botosan, 1997) and cost of debt capital (Sengupta, 1998; Eng and Mak, 2003: 326).

The quality of financial reporting and other financial outcomes are affected by characteristics of corporate governance and auditors. Researchers have attempted to understand their relationships using various perspectives. In the accounting and finance academic literature, particularly in the USA, an agency theory perspective is commonly used to explain the concept of corporate governance. Control of ownership and various attributes of boards of directors and board committees are thought to be important factors in aligning management's objectives with those of the owners. The role of independent (outside) directors has been increasingly emphasized for proper corporate monitoring. This has been particularly true for audit committees, and more recently for compensation and nomination committees. Completely independent audit committees are now required for most publicly held companies. Independent auditors are also part of the monitoring process for financial reports. Various measures of auditor independence, including non-audit fees and auditor quality (usually size) have been employed to understand the corporate governance and monitoring environment (Kalbers, 2009: 193).

Full voluntary disclosure, however, rarely seems to occur in reality, and firms typically do not disclose more than regulation requires. One possible reason for the lack of full disclosure is that disclosure is costly to firms. First, there may be a direct cost associated with producing and disseminating information. In particular, information may need to be disclosed or certified by third parties such as External Auditors. Second, since disclosure reveals information to competitors or others who interact strategically with the firm, it may cause the firm to lose competitive advantage or bargaining power in various contexts. However, as pointed out in Fishman and Hagerty (1998), even if disclosure is costly, it does not imply that disclosure regulation is desirable. It is quite possible that firms' disclosure policies are socially optimal given the cost of disclosure (Admati and Pffeiderer, 2000: 480).

Prior work suggests that voluntary disclosure is greater when the quality of information held by managers is relatively high and/or when information asymmetry is relatively great.

Verrecchia (1990: 376) examines managers' decisions to voluntarily disclose proprietary information and concludes "the intuition that higher-quality information is accompanied by more disclosure appears to be a robust economic notion (at least a first-order effect), and thus might be useful in assisting future empirical investigations".

Jung and Kwon (1988) show that the disclosure region (the set of signals which are voluntarily disclosed) increases as outsiders' beliefs become relatively more diffuse, suggesting that increases in informational asymmetry are accompanied by greater voluntary disclosure.

A commitment to increased levels of disclosure reduces the possibility of information asymmetries arising either between the firm and its shareholders or among potential buyers and sellers of firm shares. This, in turn, should reduce the discount at which firm shares are sold, and hence lower the costs of issuing capital (Leuz and Verrecchia, 2000: 92).

Owing to limits to investor attention, information that is presented in salient, easily processed form is assumed to be absorbed more easily than information

that is less salient, or that is only implicit in the public information set (Hirshleifer and Twoh, 2003: 339).

Regulated financial information provides valuable information to investors. However, because this research does not compare the relative informativeness of regulated and unregulated financial information, it does not necessarily imply that regulation is superior to a free market approach to disclosure.

The finding that the value of regulated accounting data varies systematically based on firm characteristics, time dependent variables, and country-specific institutions is also subject to alternative interpretations.

Do the differences reflect the influence of systematic economic factors that make regulation more or less effective? Or, is the variation driven by correlated omitted variables such as firm and country growth, or risk?

Another branch of accounting research examines the value relevance of information presented under proposed new financial reporting standards. This research uses the association between earnings and stock prices or returns as a measure of value relevance (Healy and Palepu, 2001: 413).

Shareholders and other stakeholders require companies to disclose information concerning their prospects for future performance and the sustainability of current value-creation drivers. This requires effective communication about the risks affecting a firm's strategies and the actions planned to take to capitalize on emerging opportunities as well as to minimize the risk of failures (Beretta and Bozzolan, 2004: 265; 267).

Scholars expect greater disclosure-related benefits will accrue to family firms. However, if earnings quality is better for non-family firms and non-family firms are more likely to make management forecasts of bad news, we expect greater disclosure-related benefits will accrue to non-family firms.

Finally, family firms with founder CEO, rather than family firms with descendent CEO, are primarily responsible for family firms exhibiting better disclosure practices and disclosure-related consequences as compared to non-family firms (Ali *et al*., 2000).

Other studies have examined the relationship between ownership structure and disclosure or management forecasts of earnings. Ruland *et al*. (1990) hypothesize that firms that release earnings forecasts have a higher proportion of outside ownership than other firms.

Their hypothesis arises from Jensen and Meckling's (1976) theory that as the manager's share ownership falls, outside shareholders will increase monitoring of manager's behaviour.

As the manager's share ownership falls, the manager will have increased incentives to consume perks and reduced incentives to maximize job performance. To reduce monitoring costs by outside shareholders, the manager will provide voluntary disclosure (Eng and Mak, 2003: 329).

3 – Widely held firms versus closely held firms

Until a few years ago governance studies focused on the consequences of ownership dispersion in terms of agency costs between shareholders and managers, *i.e.* on managerial opportunism (Berle and Means 1932; Marris, 1964). The dispersion of shareholdings among a large number of investors creates two governance problems (Hart, 1995).

First, it determines the separation between ownership and control, *i.e.* it transfers the firm's control from shareholders-entrepreneurs to salaried managers.

Second, it weakens the shareholders' incentive to control management's behavior, because who performs this activity covers all costs and shares the benefits with other shareholders.

In agency theory terms, shareholders are principals and managers are agents. In any agency relationship there is a potential loss, which is the extent to which returns to the residual claimants fall below what they would be if the principals (*i.e.* the shareholders) exercised direct control of the corporation (Jensen and Meckling, 1976). In this system, the main governance problem is to align or control managers' decisions so that they act in shareholders' interests.

To this purpose, it is necessary to introduce some mechanisms (such as an independent and active board of directors, an efficient and vigorous market for corporate control, the use of stock option plans, and so on) to solve or to reduce the risk of managerial opportunism (Shleifer and Vishny, 1997).

Recent studies cast doubt on the assumption that widely dispersed ownership is common in publicly traded companies. La Porta *et al*. (1999) investigated the ownership structures of large corporations in twenty-seven developed economies, making an effort to identify the ultimate controlling shareholders of these firms.

Their results show that United States style corporate ownership is quite exceptional around the world. Outside the UK and the US, the main shareholders of large companies preserve sufficiently high ownership concentration to solve the managerial agency problem. Subsequent studies expanded the number of firms and countries examined, supporting and extending the findings of La Porta *et al.* (1999).

In brief, Barca and Becht (2001), Claessens *et al.* (2000), and Faccio and Lang (2002) show that, outside the US and the UK, the public companies are not widespread and the large companies are under the influence of a controlling shareholder, usually a family.

