



Accounting Research Journal

Tone disclosure and financial performance: evidence from Egypt

Doaa Aly, Sherif El-Halaby, Khaled Hussainey,

Article information:

To cite this document:

Doaa Aly, Sherif El-Halaby, Khaled Hussainey, (2018) "Tone disclosure and financial performance: evidence from Egypt", Accounting Research Journal, Vol. 31 Issue: 1, pp.63-74, <https://doi.org/10.1108/ARJ-09-2016-0123>

Permanent link to this document:

<https://doi.org/10.1108/ARJ-09-2016-0123>

Downloaded on: 22 May 2018, At: 23:01 (PT)

References: this document contains references to 56 other documents.

To copy this document: permissions@emeraldinsight.com

Access to this document was granted through an Emerald subscription provided by emerald-srm:178665 []

For Authors

If you would like to write for this, or any other Emerald publication, then please use our Emerald for Authors service information about how to choose which publication to write for and submission guidelines are available for all. Please visit www.emeraldinsight.com/authors for more information.

About Emerald www.emeraldinsight.com

Emerald is a global publisher linking research and practice to the benefit of society. The company manages a portfolio of more than 290 journals and over 2,350 books and book series volumes, as well as providing an extensive range of online products and additional customer resources and services.

Emerald is both COUNTER 4 and TRANSFER compliant. The organization is a partner of the Committee on Publication Ethics (COPE) and also works with Portico and the LOCKSS initiative for digital archive preservation.

*Related content and download information correct at time of download.

Tone disclosure and financial performance: evidence from Egypt

Financial
performance

Doaa Aly

Department of Accounting, University of Gloucestershire, Cheltenham, UK

Sherif El-Halaby

MSA University, Cairo, Egypt and Arab Open University, Kuwait City, Kuwait, and

Khaled Hussainey

Portsmouth Business School, University of Portsmouth, Portsmouth, UK

63

Received 26 September 2016
Revised 5 March 2017
21 April 2017
20 June 2017
Accepted 28 June 2017

Abstract

Purpose – This paper aims to examine the extent to which financial performance (FP) represents one of the main determinants for tone disclosure (TD) in Egyptian annual reports. The authors also measure the bidirectional relationship between TD and FP.

Design/methodology/approach – The manual content analysis is used to measure the levels of TD in annual reports for a sample of 105 firms listed on the Egyptian stock market. The sample covers a three-year period (2011-2013).

Findings – The descriptive analysis in this paper shows that Egyptian firms disclose more good news than bad news. Therefore, the net news disclosure, or net variances, between good/bad is positive. The empirical analysis shows a positive association between the narrative disclosure of good/bad news and FP based on return on assets. The authors also find a highly significant association between the auditor, profitability, leverage, firm growth and financial reporting of good/bad news information. Finally, the results of the ordinary least squares regression show that the causality between the two endogenous variables runs from FP to TD. Thus, TD is determined by FP.

Originality/value – This study offers a novel contribution to disclosure studies by being the first study to examine TD in one of the developing countries.

Keywords Firm performance, Content analysis, Tone disclosure

Paper type Research paper

1. Introduction

The goal of our paper is to examine the impact of financial performance (FP) on tone disclosure (TD). We also examine the impact of TD on FP. Although the association between disclosure and firm performance has received major interests in accounting research, the findings are always mixed (Baek *et al.*, 2004). In addition, none of prior research has examined the bidirectional relationship between TD and FP in developing countries, particularly in Egypt.

We are motivated to focus on the Egyptian context for several reasons. One reason is the rapid growth of Egypt as an emerging economy with noteworthy foreign investment potential (Elsayed and Hoque, 2010). Egypt has a diverse financial reporting environment that might affect initial disclosure requirements differently. According to Gray's (1988) model, accounting measures and disclosures in Egypt will tend to be more conservative and less transparent. There is a need for Egypt to raise capital and promote confidence as well as take stakeholders into consideration. The Egyptian environment has been dynamic, growing through different economic and political systems that arguably affected accounting



disclosure practices. Egypt is one of the countries that was affected by the Arab Spring based on the 25 January revolution. Hence, Egypt provides an opportunity for empirical research to gain insights into the impacts of political crisis regarding the extent of disclosure. Moreover, Egypt is used as an example of a major developing economy in the Middle East and North Africa regions, which was generally overlooked in prior research (Ebrahim and Abdel Fattah, 2015).

Although prior research has extensively analysed the impact of TD on FP and stock price (Hutton *et al.*, 2003), this paper provides evidence of the same association and the reverse relationship: FP affects TD. Using a sample of 105 Egyptian listed firms during 2011-2013, we found evidence that good news disclosure is positively associated with firms' FP, suggesting that Egyptian firms that report more positive news achieve a higher FP. Our result supports the argument TD contains value relevant information.

The paper is structured as follows: Section 2 reviews the theoretical and empirical literature and develops the research hypotheses; Section 3 presents the research design; Section 4 presents the empirical results; and Section 6 concludes.

