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**TO WHAT EXTENT COMPANIES LISTED
ON ALTERNATIVE INVESTMENT MARKETS
DISCLOSE STRATEGIC INFORMATION IN THEIR
ANNUAL REPORTS? – COMPARATIVE CASE STUDIES**

**W JAKIM STOPNIU SPÓŁKI NOTOWANE
NA RYNKACH ALTERNATYWNEGO OBROTU
UJAWNIAJĄ INFORMACJE STRATEGICZNE
W RAPORTACH ROCZNYCH –
ANALIZA PORÓWNAWCZA PRZYPADKÓW**

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Summary: Disclosure of strategic information in annual reports increases its usefulness from the viewpoint of not only investors but also other stakeholders. However, a perception of that problem in the context of the whole market reveals that cost-benefit balance due to this kind of disclosures may change over time. This paper aims at qualitative assessment of strategic information disclosures (SIDs) in annual reports of companies listed on the alternative investment markets. As a research method comparative multiple-case studies were applied. Based on information coming from annual reports of 15 companies listed on the AIM London and Warsaw NewConnect the paper recognises a problem and diagnoses the current situation. IT sector is the most dynamically developing market both in the UK and in Poland. As a result of a technological progress IT sector has to be forward-looking in order to respond adequately to customer needs. Therefore a vision of the future and a good development strategy are pivotal issues. The research results evidenced that the quality of SIDs was higher on average in annual reports of companies listed on the AIM London compared with that listed on the Warsaw NewConnect.

Keywords: alternative investment markets, annual report, strategic report, strategic disclosures.

Streszczenie: Ujawnianie informacji strategicznych w raportach rocznych podnosi ich użyteczność z punktu widzenia nie tylko inwestorów, ale również innych interesariuszy. Jednak spojrzenie na ten problem w kontekście całego rynku uwidacznia, że bilans korzyści z tytułu tego rodzaju ujawnień może się zmieniać w dłuższym czasie. Celem tego artykułu jest ocena jakościowa ujawnianych informacji o charakterze strategicznym przez spółki notowane na rynkach alternatywnych. Badanie ma charakter porównawczego studium przypadków na podstawie danych retrospektywnych pochodzących z raportów rocznych badanych jednostek. Jego

celem jest rozpoznanie i zdiagnozowanie sytuacji. Ocenie zostało poddanych 15 spółek z sektora informatycznego, w tym 10 notowanych na *AIM London* i 5 notowanych na *NewConnect*. Sektor informatyczny jest jednym z najbardziej dynamicznie rozwijających się rynków w Wielkiej Brytanii i w Polsce. Z uwagi na szybkie zmiany technologiczne sektor ten musi perspektywicznie patrzeć w przyszłość i monitorować pojawianie się wszelkich nowości tak, aby w adekwatny zaspokajać potrzeby klientów. Dlatego ważną kwestią jest posiadanie dobrej strategii rozwojowej oraz wizji przyszłości. Jak wykazały wyniki badania jakości ujawnień informacji strategicznych spółek notowanych na *AIM London* jest średnio wyższa niż jakość ujawnień spółek notowanych na *NewConnect*.

Słowa kluczowe: rynki alternatywnego obrotu, raport roczny, raport strategiczny, ujawnienie informacji strategicznych.

1. Introduction

New integrated reporting approach recommends companies to disclose not only strategic information but also its linkages to resource allocation plans and business model in their annual integrated reports [IIRC 2013]. Although Financial Reporting Council [FRC 2014] believes that strategic information disclosures (SIDs) in annual reports, and in particular the separation of strategic report, may foster investment there are doubts whether investors actually use that information to take key investment decisions. Strategic information disclosed in annual reports seems to be difficult to verify due to its non-financial and descriptive character. Strategic disclosures are as a rule ex-ante the description of firm's intended strategy which exemplifies management's projected course of action [Sieber et al. 2014]. Consequently, if investors infer that strategic disclosures are costless they may perceive them as an implausible source of information thus constituting "cheap-talk" [Crawford, Sobel 1982]. However, if investors assume that due to strategic disclosures competitors start to realise their own strategy, limit impacts of the company and invoke costs on its side than the value of such information may increase from investor's viewpoint [Verrechia 1983; Gigler 1994; Sieber et al. 2014].

The paper aims at qualitative assessment of strategic disclosures included in annual reports of companies listed on alternative investment markets. As a research method a multiple comparative case studies' approach was applied. The purpose of this research is to diagnose a quality of strategic disclosures in 10 IT companies listed on the *AIM London* and 5 IT companies listed on the *NewConnect* in Warsaw.

Since a research sample is purposive a choice of the examined objects needs to be substantiated.

