Are Corporate Governance Mechanisms Associated with Information Asymmetry Level among UAE Listed Companies?

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Abstract

Asymmetry of information involves the possession of information in different ways between the most informed stakeholders and the uninformed stakeholders which may affect the performance of companies. Using agency theory, this study investigates the relationship between corporate governance mechanisms and level of information asymmetry in UAE based on 64 annual reports for the year ended 2010. The findings indicate that board size and information asymmetry are positively related among UAE listed companies, while board ownership and company size are negatively related with information asymmetry. These results suggest that large size of the board of directors may lead to information asymmetry because they seem to be unable to monitor the management and protect the interest of shareholders. In addition, evidence of high information asymmetry among UAE companies imply that the implementation of the Code of Corporate Governance seems to be less likely to resolve agency problems due to asymmetric information.

Keywords: Corporate governance, information asymmetry, board, Tobin's Q, UAE

1.0 Introduction

The asymmetry of information involves the possession of information in different ways between the most informed stakeholders and the uninformed stakeholders which may affect the performance of companies. Information asymmetry thus occurs when one or more investors are privy to the company's value while the rest can only access public information (Brown & Hillegeist, 2007). Nevertheless, the elimination of information

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asymmetry can be carried out by maximizing the access to information regarding the company that is non-standard and also by increasing the information visibility of what the company offers the stakeholders.

The interests of these stakeholders and others (i.e. customers, suppliers, employees and government) could be further protected by companies which are made accountable for their actions through effective corporate governance (Vinten, 1998). Using corporate governance systems, the company is viewed by the stakeholders as a set of expectations akin to a polycentric vision of systems which the company is the center with the stakeholders attempting to govern it (Marcel, Orţan, & Otgon, 2010). In addition, the legal institutions issue the code of corporate governance in order to protect the shareholders' interest. For example, the OECD underlines that corporations need to be run in the interest of shareholders (OECD, 2004). Hence, Donato & Tiscini (2009) believe that corporate governance mechanisms such as board size, board meeting and board ownership may have a role to influence the level of information asymmetry.

Furthermore, the United Arab Emirates government has played a significant role to protect investors, shareholders and other parties. In May 2006, the government of UAE through the Emirates Securities and Commodities Authority promulgated the Code of Corporate Governance for listed companies and subsequently updated it in 2010. Compliance with the code is mandatory for joint stock public companies in the UAE, as well as companies listed on the Abu Dhabi Securities Exchange and Dubai Financial Market. Consequently, the issuance of the Corporate Governance Rules and Corporate Governance Standards in 2009 by Securities and Commodities Authority (SCA, 2009) could protect the shareholders' interest. In this context, these policy makers could emphasize the role of the board of directors in order to reduce the information asymmetry between the owners and managers.

To the best of our knowledge, studies have not directly examined the relationship between corporate governance and information asymmetry among UAE listed companies. Furthermore, corporate governance disclosures which were made mandatory as from 30th April 2010 by Emirates Securities and Commodities Authority could provide interesting findings in UAE context for policymakers, shareholders and researchers. The remainder of this paper is divided into 3 sections. The next section of the paper discusses hypotheses development. Section 3 presents the methodology, section 4 discusses the empirical findings and discussions, and the final section ends with conclusions.

2.0 Hypotheses Development

In line with the agency theory, board of directors is a key mechanism in ensuring that an agents perform their work to increase the shareholders' wealth. In other words, the principals (i.e. shareholders) primarily bestow the responsibility of decision making to the agents (i.e. board directors) who are held responsible for using and controlling the economic resources of the company (Fama & Jensen, 1983). In many cases, management may not always work for the benefit of the shareholders owing to adverse selection and moral hazards arising from information asymmetry. Hence, the board's role is to eradicate or decrease information asymmetry (Mnif, 2009) in order to reduce the agency problems which may occur between managements and stakeholders. Therefore, the agency perspective assumes that corporate governance mechanisms (i.e. board size, board meeting and board ownership) could have a relationship with information asymmetry.

