Integrated report, information asymmetry, and cost of equity

Relatório integrado, assimetria de informações e custo de capital próprio

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Abstract

This research ran to examine the effect of Integrated Report (IR) on Information Asymmetry (IA) and the Cost of Equity (COE) of companies. The sample companies were those registered in the International Integrated Reporting Council (IIRC) database from 2013 to 2015. The test results using multiple linear regression proved that IR affected IA negatively and that each part of IR, namely Guiding Principles and Content Elements, had a direct negative impact. The higher IR, the lower both IA and COE. The results of this study may contribute on the increasing information quality in Indonesia.

Keywords: Information Asymmetry. Integrated Report. Cost of Equity. Integrated Reporting.

Resumo

Esta pesquisa procurou examinar o efeito do Relato Integrado (RI) na Assimetria Informacional (IA) e no Custo de Capital Próprio (COE) das empresas. As empresas da amostra foram as registadas na base de dados do International Integrated Reporting Council (IIRC) de 2013 a 2015. Os resultados do teste de regressão linear múltipla provaram que a RI afetou negativamente a IA e que cada parte da RI, nomeadamente Princípios Orientadores e Elementos de Conteúdo, tinha um impacto negativo direto. Quanto maior o IR, menor o IA e o COE. Os resultados deste estudo podem contribuir para o aumento da qualidade da informação na Indonésia.

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Introduction

It has been hypothesized that investors and creditors rely on financial statements, which contain information about past financial performance and provide signals for future performance, thus becoming vital in decision-making. Over the decades, classical research in accounting showed sufficient evidence that investors used financial reports to make economic decisions (Ball and Brown, 1968; Firth, 1981; Previts, Bricker, Robinson, and Young, 1994). However, as business, operations and corporate responsibilities become more complex, investors need information not only on quantitative financial reports but also on governance reports, social responsibility reports, and management discussions. For this reason, reports issued by companies are now including annual reports, sustainability reports, and Integrated Reports (IR).

Some people criticize the concept of sustainability reporting that produces independent reports without integrating financial and other reports (Berndt et al., 2014; Zhou, Simnett, Green, 2017) and, therefore, causes difficulty in analyzing the implication of non-financial performance and its contribution on financial performance and firm value (Eccles and Serafeim, 2014). The limited use of sustainability reports by information users has become a concern (Eccles and Krzus, 2010; Eccles and Serafeim, 2014; Zhou, Simnett, Green, 2017). Evidence on the relationship between sustainability reporting and financial performance and firm value is limited (see Jones, Frost, Loftus, and Van Der Laan, 2009), indicating little use of such information by investors.

To increase the value relevance of reports published by companies, the International Integrated Reporting Council (IIRC) has initiated a new form of reporting called Integrated Reporting (IR). Companies should issue reports that provide more concise, holistic and comprehensive information about their performance in all aspects, including financial, human, intellectual, environmental, and social, that can affect value creation capabilities. The reports should contain the most strategic and relevant information important to investors' investment decisions (Cheng et al., 2015), show the relationships between elements in annual reports and sustainability reports, and explain how they affect the companies' ability to create and sustain values over the long, short, medium, and long terms (IIRC, 2013). IR initiatives that can assist analysts in assessing companies' prospects can give some capital market benefits for
companies, such as improved reputation and increased transparency, which can result in lower cost of capital (IIRC, 2011; IRCSA, 2011; PwC, 2014).

The IIRC, in late 2013, published the IR framework to be adopted globally. Some viewed that IR can solve many problems in earlier reporting systems by promoting more comprehensive and connected information. However, no adequate evidence relating to the value relevance of IR was found. Whether enterprise capital providers used IR in decision-making was still a big question.

Opinions in support of the usefulness of IR said that such reports could provide broader and more detailed information to external and internal stakeholders (Krzus, 2010; Cheng et al., 2014; Lai et al., 2016; Reimsbach et al., 2018). Furthermore, annual reports in the form of IR were expected to create accurate information and have an impact on Information Asymmetry (Eccles & Krzus, 2014).

