Disclosure of Nonfinancial Information

Subjects: Others

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Services in the financial sector are developing rapidly and are not necessarily provided only by traditional banks and financial companies. Many nonfinancial companies provide financial services, and this may open the sector to additional risk. In this context, the aspects of both financial and nonfinancial reporting are important and need to be taken into consideration as a whole to provide a complex picture of a particular institution.

Keywords: European financial services SMEs ; nonfinancial information ; sustainable reporting ; disclosure ; lexical analysis ; nonfinancial reporting

1. Introduction

Initially, disclosure of nonfinancial information was voluntarily assumed by companies, mainly large global ones. The European Commission decided that the heterogeneity in this field was an inconvenience for transparency and comparability, so it required the compulsory issuance of nonfinancial information by big European groups [1]. Although the transposition of this directive can vary and includes certain flexibility in order to be adopted by each Member State, no state has extended the obligation of issuing this sustainable information to small and medium-sized enterprises (SMEs) [2]. Bearing in mind that most of the companies in Europe are SMEs, it is important to study the nonfinancial information that they provide because disclosure of nonfinancial information is a way to improve companies' transparency and communication of social and ethical practices.

Lexical analysis was used to study disclosure of nonfinancial information because it is mainly narrative, and this is a good way to obtain conclusions from the text provided and the words used to compose the narrative. The analysis is based on reporting by European financial sector SMEs, and the background on this field is scarce. Sustainability reporting in the financial sector is mainly inadequate and focused on financial aspects rather than on material issues, as highlighted by the UN when studying sustainability reporting in the financial sector [63]. Only a few of these initiatives of sustainability reporting provide a picture of all sustainability factors of financial companies [63]. In addition, the overwhelming majority of SMEs perceive sustainability reporting as a burden, and it appears that SMEs either do not have the capacity to comply or are reluctant to invest the necessary resources [64], so taking all this together, we propose the following research questions:

RQ_1: Are European financial sector SMEs preparing their sustainability reports only in accordance with minimum nonfinancial disclosure requirements?

RQ_2: Are European financial sector SMEs still more influenced by financial terms in their nonfinancial reporting?

2. Sustainability Reporting of SMEs

SMEs are the backbone of the European economy and are traditionally dependent on bank loans for their external financing. The last financial crisis and now the situation generated by COVID-19 have increased both the need for financial resources and the difficulties in accessing it. The European Commission highlights these difficulties and promotes the provision of suitable alternatives to bank loans, so it enacted a specific regulation "to make SMEs more visible to investors and markets more attractive and accessible for SMEs. Regulatory changes will keep the right balance between prudential regulation and financing of SMEs, and between investor protection and tailored measures for SMEs" [3]. This sector is also in the spotlight of transparency after the recent crisis and has an additional obligation with society to try to balance the unequal distribution of information [4]. The development of this sector is linked to economic growth [5], and the effect of the recent crisis on bank credit has increased the importance of other types of financial resources, such as trade credit [6]. Thus, the recent evolution of the financial sector has turned to SMEs to provide these services because their traditional problems in obtaining financial resources can be more easily solved by other SMEs [7]. Although at first sight the small size can seem to be a limitation to operating in the financial sector, it can be an important advantage because specializing as another SME or in retail services in order to provide a more similar service is seen as a positive way to attract SMEs to this sector [7]. Banks and, by extension, financial services companies are expected to approach climate risks and other risks related to sustainability in the same way that they approach any other financial risks [8].

The development of regulations in Europe to require sustainability reporting by financial services companies and obtain financial resources is under discussion, and recently a roadmap of regulation on taxonomy-related disclosures was launched by undertaking the reporting of nonfinancial information included in the European Commission's Action Plan on financing sustainable growth [9]. European financial sector companies have their own regulatory and supervisory bodies that do not depend on their size in terms of national and international financial compliance, although groups of European listed companies are directly regulated by European Union–International Financial Reporting Standards (EU-IFRS). IFRS also include requirements on disclosure as a response to the need for high-quality standards in order to be endorsed in Europe. In this line, in 2018 the European Securities and Markets Authority (ESMA) expanded its supervisory activities to nonfinancial information on environmental, social, and governance (ESG) matters assessing compliance with IFRS, and in 2019 it continued to focus on this disclosure. When speaking specifically about regulation of nonfinancial disclosure, large financial services companies are mainly considered entities of public interest in each Member State, which means that they are compulsorily required to disclose nonfinancial reporting according to Directive 2014/95/EU, although the specific requirements depend on its transposition by each Member State [1]. Hence, financial services SMEs that publish sustainability information do it voluntarily because they are not within the scope of the directive, and this field is not regulated.

Background information on the field of sustainability reporting of financial services SMEs is scarce and far from sufficient to develop requirements about it now when the European Commission is working on a review of nonfinancial reporting. Studying nonfinancial information is also difficult due to its mainly qualitative and narrative nature, which makes the information heterogeneous. Although most companies are using GRI standards, this does not suppose comparable homogeneous information.

3. Results and Conclusions

Our analysis is based on European SMEs included in the GRI database, hence the population of SMEs that voluntarily use GRI standards, although only between 10 and 15% of sustainability reports in the database from 2017–2018 came from SMEs [10]. Then we focused on European SMEs operating in the financial services sector. Bearing in mind their specific activity, sustainability reports by European financial sector SMEs represent an important percentage of reports in comparison with nearly all other sectors (5.7%).

The results obtained from the lexical analysis lead us to think that the answer to our first research question is yes, because there is no significant use of symbolic concepts in the narrative discourse in the reports analyzed, hence there is minimum compliance with nonfinancial requirements. Opposite results were obtained by the authors of [11] after applying lexicometric analysis to speeches delivered by European Central Bank presidents, although in this case we analyzed sustainability reporting.

Although initially it may be thought that sustainability reports are specific for each company, the broader corpus analysis suggests they were prepared similarly and used the same template [12], even more if it is pointed out that the four companies are in different countries and, although operating in financial services, are focused on different niches. As the sector is a strongly determinant variable of nonfinancial reporting [13][14][15], the analyzed reports follow the same pattern. Financial services companies not only operate in the same sector, but also have their own regulatory and supervisory bodies. So, in this case the sector is decisive in following the same financial trend in sustainability information, and as found in KPMG´s 2017 survey, financial services companies are in last place in corporate responsibility reporting [16].

These financial services companies are still imbued with traditional financial objectives and information. This means that finally what counts most in sustainable reports is financial information over nonfinancial, or at least the typical financial aspects of the business in this important sector are highlighted more through the language used. The analysis of the most frequent words in context shows that all financial terms are related to other financial terms. Hence, our second research question is supported. These results are the same as those obtained in previous studies, although in developing countries, based on financial services companies, because it is argued that the most important priorities of these enterprises are those directly related to their business operations [17].

Although a first view of sustainable reporting may show that companies try to exert more effort to increase the extent of their disclosure, the deep lexical analysis of these reports shows that the language used is not so extensive or rich, as some words are repeated many times, which highlights the problem of the lack of content in sustainability information.

This shows evidence of the gap that still exists between financial and nonfinancial information and takes us to the same question posed by other researchers: “If it is like this for disclosing firms, what is happening in the case of nondisclosing firms?” [18].

Future research directions depend on an increase in nonfinancial reports, which will make it possible to get a bigger sample, more companies, and a longer period, because currently the most important limitation is the number of sustainability reports published according to GRI by European financial services SMEs. Another future research project involves using a proper sample of nonfinancial reports to describe and compare financial sector vs. nonfinancial sector SMEs and financial sector SMEs vs. large financial sector companies.

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