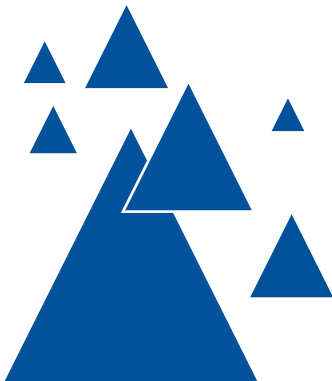




The Influence of the Business Review on Reporting Key Performance Indicators in the UK Media Sector

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OREWORD

The aim of reporting financial and non financial key performance indicators (KPIs) is to provide a better understanding of the development, performance or position of the company. Reporting of KPIs in the annual financial statements became a requirement for most companies in 2005 with the introduction of the business review. The requirement was initially introduced by amendment to the Companies Act 1985 and is now contained in the Companies Act 2006.

This paper looks at the reporting of financial and non financial KPIs in listed media companies for a four year period straddling the introduction of the business review. The study finds that despite an increase in reporting the level of compliance remains low even after the statutory requirement was introduced in 2005. In fact by 2007 25% of companies were still not reporting any KPIs. Reporting of non financial KPIs is particularly low. The paper also highlights the most popular financial and non financial KPIs reported in this sector.

The findings raise questions with regard to the usefulness of KPI reporting and why companies are choosing not to comply with the disclosure requirements of the Companies Act. This non compliance also raises wider concerns about the enforceability of Companies Act disclosure requirements in the director's report and the business review.

This project was funded by the Scottish Accountancy Trust for Education and Research (SATER). The Research Committee of The Institute of Chartered Accountants of Scotland (ICAS) has also been happy to support this project. The Committee recognises that the views expressed do not necessarily represent those of ICAS itself, but hopes that the project will add to the knowledge about KPI reporting in the UK.

David Spence
Convener, Research Committee
November 2009

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EXECUTIVE SUMMARY ---

The reporting of key performance indicators (KPIs) is required in the business review. The business review is a product of the European Union Accounts Modernisation Directive (EU AMD, 2003) which requires companies to produce an 'enhanced directors' report' in order to provide greater disclosure for users of financial reports. In the UK, the business review became a requirement for financial periods beginning on or after 1 April 2005 via the Companies Act 1985 (as amended by SI 2005/1011, hereafter 'as amended'). The requirements for the business review are now contained in the Companies Act 2006 (section 417(6)) which specifically requires companies to disclose in their business review both financial and non-financial KPIs in order to provide a better understanding of the development, performance or position of the company. These requirements support the view that the traditional financial reporting model, which focuses on financial information, does not provide adequate information for decision-making processes. Companies should, therefore, provide further analysis of their performance and position by providing additional information, both financial and non-financial, to help users understand the financial statements. Small companies are exempt from the business review requirements. Medium sized companies are required to comply with the business review, except for the disclosure of non-financial information.

This research investigates the reporting of KPIs by UK media sector companies listed on the London Stock Exchange. The research uses content analysis to examine KPI reporting in annual reports published over the period 2004 to 2007. Specifically, the research examines the extent to which the introduction of the business review influenced the

nature and level of KPI reporting in the annual reports of 32 UK media sector companies. Prior disclosure studies reveal that voluntary disclosure is associated with corporate governance and other company-specific factors, and this study also investigates whether the reporting of KPIs in the media sector differs with corporate governance and company-specific factors. To achieve these aims, four research questions are addressed:

- What is the nature and extent of KPI reporting over a two-year period prior to the introduction of the business review?
- What is the nature and extent of KPI reporting over a two-year period after the introduction of the business review?
- Is there a significant difference in the extent of KPI reporting between the two-year period before and the two-year period after the introduction of the business review?
- Which governance and company-specific factors are associated with the extent of KPI reporting over the four-year period?

The results suggest that the reporting of KPIs by the UK media sector is very low, although there was an increase in the number of companies reporting KPIs after the introduction of the business review in 2006. Additionally, the number of KPIs as well as the level of disclosure of these KPIs also improved after the introduction of the business review. For the two-year period prior to the introduction of the business review (2004 and 2005), 18 (43.7%) companies did not disclose any KPIs, whilst only nine (28.5%) and eight (25%) companies did not report any KPIs in 2006 and 2007 respectively. On average, the number of KPIs disclosed by the companies for the two-year period before and after the introduction of the KPI reporting requirements was 1.76 and 3.81 respectively. In terms of the type of KPI reporting, the results show that before the introduction of the business review, companies generally

only disclosed financial KPIs. During the two-year period before the introduction of the business review, the average number of financial KPIs was 1.70 compared to 0.06 for non-financial KPIs. Not only did the introduction of the business review see an increase in the reporting of financial KPIs to an average number of 3.19, it also led to an increase in the reporting of non-financial KPIs. On average, the number of non-financial KPIs after the business review was introduced increased from 0.06 to 0.62 items. Statistical tests for differences between prior and post business review reveal that there are significant differences in the reporting of KPIs, suggesting that, as would be expected, the introduction of the business review did influence the change in KPI reporting in the annual reports of media sector companies. However, even post business review, a significant number of companies were not complying with the disclosure requirements.

In addition to counting the number of KPIs reported by individual media sector companies, this study also developed a checklist of the KPIs generally disclosed by these companies. The checklist was used to measure the extent to which each company reported KPIs. This was achieved by creating a KPI disclosure index for each company, which was computed as the number of KPIs reported by the individual company divided by the total number of KPIs in the checklist. The results are consistent with those reported using the KPI counting methodology.

Finally, the results of the study demonstrate that the introduction of the business review, the proportion of non-executive directors, company size, profitability and gearing are associated with the extent of KPI reporting. These results suggest that both regulation and corporate governance play an important role in influencing firms' KPI reporting.

The results of the study have implications for policy makers and companies. Whilst there seems to be general recognition that KPI reporting has value, the reporting by companies is still very low, especially the non-financial KPIs. Some companies are not complying with the disclosure requirements at all, suggesting that policy makers may have

to take further action. To inform policy making in this area, further research is necessary:

- to ascertain why companies have not yet responded to the Companies' Act requirements for reporting KPIs; and
- to determine whether users of accounts find KPIs useful for their decision-making processes.

1 INTRODUCTION AND OBJECTIVES OF THE STUDY

Introduction

The reporting of key performance indicators (KPIs) has grown in importance in recent years. This has been driven partly by the perceived declining value relevance of traditional reporting models (e.g. Francis and Schipper, 1999; Lev and Zarowin, 1999) and the call to enhance disclosure of information provided in the annual reports. To make financial reporting value relevant, the accounting profession (such as FASB, 2001; ICAEW, 2000) has proposed the design of new reporting models that provide relevant information to investors. An important aspect of these proposed reporting models is the call for companies to report financial and non-financial KPIs in their annual reports in order to help users of annual reports understand the operations of the company 'through the eyes of management' (Beattie *et al.*, 2004). Consequently, in 2003, the European Union issued the Accounts Modernisation Directive (EU AMD, 2003) requiring companies to provide, in addition to other information, a business review which should include an analysis of the operations of the company using KPIs. In the UK, the business review became a requirement for financial periods beginning on or after 1st April 2005 via the Companies Act 1985 (as amended by SI 2005/1011, hereafter 'as amended'). This followed the decision to withdraw the mandatory requirement for an Operating and Financial Review (OFR), as outlined by the ASB (2005) *Reporting Standard: Operating and Financial Review*. The business review reporting requirements are now enshrined in the new Companies Act 2006. Consistent with the EU AMD (2003), the Companies Act 2006 (section 417) specifically states that:

The review must, to the extent necessary for an understanding of the development, performance or position of the company's business, include:

- (a) analysis using financial key performance indicators; and*
- (b) where appropriate, analysis using other key performance indicators, including information relating to environmental matters and employee matters.*

The requirement is applicable to all companies except those defined as 'small' under the Companies Act. Medium-sized companies are only required to report on financial KPIs. By definition KPIs are:

...factors by reference to which the development, performance or position of the business of the entity can be effectively measured. They are quantified measurements that reflect the critical success factors of the entity. (ASB, 2006, p. 8)

The requirement to report both financial and non-financial KPIs is an acknowledgement that financial measures alone fail to reflect the corporate value creating potential of firms in a dynamic business environment (Amir and Lev, 1996; Barth *et al.*, 2001; Holland, 2003). Consequently, the decision usefulness of non-financial measures of performance has attracted considerable interest from regulators, practitioners and academics. For example, it has been argued that non-financial assets such as intangibles play a significant role in the value-creating processes and activities within individual firms (e.g. Holland, 2003; OECD, 2006; Davidson and Skerratt, 2007; Beattie and Thomson, 2007). To understand the performance as well as the potential of firms, users or investors need to augment financial information

with non-financial information on the key drivers of shareholder value within individual firms. As argued by Amir and Lev (1996), share price movement is influenced by both financial and non-financial measures of performance. Consistent with this argument, Holland (2003) suggests that non-financial assets (intangibles) combine and interact with financial assets to create value in ways that are unique to individual firms. Indeed prior studies show, for example, that investment analysts use both financial and non-financial measures to assess firm performance (e.g. Previts *et al.*, 1994; Amir and Lev, 1996) and to evaluate the long term firm performance (Dempsey *et al.*, 1997). Rajgopalan *et al.* (2003) also show that in estimating a firm's future earnings, investment analysts use both financial and non-financial measures.

