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THE PERCEPTIONS OF THE INSTITUTIONAL INVESTOR REGARDING THE QUALITY OF THE ANNUAL REPORT

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A Research Report submitted to the Faculty of Commerce, University of the Witwatersrand, Johannesburg, in partial fulfilment of the requirements for the Degree of Master of Commerce.

Johannesburg 1993

ABSTRACT

This is an exploratory report. It addresses the impact that the quality of the annual report has on the institutional investor's perception of the image of a company and how such quality influences their investment decisions.

The research methodology is based upon interviews in which a structured questionnaire was used as a data gathering mechanism. The portfolio managers who responded to the questionnaire are responsible for the combined management of financial funds amounting to R128billion.

The main conclusion reached in this report is that while the annual report plays a meaningful role in the investment decisions of portfolio managers, it competes with other sources of information which are used to make investment decisions.

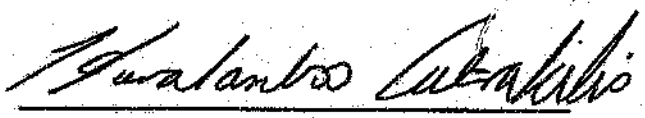
While the preparers of the annual reports have an understanding of the informational needs of institutional investors, it is suggested that greater emphasis should be placed by the preparers on the presentation of future orientated financial information.

DECLARARTION

I hereby declare that this research report, entitled

THE PERCEPTIONS OF THE INSTITUTIONAL INVESTOR REGARDING THE QUALITY OF THE ANNUAL REPORT

is my own work except to the extent indicated in the acknowledgements and references and by comments included in the body of the research report. It is being submitted in partial fulfilment of the Degree of Master of Commerce at the University of the Witwatersrand, Johannesburg. I further declare that this research report has not been submitted to any other University for degree purposes.



HARALAMBOS CATRAKILIS

SIGNED AT JOHANNESBURG ON THIS 30th DAY OF APRIL 1993

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PREFACE

I would like to thank Mr Robert Garnett of FinansBank for his invaluable input and motivation in assisting me to formulate the concept and for making time to indulge in lengthy theoretical discussions.

The author's interest in the impact of Financial Statements on investment decisions arose during his employment with Arthur Andersen and Co, a major international auditing firm. This interest was further aroused when the author entered the South African Merchant Banking environment and was exposed to large institutional capital raising activities. At that time a preliminary review indicated that little research had been carried out locally on the investor's perception of the information contained in the Annual Report.

The scope of this report is limited to an exploratory investigation of the perception of major institutional users and financial executives of certain large South African companies regarding the Annual Report and to the procurement of their views relating to selected components within the report.

Finally, I would like to express my sincere appreciation to my supervisor, Professor Margo Steele of the Department of Accounting, for her patience, support, encouragement and guidance in the completion of this report.

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1. INTRODUCTION AND STATEMENT OF THE PROBLEM

1.1. Introduction

The annual financial statements ("annual report") of a company are the most widely used single source of information about the company. The literature in the area of finance and the marketplace commentary implies, however, that annual reports are not particularly valuable in the investment decision-making process (Hines, 1982, Page 296). Accounting theory postulates that of the many objectives which companies seek to achieve by means of the annual report, the most important is that of stewardship accountability which provides shareholders with an understanding of results and operations of the company. In South Africa, accounting awards have been offered in the belief that an investor's perception of the performance and risk of a company can be influenced by a company's attitude towards its financial reporting (Financial Mail, 11 January 1991, Page 32). One of the possible effects of the awards is that man hours and company resources may be invested in producing expensive and extensive annual reports in order to win these awards.

1.2. Statement of the problem

It is proposed that presently there is a discrepancy between the preparer's objective in preparing the annual report and the user's perception of its role in the evaluation of the performance and prospects of the company.

Management ("Preparer") is investing corporate man hours and spending corporate funds to produce a glossy and extensive report in the belief that this favourably influences the investor's evaluation of the performance and risk of the company. Contrary to this perception, literature on the Efficient Market Hypothesis investment decision theory implies that the annual report is not valuable to the investor in his investment decision making process (Hines, 1982, Page 296).

1.3 Definitions

Annual reports or financial statements	The annual financial statements of companies listed in the industrial sector of the JSE.
Preparers	The financial executives of listed companies who are involved in the preparation of the annual report of their respective groups. For a list of the companies selected, see Appendix I.

Quality	Quality has been divided into two components, one being the presentational aspect ie: glossy paper, pictures etc and two, the content of the report ie: information over and above the statutory requirements.
Users or Institutional Investors	The portfolio managers of major South African institutions, including established stock brokers, who are responsible for managing equity portfolios and use fundamental analysis in the decision making. For a list of the institutions who participated in the survey see Appendix I.

2. RESEARCH AREA

This report focuses on the impact which the annual report has on the institutional investors' ("Users") perception of the company and on the investment decision making process. It identifies the differences in the perception of the usefulness of Annual Reports to users and to preparers.

2.1 Research Methodology

The research methodology is based upon interviews in which a structured questionnaire was used as a data gathering mechanism. The financial executives ("Preparers") of selected organizations, the portfolio managers ("Users") of institutions and of stock-broking firms on the Johannesburg Stock Exchange ("JSE") were interviewed regarding their perceptions of the impact of annual reports in general, and of specific selected information within the report in particular, on the investment decision making process.

2.2. Scope of the study

The report aims to identify the needs and perceptions of institutional investors only. Interviews are limited to eighteen respondents, viz. the financial executives ("Preparers") of nine selected companies, portfolio managers ("Users") from seven institutions and analysts ("Users") from two JSE stock-broking firms. The disadvantage of a sample size of eighteen is that the results may be biased, either through sample selection bias or response bias.

The justification and acceptance of a small sample size is threefold:-

2.2.1 Interviews

The interview questions focus only on annual reports of companies listed in the industrial sector of the JSE. The annual reports of mining concerns and financial institutions are excluded.

The rationale for these exclusions is that a unique evaluation process is followed in assessing mining investments and a unique set of disclosure requirements is followed by financial institutions. The commonality of disclosure requirements and the evaluation process for companies in the industrial sector tends towards homogeneity.

The decision to use interviews rather than postal questionnaires limits the number of respondents. The major rationale for selecting an interview over the questionnaire is that it is a more efficient data gathering process. The reasons for selecting the interview are explained in section 5.2.

The design of the questionnaire requires respondents to answer mainly five-point Likert type questions, to rank information and to select true/false answers. This results

in non-parametric data, which effectively excludes any statistical comparisons, analysis and conclusions.

2.2.2. Users

One aim of the report is to identify the perceptions of the institutional investors ("Users") regarding the impact of the annual report on their perceptions of the company.

The institutional investor population in South Africa is not large (major players amount to no more than fifty) and the sample was selected by approaching ten major institutions based on recommendations from several merchant bankers.

2.2.3. Preparers

The population for selections of the financial executives was the Top 20 companies section, the most improved companies section and the Bottom 20 companies section in The Financial Mail Accounting Awards (Financial Mail January 1991, Page 32).

The rationale for limiting the selection to these companies is that it would identify the views of financial executives of companies covering a wide spectrum of financial reporting philosophies.

2.3. **Purpose of the research**

The purpose of the research is four-fold:

2.3.1. To identify the sources of information available to users and the importance of these sources in making investment decisions.

2.3.2. To identify the perceptions of users and preparers about the usefulness of the annual report.

2.3.3. To highlight the differences in the importance users and preparers place on information contained within the annual report.

2.3.4. To ascertain whether the quality of the annual report has any impact on the user's perception of a company and his investment decision.

2.4. **Importance of the research**

This report identifies the areas of information that users expect to find in annual reports. It identifies for preparers the information in the annual report that is of use to the user and enables preparers to present information about the activities of the company which is of use to the investors. The premise of preparers that annual reports improve the perception or image of the risk profile of a company is tested.

3. BACKGROUND

3.1. Introduction

There are two fundamental domains of knowledge which are integral to the purpose of this report. These are the Efficient Market Hypothesis and Stakeholder reporting.

Both have an impact on the usefulness of the annual report. The principles relating to these are therefore briefly documented.

3.2. Efficient Market Hypothesis (EMH)

An efficient market exists where relevant information is easily available to investors and where share prices fully and quickly reflect this information (O'Donovan 1990, Page 2).

Research indicates that there are three levels of market efficiency (Roberts 1967, Page 2):

Weak form

A weak form of market efficiency is one in which current prices accurately and immediately reflect information related to past prices. In this form the historic sequence of past prices imparts no information about future possible changes.

Semi-strong

A semi-strong form of market efficiency is one in which current prices accurately and immediately reflect all publically available information.

This makes it consistently impossible to earn superior returns by using fundamental analysis to derive new information.

Strong

A strong form of market efficiency is one in which the prices reflect all relevant information whether publicly available or privileged.

Based on EMH there are several modern investment portfolio theories, the most renowned being the Capital Asset Pricing Theory and Markowitz's modern portfolio theory. These are based on the assumptions that investors hold portfolios which provide maximum returns for acceptable risk, and that efficient markets exist.

3.3. Stakeholder reporting

Traditionally, the annual report has been directed towards providing information to the providers of financial resources ie. investors and lenders. As early as the middle 1970's however there was a movement towards the recognition of other parties, such as employees and consumers, as a

sizeable and important group of users (Le Blanc, 1974, Page 39). There has been considerable academic debate about the audience for the annual report. This has resulted in the identification of other stakeholders as user groups. The framework recognising an annual report which addresses the needs of user groups other than investors and lenders and information related to risk pervasive to all stakeholders, such as environmental information and value added statements, has developed.

These developments have led to the consideration of the preparation of "multi-level" reports rather than the current "all-purpose" report (Parker, 1986).

3.4. Summary

This section identifies two domains of knowledge that currently have an impact on the information content of annual reports.

EMH is a portfolio theory. There are many experts who do not subscribe to the efficient market theory. The fundamentalist school uses published financial statements and other information to determine the intrinsic value of a share. Subscribers to this theory base their calculations on factors such as growth rate, earnings and gearing. On this basis they believe that they can identify value in shares and possibly outperform the market. The technical

analysts use, amongst other information, trends and patterns formed by share prices and volumes to predict when to buy and sell shares.

The developments in Stakeholder reporting are increasing the volume of information contained in the Annual Report.

4. PRIOR RESEARCH

4.1. Introduction

There has been a considerable amount of research into the question of the importance of different information sources to investors. Most of the studies address the needs of individual shareholders: studies such as the Baker and Haslem Study (1973), Anderson (1979) and Lee and Tweedie (1981). As the purpose of this paper is to identify how institutional investors use annual reports, five empirical studies which have focused on, inter alia, the impressions of institutional investors are reviewed. The five reports under review in sections 4.2 to 4.6 address the questions:

Are financial statements used for equity decisions?
Do financial statements incorporate the information required by institutional investors?
What parts of the annual report are considered most important?

It is these questions which are considered to be pertinent to the research documented in this report.

4.2. The Chang and Most Study (1985)

The first stage of this research consisted of a questionnaire survey of three user groups (individual

investors, institutional investors and financial analysts) in Florida U.S.A..

1034 questionnaires were sent to individual investors and 500 to institutional investors and a similar number of financial analysts.

The questionnaires were identical except that certain questions were adapted to the circumstances of each of the three groups. The questionnaire consisted of two parts. Part I asked for the respondents' investment objectives and their views on the relative importance and usefulness of the different sources of information presently available for making investment decisions. The respondents' need for additional investment information not currently available was also sought. Part II required respondents to disclose their personal characteristics. Respondents were asked to answer questions using a 5-point scale. To validate the research findings from the Florida survey, a national survey of the United States individual investors was performed. In addition, a survey of the three user groups was conducted in the United Kingdom ("U.K.") and New Zealand ("N.Z.").