Research conducted by Zhou, Simnett, Green (2017) provided evidence regarding the value relevance of IR. They found that IR is associated with reduced analyst forecast error and a decrease in the cost of capital in the sample companies listed on the Johannesburg Stock Exchange. This evidence showed that IR guarantees information quality because its use increases the accuracy of analysts’ predictions about company performance. In addition, because the information published by the companies was considered to be of high quality, the capital providers reduced the required rate of return, bringing to reduced cost of capital.

Previously, Babourkados and Rimmel (2016) also provided evidence on the value relevance of IR by finding that after the adoption of IR by the South African Stock Exchange (JSE), the equity valuation of annual reports increased markedly.

Research conducted by Cheng et al. (2014) stated information in measuring the implementation of IR using Guiding Principles and Content Elements contained in the IR framework. A study conducted by Cheng et al. (2014) discussed the development of the IR concept over a 4-year period, when the International Integrated Reporting Council (IIRC) in 2010 started. Cheng et al. (2014) found evidence that Guiding Principles and Content Elements contained in the IR framework significantly and negatively affected Information Asymmetry.

The two-research mentioned earlier were conducted in South Africa, as its stock exchange was the first to adopt IR and mandate the companies listed thereon to provide reports based on the IR concept. Several stock exchanges in the world, such as in Sao Paulo, Singapore, Kuala Lumpur, and Copenhagen, have paid great attention to IR (Simnett and Huggins, 2015). Our research would broaden our knowledge by including a sample not limited to those listed in JSE only. Instead, we would take our sample companies from the IIRC
database. We would observe whether IR disclosure reduces Information Asymmetry between the issuers (companies) and the investors as capital providers and reduces the cost of capital. Previous research had provided evidence regarding the relevance value of IR, but observations on whether IR disclosure can reduce asymmetric information were still rare. Therefore, this study aimed to provide evidence of the role of IR in reducing Information Asymmetry and the cost of capital using the sample companies listed in the IIRC database.

Theoretical Basis and Hypothesis Formulation

2.1 Agency Theory

According to agency theory, management as an agent has more and better information than the principal has (Jensen & Meckling, 1976). Such inequality is called Information Asymmetry, which can lead to agency conflicts. Information Asymmetry is related to the low monitoring and control of shareholders over management that, at a particular level, can be used by agents to take over company assets and maximize their interests by taking advantage of information gaps. Managers, as insiders, may have better knowledge of the actual conditions of the company that may motivate them to take personal advantage through takeovers, overcompensation, preconditions, or high-risk investments.

2.2 Stakeholder Theory

Stakeholders are individuals, groups of people, communities, or society as a whole or in part who have relationships and interests in and power over companies (Freeman, 1994). Lawrence et al. (2011) stated that a company’s survival depends on the support of its stakeholders. The stronger the stakeholders, the greater the company’s efforts to adapt. IR is considered part of the communication between the company and stakeholders. Stakeholders consist of two groups: primary and secondary. The former means those having direct control over the products the company needs, while the latter comprises parties that do not directly supply the goods the company needs but have a beneficial influence (Freeman, 1994). Referring to agency theory and stakeholder theory, we can conclude that the uneven distribution of information to both principles and stakeholders can potentially cause Information Asymmetry and increase the cost of capital. IR disclosure can reduce these problems.
2.3 IR and Information Asymmetry

Information Asymmetry can encourage managers to mask underperformance by spreading good performance. This problem arises from an information gap known as the lemon problem, which can lead to wrong investment decisions. Investors may underestimate either good or bad companies. To reduce these misjudgments, an optimal contracting system and disclosure regulations are two alternative solutions that can provide incentives for managers to do full disclosure. One solution to the lemon problem proposed by agency theory is disclosure (Kreps, 1990).

Finally, the lemon problem leads to a demand for information brokers like financial analysts and rating agencies who produce private information to reveal superior information on managers. IR is the result of integrated enterprise management thinking in which principals, managers, and company management must be involved in formulating strategies, controlling, and making decisions in the use of company resources, as well as in analyzing the relationships and interactions between the resources they have that from time to time have a significant impact on company's ability to create value (Wild et al., 2005).

