Privatization and Corporate Disclosure: The Influence of Ownership Changes, Governance Reforms and Regulation on Corporate Disclosure Practices in Jordan

Mahmoud Al-Akra

Bachelor of Economic Sciences (Accounting) Aden University

Master of Commerce (Accounting) Charles Sturt University

A thesis submitted for the Degree of Doctor of Philosophy of

The University of New England

February 2008

Acknowledgements

I would like to express my gratitude to many people who contributed to the completion of this thesis. My first thanks is to my supervisor Professor Ian Eddie, Dean of the Faculty of Business and Government at the University of Canberra, who showed his support and encouragement when undertaking this research and whose knowledge and understanding provided me with the impetus to improve my research approach.

I also would like to acknowledge the role of Dr Muhammad Jahangir Ali, senior lecturer at the Department of Accounting at La Trobe University, my previous co-supervisor for providing me with his support and assistance throughout the years.

Special thanks to my new co-supervisor Professor Patrick Hutchinson, School of Business at UNE, whose valuable comments contributed to the fulfilment of this thesis. I would like to thank Dr. Omar Marashdeh, a previous senior lecturer in financial economics at the Graduate School of Business, the University of Sydney, and Associate Professor Stephen Owusu-Ansah, the University of Texas-Pan American, for their valuable comments.

Also, I extend my appreciation to the academic and administrative staff of the Business School at UNE, the staff at the Dixon library and the staff at the Research Services Office for their excellent services. My appreciation also goes to the Ministry of Industry and Trade in Jordan, the department of the Company Controller, the Jordanian Association of Certified Public Accountants and the Executive Privatization Commission in Jordan for their valuable assistance and providing me with the information and needed data.

Finally, I would like to thank my family whose love, support and encouragement during the hard times made the completion of this thesis possible. Special thanks to my father and mother whose warm words gave me the needed inspiration, and my wife who showed wonderful understanding, support and help throughout the years.

Abstract

Privatization is an economic policy used by more than a hundred countries worldwide so as to promote the use of markets to allocate resources. Privatization leads to major changes in the ownership structures of firms. Also, governments executing privatization programs have significantly changed their corporate governance systems and disclosure rules (Megginson & Netter 2001). Jordan is one of the developing countries that had recently embarked on a privatization program which resulted in the reduction of the state's ownership from around 15% when the privatization program commenced in 1997 to less than 6% in 2003 largely absorbed by foreign investors. In addition, privatization in Jordan led to major corporate governance and disclosure regulation reforms.

This study empirically examines the impact of privatization on corporate disclosure in Jordan using a novel approach through three channels. First, changes in ownership from the state to private owners who have distinct incentives and abilities to monitor management. Second, changes in corporate governance systems which enhance the quality of corporate disclosure. Jordan reformed its corporate governance system which was incorporated in the 1997 Company Law, the 1997 Temporary Securities Law and the 2002 Securities Law. Third, changes in disclosure regulation so as to improve mandatory disclosure compliance. Jordan, through the enactment of the new Company Law and Securities Law, mandated the adoption of the full version of the IAS/IFRSs and imposed sanctions for non-compliance.

The analysis utilized both cross-sectional regression models and panel data techniques. Panel data was used to account for the dynamic effect of ownership changes resulting from privatization and the resulting governance and disclosure regulation reforms by comparing disclosure in 1996 to that in 2004 (one year before privatization and one year after). The study used the annual reports of the years 1996 and 2004 of 80 public non-financial listed Jordanian companies.

The analysis revealed that while state ownership was a significant determinant of the level of voluntary disclosure, the transfer of ownership to foreign investors produced a significant positive influence on voluntary disclosure. Also, governance reforms through strengthening investor protection had significant influence on voluntary disclosure. Finally, disclosure regulation reforms, and one of the governance mechanisms, the mandate of audit committees, produced a significant influence on mandatory disclosure. Overall, this study showed that privatization had successfully influenced corporate disclosure in Jordan both voluntary and mandatory.

I certify that the substance of this thesis has not already been submitted for any degree and is not currently being submitted for any other degree or qualification.

I certify that any help received in preparing this thesis, and all sources used, have been acknowledged in this thesis.

Mahmoud Al-Akra

……..

