IMPACT: International Journal of Research in Applied, Natural and Social Sciences (IMPACT: IJRANSS)
ISSN(E): 2321-8851; ISSN(P): 2347-4580
Vol. 3, Issue 8, Aug 2015, 49-56

CORPORATE DISCLOSURE IN THE FINANCIAL REPORTS OF AN EMERGING COUNTRY: THE CASE OF KAZAKHSTAN

AIZHAN BAIMUKHAMEDOVA
KIMEP University Almaty, Kazakhstan

ABSTRACT

This study sets out to examine empirically the determinants of corporate disclosure in the annual reports of 37 listed firms of Kazakhstan Stock Exchange (KASE) in Kazakhstan forming approximately of the total largest and most liquid firms incorporated on KASE. It also reports the results of the association between company-specific characteristics and disclosure of the sample companies. A disclosure checklist consisting of 79 items of information is developed and statistical analysis is performed using multiple regression analysis.

Through content analysis of annual reports, we identified the level of information disclosure in Kazakh listed companies. According to the results, corporate disclosure level is not high among Kazakh companies currently; the majority of the disclosures are quantitative; and while all firms spread good news, no one discloses the bad ones. The findings indicate that firm size, beta, and leverage are significant and other variable book to market value of equity is insignificant in explaining the level of information disclosure.

This research is the first to perform a comprehensive investigation of the relation between disclosure and cost of capital for firms immersed in poor governance and institutional regimes. The study contributes to the existing research by justifying the choice of theoretical and methodological approaches, construction of the disclosure index and the selection of factors for the models based on the specifics of Kazakhstan.

KEYWORDS: Disclosure Policy, Cost Of Equity Capital, Financial Risk

INTRODUCTION

This study explores the extent and levels of corporate disclosures in the annual reports of the listed companies on KASE in Kazakhstan, a growing emerging country. The disclosure of financial information in annual reports is a key area of accounting research and, more specifically, corporate disclosure has received a great attention to the academicians and several research is done both in developed [1] and developing countries, however, a very few attention is done in Central Asia in general and Kazakhstan in particular. The annual report is a significant element in the overall disclosure process, because it is the most widely disseminated source of information on publicly held corporations.

Disclosure refers to providing information which enables stakeholders to evaluate future performance of a company. Disclosing information reduces information asymmetry between firms and stakeholders. It plays a role in closing the information gap between the two parties, thus permitting stakeholders to make healthier decisions about companies.

The available literature has suggested many ways in which a firm or its management can benefit from enhanced disclosure. Moreover, while information disclosure is socially desirable, the tradeoff between its benefits and costs may

lead to partial or no disclosure and one thereupon should decide whether the disclosure should be voluntary or mandatory. In addition, the economic and accounting literature has asserted that, in the view of informational asymmetry, (costless) disclose of private information brings general gains in economic efficiency.

There are several motivations for the present study. Although there is a growing body of research on disclosure practices of firms, many of the studies have been conducted in developed countries. Aljifri and Hussainey (2007) point out the scarcity of studies that have investigated disclosure of corporate information in developing countries, this observation also holds true for Kazakhstan which is an important developing country in CIS region with its rapidly growing economy. In addition, the subject has not been studied as much as other areas of information disclosure, such as social, environmental, and intellectual capital. Furthermore, sufficient knowledge is lacking with respect to the factors that influence disclosure.

LITERATURE REVIEW

The firm's decision to voluntarily disclose information depends on its conjectures about the beliefs held by competitors and investors. The study of Milgrom and Grossman concluded that if the firm can make credible disclosures about its value to uninformed investors, in equilibrium the firm will disclose all of its information regardless of how good or bad are the news. Many recent studies have hypothesized that firms' voluntary disclosure choices are aimed at controlling the interest conflicts among shareholders, debt holders, and management [2]. It is meant that the extent of these interest conflicts, hence the incentives behind voluntary disclosure choices vary with certain firm characteristics.

There is an important strand of the financial accounting literature that investigates the relation between disclosure and cost of equity capital. The basic idea is that higher levels of disclosure contribute to a reduction in information asymmetry between managers and investors and, consequently, cause a reduction in the idiosyncratic component of cost of equity capital. However, results of these investigations have not been conclusive. Some authors argue that the absence of statistical and economically significant associations between disclosure and cost of capital can be the result of measurement problems because both variables are not directly observed and proxies need to be used.

