CHAPTER 1

Orientation and general background

No problem can be solved from the same consciousness that created it. We must see the world anew. - Einstein

1.1 Introduction

Financial + Communication = ?

Financial public relations? Investor relations? Accounting communication?

The answer to this equation is not as simple as "1+1=2". Maybe it is because there is no correct answer... or maybe there is more than one correct answer. Over the years, various disciplines and subdisciplines have attempted to solve the "equation": terms such as "financial public relations", "investor relations" and "accounting communication" are well known. The existence of all these terms, as well as numerous definitions for each, have led to a great deal of confusion regarding the exact nature of financial communication.

It is for this reason that the term "financial communication" is preferred in this dissertation. It cannot be directly connected to any of the disciplines that have laid claim to it - public relations, accounting, the specialist field of investor relations or marketing. The term does, however, suggest an inherent interdisciplinary nature.

Of all the disciplines mentioned above, accounting is the oldest. According to Belkaoui and Jones (1996:1), the first form of record keeping dates back to approximately 3000BC. The double-entry bookkeeping system is attributed to Luca Pacioli, who published a book in 1494, explaining the system. The idea of financial disclosure -

reporting financial results to owners (investors) and the public - can be traced back to the mid-nineteenth century (Puxty, 1990:350).

During the 20th century, the phenomenon of publicly traded shares in companies has given rise to the development of a subdiscipline of public relations, known as financial public relations. According to Marcus and Wallace (1997:311), public relations practitioners have taken responsibility for the dissemination of financial information until the mid-1970s. However, because many public relations practitioners do not have a sound financial background and understanding of the financial dynamics of an organisation, confidence in them as reliable and credible sources of information has waned.

Three trends have resulted from this disillusionment with financial public relations. Firstly, the accounting (financial) function has assumed responsibility for financial communication. A second, more recent trend is the emergence of investor relations, a separate and specialised discipline (Marcus & Wallace, 1997:2). What is interesting, is that the term “investor relations”, not ”financial public relations”, is used in some public relations text books (Baskin, Aronoff & Lattimore, 1997; Cutlip, Center & Broom, 2000; Seitel, 2001). Lastly, there is increasing evidence of a marketing approach to investor relations (Dilenschneider, 2003:33; Jameson, 1996:185). This last approach to financial communication will be briefly discussed in Chapter 2, but is not the main focus of this study.

It is evident from the above, that financial communication has been characterised by “turf wars”, mainly between public relations and accounting, and investor relations to a lesser extent. However, financial communication entails more than the debate surrounding functional/disciplinary responsibility. According to Wilson (1980:10), there are four main aspects of investor relations (read financial communication) that warrant research:

- organisation of the function;
- the various audiences with which the organisation communicates;
- the nature of the information conveyed to these audiences; and
- the communication channels used to transmit the information.

It is important to note, though, that the logical point of departure for research about financial communication is the management and organisation thereof. Decisions regarding the dissemination of information to various audiences, using various communication channels, have to be made within a well-organised structure. In fact, the management and organisation of financial communication have been the topic of various studies conducted previously in the USA, UK and Europe (McGrath, 1974; Marston, 1996; Marston & Straker 2001; Petersen & Martin, 1996). The results of all these studies indicate that in most cases, the accounting (financial) function takes responsibility for financial communication.

However, in South Africa, research about the management and organisation of financial communication has been limited. In 1997, preliminary research brought to light the differences in opinion about the responsibility for the management of financial communication, as well as the academic background needed by the incumbent assuming this responsibility. Questionnaires were sent to communication practitioners, while personal interviews were conducted with chartered accountants. Both groups of respondents claimed responsibility for financial communication. However, it was found that the communication practitioners were more inclined to support an integrated or cross-functional approach to financial communication, than accountants were (Schoonraad, 1998). Although the project was limited in terms of scope and depth, it provided the foundation for this study - an investigation into the current approach to financial communication, in the South African context.

