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Income Diversification Strategy and Market Performance: The Moderating Role of Voluntary Disclosure in Iran's Banking Industry[1]

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Research Paper

INTRODUCTION

Banks with favorable market performance can attract more investment from shareholders, thereby improving their retained earnings. Effective bank performance enhances the efficacy of stabilization policies, leading to greater resilience against economic disruptions. Internal bank factors, alongside external macroeconomic factors, significantly impact bank performance. Internal factors, primarily governance features, are influenced by management and board decisions. In contrast, external factors, beyond the company's control, affect bank profitability. Managers continuously seek methods to enhance their economic performance, with income portfolio diversification emerging as a critical strategy. Lee et al. (2021) argue that income portfolio creation influences bank market performance, emphasizing the modern banking finance principle of income diversification. Banks can achieve income diversification by forming a basket of incomes, including both shared and non-shared bank revenues,

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thereby eliminating certain investment risks and reducing unsystematic risks.

A major factor influencing bank market performance is the extensive and voluntary disclosure of all operational and financial information. Voluntary disclosure, beyond the requirements of standards and legal obligations, involves providing financial and non-financial information and managerial strategies aimed at creating competitive advantages and attracting investors. This type of disclosure improves transparency and quality of information, offering stakeholders better insights into corporate governance. Enhanced investor trust, facilitated by voluntary disclosure, can improve market performance by reducing information asymmetry, increasing stock demand, and enhancing liquidity.

Income diversification's impact on bank performance can be examined from two perspectives: firstly, the need for banks to adapt to a competitive environment, and secondly, the principle of diversification reducing bank risk. Banks can alter their income streams by changing their geographic focus and the types of loans offered. Moreover, they can expand non-interest income sources, such as banking, commercial, and custodial services. Diversification can enhance financial stability and market performance, as confirmed by various studies (Adam, 2023; Elsas et al., 2024). This research aims to investigate the relationship between income diversification strategy and market performance in banks, emphasizing the role of voluntary disclosure. Specifically, it addresses two questions: How does the capital market respond to bank income portfolio formation? And how does voluntary disclosure affect this relationship?

Research findings on the relationship between income diversification and bank performance stability vary. Studies by Stokhor (2015) and Tin (2023) show that banks with a higher share of non-interest income are more stable and profitable, especially during crises like the COVID-19 pandemic. Conversely, Satyro (2004) suggests that increased non-interest income may elevate bank risks, reducing financial performance. Banks may face challenges entering unfamiliar domains, such as U.S. banks relying on non-interest sources like leasing.

According to the agency problem, conflicts of interest between shareholders and managers are likely. Therefore, creating an effective management system and evaluating managerial effectiveness is crucial to minimize these conflicts. Voluntary disclosure can reduce costs arising from such conflicts, as indicated by Abu Afifa and Saadeh (2023). It lowers capital costs by influencing investor decisions and increasing company value (Mohammed, 2023; Du et al., 2024). The signaling theory posits that profitable and liquid companies are more inclined to disclose information to attract investors and build trust. Civil society and institutions demand more disclosure from banks, aligning with legitimacy theory, which stresses managerial accountability to societal goals. In addition, Stakeholder theory suggests that voluntary disclosure positively impacts financial performance by boosting employee motivation through non-financial reports. This leads to profitability and improved market performance. Banks with diverse income sources and low-risk profiles attract support from regulatory bodies and stakeholders.

Our research employs a descriptive-correlational method, utilizing archival studies to gather data on research variables. The deductive reasoning approach is used to analyze quantitative data collected from 20 listed banks in the Tehran stock exchange over nine years (2016-2022). The sample selection is based on systematic elimination criteria. We use multivariate regression models to test hypotheses, focusing on market performance (Q-Tobin) as the dependent variable and income diversification strategy (HHINOI) as the independent variable, with voluntary disclosure level (VDL) as the moderating variable.

Regression models confirm the positive relation between income diversification and market performance. Furthermore, voluntary disclosure moderates the mentioned relation. Voluntary disclosure fosters trust among stakeholders and reduces information asymmetry. Concurrently, income portfolio formation lowers financial risk, increasing shareholder confidence and market value. Effective bank performance attracts more investment, enhancing retained earnings and economic stability. Based on the research findings, it is recommended that bank managers voluntarily disclose information to reduce the information asymmetry between managers and stakeholders. This action will foster trust among investors and creditors, who are the capital providers. It is also recommended that the Securities and Exchange Organization, as the market regulatory body, include incentives and optional disclosure items in its regulations to enhance the stock exchange as a transparent trading platform. Additionally,

investors are advised to consider income diversification in banks as an indicator for evaluating the proper performance of banks in their analyses. Future research should explore the impact of electronic banking, commercial risk management, and corporate sustainability on bank market performance.

Keywords: Income Diversification Strategy, Market Performance, Voluntary Disclosure, Banking Industry.

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