

# **Forward-looking information in annual reports:**

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A study into its realisation

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Thesis - Master Business Administration

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2 October 2016

## **Summary**

Do firms really execute the plans they made for the future? Are their stated objectives achieved? Do their predictions become reality? In today's dynamic business environment forward-looking corporate information forms a relevant source of information to investors. However, since uncertainty is inseparably linked to the future, no guarantee can be given that the forward-looking information firms provide will match with future reality. This research is concerned with monitoring forward-looking information provided by firms in annual reports, by comparing this information with backward-looking information on its realisation provided in later annual reports. Forward-looking information is retrieved from selected sections of the annual reports of 2004 until 2013 from two case companies active in the fashion retail industry. All units of forward-looking information are labelled according to characterising dimensions that facilitate the description of the forward-looking information as well as dimensions related to the monitoring process. From the findings it can be concluded that realisation could not be determined for all forward-looking information, as some information appeared to be not specific enough to be able to monitor it or the needed backward-looking information was found to be lacking in later annual reports. This raises further questions regarding the disclosure practices of firms concerning forward-looking information and reporting back on it. For the forward-looking information units for which realisation could be determined it was found that, although for eighteen out of twenty firm-years these were mostly found to be matching with subsequent reality, every firm-year included forward-looking information that appeared to be mismatching with backward-looking information on its realisation. This might indicate the difficulty for firms to exactly predict and plan their future. Investors must be aware of the fact that certainty regarding the realisation of forward-looking information is non-existing. Follow-up research is needed that extends the findings of the present explorative study.

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## **1 Introduction**

For all economies the challenge of optimally channelling funds from savers to companies that are in need of financial resources to realise their business ideas is a critical one (Healy & Palepu, 2001). Economies that are capable of managing this matching process well, can boost the creation of jobs and wealth. Capital markets play a significant role in allocating savings to investment options (Palepu, Healy, & Peek, 2013). They can be defined as “markets where entrepreneurs raise funds to finance their business ideas in exchange for equity or debt securities” (Palepu et al., 2013, p. 16). For a capital market to be able to function efficiently corporate disclosure is essential. The existence of problems regarding differences in incentives and asymmetric information between managers and external investors, which hinder an efficient matching process of financial resources to investment opportunities, increases the need for disclosure and financial reporting (Healy & Palepu, 2001). The annual report is one medium that firms use to provide corporate disclosure and it is generally regarded as one of the most important tools to transmit corporate information to investors and other stakeholders (Botosan, 1997; Branco & Rodrigues, 2006).

McLaney and Atrill (2016) note that: “Over the years, there has been a trend towards greater disclosure of information in the published annual financial reports of limited companies. (...) They cover a very wide range of information and their boundaries are becoming ever more difficult to establish” (p. 160). The finding of a changed nature of business several years prior thereto serves as an explanation for such changes in corporate disclosure (McLaney & Atrill, 2016). Beattie, McInnes, and Fearnley (2004) argued that some fundamental changes have altered the nature of business: intangible assets started to play a bigger role in a firm’s processes of value creation and so its competitive advantage. More specifically, they were talking about intangible assets that are not included in a company’s financial statements. In line with this, Beretta and Bozzolan (2008) state: “In fact, the increasing complexity of regulations, business contexts, firm’s strategies, and operations makes it quite difficult to appreciate the substance of financial statements without accompanying narrative explanations” (p. 334). Such essential changes gave rise to the emergence of literature stating that traditional financial reporting, which mainly focuses on the provision of information that is backward-looking, quantitative, and financial, became no longer appropriate to meet the information demand of the changing market (AICPA, 1994; Lev & Zarowin, 1999; FASB, 2001; Breton & Taffler, 2001; Eccles, Herz, Keegan, & Phillips, 2001).