1.2 Problem statement

It is evident from the previous section that there are numerous and diverse perspectives regarding the nature of financial communication, its "disciplinary home" and an ideal arrangement in terms of management and organisation. Therefore, the problem that this study addresses is:

Confusion exists regarding the nature, management and organisation of financial communication.

1.3 Research objectives

In order to address the research problem in an organised and systematic manner, the following research objectives have been formulated:

1. To describe the current approach to financial communication, from a theoretical perspective.
2. To identify the shortcomings of the current approach to financial communication, from a theoretical perspective.
3. To provide a theoretical justification for an *inclusive* (stakeholder) approach to financial communication.
4. To develop a conceptual model, based on an *inclusive* and *integrated* approach to financial communication.
5. To use empirical research to establish whether a number of South African companies listed on the Johannesburg Stock Exchange (JSE):
   - follow an *inclusive* (stakeholder) approach to financial communication;
   - follow an *integrated* approach (in terms of management and organisation) to financial communication.
6. To identify similarities and/or differences between the results of this study and results of three similar studies conducted previously in the USA, United Kingdom and Europe.

The first four objectives guide the theoretical component of the study, while the fifth and six objectives guide the empirical component. It must be noted, however, that the sixth objective requires that the results of previous studies be reported, before similarities and/or differences can be identified. These results are reported in the theoretical component that deals with investor relations.

1.4 Conceptual framework

There are two main disciplines that have contributed to the current understanding of financial communication: public relations and accounting. In addition, investor relations has developed as a specialised discipline on its own, although it can be said that it has its roots in public relations as well as accounting. A number of public relations text books use the term "investor relations", while empirical evidence (McGrath, 1974; Marston, 1996; Marston & Straker 2001; Petersen & Martin, 1996) suggest that, in most cases, the accounting function currently assumes final responsibility for investor relations.

The first two objectives of this study are aimed at describing this current understanding of financial communication and identifying its shortcomings. This description will be based on public relations (specifically financial public relations/investor relations), investor relations (as specialist field) and accounting theory. It will be noted that the current approach to financial communication is characterised by 1) a narrow focus on the financial community (shareholders, analysts, banking institutions, the financial media et cetera) and 2) a lack of integration.

This leads to the third and fourth objectives of this study. Theories related to strategic management and public relations will be used to justify an inclusive (stakeholder) approach to financial communication. These include corporate governance, corporate social responsibility, stakeholder theory and relationship management (from a public relations perspective). These theories, in addition to the ones mentioned in the previous paragraph, will then be used to develop a conceptual model for an inclusive and integrated approach to financial communication. The empirical component of the study (the fifth objective) is aimed at establishing whether there are indications of an inclusive and integrated approach to financial communication in the South African context.

The purpose of academic research is either to develop new theory, or to change or expand existing theory. In this study, theories from various disciplines are used to expand existing theory on financial communication. According to Neuman (2000:42), theory consists of various components or building blocks, known as *concepts*. A concept is a general idea or notion, a vague impression (Neuman, 2000:193). However, a vague or general idea does not provide a clear framework for research. Therefore, *constructs* are used to turn these vague ideas into systematically organised ideas.

