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## *Impact of Voluntary disclosures on Investors' Confidence in Indian Listed Companies*

**Joshi Rajsee**N.R. Institute of Business Management  
GLS University  
Ahmedabad, India

*Abstract: This paper is an attempt to provide empirical evidence on the impact of voluntary disclosures on investors' confidence in Indian listed companies. To do so, CNX 500 companies (excluding banking and financial institutions) were selected and their voluntary disclosures in the Annual Reports were scrutinized to determine the level of voluntary disclosures. A dichotomous scoring technique was adopted to score the selected 405 companies on the basis of self-constructed voluntary disclosure index. Literature review suggests that the relative effective bid-ask spread is the most appropriate measure to evaluate investors' confidence. Therefore, relative effective bid-ask spread was calculated for the selected 405 companies taking into consideration a period of 100 days from the time of publication of annual report. Regression analysis was adopted to study the impact of voluntary disclosures on investors' confidence. Analysis revealed that there is a strong relationship between voluntary disclosures in the Annual report and investors' confidence. Based on the results, companies can attract more domestic and international investors as well as sustain their existing investors by increasing their level of voluntary disclosures.*

*Key Words: Level of Voluntary Disclosures, Self-constructed voluntary disclosure Index, Impact of voluntary disclosures, Investors' confidence, Stock market liquidity*

### I. INTRODUCTION

India has realized the importance of increased transparency to attract and maintain the confidence of domestic as well as international investors. Corporate governance of a firm is disciplined by both external as well as internal mechanisms. Corporate disclosures are one such internal mechanism which facilitates investors and other stakeholders to monitor the firm's performance. Singhvi and Desai (1971) stated that the quality of corporate disclosures in annual report considerably influences the extent and quality of investment decisions made by investors. Annual reports are commonly regarded as an important means of acquitting accountability in the corporate and government sectors and often are one of the means by which corporate can improve stakeholders' confidence. The present study attempts to assess the level of voluntary disclosures in the Annual Reports of Indian listed companies and its impact on investors' confidence.

### II. LITERATURE REVIEW

According to Healy and Palepu (2001) and Diamond and Verrecchia (1991) voluntary disclosure can reduce information asymmetries among informed and uninformed investors and assist them to make appropriate decisions about the price of the companies' securities. As a result, companies are more likely to attract more investors because the investors will be confident that any stock transactions occur at a fair price. This in turn leads to an improvement of the companies' stock liquidity. The literature provides evidence that extensive voluntary information can reduce information asymmetry and increase stock market liquidity.

Welker (1995) examines the association between the stock market liquidity and corporate disclosure policy, and finds that the greater the information disclosure, the lower the level of bid-ask spreads. Healy, Hutton, and Palepu (1999) investigate whether companies benefit from disclosing more voluntary information by examining changes in bid-ask spreads and the analyst disclosure rating. Their results indicate that increase in disclosure rating is followed by improved stock liquidity.

Bernard S. Black & Vikramaditya S. (2007) and Petersen and Plenborg (2006) investigate the relationship between the level of voluntary disclosure and the information asymmetry for 36 industrial companies listed on the Copenhagen Stock Exchange during the period 1997-2000. They constructed a disclosure checklist in attempt to measure the level of voluntary disclosure, used the bid-ask spread and the turnover ratio as their proxies for information asymmetry. The results from this study indicated that voluntary disclosure is negatively associated with proxies for information asymmetry and so reduces information asymmetry. Thus literature suggests that a voluntary disclosure reduces information asymmetry but it is vital to impact of voluntary disclosures on investors' confidence. The present study attempts to know the impact of voluntary disclosures on investors' confidence.

### III. RESEARCH OBJECTIVES AND HYPOTHESES

Primary objective of the study is 'To establish a relationship between voluntary disclosures in Annual Report of the companies and its impact on the investors' confidence level'. It is also imperative 'To know the impact of individual categories of voluntary disclosures on investors' confidence in the company'.

To test the research objectives, following hypotheses were developed:

H01: Market liquidity is not positively related to the overall voluntary disclosure score.

H02: Market liquidity is not positively related to the disclosure score from general and strategic information of the annual report.

H03: Market liquidity is not positively related to the disclosure score from financial information section of the annual report.

H04: Market liquidity is not positively related to the disclosure score from non-financial information section of the annual report.

H05: Market liquidity is not positively related to the disclosure score from forward-looking information section of the annual report.

### IV. SAMPLE SELECTION

With the objective to measure the level of voluntary disclosures, CNX 500 companies were selected as it represents about 95.77% of the free float market capitalization of the stocks listed on NSE as on March 31, 2015. Of these 405 companies were selected excluding Banking and Financial Sector.

#### A. *Sector-wise Classification of Selected Companies*

The present study has been undertaken using a sample of 405 Indian companies. In order to ensure that the sample is a cross section of Indian companies, sufficient representation has been given for almost all major industries of the economy. The sample constitutes 18 different industries. Table I shows the Industry-wise classification of the 405 companies.

