The Determinants and Characteristics of Voluntary Disclosure by Ethiopian Banks

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Abstract

The paper investigates the extent of relationship between the determinants and characteristics of voluntary disclosure made by the Ethiopian Banks. Ethiopia, a country located in the horn of Africa, has a financial sector which immature and closed to foreign ownership and operation which make the country unique compared with other countries in the sub-Saharan region. In this study a sample of nine banks selected from those financial corporate entities operating in Ethiopia. The period of study is from 2007-08 to 2011-12. For this study we have used size, debt, board size, board composition and profitability as determinants of corporate disclosure. To examine the extent of relationship between these determinants and corporate voluntary disclosure, we have used multiple regression model. The findings indicate that there is a positive relationship between bank size and board size and voluntary disclosure, which is statistically significant. The relationship between debt, board composition and profitability with voluntary disclosure is found to be negative.

Keywords: Banks, Ethiopia, Voluntary Disclosure

1. Introduction

In this study, based on the annual reports of the Ethiopian banks, the extent and level of voluntary disclosure is assessed. The financial regulation makes the country different from other neighbouring countries as the sector is not open to foreign ownership.

Annual reports are the most widely used tools to disseminate information. Using annual reports for voluntary disclosure has advantages from the information provider view point as well as the information needy perspective. The information preparer, usually board of directors and management, uses annual reports to disclose more information beyond what is required (Hossian and Hammami, 2009). The information needy, on the other side and that refers the general public, is in search of such voluntary disclosures to make more informed decisions as there is inadequacy in the contents of compulsory information (Alsaeed, 2005).

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Information disclosure is a socially desirable element, however, it brings costs and benefits. Due to the interaction between costs and benefits, sometimes it may lead to partial or no disclosure (Frolov, 2004 and Diamond, 1985 cited in Hossian and Hammami, 2009). Indeed, the economic and accounting literature has asserted that, in the view of informational asymmetry, (costless) disclosure of private information brings general gains in economic efficiency. However, the size of the gains and the ultimate effect on the financial prices may vary considerably depending on the 'informativeness' of disclosed information and on the ways the information is disseminated and used (Hossain and Reaz, 2007)

Ethiopia does not have stock markets. Hence, the financial reporting and disclosure of the banks is regulated by the 1960 Commercial Code. On top of this, proclamations issued by the government for doing business in the banking sector and various directives issued by the regulatory body, National Bank of Ethiopia (NBE). In the contemporary Ethiopia the concern of having good corporate governance in the financial sector is becoming the interest of many stakeholders. In this regard, the present study is designed to investigate the extent of voluntary disclosure in the Ethiopian banks.

The remaining parts of the paper present literature review and hypotheses development, importance of the study, statement of the problem, objectives of the study, research methodology, discussions and conclusions, limitations of the study, and scope for further research.

2. Main Body of the Study

2.1. Review of Literature and Development of Hypothesis

Previous studies examine the extent agency problem brought in the information asymmetry between managers and shareholders. Hence, there is a strong demand for corporate disclosure and financial reporting (Healy and Palepu, 2001). By disclosing more information the agency cost of a firm is also expected to be reduced. In this regard, various studies have examined different determinants of corporate voluntary disclosure practices. Most of the studies focus on finding association between firm characteristic variables such as, ownership characteristics, firm size, profitability, leverage, liquidity, and age of firm and voluntary disclosure. For instance, Haniffa and Cooke, (2002), Ho and Wong (2001) and Chen and Jaggi, (2000), in Barako et al, (2006), Hossain and Reaz (2007), Akhtaruddin et al (2009), and Hossain (2008) in Nandi and Ghosh, (2013) and Hasan et al (2013).

Therefore, because corporate disclosure is the most important means by which companies can become transparent (Healy & Palepu, 2001), this study makes an investigation on the determinants and characteristics of disclosure by the Ethiopian Banks. Some of the literatures reviewed in this regard are summarized below. Based on results of earlier empirical research, the nature of banking business and data availability, we developed the following hypotheses.

Size: Much evidences of prior studies support the prevalence of positive relationship between firm size and the extent of disclosure (Singhvi and Desai, 1971, Botosan, 1997, Ahmed and Nicholls,

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1994, Kahl and Belkaoui, 1981, Hossain and Reaz, 2007, Alsaeed, 2005). Justifications are provided in this regard. One of which is large firms are exposed to public attention than small firms and hence they are expected to disclose more information. The second one is large companies possess sufficient resources for collecting, analysing, and presenting large data at lesser cost. The third, agency costs are higher for large companies as shareholders are widely spread. Accordingly, the following hypothesis is formed.

