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DETERMINANTS OF DISCLOSURE IN THE COMMERCIAL BANKS OF PAKISTAN

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Abstract
This paper examines the determinants of disclosure in Pakistani commercial banks. Disclosure ensures transparency and safeguards the rights of stakeholders. The code of corporate governance for corporate sector in Pakistan was introduced in 2002 and was revised in 2012 along with State Bank of Pakistan (SBP) Prudential Regulations make it compulsory for commercial banks to disclose all the required information to various stakeholders. This study uses annual data for the period 2003 to 2015.Corporate disclosure index (CDI) has been used as dependent variable, whereas firm size, return on assets, auditor reputation, board composition, board size, listing age, block holders ownership, institutional ownership and risk taking have been used as independent variables. The results report over all, a satisfactory level of corporate disclosure for commercial banks in Pakistan. Risk taking and block holder ownership predicting negative relationship with corporate disclosure, while board composition, board size, return on assets, auditor reputation, institutional ownership, firm size and listing age predicting positive impact on the corporate disclosure practices of commercial banks in Pakistan. The results are expected to help policy makers to reshape their policies by encompassing the approaches that facilitate the risk management of banks in Pakistan. The study will also help researchers in strengthening their level of understanding of these relationships. Replication of the study may help to validate the hypothesized model and their consequent application in the organizations that share somewhat similar organizational structures.
Keywords: Corporate disclosure, Board Characteristics, Ownership Structure, Risk Taking, Performance

Introduction

Disclosure of information can be voluntary disclosure as well as mandatory disclosure. Mandatory disclosure usually focus on presenting

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financial statements and the required footnotes as made compulsory by laws and regulations, while voluntary disclosure provide freedom to the management to choose among which information to disclose (Uyar & Kilic, 2012a). Business organizations are well aware of the importance of disclosing and presenting information regarding the financial and non-financial performance of the firm in today's turbulent and competitive business environment (Akisik & Gal, 2011). Various financial crisis and corporate scandals compelled investors, regulators and academicians to demand greater transparency from the business organizations. Enhanced corporate transparency leads to minimize the information asymmetry between stakeholders and managers through information disclosure using annual reports, websites, company prospectus and press releases.

As result of public disclosure all the stakeholders including investors become aware of the financial and non-financial results including employees, environment, customers and social responsibility. Consequently, asymmetry of information between managers and stakeholders is reduced and management legitimizes their activities and therefore minimizing the agency costs. According to Singhvi and Desai (1971) inadequate disclosure of company information in financial statements leads to fluctuations in share prices. Also lower level of transparency in disclosure policies leads the firm to face difficulty in financing their operations and may incur higher cost of capital.

The present study examines the determinants of disclosure in the banking sector of Pakistan. Disclosure analysis in banks is a widely studied subject in the developing economies and is not extensively studied in the developing countries context, like Pakistan. The Codes of Corporate Governance were introduced for the first time in 2002 in Pakistan and the revised codes were established in 2012, to improve the governance structure, ensure transparency accountability and disclosure of business institutions in Pakistan. The Code of Corporate Governance as implemented by Securities and Exchange Commission of Pakistan (SECP) and State Bank of Pakistan (SBP) regulations are promulgated to improve the banking operations in Pakistan and thereby determine the disclosure level of information to stakeholders. The present study makes an investigation in the various determinants of disclosure in the emerging economy like Pakistan.

Literature Review

Firm size and Disclosure

The literature has widely used the relationship between firm size and disclosure. Cooke (1989) documents a positive significance relationship between firm size and corporate disclosure. He reported that firms with more disclosure practices can be found in larger firms. In a similar study, Ahmed and Nicholls (1994) evidenced insignificant relationship of firm size with disclosure. They argued that it is not essential that larger firms will more exposed to disclosure only. While in similar studies, most of the researchers evidenced a positive relationship between firm size and disclosure (Wallace et al, 1994; Craig and Diga, 1998). The literature evidenced many reasons of the relationship between firm size and voluntary disclosure. In this connection, Ashbaugh et al.(1999) argue that as large firms are more publicly visible therefore they have stronger incentive to increase their image and corporate reputation. However in the same line of studies, Firth (1979) documents that enhanced disclosure reduce government interventions. Hossain et al. (1994) assert that large firms are more expose to disclosure practices for the reason of creating more demand for their securities in the capital market. Based on the above mentioned relationship in the two variables, the following proposition has been developed.