The authors found that, when buying shares, the objective of institutional investors in the U.K. and N.Z. as well as the U.S was a combination of long term growth and dividend income. (See extract below)

Mean values and T-test results - importance of individual investors' investment objectives						
	X			T (Probability)		
Investment objectives	U.S.	U.K.	N.Z	U.S.:U.K.	U.S.:N.Z.	U.K.:N.Z.
Dividend Income	3.243	3.702	3.603	2.53(.013)*	.48(.634)	2.33 (.022)*
Short-Term capital gains	2.376	2.609	2.085	1.11(.273)	2.17(.033)	-1.58 (.177)
Long-Term capital gains	4.232	3.952	4.017	-1.91(.059)	-.36(.719)	-1.43 (.156)
Combination of dividend income and capital gains	4.097	4.212	4.433	.76(.477)	-1.35(.178)	2.49 (.014)*

* Significant at level of 0.05

When institutional investors were asked to rate their sources of information the following responses where obtained:

Mean values and T-test results - importance of individual investors' information sources						
	X			T (Probability)		
Information Sources	U.S.	U.K.	N.Z	U.S.:U.K.	U.K.:N.Z.	U.S.:N.Z.
Stockbroker's advice	2.516	3.872	3.450	7.66(.000)**	2.11(.038)*	5.60(.022)**
Advisory services	3.082	2.646	3.052	-2.39(.018)*	-1.84(.068)	- .16(.871)
Corporate annual reports	3.440	3.952	3.377	3.53(.001)**	3.00(.003)**	- .36(.723)
Newspapers and Magazines	2.617	2.905	2.950	1.98(.050)*	- .24(.811)	2.04(.044)*
Proxy statements	2.360	3.169	3.000	5.19(.000)**	.84(.403)	3.38(.001)**
Advice of friends	1.397	1.370	1.550	- .21(.833)	-1.08(.282)	1.10(.274)
Tips and Rumours	1.353	1.333	1.414	- .17(.869)	- .60(.548)	.49(.628)

* Significant at level of 0.05
** Significant at levels of 0.05 and 0.01

With regard to the ranking of items in the annual report, the authors concluded that in all three countries both institutional investors and financial analysts rated the income statement as the most important and pictorial information as the least important.

4.3. The SRI International Study (1987)

In 1986 and 1987 SRI International (formerly Stanford Research Institute) ("SRI") under the sponsorship and guidance of the Financial Executives Research Foundation designed a study to advance corporate understanding of investor needs and the role of the annual report as a vehicle for financial communications. SRI conducted exploratory research in the form of personal interviews and group discussions, followed by nationwide surveys in the U.S of individual investors and professional investors and advisors.

The authors made the following observations regarding institutional investors:

> Institutional investors have "...a quantitative orientation, an appetite for detail, and a distaste for what they perceive as exaggeration and incomplete disclosure. Their scepticism focuses mostly on the qualitative aspects of corporate information...." (Page 14)

> Numerous sources of information are used by institutional investors. They have, however, a few sources that provide basic and very important information and other sources are used to confirm or enhance the information in these primary sources. (Page 15)

Institutional investors "...appear to place greatest importance on information that sheds light on both the company's performance and the environment influencing that performance." (Page 29)

"Economic information seems too general and nonspecific to be useful..."quality of management" did not emerge as one of the important types of information...." (Page 29) This is a departure from other studies but indicates that although quality of management is important, these investors prefer to evaluate management quality by reviewing other measures such as performance, reputation etc.

Institutional investors did not record a high need for company forecasts because their experience had shown that these forecasts were usually optimistic. Company goals are important to institutional investors, because they give valuable insights to the plans of the company. They use the annual report more than any other source of information. The authors do not, however, state in what capacity it is used.

After the annual report users rely on the following sources of information:

SEC Form 10K
company quarterly reports
other analysts
company management.

Most users felt that they could identify biases in an annual report.

"...`Most used' sources did not correlate with `most useful' sources." When a source is inexpensive and easy to get, it is widely used even though it may not be useful. Of all the sources used by institutional investors and analysts the following are the most useful in investment decision making:

- company management
- fellow analysts
- SEC Form 10K.

Corporate officers saw their annual reports as multipurpose reports. They considered the role of stewardship was of primary importance. Preparers also felt that the report was prepared primarily for the existing shareholder.

4.4 **The Firth Study (1978)**

In his study Firth used a questionnaire as his basic research instrument. The questionnaire comprised of 75 items that were, or could have been, disclosed in a company's annual report. The respondents were asked to weigh each of the items in terms of importance. The research was conducted locally, in the U.K and as a result the questionnaire was sent to:

250 financial directors,
250 qualified accountants,
120 financial analysts working with stockbrokers and financial institutions, and
130 loan officers of major banks and finance houses in the city of London.

In general, historic accounting information tended to receive fairly high scores.

Firth requested his respondents to rate information that could have been disclosed in financial statements, but at that stage was not. Some of these items were regarded as important and to be included in an annual report. Forecasts of future information did not receive as high a score. This, Firth surmised, could have been attributed to the fact that both users and preparers placed some doubt on the accuracy of forecasts. More specifically, Firth's analysis of the responses to questions regarding post-balance sheet events and inflation adjusted accounts indicated that all groups surveyed regarded this information as important.

Firth (page 67) concluded that financial directors and auditors were in substantial agreement regarding the weighting of information and that financial directors and auditors did not share opinions similar to those of financial analysts and bank loan officers. As a whole, financial analysts and bank loan officers placed more importance on all items than did financial directors and auditors. Firth concluded that the high degree of similarity between financial analysts and bank loan officers suggests that one annual report could satisfy the needs of all users. The differences between users and preparers in Firth's study, with the former group placing a greater weight on information, could result in information not being released to users although it could be supplied with little extra cost and without discussing competitive information.

4.5. The Meth Report (1985)

This report addresses the impact of disclosure in annual reports in a South African context. Although, the report deals with disclosure, the objectives of the Meth Report are not as closely related to the objectives of this report as are the other reviewed reports. Meth (Page 5) states that the ultimate objective of his report is to establish whether a relationship exists between the level of disclosure of relevant investor information and specified company characteristics. As the research in this report was conducted in a South African environment, and many of Meth's subsidiary objectives and results were of significance in structuring the questionnaire used in gathering data for this report, a detailed review of Meth's research is given. The report completed by Meth resulted in the development of a disclosure score card that measures the extent of disclosure of individual information items by companies and the overall level of disclosure of each respondent company (Page 63).

In order to fulfil the objectives of the report Meth constructed a weighted index of disclosure importance by sending a questionnaire to 395 investment analysts requesting them to weight on a five point scale each of 49 items of disclosure appearing in the questionnaire.

Meth's (Page 63) survey of investors indicated that the investors ranked as most important a discussion of the firms' results for the past year with reasons for changes. As least important they ranked the names and salaries of senior management. For the 10 items ranked as most important, eight had a standard deviation of less than one which suggested substantial agreement between investment analysts.

In terms of the information requested the level of disclosure for each item of information was not high. A score of 100% would indicate full disclosure of that item by all firms in the survey, while 0% would indicate complete non-disclosure by all the companies.

He stated that Firth (Page 81) suggested that two major reasons exist for the poor disclosure. One may be that preparers are not aware of the information needs of investors, and another could be that the information may reveal important information to competitors. When comparing the ranking of information by investors to the disclosure level in annual reports Meth (Page 85) concludes that there is little correlation between the level of disclosure of items and their perceived relative importance. Meth stated that over the survey period the level of disclosure had improved (see table 1 below).

The average disclosure level for all items was:

TABLE 1 - LEVEL OF DISCLOSURE FOR THE PERIOD 1979 TO 1983 (Page 89)

Year		%age
1979	-	24.39
1980	-	27.12
1981	-	29.45
1982	-	29.31
1983	-	29.68

Regarding specific items of inform[illegible] the report indicates that the items that showed the gr[illegible]est improvements over the survey period were ranked as unimportant by investors, allowing Meth to conclude that disclosure improvements were taking place in relatively unimportant information items (Page 86).

4.6 **The Bell Report (1984)**

This study investigated whether the alternative forms of information presentation affect the use of information in evaluating corporate performance.

The study considered two forms of presentation, namely, numeric and non-numeric, with the numeric form referring to a number whether presented as a figure or a word, while non-numeric messages described an adjectival-qualtitative description, e.g. extremely large decline. The Bell study did not address other dimensions of presentation form such as formatting, use of graphs or charts.

Numeric and non-numeric messages were perceived differently by users. Cherry (1966, Page 10) reported that users perceive numeric messages to be based on measurement and to be more precise than non-numeric information. Bell's basis for argument was that information presented numerically can be more easily (in)validated than when presented non-numerically. If this were the case, Bell's question becomes - Is non-numeric information really used in corporate evaluations by financial analysts? In recent years there has been increased movement to quantify previously non-quantified information. Human resource accounting and social accounting are two areas where suggestions have been made to report numerically information that was previously disclosed non-numerically.

Research by Flamholtz (1979, Page 31) indicated that numeric information would be used in business decisions while non-numeric information would be discounted or ignored entirely.

Bell presented his subjects with three components of the annual report:

Balance sheet

Income statement

President's letter.

He used the president's letter to present information in a numeric and non-numeric form. Bell produced a version of the president's letter in which the president discussed financial performance, operating productivity, general economic conditions and efficient utilization of corporate assets. In the second version, the president focused on changes in strategy, policy, organizational structure, social and political conditions and manpower development and utilization. The participants were then asked to evaluate two Research and Development companies and two production companies

In both instances the companies being evaluated had significantly different financial statements. The twelve participants were members of the financial analysts society of Los Angeles.

The results of Bell's study indicated that non-numeric information was used more in the evaluation of R & D companies. Bell pointed out that:

> "This might have occurred because efforts and resources expended can be directly linked to results in production companies, while such links cannot be made for research and development companies." (Bell, p.180).

Bell concluded that the form in which information is presented can affect its use in the evaluation process differently across functional types of organizations.

According to Bell this occurs in situations where imperfect information is used for evaluation, and feedback on correctness is inadequate (therefore R & D companies are affected). On the other hand where production companies are evaluated and numeric performance measures have systematic status, information used seems less dependent on the form of presentation.

5. EMPIRICAL RESEARCH

5.1. Introduction

The research was based upon interviews using a structured questionnaire as a data gathering mechanism.

The interview process covered both preparers and users of annual reports. The objective of the method selected was to develop an interview based on a questionnaire that addressed the research questions. After the questionnaire and the interview format were selected, a pilot study was performed to ensure that the objectives of the questionnaire and interviews were achievable.

The financial executives ("Users"), either financial directors or company secretaries, in nine selected organisations (See 2.2.2.), were interviewed in order to identify what they considered important issues when preparing the annual report of the group or, in certain cases, for any set of financial statements. In addition, nine portfolio managers ("Users") were interviewed from selected institutional investors (See 2.2.2.) to identify how they perceived information sources and what their views were regarding certain components of the annual report, as well as certain more specific items in the annual report.

(See appendix I for a list of interviewees.)

5.2. Compiling the questions

In order to identify whether the annual report plays a significant role in an institutional investor's decision the research questions in the questionnaire were divided into four general areas. The areas relate to:

a) The sources of information available to users and the importance of the sources in making investment decisions.

b) The perception of users and preparers of the usefulness of the annual report as it is currently prepared.

c) The differences in importance, users and preparers place on information contained within the annual report.

d) The quality of the annual report, with quality being divided into two components, one being the presentational aspect, and two being the content of the report, and whether it has any impact on the user's perception of the company and his investment decision.

The most efficient data gathering instruments available for obtaining the views of both the preparers and the users of annual reports, were considered to be a questionnaire or an interview.

It was decided that the data capture would be more efficiently expedited if the author were to follow an interview process using a structured questionnaire. The nature of the questions asked in the questionnaire would require a measure of interpretation. A personal interview would ensure that all the respondents interpreted the question consistently.

There are two basic types of interviews - exploratory and structured interviews (Vockell, 1983, Page 76).

An exploratory interview is designed to elicit good ideas for subsequent data collection. It is informal and quite unstructured. The researcher merely asks leading questions, notes the answers, and uses the responses as a basis for the next question. In a structured interview the questionnaire is applied as a data gathering mechanism during the interview process.

Although the interview is a more efficient data gathering process, it has certain important advantages and

disadvantages which should be noted. A major advantage of the interview over the ordinary questionnaire, lies in its flexibility. An interview is time consuming. The questions are being posed by the interviewer on an one-on-one basis.

The personal interview limits response time because of time constraints. The personal presence of the interviewer often reduces the respondent's spontaneity. Anonymity disappears and so the willingness to be completely frank and honest, may be reduced. A questionnaire can be circulated to a larger number of respondents.

5.3. Selection of sample - Users

Based on discussions with several Merchant Bankers, the major institutional investors were selected on a judgmental basis. The ten large institutions selected were then approached telephonically to identify which member of their investment teams would be an appropriate respondent. The portfolio managers of financial institutions which displayed the following characteristics, were ap ched:-

- Institutions which are leading South African institutional share investors and thus play a major role as financial intermediaries in the South African market. Their investment policies and actions feature prominently in the overall domestic market.