Signature

Table of Contents

Acknowledgements	ii
Abstract	iii
Table of Contents	vi
List of Tables	xi
List of Figures	xiii
Chapter 1 Introduction	1
1.1 Statement of the Problem	1
1.2 Motivation and Justification of the Study	2
1.2.1 The Importance of the Influence of Privatization on Disclosure	2
1.2.2 The Suitability of Jordan Privatization Program	5
1.3 Objectives of the Study	7
1.4 Research Question	8
1.5 Significance of the Study	8
1.6 Prior Research	9
1.7 Research Methodology	11
1.8 Limitations of the Study	11
1.9 Organization of the Study	12
Chapter 2 The Impact of Privatization on Corporate Disclosure	14
2.1 Introduction	14
2.2 Privatization: An Overview	16
2.3 Methods of Privatization	17
2.4 Benefits of Privatization	18
2.5 The Relationship between Privatization and Disclosure	18
2.5.1 Ownership Structure and Voluntary Disclosure	20
2.5.1.1 State Ownership	21
2.5.1.2 Government Agencies Ownership	23
2.5.1.3 Individual Ownership	24
2.5.1.4 Institutional Ownership	25
2.5.1.5 Foreign Ownership	26
2.5.1.6 Arab Ownership	27
2.5.2 Corporate Governance and Voluntary Disclosure	28
2.5.2.1 Corporate Governance Variables	32
2.5.2.1.1 Board Composition: The proportion of non-executive directors on board	32
2.5.2.1.2 The Presence of an Audit Committee	33
2.5.2.1.3 Role Duality	34
2.5.2.1.4 Board Size	35
2.5.2.1.5 Family Control	35
2.5.2.2 The effect of External Governance Reforms: Investor Protection	36

2.5.3 Accounting Regulation and Disclosure	37
2.6 Jordan's Privatization Program	39
2.7 Chapter Summary	42
Chapter 3 The Impact of Accounting Regulatory Reform on Corporate Disclosure	43
3.1 Introduction	43
3.2 Evolution of Corporate Disclosure Regulation	45
3.3 Disclosure Regulation: Theoretical Arguments	46
3.3.1 The Case for Regulation of Disclosure	47
3.3.1.1 Market Failure	47
3.3.1.2 Inequity of Access	49
3.3.2 The Case against Accounting Regulation	49
3.4 Institutional Arrangement for Accounting Standard Setting	50
3.5 Modes of Accounting Regulation	51
3.6 Enforcement Mechanisms for Accounting Regulation	53
3.7 Studies Examining Disclosure Regulation and Enforcement	54
3.7.1 Studies Investigating the Effect of Enforcement Mechanisms	54
3.7.2 Studies Investigating the Accounting Regulatory Environment and Legal Environment	57
3.7.3 Studies investigating the Introduction of Accounting Regulation	59
3.8 Institutional Environment of Accounting Regulation in Jordan	64
3.8.1 Historical Overview of the Financial Reporting Environment in Jordan	64
3.8.2 Jordan and IAS/IFRS	67
3.8.2.1 International Pressures	68
3.8.2.2 The Jordanian Accounting Regulatory System	68
3.8.2.3 Features of IAS/IFRS	69
3.8.2.4 The Environment of Jordan	69
3.9 Recent Reforms of Accounting Disclosure Regulation	70
3.10 Accounting Standards Enforcement and Compliance	72
3.11 Summary and Conclusion	75
Chapter 4 Corporate Disclosure	77
4.1 Introduction	77
4.2 Disclosure Definition and Types	77
4.3 Motivations of Voluntary Disclosure	78
4.3.1 Private Contracting	79
4.3.2 Mitigating Information Asymmetry	79
4.3.3 Management Signalling and Compensation	80
4.3.4 Market for Corporate Takeover	80
4.3.5 Market for Lemons	80
4.3.6 Increasing Analyst Coverage	81
4.3.7 Extending Mandatory Disclosures	81

