March 15, 2014

Role of Disclosure in Corporate Governance

Transparency and disclosure are fundamental components of effective corporate governance in both corporate and public sectors. With the globalized integration of markets, information has been playing an important role in modern economies. Countries that offer better governance, sound policies and increased transparency develop their financial markets, attract foreign investors and give confidence to the local investors.[1]

Transparency and disclosure are a continuing responsibility of any organization. Disclosure is the release of information to the public. Transparency is the flow of all material matters including financial situation, performance, ownership and governance in a timely, reliable and accurate manner. It also means ensuring that quality information is made available to the public and not just privileged to a small number of people.

The table below describes the five pillars of quality disclosed information.

Truthfulness	Disclosed information must give accurate description of circumstances
Completeness	Disclosed information must be adequate to help investors make informed decisions. It also must include both financial and non-financial matters.
Materiality	Disclosed information must be material and relevant to affect investment decisions.
Timeliness	Disclosed information must be timely to enable investors to react as quickly as possible.
Accessibility	Disclosed information must be available to investors at low costs.

Table 1 - The five pillars of quality disclosed information[2]

So why is disclosure important?

- Reliable and timely information helps decision makers and enables them to make good business decisions that directly affect the growth and profitability of the business.

- Disclosure alongside proper auditing serves as prevention tools for fraud and corruption and differentiates the company from those that do not apply good governance practices. Without reliable disclosed information, companies fail to maximize their competitive advantage and risk losing the public's trust and major customers.[3]

[1] Saidi N. (2004) "Corporate Governance in MENA Countries: improving Transparency and Disclosure" [online] available from http://www.oecd.org/investment/investmentfordevelopment/33944145.pdf (accessed 15 February 2014)
[2] Fung B. (2014) "The Demand and Need for Transparency and Disclosure in Corporate Governance" Universal Journal of Management, Vol. 2, No. 2: pp. 72-80
[3] PricewaterhouseCoopers LLP (2012) "Communicating your competitive advantage: High-quality sustainability reporting" [online] available from https://www.pwc.com/us/en/corporate-sustainability-climate-change/assets/pwc-sustainability-reporting-2012.pdf (accessed on 5 March 2014)

- Disclosure improves relations with stakeholders and the communities where the company operates. Good disclosure helps public understanding of the company's policies, performance and activities in terms of environmental and ethical standards, social involvement, supply chain management and other issues integral to the business and the relationship with communities. Good disclosure improves the relationship with consumers as well. Consumers will draw a negative inference if companies refuse to disclose information that can affect their decision making in purchasing the product/ service. The disclosed information can allow informed consumers to make better use of the product or service which can leave them more satisfied and at the end pay for the products or services.[4]

- Disclosure increases the value of an organization. For example, reducing the asymmetry of information between those inside and outside the company can ease the company's capacity to issue securities and therefore reduce its cost of capital and increase stock liquidity.[5]

The company board needs to adopt a disclosure policy and ensure its follow-up and implementation as required by the law and the relevant regulations. The main purpose of the disclosure policy is to make sure that the required information is disclosed to the public, investors, employees, customers, and any other party accurately, timely and conveniently. There are three parts to a disclosure policy as follows:

1. What information is to be disclosed?
2. When should such information be disclosed?
3. Who is accountable to disclose such information and to whom?

Complications and complexities in the rules and requirements of disclosure might undermine companies' capability to apply them. Directors need to understand the characteristics of good disclosure, manage the disclosure process, and evaluate disclosure in terms of fairness. Good corporate disclosure needs to be seen as growth enhancing rather than a compliance burden with more related costs and regulatory bureaucracy.

Weak disclosures can contribute to unethical behavior and loss of the company's market integrity.[6] US's international firm Enron collapsed as a result of corruption and deceptive practices that shook the country's economy. The problem behind this scandal was the inadequate governance process. It was due to the failure in the diligence and activism of the corporate directors. Such problems can be prevented by greater transparency.

Transparency establishes the legitimacy and increases accountability of organizations as responsible organizations in society. More and more, society perceives organizations that lack transparency with doubt and suspicion. The basic assumption in the mind of most people is that obscure organizations have something to hide.

Transparency is very important to corporate governance because it allows the board of directors to assess the effectiveness of the company's management and make counteractive actions to address the situation. For that reason, it is vital for all companies to provide comprehensible and reliable representation of their financial performance.

