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If there are concerns about whether quarterly reporting adds value, regulators should also consider how to improve it, and not just consider dropping it.

Scrapping quarterly reporting a bad move

It'll worsen information disparity between insiders and investors; neither continuous disclosure nor stronger regulation is a substitute. BY MAK YUEN TEEN AND CHEW YI HONG

ON April 28, Noble Group held its annual general meeting (AGM) for the financial year ended Dec 31, 2016, then shocked the market at 10.37 pm on May 9 with profit guidance for its unaudited 2017 first-quarter results indicating a likely net loss of around US$130 million. By the end of the next trading day, its shares had fallen about a third. The company released its unaudited first quarter results after the close of trading that day. Noble blamed "dislocation in the coal market" – presumably this has nothing to do with President Donald Trump.

Various analysts rushed to cut their price targets by 50 per cent or more after the profit guidance. Shareholder Mano Sabnani said in a Straits Times article that the announcements were ". . . 'puzzling' after the annual and special general meetings in April . . . there were plenty of positive notes and the impression given was that the share consolidation was the last piece needed before a sustained turnaround". When the chief financial officer was asked why the issue was not disclosed by management earlier, he said that the answer to that question was "not relevant".

If Noble did not have to report its results on a quarterly basis, one wonders when management would have deemed the new information to be relevant and disclosable to shareholders. Would it be when the half-yearly results were due to be released? In the meantime, those with knowledge of this information would have been dealing at an advantage over current and potential investors without such knowledge.

To be fair, Noble was more timely with its profit guidance for the second quarter results, releasing it about two weeks prior, which signalled a total net loss of US$1.7-1.8 billion.

Let's consider another example – the Catalist-listed, Bermuda-incorporated S-chip, Sinocloud, which has a current market capitalisation of just over S$10 million. On June 28, 2013, Sinocloud (then trading as Armarda) paid a HK$27.5 million refundable deposit for a PRC project. Based on the threshold tests in Catalist rule 1006 for determining if acquisitions and realisations are disclosable or require shareholders' approval, the deposit constituted 8.7 per cent of the market capitalisation at that time and 28.6 per cent of the latest audited net tangible assets of the group as at March 31 2012 – well above the thresholds for disclosure. The "catch" is whether it is considered "an acquisition . . . which is in, or in connection with, the ordinary course of its business or of a revenue nature", in which case it is not covered by the rules.

Then there is the "Continuous Obligations" requirements in Chapter 7, supplemented by Appendix 7.1 "Corporate Disclosure Policy", setting out subjective and objective criteria for continuous disclosure. But here again, there is considerable room for discretion by issuers as to whether to disclose certain information.

Sinocloud did not make any announcement at the time of the deposit, which first appeared in the breakdown of its prepayments and receivables in its first quarter results on Aug 14, 2013 – or 1½ months after the deposit was made. It went on to increase the deposit twice, converted the then HK$50.05 million deposit into a HK$84 million convertible loan, extended the maturity date of the loan by 12 months, and took other actions – with disclosure in each instance made well after the event or when quarterly results were announced.

These two cases are by no means outliers. Spindex Industries, Swiber and YuuZoo are other recent examples of possible lack of timely disclosures or other disclosure lapses. Our concerns with the quality and timeliness of disclosures led us recently to allude to "a lackadaisical attitude towards compliance with listing and regulatory requirements on the part of some issuers."

Given this, should SGX be using the continuous obligation to make timely disclosures of material events and the enhancement of our securities regulation with regard to what constitutes "material" information as arguments for doing away with quarterly reporting, as it has done?

Mark Posen of MIT and Robert Pozen of Harvard Law School said on the Harvard Law School Forum on Corporate Governance and Financial Regulation: ". . . with companies going dark for six months (with semi-annual reporting), the gap between inside information and public information will widen – increasing the temptation for insider trading."

INFORMATION ASYMMETRY

A 2016 doctoral study at Yale University explains how quarterly reporting reduces information asymmetry by reducing the time over which the information advantage of informed traders is able to grow and accumulate. Empirical tests using data from US, Europe, Singapore and Japan supported the impact of quarterly reporting on reducing information asymmetry. Another 2012 US study found that an increase in reporting frequency reduced information asymmetry and the cost of equity capital.

There is no consistent empirical evidence that quarterly reporting creates managerial myopia, as some have argued. For example, a recent UK study found that the initiation of mandatory quarterly reporting in 2007 had no material impact on the investment decisions of UK listed companies. Instead, analyst coverage of listed companies increased and the accuracy of analyst forecasts of company earnings improved. When quarterly reporting was no longer required in 2014, the levels of corporate investment of the companies that stopped quarterly reporting were no different from those that continued quarterly reporting. Rather, there was a general decline in the analyst coverage of stoppers and less of such decline for companies continuing to report quarterly.

