The Impact of Voluntary Disclosure Level on the Cost of Equity Capital in an Emerging Capital Market: the Case of the Amman Stock Exchange

By

Ayman Elias Haddad

(BSc. MSc)

A dissertation Submitted for the degree of Doctor of Philosophy

School of Management
University of East Anglia

February 2005

ABSTRACT

The impact of disclosure level on the cost of equity capital is an important topic in today's accounting research. This issue is motivated by the economic theory that greater disclosure lowers the information asymmetry and the estimation risk which in turn reduces the cost of equity capital. However, the empirical evidence on the association between disclosure level and the cost of equity capital is limited, focused on developed markets (e.g. USA, Canada) and has reported mixed results (e.g. Botosan, 1997; Richardson and Welker, 2001). In this study, I examine the impact of voluntary disclosure on the cost of equity capital in the Amman Stock Exchange as an example of an emerging capital market by regressing the cost of equity capital on disclosure level and other firm characteristics. My measure of disclosure level is based on the amount of voluntarily disclosed information provided in the 2000 annual reports of a sample of non-financial sector companies listed on the Amman Stock Exchange through developing a self-designed disclosure index relevant to the Jordanian situation. This index is split into three main groups with nine categories. In general, the overall voluntary disclosure is poor, with almost 81% of the 62 items of information included in the disclosure index having a disclosure level below 50%. In addition, it is found that the extent of disclosure varies across the categories of information with, the category of background information being the most reported in corporate annual reports and the projected information category being the least reported. My measure of the cost of equity capital is based on the residual income model employed by Gebhardt et al. (2001). The result shows that on average the rate of return required by investors (the cost of equity capital) for bearing the risk of putting their capital into a business is, on average, 10%. Finally, the results on the *relationship between the disclosure level reported in corporate annual reports and the cost of equity capital provides a significant negative association. The magnitude of the coefficients of disclosure levels suggest that companies included in the sample with most forthcoming corporate financial reporting gaining somewhere between a .067%-.083% reduction in their cost of equity capital compared to the least forthcoming firms. In addition, it has been found that, when compared to other disclosure categories that comprised my disclosure index, the background information category and the market data information category have the most influential impact on explaining the variation in the cost of equity capital for the Jordanian companies listed on the Amman Stock Exchange.*