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## Sentiment, Readability, and Disclosure Quality in Corporate Financial Reporting: A Textual and Behavioral Perspective on Market Information Efficiency

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### ABSTRACT

Corporate financial reporting has evolved from a predominantly numerical disclosure system into a complex narrative-driven communication mechanism where textual content plays a decisive role in shaping investor perception, market reactions, and information efficiency. This study develops an extensive theoretical and empirical synthesis of how sentiment, readability, and disclosure quality embedded within corporate financial reports influence capital market outcomes. Drawing strictly from established literature on textual analysis, sentiment mining, disclosure adequacy, regulatory filings, and behavioral finance, the article examines the informational role of narrative disclosures such as annual reports, SEC filings, earnings communications, and voluntary textual supplements. By integrating classical disclosure theory with modern text analytics and deep learning-based sentiment extraction, this research bridges early foundational disclosure studies with contemporary computational approaches. The article elaborates on how linguistic tone, complexity, and structure affect stock return synchronicity, analyst behavior, investor attention, and fraud detection. It also critically evaluates the implications of digital reporting formats such as XBRL and multimodal disclosures that combine textual and vocal sentiment. Through an in-depth descriptive methodology, the findings reveal that textual characteristics are not merely stylistic artifacts but function as economically meaningful signals that shape capital allocation decisions, corporate transparency, and governance outcomes. The discussion highlights theoretical tensions between information overload and informativeness, managerial discretion versus market discipline, and technological sophistication versus interpretive bias. Limitations related to context dependency, linguistic ambiguity, and regulatory heterogeneity are explored in detail, alongside future research directions focusing on cross-country disclosure regimes and ethical considerations in automated text interpretation. This study contributes to accounting, finance, and information systems literature by offering a unified, deeply elaborated framework for understanding narrative financial disclosure as a central pillar of modern market information architecture.

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### INTRODUCTION

In The architecture of corporate financial reporting has undergone a profound transformation over the past several decades. Traditionally dominated by quantitative financial statements, reporting practices now increasingly emphasize narrative disclosures that contextualize numerical performance and articulate managerial intent, expectations, and risk assessments. Annual reports, management discussion and analysis sections, earnings announcements, and regulatory filings have become linguistically rich documents that communicate far more than balance sheet positions or income flows. This evolution reflects growing recognition that investors, analysts, and regulators rely not only on numerical accuracy but also on interpretive clarity and qualitative signals embedded within textual disclosures to make informed economic decisions (Singhvi, 1968; Singhvi and Desai, 1971).

Early disclosure research emphasized the adequacy and completeness of financial information as determinants of market efficiency and investor confidence. Singhvi (1968) and Singhvi and Desai (1971) demonstrated that insufficient disclosure increases information asymmetry, elevates perceived risk, and adversely affects firm valuation. These foundational studies laid the groundwork for understanding disclosure quality as a central mechanism through which firms communicate with external stakeholders. Over time, this perspective expanded to incorporate behavioral and informational dimensions, recognizing that disclosure effectiveness depends not only on what is disclosed but also on how it is communicated.

The rise of textual analysis in accounting and finance research marks a significant shift in the study of corporate disclosures. Advances in natural language processing and machine learning have enabled scholars to systematically analyze large corpora of financial texts, uncovering patterns in sentiment, tone, readability, and thematic emphasis. Ball, Hoberg, and Maksimovic (2012) pioneered text-based approaches to redefining financial constraints, illustrating how narrative disclosures reveal managerial perceptions of capital access beyond traditional financial ratios. Subsequent studies demonstrated that linguistic features in corporate reports contain incremental information relevant to market participants (Azimi and Agrawal, 2018; Bai, Dong, and Hu, 2019).

Despite this growing body of research, significant gaps remain in the theoretical integration of classical disclosure theory with modern text analytics. Much of the literature focuses on isolated textual features, such as sentiment polarity or readability scores, without fully articulating how these elements interact within broader disclosure ecosystems. Furthermore, while computational methods have become increasingly sophisticated, their implications for disclosure regulation, managerial behavior, and investor cognition remain underexplored. This article addresses these gaps by offering a comprehensive, theory-driven examination of sentiment, readability, and disclosure quality as interconnected dimensions of corporate financial reporting.

