

Firm's Trading Status in the Stock Market and the Extent of Disclosure in India

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Abstract: *An empirical study was undertaken to examine the association between the firm's trading-status in the stock market and the extent of mandatory and voluntary disclosures in the annual reports of 100 non-financial companies listed both on Mumbai Stock Exchange and Delhi Stock Exchange. The extent of disclosure was examined by using unweighted disclosure index comprising of 183 information items. The study reveals that the companies disclose, on an average, 81 percent mandatory and 27 percent voluntary information items in their annual reports. The study finds an association between the extent of disclosure and firm's trading status. It shows that the extent of disclosure would be revealed more in those firms, which are classified into higher trading status in terms of capital base and activeness in the stock market.*

Keywords: *Firm's trading-status, Mandatory disclosures, Voluntary disclosures.*

Introduction

Disclosure of financial and non-financial information about the operating performance and the financial position of the companies are universally considered as the prerequisite for efficient functioning and fairness of capital market. Sometimes, in order to be successful in securing capital, a company provides more information in its annual report voluntarily than that required by statutes as mandatory. For making full, fair, and adequate disclosure of information in the annual reports, financial reporting and disclosure are regulated by different authorities and statutes. In India, disclosures in company reports are mainly regulated by the Companies Act 1956, the Securities Contracts (Regulations) Act 1956, the Capital Issues (Control) Act 1947, the Income Tax Act 1961 and the relevant banking and insurance companies Act. In fact, disclosure of information through annual reports has been an emerging issue in the field of financial accounting and reporting.

Given the importance of disclosure in industrial sector in general and capital market in particular, some relevant questions may be asked, such as:

- Do the listed companies disclose more information than that required by statutes as mandatory?

- Among the listed companies which category of companies is providing more information than the others?
- Is there any association between the extent of disclosure and the trading status of a company in the stock market?

In view of the above questions, the central theme of the study is to examine the extent of disclosure made by the listed non-financial companies classified on trading-status basis and to find out any association between the two in India.

Trading-Status of the Companies

Securities traded on the Exchange are broadly classified into four groups, namely, 'A' group, 'B1' group, 'B2' group and 'Z' group. Companies in the 'A' group typically have a large capital base with widespread shareholding, a steady dividend, good growth record and a large volume of business in the secondary market. Relatively liquid scrips are placed in a category called B1 group. Excluding non-convertible debentures other securities are placed in category called B2 group. Companies that do not fall under the other three groups are 'Z' group companies.

Prior Studies

The main points that have emerged from the review of prior studies are: disclosure of information in corporate annual reports has been an important area of research in both developed and developing countries and the issue has drawn more considerable attention in the developed countries than the developing ones. A number of different methodologies have been used in this area of research. In most of the studies, a disclosure index was prepared in order to measure the extent and level of disclosure in the annual reports based either on a user's survey or on a search of corporate reporting literature. In some studies, disclosure index was prepared by surveying a sample of users to determine the user's perception as to the important items of information to be reported in the annual report as well as the weight to be assigned to the items of information incorporated in the disclosure index while in other studies weightage have been given based on the researcher's own subjective assessment. In some studies emphasis has been given on the adequacy of total disclosure based on a checklist consisting of mandatory and voluntary disclosure items. Some studies have used mandatory items only whereas some others have used voluntary items. However, a review of literature suggests that the number of items included in various disclosure indices generally range from 10 to 289. It means that the concept of adequate disclosure varies across researchers.

There are some studies wherein only weighted index has been used, where as other researchers used unweighted disclosure index (as in most of the cases the both weighted and unweighted indices have given the identical results). Some researchers have used both weighted and unweighted indices. But, it is surprising that the weighted and unweighted models produce only slightly different results in terms of significant and insignificant variables (Hossain, 1998).

