Original Research Paper **Commerce**

ANALYSIS ON RISK DISCLOSURE PRACTICES OF COMMERCIAL BANKS IN ETHIOPIA

| **K.Sambasiva Rao** | Professor, Department of Commerce and Management Studies, Andhra University Visakhapatnam 530003, Andhra Pradesh, India |
| **Teshome Dula Jirra** | PhD Scholar, Department of Commerce and Management studies, Andhra University, Visakhapatnam 530003, Andhra Pradesh, India |

ABSTRACT

This study examines the effect of corporate governance attributes and bank characteristics on risk disclosure. The data used in this study was secondary data; Annual reports of 14 commercial banks for the period 2010 to 2015 were collected from national bank of Ethiopia. To measure the risk disclosure, 37 attributes of risk related information were selected and the level of risk disclosure was measured by dividing the total score to the maximum obtainable score 37. Content analysis was used to measure risk disclosure score and to test the effect of explanatory variables on the response variable, data was analyzed using random effect model. The result of the study showed that risk disclosure is positively affected by risk committee size, gender diversity in board room, and frequency of risk committee meeting. Moreover, the result of the study also showed that ownership type has a significant negative relationship with risk disclosure.

KEYWORDS | *Risk Disclosure,* Banking, Ethiopia

1. Introduction

Ethiopia is among the fastest growing countries in Sub-Saharan Africa and it has managed to sustain that growth over decades. This growth needs to be supported by high quality financial reporting and there is high level of support to financial reporting reforms by the Government. Implementation of IFRS in Ethiopian companies, including Banks, was manifested by the issued Proclamation No. 847/2014; Financial Report Proclamation of Ethiopia which obliges companies to follow IFRS in their financial statement presentation. However, the Ethiopian banking sector lacks standardized risk disclosure because of non existence of disclosure standards. In the banking industry, one standard of disclosure is risk reporting. It reinforces the company's authenticity and reputation thus keeping up the trust of stakeholders (Oliveira et al. 2011).

The Basel II Capital Accord (Pillar 3) emphasized the noteworthiness of useful risk disclosures in banks for redesigning business sector Discipline (Basel Committee on Banking Supervision, 2006). However, risk disclosure practices in Developing country like Ethiopia is still unstandardized and subject to inconsistency. National bank of Ethiopia bank supervision directorate report (2009) indicated that internal communication of risk appetite and findings is low in 60% of banks in Ethiopia. Thus, this research contributes to provide a sound basis for the standardization of risk disclosures in Ethiopian banking sector. Further, fills a gap in the risk disclosure literature related to Ethiopian commercial banks.

2. Review of Literature

According to Linsley and Shrives (2006), risk disclosures is about informing the users of accounting information about any threat which may affect or has already affected the organization or its management. Disclosure of risks has received a greater amount of attention in debates regarding corporate disclosures. Those in favor of increased risk related disclosures by companies have argued that good corporate governance requires directors to be accountable to shareholders for the risks that a company faces and improved risk disclosure enhances understanding of a company's risk profile. The findings of Hassan M. (2014) the firm size is positive and statistically significant, suggesting that larger firms are disclosing more quality information about their risks.

Hossain Mohammed (2008) have been taken CAR as a proxy for market discipline, the results showing that it was significant at 5%, but with negative signs. This situation indicates that the level of disclosure is adversely related to CAR.

It was argued that a company in which the government is a considerable shareholder discloses more voluntary information in their annual reports (Ghazali, 2007). In addition, Naser et al (2002) pointed out that government participation in the ownership of a company's shares can be viewed as a supervising mechanism that may affect the quality of information disclosure in the annual reports**.**

Hossain and Taylor (2007). They found the profitability variable, as measured by return on assets (ROA), is not significant in determining the extent of voluntary disclosure in annual reports of Bangladeshi commercial banks. Hawashe Al-mahdy(2015), Indicate that government ownership is negatively associated with voluntary disclosure level. Board of directors plays an important role in the corporate governance of companies. Agency theory predicts that larger boards incorporate a variety of expertise which results in more effectiveness in boards' monitoring role

According to Cheng and Courtenay (2006), the more directors on the board, the less efficient it would be at monitoring management. This is also supported by agency theory; bigger boards are bad and corrupt, while smaller boards are good and effective in terms of enhancing performance and disclosure (Jensen and Meckling, 1976).