Firstly, IT sector is one of the most dynamically developing market in the UK [UK tech sector... 2014] and in Poland [Branża Teleinformatyczna... 2014]. As a result of rapid technological changes IT sector is forced to be forward-looking in order to respond adequately to customer needs. Therefore, a vision of the future and a good development strategy are pivotal issues to be disclosed in annual reports. Due

to that disclosures annual reports are evaluated as a useful source of information not only by investors but also by other stakeholders [Higgins, Diffenbach 1989; Ungerer 2013].

Secondly, alternative investment market assembles particularly small and me-dium-sized companies which are pioneers in providing new IT solutions. P. Virgo – a strategic adviser to the Institute for the Management of Information Systems claims that “The UK IT industry has gone the way of shipbuilding and engineering. IT now comprises a clutch of small to medium-sized software and service companies” [Riley 2003]. Those small and medium-sized ICT providers which are very often at the beginning of their business odyssey should be sensitive to that how they present themselves to shareholders. Therefore the disclosure of a bright and transparent strategy together with a business model may attract potential investors.

On the one hand, research results may be significant to companies listed on the *NewConnect* since they show the disclosure practices of companies listed on the AIM London which operate in the same sector. On the other hand, investors interested in forward-looking information about IT sector may be attracted by this paper. A comparison of a quality of strategic disclosures will point out advantages and disadvantages of reporting practices of companies listed on alternative investment markets in different countries but in the same sector.

Moreover, the subject discussed in this paper refers to research which has been already carried out within Europe [Santema et al. 2005] – in particular in Denmark [Santema, van de Rijt 2001], Holland [Coebergh 2011], Germany [Sieber et al. 2014] as well as in South Africa [Ungerer 2013] and Brazil [Pagliarussi et al. 2010].

2. Strategic information in annual reports – Impact of Companies Act 2006

The Companies Act 2006 introduced a new reporting regime in the UK concerning the separation of strategic report in annual reports instead of the existing business review. The new regulations apply to financial years starting after 30 September 2013 and to all companies with the exception of those reporting under the small entities regime. Therefore, all companies listed on the London Stock Exchange’s Main Market are obliged to follow section 414 of the Act while preparing strategic report, and in particular its part C which formulates a content of a strategic report.

The content must include a fair review of the company’s business which imposes balanced and comprehensive analysis of corporate development and performance during the financial year, and the position of the company’s business at the end of that year (414C, subsections 3-4). The analysis should be based on key financial performance indicators, and where appropriate other indicators relating to environmental and employee matters (414C, subsections 3-4). In order to facilitate comprehension of corporate performance or the position of business, a company is

expected to disclose the main trends and factors likely to influence the future development, performance and position of business, and information about environmental and employee matters, and social, community and human rights issues. A company should also report on any policies in relation to those matters and on the effectiveness of those policies (414C, subsection 7).

Moreover, a strategic report must describe a corporate strategy, a company's business model, a breakdown showing at the end of the financial year the number of persons of each sex who were directors, senior managers and employees of the company (414C, subsection 8). A description of the principal risks and uncertainties that a company may face is required as well. However, the Act does not impose the disclosure of information which would, in the opinion of the directors, be seriously prejudicial to the interests of the company (414C, subsection 14).

Interestingly, the new regulations do not refer to AIM market although as indicated in this study some companies have already built a strategic report into annual statement. The companies listed on the AIM London follow AIM rules. Consistent with rule no 19 an AIM company incorporated in an EEA country must prepare and present its annual report in accordance with International Accounting Standards (IAS). If such a company is not a parent company, it may prepare and present annual report either in accordance with IAS or in accordance with legislation and regulations due to its country of incorporation (i.e. US GAAPs, Canadian GAAPs, Australian IFRSs, Japanese GAAP). It is worth noticing that the UK represents Anglo-Saxon accounting model oriented towards the satisfaction of information needs of investors who are very demanding and thus expect a broad framework of voluntary disclosures [Krasodomska 2010]. In Poland, more conservative Continental European accounting model is present. It focuses on creditor protection and aims at provision information which are required by a tax law and financial institutions such as banks. The level of voluntary disclosures is rather small, however, the orientation on robust corporate development prevails [Krasodomska 2010].

3. Research methodology

This study employs a qualitative approach based on a comparative case-study narrative analysis. The research design was organized into three stages.

Firstly, a case selection was made (see Table 1). I purposefully selected all companies from IT sector listed on alternative investment markets in Poland and the UK. Then I grouped these two populations into separate clusters according to the length of their listings. In case of AIM companies I determined the following four time scales: below 5 years, 5-10 years, 10-15 years, 15 years and over. Such a division resulted from the age of AIM London which was launched in 1995. In case of NewConnect market which started its activity in 2007 the following four time scales were established: below 2 years, 2-4 years, 4-6 years, 6 years and over.

