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Integrated information and the cost of capital

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ABSTRACT

The growing requirements for corporate transparency have encouraged companies to report their performance to shareholders, investors and society in general from the economic, social and environmental points of view. However, many reports involve difficulties at the moment of analysing the information. To help minimize this problem, the integrated report has arisen. This document integrates all the financial, social and environmental information, jointly disclosing the key performance statistics.

Previous research has revealed that disclosing financial information gives important economic advantages to companies. This work aims to extend the existing empirical evidence, analysing the effect that the disclosure of integrated information has on the cost of capital. Accordingly, we used a sample of 995 companies in 27 countries and 3294 observations. The period in which the sample was taken was from 2009 to 2013. The results, after applying the panel data methodology, confirmed that a negative relationship exists between the cost of capital and the disclosure of an integrated report. The reduction of the cost of capital as a result of the disclosure of an integrated report is especially relevant to those companies that need to increase their basic funding. They have considerable problems with asymmetric information or they operate in markets with limited protection for investors.

1. Introduction

Multinational companies have a significant influence on the planet: the decisions that their board members make affect populations and sometimes even countries. Society has started to demand greater transparency from corporations regarding their method of operation and the impact that their performance has on the triple point of view, that is, economic, social and environmental.

In this context, some companies aim principally to disclose information that minimizes these social tensions. This voluntary practice has benefits like the reduction of political costs relating to legal requirements, taxes, rates and so on (Rodríguez Domínguez, Gallego Álvarez, & García Sánchez, 2008); at the same time, it allows companies to minimize the problem of asymmetric information and the costs of funding (Baiman & Verrecchia, 1996) and of capital (Easley & O'hara, 2004a, 2004b) as a result of the credibility and trust gained from investors and the liquidity of securities (Healy, Hutton, & Palepu, 1999). However, it may also bring costs related to the use of this information by actual and potential competitors or the possibility that this information could be used in lawsuits against the companies (Prado-Lorenzo & García-Sanchez, 2010). In this sense, the board members need to appraise the advantages and the adverse effects associated with corporate transparency.

The cost of capital occupies a very important place when making management and investment decisions. It reflects the problems of asymmetric information. It motivates academic researchers to orient their work towards analysing the role of the voluntary disclosure of information in the reduction of the cost of capital to mitigate this agency problem. For example, Elliot and Jacobson (1994) argued that a large volume of disclosed information would help to reduce the capital cost. It would contribute to investors and creditors having a better understanding of the economic risk of the investment that they have made already or are planning to make. In other words, the information disclosed by companies affects the perception that the investors could have of the actual situation in the company and of the future expectations. These perceptions could affect key variables like the capital cost.

Nowadays, corporate management has the opportunity to disclose voluntary non-financial information through several

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reports, such as sustainability, intellectual capital and corporate governance reports. However, the existence of this important number of statements including different kinds of information has caused the development of a large amount of difficulties in analysing the issued information and making decisions about the company behaviour. To help ease these problems, some companies have begun to integrate all their information into a single document as an integrated report for a sustainable strategy (Eccles & Kruz, 2010). This statement provides, in a composite, organized and cohesive form, information on the company's strategy, corporate governance, performance and prospects in such a way as to reflect the commercial, social and environmental contexts in which it operates. Thus, a clear and concise statement is provided of how the organization operates and how it creates and maintains value (International Integrated Reporting Committee, IIRC, 2011).

The purpose of this research is to analyse the effect of the voluntary disclosure of integrated information on the cost of capital. To assess this relation, we used 3294 observations corresponding to 995 companies in 27 countries in the period of 2009–2013.

The results show that companies that disclose an integrated report have a lower cost of capital, confirming the use of integrated information in decision making. This effect is especially important to companies that increase their basic funding or experience more problems related to asymmetric information. Furthermore, this typology of information is more valued by investors operating in capital markets with less protection for them.

Our results contribute to the literature in several aspects. First of all, unlike previous studies, we use a proxy of disclosure accuracy, not a proxy of disclosure quantity. Secondly, we consider jointly the effect all of typologies of financial and non-financial information, presented in an integrated form. Results show that it is the accuracy of integrated information disclosure, not the quantity of information disclosed in different reports, that reduces the cost of capital.

