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Voluntary Disclosure of Information and Stock Returns

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Abstract:

One of the accounting information goals is helping users in predicting investment return on investment. Some variables affecting firms' stock returns in market result from financial information provided by management. Extent of effect of this information is complicated and somehow unknown.

Investors , invest on an economic unit when they have enough information (including financial information). Thus using policies and plans of information disclosure may deliver top information and knowledge of managers to the capital market and be effective in communication between managers and investors.

In this paper it is attempted to investigate Voluntary disclosure of information and evaluate its relevance to stock returns. In other words, the aim of this study is investigating market response to voluntary disclosure of information

Keywords:
Voluntary disclosure of information, stockholder, rate of return

Introduction:

Decision making requires information and managers always confront with this problem that which information investors need for decision making. Every decision maker has a framework for his decision making based on his own mental structure and he encounters with issues regarding his decision making framework so that Stamp reports that one of the major difficulties in accounting standards development is lack of knowledge of decision making nature and logical process which decision maker attempts to access.

The firm's rate of return on investment is one of the main decision making criteria for investors and rate of return on investment calculation as a criterion for firm performance evaluation is obtained from information disclosed by the firm management.

Review of Related Literature

Cases of works on information disclosure is summarized in the following so that it is concluded that which information should be reflected in financial reports and how people process information for achieving their prediction and decision making regarding future uncertain events.

1. Sing-Vey and Desay (1971) performed a research titled as 'experimental quality analysis of financial disclosure by firms' in USA. They argue that information disclosure by the firms may be in various forms and annual report to stockholders is an important form of periodical disclosure. They found that:
   - Disclosure quality is better in large firms compared that smaller ones.
   - Disclosure quality is better in the firms with more number of stockholders
   - Disclosure quality is better in the firms audited by CPA institutes compared to the firms audited by small institutes.
2. Botosan (1997) performed a work titled as 'Disclosure Level and Cost of Equity Capital'. He used annual reports of the firms and rating by Association for Investment Management and Research (AIMR) for measurement of voluntary disclosure level and found that cost of equity capital is decreased by more voluntary disclosure.
3. Hail (2001) investigated the impact of voluntary corporate disclosure on the expected cost of equity capital and stated that quality of disclosure is inherently subjective like cost of equity capital and its evaluation is very difficult. He scaled sample firms for fiscal year 1997 based on disclosure index in three categories for calculation of disclosure quality of financial accounts:
   - Context and non-financial information including 10 items and totally 20 scores
   - procedural analysis and managerial analysis including 11 item and 20 scores
   - information on value based risk and project related information including 9 items and 14 scores

   Hail concluded that there is a negative and very important relationship between disclosure quality and the expected cost of equity capital.

Information Disclosure

Groups using financial reports consist of various people and levels of the community with different goals and knowledge level. Thus providing financial reports in such a way that offer information needed by all groups of uses is not possible. On the other hand, disclosure principle necessitates that all important facts related to financial events and activities of the economic unit is reported completely and appropriately.

Hendriksen and van Breda (1992) stated that following questions should be answered so that appropriate (and acceptable) information can be disclosed:

1. To whom information should be given?
2. What is the aim of information disclosure?
3. To which extent information should be disclosed?

Bedford's Suggestion for Information Disclosure

Bedford suggests that tools or methods are provided thereby more useful information is given to decision makers and managers, instead of just relying on accepted principles of accounting as the only method of measurement.

Suggestion by Lo: Equality Policy and Effectiveness of Accounting Policies

Lo argued that in order to improve accounting policies, attention of policy makers should be directed to this issue explicitly and in fact equality means that everyone is equal in capital market. Equality view leads to eradication of the original source of inequality and this is a information advantage for knowledgeable investors and it decreases harmful effects of defensive actions often performed by ignorant people, and subsequently it leads to increased public welfare.

A. G.'s View: Consumer Privacy

From this view, selection of accounting policy can never be neutral. There is always one whose want or taste is met and there is one whose want isn't met. Ethically the question is that what the basis of policy making should be and interests of which groups should be met. There are two options. First, standard definer has identical communication with interests of all people. And regarding principle of impartiality such standards should be defined that leads to maximization of social welfare.

Second, interests of one group are prioritized and privileged over others and it cannot be other than consumer group so that interests of users are met.

