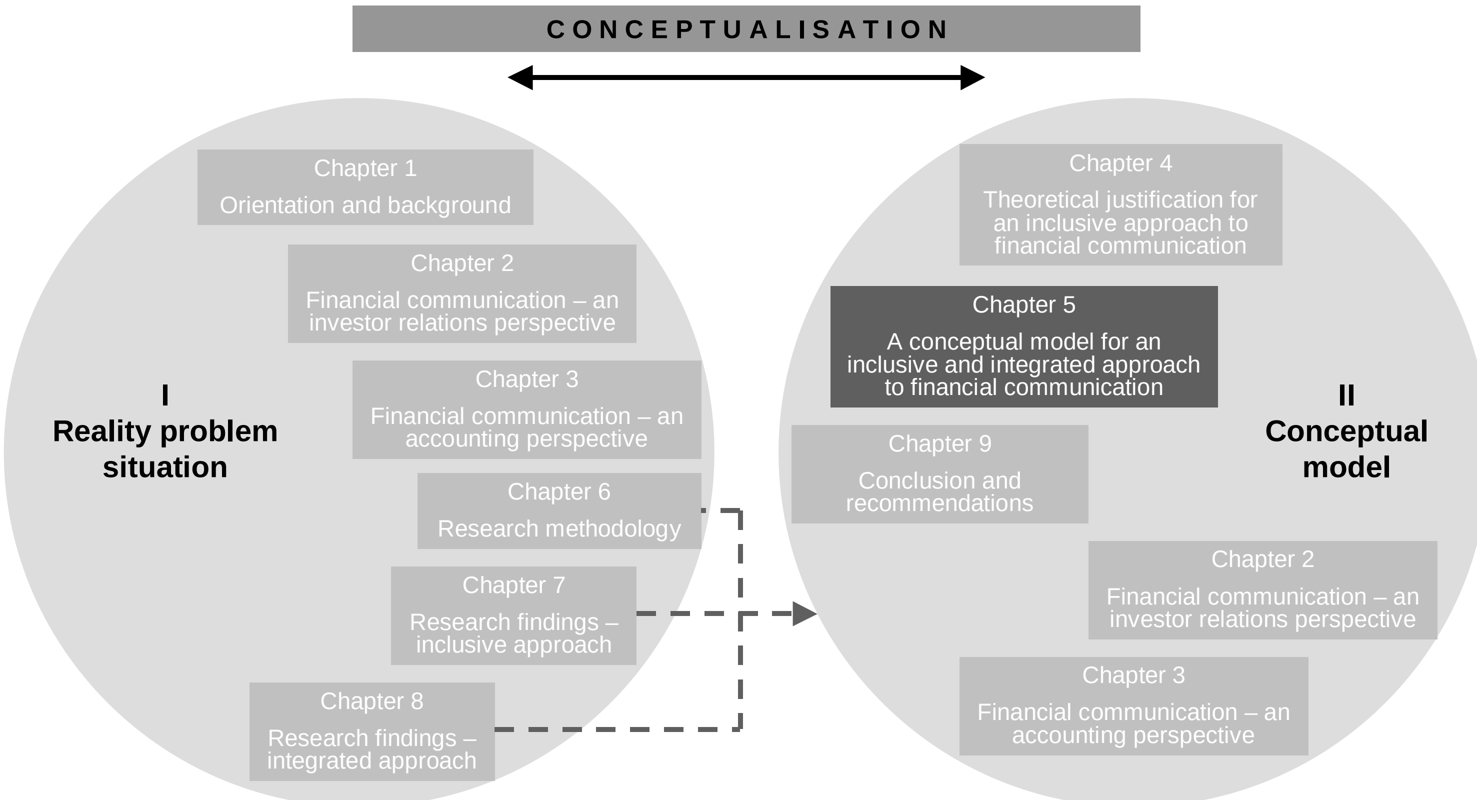


Research objective:

4. To develop a conceptual model, based on an *inclusive* and *integrated* approach to financial communication.

CHAPTER 5

A conceptual model for an inclusive and integrated approach to financial communication

Although all models are "false" in the sense that no representation can capture reality perfectly, we would have no understanding of reality at all if we had no model with which to work. - Grunig & Grunig (1992:286)

Rather than seeing traditional departments and narrow specialist groups operating in institutional "silos" in competition: for supremacy; to protect their "turf" … for "a seat at the boardroom table" … to secure "the ear of the dominant coalition" … a model of integrated communication systems seeks to build bridges between the "islands of communication" … and to eventually establish new task groupings, perhaps by way of cross-functional working in the interim.

- Varey & White (2000:5)

5.1 Introduction

The problem that this study seeks to address is that confusion exists regarding the nature, management and organisation of financial communication. In Chapter 2, the problem is discussed from an investor relations perspective, while Chapter 3 provides an accounting perspective to the problem. The major shortcoming of both these perspectives is that both only concentrate on communication with the *financial community*. This leads to the major argument presented in Chapter 4 – a theoretical justification for an inclusive (stakeholder) approach to financial communication. Perspectives from the corporate governance, corporate social responsibility, stakeholder theory and public relations as relationship management literature are used to construct this argument. Another shortcoming of the current approach to financial communication (from and investor relations as well as an accounting perspective) is that there is a lack of integration, both in terms of management and organisation.

None of the perspectives discussed in Chapters 2, 3 and 4 provide a complete picture of the financial communication process. Rather, each perspective represents “one piece of the puzzle”. Thus, the purpose of this chapter is to combine these perspectives in a conceptual model for an inclusive, as well as an integrated approach to financial communication.

