

Full Length Research Paper

Firms' characteristics and forward-looking information in management commentaries of Italian listed companies

Elisa Menicucci

Faculty of Economics, Polytechnic University of Marche, Ancona, Italy.

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The purpose of this paper is to investigate the association between firms' characteristics and the level of forward-looking information in management commentaries of Italian listed companies. The firms' characteristics investigated in the study are their size, profitability and leverage. The methodology of the study is content analysis of management commentaries of the Italian companies listed on the FTSE All-Share Index for the year 2010. The relationship between some firms' characteristics and the disclosure of forward-looking information is examined using multiple linear regression analysis. The results of univariate and multivariate analyses indicated that profitability has significant negative association with the level of forward-looking information. Conversely, firms' size and leverage variables are found to have an insignificant relationship with the level of forward-looking information.

Key words: Forward-looking information, firm size, profitability, leverage, disclosure, management commentary, Italy.

INTRODUCTION

The role of forward-looking disclosure in capital markets is today crucial since the economic environment is too dynamic to rely on historical information only. Along with the economic development, the historical information disclosure of listed companies cannot satisfy investors' diversified information needs.

Especially, the rapid change of economic conditions makes the potential deficiencies of historical information to become more evident. In some cases, historical information could not sufficiently provide insights to stakeholders to forecast critical success factors, opportunities, risks and management plans.

It is believed that disclosure of forward-looking information would improve the capability of investors to anticipate future earnings and to make better investment decisions to assess future cash flows (Hussainey et al., 2003).

A number of papers pointed out the usefulness of forward-looking financial information for investors to base their investment decision-making process. For instance, Kieso and Weygandt (1995) asserted that forward-looking information is helpful to investors in their forecasts.

Also the financial community and Accounting Standard Setters such as FASB (2001) and IASB (2010) have increasingly allowed more voluntary disclosure of forward-looking information as a mean to satisfy investors' information needs.

For example, American Institute of Certified Public Accountants (AICPA, 1994), the Canadian Institute of Chartered Accountants (CICA, 2002) and the Institute of Chartered Accountants of England and Wales (ICAEW, 2003), all highlight the importance of forward-looking information for informed investors' decision making.

In addition, according to IASB (IASB, 2010), management commentary should include forward-looking information and explain management perspective of the company's direction (IASB, 2010). This information should indicate key trends and factors determining future results, position and development of the company and should identify expected opportunities and risks resulting from those trends.

Before investigating the object of this study, it would be better to define the concept forward-looking information.

Forward-looking information is the category of information concerning future forecasts that enable users to assess a company's future performance. It includes management's plans, evaluations of opportunities and risks, and forecasted data about the company's operations. Furthermore, forward-looking information regards financial forecasts such as future earnings, expected revenues and anticipated cash flows. Forward-looking information also involves non-financial information regarding objectives, strategies, risks and uncertainties that could considerably influence current results and expected targets. According to ICAEW (2003), such forward-looking disclosure engages any information that might have an effect on subsequent financial statements.

In the perspective of forward-looking information, the nature of business, management's objectives and strategies, resources, risks and relationships, prospects, forecasted performance of the firm and other information in several issues can be disclosed. The level of this type of information would be significant in estimating the extent to which the company's financial position, liquidity and performance may change in the future (IASB, 2010). Already numerous studies analyzed empirically the benefits of forward-looking information with respect to corporate future performance (Clarkson et al., 1994; Bryan, 1997).

This paper studies the effect of firms' characteristics on the level of forward-looking disclosure in management commentary, taking into account a quantitative measure of forward-looking information. In our study, we developed hypotheses about the association between forward-looking information and firms' characteristics that might affect disclosure strategies followed by managers in Italian listed companies.

With this aim, corporate attributes which have a direct effect on the level of forward-looking information are determined by a detailed examination of the relevant disclosure literature.

Our study contributes to the prior studies on disclosure strategies by showing that the amount of forward-looking information disseminated in the management commentaries are influenced by firms' characteristics.

LITERATURE REVIEW

Recently, studies about the effect of firms' characteristics

on disclosure have proliferated and this topic has received a great emphasis in academic literature. In particular, some prior studies have investigated the correlation between firms' characteristics and disclosure of forward-looking information (Meek et al., 1995; Patton and Zelenka, 1997), but empirical evidence about the effect of firm-specific attributes on this kind of disclosure is uncertain and sometimes fails to provide conclusive results (Donnelly and Mulcahy, 2008).