- Institutions which have a strong commitment to and believe in fundamental analysis. Due to the focus of this report, such commitment was necessary.

The selection regarding the stock brokers was made considering the following qualifications:-

- Large and reputable stock broking firms which are members of the Johannesburg Stock Exchange.

- Analysts with a strong commitment to a belief in fundamental analysis.

The total assets administered by the institutions sampled amounts to R128 billion. Of the respondents, 45% administered funds of < R 5 billion and 55% assets > R5 billion. Of the portfolio managers interviewed, 67% followed less than 100 companies, and no portfolio manager followed more than 150 companies.

One institution declined to participate.

(See Appendix I for a list of interviewees)

In a pilot study performed in the intial stages of the research design, it became apparent that the decision makers

for or on behalf of the large institutions were Portfolio Managers ("Users") rather than the Financial Analysts. Financial analysts tend to disseminate large quantities of information and therefore require a plethora of information in order to prepare a concise and brief investment report that will be forwarded to Portfolio Managers. It later became apparent that in many of the institutions the interviewee was both a portfolio manager and a financial analyst. It was stressed during the interview process that, for purposes of the interview the respondent was to reply to the questions in the light of his requirements as a portfolio manager.

5.4. Selection of Sample - Preparers

The population of this group comprises financial executives of companies listed on the JSE Industrial Sector and therefore excludes companies on the mining and financial sectors of the JSE.

The companies whose Financial Executives ("Preparers") were approached to undertake an interview were selected using the following criteria:-

- Companies appearing in either the top twenty, the bottom twenty or the most improved ranking in the

Financial Mail Annual Accounts Award for 1990, as disclosed in the issue of the Financial Mail dated 11 January 1991, page 32-34.

The objective was to select six companies from the top twenty and the remainder of the companies from either, the bottom twenty, or, the most improved rankings, thereby obtaining a preparer's perspective from the full spectrum of financial reporting.

More emphasis was placed on the top twenty section of the accounting awards as most of the companies in which institutions invest, tend to feature in the top twenty rather than in the bottom twenty of the accounting awards.

- Companies selected from both rankings with a profitable track record and net assets in the last annual report of at least R10 000 000.

A review of the bottom twenty section of the Financial Mail accounting awards identifies one major group that is a highly rated company and is normally a favourite investment of portfolio managers ("Users") at all the large major financial institutions. However, in accordance with their current attitude towards reporting and communication with

both investors and the public in general, the financial representatives ("Preparers") of this company, refused to participate in the survey. The company had issued a directive prohibiting employees or representatives of the company from participating in any research which might affect the profile of the company or might suggest that their attitude towards financial reporting and communication in general had in any way changed over time. As a result, this major group was deleted from the sample. All other companies and institutions approached were willing to participate in the survey.

On the basis of the top twenty, bottom twenty and most improved sections of the annual awards as computed by the Financial Mail (1991, page 32), companies fulfilling the criteria identified above were selected.

Top Twenty Companies

The basis upon which companies listed in the top twenty awards were selected ensured that the sample did not result in being representative of only one of the major large industrial conglomerates of South Africa, ie: Barlow Rand or Anglo American etc..

The sample is representative of the majority of large conglomerates in South Africa.

Most Improved or in the Bottom Twenty

A judgmental method was used to select companies from the most improved and bottom twenty. Two companies from this list were selected. A company was selected from the bottom twenty. The company however refused to participate and was deleted from the sample.

The preparers in the sample comprised 63% financial directors, 25% financial managers and 12% company secretaries. Of the companies sampled, 75% were in the top twenty of the accounting awards and 25% were ranked as most improved by the accounting awards (Financial Mail, 11 January 1991, Page 32). The company selected from the bottom twenty was deleted from the sample.

5.5. Questionnaire Design

The basic research instrument consisted of a questionnaire containing approximately 30 items, with each item being selected in order to support the research questions. The selection of the items was based largely on an examination of the relevant literature. The questions were selected on the basis of ensuring that the overall research questions would be addressed once the detailed questions had been answered by the respondents. In certain instances, items were included in the questionnaire, not only to address the overall research questions, but also to

facilitate a comparison with other studies referred to in the prior research.

The questionnaire was tested for relevance, validity and accuracy. It was then tested in two pilot interviews.(Refer to Appendix II and III for detailed questionnaires).

5.6. Administration of the Questionnaire

The interview was structured as follows:

A brief telephonic discussion was conducted in which the caller informed the interviewee of the objectives of the research. A copy of the questionnaire was forwarded to the participant for his scrutiny but not for completion as it would be completed by the interviewer. The interviews relating to portfolio managers (Users) and financial executives (Preparers) were scheduled to be conducted over a three week period.

Potential bias resulting from the natural human reluctance to appear incompetent was taken into account in the interview process whenever possible by presenting the questionnaire in a non threatening manner and ensuring that there was no misunderstanding of the questions posed.

At the beginning of each interview, the objectives of the research were briefly outlined in order to place the interview and the questions in perspective.

The completed questionnaires have not been included in this report. A summary and an interpretation of the results is in section 6.

5.7. Validation of results

Responses to closed-ended questions that appeared biased or at odds with the other responses were queried and satisfactory responses obtained. Where possible, the research results were evaluated against prior research.

The design of the questionnaire has resulted in the answers and data collected being non-parametric. The information collected was in the form of answers to a five-point Likert type scale and true/false type questions. The five-point Likert type questions are non-parametric in that the interval between the rankings is not equally spaced. The use of means and other statistical tests to interpret such non-parametric information is not considered statistically valid and therefore not applied to the results.

Conclusions have not been made based on any of the "statistical" type measures. The purpose of the research was to document the opinions of large institutional investors, to illustrate their perceptions regarding the usefulness of annual reports, and as a result the sample selected may not be representative of the population of all investors.

6. RESEARCH RESULTS

6.1. Introduction

The research report addresses the sources and usefulness of the information contained in the annual report to portfolio managers of large institutional shareholders for making investment decisions. In many cases preparers were asked questions similar or identical to those asked of users. This was considered necessary to establish whether preparers and users have the same perceptions regarding information. The report also addresses other aspects of reporting: the differences in importance users and preparers place on information; and the impact of the quality of the annual report on the user's perception of a company and on his investment decision

The responses of the various respondents have been summarized and interpreted under 6.2 below. A copy of the questionnaire used in the interview is included in Appendix II ("Preparers") and Appendix III ("Users").

6.2. Research Results

6.2.1. Objectives in acquiring Equities

Question II (in Appendix II and III) in both questionnaires addresses the objectives of portfolio managers in acquiring shares on the JSE. The respondent was required to rank the

five possible investment objectives, with the most important being ranked 1 and the least important being ranked 5.

Table 1 in Appendix IV shows that portfolio managers ("Users")and the financial executives ("Preparers") ranked a combination of long-term capital growth and dividends as most important.

The observation was made during the interview with two users that a criterion which they considered to be of major importance had not been included on the list presented. In their assessment of companies, earnings growth is considered to be a fundamental objective.

Certain users stated that dividend income did not play a significant role in their organizations, but if they considered certain funds in isolation, such as income funds or pension funds, then dividends play a more significant role.

One user stated that his investment department believed in the minimum dividend theory, and that the balance sheet of the company should be strong enough to maintain the level of dividend, although it was not necessary that a dividend be declared. Although dividends were rated low by both groups (users and preparers), they were rated lower by the users which may explain the acceptance of the low dividend yields reported on the JSE. A Preparer commented that the change

in tax legislation has made the combination of long-term capital gains and dividends more attractive.

6.2.2. Sources of Information

Question III and V in the User and Preparer questionnaires (Appendix III and II, respectively) respectively required respondents to identify sources of information independently. The sources of information identified are listed in Table 2 in Appendix IV. Table 2 illustrates the emphasis placed on information derived from brokers. All the preparers named brokers' reports as a source of information, and 89% of users named these as a source. The lower rating in terms of users can be ascribed to the user sample including two brokers who were the only users that placed little importance on brokers' reports.

The internal analyst was not identified as a source of information as frequently as may have been expected.

The following observation was made regarding internal analysts:

> "I do not expect my analysts to re-invent the wheel! If we feel that the fundamentals of an industry are sound, we will select, based on our perceptions, the two strongest brokers in that industry and obtain their views. The same applies for the analysis of companies."

South African institutions place a large emphasis on direct contact with management. This phenomenon appears to be a function of the size of the JSE. The incestuous nature of the JSE is corroborated by a preparer who stated that one of the sources of information is the cross shareholdings by the major financial institutions and others. The shareholding gives these users insights to a company to which an ordinary shareholder is not privy. In some instances institutions are represented on the board of directors and have access to management accounts.

Questions IV and VI in the User and Preparer questionnaires (Appendix III and II, respectively) required respondents to rank sources of information presented in the questionnaire. There is a distinction between the information displayed in Table 2 and the information displayed in Table 3. Table 2 documents the sources of information respondents instinctively identified, Table 3 records the importance placed on different information sources as identified by the author.

Users placed most importance on information gathering by their own internal analysts. The second most important source of information given by users was personal contacts and interim reports followed.

It is interesting that an internal analyst was not identified as a source of information; however, when discussing the decision making process users stated that the internal analyst is regarded as an important source. The analysts' importance appears to be more in the collation of information rather than being regarded as an information source.

Diverse responses by users were given for the following sources:

- Interviews/Discussions with management,
- other newspapers,
- brokers reports, and
- trade publications.

The major reason for the diversity relating to discussions with company management relates to users from one particular institution. This institution was the only user that had a short term perspective on investments and combined technical analysis with fundamental analysis. If this user is removed from the sample for that question, the diversity is reduced - as 75% of the respondents will have answered four (4) or five (5) and the remainder a three (3).

The major reason for the diversity regarding the "other newspapers" relates to two users that are both from predominantly Afrikaans staffed institutions. It would be

misleading to remove these two users from the test as Afrikaans institutions are large players in the investment markets and the response, therefore, signifies the importance of "other newspapers" in the investment community. The brokers within the user sample create the diverse response pattern in the answers relating to the importance of brokers' reports.

Preparers ranked discussions with company management as the most important, followed by internal analysts at institutions and brokers reports (see Appendix IV, Table 3).

Table 4 in Appendix IV indicates that all of the top five sources, in terms of importance, as ranked by preparers are also in the top five of users. The emphasis placed on each item, however, differs in each group. In all cases, except for discussions with management, users placed more importance on the source than the preparers did. An interesting observation is that portfolio managers do not place as much emphasis on discussions with management as preparers have been led to believe. They do emphasize analyst reports, however, and this may be where the preparers may have identified discussions with management as important. The financial analysts at the large institutions are constantly in contact with management when preparing reports to be submitted to portfolio managers. Portfolio managers rank the end product, that is, the analyst's report, as very important. Preparers are exposed to the

means of generating the end product, and therefore place the emphasis on the discussions they have with the analysts. The perceptions of the user and the preparer are therefore similar.

The annual report is a widely used source of information and is regarded as one of the five most important sources of information by users. Preparers, in turn, are aware of the sources of information that users are accessing in order to make investment decisions.

6.2.3. The Perceptions of Users of the Annual Report

In order to obtain the views of the users and preparers of the annual report, several true or false questions were designed. Table 5, Appendix IV, illustrates the results of these questions.

The responses between the two groups regarding their perceptions are similar in most cases (see table 5 in Appendix IV). The first difference appears in the need for different versions of an annual report for different audiences. The users of financial statements were strongly against the creation of different reports for different audiences. Although not directly expressed, the impression was created that if different versions were to exist, users would fear that certain critical information that would appear in a general-purpose report, would be excluded from

their version of an annual report. The response of preparers took into consideration the different audiences for whom they prepare the annual report, as well as the diverse requests that they receive from their shareholders, bankers, employees and other interested parties. 55% of users considered that they would not be able to identify a situation where management was glossing over problems. The following observation was made:

> "Where we have an investment that has not performed to expectations, we revi annual reports to see if the problem had been y management in the annual report....In most that there is no evidence to highlight that t ms were about to occur..."

67% of the users stated that they had to read the notes to the annual report to get an accurate picture of the performance of the company. To clarify the word accurate, the following question was put to the respondent during the interview: " If you read the chairman's statement, the income statement and balance sheet do you feel you have an accurate (as opposed to comprehensive) picture of the performance of the company?" In light of the effort and time that is invested to insert additional information into the non-statutory portions of the report, it is surprising

that such a high proportion of users surveyed stated that they had to review the notes in order to get an accurate picture.

