Value Based Performance Reporting: A Study of the Information used by Australasian Analysts in their Assessment of Long-Term Firm Performance (Value).

A thesis presented in partial fulfillment of the requirements for the degree of Master of Business Studies in Accounting

Massey University

Clay Colin Macfarquhar

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# ABSTRACT:

Public company shareholders and potential investors rely on statutory and voluntary disclosures to enable an informed assessment of company performance and value. It is widely acknowledged that traditional historic accrual accounting measures do not offer a complete picture of firm performance, and that there is demand for an expanded set of performance indicators to service the needs of concerned stakeholders. The reliance on voluntary disclosure of company specific non-financial information is of particular concern to this thesis as the examination of existing literature displays evidence that such areas of performance are under-reported externally.

With reference to a range of performance indicators that New Zealand and Australian Chartered Financial Analysts identify as relevant in their assessment of performance and value, this study identifies areas of performance that are under-reported by management and where information asymmetry is proposed to exist. The issue of under-reporting is assessed through gap analysis comparing the surveyed analysts ratings for the 'predictive value' (PV) measure of each performance item/indicator to the respective ratings for 'ease of acquisition' (EA).

The study finds that analysts rely on a broad range of financial and non-financial information in their assessment of firm performance. More specifically the reporting of traditional financial information remains relevant and the extent of its provision is adequate, however the study finds that in many cases information not forming part of traditionally reported financial information has 'predictive value' relevance but is relatively more difficult to acquire. The thesis research findings therefore indicate that information reporting reliant on voluntary disclosure is at greater risk of being under-reported (externally). Such under-reporting has been found to be associated with non-financial information that relies on management identifying relevant company specific measures and subsequent voluntary disclosure. In an attempt to emphasise the importance of restoring the information balance between management and interested external parties (for performance assessment and valuation purposes), the thesis will include an exploration and discuss of literature on the benefits associated with full disclosure, along with potential means of identifying relevant measures for external reporting.

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# Table of Contents

## List of Tables

## List of Charts

# CHAPTER ONE: INTRODUCTION

## 1.0    Introduction

The research reported in this thesis is concerned with the information needs of the market (for valuation and investment purposes), along with whether company statutory and voluntary disclosures are meeting these requirements. Through the examination of existing literature evidence is found that questions the ability of the current regulatory reporting framework's ability to meet the needs of the market (Dempsey et al, 1997; AAA, 2002). The potential existence of information asymmetry, along with the consequences and potential solutions provide motivation for the thesis research to further explore this aspect of external performance reporting.

Through a survey of New Zealand and Australian CFA analysts (as representatives of the market), the thesis will assess the market's information requirements and ease with which this information is acquired (Dempsey et al, 1997), where the relative comparison of these surveyed measures will allow for the identification and discussion of information gaps. To emphasise the importance of addressing these information gaps, the benefits of meeting the market's information requirements (for performance assessment and valuation purposes) are explored through existing literature, as are potential means of identifying relevant measures that should form part of external reporting.

The following sections of the chapter will:

- Establish the background for the thesis research, including an introduction to recent issues in external performance reporting.
- Explain the importance and contribution the thesis research seeks to achieve, including an overview of the research aims and method.
- Set out the structure of the thesis, including a brief summary of the thesis chapters.

## 1.1    Background

The key objective of every company's management team should be to maximise shareholder wealth (Shapiro, 1990). In an effort to do this management need to not only make key decisions that determine the success of the business now and in the future, but also ensure that the market is sufficiently informed to enable a comprehensive assessment of the business's value (Bartov & Bodnar, 1996).

Despite reporting requirements being set out in legislation and through listing regulations, recent research has found that a majority of management are of the opinion that their shares are undervalued by the market (Graham & Campbell, 2002). This raises the issue of a potential information gap between what management know and what has been communicated to the market. This information gap has most likely arisen due to external reporting frameworks not reflecting the significant developments that have transformed internal reporting's focus from traditional financial information to a broad set of financial and non-financial firm specific measures (Kaplan, 1998; AAA, 2002).