Objectives, importance and scope of the study

The objective of this research is to investigate the reporting of KPIs in the annual reports of UK media sector companies listed on the London Stock Exchange. In this context, the research examines the extent to which the introduction of the business review influenced the nature and level of KPI reporting by media sector companies. In addition, the research also seeks to determine the role that selected corporate governance and company-specific factors play in the reporting of KPIs in the media sector. In order to address these objectives, four research questions are addressed:

- What is the nature and extent of KPI reporting over a two-year period prior to the introduction of the business review?
- What is the nature and extent of KPI reporting over a two-year period after the introduction of the business review?

- Is there a significant difference in the extent of KPI reporting between the two-year period before and the two-year period after the introduction of the business review?
- Which governance and company-specific factors are associated with the extent of KPI reporting over the four-year period?

Investigating these issues is important for a number of reasons. First, it provides insights into the nature of KPIs that are generally reported by media sector listed firms. This provides users of accounts or investors with a basis on which to compare firms in their investment decision-making processes. This is particularly important given that the reporting of KPIs should enable users to understand the perceived value creating activities and potential in this sector, thus enhancing their decision-making processes, especially to buy, hold or sell shares. Second, the research is important for policy-makers as it enables them to assess whether the requirement through legislation for the disclosure of KPIs is having the intended result. This may help policy-makers to decide whether additional rules are required to ensure compliance. Policy makers may also benefit from the findings of the research by knowing the factors of firms that are more (or less) likely to report KPIs. This can only help in the regulation process. Finally, the results may also provide insights into further research in this area. For example, further research could consider the usefulness of the various KPIs reported by the media sector companies to the users. This could then be used to improve the quality of KPI reporting by media sector companies in future.

This research is restricted to the reporting of KPIs in the annual reports of media sector companies for two main reasons. One, most KPIs are inherently relevant to a specific industry and in certain cases, even specific to individual companies (PricewaterhouseCoopers, 2006). Two, unlike some of the other sectors, the media sector is not heavily reliant on traditional assets as critical success factors, yet up to now there

is very little that is known regarding KPIs in this sector. The use of the annual report to investigate KPI reporting is based on prior research suggesting that the annual report is an important media for corporate communication (see Beattie *et al.*, 2004).

Outline of the study

Having provided the background and objectives of the research project, the rest of this paper is organised in the following manner. Chapter two discusses the KPI reporting framework and the literature associated with KPI reporting. Chapter three reports on the data and research methodology adopted in the research. Chapter four discusses the results of the research. Finally, Chapter five provides a summary and concluding remarks.

2 KPI REPORTING FRAMEWORK AND LITERATURE REVIEW

Introduction

The purpose of this chapter is to discuss the reporting framework for Key Performance Indicators (KPIs) in the UK. It discusses how the requirements to report KPIs came about and the current requirements and recommendations for best reporting practices. The chapter also discusses extant studies on the extent of KPI reporting and the reasons why companies report KPIs are also discussed.

The reporting framework

The business review is a product of the European Union Accounts Modernisation Directive (EU AMD, 2003). The EU AMD (2003) requires companies to produce an 'enhanced directors' report'. In the UK, the requirements of the directive were first implemented in the form of the Operating and Financial Review (ASB, 2005) which extended the requirements of the EU AMD (2003) in order to provide greater disclosure for shareholders (Trucost, 2005). However, the OFR mandatory requirements were subsequently abolished by the government in November 2005 in order to reduce the regulatory burden on companies. Instead, the reporting requirements for the business review were initially included in the Companies Act 1985 (as amended) and are now contained in the Companies Act 2006 (section 417).

The Companies Act states that the directors' report for a financial year must contain a fair review of the business of the company, and a description of the principal risks and uncertainties facing the company.

The review required is a balanced and comprehensive analysis of the development and performance of the business of the company during the financial year, and the position of the company at the end of that year, consistent with the size and complexity of the business. Further, the Act states that the review must, to the extent necessary for an understanding of the development, performance or position of the business of the company, include analysis using financial key performance indicators, and where appropriate, using other key performance indicators, including information relating to environmental matters and employee matters. This means companies should report both financial and non-financial KPIS in their annual reports. Exemptions are, however, available for 'small' and 'medium' sized companies. Whilst small companies are not required to comply with the reporting requirements at all, medium-sized companies are required to report on financial KPIS only.

However, both the EU AMD (2003) and the Companies Act do not stipulate any particular KPIS that companies have to include in the business review. Hence, the selection and number of KPIS included in the review is at the discretion of the directors (Trucost, 2005). In view of the lack of detailed guidelines from the Companies Act and the EU AMD (2003), the ASB's (2005) view is that the OFR remains the statement of best practice which UK companies are encouraged to follow in reporting KPIS (ASB *Reporting Statement: OFR*). In addition, PricewaterhouseCoopers (2006), developed their own model for reporting KPIS based on ASB (2005) and their own in-house experience. A summary of PricewaterhouseCoopers (2006), recommendations on what details should be reported when reporting KPIS is presented in Table 2.1.

Table 2.1 Business review and KPI reporting

Recommendations for reporting KPIs
1. Link to strategy
2. Definition and calculation
3. Purpose
4. Source, assumptions and limitations
5. Future targets
6. Reconciliation to GAAP
7. Trend data
8. Segmental
9. Changes in KPIs
10. Benchmarking

Source: PricewaterhouseCoopers (2006)

Literature review

This section summarises the literature on KPI reporting in the UK and the possible reasons why companies may report KPIs in their annual reports.

Previous studies of KPI reporting

The requirements to report KPIs as part of the business review are fairly new. As a result studies that investigate KPI reporting in annual reports are limited. In an investigation of the OFR and narrative reporting, Deloitte (2005) examined the reporting of KPIs and found that the disclosure of KPIs varied greatly in quantity and quality. The results reveal that 74% of the top 350 companies disclosed clear KPIs compared to 41% of the middle companies by market capitalisation and only 19% (or four companies) in the smallest 350 companies. The

average number of KPIs disclosed was 3.6, with a range of between one and nine.

Black Sun plc (2006a) reported that the percentage of companies disclosing KPIs rose from 19% in 2004 to 36% in 2005. The study also shows that the number of KPIs discussed ranged between one and eight, most of which were financial in nature. In a follow up study, Black Sun plc (2006b) reported that whilst 57% of the companies specifically identified both financial and non-financial KPIs, only 26% specifically identified the non-financial KPIs that are material to the group.

In a follow-up to the 2005 study, Deloitte (2006) also examined the annual reports of 100 FTSE 350 companies spread evenly between the large, middle and small by market capitalisation. The objective, among others, was to find out how companies had performed in the context of meeting the new requirements of the Companies Act 1985 (as amended). They used the ASB (2006) *Reporting Statement* to measure the extent of reporting. The findings suggest that the proportion of companies disclosing KPIs had decreased from 49% to 45%. They also report that the average number of KPIs disclosed was six. The range of KPIs disclosed in the top 350 companies was one to 18 (2005: one to eight), in the mid tier it was three to 11 (2005: one to nine) and in the smallest group it was one to eight (2005: one to six). The survey also found that the average number of non-financial KPIs disclosed had increased from one to two.