45% of users also felt that many of the companies on the JSE were preparing annual reports to comply with statutory requirements rather than to inform shareholders (See Appendix IV, Table 5). This response seems at odds with their statement that they are generally satisfied with the quality of the annual reports.

The users sampled in this report stated that they are only interested in approximately 100 companies (average over users). It may be inferred that the top 100 are reporting to the satisfaction of the users but that the remaining companies on the JSE may not be doing so.

6.2.4. Importance of Information Contained in the Annual Report

Questions V and VII of the user and preparer questionnaires (Appendix III and II, respectively), respectively are aimed at determining how important it is that certain information be contained in the annual report. The question does not attempt to determine whether the information is important, but, rather whether it is important that the information appear in the annual report. Table 5 in Appendix IV shows the results of the answers received from the samples of both users and preparers.

Users of annual reports were of the opinion that, except for commentary on the economy, information about the company's products and the opinions of other professionals, all other information contained in the question should be included in an annual report. Users were of the opinion that information about the products of the company need not be contained in the annual report. When making investment decisions, the nature of the company's business was important, but details of products did not play a major role in the majority of industrial companies.

With the information about the nature of the business, the user is able to evaluate the risk associated with the company from other sources of information. Bias was the major concern expressed by users about including opinions or analysis of other professionals in an annual report.

Although most institutions placed reliance on brokers' reports, they did not want brokers' reports to be incorporated in the annual report. The responses within the user sample reflected that users were in agreement in respect of most of the questions in this section. There was a diverse response, however, to the question concerning whether commentary on the economy should be included in the annual report. Certain respondents (33% of users, see Appendix IV, Table 6) were of the opinion that reference to the economy in an annual report is used as a scapegoat for poor company performance. They were of the opinion that

more accurate economic projections could be obtained from other sources. Other users (22% of users, see Appendix IV, Table 6) considered the company's view of the economy a useful yardstick for gauging whether the company's views correlated with their own expectations.

Preparers of annual reports highlighted other areas of information as critical for inclusion in the annual report. The preparers identified recent events, cashflow and information business units as important information. It is interesting to note that the quantitative forecast was not highly ranked by preparers. Comments made during the interviews highlight the concern:

> " Any quantitative forecast by management can be used to hang them...would not look good if they go wrong and the forecasts are not met."

Another area of interest was the response by preparers regarding the disclosure of risks. Seven of the eight respondents gave responses of 4-5, and comments gathered on this during the interviews were interesting. A preparer commented that as long as mention was made of the risk then management had fulfilled its obligation. Another's comment was that:

> "...Shareholders should do their homework before they enter into the markets...buyer beware..."

Users of annual reports require preparers of annual reports to go further than the statutory information required.

6.2.5 The Effect of the Quality of the Annual Report

Introduction

In designing the questionnaire and in the pilot studies the respondents had difficulty interpreting the word "quality". The word quality has been divided into two components for purposes of this report:

- presentation, and
- content.

Presentational impact on Investment Decisions

(See Appendix IV, Table 7)

Users were asked to state whether the fact that a report appears on glossy paper would impact their investment decisions.

During the interview the impact on the investment decision was emphasized, and not whether the report affected their perception of the company. The majority (67%) of users stated that this characteristic was not an important factor in the investment decision process. Also, the fact that the company appears in the top twenty of the accounting awards did not seem to affect the investment decisions of the majority (67%, See Appendix IV Table 7) of user

respondents. What did appear to be an important characteristic for at least half the portfolio managers, was whether an audit opinion was signed by a "Big 8" accounting firm. One of the users that rated this characteristic as not important but qualified this by stating that if a report is signed by a "Big 8" audit firm, and the company subsequently changes to a smaller audit firm, then the characteristic becomes important. The fact that the company has been audited by a small audit firm for years, however, does not make the characteristic important. It is the change that is important. It was emphasized that a move from a small firm to a large firm is not as perturbing as a move from a large firm to a small firm.

Perception of the Company (see Appendix IV Table 8)

The majority of users (78%) surveyed stated that the presentational appearance of an annual report affected their perception of the company. One user stated that there is a fine balance between a report that is overdone and a report that is well presented but justifiable.

The business and operations of the business must warrant a detailed and well presented report. It may thus be construed that a poorly presented report may not only impact the user's perception of the company, but also create certain misapprehensions in making the investment decision.

A comparison of the responses of users and preparers as to how important the presentation of information is in the decision making process indicates general agreement that the manner of presentation is important. The two areas where users and preparers seem to differ relate to the cosmetic aspects of the document. More preparers (62% vs 22%, Appendix IV, Table 7) rated graphs and photographs as important. The responses from both sample groups (Users 67%, Preparers 50%, Appendix IV, Table 8) indicate that the presentation of information impacts on investment decisions.

The subtle differences between the results displayed in Table 7 and Table 8 are as a result of the questions posed. In Table 7 the questions were posed in the context of how the items affected investment decisions. Table 8 displays answers to questions that were posed in the context of how the items affected their perceptions of the company.

The Effect of Content on the Investment Decision

In order to assess the impact of the content of an annual report on investment decisions, two sets of questions were formulated. The first set comprising question XXII (See Appendix III) of the user questionnaire and question XIX (See Appendix II) of the preparer questionnaire listed the different components of the annual report as identified by the author after a review of the score sheets for both the Financial Mail "Top Twenty" Rules for 1990 Reports and the

Chartered Accountants/Business Times Reporting Award 1989 Mark Plan. The total number of items identified amounts to seventeen.

Respondents were asked to identify the ten items they would consider important and to rank thos items in order of importance, with one being the most important and ten the least important (see tables 9 and 10 in Appendix IV for results). When interviewing users the word importance was further elaborated upon with the following question:

> " If when making investment decisions as a portfolio manager you could have access to only ten of the items listed below, which would you choose?"

When interviewing preparers the word "importance" was elaborated upon in the following way:

> " When preparing your annual report, if you were restricted to ten of the seventeen items listed below, which would you select to incorporate into the annual report? Please list them in order of importance."

During the interview the following aspects were clarified. The directors' report was to be considered the report that has to be submitted in terms of Schedule 4 of the Companies Act (1973, as amended), and the chairman's statement was to be considered as the report that includes all the additional

disclosure management might wish to make. In both situations, the respondent was asked to make a selection on the basis that there was no statutory requirement to present any of the components.

Financial highlights (89% rated it 11 or greater), stock exchange performance (89% rated it 11 or greater) and inflation adjusted supplementary accounts (67% rated it 11 or greater) were considered least important by the majority of users surveyed. The income statement (89% rated it 1 or 2), balance sheet (89% rated this item 1 or 2) and cashflow statement are regarded by users as the most necessary components of the report (66% of users rated the cashflow 1-6). The preparers, in turn, rated the income statement, Chairman's report and summary of results for the last 5 to 10 years as most important. The stock exchange performance section (89% of preparers rated it 11 or greater), interim results announcement (88% of preparers rated this item 11 or greater) and auditors' report (100% of preparers rated the audit opinion 9 or greater) are considered unnecessary by the majc ity of preparers.

Detailed Information (see Appendix IV, Table 11 and Table 12)

The second set of questions posed (Question XXIII to Users and XX to Preparers Appendix III and II, respectively) in order to ascertain the views of users and preparers regarding the content of information comprised of a list of

individual items that are, or could be, presented in a set of financial statements. Each respondent was asked to rank each item on a five point scale with one being not important to the investment decision and five being very important to the decision. During the interview process it was emphasized that the answer was to be given in the context of how important the information was to an investment decision.

Many of the items selected have also been tested by Firth (1978, Page 62) and Meth (1985, Page 63) and as a result the author has computed a mean score for these items to allow for comparison to the previous studies. The mean scores are given for illustrative purposes only and are not used to draw any conclusions.

Table 11 in Appendix IV illustrates the responses to the questions by the users surveyed in this study and compares their responses to the results obtained by Meth (1985) and Firth (1978). Table 12 compares the replies of the users to the replies given by the preparers.

The items listed in table 11 are those items for which there was a similar test performed by either Firth (1978) or Meth 1985). It should be noted that although similar items are tested, the surveys differ in terms of the samples. Firth examined the disclosure views of financial analysts employed

by stockbrokers and investment institutions. Meth sent out a questionnaire to members of the investment analyst society resident in South Africa.

It is, however, interesting that the high scores (Maximum possible score is 5) in the Meth study were in respect of the discussion of the company's results for the past year (4.69), disclosure of a dividend policy (4.49) and a discussion on the progress of recent acquisitions (4.21).

A percentage of users surveyed in this report identified the following items as very important: (Maximum possible score is 5)

disclosure of cost of goods sold (4.11),
extent of dependence on a few customers (4.22),
information relating to capital expenditure (4.22), and
discussion of the company's results (4.33).

The disclosure of Gross Profit is a requirement in terms of the U.K. Companies Act, which indicates that there may be a need locally for such a disclosure requirement. This may also indicate that over the period between the two surveys the trading conditions in South Africa have deteriorated and it is therefore important for users to obtain detailed information regarding the fundamental well-being of the business.

Comparison with U.S Study

When comparing the responses of South African portfolio managers to the results obtained in surveys in the U.S, U.K and New Zealand (Most et al, 1985) (refer to 4.2 above) it is noteworthy that in all the above markets, the intention of institutional investors is to hold equities for a long period of time. These results correlate closely with those of the U.K and New Zealand, in that the combination of gains and dividends was considered to be the most important objective.

Table 2 in Appendix IV displays a comparison of the results obtained based on interviews with South African institutions and the results of the SRI International (1987) report. This indicates that the sources of information differ significantly. While U.S users favour the annual report (85%), South African institutions prefer the "interview with management" (89%). Both South African and U.S institutions use other professionals (ie Brokers' reports) in making investment decisions (S.A Users - 78%; U.S Users - 54%).

The major departure between the two countries is on the emphasis placed on interim reports. It is interesting that the U.S users use this information source extensively to make investment decisions (57%), whereas the local users do not place great reliance on such announcements (22%). The reasons for this difference may be the size and activity of the markets and the frequency of the announcements.

A comparison of the S.A users versus the U.S users as displayed in Table 4 of Appendix IV, shows that three of the top five S.A sources (Internal Analysts, discussions with management and Annual Reports) are also highly regarded by U.S institutions. Interim results in S.A are the equivalent to quarterly announcements in the U.S. Personal contacts were ranked 14th by U.S investors, and internal analysts were ranked 17th (SRI 1987). In the S.A top five, there is no equivalent to a SEC Form 10K and other analysts (ie brokers reports) were ranked seventh.

In order to complete the study, question XXIV from the user questionnaire (See Appendix III) and question XXI from the preparer questionnaire (See Appendix II) allow the respondent to rank certain phrases regarding annual reports as either not important or very important.

The inclusion of this question was mainly to facilitate a comparison of the results of this study with that of the SRI International (1987) study. A secondary objective was to identify whether users and preparers thought that the annual report could be improved.

The results of the questions to users and preparers are contained in Table 13 in Appendix IV. It is interesting to

note that users identified the following issues as most useful if the annual report were to be improved:

inclusion of financial projections (89%),
providing industry trend information (89%), and
inclusion of an abstract in the annual report (89%).

Preparers, on the other hand identified the following issues which they regarded as important and which would improve the usefulness of the report:

Management ought to define their goals and objectives more clearly .
Management should be more frank abc . reporting poor performance.
The annual report provides industry trend information.

Table 14 compares the results of this question with the results obtained by the SRI in 1987.

It must be stressed that the U.S sample consisted of 312 telephone interviews. This study consisted of nine personal interviews.

The only response which appears to differ significantly from the U.S survey is the reply to forecasts. South Africans seem to be more interested in the forecasts. A possible

explanation for this could be the difference in inflationary environments in the two countries. Inflation in the U.S has over the past two decades been significantly lower than inflation in South Africa.

6.3. Research findings

The research results that were summarized and interpreted in 6.2 are evaluated in this paragraph. The research findings have been grouped under the applicable research questions to maintain a similar structure to that used in section 6.2. In some instances, where one set of findings held implications for another set of findings, these findings were addressed in the most appropriate place.

The research question/objective addressed was:

> Identify the sources of information available to users and the importance of these sources in making investment decisions.