However, in this situation the market for corporate control does not function efficiently (Shleifer &

Vishny, 1997) and there appear the conditions for the rise of a different agency problem, *i.e.* the tension between the interests of controlling and minority shareholders: the main governance problem becomes to reduce the incentives and the opportunities of controlling shareholders to expropriate minority shareholders (La Porta *et al.*, 1998, 1999).

3.1. – *Corporate governance in Italy*

The Italian corporate governance regime exhibits low legal protection for investors and poor legal enforcement (La Porta *et al.*, 1998), underdeveloped equity markets (La Porta *et al.*, 1997), a dominant shareholder, usually a family. Previous studies showed that family owners of the largest Italian companies use a number of legal mechanisms – like pyramidal groups, syndicate agreements, and shares with limited voting rights – to separate ownership from control (Aganin and Volpin, 2003; Bianchi *et al.*, 2001; Faccio and Lang, 2002; La Porta *et al.*, 1999). Arguably because of these institutional characteristics, private benefits of control are high (Zingales, 1994), and minority shareholders are often expropriated (Bragantini, 1999).

Existing regulation does not allow banks and other financial institutions to own large shareholdings in industrial companies. Moreover, financial institutions do not usually exert a significant influence on the governance of large companies due to existing corporate practices (e.g. multiple loans with different banks). Institutional investors do not play a relevant role because of their limited shareholdings, their strict connections with the Italian banks and a regulatory environment that does not favour their activism. Finally, the stock market plays a limited role and the market for corporate control is almost absent. In sum, the Italian governance system can be described as a system of 'weak managers, strong blockholders and unprotected minority shareholders' (Melis, 2000, p. 354).

A recent study (ISTAT, 2008) shows that unlisted SMEs represent over 99% of total companies in Italy, and 93% of the workforce is employed in them (Table 1).

Table 1 – Small and medium size entities in Italy

Source: Istat (Italian Institute of Statistics), Rapporto annuale (Annual Report), 2008, p. 70.

	1-9 employees	10-49 employees	50-249 employees	≥ 250 employees	Total
Primary industry	0,11	0,03	0,01	0	0,15
Traditional manufacturing	5,21	0,74	0,08	0,01	6,04
Specialized supply	1,09	0,29	0,05	0,01	1,44
R&S	0,61	0,06	0,01	0	0,68
Economies of scale	2,54	0,63	0,08	0,01	3,26
Housing	13,02	0,72	0,03	0	13,77
Commerce	26,94	0,8	0,06	0,01	27,81
Hotels and restaurants	5,74	0,36	0,02	0	6,12
Transports and communications	3,13	0,25	0,04	0,01	3,43
Firms services	25,63	0,48	0,07	0,01	26,2
Family services	10,79	0,25	0,05	0,01	11,1
Total	94,81	4,61	0,5	0,08	100

Individual proprietorship and partnerships also prevail among Italian SMEs (Table 2).

	Joint-stock company					Individual proprietorship and partnerships				
	1-9 employees	10-49 employees	50-249 employees	≥ 250 employees	Total	1-3 employees	4-9 employees	10-19 employees	20 employees	Total
Primary industry	0,04	0,12	0,12	0,51	0,79	0	0,02	0,01	0	0,03
Traditional manufacturing	0,56	2,2	1,79	1,33	5,88	0,85	1,76	0,79	0,29	3,69
Specialized supply	0,28	1,16	1,27	1,03	3,74	0,16	0,29	0,18	0,06	0,69
R&S	0,08	0,25	0,35	0,87	1,55	0,13	0,11	0,03	0,01	0,28
Economies of scale	0,55	2,18	1,85	2,27	6,85	0,35	0,89	0,52	0,17	1,93
Housing	1,25	1,91	0,66	0,3	4,12	2,37	2,68	0,7	0,17	5,92
Commerce	2,08	2,51	1,32	2,11	8,02	5,76	3,81	0,59	0,12	10,28
Hotels and restaurants	0,48	0,8	0,35	0,67	2,3	0,95	2,28	0,56	0,18	3,97
Transports and communications	0,35	0,84	0,89	3,23	5,31	0,58	0,47	0,16	0,07	1,28
Firms services	1,73	1,55	1,47	3,4	8,15	1,64	1,12	0,18	0,12	3,06
Family services	0,45	0,92	1,14	1,16	3,67	0,99	0,8	0,1	0,03	1,92
Total	7,85	14,44	11,21	16,88	50,38	13,78	14,23	3,82	1,22	33,05

Table 2 – Type of companies in Italian firms

Source: Istat (National Institute of Statistics), Rapporto annuale (Annual Report), 2008, p. 73.

Finally, Italian SMEs are not Ias adopters. On 25 February 2005, the Italian Council of Ministers approved a Legislative Decree regarding the options provided by Article 5 of Regulation 1606/2002 of the European Parliament (the EU Accounting Regulation) to permit or require the adoption of the International Financial Reporting Standards (which includes IASs and Interpretations) in respect of annual accounts and of non-publicly-traded companies (Table 3).

Listed companies, issuers of financial instruments widely distributed among the public, banks, stock broking companies, fund management companies, regulated financial institutions
• Consolidated financial statements: IFRSs compulsory from 2005 • Separate financial statements: IFRSs optional from 2005. IFRSs compulsory from 2006.
Insurance companies
• Consolidated financial statements: IFRSs compulsory from 2005 • Separate financial statements: IFRSs not permitted in 2005. IFRSs compulsory from 2006 only for listed companies that do not prepare consolidated financial statements
Subsidiary and associated companies of the above companies, and other companies that prepare consolidated financial statements
• Consolidated financial statements: IFRSs optional from 2005 • Separate financial statements: IFRSs optional from 2005
Companies other than the above
• Individual financial statements: IFRSs optional from a year to be determined by the Ministry for the Economy and Justice
Small Companies preparing financial statements in abbreviated form
Individual financial statements: IFRSs not permitted

Table 3 – Ias adopters in Italy

Type of company and corporate governance mechanisms. Under Italian Law two main types of company may be incorporated: S.p.A. (*Società per Azioni*) and S.r.l. (*Società a responsabilità limitata*).

Società per azioni is the normal form for larger companies (joint stock companies). This society may be listed on the Stock Exchange although the absolute majority are not.

Società a responsabilità limitata corresponds to a closely held limited company. It is the kind of structure which is more suited to small-to-medium sized enterprises where limited liability is required. This is by far the most common type of company used by Italian entrepreneurs and that most frequently chosen by foreign parent companies when setting up their subsidiaries in Italy.

