

Users' Perception on Voluntary Disclosures in Bangladeshi Corporate Annual Reports

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Abstract

The corporate disclosure of Bangladeshi firms has been characterized by inadequacy, lack of reliability and accountability. In spite of aforesaid characteristics some of the companies in Bangladesh have started to realize the importance of voluntary disclosures and have reported issues such as environment protection, human resource, social responsibilities voluntarily in addition to the mandatory disclosures in the annual reports. The aim of this paper is to find out annual report users' perception on voluntary disclosure issue. A questionnaire survey was carried out among different users of annual report. Most of the respondents in the survey said that this kind of voluntary disclosure is important for decision making. The findings also shed light on various reasons responsible for voluntary information disclosure in corporate annual reports of Bangladesh.

1. Introduction

Now days, the demand for company information from the part of the various stakeholder groups is increasing. In today's society, the words like 'Information economy', 'knowledge-based economy' etc. has become very common. Corporate financial reporting and in particular annual reports are important avenues for communicating company's financial and non-financial information. All stake holders such as investors, employees, suppliers,

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customers and creditors are able to access to the company's annual report. It is necessary for the company to provide its information to fulfill their needs and build their own style of company image. Information contained in the company's annual report consists of both mandatory and voluntary information. The company has to follow laws, regulations and accounting standard to provide the mandatory information while voluntary information is depended on management's judgment to be included in the annual report. It is really mattered what kind of voluntary information the company has disclosed as they have to consider the benefit and risk of providing information to the public.

Voluntary disclosure in the context of globalization of the world's financial markets has received considerable attention in the accounting literature in recent years. However, much of the research to date has been focused on developed countries (Cooke, 1989; Meek and Gray, 1989; Meek et al, 1995; Chau and Gray, 2002). Little attention has been devoted to the voluntary disclosure of companies in Bangladesh, a developing economy that is gaining increased important in the global market.

Bangladesh is one of the poorest economies of the world. Most of the people, especially the investors are very little aware of the corporate disclosures. Here the culture of disclosure by corporate body is mainly influenced by the requirements of the Companies Act and the regulations of the Security Exchange Commission. According to Ahmed and Nicholls (1994) the level of corporate disclosure is very poor. The corporate disclosure is characterized by inadequacy, lack of reliability, transparency and accountability. In spite of the aforesaid features, some of the companies in Bangladesh have started to fed the importance of voluntary disclosures and have reported voluntarily on their involvement in environmental protection, philanthropy, social causes, employee schemes in addition to the mandatory disclosures. In past few years, this practice got much popularity in Bangladesh. The effort of these organizations can be considered praiseworthy because they are doing it out of their own consciousness as there is no mandatory rule of this kind of disclosures from the regulatory bodies. Adequate disclosures to the stakeholders in this regard can be most effective mechanism to strengthen the decision making capabilities of the shareholders. This sort of reporting by some of the organizations might encourage other business organizations to do the same thing and such voluntary disclosure would ameliorate their reporting standards. This development may have profound impact on the Bangladeshi financial market.

We can observe two categories of users of annual report: sophisticated users such as broker, financial analyst, chartered accountant which need information in order to counsel the non-sophisticated users, who do not have specialized knowledge and they appeal to the first category. This paper focuses mainly on the sophisticated users' perception on different aspects of voluntary disclosures in annual report. This study is, therefore, expected to shed light on voluntary disclosure in a growing capital market like Bangladesh.

2. Objectives of the Study

The study attempts to achieve the following objectives:

1. To find out annual report users' perception on voluntary disclosure issue in decision making.
2. To find out the reasons responsible for voluntary disclosure in corporate annual reports.

3. Theoretical Framework

3.1 Voluntary disclosure

Voluntary disclosures are information disclosed in the company's annual report in excess of requirement which represent free choices of the company's management in order to provide the users with the information related to their decision making (Meek et al., 1995; Eng and Mak, 2003; Cheng and Courtenay, 2006; Chen and Jaggi, 2000). In addition to the regulated financial report, some companies include voluntary communications such as management forecast, analyst's presentation and conference calls, press releases, internet and other corporate reports as well as voluntary disclosures such as financial analysts, industry experts and the financial press (Healy and Palepu, 2001).

The dissatisfaction with mandatory financial reporting of the investors, financial market and the demand for increased stakeholder reporting which is resulted for the increasing popularity of the stakeholder have led to demand companies to voluntarily provide more comprehensive information about their long-term strategies and performance (Boesso and Kumar, 2007).

