

Integrated Reporting and Corporate Valuation

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Introduction

Integrated Reporting (IR) has been gaining significant importance in recent years. To date, there is little empirical research on the potential benefits of IR. This study examines the association between IR and Corporate Valuation. Specifically, the primary research questions are (i) do equity investors value IR? and (ii) what are some firm characteristics that are associated with IR?

IR as per the International Integrated Reporting (IIR) Framework by the International Integrated Reporting Council (IIRC) provides an integrated representation and communication of how company strategy, business model, governance, opportunities, risks, performance and prospects leads to value creation over time. IR allows readers to look beyond the companies' short-term results to form a clearer view on long-term value. IR integrates thinking in business model and operating context into business strategy, outcome, performance and governance.

Data and Methodology

This study used 100 South African companies listed on the Johannesburg Stock Exchange (JSE) for the Period 2009 to 2012. All JSE Listed Companies have to adhere to the King III Code of Governance to adopt IR on a 'Comply or Explain' Basis for all financial years ending on or after 1 March 2010. The sample covers many industries such as agriculture, mining, chemical, electronics, manufacturing, transportation and services. We collect financial information and stock price data from the annual reports, Standard and Poor's Global Vantage Database and Datastream Database.

Based on the annual report disclosures on IR, we construct a disclosure score, IR Score, based on the major content elements for an integrated report following the International Integrated Reporting (IIR) Framework and the IR Guiding Principles for each company-year observation.

Analysis and Results

Following prior studies on corporate valuation, we employ Tobin's Q (defined as market value of equity to book value of equity) to measure market valuation by investors. Hence, to test the association between corporate valuation and IR, we perform a multivariate regression of Tobin's Q on IR Score.

We find a significant positive association between IR Score and Tobin's Q. Thus after controlling for various firm characteristics that affect equity valuation (such as firm size, sales growth, capital expenditure intensity, operating profitability, liquidity, industry membership and time trends), we find that firms with higher IR Score have higher Tobin's Q (Please see Figure 1). In other words, firms with higher IR Score have higher market valuation.

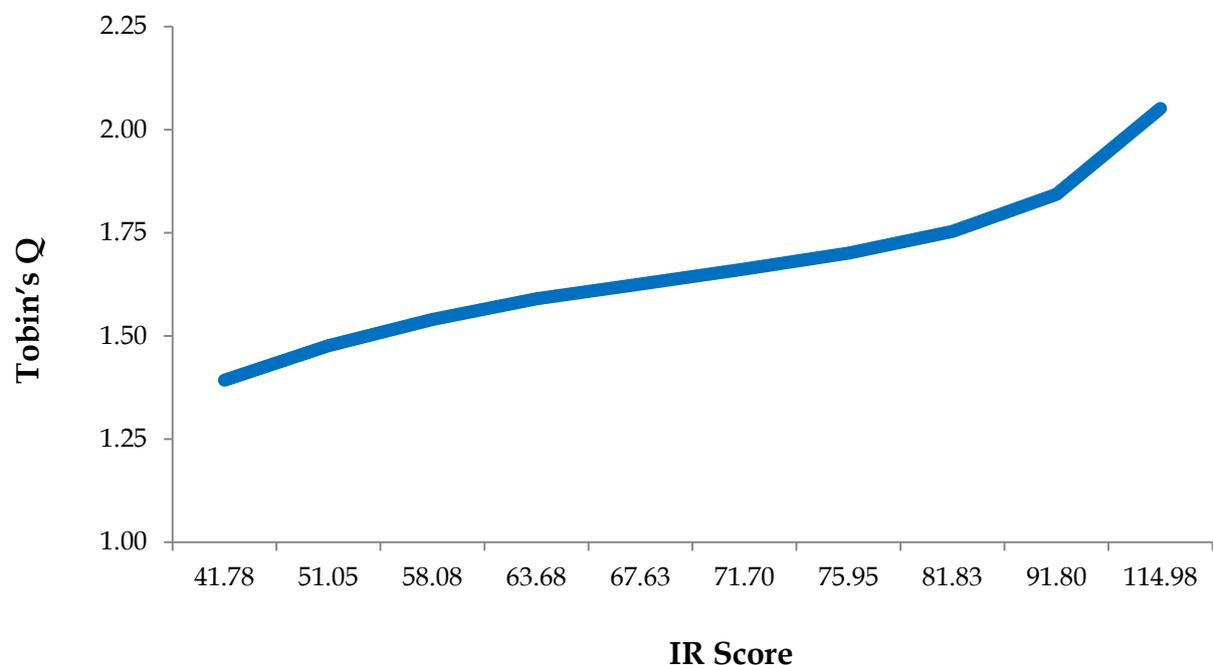
To put things in perspective, we assess the economic significance of our results. We consider an illustrative firm with a Tobin's Q of 1 (i.e. market value of equity and book value of equity are both at for example \$100 million). Depending on regression model specifications, an improvement in IR Score from the 25th percentile to the 50th percentile is associated with an increase of about 5% to 9% in market valuation. Hence, our results are economically meaningful.