The highly influential report of the AICPA (1994), also known as the Jenkins Report, formulated a number of key recommendations to increase the quality of corporate reporting, which included increasing the attention for and provision of forward-looking information. To make investment decisions, investors want to predict future firm performance as accurately as possible. Forward-looking information can be very useful in getting a good perspective on a firm's future (AICPA, 1994). This is especially true since the more dynamic business environment makes it harder to predict the future by solely relying on backward-looking information (Beattie, 2000). PWC (2007) mentions transparent information about current as well as future business performance as being the raw material for making effective decisions in capital markets.

The relevance of forward-looking information to investors makes it an interesting research topic. A substantial part of scientific research that focuses on forward-looking disclosure is concerned specifically with examining management earnings forecasts. However, a recent study highlights that it is not very common for firms to provide such quantitative statements related to earnings, and therefore questions the attention it gets (Bozanic, Roulstone, & Van Buskirk, 2015). Moreover, research indicates that forward-looking information has a predominantly qualitative character (Beattie et al., 2004; O'Sullivan, Percy, & Stewart, 2008; Athanasakou & Hussainey, 2014) and frequently covers topics that are non-earnings-related (Schleicher & Walker, 2010). Though, relatively little research focuses on forward-looking information beyond just management earnings forecasts, a point which is also stressed by several other researchers (Beretta & Bozzolan, 2008; Schleicher & Walker, 2010; Bozanic et al., 2015). By focussing on forward-looking information in a broader sense, this study attempts to contribute to growing the academic knowledge on this topic.

In contrast to historical or backward-looking information, for forward-looking information it is not possible to determine whether it is 'true' at the time the statement is made, since it refers to a future situation. Clearly, it is difficult to foresee how the future will look. This also applies to companies and their managers. Uncontrollable and unanticipated factors can cause actual performance to differ from what the company stated in advance. For investors it might be useful to get insights into the reliability of forward-looking information, so they can decide whether or not to use this kind of information in making investment decisions. This is especially true since forward-looking information is largely unregulated (PWC, 2007), which entails that firms have a lot of freedom in deciding what information they want to provide

related to the future. Schleicher and Walker (2010) question its unregulated and unaudited nature, because the results of their study point at the application of impression management through forward-looking information. Moreover, the numerous corporate reporting scandals of the twenty-first century, such as the well-known cases of Enron, WorldCom, and Royal Ahold (Ball, 2009), taught us the existence of the chance that firms might intentionally disclose information that is a distorted version of the information they actually possess.

The above provides support for examining the correspondence of forward-looking information with subsequent reality. Do firms really execute the plans they made for the future? Are their stated objectives achieved? Do their predictions become reality? Monitoring the realisation of forward-looking information provided by companies could provide investors with useful information about the value of forward-looking information and how to deal with it. It might help them to make improved investment decisions, thereby mitigating capital misallocation. Therefore, the following research question is central to this study:

*How does forward-looking information provided by companies in annual reports relate to backward-looking information on its corresponding realisation provided by companies in subsequent annual reports?*

Because of the aforementioned importance of the annual report in firms' communication with investors, the focus solely lies on this source of corporate information. To the best of the author's knowledge, no study has yet conducted a research that carries out a thorough one by one check of forward-looking information. Besides extending the limited knowledge on broadly defined forward-looking information, this study's theoretical contribution therefore also lies in filling this research gap. Moreover, this explorative research likely provides new insights that could form the basis for future research, which might further strengthen the knowledge base on forward-looking information. In order to formulate an answer to the central research question, the forward-looking information provided over the ten year period from 2004 until 2013 by two case companies active in the fashion retail industry is examined. H&M and Inditex are chosen to fulfil the role of being the case companies used in this study.

The remainder of this study is organised as follows. Section 2 reviews literature related to the research topic of corporate forward-looking information. Section 3 discusses the research design by explaining the three approaches to answering the main research question as well as the two parts that make up the research. Section 4 specifies the methodology used to carry out

the research. In addition, it contains a description of the fashion retail industry and the two case companies. Section 5 presents the results of the first part of the research, which is concerned with mapping the forward-looking information that is included as data in this study, by giving a description of it. After that, Section 6 describes the results that follow from the second part of the research, that is to say, from monitoring the forward-looking information. Section 7 discusses this study by mentioning its limitations and suggestions for further research. Finally, Section 8 draws conclusions.

