

# BUILDING PUBLIC TRUST

The Future of Corporate Reporting

Samuel A. DiPiazza Jr.  
*CEO, PricewaterhouseCoopers*

Robert G. Eccles  
*President, Advisory Capital Partners*



## **Creating Measurement and Reporting Standards for Nonfinancial Measures**

## **Will Financial Indicators Solve the GAAP Gap?**

**American Enterprise Institute  
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**Dr. Robert G. Eccles  
President, Advisory Capital Partners  
Senior Fellow,  
PricewaterhouseCoopers**

# Important Value Drivers for Company Executives by Industry

## BANKING

- Loan Loss
- Earnings
- Capital Adequacy
- Risk Management Practice
- Customer Retention
- Customer Penetration
- Asset/Liability Management
- Asset Quality
- Return on Risk Adjusted Capital
- Capital
- Management
- Quality of Management
- Plans for Growth
- Market Growth
- Fee-based Revenue Growth
- Delivery Channels
- Economic Profit
- Performance by Business Segment
- Market Risk Exposure
- Cost/Income
- Market Share
- Assets Under Management
- Employee Satisfaction
- Brand Equity
- Product Innovation
- Investment Performance
- Degree of Diversification
- Regulatory Reputation
- IT Expenditures

## INSURANCE

- Performance by Business Segment
- Expense Ratio
- Capital Management
- Risk Management Practices
- Plans for Growth
- Investment Performance
- Distribution Channels
- Quality of Management
- Earnings
- Asset/Liability Management
- Return on Risk
- Adjusted Capital
- Market Growth
- Customer Retention
- Capital Adequacy
- Claims Ratio
- Economic Profit
- Employee Satisfaction
- Customer Penetration
- Market Risk Exposure
- Assets Under Management
- Asset Quality
- Embedded Value
- IT Expenditures
- Brand Equity
- Product Innovation
- Regulatory Reputation
- Market Share

# Important Value Drivers for Company Executives by Industry

## INVESTMENT MANAGEMENT

- Profit Margins
- Investment Product Performance
- Quality of Management
- Asset Growth from Investment Performance
- Asset Growth from Product Cash Flow
- Employee Retention
- Compensation Levels of Professional Staff
- Asset Retention
- Competitive Landscape
- Product Diversification Strategy
- Compensation Strategy
- Investment in Technology to Improve Business Processes
- Assets under Management
- Enterprise Risk Management
- Market Share
- Experience/Quality of Investment Research Professionals

## HIGH TECHNOLOGY

- Strategic Direction
- Cash Flow
- Market Growth
- Gross Margins
- Quality/Experience of Management Team
- Market Size
- Competitive Landscape
- Earnings
- Speed to Market (first to market)
- Market Share

## TELECOMMUNICATIONS

- Competitive Landscape
- Capital Expenditures
- Market Growth
- Customer Churn Rate
- Regulatory Environment
- Pricing Strategy
- Network Reach, Quality & Capability
- Earnings
- Revenue Metrics by Driver (e.g. Average Revenue per user)
- Significant Operating Costs by Category
- Sales & Marketing Strategy
- Cash Flow by Business Segment

# Important Value Drivers for Company Executives by Industry

## PHARMACEUTICALS

- Market Growth & Potential by Therapeutic Area
- Product Focus Strategy
- Earnings
- R&D Pipeline
- Market Share by Therapeutic Area
- Regulatory Issues
- Product Innovation Strategy
- Performance by Business Segment
- Effectiveness of Product Launch
- Reputation with Prescribers
- Quality of Management
- Market Growth & Potential by Geographic Area
- Market Growth by Geographic Market
- Partnering Strategy
- Cost/Revenue Ratios
- Quality of Selection of Development Targets
- Recruitment & Retention of Talented People
- Risk Profile of Product
- Efficiency of Manufacturing Facilities
- Profitability of Licensing Arrangements
- Economic Profit
- Value of Key Intellectual Assets
- Brand Awareness of Levels with Patients

## PETROLEUM

- Supply, Demand and Prices for Petroleum Products by Region
- Cash Flow
- Unit Cost by Refinery
- Value of Proven & Probable Reserves
- Refinery Margins by Region
- Capital Expenditures
- Strategic Direction
- Reserve Replacement Costs
- Refinery Utilization
- Refinery Acquisition Cost of Crude
- Earnings
- Supply, Demand & Prices for Crude Oil & Natural Gas
- Performance by Business Segment
- Exploration Success Rate
- Return On Average Capital Employed or Similar Return Measure
- Quality of Management
- Petroleum Product Sales by Volume by Refinery
- Risk Management
- Quality of Workforce
- Hedging Strategy
- Market Share
- Operating Profit per Equivalent Measure by Geographic Location