Before any discussion can begin on the sources used by institutional investors, it is important to identify their objectives. Table 1 in Appendix IV indicates that the majority of institutions invest in equities for long term capital growth and dividends. Although the majority selected the combination of both, it is significant to note that the majority of portfolio managers placed more

importance on long term capital gains (66% of users rated this 1 or 2) than they did on dividends (11% of users rated this 1 or 2). The comments made during the interview by portfolio managers indicated that they are capital growth orientated. Many use earnings as a surrogate for measuring capital growth.

The interviews with portfolio managers, the brokers' report and annual report were the most common sources of information identified by users and preparers (See Appendix IV, Table 2). Significantly, however, users within the financial institutions identified interim results publications and personal contacts as most important (See Appendix IV, Table 3). Ultimately, all information about the company and its performance originates within the company itself. By the time the information reaches the user it has gone through numerous screenings and interpretations. The "most used" information does not necessarily correlate with the "most important" information. This phenomenon also occurred in the research conducted by the SRI (1987). When a source is inexpensive and easy to obtain, it is widely used even though it may not be very useful. For institutional investors, the sources "most used" are easily available. Two of the most important sources, internal analysts (ie. analysts within the institution) and personal contacts are not easily accessible to the general interested public. Internal analysts are a highly paid resource of an individual institution, and personal contacts take years of relationship building to establish.

In 1987 the SRI (Page 34) made the following comment:

> ".... Investors value each source of information based on its objectivity, content, accessibility, and timeliness. These components are not measured explicitly, but valued subjectively, depending on individual abilities and preferences."

It is true to say that all users interviewed want unbiased information. They do not want information that has been distorted by inappropriate interpretation and analysis. Users place high value on information sources which allow them personally to filter out bias, or on information sources which they believe have removed bias. It is therefore important for preparers to be aware of the sources of information which users find most useful. Should the preparer wish to change institutional thinking regarding his particular company, it is important for him to know which information sources should be targeted. The user will pay only for a service which he feels is giving him unbiased information. The most easily accessed information is not necessarily the most used information.

The research question addressed was:

<u>Identify the perceptions of users of annual reports.</u>

Users are in general satisfied with annual reports. A review of Table 5 in Appendix IV illustrates the overall

satisfaction users and preparers experience in their use of annual reports. Users regard the annual report as the primary source of information. Although other more precise or filtered sources of information may exist, users contend that without the annual report, there would be no starting point of reference for any investment analysis.

Users also consider certain information to be obtainable only from the annual report. Once the item has been identified in the annual report it can be further explored by either an internal or external analyst. The majority of users surveyed are of the opinion that annual reports do provide information that a user cannot get from any other published source.

The majority of users indicated that they needed to read the notes to the financial statements to get an accurate picture of the company. An accurate picture of the company was not obtained by reading the chairman's report, income statement and balance sheet exclusive of the notes to the financial statements.

Users consider it to be important that the annual reports are truthful (78% of users (See Appendix IV, Table 13) rated this 5 or 4, 5 being most important) and that they should provide information about the future in the form of projections (89% of users rated this 5 or 4, 5 being most important (See Appendix IV, Table 13)). The concern about

the truthfulness of annual reports that users have expressed throughout this research report is surprising as auditors have a statutory role to remove this factor from investment analysis. Information about the future is considered to be an important component of reporting which makes annual reports more useful. Users are of the opinion that this information is available, as management uses it to plan and to operate the business successfully.

Although 89% of South African users want the company to provide financial projections only 55% of U.S. investors felt that this was necessary (See Appendix IV, Table 14). The major reason for this is that the U.S. investors did not trust forecasts presented by management. They felt that they were invariably optimistic. South African users presumably want forecasts in order to make a comparison with their own assessments. Because of the high inflationary environment, South Africa's economic climate makes projections important in investment analysis, as historic results lose their forecasting characteristics.

The research question addressed was:

> Highlight the differences in importance users and preparers place information contained within the annual report

In evaluating non statutory information contained in the annual report (see Table 6 in Appendix IV) users and preparers exhibit basically identical views on the importance placed on the different components. In areas where there was no consensus, the results could be attributed to different perspectives on the issues. While users (100% rated this 4 or 5, 5 being most important) wanted quantifiable forecasts, preparers (50% rated this 4 or 5, 5 being most important) did not rate this as important.

Users consider the information to be useful for investment analysis, but preparers believe that users want the information in order to hold management accountable. While users state that there is little need to discuss the company's products in detail, preparers consider this to be a necessary part of the annual report. Users are thinking as institutional investors, but preparers know that they must cater for the needs of all investors, including those of institutional users.

The areas where there appear to be differences in the ranking of information between users and preparers are (Appendix, Tables 9 and 10):

The balance sheet

Cashflow statement

Interim statements

89% of the portfolio managers ranked the balance sheet as either number one or number two (one being the most important, ten the least important, See Table 9 in Appendix IV) whereas only 38% of preparers ranked it 1 or 2 in importance in investment decision making.

The diversity surrounding the cashflow statement is of significance. The majority of portfolio managers ranked the statement as a five or greater. The majority of preparers ranked the statement between one and four. This may indicate either a lack of understanding of the statement or, that users are not interested in the historic cash flow but rather in the future cash flows of the company. It is possible that since cashflow information is a relatively recent development users do not yet know how to use the information. When comparing the views of users in this report to those of users in the Firth (1978) and Meth (1985) studies (See Appendix IV, Table 11), certain points of interest are identified. The salaries of both directors and senior management are not important to South African users but are important to U.K investors. A larger emphasis is being placed on cost of goods sold by 1991 users as compared to 1985 South African users.

In South Africa, employee reporting has become more important than it was to users in 1985.

When users and preparers were asked how important they considered an individual piece of information to be to an investment decision, interesting differences were noted. Users (78%) feel that the size of a company's order book is important to an investment decision (See Table 12 in Appendix IV). Preparers (38%), on the other hand, do not think it is important. The same applies to disclosure of cost of goods sold and a breakdown of expenses in variable and fixed portions. The major reason for this difference is that the preparers have to be conscious of competitor sensitive information, whereas users are looking at the information from an investor's perspective only.

Dividend policy is not as important to users (55% rated this 5 or 4, 5 being most important) as it is to preparers (100% rated this 5 or 4, 5 being most important) of annual reports.

In the economic environment prevailing in the period covered by this empirical research it appears that users are becoming sceptical of dividend policies. The 1991 South African user places less emphasis on the dividend policy than he did in 1985. Users are interested in employee reporting specifically and less interested in corporate social responsibility in general, which includes the recognition of the human resource as an important contribution to the organisation.

Preparers find it necessary to report on social responsibility in general and less important to report specifically on employee statistics and welfare.

The research question addressed was:

> Ascertain whether the quality of the annual report has any impact on a user's perception of a company and his investment decision

The word quality has been broken into two components for purposes of this report. It consists of presentational quality and content quality. The majority of portfolio managers ("Users") agreed that the presentational quality of the annual report contributes to their impression of the company (See Appendix IV, Table 8). Of significance is the fact that when users were asked whether the presentation of information affected investment decisions, the majority (67%) answered in the affirmative.

With regard to the content of an annual report the most important non-statutory information used in the investment decision by a user was the chairman's statement (excluding divisional reviews) (See Appendix IV, Table 9). Other important information was:

segmental reporting - quantitative,

interim statements,

summary of last 5 years' performance.

Very little emphasis was placed on the supplementary inflation adjusted accounts.

6.4. Applicability of EMH

It is apparent that the users in this survey are of the opinion that EMH is dependent on good fundamental analysis. Two questions were asked regarding the respondents' views on EMH (questions XXV and XXVI in the User Questionnaire (Appendix III) and XXII and XXIII in the Preparer Questionnaire (Appendix II)).

The specific responses to these two questions show that 70% of the users agree with the semi-strong EMH (see Appendix IV, Table 15). Two users stated that they did not believe in the EMH, but replied in the affirmative to the question regarding the efficiency of the JSE. These were removed from the results of the sample as any response to the JSE'S efficiency was not in the context of the EMH theories.

The responses may, however, be a reflection of the knowledge of the sample as a whole with regard to modern portfolio theories. It appears that the portfolio managers were either ignorant of the theories of Markowitz and other modern portfolio theorists, or, at best, aware of the theories but not how they related or interacted with the JSE.

7. CONCLUSIONS AND SUGGESTIONS FOR THE FUTURE RESEARCH

7.1 Conclusion

This report is exploratory in its nature, the sample size amounted to seventeen respondents and the nature of the data was non-parametric. The conclusions expressed in this report are, therefore, on the basis of the responses obtained in this sample and no extrapolations, conclusions or analysis of the general population of institutional users or preparers of annual reports is established.

Although the annual report is not the most useful source of information to the portfolio manager, it is regarded as one of the most commonly used. The responses regarding the sources of information confirm that due to the size of the South African Market, and the majority of the investment activities of the institutions being limited to the top 100 companies, the personal interviews and relationships with the companies appear to be the most useful sources of information to users. The research also indicates that users use broker reports to a large extent.

Users are in general satisfied with annual reports. There are certain areas where they feel that improvements can be implemented.

The major component of concern is the lack of projections into the future, by way of forecasts or other quantifiable measures.

The views of the users and the preparers were similar except for certain cases in which there were major differences. Areas of note, regarding the differences are the Balance Sheet, Cashflow Statement and Interim Reports. The majority of users ranked the Balance Sheet and Interim Reports as important and the Cashflow Statement as moderately important. The fact the the Cashflow Statement is not used extensively by users may be ascribed to the fact that the accounting statement requiring the completion of the Cashflow Statement (AC 119) is relatively new and therefore the possibility exists that users do not know how to use the information.

Preparers, on the other hand, ranked Cashflow Statements as important and the Balance Sheet as moderately important and the Interim Statement as not important.

The majority of the users concluded that the presentation of the annual report affected their perception of the company and their investment decisions.

The annual report does play a role in the investment decisions of institutional investors. Although, the portfolio manager ("User"), who is the decision maker as

opposed to the analyst, has other sources of information that he accesses, it appears that the annual report plays a very important informational and confirmatory role.

As a preparer it is important to note that there are other important channels of information in the eyes of the institutional investors. When management wish to inform institutional investors of certain events it may be worthwhile to investigate the channel of information which would be most effective.

While users are satisfied with the annual report, they are concerned about the candidness of management when making statements in the annual report. They do not consider it necessary to go into extensive detail about projections on the economy, nor to turn the annual report into a product catalogue. The annual report as it is presently being prepared seems to focus on its stewardship function, ie reporting on the past. Users want more quantitative information on the projections and forecasts of the company.

The similarity in replies of users and preparers indicated that the preparers had a generally good understanding of the needs of users. In many cases where there was a difference in the replies the preparer was considering his other audiences. It is of significance that the differences identified in Appendix IV Tables 9 and 10

indicate that users do not always place a strong emphasis on areas that preparers consider important.

The quality of the annual report plays a significant role in assisting a user to develop a general impression of the company, and both the content of the annual report and the presentation of that information are important in the investment decision.

The annual report is important to an institution once it feels that the company meets its investment criteria. Until those criteria are met, the institutional investor will not be interested in the company, and as a result is not that preparer's target market.

There are three aspects which appeared most frequently when portfolio managers were asked to identify the criteria used to identify companies in which they would invest:-

Track Record
Availability of Script
Portfolio Analysis

While the annual report plays a confirmatory role in establishing the track record of a company, without the above three criteria most institutions will not be interested in the annual report of the company.

7.2 Suggestions for Future Research

The annual report has been identified as an important investment tool. This study was however, exploratory and indicates that an in depth investigation to ascertain the needs of investors and preparers of financial statements may be fruitful.

The study has identified certain components of the annual report as critical to institutional investors. Whether the disclosure of the information content of these components can be improved should be further investigated.

APPENDIX I

Table 1 - Institutions Included in this Sample

(In alphebetical order)

1. Anonymous
2. Davis Borkum & Hare
3. Fedsure
4. Genbel
5. J D Anderson
6. Momentum Life
7. Sanlam
8. Southern Life
9. U A L

Table 2 - Industrial Companies Included in this Sample

1. Adcock Ingram Limited
2. Allied Technologies Limited
3. Holdains Limited
4. Interleisure Limited
5. Iscor Limited
6. Pretoria Portland Cement Limited
7. Sappi Limited
8. Toco Holdings Limited
9. Declined to Participate

APPENDIX II - PREPARERS QUESTIONNAIRE

Identify the sources of information available to users

I An assessment of a company in order to make a decision about buying, holding or selling shares is made periodically. What events occur that result in the need for an investor or potential investor to make the assessment and subsequent investment decision?

Buying shares for the first time

.....

.....