Table 1. Basic information on a research sample

Company name	Symbol	Market capitalization*	Admission date
AIM London			
Scisys plc	SCIS	26,40 mn £	1997-08-25
Earthport plc	EART	209,24 mn £	2001-01-30
IndigoVision Group plc	INDI	28,66 mn £	2003-12-15
eServGlobal Limited	ESER	86,21 mn £	2005-10-31
cloudBuy plc	CLOU	35,67 mn £	2005-12-14
Idox plc	IDOX	138,32 mn £	2007-06-05
Corero Network Security plc	CORE	11,56 mn £	2011-03-02
dotDigitalGroup plc	DOTD	80.89 mn £	2011-03-29
Quindell plc	QUIN	308,71 mn £	2011-05-17
WANdisco plc	WAND	95,79 mn £	2012-06-01
NewConnect			
Infosystems S.A.	INFO	8,71 mn zł	2007-10-24
11 bit studios S.A.	11BI	68,71 mn zł	2010-10-28
Bloober Team S.A.	BLOO	20,67 mn zł	2011-06-27
Edison S.A.	EDIS	4,33 mn zł	2012-03-30
Examobile S.A.	EXAM	6,24 mn zł	2012-12-17

*Market capitalization as on 21.11.2014.

Source: own presentation based on: <http://www.londonstockexchange.com>, <http://www.newconnect.pl>

Afterwards I chose a random basis and proportionally 10 annual reports of companies listed on AIM London and 5 annual reports companies listed on NewConnect from previously pre-determined two populations regarding a size of particular cluster. The sample size reflected 10% of population.

A choice of IT sectors was dictated by some premises. Both in London (100 companies with a share of 8.9%) and in Warsaw (43 companies with a share of 9.6%) IT sectors were rated in the top four most numerous sectors on the alternative investment markets in 2013. However, while comparing them in terms of a market value creation a situation differs depending on a country. IT sector on AIM London was the second best sector behind Oil & Gas branch whereas IT sector on NewConnect was ranked in the eighth place.

Secondly, I conducted a qualitative narrative analysis of annual reports of the selected companies and examined the following issues:

- separation of a strategic report in an annual report,
- reference to strategic issues in a Chairman's statement¹ or in a CEO's review,
- formulation of a mission statement,
- description of a development strategy,

¹ In case of Polish companies in a Chairman's letter.

- disclosure of key performance indicators,
- description of a business environment,
- presentation of a business model,
- reporting on human resources and relations in a strategic context,
- disclosure of social responsibility strategy,
- reporting on risks and uncertainties.

Finally, using the scoring method I evaluated a quality of disclosures. I assumed the following 5-grade-scale: 0 – lack of information, 1– incomplete disclosure, 2 – partial disclosure, 3 – considerable disclosure, 4 – full disclosure.

4. Quality of voluntary SIDs in annual reports – exploratory and descriptive case studies

The study contributes to the literature by evaluating the quality of voluntary disclosures in terms of strategic issues. The paper analyses carefully structures and contents of annual reports. It discusses and compares various approaches to SIDs of two separable groups of companies from alternative investment markets in London and Warsaw.

Fig. 1 shows the results of scoring evaluation. It may be stated that 6 out of 10 companies include strategic reports in their annual statements. A strategic report constitutes a substantial part of an annual report (38%) only in case of *Scisys*. The length of the rest of strategic reports do not exceed 20% of annual reports. The evidence proves that lack of a strategic report does not induce an absolute low quality of SIDs in annual reports. *DotDigitalGroup*, for example, is assessed relatively well in terms of SIDs (2.7) though it does not distinct a separate place dedicated to strategic issues in its annual report.

Corero Network Security (3.5) and *Scisys* (3.2) are the examples of the best practices in a research sample in terms of SIDs. *Corero Network Security* provides products, services and technology which aim at scalable, flexible and responsive defence against DDoS (Distributed Denial of Service) attacks and cyber threats before they reach corporate IT infrastructure. The company includes a strategic report in its annual statement.

The first part of a complex strategic report deals with a review of corporate performance. *Corero Network Security* reports both on financial and non-financial performance. The latter includes: award for Best IT Products & Services for Finance, Banking & Insurance, new customer wins, progress in next generation product development, creation of a reporting platform based on intelligence solutions. The second part of strategic report is dedicated to the presentation of business activity. Therefore, *Corero Network Security* answers to three pivotal questions: *What we do?*, *Why we do it?* and *How we do it?* In response to the first question a company specifies a range of its services and reveals key steps of protection against DDoS attacks and cyber threats.