An annual report in the form of an IR can increase information quality (Eccles & Krzus, 2010; Eccles & Serafeim, 2014). Research by Cheng et al. (2014) on companies in Australia also supported that annual reports in the form of an IR can improve the quality of information. This study provided us with evidence about the value relevance of IR. However, whether or not IR reduces asymmetric information is still in doubt.

There are two basic frameworks to maximize the value of IR and reduce Information Asymmetry: Guiding Principles and Content Elements. Guiding principles are how IR is structured and presented to be of value to readers. Cheng et al. (2014) stated that Guiding Principles include (1) strategic focus and future orientation, (2) connectivity of information, (3) stakeholder relationship, (4) materiality, (5) conciseness, (6) reliability and completeness, and (7) consistency and comparability. Meanwhile, Content Elements consist of those that need to be disclosed in (IR) and, in essence, are related to one another, and do not stand alone exclusively. Then the first hypothesis (a) is as follows:

**H1a: Companies that make Integrated Reports in accordance with IR Guiding Principles have lower Information Asymmetry**

Furthermore, Content Elements include (1) organizational overview and external environment, (2) governance, (3) business model, (4) risks and opportunities, (5) strategy and resource allocation, (6) performance, (7) outlook, and (8) basis of preparation and presentation. These content elements appear as questions to be answered in an IR, not as
required specifications. The theoretical arguments above support the idea that IR can help reduce Information Asymmetry if the presentation of IR has the essence that the report content can be interconnected and provide value for the benefit of the readers. So the first hypothesis (b) is as follows:

$$H_{1b}: \text{Companies that make Integrated Reports that comply with IR Content Elements have lower Information Asymmetry}$$

### 2.4 IR and Cost of Equity Capital

The literature described previously indicated that Cost of Equity Capital can be influenced by reducing Information Asymmetry between the company and its investors (Healy and Palepu, 1993; Verrecchia, 1983; Lambert et al., 2012). IR can help reduce Information Asymmetry in at least three ways (Zhou, Simnett, and Green, 2017). First, the company must commit to create sustainable activities to increase its value and help identify risks and opportunities in the business. Thus, reporting in an integrated manner notifies the readers that sustainability is an integrated part of the company's day-to-day business conduct and that significant risks and opportunities are being managed properly. Secondly, IR must have the ability to broaden the information set to include all of the company's value drivers (e.g., financial, environmental, social, and human) into a single report and to link them to describe value creation activities. Thirdly, as Graham et al. (2005) said, the company must have the most important motivation: to reduce uncertainty about its prospects for making voluntary disclosures. IR principles emphasize disclosure of strategy, business model, and forward-looking information to reduce uncertainty around the company's long-term performance.

Financial information can theoretically affect Cost of Equity Capital which forms both direct and indirect relationships (Zhou, Simnett, and Green, 2017). Examples of direct relationships are risk sharing and reduced estimation or information risk (Merton, 1987; Barry and Brown, 1984, 1985; Brown, 1979; Coles et al., 1995). The indirect relationships include the effect on market liquidity and Information Asymmetry (Baiman and Verrecchia, 1996; Diamond and Verrecchia, 1991; Easley and O'Hara, 2004; Verrecchia, 2001).

Empirical evidence showing a negative relationship between discretionary disclosure and Cost of Equity Capital is still less consistent and less firm to draw definite and unambiguous conclusions (Beyer et al., 2010; Botosan, 2006; Core, 2001; Healy and Palepu, 2001; Kothari, 2001; Leuz and Wysocki, 2008). However, overall, empirical studies generally provided support for the theoretically negative relationship between the quality of discretionary disclosure and Cost of Equity Capital (with various indicators) (Botosan, 1997;
H2a: Companies that make Integrated Reports that comply with IR Guiding Principles have lower Cost of Equity Capital

If the company adheres to IR principles, Integrated Reports can help reduce uncertainty regarding the company's long-term performance, thus resulting in a lower Cost of Equity Capital. Theoretical arguments support the notion that IR can help reduce Cost of Equity Capital if IR principles are adequately applied.