In 2003, a great reform of the Italian Civil Code was applied in order to change the corporate governance systems of Italian firms, with particular reference to auditing mechanisms. Besides, in Italian legislation three different governance models are allowed, *i.e.* the so called "traditional model", the "dualistic model" and the "monistic model" (Table 4).

Most of the SMEs did not modify their governance system, so they maintain the "traditional model", even if it was emended by the above mentioned reform which assigned to an External Auditor or to an Auditing Company all the Financial Reporting auditing activities. In the companies which do not issue shares in the capital market and are not obliged to prepare a consolidated financial statement, all Financial Reporting Auditing activities are delegated to the Statutory Committee (Cortesi *et al*., 2009: 78).

Corporation	No.	%
Traditional model	24.399	98,12%
Monistic model	324	1,30%
Dualistic model	143	0,58%
Total	24.866	100,00%
Limited liability company	No	%
Sole director	266.902	71,00%
Board of directors	109.000	29,00%
Total	375.902	100,00%

Table 4 – Main types of company in Italy

Source: Il sole 24 ore

In the prevailing model (the "traditional" one), the governance structure of corporations is two-tired: the managing board (*consiglio di amministrazione*) has the function of ratifying decisions that have been previously taken by the controlling group, and is supplemented by a board of auditors (*collegio sindacale*) who are responsible for internal monitoring.

Statutory auditors and audit firms should be independent when carrying out statutory audits. They may inform the audited entity of matters arising from the audit, but should abstain from the internal decision processes of the audited entity. If they find themselves in a situation where the significance of the threats to their independence, even after application of safeguards to mitigate those threats, is too high, they should resign or abstain from the audit engagement. The conclusion that there is a relationship which compromises the auditor's independence may be different as regards the relationship between the auditor and the audited entity from that in respect of the relationship between the network and the audited entity.

Family firms. For the purpose of this study, family firms are defined as companies in which one or more families linked by kinship, close affinity, or solid alliances hold a sufficiently large share of capital to enable them to make decisions regarding strategic management (Corbetta, 1995). This is a broad definition (Astrachan and Shanker, 2003) that has been used

previously in other studies (Corbetta and Minichilli, 2005; Gubitta and Gianecchini, 2002). Owners/founders perceive their firm as a "value" which must be transmitted to their heirs. From their perspective, appointing professional managers to run the firm implies the substantial failure of an entrepreneurial system based on the strength of family ties. Firms controlled by the entrepreneurs who started them often close down - rather than becoming corporations - when their founders are about to retire and no viable conditions exist for the persistence of family control after their retirement. In other words, when their heirs are unable to continue the family business, or when there are no heirs, they prefer to close the firm down rather than hand over control to outsiders (Santarelli and Lotti, 2005: 184; 190).

Outside board members, instead, can bring fresh perspectives and new directions (Jain, 1980); monitor the progress of the family business and act as arbitrators; help in the succession process by providing support for the newly elected leader; analyse perceived strengths and weaknesses more objectively; help reduce the loneliness of the owner-manager; and act as catalysts for change, sounding boards for the owner-manager, and low-cost consultants (Mueller, 1988; Heidrich, 1988).

Unlike managerial companies, the success of family firms depends on the ability to manage three networks: the familial network, which encompasses all the members of this institution (whether or not they are involved in the management or in the equity); the organizational network, which includes all the people who take part in the business (at the top, middle, and low levels, familiar or not); and the environmental network, which involves the external stakeholders, such as customers, suppliers, banks, and other institutions (Bauer, 1993).

In many cases, the family council is adopted in order to comprise the actual members of the family, including in some cases in-laws, young adults, and family members not directly involved in the business. The family council's task is to develop a new generation of family members, regulate their involvement in the business, and align the business with the family's plans (Jaffe, 2005: 50).

Prior studies show that the majority of both private and listed companies in Italy can be classified as family firms (Corbetta and Minichilli, 2005; Montemerlo, 2000). Apart from the availability of a large population for the sample selection, Italian family firms are characterized by a number of features that make them particularly suitable for the purpose of our study. First, earlier research (Bianchi and Enriques, 1999; Brunello *et al.*, 2003; Corbetta and Minichilli, 2005; Montemerlo, 2000; Volpin, 2002) has shown that in Italian family businesses, a large part of the controlling family's wealth is invested in the company. In particular, in 57% of the cases analyzed by Montemerlo (2000), more than 75% of the family's assets were actually invested in the business, compared to less than 30% for family firms in the United States. As a consequence, the controlling family is very much involved in the activities of the company. Second, the top management and the board of directors are dominated by family members or people very close to the controlling family; also, in the majority of cases, the current largest shareholder is the founder or a relative of the founder of the company. This suggests that in Italy the controlling families tend to keep control for the long term.

Finally, the ownership of the company is strongly concentrated, and the controlling family is reluctant to allow institutional or other outside investors to reach significant ownership positions. In particular, Brunello *et al.* (2003) show that in Italian companies the largest shareholder owns on average more than 50% of the share capital, while the second largest shareholder owns on average from 8% to 10% of the shares. Financial institutions hold a small fraction of the equity of Italian listed companies, with no active role; more often they are involved in family firms as lenders rather than shareholders.

3.2 – *Business law*

In a European context, the effects of differences in reporting practices may have been mediated, to some extent, by various EU Directives and the gradual adoption of international financial reporting standards. At the same time, national disclosure requirements have been increasing significantly as various regulatory, statutory and governance initiatives have sought to ensure greater transparency and accountability in response to financial scandals (Bozzolan *et al*., 2006: 95).

With reference to Italian small and medium sized entities, in the enabling decree (Legislative Decree 127 of 9 April 1991), articles 1-20 amended the Civil Code with respect to the provisions of the Fourth Directive whilst articles 21-46 set out a new law concerning groups of companies, no reference being made to the Civil Code in the latter case (Riccaboni and Di Pietra, 1996: 14).

Annual accounts of small and medium firms are regulated by the Civil Code which derives its rules from the Fourth Council Directive of 25 July 1978 based on article 54 (3) (g) of the Treaty (78/660/EEC) emended by various following Directives.

In the Directive 2003/51/EC of the European Parliament and of the Council of 18 June 2003, from which article 2428 of the civil code is derived, stated that the annual report shall include at least a fair review of the development and performance of the company's business and of its position, together with a description of the principal risks and uncertainties that it faces. The review shall be a balanced and com-

prehensive analysis of the development and performance of the company's business and of its position, consistent with the size and complexity of the business. To the extent necessary for an understanding of the company's development, performance or position, the analysis shall include both financial and, where appropriate, non-financial key performance indicators relevant to the particular business, including information relating to environmental and employee matters.