5.2 What is a model?

Models form an essential part of people’s understanding of the world they live in. Severin and Tankard (1988:30) remark that models are used every time people systematically think about, visualise or discuss a structure or process (past, present or future). A model can therefore be defined as a theoretical and simplified representation (in graphic form) of a piece of reality, or anticipated reality (McQuail & Windahl, 1981:2; Severin & Tankard, 1988:17). Models and theories are often confused with one another. The role of a model is *representation*, while the role of theory is *explanation* (Cooper & Schindler, 2003:55). In other words, a model *represents* a certain theoretical explanation of a structure or process.

Models can be used for several purposes. Severin and Tankard (1988:31) refer to four distinct functions of models. In the first place, models make it possible to order and relate data and show similarities and relationships between data that have not been identified before. This is known as the *organising* function of models. Models can also explain something that has not been understood before, in a simplified way – the *heuristic* function of models. Models also have the function of *predicting* outcomes or a certain course of events (McQuail & Windahl, 1981:2). Lastly, when a model allows completely quantitative predictions, it can be used for *measurement*. In the context of this study, the organising function of models is the most applicable.

Cooper and Schindler (2003:55) identify three major functions of modelling, namely description, explication and simulation. *Descriptive* modelling is appropriate when theory about a system and its elements is inadequate or nonexistent. *Explicative* modelling aims to improve understanding of the key concepts of well-developed theories. The purpose of *simulation* modelling is to reveal and clarify relations between these concepts. Of the three major functions, descriptive modelling is the most relevant to this particular study.

Severin and Tankard (1988:31) point out that a model provides a framework within which a particular problem can be considered. Although early versions of a model might not lead to prediction, it can still help to identify knowledge gaps and areas where research is needed. This view is closely related to certain elements of the whole systems model of problem solving of Mitroff *et al*. (1974:47), as discussed in Chapter 1. Circle I involves the identification of a reality problem situation. Activity 1, conceptualisation, leads to Circle II - the development of a conceptual model. Conceptualisation requires global, intuitive thinking and involves formulating "interesting problems, puzzles or paradoxes" (Mitroff *et al*., 1974:50). The conceptual model defines the reality problem situation in broad terms. In other words, it provides the framework within which the problem can be considered.

It is important to note that Mitroff *et al*. (1974:47) distinguish between a conceptual model and a scientific model. A scientific model is more formal than a conceptual model. Modelling, activity 2 of the Mitroff *et al*. (1974:48; 50) model, requires formal analytical skills and the ability to formulate "significant relationships within some formal system of abstract thought". Only a scientific model can be formally validated (activity 6), by determining whether it accurately represents the reality problem situation. This is done by using various analytical tools.

This chapter is dedicated to the development of a conceptual model for an inclusive and integrated approach to financial communication. Therefore, when one applies the above to this particular study, this conceptual model serves three functions, namely:

- providing graphical representations of the various theoretical perspectives surrounding financial communication (as discussed in Chapters 2, 3 and 4);
- organising these theoretical perspectives by identifying similarities between them, as well as acknowledging each one's unique contribution to a broader understanding of financial communication; and
- establishing a broad framework within which future research can be conducted.

In the section that follows, various theoretical perspectives surrounding financial communication are briefly reiterated, accompanied by graphical representations.

5.3 Perspectives surrounding financial communication

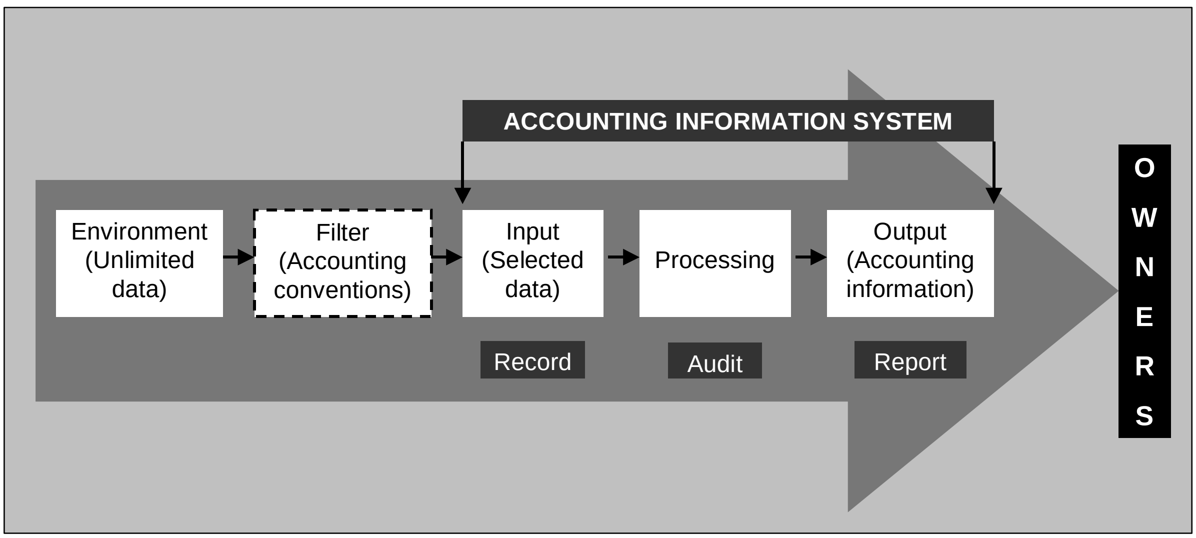
In Chapter 2, the current approach to financial communication is described from an investor relations perspective. The Financial Director (or accounting professional) is identified as a major role player in the management of investor relations. In Chapter 3, financial communication is then described from an accounting (or accountant's) perspective. In this chapter, a slightly different train of thought is followed. The accounting perspective to financial communication is described before the investor relations perspective. The reason for this will become evident in the discussion that follows.