Various studies have expanded voluntary disclosure theory into non-financial information with the assumption that non-financial information will be relevant to firm value (Margolis et al., 2009; Margolis and Walsh, 2003; Orlitzky et al., 2003). In line with this assumption, several studies examined the effect of disclosure on Cost of Equity Capital and generally have documented a negative relationship (Dhaliwal et al., 2011, 2013; El Ghoul et al., 2011; Plumlee et al., 2015). These studies generally only examined the status of CSR reports' issuance (published or unpublished) without further distinguishing the quality of these reports. Such disclosure reports cannot be easily linked to the company's strategy and business model, thus less effective in communicating company performance to investors (Eccles and Krzus, 2010; Serafeim, 2014; Zhou, Simnett, and Green, 2017).

Serafeim (2014) demonstrated the value of this reporting format based on the investors of companies practicing IR. Research by Zhou, Simnett, and Green (2017) examined the impact on analysts' earning forecasting and changes in Cost of Equity Capital of reporting companies. Zhou, Simnett, and Green (2017) found that analysts' forecast error decreases as the company's degree of alignment with the IR framework increases. Further, the increase in compensation corresponds to a subsequent decrease in Cost of Equity Capital for a given reporting unit. The results show that IR gradually produces useful information for the capital market beyond existing reporting mechanisms. Then, the second hypothesis (b) is as follows:

H2b: Companies that make Integrated Reports that comply with IR Content Elements have lower Cost of Equity Capital

2.5 Sample and Data

The sample included companies that had implemented IR and been registered in the International Integrated Reporting Council (IIRC) database for 2013-2015, namely Publicly Listed Companies that had Featured Pages and Guiding Principles or Content Elements.
### Operational Variables

#### 3.1 Dependent Variables

In the first hypothesis (1), Information Asymmetry played as the dependent variable with the stock price volatility approach as information asymmetry between companies and the stock market. This variable was measured using the standard deviation of monthly prices for 1 (one) year (Krzus, 2011). Due to the volatility of stock returns, very good information entered the stock market, bringing to less Information Asymmetry. In this situation, the higher the volatility of stock returns, the lower Information Asymmetry.

In the second hypothesis (2), Cost of Capital functioned as the dependent variable tested using the following OLS regression (Dhaliwal et al., 2011; Zhou, Simnett, and Green, 2017):

\[
\Delta ICC_{i,t+1} = \beta_0 + \beta_1 \Delta IR_{TOTAL,i,t} + \beta_2 \Delta SIZE_{i,t} + \beta_3 \Delta BM_{i,t} + \beta_4 \Delta LEV_{i,t} + \beta_5 \Delta LTG_{i,t} + \\
\beta_6 \Delta DISPi_{i,t} + \beta_7 \Delta BETA_{i,t} + \beta_8 \Delta ABS\_DA_{i,t} + \beta_9 CSR_{i,t} + \Sigma IND + \Sigma YEAR + \varepsilon_{i,t}
\]

Following Zhou, Simnett, and Green (2017), all variables were analyzed in their changing form, and a lead-lag approach was used in the model to fix the endogeneity problem. To examine the role of the information environment in the relationship between IR and ICC, the sample companies were divided into high- and low-analyst sub-samples based on the average number of company analysts in the sample. Regression in the equation was performed separately for the two sub-samples.

Implied Cost of Capital (ICC) ICC in this study also followed Zhou, Simnett, and Green (2017) and was calculated using the PEG model from Easton (2004), namely ICC_PEG. This study used the PEG model based on its popularity in previous studies and the finding that it tends to outperform the other methods (Botosan and Plumlee, 2005).