2. Disclosure theories, literature review and research Hypotheses

2.1 *The impact of financial performance on tone disclosure*

Agency theory proposes that managers of profitable firms disclose more information to magnify their success and to increase investors' confidence in the management of firms. Managers might wish to encourage positive impressions using management impression techniques to attract many parties, such as potential lenders and investors. It also suggests that managers of profitable firms disclose more information to boost their compensation (Abd-Elsalam, 1999). However, management might disclose less information because of loss or lower profitability, as managers want to be vague about such poor FP results (Wang *et al.*, 2008). Moreover, the signalling theory recommends that profitable firms have an incentive to disclose more information, to signal the firm's FP to investors to support continuation of management's positions (Oyeler *et al.*, 2003). Clatworthy and Jones (2006) argued that extreme changes in FP can affect the thematic content of the narrative disclosure, such as the chairman's statement. Clatworthy and Jones (2001) found that profitable firms are more inclined to discuss their results and acquisitions and disposals, whereas unprofitable firms include more discussion of board changes. Clarke (1997, p. 36) found that "firms with negative results do divert attention away from themselves by referring to the environment, target markets and emotive words rather than firms' actions and performance indicators". Clatworthy and Jones (2003) found that good FP presents more good news than bad news, as measured by overall words and keywords, and bad FP does not dwell on bad news. Prior research identifies that the writing style adopted by firms in the chairman's statement is contingent on FP. For instance, Sydserff and Weetman (2002) found that the narratives of firms experiencing poor FP are written in a style that detaches the reader from the message.

Profitability is central to the discussion of corporate disclosure. More profitable firms will be able to support the cost of information production and dissemination and, therefore, will be in a position to disclose more information. Inchausti (1997) revealed that profitability is capable of influencing the extent to which firms disclose information in their annual reports. Ismail and Chandler (2005) found a positive association between disclosure and FP. It should be noted that empirical results do not always confirm a positive relationship (Garcia-Ayuso and Larrinaga, 2003). In the context of the agency and political cost theories, Ng and Koh (1994) pointed out the fact that profitable firms are more exposed to political pressure and public scrutiny, and use more self-regulating mechanisms to avoid regulation. Singhvi and

Desai (1971) claimed that, when a firm's FP is high, managers are motivated to disclose detailed information to support their positions. This positive correlation between a firm's FP and corporate disclosure is also implied by the theoretical model of voluntary disclosure in the face of adverse selection. The firm is likely to disclose more frequently when it is experiencing favourable earnings results, and earnings forecasts are associated with positive returns. Chiu and Wang (2015) examined determinants of corporate reporting by using a sample of 246 listed firms in Taiwan. They demonstrated that measures of stakeholder power, strategic posture, economic resources, firm size and media visibility are related to corporate disclosure. Cho *et al.* (2010) found that firms that are more profitable tend to use more positive language in their disclosures or decisive language. The literature's research results on profitability as a determinant of disclosure appear inconclusive (Street and Gray, 2002). Aras *et al.* (2010) did not find any association between FP and disclosure. Oeyono *et al.* (2011) found a positive association between both variables. Furthermore, few studies have asserted that there is a negative association between disclosures and FP (Rahman *et al.*, 2011). Management appears to elaborate on positive FP in the narrative sections, such as the chairman's statement, but prefers to communicate poor FP more concisely. Nevertheless, this paper argues that good FP is a good incentive for more disclosure, particularly good news, as profitable firms have better stories to tell and are more able to afford the cost of disclosure. We proxy FP with return on assets (ROA) and anticipate a statistically positive relationship between the proxy and TD. Therefore, we hypothesise that:

H1. There is a relationship between financial performance and tone disclosure.

2.2 The impact of financial performance on tone disclosure

Empirical results on disclosure are commonly consistent with finance-theory predictions that more public information improves a firm's value by decreasing the firm's cost of capital (Hassan *et al.*, 2009). Lambert *et al.* (2007) argued that increased disclosure may affect a firm's value by increasing the actual cash flows stockholders accrue as a result of lessening agency problems. Theoretical models of disclosure assume that managers maximise their firm's stock price and conclude that when a higher price can be obtained by withholding the news, managers will abstain from disclosure (Verrecchia, 1983). Ayers *et al.* (2011) showed that, following good news, shares outperform immediately after the announcement. Skinner (1994) found that bad news disclosures generate larger stock price reactions than good news. Athanasakou and Hussainey (2014) showed that narrative reduces market uncertainty about future earnings and increases the credibility of financial statements. Managers pursuing stockholder wealth maximisation will only disclose news likely to increase share prices. Lev and Penman (1990) provided evidence that US firms are more likely to disclose good news than bad with respect to earnings disclosures. They supported the "good news hypothesis", that good news firms make more disclosures than bad news firms to achieve benefits, such as a reduction in information asymmetry and a lower cost of capital. Dedman and Lin (2002) found that only half of their sample of CEO departures was announced to the regulatory news service, even though this was proved by the share price reactions to the release of this information by the financial press. Miller (2002) documented a positive association between share price/earnings performance and disclosure. Good/bad news is also associated with abnormal returns at the time of an earnings announcement (Francis *et al.*, 2002). These researchers stated that firms with higher disclosure scores exhibit higher levels regarding the share-price anticipation of future earnings than firms with lower

disclosure scores. [Schleicher and Walker \(2010\)](#) found that loss-making firms provide a more positive tone, whereas firms with an earnings decline provide a more negative tone. [Hassan et al. \(2009\)](#) stated that disclosure is a mechanism to mitigate agency costs arising from the possibility that managers may not act in the best interest of shareholders. The investors' business comprehension increases with disclosure and thus enhances the firms' value. Mechanisms of disclosure allowing investors to upsurge their ability in firm monitoring then increase FP. [Clarkson et al. \(2008\)](#) documented a positive association between disclosure and firm's value. Consistent with signalling theory, management, when in possession of "good news" due to better FP, is more likely to disclose more detailed information to the stock market than that provided by "bad news" firms, to avoid the undervaluation of their shares. Empirical research offer mixed outcomes. For instance, [Francis et al. \(1994\)](#) found no evidence of announcement-day market returns being associated with the tone of press coverage in the year prior to the adverse announcement. In contrast, [Davis et al. \(2012\)](#) found that narrative disclosure is associated with abnormal returns. [Smith and Taffler \(2000\)](#) showed that narrative disclosures based on the content of the chairman's statement are associated with FP. Thus, we expect a positive effect of TD on FP.