The other attribute of corporate governance is Board diversity which refers to the varying profiles that may exist amongst members of the board and how the variety may affect the decision-making process (Allini et al., 2015). The author Stated that the presence of woman on the board of corporate firm is becoming of interest to many researchers.

Ho et al. (2001) reported that women on top management teams influence decisions positively, while Bianco et al. (2011) strongly question their capacity to impact upon or add extra value to the team. Thus, the existence of such inconclusive outcomes based on prior studies can tiger further research. Based on empirical studies reviewed, the following hypothesis was formulated for this study:

H_1: There is positive association between board size and Risk related information disclosure in the Banking sector.

H_2: There is a positive relationship between Proportion of women on the board of directors and risk related

information disclosure in banking sector

H3: There is positive relationship between risk committee size and risk disclosure in banking sector

H4: there is positive relationship between risk committee meeting and risk disclosure in banking sector

H5: there is positive relationship between ownership type and risk disclosure in banking sector

3. Research design and Methodology
3.1. Research design
The central role of research design is to minimize the chance of drawing incorrect causal inferences from data. This research was explanatory research in design and quantitative type of research.

3.2. Research Method
3.2.1. Data and sample
The population of the study was all commercial banks operating in Ethiopia during the year 2010-2015. There were nineteen (19) banks operating in Ethiopia, where eighteen 18 are commercial banks ,and 1 Development bank owned by government .Out of the 18 commercial banks, Two banks were public owned while sixteen banks were privately owned. Out of 18 commercial banks, we have selected 14 commercial banks purposively. The selected banks were commercial banks which had served more than six year. The data source was Audited financial reports collected from national bank and sampled banks during the period 2010-2015. After collection of secondary data, 37 risk disclosure attributes were selected and, on the bases of a dichotomous model; they were coded as 1 if disclosed in annual audited financial statement or 0 if not disclosed in annual audited financial statement.

3.2.2. Variable Definitions
The dependent variable of this study was Risk disclosure and it was measured using content analysis; annual audited financial reports were reviewed and 37 attributes of risk disclosure were assigned value on the bases of a dichotomous model; they were coded as 1 if disclosed or 0 if otherwise. This approach was adopted from (Ghazali, 2007).

Total Disclosure$=\sum_{i=1}^{n}$1di= Actual Score / Maximum Score (37 points)

Where d=1, if the item is disclosed; 0, if the item is not disclosed

Table 1.Independent Variables

Variables	Definitions and Measurement
Board Size (BS)	The number of directors sitting on the board
Board diversity (NFD):	Number of female directors represented in board room
Risk committee meeting (RCM)	Total number of meeting held by risk committee
Risk Committee Size(RCS)	The total members of risk and compliance sub-committee
Capital Adequacy Ratio (CAR)	means of bank regulation through the use of financial ratios ,measured as Total capital/Total risk weighted Asset
Ownership type(OWNR)	If a bank is public owned, it is assigned value 1, and 0, if owned by private.
Control Variables	
Operating Efficiency of Management(ME)	Operational efficiency is about the output to input ratio; OE = interest income+non-interest income / Interest expense+non-interest expense
Bank size(lnTA)	Natural logarithm of bank asset
Profitability(ROA)	Measured by dividing Net income to average asset

3.3. Model specification

The model used for this study was a panel data model; random effect model. The random effect panel data model assumes that the variation across entities is assumed to be random and uncorrelated with the predictor or independent variables included in the model. It allows for time-invariant variables to play a role as explanatory variables. The research has the following general model:

$$Yit = \alpha_i + \Sigma\beta Xk_{it} + u_i + \varepsilon_{it}$$

Where
Yit- the dependent variable for bank i,at time t
Xk_{it}, the independent variables
α_i-intercept for bank i
ε_{it} is the error term
Ui-unobserved bank specific heterogeneity
The hypothesis designed in this study were tested based on results obtained using the model below

$$RD_{it} = \beta0 + \beta_1 BS_{it} + \beta_2 PFD_{it} + \beta_3 RCM_{it} + \beta_4 ME_{it} + \beta_5 RCS_{it} + \beta_6 CAR_{it} + \beta_7 ln_{TAit} + \beta_{8OWNit} + \beta_9 ROA_{it+Ui+}\varepsilon_{it}$$