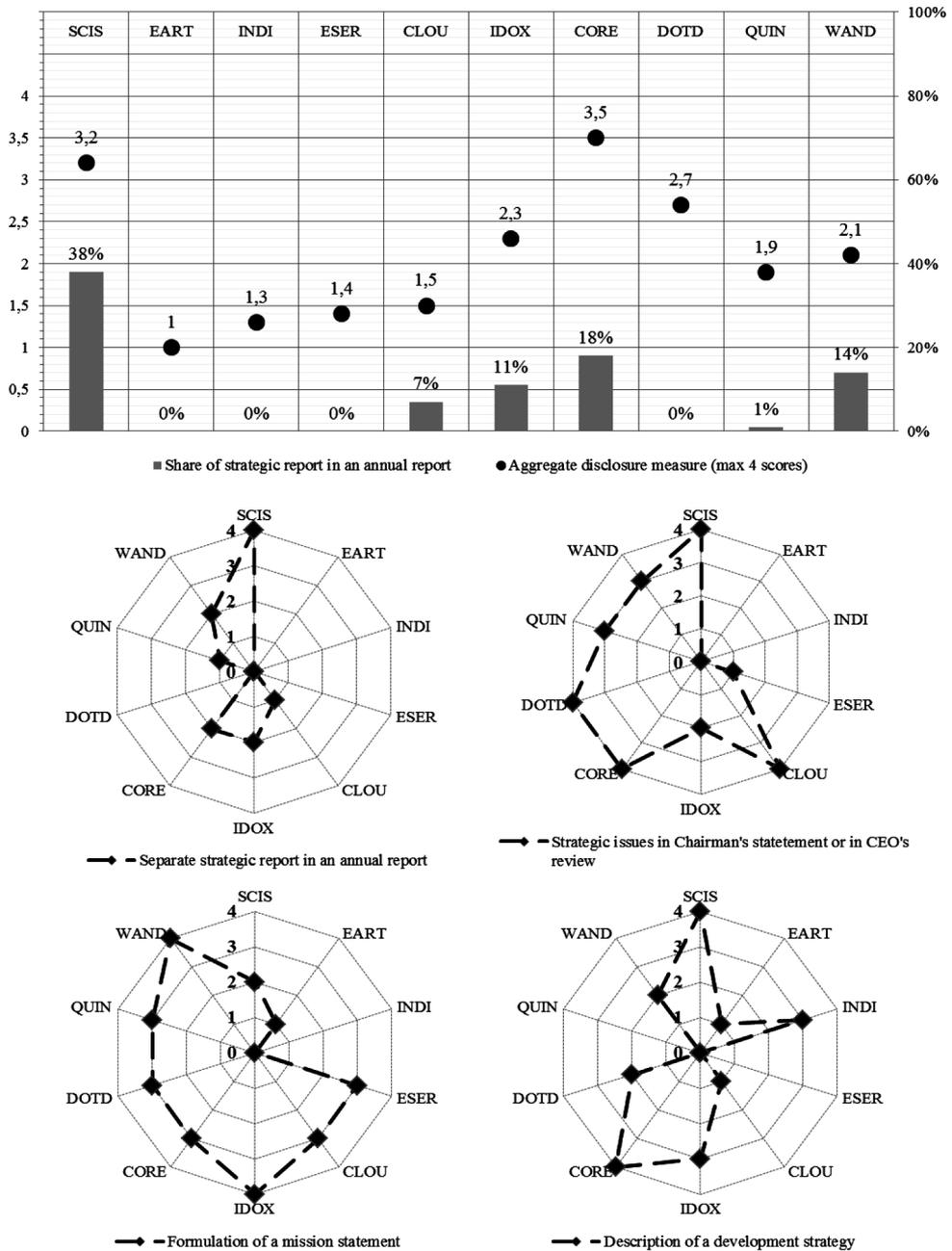


Figure 1. Quality of strategic disclosures provided by the companies listed on the AIM London

Source: own presentation.

Corero Network Security justifies a necessity of its business activity indicating a dynamic IT development within cloud services, mobile computing, online services and social networking. In fact this area is particularly vulnerable to cyber crimes. In that context the company notices its competitive advantage since it possesses technologies, tools and applications targeted at inspecting traffic, preventing intrusions and limiting excessive requests and connections which slow down network bandwidth. The company describes also its business environment, opportunities and key challenges. Interestingly, the company discloses in details its competitive advantages concerning flag products and new generation products.

In response to the last question the company demonstrates its business model, discloses revenue nature and sources, reports on contractual agreements and services provided. *Corero Network Security* delineates its difference distinguishing the company from the other competitors. A potential reader could learn about how and where a value is generated. The company communicates that corporate value is created by winning new contracts and renewing the existing ones and delivering upgrades to the existing customers. The company carries out sector and geographic analysis to disclose where corporate value is generated.