## **2 Literature review**

Corporate disclosure can be seen as the overarching topic of this study, as forward-looking information represents one form of corporate disclosure. Therefore, in the first subsection of this literature review corporate disclosure in general is discussed to create a solid background for the rest of the study. Thereafter, since this study focuses on corporate disclosure in the form of forward-looking information, the literature review will concentrate on that specific topic by defining it, discussing its characteristics and determinants, and discussing factors influencing firms' disclosure behaviour of forward-looking information.

### **2.1 Corporate disclosure in general**

As already indicated in the introduction, corporate disclosure is essential for capital markets to function efficiently, which in turn, by facilitating an efficient matching process of financial resources to investment opportunities, is crucial for having a flourishing economy. Disclosure is essential in this because connecting savers to entrepreneurs is not as easy as it might sound. Problems regarding information and incentives complicate that matter, which according to Healy and Palepu (2001) can be divided into two main problems: the 'information problem' and the 'agency problem'. Regarding the information problem they refer to Akerlof's (1970) 'lemons' problem, which is caused by asymmetry between information available to entrepreneurs and investors, and by their conflicting incentives. Because of this it is hard to identify the 'good' and the 'bad' business ideas, making investors assign an average level of value to both, which means that good ideas will be undervalued and bad ideas will be overvalued. This inability to correctly value investment opportunities can lead to a capital market breakdown, because the good ideas may be expelled, leaving the bad behind. Through disclosure, asymmetry in information between the two parties can be reduced (Healy & Palepu, 2001). The agency problem is a result of the norm that the owners (investors) are not the same persons as the controllers (management). Managers are supposed to act on behalf of the investors, to maximise investors' wealth. However, self-interested managers have an incentive to use investors' funds for their own best interests, which might differ from those of the investors (Jensen & Meckling, 1976). Corporate disclosure can mitigate the agency problem, since it allows investors to monitor managerial behaviour (Healy & Palepu, 2001).

Given the importance of corporate disclosure for the overall state of the economy, it is not very remarkable that it is subject to regulations mandated by law. Moreover, events such as corporate reporting scandals and the global financial crisis have increased the attention for



corporate disclosure regulations (Leuz & Wysocki, 2008). A recent trend concerning regulation is that of increasing the global harmonisation of reporting rules. For example, since 2005, practically all listed companies in the European Union are required to adopt a set of uniform reporting standards, named International Financial Reporting Standards (Leuz & Wysocki, 2008; McLaney & Atrill, 2016). These standards provide companies with a common set of rules that tell them what information they are required to disclose and how they must disclose it. This eases comparison of the performance of firms from different countries (McLaney & Atrill, 2016).

Through regulation, disclosure can be roughly divided into mandatory disclosure and voluntary disclosure. Early studies by Grossman (1981) and Milgrom (1981) on voluntary disclosure presented the theory of full disclosure, in which eventually an equilibrium is reached where firms disclose all relevant private information: not only the good but also the bad news. Prior thereto an unravelling process takes place, which works as follows. Without any disclosure by firms, the present information asymmetry causes investors to see all firms as being identical, and thus of the same average value. This gives firms with a value higher than average an incentive to fully disclose, so as to differentiate themselves from companies with worse news. Investors then rationally assume that the average value of the firms that do not disclose has to be lower. This drop in average value causes some below-average valued firms to become above-average, giving them the same incentive to disclose. Repeating this reasoning leads to an equilibrium state of voluntary full disclosure by all firms, except those having the worst possible news. So, in such a case government intervention would not be necessary to stimulate disclosure.