In addition, we have observed that the effect of voluntary disclosure of integrated reports on cost of capital is determined by firm incentives, as well as on the institutional environment. In this sense, firms that have greater information asymmetries and higher cost of capital, and that use long-term financial funds are the main beneficiaries of this relationship. From a macro-country perspective, weaker institutions in relation to stock-market development and investor-protection rules foment the benefits associated with accurate information disclosure.

Methodologically, this paper improves on the previous literature by analysing simultaneous equations for panel data, based on the Generalised Method of Moments (GMM) estimator proposed by Arellano and Bond (1991), to correct for problems of endogeneity, taking lags of integrated reports and the cost of capital as instruments of these independent variables. GMM is more consistent than other estimators (de Miguel, Pindado, & de la Torre, 2005) because it not only corrects endogeneity but also controls for the unobservable heterogeneity which arises because an integrated information disclosure decision is taken by specific individuals within a firm, thus generating a particular behaviour pattern. These individual characteristics usually remain constant over time but are unobservable to the researcher (Chi, 2005).

This article is structured in five sections following this introduction. The first part consists of the theoretical background and a preview of the empirical investigation; the second part provides a description of the dependent variable and the control variable as well as the sample and methodology; the third part describes the results of the analyses; and the fourth section presents the complementary results and finally the conclusions that are most relevant to the research.

2. Theoretical background

2.1. Voluntary disclosure and integrated information

With the purpose of facilitating the decision making of investors and other interested groups, companies are issuing integrated reports that offer an easy, clear and complete view of the company. The information that they contain concerns the company strategies, corporate governance, social responsibility and finance and it can all be found in one document.

The publication of an integrated report does not mean that a company will not publish other, more specific, information or data aimed at particular users. In fact, it involves the production of information comprising financial and non-financial aspects that can be utilized by all types of users (Eccles & Kruz, 2010). However, the integrated report will become the company's primary report and will replace rather than add to the existing requirements, ensuring that only information that is regarded as relevant to the creation of value in the short, medium and long term will be disclosed (Deloitte, 2012).

Previous research has focused on analysing the disclosure of the typology of this report, specifically Frías-Aceituno, Rodríguez-Ariza, and García-Sánchez (2014). Taking into account the postulates of the four principle theories of information disclosure – agency theory, the theory of signals, the theory of the political cost and the theory of the property cost – they observed that the companies that operate in a concentrated sector are less likely to publish integrate reports, with the aim of preserving their abnormal benefits. Another study conducted by the same authors, Frías-Aceituno, Rodríguez-Ariza, and García-Sánchez (2013), focused the analysis on the role of the disclosure in the size, activity, independence and diversity of the administrative council, which are related to the growth of this voluntary new kind of report. The results show that the level of transparency and integration of the corporate information is a priority to large companies and ones with considerable opportunities for growth. This process is also affected by the characteristics of the council. Regarding this, size and gender diversity are the most influential factors in the decision to extend and improve the process of reporting accounts.

Adopting an institutional approach, Frías-Aceituno, Rodríguez-Ariza, and García-Sánchez (2013) concentrated their research on examining the influence of the legal system on the development of integrated reports. These authors demonstrated that companies located in countries with civil law and with major development of law and order are more likely to issue integrated reports that favour decision making. Furthermore, García-Sánchez, Rodríguez-Ariza, and Frías-Aceituno (2013) evaluated the impact of the cultural system on the development of the integrated report as a document linked to corporate development, highlighting that companies located in societies with collectivist values and strong feminism are in the vanguard of the integration of the information.

In this research, we adopt a new approach to the analysis and disclosure of integrated reports, the interest lying in evaluating the effect that the disclosure of the document has on the corporate cost of capital; in the following paragraph, we present our work theory.

2.2. Financial and non-financial information disclosure and the cost of capital

Information asymmetry theory assumes that at least one party to a transaction has relevant information, whereas the others do not. According to Kim and Verrecchia (1994), this allows us to talk about the existence of buyers and sellers in the market with different skills in information processing. According to Akerlof (1970), the asymmetric distribution of information among market participants creates a barrier to the smooth exchange of assets at