Radley Yeldar (2006) surveyed the extent of narrative reporting by the FTSE 100 companies using the ASB (2006) *Reporting Statement: OFR* as a guide to determine the criteria for their assessment of the reports. Among the ten aspects of narrative reporting examined was the reporting of KPIs. Top marks for KPI reporting were awarded to companies that clearly defined them, included both financial and non-financial and graphical presentation as well as explaining why the KPIs were chosen and why they were important to the business. Companies that were awarded low marks had no non-financial indicators, year-

on-year comparisons, poor explanation and obscure KPIs. The report concluded that KPI reporting was getting better with 14% of the FTSE 100 companies fully defining or explaining their KPIs.

PricewaterhouseCoopers (2006) used guidance based on the *ASB Reporting Statement* coupled with extensive in-house knowledge developed from research on how companies should communicate effectively to illustrate good KPI reporting (see Table 2.1). The study found that none of the seven companies examined communicated every desirable aspect of KPI content.

Finally, the ASB (2007) undertook its own review of narrative reporting. Among other findings, the review found that only 4% of the annual reports reviewed could be classified as indicating 'best practice' judged in terms of the *ASB Reporting Statement* in their reporting of financial KPIs. Thirty percent of the companies were classified as having 'good' and 53% as having 'fair' KPI reporting practices. Nine percent of the companies were deemed 'poor' and the remaining 4% 'very poor'. The reporting of non-financial KPIs was found to be even worse than that of financial KPIs. The results suggest that only 4% and 26% of the companies could be described as having 'best' and 'good' non-financial KPI reporting practices respectively. Thirty five percent of the companies were classified as having 'fair', 22% 'poor' and 13% 'very poor' non-financial reporting practices.

The studies outlined above have a number of limitations. First, as indicated earlier, the focus of all the studies reviewed was narrative reporting and KPI reporting was only a small part of the studies. There is, therefore, a need for a more in-depth and focussed study on KPIs given their importance in performance measurement. Second, most of the studies, except Deloitte (2005 & 2006), surveyed only a few companies from different sectors. However, KPIs are more likely to be company and sector specific (PricewaterhouseCoopers, 2006). Investigating companies from a number of sectors may not give a clear picture. A study dedicated to one sector is therefore needed to fully understand the nature

and extent of KPI reporting. Third, whenever, a new legislation such as reporting of KPIS comes into force, it is important to know whether it had the desired effect. There is currently no study that examines whether the introduction of the business review made a difference in the extent of reporting of KPIS. The present study therefore, fulfils such a need. Finally, for policy purposes it is important to investigate what influences the variation in the extent of reporting of KPIS. Previous research has examined whether corporate governance or company-specific factors influence certain aspects of reporting such as voluntary or mandatory disclosure. However, none of the studies discussed above have sought to determine the association between KPI reporting, governance and company-specific factors with the exception of Deloitte (2005 & 2006) which examined the influence of company size by market capitalisation.

Reasons for reporting KPIS in the annual reports

The literature discussed above clearly shows that whilst some companies report KPIS in their annual reports, others do not. One reason for reporting KPIS, of course, should be to comply with the business review requirements as stipulated in the Companies Act 1985 (as amended) and the subsequent 2006 Act. Failure to comply may have consequences such as financial penalties or loss of reputation and credibility (Checkel, 2001). A number of other reasons have been proffered to explain why companies may report more information. These include corporate governance mechanisms and company-specific factors.

In the context of corporate governance, the role of non-executive directors in protecting the interests of shareholders has been emphasised. It has been argued that a higher proportion of non-executive directors (NEDs) on the board should result in better monitoring of management actions and limit executive directors opportunism (e.g. Fama and Jensen, 1983). In this respect since NEDs should be independent of management they may act in the best interests of outside investors. To

the extent that KPIs are important to investors in their decision-making process (EU AMD, 2003; ASB, 2006), NEDs may be inclined to encourage executive directors to become more responsive to investors' information needs by reporting KPIs in the annual reports. Hence, the expectation is that the proportion of NEDs should be positively associated with the reporting of KPIs in annual reports.

There has also been some suggestion that directors' share ownership can influence the extent to which companies provide information such as KPIs. The suggestion is based on two main reasons. First, the reporting of additional information to the shareholders about the outcomes of the directors' decisions reduces agency costs (Craswell and Taylor, 1992). This is on the assumption that the marginal cost to management of providing this additional information may be much lower than the cost to individual shareholders of ascertaining the same information. Second, directors interested in trading their shares have incentives to disclose high levels of information such as KPIs. The rationale for this may be to meet restrictions imposed by insider trading rules and to increase liquidity of the firm's shares (Healy and Palepu, 2001). Restrictions on insider trading also provide directors with motives to report more KPIs to avoid falling foul of the trading rules in the event that they decide to trade their shares.

The role of the audit committee in the financial reporting process has received a lot of attention. The audit committee has the ultimate responsibility to enhance the quality of financial reporting in the company, working with both internal and external auditors (Mangena and Taurigana, 2008). In this respect, the size of the audit committee has been suggested as a factor that may influence the quality of financial reporting, including the level of information reported in annual reports. Audit committee size is important because the complexity of accounting and financial reporting matters reviewed by the audit committee requires considerable director resources, both in terms of the number of directors dedicated to the committee and the time each

director devotes to committee matters (Smith Committee, 2003). On the balance of probabilities larger audit committees give rise to more effective monitoring by providing the necessary strength and diversity of expertise and views to ensure effective monitoring (Mangena and Tauringana, 2008). In the context of KPI reporting this may mean that larger audit committees are more likely to recommend reporting of more KPIS to ensure that sufficient information is available to investors to make investment decisions.

In addition to corporate governance, academic research has also linked a number of the company-specific factors to differences in disclosure levels (Buzby, 1975; Schipper, 1991). For example, the size of the company may lead to greater levels of reporting for a number of reasons. These include political costs, such as societal demands for greater regulation (e.g. price controls), higher corporate taxes and the threat of nationalisation. In this respect, large companies are more sensitive to political costs and would endeavour to allay public criticism or government intervention in their operations by disclosing more information (Firth, 1979). Another reason is that because the larger the company, the more likely it will be able to attract a wide variety of highly skilled individuals necessary to introduce more sophisticated management reporting systems that can disclose an extensive array of information (Buzby, 1975). Finally, the extent of disclosure can also differ by company size because large companies face greater demand for information from the financial press and financial analysts than small companies (Schipper, 1991). Given that KPIS are believed to be important to analysts large companies are more likely to report more KPIS to meet this information need.

The company's level of debt (gearing) has also been linked to differences in levels of information disclosure that may include KPIS. In particular, the existence of debt provides incentives for managers or shareholder-managers to adopt investment policies that would increase the value of shares while decreasing the value of debt. Directors, for

example, could issue additional debt and use the proceeds to pay dividends, leaving both old and new debt-holders with cash leftovers (Watts and Zimmerman, 1986). However, with rational expectations, the market anticipates the directors' value-reducing behaviour and prices the debt accordingly. In the final analysis, the shareholder-director will incur the agency costs in the form of a higher cost of debt (Kelly, 1983). Given that a key function of the directors is to raise funds at the lowest possible cost, the director-manager would have incentives to write contracts to minimise the costs arising from the conflict of interests with bondholders. Such contracts include financial restrictions in the form of debt priorities and limitations on the total debt issued. KPIs form a significant information set for monitoring these contracts by the debt-holders. For example KPIs such as net debt to EBITA, debt capacity, operating cash flow and net bank debt can be helpful for debt-holders in assessing the capacity of the company to continue servicing its debts. Hence companies will have incentives to report KPIs in their annual reports, and thus gearing should be positively associated with the reporting of KPIs to enhance monitoring (Leftwich *et al.*, 1981).

Finally, the level of a company's profitability may also affect the levels of KPI disclosure within the media sector. Given that the capital markets require an understanding of key drivers of value within companies (Amir and Lev, 1996; Holland, 2003), more profitable companies may have incentives to provide more KPIs in order to distinguish themselves from less profitable firms and avoid being labelled 'a lemon' (Akerlof, 1970), and reduce the cost of capital (Amir and Lev, 1996). The reporting of KPIs may not only assure shareholders about the strong financial position of the company, but may also help shareholders and other outside investors about the value creating potential of the company. In this context, a positive relationship between profitability and KPI reporting should be expected.

Summary

This chapter has explained the KPI reporting framework within the context of the UK and reviewed the existing studies on the extent of KPI reporting. In particular the chapter explained how the requirements to report KPIS came about and the current requirements and recommendations for best reporting practices. For the literature review, it was concluded that the research on KPIS is limited and most of the available surveys have tended to focus on different industries. It was argued that this is problematic because KPIS are unique to industry sectors, and in certain cases, unique to particular companies. This implies that investigating different industries does not provide a clear picture of KPI reporting. Hence further research is required focusing on a specific industry. It was also argued that the studies reviewed have not examined the possible factors that influence the reporting of KPIS.