#### 3.2 Independent Variable

The Integrated Report (IR) measurement followed the research of Cheng et al. (2014), namely comparing the number of Guiding Principles and Content Elements contained in the companies’ annual reports with the number of Guiding Principles and Content Elements contained in the IR framework. This measurement used the content analysis method by coding texts written in different categories with the same characteristics based on predetermined activities (Weber, 1988). The formula for calculating the IRD is as follows:

Revista Gestão e Secretariado (GeSec), São Paulo, SP, v. 14, n. 6, 2023, p. 9770-9787.
**IRD** = \( \frac{X}{n} \)

in which

- **IRD**: Company’s Integrated Report Disclosure
- **N**: The number of IR disclosure items by the IR Framework, \( n = 7 \) and \( 8 \)
- **\( \sum X \)**: The number of items disclosed by the company; \( X \) is worth 1 if the item is disclosed and is worth 0 if the item is not disclosed

### 3.2.1 Control Variables

The control variables in this study were profitability and firm size. Firm size was proxied by (logarithm) the company’s total assets. Meanwhile, profitability was proxied by ROA, which, according to Wild *et al.* (2005), used the following formula:

\[
ROA = \frac{Earnings\ After\ Tax \times 100\%}{Total\ Asset}
\]

### 3.3 Hypothesis Testing

The OLS regression model used in this study to test the hypothesis is as follows:

**First Hypothesis**: \( Spread = \beta_0 + \beta IRD + \beta ROA + \beta SIZE + \varepsilon \)

**Second Hypothesis**: \( ICC = \beta_0 + \beta IRD + \beta ROA + \beta SIZE + \varepsilon \)

**Notes**:
- **Spread** = level of Information Asymmetry (proxied by return volatility)
- **ICC** = Implied Cost of Capital
- **IRD** = level of disclosure of Integrated Report
- **ROA** = Profitability calculated based on the ratio of net profit after tax to total assets
- **SIZE** = Firm size calculated based on the natural logarithm of total assets (Ln total assets).

### Results

#### 4.1 Descriptive Statistics

The results of the descriptive statistics of the observational data are as follows:
Table 4.1 shows that the disclosure of Guiding Principles had an average of 0.36, indicating that only 36% of the total Guiding Principles were disclosed. The standard deviation of 0.17, lower than the average, showed no significant deviation from both the minimum value of 14% and the maximum value of 86%.

Disclosure of Content Elements had an average of 0.15, showing that only 15% of the total Content Elements were disclosed. The standard deviation of 0.10, lower than the average value, showed no significant deviation from the minimum value of 00% and the maximum value of 50%.

Profitability had an average of 0.04, indicating that the profitability of the sample companies on average was only 4% of their assets. The standard deviation was 0.08, higher than the average value, meaning that there was a significant deviation from the minimum value of -0.15 and the maximum value of 0.38.

The average company size was 4760198.5447, with a standard deviation of 15315004.37499, higher than the average value, showing that there was a significant deviation from the minimum value of -1154.50 and the maximum value of 92410911.00.

Return volatility had an average of 0.04, indicating that the return volatility of the sample companies on average was only 4% of their assets. The standard deviation of 0.08, lower than the average value, showed that there was a significant deviation from the minimum value of 0.02 and the maximum value of 1.07. These results indicated a great deviation in firm information asymmetry, because return volatility is inversely proportional to information asymmetry.

The average cost of capital was 0.13, indicating that the sample companies' cost of capital had an average profit of 0.13. The standard deviation was 0.22, higher than the average value, showing a significant deviation from the minimum value of 0.03 and the maximum value of 1.48.
4.2 Results of Regression Analysis and Hypothesis Testing