5.3.1 Financial communication from an accounting perspective

In Chapter 3, reference is made to six images of accounting, as identified by Davis *et al*. (1982:309-313). One of the images, accounting as information system, is especially useful to describe part of the financial communication process. Glautier and Underdown (1995;13) refer to the input, processing and output components of the accounting information system, while Gouws (1997:63) refers to the need to record, audit, report, interpret, analyse, compare, decide and respond.

Furthermore, accounting is characterised by two main objectives – accountability (or stewardship) and decision-usefulness. According to the accountability objective, the purpose of accounting is to provide information that will help principals (owners, investors) determine how well their investments have been utilised by the agent (corporate management). In Figure 5.1, the views of Glautier and Underdown (1995:13) and Gouws (1997:63) regarding the accounting information system, are combined. The accounting information system is specifically depicted in terms of the accountability objective.

Figure 5.1 The accounting information system in terms of the accountability (stewardship) objective

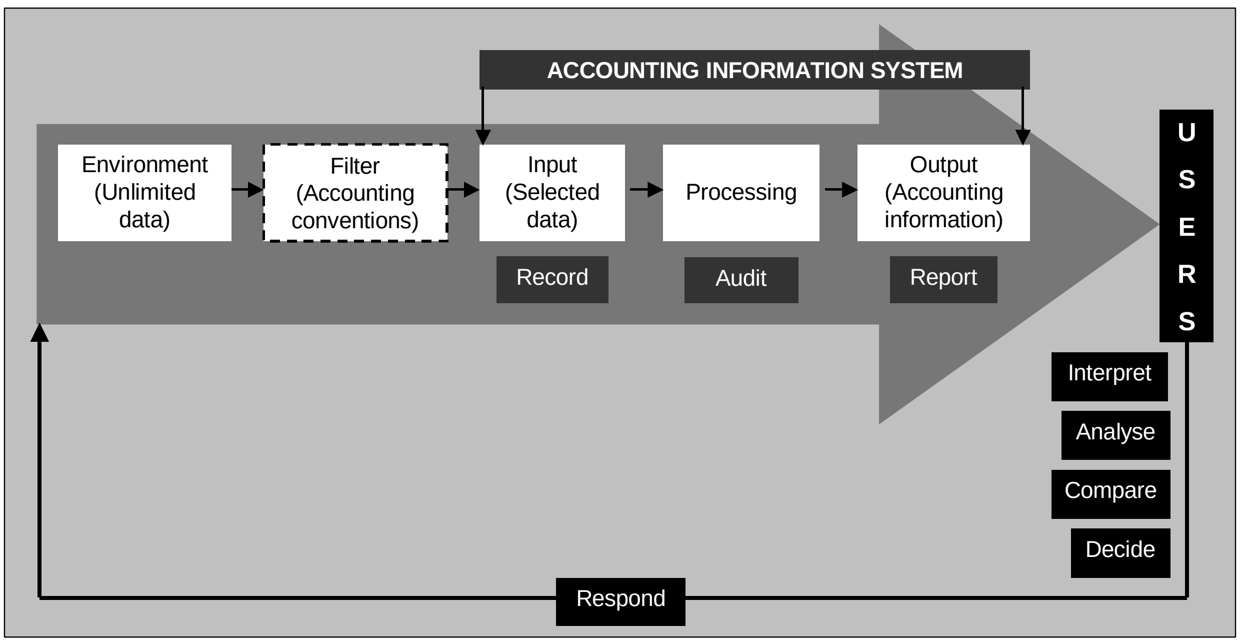


Adapted from: Glautier & Underdown (1995:13) and Gouws (1997:63)

In the conclusion to Chapter 3, it is noted that accounting is very selective in its observation of data from the environment – accounting conventions serve as a filter that only admits certain types of data to be recorded (input). This data is then processed into output, in the form of financial statements. Owners (or principals) use these statements to evaluate the company's performance. Note that this is a one-way process.

The second objective of accounting – decision-usefulness – encompasses the accountability objective, and adds a further dimension to the accounting information system: users' information needs. The accounting information system is now designed with the information needs of users foremost in mind. In other words, users' information needs determine the nature of the input, processing and output components of the accounting information system. In Figure 5.2, a combination of the views of Glautier and Underdown (1995:13) and Gouws (1997:63) is used again, but this time the accounting information system is portrayed in terms of the decision-usefulness objective.

Figure 5.2 The accounting information system in terms of the decision-usefulness objective



Adapted from: Glautier & Underdown (1995:13) and Gouws (1997:63)

Users use the output of the accounting information system to decide how and where to allocate their resources. For example, information from different companies is interpreted, analysed and compared in order to decide which one offers the best investment possibilities. This is where the accountability objective of accounting still plays an important role. Users' decisions serve as feedback, which, in turn, has an influence on the design of the accounting information system. Therefore, when the decision-usefulness objective lies at the heart of the accounting information system, it becomes a two-way process. The decision-usefulness objective of accounting is based on similar assumptions as the two-way symmetrical model of public relations. The similarities between the various perspectives surrounding financial communication are highlighted Section 5.4.

