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The Association Between Corporate Risk Disclosure and Firm Performance in Emerging Country – The Case of Egypt

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ABSTRACT

The aim of this paper is to investigate the association between corporate risk disclosure and firm performance (ROA, ROE, and ESP) , Using SPSS statistical, result show that there is an insignificant association between liquidity risk, interest rate risk, credit risk, exchange rate and firm profitability I believe that this study contributes to literaturefor several reason firstly , it is important to regulators to release a mandatory risk disclosure that could affect decision making such as investors, creditors and other stakeholders , secondly , researcher can re-taken this research using other research methodology .
This study is restricted to examine one year annual report 2013, exclude financial sector due to their specific law and rules and sample size on the other hand, this research paper is limited to investigate the association between risk disclosure mainly financial risk, liquidity risk and profitability

Keyword: Egypt, Risk Disclosure, Credit Risk, Liquidity Risk, Foreign Exchange Risk, Rate Risk Disclosure, Return on Assets (ROA), Return on Equity (ROE) , Earning Per Share (EPS), Signal Theory, Financial Risk

1. Introduction

Risk reporting is defined as a set of information communicated in financial statements dealing with managers estimates judgments reliance on market – based accounting policies such as impairment derivatives hedging , financial instruments , economics , political , financial risk management and internal control risk , this definition is in line with other suggests by several authors who argue that risk

disclosure is all types of information communicated in financial statements dealing with business uncertainties.

Two streams of theories have been employed to explain why firm communicate risk information, these streams include the economic theory approach and social and political theory approach.

The economic theory approach relies on self interest and profit maximization of economic agents using agent theory, political cost theory, signal theory and propriety, cost theories while the social and political approach focuses on the political approach and relationship linking firm to stakeholders in the society to understand the motivation of risk disclosure (Khlif and Hussainey, 2014)

This research paper aims to investigate the association between corporate risk disclosure and firm performance in Egypt based on signal theories.

To accomplish the purpose of the study I obtain a data from 37 listed companies using

Content analysis (sentence number), the statistical analysis indicates that there is a negative insignificant association between financial risk, credit risk, interest rate risk, exchange rate risk and liquidity risk and profitability measured by return on equity ROE, return on assets, ROA, earning per share EPS

I believe this paper contributes to literature for several reasons,

Previous studies have examined the extent of corporate risk disclosure (CRD) and firm characteristics (size, profitability, listed, industry and governance (see table 1)

They show mixed results for example (Mohobbot, 2005; Elzahar and Hussainey, 2012; Al-shammari, 2014) show a positive impact on company's profitability

In contract (Vandemelle, 2009), (Mousa and Elamir, 2013) found that there is a significant negative relationship between corporate risk disclosure and profitability

This is study differ from previous research by using 3 measures of profitability (ROA, ROE, EPS)

The study is important for the accounting setter to take a step in improving risk disclosure in either annual report and management discussion and analysis

In addition because it is important to regulators to release a mandatory risk disclosure which could affect decision making, such as investors, creditors and other stakeholders

To the know of the author there is one study focus on risk reporting and their determinants , Mokhtar and Mellett (2013) Examine the extent of mandatory and voluntary risk reporting and investigate the impact of competition , corporate governance and ownership structure on risk reporting in annual reporting in annual reports of Egyptian companies , they conclude that based on agency theory and propriety costs ,competition, role duality , board size and auditor size are the key determinants of risk reporting practice in Egypt , this current research extent the mentioned paper by examining the impact of firm profitability on CRD on non financial listed company in Egypt

Risk is categorized as market risk, credit risk, liquidity risk, operational risk, legal and regulatory risk, business risk, strategic risk and reputation risk

Market risk is the change in financial market price and rate will reduce the value of a security or portfolio, it rises for a several of factors such as interest rate, foreign exchange, commodity price, price sensitive revenue or expenses, stock option plans and pension liabilities

credit risk is the distribution of financial losses due to unexpected change in the credit quality of counterparty in a financial agreement example of credit risk can be downgraded by a rating agency, failure or liquidation

