CHAPTER-VII

FINDINGS AND SUGGESTIONS

Transparency is the cornerstone of corporate financial reporting. Analysts and other stakeholders need complete information to evaluate the sustainability and growth of a company and to monitor the performance of its management. Complete disclosure of information results in appropriate valuation of companies and thus improves the efficiency of the capital market. The aim of accounting is to communicate economic message on the result of business decision to the users from time to time. Thus corporate reporting is a total communication system between a company and its users.

Growing and rapid changes in business technology and economy has led to the diversification and complexities of the businesses. Businesses and corporations begun to diversify their business operations into multi-operational and multinational enterprises; the main objective of diversification being to spread risk and take the advantage of growth opportunities in other markets. With the robust diversification and globalisation, it is obvious that the preparation of consolidated financial statements alone could no longer represent the overall view of financial information precisely and correctly to the users of financial statements due to different growth rates, profitability and risks among the segments in a diversified operations and companies. With these complexities of the business, users of the financial statements will face difficulties in evaluating the performance of an organisation and predict their future activities.
only from the Income statement and Balance Sheet and make informed judgments. Thus, segment reporting is invented to fill this gap.

Segment reports have always been promoted as a means to understand more fully the operations and results of the total enterprise. Following 20 years of identifying reportable segments by means of risk-return differences, the FASB/CICA have recently adopted the managerial approach to segment identification, which specifically places relevance over comparability. (IFRS 8) Ijiri (1995) implies that this overriding concern may disadvantage external users who require different types of information to managers of resources.

Realising this importance of segmental reporting, we attempt to study in this work, the segmental reporting practices of selected IT firms. The IT sector was specifically selected in view of its recent growth rate, contribution to national exchequer, exports and in providing employment opportunities. India has been identified as a “outsourcing destination” for the sheer growth of IT companies. Even foreign IT firms have their offices established in Indian soil. The sector is providing multi furious solutions to global clients. The business of IT is being organised into several sectors, both business and geographical. The important business segment includes software development, e-solutions, etc. The geographical segments include different areas where IT companies have clients.

We selected a sample of 100 listed IT firms in India and questionnaire method is used for data collection. A total of 45 firms responded to the
questionnaires. Using several statistical testing tools, the study analyses the segmental reporting practices. In the following pages, we list out the major findings of the study:

1. The total Indian IT sector is dominated by software industries and these listed companies are concentrated in few cities like Bangalore, Chennai, Delhi and Hyderabad. In our study Karnataka State leads with 15 sample units having its headquarters at Bangalore.

2. IT services exports dominates the domestic market in the Indian IT sector and exports to North America accounts around 60% of the exports.

3. More number of sample units are established between 1991 and 2000. Out of 45 sample units 29 units were established during this period reasons traced as liberal policy adopted by India and various IT policies introduced by Government of India to boost Indian IT industry.

4. All sample units under study are listed in India and among these 8 units are listed in foreign stock exchanges like LSE, NYSE, NASDAQ and Luxembourg. It is found that companies listed outside India are large in size.

5. Out of 45 respondents, 22 companies are small and 23 are large in size categorized on the median values of 2006 based on sales, capital employed and total assets. Where as there are 22 small and 23 large size firms based on assets employed.
6. Out of the total 45 respondents more number of firms (38%) have identified only 2 reportable segments as against 29% of the sample units have identified 5 and above reportable segments. But large size companies (43%) have identified more number of reportable segments (5 and above) than small companies. 59% of small size companies have identified only 2 reportable segments.

7. Sample units listed both in India and abroad have more diversified activities and have identified more number of reportable segments than listed only in India. Nearly 38% of sample units listed both in India and abroad have identified more than 5 reportable segments against 41% of companies listed only in India which have identified only 2 segments.

8. All 45 sample units have adopted AS-17 for their reporting. Out of these 8 firms adopted both Indian and US GAAP for segment reporting. But it is noticed that 95% of the small size (based on assets employed) units follow Indian GAAP and nearly 35% of large size firms of the sample units adopt both India and US GAAP.

9. Profitability has its influence over the standard adopted by companies. 95% of the low profitable companies adopted AS-17 for reporting while 35% of high profitable firms adopted both Indian & US GAAP as they are listed both in India and abroad.

10. Nearly 65% of sample units have identified both business and geographical as their reportable segments.
11. An average of 82% sample firms feel that their major source of risks and returns is line of business and hence they chose business as their Primary Segment for reporting and it is as high as 91% in case of large size companies. Very few companies consider geographical as their Primary Segment.

12. It is interesting to observe that, revenue is considered as the only criteria in identifying reportable segments. All the 45 sample units (100%) choose revenue as their criterion for identifying reportable segments compared to other two criteria profits and assets.