H_1: Bank size is positively related with voluntary disclosure levels.

Firm performance and Disclosure

Numerous researchers have explored the relationship between profitability and disclosure. In most of empirical studies, the positive relationship exists between firm's profitability and disclosure. Like, Wallace and Naser (1995) assert that there is strong significant correlation between profitability and disclosure. They argued that firms with more disclosure will have more profitability due to the demand of the investors buying its securities, which in turn improve the corporate value of the firm. While in similar study, In chausti (1997) also documents the findings of the previous mentioned researcher, who argued that positive association exist in firm's profitability and corporate disclosure. Owusu-Ansah (1998) documents that voluntary disclosure can passively affect the financial performance of a firm. Lang and Lundholm (1993) argue that highly profitable firms disclose more information for the enhancement of firm value and capitalization.

Keeping in view the above arguments in the literature, the following proposition is developed.
H_2: Firm performance is positively related with disclosure level

Auditor reputation and Disclosure

The Company Ordinance in Pakistan ensures that external auditors are responsible for giving appropriate judgment regarding the sanctity of the contents of financial statements. External auditors bring their experience from other firms and constrain the executives and directors of the firm for making appropriate voluntary disclosures. Their focus is on the reporting of performance measures, disclosing financial position and variations in the financial position of the firm.

Firth (1979) argues that the reputation of the auditor can affect the disclosure quality. Firms audited by well reputed audit firms, are well exposed to disclosure as they conceive it important for the trust of the stock holders. Similarly Kent and Ung (2003) suggest that firms being audited by the top class audit firms, willing more generously to disclose their information in the form of risk disclosure, information disclosure, financial and non- financial disclosure. Inchausti (1997) documents a positive relationship between the firm audited by well reputed audit firm and its disclosure strategy. Keeping in view the above arguments, the following proposition is developed.
H_3: Auditor reputation positively affects the voluntary disclosure.

Board Composition and Disclosure

Board composition represents the proportion of non- executive directors to the total number of directors in a company's board. Fama (1983) suggest that non- executive directors act as reliable sources to minimize agency problems between ownership and management. He argues that more non-executive directors in board help firm in its voluntary disclosure. Similarly Franks et al. (2001) document that non- executive directors ensure board effectiveness by providing checks and balances in the company affairs and force firm to more disclosure practices. Chen and Jaggi (2000) also evidenced a positive relationship between more non-executive directors in board and disclosure quality. Haniffa and Cooke (2002) confirm the relationship between better corporate disclosure and presence of non- executive directors in the board. All these empirical evidences confirm that non- executive directors in the board are important mechanism to solve agency problems between ownership and management.

H_4: Higher proportion of non-executive directors leads to higher voluntary disclosure.

Board Size and Disclosure

Agency theory suggests that larger board size ensures board monitoring and also important for strategic decision making. There is also less likely hood for larger boards to be dominated by the management (Hussainey and Wang, 2010). Yermack (1996) state that large board enhances financial performance and the more expertise and diversity help the firm to be more expose to disclosure. Similarly, Barako et al. (2006) confirm the positive relationship between disclosure and board size. They document that firms with more board member can be vital in term of the disclosure strategy. Hussainey and Al-Najar (2011) also document the same findings of the above researchers, confirming a positive relationship between voluntary disclosure and board size. The below hypothesis has been developed based on the debate of the researchers in the relationship of board size and disclosure.

H_5: There is a positive relationship between voluntary disclosure and board size of a firm.

Listing Age

Listing age has not been widely explored in the context of emerging market like Pakistan. Various researchers have different view point in the effects of listing age on disclosure. Owusu-Anash (1998) gave reasons for the influence of company age on information disclosure. He stated that gathering, processing and dissemination of information by younger firms are more costly due to which they suffer competitive advantage. Several studies have used listing age as variable in developed countries and a gap exist in the context of emerging market. Like the study of Hossain and Hammami (2009) confirm a positive relationship between firm's age and disclosure levels. Graham et al(2005) also confirmed that the extent of voluntary disclosure can be predicted on how long the firm is in the operations.