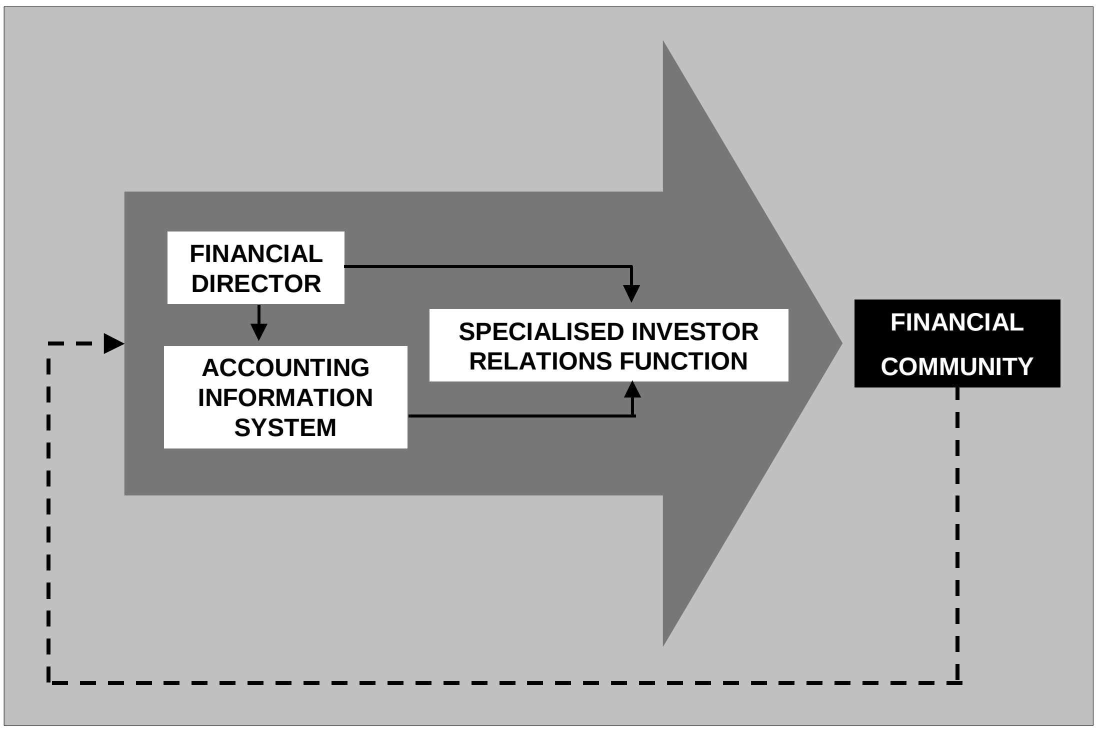
5.3.2 Financial communication from an investor relations perspective

Even though the decision-usefulness objective leads to a reconceptualisation of the accounting information system as a two-way process, the output still remains a problem. Only users with a sound financial background are able to interpret and use the information in financial statements. "Ordinary" users need experts to interpret the information and advise them accordingly.

This is where the investor relations function enters the picture. According to Thompson (in Allen, 2002:209), the objective of investor relations is to provide information to investors that is clear and understandable, or to "tell the company's story" (Green, 1997:11). In other words, the investor relations function serves as an intermediary between a company's accounting information system and the users of the information output. Furthermore, there are outsiders such as analysts and the financial media that also function as intermediaries between a company and various users. Being users themselves, they interpret financial information received from a company and advise other users regarding the allocation of their resources.

However, White and Mazur (1996:219) report that in many cases, Investor Relations Managers only fulfil a supporting role. A company's financial messages should be communicated by the Chief Executive Officer or Chairman, Financial Director or at least by a member of the Board. The role of the Investor Relations Manager is to advise these executives in terms of what they should be saying, and to whom. According to Marston (1996:478), prominent members of the financial community, such as fund managers, still prefer contact with these senior executives, rather than with the Investor Relations Manager. Although the position of Investor Relations Manager or Officer exists in many companies, the investor relations function remains the primary responsibility of the Financial Director. The investor relations perspective to financial communication can be depicted as in Figure 5.3.

Figure 5.3 Financial communication from an investor relations perspective



Source: Own observation

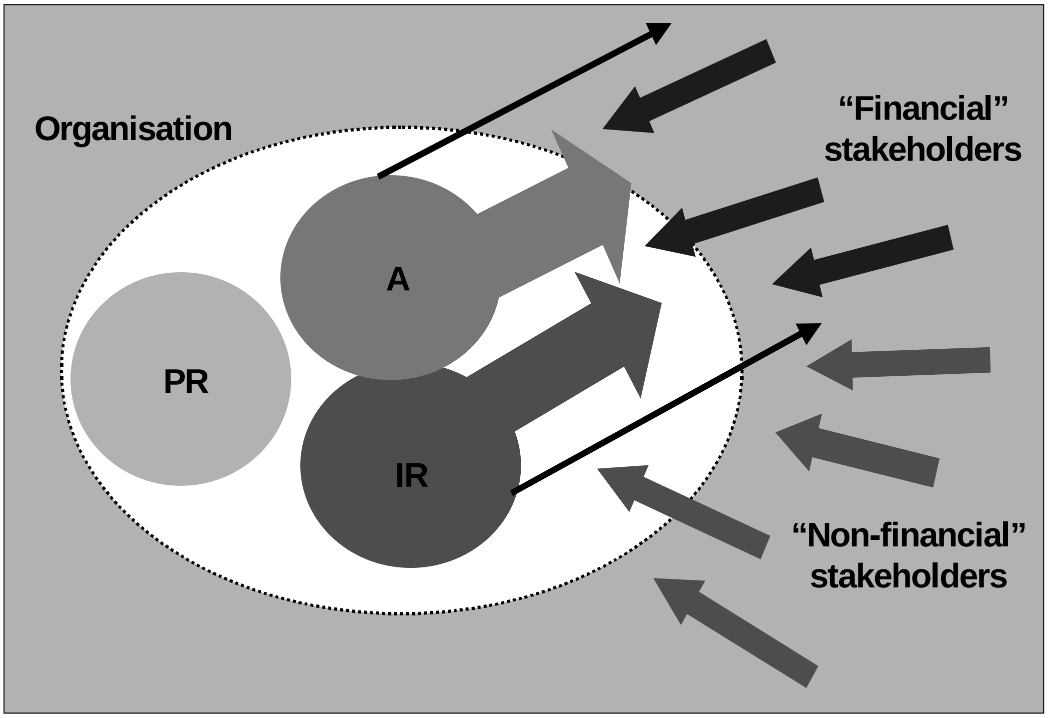
In Figure 5.3, the Financial Director is depicted as having two roles. Apart from overseeing the design and functioning of the accounting information system, he or she also manages the investor relations function. Also note that investor relations is depicted as a two-way process. Grunig and Hunt (1984:348-9) are of the opinion that the legal and statutory requirements associated with financial disclosure, limit investor relations to the use of the one-way public-information or two-way symmetrical models of public relations. An overview of the most commonly stated objectives of investor relations (see Chapter 2, Section 2.4) provides evidence of this. For example, Smith (1989:12) states that one objective of investor relations is to convey something of the spirit of the company and its objectives (public information model), while Baskin *et al*. (1997:317) refer to the building of positive relationships with the financial community (the two-way symmetrical model).

