VOLUNTARY INTERNET FINANCIAL REPORTING AND DISCLOSURE – A NEW CHALLENGE FOR ROMANIAN COMPANIES

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The majority of IFR and disclosure studies are focused on USA and European developed countries. Only a few studies have been carried on CEE countries. This paper examines the extent of voluntary internet financial reporting and disclosure of the Romanian listed companies for the financial years 2005, 2006 and 2007. After presenting the explanatory grounds regarding the main motivations of voluntary disclosure our study investigates the IFR and voluntary practices of the sampled companies. It is worth mentioning that in order to conduct our exploratory research we have established the criteria for sampling. We have also measured the voluntary disclosure of financial and non-financial information of sampled Romanian listed companies and found that there is a small interest in such a practice and also there is still much conservatism, confidentiality and a lack of modern knowledge in web-based financial reporting.

Key words: financial reporting, Internet, voluntary disclosure, listed companies

JEL codes: M41, G10, G14

1. Introduction

In a modern framework the main objective of financial reporting is to supply useful information to stakeholders. The American FASB in its conceptual framework states that financial reporting should provide information useful to investors, creditors and other users. Also, the IASB has a similar framework. To promote confidence and encourage investors Romanian companies should meet stakeholders' demands for greater speed and volume of transparent and timely financial information. Certainly, the Internet can provide better and more effective ways of communicating financial and non-financial information. Therefore, there is a need to analyze the role played by the Internet in disclosure financial and non-financial information in Romania in order to find out how that role may be enhanced.

This paper focuses on finding and briefly describing the explanatory grounds for voluntary Internet financial reporting and disclosure and also measure the voluntary disclosure of Romanian sampled listed companies. For measuring the level of voluntary disclosure we have analyzed the content of annual reports of sample companies. Annual reports are the main annual source of communication between the company and its external investors, through these means the company publishes investment related information. The annual reports examined in this paper are based on the 2005, 2006 and 2007 fiscal years.

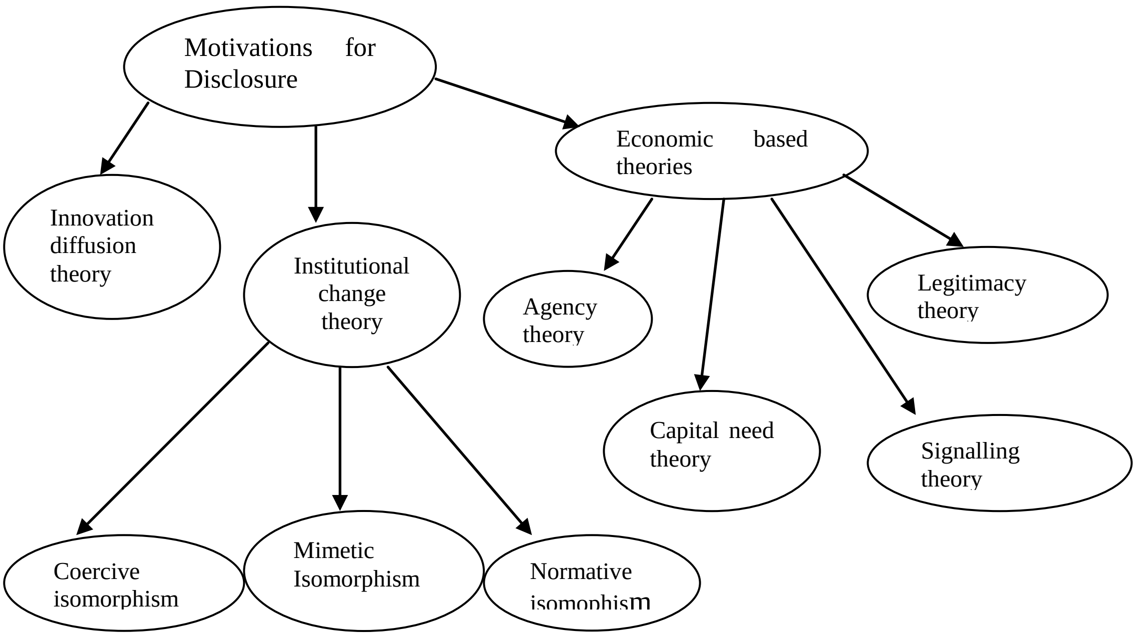
As a main aspect concerning mandatory and voluntary disclosure throughout Internet we have to point out that for Romanian listed companies unfortunately there is no legal requirement to post the financial and non-financial information on the Web. Only the BSE Code of Corporate Governance contains a special provision related to publishing financial and non-financial information on the Web. Regarding the extent and quality of the Annual Reports we have found that only 7 companies from the selected sample disclose various information like: company background, company evolution, marketing strategies, management issues and also much financial information, trends and evolutions of the most relevant ratios. Companies like Antibiotice Iasi, Compa Sibiu, Santierul Naval Orsova or Petrom SA disclose much more data outdistanced from other companies. For instance, Antibiotice SA disclose throughout the own website in English information about company background like: mission and values, history, board chairman's statement, domestic market, international market, management team and board of directors. We have found also data about shareholders, product portfolio, export brochure, quality policy, and drug safety. The company voluntary discloses financial information about stock quotes presenting the evolution of shares during 2000-2008, specifically: number of issued shares, share quota, market capitalization at the end of the year, dividend per share, PER at the end of the year.

