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TRANSPARENCY AND DISCLOSURE SCORES OF GREEK LISTED FIRMS: AN EMPIRICAL STUDY

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ABSTRACT

The purpose of this study is to relate transparency and disclosure scores of a sample of 40 Greek firms listed in the Athens Stock Exchange to the required use of the International Financial Reporting Standards (IFRS). The research method adopted in this paper is to compute the Transparency and Disclosure Scores (T&DS) developed by Standard and Poor's for the fiscal year before (2004) and after the introduction of IFRS (2005). The results indicate that T&DS are lower for Greek firms than European ones and did not increase significantly post IFRS adoption. Regression analysis suggests that disclosure scores of firms listed in the ASE are positively related to return on equity, and negatively related to market value. Furthermore, we find that increases in transparency are associated to improved performance.

JEL classification: G3, L2

Keywords: Corporate governance, disclosure, Greece

INTRODUCTION

Disclosure is generally perceived to have a cardinal role in corporate governance. Indeed, increased disclosure requirements are a response to the recent corporate governance failures (*e.g.*, Enron, Parmalat, etc) that have made headlines. In Greece, this can be seen in the reporting requirements of the corporate governance legislation. Thus, increased disclosure is perceived as better governance because disclosure enables better decision making by actors in the capital markets. This study investigates disclosures by firms listed in the Athens Stock Exchange and explores how these were affected by the required use of International Financial Reporting Standards (IFRS) which emphasize supplementary disclosures, as opposed to recognition in the financial instruments.

Shleifer and Vishny (1997) define corporate governance as the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment. Corporate governance is essentially an agency problem which is caused by separation of ownership and control. Of course, agency problems also arise in the relationship of block holders versus minority shareholders and in debt financing. In such situations, information is required in order that suppliers of finance control the agents.

Corporate governance mechanisms are economic and legal institutions that are a product of the economic and social environment. As such, they can be altered through the political process. One such notable change is the mandated adoption of IFRS by Greek companies.

The purpose of this study is to investigate whether disclosure practices and consecutively corporate governance of Greek listed firms were affected by the compulsory introduction of the IFRS. The Greek stock market is used in this study because evidence suggests that financial statements are particularly opaque in Greece. Reviewing various aspects of earnings "opacity" for 34 countries in the years 1984-1998, Bhattacharya, Daouk and Welker (2003) report Greece ranks in the bottom of the least transparent group on all three measures (earnings aggressiveness, loss–avoidance and earnings smoothing) used by the authors, while Leuz, Nanda and Wysocki (2003) show that Greek companies appear to engage in some of the most extreme earnings management practices in the world. Leuz et al argue that this level of earnings management is a result of high private benefits control (*e.g.*, entrenched family interests) acquired under a legal regime where protection, by the law, of minority shareholder rights is weak.

The remainder of the paper is structured as follows. The first part reviews the literature on corporate disclosures. We then present the status of Greek corporate governance and its regulatory framework. Subsequently we present the methodology and the findings of our analysis. The final section of the paper summarizes the conclusions and discusses policy implications.

LITERATURE REVIEW

Corporate disclosures are an essential element of well functioning markets including both the capital markets as well as the market for managerial skills, markets for goods and services etc. Firms disclose information to the capital market both through regulated financial statements (annual and interim reports) and ad hoc voluntary communications such as their Internet sites, press releases and so on. In addition, one can locate disclosures about a firm made by third parties such as brokerage houses and, primarily, the financial press.

Despite of the cardinal role of corporate disclosures in the financial markets, there is no unambiguous theoretical framework regarding corporate disclosure supply and, more specifically, about the effects of regulation of corporate communications. In

addition, there has been limited direct empirical evidence on the incentives and costs of corporate disclosures (for a survey see Healy and Palepu, 2001).