3 RESEARCH METHODS

Introduction

In this chapter, the research methods used in the study are described. First, the process by which the sample companies were identified and annual reports collected is explained. Further, the development process of the checklist used and the way the measures for the extent of KPI reporting are also described. In particular, the chapter explains how annual reports are scored and how the different measures are computed.

Data source and sample selection

The results reported in this study are based on the analysis of annual reports of media sector companies listed on the London Stock Exchange (LSE) over a four-year period. The four-year period relates to a two-year period before (2004 and 2005) and a two-year period after (2006 and 2007) the introduction of the requirement for companies to prepare a business review which must include the use of KPIs when discussing financial position and performance. As at 31 March 2008 the total number of media companies listed on the LSE, including the Alternative Investment Market (AIM) was 157. From this number, 20 foreign companies and 101 AIM listed companies were eliminated. The AIM companies were eliminated because we wanted to focus on companies on the main exchange. Finally, four companies were eliminated because they were only recently listed and therefore full sets of annual reports for the four year period covered by the research were unavailable. The resultant number of companies for the research was 32 (see Table 3.1)

and a list of these companies is provided in Appendix One. For each company, the annual reports for four years (2004 to 2007, inclusive) were downloaded from the company’s website. In total, 128 annual reports were collected for the analysis.

Table 3.1 Sample selection

Panel A: Total sample		Number
Total media sector companies listed on LSE (including AIM)		157
Less those incorporated outside the UK		(20)
Less those listed on AIM		(101)
Total companies available		36
Less those recently listed		(4)
Total companies available		32

Panel B: Sample by sub-sector	Number	%
Broadcasting	8	25%
Media agencies	8	25%
Publishing	16	50%
Total	32	100%

Measurement of KPI reporting

To investigate the reporting of KPIS in the annual reports of the selected companies, the content analysis method of data collection was used in the research. First, given that there are no previous studies on KPI disclosure by the media sector companies, a checklist of KPIS that are reported by the sector companies was developed. This involved reading the annual reports of all the companies for the period 2004 to 2007. The procedure produced a final list of 79 KPIS, of which 44 were financial and 35 non-financial KPIS (see Appendix Two).

To quantify the extent of KPIs disclosure for each company, the disclosure index methodology (Cooke, 1991; Taurangana and Mangena, 2006) was employed. The method uses a dichotomous scoring procedure where a company is awarded one if a particular KPI is present and zero if it is not (e.g. Cooke, 1989 and 1991). In scoring the annual reports, consideration was taken to ensure that the KPIs were applicable to all the companies in order to avoid penalising companies for KPIs which were not applicable to the company. A KPI is not applicable to a particular company or sub-sector if it is peculiar to a company or sub-sector. For example, the KPI, television market share, is applicable to the broadcasting sub-sector but not to the media agencies and publishing sub-sector companies. From the resultant data, two measures of KPI reporting were created. The first measure is a simple count of the total number of KPIs (financial and non-financial) disclosed by each company in each of the four annual reports from 2004 to 2007 inclusive. This measure was considered necessary for comparison with previous surveys that used the number of KPIs reported (see Deloitte, 2005; Radley Yeldar, 2006). The second measure is a disclosure index, which expresses the total KPI score for each company as a percentage of the total number of KPIs applicable to that company. For example, if a company disclosed 5 KPIs but one of the items in the index did not apply to that company, the score for the company would be $5/(79-1) = 6.41\%$. To ensure that the scoring of KPIs reported was consistent and accurate, another researcher was provided with 25% of the sample annual reports to conduct the same scoring procedures independently. The results were found to be similar with a Spearman rank correlation test of 0.9 (at the 5% level).

Summary

This chapter explained how the companies used for this study were identified and the annual reports collected. It also explained how KPI reporting for each company was measured through the disclosure index

methodology. This involved scoring the annual report depending on whether a particular KPI is reported in the annual report or not. The disclosure score for each company is found by dividing the individual company's score with the maximum possible score for that company.

4 FINDINGS OF THE RESEARCH

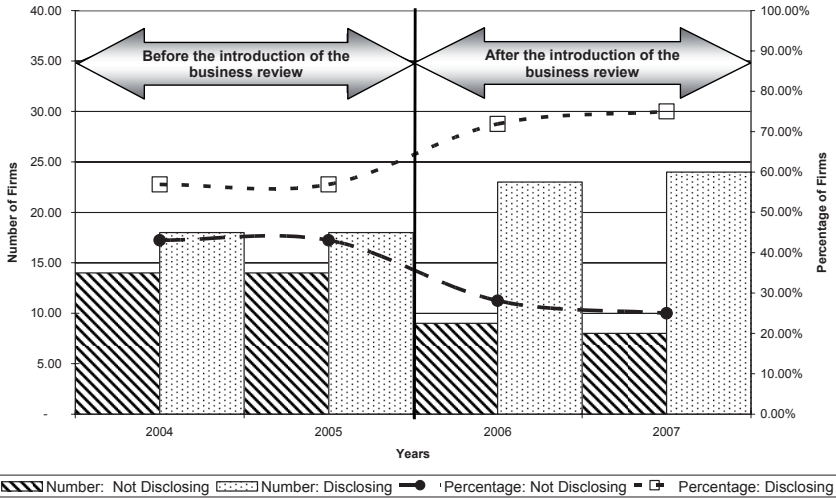
Introduction

The objectives of the research were set out in chapter one. In this chapter the findings addressing those objectives are presented in the following sections. First, the descriptive statistics on the reporting of KPIs by the media sector companies are summarised. Second, the results of the impact of the business review, corporate governance and company-specific factors are presented.

Companies' reporting of KPIs

Figure 4.1 shows both KPI disclosing and non-disclosing companies for the four year-period 2004 to 2007. As the figure indicates, for each of the years 2004 and 2005 (the period before the introduction of the business review), only 56.3% (18 companies) of the companies disclosed some KPIs, whilst 43.7% (14 companies) did not report a single KPI in their annual reports. However, following the introduction of the mandatory business review in 2006, there is a noticeable reduction in the non-KPI disclosing companies from the 43.7% in 2005 to 28.1% (9 companies) and 25% (8 companies) in 2006 and 2007 respectively.

Figure 4.1 Number and percentage of firms disclosing and not disclosing KPIS two years before and after the introduction of the business review



The results reported in Figure 4.1 also shows that the percentage gap between KPI disclosing and non-disclosing companies widened from about 12.6% before the introduction of the business review (2004 and 2005) to 43.8% in 2006 and subsequently growing to 50% in 2007. This suggests that some companies responded to the business review requirements to disclose KPIs in their annual report. However, still 25% of the companies in 2007 failed to report any KPIs in their reports, suggesting non compliance with the law. Efforts to find the reasons for non-disclosure were all in vain as emails that were sent to the non-disclosing companies did not receive a reply. A possible reason could be confidentiality of KPI information. As stated in the 2007 annual report of Aegis plc, for example,

We also use a number of non-financial KPIs across our businesses. These differ by type of business and geographic region. In many cases we consider them to be commercially sensitive and it would not be appropriate to publish them externally. (p. 18)

Non-disclosure of information in the business review on the grounds that it would be seriously prejudicial to the company's interests, is allowed by the Companies Act 2006 (section 417 (10) and (11)) which states:

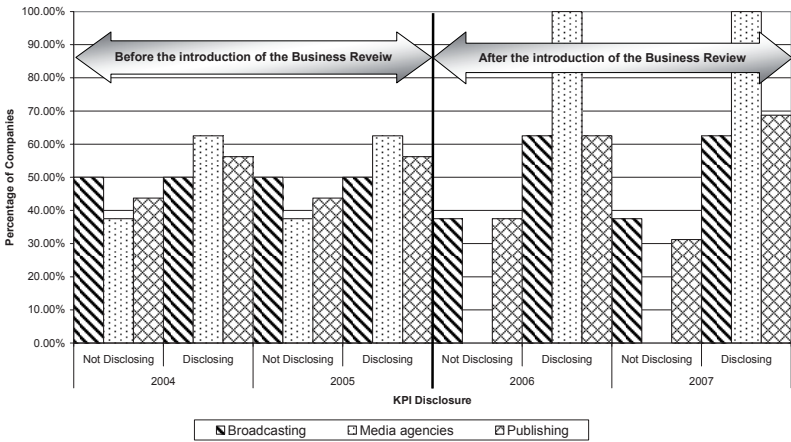
(10) Nothing in this section requires the disclosure of information about impending developments or matters in the course of negotiation if the disclosure would, in the opinion of the directors, be seriously prejudicial to the interests of the company.