Table I: Industry-wise Classification of Selected Companies

Sector-Wise Classification	N	%	Sector-Wise Classification	N	%
Consumer Goods	67	16.54	Media & Entertainment	17	4.20
Industrial Manufacturing	41	10.12	Cement & Cement Products	17	4.20
Energy	38	9.38	Chemicals	15	3.70
Pharma	37	9.14	Textiles	10	2.47
Construction	35	8.64	Fertilizers & Pesticides	9	2.22
IT	30	7.41	Telecom	8	1.98
Automobile	27	6.67	Paper	3	0.74
Services	27	6.67	Food Processing	3	0.74
Metals	19	4.69	Healthcare Services	2	0.49
<b>Total</b>				<b>405</b>	<b>100</b>

### B. Size-wise Classification of Selected Companies

Size-wise Classification of the selected companies is given in Table II. Market Capitalization is considered as the most appropriate measure to evaluate the size of the company. The classification shows that the sample companies are not skewed by large size companies.

Table II: Classification as per Market Capitalization of Selected Companies

Market Capitalization	N	%
More than 200,000 Crore	8	1.98
100,000 Crore to 200,000 Crore	7	1.73
50,000 Crore to 100,000 Crore	24	5.93
10,000 Crore to 50,000 Crore	88	21.73
5000 Crore to 10,000 Crore	80	19.75
1000 Crore to 5000 Crore	181	44.69
Less than 1000 Crore	17	4.20
<b>Total</b>	<b>405</b>	<b>100</b>

## V. SCORING OF VOLUNTARY DISCLOSURES

A self-constructed Voluntary Disclosure Index was constructed to measure the level of voluntary disclosures in Annual report published. A dichotomous procedure was employed in this study. With this measurement method, the contents of the company's annual report are checked against the items on the disclosure checklist and awarded as one (for disclosed item) zero (for not disclosed item). Voluntary disclosure index comprised of 34 voluntary disclosures divided into four broad categories as 'General & Strategic Company Information', 'Financial Information', 'Non-Financial Information' and 'Forward looking Information'.

Therefore, in this study companies received a score of 1 if an item included in the disclosure checklist is disclosed and 0 if it is not disclosed. Since there are four categories of information from the checklist, the level of the information disclosed is

measured as the sum of the total disclosure index across all categories. Category-wise Voluntary disclosure score of selected 405 companies is shown in Table III.

Table III: Category-wise voluntary disclosure score

Categories of Voluntary Disclosures	% of Companies Disclosing Voluntarily
A. General & Strategic Information	82%
B. Financial Information	76%
C. Non-financial Information	73%
D. Forward looking information	30%

It was observed that 82% of the companies disclosed 'General and Strategic Information' and more than 70% of the companies disclosed 'Financial and Non-financial Information'. Whereas forward looking information was disclosed by merely 30% of the companies.

## VI. CALCULATION OF EFFECTIVE RELATIVE BID-ASK SPREAD

Prior literature cites different liquidity measures, including the quoted spread, relative bid-ask spread, and the effective relative bid-ask spread. Consistent with Heflin, Shaw, and Wild (2001), the current study employs the effective relative bid-ask spread as a proxy for stock market liquidity. Heflin et al. (2001) acknowledge that the effective relative bid-ask spread is likely to be a better spread-based measure for market liquidity than other spreads because the effective spread is a better measure of true trading cost, which reflect actual transaction prices, than either raw or relative spreads. Effective relative bid-ask spread has been calculated as:

$$\text{Effective spread} = \frac{2|\text{price} - \text{midpoint}|}{(\text{bid} + \text{ask})/2}$$

where: price = transaction price

$$\text{midpoint} = (\text{bid} + \text{ask})/2$$

To estimate the market liquidity of the sample companies, the data are collected on daily basis. The daily averages of bid, ask, and transaction price for each listed company were collected manually from NSE database. After that, the daily effective relative bid-ask spreads for each listed company were calculated, and then, the average across each listed company's daily effective relative bid-ask spreads to yield one observation per company.

Indian companies currently do not follow the same financial year. Companies currently have year ends in the month of March, June, September or December. The Companies Act 2013, which has partially replaced Companies Act, 1956, has made an important change made that now all the companies are required to have a uniform financial year. In other words every company's financial year will be the period ending on 31 March every year. However, it is yet to be implemented by all the companies. As per Clause 41 of the Companies Act, companies need to submit the audited financial results for the entire financial year within sixty days of the end of the financial year. Therefore the respective year end for each company was considered and 100 trading days after the deadline for listed companies to submit their annual reports was considered.