Liquidity risk occurs when the companies is not able to meet the payment of commitment it has made

Operational risk refers to the potential losses due to inadequate or failing internal process, people and system or resulting from external events

Business risk is uncertainty about the demand of the product, the price can be changed or the product, the production costing, stock, the risk associated from competitors and potential losses of competitive advantages

Legal, tax and regulatory risk arise from a whole of reason; an example is the involvement in lawsuits or the infringement of legal norms or the change of tax law

Strategic risk comes from the risk associated with significant investment for which high risk; uncertainty exists about success and profitability

Reputation risk refers to the risk that a good reputation which can lead to value creation turns to bad reputation and then the company being destroyed

This current study undertakes mainly the financial risk and liquidity risk

This study is limited to examining the association between financial risk, liquidity risk and firm performance, many studies are needed to investigate the other kind of risk and firm performance, this study use only person analysis method, research may take this research using other statistical analysis, finally I measure performance using accounting ratio, research may examine the association between corporate risk disclosure and performance using another method

This paper is organized as follows section 1 risk theory and background, section 2 Hypotheses and question research, section 3 data collection and methodology and final section 4 conclusion, section 5 summary and suggest for the future research.

1.1. Risk Theories and Background

Risk reporting can encourage a more rigorous and consistent risk management process it connects closely with all stage of risk management and act as a drive for enhancing risk identification , measurement , control transfer an evaluation what gets reports managed , the more comprehensive and detailed the risk reporting is the more robust the risk management system could potentially be clear and consistent statements of risk information can help manager to make well informed and considered information, this in turn lead to competitive advantage and increased value of the company.

Furthermore, business reporting aims to provide all relevant information regarding the past, present and future states of the company to the stakeholders for making economic decisions Analyst need risk information to value companies and make investment recommendations.

In addition, investors want risk information to decide the trading volume and timing of their share finally it is argued that more transparent risk information disclosure can protect shareholders by enhancing accountability and corporate governance practice. (Liu, 2006)

Acknowledge the importance of risk, the accounting standard and regulatory agencies have taken several steps to improve disclosure, for example, in the USA financial reporting release no: 48 require SEC registrants to disclose both qualitative and quantitative information on market risk in the notes to the accounts and also in the management discussion and analysis section. In the UK, the operating and financial review recommends a company to disclose its review of key risks and strong by encouraging the inclusion of a clear discussion of trends affecting the future. In Germany require information on risk to be presented in a separate section of the management report that accompanies the consolidate financial statements , in Australia , the Australia ASX corporate principals and recommendation issued principal 7 on risk management and recognition (Amran *et al.*, 2009)

In addition the international accounting standard board issues an exposure draft on management commentary in the 2009 and 2010 and IFRS practice statement, these discuss the framework for the preparation and presentation of a management commentary should include among others, a clear description of the significant resources, risks and relationship are managed.

In Egypt, the ministry of investment issued a ministerial decree no: 243 that contains 35 EAS, which are based substantially on the IAS but with a minor difference effective from 2007, these standard include for the first time a risk related accounting standards, namely EAS 25 since the later is the Arabic translation of the former however EAS25 based on IAS 32 before last amends in 2010 (Mokhtar and Mellett, 2013)

Based on the mentioned background risk, the current research examines only the relationship between financial risk and firm performance

2. Hypotheses and Question Research

2.1 signal theories :

Signaling theory is concerned with how to address problems arising from information symmetry in any social setting. It suggests that information asymmetry should be reduced if the party possessing more information can send signals to other interest-related parties. A signal can be an observable action, or an observable structure, which is used to indicate the hidden characteristics (or quality) of the signaler. The sending of a signal is usually based on the assumption that it should be favorable to the signaler (e.g. indicating a higher quality of its products compared with its competitors)

