Value drivers without a platform

What counts and who doesn´t deliver

70 percent of a company's "actual" value does not appear on the balance sheet – this is according to the corresponding statements by experts from PricewaterhouseCoopers and Accenture. Against this background one could expect, listed companies in particular, to fill this information gap in their annual report. Media Tenor, along with its advisory board member Prof. Robert Eccles – senior consultant with PwC and co-author of "Value Reporting Revolution" – analyzed which of the DAX 30 companies succeeded in doing so. Content analyses of the annual reports from 2005 and 2003, focusing on the communication of "value driver topics", were related to the media image of the stock market heavyweights.

The main result is that in the company-produced medium of the 'annual report', only 33.8% of the information treats value drivers such as innovation, market growth, reputation, brands and customer relations. DAX companies therefore do not respond to investors' expectations to find meaningful statements on the so-called "intangibles" in annual reports. Instead, companies focus on "historical" financial data, which they provide in their annual reports with a considerable delay.

Information gap between supply and demand

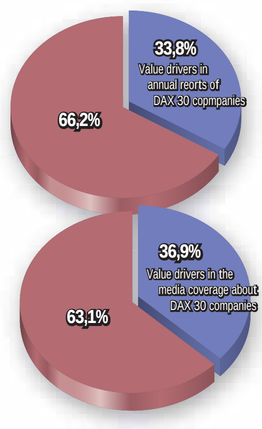
The only way annual reports could possibly make sense for private and institutional investors would be to focus on information that helps evaluate a company's future prospects particularly regarding the supposedly soft factors. This type of information does not appear on the company's balance sheet, and it is only quantifiable with some extra effort: Quality of the management, ability for product innovation, market growth or customer relations.

There is a gap between the supply of mandatory, albeit historical financial data, and the demand for future-related evaluations of the companies' value drivers. This gap varies from company to company. It can be closed via a number of channels. On the one hand, the company could provide this information in their own publications such as the annual report, which IR-professionals can fully control. On the other hand, the mass media such as newspapers, investment magazines or reputable blogs and newsgroups can do the job. A company is able to influence, but not control the media through deft PR measures. More or less competent analysts, fund managers and other experts or journalists can freely express their opinions and affect the investors' readiness to assume risk.

Graph 1:

The gap between the "supply" of information on value drivers in the annual reports and the "demand" in media coverage is 3.1% or 9% of the supply.

1) Value drivers in annual reports of DAX 30 companies



Value drivers in media coverage on DAX 30-companies

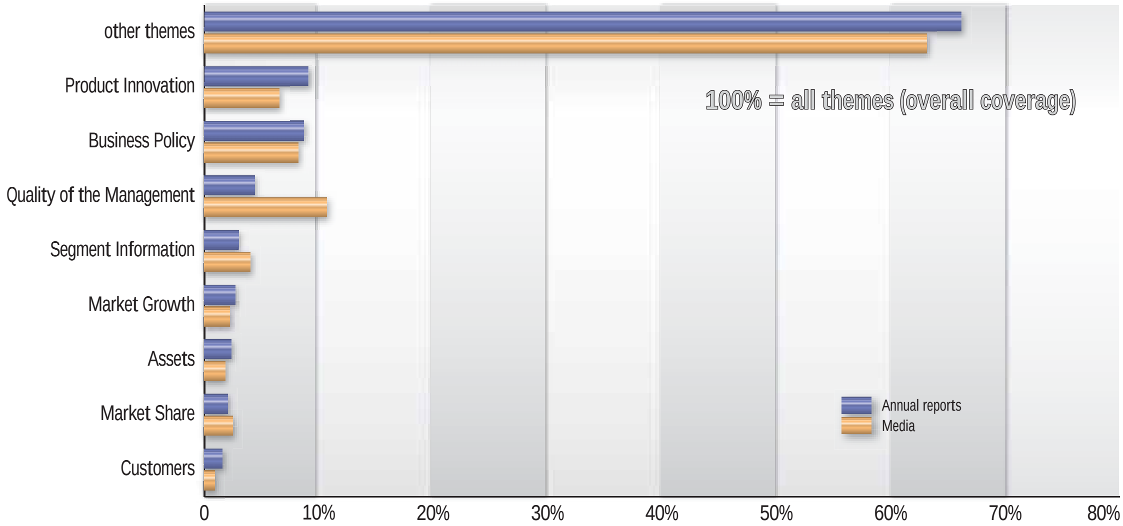
Identifying decisive value drivers

Firstly, the question is whether or not each of the DAX 30 companies managed to communicate their value drivers through their own communication channels such as the annual report. Companies with high values have the opportunity to further improve their competitive position through efficient communication. By identifying the decisive value drivers for their companies, measuring and documenting them in their development over time, they signal to investors that the management professionally administers important assets. The access to market capital of such companies thus improves. The risk premiums investors demand end up being lower, since the return on an increase in capital is higher or the interest on issued corporate bonds is lower. The cost of capital decreases and the "Economic Value Added" increases. As a consequence, a successful company can improve its competitive position through "Active Value Reporting".