Where:
RD$_{it}$ –stands for risk disclosure of bank i at time **t**
BS- stands for board size
PFD-stands for percentage of female directors in board room
RCS- stands for risk committee size
ME- stands for operating efficiency of management
RCM- stands for frequency of risk committee meeting
OWN -stands for ownership type
CAR- stands for Capital adequacy ratio (a measure of external corporate governance)
LnTA -stand for bank size and expressed ass natural logarithm of total asset
ROAit- stands for return on asset of bank i, at time t
B0 -is intercept
$\beta1, \beta_2 ……… \beta8$ are coefficient of independent
u_i -is bank specific unobserved heterogeneity
εit is the error,i=bank ,t=time

4. Result and discussion
The analysis presented in table bellow shows result of regression analysis. The result of all independent variables was discussed based on the empirical result.

Table 2: Regression Result

	Coef.	Std. Err.	Sig.
BS	-.0453196	.0122452	0.000***
NFD	.0460632	.0271123	0.089*
RCM	.0099065	.0058929	0.093*
RCS	.0492941	.0203741	0.016**
lnTA	-.1620067	.0649383	0.013**
OWNR	-.3923176	.0850106	0.000***
ME	.0274763	.0245386	0.263
CAR	-.0183687	.0052423	0.000***
ROA	-.0373976	.0119121	0.002***
R-squared value	0.4720		
Adj.R-squared	0.4078		
Model specification test (Ramsey RESET test) p-value	0.4246		
* 10% level of significance, ** 5% level of significance,*** statistically significant at 1% level of significance			

Source: Researchers own computation

As can be seen from the above regression result, the predictive power of the model was 47%; which implies that 47% of the variation in risk disclosure is explained by the independent variables. The result showed a positive and significant relationship between risk disclosures, number of Female director in board room (NFD), frequency of risk committee meeting (RCM), and risk committee size (RCS). It indicates that as the number of female in

board room increase, there is a better decision related to disclosure. The result shows as risk committee size and risk committee meeting frequency increases, there is possibility of better decision related to risk disclosure in commercial banks. However, board size and ownership type are negatively related to risk disclosure in commercial banks. The result of the study also shows that capital adequacy ratio, and Bank profitability measured by Return on Asset were variables which had significant negative relationship with risk disclosure in commercial banks. The detail discussion of the regression result on the basis of the research hypothesis is presented here under;

Hypothesis (H1): Board size (BS)
The result of the GLS random effect model as presented in table 2 shows the regression coefficient for the predictor variable (BS) is -0.0453. Therefore, H1: there is positive relationship between board size and risk disclosure is rejected.

Hypothesis (H2): number of female directors in board room
As indicated in table 2 the regression coefficient for the predictor variable (NFD) is 0.046 .Therefore, H2: there is positive relationship between number of female directors in board room and risk disclosure is accepted.

Hypothesis (H3): risk committee size
Similarly, the regression coefficient for the predictor variable (RCS) is 0.049 .Therefore, H2: there is positive relationship between risk committee size and risk disclosure is accepted.

Hypothesis (H4): risk committee meeting frequency
The result also showed that the regression coefficient for the predictor variable (RCM) is 0.0099.Therefore, H2: there is positive relationship between risk committee meeting frequency and risk disclosure is accepted.

Hypothesis (H5): ownership type
Moreover, the regression coefficient for the predictor variable (OWNR) is -0.392. Therefore, H2: there is positive relationship between ownership type and risk disclosure is rejected.