In this context, the Internet has become a critical transmission mechanism, and the corporate website now offers a fast, flexible, almost costless, and incredibly accessible method for disseminating data. Contemporary technological developments such as XBRL (eXtensible Business Reporting Language) have significantly enhanced the Internet's potential as a mechanism for transmitting information. XBRL is a worldwide standard for the publishing, exchange, and analysis of financial reports and data. The information can also be reliably extracted and analysed across companies with no manual intervention; in fact XBRL provides a widely embraced open standard technology for data exchange and transformation, is likely to bring major changes to the way companies provide both compulsory and voluntary information to both investors and regulators, and will likely impact the way shareholders use accounting information. Information issued in the XBRL format enables investors and analysts to use and analyse precisely categorized information instantly, without the need to convert the data into another format. XBRL also offers significant benefits to both the suppliers and consumers of financial and nonfinancial information such as decreased costs of publication, reduced preparation time, simplified information access, wider information availability, and enhanced analytical capabilities (Schuster, 2006: 5; Fradeani, 2006).

3.3 – *Anti-frauds laws*

Stolowy and Breton (2004: 6) use an all-inclusive term – "accounts manipulation" – which they define as "the use of management's discretion to make accounting choices or to design transactions so as to affect the possibilities of wealth transfer between the company and society (political costs), funds providers (cost of capital) or managers (compensation plans)" They partition "accounts manipulation" into "'creative accounting", "earnings management", and "fraud" (Kalbers, 2009: 191).

Financial regulation is directed at the control of fraud and at the regulation of standards in the market and in the business and financial service. The regulatory approach is normally associated with the form of law and enforcement which developed in Italy at the end of the 19th century. A regulatory approach is associated with a minimal use of criminal sanctions, although it is important to recognize that this emerged pout of a long history of negotiation between business groups, regulators and government. To regulatory approaches the main of law is to secure and maintain high standards of business and commerce, and enforcement should ensure an appropriate balance between the interests of industry and public protection. Finally, regulatory enforcement is normally taken to involve cooperative compliance strategies including persuasion, advice and education (Croall, 2003: 45-46).

Legislative Decree No 61 of 11 April 2002 regulating criminal and administrative offences in respect of commercial companies, in accordance with Article 11 of Law No 366 of 3 October 2001 ('Legislative Decree No 61/2002'), which came into force on 16 April 2002, replaced Title XI of Book V of the Italian Civil Code by a new Title XI, entitled 'Criminal provisions in respect of companies or groups of companies'.

That legislative decree was introduced in the context of the reform of Italian company law carried out by a series of legislative decrees adopted on the basis of the authorisation provided for by Law No 366 of 3 October 2001.

In particular, Legislative Decree No 61/2002 introduced into Articles 2621 and 2622 of the Italian Civil Code new criminal provisions penalising the submission of false information on a company, an offence also referred to as 'false accounting'.

The crime set forth by art. 2621 of the Italian Civil Code is committed when - with the purpose of deceiving the shareholders or the public and of obtaining for the offender or for others an unlawful profit - statements, reports or other company notices and announcements, set forth by the law, addressed to shareholders or the public, contain material facts not corresponding to the truth, even if still under evaluation, or they fail to include information that is mandatory according to the law regarding the economic, assets and liabilities, or financial situation of the company or of the group to which it belongs, in a way that leads recipients to erroneous deductions on the above-mentioned situation. Liability is excluded if the false statements or the omissions do not alter in a significant way the representation of the economic, assets and liabilities, or financial situation of the company or of the group to which it belongs. Liability is however excluded if the false statements or omissions determine a change in the accounting's economic result, gross of withholdings, not exceeding 5 per cent or a change of the net assets and liabilities not exceeding 1 per cent. In any case, there is no liability if the conduct arises from estimates that - if individually considered - differ in an amount not exceeding 10 per cent compared to the correct one.

The crime set forth art. 2622 of the Italian Civil Code is committed when, with the purpose of deceiv-

ing shareholders or the public and of obtaining for the offender or for others an unlawful profit, the financial statements, reports or other company notices and announcements provided by the law, addressed to shareholders or the public, contain material facts not corresponding to the truth, even if still under evaluation, or the omission of information that is mandatory according to the law regarding the economic, assets and liabilities, or financial situation of the company or of the group to which it belongs, in a way that leads addressees to erroneous deductions on the above-mentioned situation, causing a patrimonial damage to the company, to shareholders or to creditors.

The two crimes set forth articles 2621 and 2622 of the Italian Civil Code, indicate a conduct that almost entirely coincides and differs only in the event of the occurrence, (art. 2622 Italian Civil Code) or non-occurrence (art. 2621 Italian Civil Code) of a fact causing a patrimonial damage to the company, to its shareholders or to its creditors. Both the above-mentioned crimes are committed: (i) stating in financial statements, reports or other company announcements and notices as provided by the law, aimed at shareholders or the public, material facts that do not correspond to the truth (ii) through the omission, in the same documents, of information, that are mandatory by law, regarding the economic, assets and liabilities, or financial situation of the company or of the group to which it belongs; the above-mentioned conduct (commission or omission) must be carried out with the intention of deceiving the shareholders of the public and must lead the recipients of the abovementioned company notices and announcements to erroneous deductions since they are intended only to obtaining an unlawful profit for the offender or of third parties (Alessandri, 2002; Comoli, 2002; Cavazzoni, 2004).

Some scholars write over and above the obligation of individuals and companies to comply with the law, a corporate culture of compliance is probably the single most important bulwark against the emergence of criminal practices among company agents. A corporate compliance function essentially addresses the legal and reputational risk that a company faces from the behaviour of its agents and organs (Nestor, 2004: 348).

The leading reasons cited in international literature for the expected increase in fraud are: a) economic pressures, b) inadequate punishment of convicted managers, c) weakening of society's values, d) insufficient emphasis on prevention and detection, and e) more sophisticated criminals. Poor internal controls, management override of internal controls, and collusion between employees and third parties are also seen as factors contributing to fraud. One important issue is the determination of the causes and the provision of an explanation for the situation (Belkaoui and Picur, 2000: 33).

In Italy, all the five reasons might operate so these changes toward a more lenient criminal law for accounting fraud were based on the assertion that financial standards had been too onerous for non-listed companies. Instead of a "one-size-its-all provision", a multi-tiered approach was claimed to be more appropriate (Savioli, 1997; Zigiotti, 2000; Cavalieri, 2003).

Beasley (1996) shows that the incidence of financial statement frauds is negatively related to the proportion of outside directors of the board. The presence of an audit committee does not significantly affect the likelihood of financial statement fraud (Cox and Weirich, 2002: 375). Bonner *et al.* (1998) demonstrates the relationship between the type of fraud and litigation. They concluded that there existed some support for the hypothesized higher incidence of auditor litigation when a company's financial statements contain a fraud that is commonly occurring or that involves fictitious transactions and events (Cox and Weirich, 2002: 375).

