

# EARNINGS DISCLOUER, IDIOSYNCRATIC RISK & CREDIT RISK

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## Abstract

The current study aims to investigate the nature of relationship between idiosyncratic risk, earnings disclosure and credit risk. The study is investigated in Asian context specifically in Pakistan. And it is hypothesized that idiosyncratic risk and earnings discourser gives rise to credit risk. Moreover, the data is acquired through connivance sampling technique and study results revealed it findings with respect to historic findings.

**Key Terms:** Earnings Disclosure, Idiosyncratic Risk, Credit Risk, Convenience Sampling

## Introduction

Credit risk is usually found in corporate sector's that pinches corporate productivity and makes it unable to repayment of debt. Such risk is originated through cash flows transactions for investment motives. Such investments are done on the bases of credit rating. But such risk is boosted by the corporate idiosyncratic risk. A nature of risk that is associated to any financial or real asset. Such assets are the source of revenue or profit generation. So when these are found in threat ultimately roots of repayment and funds collections stops that give rise to credit risk.

While, earnings disclosure is a phenomena that also plays vital role with respect to credit risk (Jiang,2008). Thus, earnings disclosure gives rise to credit risk because its announcement/ disclosure creates an additional fund outflow (Iqbal, Chaudry & Iqbal, 2015). So in Pakistan past studies has less investigated credit risk and investigated mainly with its determinants or with company specific factors (Iqbal et al, 2015, Iqbal et al., 2014, Iqbal, Nasir & Iqbal, 2015). The current study is hypothesizing to investigate the relationship of idiosyncratic risk and earnings disclosure with credit risk (Lin, Shin, 2014).

So it is aimed to investigate the nature of relationship and quality of decisions associated with them. Moreover, the study will reveal key significance and practical implications for theorists, practitioners and new researchers.

The scheme of the study is that first part explains the introduction and literature. While, second part elaborates the methodology, sample of the study, hypothesis and measurement models, third part explains the results and fourth part discusses the study findings and conclusion.

## Study Methodology

The study is exploratory and investigates the relationship of earnings disclosure and idiosyncratic risk with credit risk. And the model is 2SLS in nature where it is plan to test the nature of relation of variables. The data is acquired from Karachi Stock Exchange Database. While the sample range of the data consists of five years from 2010 to 2014. Thus, the sample consists of 3478 observations of manufacturing sector of Pakistan with sample companies of 167 companies.

The sector representation of sample contains on Chemical sector, Beverages Sector, Food Sector, Sugar Sector, Automobiles Sector & Pharmacy Sector with 34%, 12%, and 14%, 18%, 10% & 12% respectively. While, the data is acquired through convince sampling technique. The econometric model and measurement models are as follows,

$$Y = c + ED + e \dots\dots\dots (01)$$

$$Y = c + ID + e \dots \dots \dots (02)$$

$$Earnings\ Disclosure = \frac{(P_{it} - 1) + C_{it}}{P_{it}} - 1$$

$$Idiosyncratic\ Risk = Ln \left[ \frac{P_t}{P_t - 1} \right]$$

$$Credit\ Risk = \left[ \frac{LLPTA}{TA} \right]$$

On the bases of above model hypothesis of the study are as follows,

H1: There is positive significant relationship of earnings disclosure with credit risk.

H2: There is a positive significant relationship of idiosyncratic risk with credit risk.

### Study Results

Table 01  
 (Descriptive Statistics)

| Variable | Mean  | Standard Deviation |
|----------|-------|--------------------|
| ED       | 0.057 | 0.41               |
| CR       | 6.45  | 2.11               |
| IR       | 2.33  | 5.68               |

*ED = Earnings Disclosure, CR= Credit Risk, IR = Idiosyncratic Risk*

The table 01 explains the descriptive results of the study where mean value of earnings disclosures are 0.057, credit risk 6.45 and idiosyncratic risk has 2.33. Moreover, standard deviation of earning disclosure is 0.41, credit risk 2.11 and idiosyncratic risk value is 5.68 respectively.

Table 02  
 (Data Normality & Reliability)

| Variability | Skewness | Kurtosis | Cronbach's Alpha |
|-------------|----------|----------|------------------|
| ED          | 2.67     | 0.186    | 0.76             |
| CR          | 1.17     | 0.66     | 0.83             |
| IR          | 1.25     | 1.04     | 0.77             |

*ED = Earnings Disclosure, CR= Credit Risk, IR = Idiosyncratic Risk*

The table 02 tabulated results of data normality and reliability. Thus, data has sustainable data reliability and normality. Because kurtosis value is within the range of +2 to -2 range i-e earnings disclosure 0.186, credit risk 0.66 and idiosyncratic risk has 1.04. Moreover, there is found reliable of all variables because Cronbach's alpha value of earning disclosure is 0.76, credit risk 0.83 and idiosyncratic risk 0.77 respectively that are greater than the 0.71.

Table 03  
 (Correlation Analyses)

| Variable | 1      | 2      | 3 |
|----------|--------|--------|---|
| ED       | 1      |        |   |
| CR       | 0.57** | 1      |   |
| IR       | 0.67** | 0.71** | 1 |

\*Significance at  $p < 0.05$  level, \*\* Significance at 0.01 level, \*\*\* Significance at 0.001 level

Table 03 explains the correlation analyses results were earning disclosure is correlated with credit risk, credit risk correlated significantly with idiosyncratic risk at 0.57\*\* ( $p < 0.01$ ) and idiosyncratic risk is found significant with 0.67\*\* ( $p < 0.01$ ) & 0.71\*\* ( $p < 0.01$ ) respectively

Table 03  
 (Regression Analyses)

| Variable | B     | Significance |
|----------|-------|--------------|
| ED       | 6.999 | 0.000        |
| CR       | 3.001 | 0.000        |
| IR       | 11.18 | 0.000        |

ED = Earnings Disclosure, CR= Credit Risk , IR = Idiosyncratic Risk

A stepwise regression is performed in because of estimation power and variables rejection perspective. Thus, the table four explains the earnings disclosure as significant with beta value as 6.999, credit risk is found significant with beta value of 3.001 and idiosyncratic risk is found significant with beta value of 11.18. Therefore, all hypotheses are accepted and results are coherent with historic studies.

### Conclusion

In current study 2sls is performed to check the relationship. Thus, study revealed its results with respect to historic investigations and concluded that earnings disclosure and idiosyncratic risk gives rise to credit risk and affects it positively. Therefore, managers have to focus on earnings disclosure and gross root reasons of idiosyncratic risk to decrease it or diversify it. Otherwise, it may lead to over increase the level of credit risk that will be more harmful for financial concerns. Moreover, in Pakistani context companies should plan and prepare the risk profiles. Because the main hurdle to each company here is being unaware from corporate risks. Hence, risk profile will give them sound advantages and proactive, moves to recover betterly.

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