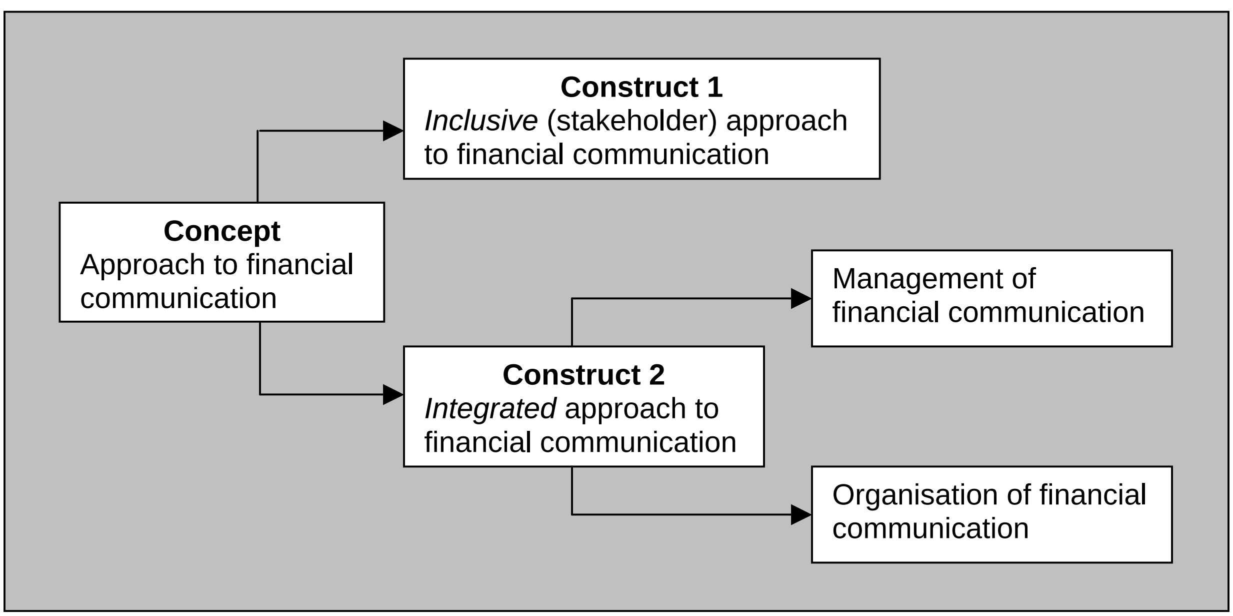
In the problem statement of this study, reference is made to the *nature*, *management* and *organisation* of financial communication. The terms "management" and "organisation" imply a certain *approach* to, or way of dealing with, financial communication. In addition, the "nature" of financial communication will influence the approach followed. Thus, "approach to financial communication" is the *concept* underlying this study. Two constructs are used to make this concept more concrete:

- an *inclusive* (stakeholder) approach to financial communication; and
- an *integrated* approach (in terms of management and organisation) to financial communication.

The word "inclusive" is used in the stakeholder literature. For example, Clarke (1997:214) uses the term "inclusive company" to describe the importance of managing stakeholder relationships. In similar fashion, the 2002 King Report on Corporate Governance (King Committee on Corporate Governance, 2002:98) advocates an inclusive approach - all relevant stakeholders should be considered when developing a company's overall strategy. In this study, an *inclusive* approach to financial communication is operationalised as "communication with all relevant stakeholders that need financial information, in order to make decisions regarding the allocation of their scarce resources".

Various authors note the lack of integration in investor relations efforts (Ferris & Newman, 1991; Johnson, 1990; Neilson, 1990; Petersen & Martin; 1994,1996). Others emphasise the importance of co-ordination and co-operation between functions such as public relations/corporate communication and investor relations (Ferris & Newman, 1991; Johnson, 1990; McMullen, 1990; Smith, 1989). Therefore, an *integrated* approach to financial communication is operationalised as "co-operation and co-ordination between functions/departments and their respective managers, in the management and organisation of financial communication". The term "management" refers to reporting relationships/structures, while the term "organisation" refers to the position of financial communication in the organisational hierarchy. Figure 1.1 represents the conceptual framework of this study in graphical format.

Figure 1.1 Conceptual framework underlying this study



1.5 Definition of terms

For the purposes of this study, “financial communication” is defined in the following way:

> The establishment and maintenance of mutually beneficial relationships between a company and its relevant stakeholders, by exchanging information that is needed to facilitate optimal decisions regarding the allocation of scarce resources.