However, it is hard to believe that this process works the same in practice as in theory. Subsequent papers came up with additional factors that hinder the full disclosure reasoning. Verrecchia (1983) mentions proprietary costs as a reason for managerial discretion applied in information disclosure, that is to say, managers withholding information that might even represent favourable news. He aims at costs that stem from situations in which other parties use the disclosed information in a way disadvantageous to the disclosing firm. “For example, firms in highly competitive industries may regard public disclosures of any kind as potentially costly in the assistance it renders competitors” (Verrecchia, 1983, p. 191). While in the full disclosure theory rational investors infer from the absence of information that it must be unfavourable news, when taking proprietary costs into account this unambiguous inference is

no longer valid. Furthermore, Dye (1985) states that the often lacking knowledge among investors about which information managers actually possess serves as a legitimate explanation for managers hiding non-proprietary information. In this case the no news means bad news assumption also does not hold. The above has shown that disclosure might be a more complex phenomenon than as suggested by Grossman (1981) and Milgrom (1981).

In addition to the well-known annual report, information can be disclosed by companies through several other sources. Examples include: management forecasts, press releases, conference calls, and the company website (Healy & Palepu, 2001). “Although the annual report is not the only source of information about the performance of a company, it is considered to be an influential source because of its wide coverage and availability” (Hooks, Coy, & Davey, 2002, p. 502). The time in which annual reports were only used to present the main financial statements is over: nowadays, a very broad set of information is included in it. This change is due to, among others, the more complex nature of business (McLaney & Atrill, 2016).

## **2.2 Definitions of forward-looking information**

By clarifying the concept of corporate disclosure in general, the foundation of this literature review has been made. From now on, the focus shifts to forward-looking information in particular, which is the main topic of this study. Forward-looking information represents one form of corporate disclosure and can be classified as voluntary disclosure, since it is largely unregulated (PWC, 2007). This subsection is concerned with discussing definitions of forward-looking information that are present in literature.

Scientific research focusing on forward-looking information provided by firms uses different conceptualisations of the term. A substantial part of it is concerned specifically with forward-looking information in the form of management earnings forecasts (e.g. Baginski, Hassell, & Kimbrough, 2002; Rogers & Stocken, 2005; Hirst, Koonce, & Venkataraman, 2008; Kim & Shi, 2011). According to Hirst et al. (2008) such forecasts are seen as being a key disclosure mechanism for influencing market expectations. In line with this, Kim and Shi (2011) state that management earnings forecasts represent important tools for managers to enhance the understanding of business performance among investors. This apparent importance may well be an explanation for the substantial academic interest devoted to the topic. However, forward-looking information includes more than just management earnings forecasts. A recent

study emphasises that it is not very common for firms to provide such forecasts and therefore puts question marks at the attention it gets (Bozanic et al., 2015). Moreover, the infrequent nature of earnings forecasts is one of the reasons Schleicher and Walker (2010) mention for using a more broad definition of forward-looking disclosures, which allows for the inclusion of statements that are qualitative and not related to earnings. In literature no standardised definition of forward-looking information in a corporate disclosure setting can be found. Some examples of definitions include:

*“Forward-looking information is any prediction or information that aids prediction. It includes management's plans, assessments of opportunities and risks, and forecasted data.”* (AICPA, 1994, p. 20)

*“Forward-looking disclosure is the class of information that refers to current plans and future forecasts that enable investors and other users to assess a company's future financial performance.”* (Aljifri & Hussainey, 2007, p. 883)

*“All statements other than statements of historical fact included herein, including, without limitation, those regarding our financial position, business strategy, management plans and objectives for future operations are forward-looking statements.”* (Inditex, 2013, p. 173)

*“All statements addressing our future operating performance, and statements addressing events and developments that we expect or anticipate will occur in the future, are forward-looking statements (...).”* (Pepsico, 2016, p. 146)

The lack of a standardised definition and the fact that literature dealing with forward-looking information often skips defining it might be caused by the obviousness of the term, since the name already reveals a great part of its meaning, causing some to think that it is not necessary to explicitly describe the meaning of the term. However, the shared common understanding which can be deduced from the aforementioned definitions is that forward-looking disclosure provides information regarding the state of the future and that it comes in different forms.