2.1 Board Size

Increase in board size can improve companies' board effectiveness to support the management in reducing agency cost that results from poor management and would in turn lead to better financial results (Jensen & Meckling, 1976). Larger boards which are able to commit more time and effort to overseeing management are more effective monitors of the financial accounting process, then bondholders should benefit through financial transparency and reliability (Lipton & Lorsch, 1992).
In addition, Abdullah (2004) argued that large size of board would result in better monitoring of the actions of the company's management teams. The ability of large boards to monitor is higher and the benefits can outweigh the costs in term of poorer coordination, communication and flexibility associated with larger groups (Andres, Azofra & Lopez, 2005). In this context, better corporate governance that minimizes agency problems can lead to a decrease in agency cost and information asymmetry (Mirchandani & Gupta, 2018).

Thus, the following hypothesis is formulated:
H1: *Ceteris paribus*, information asymmetry is related to the number of members on the board.

2.2 Board Ownership

A greater manager ownership that generates greater alignment of the interests of shareholders and managers could mitigate agency problems between the two parties (Demsetz, 1983). To this extent, an additional overseeing which is needed by ordinary shareholders as managerial ownership has been known to decrease and the monitoring is expected to urge the managers to disclose information voluntarily (Jensen & Meckling, 1976). Shiri et al. (2016) indicated that information asymmetry is more in companies that have lower disclosure quality. Consequently, accounting disclosure could serve as a safe transmission of information between management and investors which plays an important role in mitigating information asymmetry (Healy & Palepu, 2001).

Gerayli et al. (2011) found an association between the level of information asymmetry and director ownership among Iranian listed companies. Their findings suggest that higher board shareholding are related to lower degrees of information asymmetry.

Thus, the following hypothesis is formulated as follows:
H2: *Ceteris paribus*, information asymmetry is related to director ownership.

2.3 Board Meeting

Board of directors meeting is defined as the number of meetings held by the board during the year. According to Vafeas (1999), the number of board meetings is a good proxy for the directors' monitoring effort and also shows that frequent board meetings can be a remedy to limited director interaction time. Board meetings are important ways to improve the board members' effectiveness (Lipton & Lorsch, 1992) because directors are more likely to obtain all the information regarding the performance of the company and to take actions to address company issues during regular board meeting (Christozov et al., 2006).

Vafeas (1999) found a negative relationship between the number of board meeting and performance. On the other hand, board of directors meeting, which is positively related with capital structure, indicate that board of directors that do not meet, or meet only a small number of times are unlikely to be effective monitors (Menon and Williams, 1994). In particularly, board diligence as proxy by the frequency of board meetings is expected to lead to effective monitoring and to decreasing agency problems stemming from lower information asymmetry through higher disclosure of voluntary information (Christozov et al., 2006).

Thus, the following hypothesis is formulated as follows:
H3: *Ceteris paribus*, information asymmetry is related to the number of board meetings.

3.0 Methodology

This study uses Tobin's Q as proxy for information asymmetry. A high Tobin's Q (i.e. measured by the market value of a company's equity, plus the book value of its liability, divided by the book value of equity and liability at the end of year) implies that there is a variance in the demand for shares of the company and consequently result to an increase of information asymmetry (Denis et al., 2010; Tobin & Brainard, 1977). In addition, multiple regression analysis is employed to examine the relationships between corporate governance mechanism and information asymmetry based on 64 annual reports for the year ended 2010.

The predictor variables included in this study are described and summarized in Table 1.

Table 1

Summary of Predictor Variables

Variables Names	Variables Acronym	Operational definition
Board of Directors Size	BSIZE	The total number of directors on the board members
Board of Director Meetings	BMEET	The number of meetings held by board during the year
Board Ownership	BOWNER	Percentage of shares held by director members in the company
Company Size	COMSIZE	Log of total Assets

4.0 Findings and Discussions

4.1 Descriptive Analysis

The descriptive analysis provides evidence that the average of board size (BSIZE) is 8 members with maximum size of 17 and minimum size of 5 members respectively. This result implies that the UAE companies in general have a large board of directors which corresponds to the corporate governance code in UAE: “The appropriate number of members is determined by the size of the company but a good practice for the small and medium enterprises (SMEs) would be between five to ten members”. Lipton & Lorsch (1992) suggested that larger boards are able to commit more time and effort to overseeing management. Therefore, stakeholders should benefit through improved financial transparency and reliability due to the board of director’s effectiveness in monitoring the financial accounting process. Similarly, Adams & Mehran (2002) indicated that some companies require larger boards for effective monitoring like banks and large companies.