The last part of strategic report is dedicated to corporate strategy for sustainable growth. The company emphasizes the main strategic objectives in reference to market, technology, sales, management and employees. This part documents also the principal risks and uncertainties. However, a narrative is superficial since it identifies vulnerable zones, including: market awareness, technology change and innovation, people, partner engagement and development, geographic distribution rather than exact list of risks.

Scisis, a leading developer of IT services which develops robust, real-world application solutions and products holds the best practices within risk reporting in the research sample. The company demonstrates transparently and in an aggregated way groups of risks within the following areas: economic uncertainty, finance, bidding, project execution, expansion into new territories and via acquisition, employees. Moreover, the company identifies risk impacts and mitigation means as well as reporting and monitoring frequency.

Strategic report of *Scisis* starts with a comprehensive explanation of what the company does and why it is worth investing in its stocks. The next strong point is Chief Executive's report preceded by Chairman's statement and followed by Finance Director's review. The Chief Executive's report refers to strategy execution by particular divisions and realization of a strategic plan for sustainable growth through perfecting customer relationships and delivering to customer expectations. The Chief Executive discloses rules which are implemented in order to ensure organic growth within the existing and adjacent niches. They consist in extension of business with present customers and expansion into new areas as well as building innovation into client solutions and development of proprietary products. The Chief Executive's report deals with the permanent improvement of internal processes and indicates

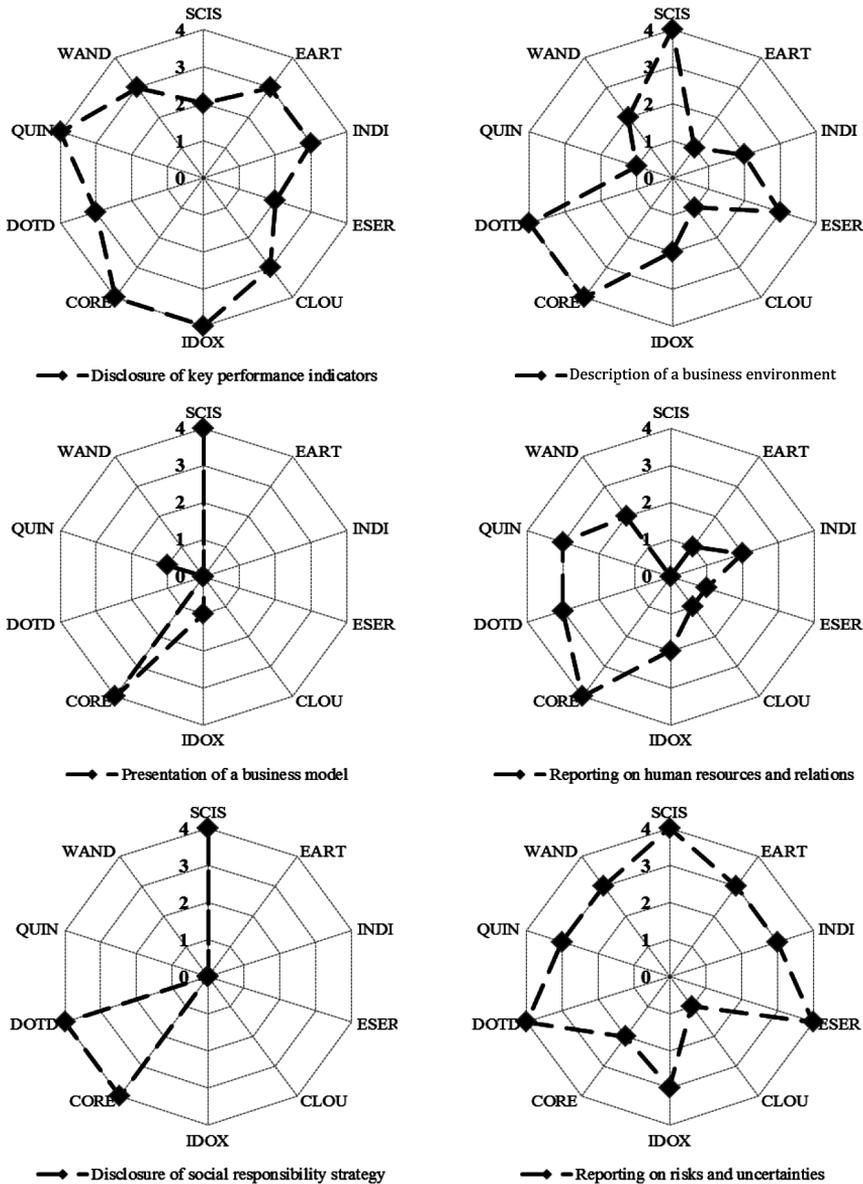


Figure 2. Quality of strategic disclosures provided by the companies listed on the AIM London
 Source: own presentation.