5. Conclusion
The result of the study shows that; risk committee size, number of female directors, management operational efficiency and frequency of risk committee meeting are positively related to risk disclosure in Commercial banks of Ethiopia. Whereas, ownership type, bank size, returns on asset, capital adequacy ratio, and board size are negatively related to risk disclosure in commercial banks. In this study, the disclosure interest rate risk, currency risk, operational risk, credit risk, and liquidity risk were measured by using content analysis. Relatively disclosure of credit risk attributes and liquidity risk attributes were showing progressive improvements during the period of observation. However, the disclosure score of operational risk attributes were the least during the years of observation. Moreover, there was inconsistency of disclosure from year to year and inconsistency across the commercial banks sampled. This inconsistency was due to lack of standards of risk disclosure which serves as bench mark for bank supervision. Therefore, even if remains debatable whether regulation should play the primary role in encouraging better risk reporting, the National bank of Ethiopia should give due emphasis and set standards of risk disclosure in banking sector.

As depicted in the regression result, bank size has negative relationship showing negative coefficient of -0.1620067. It implies that larger banks are disclosing less information about risk than smaller banks. The result also indicated that ownership type has significant negative relationship showing coefficient of -0.3923176. It imply that government owned banks are disclosing less information related to risk than private owned banks.

References
1. Allini, A. Rossi, F, M. & Hussainey, K. (2015). The Board's Role in Risk Disclosure: An Explanatory Study of Italian Listed State-Owned Enterprises, Accessed through https://elsamadony.files.wordpress.com
2. Bianco, M., Ciavarella, A. and Signoretti, R. (2011). Women on boards in Italy, accessed through www.consob.it/documenti/quaderni/qdf70.pdf
3. Federal Negarit Gazette of the Federal Democratic republic of Ethiopia .Financial reporting Proclamation, proclamation No. 847/2014.
4. Ho, S. M. S., & Wong, K. R. (2001).A study of the relationship between corporate governance structures and the extent of voluntary disclosure. Journal of International Accounting, Auditing, and Taxation, 10(2), 139-156.
5. Linsley, P. M., & Shrives, P. J. (2006).Risk reporting: A study of risk disclosures in the annual reports of UK companies. British Accounting Review, 38(4), 387-404.
6. Ghazali, (2007).Ownership structure and corporate social responsibility disclosure: some Malaysian evidence. The international journal of business in society, 7 (30) 251 – 260
7. Hassan M. (2014).Investigating The Impact of Firm Characteristics on the Risk Disclosure Quality. International Journal of Business and Social Science, Vol. 5, (1), 109-115
8. Naser, K., Alkhatib, K. &Karbhari,.Y(2002).Empirical evidence on the depth of corporate information disclosure in developing countries: The case of Jordan. International Journal of Commerce and Management, 12(3/4),122-34.
9. Hawashe Al-mahdy(2015). Commercial Banks' Attributes and Annual Voluntary Disclosure: the case of Libya. International Journal of Accounting and Financial Reporting, 5, (2) 162-308
10. Cheng, E. C. M., & Courtenay, S. M. (2006). Board composition, regulatory regime and voluntary disclosure. The International Journal of Accounting, 14(3), 262-289.
11. Jensen, M. C. and Meckling, W. H. (1976) .Theory of the firm: managerial behavior, agency costs and ownership structure'. Journal of Financial Economics, 3 (4): 305-360.
12. Hossain M. (2008).The Extent of Disclosure in Annual Reports of Banking Companies: The Case of India. European Journal of Scientific Research, 23 No.(4) ,660-681
13. Basel Committee on Banking Supervision (2006). Enhancing Corporate Governance for Banking Organizations. Basel, Switzerland: Bank for International Settlements.
14. Oliveira, J., Rodrigues, L.L., Craig, R. (2011).Voluntary risk reporting to enhance institutional and organizational legitimacy: Evidence from Portuguese banks. Journal of Financial Regulation and Compliance, 19(3), 271-289.
15. Hossain, M., & Taylor, P. J. (2007). The empirical evidence of the voluntary information Disclosure in the annual reports of banking companies: The case of Bangladesh. Corporate Ownership and Control, 4(3), 111-125.
16. National Bank of Ethiopia Banking Risk management survey report (2009) retrieved through www.nbebank.com/pdf/bankrisk