The central problem motivating this research lies in understanding whether narrative disclosures genuinely enhance market transparency or whether they introduce new forms of complexity and bias. On one hand, textual disclosures can reduce information asymmetry by providing context, explanations, and forward-looking insights. On the other hand, managerial discretion over language choice may enable obfuscation, selective emphasis, or impression management. The tension between informativeness and manipulation underscores the need for a nuanced analysis that considers both the content and consequences of textual reporting.

By synthesizing insights from accounting, finance, and information systems literature, this study develops a holistic framework for analyzing narrative financial disclosures. It situates modern sentiment analysis and deep learning approaches within the broader historical evolution of disclosure research, emphasizing continuity rather than rupture between early theoretical foundations and contemporary methodologies. In doing so, the article contributes to a deeper understanding of how language shapes financial markets and informs regulatory and managerial practice.

## METHODOLOGY

This study adopts a descriptive and integrative methodological approach grounded in rigorous textual and theoretical analysis. Rather than introducing new empirical datasets or computational experiments, the methodology focuses on synthesizing and critically examining established research findings to construct a comprehensive interpretive framework. This approach is particularly suitable given the study's objective of achieving conceptual depth and theoretical elaboration across multiple dimensions of financial disclosure research.

The primary methodological foundation rests on textual analysis as conceptualized in prior literature. Textual analysis in accounting and finance involves the systematic examination of narrative disclosures to extract meaningful information related to sentiment, tone, complexity, and thematic content (Chen et al., 2011; Chen, 2013). Studies such as Azimi and Agrawal (2018) demonstrate how deep learning models can identify sentiment signals in corporate annual reports that are predictive of future performance. While this

article does not replicate such models, it draws extensively on their conceptual logic to explain how sentiment functions as an informational proxy for managerial outlook and firm prospects.

Readability analysis constitutes another core methodological pillar. Readability refers to the ease with which readers can comprehend textual content and is often operationalized through linguistic complexity, sentence length, and vocabulary sophistication. Bai, Dong, and Hu (2019) show that lower readability in financial reports is associated with higher stock return synchronicity, suggesting that complex language reduces firm-specific information assimilation. This study elaborates on the theoretical mechanisms underlying this relationship, emphasizing cognitive processing constraints and information diffusion dynamics.

Disclosure quality is examined through both classical and modern lenses. Classical disclosure studies focus on completeness, timeliness, and accuracy, while modern approaches incorporate narrative richness and technological format. Bartley, Chen, and Taylor (2011) analyze differences between XBRL filings and traditional 10-K reports, highlighting how structured digital formats influence accessibility and comparability. The methodology here involves integrating such findings into a broader narrative about how reporting formats interact with textual content to shape user interpretation.

The study also incorporates insights from fraud detection literature, particularly the use of textual cues to identify anomalous or deceptive reporting behavior. Bao et al. (2015) demonstrate that linguistic patterns can serve as early indicators of accounting fraud, offering a novel perspective on disclosure as both a communicative and diagnostic tool. This article elaborates on the ethical and governance implications of such methodologies, situating them within broader debates on surveillance and accountability.

Overall, the methodological approach emphasizes theoretical triangulation, drawing connections across diverse strands of literature to develop a cohesive explanatory model. By relying strictly on established references and avoiding speculative extrapolation, the study ensures conceptual rigor and scholarly integrity while achieving substantial depth through detailed elaboration.

## RESULTS

The synthesized findings from the reviewed literature reveal several consistent patterns regarding the role of textual characteristics in corporate financial reporting. One of the most salient results is that sentiment embedded within narrative disclosures carries significant informational value beyond traditional financial metrics. Azimi and Agrawal (2018) demonstrate that sentiment extracted through deep learning techniques predicts future earnings and stock returns, suggesting that narrative tone reflects managerial expectations and internal assessments not fully captured by numerical data.

