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Islamic financial institutions, corporate governance, and corporate risk disclosure in Gulf Cooperation Council countries

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ABSTRACT

Using content analysis we evaluate the determinants of corporate risk disclosure in a sample of 424 publicly traded firms in the Gulf Cooperation Council countries. We hypothesize that corporate risk disclosure will be lower in Islamic financial institutions when compared to conventional financial institutions and higher in firms that have high quality corporate governance contexts. We also argue that corporate risk disclosure will vary across the Gulf Cooperation Council countries despite sociocultural and regulatory similarities. Results are generally supportive of our hypotheses. Implications for theory and practice are discussed.

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1. Introduction

Over the past several years standards of risk reporting have been shown to be a critical dimension of corporate disclosure. A riskier business climate often results in a riskier investment climate. To reduce this inherent risk investors demand that financial statements include information that is relevant in helping to accurately assess the risks and uncertainties concerning a business enterprise's future cash flows and operating results. It is widely accepted that risk reporting results in both greater transparency and heightened investor confidence with benefits to the market performance of the firm (e.g. Meier et al., 1995; Solomon et al., 2000; Schrand and Elliott, 1998; Cabedo and Tirado, 2004; Linsley and Shrives, 2006; Abraham and Cox, 2007; Linsley and Lawrance, 2007; Hassan, 2009, 2014).

Much of the empirical work to this point has focused on the standards of the risk reporting practices of publicly traded firms in developed countries ranging from the United Kingdom (e.g. Solomon et al., 2000; Linsley and Shrives, 2006; Abraham and Cox, 2007; Iatridis, 2008; Linsley and Lawrance, 2007; Elshandidy et al., 2013) to Italy (Beretta and Bozzolan, 2004; Maffei et al., 2014), Canada (Lajili and Zéghal, 2005), the United States (Rajgopal, 1999; Linsmeier et al., 2002; Jorion, 2002; Schrand, 1997), Australia (Poskitt, 2005), Finland (Miihkinen, 2013), Spain (Madrigal et al., 2012), and Portugal (Oliveira et al., 2011a,b). Notwithstanding the work of Amran et al. (2009), Mokhtar and Mellett (2013), Elkelish and Hassan (2014), and Hassan (2009, 2014) very little attention has been given to the risk reporting practices of publicly traded firms in emerging economies.

With the exception of Dobler et al. (2011) who studied the risk disclosure practices of U.K., U.S., Canadian, and German manufacturing firms in a multi-country sample very few studies have investigated the risk disclosure practices of firms outside a single country context. Specifically, empirical work has focused on the risk disclosure practices of financial (Oliveira et al., 2011a; Maffei et al., 2014; Hassan, 2014) and non-financial (Oliveira et al., 2011b; Madrigal et al., 2012; Elshandidy et al., 2013) firms in the context of single-country studies.

This study extends prior work by evaluating the risk disclosure practices of firms operating in the Gulf Cooperation Council ("GCC") countries, which includes Bahrain, the Kingdom of Saudi Arabia, Kuwait, Qatar, the Sultanate of Oman, and the United Arab Emirates. Specifically, we evaluate the impact of firm level characteristics on corporate risk disclosure ("CRD") practices in a sample of 424 publicly traded GCC firms. This empirical context is unique in that despite having developed relatively new market strategies typically associated with Western economies such as market diversification, economic deregulation, and the reformation of economic life (Anderson, 2000; Europa Regional Surveys of the World, 2003, 2004; Kamla and Roberts, 2010) firms in GCC countries are generally considered to operate in an Arab-Islamic context that is often considered to be opaque in terms of disclosure practices (Kamla and Roberts, 2010). Notwithstanding this view, investors have become increasingly interested in stabilizing the capital markets in an Arab-Islamic context that is home to many international financial institutions, a center of regional trade, and is being integrated into the global economic system with increasing speed (Kamla and Roberts, 2010). Hence, the adoption of international standards of risk reporting ("ISFR") is a critical component of this process.

In as much, this study is a comprehensive evaluation of the risk reporting practices of three different types of GCC firms including financial (Islamic), financial (non-Islamic), and non-financial firms. Accordingly, the study identifies the institutional characteristics that yield variation in the risk reporting practices of firms operating in different sectors of the GCC. It is noteworthy that, unlike conventional financial institutions, Islamic financial institutions adhere to Islamic principles while attempting to meet emerging international standards of risk reporting (Olson and Zoubi, 2008). GCC countries are similar in that they have similar sociocultural characteristics, share a common language, are dependent on natural resources, have similar levels of wealth, and pursue development in the social, economic and political spheres simultaneously (Baydoun et al., 2013). Given these similarities publicly traded firms in the GCC are also similar in that they comply with Basel II requirements (Baydoun et al., 2013). These characteristics yield an isomorphic move toward greater similarity in the risk reporting practices of firms in the GCC.

This study, therefore, is novel in that it investigates firm-level determinants of the risk reporting practices of GCC firms. Specifically, it evaluates the extent to which CRD practices vary as a function of financial institution type whereby we expect that Islamic financial institutions will disclose less

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