Overall, the results suggest that size is a strong factor in predicting company laws compliance. Larger firms are more likely to be in compliance with company law than smaller firms. This result is robust to a variety of specifications (Webb, 2008: 21).

3.4 – *Tax laws*

The law of 7 April 2003 n. 80 (G.U. n. 91 of the 18 April 2003) previews a deep rearrangement of the fiscal system, with the reduction of the several taxes existing today to five main taxes, collected in a single code: income tax, companies' income tax, value-added tax, services tax, inland duty. The reforms aimed to the gradual elimination of the regional tax on productive activities (IRAP).

The tax of companies' income (IRES) is based on the application of a single rate of 27,5%, will also foresee the possibility for companies to ask for a national and international fiscal consolidation system, fiscal neutrality for capital gains from the sale of participation interests (participation exemption) the extension of the CFC rules (foreign controlled companies) to the connected companies. The income corporation tax is paid by companies that have corporate status, therefore stock corporations, limited companies, mutual companies, private and public organisations that both have and do not have business as their main activity (including associations, consortiums). It is also paid by companies and organisations, with or without corporate status, that do not reside but have permanent establishment in Italy (Leo, 2007; Tinelli, 2007; Fantozzi, 2010).

The corporate tax base is obtained first by applying the relevant positive and negative adjustments to the business profit (loss) and then subtracting some

expenses relating mainly to charities and gifts of the company towards specific institutions or for specific aims.

Corporate income relevant for fiscal purposes is obtained from total business profits (losses) resulting from the company balance sheet adjusted according to specific fiscal rules. Specifically, components of the business profits have to be modified in order to take account of specific fiscal criteria, which may affect positively or negatively the corresponding accounting variables. These fiscal adjustments reflect the difference existing between the conventional accounting rules and business accounting for tax purposes.

Since both financial reporting and taxation have the need for economic results in common, it seems reasonable to connect the two systems in a way that allows reference from one system to the other. In Italy, taxation depends on financial reporting: so all entries in the books are relevant for taxation. The fact that taxation depends on financial reporting can lead to the reverse effect, namely the influence of tax rules on financial accounting. First, the taxpayer, knowing that entries in the books are relevant for taxation, might tend to understate his profits and exaggerate his expenses, in order to minimize taxation. Second, in order to minimize the workload of the reconciliation for tax purposes, the company let tax law prevail over the objective of the financial reporting. Third, in some cases tax law requires that in order to benefit from these tax benefits, tax reporting techniques have to be used in the financial statements (Eberhartinger, 1999: 94-95).

In a general sense, the firm's taxation decisions are deliberate and the implications for strategy are intended outcomes. Firms incur a high level of expenditure attempting to obtain the best tax position, often both employing in-house expertise and using the services of external, expert tax consultants. It is to be expected therefore that tax decisions will be a carefully thought-through part of the strategy process (Galister and Hughes, 2008: 37).

3.5 – *Internal and external audit*

Internal auditing is a sub-field of auditing that has been continuously evolving (Birkett *et al.*, 1999a, 1999b) requiring synthesis of research findings (Allegrini *et al.*, 2006) and constant updating of the professional body of knowledge (Abdolmohammadi *et al.*, 2006).

Audit committees and an effective internal control system help to minimise financial, operational and compliance risks, and enhance the quality of financial reporting.

Auditing standards explicitly require auditors to provide reasonable assurance that material financial statement fraud is detected (Beasley, 1996: 444).

The main purpose of establishing audit committees is to assist the directors to function efficiently. In this respect the aims are threefold: first, to increase confidence in the credibility and objectivity of the company's published financial information; secondly, to assist directors in meeting their financial responsibilities; and thirdly, to strengthen their independent position (Hemraj, 2003: 153).

Internal auditing is an independent professional service which is not regulated by Italian laws and which is adopted in only a few Italian small and medium firms (Marchi, 2008).

The Internal Audit efforts implemented after the Legislative Decree 231/2001 which regards the administrative liability of corporations. Under this law the company is liable for crimes committed in its interest or to its benefit by individuals who represent, administer or manage the Company (Miglietta *et al.*, 2007: 50).

The Company is exempt from liability for the crimes committed by the aforementioned individuals, if it proves it has adopted and effectively implemented appropriate organizational and management models to avoid the crimes.

Furthermore it has to have charged an Internal Board (*i.e.* Supervisory Body) with monitoring the functioning of and compliance with the models adopted.

The exemption from administrative liability for crimes is, for enterprises, an opportunity to reduce the risk of legal action, lawsuits or juridical proceedings (legal risk).

In Italy, a separate board of auditors has traditionally performed the internal audit functions. Neither the board of directors nor the board of auditors have ever been able to exercise effective control over managers (and hence over the dominant shareholders who appoint them). More generally, Italian corporate law has historically provided poor protection for investors, while enforcement institutions, like courts or the Italian securities and exchange commission (Consob), have been unable to make up for the deficiencies of the law (Enriques and Volpin, 2007: 128).

The external auditing, in Italy, can be carried out by an independent professional auditor under three different forms which only partially overlap:

a) *società di revisione* (audit company) (legislative decree n.58/1998)

b) *revisore esterno* (legislative decree n.88/1992)

c) collegio sindacale.

Nowadays the legislative decree n. 39/2010 unified the three forms under the common professional status of *revisore legale dei conti* (official auditor) as described in the European Directive 2006/43/UE and regulated rigorously the way of executing the auditing functions imposing the adoption of International

Standards of Auditing (in the clarified version) drafted by the IFAC.

The small and medium entities usually have a *collegio sindacale* which prepares an annual report included in the financial statements. From 2007, with legislative decree n. 32, then with local audit standards (Principio di revisione PR001 and Principio di revisione PR002) and finally with article 14 of the legislative decree 39/2010, all regulating the structure and content of the audit report on annual report there is a legally prescribed format that can ensure stakeholders about the degree of reliance that can put the credibility of financial statements and other documents.

3.6 – *Accounting professionals role in the firm*

The Italian accounting profession belongs to the broader field of liberal arts - unique at international level. The regulation of the Italian accountancy profession has been completely reformed by the legislative decree nr. 139 enacted on 28 June 2005.

On January 1st 2008 the *Ordine* of *Dottori Commercialisti* and the *Collegio* of *Ragionieri* - professions established in the first half of last century and linked by common competences and purposes - merged in the *Albo Unico* of *Dottori Commercialisti* and *Esperti Contabili*. Two section will be created in the new roll: section A will be staffed by the "dottori commercialisti" (chartered accountants), and the section B by the "esperti contabili" (accounting experts).

