

VOLUNTARY DISCLOSURE AND PERFORMANCE IN TIME OF ECONOMIC INSTABILITY. THE CASE STUDY OF TURISM FELIX COMPANY

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In the last few decades, the problem of voluntary disclosure of financial or non-financial information has been, in the attention of specialists, given the fact that information asymmetry, as explained by the agency theory, has become an important factor for the actors of financial markets. High quality financial reports consistent with the IAS/IFRS, issued at regular intervals, have the role of offering data for in-depth financial analysis that can be the basis for decisions regarding stock market investments. The performance of company, estimated by using the EVA, MVA, VA indicators, are directly linked with the average cost of capital, which in turn is sensitive to the evolutions of the stock market, measured both by the level of the asset attached to the entity and of the level of financial market. The impact of voluntary disclosure on company's performance in our paper has been studied on TUFEL company listed on the Bucharest Stock Exchange, confirming a refined degree of predictability.

Key words: voluntary disclosure, performance, cost of capital, EVA, TURISM FELIX

JEL codes: M41, M10, G14

1. Introduction

Through this study we hope to emphasize the fact that in any insecure economic period, a society that is marketable (on stock market) is interested in reporting data as frequent as possible. The voluntary reports offer credibility and predictability to the marketable entity, for the existing investors or for the potential ones in an economical and financial environment characterized by increased uncertainty.

All over the world there are strict rules regarding the shape and the content of synthesis documents and the moment of placing them in the public domain. Studies have shown that the nature and the number of information voluntarily disclosed correspond to the size of the company; the number of shareholder and the structure of shareholding; the status of marketable company; the company's performances; debt-to-equity ratio; recommendations from the Audit Report; company's internationalization ratio; company's original branch; the costs associated with information communication. Costs are considered a key factor that deeply influences the company's decisions regarding the communication policy. These costs are: cost of production information; disputation costs; political costs; competitive disadvantage cost.

The theory that explains *informational asymmetry* is *agency theory*⁴³⁸. According to this theory there is an *agency connection* between managers and shareholders and is based on the bonus remuneration system. Gathering resources and maintaining at a positive level a number of economic indicators such as the *stock price* are elements that strongly motivate the managers into voluntarily sharing information. The models developed in the last years have used, as a signaling instrument, the *accountant information management*. Managers can transmit, through their content and the moment of the publication of these models, signals of company's return rate perspectives. The signaling through the content of the

⁴³⁸ Liliana Malciu, *Cererea & oferta de informații contabile*, Editura Economica, București 1998, pag. 74

information is done by choosing the accountant method, through informing certain sectors and through informational budget. There is a direct relation between the origin of information and its publishing date.

2. The cost of capital and the value creation

The investor is the one that wants the best return rate of its capital, therefore he will orient his interest towards the companies that create value. The accountant indexes consider the company as performing well when it turns out profit. But the result must not only be positive, but it has to compensate the cost of resources brought in by the shareholders⁴³⁹. For the “capital” factor there is a minimum remuneration called the capital cost. If a company earns its capital cost, its objective is achieved and has satisfied its shareholders expected earnings. *The shareholders will not accept a remuneration that is below the risk free interest rate because any investment has a superior risk in comparison with risk free asset. Any investment must offer a remuneration that contains a risk bonus.*

3. A brief review of the literature on the topic

The financial market works as any other market, on the basis of demand and offer, having as a base of transaction, the capital. Research in the modern theory of the portfolio, contains a series of models of analysis and estimations of the central relation of portfolio management, that is the correlation risk-return rate. Markowitz's theory created an economic-mathematical model that follows the behavior of the financial market's subjects and has introduced the *practice of diversification of the title portfolio*, depending on the correlation risk-return rate. Sharpe has divided the risk that characterizes financial titles into two subclasses: the systematic risk and the specific risk. In a general formula, Shape has introduced into the equation of a title's return rate, the notion of volatility, that shows the connection between the evolution of a title's return rate and a macroeconomic factor's return rate, usually considered the *market's medium return rate*. Subsequently, Lintner and Shape use for the first time the hypothesis of introducing *the risk free asset* into the portfolio and thus the risk bonus appears as a result of investment demand in risky assets. The risk free asset offers certain remuneration without an existing risk taken. The equation $=r_f + \beta_i (r_p - r_f)$ called also CAPM (Capital Asset Pricing Model) emphasizes the connection between the risk asset, the risk free asset and volatility. Based on Markowitz and Shape's researches, Ross established a multi-factorial model, called APT (Arbitrage Pricing Theory), through which he accomplishes a connection between title's individual return rate and a series of macroeconomics factors.

