AN EMPIRICAL EXAMINATION OF THE RELATIONSHIP BETWEEN VOLUNTARY AND MANDATORY DISCLOSURES AND FINANCIAL PERFORMANCE: ASIAN EMERGING MARKET PERSPECTIVE

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INTRODUCTION

Corporate communication is vital for investors in today's business world, and disclosure of information is a key part of it. The amount and type of information disclosed by a company are influenced by various factors. To ensure compliance with the specified regulations, it is essential that both mandatory and voluntary disclosures are included in annual reports. Both disclosures must interplay properly for better financial company performance, providing greater transparency to users. According to Aguilar and Maciel (2019), mandatory information disclosures positively influenced the decision-making process in the capital market. Furthermore Wahlen, (2015) explained that fair value disclosure provides greater transparency and accountability about the firm’s activities. Additionally, Taylor (2008) stated that sufficient fair-value information disclosures enable one to make better economic decisions. The primary objective of this study was to conduct a comprehensive analysis of the effects of mandatory disclosures concerning fair-value assessments and voluntary disclosures regarding corporate social responsibility on a company's performance. This investigation aims to offer significant insights into the mechanisms through which disclosures influence a company's overall performance.

The financial environment of today is highly competitive because companies acquire a wide range of dynamic capabilities in order to differentiate themselves from one another. To meet this new challenge, businesses must form strong social, economic, and environmental bonds. Wu and Shen, (2013) stated that Corporate Social Responsibility (CSR) could facilitate brand differentiation and improve performance by enhancing the brand in the market. As per the SLFRS 13 fair value has been defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Financial Accounting Standard Board (FASB) has been providing some additions in relation to fair value disclosures of public entities in 2018. Under that, firms are required to disclose their financial assets and liabilities using three levels based on the nature and observability of inputs. A study conducted by Zhang et al., (2020) examines the relationship between bank performance and fair value disclosures by analyzing the percentage of disclosure across different levels of fair value. Similarly, employ the fair value hierarchy technique to determine the relationship between fair value disclosure practices and performance (Kasyan et al., 2018).

Voluntary disclosures, which involve information beyond what is legally required, can serve as a means for companies to communicate their commitment to ethical, social, and environmental considerations. On the other hand, mandatory disclosures, often stated by regulatory frameworks, offer a standardized benchmark for financial reporting. The simultaneous interaction between these two types of disclosures holds the potential to influence investors' perceptions, decisions significantly, and ultimately, the financial performance of a company. Sri Lanka, with its evolving financial sector, offers a unique environment for this investigation. The financial background has witnessed substantial transformations in recent years, marked by the emergence of diversified financial institutions. In light of these considerations, this research aims to investigate the relationship between voluntary and mandatory disclosures and the financial performance of diversified financial institutions in Sri Lanka. By examining the relationship between these two aspects of communication and their potential consequences for financial outcomes, this study seeks to contribute valuable insights to the academic literature and the practice of corporate decision-making. This study evidenced on the mechanisms through which disclosure practices meet with financial performance, offering a comprehensive perspective that can inform strategic approaches of diversified financial institutions.

METHODOLOGY

This study primarily focuses on investigating the connections between two types of information disclosures, Corporate Social Responsibility (CSR) disclosures as a form of voluntary disclosure and Fair value disclosures as a mandatory disclosure, and their impact on the performance of diversified financial companies listed in Sri Lanka. CSR disclosures have been assessed by utilizing a developed CSR Index based on data from companies' annual reports. This method aligns with the approach taken in earlier studies related to CSR disclosures, where content analysis was used to measure the level of CSR disclosures (Nabil, 2010; Usman & Amran, 2015). The CSR disclosures were grouped into seven key categories, including employee welfare, customer service, shareholder wealth, social, legal, and environmental reporting. There were also 40 subindices considered relevant to seven categories of CSR disclosure. The level of fair value disclosures was measured using the percentage of total assets disclosed under fair value levels 1,2, and 3. The operationalization of the study is presented in Table 1.

Table 1

Operationalization

Variable	Operationalization	Source
Dependent Variable		
Financial Performance	OPM = Operational Profit / Total Annual Revenue ROA = Annual Net Income / Total Assets ROE = Annual Net Income / Share Holder Equity	(Zhang et al., 2020), (Sayekti, 2015)
Independent Variable		
Voluntary Discloser- (CSR)	Seven CSR disclosure categories - Employee Welfare, Customer Service, Shareholder Wealth, Social, Environmental, and Legal. Further, it was divided into 40 subindices. Coded as a "1" if disclosed, and as a "0" if not disclosed. CSRI = ∑d / n CSRI – Corporate Social Responsibility Index ∑d – Total score of the company n – Maximum score offered	(Ho et al., 2019)
Mandatory Discloser- Fair value (FV)	Percentages of total assets disclosed at levels 1, 2 and 3 of the fair value hierarchy. Lvl 1 FVD (%) = (Lvl1 / (Lvl 1 + Lvl 2 + Lvl 3)) *100% Lvl 2 FVD (%) = (Lvl2 / (Lvl 1 + Lvl 2 + Lvl 3)) *100% Lvl 3 FVD (%) = (Lvl2 / (Lvl 1 + Lvl 2 + Lvl 3)) *100% FVD = Fair value Disclosure	(Kasyan et al., 2018), (Zhang et al., 2020)

The population of this study was diversified from listed financial companies in Sri Lanka.