The classic signaling model occurs in a market setting between the seller and the buyer. To begin with, the seller usually possesses an information advantage over the buyer regarding its products or services. Although buyers do not have much information with respect to specific goods, they may have some general perceptions in purchasing (e.g. Certain percentage of products (p %) offered will be faulty, and those faulty products should sell at a price of x while the normal products should sell at a price Then the buyer will value the products at the same price based on a weighted average of the general perceptions. As a consequence, the seller possessing products with a quality above average incurs an opportunity, loss because its products should sell at a higher price if the buyer knows about the superior quality of the products, whereas the seller with a quality

Below average will obtain an opportunity gain accordingly. Therefore the seller of high

Quality products have an incentive to signal the quality of his products to the buyer in

In order to justify the higher price. To be effective, the signal should be difficult to be imitated by the low quality sellers. The signaling will be an iterative process which continues as long as the higher in price obtained exceeds the signaling costs

If the classic model is placed in a general business setting, it can be interpreted as follows. Initially the management of a firm usually has more information than the investors with regard to the operation of the firm (e.g. The viability of a project, expected profits, or risk exposure). Due to the asymmetric information, the investors do not know about the quality of the firm, and therefore cannot distinguish the quality of various firms.

Consequently the firm with a quality above average incurs an opportunity, loss because its superior quality is not perceived by the investors, while the firm, with a lower quality

Obtains an opportunity gain. Under the circumstances, the high-quality firm has an incentive to highlight its superior quality in order to attract more investors

Signaling theory suggests that companies with a high quality should signal their advantages to the market. On the one hand, signaling would make investors and other stakeholders reassess the value of the company, and then make decisions more favorable to the company On the other hand, the favor of various stakeholders would make a company obtain more investment, and therefore reduce the costs of raising capital.

There are a number of means for companies to signal information about themselves. (An *et al.*, 2011)

Previous research examines factors determining corporate voluntary disclosure based on signal theories used profitability (Chau and Gray, 2002; Watson and Marston, 2002; Cheng and Courtenay, 2006; Webb *et al.*, 2008) in line with these studies, the current paper examines the association between corporate risk disclosure and firm performance using profitability as a proxy of performance

2.2 Corporate Risk Disclosure and Profitability

signaling theory , illustrates that companies that are better at risk management will have higher level of relative profitability and they will want to signal their superior risk management abilities to the market place via disclosure in the annual reports , disclosuring more risk information management not only to show their risk to management efficiency but also to show their transparent attitude to the stakeholders using this opportunity , although is very difficult to know the actual attidute of the management at a confortable profit position of the company whatever may be the actual intention of disclosing risk information (Mohobbot, 2005) it seems suggest the following hypotheses :

H1 :There is a significant association between credit risk and profitability

H2:There is a significant association between liquidity risk and profitability

H3:There is a significant association between interest rate risk and profitability

H4 :There is a significant association between the foreign exchange rate and profitability

3.Data collection and methodology:

Weber 1990 defines content analysis as a research method that uses a set of procedures to make valid inference from text , weber added that the rule of this inferential process varies based on the interest of the investigator , this research technique enable a replicable and valid inference from data according to the context in order to ensure the replicable maner of inference.(Amran *et al.*, 2009)

Prior studies has used content analysis to measure corporate disclosure level (Amran *et al.*, 2009). some research, use content analysis to measure specific type of disclosure, such ad risk disclosure (Berretta and Bozzilian, 2004; Linsley, 2006; Abraham and Cox, 2007), there are two principal method of content analysis, the manual method and the automated method, both method may employ the word, the sentence or line as the unit of analysis (Hussainey *et al.*, 2013) According to the mentioned agreement, I count line under the subtitle of credit risk, liquidity risk, interest rate risk, foreign exchange rate risk which they appear in the nonfinancial sector of the Egyptian listed companies 'annual reports for the year ended 2012

In addition, I measured profitability by using return on assets (ROA), return on equity (ROE) in accordance with previous studies (Vandemelle, 2009; Mousa and Elamir, 2013) and I added another measure to measure profitability which is earning per share (EPS)

4. Conclusion

Person correlation statistical analysis shows that There is a negative insignificant relationship between ROE and credit risk, interest rate risk (-o, 032, -0.031<0.333) respectively meanwhile positive insignificant association between ROE and exchange rate, liquidity (0.068, 0.066) <0.3333