3.1.1 The classification of the content of voluntary disclosures

In order to analyze the voluntary disclosure of the company, another important step is to classify the content of information disclosed. Boesso and Kumar (2007) have classified disclosures in their study in terms of type of information as financial, non-financial and information on outlook, forward looking and historical. They mentioned that this classification allowed them to recognize the effectiveness of voluntary disclosure as a tool for stakeholder management.

Some studies classified voluntary disclosure into three categories as strategic information, financial information and non-financial information (Meek, 1995; Engand Mak, 2003; Lim et al., 2007). These types are directed at different users of the annual report such as investors and other stakeholders (Lim et al., 2007). Strategic and financial information have been recognized as decision-relevance to investors while non-financial information is recognized as a company's accountability and targeted on a broader group of stakeholders than the owners and investors (Meek et al., 1995). Another study is from Xiao and Yuan (2007) regarding the impact of ownership structure and board composition on voluntary disclosures of listed

companies in China. In their study, they classified the voluntary disclosures as background information, business information, financial information and non-financial information.

3.1.2 Role of disclosure in the capital market

In the study of Healy and Palepu (2001), they examine the role of disclosure in the modern capital market. They found that information disclosure is able to solve both information problem and principle-agent problem. The first problem, information or lemon problem arises from an imbalance or asymmetry of information and conflicting incentives between investors and management of the company (Healy and Palepu, 2001). Concerning this problem, the investor in the capital market may value all companies at an average level, thereby undervalue a good company and overvalue a bad company (Healy and Palepu, 2001). They suggest that regulations which require the managers to fully disclose their information may help to solve the information problem.

The second problem is principle-agent problem. They suggest that this problem is able to solve to by optimal contracts between managers and investors which help to align the interests of the managers with those of the investors and require the managers to disclose relevant information to the investors (Healy and Palepu, 2001). Another solution is the board of directors who have responsibilities to monitor managers on behalf of the investors (Healy and Palepu, 2001)

3.1.3 Benefits and Limits of Voluntary Disclosure

The greatest benefit of voluntary disclosure is the increase of the firm's credibility and the next ones are in the order of the importance conferred to them by: the increase of the shares' value, the increase of the potential investors number, several suggestions from the analysts, the improvement of the access to the capital, the increase of the balance between the share's price and the share's profit, the diminution of the shares' volatility, the increase of the shares' liquidity, the improvement of the relations with the suppliers, the diminution of the political interventions to regulate the market.

The competitive dynamics of the products and services markets play a restrictive role regarding the firms' voluntary disclosure policies. The managers are often forced to choose between maximizing the competitive advantage of the firm's market by not publishing information which would affect the competitive position or to publish that information in order to help the capital market to achieve an efficient evaluation of the company's shares. Another limit would be that in the past the annual reports were involved in satisfying the shareholders' needs and not those of the employees and stakeholders.

There are many factors and aspects which can influence the general policy of a firm's voluntary offer of information, as: the level, the frequency and the method of disclosure used; the objectives established by the firm regarding disclosure; the firm's size, the status

regarding listing, the organisational culture and the business complexity; the number, type and culture of the firm's shareholders; the disclosure costs; the level of favourable news about the firm; the competition intensity, the market level and the profit rate obtained by enterprise.

3.2 Theoretical Disclosure Frameworks

There are many reasons why firms provide information beyond that which is mandated by regulation. Some theories try to explain those reasons within a coherent theoretical framework. However, no single theory can explain disclosure phenomena completely (Leventis and Weetman, 2000).

Agency theory

Agency theory has been one of the most important theoretical paradigms in accounting during the last 20 years (Lambert, 2001). It conceives disclosure as a mechanism which decreases the costs resulting from conflicts between managers and shareholders (compensation contracts) and from conflicts between the firm and its creditors (debt contracts). Therefore disclosure works as a mechanism to control manager's performance. As a consequence, managers are stimulated to disclose information voluntarily.

Political costs theory

According to political cost theory, companies that are politically visible and subject to high political costs (which are highly dependent on firm size) are likely to disclose more information (Watts and Zimmerman, 1978). The political cost hypothesis predicts that large firms, rather than small firms, are more likely to use accounting choices that reduce reported profits (Watts and Zimmerman, 1990).

Signaling theory

In circumstances of information asymmetry (Akerlof, 1970), signalling theory suggests that companies with superior performance (or good companies) use financial information to send signals to the market (Ross, 1977; Spence, 1973). Spence (1973) showed that if the cost of signal is higher for the bad type than it is for the good type. The bad type may not find it worthwhile to mimic, and so the signal could be credible. Ross (1977) demonstrated how debt could be used as a costly signal to separate the good from the bad. Therefore, managers can be motivated to disclose private information voluntarily. This is because they expect this to provide (and to be interpreted as) a good signal about their company's performance to the market, and as reducing information asymmetry.