Disclosure by firms is a voluntary decision since even required disclosures (especially those beyond the core financial statements) presuppose willingness to comply. Disclosed information serves to reduce the unfavorable effects of moral hazard and adverse selection by capital markets first regarding the firm itself and then of the management team. Ceteris paribus, firms would disclose relevant information as fully as possible, especially when there are applicable legal requirements, to avoid adverse selection (Grossman, 1981). Nevertheless, there is a possibility that companies would act strategically and disclose favorable items and suppress unfavorable ones (Milgrom, 1981) especially when such items affect management's remuneration and, generally, the managers' position in the market for managerial talent.

Non-disclosure should not be necessarily attributed to management's base motives; Verrechia (1983, 1990) demonstrated that the incentive to disclose information is a decreasing function of the potential, negative, effects of the disclosure on the firms' future cash-flows. Thus, non-disclosure should not necessarily be interpreted as bad news because it may be a favorable item whose disclosure would negatively affect the firm's future cash-flows. Thus, the non-disclosure is a positive action by the firm's management.

Diamond (1985) showed that disclosures result in Pareto improvement in welfare because they reduce investors' need to search privately for information which has substantial costs. Indeed, Darrough and Stoughton (1990) developed alternative scenarios based on industry dynamics. Their model predicts that firms that have less fear of potential entrants in their markets are more likely to respond to market demands for information.

Given the hazy theoretical framework, the present study is primarily an exploratory one. A related study by Aksu and Kosedag (2006) examined the transparency and disclosure scores and their determinants in the Istanbul Stock Exchange.

GREEK CORPORATE GOVERNANCE ENVIRONMENT

Developments in the Greek capital market initiated the corporate governance debate in Greece. During the late 1990s and early 2000s, the Greek capital market experienced period of rapid price increases followed by substantial losses. In 1998 and 1999 in particular, a massive entrance of, mainly, individual but also institutional investors in the stock market, mostly through placements on small-and medium- capitalization stocks, led to increased stock prices and liquidity. Ex post, it can be said that self-fulfilling expectations resulted in a significant divergence between actual prices and prices justified by corporate fundamentals. In late 1999, the bubble burst. For the next few years, investors in the Greek capital market suffered substantial losses; the ASE General Index realized an annual decrease of 38.8% in 2000, 23.5% in 2001 and 32.5% in

2002. Furthermore, both the total value of transactions and the ASE capitalization decreased. Total market capitalization during 2002 amounted to €65,759.7 millions, a decrease of 66.7% in relation to 1999.

Following these events, the Hellenic Capital Markets Committee (HCMC) completed a wide range of institutional reforms. HCMC's regulatory activities were mainly directed at the protection of investors, the enhancement of market transparency, the protection of trading and clearing systems, the enactment of codes of conduct and the assurance of the smooth function of the capital market (Spanos, 2004). Good corporate governance was seen as an important tool in this context (Spanos, 2004; Mertzanis, 2001).

Legal Framework

Greece belongs to the group of countries with codified company law. The legal framework is similar to what is applicable in other Western European countries and there is little room for self-regulation by capital market participants. Another characteristic of the Greek corporate governance legal framework is that it is highly fragmented; there are regulations coming from many agencies as well as laws.

The notion of corporate governance was first introduced in Greece in 1998 through a discussion paper published by the ASE. Following a series of conferences and discussions, a voluntary code of conduct was adopted in 1999, promulgated by the HCMC (Hellenic Capital Markets Committee, 1999). This Code adopted the approach comply or explain according to which firms that didn't comply with the Code's requirements should explain why.

A major contribution during 2000 to the enhancement of transparency and disclosure regarding the behavior of listed companies in the capital market was the enactment of HCMC regulation 5/204/2000: "A code of conduct for companies listed in the ASE and their affiliated persons." This Code set rules for listed firms regarding the obligations of block-holders, board members, management and related parties. For the first time, violations of the Code's requirements would result in administrative sanctions (mainly fines) imposed by the HCMC.

In August 2001 the Federation of Greek Industries (FGI) introduced the "Principles of Corporate Governance" for all companies, but especially for the companies listed on the ASE. This code was adopted by the FGI, partly at least, in order to avoid regulation by law.