However, properties of the two-way *asymmetrical* model are also evident. For example, Seitel (2001:458) states that one of the objectives of investor relations is to disclose information that will have an impact on investors' decisions to buy, sell or hold shares. In other words, research must be done beforehand, to establish what information will influence investors' decisions. It is also noted in Chapter 2 that investor relations is increasingly seen as a marketing function that actively sells the company's shares. A related view is that investor relations is a specialised discipline that helps the company compete for capital (Marcus & Wallace, 1997:1). The emphasis is therefore not on mutual benefit (for both the company and investors), but on persuasion, in order to reach the company's objectives. In conclusion, investor relations is most commonly described as a two-way communication process.

5.3.3 The current approach to financial communication

It is apparent from the investor relations literature that financial communication is no longer seen as the responsibility of the public relations function. Furthermore, according to both the investor relations and accounting perspectives, financial communication is only directed at the financial community. Figure 5.4 portrays a synthesis of these perspectives.

Figure 5.4 The current approach to financial communication



Source: Own observation

In the figure above, public relations (PR) is isolated from financial communication efforts. There is also a slight overlap between the accounting (A) and investor relations (IR) functions. This is to indicate that both are characterised by a narrow focus on "financial" stakeholders and that, in many cases, the Financial Director assumes final responsibility for investor relations.

5.4 Similarities between the perspectives surrounding financial communication

It has been noted previously that one function of models is to highlight connections or similarities between data. In this study, perspectives from seemingly unrelated disciplines are used to describe the current approach to financial communication, as well as to justify a broader, inclusive approach. However, when one examines the main themes of Chapters 2, 3, and 4, one can identify certain common denominators. These are summarised in Table 5.1.

Table 5.1 Similarities between the perspectives surrounding financial communication

Chapter 2		Chapter 3		Chapter 4
▪ Isolation of investor relations from public relations ▪ Financial Director assumes final responsibility for investor relations	↔	▪ Expanding role of the accounting profession and professional		
▪ Communication only with financial community	↔	▪ Accountability objective – accountable only to investors/"owners"		
		▪ Decision-usefulness objective – consider the financial information needs of a wide range of users	↔	▪ Corporate governance – inclusive approach ▪ Stakeholder theory ▪ Two-way symmetrical communication
		▪ Corporate social accounting	↔	▪ Corporate social responsibility (triple bottom line)
		▪ The ethics of care - emphasises relationships	↔	▪ Corporate governance ▪ Stakeholder theory ▪ Public relations and relationship management

The term "financial communication" implies an interdisciplinary nature. However, current approaches to financial communication do not acknowledge the full extent of this interdisciplinary nature. In the sections that follow, an inclusive, as well as an integrated approach to financial communication is advocated, based on the contributions of various disciplines.

5.5 An inclusive approach to financial communication

Perspectives from corporate governance, corporate social responsibility, stakeholder theory and public relations as relationship management provide the theoretical backbone for an inclusive approach to financial communication. Normatively speaking, this means that financial communication should not only be directed at the financial community, but at a broad range of stakeholders. Stakeholders - "financial" and "non-financial" - make decisions regarding the allocation of resources. These decisions all have financial implications. In addition, these decisions imply that new relationships are formed between an organisation and its stakeholders, or that existing ones are either maintained or terminated.