Theoretically, badly managed companies may use the measures of efficient Investor Relations at any time. However, communicating alleged "value drivers", which turn out to be hot air in the long run, will boomerang and damage the reputation. In this case it is better not to raise any expectations than to mislead and necessarily disappoint expectations eventually.

Conversely, companies can create or regain credibility by openly communicating weaknesses. Such openness, however, can normally only be seen after a change in management, when mistakes can still be attributed to predecessors.

2) Aggregated value drivers (8 image factors) in annual reports/media



Statements in shares of total coverage

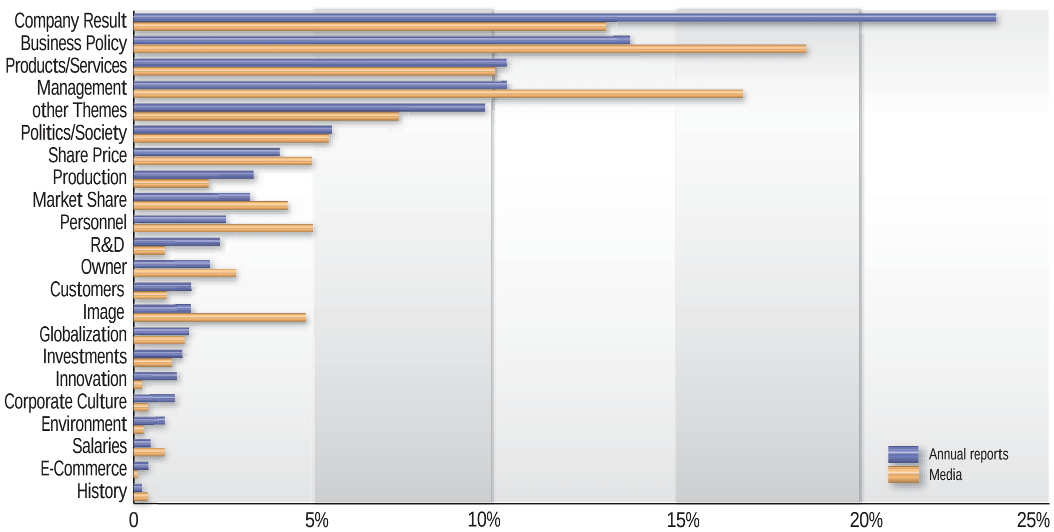
Source: Media Tenor 01/01/2005 – 12/31/2005 Basis: 172.502 statements in 13 Media / 38.291 statements in 30 annual reports

The quality of management is decisive – but companies offer little information.

Measuring information gaps

Media Tenor measures the information gap between the book value of a company and its "true" value (some tend to equal this gap with the difference between market value and book value) on several levels. This study uses the method of content analysis, in order to do a topical and formal (tone and timeliness of the statements) analysis of the annual report. A comparison with the average of DAX 30 companies or with the average of the respective industry sector shows which company notably provides the financial community with information on value drivers, and what relative importance it attributes to one or the other value driver.