The first part of this definition is derived from Cutlip, Center and Broom’s (1994:2) definition of public relations as “the management function that establishes and maintains mutually beneficial relationships between an organisation and the publics on whom its success or failure depends”. The second part of the definition is derived from the accounting literature. For example, Wolk, Tearny and Dodd (2001:3) define financial accounting by referring to “… accounting information that is used by investors, creditors and other outside parties for analyzing management performance and decision-making purposes”. Belkaoui and Jones (1996:29), Glautier and Underdown (1995:18) and Lehman (1992:21) also refer to the role of accounting information in the allocation of resources.

Note that the term “stakeholders” is used in the above definition of financial communication. Freeman (1984:25) defines stakeholders as any group or individual who can affect or is affected by the achievement of the firm’s objectives. It is also important to note that the phrase “exchanging information” is used to emphasise the two-way nature of financial communication. Information is not merely provided or disclosed by one party to another. Following an open systems perspective, information is *shared* between the organisation and its environment.

Two terms are used to refer to financial communication, namely “financial public relations” and “investor relations”. Buchner (1994:231) defines *financial public relations* as “… the science of communicating with specific target audiences, respectively or generally, about a company's trading activities and conditions, financial status, strategy, and values, on a consistent basis, so that they may accurately evaluate their investment".

There are mixed opinions regarding the disciplinary home of *investor relations*. Cutlip *et al.* (1994:19) define investor relations as "the specialized part of corporate public relations that builds and maintains mutually beneficial relationships with shareholders and others in the financial community". However, Marcus and Wallace (1997:2;313) contest this view and state that investor relations is not merely public relations directed at the financial community, but a highly specialised and separate field. More information about the confusion around terminology is provided in Chapter 2.

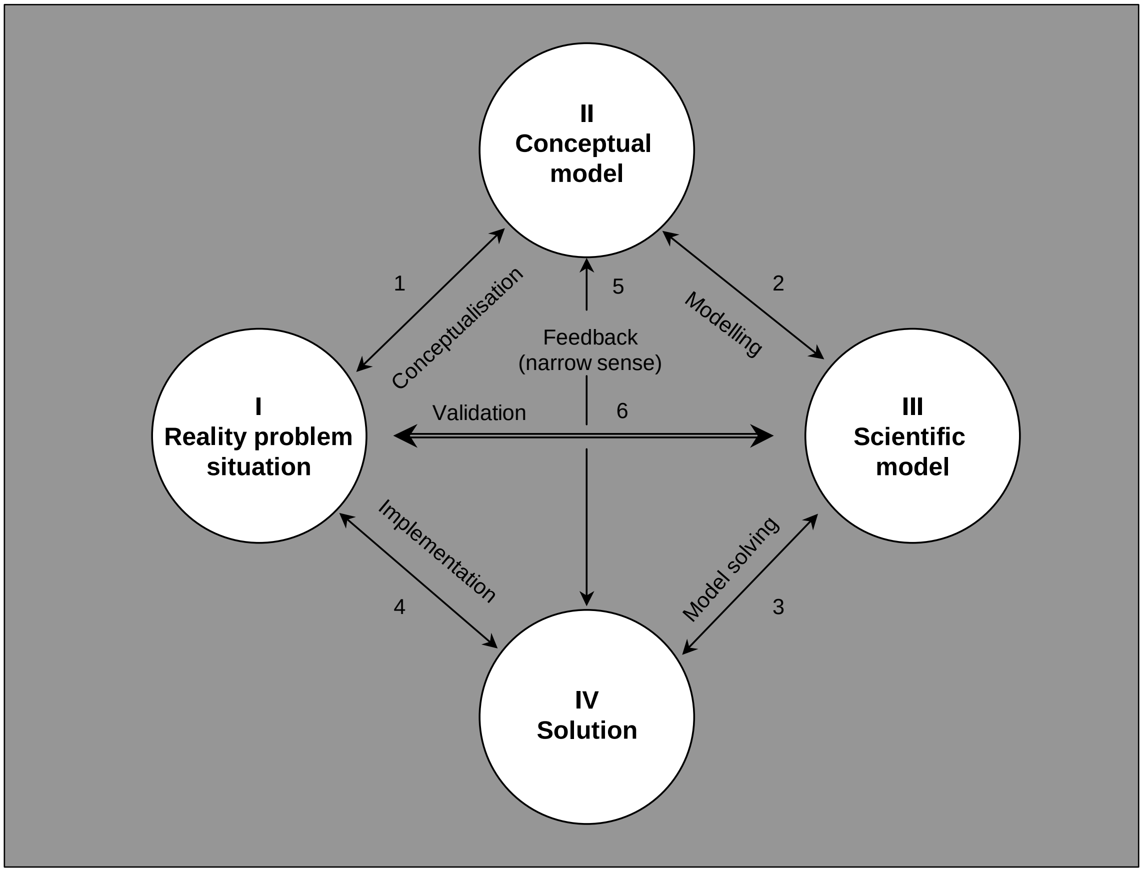
1.6 Delimitation of study and research methodology