H2. The relationship between financial performance and tone disclosure is bidirectional.

3. Research design

3.1 Sample selection

Our sample is a balanced panel data of 105 firms listed on the Egyptian stock market during the three-year period 2011-2013. Our final data set comprises 315 firm-year observations. Given the existence of both cross-sectional and time-series information, we were able to use panel-data analysis. The explanatory and control variables data are collected from OSIRIS and Datastream. The Egyptian Stock Exchange website also provided relevant data, such as industry classifications and fundamental information for all listed firms. Annual reports were purchased from the Egyptian stock market. The annual reports were in Arabic, so counting the sentences of good news and bad news was carried out manually. For consistency and reliability, a sample of the annual reports was given to an Egyptian colleague to read and count the sentences of good and bad news, to ensure the results we obtained were accurate.

3.2 Research variables and model

3.2.1 *Dependent variable (tone disclosure)*. We count the number of good news statements and bad news statements, and then we calculate net news based on the variances between good and bad news information. To test the validity of our disclosure measure, we gave a sample of the annual reports to an Egyptian professional to read and count the sentences of good and bad news, to make sure that our score is valid.

3.2.2 *Measurement of independent and control variables*. We use ROA as a measure for firm performance. We consider seven control variables: firm size ([Hackston and Milne, 1996](#)), audit quality ([Francis, 2004](#)), industry sector ([Dye and Sridhar, 1995](#); [Haniffa and Cooke, 2005](#)), leverage ([Jensen and Meckling, 1976](#)), firm age ([Muttakin and Khan, 2014](#)), liquidity ([Wallace and Naser, 1995](#)) and firm growth ([Khurana et al., 2006](#)).

3.2.3 *Empirical model*. For first stage of this study, which focused on the impacts of ROA on TD, we specify three models: in the first model, we use good news as a dependent; in the second model, we use bad news as a dependent; and in the third model, we use net news.

Following preceding narrative disclosure studies (Ressas and Hussainey, 2014), we use the following ordinary least square regression models:

$$\begin{aligned} \text{GND}_{it} = & \beta_0 + \beta_1 \text{ROA}_{it} + \beta_2 \text{LIQ}_{it} + \beta_3 \text{LEV}_{it} + \beta_4 \text{F.GROW}_{it} \\ & + \beta_5 \text{SIZE}_{it} + \beta_6 \text{SECT}_{it} + \beta_7 \text{AGE}_{it} + \beta_8 \text{AUDIT}_{it} + \varepsilon_{it} \end{aligned} \quad (1)$$

$$\begin{aligned} \text{BND}_{it} = & \beta_0 + \beta_1 \text{ROA}_{it} + \beta_2 \text{LIQ}_{it} + \beta_3 \text{LEV}_{it} + \beta_4 \text{F.GROW}_{it} \\ & + \beta_5 \text{SIZE}_{it} + \beta_6 \text{SECT}_{it} + \beta_7 \text{AGE}_{it} + \beta_8 \text{AUDIT}_{it} + \varepsilon_{it} \end{aligned} \quad (2)$$

$$\begin{aligned} \text{NND}_{it} = & \beta_0 + \beta_1 \text{ROA}_{it} + \beta_2 \text{LIQ}_{it} + \beta_3 \text{LEV}_{it} + \beta_4 \text{F.GROW}_{it} \\ & + \beta_5 \text{SIZE}_{it} + \beta_6 \text{SECTOR}_{it} + \beta_7 \text{AGE}_{it} + \beta_8 \text{AUDIT}_{it} + \varepsilon_{it} \end{aligned} \quad (3)$$

where GND = good news disclosure; BND = bad news disclosure; NND = net news disclosure; ROA: return on assets; AUDIT: dummy code 1 if the firm is audited by one of the four big auditor offices or 0 otherwise; SIZE: natural logarithm of total assets; LIQ: liquidity (current assets to current liabilities); LEV: leverage (total debts to total assets); F.GROW: firm growth (assets growth); AGE: age of the firm; and SECT: category of each sector.

For the second stage of this study, which focused on the value relevance of TD on a firm's performance, measured by ROA, we specify three additional models, as follows:

$$\begin{aligned} \text{ROA}_{it} = & \beta_0 + \beta_1 \text{GND}_{it} + \beta_2 \text{SIZE}_{it} + \beta_3 \text{LIQ}_{it} + \beta_4 \text{LEV}_{it} + \beta_5 \text{F.GROW}_{it} \\ & + \beta_6 \text{SECTOR}_{it} + \beta_7 \text{AGE}_{it} + \beta_8 \text{AUDIT}_{it} + \varepsilon_{it} \end{aligned} \quad (4)$$

$$\begin{aligned} \text{ROA}_{it} = & \beta_0 + \beta_1 \text{BND}_{it} + \beta_2 \text{SIZE}_{it} + \beta_3 \text{LIQ}_{it} + \beta_4 \text{LEV}_{it} + \beta_5 \text{F.GROW}_{it} \\ & + \beta_6 \text{SECTOR}_{it} + \beta_7 \text{AGE}_{it} + \beta_8 \text{AUDIT}_{it} + \varepsilon_{it} \end{aligned} \quad (5)$$