solid actions towards the enhancement of multi-project management process as well as the development of diverse instead of monolithic business models in reference to different markets and customers. Maintaining and fostering employees' qualifications and motivation are the next matters being discussed in the report. At the end the

Chief Executive presents an outlook for the future which may be summarized as follows: (1) exploring and exploiting options for increased organic growth, (2) innovating, (3) getting better, (4) actively pursuing acquisitions, (5) looking forward to an encouraging future.

DotDigitalGroup is ranked third place in terms of SIDs (2.7) although the company does not distinct separate strategic report in its annual statement. Nevertheless *DotDigitalGroup* discloses strategic concerns and detailed commentary on business environment in the Chief Executive's report. Moreover, the company prepares a special section dedicated to corporate social responsibility (CSR) issues. That section informs on CSR policies towards clients, employees, community, environment, suppliers and risks.

The next place in a ranking belongs to *Idox* (2.3), which is a supplier of software solutions and services to the UK public sector and highly regulated asset intensive industries around the world. The company includes a separate strategic report in its annual statement which covers a concise review of a strategy, business model and principal risks and uncertainties. *Idox* presents key performance indicators broken down into financial and non-financial measures. The latter category relates to quality, environmental and information security management.

Although the company did not perform well in 2013, Chairman and Chief Executive does not conceal that fact. They discuss financial performance and explain that despite disappointing results in 2013 they have taken a number of positive actions including: strengthening and deepening senior management team, restructuring and simplifying company by disposing of the non-core recruitment division, building long-term customer relationships, extending the business into international markets.

Interestingly, the Chairman frankly conveys in his statement:

Such difficult times require that extra degree of fortitude, but the board believes that, following the streamlining of the business and operational and management changes that have been implemented, the Group is now better positioned to build on its underlying strengths and high market share in its two chosen markets to deliver an improved 2014. [Annual Report for 2013 of Idox plc]

WANdisco is ranked fifth place considering strategic information disclosures (2.1). The company informs on its mission out of the strategic report, however, a mission statement directly precedes the strategic report. *WANdisco* explains etymology of company's name where *WANdisco* stands for Wide Area Network distributed computing. The company presents itself as a leading provider of enterprise-ready, non-stop software solutions that facilitate global organisations to meet data challenges of secure storage, scalability and availability. The company introduces its products, key customers and underlines the uniqueness of solutions provided.

WANdisco's strategic report starts with a statement of a person holding two positions of Chairman and Chief Executive, who describes technology applied,

refers to assumed goals, reports on key performance and investments. The Chairman and the Chief Executive formulates thanks to front-line employees, highly skilled engineers and senior managers as well as presents an outlook. *WANDisco's* strategic report covers a review of Chief Financial Officer (CFO) as well. The CFO refers to advantages of subscription license model which is implemented in the company. Due to that model *WANDisco* may easily project an amount of deferred revenues. Therefore, Annualised Value of Bookings (AVB) is a key forward measure of an activity in a subscription business where revenue presented annually over the contract life-cycle reflects historic performance and ensures a consistent comparison of results. The major part of the strategic report deals with opportunities arising in medical care market where there is need for solutions that could provide real-time access to patient data available for immediate retrieval and analysis. Although the strategic report of *WANDisco* is complex, a separate strategic plan is not included, which is a shortcoming.

The next company in the ranking is *Quindell* (1.9), which interestingly reports on human resources. The company stresses that its success owes a team of highly experienced staff who ensure that *Quindell* operates to its full potential. The contribution of efficiently and effectively working staff causes that the company is seen as an innovative organization. *Quindell's* belief is that award-winning people deliver award-winning customer service and industry solutions. The company emphasizes that human resources management is based on five pillars (Fig. 3).

CloudBuy is ranked seventh place in terms of SIDs (1.5). The company provides integrated solutions to automate customers procurement and eCommerce business requirements. *CloudBuy* delivers secure cloud platform with five various applications: *cloudBuy, cloudSell, cloudAnalytics, cloudIntegration i cloudSecurity*.

The strategic report of *CloudBuy* is preceded by the business overview which informs about the uniqueness of company's offer. *CloudBuy* intention is to maintain a balance between buyers' expectations and suppliers' needs. The company underlines that its IT solutions are highly functional since they intelligently ensure information flow between a purchase order and a final transaction. Continuous access to a cloud platform makes it possible that *customers have the knowledge at their fingertips to continually optimize all procurement activities across the organization* [Annual Report for 2013 of *CloudBuy* plc].

