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Are Companies Rewarded for More Voluntary Disclosure? Evidences from Literature

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Abstract

Voluntary disclosure are potentially important way for management to communicate ?rms' performance and governance to the outside investors. In this paper, we provide a theoretical framework for voluntary disclosure and the different cost-benefit associated with it whereby empirical studies reveals that there is a trade-off between the multiple cost and related benefit while deciding the extent of such disclosure. This paper have also shown some board classification of voluntary disclosure in the academic research whereby studies reveal that, different types of voluntary disclosure by management is based on the relevance of such information in terms of market value of firms. Further, we review research on the relation between voluntary disclosure of information and its impact on market valuation of the firm under different market setting and summarizes the major research findings. Our paper concludes that, there exist a positive and significant relationship between voluntary disclosure and firm value in the developed market whereas empirical findings from the developing market does not provide any conclusive evidence in this regard due to the presence of some unique characteristics such as closely held corporation, weak investor protection environment, state ownership, weak board independence, illiquid stock markets, heavily bank-orientated economy, frequent government intervention economic uncertainties and low level of disclosure which necessitates to revisit this relation in context of emerging economies.

Keywords: Voluntary Disclosure, Firm Value, Review.

Introduction

The issue of voluntary disclosure in the annual reports and in other information media has been one of the rapidly growing research areas in the field of reporting. In this, several factors have been focused such as determinants of voluntary disclosure, disclosure environment, the relationship between disclosure and many financial terms such as liquidity, risk, stock price and cost of capital. Voluntary disclosure appears to be an important consideration for the firm in gaining access to the limited reservoirs of resources as improved voluntary disclosure ensures greater participation of lenders and borrowers by reducing information asymmetries and also helps to make the capital market more efficient in terms of its operation and allocation of resources (Aljifri,2008; Kordestani,2012). However, there is no unequivocal evidence to suggest that increased discretionary disclosure enhances firm value in different market settings.

In this paper, we review research on the relation between voluntary disclosure of information by management and its impact on market valuation of the firms in both developed and developing countries, summarizes the major research findings. The key research question in the studies reviewed is whether there is a relation between voluntary disclosure and market valuation of the firm. Economic benefits of voluntary disclosure can be routed through diverse ways such as, reducing adverse selection (i.e, enables managers and investors to identify value creation opportunities with less error), predicting of financial performance, lowering liquidity risk, preventing managers from expropriating the wealth of investors, reducing the likelihood of extreme market reactions, maintaining business reputation. These factors directly/indirectly contributes towards lowering the risk premium demanded by investors, thus reducing cost of external financing which ultimately contributes towards firm value (Bushman and Smith,2001;Chee Mun et al,2011;Villiers and Staden,2011). The remainder of this paper is organized as follows.

Section 2 provides the theoretical framework of voluntary disclosure which begins with the normative theory and extends into positive accounting theory, agency theory and further evolves to contingency theory, signaling theory, capital need theory and legitimacy theory.

Section 3 focuses on the concept of voluntary disclosure and the different cost-benefit associated with it whereby empirical studies reveals that firms make a trade-off between the multiple cost and related benefit while deciding the extent of such disclosure. Section 4 discusses the methodology used for collecting relevant materials for this paper.

Section 5 reviews some board classification of voluntary disclosure in the academic research whereby studies reveals that, different types of voluntary disclosure by management is premised on the decision-usefulness approach. This approach assumes that information is value relevant (decision useful) if it is capable of making a difference to an investor's decision and its publication is associated with a significant change in share price (Ball and Brown, 1968).Due to the discretionary nature of voluntary disclosure it is the outcome of the selection process which are considered to be worthwhile in enhancing firm value.

Section 6 discusses the empirical relationship between voluntary disclosure and firm value followed by analysis of the empirical findings in developed, developing and multi country studies and highlighting the avenues for future research. Finally, last section concludes the paper.