3) Aggregated value drivers (22 image factors) in annual reports/media

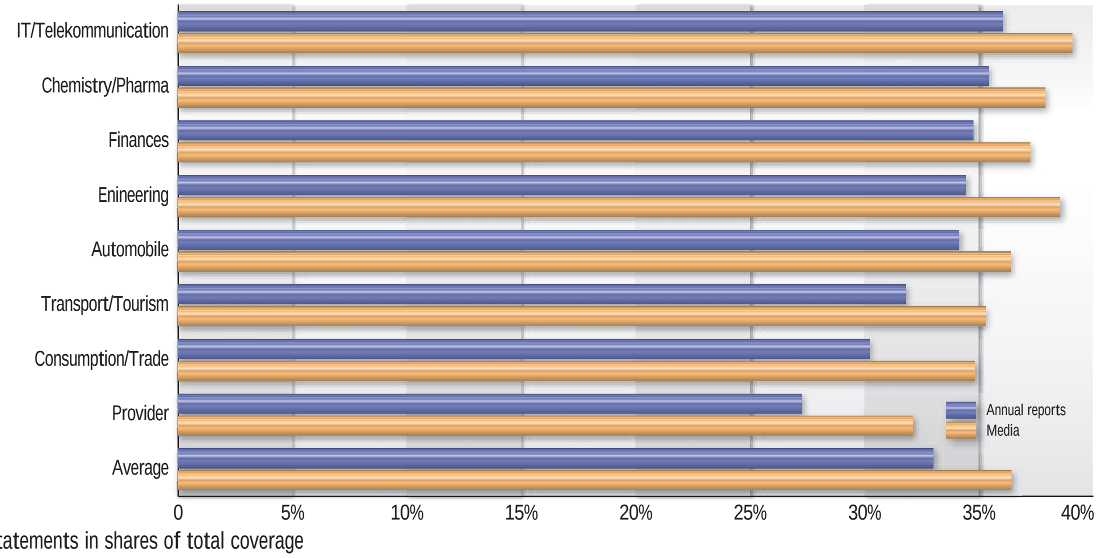


Statements in shares of total coverage

Source: Media Tenor 01/01/2005 – 12/31/2005 Basis: 172.502 statements in 13 Media / 38.291 statements in 30 annual reports

The technology- and innovation-driven B2B industries tend to communicate intellectual capital more strongly than consumer-oriented sectors.

4) Share of value drivers by industry in annual reports/media

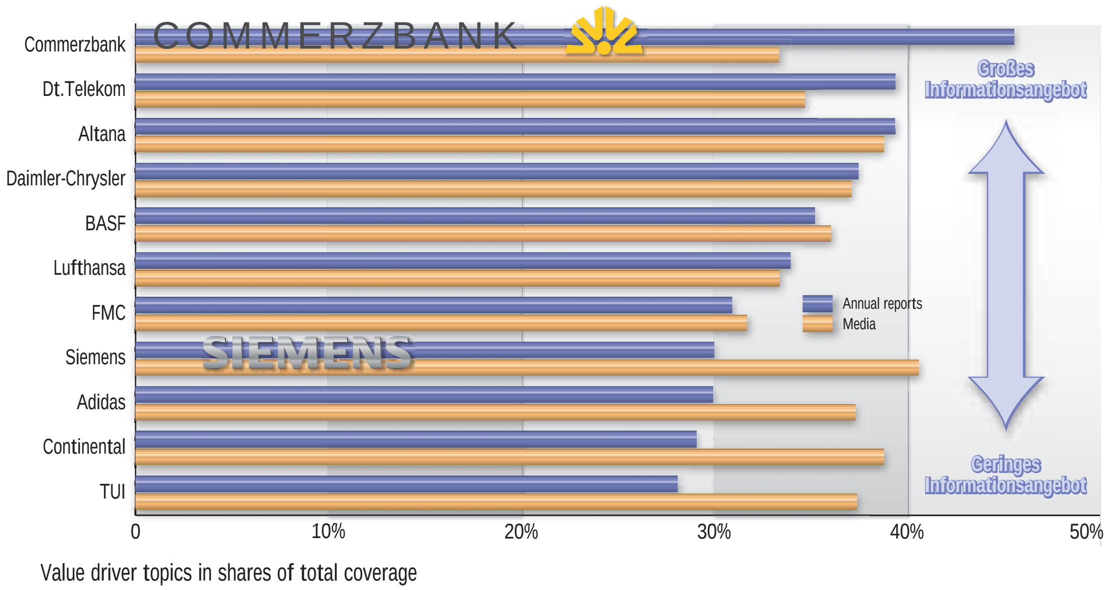


Source: Media Tenor 01/01/2005 – 12/31/2005 Basis: 172.502 statements in 13 Media / 38.291 statements in 30 annual reports

A second point of comparison is the content analysis of the media coverage on DAX 30 companies in the German opinion leading media during the fiscal year 2005. It shows to what extent companies offered information on value drivers through the annual report and to what extent this information actually seemed relevant to and was "demanded" by the print and TV media analyzed.

Finally, the aspect of reputation-oriented communication was analyzed. The presence of topics such as Corporate Social Responsibility (CSR), company climate or environment is not a linear indicator for a company's focus on values. Yet when such topics are credibly communicated internally and externally, this can, for example, strengthen the employees' identification with or the customers' trust in the company. After all, instruments such as sustainability indexes have gained in significance in the past years. Win-

5) Share of value drivers by companies in annual reports/media



Source: Media Tenor 01/01/2005 – 12/31/2005 Basis: 172.502 statements in 13 Media / 38.291 statements in 30 annual reports

ning over qualified employees or new customers is not easy.