In May 2002 the Ministry of the Economy amended corporate law (L. 2190/20) and incorporated fundamental corporate governance obligations for all listed companies. With these changes, Greek legal requirements were fully harmonised with the guidelines and directives of the EU. This law also provided for sanctions to be imposed the HCMC. Particular provisions of this law concern the role of non-executive directors, disclosure requirements concerning election of board members and which board members are executive, non-executive and independent members.

A few months latter, the Athens Stock Exchange announced a series of "qualitative criteria" that listed firms should meet regarding corporate governance, transparency and communication with investors.

Finally, following a change of government, a series of laws (3340/2005, 3371/2005, and 3401/2005) were enacted in 2005 concerning investor protection, market manipulation, insider trading and requirements that a company should meet before and IPO.

In retrospect, improvements in corporate governance have occurred in Greece. However, in spite of the number of laws and regulations that have been adopted, corporate governance improvements are mainly confined to a small number of large listed companies that are more in tune with the international corporate stage (Spanos, 2004).

The Ownership Structure of Greek Listed Firms

The ownership structure of Greek Listed firms is characterized by high concentration. Greece presented high concentration of ownership among the French civil law countries, with 67 per cent average ownership concentration5 (La Porta *et al.*, 1999). According to a study conducted by the HCMC (2001), for the 370 listed companies in Greece average ownership dispersion was 47.22%. In total, according to the study, the 370 listed companies were held by 974 major shareholders[1], while major shareholders per listed company were 3 (on average). More details about ownership dispersion by market segment are presented in Table 1. These results indicate that competition for control at the company level is likely to be low.

Table 1
Ownership Dispersion of Greek Listed Firms

	Main Market	*Parallel Market*	*New Market*	*Total*	*FTSE-20*	*FTSE-40*
% Ownership Dispersion	48.74	30.42	25.05	47.22	54.04	44.40
Capitalization (In million euros)	91,500	8,204	46	99,750	55,411	15,630
Number of Big Shareholders (owning >= 5% of equity)	653	317	4	974	52	101

There are two groups of companies among Greek listed firms dominated by block-holders. The first are the (Greek) state-controlled firms, which are controlled by the state either directly or indirectly through state-sponsored pension funds. These firms are amongst the biggest in the Athens Stock Exchange. Although the tendency is to use professional managers in these firms, political involvement is frequent. The second group are family-owned firms where extended family members frequently have the majority of shares. The family firm, where the family is involved in the management of the firm, is an important and common form of business organisation in Greece. Large families usually control most of the small and medium-sized companies listed in the

ASE and make up most of the membership of FTSE-80. Characteristically, members of the controlling families usually serve as the top manager in these firms.

The role of families and other large block-holders, such as the state, controlling listed companies is controversial in the literature (Mishra *et al.*, 2001). In the case of family ownership, in Greece as has been found in other countries the family can either be an effective mechanism of monitoring management and, thereby, enhance firm performance.

Alternatively, block-holders may be an obstacle to corporate change and a source of inefficiency. However, the main problem of the block-holder controlled companies is the danger that power may be exercised at the expense of the minority shareholders; controlling block-holders can use their power to extract private benefits. Therefore, the agency problem arises as a conflict between "strong block-holders and weak minority owners", rather than between "strong managers and weak owners." Consequently, the discussion on corporate governance in Greece usually concerns the protection of minority shareholders' interests. It is worthwhile to mention that, as early as 1977, Greek corporate law was amended to make distribution of dividends compulsory.

Corporate Governance and IFRSs

International Financial Reporting Standards (IFRSs) are generally considered a high quality financial reporting framework. When they were adopted by the Commission of the EU, as one of the measures for the integration of European capital markets, it was believed that their use would lead to better information disclosure in the capital markets as well as international comparability of the financial performance of listed firms which would be of benefit to investors. Following the adoption of L 2992/2002, the use of IFRSs became compulsory for Greek firms as of 1/1/2005. It should be noted that IFRSs differ, inter alia, from the pre-existing Hellenic General Accounting Plan because they require substantially more disclosures about the reporting entity.