It is important to identify the major focus of a study and ensure that it is comprehensively dealt with. This is vital, especially when the field of enquiry is characterised by limited prior research. In such cases, a natural response is to attempt too much at once.

The focus of this study is mainly on the first aspect of financial communication, as identified by Wilson (1980:10): the organisation (and management) of financial communication. However, the construct "*inclusive* approach to financial communication" touches on the second aspect as well: various audiences (or stakeholders) with which the organisation communicates. The third and fourth aspects, communication messages (information) and communication channels fall outside the scope of this study.

Another way to explain the delimitation of this study is by means of the systems model of problem solving, developed by Mitroff, Betz, Pondy and Sagasti (1974:48). This model is depicted in Figure 1.2.

Figure 1.2 A systems view of problem solving



Source: Mitroff *et al*. (1974:48)

The model takes a systems approach to the different varieties of scientific activities and has no definite starting or ending points. Research is seen as a continuous process that may begin at any of the four circles. One researcher may start at Circle I (the identification of a reality problem situation), develop a conceptual model (Circle II) through Activity 1 (conceptualisation) and formulate a scientific model (Circle III) through Activity 2 (modeling). Another researcher may follow up by deriving a solution (Circle IV) from the scientific model (through Activity 3 – model solving) and implement it in practice (Activity 4, which loops back to Circle I).

Mitroff *et al*. (1974:53) remark that a single research project rarely covers all the circles and activities. Rather, various combinations of circles and activities can be used. For example, a researcher might choose not to proceed from Circle III to Circle IV, but to "loop" back to Circle I and validate the scientific model (through Activity 6). Another researcher might decide not to implement the solution to a problem (Circle IV), but to refine the conceptual model (Circle II) through Activity 5 (feedback in the narrow sense). According to Mitroff *et al.* (1974:47) there are 3 555 different possible combinations of the different elements of the model.

The research for this dissertation is limited to Circle I, Activity 1 and Circle II. In the first phase, the problem this study seeks to address (confusion regarding the nature, management and organization of financial communication) will be described. This will be done by means of a review of public relations, investor relations and accounting literature. During the second phase, a conceptual model for an inclusive and integrated approach to financial communication will be developed, based on the literature review mentioned above, as well as a review of corporate governance, corporate social responsibility, stakeholder and relationship management literature. The conceptual model will represent a broad framework within which future research about the approach to financial communication can be conducted. It is not within the parameters of this study to develop a scientific model that can be validated or implemented.

In order to supplement the theoretical component of the study, empirical research will be conducted, to establish whether there are indications of an inclusive and integrated approach to financial communication in the South African context. The research will be exploratory in nature, due to the fact that limited prior research has been conducted in South Africa about this topic. Although exploratory research is usually qualitative, the research conducted in this study will be quantitative. The purpose is to obtain a wide range of perspectives on the topic, rather than in-depth information. The sample will be the 300 largest South African companies listed on the Johannesburg Stock Exchange (JSE), based on market capitalisation. Data collection will be done by means of an electronic questionnaire survey. The questionnaire will consist mainly of close-ended questions, with a limited number of open-ended questions. Descriptive statistics and content analysis will be used to analyse the data obtained. Results will be presented graphically by means of tables, bar charts and pie charts.