Traditional CSR topics alone won't do the job. Instead, companies need to permanently communicate their own offers for continuing education, portraits of the Corporate University, work-life-balance issues, etc. Moreover, the tonality is a direct credibility indicator: The share of self-critical statements in an annual report or the more or less significant discrepancy between self-image and media image can suggest whether or not a company is likely to point out mistakes, to learn from and quickly counteract them. Finally, the share of future-related statements in the annual report and the media indicates how serious a company is about managing expectations and how successful it is in preventing disappointments that damage their reputation.

DAX 30 companies don't deliver

On average, the DAX 30 companies do not fulfil the media's demand for information on value-driving factors. The share of statements about value drivers in annual reports is only 33.8%, and in media coverage it is only insignificantly higher with 36.9% (**graph 1**). The first gap between self image and media image of the DAX 30 companies is therefore 3.1%, and there is an overhang of 9% "demand" to the "supply".

Graph 2 illustrates characteristic prioritizing. In their annual reports, companies attribute an extra strong importance to the value driver of product innovation. In media coverage, because of the increasing trend towards personalization, the quality of management plays a comparatively significant role.

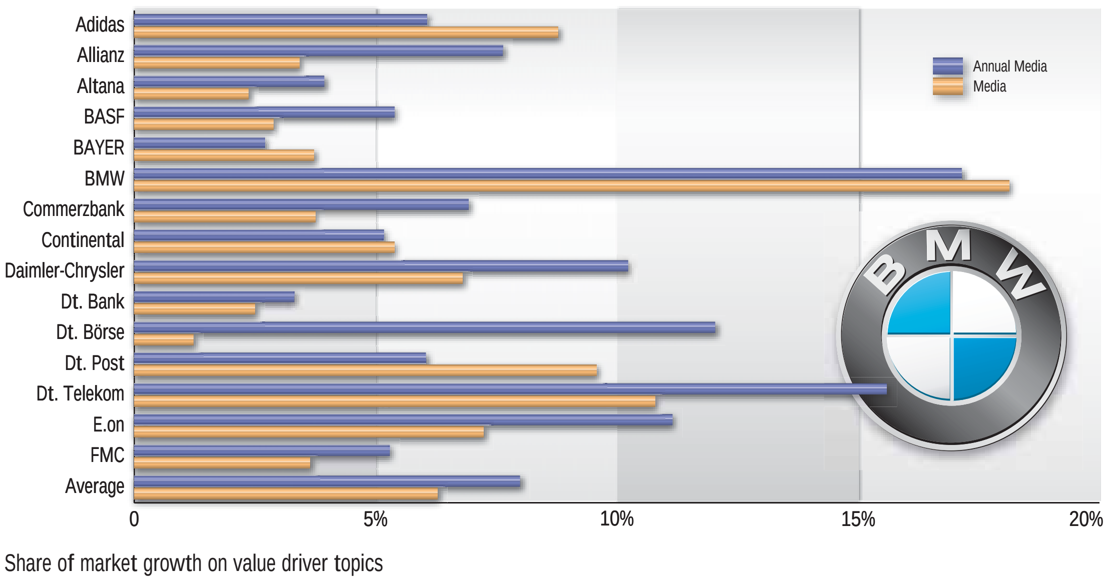
Media Tenor analyzes the company coverage in the opinion leading media and categorizes the content into more than 300 topics, which are aggregated into 22 image factors. Using this analysis scheme for the medium of the annual report and comparing it with media coverage, it becomes obvious that the annual report is highly overestimating the topic of company results.

The community of investors is thus assailed with a huge amount of more or less redundant information, receiving innumerable commentaries on balance sheets and operating statements (**graph 3**). The share of statements on company results of the past is 54.3% compared to 9.5% in the media. Companies do not take the opportunity to manage the profit expectations of investors: The share of future-related statements on financial results is 20.9% in the annual report. The demand of the media, where the share is 24.4%, is therefore not met. The IT/telecommunications sector (Deutsche Telekom, Infineon, SAP, Siemens) has the highest share in both media types, followed by the chemical, pharmaceutical and financial industry.

Power utilities and consumer goods companies (Adidas/Metro) performed below average. The more innovation- and technology-driven B2B industry thereby communicates immaterial value drivers more strongly than industries catering consumers (**graph**

BMW manages to satisfy the above-average media interest in the growth of its markets with a corresponding share of information in its annual report.