13. It is found from the study that, there is a consistency maintained in retaining the criteria for identifying reportable segments. On an average 86% of sample units have not changed their criteria for identifying reportable segments. Only 14% of companies have changed their criteria.

14. Consistency is also found with regard to number of times that firms have changed their criteria for identifying reportable segments. An average of 9% of the sample firms have changed only once while it is high (13%) in companies listed in abroad, who have changed 3 times.

15. It is found interesting that 100% of the firms who have changed their criteria of identifying reportable segment quote, change in the business composition is the only reason for the change, no other reasons like, change in management, mergers & acquisitions, change in Accounting Standard etc, have affected such change.
16. It is found that more number of firms provide segmental revenue information than other type of information in their segmental reporting. 86% of low profitable, 77% of small size companies and companies listed in India provide segmental revenue information compared to other type of information such as, segmental assets & liabilities, segmental revenue & expenditure, segmental profits etc.

17. Comparative segmental information helps in decision making. It is found from the study that percentage of such period-wise information provided by large size companies is very high (91.31%) as against 86% by both high & low profitable companies and firms listed both in India and abroad.

18. Providing segment information on comparative basis enables to make more accurate decision. It is found that sample units comply with the standard as most of the sample units provide 2 year comparative segmental information. It is observed that few companies provide segmental information for more than 2 years. Nearly 17% of large size and 26% of high profitable sample units provide segmental information of 3 and more than 3 years as against 13% by firms listed both in India and outside India.

19. The study analyses the reasons for not providing period-wise comparative information. The majority of the firms opine that non-existence of management policy was the reason for not providing such information. A few sample units expressed that it is not mandatory.
20. Segmental information provided at a glance gives a quick view of the performance of the companies. It is found that majority of the sample units provide such information at a glance. It is as high as 92% by companies those listed only in India.

21. The study finds that sample units face no difficulties in providing segmental information, 88% of the companies listed both in India and abroad experienced felt no difficulties any time in providing segmental information. Only 5% of small size sample units face difficulties since beginning.

22. The study analyses how importance of segment reporting for the sample IT companies point of view. It is found that, large size companies and companies with high profitability felt that investor’s relationship and adopting transparent disclosure practices are very important reasons for adopting AS-17. It is also found that all sample companies are very particular in complying with the Accounting Standard as they felt it very important.

23. All companies under study have realized the importance of segmental reporting. The study finds more than 90% of a sample unit expresses it as a necessity. Among the sample units, 95% of large size companies, low profitable companies and 97% of companies listed only in India felt that it is a necessity and it must be made mandatory.
24. The study reveals the impact of segment reporting on segmental performance. 86% of small size companies and low profitable companies have felt a positive impact and they agree that segmental performance has improved. It is interesting to observe that none of the sample units felt that their performance has deteriorated by providing segmental information.

25. The study examined the various benefits of segmental reporting on financial performance. Majority of the companies felt that, segmental reporting has reduced the perceived risk of investors and increased company’s public image. It is surprising that none of the sample companies have expressed that it has enabled them to issue large-size capital.

26. The study analyses whether the companies provide only that segmental information which complies with the Standard? Or provide more voluntary information? The study reveals that overall the percentage of voluntary information provided is less.

   It is observed that more number of sample units provide Pie-charts, bar diagrams and other statistical information compared to other information such as segment-wise capital expenditure, cash flow analysis, segment-wise customer profile, etc. The study finds that companies are interested in providing information which is mandatory under law than voluntary information.

27. The study tried to develop a relation between size and profitability of the firm and segmental reporting practices. A simple correlation between size
and extent of reporting measured by score is developed for this purpose and it is revealed that there is a positive correlation between size, profitability and score. The big size and highly profitable firms disclose better than small size and low profitability firms.

28. Segmental reporting is influenced by various factors. These determinants are size, profitability, equity capital, listing status, shareholding pattern and proportion of independent directors. Table-6.52 was developed showing Karl Pearson’s Coefficient Correlation. The study finds that there is a positive relation between profitability, assets, listing status, shareholding pattern and proportion of independent directors and the extent of segmental reporting practices. It is observed that profitability of IT firms has negative correlation with asset size, listing status, shareholding pattern and independent directors. The study also finds from the table 6.52 that large IT firms are less profitable than small IT firms.