Table 1 shows that there is a positive insignificantly association between ROA and credit risk (0.03<0.333) and the negative insignificant relationship between liquidity risk and interest risk

Finally the analysis indicates an insignificant negative association between (EPS and credit risk , liquidity risk and position insignificantly interest risk and exchange rate based on the above statistical results I reject the hypotheses (h1 to h4) There is a negative insignificant relationship between ROE and credit risk, interest rate risk (-o, 032, -0.031<0.333) respectively meanwhile positive insignificant association between ROE and exchange rate, liquidity (0.068, 0.066) <0.3333

In addition The table 1 shows that there is a positive insignificantly association between ROA and credit risk (0.03<0.333) and the negative insignificant relationship between liquidity risk and interest risk

Finally the analysis indicates an insignificant negative association between (EPS and credit risk , liquidity risk and position insignificantly interest risk and exchange rate based on the above statistical results I reject the hypotheses research (h1 to h4)

Further Anova analysis (table 2) confirms Pearson analysis

Table-1. Pearson Correlation

		ROE	**CREDIT RISK**	**INTEREST RISK**	**EXCHANGE RISK**	**LIQUIDITY**
Pearson Correlation	ROE	1				
	CREDIT RISK	-0.032	1			
	INTEREST RATE	0.068	0.113	1		
	EXCHANGE RATE	-0.031	0.064	0.677	1	
	LIQUITY RISK	0.066	0.005	-0.056	-0.139	1

		ROA	**B1**	**B2**	**B3**	**B4**
Pearson Correlation	ROA	1				
	CREDIT RISK	0.013	1			
	INTEREST RATE	-0.08	0.113	1		
	EXCHANGE RATE	-0.22	0.064	0.677	1	
Pearson Correlation		EPS	B1	B2	B3	B4
	EPS	1				
	CREDIT RISK	-0.102	1			
	INTEREST RATE	0.113	0.113	1	0.677	
	EXCHANGE RATE	0.083	0.064	0.677	1	
	LIQUITY RISK	-0.157	0.005	-0.056	-0.139	1

Calculated Pearson Correlation Sig, at (0.05) level =0.333

Table-2. Anova Analysis of Variance

Model		**Sum of Squares**	**Df**	**Mean Square**	**F**	**Sig.**
ROE	Regression	4290.074	4	1072.518	0.167	.953
	Residual	205118.8	32	6409.961		
	Total	209408.8	36			

Model		**Sum of Squares**	**df**	**Mean Square**	**F**	**Sig.**
ROA	Regression	6778.799	4	1694.7	0.793	.539
	Residual	68399.13	32	2137.473		
	Total	75177.93	36			

Model		Sum of Squares	df	Mean Square	F	Sig.
RPS	Regression	1.41	4	0.352	0.408	.802
	Residual	27.648	32	0.864		
	Total	29.057	36			

Signficant Results (F) (4, 32) IS 2.69
ANOVAs analysis confirms person results

5. Summary and Suggest for Future Research

External reporting of risk related information is mainly required from firms and organizations using external financing and is often mandated by regulatory agencies, creditors and investors. Risk reporting in this case usually involves principal regulatory requirement in the form of prospectus uses and annual reports. prospectus use cover a full range of relevant risk type and consideration for potential investors while annual reports provide qualitative risk information in financial statements mainly in the footnotes or in the exchange regulator requirement sections namely management discussion and analysis (Zeghal, 2005). This paper aims to investigate the association between corporate risk disclosure and firm performance measure by profitability (accounting ratio), by imposing the next hypothesis: There is a positive significant association between corporate risk disclosure and firm profitability. Obtain data from 37 listed companies' websites and used SPSS , resulting shows that there is an insignificant association between CRD and profitability of Egyptian listed companies .This study is consistent with (Hussainey *et al.*, 2013; Al-shammari, 2014).