# Important Value Drivers for Company Executives by Industry

## CHEMICALS

- Free Cash Flow
- Strategic Direction
- Manufacturing Costs
- Earnings
- Market Growth
- Performance by Business Segment
- Product Quality
- Quality of Management
- Capital Expenditure
- Utilization of Facilities
- Market Share
- Customer Loyalty

## METALS

- Market Share
- Energy Prices & Supply
- Earnings
- Costs per Ton Delivered
- Market Growth
- Metals Prices
- Capital Expenditures
- Performance by Business Segment
- Potential Supply Globally & Locally
- Utilization of Facilities
- Product Quality
- Free Cash Flow
- Age & Quality of Plant
- Strategic Direction
- Value of Tangible Assets
- Implementation of new Processes & Technologies
- Quality of Management
- Regulatory Environment

## MINING

- Strategic Direction
- Cash Cost per Ounce/Kg/Ton
- Capital Expenditures
- Earnings
- Existing/Potential Environmental Liabilities
- Health & Safety Performance Statistics
- Metal Prices
- Quality of Management
- Acquisition Strategies
- Ounces/Kilograms/Tons Produced per Year
- Performance by Business Segment
- Cost per Ounce/Kg/Ton
- Labor Relations
- Sustainable Development Strategy
- Environmental Policy/Risks
- Potential Supply/Production Globally & Locally

# Important Value Drivers for Company Executives by Industry

## DIVERSIFIED MANUFACTURING

- Free Cash Flow
- Performance by Business Segment
- Market Growth
- Earnings
- Manufacturing Costs
- Quality of Management
- Strategic Direction
- Capital Expenditures
- Market Share
- Product Quality

## CONSUMER GOODS

- Capital Expenditure
- Free Cash-flow
- Sales Volume
- Quality of Strategy
- Growth of Strategy
- Performance by Business Segment
- Market Growth
- Performance by Geographic Market
- Marketing Strategy
- Customer Loyalty & Advocacy
- Customer Service
- Weighted average cost of capital
- Employee Satisfaction & Advocacy
- Earnings
- Sales & Gross Margins by Product Category
- Market Share
- Product Innovation
- Marketing Costs
- Brand Portfolio Management Date
- Percent of New Products in Sales
- Employment, Environmental Policies
- Product Range Development
- Stock Levels in the Supply Chain
- Distribution Channel Complexity

# Important Value Drivers for Company Executives by Industry

## RETAIL

- Market Growth
- Earnings
- Same Store Sales
- Gross Margins
- Free Cash-Flow
- Market Share
- Performance by Business Segment
- Store Portfolio Changes (e.g., new stores)
- Weighted Average Cost of Capital
- Customer Satisfaction
- Expected Return on New Stores Refurbishment
- Quality of Management
- Capital Expenditure
- Sales per Square Foot
- Inventory Turns
- New Store Formats Tested & Performance Data
- Brand Value
- Product Availability

## REAL ESTATE

- Financing Strategy
- Occupancy Rate
- Macro-Economic Factors (e.g., GDP growth, inflation, population & job growth, interest rates)
- Investment Strategy
- Return on Invested Capital
- Revenue from New Developments or Acquisitions
- Investment in New Acquisitions & Development Properties
- Earnings
- Market Rental Rate
- Quality of Management
- Free Cash Flow