To date, a broad focus of firm specific measures has not been reflected in the external reporting requirements, where reporting authorities have not been able to develop a framework that ensures full disclosure of performance to the market (AAA, 2002). Although academic studies highlight the link between non-financial performance and value, legislative reporting requirements are unable to set out non-financial reporting requirements due to the firm specific nature of this information (AAA, 2002). The disclosure of non-financial information therefore relies on each company voluntarily identifying and reporting relevant non-financial performance (AAA, 2002).

Despite incentives such as increased valuations, reduced share price volatility, lower cost of capital, and greater management credibility, there is evidence of information asymmetry between management and external parties, which infers that the existing reliance on voluntary disclosure of broader performance measures seem to be failing (Dempsey et al, 1997; AAA, 2002; PWC, 2003).

## 1.2 Importance and Contribution of the Thesis

Briefly, the findings of this research potentially serve as an insight into the Australasian market's information requirements, along with identifying areas where under-reporting potentially exists. This is achieved through the survey of Australasian Chartered Financial Analysts (CFA), as representatives of the market, for their opinion of the perceived predictive value and ease of acquisition for 80 different items of information (Dempsey et al, 1997).

Where information gaps exist, the thesis seeks to emphasise the consequences of not meeting the information requirements of the market by exploring existing literature for evidence of both the existence and consequences of information asymmetry. Finally, the thesis will discuss the ability of existing management tools and concepts, such as the Balanced Scorecard's cause and effect relationship's ability to be applied to the identification of measures that should be reported externally to the market. This unique application of predominantly internally focussed concepts, aims to identify value relevant measures, in an attempt to ensure the market recognises the full value of the company's shares.

As non-financial reporting relies significantly on voluntary disclosure, it is important that the thesis contribution goes beyond raising an awareness of areas where under-reporting exists, to include an assessment of existing literature that outlines the cost of under-reporting / benefits of full disclosure, along with potential tools for identifying relevant information to report to the market.

Therefore the research aims and objectives of this thesis are to examine:

Through an examination of existing literature:

- What are the consequences of under-reporting / benefits of full disclosure of information relevant to the markets assessment of performance and value?
- What methods may be employed to identify relevant information to report to the market (for its assessment of performance and value)?

<u>Through survey research:</u>

- What measures are relevant in assessing value?
- What information is difficult to acquire?
- Are there any information gaps? Otherwise stated, is it hard to acquire information that is relevant to the assessment of value?
- As non-financial information is not directly covered by the regulatory reporting framework, is non-financial information under-reported to the market.

<u>More specifically, the thesis research will seek to answer the following research questions through a survey of analysts:</u>

- What is the perceived predictive value of performance measures?
- What is the perceived ease with which information on each of the measures can be acquired?
- Does an information gap exist?
- Is non-financial information under-reported (externally)?

## 1.3    Thesis Structure

The thesis comprises four more chapters, where:

Chapter two maps out existing literature relevant to and underpins the thesis research. This includes a broad examination of literature to understand, what information asymmetry is, why it exists, consequences of information asymmetry, along with potential methods of ensuring the market is fully informed. Chapter two aims to go further than examining topics traditionally associated with information asymmetry, to explore changes in the competition environment, along with management accounting developments, in an attempt to put the issue of information asymmetry and potential solutions in perspective with the current business environment.

Chapter three explains and justifies matters of methodology, design, and analysis techniques. This includes justification for the use of a web-based survey, the population surveyed, and specific methods of analysis.

Chapter four presents the findings and discussion of the analyst survey results. This chapter will identify what the surveyed analysts find relevant in their assessment of value, the ease with which this information can be acquired, and ultimately any potential information gaps.

Chapter five concludes the thesis by summarising the key findings, implications of findings and future areas of research.

## 1.4    Chapter Summary

The introduction chapter has set out the background, intended contribution and structure of the thesis. The literature review that follows, will further explore developments in both management and external reporting, along with evidencing the existence of information asymmetry and its consequences. The importance of the thesis research is emphasised as the literature review progresses from examining evidence of information asymmetry, to the causes and ultimately the cost of information asymmetry. Finally, the literature review will look to existing literature as a means of assessing potential methods of identifying firm specific reporting that will ensure interested external parties are fully informed of information that benefits their assessment of performance and value.