RESEARCH METHODOLOGY

Sample and Data

In this study, we use a sample drawn from the population of firms listed in the Athens Stock Exchange both in the years 2004 and 2005. The principal sources of our data are the financial statements of the firms themselves as well as returns data from the *Datastream* database.

The sample consists of 40 relatively large (based on market capitalization) and liquid (based on trade volume) firms. Of these, 13, 12 and 15 firms are respectively constituents of the FTSE-20, FTSE-40 and FTSE-80 indices representing all sectors.

Variable Definition

The most important variable for our study is the Transparency and Disclosure (TD) scores in three categories for the 40 firms in our sample. The creation of this database

of *TD* scores is described in detail in a Standard and Poor's (S&P) study regarding Transparency and disclosure in 2002. The disclosures investigated concern ownership structure, investor relationships, financial transparency, as well as board of directors and management structure. Overall, the S&P questionnaire includes 98 items but our study uses 8 more items following Aksu (2006).

Using the scoring methodology of S&P, we first measure the transparency and disclosure quality of the sample firms in 2004 and then 2005 by objectively searching for 106 mandatory and discretionary information items disclosed in company annual reports. We basically count the 'Yes', 'No', 'N/A' answers (yes = 1 pt.) as a % of the maximum possible 'yes' answers in each category of *TD*:

$$TDS = \sum_{j=1}^{3} \sum_{k=1} S_{jk} / TOTS$$

where:

- j = the attribute category subscript,
- k = the info item (attribute) subscript, and
- $TOTS$ = the total maximum possible "yes" answers for each firm. i
- S_{jk} = the number of info items disclosed (answered as "yes") by the firm in each category.

In our analysis we also examine TD scores and firm-specific variables that capture agency costs, risk and financial performance both as control variables and to explain the variation in these scores. These are:

- size defined as the log of market capitalization (lnMVE),
- growth potential measured by the market-to-book value of equity ratio,
- firm performance measured using accounting data as ROE (return on equity.)

Descriptive Statistics

Table 2 presents descriptive statistics for overall TD scores as well as ownership structure scores (OwnStr), financial disclosure scores (FinDisc) and board of directors and management structure scores (BrdMgmt) for the years 2004 and 2005 for the firms our sample. From Table 2 we observe that despite the adoption of IFRS disclosures

Table 2
Descriptive Statistics for *TD* Scores

	Year	*Mean*	*Median*	*StandardDeviation*	*Min*	*Max*
OwnStr	2004	35.88	38.10	12.33	3.13	58.33
	2005	26.54	26.19	15.58	0.00	57.14
FinDisc	2004	42.75	41.67	9.83	21.88	69.44
	2005	54.84	55.56	8.88	33.33	69.44
BrdMgmt	2004	27.06	27.78	9.16	8.33	61.11
	2005	19.32	19.44	11.78	2.78	41.67
Overall	2004	35.02	34.95	7.90	18.27	59.38
	2005	34.18	34.17	9.43	14.42	52.69

about ownership structure and board management were lower in 2005 than 2004 while only financial disclosures were higher. These results also lead to slightly lower overall disclosures, on average.

Furthermore, in Table 3 we report firm-specific agency, risk and performance variables likely to impact the *TD* scores. Both tables report the mean, median, standard deviation, min and max values. The companies in our sample have, on average, substantially higher market than book value while the average return on equity (13.18%) is quite high.

Table 3
Descriptive Statistics for Control Variables

	Mean	*Median*	*Standard Deviation*	*Min*	*Max*
Ln(mve)	12.62	12.56	1.87	9.76	16.31
Market to Book	2.51	1.68	2.81	0.17	19.21
ROE	13.18	9.82	26.27	–52.59	133.77

In Table 4, we present average *TD* scores for the firms in our sample classified according to which market index they belong. It is noteworthy that it is companies from the mid-size index have, on average, the highest *TD* scores. This can be explained; FTSE-20 companies are dominated by the state-controlled block-holdings, while FTSE-80 companies are (relatively) small-sized entities dominated by family block-holdings. On the other hand, FTSE-40 firms are large and dynamic firms that need external financing and thus actively try to attract investors. As the theories outlined earlier suggest, these firms disclose more information.