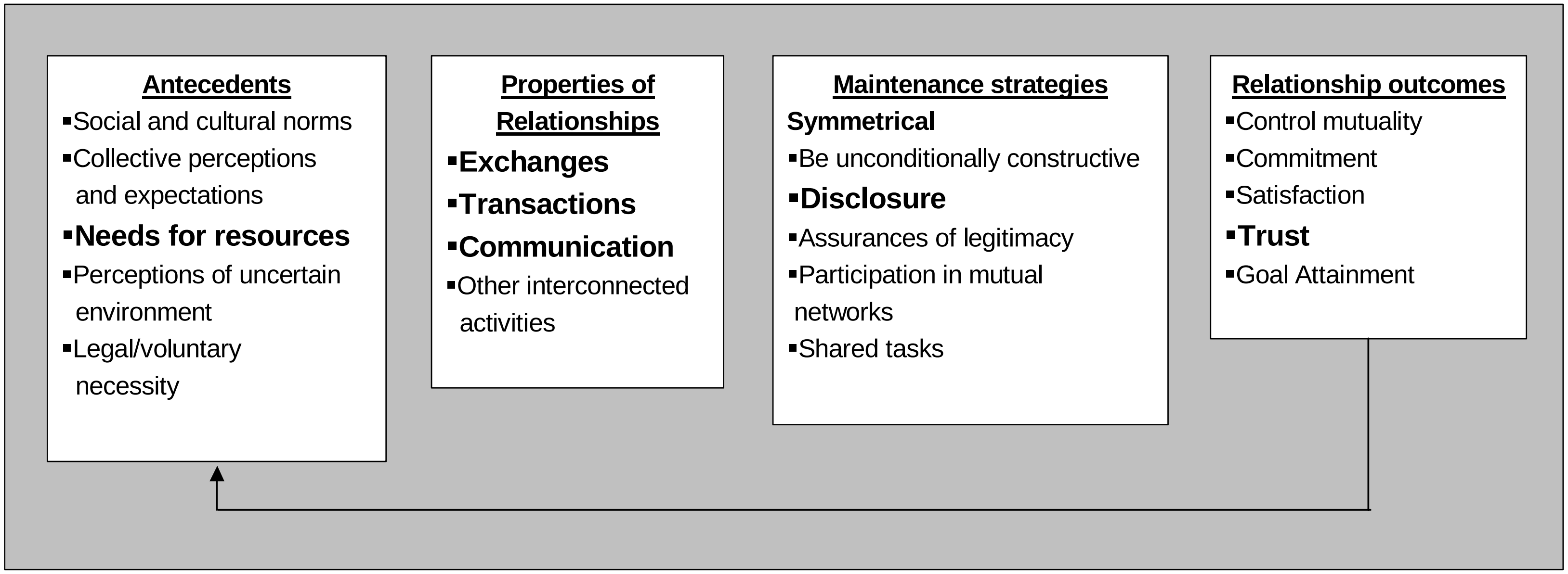
In contemporary times, a company's most valuable asset is its relationships with stakeholders. The public relations literature dedicated to relationship management, provides valuable insight into the reasons why stakeholders engage in relationships with organisations, as well as the nature and outcomes of these relationships. For example, Broom *et al*. (1997) developed a model that describes organisation-public relationships in terms of antecedents, relationship concepts and consequences. A later version by Grunig and Huang (2000) describes relationships in terms of situational antecedents, maintenance strategies and relationship outcomes.

Both these models contain aspects that are especially significant for financial communication. For example, one of the antecedents listed by Broom *et al*. (1997) is the need for resources. Organisations and stakeholders engage in relationships based on a mutual need for financial and other resources. The role of financial communication is to provide information that will help stakeholders (and in some cases the organisation as well) to decide where and how to allocate resources (and by implication, which relationships to enter).

Similarly, relationships between the organisation and stakeholders are characterised by exchanges, transactions and, therefore, financial communication. Disclosure (or openness), as one of the maintenance strategies mentioned by Grunig and Huang (2000), relates directly to the financial communication process. In accounting terms, disclosure refers to making information about the company's performance and prospects available. Building and maintaining trust is one of the most important objectives of investor relations (Allen, 2002:207; Arfin, 1994:38). Grunig and Huang (2000) cite trust as one of the outcomes of organisation-public relationships.

Although all the aspects covered in the models of Broom *et al*. (1997) and Grunig and Huang (2000) are applicable to financial communication, some are especially useful to describe the financial communication process. Figure 5.5 represents a combination of these models. Those aspects that are particularly relevant to financial communication are highlighted. Note that trust, as outcome, serves as *antecedent* to maintain existing relationships.

Figure 5.5 A combination of the models of Broom *et al.* (1997) and Grunig and Huang (2000)



Combined from: Broom *et al*. (1997:94) and Grunig and Huang (2000:34)

5.6 An integrated approach to financial communication

In Chapter 2, a lack of integration is identified as one of the shortcomings of the current investor relations approach to financial communication. Furthermore, results of empirical research suggest that in most cases, the Financial Director (an accountant) assumes final responsibility for investor relations (Marston, 1996; McGrath, 1974; Petersen & Martin, 1994). Vinten (2000:381) remarks that, by stereotype, accountants are not known for their recognition of the wider stakeholder concept. However, Vinten also acknowledges that this scenario is changing. The stakeholder concept is well established in business literature and practice. Accountants have no choice but to take note of it.

Nevertheless, the management of relationships with stakeholders is not the main focus of accounting theory or practice. However, according to a growing body of literature, it is the main focus of public relations. Contemporary definitions refer to public relations as the management of relationships (Cutlip *et al*., 1994:2; Grunig, 1992a:20; Varey & White, 2000:10). It is therefore suggested that an *inclusive* approach to financial communication also calls for an *integrated* approach to the management and organisation of the financial communication process.