4.4 Constraints of Voluntary Disclosure	81
4.4.1 Disclosure Precedent	82
4.4.2 Litigation Costs	82
4.4.3 Proprietary Costs	82
4.4.4 Agency Costs	82
4.4.5 Political Costs	83
4.4.6 The Increase in Stock Market Volatility	83
4.5 Empirical Disclosure Research	83
4.5.1 Disclosure Indexes	84
4.5.2 Disclosure Studies	85
4.5.2.1 Studies Relating Disclosure to Firm Specific Attributes	86
4.5.2.1.1 Developed Countries Studies	86
4.5.2.1.2 Developing Countries Studies	87
4.5.2.1.3 Comparative Studies	89
4.5.2.2 Corporate Governance Studies	90
4.5.2.3 Studies Examining Disclosure Compliance with IAS/IFRS	90
4.6 Summary and Conclusion	92
Chapter 5 The Impact of Privatization through Changes in Ownership Structure and Governance Reforms on Voluntary Disclosure: Empirical Evidence	94
5.1 Introduction	94
5.2 Panel Data Analysis	95
5.3 Development of Hypotheses of Control Variables	95
5.2.1 Firm Size	96
5.2.2 Leverage	97
5.2.3 Profitability	98
5.2.4 Size of auditor	99
5.2.5 Liquidity	100
5.2.6 Industry type	100
5.2.7 Listing	101
5.2.8 Company Age	102
5.2.9 Voluntary Disclosure Changes of Privatized Firms Compared to Non-privatized Ones	103
5.3 Research Design	103
5.3.1 Data Selection	103
5.3.2 Voluntary Disclosure Indices (VOLDIS)	104
5.3.3 Measurement of Independent Variables	106
5.4 Descriptive Statistics and Univariate Tests	107
5.4.1 Dependent Variable	107
5.4.2 Independent Variables	110
5.4.2.1 Ownership Variables	110
5.4.2.2 Governance Variables	111
5.4.2.3 Control Variables	112

5.5 Multiple Regression Models	118
5.5.1 The 1996 Cross-sectional Regression Model	120
5.5.1.1 Model A	121
5.5.1.2 Model B	125
5.5.1.3 Model C: Reduced Regression	129
5.5.1.4 Results	131
5.5.2 The 2004 Cross-sectional Regression Model	133
5.5.2.1 Model A	133
5.5.2.2 Model B	136
5.5.2.3 Model C: Reduced Regression	139
5.5.2.4 Results	141
5.5.3 1996 versus 2004	143
5.5.3.1 Pooled Regression using Privatized Firms' Data	144
5.5.3.1.1 Model A	145
5.5.3.1.2 Model B	148
5.5.3.1.3 Results	152
5.5.3.2 Pooled Regression using Non-Privatized Firms' Data	154
5.5.3.2.1 Model A	154
5.5.3.2.2 Model B	158
5.5.3.2.3 Results	163
5.5.3.3 Pooled Regression using Data for All Firms	168
5.5.3.3.1 Model A	169
5.5.3.3.2 Model B	172
5.5.3.3.3 Results	176
5.6 Summary of Results	178
5.7 Conclusion	181
Chapter 6 The Impact of the Introduction of Accounting Disclosure Regulation on Mandatory Disclosure Compliance: Empirical Evidence	183
6.1 Introduction	183
6.2 Hypothesis Development	184
6.2.1 Mandatory Disclosure and the Presence of Audit Committees	184
6.2.3 Mandatory Disclosure and Corporate Attributes	185
6.3 Mandatory Disclosure Index	185
6.4 Descriptive Statistics and Univariate Tests	187
6.5 Multiple Regression Models	188
6.5.1 The 1996 Cross-sectional Regression Model	189
6.5.1.1 Model A	189
6.5.1.2 Model B	193
6.5.1.3 Reduced Model C	194
6.5.1.4 Results	197
6.5.2 The 2004 Cross-sectional Regression Model	198
6.5.2.1 Model A	198
6.5.2.2 Model B	202