Theoretical Framework:

Financial reporting research prior to 1960s was mainly following normative theory, seeking to prescribe "what information ought to be disclosed" and "how they should be presented" in the financial statement. Followers of normative methodology did not attempt to explain empirically the predictive ability of the reporting practices (Lal,2009). To overcome this limitation, positive accounting theory was developed with a focus on explaining and predicting reporting practices. However, positive accounting researchers in the initial years just investigated the "decision usefulness" of information based on the underlying empirical relationship between disclosed information and stock prices (Watts and Zimmerman,1990). But examining reporting practices only on the basis of decision usefulness perspective is a one sided coin, ignoring managers' intentions to disclose such information. During 1970s finance academics, such as Jensen and Meckling (1976), Watts and Zimmerman (1986) attempts to fill this gap by incorporating an explanation of the "opportunistic perspective" of information. They opined that managers uses accounting and reporting choices based on the contract between principals (owners) and agents (managers). Positive Accounting Theory analyses "what is" as opposed to the normative approach, which prescribes "what should be". It is designed to explain and predict which firms will and which firms will not use a particular accounting method based on the self interest of the managers (Lal,2009). It is concerned with how firms work under real situation with the aim of maximizing their value. Moreover, agency theory also explains that agency relationship between owners and managers creates information asymmetry (Agency conflict) between them because later is considered to have better access to information than former (Jensen and Meckling, 1976) which can be mitigated on the part of managers by using voluntary disclosure as a tool (Barako et al, 2006).Contingency theory is applied by Thomas (1986) in explaining corporate reporting practices. The proposition drawn by him is that management's choice of financial reporting practices is contingent upon different constraints on entities such as societal variables, user characteristics, organizational environment and firm specific attributes.

Existing literature also provides some other theories in explaining voluntary disclosure, such as Signalling theory, Capital need theory, and Legitimacy theory. As per Signalling theory, companies which consider themselves superior than others signal the market through voluntary disclosure in order to – i) attract investment, and ii) gain favorable reputation to ultimately maximize firm value(Verrecchia,1983; Campbell et al, 2001) whereas Capital need theory posits that companies can lower their cost of capital and maximize their value by increasing their disclosure of credible information (Frankel et al, 1995; Iatridis,2006;Tan et al.,2014). Lastly, the Legitimacy theory argues that an organization can continue to survive only if, it is perceived to operate within the bounds of a set value system prevalent in society (Dowling and Pfeffer, 1975). According to it, management reflects organizations' image to society by disclosing more information voluntarily to assist it (society) in decision making and thereby claims legitimacy to exist and operate (O'Donovan, 2000; Haniffa and Cooke 2005).Therefore, the above theoretical framework provides clear linkage between voluntary disclosure and firm value where voluntary disclosure can be used as a tool by the management to reduce agency cost and to convey organization's image to stakeholders, which in turn have an impact on firm value.

Concept:

Disclosure by firms can be categorized as mandatory and voluntary. While mandatory disclosure prescribes basic information that are applicable to the companies under different regulatory regime, whereas Voluntary Disclosure is supplementary in nature which augments the mandatory disclosure (Ansah,1998; Ho and Wong, 2001).The term voluntary disclosure as defined by Financial Accounting Standards Board (FASB, 2001), "primarily includes the statements, that are not explicitly required by Generally Accepted Accounting Principles (GAAP) or specific country rules." In recent years, there has been an increase in dissatisfaction over mandatory financial reporting for the reason of its inability to meet the informational needs of different user groups which called for increased voluntary disclosure (Meek, et al, 1995; Chen and Jaggi, 2000; Eng and Mak, 2003; Bossco and Kumar, 2007).Further, market valuation of the firm are likely to be more related with voluntary disclosure than mandatory disclosure as firms are expected to comply with the mandatory disclosure requirement but they are not further rewarded for such compliance whereas adoption of voluntary disclosure practices by firms are rewarded by investors (Cheung et al.,2010). In addition, presence of a strong and complex mandatory reporting requirements also raise the need for voluntary disclosure as the intricate nature of financial statement and reporting standard hinder information accessibility of users and consequently managers uses additional voluntary disclosure in order to convey the information in a more simple and understandable manner (Guay et al.,2016;Cordazzo,2017). Voluntary disclosure is also motivated by number of factors, like its contribution to cost of capital (Meek et al., 1995; Botosan, 1997), equity values (Healy and Palepu, 1993), market liquidity (Diamond and Verrecchia, 1991; Kim and Verrecchia ,1994; Bokpin,2012; Schoenfeld,2017), mitigating the agency problem by reducing information asymmetry between managers and owners and protecting investors' interest (Fama and Jensen, 1983); stakeholder pressure (Qu et al.,2013), stock compensation (Brockman et al,2010); increased analyst coverage (Shehata,2014) and management talent signaling (Elshandidy,2013). However voluntary disclosure is not costless because it is associated with the emergence of proprietary costs (Dye, 1986; Campbell et al., 2001), expenses related to information production and dissemination (Hassan and Marston,2010) political cost (Cormier et al,2005) and litigation costs (Darrough and Stoughton, 1990). Thus, there is a trade-off between the multiple cost and related benefit when deciding the extent of such disclosure (Broberg et al.,2010; Gisbert et al.,2014).

Literature Search Method:

The purpose of this paper is to investigate the relationship between voluntary disclosure and firm value as revealed by literature. Accordingly, this paper is based on secondary information obtained from different journal articles, books and reports. To identify the relevant research papers on the relation between voluntary disclosure and firm value published in academic journals we followed a systematic process which combines electronic search. In Google Scholar we used different combinations of keywords such as "impact of voluntary disclosure on firm value", "factors influencing firm value", "relationship between voluntary disclosure and firm value" to get the relevant materials. Our search yields a total number of 28 published studies with regard to the empirical association between voluntary disclosure and firm value in both developed and developing countries over the period of 2002-2017. Annexure-I list these papers by journal.

Classification Of Voluntary Disclosure:

The term voluntary disclosure is an abstract concept difficult to measure. Moreover studies shows that there is no standard guidelines for companies regarding comprehensive voluntary disclosure, thus the content of the information as disclose by companies are not clearly comparable (Kaeokla and Jaikengkit,2013; Babatunte and Samuel, 2015) posing challenge for the researchers. However, literature shows that researchers tries to measure this abstract concept by using different proxies. Theses proxies can be divided into two categories i.e, without recourse to original disclosure vehicle (Botosan and Plumlee, 2002; Chiu and Chi, 2009; Jiao,2011; Lawrence, 2013; Heb,2014) and with recourse to original disclosure vehicle (Boston,1997;Eng and Mak,2003;Uyar and Kihc, 2012; Sahore and Verma ,2017).The former uses disclosure surveys, analyst ratings, analyst forecast accuracy where as the latter uses disclosure vehicles like annual reports, firm's website etc. in order to construct disclosure Index or content analysis (Hassan and Marston, 2010).

There are different factors associated with voluntary disclosure as stated in section 2. Indeed, regulators (including IASB and FASB) agree that relevance and reliability (faithful representation) are the basic characteristics of useful information (Tahat,2016). In general decision-usefulness approach is considered as the theoretical base in making different types of disclosure. This approach assumes that information is value relevant (decision useful) if it is capable of making a difference to an investor's decision and its publication is associated with a significant share price change. Boardly, voluntary disclosure are classified by academic researchers into three types, namely, strategic information which includes general corporate information, corporate strategy, acquisition and disposals, research and development and future prospects; financial information such as segmental information, financial review, foreign currency information, stock price information and non-financial disclosure which includes information about directors, employee information and social policy (Meek et al., 1995; Eng and Mak, 2003 Qu et al,2013).This way of categorizing disclosure information was originated by Gray et al. (1995) and Meek et al.(1995) and followed by a number of studies. The nature of each of these information and their relevance in decision making is discussed below:

General and Strategic corporate information:

This section of information is considered to be relevant to a broader set of users. It contains non-financial information about general corporate outlook, specific corporate information, economic environment, corporate strategies and future prospects that may affect the operational performance of firms (Lim and Chow,2007; Cahyaningtyas, et al.,2015).The disclosure of these information plays an important role in the evaluation of a firm's earnings forecast and limits market surprises(Bukh et al, 2005).Thus, management tends to use information related to their key function (strategy formulation) as the basis of corporate disclosure to enhance company's image to stakeholders and to attract strategy specific investment (Ho and Wong, 2004; Ferreira and Rezende,2007). Furthermore evidences also suggest that increased used of strategic disclosure improves firm value (Bukh et al.,2005; Padia,2012).

Forward looking statement:

The value relevance of forward-looking information to capital market efficiency have been widely acknowledged by different regulators (American Institute of Certified Public Accountants, 1994; Financial Accounting Standards Board, 2001). It is concerned with information related to future prospects of the firm which provides insight into key issues and challenges in the external environment faced by the firm (Ho and Taylor, 2013). Firms voluntarily disclose these information with the change in firm performance to assist investors in making precise forecast of earnings (Qu,2015; Hassanein and Hussainey,2015). Forward-looking information is consequential, influencing investor and analyst beliefs about firm value (Bozanic,2017). Evidence also indicate that voluntary disclosure of forward-looking statements enhance the share price anticipation of future earnings (Wang and Hussainey, 2013).

Research and Development (R & D) disclosure:

This section offers unique information required by external stakeholders to evaluate the level of risk and information asymmetry associated with R & D investments (Merkley, 2014). Indeed, any voluntary disclosure regarding R & D projects increases proprietary costs (Verrecchia, 1983; Dye, 1985). However, return associated with such projects are relatively uncertain due to their dynamic nature (Nekhili et al.,2016).Thus to attract investment firm choose to disclose more information about their R&D activities voluntarily, in order to convey the firm's true value to outsiders(Merkley,2014).Empirical evidence also shows the relevance of such information in terms of market valuation (Yang, 2008).

Board structure and management disclosure:

This section focuses on the information about board composition, effectiveness and shareholders rights. Since major corporate governance reforms around the world had mostly mandated such disclosure however, some information are yet to be mandated. These information is required by investors to evaluate board expertise and skills and assess any potential conflicts of interest between shareholders and managers that may affect their judgement (OECD,2015).Evidence also supports the fact that comprehensive corporate governance disclosure in annual report have more accurate earnings forecasts and attract more analyst following which represent improvement in firms information environment and thereby enhancing firm value (Yu,2010).

Financial information disclosure:

It is concerned with the historical information presented in the accounts, including the key financial ratios, the review of the firm's performance, value added statement as well as effect of external factors on the financial position and performance of the firm (Lim and Chow, 2007; Duraya, 2011). Disclosure of these financial information provides an overall understanding of the factors determining the performance and future growth of company and may be of particular relevance for decision-making (Ho and Taylor, 2013).

Stock market information:

These information are considered as highly related to both existing and potential investors, as it reveals quantitative information relating to the trend of volume of shares traded, market capitalization and share prices which indicates the present state of the company and its future growth prospects (Ho and Taylor,2013).This information constitutes the bedrock of disclosure especially to investors (OECD, 2001).

Foreign exchange information:

These information are considered to be an integral part of the risk reporting made by the firms. It enable investors in assessing the degree of exchange rate risk faced by the firm which in turn have an impact on firm value (Ameer,2009).Thus, firms voluntarily increases disclosure of such information with the anticipation of increase in share price(Abdel-Azim and Abdelmoniem,2015).