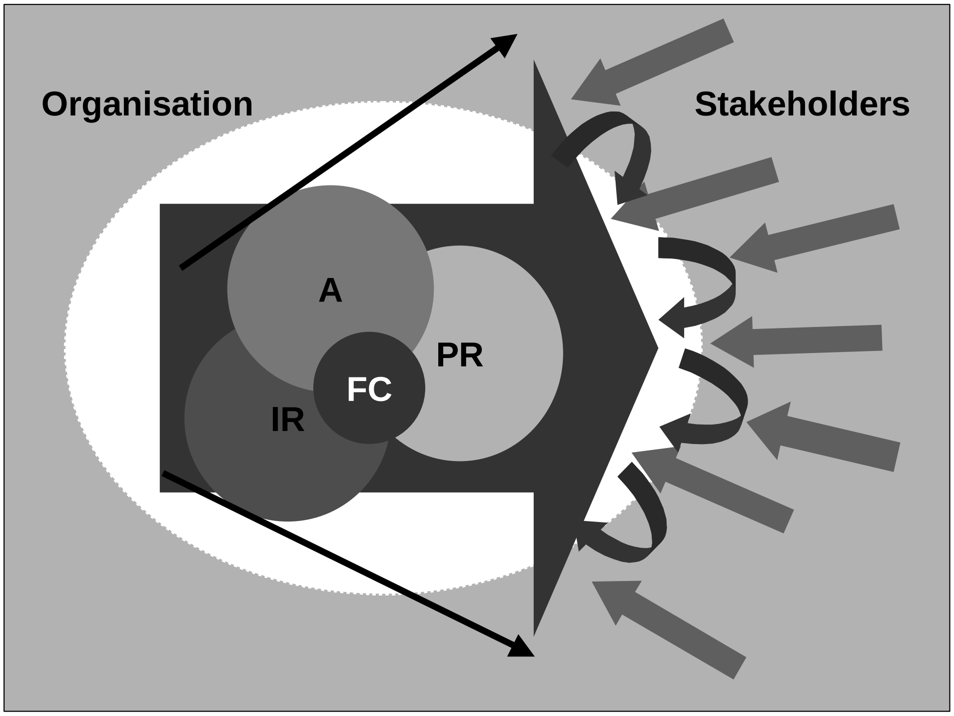
The financial communication process can be conceptualised by combining various perspectives surrounding financial communication. Following an inclusive approach, the first step in the process is to identify all relevant stakeholders. According to Grunig and Repper (1992:117;126), the strategic role of public relations is to define and understand an organisation's environment. This is done by drawing a stakeholder map, based on extensive environmental scanning. Grunig and Huang (2000:31) note that this information is difficult for other managers to obtain.

In the context of financial communication, it is therefore proposed that public relations should play an active role in identifying all potential stakeholders, financial and non-financial. Currently, this is not the case. It has been noted before that investor relations is increasingly isolated from public relations. To ensure an inclusive approach to financial communication, this trend should be reversed – public relations should re-enter the “financial communication picture”.

However, the 2002 King Report on Corporate Governance warns against a too inclusive approach (King Committee on Corporate Governance, 2002:7). All stakeholders are not equally important at a particular point in time. Grunig and Hunt (1984:145) distinguish, amongst others, between active and passive publics. According to Grunig and Huang (2000:32), active publics (those stakeholders who recognise that an organisation’s behaviour holds problematic consequences for them) are the most strategic for an organisation. Thus, a distinction must be made between active and passive publics.

Grunig and Huang (2000:32) remark that separating strategic publics (or stakeholders in more general terms) from less strategic ones is not an easy task. Each member of the Board of Directors might have a different perception of what makes a public strategic or not. This, however, is not necessarily a drawback. It is proposed that the distinction between active (strategic) and passive (less strategic) publics should not be made by public relations alone. The perspectives and experience of the Investor Relations Manager, the Financial Director and other Board members are important. Thus, a cross-functional team should take responsibility for the identification of relevant stakeholders, “financial” and “non-financial”. This is to ensure an inclusive approach to financial communication. Figure 5.6 depicts this approach.

Figure 5.6 An inclusive approach to financial communication



Source: Own observation

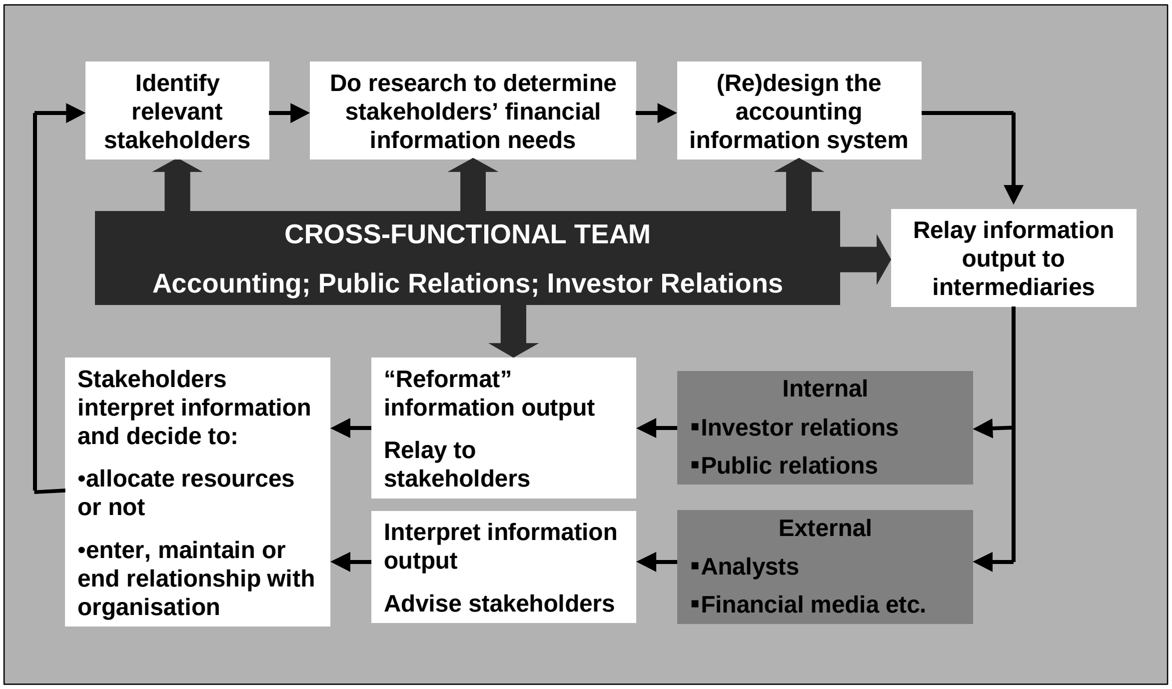
Note that financial communication (FC) is portrayed as an interface between public relations (PR), investor relations (IR) and accounting (A). Public relations is no longer isolated, but actively involved in the financial communication process.