Buying, Holding or Selling shares in an existing portfolio

.....

II When making decisions about buying, holding or selling shares what are the important objectives of investors? Please rank the items below in order of importance with 1 being the most important and 5 being the least important.

a) Dividend income .....

b) Profits from an increase in market price within 6 months (Short-term capital gains) .....

c) Profits from an increase in market price after 6 months (Long-term capital gains) .....

d) A combination of dividend income and long-term capital gains .....

e) A combination of dividend income and short-term capital gains .....

III In South Africa Annual Financial Statements are a statutory requirement. Over and above the statutory requirements please state management's objectives when preparing the Annual Report. (In order of importance)

1. .....

2. .....

3. .....

4. .....

5. .....

IV. Discuss the above benefits, with the aim of assessing whether the Annual Report is the most cost effective manner of achieving the objectives stated in B above.

.....

.....

.....

.....

.....

V. Please list the sources from which information is gathered by an investor to make a decision to buy, sell of hold a share.

1. Sources of information from within the Company

.....

.....

.....

.....

.....

.....

.....

2. Sources of information from outside the Company

.....

.....

.....

.....

.....

.....

VI When making decisions about buying, selling or holding shares what are important sources of information to an investor? (Please circle one number for each).

		Not Important				Very Important
1.	Your own discussions with company management	1	2	3	4	5
2.	Analysts' presentations	1	2	3	4	5
3.	Company Financial Statements	1	2	3	4	5
4.	Statistical Fact Books (ie: JSE handbook etc)	1	2	3	4	5
5.	Interim results publications	1	2	3	4	5
6.	Company press releases	1	2	3	4	5
7.	General business publication (Finance Week, Financial Mail etc)	1	2	3	4	5
8.	Business Day Newspaper	1	2	3	4	5
9.	Other newspapers (ie Citizen Star, Beeld Business Section)	1	2	3	4	5
10.	Analysts in my company	1	2	3	4	5
11.	Other analysts (ie: Brokers reports etc)	1	2	3	4	5

12.	Investment information services (ie: Ivor Jones, MacGregors)	1	2	3	4	5
13.	Personal contacts (Business Associates)	1	2	3	4	5
14.	Radio and T.V.	1	2	3	4	5
15.	Trade Publications	1	2	3	4	5
16.	Rumours and Tips	1	2	3	4	5
17.	Friends	1	2	3	4	5
18.	Suppliers	1	2	3	4	5
19.	Government Reports	1	2	3	4	5
20.	Other; please specify					
	.....	1	2	3	4	5
	.....	1	2	3	4	5
	.....	1	2	3	4	5

VII Below is a list of the different types of information that could appear in an Annual Report. For each type of information please indicate how important that type of information is to an investor when making decisions about buying, selling or holding shares.

		Not Important				Very Important
1.	Recent developments and outlooks for the industry in which the company operates	1	2	3	4	5
2.	The outlook for the economy	1	2	3	4	5
3.	The company's position in the industries in which it competes, such as product market share, and growth therein, etc	1	2	3	4	5
4.	Company goals and strategic direction	1	2	3	4	5
5.	Forecasts of company performance	1	2	3	4	5
6.	Recent events affecting the company, such as management changes, product introductions, acquisitions, etc	1	2	3	4	5

		Not Important				Very Important
7.	Information on the major business units within the company	1	2	3	4	5
8.	Annual company cashflow, that is, sources and users of funds, information	1	2	3	4	5
9.	Risks to which the company is exposed	1	2	3	4	5
10.	Information on the company's products	1	2	3	4	5
11.	Opinions and analysis on the company by other analysts or other professionals	1	2	3	4	5

The perceptions of Users of the Annual report as it is currently prepared.

VIII Annual Reports are the most useful published source of company information for investment analysis.

TRUE FALSE

IX Companies should publish different versions of the Annual Report for different audiences, eg: individual shareholders, employees and professional analysts.

AGREE DISAGREE

X. Annual Reports provide information I cannot get from other published sources.

TRUE FALSE

XI I have to read the notes to the Annual Report to get an accurate picture of a company's performance.

TRUE FALSE

XII Many companies' primary purpose in supplying Annual Reports is to satisfy legal requirements rather than supply shareholders and the investing public with useful information about the company?

TRUE FALSE

To ascertain whether the quality of the Annual Report affects the investment decision

XIII When making investor decisions about buying, selling or holding shares and using an Annual Report what characteristics are important to an investor?

		Not Important				Very Important
1.	The report appears in glossy paper	1	2	3	4	5
2.	The company be in the top twenty of the accounting awards	1	2	3	4	5
3.	The audit report be unqualified	1	2	3	4	5
4.	The report is signed by a "Big 8" audit company	1	2	3	4	5
5.	The quantitative information is graphically displayed	1	2	3	4	5
6.	There are a significant number of photographs displaying the operations and products of the company	1	2	3	4	5

XIV The appearance of the company's Annual Report, e.g colours, graphics and the quality of paper, contributes to my impression of a company.

TRUE FALSE

XV The use of graphs and charts adds to my understanding of company performance

TRUE FALSE

XVI Does the quality of the Annual Report impact on investment decisions?

TRUE FALSE

XVII Most Annual Reports are candid in their discussion of company performance.

TRUE FALSE

XVIII Interim Reports do <u>not</u> contain the tailed information I require.

TRUE FALSE

Information contained in an Annual Report

XIX Below is a list of the general components of an Annual Report. Please identify from the list the 10 issues you consider important and then rank those items in order of importance, with 1 being the most important and number 10 being the least important to the investment decision (either buy, hold or sell).

Stock Exchange Performance	.....
Chairman's Report	.....
Director's Report	.....
Summary of results for the last 5 to 10 years	.....
Income Statement	.....
Cash Flow Statement	.....
Balance Sheet	.....
Financial Highlights	.....
Footnotes to Financial Statements	.....
Auditors' Report	.....
Segmental Reporting - Quantitative, ie: Turnover/ Earnings/Assets	.....
Segmental Reporting - Qualitative, ie: Divisional review	.....
Accounting policies	.....
List of officers and directors	.....
Interim Reports	.....
Value Added Statement	.....
Inflation adjusted supplementary accounts	.....

XX Below is a list of specific items of information currently in an Annual Report or items that could possibly be included in an Annual Report. For each item of the report, please indicate the importance an investor attaches to such when making an investment decision.

		Not Important				Very Important
Income Statement						
1.	Salaries of company directors:-					
	- by director	1	2	3	4	5
	- aggregate	1	2	3	4	5
2.	The salaries of senior management:-					
	- by manager	1	2	3	4	5
	- aggregate	1	2	3	4	5
3.	Statement of the rate of return required by the company on its projects	1	2	3	4	5
4.	Extent of dependence on a few customers	1	2	3	4	5
5.	Money value of the company's order book	1	2	3	4	5
6.	Information relating to research and development (Eg. progress with new product developments, planned expenditure)	1	2	3	4	5

		Not Important				Very Important
Income Statement Cont						
7.	Classification of expenses for past year into fixed and variable components	1	2	3	4	5
8.	Cost of goods sold	1	2	3	4	5
9.	Details relating to imports and exports	1	2	3	4	5
10.	Disclosure of turnover in rands	1	2	3	4	5
11.	Dividend policy	1	2	3	4	5
Chairman's/Directors' Report						
1.	Functional responsibilities of company directors and their major outside affiliations	1	2	3	4	5
2.	Names and functional responsibilities of senior management	1	2	3	4	5
3.	Brief narrative history of the company	1	2	3	4	5

		Not Important				Very Important
Chairman's/Directors' Report Cont						
4.	Discussion of the company's results for the past year	1	2	3	4	5
5.	Discussion of the impact of inflation on the financial results	1	2	3	4	5
6.	Number of types of employees	1	2	3		5
7.	Indication of employee morale (ie: labour turn-over, strikes, absenteeism)	1	2	3	4	5
8.	Information on corporate social responsibility (ie: attitude of company, expenditures)	1	2	3	4	5
9.	Definition of ratios and terms	1	2	3	4	5
Balance Sheet						
1.	Discussion of the progress of any recent acquisitions	1	2	3	4	5
2.	Information about the leasing of assets	1	2	3	4	5

3.	Information relating to capital expenditures (eg. expenditure in past year, planned expenditure)	1	2	3	4	5
4.	Geographical location of the company's assets	1	2	3	4	5
5.	Current resale value of the company's assets	1	2	3	4	5
6.	Breakdown of borrowings (eg. lending institution date of maturity, security)	1	2	3	4	5
7.	Information on contingent liabilities	1	2	3	4	5
8.	Information relating to post balance sheet events	1	2	3	4	5

XXI The following statements describe ways that the Annual Reports might be improved. Please use the same 5 point scale to indicate your feelings about each item. Each statement starts with "Annual reports would be more useful to me if ....."

		Not Important				Very Important
1.	they provided standard financial statements for each business segment (ie. Divisional Review)	1	2	3	4	5
2.	the management discussion was frank about reporting poor company performance	1	2	3	4	5
3.	they provided analysis of the financial statements in the form of a company performance statistics and ratios	1	2	3	4	5
4.	management objectives and goals were defined	1	2	3	4	5
5.	they provided financial projections	1	2	3	4	5
6.	they provided industry trend information	1	2	3	4	5
7.	they presented more information in the form of graphs	1	2	3	4	5

		Not Important				Very Important
8.	they were provided on video cassettes	1	2	3	4	5
9.	they used understandable language without technical jargon	1	2	3	4	5
10.	they provided a detailed index	1	2	3	4	5
11.	all Annual Reports were published in a standard format	1	2	3	4	5
12.	they provided a brief abstract summarising key facts and statistics to be found in the Annual Report	1	2	3	4	5

XXII Do you agree with the Efficient Market Hypothesis contention that the current share price reflects all publically available information?

YES NO

XXIII Do you believe that the JSE is an efficient market?

YES NO

XXIV Are you generally satisfied with Annual Reports?

YES NO

XXV In your opinion, has the content of information in Annual Reports improved over the past 5 years?

YES NO

XXVI In your opinion, has the presentation of information in Annual Reports improved over the past 5 years?

YES NO

Information about the respondent

XXVII What is the approximate Rand value of assets under management in your organisation? .....

XXXVIII Approximately how many companies do you follow?

.....

XXXVIX Turnover of the company for the last Financial Year?

.....

APPENDIX III - USERS QUESTIONNAIRE

Identify the sources of information available to users

I An assessment of a company in order to make a decision about buying, holding or selling shares is made periodically. What events occur that result in the need to make the assessment and subsequent decision?

Buying shares for the first time

.....

.....

Buying, Holding or Selling shares in an existing portfolio

.....

II When making decisions about buying, holding or selling shares what are your important objectives? Please rank the items below in order of importance with 1 being the most important and 5 being the least important.

a) Dividend income .....

b) Profits from an increase in market price within 6 months (Short-term capital gains) .....

c) Profits from an increase in market price after 6 months (Long-term capital gains) .....

d) A combination of dividend income and long-term capital gains .....

e) A combination of dividend income and short-term capital gains .....

iii Please list the sources from which information is gathered in order to make a decision to buy, sell or hold a share.

1. Sources of information from within the Company

.....

.....

.....

.....

.....

.....

2. Sources of information from outside the Company

.....

.....

.....

.....

.....

.....

IV When making decisions about buying, selling or holding shares what are your important sources of information? (Please circle one number for each).

		Not Important				Very Important
1.	Your own discussions with company management	1	2	3	4	5
2.	Analysts' presentations	1	2	3	4	5
3.	Company Financial Statements	1	2	3	4	5
4.	Statistical Fact Books (ie: JSE handbook etc)	1	2	3	4	5
5.	Interim results publications	1	2	3	4	5
6.	Company press releases	1	2	3	4	5
7.	General business publication (Finance Week, Financial Mail etc)	1	2	3	4	5
8.	Business Day Newspaper	1	2	3	4	5
9.	Other newspapers (ie Citizen Star, Beeld Business Section)	1		3	4	5
10.	Analysts in my company	1	2	3	4	5
11.	Other analysts (ie: Brokers reports etc)	1	2	3	4	5

12.	Investment information services (ie: Ivor Jones, MacGregors)	1	2	3	4	5
13.	Personal contacts (Business Associates)	1	2	3	4	5
14.	Radio and T.V.	1	2	3	4	5
15.	Trade Publications	1	2	3	4	5
16.	Rumours and Tips	1	2	3	4	5
17.	Friends	1	2	3	4	5
18.	Suppliers	1	2	3	4	5
19.	Government Reports	1	2	3	4	5
20.	Other; please specify					
	.....	1	2	3	4	5
	.....	1	2	3	4	5
	.....	1	2	3	4	5

V Below is a list of the different types of information that could appear in an Annual Report. For each type of information please indicate how important that type of information is to you when making decisions about buying, selling or holding shares.