(11) Nothing in subsection (5)(c) requires the disclosure of information about a person if the disclosure would, in the opinion of the directors, be seriously prejudicial to that person and contrary to the public interest.

...and companies may be taking advantage of these exemption provisions under the Act.

Figure 4.2 shows an analysis of companies disclosing and not disclosing any KPI by sub-sectors: broadcasting, media agencies and publishing. The results show that the media agencies sub-sector has the highest percentage of companies disclosing at 62.5% in 2004 and 2005. This is followed by the publishing sub-sector with 56.25% and the least disclosing sub-sector is broadcasting with 50%.

Figure 4.2 Percentage of companies disclosing and not disclosing KPIS by sub-sector



The results also show that the media agencies sub-sector continued to have a greater percentage of companies disclosing at least one KPI after the business review became mandatory. For example, in both 2006 and 2007, 100% of the sub-sector’s companies disclosed at least one KPI compared to 62.5% and 68.75% for the publishing sub-sector and 62.5% for the broadcasting sub-sector, in 2006 and 2007, respectively.

Nature and extent of KPI reporting

The analysis presented above is based on the number of companies disclosing KPIS. Whilst it shows that an increasing number of companies are reporting KPIS, it does not provide insights into the nature and level of KPI reporting and thus does not differentiate between low and high disclosing companies. This section attempts to provide such insights

which are important in understanding KPI reporting in the media sector. The results are presented below.

Appendix Two shows the number of companies reporting each of the 44 financial and 35 non-financial KPIs over the four-year period. The most popular 10 financial and five non-financial KPIs are presented in Table 4.1. From Table 4.1, EPS is the most popular financial KPI, followed by revenue, operating profit, operating margin, and profit before tax. The other popular financial KPIs include: operating cash flow; dividend per share; returns (measured by increase in share price); return on capital employed; gross profit margin; and cash conversion. The popular non-financial KPIs are: head count (number of people); customers logging on to the company's website; share of commercial impact; relationship with clients; and staff engagement.

Table 4.1 Most popular financial and non-financial KPIs reported by sample companies

Financial KPIs	Non-financial KPIs
Earnings per share	- Headcount - Number of unique users logging on to our website - Share of commercial impact (%)
Revenue	
Operating profit	
Operating margin	- Relationship with clients - Staff engagement
Profit before tax	
Operating cash flow	
Dividend per share	
Total shareholder return (share price)	
Return on invested capital	
- Gross profit margin	
- Cash conversion	

Table 4.2 presents a summary of the nature of KPIs reported over the four-year period.

Table 4.2 Nature and number of KPIs reported in annual reports

Panel A: Two years before the introduction of the business review									
	2004			2005			Overall		
	N=32			N=32			N=64		
	FKPIs	NFKPIs	Total	FKPIs	NFKPIs	Total	FKPIs	NFKPIs	Total
Average	1.62	0.00	1.62	1.78	0.12	0.90	1.70	0.06	1.76
Minimum	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Maximum	6.00	0.00	6.00	10.00	4.00	10.00	10.00	4.00	10.00

Panel B: Two years after the introduction of the business review									
	2006			2007			Overall		
	N=32			N=32			N=64		
	FKPIs	NFKPIs	Total	FKPIs	NFKPIs	Total	FKPIs	NFKPIs	Total
Average	3.00	0.38	3.38	3.38	0.87	4.25	3.19	0.62	3.81
Minimum	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Maximum	10.00	4.00	10.00	10.00	6.00	12.00	10.00	6.00	12.00

FKPIs = Financial key performance indicators
NFKPIs = Non-financial key performance indicators
N = Number of companies in sample
Total = The total average, minimum and maximum KPIs reported. The minimum and maximum numbers do not equate to the total of the numbers reported under the FKPI and NFKPI columns, as the company with the maximum KPIs reported may not be the company with the maximum FKPIs and maximum NFKPIs.

The results show that for the period before the introduction of the business review (2004-2005), the average number of KPIs is 1.76. In 2004, all the KPIs reported were financial in nature, and the maximum number of KPIs reported was only six. However, in 2005, some companies began to include non-financial KPIs in their reports,

although the number reported was very low with a maximum of four non-financial KPIs being reported. In terms of financial KPIs, the average KPIs reported slightly increased from 1.62 in 2004 to 1.90 in 2005, with the maximum number of financial KPIs increasing from six to ten.

For the period after the introduction of the business review (2006-2007), the table shows an increase in the average total number of KPIs reported compared to the 2004-2005 period. The number of KPIs reported more than doubled from 1.76 in 2004-2005 to 3.81 in the period 2006-2007. Whilst there were companies still not reporting any KPIs (as reflected by a minimum of zero), the maximum number of KPIs reported increased from 10 to 12. In terms of the nature of KPIs, the results show that companies focus on reporting financial KPIs although there is a slight increase in the number of reported non-financial KPIs. On the whole, the results in Table 4.2 suggest that there was a gradual increase in the number of both financial and non-financial KPIs reported from 2004 to 2007.

The summary statistics reported in Table 4.2 are further analysed according to the three sub-sectors to gain additional insights into KPI reporting in the media sector. The results of this analysis are reported in Tables 4.3 and 4.4 for before and after introduction of the business review respectively. Table 4.3 shows that among the three sub-sectors, publishing companies disclosed more KPIs than the broadcasting and media agencies companies prior to the introduction of the business review. For the two-year period, the average number of KPIs disclosed by companies in the publishing sub-sector was 2.12 compared to 1.50 and 1.31 for the media agencies and broadcasting sub-sectors, respectively.

Table 4.3 Nature and number of KPIs reported in annual reports by sub-sector prior to introduction of business review

Panel A: Broadcasting									
	2004			2005			Overall		
	FKPIs	NFKPIs	Total	FKPIs	NFKPIs	Total	FKPIs	NFKPIs	Total
Average	1.12	0.00	1.12	1.50	0.00	1.50	1.31	0.00	1.31
Minimum	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Maximum	3.00	0.00	3.00	4.00	0.00	4.00	4.00	0.00	4.00

Panel B: Media agencies									
	2004			2005			Overall		
	FKPIs	NFKPIs	Total	FKPIs	NFKPIs	Total	FKPIs	NFKPIs	Total
Average	1.50	0.00	1.50	1.00	0.50	1.50	1.25	0.25	1.50
Minimum	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Maximum	6.00	0.00	6.00	3.00	4.00	4.00	6.00	4.00	6.00

Panel C: Publishing									
	2004			2005			Overall		
	FKPIs	NFKPI	Total	FKPIs	NFKPIs	Total	FKPIs	NFKPIs	Total
Average	1.93	0.00	1.93	2.31	0.00	2.31	2.12	0.00	2.12
Minimum	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Maximum	6.00	0.00	6.00	10.00	0.00	10.00	10.00	0.00	10.00

FKPIs = Financial key performance indicators
NFKPIs = Non-financial key performance indicators
Total = The total average, minimum and maximum KPIs reported. The minimum and maximum numbers do not equate to the total of the numbers reported under the FKPI and NFKPI columns, as the company with the maximum KPIs reported may not be the company with the maximum FKPIs and maximum NFKPIs.

The number of KPIs increased from an average of 1.93 in 2004 to 2.31 in 2005 for publishing companies, whilst broadcasting companies increased the number of KPIs from an average of 1.12 in 2004 to 1.31

in 2005. Although some companies in the media agencies sub-sector reported the most KPIs (as suggested by a maximum of 6 in 2004) compared to the broadcasting sub-sector, the average number of KPIs reported was the same for each of the two years 2004 and 2005 (1.5). However, except for the media agencies sub-sector which reported non-financial KPIs in 2005, none of the companies in the other two sub-sectors reported any non-financial KPIs.

However, Table 4.4 shows that there was a change in the period after the introduction of the business review. There was a general improvement of KPI reporting in all the sub-sectors compared to the period prior to the introduction of the business review, in terms of both financial and non-financial KPIs. This suggests that the introduction of the business review may have compelled companies in the sector to report more KPIs, although some companies still failed to report any KPIs in the post-business review periods.