Hypothesis 1: Large banks are more likely to disclose more voluntary information than small firms.

Debt : Highly leveraged companies are supposed to disclose more information that less levered companies. Fama and Miller, 1972, suggest a positive relationship between leveraged and voluntary disclosure. Also, a large number of empirical studies report in their findings leverage positively affects the extent of disclosure (Jaggi and Low, 2000, Ahmed and Nicolls, 1994, Kahl and Belkaoui, 1981, Wallace et al., 1994). Leverage is measured by debt to equity ratio. As a result, the following hypothesis is formulated.

Hypothesis 2: Highly leveraged banks are more likely to disclose more information than less leveraged banks

Board size : Board size is an important corporate governance attribute, which refers the total number of members exists in the body of board of directors. Increased board size enhances the monitoring and control capacity of the board of directors. Hence, it influences the level of corporate disclosure, which is one of the strategic decisions board of directors should act up on. While Akhtaruddin et al (2009) and Nandi and Ghosh (2012) in the findings of their studies indicate that there is a positive association between board size and voluntary disclosures, Hasan et al (2013) in their study they report, the relationship between board size and financial disclosure is negative. Hence, the hypothesis formulated in this regard is:

Hypothesis 3 : Banks with higher board size disclose more information than banks with small board size.

Board Composition : Is used to refer the board members who are not part of the executive management group. Hence, they are called non-executive directors/NED/ or outsiders. It is generally understood the higher proportion of the NED in the board, it enhances the corporate disclosure. This is because, when the proportion of NED to the total board members is getting higher the monitoring and controlling ability of the board over management is enhanced (Fama and Jensen, 1983). Akhtaruddin et al (2009) and Hossain and Reaz (2007) explain there is a positive association between the proportion of NED on the board and corporate voluntary disclosure. Accordingly, the following is hypothesized.

Hypothesis 4 : A higher proportion of non-executive directors is positively related with voluntary disclosure

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Profitability : Signalling theory, in finance, explains that those profitable firms disclose more information in the annual reports to differentiate them from poor performers. Most researchers have found positive relationship between profitability and the extent of disclosure (Haniffa & Cook, 2002, Hossain 2008). Return on Equity is employed as a measure of profitability.

Hypothesis 5 : Banks with higher return on equity disclose more information than banks with lower return on equity.

2.2. Research Methodology

The research design of this study can be considered correlational as it attempts to examine the relationship between the corporate governance attributes and the voluntary corporate disclosure.

Ethiopia's formal incorporated FIs include government and privately owned banks, insurance companies, and micro-finance institutions. Currently, there are 17 [three government owned and fourteen private] banks operating in Ethiopia. Out of seventeen, nine banks are considered in this study. These are, Awash International Bank S. Co. /AIB/, Bank Of Abyssinia S. Co. /BOA/, Commercial Bank of Ethiopia /CBE/, Construction and Business Bank /CBB/, Cooperative Bank of Oromia /CBO/, Dashen Bank /DB/, Development Bank of Ethiopia /DBE/, NIB International Bank (NIB) and United bank /UB/.

The data for this study was collected from secondary sources, mainly of the annual reports of the selected FIs. In order to increase the validity and reliability of the results, hard copies of the annual reports were analyzed from periods of 2007/08 to 2011/12. Gray et al (1995) in Hossain and Reaz (2007) explain the annual reports of companies, as the only report produced regularly, is made primarily to build external images of the companies. Moreover, primary data were also used to capture pertinent data on board composition FIs via standard questionnaires distributed to board secretaries of the selected FIs.

2.3. Voluntary Disclosure Index Construction

Because annual reports are the most convenient way to disseminate information to stakeholders, they are the principal focus for voluntary index construction. The voluntary index is prepared based on the work of Hossain and Reaz (2007). They used a total of 65 items which are categorized into nine groups. In this study we have selected 64 items of them but maintaining the number of categories the same. These nine categories are: the background about the bank (6 items), corporate strategy (2 items), corporate governance (11 items), financial performance (12 items), risk management (12 items), accounting policy review (2 items), key non-financial statistics (8 items), corporate social disclosure (4 items), and others (7 items). The items are selected based their repeated use in previously done several research studies.