## VII. ANALYSIS AND HYPOTHESES TESTING

To provide evidence on the relationship between the level of voluntary disclosure and stock market liquidity based on samples of Indian listed companies, following research hypotheses were tested:

**H01. Market liquidity is not positively related to the overall voluntary disclosure score.**

To statistically test this, regression analysis was used with ‘Market liquidity’ as the dependent variable and ‘Voluntary Disclosure Score’ as the Independent variable.

Model	R	R Square	Adjusted R Square	Std.Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.476 <sup>a</sup>	.227	.226	.00043432	.227	449.543	1	405	.000

Results show that significance level is less than 0.05, hence Alternate hypothesis is accepted which shows that there is significant positive relationship between market liquidity and the extent of voluntary disclosure. The accuracy of the regression model is explained by the adjusted R-square value which shows the variation in dependent variable due to independent variable. The value of 0.226 explains that 22.6% of variation in the effective relative bid-ask spread is due to the extent of voluntary disclosures.

This leads to another research question which is whether each type of information disclosure affects market liquidity, and if so, in what direction. This question is examined by testing whether the four categories from the self-constructed disclosure index (general and strategic information, financial information, non-financial information and forward-looking information) have an impact on the market liquidity. Regression analysis was used to test the relationship with sub-categories of disclosures as independent variable and ‘market liquidity’ as the dependent variable.

The specific hypotheses tests are:

**H02: Market liquidity is not positively related to the disclosure score from general and strategic information of the annual report.**

Model	R	R Square	Adjusted R Square	Std.Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.141 <sup>a</sup>	.022	.021	.000501633	.022	236.158	1	405	.000

Results show that significance level is less than 0.05, hence Alternate hypothesis is accepted which shows that there is significant positive relationship between market liquidity and the extent of general and strategic information disclosure. The accuracy of the regression model is explained by the adjusted R-square value which shows the variation in dependent variable due to independent variable. The value of 0.021 explains that 2.1% of variation in the effective relative bid-ask spread is due to the extent of general and strategic voluntary disclosures.

**H03: Market liquidity is not positively related to the disclosure score from financial information section of the annual report.**

Model	R	R Square	Adjusted R Square	Std.Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.319 <sup>a</sup>	.102	.101	.000481101	.102	291.876	1	405	.000

Results show that significance level is less than 0.05, hence Alternate hypothesis is accepted which shows that there is significant relationship between market liquidity and the extent of financial information disclosure. The accuracy of the regression model is explained by the adjusted R-square value which shows the variation in dependent variable due to independent variable. The value of 0.102 explains that 10.2% variation in the effective relative bid-ask spread is due to the extent of financial voluntary disclosures.

**H04: Market liquidity is not positively related to the disclosure score from non-financial information section of the annual report.**

Model	R	R Square	Adjusted R Square	Std.Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.274 <sup>a</sup>	.075	.073	.000573763	.075	85.557	1	405	.000

Results show that significance level is less than 0.05, hence Alternate hypothesis is accepted which shows that there is significant positive relationship between market liquidity and the extent of non-financial information disclosure. The accuracy of the regression model is explained by the adjusted R-square value which shows the variation in dependent variable due to independent variable. The value of 0.073 explains that 7.3% of variation in the effective relative bid-ask spread is due to the extent of non-financial voluntary disclosures.

**H05: Market liquidity is not positively related to the disclosure score from forward-looking information section of the annual report.**

Model	R	R Square	Adjusted R Square	Std.Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.243 <sup>a</sup>	.061	.059	.000578676	.061	77.296	1	405	.000

Results show that significance level is less than 0.05, hence Alternate hypothesis is accepted which shows that there is significant positive relationship between market liquidity and the extent of forward looking information disclosure. The accuracy of the regression model is explained by the adjusted R-square value which shows the variation in dependent variable due to independent variable. The value of 0.061 explains that 6.1% of variation in the effective relative bid-ask spread is due to the extent of forward looking voluntary disclosures.

## VIII. CONCLUSION

The current study concludes that there is a significant positive relationship between level of voluntary disclosures in the Annual report of the companies and its market liquidity. The study also tests the relationship of market liquidity and various categories of voluntary disclosures. It indicates that 'financial disclosures' has the most significant relationship with investors' confidence followed by 'non-financial' and 'forward-looking' disclosures. The study shows that General and Strategic voluntary disclosures have the least impact on investors' confidence in the companies. The current study indicates the fact that companies can attract more domestic and international investors as well as sustain their existing investors by increasing their level of voluntary disclosures.

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**AUTHOR(S) PROFILE**

**Rajsee Joshi**, Assistant Professor, Faculty of Management, GLS University is a passionate researcher and academician. She holds a Masters degree in Business Administration with specialization in Finance. She has cleared UGC-NET and is a PhD. Research Scholar since October, 2012. Her interest areas are Financial Management, Corporate Governance and Strategic Financial Management. She has presented research papers in National and International conferences on areas like Corporate Governance, Dividend policy and Micro-Finance.