As Table 4.4 indicates, the media agencies sub-sector companies, on average, reported 4.68 KPIs during the two year period (2006/2007) compared to 3.87 and 2.81 KPIs for the publishing and broadcasting sub-sectors, respectively. The results for the individual years (2006 and 2007) show an increase from 4.50 in 2006 to 4.88 in 2007 for media agencies which is higher than the 3.25 to 4.50 for the publishing sub-sector and 2.50 to 3.12 for the broadcasting sub-sector. Further analysis of Table 4.4 also highlights that, compared to the period 2004 to 2005, companies in the broadcasting and publishing sub-sectors introduced non-financial KPIs in their annual reports. Consistent with the total KPI reporting, the media agencies sub-sector companies dominate the other sub-sectors in reporting non-financial KPIs. In 2004, the media agencies sub-sector reported, on average no non-financial KPIs, but by 2007 reported 1.38 non-financial KPIs. This seems to suggest that the media agency companies were more responsive in incorporating the requirements of the business review. The Kruskal-Wallis tests conducted to determine whether there are differences among sub-sectors showed a statistical significant difference, with a Chi-square of 6.030 and p-value of 0.049.

Table 4.4 Nature and number of KPIS reported in annual reports by sub-sector after introduction of business review

Panel A: Broadcasting									
	2006			2007			Overall		
	FKPIs	NFKPIs	Total	FKPIs	NFKPIs	Total	FKPIs	NFKPIs	Total
Average	2.12	0.38	2.50	2.37	0.75	3.12	2.25	0.56	2.81
Minimum	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Maximum	5.00	3.00	5.00	5.00	6.00	9.00	5.00	6.00	9.00

Panel B: Media agencies									
	2006			2007			Overall		
	FKPIs	NFKPIs	Total	FKPIs	NFKPIs	Total	FKPIs	NFKPIs	Total
Average	3.50	1.00	4.50	3.50	1.38	4.88	3.50	1.18	4.68
Minimum	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Maximum	7.00	4.00	8.00	7.00	4.00	8.00	7.00	4.00	8.00

Panel C: Publishing									
	2006			2007			Overall		
	FKPIs	NFKPIs	Total	FKPIs	NFKPIs	Total	FKPIs	NFKPIs	Total
Average	3.19	0.06	3.25	3.81	0.69	4.50	3.50	0.37	3.87
Minimum	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Maximum	10.00	1.00	10.00	10.00	5.00	12.00	10.00	5.00	12.00

FKPIs = Financial key performance indicators
NFKPIs = Non-financial key performance indicators
Total = The total average, minimum and maximum KPIS reported. The minimum and maximum numbers do not equate to the total of the numbers reported under the FKPI and NFKPI columns, as the company with the maximum KPIS reported may not be the company with the maximum FKPIs and maximum NFKPIs.

The influence of the business review, corporate governance and company-specific factors on the extent of KPI reporting

The previous section summarised the extent of KPI reporting in the media sector in terms of the number of KPIs reported in the annual reports. The results in the previous section suggest that companies increased the number of KPIs after the introduction of the business review. Additionally, the analysis revealed that whilst the reporting of KPIs is very low, the number of KPIs differs amongst companies. In this section, further analyses are carried out to determine whether there is any difference in the level of disclosure between the period prior to and post the introduction of the business review. In addition, because previous studies suggest that corporate governance and company-specific factors influence disclosure, further analysis is undertaken to determine whether KPI reporting is affected by such factors. This analysis is carried out using a regression analysis approach. For the analysis to be meaningful, the measures for the extent of KPI reporting used are those developed using the disclosure index methodology as explained in chapter three. The disclosure index methodology expresses the number of items disclosed by each company as a percentage of the total number of KPIs applicable to that company. As a result the disclosure score (expressed as percentage) is a relative measure. This allows more meaningful comparisons between periods and amongst different companies.

Summary of KPI reporting using disclosure index

In Table 4.5 the extent of KPI reporting using relative figures is presented. As shown in the Table, the two-year average KPI reporting for the period before the introduction of the business review is 2.73%. The minimum and maximum disclosure scores during the two year period are 0% and 14% respectively. The average over the two-year

period following the introduction of the business review (2006 and 2007) is 5.86%. The minimum disclosure score remained at 0%. This is consistent with the earlier findings that some companies did not disclose any KPIS throughout the four-year period. The result indicates that there was an increase in KPI reporting after the introduction of the compulsory business review.

Table 4.5 Nature and extent (%) of KPIS reported in annual reports

Panel A: Two years before the introduction of the business review									
	2004			2005			Overall		
	FKPIs %	NFKPIs %	Total %	FKPIs %	NFKPIs %	Total %	FKPIs %	NFKPIs %	Total %
Average	3.97	0.00	2.56	4.38	0.75	2.91	4.17	0.38	2.73
Minimum	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Maximum	15.00	0.00	11.00	23.00	24.00	14.00	23.00	24.00	14.00

Panel B: Two years after the introduction of the business review									
	2006			2007			Overall		
	FKPIs %	NFKPIs %	Total %	FKPIs %	NFKPIs %	Total %	FKPIs %	NFKPIs %	Total %
Average	7.47	1.91	5.19	8.28	3.78	6.53	7.88	2.84	5.86
Minimum	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Maximum	23.00	24.00	14.00	23.00	26.00	17.00	23.00	26.00	17.00

The percentage calculated is based on the number of KPIS reported compared to the total number of available relevant KPIS

- FKPIs
- =
- Financial key performance indicators
- NFKPIs
- =
- Non-financial key performance indicators
- Total
- =
- The total average, minimum and maximum KPIS reported. The minimum and maximum numbers do not equate to the total of the numbers reported under the FKPI and NFKPI columns, as the company with the maximum KPIS reported may not be the company with the maximum FKPIs and maximum NFKPIs.

To determine whether there is a statistically significant difference between pre and post business review average KPI reporting scores, t-tests were performed. The results show that the average (mean) difference between the KPI disclosure scores for the two periods is 3.125%, with higher disclosures in the post business review period. The difference is significantly different from zero, with a t-statistic of 4.403 (significant at 1% level or better). These results suggest that the introduction of the business review had a significant impact on the reporting of KPIs in the media sector.

Impact of governance and company-specific factors: regression results

In order to determine the influence of corporate governance and company-specific factors, the following multiple regression model is estimated where the disclosure score is analysed against pre or post business review, the proportion of NEDs, the percentage of shares owned by directors, audit committee size, company size, profitability and gearing.

$$KPIS = \beta_0 + \beta_1 BREV + \beta_2 PNED + \beta_3 DISH + \beta_4 AUDS + \beta_5 SIZE + \beta_6 PROF + \beta_7 GEAR + \varepsilon_j$$

All the variables in the model are defined in Table 4.6.

Table 4.6 Definition of variables included in the multiple regression models

Variable	Definition
KPIS	KPIS disclosure score for each company measured by the dichotomous index methodology: ‘1 if a KPI is reported, 0 otherwise’.
BREV	Business review, coded 1 for the period after KPI reporting requirements came into force (i.e. 2006 and 2007); 0 otherwise.
PNED	Number of non-executive directors divided by the total number of directors on the company’s board of directors at the annual report date.
DISH	Percentage of shares owned or controlled by directors at annual report date.
AUDS	Number of directors on the audit committee at the annual report date.
SIZE	Company size measured in terms of the natural log of total assets at the annual report date.
PROF	Profit measured as operating profit divided by shareholders’ funds at the annual report date.
GEAR	Long-term debt divided by shareholders’ funds at the annual report date.
$\beta_0, \dots, \beta_7$	Regression coefficients.
ε_j	Error term.

The summary descriptive statistics of the corporate governance and company-specific factors are presented in Table 4.7. As Table 4.7 shows, the average proportion of NEDs is 56% percent which suggests that most boards are composed of more NEDs than executive directors. The directors’ shareholding ranges from a minimum of zero percent to a maximum of 59%. Table 4.7 also shows that the average audit committee comprises of three directors with a minimum of two and a maximum of five directors. Both the proportion of NEDs and the size of the audit committee in the media sector are consistent with the recommendations of the UK Combined Code of 2006, suggesting that in the main companies do comply with best practice in corporate governance.