Specifically, several studies justify that higher quality financial disclosures are positively associated with general market liquidity, institutional ownership, analyst forecast accuracy and analyst following, and are negatively associated with the ex ante cost of equity capital and agency costs [3].

Other benefit from improving disclosure is that providing better information firms try to reduce potential investors' estimation risk regarding the parameters of a security's future return or payoff distribution. It is assumed that investors attribute more systematic risk to an asset with low information than to an asset with high information.

HYPOTHESIS DEVELOPMENT

Thus, whether disclosure is useful in reducing the cost of equity capital becomes an empirical issue, which can be tested by using the following hypotheses. Size is identified as a significant explanatory variable in explaining variation in the level of voluntary disclosure in previous studies.

H1: There is a positive relationship between firm size (as measured by market capitalization) and the level of information disclosure.

Information disclosure may be used to avoid agency costs and to reduce information asymmetries. Therefore, it is argued that leveraged firms have to disclose more information to satisfy information needs of the creditors. Hence, the following hypothesis 2 was formulated:

H2: There is a positive relationship between leverage (as measured by the ratio of total liabilities to total assets) and the level of information disclosure.

Disclosure also creates shareholder value by allowing a firm to reduce the cost of its capital. The majority of the studies show this positive impact [4]. Thus, whether disclosure is useful in reducing the cost of equity capital becomes an empirical issue, which can be tested by using the following hypothesis:

H3: There is a negative association between disclosure and the company's cost of equity capital.

SAMPLE CONSTRUCTION AND DATA DESCRIPTION

The main objective of this study is to investigate whether firms that publish greater disclosure benefit in terms of a lower cost of equity capital. Disclosure of financial information is measured using a disclosure index developed from a content analysis of annual reports. The approach implemented in this study involves the use of a dichotomous procedure, where a particular information item is awarded one (for yes) and zero (for no) if it is disclosed or not disclosed, respectively. The level of disclosure for each firm is then calculated as the total number of items scored (total count of all the ones and zeros).

In using the disclosure index approach, it is first necessary to develop a checklist of items of information that firms disclose or may disclose [5]. In this research, a checklist comprising 79 financial disclosure items was developed.

The present research attempts to measure directly the cost of equity capital through Capital Asset Pricing Model. The analysis is based on companies' annual reports based on a sample extracted from the KASE. The selection procedures yield 37 Kazakhstan companies. The focus on KASE firms will ensure that the sample includes some multiple listed companies and that all companies are subject to approximately equivalent levels of disclosure pressures arising from various regulatory and capital market regimes.

RESEARCH DESIGN AND METHODOLOGY

The Model

The statistical analyses performed in the present research, includes the use of multiple linear regression models to examine the relationship between annual report disclosure level and the influencing factors.

We test our hypothesis by regressing expected cost of equity capital (COE) on market beta (BETA), the natural log of market value (LMVAL), financial leverage (LEV), book to market value of equity (BM) and total disclosure score (DISCL). That is,

$$COE = \alpha + \beta_1 BETA + \beta_2 LMVAL + \beta_2 LEV + \beta_3 BM + \beta_4 DISCL + \varepsilon \quad (1)$$

In the present research, there are four independent variables indicating the financial characteristics of the firm whereas there are three independent variables indicating corporate disclosure characteristics of the firm. These include firm size, leverage and beta. These factors are the most commonly used independent variables in the accounting disclosure

literature [6] and will be used here for testing with disclosure.

Control Variables

The literature has revealed several risk factors that affect the cost of equity. These factors must be controlled for so that a correct inference can be obtained. In this study, we control for cross-firm differences in beta, firm size, book-to-market equity and leverage.

The inclusion of firm size and book-to-market equity as our control variables is motivated by Fama and French. Fama and French and Baginski and Wahlen find a negative relation between *Size* and cost of capital. The log of the common equity of the firm scaled by the market value of equity, *BM*, is included because Fama and French, Gebhardt et al, and Baginski and Wahlen find a positive relation between *BM* and the cost of equity capital. *LEV*, measured as long-term debt plus any debt in current liabilities divided by total assets, is included to proxy for the amount of debt in the firm's capital structure. Botosan and Plumlee find *LEV* to be positively associated with cost of equity capital. However, as our estimated cost of equity is derived from BM, it is debatable whether BM should be included as a control variable.