There are also studies that use a definition that captures their methodology of selecting forward-looking information:

*“Rather, provided the projection can be classified in terms of the following four characteristics, it is recognised as a forward-looking statement for the purposes of this study: direction (up, down or no change); type (income/profit, cash flow, sales/revenue); location (Directors' Report, CEO's/Managing Director's Report,*

*Review of Operations, Chairman's Report, D&A and other); and nature (qualitative, quantitative).*" (O'Sullivan et al., 2008, p. 15)

*"I define forward-looking statements as all those sentences that contain: "will," "should," "can," "could," "may," "might," "expect," "anticipate," "believe," "plan," "hope," "intend," "seek," "project," "forecast," "objective," or "goal."*" (Li, 2010, p. 1097)

From the existence of such definitions it can be concluded that the boundary between what classifies and what does not classify as forward-looking information might not be as clear-cut. Such definitions can then be seen as an attempt to sharpen the boundary in order to simplify the process of separating forward-looking information from other information. Hussainey (2004) confirms the difficulty of this process by stating that often information that is not categorised as forward-looking nevertheless carries messages that are relevant for the future. He illustrates his statement with an example of a piece of backward-looking information (last year's R&D expenditure has grown by 10%) that still has implications for the future (increase in future cash flow is expected).

### **2.3 Characteristics and determinants of forward-looking information**

After discussing some definitions, the characteristics of forward-looking information are discussed in this subsection to further improve the understanding of it. Besides that, there will be shortly elaborated on research into the determinants of forward-looking information. But first, it might be useful to give an impression of the proportion of forward-looking statements in annual reports. Beattie et al. (2004) examined in their research all voluntary narrative sections of the 1999 annual report of 11 UK firms active in the food industry. They found that of all text units 13% has a forward-looking time orientation. Another study, with a much larger sample, examined the management discussion and analysis (MD&A) sections of 44,708 annual reports for the years ranging between 1993 and 2009. On average, 9.5% of all MD&A sentences were forward-looking in 1993 and by 2009 this number has risen to 13.7%. This increase could be attributed to encouragements of regulatory bodies to disclose forward-looking information (Muslu, Radhakrishnan, Subramanyam, & Lim, 2015). Before proceeding with the rest of this subsection, it should be noted that it became clear from sifting through literature that significant differences exist between studies with regard to their research design. The previous subsection already presented the existing differences in definitions and conceptualisations of forward-looking information, but also the information

source, unit of analysis, and the geographical environment may vary. This reduces the comparability of the different studies. Though, some clear conclusions about the characteristics and determinants of forward-looking information can be inferred. This subsection mainly presents the findings for which consistency is found across multiple studies.

Several studies are concerned with examining how companies present their forward-looking information. An often reached conclusion is that this information is mostly qualitative in nature. The aforementioned study of Beattie et al. (2004) shows that for one specific company only 5 text units of the total 216 forward-looking units present in the voluntary narrative sections of the annual report were quantitative. This result does not deviate much from the proportions that the average of all 11 companies shows. Another study, conducted by O'Sullivan et al. (2008), with a much larger sample of Australian companies, but a smaller pool of forward-looking text units to be researched, due to the strict definition used (see quotation in Section 2.2), concluded that 79% and 83% of the forward-looking statements found in all narrative parts of the annual reports of 2000 and 2002 respectively are classified as qualitative. Likewise, there are more studies that show similar results exhibiting a predominantly qualitative character of forward-looking information (Clarkson, Kao, & Richardson, 1994; Kent & Ung, 2003; Athanasakou & Hussainey, 2014). A consequence of this characteristic is that it complicates the effective monitoring of the accuracy of such information for outsiders, so this entails that they might also often be less verifiable in nature (Schleicher & Walker, 2010). Additionally, Athanasakou and Hussainey (2014) concluded that most of their sample statements do not refer to a concrete time horizon. This lack of specificity might further impede the monitoring of forward-looking statements.