Table 4
T&D Scores of the FTSE-20, FTSE 40 and FTSE-80 Companies

	FTSE-20		*FTSE-40*		*FTSE-80*	
	2004	*2005*	*2004*	*2005*	*2004*	*2005*
OwnStr DS	32.05	19.76	37.78	31.55	37.27	27.62
FinDisc DS	45.37	53.93	42.92	55.26	40.51	55.20
Brd&Mgmt DS	26.85	15.74	28.93	26.69	25.61	15.78
Overall TDS	34.91	30.55	36.35	38.46	33.95	33.37

ANALYSIS AND RESULTS

Good disclosure practices act as a mechanism of checks and balances that mitigates the agency problems arising from the separation of ownership and control in listed firms (Aksu, 2006) or, in the case of Greece, the power of block-holders to expropriate the wealth of minority shareholders. Our literature review suggests that the lower the level, reliability and timeliness of disclosure, the stronger the signal that there is hidden bad news about the company and risk for the capital suppliers. Mandatory adoption of IFRS was justified as a mechanism of improving the information available

to shareholders and other stakeholders. We thus now examine the influence of IFRS adoption on the disclosure practices of Greek firms.

Change in Disclosure Levels

The objective of our study is to investigate whether the average *TD* scores have increased in 2005 following IFRS adoption and whether any such improvement in the scores can be attributed to mandatory compliance with IFRS required for the first time in 2005 financials.

Following an extensive accounting literature on corporate disclosure quality, we use *TD* scores to represent market participants' assessments of firms' disclosure policies and employ matched pair *t*-tests to measure the significance of the improvement in the scores. Accordingly, we have the following testable hypothesis, presented in the alternative form:

H1: Firms are expected to have higher *TD* scores in 2005 than in 2004 due to more and more firms adopting IFRS

Table 5
***T*-test results**

	OwnStr_2004–OwnStr_2005	FinDisc_2004–FinDisc_2005	BrdMgmt_2004–BrdMgm_t2005	Overall_2004–Overall_2005
Difference in mean	9.33	12.09	7.75	0.84
t-stat	3.40	–7.88	3.48	0.49
Significance (2-tailed)	0.00	0.00	0.00	0.63

Our findings, presented in Table 5, are that while financial disclosure scores improved substantially in 2005 and this change is statistically significant, disclosures about ownership structure and board structure and management actually declined significantly over the period studied. Thus, overall disclosures were not affected in a statistically significant way.

Determinants of Disclosure Levels

The strongest influence on disclosure practices is normally the competitive environment of a firm of which the legal framework is a part. Thus, what is disclosed is influenced by both the local legal traditions and regulations and, to a lesser extent, by applicable international regulations -such as the IFRS.

Aksu and Kosedag (2006) explored the relationship between potential agency problems and the *TD* scores in the ISE cross-sectionally, at a point in time. In this study, we investigate the same relationship for two years (2004 and 2005) and whether changes in the explanatory power of our model are affected by IFRS adoption.

H2: IFRS adoption influenced the relationship of agency costs (as measured by size and performance) and transparency scores

To evaluate this hypothesis, we estimated the following regression models using robust regression models for the two years in our study separately and then for the pooled sample:

$$TDS_i = \beta_0 + \beta_1 * ROE_i + \beta_2 * \ln mve_i + \beta_3 * mtb_i + \varepsilon_i$$

Results are presented in Table 6:

Table 6
Regression Results: The Determinants of T&D Scores (* Significant at the 5% Level)