The concise strategic report of *CloudBuy* developed by the CEO includes past information about financial and non-financial performance. The company reports on the investment of considerable resources in product enhancement and the development of a sophisticated management system enabling better product alignment to the market needs. The company boasts that it won significant contracts in Social Care in the UK and has established itself a market leader in this developing sector. *CloudBuy* emphasizes its focus on increasing social media profile and presence on the Internet in order to generate better brand recognition and customer loyalty and find new partners to extend its business services. The company promotes its international achievements, however, related details are beyond the strategic report. The lack of future prospects

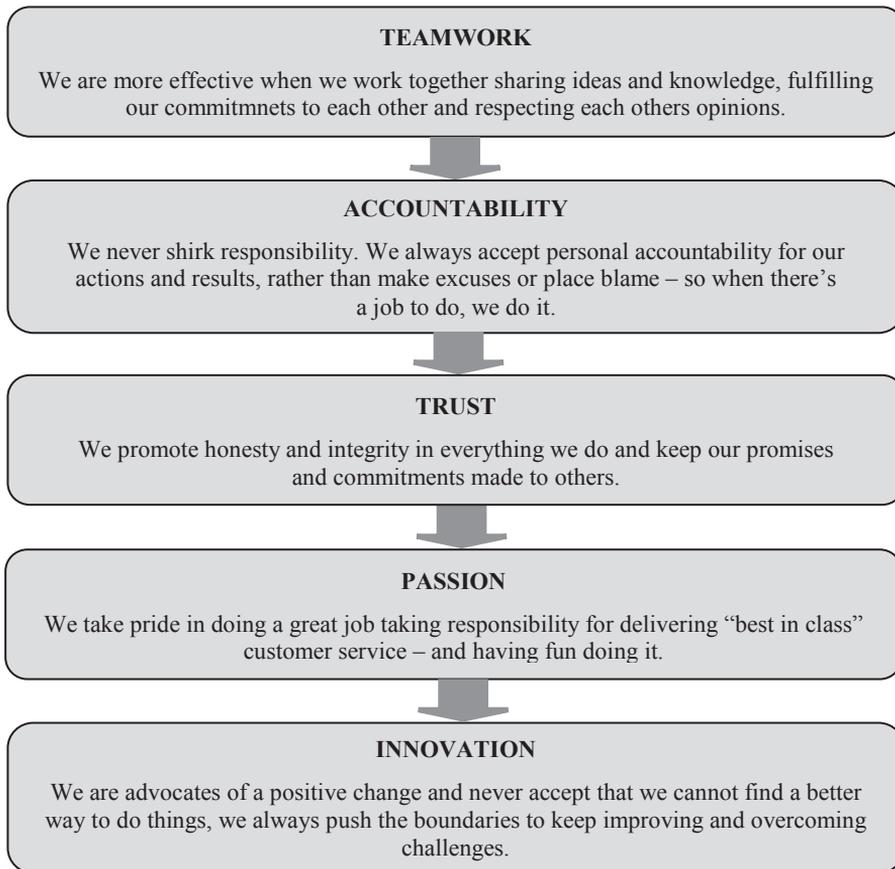


Figure 3. Five pillars of human resources management

Source: Annual report 2013 of Quindell plc.

is a substantial shortcoming of the strategic report. The company reports on past performance rather than on outlooks.

The other entities in the research sample – *Earthport*, *eServGlobal Limited*, *IndigoVision Group* – do not separate the strategic part in their annual reports, therefore they are poorly evaluated in the ranking.

A qualitative analysis of narratives from annual reports of companies listed on *NewConnect* (Fig. 4) shows that unlike AIM stock issuers Polish companies do not report on business environment, human resources and relations in the strategic context. They do not refer in principle to corporate social responsibility strategy and business model as well. Polish companies do not separate a strategic report in their annual reports. Strategic issues and outlooks are presented in Chairman’s letter as a rule. Chairman’s letter is dedicated to shareholders and precede annual reports.