Another frequently drawn conclusion is that forward-looking disclosures often tend to predict that the future will be bright. More specifically, statements bringing positive news generally appear to dominate those bringing bad news. The results shown in the study of Schleicher and Walker (2010) are an example of evidence supporting this statement. They analysed forward-looking statements in the narrative part of 502 annual reports of UK companies coming from 1996 to 2002 and found that, overall, positive statements about the future are more numerous than those of which the tone is neutral or negative. As part of their research they also grouped together all firm-years that were about to show highly increasing or highly decreasing profit and sales margins in the following year. Although the difference between the amount of

positive and negative statements was smaller for the group of firms with subsequent strongly declining margins, positive news still prevailed, which is against Schleicher and Walker's (2010) presumption. By assuming that managers are able to predict sales and profit on the short term the authors conclude from the results that firms with bad performance ahead bias the tone upwards and they state that the results point at impression management. In an earlier study, Pava and Epstein (1993) examined for 25 companies whether or not influential events that occurred in 1990 were predicted in the MD&A section of the 1989 annual report. They found that 56% of the positive events were predicted correctly, but for negative events this number was only 26%, which made them state: "we think there is no reason to believe managers are better able to predict good news than bad news. Our conclusion is that managers withheld information about trends that would negatively affect their businesses (...)" (p. 52). There will be elaborated further on the role of firms and their managers in the disclosure of forward-looking information in the next subsection. The results provided by Clarkson et al. (1994), Kent and Ung (2003), and Athanasakou and Hussainey (2014) also show that a positive character of forward-looking information is more common than a negative character.

Regarding the content of forward-looking statements it is hard to draw conclusions from the available literature. For example, Beattie et al. (2004) found that most forward-looking information is about "activities and plans to meet broad objectives and business strategy" (p. 225). Li (2010) also assessed the content by dividing 30,000 forward-looking sentences across 12 content categories. Most of them contain information about operations, productions, and general business. Because researchers tend to use different classification schemes to sort forward-looking information with regard to content, it is hard to draw clear conclusions by comparing findings from different studies. Though, when being less specific, it could be stated that forward-looking statements frequently focus on topics that are non-earnings-related and 'soft' (Schleicher & Walker, 2010), that is to say, topics that are hard to measure.

Lastly, there are also studies that have conducted research to enlarge the knowledge about which factors could provide an explanation for differences between firms with regard to their disclosure behaviour of forward-looking information. The research of Ahmed and Courtis (1999) titled 'associations between corporate characteristics and disclosure levels in annual reports: a meta analysis', established that the most frequently examined determinant in their sample of 29 relevant studies is corporate size, with the pervasive finding being a highly significant positive relationship between size and level of corporate disclosure in general. For

forward-looking disclosure in particular, empirical research also found that large companies tend to disclose more of such information in comparison with smaller companies (Kent & Ung, 2003; Beretta & Bozzolan, 2008; Wang & Hussainey, 2013; Muslu et al., 2015). A possible explanation for this relationship could be found in the relatively stable performance of bigger firms (Kent & Ung, 2003). This may make them less reluctant in providing forward-looking information, because of having a more predictable future. But also more general explanations such as the presence of advanced internal reporting systems at larger firms, their possession of financial resources to fund the provision of a higher level of disclosure, and the greater demand for information caused by a more widespread ownership might explain the positive relationship found in the context of forward-looking disclosure specifically (Ahmed & Courtis, 1999).

#### **2.4 Factors influencing firms' disclosure behaviour of forward-looking information**

The unravelling argument, discussed in Section 2.1, predicts full and truthful corporate disclosure. However, the evidence discussed in the previous subsection suggests that firms do not disclose all forward-looking information they possess. Moreover, the evidence provides indications that if forward-looking information is disclosed it is questionable whether it represents the true information firms have. It is important to create some understanding of what triggers firms and their managers to make certain decisions. Wang and Hussainey (2013) show that in their used sample of more than 5,000 firm-years, considerable differences exist in the amount of forward-looking statements provided per firm-year observation. From this it might be inferred that significant variation is present in companies' decisions to provide forward-looking information. This subsection elaborates on factors that could play a role in the disclosure behaviour of companies with regard to forward-looking information. Factors are discussed that are found to be mentioned across multiple studies. From the following, it becomes clear that the decision to forecast is a complex one which seems to be influenced by several factors. Providing forward-looking information is perceived by many companies as a real challenge (PWC, 2007).