Table 4.7 Results for corporate governance and company-specific factors

Variables	Mean	Std dev	Min	Max
KPIS	0.0430	0.0417	0.00	0.17
PNED	0.5584	0.1343	0.29	0.87
DISH	0.0617	0.1208	0.00	0.59
AUDS	3.2578	0.6550	2.00	5.00
SIZE (Mktcap in £million)	1,903.4755	2,677.7422	22.42	10,850.09
PROF	0.1170	0.1680	-0.49	0.87
GEAR	1.9524	4.9872	0.00	51.68

The variables are defined in Table 4.6

In terms of company profitability, the average return on shareholders' funds is 11% with a range of -49% to 87%. The average gearing is 1.95, suggesting that these companies are generally highly geared. The results suggest that the average market capitalisation is £1.9 billion. The smallest company has a market capitalisation of £22 million whilst the largest company's market capitalisation is £10.8 billion. Thus the companies in the sample of the study comprise both small and large companies. The results obtained from the analysis in this study may therefore be generalised to the media sector.

Table 4.8 shows the correlations between the extent of KPI reporting and business review, proportion of non-executive directors, directors share ownership, audit committee size, company size, profitability and gearing. Correlations describe the strength and direction of the relationship between two variables. The value of the correlation ranges from -1 to +1, with the sign indicating a negative or positive direction of the relationship. The absolute value reveals the strength of the relationship between the two variables. In the context of this study, it indicates the strength of the relationship between the extent of KPI reporting and business review, corporate governance and company-specific factors.

Table 4.8 Correlations

Variable	KPIS	BREV	PNED	DISH	AUDS	SIZE	PROF	GEAR
KPIS	1.000							
BREV	0.360**	1.000						
PNED	-0.150	0.039	1.000					
DISH	-0.064	-0.031	-0.237**	1.000				
AUDS	0.018	0.150	0.188*	-0.057	1.000			
SIZE	0.085	0.008	0.537**	-0.167	0.181*	1.000		
PROF	-0.114	0.016	0.154	-0.207*	-0.012	0.252**	1.000	
GEAR	-0.130	0.109	0.266**	-0.097	-0.064	0.391**	0.120	1.000

The variables are defined in Table 4.6

** Correlation is significant at the 0.01 level (2-tailed)

* Correlation is significant at the 0.05 level (2-tailed)

Table 4.8 shows that there is a significant positive correlation between KPI reporting and the introduction of the business review. This positive correlation suggests that KPIs disclosure increased when the business review was introduced. This is consistent with the expectation that on the introduction of the business review most companies will make an effort to comply because of the consequences of non-compliance. The table also shows that the correlations between KPI reporting and the individual corporate governance and company-factors are not statistically significant.

In Table 4.9, the results from the multiple regression analyses are summarised. The regression model explains a small amount of the variations in KPI disclosure among companies in the media sector. The Adjusted R^2 suggests that 23.3% of the variation in KPI disclosure can be explained by the business review, corporate governance and company-specific factors included in the model. The Adjusted R^2 is a measure of how much of the variation in KPI reporting among the media sector companies is accounted by the introduction of business review, corporate governance and company-specific factors. The fact that only

23.3% of the variation is explained implies that there are other factors that influence the reporting of KPIs in the media sector.

Table 4.9 *Regression results of the association between the business review, corporate governance, company-specific factors and KPI disclosure*

Model summary	
Adjusted R ²	0.233
F-ratio	6.519***
Number	128.000
Main variables^a	
Intercept	0.092 (4.250***)
Business review	0.034 (5.097***)
Corporate Governance factors	
Proportion of non-executive directors	-0.089 (-3.035**)
Directors' share ownership	-0.041 (-1.477)
Audit committee size	-0.005 (-.961)
Company-specific factors	
Company size	0.00001 (3.645***)
Profitability	-0.041 (-2.021**)
Gearing	-0.002 (-2.735***)

^a t-statistics are in parentheses

** Significant at the 0.05 level

*** Significant at the 0.01 level

Table 4.9 shows that the introduction of the business review, proportion of non-executive directors, company size, profitability and gearing are all significantly associated with the extent of KPI reporting. The association between business review and the extent of KPI reporting is positive and significant at the 1% level or better. These results suggest that the introduction of the business review influenced companies' decisions to report a higher level of KPIs in their annual reports. It is possible that such a response by companies derives from a fear of repercussion for non-compliance with legislation. Furthermore, given that the business review does not mandate companies to report

specific KPIS, companies may want regulators to see them as responsive to avoid further regulations. As Gray and Roberts (1989) report after surveying finance directors in the UK regarding voluntary disclosure, companies find it in their interests to respond to guidelines in order to avoid prescriptive regulations. Overall, these results suggest that some form of minimum legislation may be partially effective in encouraging companies to report more information.

Focusing on corporate governance factors, the results show that the proportion of NEDs is significantly but negatively associated with the extent of KPIS disclosure (at 5% level or better). This suggests that the greater the proportions of non-executive directors, the less KPIS are disclosed and is contrary to that predicted. These results are surprising and difficult to explain, particularly given that non-executive directors are expected to protect the interests of shareholders. It is possible that these results derive from the measure used which does not differentiate between independent and non-independent non-executive directors. If the company has a higher proportion of non-independent non-executive directors, the non-executive directors may easily be influenced by managers and therefore may not compel or encourage KPI reporting in the annual reports. The relationship between KPI reporting and directors' share ownership and audit committee size is negative, but not statistically significant, thus inconsistent with the predicted relationship.

The results also show that company size is positively related to the extent of KPIS disclosure which is consistent with the predicted relationship. Gearing ratio is negatively and significantly associated with KPI reporting. This does not support earlier arguments that highly geared companies are more likely to report more KPIS. One possible explanation is that rather than disclose KPIS in the annual report, the companies may provide such KPIS privately. Finally, the relationship between KPI reporting and profitability is negative and statistically significant at the 5% level or better. Thus more profitable companies are less likely to disclose KPIS. The negative relationship implies that the directors may be avoiding providing information on their competitive

advantage which encourage competition and therefore affect their business profitability in the future.

Summary

The chapter reported the findings of the study. It was noted that some companies were still not reporting KPIs even after the requirements of the business review came into force. The results also show that EPS, revenue and operating profit are among the most commonly disclosed financial KPIs. Among the most popular non-financial KPIs are headcount, number of users logging on to the website and relationship with clients. On the whole, the findings show that KPI reporting in the media sector is very low. The chapter also presented the results of analysing the association between the reporting of KPIs and business review, corporate governance and company-specific factors. The results suggest that the introduction of the business review, proportion of non-executive directors, company size, profitability and gearing are associated with the extent of KPI reporting.

5 SUMMARY AND CONCLUDING REMARKS

This paper investigates the reporting of KPIs in the annual reports of UK media sector companies listed on the London Stock Exchange. The paper also examines the influence of the introduction of the business review as well as corporate governance and company-specific factors on the extent of KPI reporting. Data for a four year period consisting of a two-year period before (2004 and 2005) and a two-year period (2006 and 2007) after the introduction of the business review was collected from annual reports of the 32 media companies.

The findings suggest that for both the pre and post introduction of the business review, the reporting of KPIs by the media sector is very low. However, the results reveal an increasing trend in the number of companies reporting KPIs, particularly after the introduction of the business review requirement in 2005. In spite of the increasing trend, some companies still failed to report a single KPI in their annual report. In terms of the nature and extent of KPI reporting, the results indicate that on average the number of KPIs reported by the companies increased from an average of 1.76 for the two-year period before the introduction of the business review to 3.81 after the business review introduction. In addition, the results reveal that financial KPIs dominate non-financial KPIs for both the two periods. In the period before the introduction of the business review, the average number of financial KPIs reported was 1.70 compared to 0.06 for the non-financial KPIs. The average number of financial KPIs increased to 3.19 in the two year period after the introduction of the business review, whilst non-financial KPIs increased to only 0.62. On the whole, however, the results suggest that the introduction of the business review influences the reporting of both

financial and non-financial KPIs. Statistical tests on the differences in the reporting of KPIs reveal significant differences between the two periods.

Further analysis shows that the introduction of the business review has the most significant influence on the extent of reporting of KPIs. In addition, the proportion of non-executive directors, company size, profitability and gearing are also associated with the extent of KPI reporting.