---

[4] Fishman M. and Hagerty K. (2007) "Mandatory or Voluntary Corporate Disclosure?" [online] available from http://insight.kellogg.northwestern.edu/article/mandatory_or_voluntary_corporate_disclosure/ (accessed 5 March 2014)
[5] Hermalin B. and Weisback M. (2012) "Information Disclosure and Corporate Governance" Journal of Finance, Vol. LXVII, No. 1, pp: 195-233
[6] Fung B. (2014) "The Demand and Need for Transparency and Disclosure in Corporate Governance" Universal Journal of Management, Vol. 2, No. 2: pp. 72-80

The Jordanian Code of Corporate Governance[7] states that the disclosure content needs to include a corporate governance charter, the annual report, financial statements, and non-financial disclosure. The types of disclosure that may be used for reporting are: half yearly reports hand delivered to relevant stakeholders; quarterly results made public through newspapers; and monthly newsletter made available online.

Corporate reporting is no longer just limited to financial statements, but includes a wide group of additional matters that need to be disclosed to provide stakeholders with important information that they need to evaluate their investments. It no longer concentrates on historic results; it currently includes prospective aspects such as future profits and earning targets. Non-financial performance metrics are also required alongside a growing number of financial metrics. Non-financial disclosures can include the organization's objectives, ownership, shareholder rights, governance structures, policies, board membership, the identity and qualifications of key executives, the remuneration of board members, etc. In addition to all that, companies need to report on their social contributions, environmental indicators and organizational actions. Stakeholders' demand for reliable and credible information from management in reporting of social and environmental performance has increased tremendously. Such information demonstrates that the social and environmental performance metrics disclosed are integral and representative of actual efforts and achievements and thus increases stakeholders' confidence.

Environmental issues, compliance and corporate governance remain to be the core investment concerns in emerging markets. Investors, asset owners and manager are now becoming aware more than ever that corporate financial reporting alone is not necessarily enough in determining cost of capital, share price, and other valuations. That is why many investors are now considering global Environmental, Social and Governance (ESG) indices in their investment decisions to rate companies' performances based on their disclosure in order to reduce risk and identify better performers and better investment opportunities. "Voluntary disclosure of ESG performance following the GRI Framework can prove especially useful in clearly highlighting a company's commitment to sustainable development; demonstrating compliance with environmental, workplace and other regulatory schemes; and, serving as a benchmark to compare the organization against peer groups, sectors and industries, and competitors."[8]

Not all inside information needs to be disclosed; confidential information can and should remain confidential. For example, if the information concerns a trade secret then it can be covered in a safe harbor. If the information is not covered by a safe harbor, then it needs to be disclosed.

In conclusion, a commitment to good corporate governance with high levels of disclosure and transparency will give companies a higher chance of improving their performances making them increasingly more attractive to investors. Effective disclosure is essential to good corporate governance and important for building investor confidence.

[7] http://www.ccd.gov.jo/uploads/CG%20Code%20English.pdf
[8] Governance and Accountability Inc. (2012) "Corporate ESG/ Sustainability/ Responsibility Reporting: Does It Matter?" [online] available from http://www.ga-institute.com/fileadmin/user_upload/Reports/SP500_-_Final_12-15-12.pdf (accessed on 9 March 2014)

References

Fishman M. and Hagerty K. (2007) "Mandatory or Voluntary Corporate Disclosure?" [online] available from http://insight.kellogg.northwestern.edu/article/mandatory_or_voluntary_corporate_disclosure/ (accessed 5 March 2014)

Fung B. (2014) "The Demand and Need for Transparency and Disclosure in Corporate Governance" Universal Journal of Management, Vol. 2, No. 2: pp. 72-80

Governance and Accountability Inc. (2012) "Corporate ESG/ Sustainability/ Responsibility Reporting: Does It Matter?" [online] available from http://www.ga-institute.com/fileadmin/user_upload/Reports/SP500_-_Final_12-15-12.pdf (accessed on 9 March 2014)

Hermalin B. and Weisback M. (2012) "Information Disclosure and Corporate Governance" Journal of Finance, Vol. LXVII, No. 1, pp: 195-233

PricewaterhouseCoopers LLP (2012) "Communicating your competitive advantage: High-quality sustainability reporting" [online] available from https://www.pwc.com/us/en/corporate-sustainability-climate-change/assets/pwc-sustainability-reporting-2012.pdf (accessed on 5 March 2014)

Saidi N. (2004) "Corporate Governance in MENA Countries: improving Transparency and Disclosure" [online] available from http://www.oecd.org/investment/investmentfordevelopment/33944145.pdf (accessed 15 February 2014)