Accounting professionals are the key advisers of enterprises. They oversee their entire course of life from birth - preparing business plans and associated economic, financial and tax evaluations - to development - offering financial, bookkeeping and legal advice, trouble-shooting and auditing operations - to the eventual termination of activity - where assessments of the legal and economic propriety of operations are necessary. Accountants also participate in extraordinary corporate operations by providing advice on contracts, transactions and arbitration proceedings, or by offering operating advice in the case of corporate restructuring or subjection to administration by a commissioner.

4 – Financial reporting and voluntary disclosure of Italian SME according to a unified point of view

«The theory of the accounting system is part of the theory of the firm. It is not my belief that the secret to the determination of the institutional structure of production will alone be found in the accounting system, but it certainly contains part of the secret» (Coase, 1990: 12). In effect, the idea of a relationship between accounting, as a form of economic calculation, and economics, a form of abstract knowledge about the nature of the economic, is now a longstanding and increasingly accepted one (Hopwood, 1992: 128).

In some continental European traditions the relationship between accounting and theories of the firm is institutionally framed within a wider discipline which studies the economics of institutions as a whole. In these conceptual contexts accounting is seen as a part of the firm's economy, and as being intertwined with other aspects and activities of the firm (organization, operations, management, and so on). This is the case, for instance, of the Italian School of *Economia Aziendale*, the German tradition of *Betriebswirtschaftslehre*, the Dutch *Bedrijfseconomie*, the Swedish *Företagsekonomi*, the Finnish *Liiketaloustiede*, all of which can hardly be reduced to mere accounting theories (Zambon and Zan, 2000: 800).

The traditional cohesiveness and unity of these bodies of knowledge seems to have declined towards a disciplinary fragmentation in the studies dealing with the activity of the firm: in some of these environments the term business economics increasingly appears as an institutional 'label' with mainly an educational and socially-relevant connotation, in the name of which university courses and structures, academic careers and curricula, research and practice-oriented journals are set up, oriented and managed (e.g. the Netherlands, Germany, largely Italy) (Zambon, 1996: 406).

Anyway, according to Viganò (1998: 384-385), the most significant features of *economia aziendale* can be described as follows:

(a) The concept of *azienda* identifies an economic entity which exists as a practical reality rather than as an abstraction. The *azienda* is not a mass of independent and detached components; rather, it is a natural entity (albeit deriving from human creation). Economic events occurring within this real entity exist, interact and become significant as they are linked to one another in a unitary and coordinated whole, addressed towards a predetermined aim or aims.

(b) It represents a fully autonomous and independent discipline, even in its relationships with adjacent disciplines, such as law, economics and mathematics. Moreover, it is a pragmatic science.

(c) Notwithstanding its fundamental unity, it acknowledges distinct segments (or sections) with a significant partial autonomy of their own, such as *ragioneria* (accounting), *gestione* (operations) and *organizzazione* (organization).'

Dagnino and Quattrone (2006: 41-42) stressed that in Zappa's income theory, the *azienda* as a whole becomes the center of the process of income determination. In this understanding, there is no distinction in sub-costs/revenues or profit centers. Yet, the transactions which originate the annual income are separated

according to their nature. This allows the reader of the financial report to understand whether these values are the result of a market transaction, being thus measured by the "objective" market, or of the accountant's evaluation, thus being the result of a subjective choice.

In the end, the proportion of market determined values *versus* subjective ones will inform the user of the financial report on the quality of the earnings.

A feature which is the accounting manifestation of the subjectivity which affects not only accounting as a discipline but the organization as an economic institution intertwined with other rationalities and other needs. This way of conceiving financial reporting would easily disclose the relative reliability of the end of the year accounts and could be used to interpret the recent accounting and banking scandals.

Finally, some tendencies of contemporary *economia aziendale* are oriented towards the comprehension and the explanation of voluntary and mandatory disclosure, of earnings management, of financial reporting not as distinct and autonomous issues, each of them with its theories, hypotheses and body of literature, but in a general and unitary perspective, isomorphic to the complexity of the firm.

In fact, the inclusion of accounting in business economics let Italian scholars to investigate all the relationships among the independent and dependent variables according to a systematic way of thinking, *i.e.* the *forma mentis* that every Italian scholar is engaged to develop along his path of studies and carrier (Ferraris Franceschi, 1998: 356; Mella, 1997;2008; SIDREA, 2008). But in order to carry out the research in a consistent and falsifiable way, many methods and approaches are on disposal of the Italian *ragioneria* scholars.

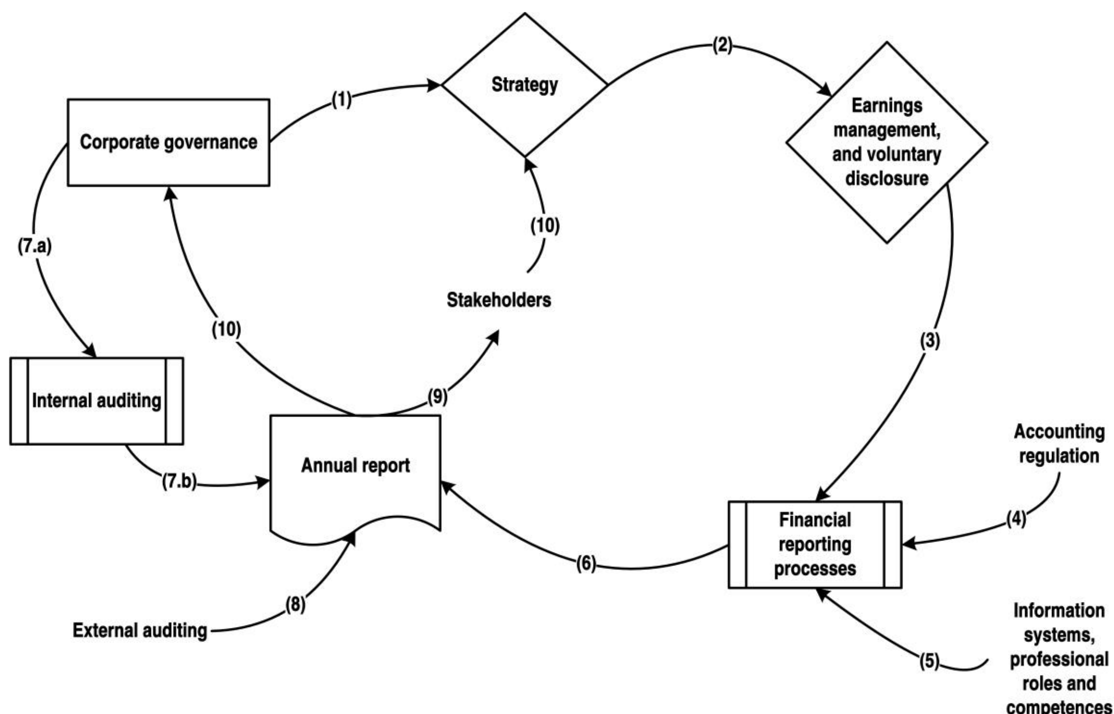
One of these approaches, particularly useful for the unitary perspective it maintains on the firm structure and activity as a whole, is surely the systemic models (Coda, 1983; Mollona, 2000; Barnabé, 2005; Bianchi, 2009).