BETA is included in the models to control for systematic risk. BETA is estimated by the market model using a minimum of thirty monthly return observations over the five-year period with a value weighted S&P 500 market index return. Financial leverage (LEV) defined as the ratio of total debt to market value of outstanding equity is used as proxy for a firm's riskiness. The higher a company's relative debt position, the more likely it will face financial distress from defaulting on interest and principal payments. BETA and LEV are included in the analysis to account for a company's systematic and financial risk. LMVAL is included to account for the richness of a firm's information environment as well as the significant association between cost of capital and market value.

Empirical Results

Relationship between transparency and cost of equity

We perform a cross-sectional time series analysis of the relationship between information disclosed in company quarterly reports and cost of equity and control variables.

At the first stage of data analysis cost of equity is dependent, company attributes including transparency score are independent variables. The summary of data analysis regarding relationship between cost of equity and disclosure score is as follows.

Table shows summary of findings regarding relationship between cost of equity and company attributes, which is proxied by BM (Book to Market Value), LMVAL (the natural log of market value), BETA (market beta), LEV (financial leverage) and DISCL (total disclosure score) between 2006 and 2012 for the 37 sample companies from the KASE.

Table 1: Regression Analysis, Cost of Equity is Dependent Variable

Dependent Variable: COE				
Method: Least Squares				
Date: 07/02/14 Time: 15:12				
Sample: 2006:1 2012:4				
Included observations: 28				
Variable	**Coefficient**	**Std. Error**	**t-Statistic**	**Prob.**
C	40.02124	10.75945	3.719636	0.0012
Table 1				
LNMC	-4.949132	0.582987	-8.489260	0.0000
BTOMV	-2.142998	10.41864	-0.205689	0.8389
BETA	21.31420	3.523528	6.049109	0.0000
DI	-0.630791	0.191992	-3.285501	0.0034
LEV	18.75409	2.593060	7.232414	0.0000
R-squared	0.852900	Mean dependent var		5.537372
Adjusted R-squared	0.819468	S.D. dependent var		2.078033
S.E. of regression	0.882937	Akaike info criterion		2.776284
Sum squared resid	17.15072	Schwarz criterion		3.061756
Log likelihood	-32.86797	F-statistic		25.51157
Durbin-Watson stat	2.262634	Prob(F-statistic)		0.000000

According to the results of the research, independent variables are statically significant at the 1% level except BM variable. The results of the OLS regression show that F-ratio is 25,5 (p value less than 0,05). Hence, the model is statistically significant, with adjusted R-square equal to 81,94%. Regression coefficient for firm size is negative and significant at the one percent level. The conclusion is that, large firms tend to have lower cost of equity. Looking next at the variables, book to market value of equity (BM) is not statistically significant. The coefficient for measuring company's systematic risk (BETA) is positive and statistically significant. On the other hand, the coefficient for transparency and disclosure is negative and statistically significant that justifies the hypothesis about inverse relationship between cost of equity and disclosure. In other words, the higher level of disclosure decreases the cost of equity of the firm. The coefficient for financial risk (LEV) of the firm is positive and statistically significant.

Table shows summary of findings regarding relationship between disclosure score and company attributes, which is proxied by MB (Market Value to Book Value), LMVAL (the natural log of market value), BETA (market beta), LEV (financial leverage) and COE (cost of equity) between 2006 and 2012 for the 37 sample companies from the KASE.

Table 2: Regression Analysis, Disclosure Score is Dependent Variable

Dependent Variable: DI				
Method: Least Squares				
Date: 07/02/14 Time: 15:24				
Sample: 2006:1 2012:4				
Included observations: 28				
Variable	**Coefficient**	**Std. Error**	**t-Statistic**	**Prob.**
C	48.05709	7.142556	6.728277	0.0000
COE	-0.521815	0.158824	-3.285501	0.0034
LNMC	-3.370215	0.828180	-4.069421	0.0005
BTOMV	-1.161652	9.481905	-0.122513	0.9036
BETA	9.109799	4.855974	1.875998	0.0740
LEV	10.29396	3.737759	2.754046	0.0116
R-squared	0.536525	Mean dependent var		28.86959
Adjusted R-squared	0.431190	S.D. dependent var		1.064784

S.E. of regression	0.803055	Akaike info criterion	2.586622
Sum squared resid	14.18774	Schwarz criterion	2.872094
Loglikelihood	-30.21271	F-statistic	5.093503
Durbin-Watson stat	2.445554	Prob(F-statistic)	0.002985

The results show that independent variables are statistically significant at 1% and 10% level except BM variable. The explanatory power of the model (adjusted R-square value) equals to 43.11%. The regression coefficient for the firm size is negative and statistically significant that does not coincide to the previous study results that the degree of corporate disclosure and transparency is an increasing function of firm size. Although most previous studies support a positive relationship, there is an unclear theoretical basis for such a relationship. The direction of association may be either positive or negative.