There are a lot of studies that attempt to investigate what motivates companies to disclose forward-looking information. A number of previous literatures focused on determinants of the disclosure level of forward-looking information and they have principally concentrated on the relations between earnings forecast and firms' characteristics. For example, Kent and Ung (2003) found that larger companies with less volatile earnings tend to provide more information on future corporate performance than smaller companies with relatively volatile earnings.

Other studies analyzed the association between forward-looking information and firms' characteristics directly affecting the disclosure behavior of companies and they led us to formulate the following hypotheses.

Hypotheses development

Firms' size

Much evidence of previous studies on the determinants of corporate disclosure documented the existence of a relationship between the firm's size and its level of forward-looking disclosure (Cerf, 1961; Cooke, 1991). Notably, a stream of empirical research has found that larger companies are less reluctant to disclose greater amount of disclosure (Wallace et al., 1994; Beattie et al., 2004; Hassan et al., 2006; Alsaeed, 2006) and to follow better disclosure practices (Ahmed and Courtis, 1999). In particular, empirical evidences from previous studies demonstrated that total level of forward-looking information is positively related with company's size (Kent and Ung, 2003; Vanstraelen et al., 2003; Leventis and Weetman, 2004; Gao et al., 2005; Hossain et al., 2005; Celik et al., 2006; Lim et al., 2007; Hossain and Hammami, 2009; Abed et al., 2011).

Just two studies, instead, have supported the absence of significant relationship between firm's size and forward-looking information (Aljifri, 2006; Aljifri and Hussainey, 2007) because findings have shown that companies of varying sizes tend to have insignificant differences in their forward-looking disclosure.

Literature review offers a wide variety of criteria for measuring the size of a company, such as capital employed and sales turnover (Firth, 1979), total assets and turnover (Cooke, 1991) and the market capitalization (Debrency et al., 2002).

In our study, we measure the firm's size (SIZE), as one of the firms' characteristics on disclosure of forward-looking information, by book value of total assets as employed by Alsaeed (2006).

Based on some of the previous studies, it can be hypothesized that:

H1: There is a positive relationship between firms' size and the level of forward-looking information.

Profitability

The association between profitability and voluntary disclosure has been examined in prior literature (Oyelere et al., 2003; Marston, 2003; Marston and Polei, 2004; Wang et al., 2008) and results in empirical research confirmed the significance of profitability as a determinant of disclosure behavior (Wallace et al., 1994; Skinner, 1994; Frankel et al., 1995; Lang and Lundholm, 1996; Tasker, 1998). Although, other studies (Ahmed and Courtis, 1999) contended that empirical evidence on the relationship between profitability and disclosure is mixed and provides unclear results.

Indeed some studies agree on the existence of a positive relationship between profitability and voluntary disclosure (Singhvi, 1968; Singhvi and Desai, 1971; Wallace et al., 1994). For instance, Singhvi and Desai (1971) observed that higher profitability might induce managers to disclose more financial information about the ability to maximize the shareholders' value. Other studies instead (Raffournier, 1995; Ettredge et al., 2002; Aljifri, 2006) indicated an insignificant relationship between profitability and the level of disclosure. Similarly, according to Alsaeed (2006) profitability was found to be irrelevant in explaining the variation of voluntary disclosure.

Surprisingly, a significant negative relationship between profitability and disclosure level has also been demonstrated. In fact, according to Wallace and Naser (1995), profitable companies may not provide additional information because their investors are particularly gratified.

With regard to forward-looking information, Aljifri and Hussainey (2007) stated a significant association between profitability and the level of forecast information. Furthermore, a positive relationship between forward-looking information and performance was argued in previous literature on forecast disclosures (Cooke, 1989; Hossain et al., 1995; Prencipe, 2004). A lot of literature stated that companies with higher return on equity are more inclined to disclose additional forward-looking information than those with lower profit margin (Cahan and Hossain, 1996).

However, Kent and Ung (2003) and Hossain et al. (2005) found no such association between performance and the level of forward-looking information and especially

other prior literature documented a negative relationship between profitability and forecast disclosure (Celik et al., 2006; Aljifri and Hussainey, 2007; Abed et al., 2011).

In accordance with previous studies (Vanstraelen et al., 2003; Hossain et al., 2005; Beretta and Bozzolan, 2008; Bravo et al., 2009), our research includes return on equity as profitability-related measure and derives it by dividing net income available for stakeholders by book value of owners' equity.

