CHAPTER 3
RATIONALE OF THE STUDY

There are three important essentials of corporate disclosure: content (what), timing (when) and presentation (how), the efficacy of which, is based upon readability and understandability of the sentence or paragraph or document.

All corporate prepare annual reports for a varied group of users (such as shareholders, regulatory bodies, employees, and other interested parties) with the purpose to correspond their financial and non financial information. There is a subject to explore whether the degree to which financial and non financial information conveyed with these reports is understood as per the exact meaning intended by their senders.

The probable reason that can be sought behind the efforts made by regulatory bodies to improve annual report readability can be that (a) organizations might use blurred language and format in disclosure to hide from observation of investors all undesirable information, and (2) the average investors may not comprehend intricate documents and this could result in capital market inefficiency. In an informational efficient world having perfect capital markets, strategic disclosures by management intended to confuse investors regarding the firm’s true financial performance would be unidentifiable, easily dismissed, and thus irrelevant to security prices.

Regardless of such hard work by the corporate and the regulatory authorities, there is yet a large amount of uninformativeness, unimaginativeness reporting of corporate communication has been seen. Firms may persuade the substance and appearance of information in various ways, fundamentally using what is called as ‘impression management’. By using this practice, organizations can influence verbal information by the reading ease manipulation (e.g., to make the text difficult to read) or by the rhetorical manipulation method/practice (e.g., using persuasive language). The reading ease manipulation method is basically used with the purpose to conceal bad news, and also to make corporate disclosures attract much attention.
If disclosure readability is strategically used by managers to hide adverse information, a relationship between firm performance and readability would be expected. This management opportunism story argues that managers have incentives to obfuscate information when the current performance is bad. Hence there is an emergent need to find out a relationship of readability scores of disclosures with certain variables that depicts a picture of firm’s performance. The variables considered are Firm’s Current Performance (ROA), Leverage (Debt/Equity), Liquidity (CA/CL), Firm Size (Total Assets) & Profitability. The five variables put light on Firm position in respect to its earning, earnings consistency, its risk, & its potential to pay its short term obligation.

These factors may lead to give an implication on readability scores of disclosures in some or the other way. This study is an attempt to provide evidence on the readability of corporate communications, which is being done through testing some of the hypothesis based on readability scores of annual reports of Indian banks and the variables considered. The results would be helpful to different sections of society:

1. Investor as they need to know the actual position of company,
2. Government as they have to be aware of the true facts of the firms as they are the building blocks of economy,
3. General public

Readability Scores are one of the innovative areas of research which is still untouched. A vital reason behind studying the relationship is that there is a need to create an awareness regarding the concept of readability. It must be very difficult for general public to understand that this concept can be so effectively utilized by the companies. This can help companies in a positive way but it can be sometimes results as negative returns for investors. Hence it becomes mandatory for one to have a viewpoint regarding the readability scores of disclosures as there can be a possibility of some hidden facts.

Thus, analyzing relationship of readability scores of disclosures and performance of bank with estimating the level of implication of performance on disclosure score will give clarity on the fact that even if the report talks good there can be some hidden facts. A detail scrutiny is implied
as investors need to see both the sides of report. Annual reports been the crucial part of communication requires an investigation by the calculation of its readability scores.

This calculation will also build a base for comparison between the banks. Comparisons are been carried out on the basis of five variables considered. Results will help to know that whether a firm with higher profitability always gives good scores. Hence the variables noted above will depict a comparison between banks and will compute whether readability scores move in line with all the five variables.