6) Share of the value driver market growth in annual reports/media



Source: Media Tenor 01/01/2005 – 12/31/2005 Basis: 172.502 statements in 13 Media / 38.291 statements in 30 annual reports

4). There are certainly significant divergences within each sector. Siemens, for example, communicates particularly few value drivers in its annual report, while the Commerzbank more than meets the demand, measured by media coverage (**graph 5**).

Winners and Losers

The study distinguished between the important value drivers of market growth, market share, business strategy, profits, product innovation, clients, quality of management as well as geographic policies/investments.

The industry overview shows that notably the financial sector has difficulties to impart their perspectives on (growing) markets to the media. The sectors of consumption (Adidas, Metro) and transport (Deutsche Post, Lufthansa, TUI), however, manage to match supply and demand. Adidas and Deutsche Post have a clear overhang in media coverage on this topic, BMW a slight one (**graph 6**). In the case of BMW, the relative weight of this value driver in media coverage is exceedingly high with 18.1% (average: 6.3%). BMW meets this challenging interest in sales opportunities and competitive environment with a communication share of 17.1% on this value driver in its annual report. Competitor DaimlerChrysler provides relatively more information (10.2%) than the media are able to absorb (6.8%).

Product innovation and customer relations are company-driven topics that the media only take up hesitantly. BMW reaches a higher penetration level on the topic of innovation than DaimlerChrysler, and Allianz manages to do so on customer relations.

Balance of information and media interest

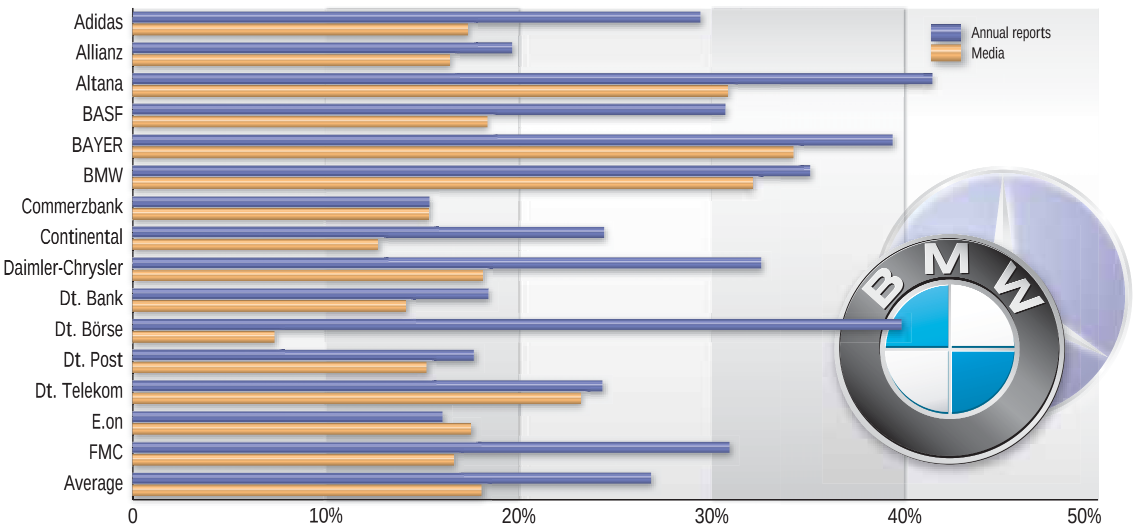
In their dramatic fight for market shares, companies use the medium of the annual report in order to inform the investor community and not to fall behind the level of attention that the media provide (the share of media coverage on market shares is 6.7%). Adidas, BASF or Bayer are lagging behind expectations. The greatest disappointment, however, is Münchener Rück. The information gap is 12.3%, which corresponds to 280% of the total information provided.

In particular the financial sector seems to attribute a great significance to business strategy in their annual reports. The difference to media interest is 11% on average. Commerzbank (21.8%) and Deutsche Bank (18.8%) overemphasize this value driver in relation to media interest. The insurance company Allianz, however, is able to communicate this aspect through the mass media, too. The relative weight in the annual report is also high, with 34.2% of all the communication on value drivers, but the discrepancy with the weight in media coverage (31.5%) is only 2.7%.

From the point of view of investors in bonds and shares, cash flow and profits are ultimately what counts for determining the value of investments. On average, companies attribute a greater importance to this aspect (6.9%) than the media (5.0%).