Suggestions:

Segment reporting is an inevitable consequence of changing expectations of investors—both small and large. A more detailed information reduces the extent of risk perceived or assumed and encourages greater level of participation in capital market activities. The increased investors’ participation helps firms to raise greater amount of resources and invest in profitable avenues. There is a reduction also in cost of raising capital.
IT firms have higher potential to contribute to the development of economies. India is a witness to the extent of IT sector contribution to development of the economy. Segment reporting can greatly help IT firms in broadening their horizon and investment avenues. Therefore, a proper integration of segmental reporting practices as a part of competitive advantage is required among IT firms. We find from our analysis a less than satisfactory adoption of segmental reporting practice among sample IT firms. Information that is mandatory only is provided and no attempt is made to provide voluntary information. Foreign listed firms provide better information than domestic listed firms. Large firms provide better information than small firms. Profitability has also been found to be an influencing factor. More profitable firms reveal better than less profitable. We feel segmental reporting should be uniform among all size and profitability firms. Investors’ requirements or needs should dominate the reporting practices than any other criteria. In view of these shortcomings, the study provides the following important, timely and useful suggestions:

➢ There is a general compliance of segment reporting by listed companies. The study recommends for suitable amendment of Companies Act 1956 to ensure that segmental reporting is adopted by all registered firms in India.

➢ There is frequent change in criteria adopted or used in reportable segments. Though a company retains the right to change the criteria adopted for identifying reportable segments there is a need to disclose the necessity and effect of the change by IT firms in India.
In case of change in identification of segments, IAS 14 requires restatement of prior period segment information. In case it is not practicable, the standard requires disclosure of data for both the old and new bases of segmentation. Where as under AS 17, it is required to disclose only the nature of the change and the financial effect of the change, if reasonably determinable. There is a need to make it on par with IAS 14, so it gives an opportunity to make comparison between pre and post effects of such change in identification of segments.

There is a wide variation in type of segmental information provided by sample IT firms in the study. The study recommends a uniform disclosure policy for the purpose of necessary comparison.

Further the segmental information is provided on comparison basis for only 2 years, i.e. current year and previous year. For better investors reporting, the study recommends disclosure of multi period segmental information in the form of “Segmental information at a glance”.

Companies listed both in India and outside India follow dual reporting practices. Reporting is more comprehensive in case of foreign listing. The study recommends extension of information provided to foreign investors to Indian investors also.

There is a wide divergence in the voluntary disclosure practices among IT firms. The standard needs to be amended for the purpose of incorporating information with regard to segmental ratios, segmental cash flows, segment...
wise product profile, customer profile, segment wise SWOT analysis, relative contribution of segment to total performance etc. A provision of information on these lines would benefit investors in the long run.

➢ The study finds a link between profitability and segmental reporting. Profitable firms disclose more than non-profitable IT firms. Therefore, we recommend for improved general management practices. An improvement in reporting performance would result in higher segmental reporting.

➢ The study finds a relationship between the composition of Board of Directors and segmental reporting. A company with greater number of independent directors reports better than others. We feel the existing vacant position of independent directors at individual company level be filled and SEBI must insist on composition of 51% of independent directors without any relaxation. A suitable training to independent directors is also required to oversee the firm’s reporting practices.

➢ The allocation of common costs to various segments does not show the basis on which the allocation is made. So there is a need to disclose the basis on which such common costs are allocated to various segments. But, some amount of subjectivity is bound to creep in allocation of such costs but as far as possible, the segment reporting should be insulated from such subjectivity.

➢ The study also finds a significant relationship between percent of shareholding by insiders and extent of segmental reporting. A firm with greater managerial stake reports better than others. Therefore, for improved
segmental reporting, making managers as one of the important stakeholders is a necessity. Therefore, stock option plans should be implemented rigorously at individual company level to sensitise manager for higher reporting methods.

Managerial incentive plans can motivate managers to disclose better. A compensation linked to economic value added (EVA) can create a conducive climate for improved reporting practices. The improved reporting reduces average cost of capital mobilized and increases EVA. This would help the manager realize greater compensation. Beside this, some other method which compensates manager for better reporting can work in improving segmental reporting practices. A detailed examination on these lines is required.

PWC (PowerHouseCooper) conducts a study and gives following suggestions for better segment reporting, the same have been considered by our study:

- Companies should enter in to the shoes of an investor and it should report those segments that will allow users to understand the business. This may involve reporting a segment that is immaterial to the company today but that could add to the understanding of the business.

- Company’s value is based on the cash flow models and the return generated on capital invested. Companies should consider in providing operating cash flow, working capital and capital employed by segment.
o Companies should clearly disclose about how certain costs are allocated (or not)

o It should be ensured that, the reconciliations are clearly explained so the users can bridge the gap between the segment measures and the IFRS-compliant income statement.

o Change in segments should be disclosed along with reasons for such a change.

o Company should consider the same level of segment reporting disclosure in the interim reports as in the annual accounts.

o Company should ensure that the management commentary is consistent with the segment disclosures.

The above suggestions, if adopted can lead to improved segmental reporting practices among sample IT firms. The improved segmental reporting can provide better information to investors in particular and other users in general.