		Not Important				Very Important
1	Recent developments and outlooks for the industry in which the company operates	1	2	3	4	5
2.	The outlook for the economy	1	2	3	4	5
3.	The company's position in the industries in which it competes, such as product market share, and growth therein, etc	1	2	3	4	5
4.	Company goals and strategic direction	1	2	3	4	5
5.	Forecasts of company performance	1	2	3	4	5
6.	Recent events affecting the company, such as management changes, product introductions, acquisitions, etc	1	2	3	4	5

		Not Important				Very Important
7.	Information on the major business units within the company	1	2	3	4	5
8.	Annual company cashflow, that is, sources and users of funds, information	1	2	3	4	5
9.	Risks to which the company is exposed	1	2	3	4	5
10.	Information on the company's products	1	2	3	4	5
11.	Opinions and analysis on the company by other analysts or other professionals	1	2	3	4	5

The perceptions of Users of the Annual report as it is currently prepared.

VI. Approximately how many Annual Reports do you personally receive each year, either directly from companies or from someone in your organisation?

.....

VII. Of these, what percentage do you personally save for future use, either in your own office or somewhere else in the organisation (in the library)? .....

VIII Which of the following statements most nearly describes the way you read an Annual Report when you first receive it?

1. file without reading it .....

2. skim the whole report to get a general impression of the company .....

3. glance through it, stopping to read items that attract your attention .....

4. scan the entire report, seeking out specific items or information .....

5. read the entire report .....

IX. Annual Reports are the most useful published source of company information for investment analysis.

TRUE FALSE

X. Companies should published different versions of the Annual Report for different audiences, eg: individual shareholders, employees and professional analysts.

AGREE DISAGREE

XI. Annual Reports provide information I cannot get from other published sources.

TRUE FALSE

XII. I can tell from the Annual Report when company management is trying to gloss over problems and poor company performance.

TRUE FALSE

XIII I have to read the notes to the Annual Report to get an accurate picture of a company's performance.

TRUE FALSE

XIV Many companies' primary purpose in supplying Annual Reports is to satisfy legal requirements rather than supply shareholders and the investing public with useful information about the company?

TRUE FALSE

To ascertain whether the quality of the Annual Report affects the investment decision

XV. When making decisions about buying, selling or holding shares and using an Annual Report how important are the following characteristics?

		Not Important				Very Important
1.	The report appears in glossy paper	1	2	3	4	5
2.	The company be in the top twenty of the accounting awards	1	2	3	4	5
3.	The audit report be unqualified	1	2	3	4	5
4.	The report is signed by a "Big 8" audit company	1	2	3	4	5
5.	The quantitative information is graphically displayed	1	2	3	4	5
6.	There are a significant number of photographs displaying the operations and products of the company	1	2	3	4	5

XVI An expensive Annual Report is a waste of the shareholders' money.

TRUE FALSE

XVII The appearance of the company's Annual Report, e.g colours, graphics and the quality of paper, contributes to my impression of a company.

TRUE FALSE

XVIII The use of graphs and charts adds to my understanding of company performance

TRUE FALSE

XIX Does the quality of the Annual Report impact on investment decisions?

TRUE FALSE

XX Most Annual Reports are candid in their discussion of company performance.

TRUE FALSE

XXI Interim Reports do **not** contain the detailed information I require.

TRUE FALSE

Information contained in an Annual Report

XXII Below is a list of the general components of an Annual Report. Please identify from the list the 10 issues you consider important and then rank those items in order of importance, with 1 being the most important and number 10 being the least important to the investment decision (either buy, hold or sell).

Stock Exchange Performance	.....
Chairman's Report	.....
Director's Report	.....
Summary of results for the last 5 to 10 years	.....
Income Statement	.....
Cash Flow Statement	.....
Balance Sheet	.....
Financial Highlights	.....
Footnotes to Financial Statements	.....
Auditors' Report	.....
Segmental Reporting - Quantitative, ie: Turnover/ Earnings/Assets	.....
Segmental Reporting - Qualitative, ie: Divisional review	.....
Accounting policies	.....
List of officers and directors	.....
Interim Reports	.....
Value Added Statement	.....
Inflation adjusted supplementary accounts	.....

XXIII Below is a list of specific items of information currently in an Annual Report or items that could possibly be included in an Annual Report. For each item of the report, please indicate the importance you attached to such when making an investment decision.

		Not Important				Very Important
Income Statement						
1.	Salaries of company directors:-					
	- by director	1	2	3	4	5
	- aggregate	1	2	3	4	5
2.	The salaries of senior management:-					
	- by manager	1	2	3	4	5
	- aggregate	1	2	3	4	5
3.	Statement of the rate of return required by the company on its projects	1	2	3	4	5
4.	Extent of dependence on a few customers	1	2	3	4	5
5.	Money value of the company's order book	1	2	3	4	5
6.	Information relating to research and development (Eg. progress with new product developments, planned expenditure)	1	2	3	4	5

		Not Important				Very Important
Income Statement Cont						
7.	Classification of expenses for past year into fixed and variable components	1	2	3	4	5
8.	Cost of goods sold	1	2	3	4	5
9.	Details relating to imports and exports	1	2	3	4	5
10.	Disclosure of turnover in rands	1	2	3	4	5
11.	Dividend policy	1	2	3	4	5
Chairman's/Directors' Report						
1.	Functional responsibilities of company directors and their major outside affiliations	1	2	3	4	5
2.	Names and functional responsibilities of senior management	1	2	3	4	5
3.	Brief narrative history of the company	1	2	3	4	5

		Not Important				Very Important
Chairman's/Directors' Report Cont						
4.	Discussion of the company's results for the past year	1	2	3	4	5
5.	Discussion of the impact of inflation on the financial results	1	2	3	4	5
6.	Number of types of employees	1	2	3	4	5
7.	Indication of employee morale (ie: labour turn-over, strikes, absenteeism)	1	2	3	4	5
8.	Information on corporate social responsibility (ie: attitude of company, expenditures)	1	2	3	4	5
9.	Definition of ratios and terms	1	2	3	4	5
Balance Sheet						
1.	Discussion of the progress of any recent acquisitions	1	2	3	4	5
2.	Information about the leasing of assets	1	2	3	4	5

3.	Information relating to capital expenditures (eg. expenditure in past year, planned expenditure)	1	2	3	4	5
4.	Geographical location of the company's assets	1	2	3	4	5
5.	Current resale value of the company's assets	1	2	3	4	5
6.	Breakdown of borrowings (eg. lending institution date of maturity, security)	1	2	3	4	5
7.	Information on contingent liabilities	1	2	3	4	5
8.	Information relating to post balance sheet events	1	2	3	4	5

XXIV The following statements describe ways that the Annual Reports might be improved. Please use the same 5 point scale to indicate your feelings about each item. Each statement starts with "Annual reports would be more useful to me if ....."

		Not Important				Very Important
1.	they provided standard financial statements for each business segment (ie. Divisional Review)	1	2	3	4	5
2.	the management discussion was frank about reporting poor company performance	1	2	3	4	5
3.	they provided analysis of the financial statements in the form of a company performance statistics and ratios	1	2	3	4	5
4.	management objectives and goals were defined	1	2	3	4	5
5.	they provided financial projections	1	2	3	4	5
6.	they provided industry trend information	1	2	3	4	5
7.	they presented more information in the form of graphs	1	2	3	4	5

		Not Important				Very Important
8.	they were provided on video cassettes	1	2	3	4	5
9.	they used understandable language without technical jargon	1	2	3	4	5
10.	they provided a detailed index	1	2	3	4	5
11.	all Annual Reports were published in a standard format	1	2	3	4	5
12.	they provided a brief abstract summarising key facts and statistics to be found in the Annual Report	1	2	3	4	5

XXV Do you agree with the Efficient Market Hypothesis contention that the current share price reflects all publically available information?

YES NO

XXVI Do you believe that the JSE is an efficient market?

YES NO

XXVII Are you generally satisfied with Annual Reports?

YES NO

XXVIII In your opinion, has the content of Annual Reports improved over the past 5 years?

YES

XXIX In your opinion, has the presentation of information in Annual Reports improved over the past 5 years?

YES NO

Information about the respondent

XXX What is the approximate Rand value of assets under management in your organisation? .....

XXXI Approximately how many companies do you follow?

.....

APPENDIX IV - TABLES OF INFORMATION

Table 1 - Objectives of investors

Objective	Portfolio Managers ("Users") 1 %	2 %	3 %	4 %	5 %	Financial executives ("Preparers") 1 %	2 %	3 %	4 %	5 %
Dividend Income	0	11	11	33	45	12	12	0	38	38
Profits from an increase in market price within 6 months (short-term capitalgains)	0	11	0	33	56	0	12	25	38	25
Profits from an increase in market price after 6 months (long-term capital gains)	11	55	22	12	0	0	63	37	0	0
A combination of dividend income and long-term capital gains	89	0	0	11	0	78	0	0	0	12
A combination of dividend income and short-term capitalgains	0	22	67	11	0	0	12	38	25	25

1 Being Very Important

5 Being Not Important

Table 2 - Sources of Information Used By Investors
(percentage of each group that stated item as a source)

Source	Portfolio Managers ("Users")	Financial Executives ("Preparers")	SRI International
Annual report	67%	75%	85%
Brokers report	89	100	54
Interviews with management	78	62	54
Internal analysts	44	25	12
Interim results	22	0	57
Press coverage	44	75	37
Co presentations	33	0	n/a
Results announcement	33	38	43
In house magazine	22	0	n/a
Competition	11	0	10
Investor guides	0	12	n/a
Suppliers	0	12	3
Cross Holdings	0	12	n/a

Table 3 - Importance of Sources of Information
(Percentage of respondents selecting the score)

5 Being Very Important

1 Being Not Important

Source	Portfolio Managers ("Users") 5+4 %	3 %	2+1 %	Financial executives ("Preparers") 5+4 %	3 %	2+1 %
Annual report	67	33	0	63	37	0
Interviews/ discussions with management	67	22	11	88	12	0
Outside analyst presentations (ie Investment analyst society)	55	45	0	63	37	0
Statistical fact books (e.g. JSE Handbook)	11	45	44	12	12	76
Interim results publications	78	22	0	63	37	0
Company press releases	55	45	0	63	37	0
General business publications (Finance Week, Financial Mail etc)	45	55	0	25	38	37
Business Day Newspaper	55	23	22	50	38	12
Other Newspapers (e.g Citizen, Star Beeld etc)	22	45	33	25	50	12
Analysts in my own institution	100	0	0	88	12	0
Other analysts (ie. brokers reports)	67	11	22	75	25	0

Source	Portfolio Managers ("Users") 5+4 %	3 %	2+1 %	Financial executives ("Preparers") 5+4 %	3 %	2+1 %
Investment Information Services (e,g Macgregors)	67	23	0	12	63	25
Personal contacts/ Business associates	78	22	0	75	13	12
Radio and T.V	0	22	78	12	25	63
Trade publications	45	11	44	50	24	25
Rumours and Tip	0	45	55	12	25	63
Annual report	67	33	0	63	37	0
Friends	11	44	55	25	50	25
Suppliers	11	22	67	25	50	25
Government Reports	11	67	22	38	38	24

Table 4 - Most Important Sources of Information
(U.S Users - source: SRI international (1987)

Rank	S.A Users	S.A Preparers	U.S Users
1.	Internal analysts	Discussions with company management	Annual report
2.	Personal contacts	Internal analysts	SEC Form 10K
3.	Interim Results	Personal contacts	Quarterly Results announcement
4.	Annual report	Interim reports	Other analysts or professionals
5.	Discussions with company management	Annual report	Discussions with company management

Table 5 - The perceptions of Users and Preparers

Statement	Portfolio Mgrs ("Users") True	Portfolio Mgrs ("Users") False	Financial Execs ("Preparers") True	Financial Execs ("Preparers") False
Annual reports are the most useful published source of company information for investment analysis.	89	11	88	12
Companies should publish different versions of the annual report for different audiences.	11	89	38	62
Annual reports provide information investors cannot get from other published sources.	78	22	88	12
An investor can tell from the annual report when company management is trying to gloss over problems and poor company performance.	45	55	n/a	n/a
An investor has to read the notes to an annual report to get an accurate picture of a company's performance.	67	33	50	50
Many companies primary purpose in supplying annual reports is to satisfy legal requirements rather than supply shareholders with useful information about the company.	45	55	25	75
Are you generally satisfied with annual reports.	78	22	75	25
The content of an annual report has improved over the past five years.	100	0	88	12
The presentation of information has improved over the past 5 years.	100	0	88	12

