Higher frequency of financial reporting hinders corporate innovation

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Company reporting frequency should be relaxed to allow for greater innovation and longer-term thinking, according to new research from the Business School (formerly Cass).

The study, co-authored by Dr. Arthur Kraft, Reader in Accounting, found that managers are forced to focus on maximizing cursory gains at the expense of implementing long-term strategy if their organizations are imposed with—or self-impose—more regular filing of financial accounts. The reduced focus on long-term goals hinders forward-thinking, which prevents investment in innovation for fear of short-term expenditure.

On the other hand, a more relaxed approach to reporting requirements gives managers the space they require to focus less on short-term increments to appease shareholders, and more scope to increase expenditure on more valuable projects.

The research examined the number, value and citations of patent applications of US firms throughout changes to the Securities and Exchange Commission's (SEC) financial regulatory requirements in the twentieth century. During the time frame covered by the research, the statutory requirements ranged from annual reporting in 1934, to semi-annual reporting in 1955 and eventually quarterly reporting in 1970.

By analyzing changes in companies that underwent the evolving financial requirements alongside those that were not bounded by the enforced regulations, the report found that firms that increased reporting frequency during this time experienced:

- A decrease of 1.87 patents per annum
- A decrease of 19.58 non-self-citations of their patents
- A loss of $1.76 million worth of patent value

The results suggest that both quantity and quality of innovative output decreases as managers are more regularly placed under the microscope. In turn, this can lead to inertia and a culture of 'standing still' if organizations are unwilling to invest.

Dr. Kraft said although managers have legal and ethical obligations to be accountable to their shareholders, over-scrutiny in the form of regular reporting could encourage an over-cautious approach.

"Increasing the frequency of reporting can increase transparency and generate external investment opportunities.

"However, shareholders and financial regulators should consider the inhibiting factors this can have on managers and their performance motivations.

"Corporate innovation has significant benefits for the global economy and managers should be encouraged to take a more holistic approach to long-term planning to help improve business sustainability," he said.

Dr. Kraft pointed to the current Coronavirus pandemic as evidence that companies needed forward-thinking, however unprecedented the current situation.

"Investments in innovation are initially expensive with research, development and implementation costs, but they are necessary components for a company wishing to grow.

"Although nobody could have foreseen the events of 2020, it is plain to see that those who have been able to adapt business models and services to a socially distant population have generally fared better through the pandemic.

"Being able to adapt to whatever the 'new normal' could look like will require investment in innovation like never before—and it is important that managers have the license to do this."

More information: Renhui Fu et al, Financial Reporting Frequency

and Corporate Innovation, *The Journal of Law and Economics* (2020).
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