As IR was a mandatory implementation in 2010 for South African listed firms on the Johannesburg Stock Exchange (JSE), our second test involves an examination of the effect of IR implementation on the change in the company's market valuation. The intuition underlying this test is that firms gradually learn about the intricacies and challenges associated with IR implementation over time. To test this association, we measure the change in market valuation (i.e. change in Tobin's Q) and the change in IR Score from 2009 to 2012.

We find a positive and statistically significant association between the change in IR Score and the change in Tobin's Q from 2009 to 2012 after controlling for various firm characteristics such as firm size, sales growth, capital expenditure intensity, operating profitability, liquidity and industry membership. In essence, holding other factors constant, if a firm improves in its IR Score across time, it is likely to experience an increase in market valuation.

Collectively, our results provide evidence that equity investors do value IR.

Figure 1: Relationship between IR Score and Market Valuation (Tobin's Q)

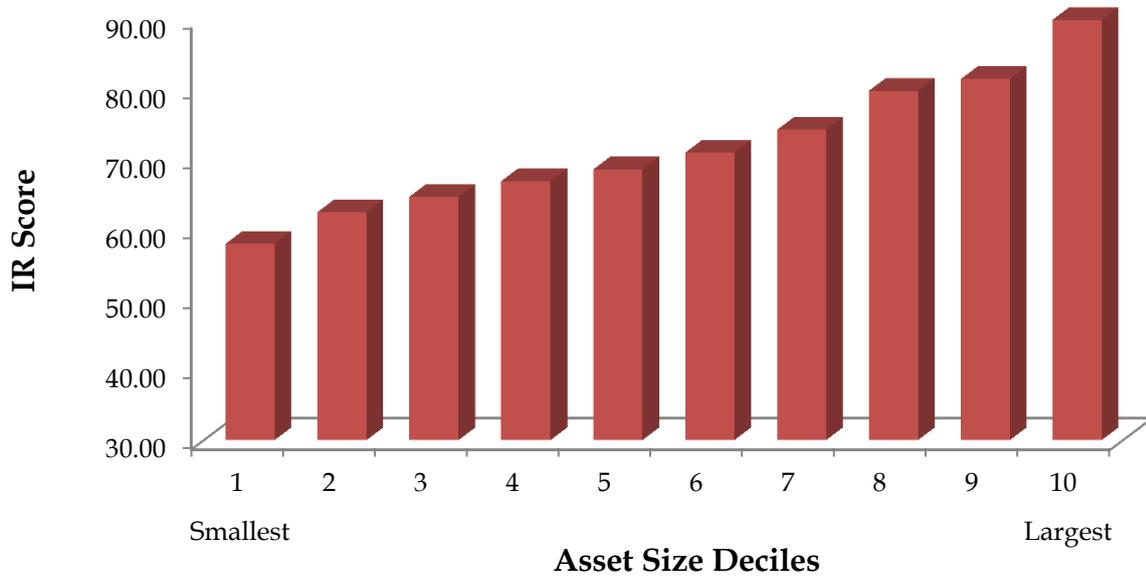


Firm Characteristics Associated with IR

Firm Size

We sort the firms into ten deciles with decile 1 comprising of the smallest firms and decile 10 comprising of the largest firms. We find that larger firms have higher IR Score (Please see Figure 2).

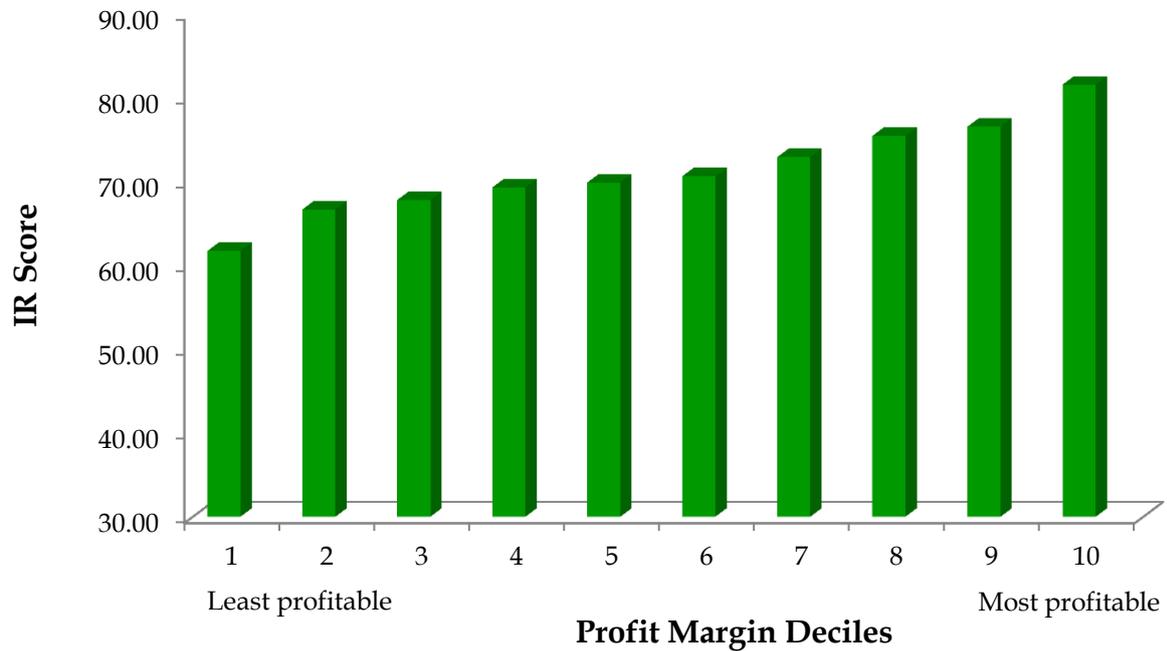
Figure 2: Plot of Asset Size and IR Score



