

The rise and fall of American annual reports

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The Securities and Exchange Act of 1934 mandated that all publicly traded U.S. companies provide yearly financial reports to investors. *“In 1959, IBM hired Paul Rand, a prominent book designer, to create its annual report. As a result, the high-concept annual report was born.”* (Addison Annual Report Handbook 2005). The invention of the modern annual report, as well as more formal, structured and transparent reporting practices and their derivatives -including the financial review or MD&A- and of investor relations as a whole, is indisputably as American as bluegrass and blue jeans.

In the 1999 *Annual Report on Annual Reports* more than 50 percent of top 100 annuals were born in the U.S.A. In 2006, one-third rank in top... 200.

Then and now

For decades the key features of American reports were summed up by **6 C's: confident,**

communicative, convincing, creative, constructed, and, for a number, **compelling.** Those were the days: opening an envelope containing a U.S. annual was for many almost like unwrapping a “Western gift” with the expectation to be wowed, and sometimes even a kind of magic.

The reporting model worked so well that it was emulated around the world, like management techniques were in the 60s and 70s.

These last years, for a majority, it's just about opening a mail (or “saving trees” by being required to print a PDF file) made of a mix of “Digest-style” narrative, Washington consensus, Californian-inspired PCness, and a Wall Street kowtow. The tune is now: “Just another 10-K”, not made to be read in a New York minute. Hardly jazzy, that is.

What happened between the yesterday's wow and today's yawn? A “net” bubble, the Enronitis, and those “S” effects (SEC-SFAS-SOX) that have turned into a pale

substitute for KISS (keep it..., unfortunately as outmoded as many buzzwords). Comparing dozens of annuals produced in the seventies through the nineties by preeminent U.S. companies with what the same or their successors are doing today -and with the way their international peers have progressed- would be ruthless.

We saw it coming. In the ***Annual Report on Annual Reports 2000*** (produced and published in New York, by the way), besides a still very U.S. top 20, we pointed out an “American slip” marked by a continued decrease of annuals ranked, and a 50% increase of non-U.S. reports making top 50 in two years.

Let’s admit it, even for trenchant supporters of American reports, and the editor and undersigned is indisputably one, there was also an optical illusion. At two levels: while some of the big companies were coming out with the greatest reports in the world, the rank and file kept on churning out very basic “for filing only” documents. The perception was a bit like seeing the New York

Times and the mainstream instead of “foxier” news. Second, among the best reports in their heyday, a mix of bullying “size matters” CEO statements, slick “style matters” PR and ingenious “money matters” IR was making it up because not a lot of alternatives were provided elsewhere on report output, substance and style.

The fall is not only due to intrinsic factors but also to the continued progress made outside the United States. And, let’s insist, on report assessment and comparison criteria made more demanding. In a vacuum, and considering content, it is still possible to find good features in a number of American reports and from IR officers (e.g. investor kits). And then you see the international ones.

The symptoms

We are now down to **3 C’s**: (excessive) **complacency**, **compliance**, and **conformism** have become the main characteristics of American reports, bar a few ones. The symptoms are:

- 10-Ks simply copied and pasted have replaced the effort of writing a report, especially for the core financial part of, with a blind obedience to one single reporting format and layout. Besides the covers -and the figures!- the two 2005 reports of two leading semiconductor archrivals just look, sound and feel the same. Thousands of reports are as interchangeable as hundreds of country songs. Differentiating through reports, also for enhancing better figures, seems to be a secondary concern, to say the least.
- A lack of long-term perspective and measures (hampered also by those successive year-on-year comparisons which, oddly, do not apply to financial condition). Should we chalk this up to the "Making the quarter" EPS culture (sorry, guidance)? Perhaps. And who asked for two-year balance sheets while equity statements span over three?
- A catalog of brands and marks often substitutes for quick and thorough segment breakdown and effective contribution analysis, which often comes late. And the way mandatory segment information is reported has not at all been improved by recent changes.
- An excessively positive self-image sustained with high doses of self-indulgence but not further substantiated. For many the model is a mix of Hollywood clichés for the first section and layout made in dullsville for the largest part of it, that is financials.
- Governance matters are pushed to proxies, often not sent out to potential investors.
- Most reports do not compare objectives and their achievement, and do no set targets.
- Split accounting policies and estimates that now seem to

- prevail over a commitment to in-depth financial analysis.
- A much lower use of ratios, charts and share indicators than make some international annuals much more valuable for analysis.

NFL vs. ROW

What is puzzling is that after having copied and often improved U.S. best practice, the ROW (“rest of the world”) -a “rest” that now weighs much more than today’s U.S. economy- follows suits, for better or worse.

The American report practice seems to have joined a list of other declining industries (such as automobile or, uh, ports). The reasons echo somewhat with the ones observed in these.

Complacency, sometimes bordering on arrogance, is certainly one of them. In a recent survey the Boston Consulting Group pointed out two of the behaviors that encourage innovation (BusinessWeek, April 24, 2006): “*asking the right questions*”, and “*going outside (and abroad) for ideas*.” This also applies to reporting

practices and American companies often do it better on the former than on the latter. Compare how the Northern neighbors -the often despised Canadians- have improved the quality of financial reports while others were dabbling, and do not even seem to have been looked across the border. Worse, a “my world is the world” tendency, reinforced these last years from Main Street to Wall Street, results in pushing others to adopt rules, good or bad, including by stretching the long arm of the law across the board and the world. Another translation of “*The Unipolar Moment*” (as defined by the Washington Post columnist Charles Krauthammer)? An opposite view was recently taken: “*Congress exportation of Sox’s standards has created difficulties for multinational companies and produced scorn for US standards.*” Who says this? Harvey Pitt, former chairman of the SEC! (Financial Times, June 21, 2006).

Another explanatory factor is that American companies (like the Japanese but contrary to the European ones) remain closely tied

to their domestic markets. Foreign sales of S&P 500 companies amount to a modest 25% of total revenues. U.S. stocks (but not bonds!) are also less in foreign hands than vice versa, yet it is not often noted that the average American investor doesn't buy as many securities abroad as in the homeland. This explains or has generated a habit of not trying to communicate with an international audience, contrary to the way the Swedes have been used to do it for decades and have translated it so effectively into their reports. A symbol? In 2006, virtually no American annual shows the country dial code yet. Everybody knows? But how many Americans know the country code for France, Hong Kong, or India?

"Companies cannot continue to structure everything around local law if they have a material U.S. shareholder base," says a

governance specialist at the Bank of New York. This is a bit like trying to apply NFL rules to a world playing football! The opposite is as true, and will increasingly be. American companies cannot continue to structure their reporting output and practice around U.S. local (yes, local!) law if they operate in increasingly globalized capital markets with a material foreign shareholder base, and competitors getting stronger not only on products and technologies but also on their reporting practice.

It looked easier to ask others' reports to look more American than to be able to make American ones sound more international. Bluegrass is old-fashioned, original blue jeans have been copied everywhere, and reporters got the blues. Even a comeback -another American strength- would be in a much larger and more level playing field.

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