$$\begin{aligned} \text{ROA}_{it} = & \beta_0 + \beta_1 \text{NND}_{it} + \beta_2 \text{SIZE}_{it} + \beta_3 \text{LIQ}_{it} + \beta_4 \text{LEV}_{it} + \beta_5 \text{F.GROW}_{it} \\ & + \beta_6 \text{SECTOR}_{it} + \beta_7 \text{AGE}_{it} + \beta_8 \text{AUDIT}_{it} + \varepsilon_{it} \end{aligned} \quad (6)$$

where GND = good news disclosure; BND = bad news disclosure; NND = net news disclosure; ROA: return on assets; AUDIT: dummy code 1 if the firm is audited by one of the four big auditor offices or 0 otherwise; SIZE: natural logarithm of total assets; LIQ: liquidity (current assets to current liabilities); LEV: leverage (total debts to total assets); F.GROW: firm growth (assets growth); AGE: age of the firm; and SECT: category of each sector.

4. Empirical results

Table I shows that the average narrative disclosure for good news, bad news and net news is 3.6, 1.6 and 1.9, respectively. The profitability ratio varies between firms, with a minimum level of -0.77 and a maximum level of 0.37 . The average ROA for our selected firms is 0.05 . In total, 32 per cent of the listed Egyptian firms are audited by one of the big four audit firms. The average age of our selected firms is 34.6 years. The mean liquidity during the three years is 5.39, whereas the average leverage is 40 per cent. On average, the firm size

Variables	N	Minimum	Maximum	Mean	SD	Skewness	Kurtosis
G.N	313	0.00	22.00	3.600	4.75256	1.677	2.346
B.N	313	0.00	24.00	1.648	2.91731	3.210	15.064
NET.N	315	-15.00	20.00	1.939	4.79844	0.739	2.413
ROA	390	-0.77	0.37	0.053	0.10679	-2.099	17.587
AUDIT	314	0.00	1.00	0.324	0.46906	0.752	-1.444
SIZE	390	4.65	10.34	8.273	1.21619	-1.072	0.818
LIQ	390	0.11	304.53	5.39	20.842	9.819	12.514
LEV	390	0.00	1.95	0.40	0.258	1.345	5.422
F.GROW	383	-424.58	1.00	-53.75	367.80	-9.275	94.813
SECT	379	1.00	16.00	5.910	4.283	1.123	-0.032
AGE	322	1.00	123.00	34.66	20.92	1.667	4.017

Notes: Variable definition: G.N: good news; B.N: bad news; NET.N: (Net news) the difference between good and bad news; ROA: return on assets; AUDIT: dummy code 1 if the firm audited by one of the four big auditor office or 0 otherwise; SIZE: natural logarithm of total assets; LIQ: liquidity (current assets to current liabilities); LEV: leverage (total debts to total assets); F.GROW: firm growth (assets growth); AGE: age of the firm; SECT: category of each sector (e.g. construction, chemicals and telecommunication)

Table I.
Descriptive analysis

(SIZE) is 8.273 million, with a minimum of 4.65 million and a maximum of 10.34 million. Our sample is drawn from a diverse range of industries, including telecommunications, manufacture and exports/imports. The average growth rate is -53.75, with a maximum value of 1.

Table II shows that net news disclosure is positively correlated with ROA and size. However, the net news disclosure score is negatively correlated with leverage. Observations in the correlation matrix show that all of the correlation coefficients are below 80 per cent. This indicates that there is no evidence of multicollinearity problems (Hair *et al.*, 2010). Tables III and IV show that variance inflation factor (VIF) does not exceed more than two. Therefore, there is no multicollinearity problem between independent variables.

Table III shows the impact of FP on TD. For model 1, where the good news serves as the dependent variable, the coefficient of good news is positive and also statistically significant,

Variables	NET.N	ROA	AUDIT	SIZE	LIQ	LEV	F.GROW	SECT	AGE
NET.N	1	0.354**	0.055	0.127*	-0.027	-0.206**	-0.087	-0.024	-0.096
ROA	0.311**	1	0.024	0.245**	-0.020	-0.483**	-0.013	-0.029	-0.120*
AUDIT	0.109	0.057	1	0.389**	-0.118*	0.141*	-0.003	-0.238**	0.154*
SIZE	0.140*	0.142**	0.416**	1	-0.070	-0.151**	-0.125*	0.005	-0.101
LIQ	0.208**	0.341**	-0.194**	-0.177**	1	-0.287**	-0.003	0.105*	-0.183**
LEV	-0.162**	-0.285**	0.194**	0.072	-0.730**	1	0.020	-0.177**	0.180**
F.GROW	-0.006	0.015	-0.037	-0.332**	0.090	-0.085	1	-0.020	-0.062
SECT	-0.034	-0.100	-0.319**	-0.125*	0.107*	-0.127*	-0.040	1	-0.044
AGE	-0.149*	0.027	0.148*	-0.114*	-0.131*	0.086	0.067	-0.092	1

Table II.
Pearson and Spearman rank correlation coefficients for the continuous independent variables

Notes: Variable definition: NET.N: (net news) the difference between good and bad news; ROA: return on assets; Auditor: dummy code 1 if the firm audited by one of the four big auditor office or 0 otherwise; SIZE: natural logarithm of total assets; LIQ: liquidity (current assets to current liabilities); LEV: Leverage (total debts to total assets); F.GROW: firm growth (assets growth); AGE: age of the firm; SECT: category of each sector (e.g. construction, chemicals and telecommunication); *statistical significance at 10% level; **statistical significance at 5% level