“Managers have incentives to disclose forward-looking information to investors to assist them in their decision making (...)” (Kent & Ung, 2003, p. 283). The information can be used to increase transparency and make investors better understand the business and its future (PWC, 2007). Closely related to assisting investors, another reason for firms in favour of adding forward-looking information revolves around the cost of external financing (Healy & Palepu,

2001; Kent & Ung, 2003; Aljifri & Hussainey, 2007). Evidence has shown that increased disclosure may result in a lower cost of capital (Botosan, 1997; Francis, Khurana, & Pereira, 2005; Francis, Nanda, & Olsson, 2008), which is beneficial for firms for obvious reasons. The theoretical explanation for this negative relationship is as follows. When the availability of information about a company is more limited, investors perceive investing to be riskier. Consequently, for bearing such information risk they want to be compensated by a premium (Barry & Brown, 1984). A firm's cost of capital can thus be reduced by lowering information risk through providing more information. Graham, Harvey, and Rajgopal's (2005) survey among over 400 executives indicates that 81.9% of the participants agrees with a lower information risk being a motivation for increasing disclosure. Understandably, the motivation to provide forward-looking information from a cost of capital perspective is especially strong when firms require external financing, which is confirmed by the finding of Clarkson et al. (1994) of a positive relationship between companies' financing requirements and the likelihood of making forecasts.

Schleicher and Walker (2010) mention two contrasting theories in their article that could underlie firms' disclosure behaviour of forward-looking information: signalling and impression management. Signalling models rely on the assumptions that the interests of managers and investors are perfectly aligned and that the information that managers disclose is always truthful. In contrast, impression management is based on Jensen and Meckling's (1976) agency theory, which highlights the possibility of conflicting interests between the two parties and that managers might be acting self-interested in such a case. "The idea that managers use their discretion over corporate disclosures opportunistically to their own personal benefit is central to the impression management literature" (Schleicher & Walker, 2010, pp. 373-374). It usually implies that managers try to mislead users of corporate reporting by presenting their company in a more favourable light than reality would dictate, resulting in a positive reporting bias (Clatworthy & Jones, 2006; Schleicher & Walker, 2010). Incentives for managers to apply impression management stem from its potential short term result of improved share performance, leading to higher share-based compensation. For investors, on the other hand, it can lead to misallocation of their capital (Merkl-Davies & Brennan, 2007). Clatworthy and Jones (2003) state that narratives in corporate reporting might be used to exercise impression management, since these are largely unaudited. Their research findings as well as that of Clatworthy and Jones (2006) indeed point at the usage of narratives for managing impressions by managers. Schleicher and Walker (2010) focus on



narratives that are forward-looking in particular and also found indications of impression management.

However, because in case of forward-looking disclosure subsequent reports can be used to judge the truthfulness of previous statements, managers are constrained in misleading investors. In particular, detection of misrepresentation might do considerable harm to management's reporting reputation (Rogers & Stocken, 2005). Evidence shows that when ex post evaluation of the truthfulness is harder for outsiders due to highly fluctuating business results, it is more likely that self-serving manipulation by managers takes place (Rogers & Stocken, 2005; Schleicher & Walker, 2010). But not only the truthfulness of forward-looking statements can be assessed, also their accuracy. The fear of being inaccurate can be a motive for firms not to provide forward-looking information. This is supported by the finding of Kent and Ung (2003) that for firms with more certainty regarding the future, as measured through earnings volatility, the likelihood of providing forward-looking information is higher. A result which they attribute to potential costs of litigation and firms' reputation concerns. Kent and Ung (2003) explain the reasoning behind the costs that may arise from building up a bad reporting reputation. They state that if firms frequently provide forward-looking information that later on appears to be inaccurate, the market might respond by discounting the credibility of subsequent forward-looking information. This potentially leads to a higher cost of capital through increased information risk.