Based on theories and previous studies a firm's profitability has been stated to be positively associated with the level of forward-looking information.

Hence, with respect to the majority of disclosure literature mentioned above, the following hypothesis is suggested:

H2: There is a positive relationship between profitability and the level of forward-looking information.

Leverage

Leverage is another variable generally used in previous studies to analyze the determinants of corporate disclosure. Empirical findings from prior literature provided mixed evidence on the association between leverage and corporate disclosure. For example, some studies have demonstrated a significant relationship between leverage and disclosure level (Malone et al., 1993; Hossain et al., 1994; Wallace et al., 1994), while others failed to find any support for the proposed linkage between the two variables (Ahmed and Nicholls, 1994; Wallace and Naser, 1995; Hossain et al., 1995; Raffournier, 1995; Celik et al., 2006).

Yet, much results of prior studies (Malone et al., 1993; Wallace et al., 1994; Zarzeski, 1996; Ahmed and Courtis, 1999) confirmed that highly leveraged firms are more likely to disclose more information than less leveraged firms in order to satisfy the needs of creditors for information. For example O'Sullivan et al. (2008) recognized leverage as a factor positively affecting the extent of voluntary disclosure.

Moreover, some of the literature concerning forward-looking information confirmed that there is a positive relationship between leverage and corporate forward-looking information (Ahmed and Courtis, 1999; Bravo et al., 2009). For example debt ratio is found to have a significant association with the level of forward-looking information (Aljifri and Hussainey, 2007).

Conversely, Celik et al. (2006) failed to find any support for the association between leverage and future information.

We use as a measure for leverage the debt to equity ratio that is defined as total debt divided by book value of equity.

The findings of a number of prior studies lead us to the following hypothesis:

Table 1. Explanation of variables.

Variable	Description	Measure
Dependent variable		
TOTFLI	Quantity of forward-looking information	Number of words containing forward-looking information
Independent variables		
SIZE	Company's size	Total assets (millions of Euro)
PROFIT	Return on equity (ROE)	Net income / Equity
LEV	Leverage	Total debt / Equity

H3: There is a positive relationship between leverage and the level of forward-looking information.

RESEARCH METHODOLOGY

The level of forward-looking information is measured by examining the management commentaries of Italian listed companies included in the FTSE-Mib Index. We select the FTSE-Mib Index because it is the major stock market index which tracks the performance of large companies based in Italy and it represents approximately 80% of the domestic market capitalization. This provided us with a population of 40 major quoted companies at the end of 2010. Clearly this not a random sample and it is representative of a large number of Italian companies whose financial statements are drawn up under IAS/IFRS.

The number of observations provides a good reliability to draw relevant conclusions according to some prior empirical studies on disclosure which selected a similar sample size (Cooke, 1992; Jaggi and Low, 2000). Moreover the sample mean of sample size of at least 30 observations is considered nearly normal (Gujarati, 2006).

The management commentaries of the year 2010 were chosen because they are relatively recent. Moreover, the accounting year 2010 is of interest principally because it is the first reporting period ending since this application date. In particular, since the year 2010 entities may apply IASB's guidelines concerning forward-looking information in Management Commentary (IASB, 2010) presented prospectively from 8 December 2010. As a result, to carry out the study analysis was restricted to one year.

Each management commentary of financial year 2010 was downloaded directly from companies' websites and was individually scrutinized in order to determine forward-looking information strategies used by companies.

Quantity of forward-looking information disclosed in management commentaries is measured by the method of content analysis that has been generally used to measure the extent of disclosure in previous studies (Harte and Owen, 1991; Cunningham and Gadenne, 2003; Beatti et al., 2004).

Content analysis requires the selection of recording units, such as a sentence, or a word, or a group of words, or a paragraph or an entire document. This paper takes "word" as a recording unit because it is considered a more reliable unit of analysis than the number of sentences or the number of paragraphs (Hackston and Milne, 1996).

A paragraph or a sentence is also not a suitable recording unit as a sentence may contain a lot of disclosure items encompassing different information that provides insight into the entity's past performance and prospects. Management commentaries were analyzed to determine the number of words disclosed by each company. That is, each management commentary is scrutinized

searching for every set of words containing forward-looking information and then the words giving forward-looking information are counted.

A scoring system based on content analysis is formulated to measure the level of forward-looking information disclosed in every management commentary and an unweighted approach is applied. As a result each word with forward-looking information is provided one point under the scoring system. Graphs, diagrams, pictures and captions to pictures of activities are kept out from analysis as inclusion of them would lead to a high level of subjectivity. So, the content analysis encompasses only narrative disclosure.