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 been 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. 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.

The practice of voluntary disclosure is usually explained by *two economics-based theories*: agency theory and signalling theory or information problem theory (Healy and Palepu 2001; Xiao *et. al.* 2004).

⁴³⁹ Iulia Jianu , *Evaluarea, prezentarea și analiza performanței întreprinderii* , Editura CECCAR ,București , 2007 pag. 363

Voluntary disclosure is focused to solve the *ex-ante* (information problem) and *ex-post* (agency problem) at once. Agency theory basically assumes that everyone is selfish, pursuing her self-interests. In the context of modern companies, there exists separation of ownership (principals) and control (agents). Since principals cannot perfectly monitor agents' behaviour and agents are selfish, agents have strong incentives to act for their own interests at the expense of principals'. Agency theory is *ex-post* since it exists after the formation of companies.

Dumontier and Raffournier (2002) classified the accounting choices into two broad categories: the way the company evaluates its transactions (choices concerning accounting valuation) and the way the company presents its accounting information (choices concerning financial statement format). The authors have shown that companies listed on foreign markets are more inclined to adopt international standards voluntarily.

Agency theory is commonly used in the literature to analyze the determinants of accounting choices. As Jensen and Meckling (1976) observed agency theory argues that there is an avoidable monitoring cost for shareholders, paid to prevent expected expropriations by management. Since companies are competing against each other in the capital market to raise funds at the lower possible cost, there is a high incentive for these companies to help investors reduce their monitoring cost, by offering them clearer and therefore more reliable information. Financial statements, in opinion of Prabowo and Angkoso (2006), are one main device to reduce the agency problem, although there are other mechanisms such as efficient market for corporate control, governmental regulation, efficient job market for managers and managerial stock ownership program. By forcing managers to prepare standardized financial statements, shareholders can monitor and control managers' action with the proxy of company's financial performance. As Healy and Palepu (2001) considered it is expected that by disclosing additional, not mandated information, managers and owners can actually reduce agency costs.

Signalling theory exists before investors put their money into certain companies. Therefore it is called *ex-ante* problem. Information problem exists because investors have no or limited information to assess the quality of companies, forcing them to value all the companies at average level. The main problem with information asymmetry is that it impairs the efficient allocation of capital and entails higher cost of capital. Akerlof (1970) sees information asymmetry as a „lemons” problem that arises when a person wants to buy a used car. The signalling theory may be relevant to analyze the determinants of accounting choices. More specifically, accounting policy choices has signalling properties. The most commonly investigated information asymmetry is between the company and the investors although such kind of asymmetry can appear between other parties too (e.g. the company and the underwriter). Previous studies have demonstrated that increased disclosure decreases information asymmetry.

Botosan and Plumlee⁴⁴⁰ (2001) have a research plan in which they analysed the cost of capital through the dividend discount rate. This research was based on S. Ross's classical formula, Arbitrage Pricing Theory (APT). Since in the original model, the number and nature of macroeconomic risk factors aren't defined, the researchers chose a set of six indicators: the volatility ratio defined by CAPM; financial leverage; the size of the company, the share's account value, the rate of long term profit rise; the actual market value of the stock. These set the expected nature of the correlation between them and the cost of capital. The research was carried out on a sample of 23,765 companies between 1979 – 1993.

Ionaşcu *et al.* (2009) conducts an ongoing research during the 2009 – 2011 period⁴⁴¹, with the title „*The benefits of adopting IFRS standards: a research exploring the impact of internationalizing Romania's accounting on capital cost reduction*”. The objective of their study is to identify the possible economic benefits of Romania adopting the IFRS. They start with the idea that applying IFRS, considered a high

⁴⁴⁰ Botosan, Christine A. and Plumlee, Marlene A., Estimating Expected Cost Of Equity Capital: A Theory-Based Approach (July 2001). University of Utah Working Paper. Available at SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=279309

⁴⁴¹ webpage of the research project <http://cig.ase.ro/didactice/default.aspx?idutilizator=31>

quality standards, must lead to *an increase in financial information transparency, a reduction of information asymmetry and risk*, and, as a consequence, to *a decrease in the capital cost*.⁴⁴² On the sample of 37 marketable companies that adopted IFRS beginning with the year 2000, they evaluated capital cost in two different moments: t (in 1999, before the IFRS reporting) and $t+\tau$ (in 2003, after the adoption of IFRS). The research used a quantitative type methodology, by testing the model proposed by Botosan și Plumlee(2005). Results show that, indeed, after adopting IFRS, capital cost decreased from 0,8 (before the implementation) to 0,07 (after the implementation). IFRS offered the advantage of lower capital cost for Romanian companies listed at the Bucharest Stock Market (BVB).