2. Theoretical framework – explanatory grounds for voluntary Internet financial reporting and disclosure

Disclosures in excess of those required by laws, accounting standards or stock exchange listing requirements regulations, namely voluntary disclosures, have been an area of interest to researchers for many years. Companies continue to disclose voluntary information despite ever increasing mandatory requirements and so the motivation for such behaviour has bee the focus of much attention (Watson *et al*., 2002). It is often argued that companies might find it advantageous to provide additional pieces of information to investors and analysts through the annual report. This statement is based on the fact that information asymmetry between companies and potential investors, due to a low level of disclosure, increases cost of capital by introducing adverse selection between buyers and sellers of the company's shares. Focusing on attraction of investors, companies with limited liquidity must issue shares with a discount that reduces funds companies receive from the issue and thus, increases the cost of capital. As Diamond and Verrecchia (1991) showed, by disclosing more information companies are likely to reduce information asymmetry and hence attract liquidity in the company's shares, which lead to lower cost of capital. So, we have to underline that voluntary disclosures can take several forms: press releases, conversations with financial analysts, letters to shareholders and the provision of additional information in annual reports. We are interested not only in the presence of disclosure but also in its form.

The main purpose of this section is to discuss the theories that provide explanatory grounds for voluntary IFR and disclosure.

Figure 1. Theories explaining motivations for disclosure



Source: Aly and Simon (2007)

As we can see in Figure 1, three set of theories are influencing the motivations for disclosure. The first set is related to innovation diffusion theory, the second set is related to institutional change theories which refers to coercive, mimetic and normative isomorphism while the other set of theories is economic based theories.

Innovation Diffusion Theory

Mahajan and Peterson (1985) defined diffusion of innovation as *"the process by which innovation is communicated through certain channels over time among members of a social system"*. As Clarke (1999) showed, diffusion of innovation theory tries to explain and describe the mechanism of how a new invention, in this case IFR is adopted and becomes successful. Also Sevcik (2004) observed that it might take a long time for an innovation to be adopted and even then not all innovations are adopted and resistance to change may be an obstacle to diffusion of innovation. Clarke (1999) identified five stages through which an innovation passes: knowledge, persuasion, decision, implementation and confirmation.

Institutional Change Theories

Hatch (1997) noted that an American sociologist, Philip Selznick, observed that organizations adapt not only to the strivings of their internal group but also to the values of external society. Also Richard Scott defined institutionalization as *"the process by which actions are repeated and given similar meaning by self and others"*. Hatch (1997) explained that some actions are repeated because explicit rules or laws exist to ensure their repetition, such as the legal and political influences, while other actions are supported by standards, values, expectations and cultural influences. Sometimes, actions are repeated because of a desire to be look like another institution. Generally, these actions are governed by social influences.

According to Carpenter and Feroz (1992) coercive isomorphism results from political influence and problems of legitimacy. Formal and informal pressures will be exerted on the organization by other organizations or by cultural expectations in the society in which the organization is a

member. Therefore, coercive isomorphism is a form of forced selection where a company is forced by powerful organizations such as the government or providers of capital to adopt an innovation, such as IFR, regardless of its benefit to the organization.
The same above mentioned authors considered that mimetic isomorphism occurs *"when organizations model themselves after others"*. In such case, companies follow earlier adopters from the same sector as a result of uncertainty about organizational technology. As Xiao *et al*. (2004) pointed out very shortly, it is a form of fashion when companies imitate others.
Normative isomorphism results from actions of professionals who create standards and homogenous organizational practices to be followed (Xiao *et al.*, 2004). DiMaggio and Powel (1983) explained that there are two features of professionalization which are considered important sources of isomorphism: the first is related to the formal education produced by university specialists and the second is related to the growth and expansion of professional networks across which new models might diffuse rapidly. As we know, universities and professional training institutions are important centres for the adoption of innovation.