In this phase we define both the checklist and the coding procedure to capture the disclosure of forward-looking information and we use a checklist that considers different dimensions: the content and the characteristics of information disclosed. A Disclosure Index is constructed to measure the level of forward-looking disclosure. Without a clear body of academic literature concerning the content of forward-looking disclosure, we built the checklist of specific disclosure items using the guidelines issued by IASB for management commentary (IASB, 2010).

This IASB's practice statement provides a detailed list of items which was deemed useful to users. Hence, it allows us to develop a comprehensive Disclosure Index that can be used to investigate the extent of forward-looking disclosure.

Firms' characteristics such as firms' size, profitability and leverage were also examined.

As in many prior disclosure studies, regression analysis is carried out to demonstrate the impact of firms' characteristics on the forward looking disclosure level of the companies. To this end both univariate and multivariate analyses are developed in this study. In order to test the joint effect for the variables of the study, the research model includes one dependent variable TOTFLI (total number of words containing forward-looking information disclosed in management commentaries) and three independent variables (firms' size, profitability and leverage). On the basis of prior studies, we employ as a measure for firms' characteristics the variables described in the hypotheses development. Therefore, the independent variables considered in this study are the following: SIZE (Firms' size, measured by book value of total assets); PROFIT (Profitability, measured by return on equity); LEV (Leverage, measured by total debt to equity).

The explanations of dependent and independent variables employed in the analysis are presented in Table 1.

The regression analysis is used to test the hypotheses of this study and the regression model is given by:

$$TOTFLI = \beta_0 + \beta_1 SIZE + \beta_2 PROFIT + \beta_3 LEV + e$$

where,

TOTFLI refers to forward-looking information disclosed by each company; β is the regression coefficient; $i = 0,1,2,3$; SIZE refers to the size

Table 2. Descriptive statistics.

Variable	Minimum	Maximum	Mean	Std. Deviation
Dependent variable				
TOTFLI	91.000	4833.000	1006.750	1023.708
Independent variables				
SIZE	0.448	244278.936	8502.435	52769.522
PROFIT	-36.420	28.620	10.202	10.788
LEV	0.090	5.650	1.065	1.256

Table 3. Correlation matrix.

Variable	TOTFLI	SIZE	PROFIT	LEV
TOTFLI	1.0000			
SIZE	0.1288	1.0000		
PROFIT	-0.4539**	-0.0439	1.0000	
LEV	0.0859	0.5449	-0.1064	1.0000

**Significant at the 0.05 level (2-tailed).

of company; PROFIT refers to profitability; LEV refers to leverage; e is the error term.

RESULTS

This section discusses the empirical methods used to examine the research hypotheses of this study and illustrates the results. It includes two statistical methods: a descriptive analysis and a regression analysis.

Descriptive analysis

Table 2 presents the results of descriptive analysis regarding the level of forward-looking information disclosed by the firms and the measures of companies' characteristics which are included in the analysis.

Results show a broad variability in the values of the measure of forward-looking information. A wide range of variation of quantity of forward-looking information is found. The level of forward-looking information has considerable dispersion in the scores, as represented by the minimum, maximum and standard deviation. The extent of disclosure of forward-looking information ranges from 91.000 to 4833.000. On average Italian listed companies provide 1006.750 words related to future information, which indicates low level of this disclosure across the companies. Results could be explained on the basis that no effective regulations enforce companies to reveal forward-looking-information.

Regression analysis

Before conducting the regression analysis, whether there

is an econometric problem of data set used in the model is tested by using the correlation matrix. We have verified the independence of variables to be ensured of the absence of correlation problems that may prejudice our results.

Table 3 presents correlation coefficients for the variables included in the analysis. The results confirm that no correlation problem subsists between the independent variables. The correlation between each of the variables is not elevated and the highest correlation found between leverage and firms' size is tolerable.

Correlation matrix shows respectable values of the correlation coefficients and indicates that a univariate analysis can be performed by examining individual associations between independent and dependent variables.

Regression coefficients are presented in Table 4 which displays the results of the OLS-regression analysis. The table shows the influence of company's characteristics on the level of forward-looking information. According to regression analysis, the extent of forward-looking information is affected only by profitability.