The mean number of board meetings is 5.82 implying that the level of board meetings of UAE companies is moderate as the minimum number of meetings is 3 and the maximum number of meetings is 12. This analysis suggests that UAE companies have complied with the code of corporate governance which states that “the board of directors should meet at least quarterly or as frequently as necessary for the discharge of its obligations.”

Table 2

Descriptive Statistics

Variables	N	Minimum	Maximum	Mean	Std. Deviation
Information Asymmetry (Tobin Q)	64	0.06	2.84	0.92	0.55
Board size (number)	64	5	17	8.00	2.00
Board meetings (number)	64	3	12	5.82	1.78
Company size (Log)	64	4.77	8.46	6.42	0.86
Board ownership (%)	64	0	72%	3.83%	0.11

In addition, the mean of shares held by the board members in UAE companies is 3.83% with a minimum value of 0 and a maximum value of 72 percent. The disclosure of board members' shares may provide an indication that UAE Companies communicate with their stakeholders to ensure timely and accurate disclosure of information on the company's activities. Providing information about the transactions of shareholders and employees imply that companies have a high quality information system. In particular, 42 (66%) of the UAE companies have not recorded any shares held by the members of board of directors. In addition, the company size in UAE has a mean value of log assets of 6.42 with a minimum of 4.77 (58,667 AED) and maximum of 8.46 (28,621,588 AED). Further, the mean percentage of Information Asymmetry among UAE listed companies is 0.9276 with the maximum of 2.84 and the minimum of 0.06 respectively while the standard deviation of this variable is 0.55. This statistical analysis provides evidence that information asymmetry is likely to be high among UAE companies. In addition, the first objective which is related to the investigation of the level of information asymmetry in UAE companies is provided by descriptive analysis in Table 2. The level of information asymmetry in UAE companies seems to be high despite the code of corporate governance that was updated in 2010. This result perhaps is due to the lack of transparency and the production of little information related to the companies.

Table 3

Correlation

	BSIZE	BMEET	COMSIZE	BOWNR	IA
BSIZE	1	-0.015	0.183	-0.058	0.201
BMEET		1	0.169	-0.137	-0.061
COMSIZE			1	-0.101	-0.268*
BOWNR				1	-0.075
IA					1

* Correlation is significant at the 0.05 level (2-tailed).

High correlation between the independent variables is a serious problem in multiple regressions given that the difficulty to identify the effect of each independent variable on the dependent variable. Nevertheless, a widely used method to detect and measure multicollinearity is the Variance Inflation Factor (VIF) for each independent variable (Naser et al., 2002). Silver (1997) noted that the Variance Inflation Factor (VIF) above 10, the independent variables are considered highly correlated. Table 3 shows that no multicollinearity problem exists due to the fact that no VIF value exceeds 10 in the present study. In addition, the normality of the data is tested by analyzing the skewness and kurtosis. The value of Skewness must be less than ±3 and Kurtosis must not be more than ±10 (Kline, 1998) in order to achieve a normal data.

5.0 Multiple Regression Analysis

This section presents an analysis and discussion of the relationship between information asymmetry (Tobin's Q) as a dependent variable and the independent variables (i.e. board size, board meetings and board ownership) along with the company size as a control variable using a multiple regression technique. The equation used to explain the relationship is:

$$Information\ Asymmetry = \alpha 0 + \beta 1BSIZE + \beta 2BMEET + \beta 3\ BOWNER + \beta 4COMSIZE + \varepsilon$$

Where :
Tobin's Q : as a proxy of information asymmetry (IA).
α0 : Intercept.
BSIZE : Board Size.
BMEET : Board Meetings.
BOWNR : Board Ownership.
COMSIZE : Company Size.
ε : Error term.

Table 4

Summary of Regression Model

Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
0.5429	0.29442	2.248

Table 4 shows that the adjusted R^2 is 54.29% which can be explained by the six independent variables and a control variable. In addition, Durbin-Watson value is 2.248 indicates that there is no autocorrelation among the variables. Kazmier (1996) indicated that the value of the test statistic should not be more than 4.