H_6: There is a positive relationship between company age and voluntary disclosure level.

Block Holder Ownership and Disclosure

Most of the studies have documented a negative relationship between voluntary disclosure and block holders ownership (McKinnon and Dalimunthe, 1993). Fan and Wong (2002) described numerous reasons for those firms having concentrated type of ownership and low level of disclosure practices. Like in such a situation the controlling shareholders have access to all kind of information and exhibit low behavior towards and are less driven to disclosure practices. All control and decision making lies with those who hold the majority of shares and have big hand in the decision making of the firm.

H_7: There is a negative relationship between voluntary disclosure and block holder ownership.

Institutional Shareholders and Disclosure

On the part of the institutional shareholders has been a determinant of disclosure, a gap exist in the emerging market, due to the fact that very rarely, it has been touched by the researchers in similar studies. Institutional investors provide major funds to the financial markets, due to the reason, as they provide large amount of fund, have more experience and have huge amount of capital. They have large professional experience and have large proportion of capital. They always require transparent disclosure requirement to protect shareholders rights and wealth. Healy et al. (1999) confirm a positive relationship between disclosure and institutional shareholders. Similarly in same kind of study, Bushee and Noe (2000) provided reasons of institutional investor priorities for higher disclosure requirements. First, high disclosure attracts institutional investors, due to the fact that disclosure reduces the price impact. Secondly, corporate disclosures can be predicted as low cost means, regarding the monitoring of managers. Hence, based on the above discussion, the following proposition is developed to be tested in emerging market of Pakistan.

H_8: There is a positive relationship between institutional ownership and voluntary disclosure.

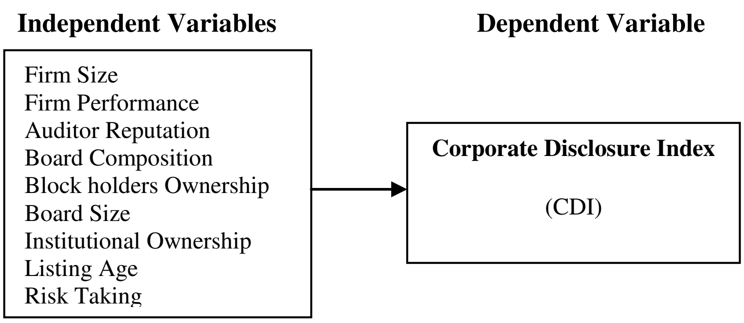
Risk taking

Fischer (1999) viewed that disclosure of information can be vital in reducing the probability of bank risk and failure. As the recent meltdown in banking sector was merely due to least disclosure and bank transparency. Banks with higher disclosure levels tend to have lower risk

(Baumann and Nier, 2004). Nier (2005) also confirms that banks with more disclosure practices and having transparency exercise lower stock volatility and expose to lower financial risk. He argued that High level of disclosure in the bank leads to better market discipline and lower risk taking. Based on the above mentioned view points and findings of the researchers, the following hypothesis is developed, to be tested in the context of Pakistan.

H_9: There is appositive relationship between risk taking and voluntary disclosure.

Theoretical Frame Work



Research Methodology

Population, Sample Selection and Data Sources

The population of this study includes all commercial banks listed on Pakistan stock exchange. The data has been collected through random sampling technique. Data for this research study was based on ten commercial banks for the period 2003 to 2015. These sample banks acquire 82% market share of customer deposits. The data for the study has been collected from annual reports, obtained from the bank's website and the library of the State Bank of Pakistan.

Operational definition of variables

Dependent Variable

Corporate disclosure index (CDI) has been used as dependent variable. A disclosure index was developed in light of the Cadbury Report, King II, CAGG Guidelines, OECD Principles and International Standard of Accounting and Reporting (ISAR's). A corporate disclosure index was calculated for each bank including financial communications, related part transactions, disclosure on key financial indicators and board characteristics. CDI is calculated as:

$$CDI = \frac{\text{Total Score of the Individual Bank.}}{\text{Maximum Possible Score Obtainable by the Bank}} \times 100$$

Independent Variables

Definition and measurement of independent variables are given in Table 1.