Firm Profitability

We sort the firms into ten deciles with decile 1 comprising of the least profitable firms and decile 10 comprising of the most profitable firms. We find that more profitable firms have higher IR Score (Please see Figure 3).

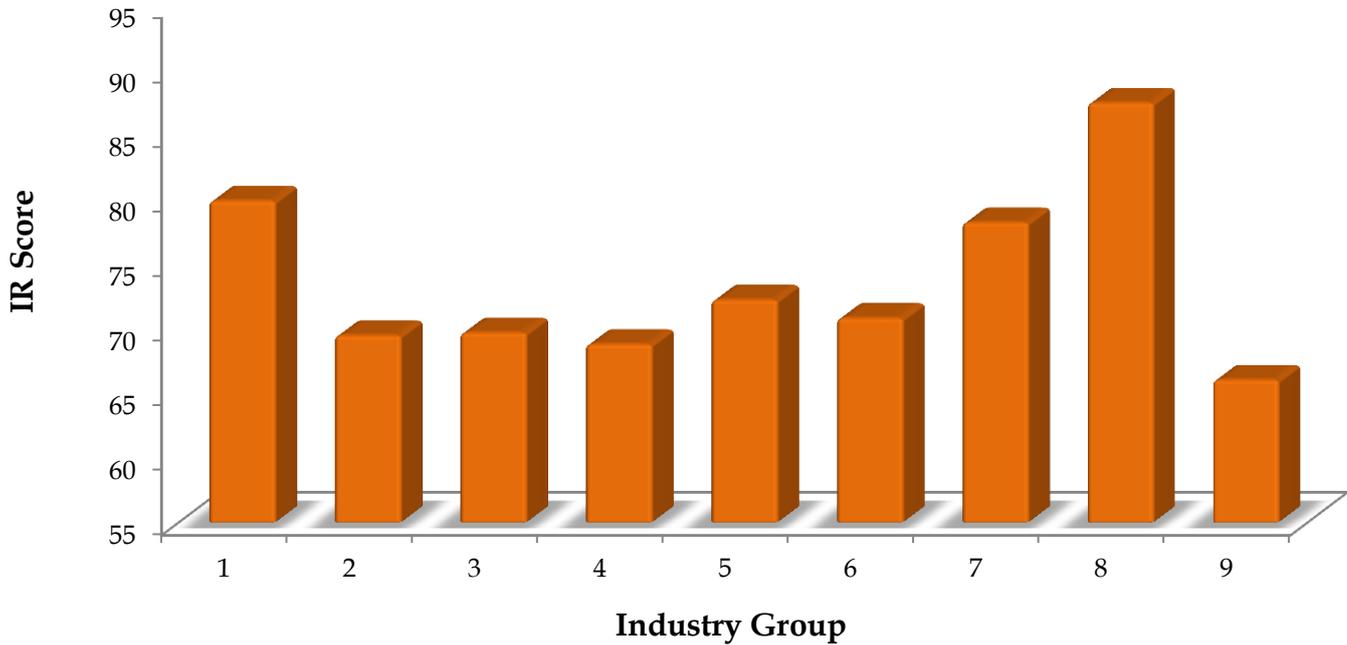
Figure 3: Plot of Profit Margin and IR Score



Industry Groups

We classify the firms into industry groups following the Standard Industrial Classification system. We find that there is considerable variation in IR Score across different industry groups (Please see Figure 4). Firms in agriculture, mining and services industries have higher IR Score.

Figure 4: Industry Groups and IR Score



INDUSTRY GROUP - LEGEND

1 - Agriculture, Mining & Construction

2 - Manufacturing, Food, Textiles, Paper, Chemical Products

3 - Manufacturing, Electrical, Electronic Equipment, Clay, Concrete Products

4 - Transportation, Communications, Electric, Gas & Sanitary Service

5 - Wholesale Trade & Retail Trade

6 - Patent Owners & Lessors, Insurance Agents & Brokers

7 - Services - Hotels & Motels, Employment Agencies, Computer Software

8 - Services - Education, Management Consulting, Engineering

9 - Others - Venture Capital, etc.

Conclusion

Collectively, our results provide evidence that equity investors do value IR. Firms with higher IR Score have higher market valuation. We also find that larger firms, more profitable firms and firms in certain industry sectors have higher IR Score.