1.7 Importance of this study

A limited amount of research has been done about the nature, management and organisation of financial communication in South Africa. Furthermore, research that specifically focuses on the interdisciplinary nature of financial communication is much needed.

This study will contribute to the body of knowledge in financial communication in three ways. In the first place, the current approach to financial communication will be described from two main disciplinary perspectives: investor relations (as part of public relations and as a separate, specialised field) and accounting. Secondly, a theoretical justification will be provided for an inclusive (stakeholder) approach to financial communication. Most importantly, a conceptual model for an inclusive and integrated approach to financial communication will be developed. Academics and practitioners in fields related to financial communication (such as accounting, public relations and investor relations), may find this study, and specifically the conceptual model, a useful starting point for further debate and research.

1.8 Demarcation of chapters

This dissertation consists of nine chapters that form part of four major sections: an introduction (this chapter), a theoretical component (Chapters 2-5), an empirical component (Chapters 6-8), and a conclusion (Chapter 9). Table 1.1 is a summary of the demarcation and content of each of the chapters.

Table 1.1 Demarcation and content of chapters

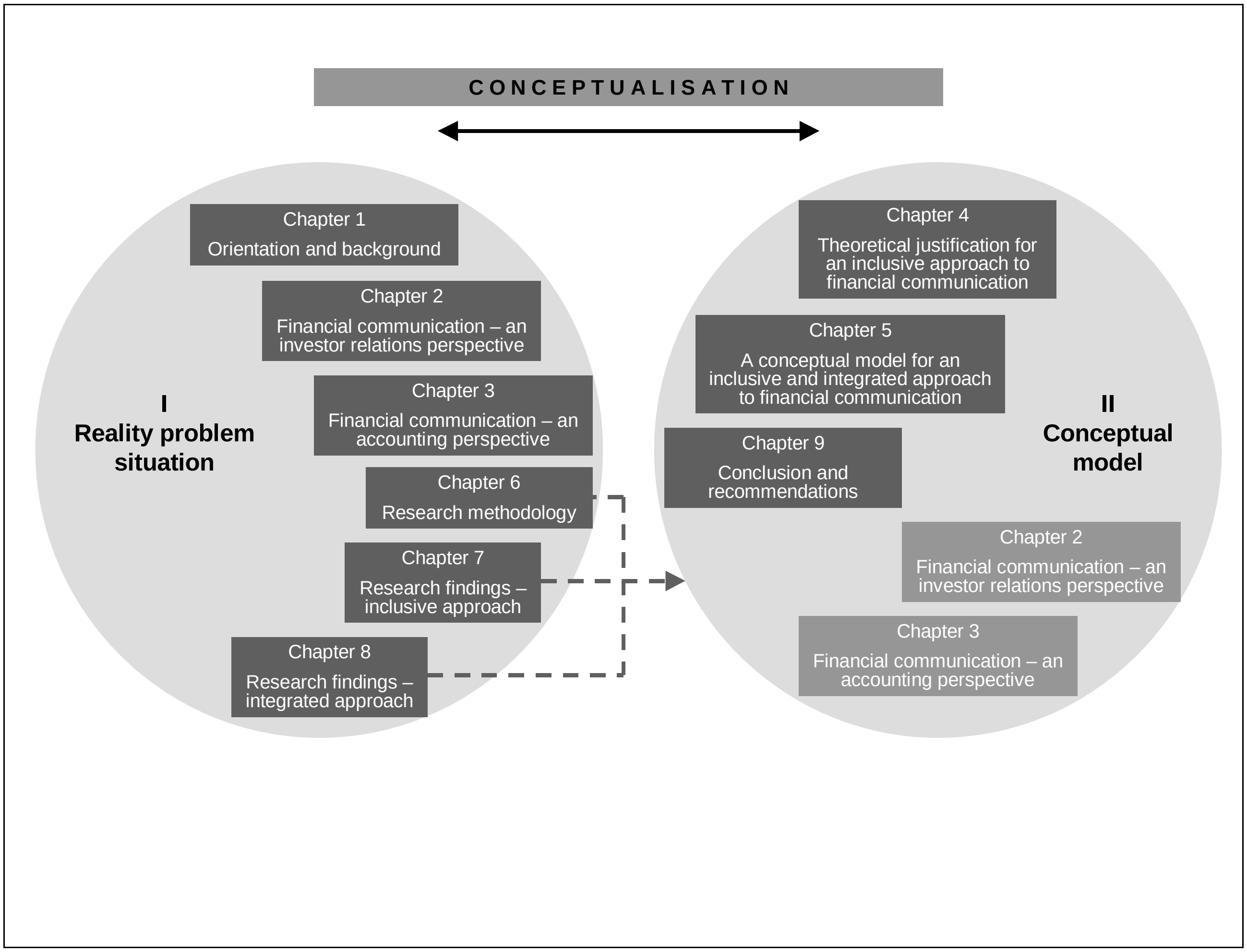
CHAPTER	CONTENT
Chapter 1: Orientation and general background	The reader is introduced to the problem that the study investigates, as well as the broad context within which the problem exists. The conceptual framework underlying the study is set out.
Chapter 2: Financial communication – an investor relations perspective	The current approach to financial communication is described from an investor relations perspective. It is noted that no clear distinction can be made between the terms “investor relations” and “financial public relations”, although investor relations is currently seen as a specialised field, apart from public relations. The main emphasis is on the management and organisation of financial communication.
Chapter 3: Financial communication – an accounting perspective	Following from one of the conclusions of Chapter 2 (that the accounting profession currently dominates financial communication), the current approach to financial communication is described from an accounting perspective. Major themes are the objectives of accounting and the expanding role of the accounting profession
Chapter 4: Theoretical justification for an inclusive approach to financial communication	Perspectives from corporate governance, corporate social responsibility, stakeholder theory and public relations as relationship management are used to justify an inclusive approach to financial communication. One of shortcomings of the current approach to financial communication (a narrow focus on the financial community) is the basis of this chapter.