System dynamics is an aspect of systems theory as a method for understanding the dynamic behaviour of complex systems. The basis of the method is the recognition that the structure of any system — the many circular, interlocking, sometimes time-delayed relationships among its components — is often just as important in determining its behaviour as the individual components themselves.

System dynamics is an approach to understanding the behaviour of complex systems over time. It deals with internal feedback loops and time delays that affect the behaviour of the entire system. What makes using system dynamics different from other approaches to studying complex systems is the use of feedback loops and stocks and flows.

These elements help describe how even seemingly simple systems display baffling nonlinearity. The elements of system dynamics diagrams are feedback, accumulation of flows into stocks and time delays. In the perspective of accounting included in business economics studies in a deep and convict way, system dynamics is especially applied in modelling strategic dynamics (Coda and Mollona, 2006) linking corporate governance, accounting regulation, stakeholders pressures and auditing in a combined and unitary scheme (Figure 1).

Figure 1 – The strategic dynamics model proposed



The model may be explained as follows.

Relation (1) Strategy process usually involves both an intentional strategy process and an emergent process. However, while most firms have both types of processes at work, their respective importance will differ. It is possible to envisage a strategy process continuum. At one extreme are firms in which the strategy process is very deliberate and formalized and where managers are constrained from deviating from the intended strategy. At the other extreme are firms that have no formal strategic planning process, where senior managers devote little time to intentional strategy process. These firms rely on the independent or 'autonomous' action of managers that occurs outside any formal strategy. At this end of the continuum the line managers initiate the activities that, in aggregate, constitute firm strategy. Apart from these extreme cases, most companies follow a hybrid process and rely on a combination of intentional and emergent processes. They have both a formal, intentional process in which senior manager articulates strategy, and a process in which a middle manager or a line manager can undertake a project outside the intended strategy (Mintzberg and Waters, 1985).

The basic strategic management processes, for both family and non-family firms, is similar in the sense that a strategy, whether implicit or explicit, must be formulated, implemented, and controlled. The differences are in the set of goals, the manner in which the process is carried out, and the participants in the process. In family firms, the owner-family is likely to influence every step of the process, whereas in nonfamily firms, family influences are at best (or worst) indirect (Sharma, Chrisman and Chua, 1997: 2-3).

Board strategic involvement in small firms is somewhat conflicting. Some researches show that the board of small firms tends to be rather passive in its strategic involvement, and even claim that the strategic participation is not the dominant activity of the board in very small firms unless they are specific contextual conditions (Pugliese and Wenstop, 2007: 386).

A family business is more likely to have multiple, complex, and changing goals rather than a singular, simple, and constant goal. Found the following to be the six most important goals: to have a company where employees can be happy, productive and proud; to provide financial security and benefits for the owner; to develop new quality products; to serve as a vehicle for personal growth, social advancement, and autonomy; to promote good corporate citizenship; and to provide job security (Tagiuri and Davis, 1992). Because of the variety of goals in small family businesses, the various partial success measures will not provide uniformly appropriate success indicators for different small family businesses. Measuring success with different isolated partial success measures will thus indicate various levels of success for one and the same business and, as a consequence, also yield inaccurate comparative results across multiple companies in the same sample. These isolated partial success measures will also be influenced by company size, company age, industry and other variables that might not indicate success alone (Sharma, 2004).

Family firms are arenas characterized by financial and non-financial family goals. When financial goals prevail in a family, family members' motivation to operate in the family firm will be based on lower order needs and extrinsic factors, thus favouring the emergence of agency relationships. On the contrary, when nonfinancial goals prevail, this will foster motivation based on higher-order needs and intrinsic factors, thus favouring steward-principal relationships (Corbetta and Salvato, 2004: 357-358).

The nature of the founder's role in the family firm's development, understanding, and commitment to a vision, a set of goals, and a culture can be viewed in terms of the centrality of her/his position in the firm's top management group network. Four types of family business culture have been identified: paternalistic, laissez-fare, participative, and professional (Dyer, 1988). To have an effective firm strategy, founders must have a clear understanding of the organizational culture they have inspired and of its fit with the family firm's culture (Kelly, Athanassiou and Crittenden, 2000: 29).

Relation (2) Prior studies find that the quality of corporate disclosure is associated with certain firm characteristics. These studies measure corporate disclosure by developing a disclosure index or score to measure voluntary disclosure in financial statements.

Generally speaking, board composition (measured by the proportion of outside directors) is expected to be positively associated with voluntary disclosure. The role of the board of directors is to monitor management decisions. Having a higher proportion of outside non-executive directors on the board would result in better monitoring of the activities by the board and limit managerial opportunism (Fama, 1980; Fama and Jensen, 1983). Outside directors who are less aligned to management may be more inclined to encourage firms to disclose more information to outside investors. Then, it is expected that having more outside directors on the board will also result in more voluntary disclosure. Voluntary disclosure is measured by the amount and detail of non-mandatory information that is contained in the management discussion and analysis in the annual report (Eng and Mak, 2003: 327).

Relation (3) The financial reporting process, therefore, finds nourishment in the accounting policies, in relation to those, will be directed between the limitations imposed by the accounting regulation and

will insert the content of voluntary disclosure who have been chosen.

Relation (4) Management decisions may cause financial reporting to range from "high quality" at one end of the spectrum to fraud at the other end. Some management behaviour in financial reporting may be considered unethical, but not necessarily fraudulent (illegal). Because financial reporting is not an exact science, the competence and integrity of management are both relevant in preparing high quality financial reports (Kalbers, 2009: 195). The use of generally accepted accounting principles serves the need of a better quality of the information given by the financial statements and a consequent more effective accountability of the controlling agents (Pizzo, 2000).

The institution of more and more detailed accounting principles and procedures limits the controlling agent's discretion in the drawing up of the financial statements (Melis, 1995).