Economic Based Theories

As many authors revealed (Cooke 1989, Hossain *et al.* 1994, Bogdan *et al.* 2009) agency theory may explain why managers voluntarily disclose information. So, managers in the knowledge that shareholders will seek to control their behaviour through bonding and monitoring activities, may have an incentive to try and convince shareholders they are acting optimally and disclosure may be a means of achieving this. Previous researchers like Verrecchia (2001) have demonstrated that through grater disclosure companies attempt to reduce the cost of capital by reducing investor uncertainty. Therefore, one way of reducing agency costs is to increase the amount of information included in the annual reports.
The constant need for capital is another reason why management has a prime argument for disclosure and needs to do an effective job in explaining the company to investors. Watson *et al.* (2002) underlined that highly leveraged companies are likely to increase their disclosure also to satisfy the needs of debenture holders and trustees. Also, the FASB Working Group (the organizational structure of the Business Reporting Research Project consisted of a Steering Committee and seven Working Groups) states that….*"after one company provides a particular disclosure requested by investors, competitive pressure causes other companies to follow suit. A company's cost of capital is believed to include a premium for investors' uncertainty about the adequacy and accuracy of the information available about the company'.*
Signalling is a reaction to informational asymmetry in markets. In such a case, companies have information that investors do not have. Asymmetries can be reduced if the part with more information signals to others. Signalling theory was mainly developed by Spencer (1973) to explain behaviour in the labor markets but can also help explain voluntary disclosures. Companies will try to adopt the same level of disclosure as other companies within the same industry because if a company does not keep up with the same level of disclosure as others, it may be perceived by stakeholders that is hiding bad news. Therefore, companies may use Internet disclosure to keep up with other companies in the same industry. Craven and Marston (1999) stated that….*"the very use of the Internet might itself be a signal of high quality. It implies that the company is modern and up to date with the latest technology rather than old fashioned and conservative"*.
Legitimacy theory is based on the premise that companies signal their legitimacy by disclosing certain information in the annual report. This theory is centred on the notion of a contract or agreement between an enterprise and its constituents. Several authors (Guthrie and Parker, 1989; Deegan and Gordon, 1996) have used legitimacy theory to explain disclosures in environmental and social reporting. By voluntarily revealing certain information, directors can communicate with stakeholders, who as a result will feel more assured about the performance of the company.

Skinner (1994) stated that managers of companies with bad earnings news have an incentive to pre-disclose that information to reduce the cost of litigation. But, litigation can potentially decrease managers' incentives to provide disclosure, particularly of forward-looking information. Up to here we may conclude that early adoption of IFR could be due to organizational characteristics suggested by economic based theories (Xiao et al., 2004) while later stages of adoption may be due to innovation diffusion theory.