There are researchers who have measured the extent of disclosure longitudinally to determine whether quality of disclosure has improved over time, whereas most of the studies have focused on only one year. The number of companies included in the samples in those studies has varied from 14 to 527. No disclosure study, as reviewed, other than Hossain (1998) was

industry specific. The number of corporate characteristics that were examined by researchers to measure the extent of disclosure has ranged from 2 to 11. Some researchers have found some corporate attributes significant relationship while others have found no such relationship with the same attributes. Most studies are country specific, although, few in developed countries and a few in developing countries are among or between the countries. To establish the relationship between the extent of disclosure and company variables, some researchers have used multiple ordinary least square regression, while some others have used stepwise regression or simple linear regression and others have used rank correlation coefficient as a statistical tool. Whatever may be the variables and method of analysis, disclosure index can provide useful tools for measuring disclosure adequacy and practices if the results obtained from the disclosure index are complemented by qualitative analysis.

Methodology

Considering the influence of concerned regulatory and professional bodies only the listed public limited companies have been selected. Companies listed on Mumbai Stock Exchange as well as Delhi Stock Exchange have been taken into account as unit of population on judgmental basis. Since the financial companies are different from non-financial companies and they prepare their annual reports according to their different statutes and have specialized nature of operations and financial disclosures, listed financial companies (e.g. bank and insurance companies) are excluded. The companies are selected by using a stratified random sampling approach. Ultimately 100 sample companies are picked up proportionately from each trading-category group on random sampling basis. Of the total 100 companies, 14 companies are picked up from 'A-category', 25 companies from 'B1-category', 38 companies from B2-category and 23 companies from 'Z-category'. The survey of annual reports covers companies, which published their annual reports during the period ended between June 30, 2004 and December 31, 2004.

The major task of the present study is to develop a suitable disclosure score-sheet comprising items of information that are expected to be disclosed in corporate annual reports. The mandatory disclosure items of information have been selected by studying thoroughly the disclosure requirements set forth by the regulatory framework currently in force in India and the voluntary information items have been selected by studying relevant literature. The numbers of disclosure items in the annual reports finally selected are 183 of which 170 information items are mandatory and 13 information items are voluntary.

To determine the level of disclosure in corporate annual reports, various approaches have been used in different researches. In this study, approach to scoring items is essentially dichotomous in that an item scores *one* only if disclosed and *zero* if not disclosed. However, where an item of disclosure is clearly not relevant to a particular company, the entity is not penalized for non-disclosure. This is considered to provide a more realistic assessment than a strict dichotomous approach. The disclosure model thus measures the total disclosure (TD) score of a company each for mandatory and voluntary as additive as follows:

$$TD = \sum_{i=1}^n di$$

And, Disclosure Index (DI) = m/n ,

where, $d = 1$, if the item i (i th relevant item) is disclosed;

$d = 0$, if the item i (i th relevant item) is not disclosed.

and, $m \leq n$;

m = the number of predetermined information items which the company actually disclosed;

n = the number of predetermined information items which the company is expected to disclose.

Thus, the disclosure index for a company is the total number of items disclosed divided by the total number of items in the score-sheet that applies to the company. And the additive model used here is unweighted on the implied assumption that each item of disclosure is equally important in view of the disclosure requirement set forth by the regulatory framework.

Findings of the Study

Descriptive Statistics of the Disclosure Indexes by Type of Disclosure

The data in the table 5.1 provides some descriptive statistics categorized by type of disclosure. It reveals some insights into differences in overall patterns of disclosure. The mandatory mean disclosure index, for all companies taken together, is 0.81 i.e., all the companies, on an average disclosed 81 percent of relevant mandatory information items in their annual reports. Mandatory mean disclosure is high (0.81) compared to that for voluntary mean disclosure (0.27), which implies that the companies tend to fulfill the mandatory requirements than to disclose voluntary information. The range of mandatory disclosure and voluntary disclosure are from 58 percent to 97 percent and 15 percent to 69 percent respectively.

Table-5.1: Descriptive Statistics of the Disclosure Indexes by Type of Disclosure

	Disclosure	
	Mandatory	Voluntary
Mean	0.81	0.27
Std. Deviation	0.086	0.121
Maximum	0.97	0.69
Minimum	0.58	0.15

The result also indicates that none of the companies discloses all mandatory items and they do not comply fully with the disclosure requirements set by the regulatory bodies and Acts. That is, no company has a mandatory disclosure index of 1.00. Standard deviation of mandatory disclosure is 0.086 whereas that of voluntary disclosure is 0.121, which implies remarkable variation between the two disclosures.