The coefficient for BETA is positive and statistically significant, showing that the degree of corporate disclosure and transparency are positively related to a measure of systematic risk of the firm. The coefficient for COE is negative and statistically significant, thus supporting the research hypothesis 1. The coefficient for measure of debt level (LEV) is positive and significant, showing that firm with a greater amount of debt tend to have high degrees of corporate disclosure and transparency.

The results of the correlations between the financial disclosure and firm characteristics are given in Table 3 Pearson correlation. A correlation is a measure of the strength and direction of the relationship and ranges between -1 and +1. The negative and positive signs reflect the direction of the relation whilst the strength of the relation is reflected in the absolute value, called the correlation coefficient. A higher correlation coefficient indicates a stronger relationship. Examining the Pearson correlation coefficients (shown above the diagonal), we find that DI is negatively correlated with lnMC, Correlation coefficient = -0,522. We find that lnMC is highly positively correlated with Lev (0,840). In contrast, the correlation between DI and BtoMV is slightly lower with the coefficient of 0,409. A strong negative relationship exists between BtoMV and Lev with the coefficient of -0,910. A negative relationship exists between Lev and Beta, the correlation coefficient is equal to -0,485.

Table 3: Pearson Correlation

Correlations

		CoE	lnMC	BtoMV	Beta	DI	Lev
CoE	Pearson Correlation	1	-.111	-.208	.303	-.160	.270
	Sig. (2-tailed)		.575	.289	.117	.415	.165
	N	28	28	28	28	28	28
lnMC	Pearson Correlation	-.111	1	-.848**	-.357	-.522**	.840**
	Sig. (2-tailed)	.575		.000	.062	.004	.000
	N	28	28	28	28	28	28
BtoMV	Pearson Correlation	-.208	-.848**	1	.348	.409*	-.910**
	Sig. (2-tailed)	.289	.000		.070	.031	.000
	N	28	28	28	28	28	28
Beta	Pearson Correlation	.303	-.357	.348	1	.020	-.485**
	Sig. (2-tailed)	.117	.062	.070		.919	.009
	N	28	28	28	28	28	28
DI	Pearson Correlation	-.160	-.522**	.409*	.020	1	-.370
	Sig. (2-tailed)	.415	.004	.031	.919		.053
	N	28	28	28	28	28	28
Lev	Pearson Correlation	.270	.840**	-.910**	-.485**	-.370	1
	Sig. (2-tailed)	.165	.000	.000	.009	.053	
	N	28	28	28	28	28	28

**. Correlation is significant at the 0.01 level (2-tailed).

*. Correlation is significant at the 0.05 level (2-tailed).

CONTRIBUTION AND SIGNIFICANCE OF THE RESEARCH

The significance of corporate disclosure practices has been of growing interest both in theory and in practice. Today informational transparency of the company is an integral part of good corporate governance that reduces the information asymmetry between agents and principals. Therefore, it is interesting to measure the quality and quantity of transparency in Kazakhstan companies through voluntary and mandatory disclosure of information on the corporate website and corporate reports. The relevance of this approach is evidenced by the presence of a large number of empirical studies on the issues of disclosure and transparency effects on the cost of equity capital.

Most research on disclosure quality and cost of equity capital relations has been conducted in developed countries whereas empirical studies from Kazakhstan are very scarce. This research is the first to perform a comprehensive investigation of the relation between disclosure and cost of capital for firms immersed in poor governance and institutional regimes.

The study contributes to the existing research by justifying the choice of theoretical and methodological approaches, construction of the disclosure index and the selection of factors for the models based on the specifics of Kazakhstan.