With regard to the methods of indexing, there are two different but equally important methods. He first one is unweighted index. Here we use dichotomous score, '1' for disclosed item otherwise

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'0'.The second method is called weighting index. This method is based on subjective importance. In this study we used the unweighted method. So to calculate the disclosure index for each institution the following formula is used.

$$VDI = \sum_{j=1} \frac{dj}{n}$$

Where: VDI the aggregate voluntary disclosure Index

dj 1 If j^{th} item disclosed, 0 other wise

n the maximum score each company can obtain. In this case, the key factor is whether or not a company discloses an item of information in the annual report.

Because our sample includes government owned and privately owned banks, which may have not equally applicable disclosure requiring items, we use a relative index method. The relative index approach is the ratio of what a particular company actually disclosed to what the company is expected to disclose. Owusu-Ansah (1998) cited in Akhtartuddin (2005) suggests the use of a relative index method. This approach has been employed in several prior studies e.g. Wallace et al., (1994) (also Cooke, 1989; Inchausti, 1997; Owusu-Ansah, 1998; Wallace & Naser, 1995; were cited in Akhtartuddin, M. (2005).

2.4. Variables, Predicted Values and Proxies

Table 1 presented here summarizes the Independent variables and control variables with their description and respective predicted signs and proxies

Table 1 : Variables and their descriptions

Variables	Description	Predicted signs	Proxies
Size	Total assets of the bank	+	Natural Logarithm of total assets
Debt	Total debt divided by total assets	+	D-E Ratio
Board Size	Total Number of board members of a bank	+	None
Board Composition	Ratio of the number of NED to total number of directors on the board	+	None
Profitability	Net profit to total shareholders' funds	+	ROE Ratio

2.5. Model Development

In this study, we used multiple regression model to test the association between the corporate governance attributes and the corporate voluntary disclosure is presented below:

$$VDI_{it} = \alpha + \beta_1 FSZ_{it} + \beta_2 DBT_{it} + \beta_3 BSZ_{it} + \beta_4 BC_{it} + \beta_5 PRF_{it} + \varepsilon_{it}$$

Where:

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- α = The Constant,
- β = The slope of the regression equation, and
- VDI_{it} = Voluntary disclosure index of the ith company in the year t,
- FSZ_{it}= Firm size of the i^{th} company in the year t,
- DBT_{it}= Debt or leverage of the ith company in the year t,
- BSZ_{it} = Board size of the i^{th} company in the year t,
- BC_{it}= Ratio of non-executive directors to total members in the board of the i^{th} company in the year t,
- PRF_{it} = Return on equity of the i^{th} company in the year t,
- ε_{it} = The error term

2.6. Descriptive Statistics

Panel A, B, and C of table 3 report the descriptive statistics of the voluntary disclosure index or score which is the dependent variable. Accordingly, as the data is presented in table 2, on average the banks publish in their annual reports 36% of the voluntary items of information. 0.41 (41%) and 0.30 (30%) are the maximum and the minimum scores of the voluntary disclosure, respectively, with a standard deviation of 0.04 (4%).

Table 2 : Descriptive Statistics

Variable	Mean	Std. Dev.	Min.	Max.
Voluntary Disclosure	0.36	0.04	0.30	0.41
Firm Size	21.60	1.29	18.67	23.94
Debt	6.51	3.49	0.14	16.21
Board Size	8.64	2.35	4.00	12.00
Board Composition	0.91	0.12	0.67	1.00
Profitability	0.18	0.09	-0.14	0.32

The natural logarithm of total assets, which is the measure of the size of the banks ranged from 18.67 to 23.94 having a mean of 21.60. This implies the size of total assets is skewed. The result is similar to the findings of Hossain and Hammami (2009). Also, banks debt, measured by D-E ratio, is ranged from 0.14 to 16.21 with the mean value of 6.51. This implies the banks were highly leveraged during the study period. Board size ranged from 4 to 12 with a mean of 8.64 for all sample institutions. The floor and the ceiling board size for all corporate entities are limited by the Commercial Code 1960. Board composition, measured as the ratio of the number of NED to the total board members, ranged from 0.67 to 1.00 with a mean of 0.91. This is because all most in all the institutions the number of NED is getting increasing. Profitability of the bank, as measured by ROE, has ranged from -0.14 to 0.32 with a mean of 0.18. This implies there was a huge variability in profitability among the bank.