Voluntary Disclosure and Firm Value:

Theoretically, voluntary disclosure is expected to improve firm value through reduced agency cost (Jensen and Mackling, 1976; Healy and Palepu ,2001) based on agency theory; signals the market about firm performance in anticipation of favorable market response (Ross,1977) based on signaling theory; helps in legitimating the firms activities (Dowling and Pfeffer ,1975) from legitimacy theory and meets the diverse information needs of stakeholders in order to assist them in taking rational economic decision (Joshi, 2015) based on stakeholders theory. While voluntary disclosure is associated with many benefits it comes with certain costs as stated above. With regard to cost, evidences suggest that firms mostly incur short term cost in order to avail long term benefit of voluntary disclosure. For eg: Cheng et al, (2009) investigates whether disclosure of company's involvement in illegal acts changes investor perceived credibility of disclosure and its valuation. Their findings indicate that although such disclosure reduces reliability of other disclosure and consequently leads to decline in valuation but such decline does not appear to be permanent as in long run it can get back to its position by gaining investors confidence through voluntary disclosure of credible information. Further, firms with greater incidence of litigation cost choose to pre disclose information voluntarily in order to lower such cost (Core,2001). Besides, firms also incur proprietary cost in order to avoid adverse selection as not disclosing something itself act as bad news which can affect the share value negatively. However, firms makes a cost-benefit assessment when deciding on the extent of voluntary disclosure as there are instances where firms withheld information previously published voluntarily due to change in firm's competitive environment (Depoers,2000;Depoers and Jeanjean,2012).

The relationship between voluntary disclosure and firm value is widely debated and researched topic. The firm valuation impact of voluntary disclosure can be routed from facilitating firm future financial performance prediction and signaling role (numerator effect) and/or through reduction in cost of capital (denominator effect) (Clarkson et al, 2013). Accordingly, literature provide evidences showing numerator effects whereby companies disclose information voluntarily in order to make a better informed assessment of firm performance so as to avoid undervaluation of their share (Luo et al,2006;Moumen et al,2015; Cahan et al.,2016; Sahore and Verma,2017) where some studies documents reduction in the cost of capital through improved voluntary disclosure i.e, denominator effects (Botosan,1997; Reverte,2012;Dhaliwal et al,2014; Plumlee et al, 2015).However, some studies report insignificant influence of voluntary disclosure in determining firm value(Barako,2007; Bangh and Plenborg,2008; Wang et al,2008;Hassan et al.,2009; Zerian,2012; Khan and Rahim ,2016) suggesting that the relation between VD and FV depends on the complex interplay of a number of conflicting factors like competitive disadvantage, misinterpretation by investors, ineffective market, low level of disclosure.

Analysis:

For better understanding of the relationship between voluntary disclosure and firm value we categorized the studies into those on developed, developing and multi country studies as shown in table -1. Total number of studies reviewed from developed countries is 9, of which 8 studies is consistent with the view that voluntary disclosure reduces information asymmetry and facilitates a firm's access to lower-cost external financing and positively influences firm value whereas the scenario is not the same in developing market as the overall studies reviewed in such context is 13 of which 8 studies supports positive effect of voluntary disclosure on firm value whereas 5 studies reports their relation to be insignificant. This may due to the presence of some distinguishing characteristics of the developing economy such as closely held corporation, weak investor protection environment, state ownership, weak board independence, illiquid stock markets, heavily bank-orientated economy, frequent government intervention and economic uncertainties and deep-rooted tendency of disclosing minimum for want of maintaining secrecy(Tsamenyi et al,2007; Samaha et al,2012;Kansal et al,2014; Kaur et al,2016). Further, studies also suggest that, in order to increase value relevance of voluntary disclosure in the emerging market more comprehensive and consistent approach should be adopted (Depoers and Jeanjean,2012; Lo and Wong,2016). Thus in context of an emerging economy, voluntary disclosure does not always necessarily enhance firm value which gives a reflection of the complex relationship between them(Wang et al.,2013) .Moreover market response to voluntary disclosure also depends on managers' forecasting credibility and disclosure style, since investors respond more strongly to forecasts issued by managers with the highest prior forecasting accuracy background rather than boilerplate (Yang, 2012; Lawrence, 2013; Tan et al, 2017). Nevertheless, different multi country studies reports positive influence of voluntary disclosure on firm value. This inconclusive evidences in the developing market necessitates to revisit this relation under such context.