Voluntary or Mandatory Disclosure:

Several studies have examined economic achievements of voluntary disclosure. They argue that potentially firms with broad voluntary disclosure influence on the capital market in three ways: improvement of their stock liquidity in capital market, decreased capital cost, and increased financial analysts.

However, Hendriksen and van Breda maintain that the firms are reluctant to increase financial information disclosure level, unless they are mandated by accounting profession or the government. They reviewed studies and observed that there are various reasons for reluctance of the firms for increased financial information disclosure level:

1. Information disclosure causes that competitors become aware of their unfavorable situation and it is harmful for stockholders.
2. It is said that labor unions may bargain better when they gain information on wages.
3. It is often argued that investors are not able to understand accounting procedures and policies and information disclosure leads to their aberrance rather than their guidance.
4. There is a view that other available information sources may provide financial information needed by investors with a lower cost than information provided by financial statements.
5. Lack of awareness of investors' needs is a reason for limiting information and in fact less information disclosed.

Return Concept:

Return can be defined as ignoring current interest hoping to achieve more benefits in the future.

Return in investment process is a drive causing motivation and it is regarded as a reward for investors. Return on investment is important for investors because investment game is totally for the aim of achieving return. Return evaluation is the only logical way (before risk evaluation) that investors can perform for comparing alternative different investments.

Return on investment consists of two parts: 'qualitative return' and 'quantitative return'.

Quantitative return includes:

- Gain or profit: funds that are awarded to an investment periodically. In other words, it is cash payments that are paid to holders of assets and securities.
- Investment gain (loss): it is increase (or decrease) in asset price which is commonly known as price changes. It is more important to ordinary stockholders than for holders of long-term bond and fixed-income securities.

Qualitative return includes issues related to the firm's (including goodwill), social privileges and potential influence in socioeconomic trends.

Real Stock Returns:

It consists of ratio of the investment total income (loss) in a given period to capital consumed at the beginning of the period to obtain these benefits. Return includes changes in original capital (stock price) and DPS.

Return scale is regarded as an important index in evaluating financial performance of the firms. Since increasing wealth of stockholders is considered as the main goal of economic units, the firms should act in such a way that increases wealth of stockholders by achieving appropriate return. And increased wealth of stockholders is defined as stock 'positive return' in each fiscal period.

Return is a complicated and multidimensional concept which is closely related to interest, value and price criteria. Although interest, value and price criteria can be derived from financial statements, these criteria are different from accounting interest, economic value and economic return which are interested by most users. The firms accepted in the stock exchange can assess these variables using market information and analysts always attempt to identify mispriced stocks using financial statements information and other available information.

The research Methodology:

This study is a post event correlation one and investigates relationship between variables. Library reviews and field study were used for data collection. Data needed for verifying the hypothesis were collected through field study and studying financial accounts of the firms in statistical population, and SPSS 17 software and Pearson method was used for testing hypothesis.

Considering the goals of this paper, following hypothesis was examined in the firms accepted in Tehran stock exchange:

- There is significant relationship between information disclosure quality and stock returns change in investment firms.

This hypothesis includes two variables; disclosure quality is independent variable and stock returns is dependent variable.

Statistical populations consists of all firms accepted in Tehran stock exchange whose name have been registered in the list of Tehran stock exchange rates up to end to 2004 and have provided initial data needed for this study for Tehran stock exchange for 5 consecutive years (2004-2008).

Many authors have attempted to measure disclosure level which have been obtained using two criteria:

1. weighted criteria of disclosure measurement
2. weightless criteria of disclosure measurement

Johnson disclosure index was used in this study which is a weightless criterion and it is calculation basis of disclosure quality in this work. Thus, disclosure quality was classified by investigating 40 questions of voluntary information disclosure in firms' financial accounts in research statistical population.

Data and Findings Evaluation:

Data were evaluated using Kolmogorov - Smirnov test and following results were obtained:

Table 1. Kolmogorov - Smirnov test

Year	P-Value of quality data	P-Value of return data
2004	0.357	0.469
2005	0.532	0.104
2006	0.411	0.414
2007	0.487	0.795
2008	0.432	0.910

Regarding p-value of research data is larger than 0.05 in all years, thus it can be said that research data have normal distribution.