Variables	Model (1) Good news		Model (2) Bad news		Model (3) Net news		VIF
	Coefficients	<i>t</i> statistics	Coefficients	<i>t</i> statistics	Coefficients	<i>t</i> statistics	
Constant		1.959		2.544		0.362	
ROA	0.208	3.074**	-0.113	-1.915*	0.273	4.086***	1.199
LIQ	-0.113	-1.657*	-0.084	-1.587	-0.049	-0.732	1.219
LEV	-0.163	-2.274*	-0.002	-0.040	-0.123	-1.731*	1.351
F.GROW	-0.114	-1.839*	-0.026	-0.522	-0.091	-1.484	1.018
SIZE	-0.012	-0.173	-0.061	-1.092	0.050	0.742	1.202
SECT	0.069	1.071	0.066	1.271	0.023	0.357	1.099
AGE	-0.060	-0.920	0.029	0.564	-0.076	-1.186	1.114
AUDIT	-0.019	-0.271	-0.102	-1.852*	0.027	0.390	1.250
YEAR dummy	Included		Included		Included		
Model summary	0.122		0.217		0.143		
<i>R</i> ²	4.007		2.399		4.804		
<i>F</i> -value	0.000		0.016		0.000		
<i>p</i> -value							

Notes: Variable definition: G.N: good news; B.N: bad news; NET.N: (net news), the difference between good and bad news; AUDIT: dummy code 1 if the firm audited by one of the four big auditor office or 0 otherwise; SIZE: natural logarithm of total assets; LIQ: liquidity (current assets to current liabilities); LEV: leverage (total debts to total assets); F.GROW: firm growth (assets growth); ROA: return on assets; ROE: return on equity; AGE: age of the company; SECT: category of each sector (e.g. construction, chemicals and telecommunication); *statistical significance at 10% level; **statistical significance at 5% level; and ***statistical significance at 1% level

Table III.
Impact of financial
performance on
disclosure quality

Variables	Model (4) Good news		Model (5) Bad news		Model (6) Net news		VIF
	Coefficients	<i>t</i> statistics	Coefficients	<i>t</i> statistics	Coefficients	<i>t</i> statistics	
Constant		0.809		1.484		0.979	
G.N	0.134	3.141**					1.040
B.N			-0.083	-1.915*			1.039
NET.N					0.185	4.346***	1.057
LIQ	-0.134	-2.994	-0.155	-3.462	-0.136	-3.081	1.132
LEV	-0.494	-10.696	-0.511	-11.096	-0.479	-10.449	1.209
F.GROW	0.024	0.575	0.013	0.292	0.025	0.592	1.029
SIZE	0.160	3.420	0.154	3.250	0.151	3.263	1.246
SECT	-0.105	-2.411	-0.097	-2.208	-0.096	-2.231	1.073
AGE	-0.016	-0.374	-0.020	-0.458	-0.010	-0.236	1.061
AUDIT	-0.007	-0.147	-0.017	-0.347	-0.018	-0.386	1.254
YEAR dummy	Included		Included		Included		
Model summary	0.313		0.302		0.328		
<i>R</i> ²	22.234		21.133		23.836		
<i>F</i> -value	0.000		0.000		0.000		
<i>p</i> -value							

Notes: Variable definition: G.N: good news; B.N: bad news; NET.N: (net news), the difference between good and bad news; AUDIT: dummy code 1 if the firm audited by one of the four big auditor office or 0 otherwise; SIZE: natural logarithm of total assets; LIQ: liquidity (current assets to current liabilities); LEV: Leverage (total debts to total assets); F.GROW: firm growth (assets growth); ROA: return on assets; AGE: age of the company; SECT: category of each sector (e.g. construction, chemicals and telecommunication); *statistical significance at 10% level; **statistical significance at 5% level; and ***Statistical significance at 1% level

Table IV.
Impact of disclosure
quality on financial
performance

with the ROA at 5 per cent. For Model 2, where the bad news serves as the dependent variable, the coefficient is negative and also statistically significant, with the ROA at 10 per cent. For Model 3, where the net news serves as the dependent variable, the coefficient is positive and statistically significant, with the ROA at 1 per cent. Therefore, as predicted in *H1*, a firm's likelihood of disclosing its good news is positively associated with its FP, as reported in Model 1. Thus, *H1* is accepted. The positive effect of FP on disclosure is consistent with the signalling theory, which proposes that managers of profitable firms are more likely to disclose more information in their annual reports to justify their remunerations and to signal their superior performance to the market (Wallace *et al.*, 1994). This means that profitable firms provide more positive good news than loss-making firms. In other words, profitable firms disclose good news information in their narratives to send a positive signal to all stakeholders. Our findings are also consistent with those of Clatworthy and Jones (2003) and Schleicher and Walker (2010).

With regard to the control variables, our results support the suggestions that leverage is negatively significant with disclosure, as reported in Models 1 and 3. We also find a negative association between liquidity as well as firm growth and good news, at the 10 per cent level. Regarding the role of the external auditor, we find a negative association between auditors and bad news, at the 10 per cent level. For other variables, we could not find any significant association between size, sector and firm age towards narrative disclosure in the three models.