BMW seems to think that, given its high profitability, it can scale back in the annual report (2.4%). The media cover it with a share of 5.2%. The opposite is

7) Share of the value driver product growth in annual reports/media



Share of product innovation on value driver topics

Source: Media Tenor 01/01/2005 – 12/31/2005 Basis: 172.502 statements in 13 Media / 38.291 statements in 30 annual reports

true for the crisis-ridden competition: DaimlerChrysler attributes a much higher relative weight to profits in its annual report than BMW and the media (4.3% versus 3.5% in the media). With VW the divergence is even greater (6.7% versus 2.7%). The higher the profitability, the lower is the need for justification. This rule is also confirmed with SAP compared to Siemens or Infineon.

What further counts

Whether or not profits will be made in the future strongly depends on the companies' ability to develop new products. The research-intensive chemical and pharmaceutical industries notably focus on product innovation, and so does the automobile sector. The IT/telecommunications sectors follow third, while the relative weight of this value driver is below average in the other industries. Here BMW is ahead again, giving more or less the same relative attention to product innovation in its annual report as DaimlerChrysler and VW do.

But only BMW succeeds in raising almost the same amount of media interest for this otherwise mostly neglected topic (**graph 7**). Only the pharmaceutical companies Altana, Bayer and Schering are similarly successful in communicating this subject through the media.

Customer relations is another topic that seems to be important for companies and their shareholders, but that the media tend to ignore. The information gap between annual reports and media coverage is most significant in the financial industry, and here particularly with Commerzbank, Hypo Real Estate and Münchener Rück. Allianz manages to keep media interest at the level of relative weight that it gives to the topic in its annual report (4.0% versus 3.7% in the media, graph 8).

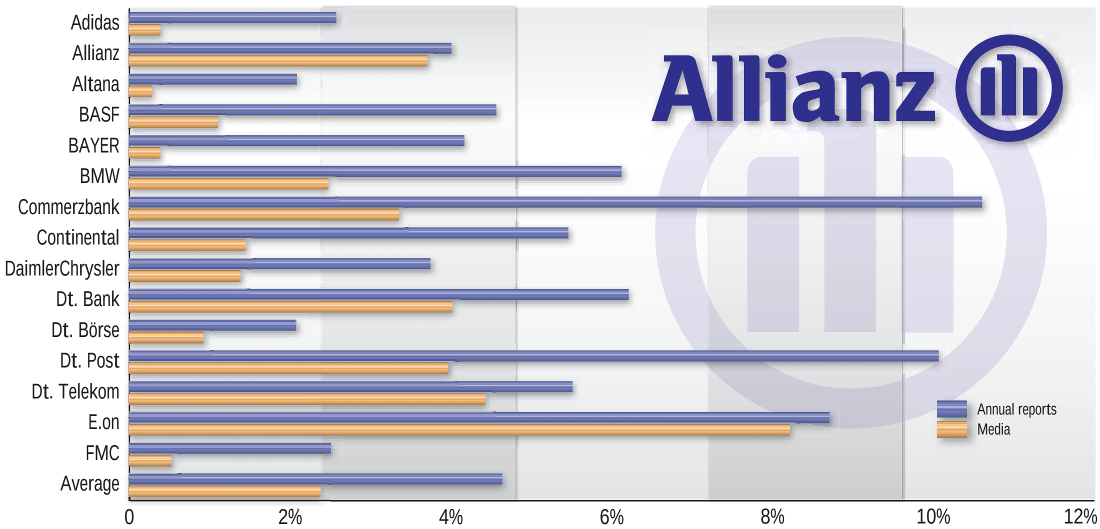
The quality of management is definitely one of the most important value drivers. In media coverage it has a particularly strong prominence. The high news value of negative stories as well as the tendency toward personalization led to an overbalance of this value driver with crisis-ridden companies such as VW, Deutsche Bank, Deutsche Börse or DaimlerChrysler. Companies such as Adidas, Bayer or Fresenius Medical Care show that one can report on this value factor to exactly the same extent that the media expect. RWE is the only DAX 30 company that manages to exceed the level of media coverage (18.7%) in their annual report (20.5%).

Reputation Management

It is crucial to communicate the actual value drivers, in order to put the value of a company in perspective. But psychological aspects play an important role, too. On the one hand, they are manifested in formal criteria, with which one can measure a company's success in communication. For Reputation Manage-

Customer relations are the basis for each company – but information on this asset is rare.