This may have a positive influence on the corporate governance system, since by controlling and manipulating the quality of corporate information disclosed in the financial statements, the dominant stakeholder (*i.e.* the one that effectively controls the corporation) would be able to influence the uncertainty attached to the estimates that shareholders (and, in general, all the strategic stakeholders) make of any given variable (Forker, 1992). By doing so, the dominant stakeholder would make monitoring procedures less effective, thus he/she would become less accountable to the other strategic stakeholders.

Relation (5) An important role is played by the resources and skills that are available to that process, even in terms of specific skills in communication (Coda, 1991,b: 57-58) also consider the role of "*Dottore commercialista ed esperto contabile*" (Accounting professional). He brings accounting culture in the firm. In Italian SME he chooses, most often, accounting software and set the plan of accounts and suggests the most appropriate earnings management and tax planning or directly exercise discretion in the preparation of financial statements and decides accounting policies.

Relation (6) The result of the administrative process that is downstream of the guidelines of corporate strategy and the accounting policies and financial reporting processes is made by the annual report.

Relation (7) The need to optimize company risk assessment as a critical factor in achieving their own strategic aims, the international and national financial scandals, often a result of the weak internal control systems of the companies involved and the general inadequacy in the running of the same, as well as the frequent problems of internal revision, organization on behalf of the administrators and management responsibility, are all factors to be considered positive and stimulating because aimed at improving the administration of SME companies, in respect of the accounting rules and the interests of all the stakeholders.

Relation (8) The external audit is intended to enhance the credibility of the financial statements of a firm. Auditors are supposed to verify and certify the quality of financial statements issued by management. However, over the last several decades, a substantial and increasing portion of an accounting firm's total revenues have been derived from consulting services of various kinds. Provision of this non audit service can potentially hurt the quality of an audit by impairing auditor independence because of the economic link between the auditor and the client (Agrawal and Chadha, 2005: 376).

Relation (9) To what extent do other factors, such as the legal protection of investors' rights or other corporate control mechanisms, the auditing regime, or the relative importance of securities markets versus bank financing, influence the economic effects of financial accounting information? We expect the interactions between the quality of financial accounting regimes and effectiveness of corporate control mechanisms to provide evidence on the governance effects of financial accounting information per se. We expect the interactions between financial accounting regimes and other domestic institutions to provide evidence of the determinants of the total economic value of financial accounting information from better governance as well as other channels. The fourth theme is how the economic effects vary with specific features of the accounting regimes (Bushman and Smith, 2001: 292-293)

The active role of the reporting activity, resulting from the concrete way the stakeholder oriented report is constructed, has two orders of consequences: (1) to guide company activities through a particular representation of the results (perceived as objective), on the basis of which the company reacts by adjusting its objectives, actions, and activities; and (2) to concretize the stakeholder oriented concepts, namely CSR, sustainability, environmental respect and corporate governance: directly – through the narrative parts of the report, such as conceptual definitions and discursive descriptions of the stakeholder oriented activities performed; and or indirectly – through the structure and content of the data reported, that contribute to visualize and diffuse a company-specific picture of the concept (Zambon and Del Bello, 2005: 135).

Relation (10) The presence of a dominant stakeholder (top management, blockholder, large creditor, etc.) may influence negatively the quality of corporate communication, by making the financial reporting system pursuing his/her own interests, rather than pursuing the overriding "true and fair view" objective.

If unaccountable, the dominant stakeholder has an incentive to have an opportunistic behaviour. He/she is likely to select accounting procedures to maximise his/her own utility (Gordon, 1964), manipulating the information in the financial statements to pursue that goal.

In fact, the presence of a dominant stakeholder was found to be associated with poor disclosure (Forker, 1992) and an overall inadequate quality of corporate communication (Fiori, 1999).

From a normative perspective, the presence of a dominant stakeholder should not have a significant influence on the quality of corporate communication, since the information flow should not be manipulated by the stakeholder who controls the corporation (Dezzani, 1981).

Wartick and Cochran (1985), following Carroll (1979), used the terms reactive, defensive, accommodative, and proactive, to characterize corporate strategy or posture toward social responsiveness. This approach was converted into the RDAP Scale (Clarkson, 1995: 108).

Fairness and balance in the distribution to its primary stakeholder groups of the increased wealth and value created by the firm are necessary to preserve the continuing participation of each primary group in the firm's stakeholder system and to avoid favouring one group unduly and at the expense of other groups.

If any primary group perceives, over time, that it is not being treated fairly or adequately, whether it is the employee, customer, or shareholder group, it will seek alternatives and may ultimately withdraw from that firm's stakeholder system. If that withdrawal occurs, the firm's survival will be threatened (Clarkson, 1995: 112).

Research has revealed significant variations in perceptions of family firm stakeholders regarding even the most fundamental issues (Poza, Alfred and Maheshwari, 1997).

Particular importance has to be paid to understand the extent of alignment in the definition of success used by the key players of family firms. The tenets of stakeholder theory may prove useful in gaining such an understanding.

An alignment of stakeholders' perspective on what "success" means to them could be an important predictor of success of family firms, as such an alignment can lead to agreement on appropriate mode and extent of involvement of key family and non-family members in the firm.

On the contrary, a mismatch in the definitions of success or goals that different stakeholders strive to achieve for the family firm could point toward a tenacious source of conflict (Astrachan and McMillan, 2003).

5 – Limitations of the paper and future research directions

The authors would acknowledge a number of limitations of this study. First of all, the study is based on a theoretical basis. Future research aimed at examining, by surveys and case studies, relationships between the variables of the model needs, in order to explain and predict corporate financial disclosures in Italian small and medium firms, are planned.

Hence, we propose a preliminary explanation of the influence of some involvement variables on voluntary disclosure and financial reporting quality. In particular, this article makes a contribution by integrating different theoretical perspectives on boards and their related roles, with concepts capturing from mainstream Italian *economia aziendale* literature approaches referring to corporate governance, information systems, internal auditing, accounting regulation, earnings management, and stakeholder theory.

The resulting model has some contingency qualities, although limited to considering some strategy, accounting policies, voluntary disclosure, financial reporting processes, accounting regulation, professional roles, external and internal auditing, and so on.

Our model may also be subject to relatively straightforward empirical testing. Empirical approaches can be used to measure the comparative effects of these various dimensions in order to determine those that are most influential in fraudulent financial reporting. From a methodological point of view, identifying the population of firms involved in fraudulent financial reporting is problematic. First and foremost, fraud samples are limited to only frauds judged in trials. Frauds never discovered are not available for study. Frauds that are caught by the auditor and/or firm and subsequently corrected within the company are generally not revealed publicly and therefore, are similarly, not available for study (Kaminski *et al.*, 2004: 21).

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