Table IV shows the impact of TD on FP. For Model 4, where we measure the impacts of good news on the FP, the result is both positive and significant, at the 10 per cent level. This means that, when a firm discloses good news about its activities, ROA is growing. The reverse association approved in Model 5 identifies that the disclosure of bad news has a negative impact on the firm's performance, or ROA, at the 10 per cent level. For Model 6, we find that net news has a positive impact on ROA, at the 1 per cent level. Thus, we conclude that TD has an impact on FP. Also, Models 4, 5 and 6 investigate *H2*, that is, whether the narrative good and bad news disclosure of a firm has a favourable influence on the FP. *H2* is accepted, as shown in our three models. This result conforms to the traditional view that more information adds value to firms. Our results are consistent with the signalling theory and relevant literature (i.e. Drobetz *et al.*, 2004), who determined that firms with better disclosure practices are associated with a higher FP. The effect is not only statistically significant, but its magnitude is also considerable from an economic point of view.

The positive effect of TD on FP shows that disclosing more good information leads to a higher FP. This indicates that increasing good news information reduce information asymmetry and results in a reduction in both monitoring and capital costs (Cheung *et al.*, 2010). Moreover, an higher level of disclosure improves management accountability and hence the firm value. Investors are more likely to evaluate the performance of these firms more highly, and this increases investment interest and a firm's performance. On the other hand, the analytical accounting models challenge the traditional sight of disclosure effects. Wagenhofer (2004) argued that the effects of disclosure depend on uncertainty, multi-person settings with conflicts of interest and information asymmetry. Thus, it is possible to expect a negative relationship between increased TD and FP. For instance, more public disclosure might reduce the acquisition of information by market participants, and thus decrease the total amount of information available in the capital market. More public information might also have negative net benefits if the information places a firm at a competitive disadvantage relative to its rivals. These results emphasise that the association between FP and disclosure is complex and depends on the interaction of a number of factors, such as category of disclosure and the context in which this association is examined.

To conclude, our findings support our hypotheses that there is an association between FP and TD. Consequently, this suggests that the narrative disclosure is determined by their FP. This proposes that the causality between the two endogenous variables runs from FP to TD and from TD to FP. Our findings are consistent with recent research by [Farag *et al.* \(2014\)](#), who provided evidence about the positive direction between disclosure and FP. Our findings show that high-profitable firms report more good news and less bad news in the narrative sections of annual reports. The study found that variances between good and bad news were positive during the three years, which reflects that Egyptian firms between 2011 and 2013 disclose good news more than bad news. However, [Beekes *et al.* \(2015\)](#) argued that firms generally have increased their disclosure frequency and demonstrated an improvement in the timeliness of bad news relative to good news, indicating a levelling of disclosure practices and greater transparency. Our result may be explained by the political situation after the 25 January revolution, which enhanced the market situation and attracted investors. This justification supports the argument about the effect of crisis on financial reporting. Our findings are consistent with [Keusch *et al.* \(2012, p. 623\)](#), who found that “a crisis situation leads to more extensive use of self-serving bias as adverse external economic conditions are used by managers to present themselves in the best possible light”. However, our findings are inconsistent with those of [Ressas and Hussainey \(2014\)](#), who provided evidence that, in a crisis period, firms report more bad news and less good news information. This might indicate that managers offer credible information at a time of crisis. [Clatworthy and Jones \(2003\)](#) showed that firms prefer to use bad news disclosure to blame the external environment rather than an economic or political crisis. Moreover, the evidence about the positive variances of good/bad news by Egyptian firms is consistent with the idea that managers face an asymmetric loss function in choosing their voluntary disclosure policies. Managers behave as if they bear large costs when investors are surprised by large negative earnings news, but not when other earnings news is announced.

5. Conclusion

We offer evidence on the bidirectional association between TD and FP. We add to the scarce evidence on TD in developing countries. We extend prior research, which mainly focus on one direction, to measuring the bidirection between FP and disclosure.

We provide evidence that Egyptian firms tend to benefit from greater good news disclosure. Our results may help regulators to adopt an appropriate balance of legislation, regulatory reform and enforcement to make improvements in the good and bad disclosure practices as well as the enhancement of organisational legitimacy. While previous research showed that analysts and investors rely on annual report narratives for decision-making, these statements remain largely unregulated and unaudited. The study will be of value to academic researchers in the field of impression management and to users of annual reports who may rely on narrative sections, such as the chairman’s statement, for decision-making.

We focus only on annual reports. Future research may consider other financial communication channels. We focus only on Egyptian firms. However, we believe that the same hypotheses are worth testing outside Egypt, and that it is reasonable to expect a higher level of tone management disclosure in other countries with better investor protection and with more developed capital markets. While this study used ROA as an accounting measure for performance, further research may use Tobin’s Q or other market-based measure of performance. Future research may also examine the impact of the Arab Spring on the association between TD and FP. Finally, it might be interesting to test the association between TD and FP before and after political crises such as the Arab Spring.