4. Research Methodology

In the process of drafting this paper, we have followed the next steps:

Choosing the subject of the research and establishing the significance of the problem

The current paper wishes to argue that accounting information being credible, standardised and available in real-time is the basis of the decisions that an investor makes in an uncertain economical environment. These decisions are measured through an indicator of our choosing, cost of capital. The influence of this indicator on the company's performance are measured through the concept of value creation.

Documentation, by resorting to the international and national literature in this domain

The international literature used is mainly about the theoretical contributions of researchers like, Sharp, Lintner, Botosan and Plumlee, but also about empirical testing done by numerous researchers such as Botosan (2006), Ionașcu (2009).

Defining the research questions:

Our research was based on the following the research questions:

Q1: *AV – actual value, MVA –market value added and EVA –economic value added represent measures of performance and are directly correlated with average capital cost;*

Q2: *voluntary disclosure of financial information help to better estimate capital cost by investors;*

Q3: *a society that operates in a sector where stock have a volatility of less than 1, the average capital cost is relatively stable.*

Possible errors may arise from the data collecting methodology or from the stated research questions.

Choosing the data collecting methods and techniques

The chosen society satisfied the following criteria: to be marketable on BVB; to publish interim reports in standard form, as set out by IAS 34. These public reports are disclosed through the own society's web page.

Data analysis and the validation or rejection of research questions

The validation or rejection of our research questions shall be made by applied quantitative analysis on the gathered data. ACC – average capital cost, AV – actual value, MVA –market value added and EVA –economic value added are calculated in 5 different moments in the 2008 – 2009 period, using the aforementioned conceptual framework and the financial information from the annual and interim reports. By analysing the results, we shall determine the validity of the presumption that: *voluntarily disclosed financial information in a standardised format decreases capital cost and alters the created value in such a way that informed investors will have access to decision criteria during the year 2009.*

Data interpretation

After obtaining the results, we analyse both the absolute values from a quantitative point of view, as well as their evolutions in time. By comparing amounts and evolutions we shall have a qualitative analysis of the results.

⁴⁴² Ion Ionașcu , Stere Mihai , Mihaela Ionașcu ,*Implementarea IFRS și reducerea costului capitalului pentru companiile românești cotate* , Revista Audit financiar , Nr 1/2010

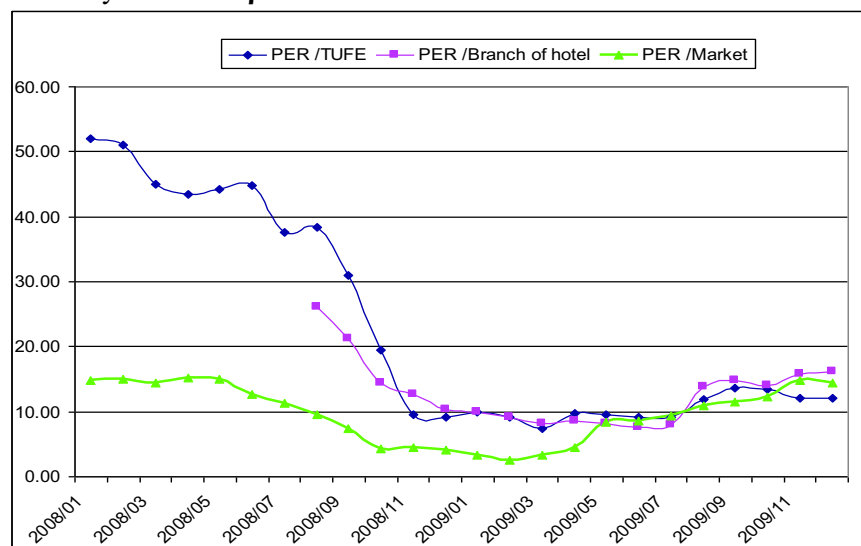
5. Results of the performed analysis on TURISM FELIX SA

The case study focuses on the *average capital cost*, in the conditions of voluntary disclosure of financial information, on a trimestrial basis, and the accuracy of the risk evaluation as compared with the annual mandatory reporting, as well as a performance estimation by calculating the **MVA**, the **EVA** and the **AV**. The analysed company is TURISM FELIX SA, a stock company from the Bihor county, with a social capital of 49.614.945,60 lei, marketed, in the Category II section, with the symbol TUFE, at the Bucharest Stock Market (BVB) since March 21, 2007. Currently 496.149.456 stocks of the company are being transacted.

