

# [Corporate structure](https://assignbuster.com/corporate-structure/)

Demand for disclosure has been spurred by information asymmetry and agency conflict between management and investors. Good corporate structure principles are the foundation upon which trust of investors and lenders is built, corporate governance is aphilosophyand mechanism that entails putting in place better structures and processes through which the affairs of a company are directed and managed to enhance long term shareholders value through transparency andaccountability.

Previous empirical studies on the association between cost of equity capital and voluntary disclosure have documented confusing results, Botosan and Plumlee (2002) found a positive association exists between voluntary disclosure and cost of equity capital while Gietzmann and Ireland (2005) found a negative relationship between disclosure and cost of capital.

Increased application of corporate governance all over the world has risen after major corporate scandals due to lack or improper corporate disclosure, this has resulted to investors and lenders lose confidence in the traditional financial reporting. Transparency and disclosure creates and sustains confidence of investors, stakeholders and the winder society and provides opportunity for continuous improvement of business structure and processes this has resulted to re-examination and scrutiny of the existing corporate disclosure thus spurring the need for expanding the existing disclosure policy.

Voluntary disclosure, being one key pillar of corporate governance is regarded as an external mechanism for the control of the management, protection of the shareholders and a decrease of the agency costs resulting from information asymmetry between the management and shareholders. Botosan (2002) observed that firms which disclose more information in their annual reports enjoy the benefit of lower cost of capital.

The current growing trend towards increased corporate disclosure will soon transform into a veritable river of additional information. Although the purpose of disclosure is to provide adequate and sufficient information to the various stakeholders, managers may choose not to disclosure certain information in orders to protect competitive advantage Kavitha and Nandagopal,(2011).

Studies have shown that public firms are careful about disclosing information that might lead to competitive disadvantage, example, information about technological innovations, strategic and specific operation data Elliott and Jacobson (1994). The decision on the optimal level of disclosure is thus affected by the interplay between the costs and the benefits of disclosure.

1. 2 Voluntary Disclosure Elements of voluntary disclosure will be classified into four classes of information disclosure as forward-looking, financial, corporate socialresponsibilityand board size. Voluntary disclosure is regarded as an important economic tool that aids communicating information to different market players in an industry with an aim of providing clear view about business's long term sustainability.

Information disclosure conveys company's information to the owners, stakeholders and general public about the quality and value of the company Hamrouni et al.,(2015). Corporate disclosure falls into two categories, mandatory disclosure and voluntary disclosure covering all types of information, both of financial and non-financial in nature.

Laws, regulations and accounting standards stipulate mandatory information disclosure whereas voluntary disclosure is the information reported beyond the statutory requirements. Meek el al, (1995) defines voluntary disclosure as the free option on the part of the company management to provide accounting and other information deemed pertinent to the decision needs of users of their annual reports.

The extent and type of voluntary disclosure is dependent of the industry, size, governance structure, ownership structure and geographic region. Boesso and Kumar (2007) claimed that one of the determinants that led to the emergence of voluntary disclosure was the inadequacy of financial reporting as claimed by investors and shareholders .

Investors increasingly demanded openness and disclosure of information relating to performance and strategies. Organizations gains some benefit by virtue of disclosing sustainably over and above the statutory required information. Li and McConomy (1999) found that firms in better financial conditions are more likely to voluntarily adopt new International Financial Reporting Standards (IRFS) on environmental disclosure and hence become more profitable and reduce the cost of compliance.

Spanheimer and Koch (2000) noted the primary motive for adopting informative accounting as the access to global funding, worldwide comparability of financial statements, increased transparency and pressure from capital markets. Ross (1997) found that companies that provide more information disclosures reduced the occurrence of information asymmetry between the owners and manager, subsequently get to enjoy low cost of capital.

The benefits of disclosure are for example, increased share price will lower cost of capital resulting from a firm's full disclosure Nayak, (2012). Investors and creditors are better informed with a high level of disclosure making them understand the economic risk of the investment Elliott and Jacobsom, (1994).

Disclosure is generally done in the company annual report either through the statements or notes accompanying the statements. The disclosure elements in the study for measuring the level of voluntary disclosure will include forward-looking information, financial and capital information, corporate social responsibility information and board size information.

Forward-looking information represents one form of corporate disclosure. It provides a confidence signaling power to the stakeholder in the management capability to foresee the future prospects of the business. According to Celik et al. (2006) forward-looking information helps to predict the future of a company in terms of performance and strength of the management.

Management credibility is gained by accurately predicting company future forecast over and over. Even though the shareholders frequently question the management about what is going to happen to the company in future, the management cannot predict or gives a certain answer to what is going to happen but they observe market trends and then present the shareholders with explanations about what the company future prospects.

Companies that wish to access external sources offinancemay tend to disclose more forward-looking information to enable them gain investors confidence Clarkson, Kao and Richardson (1994). Jenkins Report (AICPA, 1994) formulated a number of key recommendations to increase the quality of corporate reporting, which included increasing the attention for and provision of forward-looking information.