CONCLUSIONS

Study of the relationship between corporate information disclosure and cost of equity, on the one hand, is a very relevant issue and there has been significant interest in the foreign researchers that is confirmed by the existence of a sufficiently large number of empirical studies in this area.

We should be cautious regarding the quality of information disclosed by the companies because the information provided in financial reports may not be that quality like it seems so. For this reason, it is the job of auditors to detect the mistakes, carefully check the quality of information disclosure and make sure that it is reliable. Small firms provide less information than large ones, which supply more information about their independence standards, audit committees, their management supervision systems and whistle-blowing procedures. However, compared to small firms, large ones do not appear to give superior information about their environment. These results obviously raise questions that lie at the heart of most financial scandals as, in the end, firms' size matters less than respecting good governance, the latter being probably the main criterion to improve financial stability.

Much work should be done to improve the quality of financial information. In order to make financial evaluations reliable, valid and comparable, the uniform internationally accepted standards must be utilized. Although disclosure requirements have increased over the years, prescriptive disclosure has not eliminated the differences in the quality and extent of disclosure offered by companies; significant variation across companies is still observed.

REFERENCES

1. Aljifri, K. (2008). Annual report disclosure in a developing country: The case of the UEA. *Advances in Accounting,* 24, 93−100.
2. Barry, C., and Brown, S. (1985). Differential information and security market equilibrium. *Journal of Financial and Quantitative Analysis 20,* 407-422.

3. Baginski, S. P., and Wahlen, J. M. (2003) Residual Income Risk, Intrinsic Values, and Share Prices. *The Accounting Review: January 2003, Vol. 78,* No. 1, pp. 327-351.
4. Botosan, C. A., and Plumlee, M. A. (2002). A reexamination of disclosure level and expected cost of equity capital. *Journal of Accounting Research, 40,* 21-40.
5. Botosan, C. (1997). Disclosure level and the cost of equity capital. *Accounting Review 72,* 323-349.
6. Botosan, C. (2006). Disclosure and the Cost of Equity Capital. What Do We Know? *Accounting and Business Research, International Accounting Policy Forum,* pp. 31-40.
7. Diamond, D., and Verrecchia, R. (1991). Disclosure, liquidity and the cost of equity capital. *The Journal of Finance (September),* 1325-1360.
8. Easley D. and O'Hara M. (2004). Information and the Cost of Capital. *The Journal of Finance 59(4),* 1553-1583.
9. Espinosa, M., and Trombetta, M. (2007). Disclosure interactions and the cost of equity capital: Evidence from the Spanish Continuous Market. *Journal of Business Finance and Accounting, 34 (9and10),* 1371-1392.
10. Francis, J. R., Khurana, I. K., and Pereira, R. (2005). Disclosure incentives and effects on cost of capital around the World. *The Accounting Review,* Vol. 80, No 4, pp. 1125-1162.
11. Graham, J. R., Campbell R. H. and Rajgopal. S. (2005). The Economic Implications Of Corporate Financial Reporting, *Journal of Accounting and Economics,* Vol. 40(1-3 Dec), 3-73.
12. Hail, L. (2002). The impact of voluntary corporate disclosures on the ex-ante cost of capital for Swiss firms. *European Accounting Review 11(4),* 741-777.
13. Healy, P., Hutton, A., and Palepu, K. (1999). Stock performance and intermediation changes surrounding sustained increases in disclosure. *Contemporary Accounting Research, 16 (3),* 485-520.
14. Healy, P. M., and Palepu, K. G. (2001). Information asymmetry, corporate disclosure, and the capital markets: a review of the empirical disclosure literature. *Journal of Accounting and Economics, 31 (1-3) (September), 405-440.*
15. Inchausti, B. G. (1997). The influence of company characteristics and accounting regulation on information disclosed by Spanish firms. *The European Accounting Review, 6 (1), 45-68.*
16. Klein, R. W. and Bawa V. S. (1976). The Effect of Estimation Risk on Optimal Portfolio Choice, *Journal of Financial Economics 3,* 215-231.
17. Lambert, R., Leuz, C., and Verrecchia, R. (2007). Accounting Information, Disclosure, and the Cost of Capital. *Journal of Accounting Research,* Vol. 45, Is. 2, pp. 385-420.
18. Lang, M., and Lundholm, R. (1993). Cross-sectional determinations of analyst ratings of corporate disclosure. *Journal of Accounting Research, 31 (2),* 246-271.