Table 6 - Importance of Information Contained in the Annual Report (Percentage of respondents selecting the score)

	Portfolio Managers ("Users")			Financial executives ("Preparers")		
	5+4 %	3 %	2+1 %	5+4 %	3 %	2+1 %
Recent developments and outlooks for the industry	100	0	0	75	12	13
The outlook for the economy	22	45	23	25	50	25
The company's position in the industries in which it competes	89	11	0	62	38	0
Company goals and strategic direction (non-quantitative)	67	11	22	75	25	0
Forecasts of company performance (quantitative)	100	0	0	50	12	38
Recent events affecting the company	100	0	0	88	12	0
Information on the major business units	100	0	0	88	0	12
Annual cashflow information (past year)	100	0	0	88	0	12
Risks to which the company is exposed	78	22	0	88	0	12
Information on the company's products	11	67	22	75	13	12
Opinions of other professionals	0	11	89	25	0	75

5 Being Very Important

1 Being Not Important

Table 7 - Views on the quality of presentation of the annual report

	Portfolio Managers ("Users")			Financial executives ("Preparers")		
	5+4 %	3 %	2+1 %	5+4 %	3 %	2+1 %
The report appears on glossy paper	11	22	67	0	38	62
The company be in the top 20 of the accounting awards	22	11	67	38	12	50
The audit report be unqualified	55	11	34	88	12	0
The audit report is signed by a "big 8" audit company	55	11	34	50	12	38
The quantitative information is graphically displayed	22	55	23	62	12	26
There is a significant number of photographs displaying the operations and products	22	22	56	0	63	37

5 Being Very Important

1 Being Not Important

Table 8 - Views on Quality of Presentation of the Annual Report

Statement	Portfolio Mgr ("Users") True	False	Financial Exec ("Preparers") True	False
An expensive annual report is a waste of s/holders money	63	27	n/a	n/a
The appearance of an annual report contributes to my impression of the company	78	18	88	12
The use of graphs and charts adds to an investors understanding of the company	89	11	88	12
The presentational quality of the annual report impacts on investment decisions	67	33	50	50
Most annual reports are candid in their discussion of company performance	55	45	50	50
Interim reports do not contain the detailed information investors require to make an investment decision	67	33	75	25

Table 9 - Components of the Annual Report considered Important By Portfolio managers ("Users")

Component	1+2 %	3+4 %	5+6 %	7+8 %	9+10 %	11> %
Stock exchange performance	0	0	0	11	0	89
Chairman's report	0	45	11	11	11	22
Directors' report	0	22	11	0	0	66
Summary of results for the last 5 to 10 years	11	0	22	33	11	23
Income statement	89	11	0	0	0	0
Cash flow statement	11	22	33	11	23	0
Balance Sheet	89	0	0	0	0	11
Financial Highlights	0	0	0	0	11	89
Notes to financial statements	0	11	11	22	11	45
Auditors report	0	11	0	22	11	56
Segmental reporting-quantitative	0	33	22	0	11	34
Segmental reporting-qualitative	0	11	11	22	11	45
Accounting policies	0	0	11	33	33	23
List of officers and directors	0	0	22	22	22	34
Interim statements	0	22	11	11	11	45
Value added statement	0	11	11	0	11	67
Inflation adjusted supplementary accounts	0	0	11	0	22	67

1 Being Most Important

10 Being Least Important

Table 10 - Components of the Annual Report considered Important By Financial Executives ("Preparers")

	1+2	3+4	5+6	7+8	9+10	11>
Component	%	%	%	%	%	%
Stock exchange performance	0	0	0	0	11	89
Chairman's report	25	25	50	0	0	0
Directors' report	0	0	38	0	0	62
Summary of results for the last 5 to 10 years	25	38	12	25	0	0
Income statement	50	28	12	0	0	0
Cash flow statement	50	25	0	12	0	12
Balance Sheet	38	25	12	12	12	0
Financial Highlights	12	0	12	38	0	38
Notes to financial statements	0	0	0	38	12	50
Auditors report	0	0	0	0	38	62
Segmental reporting-quantitative	0	25	25	25	12	13
Segmental reporting-qualitative	0	12	0	25	0	63
Accounting policies	0	12	0	13	25	50
List of officers and directors	0	0	12	0	25	63
Interim statements	0	0	0	0	12	88
Value added statement	0	0	12	0	38	50
Inflation adjusted supplementary accounts	0	0	12	12	12	64

1 Being the Most Important

10 Being the Least Important

Table 11 - Comparison with Other Studies on Individual Items of Information (mean scores)

5 Being Very Important

1 Being Not Important

Individual Item	Users in Current Study	Firth (1978) Study	Meth (1985) Study
Income Statement			
The salaries of company directors - by director	1.89	3.90	n/a
The salaries of senior management - by manager	1.78	4.42	2.28
Statement of the rate of return required by the company on its projects	3.89	4.01	4.04
Extent of dependence on a few customers	4.22	4.08	3.98
Money value of the company's order book	4.11	4.20	3.71
Information relating to research and development	3.44	4.51	3.55
Classification of expenses for past year into fixed and variable components	3.89	4.63	3.62
Cost of goods sold	4.11	4.71	3.57
Details relating to imports/exports	4.22	4.32	n/a
Dividend policy	3.67	n/a	4.49
Chairman's/Directors' Report			
Functional responsibilities of company directors and their major outside affiliations	3.33	4.01	2.93
Names and functional responsibilities of senior management	3.33	4.24	2.79
Brief narrative history of the company	3.22	3.95	2.67

Individual Item	Users in Current Study	Firth (1978) Study	Meth (1985) Study
Discussion of the company's results for the past year	4.33	4.27	4.69
Discussion of the impact of inflation on the financial results	3.56	3.92	3.40
Number and types of employees	3.44	3.69	2.76
Indication of employee morale	3.78	3.55	3.10
Information on corporate social responsibility	2.67	3.48	2.56
Balance Sheet			
Discussion of the progress of any recent acquisitions	4.33	4.14	4.2[illegible]
Information about the leasing of assets	3.44	3.20	n/a
Information relating t[illegible] capital expenditures	4.22	4.46	4.29
Geogr[illegible]phical location of the company's assets	3.33	4.11	3.[illegible]7
Current resale value of the company's assets	3.22	n/a	3.[illegible]7
Breakdown of borrowings	3.67	4.20	n/a

Table 12 - Views on individual items of information in the annual report

5 Being Very Important

1 Being Not Important

("Preparers")	Portfolio Managers ("Users")			Financial executives		
	5+4 %	3 %	2+1 %	5+4 %	3 %	2+1 %
Income Statement						
The salaries of company directors						
- by director	11	22	67	12	13	75
- cumulative	11	33	54	12	50	28
The salaries of senior management						
- by manager	11	11	78	0	12	88
- cumulative	0	11	89	12	13	75
Statement of the rate of return required by the company on its projects	78	22	0	75	25	0
Extent of dependence on a few customers	89	11	0	75	25	0
Money value of the company's order book	78	22	0	38	50	12
Information relating to research and development	55	33	12	63	12	25
Classification of expenses for past year into fixed and variable components	78	22	0	25	25	50
Cost of goods sold	89	11	0	38	38	24
Details relating to imports/exports	78	22	0	63	37	0
Turnover disclosed in Rands	100	0	0	100	0	0
Dividend policy	55	23	22	100	0	0

	Portfolio Managers ("Users")			Financial executive ("Preparers")		
	5+4 %	3 %	2+1 %	5+4 %	3 %	2+1 %
Chairman's/Directors' Report						
Functional responsibilities of company directors and their major outside affiliations	55	11	34	38	25	37
Names and functional responsibilities of senior management	45	33	22	88	0	12
Brief narrative history of the company	33	55	12	25	50	25
Discussion of the company's results for the past year	78	22	0	88	12	0
Discussion of the impact of inflation on the financial results	55	45	0	50	38	12
Number and types of employees	45	45	10	25	38	37
Indication of employee morale	78	11	11	50	25	25
Information on corporate social responsibility	11	55	34	50	25	25
Definition of ratios and terms	45	11	44	88	12	0
Balance Sheet						
Discussion of the progress of any recent acquisitions	89	11	0	100	0	0
Information about the leasing of assets	33	67	0	50	38	12
Information relating to capital expenditures	89	11	0	88	12	0
Geographical location of the company's assets	45	33	22	38	25	37
Current resale value of the company's assets	45	33	22	38	50	12

	Portfolio Managers ("Users")			Financial executive ("Preparers")		
	5+4 %	3 %	2+1 %	5+4 %	3 %	2+1 %
Breakdown of borrowings	67	33	0	63	27	0
Information on contingent liabilities	78	22	0	75	25	0
Information relating to post balance sheet events	100	0	0	88	12	0

Table 13 - Ways in Which Annual Reports may be Improved

5 Being Very Important

1 Being Not Important

	Portfolio Managers ("Users")			Financial executive ("Preparers")		
	5+4 %	3 %	2+1 %	5+4 %	3 %	2+1 %
They provided standard financial statements for each business segment	67	11	12	50	38	12
The management discussion was frank about reporting poor company performance	78	22	0	100	0	0
They provided analysis of the financial statements in the form of company performance statistics and ratios	67	33	0	75	13	12
Management objectives and goals were defined	78	11	11	100	0	0
They provided financial projections	89	11	0	63	12	25
They provided industry trend information	89	11	0	88	12	0
They presented more information in the form of graphs	22	67	11	38	38	24
They were provided on video cassettes	0	11	89	25	0	75
They used understandable language without technical jargon	67	11	22	50	50	0
They provided a detailed index	33	33	33	50	38	12
All annuals were published in a standard format	22	0	78	12	38	50
They provided a brief abstract summarising key facts and statistics to be found in the annual report	89	11	0	75	13	12

Table 14 - Comparison with Other Studies Ways in Which Annual Reports may be Improved

5 Being Very Important

1 Being Not Important

	South African Portfolio Managers ("Users")			U.S (SRI) Professional Investor		
	5+4 %	3 %	2+1 %	5+4 %	3 %	2+1 %
They provided standard financial statements for each business segment	67	11	12	82	11	7
The management discussion was frank about reporting poor company performance	78	22	0	88	8	4
They provided analysis of the financial statements in the form of company performance statistics and ratios	67	23	0	74	21	5
Management objectives and goals were defined	78	11	11	75	19	6
They provided financial projections	89	11	0	55	25	21
They provided industry trend information	89	11	0	75	18	7
They presented more information in the form of graphs	22	67	11	37	39	24
They were provided on video cassettes	0	11	89	13	17	70
They used understandable language without technical jargon	67	11	22	33	30	37
All annual reports were published in a standard format	22	0	78	41	23	36
They provided a brief abstract summarising key facts and statistics to be found in the annual report	89	11	0	55	25	20

Table 15 - The Applicability of EMH

	Users		Preparers	
	Yes	No	Yes	No
Do you agree with the EMH contention that the current share price reflects all publically available information?	70%	30%	75%	25%
Do you believe the JSE is an efficient market?	40%	60%	50%	50%

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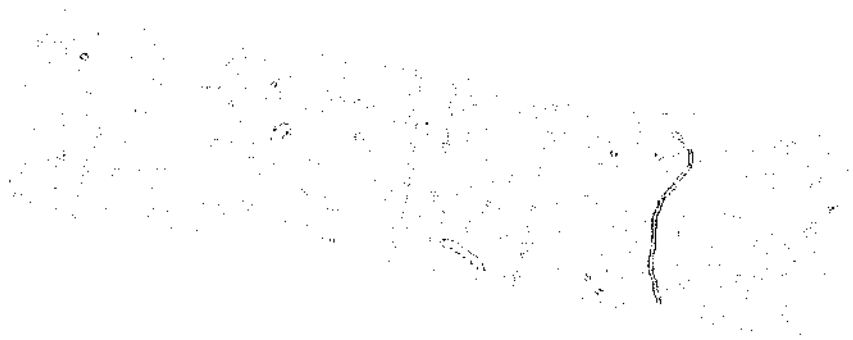
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