Table 1: Independent variables definition

Variable	Definition	Measurement
FS	Firm Size	Natural log of total assets of firm. The same variable was similarly measured by Craig and Diga, (1998).
ROA	Firm Performance	Return on Assets. ROA has been calculated as net income/ total assets. It has been similarly measured by Naser (1995).
AUR	Auditor reputation	1 if auditor is from big four audit firms, 0 otherwise.It has been similarly measured by Kent and Ung (2003).
BC	Board composition	Total number of outside directors divided by number of total directors. It has been measured similarly by Cooke (2002).
BS	Board size	Total number of directors in a board. The same variable has been similarly measured by Hussainey and Al-Najar (2011)
AGE	Listing age	Number of years since listed on Pakistan Stock Exchange (PSX).It has been measured as per the measurement of Hossain and Hammami (2009)
BKH	Blockholders ownership	Proportion of common shares held by shareholders with equity of 5 percent or above.Here in this research we follow the measurement pattern used by Fan and Wong (2002).
INT	Institutional ownership	Percentage of ownership held by institutional shareholders. We follow the measurement criteria used byBushee and Noe (2000).
SDROA	Risk taking	Standard deviation of return on assets. In this research we follow the measurement method developed Nier (2005).

Regression Model

The following regression model is estimated to test the association between dependent variable and independent variables.

CDI = β_0 + β_1 FS+β_2 ROA+ β_3 AUR+β_4 BC + β_5 BS+β_6 AGE+ β_7 BKH+β_8 INT+β_9 SDROA + e

Data Analysis

Correlation Analysis

Table 2: Correlation Analysis

	CDI	AGE	BC	AUR	BKH	BS	INT	FS	ROA	SDROA
CDI	1.000	-0.106	-0.098	0.049	0.022	-0.089	-0.014	-0.132	-0.081	-0.025
AGE	0.106	1.000	0.454	0.376	0.377	0.101	-0.045	0.424	0.223	0.139
BC	0.098	0.454	1.000	0.139	0.306	0.036	-0.045	0.140	0.275	0.027
AUR	0.049	0.376	0.139	1.000	0.173	-0.077	0.172	-0.044	0.156	0.029
BKH	-0.022	0.377	0.306	0.173	1.000	-0.079	-0.253	0.162	0.098	0.030
BS	0.089	0.101	0.036	-0.077	-0.079	1.000	-0.231	0.547	0.081	0.286
INT	0.014	-0.045	-0.045	0.172	-0.253	-0.231	1.000	-0.328	-0.279	0.171
FS	0.132	0.424	0.140	-0.044	0.162	0.547	-0.328	1.000	0.419	0.236
ROA	0.081	0.223	0.275	0.156	0.098	0.081	-0.279	0.419	1.000	0.029
SDROA	-0.025	0.139	0.027	0.029	0.030	0.286	0.171	0.236	0.029	1.000

Table 2 shows the correlation between corporate disclosure index (CDI) as dependent variable and firm size, return on assets, auditor reputation, board composition, board size, listing age, block holders ownership, institutional ownership, risk taking as independent variables. The correlation coefficients predict a negative relationship for disclosure index with block holders ownership and risk taking where as a positive correlation is shown with age, board composition, board size, institutional ownership, firm size, return on assets and auditor reputation . The reported correlation co-efficient indicate that there is no problem of muilticolinarity, as there is no correlation coefficient covering the level of strong correlation i.e. .80 or above as suggested by Gujarati (2003).

Breusch-Pagan Test

Table 3: Breusch-Pagan test		
Kind of Test	Critical	Reported
Breusch-Pagan Test	0.05	0.102

Table 4 shows results of Breuch-Pagan test for knowing the problem of heteroscedasticity in the data. The results document that there is no problem of hetroscadasticity, reason being the reported value is insignificant at 5% probability level.

Hausman Test

The Hausman test has been applied to choose between fixed effect model and random effect models. The null hypothesis for Hausman test was that random effect model was preferred to fixed effect model. Hausman test reported a chi-square value of 11.831 with a p-value of 0.223.this implies that there is random effect in the data and random effect model is an appropriate model to be used for the analysis of the data of this study.