The identification of relevant stakeholders is only the first step in the financial communication process. The next step involves research to determine the specific financial information needs of each of these groups. The rounded arrows in Figure 5.6 depict the process of determining the information needs of all relevant stakeholders, as well as measures to facilitate continuous feedback from these stakeholders. This step is vital to ensure that financial communication is a dynamic two-way process and not merely a one-way financial disclosure exercise.

The information needs of stakeholders influence the design of the accounting information system. This relates directly to the decision-usefulness objective of accounting. However, financial disclosure, the output of the accounting information system, is not the end of the financial communication process. As noted previously, not all stakeholders are able to interpret and use financial information in the format dictated by statutory requirements. The information therefore needs to be “reformatted” to address the needs of various stakeholders. According to Diamond (1997:30), this is the role of the corporate communication (or public relations) practitioner – he or she has the knowledge and skills to translate one-way financial *disclosure* into two-way financial *communication*.

From the above, it might seem as if the financial communication process is conceptualised as a linear one, with different managers and functions assuming responsibility for different stages. This, however, is not the intention of the conceptual model. The model rather suggests that the entire financial communication process should be managed and organised in an interdisciplinary or cross-functional manner. In other words, the Public Relations Manager, Investor Relations Manager (as specialist), the Financial Director and their respective departments should be involved in all the steps. Figure 5.7 depicts this approach.

Figure 5.7 A model for the integrated management and organisation of financial communication



Source: Own observation

This is not to say that the three functions (and their respective managers) depicted in Figure 5.7 play equal roles in all of the steps. For example, it is the strategic role of public relations to do environmental scanning and identify all relevant stakeholders – those groups that have an influence on the company, or who are being influenced by it (Grunig & Repper, 1992:117;126). The Financial Director and Investor Relations Manager (and their respective functions) can then assist the Public Relations Manager and department to distinguish between strategic and less strategic stakeholders (publics).

Combined efforts will also be necessary to determine the financial information needs of stakeholders. The expertise and experience of the Financial Director and the Investor Relations Manager (and their respective departments) will be helpful in establishing the information needs of “financial” stakeholders. The role of the Public Relations Manager (and department) will be to focus the attention of these executives and departments on the information needs of “non-financial” stakeholders as well.

When it comes to the design of the accounting information system, the Financial Director (and department) will obviously take the lead. However, because all stakeholders are not able to access, interpret and use the output of the accounting information system, intermediaries are needed to either “reformat” the information, or to interpret it on behalf of stakeholders. There are two such intermediaries within the organisation. In the first place, the Investor Relations Manager (and function) might take the lead in communicating with sophisticated, as well as less sophisticated *financial* stakeholders. In the latter instance, it might be necessary to reformat the output of the accounting information system. Similarly, the Public Relations Manager (and function) might take responsibility for reformatting accounting information, so that *non-financial* stakeholders can understand, interpret and use it. There are also external intermediaries (such as analysts and the financial media) who interpret the information and advise stakeholders accordingly.

Finally, the cross-functional team will have to monitor the company’s relationships with the various stakeholder groups. Is the information provided to each group adequate to facilitate informed decisions regarding the allocation of resources? Why was a particular relationship terminated, or why did a particular stakeholder decide not to enter into a relationship with the company? Information obtained by asking questions like these can then be used to redraw the company’s stakeholder map and redesign the accounting information system accordingly.

It is acknowledged that other functions and disciplines should also be involved in the financial communication process. For example, legal and marketing expertise is also needed. A company has to abide by certain rules and regulations related to financial disclosure, and it also needs to “sell its shares”, in order to attract the capital it needs.

However, the focus of this study is only on the role of public relations, accounting and investor relations (as a specialist field) in the financial communication process.

5.7 Conclusion

The content of this chapter is a natural progression of the contents of Chapters 2, 3 and 4. Perspectives from investor relations, accounting, corporate governance, corporate social responsibility, stakeholder theory and public relations as relationship management have been merged into a conceptual model for an inclusive and integrated approach to financial communication. The "pieces of the puzzle" have been fitted to complete the "big picture" (see Figures 5.6 and 5.7).

The conceptual model proposed in this chapter is by no means the final say on financial communication. According to Mitroff *et al*. (1974:51), a conceptual model can never substitute a more formal, scientific model. However, it provides a starting point for interdisciplinary research and debate on the nature, management and organisation of financial communication. Financial communication cannot be tied to one distinct discipline – it is rather a grey area, or interface. It is therefore imperative to identify all the disciplines to which it is related, as well as the similarities between these disciplines, in order to build a sound theory of financial communication. This study only focuses on the contribution of the accounting, public relations and investor relations disciplines to financial communication.

The conceptual model is based on theory alone. Therefore, the next logical step, in terms of the Mitroff *et al.* (1974) model, would be to develop the conceptual model into a scientific model and test it in practice. This falls outside the scope of this study. However, *exploratory* and *descriptive* research has been done to investigate how a number of listed South African companies approach financial communication.

The objectives of exploratory research are, among others, to establish research priorities, clarify concepts and develop questions or hypotheses for further research (Cooper & Schindler, 2003:146; Neuman, 2000:21). Descriptive research aims to answer questions of who, what, where, when or how (Cooper & Schindler, 2003:149). Therefore, the empirical component of this study helps to describe the reality problem situation - Circle I of the Mitroff *et al.* (1974) model. It also supplements the broad theoretical framework (conceptual model) within which future research can be conducted – Circle II of the Mitroff *et al*. (1974) model. The research methodology is discussed in Chapter 6, while the results are presented and interpreted in Chapters 7 and 8.