The regression analysis results had 4 (four) models, namely models 1a and 1b to answer Hypothesis 1 and models 2a and 2b to test Hypothesis 2. The results of the one-tailed regression testing and the coefficient of determination are shown in Table 4.2.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Model 1a</th>
<th>Model 1b</th>
<th>Model 2a</th>
<th>Model 2b</th>
</tr>
</thead>
<tbody>
<tr>
<td>GP</td>
<td>0.485*</td>
<td>-0.212</td>
<td></td>
<td>-0.365*</td>
</tr>
<tr>
<td>(t value)</td>
<td>(2.259)</td>
<td>(-1.253)</td>
<td></td>
<td>(-1.711)</td>
</tr>
<tr>
<td>CE</td>
<td></td>
<td>0.797*</td>
<td></td>
<td>-0.365*</td>
</tr>
<tr>
<td>(t value)</td>
<td></td>
<td>(0.027)</td>
<td></td>
<td>(-1.711)</td>
</tr>
<tr>
<td>Profit</td>
<td>-0.210</td>
<td>-0.150</td>
<td>-0.212</td>
<td>-0.301</td>
</tr>
<tr>
<td>(t value)</td>
<td>(-.476)</td>
<td>(-.353)</td>
<td>(-.928)</td>
<td>(-1.055)</td>
</tr>
<tr>
<td>Size</td>
<td>0.012</td>
<td>0.000*</td>
<td>0.000</td>
<td>0.000</td>
</tr>
<tr>
<td>(t value)</td>
<td>(.408)</td>
<td>(2.298)</td>
<td>(.307)</td>
<td>(-1.56)</td>
</tr>
<tr>
<td>F</td>
<td>1.868</td>
<td>3.152</td>
<td>0.811</td>
<td>1.277</td>
</tr>
<tr>
<td>Sig F</td>
<td>0.149</td>
<td>0.034</td>
<td>0.496</td>
<td>0.296</td>
</tr>
<tr>
<td>Adj R²</td>
<td>0.115</td>
<td>0.180</td>
<td>0.00</td>
<td>0.019</td>
</tr>
</tbody>
</table>

Table 4.2 Regression Test Results
* significance at the 5% level
Variable definitions
GP= Guiding Principles, CE= Content Elements, Profit=profitability, Size= Firm size.
See Appendix 3

Hypothesis 1 had a role to test the existence of a negative effect between IR disclosure on Information Asymmetry, while Hypothesis 2 was to test IR disclosure on Cost of Capital

- Hypothesis 1a stated that companies that make Integrated Reports following IR Guiding Principles would have lower Information Asymmetry. Table 4.2 shows that GP (Guiding Principles) had a positive effect on return volatility, with a coefficient of 0.485 and significant (0.014<0.05). Thus, disclosure of IR Guiding Principles could increase return volatility; the increase in return volatility indicated a decrease in Information Asymmetry. So, **Hypothesis 1a was acceptable.**

- Hypothesis 1b stated that companies that make Integrated Reports that comply with IR Content Elements have lower Information Asymmetry. Table 4.2 shows that CE (Content Elements) had a positive effect on return volatility, with a coefficient of 0.797 and significant (0.013<0.05). Disclosure of IR Content Elements could increase return volatility, while the increase in return volatility indicated a decrease in Information Asymmetry. So, **Hypothesis 1b was acceptable.**

- Hypothesis 2a stated that companies that make Integrated Reports in accordance with IR Guiding Principles have lower Cost of Equity Capital. Table 4.2 shows that GP (Guiding Principles) had no effect on return volatility, with a coefficient of -0.212 but
not significant (0.109<0.05). Disclosure of Guiding Principles (IR) could not reduce Cost of Equity Capital. So, Hypothesis 2a was acceptable.

- Hypothesis 2b stated that companies that make Integrated Reports following IR Content Elements have lower Cost of Capital. Table 4.2 shows that CE (Content Elements) had a negative effect on Cost of Capital, with a coefficient of 0.365 and significant (0.042<0.05). Disclosure of IR Content Elements could reduce Cost of Equity Capital. So, Hypothesis 2b was acceptable.

The results of testing the coefficient of determination, based on Table 4.2, proved that disclosure of Guiding Principles (IR), profitability, and firm size affected Information Asymmetry by 11%; the remaining 89% depended on aspects beyond the research model.

Asymmetry Information was influenced by 18% of disclosure of IR Content Elements, profitability, and firm size; the remaining 82% were influenced by aspects beyond the research model.

Based on Table 4.2, Cost of Capital was independent of the disclosure of IR Guiding Principles, profitability, and firm size. It was affectable by disclosure of IR Content Elements, profitability, and company size by 2%; the remaining 98% were influenced by aspects beyond the research model.

**Discussion**

5.1 Companies That Make Integrated Reports in Accordance with IR Guiding Principles or IR Content Elements Have Lower Information Asymmetry

The results of this study indicated that disclosure of integrated reports in accordance with the IR Guiding Principles and IR Content Elements could lower Information Asymmetry. This finding was confirmed by stock price volatility; the ups and downs of the stock price of a company going public (Alwi, 2003) is positively related to the company's disclosure of IR Guiding Principles and IR Content Elements.