The hypothesis of this study for 5 consecutive years (2004-2008) and average of these years was tested and following findings were obtained.

Correlation between Stock Returns in 2004 and Disclosure Quality in 2004:

Findings show that there correlation (r = 0.221) between stock returns in 2004 and disclosure quality at the same year at p = 0.125 significance level. Regarding p is larger than 0.05 so there is no significant relationship.

Correlation between Stock Returns in 2005 and Disclosure Quality in 2005:
Findings show that there correlation (r = -0.249) between stock returns in 2005 and disclosure quality at the same year at p = 0.096 significance level. Regarding p is larger than 0.05 thus there is no significant relationship.

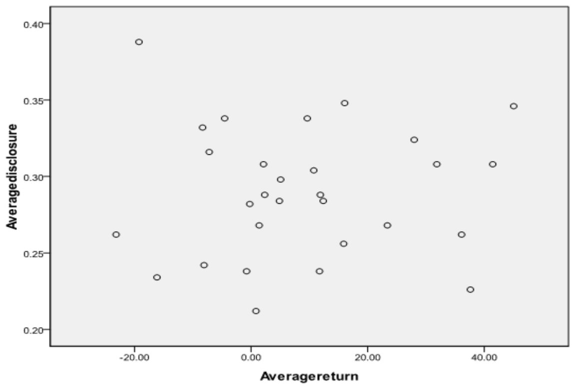
Correlation between Stock Returns in 2006 and Disclosure Quality in 2006:
Findings show that there correlation (r = 0.122) between stock returns in 2006 and disclosure quality at the same year at p = 0.264 significance level. Regarding p is larger than 0.05 therefore there is no significant relationship.

Correlation between Stock Returns in 2007 and Disclosure Quality in 2007:
As findings show that there correlation (r = -0.307) between stock returns in 2007 and disclosure quality at the same year at p = 0.053 significance level. Regarding p is larger than 0.05 so there is no significant relationship.

Correlation between Stock Returns in 2008 and Disclosure Quality in 2008:
Findings show that there correlation (r = 0.168) between stock returns in 2008 and disclosure quality at the same year at p = 0.192 significance level. Regarding p is larger than 0.05 so there is no significant relationship.

Correlation between Stock Return Average and Disclosure Quality Average:
According obtained data it is observed that there is correlation between stock returns average and disclosure quality average for 5 years (r = 0.30) at p = 0.438 significance level. Regarding p is larger than 0.05 so there is no significant relationship.

Scatter diagram of Stock Returns Average and Disclosure Quality Average:
Considering diagram (1) it seems that there is an additive relationship between disclosure quality and stock returns changes, however, there are so fluctuations over data points that no strong relationship can be implied.
Diagram (1). Distribution of stock returns average and disclosure quality average



Conclusion and Recommendations:
Regarding findings it is observed that the research hypothesis, that is significant relationship between disclosure quality and stock returns, is not approved in any of the research years.
Lack of relationship between disclosure quality and stock returns changes in investment firms is consistent with findings of some works. On the other hand, lack of such relationship can be attributed to following reasons:

1. Limitation due to subjectivity of the disclosure quality measurement. That is, by change in disclosure quality measurement index its value changes and it may influences the research results.
2. It can be attributed to ineffectiveness of the Iranian market.
3. Investors in Iranian capital market may not rely on financial accounts for decision making.
4. Presence of other variables control of which is impossible by the author or may be unknown for the author may influence on the research results.
5. It may be due to limited voluntary information items provided by the firms resulting from disclosure culture in Iran.

Although no significant relationship was obtained between disclosure quality and stock returns, it is observed that the relationship direction is mostly positive. In other words, stock returns increase by increase in disclosure quality. Therefore, the firms can increase stock returns by increasing disclosure quality, though it is low.

Considering the necessity of increased knowledge in stockholders on investment in stock exchange, Stock Exchange Organization and other respective organizations are recommended to increase awareness of potential and actual investors through educational programs and media.

In addition, regarding that there are institutions in capital markets od industrial countries which rate disclosure items in terms of importance level for investors, Tehran stock exchange can credit research works related to disclosure by rating disclosure items in terms of Iranian investors.

Considering importance of disclosure quality, economic units are recommended to pay more attention to voluntary information disclosure.

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