



Corporate reporting on risks: Evidence from Spanish companies



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ABSTRACT

In the current corporate context, information on corporate risks plays an essential role in the decision-making process and in an adequate assessment of different organizations.

The current study examines the main risks disclosed by the largest Spanish companies and analyses the factors underlying this disclosure, particularly those linked to corporate governance.

The content analysis performed shows that Spanish companies reveal relatively little information on risks. Their disclosure mainly focuses on the divulgation of the basic characteristics of the financial risks involved.

Likewise, the results obtained emphasize the complexity of the voluntary revelation of risks. While an extended management board might improve the provision of more detailed information about the risks required by the current regulation, it tends to adopt a conservative policy of reporting concerning the voluntary disclosure. Moreover, we show the relevance of transparency as a deterrent for providing voluntary information by larger companies, due to the concerns about negative strategic repercussions.

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Información corporativa de riesgos: pruebas de empresas españolas

RESUMEN

En el actual entorno empresarial, la información corporativa sobre riesgos desempeña un papel esencial en el proceso de toma de decisiones y en una adecuada valoración de las diferentes organizaciones.

El presente estudio examina los principales riesgos revelados por las mayores empresas españolas y analiza los factores subyacentes a esta revelación, especialmente aquellos vinculados al gobierno corporativo.

El análisis de contenidos realizado muestra que las empresas españolas apenas informan sobre sus riesgos. Su revelación se centra principalmente en características básicas de riesgos financieros.

Asimismo, los resultados obtenidos subrayan la complejidad de la revelación voluntaria de riesgos. Mientras que un consejo de mayor tamaño puede facilitar la provisión de información más detallada sobre los riesgos requeridos por la actual regulación, este tiende a adoptar una política más conservadora y prudente de revelación en lo que respecta a la divulgación voluntaria. Además, se evidencia la relevancia de la transparencia como elemento disuasivo a la hora de proporcionar información voluntaria por parte de las grandes empresas, como consecuencia de las preocupaciones por las repercusiones estratégicas negativas.

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1. Introduction

The increasing complexity in business strategies, operations and regulations in the corporate context has fostered certain trends that emphasize the need for organizations to provide a higher volume of

information in order to promote transparency, improve the quality of divulgation and reduce information asymmetries. These changes have meant that the usefulness of the information provided by the traditional financial statements to their potential users is less and less valuable, leading to a higher demand of relevant information and an effort by standard regulators to improve its quality and timeliness.

The deficiencies detected in financial statements have been also underscored by different authors and accounting bodies (AICPA,

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1994; FASB, 2001; ICAEW, 1998, 1999, 2002; Lev & Zarowin, 1999), suggesting the need to include new informative elements in them to fulfil the purpose of being useful to users in the decision-making process.

Amongst the issues that can be improved in the scope of corporate communication, the disclosure of risks that companies face in their operations stands out especially. Corporate risks can be defined as the possibility of a negative future impact on the economic position of the company (GASC, 2000); in other words, the loss of wealth expressed in a reduction of future earnings, cash flows, market share or any other variable that reflects a negative impact. In the current context, risk management has become an essential part of organizations' internal control and corporate governance, and a basic element of the business sphere. Nevertheless, there exists a lack of transparency in the disclosure of information on risks, due to the absence of norms and uniform measures (Lajili & Zeghal, 2005), among other factors.

It is widely believed that improved understanding of business risks by investors and other users of corporate reporting should lead to better stewardship of companies and to a more efficient allocation of resources (ICAEW, 2011). This information can be useful for investors to assess the quantity, duration and certainty of future cash flows and to determine the companies' risk profiles, market value and accuracy in the forecasts on stock prices (Abraham & Cox, 2007; Beretta & Bozzolan, 2004; Helliar & Dunne, 2004; Linsley & Shrides, 2001). In this sense, the information on risks can contribute to manage change (Abraham & Cox, 2007), reduce the cost of capital (ICAEW, 2011; Linsley & Shrides, 2001, 2006), report on the future path of the business model (Cabedo & Tirado, 2004; ICAEW, 1999) and allow companies to communicate the message that they wholly understand their own risks and have developed practices to manage them (Abraham, Solomon, & Stevenson, 2007).

As Cabedo and Tirado (2007, p. 42) underscore, there is some degree of unanimity as to the need for reporting on corporate risks, although this consensus disappears when discussing whether the release should be compulsory or voluntary. Nowadays, except for the regulation of financial risks, most of the disclosure is voluntary. Several theories of the firm support the disclosing of voluntary information. According to the Agency Theory, the release of voluntary information is an essential factor in the decision-taking process and can work as a control system over managers' activities on behalf of shareholders and other stakeholders (Jensen & Meckling, 1976). In addition, in accordance with the Theory of Political Costs, companies would disclose voluntarily information because it could lead to reducing political costs (e.g. taxes) and obtaining certain advantages (e.g. subsidies). In the same vein, the Theory of Signals holds that the divulgation can be regarded as a signal to capital markets, so that information asymmetries can be reduced, financing costs are optimized and corporate value increases (Baiman & Verrecchia, 1996).