Table 5

Multiple Regression Analysis

	Unstandardized Coefficients		Standardized Coefficients		
Variables	B	Std. Error	Beta	t	Sig.
(Constant)	2.073	0.676		3.064	0.008
BSIZE	0.129	0.037	0.619	3.463	0.004***
BMEET	-0.002	0.043	-0.009	-0.057	0.955
COMSIZE	-0.196	0.101	-0.274	-1.949	0.072*
BOWNR	-0.418	0.106	-0.577	-3.944	0.001***

*** Significant at 1%, ** significant at 5% and * significant at 10%

Table 5 presents the regression results of the relationship between information asymmetry and corporate governance characteristics and company size. Board size, company size and directors' ownership, are significantly related to information asymmetry. The findings show that the relationship between board size and information asymmetry is positive and significant at 1% level. The results suggest that the larger size of the board of directors may lead to conflict of interest resulting in information asymmetry. In other words, large board of directors is unable to monitor the management and protect the interest of shareholder. These results are consistent with the agency theory which suggests that an average board size is not appropriate and is considered ineffective as it exceeds eight members (Jensen, 1993).

Table 5 also provides evidence that board ownership in UAE companies is negatively and significantly related to information asymmetry at 1% level. This finding is consistent with Gerayli et al. (2011) who indicated that board ownership has a negative impact on level of information asymmetry which is measured by bid-ask spread. In addition, Kanagaretnam et al. (2007) examined the relationship between the quality of corporate governance and information asymmetry through share price. They found that the changes in the share price at the time of earning announcements are significantly negatively related to the percentage stock holdings of directors.

Moreover, company size serves as an effective proxy for information asymmetries. Company size of UAE listed companies is significantly and negatively related to information asymmetry at 10% level. In a similar vein, Filbeck & Webb (2001) found that investors seem to prefer investing in larger companies that display greater financial disclosure and less information asymmetry. Generally, the corporate governance in UAE companies seems to be in need of development due to many reasons such as the skills and qualifications of directors which lead to weakness decision and affects the role of board of directors in monitoring the management. In addition, the low effectiveness of the legal and regulatory procedures may also be a reason for lack of adherence of the UAE companies with the corporate governance directions.

The multiple regression analysis provides evidence that the functions of corporate governance may be in need of strengthening. Boards of directors in UAE are required to monitor management and protect the shareholders' interests. The UAE regulators seem to develop the recommendations of corporate governance code to improve the effectiveness of audit committees and the board of directors. Adawi & Rwegasira (2011) suggested that the corporate governance in UAE companies have been focused on the promotion of practices such as greater disclosure, improved rights of shareholders and boardroom reforms. Parker (2007) indicated that corporate governance may go beyond the compliance with legal responsibilities to cover information of whatever is deemed suitable to inform stakeholders about management performance.

6.0 Conclusions

This result shows that the level of information asymmetry in UAE is considered high. For emerging markets such as the UAE, companies may be concerned about the essential indicators of the quality of corporate governance required to build confidence in these markets. Adawi & Rwegasira (2011) believed that in order to stand out in the market, corporations in general, and listed companies in particular, will need to adopt discretionary practices of disclosure in order to attract local and international investors. Typically, the practice of corporate governance is tailored to suit the needs of core shareholders, in order to gain access to an expanded pool of external investment in equity. The need for improvement in the practice of governance and of the rights of shareholders is related to the concerns of external investors.

Multiple regression analysis was used to examine the relationship between information asymmetry and corporate governance mechanisms, namely board size, board meeting and director ownership among the UAE listed companies. The findings reveal a positive relationship between board size and information asymmetry of UAE listed companies, while board ownership and company size are significant and negative in direction. Consequently, the disclosure of board members' shares may indicate that UAE companies have good communication systems with their stakeholders to ensure timely, transparent and accurate disclosure of information. UAE companies may have good quality in regulations and information systems but the information seems to be asymmetric.

Hence, this findings of the present study provides various insights that should be of interest to government, shareholders, investors, policymakers and other relevant stakeholders. However, this study has limitations which may hinder the scope and generalization of the results. These limitations include the research design of the study which should consider all listed companies in UAE for many years, other corporate governance variables and other information asymmetry measurement such as bid-ask spread.

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