References

- Abd-Elsalam, O. (1999), "The Introduction and application of international accounting standards to accounting disclosure regulations of a capital market in a developing country: the case of Egypt. PhD Thesis, Heriot-Watt University, Edinburgh.
- Aras, G., Aybars, A. and Kutlu, O. (2010), "Managing corporate performance investigating the relationship between corporate social responsibility and financial performance in emerging markets", *International Journal of Productivity and Performance Management*, Vol. 59 No. 3, pp. 229-254.
- Athanasakou, V. and Hussainey, K. (2014), "The perceived credibility of forward-looking performance disclosures", *Accounting and Business Research*, Vol. 44 No. 3, pp. 227-259.
- Ayers, C., Oliver, Z. and Yeung, P. (2011), "Investor trading and the post-earnings-announcement drift", *The Accounting Review*, Vol. 86 No. 2, pp. 385-416.
- Baek, J., Kang, J. and Park, S. (2004), "Corporate governance and firm value: evidence from the Korean financial crisis", *Journal of Financial Economics*, Vol. 71 No. 2, pp. 265-313.
- Beekes, W., Brown, P. and Zhang, Q. (2015), "Corporate governance and the informativeness of disclosures in Australia: a re-examination", *Accounting & Finance*, Vol. 55 No. 4, pp. 931-963.
- Cheung, L., Jiang, P. and Weiqiang, T. (2010), "A transparency disclosure index measuring disclosures: Chinese listed companies", *Journal of Accounting and Public Policy*, Vol. 29 No. 3, pp. 259-280.
- Chiu, T. and Wang, Y. (2015), "Determinants of social disclosure quality in Taiwan: an application of stakeholder theory", *Journal of Business Ethics*, Vol. 129 No. 2, pp. 379-398.
- Cho, C., Roberts, R. and Patten, M. (2010), "The language of US corporate environmental disclosure", *Accounting, Organizations and Society*, Vol. 35 No. 4, pp. 431-443.
- Clarke, G. (1997), "Messages from CEOs: a content analysis approach", *Corporate Communication: An International Journal*, Vol. 2 No. 1, pp. 9-31.
- Clarkson, M., Li, Y., Richardson, D. and Vasvari, P. (2008), "Revisiting the relation between environmental performance and environmental disclosure: an empirical analysis", *Accounting, Organizations and Society*, Vol. 33 Nos 4/5, pp. 303-327.
- Clatworthy, A. and Jones, J. (2001), "The effect of thematic structure on the variability of annual report readability", *Accounting Auditing & Accountability Journal*, Vol. 14, pp. 311-326.
- Clatworthy, M. and Jones, M.J. (2003), "Financial reporting of good news and bad news: evidence from accounting narratives", *Accounting and Business Research*, Vol. 33 No. 3, pp. 171-185.
- Clatworthy, M. and Jones, M. (2006), "Differential patterns of textual characteristics and company performance in the chairman's statement", *Accounting, Auditing & Accountability Journal*, Vol. 19 No. 4, pp. 493-511.
- Davis, A., Piger, J. and Sedor, L. (2012), "Beyond the numbers: measuring the information content of earnings press release language", *Contemporary Accounting Research*, Vol. 29, pp. 845-868.
- Dedman, E. and Lin, S. (2002), "Shareholder wealth effects of CEO departures: evidence from the UK", *Journal of Corporate Finance*, Vol. 8 No. 1, pp. 81-104.
- Drobotz, W., Schillhofer, A. and Zimmermann, H. (2004), "Corporate governance and expected stock returns: evidence from Germany", *European Financial Management*, Vol. 10 No. 2, pp. 267-293.
- Dye, R. and Sridhar, S. (1995), "Industry-wide disclosure dynamics", *Journal of Accounting Research*, Vol. 3, pp. 157-174.
- Ebrahim, A. and Abdel Fattah, T. (2015), "Taxation corporate governance and initial compliance with IFRS in emerging markets: the case of income tax accounting in Egypt", *Journal of International Accounting, Auditing and Taxation*, Vol. 24, pp. 46-60.
- Elsayed, M. and Hoque, Z. (2010), "Perceived international environmental factors and corporate voluntary disclosure practices: an empirical study", *The British Accounting Review*, Vol. 42 No. 1, pp. 17-35.

- Farag, H., Yong, K. and Mallin, K. (2014), "Corporate social responsibility and financial performance in Islamic banks", *Journal of Economic Behaviour & Organization*, Vol. 103, pp. 21-38.
- Francis, J. (2004), "What do we know about audit quality?", *The British Accounting Review*, Vol. 36 No. 4, pp. 345-368.
- Francis, J., Philbrick, D. and Schipper, K. (1994), "Shareholder litigation and corporate disclosures", *Journal of Accounting Research*, Vol. 32 No. 2, pp. 137-164.
- Francis, J., Schipper, K. and Vincent, L. (2002), "Expanded disclosures and the increased usefulness of earnings announcements", *The Accounting Review*, Vol. 77 No. 3, pp. 515-546.
- Garcia-Ayuso, M. and Larrinaga, C. (2003), "Environmental disclosure in SPAIN: corporate characteristics and media exposure", *Spanish Journal of Finance and Accounting*, No. 15, April, pp. 184-214.
- Gray, S. (1988), "Toward a theory of cultural influence on the development of accounting systems", *Internationally Abacus*, Vol. 24 No. 1, pp. 1-15.
- Hackston, D. and Milne, M. (1996), "Some determinants of social and environmental disclosures in New Zealand companies", *Accounting, Auditing & Accountability Journal*, Vol. 9 No. 1, pp. 77-108.
- Hair, J.F., Black, W.C., Babin, B.J. and Anderson, R.E. (2010), *Multivariate Data Analysis* (7th ed.), Englewood Cliffs, Prentice Hall.
- Haniffa, R. and Cooke, T. (2005), "The impact of culture and governance on corporate social reporting", *Journal of Accounting and Public Policy*, Vol. 24 No. 5, pp. 391-430.
- Hassan, O., Romilly, P., Giorgioni, G. and Power, D. (2009), "The value relevance of disclosure: evidence from the emerging Capital market of Egypt", *The International Journal of Accounting*, Vol. 44 No. 1, pp. 79-102.
- Hutton, P., Gregory, S. and Skinner, D. (2003), "The role of supplementary statements with management earnings forecasts", *Journal of Accounting Research*, Vol. 41 No. 5, pp. 867-890.
- Inchausti, G. (1997), "The influence of company characteristics and accounting regulation on information disclosed by Spanish firms", *The Eur. Account. Rev.*, Vol. 6 No. 1, pp. 45-68.
- Ismail, K. and Chandler, R. (2005), "Disclosure in the quarterly reports of Malaysian companies", *Financial Reporting, Regulation and Governance*, Vol. 4 No. 1, pp. 1-26.
- Jensen, M. and Meckling, W. (1976), "Theory of the firm: managerial behaviour, agency costs and ownership structure", *Journal of Financial Economics*, Vol. 3, pp. 305-360.
- Keusch, T., Laury, H. and Hassink, H. (2012), "Self-serving bias in annual report narratives: an empirical analysis of the impact of economic crises", *European Accounting Review*, Vol. 21 No. 3, pp. 623-648.
- Khurana, I., Pereira, R. and Martin, X. (2006), "Firm growth and disclosure: an empirical analysis", *Journal of Financial and Quantitative Analysis*, Vol. 41, pp. 356-380.
- Lambert, R., Leuz, C. and Verrecchia, R. (2007), "Accounting information, disclosure, and the cost of capital", *Journal of Accounting Research*, Vol. 45 No. 2, pp. 385-420.
- Lev, B. and Penman, S. (1990), "Voluntary forecast disclosure, nondisclosure, and stock prices", *Journal of Accounting Research*, Vol. 28 No. 1, pp. 49-76.
- Miller, S. (2002), "Earnings performance and discretionary disclosure", *Journal of Accounting Research*, Vol. 40 No. 1, pp. 173-194.
- Muttakin, M. and Khan, A. (2014), "Determinants of corporate social disclosure: empirical evidence from Bangladesh", *Advances in Accounting, Incorporating Advances in International Accounting*, Vol. 30, pp. 168-175.
- Ng, J. and Koh, C. (1994), "An agency theory and profit analytic approach to corporate non-mandatory disclosure compliance", *Asia-Pacific Journal of Accounting*, Vol. 1 No. 1, pp. 29-44.
- Oeyono, J., Samy, M. and Bampton, R. (2011), "An examination of corporate social responsibility and financial performance: a study of the top 50 Indonesian listed corporations", *Journal of Global Responsibility*, Vol. 2 No. 1, pp. 100-112.