While there are studies that show otherwise, it is difficult to see how extending reporting frequency from quarterly to semi-annually would cause management to be less myopic.

A study by three professors from the University of Munster using Singapore data found a decrease in firm value, suggesting that mandatory quarterly reporting imposes a net burden on small firms, and no improvements in liquidity for firms around the S$75 million threshold. The study focused on the impact of mandatory quarterly reporting around the time of its introduction almost 15 years ago but the mix of companies today is fundamentally different. For instance, the S-chip wave had not yet hit our shores and there were far fewer foreign listings then. Chinese companies listing on the Chinese stock exchanges or the Growth Enterprise Market (GEM) in Hong Kong – or companies listing on almost any other Asian exchange – would have to report quarterly. In fact, quarterly reporting could be even more important today for our market than when it was first introduced.

A study by two NUS Business School professors, based on 9,900 quarterly reports from Q1 2007 to Q3 2015, found strong evidence of the usefulness of quarterly reporting. Using daily return volatility and trading volume, they found strong market reaction to the release of quarterly results, with the reaction strongest for small firms, followed by medium firms. The market also reacted positively to an increase in quarterly earnings and negatively to a decrease.

In the Business Times report, "Corporate governance reaches new high but better stakeholder engagement needed" (Aug 2), Tan Cheng Han, chairman of SGX Regco, cited widespread views that quarterly reporting adds little value and gives rise to significant compliance cost.

Those "widespread views" presumably came mainly from issuers and directors. For example, it was reported that a poll of conference delegates at a Singapore Institute of Directors' Conference in September 2014 found overwhelming support for abolishing the quarterly reporting requirement. Directors have access to regular management reports, often on a monthly basis, and are not the target users of quarterly reporting information. Directors may prefer less frequent public reporting because increased frequency means more work and greater responsibilities.

If there are concerns about whether quarterly reporting in its present form adds value, regulators should also consider how to improve it, and not just consider dropping it. For example, they could consider improving the information required to be disclosed or encouraging or requiring quarterly reports to be reviewed by auditors. Of course, this may increase costs. However, if the exchange and SGX RegCo do not consider these alternatives carefully, it would suggest that reducing requirements to attract more listings or prevent more delistings is what is driving the review of quarterly reporting.

The president of the Small and Middle Capitalisation Companies Association has said that the costs of mandatory quarterly reporting can be very taxing for smaller listed companies. We have sympathy for high compliance costs for smaller companies, but costs must be balanced against the benefits. SGX could consider other measures to help smaller companies with costs, such as changing the requirement for Catalist companies to retain a continuing sponsor in perpetuity or exempting smaller companies from having to produce sustainability reports.

The GEM market requires companies to retain a compliance adviser for two years after listing, not for as long as it remains on that board. If a Catalist company can demonstrate that it has developed adequate internal capacity for good governance and compliance, and supported it through clean audit opinions and compliance records, perhaps they should be given the opportunity to stand on their own. This may also give Catalist companies an incentive to get their act together. A compliance adviser can be appointed on an ad hoc basis if they find themselves unable to meet the requirements or for special situations.

While companies need to behave responsibly to all stakeholders for their long-term success, and institutional investors are focused on environmental, social and governance (ESG) issues, there is the question of whether sustainability reports should be imposed on smaller companies that often count mainly retail investors, rather than institutional investors, among its public shareholders. In our view, sustainability reports can be just public relations exercises that bear little resemblance to how seriously a company takes sustainability issues. It is puzzling why SGX would cite cost for reconsidering quarterly reporting, yet push through sustainability reporting that in our view has less proven cost-benefit tradeoffs for smaller companies.

IMPROVE BENEFITS

SGX could also look at measures to improve the benefits of listing for smaller companies, such as improving coverage of such firms or encouraging the development of small-cap governance-focused funds.

In May, we did a simple online survey on quarterly reporting which was completed by 69 retail investors and seven institutional investors. Overall, 58 per cent said that quarterly results were critical in their investment decisions, and 30 per cent said that they used quarterly results with other sources of information. Some 12 per cent said that they did not use quarterly results for their investment decisions but still looked at them, and none said that they did not look at quarterly results at all.

When we asked whether continuous disclosure of material information reduces the need for quarterly reporting, 79 per cent said no; and only 8 per cent said that it should be abolished. Finally, 70 per cent said that if quarterly reporting were abolished for certain companies, they would be less likely to invest in those companies. We do not claim that our results necessarily represent "widespread views" but we would be surprised if quarterly reporting is not valued by most serious investors here.

In our view, quarterly reporting is important in Singapore because of the participation of retail investors and the disparity of information available to insiders and public investors. We do not agree that the continuous disclosure obligation or the strengthening of securities regulation are in any way a substitute for quarterly reporting.

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