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2.7. Validity of the Model

Before discussing the results of the regression analysis, we checked the existence of multicollinearity, which is the condition where there is perfect or exact linear relationship among some or all the explanatory variables of the regression model (Gujarat, 2004). The first statistical tool is the correlation matrix (see table 3 below).

		VDI	FSZ	DBT	BSZ	BC	PRF
Sig. (1-tailed)	VDI	1.					
	FSZ	0.235	1.				
	DBT	-0.015	0.634	1.			
	BSZ	0.450	-0.031	-0.372	1.		
	BC	-0.438	0.069	-0.009	-0.004	1.	
	PRF	-0.089	0.136	0.345	-0.368	-0.317	1.

As portrayed in table the Pearson correlation matrix reveals that the highest simple correlation between independent variables is 0.491 between debt (leverage) and board composition. According to Gujarati (2004) and Hair et al (2011) cited in Nandi and Ghosh (2012), the simple correlation, between independent variables, not exceeding 0.90 is not considered harmful. Consequently, we can conclude that there is no multicollinearity in this data as there is no high correlation exists between the independent variables. The second statistical tool we used to check multicollinearity is the Durbin-Watson statistic. As a conservative rule, values less than one or greater than three should pose a problem (Field, 2000 in Alsaeed (2005). When the value of Durbin-Watson statistic is closer to 2 it is assumed as better. Hence, our Durbin-Watson statistic for this data is better as it closer to 2, i.e. 1.692 (see table 4 panel A below). The third statistical technique is the use of Variable Inflation Factor (VIF). According to Myers (1990) in Alsaeed (2005) even if there is no hard and fast rule, when the value of VIF goes above 10 it is a concern of multicollinearity. On the other hand, when the mean value of VIF is substantially greater than 1 then regression may be biased (Bowerman and O'Connel, (1990) cited in Hossain and Hammami, (2009)). On this basis, the average VIF of the variables in this study is 1.59 (see table 4 panel B below) which is substantially greater than one. For this reason, we confirm again, there is no multicollinearity in the model. Therefore, in general, the multicollinearity diagnostics made in our data indicated there is no colliniarity and the model is valid and reliable.

2.8. Multiple Regression Results

The multiple regression model which is significant ($\rho<0.005$) and presented in table 4 panel A shows that F-value is 7.379 ($\rho=0.000$). This result satisfactory supports the significance of the model. Coefficient of determination (R2) is 0.486. This implies that 48.6% of the variance in the voluntary disclosure index is explained by the independent variables. This result compares favourably with other studies of Hossain and Reaz (2007) at 37.6%, Ahmed (1996) at 32.2% and Hossain (unpublished M.Phil thesis) at 10% cited in Hossain and Reaz (2007).

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Table 4 : Panel A Regression Model Summary

R	R^2	Adjusted R^2	F-Value	Sig.	Durbin-Watson
0.697	0.486	0.420	7.379	0.000	1.692

Table 4 : Panel BRegression Results

$VDI_{it} = \alpha + \beta_1 FSZ_{it} + \beta_2 DBT_{it} + \beta_3 BSZ_{it} + \beta_4 BC_{it} + \beta_5 PRF_{it} + \varepsilon_{it}$				
Variable	?	t-value	Sig	VIF
Constant	0.159	0.758	0.453	
FSZ	0.021	2.035	0.049	1.839
DBT	-0.001	-0.147	0.884	2.202
BSZ	0.014	2.964	0.005	1.374
BC	-0.340	-4.076	0.000	1.150
PRF	-0.117	-0.996	0.325	1.399

3. Discussions and Conclusions

As estimated, bank size coefficient shows that this variable is significantly positively correlated to the disclosure level. Accordingly, it suggests that, banks with more assets base disclose more data than banks that have small assets. The result is in line with the results of the findings of Buzby (1995), Firth (1979), Cooke (1992) and Naser et al (2002). Hence, hypothesis 1 is supported by the evidences.

Debt ratio, though found negatively linked with the disclosure level, was insignificant. This implies, the banks in Ethiopia do not disclose their debt information in annual reports. The result is against hypothesis 2.

As expected the coefficient of board size is positive and board size is found statistically significantly related to the level of voluntary information disclosure. The empirical evidences are found to be consistent with those reported by Akhtaruddin et al (2009), and Nandi and Ghosh (2012). The multiple regression results of this study also support the argument that the larger boards provide more corporate information than the smaller firms. Hence, the empirical evidences support hypothesis 3.