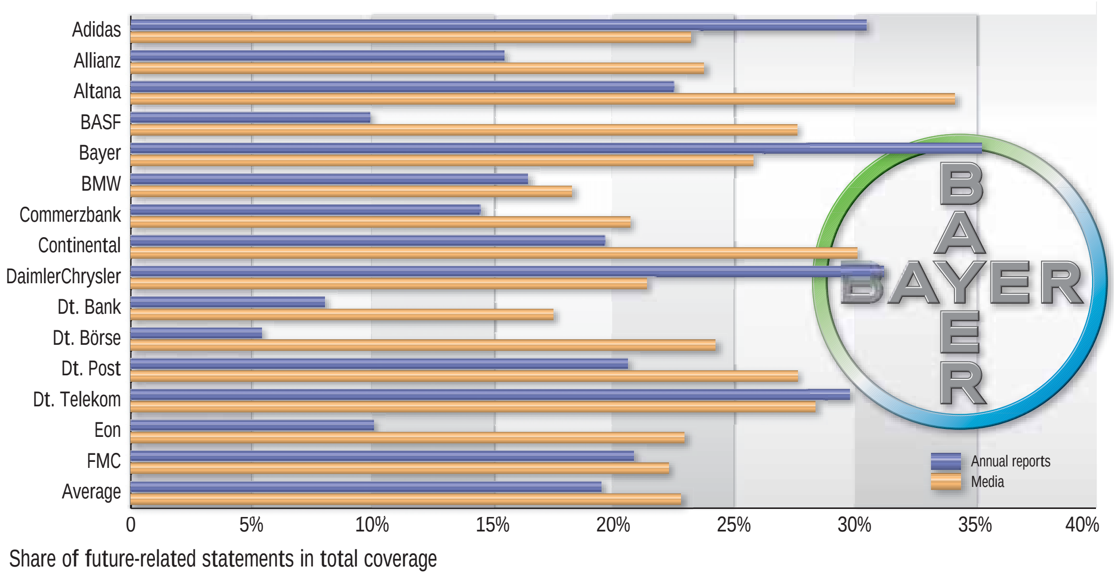
8) Share of the value driver customer relations in annual reports/media



Share of customer relations on value driver topics

Source: Media Tenor 01/01/2005 – 12/31/2005 Basis: 172.502 statements in 13 Media / 38.291 statements in 30 annual reports

9) Share of future-related statements in annual reports/media



Source: Media Tenor 01/01/2005 – 12/31/2005 Basis: 172.502 statements in 13 Media / 38.291 statements in 30 annual reports

The risk of damaging one's reputation by disappointing expectations is manifested in a higher or lower share of future-related statements. Adidas and Bayer are among the companies that are especially keen on trying to manage the expectations of the investor community.

ment, managing expectations and acceptance are crucial. On the other hand, "soft factors" such as company culture, CSR or environmental consciousness contribute to a company's reputation.

A company that succeeds in managing public expectations and preventing disappointments cannot entirely avoid times of crisis. But it can retain the trust of investors, and the turnaround will be quicker. Media Tenor measures the level of expectation management with the share of future-related statements.

Consumer-related and automobile industries more than fulfill the media's expectations. These marketing-oriented sectors are obviously used to making their customers' mouths water when thinking of new products. The opposite is true for the chemical and pharmaceutical industries. In the media, the share of future-related statements is 26.7% and only 20.2% in the annual reports. The reputation risk caused by disappointed expectations differs between each of the companies (**graph 9**). Great information gaps appear with Altana and especially BASF. Bayer, on the other hand, clearly exceeds the share of future-related statements in the media (25.8%) with 35.3% in its annual report. Bayer also reached the highest value overall, before RWE (34%) and Adidas (30.5%).