Table-1

Studies in developed country		
Effect on firm value		
Positive	**Not significant**	**Total number of studies**
Hail,2002;(Swiss);Luez andVerrecchia,2000(German); Kothari et al, 2011(US); Reverte,2012 (Spain);Plumlee et al, 2015(US), Clarkson et al., 2013(US); Hamrouni et al., 2015(French); Klerk et al,2015(UK)	Bangh and Plenborg,2008(Denmark)	9
Studies in Developing Country		
Effects on Firm value		
Positive	**Not significant**	
Luo et al,2006 (Singapore); Chiu and Chi, 2008(Taiwan); Cheung et al,2010(China); Uyar and Kihc ,2012 (Turkey); Al -Akra and Ali,2012(Jordon); Alhazaimeh,2014(Jordon); Mutiva et al., 2015(Kenya) Sahore and Verma,2017(India)	Barako,2007(Kenya); Wang et al,2008(China); Hassan et al.,2009(Egypt); Zerian,2012(Iran); Khan and Rahim ,2016(Malaysia)	13
Multi country studies		
Effects on Firm value (Positive)		
Botosan,1997; Botosan and Plumlee, 2002; Haggard et al ,2008; Jiao, 2011; Dhaliwal et al,2014; Cahan et al,2016		6

Conclusion:

Voluntary disclosure has been considered as one of the pillars of good governance as it increases the confidence of both shareholders and potential investors. There are different benefits associated with voluntary disclosure whereas, it is also not cost free. Thus, firms make a cost-benefit assessment while deciding its extent. This study summarizes the different types of voluntary disclosure made by the companies based on their value relevance as reported by different studies into some common classification such as general and strategic corporate information, forward looking statement, research and development disclosure, financial information disclosure, stock market information, foreign exchange information. Disclosure of these information is considered worthwhile by firms with the anticipation of making a significant change in firm value. This paper also aims to investigate the relationship between voluntary disclosure and firm value as revealed by literature. We investigated 28 studies from developed and developing country from 1997-2017. A synthesis of the empirical findings depicts that a positive and significant relationship between voluntary disclosure and firm value is established in the developed market whereas studies in the developing market does not provide any conclusive evidence in this regard due to the presence of some unique characteristics such as closely held corporation, weak investor protection environment, state ownership, weak board independence, illiquid stock markets, heavily bank-orientated economy, frequent government intervention and economic uncertainties. These inconclusive evidence raises the question that whether voluntary disclosure by the firms are rewarded in the emerging market which necessitates to revisit this relation under such context.

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Annexure –I

Name of the journal	**Number of studies**
American Accounting Association	2
Journal of Accounting Research	1
Journal of Accounting Research	1
European Accounting Review	1
Corporate Social Responsibility and Environmental Management	1
Journal of Accounting and Public Policy	5
Pacific-Basin Finance Journal	1
Expert Systems with Applications	1
Financial Management Association	2
Journal of Intellectual Capital	1
Procedia - Social and Behavioral Sciences	1

International Journal of Managerial Studies and Research (IJMSR)	1
The Journal of Applied Business Research	1
Pacific Accounting Review	1
European Accounting Review	1
Accounting and Finance Research	1
African Journal of Business Management	1
Accounting and Finance journal	1
Journal of International Accounting, Auditing and Taxation	1
The International Journal of Accounting	1
International Journal of Engineering Research and Applications	1
e-Academia Journal	1
Total	**28**