Regression Analysis

Random Effect Model

A set of hypothesis was considered regarding the determinants of disclosure in the commercial banks of Pakistan. The following regression results were obtained as suggested by the random effect model.

Table 4: Random Effect Model

Variables	Coefficients	Standard Error	T-Values	P-Values
AGE	0.204	0.092	2.207	0.032
BC	0.482	0.138	3.762	0.000
AUR	0.069	0.141	0.487	0.629
BKH	0.092	0.060	0.908	0.369
BS	0.579	0.106	3.372	0.001
INT	0.049	0.132	0.369	0.714
FS	0.063	0.098	2.642	0.041
ROA	0.496	0.129	4.123	0.000
SDROA	0.219	0.094	1.845	0.071
R-Square = 0.41				
Wald Chi = 29.20				

Table 4.Shows regression results for the random effect model. The results report R^2 of 0.41, which implies that 41% changes in disclosure are being caused by the independent variables of the study, coefficient of determination of 41.1 %.The results report positive significant impact of firm size on the firm disclosure. Which are consistent to the findings of previous researchers (Wallace et al, 1994; Craig and Diga, 1998). These results show that listing age (AGE) has positive significant impact on the

firm corporate disclosure. Which are in line with the findings of Hossain and Hammami (2009). Similarly board composition indicates a positive impact on the disclosure of commercial banks, documenting that banks having more non-executive directors in their board will have more practices of disclosure. Haniffa and Cooke (2002) also confirm positive impact of board composition on the disclosure practices of a firm Audit firm reputation showing positive impact on the disclosure practices of commercial banks in Pakistan, which documents that the banks audited by any of top four audit firm, exhibit more disclosure practices. The findings of this study confirm the results obtained by Kent and Ung(2003).Whom also predict same kind of relationship between audit reputation and firm disclosure practices. The results report negative impact of the block holder ownership on the disclosure practices of banks. Which are in line to the findings of previous research studies(Fan and Wong ,2002). Board size showing positive impact on the disclosure practices of commercial banks, thereby predicting that more members in board make the banks more driven towards disclosure practices. In similar study Hussainey and Al-Najar (2011)also confirm a positive relationship between board size and disclosure practices. Institutional ownership provide huge fund in company investment. The results report a positive impact of the institutional ownership on the corporate disclosure practices of commercial banks in Pakistan. The results confirm the findings of Bushee and Noe (2000) who also document a positive relationship between firm institutional ownership and disclosure. The reported results of the study indicate a positive impact of the firm profitability on the disclosure practices of commercial banks in Pakistan. Which is similarly found by a previous study of Owusu-Ansah, (1998). The results indicate a negative relationship between risk taking and disclosure practices. It documents that disclosure practices and having transparency, exercise lower stock volatility and expose to lower financial risk. Similar results were attributed by Nier (2005) in his study, who also document a negative relationship between firm risk taking and disclosure practices.

Conclusion

Disclosure of information is important to bring transparency and to safeguard rights of stakeholders. The code of corporate governance was introduced 2002 with a revised code in 2012 along with State Bank of Pakistan (SBP) Prudential Regulations make it compulsory for commercial banks to disclose all the required information to various stakeholders. This study is carried out to know the determinants of disclosure in commercial banks of Pakistan using a sample of ten banks showing 82% market share of customer deposits. The study period is from 2003 to 2015.Corporate disclosure index (CDI) was used as dependent variable. It was calculated using checklist of thirty seven financial and nonfinancial disclosure items. The independent variables include firm size, return on assets, auditor reputation, board composition, board size, listing age, block holders ownership, institutional ownership and risk taking.

The results reported a negative relationship of corporate disclosure index with block holders ownership and risk taking and reported a positive relationship with Listing age (AGE), board composition (BC), board size (BS) and return on assets (ROA) , audit reputation and firm size in the context of commercial banks of Pakistan. The results obtained in this study mostly documented the findings of previous researchers. The results have some policy implications for the policy makers. In future similar studies if conducted may use risk disclosure index along with the corporate disclosure index. The future studies can also use firm size and leverage as control variables in similar studies.

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