3. Factors influencing the extent of web-based disclosure information

A lot of scholars analyzed voluntary disclosure practices using variables derived from the two main economics-based theories mentioned and described briefly by us in the previous section of this paper (agency and signaling theory). Most studies analyzed the disclosure in the annual report and not in other communication vehicles (Ettredge et. al, 2002; Ahmed and Courtis, 1999; Hossain et. al, 1995; Cooke, 1989). Frequently are used factors like firm size, company history, leverage, profitability, industry type and intangibles to explain the extent of voluntary disclosure. For instance, Debreceny et al. (2002), concerning the positive association between company size and level of disclosure reported that larger companies have higher information asymmetry between managers and shareholders and, therefore, higher agency costs arising from such asymmetry. In order to reduce these agency costs, larger companies disclose more information than smaller companies. These companies have a greater need for capital and can be expected to disclose at a higher level. They are also likely to have lower proprietary costs associated with disclosure as their activities are exposed by other sources of information (Hossain *et al*., 1995).
Hossain *et al.* (1995) and Malone *et al*. (1993) noted a positive correlation between voluntary disclosure and a company's leverage. Singhvi and Desai (1971) reported a positive correlation between the extent of disclosure and profitability on the US market. Cooke (1991) and Raffournier (1995) reported that manufacturing companies disclose more information than other industry groups. Marston and Shrives (1991) in a review study of disclosure index studies found out that company size, leverage, profitability, listing status and audit firm size were the most frequent explanatory factors to examine. Company size and listing status were positively related to extent of disclosure, whereas leverage, audit firm size and profitability showed inconsistent results. Oyelere *et al.* (2003) extensively enlist previous articles investigating factors affecting the extent of voluntary disclosure practices. They find that there are six most frequently determining variables of voluntary disclosures: company size, audit size/quality, listing status, profitability, leverage and industry type. Starting from these findings, Prabowo and Angkoso (2006) demonstrated that ownership structure is also a frequently determinant of the extent of voluntary disclosure. Gelb (2002) reported a positive association between intangibles and disclosure. The author noted that companies with intangible assets tend to provide additional disclosures. Also Arvidsson (2003), who examined disclosure of intangibles in the annual report, found that disclosure of intangibles was associated with several factors, such as company size. Moreover, the author observed differences between the Nordic countries, with Sweden disclosing the most information of the Nordic countries. He reported no difference in disclosure between internationally listed companies and domestically listed companies.
Prior studies of voluntary disclosure conducted by Meek ang Gray (1989) showed a positive relationship between cross listings and disclosure. Foreign listing status was represented by a binary variable that took the value of 1 for a foreign listing and 0 for only domestic listings. Foreign listing is sought by companies to have a more competitive cost of capital structure as they can issue securities in markets with higher liquidity and lower cost of capital. Other benefits of multiple listings are wider marketing of products, boosting corporate image and gaining political acceptance by projecting the company as being „local" in the foreign market (Biddle and Saudagaran, 1991).

Another determinant of IFR and voluntary financial and non-financial voluntary disclosure is technology, discussed recently by Debreceny et. al (2002). High technology companies, for example, drugs, computers, electronics, communications, with soft assets, such as research and intellectual capital, human resources, R&D programs wil disclose more information as their earnings numbers are not sufficiently value-relevant. These companies are subject to rapid change in the technological and business environment. For such companies, the earnings number may not be indicative of their future prospects as such information not only fails to convey the future growth potential of the company but are also not timely enough for decision making due to their periodic nature. The Internet can allow for multifaceted and frequent disclosures on the development of new technologies and the interaction of the company with the environment. Level of technology of the company was represented by a ternary variable that took the value of 0 for low technology corporations, 1 for medium technology corporations and 2 for high technology corporations.

Operating history (company age) has been observed to affect the information disclosure level in prospectuses. Mak (1996), in a study on the relation between earnings forecast disclosure and company-specific risk, concluded that operating history, as a proxy for information asymmetry and company-specific risk, was positively related to forecast disclosure. Ding *et al.* (2005) showed that the literature has often hypothesized that larger auditors should require more extensive disclosure from their clients, namely because they have more incentives to maintain their independence. Some research provides evidence of a positive relationship between the type of auditor (big eight, big six, or big five, depending on the period) and the extent of disclosure (Craswell and Taylor, 1992; Patton and Zelenka, 1997, Prabowo and Angkoso, 2006). Raffournier (1995) states that companies are induced to comply with the usual practices of countries in which they operate. He stated that the more international the operations of a firm are, the larger is the inducement. The same way like Cooke did (1989), Raffournier finds a significant relationship between internationality and disclosure, providing evidence that companies' with foreign sales will disclose more information because they are likely to require the necessary resources. The above mentioned aimed to demonstrate that several factors affects financial or non-financial information disclosure.

4. Methodology, research design and findings for Romanian listed companies

In the present paper we have used content analysis for investigating annual reports of the eighteen companies listed on Bucharest Stock Exchange (BSE), selected after we have established the main criteria for sampling. The methodology we have used is *Standard & Poor's Transparency and Disclosure Survey Questions*. The purpose of this survey is to provide investors with an objective ranking of the corporate reporting practices of large companies and to help them understand the differences in reporting levels across markets and business sectors.

This study covers the companies listed on Bucharest Stock Exchange within 2005 and 2007. The authors have taken all the companies of Ist and IInd categories listed on BSE as the population of this study due to the fact that the number of companies is small and it is convenient to collect data related to it. The population consists of 60 companies divided into 10 sectors of activity according to BSE classification. Financial Investments Companies (S.I.F.) were excluded from the study due to the fact that they are particular Romanian closed-end investment company and their value is formed from other listed companies.