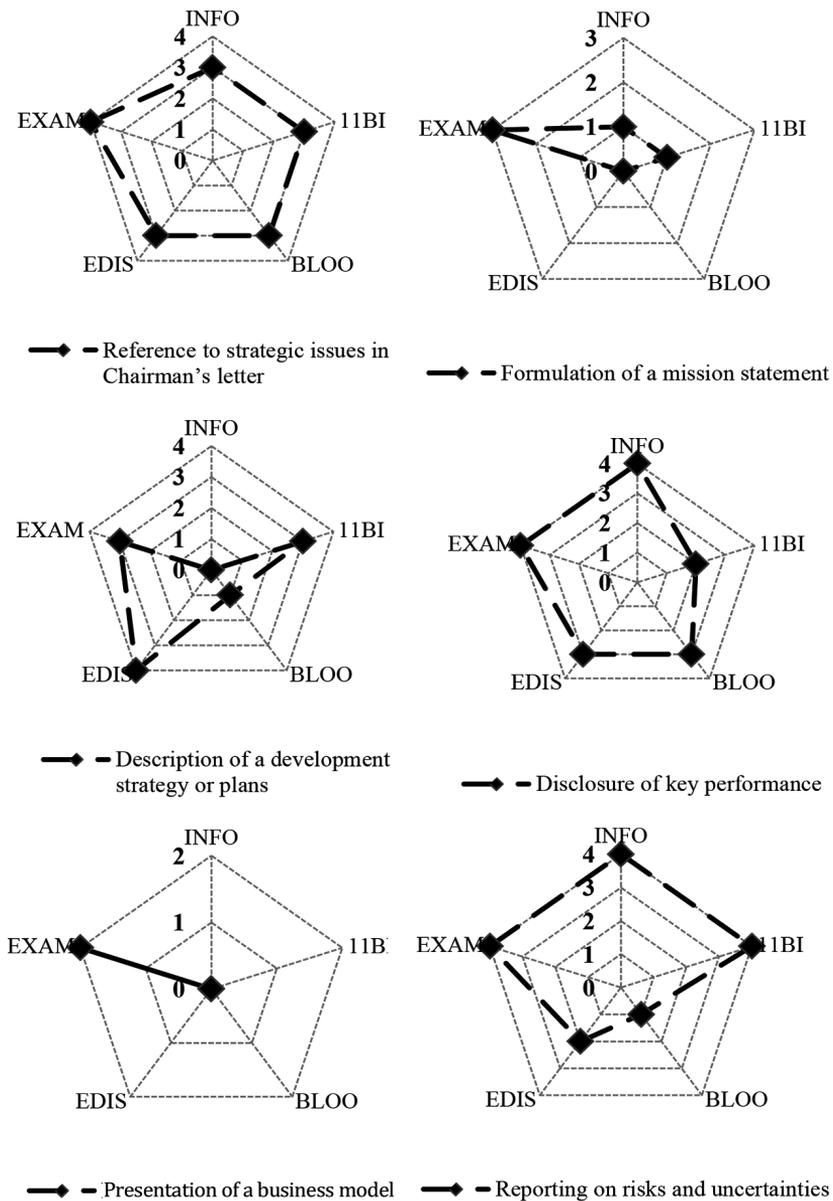


Figure 4. Quality of strategic disclosures provided by the companies listed on the *NewConnect*

Source: own presentation.

Polish companies disclose risks and uncertainties and several times describe how they cope with threats. They report also on non-financial performance, however, instead of measuring them they provide narratives. Polish companies present selected

financial data as a rule and in particular financial results. The examined entities reveal specific financial indicators to a small extent (with the exception of *Infosystems* company).

Edison – a company which offers reliable solutions of electronic documents exchange as well as a system of archiving them in their electronic form – is ranked top among all the examined entities in terms of disclosure of strategy or plans. Interestingly, the company formulates its plans with reference to four areas: sales, customer service, product development and marketing & PR. Within these areas a company depicts key objectives for the next year. Although the other Polish company – *Examobile* – was assessed even higher than *Edison* considering the aggregated measure of SIDs it must be clearly stated that the quality of SIDs between stock issuers listed on *NewConnect* and *AIM London* noticeably differs. Annual reports of AIM companies are more like business reports and may be easily implanted in a new trend of integrated reporting taking into account both a content and a presentation of key issues. At the same time annual reporting of *NewConnect* companies is focused on providing basic information and that of financial character in principle.

5. Conclusions

American and British associations of chartered accountants have attracted attention to the importance of strategic information disclosures in annual reports since the 90s [AICPA 1994; ICAS 1999; ICAEW 1999]. Presently, new integrated reporting framework recommends to separate a part of annual report which will be dedicated to strategy and resource allocation [IIRC 2013]. Organizations are expected to inspect how assumed strategy together with a resource allocation plan affect business model, capitals and risk management and are under the influence of external environment factors.

The results of comparative case-study narrative analysis evidence indirectly hypotheses assumed by S. Santema. It may be stated that the extent to which companies in Poland on average disclose their strategy is lower than in companies listed on AIM London. The average number of scores in case of Polish companies amounted to 1.4 whereas in case of AIM companies equalled 2.1. This proves that even so dynamically developing IT sector is still far behind the new requirements.

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