Legitimacy theory

This suggests that organisations continually seek to ensure that they operate within the bounds and norms of their respective societies. It is based on the notion that there is a social contract between an organisation and society, obliging an organisation to voluntarily report on activities if management perceived that particular activities were expected by the community (Guthrie *et al.*, 2004). From a legitimacy theory perspective, information disclosure is used as a tool for organisations to appear to be operating in accord with societal values, to present a socially responsible image and to gain or maintain social legitimacy (Patten, 2002). Legitimacy theory has been used to analyse social and environmental accounting by firms (Guthrie and Parker, 1989; Patten, 2002). According to Guthrie *et al.* (2004), legitimacy theory is tied closely to the reporting of intellectual capital.

Proprietary costs theory

A firm's decision to disclose information to investors can damage its competitive position in product markets (Verrecchia, 1983; Dye, 1985b; Darrough and Stoughton, 1990; Wagenhofer, 1990; Feltham and Xie, 1992; Darrough, 1993). Therefore, in the presence of proprietary costs, a firm has to trade off the positive effects of disclosure against the negative effects. However, revealing information to competitors does not always reduce the disclosing firm's future profit; in some cases, companies are better advised to share information in order to coordinate actions to their mutual advantage (Darrough, 1993). The consequences of disclosure depend on other factors, such as the nature of market competition (e.g., Darrough, 1993), the type of private information, and the threat of entry of new firms into the market (Darrough and Stoughton, 1990; Feltham and Xie, 1992).

Costs and benefits framework

Managers have incentives to make voluntary disclosures when the benefits exceed the direct and indirect costs of involved. Both mandatory and voluntary disclosures reduce information asymmetry between informed and non-informed market participants. Those disclosures help to correct any misvaluation of a firm. Consequently, they help to reduce a firm's capital cost⁴ (Botosan, 1997; Botosan and Plumlee, 2002), to increase the demand of investors (Diamond and Verrecchia, 1991; Healy *et al.*, 1999), to decrease the bid-ask spread (Yohn, 1998; Leuz and Verrecchia, 2000), and to raise the institutional interest and the analyst following (Diamond and Verrecchia, 1991; Lang and Lundholm, 1993 and 1996; Healy *et al.*, 1999).

4. Literature Review on the Perceived importance of Voluntary Disclosure

Numerous studies have addressed the perceptions of the various parties that have an interest in annual reports on the importance of voluntary disclosure when making an investment decision. Researchers have advanced various reasons why companies should disclose more

voluntary information. These reasons include that it reduces the cost of capital, affects the company's share price and affects the company's ability to raise funds in capital markets.

The study by Buzby (1975) consisted of 39 items of financial and nonfinancial information appearing in annual reports, which was then presented to a selected user group of professional financial analysts. In addition, a worksheet that utilised the same items was developed in order to measure the extent of disclosure in the annual reports of 88 small and medium-sized companies. The results revealed that many items of information, which financial analysts believed to be important, were not being adequately disclosed and that there was little correlation between the relative importance of the items and the extent of their disclosure.

The objective of the study undertaken by Benjamin and Stanga (1977) was to compare the perceived information requirements of two groups of users of annual reports, namely commercial bank loan officers and professional financial analysts. The study revealed that bankers, when making term-loan decisions, did not value information to the same extent as did financial analysts when making common stock-investment decisions. This conclusion applied to 51 of the 79 information items in which a significant difference was noted.

In view of the fact that financial directors are responsible for determining the disclosure policy that the company should adopt after considering the needs of the end users, Firth (1978) examined the importance of individual voluntary disclosure items as rated by finance directors, auditors, financial analysts and bank loan officers. His findings revealed that the rating of importance by finance directors and auditors was similar to that of financial analysts, but significant differences were found between the two groups.

The study by McNally, Eng and Hasseldine (1982) focused on the importance of financial and non-financial information by surveying the attitudes of financial editors and stock exchange members and by relating the preferences of these users to the level of disclosure by companies listed on the New Zealand Stock Exchange. The findings indicated that the level of disclosure was considerably lower than that considered desirable by the external users and that size was a dominant corporate characteristic in identifying the leading companies in respect of voluntary disclosure practices. (Myburgh, 2001)

5. Research Methodology

This paper has been prepared by utilizing both primary and secondary information. Secondary information has been collected from different articles, academic journals and research reports. A questionnaire survey on voluntary disclosures was carried out in late 2009. For the purpose of the study, questionnaires were sent to 45 users of annual reports. The users of annual reports, was a highly diversified group, comprising financial analyst, chartered accountant accounting academics, members of professional accounting bodies and individual investors. The members of the group were selected on the basis that they were all primary users of annual reports, financially literate and actively engaged in evaluating investments. Users were

randomly selected. The participants were provided with copies of related pages (where this kind of disclosure was done) of annual reports of three companies. A brief description of ‘voluntary disclosure’ issue was also provided to ensure that respondents have some degree of familiarity with the topic. Within three weeks of posting, 39 responses were received. Of these 39 respondents, 8 stated that they did not have any prior knowledge regarding this issue and hence did not wish to comment. So a total of 31 useable questionnaires were received, resulting in a response rate of 68.8%.