However, the Theory of Proprietary Costs emphasizes the potential harm that could stem from the use of the information provided, given that this information would be public not only for current and potential investors, but also for competitors. There are also other potential disadvantages that could result from voluntary disclosures (Gray et al., 1990): threats of takeovers or mergers, possibilities of intervention by government agencies and taxation authorities, and possibilities of claims from employees or trade unions or from political or consumer groups. The information would also be available for other interested users, such as governments, trade unions, consumer associations, clients or suppliers, thereby leading to likely increases in pressures on the firm (e.g. demands related to prices or salaries). Therefore, the divulgation of corporate information is the result of a trade-off between the incentives to disclose and the drawbacks stemming from that disclosure.

Along this line, Dobler (2007) looks into the issues related to the credibility of the information as a disincentive to disclosure. He argues that there are three potential explanations for a more restricted report on risks: (1) executives may not report because they do not have specific enough information about their risks; (2) they cannot reveal them credibly; (3) they can withhold information owing to the threats of commercial harm. In addition to the inherent unreliability, the Institute of Chartered Accountants in England and Wales (ICAEW, 2011) has also stressed that, in some circumstances, costs may exceed perceived benefits, leading to uninformative disclosures.

Concerning previous literature, some studies (ICAEW, 1998, 1999, 2002; Linsley & Shrides, 2005; Schrand & Elliott, 1998; Solomon, Solomon, Norton, & Joseph, 2000) have shown that companies are providing insufficient information, characterized by a lack of coherence (Linsley & Lawrence, 2007), brevity and excessive focus on past risk (Abraham & Cox, 2007), and with a main approach to financial risks (typically associated with the use of financial derivatives). However, in addition to the financial risk, organizations have to cope with corporate risks or changes in the global economic climate that may affect their values adversely.

Therefore, taking into consideration the widely-accepted perception that companies are not providing sufficient information on risks and their management, and the call to undertake better disclosures, the aim of this study is: (1) to analyse the main risks disclosed by Spanish companies, either compulsory or voluntary; and (2) to analyse some factors both linked to corporate governance and evidenced as relevant in previous empirical studies, which can boost or deter the divulgation of this kind of information. In addition to voluntary information, we also assess the extent of disclosure regarding compulsory information, given that it is not similar to reveal just simple features in search for strict compliance of the current regulation or to include a further step of disclosure by providing abundant data, ranging from vague and generic disclosure to quantitative estimations and more specific data. Although compulsory, this latter choice would imply "a strategic touch", going deeply into the information provided, with more content and detail.

We thus proceeded to analyse the disclosure of risks undertaken by the largest Spanish companies (excluding financial and insurance companies), quoted on the Madrid Stock Exchange, during the period 2007–2009. These companies show a high degree of visibility in markets and, consequently, they have strong incentives to report on their risks. Firstly, we performed a content analysis, creating a disclosure index that compiles both the volume of information revealed and its quality in relation to a set of risks whose disclosure is compulsory, mainly financial risks (credit, liquidity and market risks) and other risks whose revelation is voluntary, such as non-financial risks (operational, business, environmental, new investments, reputation, country risks). We then studied the influence of some factors on this revelation, using panel data methodologies in order to control for the unobserved heterogeneity.

Previous papers have concluded that the divulgation of voluntary information is determined by factors such as: the presence of independent directors (Abraham & Cox, 2007; Chen & Jaggi, 2000; Schellenger, Wood, & Tashakori, 1989), Board activity (Banghoj & Plenborg, 2008), Board stock ownership (Lim, Matolcsy, & Chow, 2007), as well as the corporate size (Amran, Manaf, & Che, 2009; Beretta & Bozzolan, 2004; Linsley & Shrides, 2006), leverage (Ahmed & Courtis, 1999; García-Meca & Sánchez, 2006; Rodríguez Domínguez, Gallego Álvarez, & García Sánchez, 2008, 2009), profitability (Chen & Jaggi, 2000; Marston & Polei, 2004) and the industrial sector (Gallego Álvarez, García Sánchez, & Rodríguez Domínguez, 2008; Watson, Shrides, & Marston, 2002).

However, these factors have not been analysed in relation to the corporate information on risks in a context of corporate governance

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