Currently have 55 listed financial companies on the Colombo stock exchange. The author selected 30 companies based on the highest market capitalization. A sample is a subset of the population chosen to reflect the entire population. The research data are collected from secondary sources, mainly annual reports of the listed financial companies in CSE Sri Lanka. Specifically, financial data spanning a five-year period from 2016 to 2020 was extracted from audited annual financial statements. In this study, the researcher has formulated the following two hypotheses to address the research questions and achieve the research objectives.

H_1: There is a significant impact of Mandatory Disclosure on the Financial performance of Listed financial companies.

***H_2*:** There is a significant impact of Voluntary Disclosers on the Financial performance of Listed Financial Companies.

RESULTS AND DISCUSSION

The statistical measures shown in Table 2 provide preliminary insights into the central tendencies and variability of the examined variables.

Table 2

Descriptive Statistics

	Minimum	Maximum	Mean	SD
CSR	0.979	0.208	0.608	0.233
FVL1	1.000	0.000	0.485	0.439
FVL2	1.000	0.000	0.157	0.331
FVL3	1.000	0.000	0.323	0.413
OPM	10.410	-5.650	0.230	1.356
ROA	0.190	-0.160	0.022	0.047
ROE	0.500	-0.680	0.107	0.202
FS	211.110	0.906	39.52	48.951
FL	3021.944	0.945	39.110	252.817

Note. N=145, Corporate Social Responsibility (CSR), Fair Value Level 1 (FVL1), Fair Value Level 2 (FVL2), Fair Value Level 3 (FVL3), Operating Profit Margin (OPM), Return on Assets (ROA), Return on Equity (ROE), Firm Size (FS), Financial Leverage (FL)

As presented in Table 2 CSR index demonstrates a mean value of 0.608 and a standard deviation of 0.233. The positive nature of this mean value indicates a favourable position of CSR disclosures of finance companies listed on the Colombo Stock Exchange (CSE). Moving to the FVL1, it exhibits a mean value of 0.485 with a standard deviation of 0.439. Similarly, FVL2 shows a mean value of 0.157 and a standard deviation of 0.331, while FVL3 records a mean value of 0.323 and a standard deviation of 0.413. The positive values of FVL1, FVL2, and FVL3 suggest robust disclosure practices by firms, indicative of a higher performance trace and future operational benefits. OPM demonstrates a mean value of 0.23 with a standard deviation of 1.356, while ROA exhibits a mean value of 0.022 and a standard deviation of 0.0407.

Additionally, ROE records a mean value of 0.107 with a standard deviation of 0.202. These values collectively indicate a relatively favourable performance standing for the assessed firms. In terms of financial structure, the logarithm of total assets, which reflects the FS, is characterized by a mean value of 39.52. Leverage, representing the proportion of total debt to total assets, is reflected in a mean value of 39.11, indicating a debt-to-assets ratio of 39.11%.

Table 3

Pearson Correlation Analysis

	CSR	FVL1	FVL2	FVL3	FS	FL
OPM	-0.238*	-0.1903*	-0.052	0.265*	-0.024	0.031
ROA	0.062	-0.208*	-0.035	0.143	0.127	-0.048
ROE	0.303*	-0.088	0.087	-0.002	0.326*	-0.074

Note. Correlation is significant at the 0.05 level (2-tailed). n=145, Operating Profit Margin (OPM), Return on Assets (ROA), Return on Equity (ROE).

According to table 3, shows the correlation coefficients between dependent and independent variables. The table presents a statistically significant and negative correlation between CSR disclosures and FVL1 with OPM. This implies that an increase in both CSR and FVL1 corresponds to a decrease in Companies' OPM, thereby suggesting an inverse association between these factors. Furthermore, a statistically significant negative correlation is observed between FVL1 and OPM, suggesting an inconclusive link between these variables. Similarly, when considering ROA, a statistically insignificant but positive relationship is established between CSR Disclosures, FVL3, and FS. This implies that an increase in CSR Disclosures, FVL3, and firm size could potentially lead to an increase in ROA. Conversely, a negative relationship is observed between FVL1, FVL2, and FL with ROA. In essence, an increase in the mandatory disclosure of Fair Value Levels 1 and 2 corresponds to a decrease in ROA and firm leverage.

Moreover, a statistically insignificant and relatively weak positive correlation is found between FVL2 and ROE. In contrast, a statistically significant and positive correlation is established between CSR Disclosures and the logarithm of total assets FS with ROE. This suggests that an increase in CSR Disclosures and firm size is associated with an increase in ROE. These findings serve to reveal complex relationships between variables, showing potential dynamics and interactions that impact financial performance. To test the formulated hypotheses, a panel regression analysis was used. In this analysis, the fixed effect model was employed, as indicated by the Hausman test given a significance level below 0.05. The observed p-value, being less than 0.05, suggests that the fixed effect approach is more suitable for this analysis.