In order to determine β (the sensitivity coefficient, which measures the stock's sensitivity to market fluctuations and which determines the specific risk) using the least square method, the monthly PER stock market indicator was used, both for the TUFE stocks and the market as a whole. The values of β for December 31, 2008, March 31, June 31, September 31 and December 31, 2009, were determined using the information from the Monthly Buletins issued by the BVB in the last 24 months. For the calculations, additional information was used from the financial reports of the 2008, 2009 fiscal years, as well as data from interim trimestrial reports from 2009. The following values are known from the macroeconomic environment:

- the flat income tax of 16%, according to Law 571 of 2003 – Fiscal Code;
- risk-free interest rate is 7,4%⁴⁴³ ;
- we assume an expected return rate on these stocks by investors of 27,4% ;

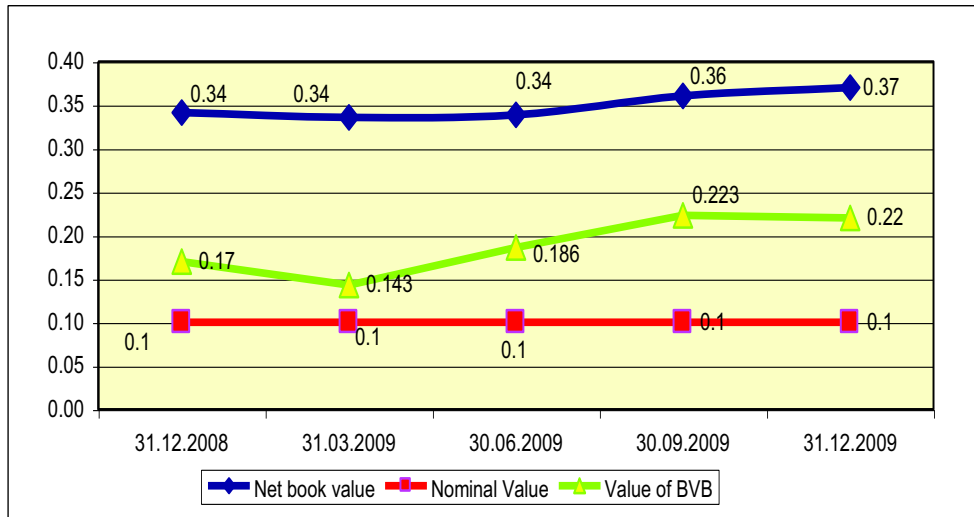
The TUFE stock's PER indicator, the market and the hotel industry figures are at the basis of calculating the volatility coefficient β .



Graph No.1. Evolution of the PER index

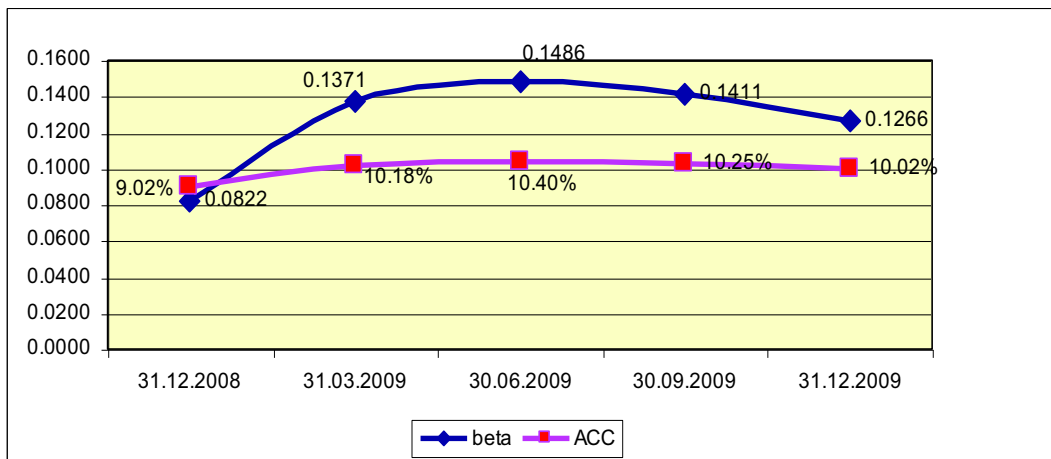
During the study, the company kept its nominal share value at 0.11lei/stock. The AGA decision during 2009 allocated the whole profit of 2008 on reserves.