Such a disclosure lets new information come to the exchange. In an efficient market, the price level adjusts rapidly and reflects that new information. Disclosing IR Guiding Principles and IR Content Elements further increases return volatility and indicates a decrease in Information Asymmetry.

The results of this study were in line with opinions that support the usefulness of IR that argue that it is able to provide broader and in-depth information to external and internal parties (Krzus, 2010; Cheng et al., 2014; Lai et al., 2016; Reimsbach et al., 2018).
Furthermore, annual reports in the form of IR are expected to create accurate information and reduce Information Asymmetry (Eccles & Krzus, 2014). Research conducted by Cheng et al. (2014) discussed IR concept development over a 4-year period since the start of the International Integrated Reporting Council (IIRC) in 2010. Cheng et al. (2014) found evidence that the Guiding Principles and Content of Elements show that IR has a negative and significant effect on Information Asymmetry. These results further reinforced that disclosure of IR Guiding Principles or IR Content Elements can lower Cost of Capital.

5.2 Companies that Make Integrated Reports that Comply with IR Guiding Principles or IR Content of Elements Have Lower Cost of Capital

The results of this study indicated that disclosures of Integrated Reports in accordance with IR Content Elements can lower Cost of Capital, while those in accordance with IR Guiding Principles cannot since investors or creditors pay attention to IR Content Elements more than to IR Guiding Principles. Moreover, with the clearer and more complex aspects of Content Elements, investors reduce the actual costs the companies incur to raise funds from debt, preferred stock, common stock, and retained earnings to finance the companies' investments or operations. These findings were in line with the evidence found by Zhou, Simnett, and Green (2017) that was considered important regarding the value relevance of IR. This evidence suggested that IR ensures information quality because the use of IR increases the accuracy of analysts' predictions about company performance. In addition, capital providers, when finding that information published by a company is of high quality, reduce the required rate of return. Such a decision can reduce the company's Cost of Capital. Previously, another study by Babourkados and Rimmel (2016) also provided evidence of the value relevance of IR by finding that after the adoption of IR by the South African Stock Exchange (JSE), the equity valuation of annual reports has increased markedly.

Other studies also expanded the theory of voluntary disclosure into non-financial information, with the assumption that non-financial information is relevant to firm value (Margolis et al., 2009; Margolis and Walsh, 2003; Orlitzky et al., 2003). In line with this assumption, several studies by Dhaliwal et al., 2011, 2013; El Ghoul et al., 2011; Plumlee et al., 2015; and Serafeim (2014), examined the impact of disclosing Cost of Equity Capital and found a negative relationship therein. Research by Zhou, Simnett, and Green (2017) even found that analysts' forecast errors decreased due to the increase in the level of corporate alignment with the IR framework.
Conclusion

This study aimed to find out how disclosures of Integrated Reports in accordance with the IR Guiding Principles and IR Content Elements could reduce Information Asymmetry and how those in accordance with the Guiding Principles (IR) and Content of Elements (IR) could lower Cost of Capital. The results indicated that Information Asymmetry was lower if the Integrated Report disclosure was in accordance with IR Guiding Principles and IR Content Elements. This finding was evidenced by the value of stock price volatility, namely that the ups and downs of the stock price movement of a company going public were positively related to the disclosure of IR Guiding Principles and IR Content Elements.

The results also showed that IR Content Elements could lower Cost of Capital, while IR Guiding Principles could not because investors or creditors paid attention to the content of IR reports more than it to Guiding Principles. Moreover, with the clearer and more complex aspects of Content Elements, investors reduced the actual costs the companies incurred to raise funds from debt, preferred stock, common stock, and retained earnings to finance the companies’ investments or operations.

Limitations and Recommendations

In measuring Cost of Capital, due to limitations faced by the researchers in terms of time and research data, this research used several assumptions. Since the data were based on various international companies, the researchers found difficulty in tracing some of them, thus suggesting that future research look for detailed data in advance to minimize the number of assumptions used.

References


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