According to regression analysis disclosure about forward-looking information is affected only by profitability. Especially, regression results show negative and statistically significant relationship between profit-ability measured by ROE and the level of forward-looking information disclosed by companies in management commentaries. Thus, hypothesis 2 which states a positive correlation between profitability and information related to the future is not supported by results for the year 2010. The coefficient, significant at the level of 0.01, presents a value of -11.6822. Hence, the direction of the coefficient suggests that companies with high profitability are more likely to disclosure less forward-looking information. Besides, results of the OLS-regression in Table 3 show a relatively low adjusted R-squared. The value of adjusted R² is 0.153407, which means that independent variables explain 15.3% of variation of dependent variable.

Our findings disprove the hypothesis but are consistent with a number of studies (Aljifri and Hussainey 2007; Abed et al., 2011) that find a negative relationship between profitability and forward-looking information. In short, companies with low profitability tend to disclose

Table 4. Regression analysis.

Variable	Coefficient	Std. Error	t-ratio	p-value
Const	1234.25	282.85	4.3636	0.00010
SIZE	0.00238434	0.00496738	0.4800	0.63413
PROFIT	-11.6822	15.5426	-1.2226	0.00431 ***
LEV	-50.6125	159.032	-0.3183	0.75213
F-statistic	3.355667			
S.E. of regression	1041.076			
Adjusted R-squared	0.153407			
P-value (F)	0.029342			

***Significant at the 0.01 level.

more forward-looking information.

One possible explanation for the results regarding forward-looking information is that managers are reluctant to disclose information including future plans and projects, even if this information is extremely useful to improve analysts' forecasts and transparency in capital markets.

Conversely, firms' size and leverage variables are found to have an insignificant influence on the level of forward-looking information. This is in contrast with our hypotheses 1 and 3 related to these variables. Regression results disprove an association between the forward-looking disclosure and these two variables. Hypotheses 1 and 3, which respectively state that the extent of forward-looking information disclosed by Italian companies is positively related to firms' size and to leverage, are not supported by results of our study. Hence, hypotheses 1 and 3 are rejected.

Although, our findings are consistent with a number of previous studies which suggest the inexistence of relationship between these variables and disclosure of forward-looking information. For example, Aljifri (2006) finds an insignificant association between the level of forward-looking disclosure and firm size. As well, Celik et al. (2006) show an insignificant association between leverage and the level of forward-looking information.

Conclusion

The objective of this study is to explore the effect of three main variables on forward-looking disclosure in the management commentaries of Italian listed companies. In order to test the influence of firms' characteristics on forward-looking information three hypotheses were proposed and tested using a regression analysis.

The regression results for the sample of 40 companies reveal that profitability negatively and significantly influences forward-looking information, whereas the other two independent variables (firms' size and leverage) are found to have an insignificant relation with the disclosure of forward-looking information.

This study extends prior literature by investigating the

influence of firms' characteristics on the level of forward-looking information. Although there exists a large number of disclosure studies, only a few are focusing on forward-looking disclosure in management commentary. There are a very restricted number of studies that have explained the variation of forward-looking information in the light of firms' characteristics and acquired results are ambiguous.

Thus this study is deemed to contribute to the current literature by illustrating that profitability is the only determinant of forward-looking disclosure.

The results of this research have significant implications. The findings afford empirical evidence on the current forward-looking disclosure practices in Italy and can be useful for preparers of financial reporting and for investors looking for profitable investment opportunities, since for the first time a paper examines the determinants of forward-looking information in Italian management commentaries.

Additionally acquired results will contribute to the understanding of the characteristics of companies in Italy and in other European countries where companies applying IAS/IFRS operate in developed markets similar to Italy. As a result, our study will provide important evidence to users to understand also the dynamics of other European markets characterized by macro economic conditions like in Italy.

Based on this research, several studies can be initiated in different contexts by inspecting other factors that may influence the level of forward-looking information also by examining other communication supports. Future research may be conducted by increasing the number of companies analyzed or by adding more variables to increase the reliability of evidence presented in this study. By doing this, the quality of the analysis may be enhanced and hence users may be better served.

It is hoped that this study will improve the insight of the underlying factors that could affect forward-looking information in Italian listed companies.

As with any research, this study has some limitations. First the research is restricted to Italian companies and by sample size. Second, the items forming the Disclosure Index were subjectively assembled from the existing

iasb's guidelines regarding management commentary. Third, the measure of forward-looking information is based on an unweighted approach that does not reflect the importance of disclosure as perceived by users.

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