6.5.2.3 Reduced Model C	203
6.5.2.4 Results	206
6.5.3 1996 versus 2004: The Pooled Regression Model	208
6.5.3.1 Model A	208
6.5.3.2 Model B	212
6.5.3.3 Results	217
6.6 Summary of Results	218
6.7 Conclusion	220
Chapter 7 Summary and Conclusion	222
7.1 Introduction	222
7.2 The Impact of Privatization on Corporate Disclosure	223
7.2.1 Evidence from Voluntary Disclosure	223
7.2.1.1 Evidence Regarding Ownership changes	223
7.2.1.2 Evidence Regarding Governance Reforms	225
7.2.1.3 Evidence Regarding the Control Variables	226
7.2.2 Evidence from Mandatory Disclosure	226
7.3 Contributions of the Study	228
7.3.1 Contributions to Accounting Research	228
7.3.2 Contributions to Accounting Practice and Regulation	230
7.4 Limitations and Future Research	231
7.5 Conclusion	233
References	235
Appendixes	258

List of Tables

Table		Page
3.1	Empirical Studies Examining the Effect of Preventive Enforcement Mechanisms on the Credibility of Accounting Information	55
3.2	Empirical Studies Examining the Effect of Punitive Enforcement Mechanisms on the Credibility of Accounting Information	56
3.3	Empirical Studies Examining the Effect of the Accounting Regulatory Environment and Legal Environment	57
3.4	Empirical Studies using the Within-Country Time Series Approach	59
3.5	Recent Accounting Regulatory Reforms and Responsible Government Agencies	70
3.6	Enforcement Measures Adopted by Jordanian Authorities	73
5.1	Voluntary Disclosure Scores: A Comparison 1996-2004 for Privatized Firms	107
5.2	Voluntary Disclosure Scores: A Comparison 1996-2004 for Non-Privatized Firms	108
5.3	Voluntary Disclosure Scores: A Comparison 1996-2004 for the whole Sample	108
5.4	Test of Differences in the Means of Voluntary Disclosure	109
5.5	Tests of Differences in the Means of Continuous Variables in 1996 versus 2004 of Privatized Firms	114
5.6	Tests of Differences in the Means of Continuous Variables in 1996 versus 2004 of Non-Privatized Firms	115
5.7	Tests of Differences in the Means of Continuous Variables in 1996 and 2004 for the Whole Sample	116
5.8	Definition of Independent Variables	119
5.9	Skewness Values for Untransformed and Transformed Continuous Variables (1996)	123
5.10	VIF Values for Rank Transformed Model, 1996 data, N = 80	123
5.11	VIF Values for Normal Scores Transformed Model, 1996 data, N = 80	127
5.12	Regression Analysis of Determinants of Voluntary Disclosure in 1996	130
5.13	Skewness Values for Untransformed and Transformed Continuous Variables (2004)	134
5.14	VIF Values for Rank Transformed Model, 2004 data, N = 80	134
5.15	VIF Values for Normal Scores Transformed Model, 2004 data, N = 80	137
5.16	Regression Analysis of Determinants of Voluntary Disclosure in 2004	139
5.17	Skewness Values for Untransformed and Transformed Continuous Variables (Pooled Privatized Firms, N=54)	146
5.18	VIF Values for Rank Transformed Pooled (Privatized Firms) Model, N = 54	146
5.19	VIF Values for Normal Scores Transformed Model, Pooled Privatized Firms, N = 54	149
5.20	Pooled Regression Estimates for the Privatized Firms (1996-2004) N = 54	151
5.21	Skewness Values for Untransformed and Transformed Continuous Variables (Pooled Non-Privatized Firms, N=106)	156