This study is limited to methodology used content analysis technique by counting sentences manual, the kind of risk disclosure (financial risk and liquidity risk) so more research is needed to explain the relationship between firm performance and risk disclosure, meanwhile research could take this study by using computer software

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Appendix

Table-1.

(Mihkinen, 2013)	Demonstrates that the quality of risk disclosure has a negative influence on information asymmetry and the risk disclosure are more useful if they're provided by small firms, high tech firms and with low analyst coverage
(Berretta and Bozzilian, 2004)	Proposed a framework for the analysis of risk communication and an index to measure the quality of risk disclosure, applying the framework to a sample of non financial companies listed in the ordinary market on the Italian stock, using the OLS model, the regression shows that the index of disclosure quantity is not influenced either by size or industry
(Solomon *et al.*, 2000)	Develop a diagrammatic representation for the conceptual framework for internal control , risk mokater management and risk disclosure using a questionnaire to conveys the attitude of UK institutional investors toward risk disclosure in relation to their portfolio investment decisions , results show that the institutional investor don't generally favor a regulated environment for corporate risk disclosure or general statements more over they found that the variation in the attitude of institutional investor appears associated with the characteristics of the fund they managed aswell as with their investments horizons
(Linsley, 2006)	Found a significant association between size and risk disclosure in opposite research have-not show an association between risk disclosure and gearing, assets cover, book market value of equity
(Ntim *et al.*, 2013)	Found that corporate risk disclosure is largely nonfinancial historical, good news and qualitative in nature over the ten – year period, they demonstrate that blockholders and institutional ownership are negatively associated with the extent of corporate risk disclosure in opposite of board diversity, board size and independent non executive directors are positively related to the extent of corporate risk disclosure finally they document that there is no association between dual board leadership structure with corporate risk disclosure
(Adamu, 2013)	Show that companies leverage and size haven"t affect corporate risk disclosure in Nigeria company
(Abraham and Cox, 2007)	Find that the corporate risk reporting is negatively related to

	share ownership of the long term institution, concerning governance, the documents that different type of independent directors fulfill different functions with both the number of executives and the number of executive directors is positively related to the level of corporate risk reporting
(Mokhtar and Mellett, 2013)	Examine the extent of mandatory and voluntary risk reporting and investigate the impact of competition, corporate governance and ownership structure on risk reporting in annual reporting in annual reports of Egyptian companies, they conclude that based on agency theory and propriety costs, competition, role duality, board size and auditor size are the key determinants of risk reporting practice in Egypt
(Elzahar and Hussainey, 2012)	Use the manual content analysis to measure the level of risk information in interim report narrative sections prepared by 72-UK companies. It also uses the ordinary least square regression analysis to examine the impact of firm specific characteristics and corporate governance mechanisms on narrative formation risk disclosure, they found that large firms are more likely to disclose more risk information in the narrative section in addition, the analysis shows the statistically insignificant impact of other characteristics liquidity, gearing, profitability and gross listing and Corporate risk disclosure
(Al-shammari, 2014)	Investigated the association between specific corporate characteristics, mainly company size, leverage, liquidity, profitability, complexity, auditor type and industry type and corporate risk disclosure in the annual reports for 109 Kuwait listed company, the study find that CRD is associated positively with size, liquidity, complexity, auditor type, further more the statistical analysis indicated an insignificant association between CRD and other firm "s characteristics (leverage, profitability)
(Mousa and Elamir, 2013)	Find that the most common type of risk disclosure is interest rate risk in the financial and nonfinancial sector on the other hand the highest number of risk disclosure is operational risk, results show there is a significant negative association between CRD and profitability measured by ROA in Bahrain listed company
(Oluwagbmiga, 2014)	Using a survey in collecting data from 258 listed companies In niergia, the result shows that the operational risk disclosure, financial risk disclosure and strategic risk disclosure are statically significant in explaining performance listed companies.
(Vandemelle, 2009)	Aims to examine the extent of risk disclosure in annual reports of Belgian listed firm, the study indicates that there is a significant negative relationship between CRD and profitability meanwhile the company size affect CRD