Overall, the evidence shows some increase in the reporting of KPIs after the introduction of the business review, although the level of reporting remains very low. In addition, companies are mostly reporting financial KPIs. However, some companies are still not reporting any KPIs at all, suggesting that they are not complying with the requirements of the Companies Act 1985 (as amended). The differences in the reporting of KPIs seem to derive from corporate governance and company-specific attributes. In this respect, there is evidence that large companies are more likely to report KPIs in their annual reports than smaller companies. The evidence also suggests that the likelihood of reporting KPIs in annual reports decreases with a large proportion of non-executive directors and the level of profitability and borrowings.

These results have policy implications. The fact that there are companies that are not complying with the Companies Act suggests that additional regulations may be required to enforce compliance. Additionally, non-compliance may mean that companies are not clear on KPI reporting, especially non-financial KPIs, and additional guidance may be required.

There are a number of further research avenues that could be pursued in future:

- Further research could extend this project to other industries and use a much larger sample. As PricewaterhouseCoopers (2006) suggests, KPIs are more likely to be company and sector specific.

- Future research could investigate the usefulness of the KPIs identified. This could be particularly helpful to companies because they need to focus on reporting KPIs that are relevant to users. Regulators may also find this relevant in developing regulatory requirements for the reporting of KPIs.
- Given the findings that very few KPIs are disclosed, future research could investigate the reasons why.
- Future research could also investigate whether there are differences in the way the same KPIs are measured by different companies.
- It may also be important to investigate to what extent companies change the reporting of their KPIs over time and whether reasons are given for this change.

These findings must be taken in the light of the limitations of the research. The first is the measurement of disclosure. Disclosure was measured by counting the number of KPIs disclosed by each company which is not satisfactory because companies are different in size and the scope of their operations. Disclosure was also measured by the disclosure index. Although the disclosure index method has been used for over forty years, there are many critics who argue that disclosure cannot be measured reliably because companies can use different words to make the same point. The second limitation is the sample size of just 32. Although the analysis is over four years a larger sample could have yielded different results. Finally, the results reported are also affected by companies in the sample that did not make any KPI disclosure at all. However, since the aim was to describe how media sector companies listed on the London Stock Exchange reported KPIs it was not possible to eliminate these companies.

R

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PPENDIX 1

List of sample companies

- 1 Aegis Group plc
- 2 Bloomsbury Publishing plc
- 3 British Sky Broadcasting Group plc
- 4 Centaur Media plc
- 5 Chime Communications plc
- 6 Chrysalis plc
- 7 Creston plc
- 8 Daily Mail & General Trust plc
- 9 Emap plc
- 10 Entertainment Rights plc
- 11 Euromoney Institutional Investor plc
- 12 Future plc
- 13 GCAP Media plc
- 14 Haynes Publishing Group plc
- 15 Huntsworth plc
- 16 Informa plc
- 17 ITE Group plc
- 18 ITV plc
- 19 Johnston Press plc
- 20 Pearson plc
- 21 Pinewood Shepperton plc
- 22 Reed Elsevier plc
- 23 Reuters Group plc

List of sample companies (Cont.)

- 24 SMG plc
- 25 Tarsus Group plc
- 26 Taylor Nelson Sofres plc
- 27 Trinity Mirror plc
- 28 United Business Media plc
- 29 UTV Media plc
- 30 Wilmington Group plc
- 31 WPP Group plc
- 32 Yell group plc

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PPENDIX 2

KPI disclosure by sample companies

Panel A: Financial KPIs		2004	2005	2006	2007
1.	Revenue	9	9	12	13
2.	Operating margin	4	4	11	12
3.	Total shareholder return (share price)	1	1	3	3
4.	Revenue per employee	0	0	1	1
5.	Profit before tax	8	6	9	9
6.	Earnings per share	14	13	15	16
7.	Cash conversion	0	0	3	3
8.	Staff costs/operating income	0	0	1	1
9.	Average fee income per client	1	1	1	1
10.	Average fee income per employee	1	1	1	1
11.	Percentage of operating income from clients shared by more than one business group	0	0	1	1
12.	Percentage of income from international work	0	1	0	1
13.	Operating profit	7	8	9	12
14.	Gross profit margin	0	1	3	2
15.	Net debt to EBITA	0	0	0	1
16.	City PBT	0	0	0	1
17.	Organic profits	0	0	1	1
18.	Debt capacity	0	0	1	1
19.	Growth in total advertising revenue (as a % at constant currency)	0	0	0	1
20.	Proportion of advertising revenue that is online (as a %)	0	0	0	1
21.	Net bank debt	0	0	0	1
22.	Net funds (borrowings)	1	2	1	1
23.	Dividend per share	2	1	3	3

KPI disclosure by sample companies (Cont.)

Panel A: Financial KPIs		2004	2005	2006	2007
24.	Net asset value per share (pence)	1	1	1	0
25.	Volume sales	0	0	2	2
26.	Average revenue yield per square metre	0	0	0	1
27.	Operating cash flow	2	2	3	4
28.	Return on invested capital	1	2	2	2
29.	Profit per employee	0	0	2	1
30.	Effective tax rates	0	1	1	1
31.	Profit after tax	0	1	1	1
32.	Constant currency growth	0	1	1	1
33.	Online advertising	0	0	0	1
34.	Regional transaction based revenue	0	0	0	1
34.	Classified advertising	0	0	0	1
36.	Organic revenue growth	0	0	2	2
37.	Forward bookings	0	0	1	1
38.	Product profitability	0	0	1	1
39.	Publishing (revenue per issue)	0	0	0	1
40.	Proportion of custom revenue attributable to data collected by internet access	0	0	1	1
41.	Revenue growth collected from business solutions	0	0	0	1
42.	Staff costs/revenue	0	0	1	0
43.	Cumulative pre-tax returns on acquisitions	0	1	1	1
44.	Unique advertisers retention rate	0	0	0	1

KPI disclosure by sample companies (Cont.)

Panel B: Non-financial KPIs		2004	2005	2006	2007
45.	Headcount	0	0	1	2
46.	Relationship with clients	0	0	1	1
47.	Number of magazines sold per month	0	0	0	1
48.	Proportion of magazines sold to total number printed	0	0	0	1
49.	Proportion of group's business derived from our brands to partnership publishing	0	0	0	1
50.	Number of unique users logging on to our websites per month	0	0	1	2
51.	Audience commitment (%)	0	0	0	1
52.	Share of commercial impact (%)	0	0	2	1
53.	Adult impact volume (numbers)	0	0	1	1
54.	Staff engagement	0	0	0	2
55.	Electricity consumption	0	0	0	1
56.	CO2 emission through travel	0	0	0	1
57.	Water consumption	0	0	0	1
58.	Waste (produced and recycled)	0	0	0	1
59.	Paper purchased/recycled	0	0	0	1
60.	Advertising market share	0	0	0	1
61.	Sponsorship growth	0	0	0	1
62.	Production hours	0	0	1	1
63.	Library content monetisation	0	0	0	1
64.	Rights exploitation growth	0	0	0	1
65.	Online visitor growth	0	0	0	1
66.	Audience market share	0	0	1	0
67.	Exhibitions (space occupied and visitor attendance)	0	0	0	1
68.	Conferences (delegates and number of exhibitors)	0	0	0	1
69.	Publishing (pages per issue and readership)	0	0	0	1
70.	Global partnership accounts as % of custom revenue	0	0	0	1
71.	Marketing ethics	0	1	1	1
72.	Employment	0	1	1	1

KPI disclosure by sample companies (Cont.)

Panel B: Non-financial KPIs		2004	2005	2006	2007
73.	Social investment	0	1	1	1
74.	Climate change	0	1	1	1
75.	Unique advertisers	0	0	0	1
76.	Directory editions published	0	0	0	1
77.	Revenue per unique advertiser	0	0	0	1
78.	Searchable advertiser	0	0	0	1
79.	Searches per month	0	0	0	1

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The Influence of the Business Review on Reporting Key Performance Indicators in the UK Media Sector

The aim of reporting financial and non financial key performance indicators (KPIs) is to provide a better understanding of the development, performance or position of the company.

This paper looks at the reporting of financial and non financial KPIs in listed media companies for a four year period straddling the introduction of the business review in 2005. The study finds that despite an increase in reporting the level of compliance remains low even after the statutory requirement was introduced in 2005. In fact by 2007 25% of companies were still not reporting any KPIs. The research identifies that the reporting of non financial KPIs is particularly low.

The findings raise questions with regard to the usefulness of KPI reporting and why companies are choosing not to comply with the disclosure requirements of the Companies Act. This non-compliance also raises wider concerns about the enforceability of Companies Act disclosure requirements in the director's report and the business review.

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