6. Findings

The first two questions of the questionnaire prepared have asked the respondents whether voluntary information should be published in annual reports and whether this kind of disclosures help users in investment decision making. All 31 (100%) of the respondents replied that the companies should disclose voluntary information in the annual reports. 25 respondents (80.65%) think that this kind of disclosures will help the users in taking investment decisions.

The last question required respondents to give their opinions on reasons why some companies provide voluntary information in addition to the mandatory information in the annual reports. Seven important reasons (Based on prior disclosure literature) were selected so that the respondents do not suffer from information overload and thus do not get confused. A five-point scale was prepared and the respondents were asked to put value for each of these reasons from 1 to 5. After getting all filled-up questionnaires, there were 31 different values for each of these reasons. Then the mean value of each of these reasons was found out and after that these reasons were ranked according to average scores. The result is shown in Table-1.

Table-1: Average Value of Each of the Reasons from Users’ Response

(n=31)

Reasons for disclosing voluntary information in annual reports	Mean	Standard Deviation	Minimum	Maximum
To reduce the information asymmetry between management and shareholders	4.712	.386	4.00	5.00
To attract new investors	4.350	.772	3.00	5.00
To allow companies to have greater access to funds	4.028	.662	3.00	5.00
To increase competitiveness in the capital market	3.370	.698	2.00	4.00
To increase share price	3.815	.591	2.00	5.00
To reduce cost of capital	2.670	.715	1.00	4.00
To help policy –makers in improving the current mandatory disclosures and set accounting standard	2.96	.558	2.00	4.00

If these reasons are ranked according to their average value it can be seen that the most important reason for disclosing voluntary information is to reduce the information asymmetry between management and shareholders. The ranking is shown in Table-2.

Table-2: Ranking of the Reasons According to Users' Response

Rank	Reasons for disclosing voluntary information in annual reports
1	To reduce the information asymmetry between management and shareholders
2	To attract new investors
3	To allow companies to have greater access to funds
4	To increase share price
5	To increase competitiveness in the capital market
6	To help policy –makers in improving the current mandatory disclosures and set accounting standard
7	To reduce cost of capital

This findings may be useful for regulators and preparers of annual reports. Regulators may use the findings to realize the importance of this kind of voluntary disclosure and to take efforts to improve the disclosure regulatory regime in Bangladesh. Preparers should match their amount of information in their annual reports with other companies in order to be successful in competing.

7. Conclusion

Voluntary disclosure is an important part of the present corporate reporting practice. Companies are in the situation of voluntarily producing and disclosing complementary statements to cover some of the deficiencies in content of traditional financial reporting. Now a days, voluntary issues such as human resource, environmental, and social responsibility have become very important. Adequate disclosures to the stakeholders in these regards can be the most effective mechanism to strengthen the decision making capabilities of the stakeholders.

The main purpose of this study was to find out users' perception on voluntary disclosures in corporate annual reports of Bangladesh. If the responses from the questionnaire survey is analyzed, it can be seen that the stakeholders are interested with this kind of information as 100% of the respondents said that this kind of issues should be disclosed in the annual reports. The number of respondents taken for the questionnaire survey is not very large. Moreover, the issues related with voluntary disclosure is limited. An extensive research with greater number of issues and respondents in the survey may help to discover more valuable facts on this issue.

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Appendix

Questionnaire

Please fill up the following questionnaire:

1. Do you think that the companies should disclose voluntary information in the annual reports?
 Yes No
2. Do you think this kind of disclosure will help the users in investment decision making?
 Yes No
3. What are the reasons for disclosing voluntary information in the annual reports? Give value to the following options according to your choice. A higher value represents a higher weight/importance. (Tick one for each issue)

Reasons for disclosing voluntary information	1	2	3	4	5
To reduce the information asymmetry between management and shareholders					
To attract new investors					
To allow companies to have greater access to funds					
To increase competitiveness in the capital market					
To increase share price					
To reduce cost of capital					
To help policy –makers in improving the current mandatory disclosures and set accounting standard					