Financial information disclosure helps stakeholders to evaluate company performance before making any investment decisions about the company. Improved information disclosure does not only bridge the information asymmetry between management and shareholders but also facilitate the functioning of the financial and economic systems. Adequate disclosure is used as a mean of attracting new investors in addition to supporting and building company reputation.

To reduce vulnerability, information disclosure should be comprehensive, timely, informative and credible in nature. Financial information is derived from the financial reports prepared from the books of accounts and analyzed in various categories such as the income statements, balance sheet, statement of cash flows and statements of changes in equity. Corporate Social Responsibility (CSR) interpreted as the way firms integrate its social, environmental and economic concerns into their value, culture, operations and strategies.

Carroll, (1999) noted CSR as an evolving concept. Centre for corporate governance (2005) issued guidelines which encouraged companies to disclose information on CSR, ownership structure and board size (Barako, 2007). CSR efforts translate into improvements in firms' financial performance. Corporate social reporting disclosure enhances company reputation by gaining trust and support from the stakeholders (Woodwar, Edwards and Birkin, 1996), additionally it helps assess congruence between the social value and social norms (Dowling and Pfeffer, 1975).

CSR enables firms to access huge sum of finance that might difficult to obtain. Board size is the total number of directors on a corporate board. The board of directors is the apex organ of a company whose central role being the formulation of polices and strategies to be followed by managers in managing firms operations. Board plays an important role in maintaining effective corporate governance. It is the Board that determines the amount of information disclosure by making strategic decision on the level of voluntary disclosure.

Chen and Jaggi (2000) noted that greater number of directors on the board may reduce the likelihood of information asymmetry. It is believed that the size of the board affects the ability of the board to monitor and evaluate management. Increase of directors in the board will consequently increase director's ability to control and promote value creating activities.

Larger board bring with them a collection of experience and expertise, therefore expanding the need for higher information disclosure, it is also argued that larger board size may find difficulty in arriving at a consensus in decision which can ultimately affect the quality corporate governance while small board size encourages faster information processing .

Brudbury (1992). 1. 3 Cost of Equity CapitalThe cost of equity is the return that an investor expects to receive from an investment in a business. This cost represents the amount the market expects as compensation in exchange for owing the stock of the business, it consist of dividends and capital gains.

From an investor's perspective, cost of equity capital is the return he expects for a share of stock he keeps in his portfolio. Fama and French (1993) found risk growth and size as the factors that influence the required rate of return by investors. When making decisions which affect the firm, Cost of equity plays a crucial role because it affects the discount rate at which expected future cash flows are valued. In archiving an effective strategic decision making and performance evaluation, the cost of equity should be estimated with accuracy.

According to Beneda (2003) the cost of equity is a vital base of comparing investment opportunities. Invertors use the concept of cost of equity as an investment opportunity in a company. Cost of equity is one of the methods used to evaluate investment decisions, example capital budgeting analysis, choice of capital structure and firm valuation.

Larger firms are associated with lower cost of capital when compared with the smaller firms since they are in a better position to raise funds from external sources on favorable terms. Equity capital plays a fundamental role in the development of a firm due to its advantages when compared to other financing forms.

The cost of equity capital is an important component with significant input in calculating the cost of capital Cotner and Fletcher (2000). It is detrimental to apply less appropriate model to estimate cost of capital, this can result to underestimation or overestimation. Underestimation may result in value destructive investments while overestimation may lead to rejection of promising investment opportunities.

The cost of equity capital is a key indicator of operations in the financial markets and is used by managers and financial resource providers. Clear financial statements reduce uncertainties associated with shareholders' equity lending to decrease in the cost of equity while incomplete and unclear financial statements increases uncertainty hence causing information risk to shareholders who hence demand higher return.

The cost of equity capital is of importance in two folds: securities valuation models are based on the cost of equity capital and without cost of equity capital it is impractible to invest companymoneyas it is difficult to determine capital structure hence unable to determine investment priority (Ahmend, 2007). Manager being agents of the shareholders try minimize the cost of equity hence maximizing shareholders wealth at this same time improving the value of the company.

In most financial decisions, cost of equity is an effective determinant factor. Cost of equity is used in capital budgeting decisions, setting optimal structure and working capital management. Implementing corporate governance practice, the high cost of equity capital problem is overcome.

The higher level of voluntary disclosure the lower investor uncertainty, with lower uncertainty investors will be willing to accept lower dividend payouts. A lower dividend stream would decrease the cost of equity capital because of a lower risk premium expected by the investors. Lower risk premium demanded by investors translate into a lower cost of equity capital of the firm.

Voluntary disclosure reduces the cost of equity capital in two ways which are based on enhanced stock market liquidity and on the reduced non-diversifiable estimation risk. More voluntary disclosure reduces investor uncertainty and attracts long term investments. Determinants of the cost of equity capital can be categorized into two: variables measured on accounting information only (accounting based) and variables measured on relations between market data and accounting data (market based).