Descriptive Statistics of the Disclosure Index by Trading-Category

Table 5.2(a) and 5.2(b) present the extent of mandatory and voluntary mean disclosure of the sample companies respectively on the basis of trading-category. There might have disclosure relationship among the companies categorized on this basis. The table 5.2(a) reveals that the mean disclosure of 'A- category' companies is 0.89 followed by 'B1' category (0.87), B2 category

(0.78) and 'Z' category (0.74). It implies that the higher the rank of categorization, the higher is the level of mandatory mean disclosure.

Table-5.2 (a) : Descriptive Statistics of the Mandatory Disclosure Index by Trading-Category

Trading-Category	No. of Com.	MeanDisclosure	StandardDeviation	Coeff. ofVariation (%)	95% conf. Inter.	
					Lower	Upper
'A' Category	14	0.89	0.04	4.39	0.87	0.91
'B-1' Category	25	0.87	0.06	6.94	0.85	0.89
'B-2' Category	38	0.78	0.08	10.10	0.75	0.81
'Z' Category	23	0.74	0.06	7.82	0.72	0.76
Overall	100	0.81	0.09	10.73	0.79	0.83

Standard deviations of disclosure, in column 4 of the table, reveal variability in disclosure levels among the trading-categories. Since the means of the overall trading-category disclosures are different, a comparison among the absolute standard deviations may be misleading and so, coefficients of variation have been computed to compare the variability in disclosure levels. It can be observed from the table that the overall coefficient of variation is 10.73. The variability among the number of companies seems to be high. The coefficient of variation of A-category of companies is 4.39, which is more consistent than the other three categories. Especially high degree of fluctuations is found in the B2-category of companies (10.10) followed by Z-category of companies (7.82). At 95% confidence level, the range of disclosure of A-category companies is from 0.87 to 0.91. It implies that 89 percent of all relevant items of information with a 95 percent confidence level for all mean of .87 to .91 are, on an average, disclosed in the annual reports.

Table-5.2(b): Descriptive Statistics of the Voluntary Disclosure Index by Trading-Category

Trading-Category	No. of Company	Mean Disclosure	Standard Deviation	Coef. of Variation(%)	95% Conf. Inter.	
					Lower	Upper
A-category	14	0.41	0.16	39.02	0.33	0.49
B1-category	25	0.27	0.10	37.04	0.23	0.31
B2-category	38	0.26	0.10	38.46	0.22	0.29
Z-category	23	0.23	0.09	39.13	0.19	0.26
Overall	100	0.27	0.12	44.44	0.25	0.30

It is found from table 5.2(b) that the voluntary mean disclosure of A-category companies is 0.41 followed by B1-category companies (0.27) and B2 category companies (0.26). The least performing category is Z-category companies (0.23). The table reveals that the higher the rank of trading-category of a company, the higher is the level of voluntary disclosure. The mean disclosure index of voluntary items of information to all companies together is 0.27. At 95% confidence level, the range of voluntary disclosure index for all sample companies is from 0.25 to 0.30.

The table 5.2(a) and 5.2(b) show the concurrent findings that the chance that a company would be classified into higher rank of trading category in terms of capital base, activeness in the stock market, the higher the extent of disclosure revealed by the firm. It can also be inferred from the findings that the companies, which are classified into 'trading category-A' and 'trading category-B1', have comparatively more incentives to disclose more material information in the annual reports.

Summary of Findings and Conclusion

The study reports the association of firm's trading-status in the stock market and the level of mandatory and voluntary information items disclosed in the annual reports. Although the selected attribute is a new one in the area of examining disclosure relationship, it has extracted unique findings. The study finds an association between the extent of disclosure and companies' trading category. It shows that the extent of disclosure would be revealed more in those firms, which are classified into higher categories in terms of capital base and activeness in the stock market. It can also be inferred that the companies, which are classified into 'trading category-A' and 'trading category-B1', have comparatively more incentives to disclose more material information in the annual reports.

The present study may be considered to be a pointer in the area of financial reporting practices in the developing countries like India and Bangladesh as well. This study may help the regulatory bodies to monitor as to whether the listed companies are complying the mandatory requirements set forth by the statutes and laws of the country. Moreover there is wide scope to undertake study in this related area from different dimensions and from different point of view. □

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