What's Missing from Annual Reports

Graham Kenny

As a shareholder of several companies, I receive many updates and reports. Even though I know how to dissect the financials and pull out any relevant ratios, I'm not satisfied with the story that these reports tell me. Nor, I'd suggest, are most shareholders. Many choose not to receive an annual report at all, online or in hard copy — and few of those who do actually read what they get. Who can blame them?

What we want to know simply isn't in there. We want assurance that our investments are secure, of course. But more than that, we want to know the *health* of the companies we're investing in. We're looking for a holistic view, just as we are when visiting the doctor for a check-up. And to get that, we need more than the financial equivalents of blood pressure and temperature readings.

Though there's been a push toward greater disclosure in several countries — such as the U.S., the UK, and South Africa — shareholders have a right to demand even more. An annual report should show what the company is *doing for* and *getting from* each group of key stakeholders (within the bounds of commercial sensitivity). Some companies are starting to share finer-grained results, which helps, but they need to go further.

Take the example of Harvey Norman, an Australia-based household-goods retailer that operates under various brands and has stores in several countries. Its revenue comes from franchises ($AU4.77 billion) and, to a lesser extent, company-owned stores (about $AU2.55 billion). The company's 2013 annual report contained the usual statements on income, changes in equity, and cash flows — standard stuff. The report neatly summarized all this in a "Financial Highlights" table with 14 measures and covered "operating and financial review" in a page and a half. That was in keeping with the Corporations Act of 2001.

Then, after the Australian Securities and Investments Commission (ASIC) released a new set of guidelines, Harvey Norman published its 2014 annual report, which devotes *nine* pages to the operating and financial review. Discussed here are topics much more germane to the company's future than last year's financials — business strategies, risks, and likely prospects.

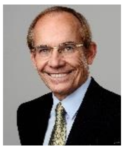
Much better, but the reporting still has a way to go. For instance, I want to know more about the franchisees, given how central they are to the company's success — not just how much revenue they bring in, but also how profitable they are. And I'd *really* like to know how satisfied franchisees are with factors that matter to them, such as the amount of support they receive from the head office. What I'm seeking, in this desperately competitive environment, is an answer to this question: Are the franchisees likely to keep sustaining the company? The number of franchisees fell this year from 696 to 677. Was this due to dissatisfaction? What's the story?

Numbers about and for customers are equally important. What are the margins? How is the company measuring customer satisfaction with service, product range, prices, and the like? How has that ebbed and flowed? Australia's second-largest internet service provider, Iinet, offers a Net Promoter Score to report on customer satisfaction — which is a start, but it's certainly not a holistic view.

Likewise with employees. What are the productivity and employee retention numbers? On the other side of this two-way street, what does employee satisfaction look like? Whole Foods Market in the U.S. provides data on voluntary turnover of full-time staff. In industries such as mining, employee safety is now reported in detail, through an injury frequency rate. Again, companies are making some progress in their reporting, but we're still missing those comprehensive scorecards.

Research shows a direct link between stakeholder engagement and market value. Since company health and wealth are at stake, it's critical not just to build strong relationships with your key stakeholders but also to track how well the organization is meeting their needs. Metrics that tell you that are *leading indicators* of future performance — exactly the kind of information savvy investors should expect.

Graham Kenny is the managing director of Strategic Factors, a Sydney, Australia-based consultancy that specializes in strategic planning and performance measurement. He is the author of *Crack Strategy's Code* (President Press, 2013) and *Strategic Performance Measurement* (President Press, 2014).



HBR ARTICLE - DECEMBER 19, 2014