Another key result concerns the impact of readability on market information processing. Bai, Dong, and Hu (2019) find that firms with less readable financial reports exhibit higher stock return synchronicity, indicating that investors rely more on market-wide information when firm-specific disclosures are difficult to interpret. This finding underscores the importance of linguistic clarity as a determinant of information efficiency and suggests that complexity may function as an implicit barrier to informed trading.

The literature also indicates that textual disclosures influence investor attention and analyst behavior. Ben-Rephael et al. (2017) show that market participants selectively attend to certain regulatory filings, such as Form 8-K, depending on their perceived relevance and content. Christensen, Heninger, and Stice (2013) further demonstrate that price reactions and analyst forecast revisions are closely linked to the informational content of SEC filings, highlighting the dynamic interplay between disclosure timing, content, and market response.

In the context of financial constraints and capital allocation, Ball, Hoberg, and Maksimovic (2012) reveal that textual analysis can redefine traditional measures of constraint by capturing qualitative dimensions of managerial communication. This result suggests that narrative disclosures provide insights into internal organizational processes and investment priorities, complementing quantitative indicators.

Fraud detection studies add another dimension to the results. Bao et al. (2015) find that fraudulent firms exhibit distinct linguistic patterns, including abnormal sentiment and evasive language. These findings imply that narrative disclosures not only inform markets but also leave linguistic traces that can be analyzed for governance and enforcement purposes.

Collectively, these results converge on the conclusion that textual characteristics are economically meaningful and systematically related to market outcomes. They challenge the notion that narrative disclosures are merely supplementary, positioning them instead as central components of financial information systems.

### DISCUSSION

The findings synthesized in this study invite a deeper discussion of the theoretical and practical implications of narrative financial disclosure. At a theoretical level, the results reinforce the view that disclosure quality extends beyond quantitative completeness to encompass linguistic and interpretive dimensions. This perspective aligns with behavioral finance theories that emphasize bounded rationality and cognitive limitations, suggesting that how information is presented can be as important as what is presented.

One critical issue concerns managerial discretion in language use. While narrative disclosures can enhance transparency, they also provide opportunities for impression management and strategic obfuscation. The association between low readability and higher stock return synchronicity (Bai et al., 2019) raises concerns that complex language may be intentionally or unintentionally used to mask firm-specific information. This tension highlights the need for regulatory frameworks that balance flexibility with clarity.

The integration of advanced text analytics, including deep learning and multimodal sentiment analysis, introduces both opportunities and challenges. Taylor and Kale (2025) demonstrate that combining textual and vocal sentiment from earnings calls and filings enhances predictive accuracy. However, reliance on automated models raises questions about interpretive bias, algorithmic transparency, and ethical responsibility. These concerns are particularly salient in cross-cultural contexts where linguistic norms and disclosure expectations vary.

Another important discussion point relates to investor attention and information overload. As disclosures become more voluminous and complex, investors may struggle to process all available information, leading to selective attention and heuristic-driven decision-making. Ben-Rephael et al. (2017) show that attention allocation is uneven, suggesting that disclosure effectiveness depends not only on content quality but also on salience and accessibility.

The limitations of the existing literature also warrant careful consideration. Many studies focus on specific markets or regulatory environments, limiting generalizability. Additionally, textual analysis methods may struggle with contextual nuances, sarcasm, or culturally embedded expressions. Future research should address these limitations by incorporating cross-country comparisons and interdisciplinary perspectives.

### CONCLUSION

This article provides a comprehensive, theory-driven examination of sentiment, readability, and disclosure quality in corporate financial reporting. By synthesizing classical disclosure theory with modern textual analysis research, it demonstrates that narrative disclosures play a central role in shaping market information efficiency, investor behavior, and corporate governance outcomes. The findings underscore that language is not a neutral vehicle for conveying financial information but an active determinant of how markets interpret and respond to corporate performance.

The study contributes to the literature by offering an integrated framework that situates modern computational approaches within a broader historical and theoretical context. It highlights the dual potential of narrative disclosures to enhance transparency and introduce complexity, emphasizing the need for careful regulatory and managerial consideration. As financial reporting continues to evolve in an

increasingly digital and data-rich environment, understanding the informational role of language will remain essential for academics, practitioners, and policymakers alike.

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