⁴⁴³ medium interest on Treasury bonds issued by the Romanian National Bank (BNR) in 2005 for a period of 15 years, according to the Monthly Bulletin of the BNR



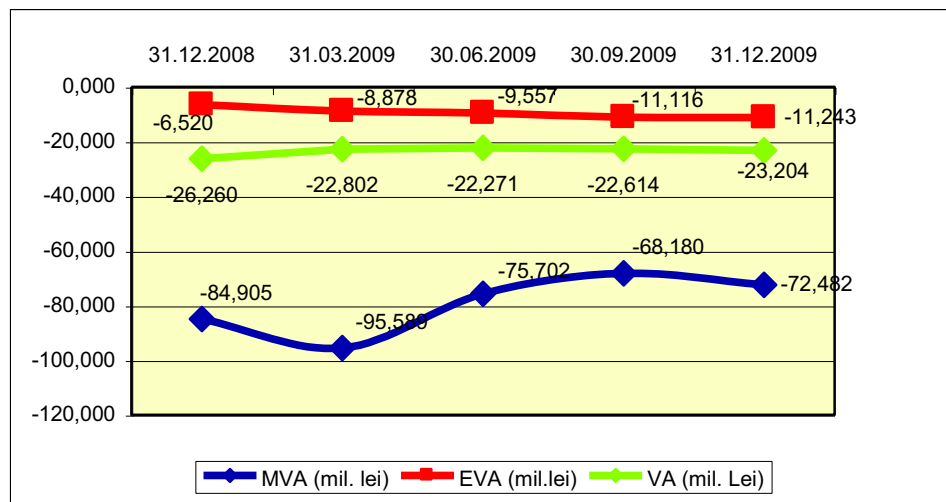
Graph No.2. Evolution in time of the market, accounting nominal values of TUFÉ stocks.

The evolution of β in paralel with the evolution of ACC shows to what degree the estimated ACC responds to the degree of volatility of TUFÉ stocks. The average capital cost shows a paralele evolution to β , but with a much more moderate amplitude (Graph No.3)



Graph No.3. Evolution of the sensitivity coefficient β and of the average capital cost ACC

Using average capital cost and market value of the stock, one can calculate the company's capacity to create value through its three approaches: MVA, EVA and AV. Calculating AV, by updating the total available treasury stream using as an update rate the ACC, was done with the following things in mind: keeping the total available flow at the level of December 31, 2008, estimating a time frame (of 4 years), operating with the average capital cost pertaining to every moment in time. Through this method, AV's obtained values show the way these evolved correlating with the average capital cost.



Graph No.4. The evolution of MVA, EVA and VA during the Dec. 31, 2008 - Dec. 31, 2009 period

Market Value Added (MVA) is calculated as the difference between the market value and the accounting value representing the *created external value*. EVA is an instrument used to measure the created value of the company through its shareholders, calculated as the difference between the net exploitation result and the invested capital cost, being also an indicator of internal performance.

6. Conclusions

The only available data, between two annual reports, on which estimates are made, are the ones from the last report, which are basically historical data and, as they get older, they become more unreliable and outdated. Through the interim report, the risk and uncertainty conditions are updated, and one can test whether the tradeable stock behaves according to the evolution of economy, or according to speculative fluctuations. The increase in the stock price during the period between January 1st and December 31, 2009, by 30% is supported by the rise of the AV by 11,5%, of the MVA by 15%. The evolution of β is presented in Graph. No. 4, in which one may notice that during a period of major turbulence on the capital market, β had significant fluctuations (+80%), and towards the end of the year reached a value of 0.126, an increase of 50% compared to the value from the beginning of the year (0.0822). The average capital cost (ACC) shows a similar fluctuation as β , but a maximum β amplitude of 80% corresponds to a maximum ACC amplitude of 15%. We can safely say that this verifies the hypothesis from the literature of this field: *if a company operates in a sector in which the stock presents a volatility that is less than 1, the average capital cost is relatively stable*. The average capital cost has risen by 13% during the year 2009, from a value of 9.02% to 10.02%.

We consider that evolution of PER stock indicator already includes the decision of investors to buy, therefore they probably acted either with full knowledge that their investments would be profitable on long run, or they acted in a speculative manner. By comparing the stock price with accounting value of stock, investors can make the natural decision of buying, given that the price of the stock is around 50% lower than its account value. This study upholds the idea that interim reports, done correctly, are welcome, and almost mandatory for companies listed on the stock exchange, especially given the socio-economic context, one of a less than stable period. It may be argued that the benefits for the reporting company vastly outweigh the effort put into the drafting of these interim reports. The benefits are measurable in time, through the stock market indicators attached to the stock, and through the trust given by existing and future investors.

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