Chapter 5: A conceptual model for an inclusive and integrated approach to financial communication	A conceptual model for an inclusive and integrated approach to financial communication is developed, based on the literature review in Chapters 2, 3 and 4. In other words, the most important themes of these chapters are integrated, to form a holistic view of financial communication.
Chapter 6: Research methodology	Survey research has been conducted to supplement the theoretical component of the study. In Chapter 6, the research methodology is described in terms of research strategy, design, methods and techniques.
Chapter 7: Research findings – an inclusive approach to financial communication	Results of the questionnaire survey, related to the first construct, "an *inclusive* approach to financial communication", are reported and interpreted.
Chapter 8: Research findings – an integrated approach to financial communication	Results of the questionnaire survey, related to the second construct, "an *integrated* approach to financial communication", are reported and interpreted. Similarities and differences are identified between these results and results of three similar studies conducted previously in the USA, UK and Europe.
Chapter 9: Conclusion and recommendations	Conclusions are drawn from both the theoretical and empirical components of the study. Based on the limitations of the study, recommendations are made regarding future research.

The model of Mitroff *et al*. (1974) has been used to indicate the delimitation of this study. It can also be used to indicate the demarcation of chapters in graphical format. In Figure 1.3, chapters that describe the reality problem situation (theoretically and empirically) are allocated to Circle I (reality problem situation), while the chapters that are used to develop the conceptual model are allocated to Circle II (conceptual model).

Note that broken lines and arrows are used to indicate that the empirical component of the study supplements the theoretical conceptual model.

Figure 1.3 Demarcation of chapters according to the Mitroff *et al*. (1974) model



Adapted from: Mitroff *et al.* (1974:48)