5.22	VIF Values for Rank Transformed Model, Pooled Non- Privatized Firms, N = 106	156
5.23	VIF Values for Normal Scores Transformed Model, Pooled Non-Privatized Firms, N = 106	159
5.24	Pooled Regression Estimates for the Non-Privatized Firms (1996-2004) N = 106	161
5.25	Pooled Regression Estimates for the Private Firms (1996-2004) N = 98	167
5.26	Skewness Values for Untransformed and Transformed Continuous Variables (for the Pooled Regression Models of the Whole Sample of Firms)	170
5.27	VIF Values for the Pooled Regression Model of the Whole Sample of Firms (Rank Transformed Variables), N = 160	170
5.28	VIF Values for the Pooled Regression Model of the Whole Sample of Firms (Normal Scores Transformed Variables), N = 160	173
5.29	Pooled Regression Estimates for the Whole Sample of Firms (1996-2004) N = 160	175
5.30	Summary of the Findings of the Regression Models	180
6.1	Descriptive Statistics of the Mandatory Disclosure Indexes for the Two Years	187
6.2	Test of Differences in the Means of Mandatory Disclosure	188
6.3	Skewness Values for Untransformed and Transformed Continuous Variables (1996)	191
6.4	Correlation Coefficients of Mandatory Disclosure Index with Independent Variables in 1996	191
6.5	VIF Values for Rank Transformed Model, 1996 Data, N = 80	191
6.6	VIF Values for the Normal Scores Model, 1996 Data, N = 80	195
6.7	Regression Analysis of Determinants of Mandatory Disclosure in 1996	197
6.8	Skewness Values for Untransformed and Transformed Continuous Variables (2004)	199
6.9	Correlation Coefficients of Mandatory Disclosure Index with Independent Variables, 2004 Data	200
6.10	VIF Values for Rank Transformed Variables, 2004 Data	200
6.11	VIF Values for Normal Scores Transformed Continuous Variables, 2004 Data	204
6.12	Regression Analysis of Determinants of Mandatory Disclosure in 2004	206
6.13	Skewness Values for Untransformed and Transformed Continuous Variables (for the Pooled Regression Model of the Whole Sample of Firms)	209
6.14	Correlation Coefficients of Mandatory Disclosure Index with Independent Variables, Pooled Data	210
6.15	VIF Values for Rank Transformed Variables, Pooled Data, N = 160	210
6.16	VIF Values for the Pooled Regression Model of the Whole Sample of Firms (Normal Scores Transformed Variables), N = 160	214
6.17	Pooled Regression Estimates for the Whole Sample of Firms (1996-2004) N = 160	217
6.18	Summary of the Findings of the Regression Models	220

List of Figures

Figure		Page
1.1	Relationship between Privatization and Disclosure	5
2.1	The Impact of Privatization on Corporate Disclosure	19
2.2	Ownership Changes and Voluntary Disclosure: Channel 1	20
2.3	Corporate Governance Reforms and Disclosure: Channel 2	31
2.4	Regulatory Reforms and Disclosure: Channel 3	38
2.5	Jordan Privatization Program	41
3.1	A Continuum of Accounting Regulation Modes	52
5.1	Normality plot for the Untransformed Dependent Variable	121
5.2	Tests of Homoscedasticity for the Cross-Sectional Regression Model 1996 (Rank Transformation) Plot of Studentized Residuals against Predicted Value Plot of Cooke's Distance versus Predicted Values	124
5.3	Tests of Normal Distribution of Residuals for the Cross-Sectional Regression Model 1996 (Rank Transformation)	125
5.4	Tests of Homoscedasticity for the Cross-Sectional Regression Model 1996 (Normal Scores Transformation) Plot of Studentized Residuals against Predicted Value Plot of Cooke's Distance versus Predicted Values	128
5.5	Tests of normal Distribution of Residuals for the Cross-Sectional Regression Model 1996 (Normal Scores Transformation)	129
5.6	Tests of Homoscedasticity for the Cross-Sectional Regression Model 2004 (Rank Transformation) Plot of Studentized Residuals against Predicted Value Plot of Cooke's Distance versus Predicted Values	135
5.7	Tests of Normal Distribution of Residuals for the Cross-Sectional Regression Model 2004 (Rank Transformation)	136
5.8	Tests of Homoscedasticity for the Cross-Sectional Regression Model 2004 (Normal Scores Transformation) Plot of Studentized Residuals against Predicted Value Plot of Cooke's Distance versus Predicted Values	138
5.9	Tests of Normal Distribution of Residuals for the Cross-Sectional Regression Model 2004 (Normal Scores Transformation)	139
5.10	Normality Plot for the Untransformed Dependent Variable	144
5.11	Tests of Homoscedasticity (Pooled Privatized Firms Rank Transformation) Plot of Studentized Residuals against Predicted Value Plot of Cooke's Distance versus Predicted Values	147
5.12	Tests of Normal Distribution of Residuals for the Pooled Privatized Firms (Rank Transformed Variables)	148
5.13	Tests of Homoscedasticity (Pooled Privatized Firms Normal Scores Transformation) Plot of Studentized Residuals against Predicted Value Plot of Cooke's Distance versus Predicted Values	150