Board composition has unexpected negative relationship with disclosure which is statistically significant. These results suggest that the banks with a higher proportion of non-executive directors disclose less corporate information. Similar outputs were also reported by Barako et al (2006) and Nandi and Ghosh (2012). Accordingly, hypothesis number 4 is found to be supported by these evidences.

The relationship between profitability and disclosure is unexpectedly negative but not statistically significant. This implies the profitable banks are tend to hide more information from the stakeholders. Hence, this result is in the contrary with the hypothesis 5.

Thus to conclude, the study found that of 0.36 as a voluntary disclosure mean index of the sample banks for the period 2007-08 to 2011-12. This result is the lowest compared with other results

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and it is most likely because lack of disciplines set out by the supervisor and the regulator of the banks or the absence of strong accounting professional association that could enforce the institutions to disclose voluntary information. With regard to the statistical relationship between corporate governance attributes and voluntary disclosure, the study discloses that the existence of NED reduces the volume of voluntary disclosure while companies with more assets tend to disclose more information.

4. Research Limitations and Direction for further Research

The following two are the most important limitations of the study. The first is because we have used five consecutive years from 2007/08, we only have got the chance to include relatively older banks excluding newly established FIs. The result would have been different if the newly established banks and insurance companies were included. The second, the voluntary disclosure index is computed based on 64 items. The result could have been changed if more items had been added or deleted.

The study is limited to only nine banks. Future studies could expand the size and study the entire sector. Also similar studies could be made in different sector might be interesting.

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6. Appendix

A	Background About Bank/general corporate information (06)	E	Risk Management (12)
1	Brief Narrative history of the bank	32	Information on Risk Management Committee
2	Basic organization structure/chart/description of corporate structure	33	Information on assets-liability management committee
3	General Description of business activities	34	Information on risk Management structure
4	Date of Establishment	35	Information on credit risk management structure
5	Official address/registered address/address for correspondence	36	Quantitative structure on gross loan positions
6	Web address of the bank/email address	37	Amount and details of problem loans and other assets or details by internal risk ratings

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B Corporate Strategy (2)
7 Management's objectives and strategies/corporate vision/motto/statement of corporate goals or objectives
8 Future strategy-information on future expansion (capital expenditure)/general development of business
C Corporate Governance (11)
9 Detail about chairperson (other than name/title)/ background of the chairperson/academic/ professional business experience
10 Details about directors (other than name/title)/background of the directors/academic/professional business experience
11 Number of shares held by directors
12 List of senior managers (not on the board of directors) /senior management structure
13 Background of senior managers
14 Details of CEO's contact address
15 Are the independent directors well defined
16 Nature of chairperson of the board of directors
17 Directors engagement/directorship of other companies
18 Picture of all directors/board of directors
19 Picture of chairperson only
D Financial Performance (12)
20 Brief discussion and analysis of a bank's financial position
21 Qualitative forecast of the earnings
22 Return on equity
23 Net interest margin
24 Cost-to income ratio
25 Earnings per share
26 Risk weighted assets
27 Debt-to-equity ratio
28 Total liquid assets to assets ratio
29 Total liquid assets to deposit ratio
30 Loan to deposit ratio
31 Dividend per share
38 Disclosure of credit rating system /process
39 Ageing schedule of past due loans and advances (NPA)
40 General description of market risk segment
41 Disclosure on value at risk (VAR) for interest rate exposure
42 Maturity of foreign currency assets and liabilities
F Accounting Policy Review (02)
43 Discussion on Accounting policy
44 Disclosure on accounting standards uses for its accounts
G Key Non-financial statistics (08)
45 Age of key employee
46 Details of branch location
47 Number of branch
48 Number of branch expansion during the current year
49 Information on branch computerizations
50 Information on ATM
51 Location of ATM and their address
52 List of top five shareholders of the bank
H Corporate Social Disclosure (04)
53 Sponsoring public health, sponsoring sporting or recreational projects
54 Information on donations to charitable organizations
55 Supporting national pride/government sponsored campaigns
56 Information on social banking activities/banking for the society
I Others (08)
57 Chairperson's/MD's report
58 On line banking facilities
59 Information on credit card business
60 Information on international banking facilities
61 Information on welfare of employees
62 Information on ISO 9001:2000 certification
63 Graphical presentation of performance indicators
64 Performance at a glance - 3 years

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