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Plain English in Financial Presentation Might Pay Off for Companies, Study Finds

A study suggests that using more readable language in the written disclosures of regulatory filings benefits public companies. This is especially true when they have poor results. When the information is difficult to read, the study found that investors are likely to either discount the company's positive assertions about future performance or place greater weight on outside information that does not support the company's rosier claims.

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Written disclosures that are difficult to read may prevent investors from accepting managers' assertions about the future or encourage investors to place greater weight on outside information that does not corroborate managers' views, according to the study.

"Overall, our findings suggest that issuing less readable disclosures limits managers' ability to convince investors that performance will improve in the future," said the study in the July 2017 issue of ***The Accounting Review***, from the **American Accounting Association**.

In contrast to previous theories that said companies would be better off by issuing less readable disclosures when their financial performance is poor, this means that such obfuscation might backfire, the study added.

To do their research, three academics went beyond previous findings that showed that investors prefer information that is more easily comprehensible and feel less confident judging obtuse information.

The researchers went one step further and found that when investors are presented with less readable information about a company's financial performance, they tend to look to outside information, such as analyst or news reports, to better evaluate management's claims.

The research was carried out by Scott Asay, an assistant professor of accounting at the University of Iowa, Brooke Elliott, professor of accounting at the University of Illinois at Urbana-Champaign, and Kristina Rennekamp, an assistant professor of accounting at Cornell University.

To examine investor behavior, the researchers conducted a controlled experiment with 203 participants who were provided an initial valuation about a company. Then they saw an earnings announcement indicating that despite an increase in sales and net income, the company performed below expectations in the most recent quarter. Moreover, the disclosure indicated that management expected future performance to improve. Thus, the overall message was that company performance was mixed.

The researchers manipulated the disclosure to be more or less readable using the SEC's suggestions provided in the Plain English Handbook published in 1998.

After reading the disclosure, the participants gave judgments that indicated how comfortable they felt about evaluating the company. They were also given the option of looking at three sources of outside information—an individual analyst's report, a report summarizing the consensus forecast of all analysts that follow the firm, and a Yahoo News story.

The researchers manipulated the outside information so that they were relatively supportive of managers' claims that future performance would improve.

Participants were then asked to indicate on an 11-point scale their assessment of the company's values with 1 being very low. They estimated their comfort level with the information provided from a seven-point scale with 1 rated as low.

When management's information was relatively low in readability and outside information gave low support for the company, participants gave the company a 6.1 investment rating on the 11-point scale. This rating was more than 10 percent below the rating for other combinations.

While the findings suggested that presenting less readable information might undermine a company's ability to convince investors that future performance is likely to improve, the study said there was a flip side.

The researchers noted that the findings might also indicate that investors might rely too heavily on more readable disclosures while discounting outside sources of information about a company.