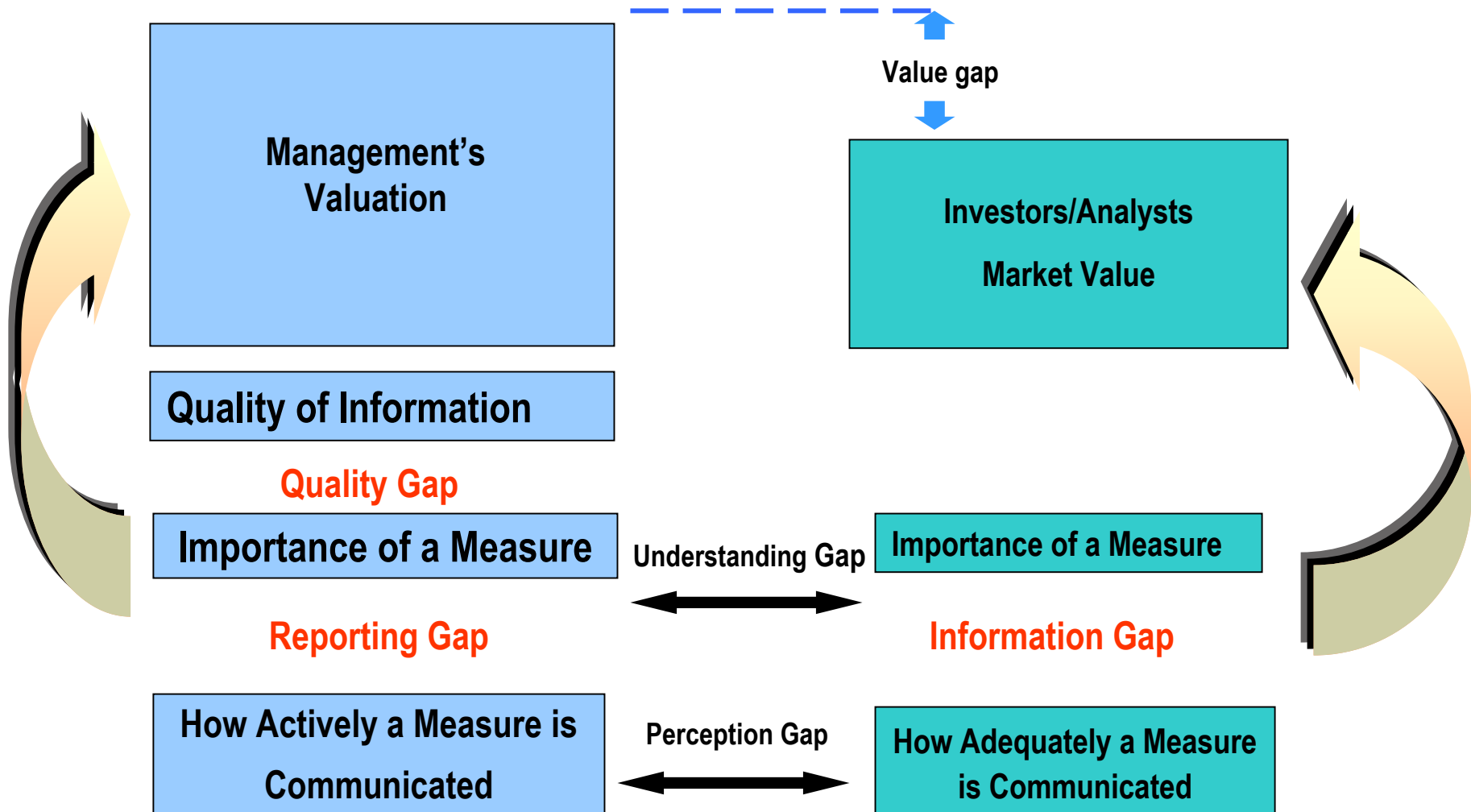
# Insights from Industry Research

- **Executives in all industries regard a broad range of measures to be highly important**
- **These measures are about both financial and non-financial value drivers and tangible and intangible assets**
- **GAAP measures are a small proportion of highly important measures in every industry**

# Insights from Industry Research

- **Earnings and cash flow are typically not ranked at the top in order of importance although they are important in nearly every industry**
- **It will be very difficult to establish quantitative measures for some of these value drivers (e.g., quality of management and strategic direction)**
- **Some of these value drivers require external data not typically captured by a company's information systems (e.g., market growth and market share)**

# Communication Gaps



# The Need for Industry-based Collaborations

- **Identify the key value drivers in the industry**
- **Determine which ones lend themselves to quantitative measurement given the existing state of knowledge and information systems capabilities**
- **Identify the various ways these value drivers are currently being measured by companies, analysts, investors and others**

# The Need for Industry-based Collaborations

- **Develop a consensus on the preferred way of measuring a value driver based on criteria of**
  - ▶ **Reliability (measure is accurate)**
  - ▶ **Utility (measure can be incorporated into analysis with other measures)**
  - ▶ **Cost/benefit (value of having the information exceeds the cost of producing it)**
- **Publish these standards on a prominent “third party” Web site, such as a trade or professional association for the industry**

# Objections to Standards for Nonfinancial Measures

## Companies

- Reduces degrees of freedom in external reporting
- Leads to a “one size fits all” approach
- Changing information systems to adhere to standards can be costly
- Developing standards entails private costs for the public good
- Many companies are in many businesses
- Industry definitions not always clear
- Developing standards can take a long time

# Objections to Standards for Nonfinancial Measures

## Investors

- **Share many of the concerns of companies**
- **Large institutional investors benefit from an “unlevel playing field”**

# Predictions

- **Standards for nonfinancial measures WILL happen**
- **Users will ultimately demand them**
- **It will be a difficult and painful but learning process**
- **Selected sectors (software and financial services) with the greatest self-interest will lead the way**
- **Developing XBRL taxonomies will be a great facilitator**
- **Timeframe is 5 to 20 years**