- Oyeler, P., Laswad, F. and Fisher, R. (2003), "Determinants of internet financial reporting by New Zealand companies", *Journal of International Management and Accounting*, Vol. 14 No. 1, pp. 26-63.
- Rahman, A., Zain, M. and Al-Haj, Y. (2011), "CSR disclosures and its determinants: evidence from Malaysian government link companies", *Social Responsibility Journal*, Vol. 7 No. 2, pp. 181-201.
- Ressas, M.S. and Hussainey, K. (2014), "Does financial crisis affect financial reporting of good news and bad news?", *International Journal of Accounting, Auditing and Performance Evaluation*, Vol. 10 No. 4, pp. 410-429.
- Schleicher, T. and Walker, M. (2010), "Bias in the tone of forward-looking narratives", *Accounting and Business Research*, Vol. 40 No. 4, pp. 371-390.
- Singhvi, S. and Desai, H. (1971), "An empirical analysis of the quality of corporate financial disclosure", *Accounting Review*, Vol. 46 No. 1, pp. 129-138.
- Skinner, J. (1994), "Why firms voluntarily disclose bad news", *Journal of Accounting Research*, Vol. 32 No. 1, pp. 38-60.
- Smith, M. and Taffler, R. (2000), "The chairman's statement; a content analysis of discretionary narrative disclosures", *Accounting Auditing & Accountability Journal*, Vol. 13 No. 5, pp. 624-646.
- Street, L. and Gray, J. (2002), "Factors influencing the extent of corporate compliance with international accounting standards: summary of a research monograph", *Journal of International Accounting, Auditing & Taxation*, Vol. 11 No. 1, pp. 51-76.
- Sydserff, R. and Weetman, P. (2002), "Developments in content analysis: a transitivity index and diction scores", *Accounting, Auditing & Accountability Journal*, Vol. 15 No. 4, pp. 523-545.
- Verrecchia, R. (1983), "Discretionary disclosure", *Journal of Accounting and Economics*, Vol. 5 No. 3, pp. 179-194.
- Wagenhofer, A. (2004), "Accounting and economics: what we learn from analytical models in financial Accounting and reporting", in Leuz, C., Pfaff, D. and Hopwood, A. (Eds), *The Economics and Politics of Accounting*, OUP, Oxford.
- Wallace, O. and Naser, K. (1995), "Firm-specific determinants of comprehensiveness of mandatory disclosure in the corporate annual reports of firms on the stock exchange of Hong Kong", *Journal of Accounting Public Policy*, Vol. 14 No. 4, pp. 311-368.
- Wallace, O., Nasser, K. and Mora, A. (1994), "The relationship between the comprehensive of corporate annual reports and firm characteristics in Spain", *Accounting & Business Research*, Vol. 25 No. 97, pp. 41-53.
- Wang, K., Sewon, O. and Claiborne, M. (2008), "Determinants and consequences of voluntary disclosure in an emerging market: evidence from China", *Journal of International Accounting, Auditing and Taxation*, Vol. 17 No. 1, pp. 14-30.

Corresponding author

Khaled Hussainey can be contacted at: Khaled.Hussainey@port.ac.uk

For instructions on how to order reprints of this article, please visit our website:

www.emeraldgroupublishing.com/licensing/reprints.htm

Or contact us for further details: permissions@emeraldinsight.com