	ROE	*Ln mve*	*mtb*	*constant*	*F-stat*
2004	0.021	–1.088	1.052	45.437	1.710
	(0.22)	(–1.43)	(0.98)	(4.95) *	
2005	0.157	–2.384	1.828	58.942	3.170
	(1.74)	(–2.35) *	(1.54)	(4.95) *	
Pooled	0.134	–1.194	–0.186	48.375	
	(2.29) *	(–1.87)	(-0.34)	(6.29) *	

As it can be seen, the regression relationship for 2005 is statistically significant and the various agency and control variables have explanatory power. The pooled regression model explains about 11% of the total variation of total *TD* scores. Results for both 2005 and the pooled model indicate that size (as proxied by the log of market value of equity) is the most significant explanatory variable but there is an inverse relationship between size and disclosure levels. It should be emphasized that introducing a dummy variable in the pooled regression model neither increases the explanatory power of the model nor is it a statistically significant variable. This is consistent with the earlier result that overall disclosures did not change in spite of IFRS adoption.

Finally, we regressed the change in total disclosure and in financial disclosures over the period 2004-05 on the firm specific size, performance and agency costs variables used above and found that of these only the market to book value ratio is a statistically significant variable.

The Relationship Between IFRS Adoption, T&D Scores, and Performance

Good quality disclosure practices by a firm create opportunities for the firm. Such a firm would be perceived as comparatively low risk and investors would be more willing to provide capital. Thus, ceteris paribus, firms have the incentives to minimize their perceived risk by putting in place quality corporate governance mechanisms.

Consequently, we expect that good quality disclosure will be associated with higher financial performance. Accordingly, we have the following testable hypothesis, presented in the alternative form:

H3: Firms with higher *TD* scores will exhibit higher financial performance.

To examine this hypothesis, we estimated (using robust estimators) a regression of performance metrics (*ROE*) on change in total (*disTDS*) and financial disclosure (DiffFin) levels before and after the adoption of IFRSs and the market to book ratio and size variables in 2005.

Our findings are summarized in Table 7:

Table 7
Regression Results of Performance on Change in Disclosure Levels and Firm Specific Variables

	Coefficient	*T-stat*	*Coefficient*	*T-stat*
DifTDS	0.271	(1.71)		
DifFin			0.396	(2.08)*
Ln mve	0.914	(0.87)	0.727	(0.70)
Mtb	4.767	(7.55)*	4.477	(6.79)*
Constant	−11.592	(-0.91)	−3.165	(−0.24)
F-Stat	32.1		33.25	

As it can be seen, there is a strong, positive, relationship between the *ROE* ratio (as a measure of financial performance) and the disclosure scores, especially the financial disclosure one. Furthermore, as predicted from pervious literature, the market to book value ratio is a statistically significant variable.

SUMMARY AND CONCLUSIONS

Greece has a satisfactory legal framework regarding corporate governance in comparison to many other countries. Survey evidence indicates that most companies understand that good corporate governance improves the long-term growth of the firm and assures the interests of all related parties. However, most companies in Greece are small and their ownership structure is dominated by block-holders, often the family of the founder or, in the case of a small number of big firms, the state. Furthermore, improvements in corporate governance face a major cultural stumbling block which is that firms aim to comply with the letter of the law rather than its spirit.

In the context of our study, we found that IFRS adoption did not improve overall disclosure levels by the Greek firms in our sample because in the period under investigation firms actually decreased their disclosure regarding ownership and board of directors' structure. However, in the case of financial disclosures IFRS adoption brought substantial improvements. These improvements are robust to the inclusion of control variables in our model such as the market to book ratio, abnormal returns and return on equity (*ROE*). A possible explanation for the different results is that financial disclosures are evaluated by auditors before expressing their opinion about the financial statements of the firm whereas there is no such monitoring mechanism for other disclosures.

These results indicate that either the regulatory framework is weak or that there is insufficient enforcement of the existing regulations, The Hellenic Capital Markets Commission should either way act to improve actual practices.

NOTE

1. The major shareholder is defined as a shareholder owning at least 5% of equity.

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