Table 4

Fixed effect Model -ROE

ROE	Coefficient	Std. Err.	T	P > |t|
CSR	0.0480	0.1511	2.96	0.004
FVL1	0.0969	0.0886	1.09	0.276
FVL2	0.0285	0.0963	0.30	0.767
FVL3	-0.0192	0.0834	-0.23	0.818
FS	-0.0002	0.0009	-0.32	0.752
FL	-1.4400	0.0004	-0.03	0.976
Constant	0.3461	0.1165	2.97	0.004
R- squared 0.1313		F statistics (p-value) 2.91 (0.0313)		

The table shows that CSR disclosures exhibited a statistically significant positive relationship with ROE, implying that higher CSR engagement might be associated with an increase in

ROE. On the other hand, the influence of FVL 1 and FVL 2 disclosures on ROE appeared to be insignificant, as indicated by their respective positive but non-significant relations. Similarly, FVL3 demonstrated an insignificant negative relationship with ROE. The impact of FS and FL on ROE also appeared insignificant.

Table 5

Fixed effect Model -ROA

ROA	Coefficient	Std. Err.	t	P > |t|
CSR index	0.1989	0.0423	4.69	0.000
FVL1	0.0231	0.0248	0.93	0.354
FVL2	0.0229	0.0270	0.85	0.398
FVL3	0.0294	0.0233	1.26	0.211
FS	5.0900	0.0002	0.02	0.984
FL	-5.9600	0.0001	-0.05	0.964
Constant	0.1187	0.0326	3.63	0.000
R- squared 0.0052.	F statistics (p-value) 4.37 (0.0005)			

Presents the results of the panel regression analysis of ROA. The results indicate a statistically significant positive relationship between CSR disclosures and ROA, while the relationships between the other variables (FVL1, FVL2, FVL3, FS, and FL) and ROA appear to be statistically insignificant.

Table 6

Random Effect Model – OPM

OPM	Coefficient	Std. Err.	T	P > |t|
CSR	0.5437	0.6463	2.39	0.017
FVL1	0.1126	0.6429	0.18	0.861
FVL2	0.1510	0.7013	0.22	0.829
FVL3	0.7398	0.6557	1.13	0.259
FS	0.0041	0.0030	1.34	0.179
FL	-0.0002	0.0004	-0.49	0.623
Constant	0.6971	0.7135	0.98	0.329
R- squared 0.1091	F statistics (p-value) 13.47 (0.0361)			

Presents the panel regression analysis of OPM. Particularly, a statistically significant positive relationship was observed between the Corporate Social Responsibility (CSR) index and OPM, suggesting that higher CSR engagement might contribute to improved OPM. However, the analysis revealed insignificant associations between OPM and other variables, including Fair Value Levels (FVL1, FVL2, FVL3), firm size (FS), and firm leverage (FL). As demonstrated in Tables 4, 5, and 6, CSR disclosures exert a significant impact on the ROE, ROA, and OPM. Therefore, hypothesis H1 was empirically proven, and H1 was supported. These findings align with the results reported in the studies of Azim et al., (2017), Ren et al., (2020), and Usman and Amran, (2015)Regarding the impact of FVL1, 2, and 3 on ROA, ROE, and OPM, panel regression analysis results revealed that there is no significant impact. Considering the insignificant impact of FVLs on Finance performance, hypothesis H2 was not supported.

CONCLUSION AND IMPLICATIONS

This study investigates the impact of voluntary and mandatory disclosures on the financial performance of financial companies in Sri Lanka. The analysis of the study's results revealed that voluntary disclosures have a significant impact on financial performance. This aligns with previous research suggesting that voluntary disclosures, particularly those related to corporate social responsibility (CSR), can serve as effective communication tools to engage stakeholders. This finding underscores the notion that proactive, transparent communication on CSR initiatives can act as a potent tool for engaging stakeholders and driving financial success. On the other hand, the study found that mandatory disclosures have no significant impact on financial performance. This implies the importance of mandatory disclosures lies in compliance with legal and regulatory requirements. Companies are obligated to provide mandatory information to ensure transparency, accountability, and adherence to legal standards. The contribution of this study to the existing literature lies in its ability to distinguish the relationship between voluntary and mandatory disclosures and financial performance, specifically within the unique setting of Sri Lanka's diversified financial sector. Based on the study's findings, several recommendations emerge for practitioners and policymakers aiming to enhance the impact of both voluntary and mandatory disclosures on financial performance. An increase in the quality and extent of voluntary disclosures can potentially lead to improvements in financial performance. Furthermore, policymakers and regulatory bodies may benefit from revisiting the framework of mandatory disclosures, considering the limited impact found in this study. This study serves as a foundation that guide future researchers in extending their investigations to include a broader sample of companies.

Keywords: Corporate social responsibility, fair value disclosure, financial performance, mandatory disclosers, voluntary disclosers

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