5.14	Tests of Normal Distribution of Residuals for the Pooled Privatized Firms (Normal Scores Transformed Variables)	151
5.15	Normality Plot for the Untransformed Dependent Variable	154
5.16	Tests of Homoscedasticity (Pooled Non-Privatized Firms Rank Transformation) Plot of Studentized Residuals against Predicted Value Plot of Cooke's Distance versus Predicted Values	157
5.17	Tests of Normal Distribution of Residuals for the Pooled Non-Privatized Firms (Rank Transformed Variables)	158
5.18	Tests of Homoscedasticity (Pooled Non-Privatized Firms Normal Scores Transformation) Plot of Studentized Residuals against Predicted Value Plot of Cooke's Distance versus Predicted values	160
5.19	Tests of normal distribution of Residuals for the Pooled Non-Privatized Firms (Normal Scores Transformed Variables)	161
5.20	Tests of Homoscedasticity (Pooled Private Firms Normal Scores Transformation) Plot of Studentized Residuals against Predicted Value Plot of Cooke's Distance versus Predicted Values	165
5.21	Tests of Normal Distribution of Residuals for the Pooled Private Firms (Normal Scores Transformed Variables)	166
5.22	Normality Plot for the Untransformed Dependent Variable	168
5.23	Tests of Homoscedasticity for the Pooled Regression Model of the Whole Sample of Firms (Rank Transformation) Plot of Studentized Residuals against Predicted Values Plot of Cooke's Distance versus Predicted Values	171
5.24	Tests of Normal Distribution of Residuals for the Pooled Regression of the Whole Sample of Firms (Rank Transformed Variables)	172
5.25	Tests of Homoscedasticity for the Pooled Regression Model of the Whole Sample of Firms (Normal Scores Transformation), N=160 Plot of Studentized Residuals against Predicted Values Plot of Cooke's Distance versus Predicted Values	174
5.26	Tests of Normal Distribution of Residuals for the Pooled Regression of the Whole Sample of Firms (Normal Scores Transformed Variables), N=160	175
6.1	Tests of Homoscedasticity for the Cross-Sectional Regression Model 1996 (Rank Transformation) Plot of Studentized Residuals versus Predicted Values Plot of Cooke's Distance versus Predicted Values	192
6.2	Tests of Normal Distribution of Residuals for the Cross-Sectional Regression Model 1996 (Rank Transformation)	193
6.3	Tests of Homoscedasticity for the Cross-Sectional Regression Model 1996 (Normal Scores Transformation) Plot of Studentized Residuals versus Predicted Values Plot of Cooke's Distance versus Predicted Values	195
6.4	Tests of Normal Distribution of Residuals for the Cross-Sectional Regression Model 1996 (Normal Scores Transformation)	196
6.5	Tests of Homoscedasticity for the Cross-Sectional Regression Model 2004	201

	(Rank Transformation) Plot of Studentized Residuals versus Predicted Values Plot of Cooke's Distance versus Predicted Values	
6.6	Tests of Normal Distribution of Residuals for the Cross-Sectional Regression Model 2004 (Rank Transformation)	202
6.7	Tests of Homoscedasticity for the Cross-Sectional Regression Model 2004 (Normal Scores Transformation) Plot of Studentized Residuals versus Predicted Values Plot of Cooke's Distance versus Predicted Values	204
6.8	Tests of Normal Distribution of Residuals for the Cross-Sectional Regression Model 2004 (Normal Scores Transformation)	205
6.9	Tests of Homoscedasticity for the Pooled Data (Rank Transformed Variables) Plot of Studentized Residuals against Predicted Value Plot of Cooke's Distance versus Predicted Values	211
6.10	Tests of Normal Distribution of Residuals for the Pooled Data (Rank Transformed Variables)	212
6.11	Tests of Homoscedasticity for the Pooled Regression of the Whole Sample of Firms (Normal Scores Transformed Variables), N=160 Plot of Studentized Residuals against Predicted Values Plot of Cooke's Distance versus Predicted Values	215
6.12	Tests of Normal Distribution of Residuals for the Pooled Regression of the Whole Sample of Firms (Normal Scores Transformed Variables), N=160	216