For measuring the level of voluntary disclosure we have analyzed the content of annual reports of sample companies. Annual reports are the main annual source of communication between the company and its external investors, through these means the company publishes investment related information. The annual reports examined in this paper are based on the 2005, 2006 and 2007 financial years. The scores are developed by searching company annual report for the inclusion of the 98 items. The company receives one point when it provides information on an

item. The results from the 98 questions are converted into a coefficient by dividing the score by 98. According to Standard & Poor's the scores are designed so as to be unaffected by non-disclosure of items that are not applicable. The scores themselves are not released to the public.
Companies were surveyed between May 2005 and May 2008 to find out whether they have websites or not, searching also for data regarding the voluntary disclosure of financial and non-financial information. All the data was gathered from the following sources: www.bvb.ro, www.cnvmr.ro, www.ktd.ro and www.kmarket.ro, sites providing stock exchange information and sites of companies listed on Ist and IInd BSE categories; we have collected the data in order to establish the market capitalization of the companies listed on BSE and also a part of the accounting and financial information regarding the financial statements and annual reports for the years 2005, 2006 and 2007; the database provided by the Reuters Press Agency regarding the market prices of the companies from the sample to determine the market capitalizations; the accounting and financial information obtained from the site of the Romanian Ministry of Economy and Finance.
Sample companies were selected purposively. Authors used the following criteria to select the sample companies:
-own websites;
-continuity in transactions between 2005 and 2008;
-disclosure of financial information (in annual reports, financial statements and financial highlights –ratios);
-audit reports.
The mentioned criteria leave only 18 companies in the research sample. The selection process of the sample can be seen from Table 1 below.

Table no. 1

Sample Selection Process	
Explanation	**Amount**
Population (companies listed on Ist and IInd BSE categories except Financial Investments Companies - S.I.F.)	61
Less companies with no websites or websites under construction (or unable to open)	-4
Companies left	57
Less companies listed between 2005 and 2008	-3
Companies left	54
Less companies that do not present annual reports (2005, 2006, 2007)	-33
Companies left	21
Less companies that do not have an audit report (2005, 2006, 2007)	-3
Final sample	18

Table no. 2 presents the descriptive statistics for voluntary disclosure index of the companies through the annual reports. A slightly increase in information disclosed year by year by the 18 companies studied can be observed. The average VD score of sample companies for the entire period is 0.5546, with the maximal and minimal score of 0.7347 and 0.3469 respectively. It seems that in Romania's securities market, most companies disclose regular information, the voluntary disclosure level of Romania being relatively low.

Table no. 2

Voluntary disclosure (VD) statistics

Year	2005	2006	2007
Score VD	0,5317	0,5550	0,5771
VD Standard deviation	0,1008872	0,09751	0,09783
VD Minimum Score	0,3469	0,3980	0,3980
VD Maximum Obtained Score	0,7143	0,7245	0,7347
VD Maximum Possible Score	1	1	1

5. Concluding remarks

Our study aims to investigate the way financial and other non-financial information are communicated throughout the websites by Romanian listed companies and to analyze the criteria in order to select properly the sample companies. A pilot study was conducted searching for the websites of all listed companies registered as category Ist and IInd at BSE. The search revealed that companies which had websites were included among the most actively traded companies. This was expected as only active companies are likely to have websites and disclose financial information on the websites. Therefore it was decided to focus upon the most active companies traded on the Bucharest Stock Exchange. Financial Investments Companies were excluded from the study.

As a major conclusion to our study, it can be reveled that at half of the year 2008, a large number of Romanian listed companies only made mandatory or advisory disclosure available on their own websites. Moreover, these companies still show a preference for traditional means of communication. It can be confirmed that among the companies analyzed, there is still an attachment to traditional paper-based ways of communication. This is shown both in contents, form or tools used for communication on websites. The results above mentioned by us speak for themselves. From our point of view these companies seem to consider the web as an "information deposit" rather than a dynamic means of communication. We consider that this situation could be caused by a lack of external stimuli, due to the lack of regulation on website disclosure.

Due to the above mentioned facts we have also found a poor voluntary disclosure practice of financial and non-financial information, among BSE listed companies explained mainly by conservatism, extreme confidentiality and a lack of modern knowledge in the Romanian financial reporting system.

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