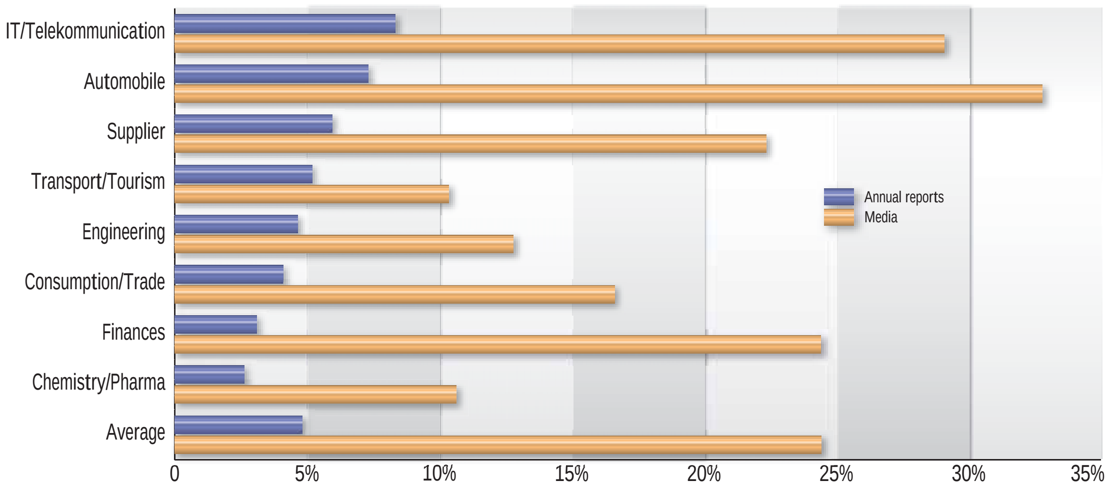
Self critizism pays off

Companies that openly discuss mistakes in their annual reports are more likely to learn from them and to take quick counteractive measures. The CEO of the insurance company and conglomerate Berkshire Hathaway, Warren Buffett, has practically made an art of self-criticism, and it is not an coincidence that he is considered to be one of the most credible business representatives in the world. The share of negative, and thus self-critical, statements in the annual report can serve as an indicator for credibility, especially when adding the media image as a benchmark. A comparison across industries shows that the IT/telecommunications as well as automobile sectors react appropriately to strong media criticism with a high share of self-criticism (**graph 10**).

The transport/logistics sector responds to moderate media criticism with a relatively high share of self-criticism, thus crediting their credibility account. In particular, this is true for TUI: The share of self-criticism is higher than the share of critical voices in media coverage – only Hypo Real Estate manages to do the same. The discrepancy between self- and outside criticism is especially striking in the financial industry, the sector that is most dependent on credibility and trust. Products like insurance policies or investment funds are highly abstract, and their benefit lies in the defense against hypothetical dangers or the gain of future profits. Companies that want to convince clients and the public of this, have to communicate factually and authentically – and this includes the ability to self-criticize.

The credibility deficits are particularly prominent at Deutsche Bank and Deutsche Börse. The balance

10) Share of critical statements on companies (by industry)



Share of critical statements in total coverage

Source: Media Tenor 01/01/2005 – 12/31/2005 Basis: 172.502 statements in 13 Media / 38.291 statements in 30 annual reports

The discrepancy between self- and outside criticism is particularly high in the financial industry, the sector that is most dependent on credibility and trust.

of the share of negative assessments in media coverage is 33.3% at Deutsche Bank and 32% at Deutsche Börse. Yet self-criticism is essentially absent in their annual reports. At Commerzbank, the high share of negative statements in the media (20%) is met with little self-criticism (0.9%). Allianz (12.3% vs.1.6%) and especially Münchener Rück (13.8% vs. 7.0%) emerge with more credibility. The positive balance of Hypo Real Estate is a result of a 2.6% critical share in the media and a 6% share of self-criticism.

HR-topics are driven by the media. Only few companies recognize their employees accordingly in their annual report. BMW, Fresenius Medical Care, Metro and Schering stand out on this issue. The share of staff-related topics is higher than in media coverage on these companies, and it reaches a share that is close to the average of relative media interest.

Topics such as the environment or CSR are company-driven, their relative weight is small. Adidas, Commerzbank or Deutsche Bank succeed in relating environmental issues to the media, while Deutsche Börse, Schering or Fresenius Medical Care, who attribute relatively high importance to the subject matter, are largely ignored. SAP declines to provide information and leaves the issue entirely to the media. CSR has got a relative weight of 2.3% in the media versus 3.4% in the annual reports. But only four companies – BASF, BMW, Infineon and RWE – manage to translate their above-average focus on CSR into above-average shares in the respective media coverage.

Conclusion

There are approaches to measure the added monetary value of PR. The breakthrough, however, would be the diffusion of standardized methods to measure and monetarily quantify different forms of intellectual capital. Only on the basis of communication-oriented reporting can companies manage their communication tactics and measure their success. (rs/chal)

Basis:

Media: Welt, FAZ, SZ, FR, Tagesthemen, heute journal, RTL Aktuell, Sat.1 News, Tagesschau, heute, ProSieben Newstime, Focus, Spiegel

Period of analysis: 01/01 – 12/31/2005

Analysis: Shares of diverse value-driving image factors as well as shares of future-oriented and critical statements in the media coverage on DAX-30-companies and their annual reports in 2005

Open questions:

How can we define value drivers that are specific to an industry sector, and categories of intellectual capital?

How plausible is the assumption that the added value of PR or the reputation value can be measured as the difference between market value and book value of a listed company?

What method can be used to measure intellectual capital and link it to financial success?