Lastly, the point regarding competition is discussed in this section, which is in several studies mentioned as being a factor that could play a role in firms' disclosure behaviour of forward-looking information (Clarkson et al., 1994; Kent & Ung, 2003; PWC, 2007). This point builds on Verrecchia's (1983) proprietary costs, already discussed in Subsection 2.1, which is identified as a factor hindering the full disclosure reasoning. PWC (2007) states that many firms are afraid of the higher demand for forward-looking information, as it might force them to reveal competition sensitive information. To give an example of this: releasing favourable forward-looking information on earnings possibly intensifies competition by encouraging new competitors to enter (Kent & Ung, 2003). So, when the forward-looking information is useful to competitors, but consequently unprofitable to the disclosing firm, the firm might decide not to disclose it.

### **3 Research design**

This section discusses the research design used for this study. The three approaches to answering the research question are explained as well as the two parts that make up the research.

As already introduced and presented in the introduction, the research question that is central to this study is as follows:

*How does forward-looking information provided by companies in annual reports relate to backward-looking information on its corresponding realisation provided by companies in subsequent annual reports?*

In order to be able to give a well-founded answer to this main research question, three different approaches for answering it will be used: the static-, dynamic-, and comparative approach. These approaches are established by the author itself and serve to strengthen the foundation on which conclusions are based. In order to carry out these approaches in this research it is necessary to include multiple companies and multiple periods. Hereby, the accidental selection of a period and company that are significantly deviating from others - and are therefore not representative - is avoided.

The static approach describes static observations that follow from monitoring individual pieces of forward-looking information by comparing it with information on their subsequent realisation. Uncertainty is inseparably linked to information regarding the future, caused by the ever existing chance of the occurrence of uncontrollable and unanticipated factors making actual performance differ from what the company indicated beforehand through forward-looking information. Determining whether it matches with its subsequent realisation might produce insights about the ability of firms to provide accurate and realistic forward-looking information. For investors this is important to know as they may want to use this kind of information in making their investment decisions. As indicated in the introduction, forward-looking information forms a relevant source of information to investors. However, basing decisions on information about the future that appears to deviate materially from how that future actually turns out to be may lead to ineffective and inefficient investment decisions, which in turn affects the overall economy. Moreover, besides managers' ability to produce reliable forward-looking information, also their willingness plays a role. Jensen and Meckling's (1976) agency theory forms the basis for this observation. The literature discussed

in the previous section suggests that self-interested managers have incentives to provide investors with a distorted view of the future. The foregoing provides scope for conducting a study concerned with monitoring forward-looking information. Additionally, its unregulated nature (PWC, 2007) and the numerous corporate reporting scandals (Ball, 2009) justify posing the above research question.

The dynamic approach describes whether changes or trends can be identified over time. This approach to answering the research question is included for the following reasons. As discussed earlier in this study, starting from the 1990s awareness arose that the nature of business had changed and that business reporting had to follow accordingly. It appears that business' more complex nature has indeed led to transformed reporting, marked by the broader set of information included in annual reports, which "now go way beyond simply presenting the main financial statements" (McLaney & Atrill, 2016, p. 160). It might be interesting to see how forward-looking information behaved during a period of change. Furthermore, reporting scandals at large companies and their failures increased the pressure on listed companies to enhance reporting quality (Beretta & Bozzolan, 2008). Additionally, the summer of 2007 marked the start of the global financial crisis, which originally started in the United States. In Europe, from late 2009, the consequences of the global financial crisis have led to another one: the European sovereign debt crisis (Lane, 2012). All in all, the corporate world has gone through turbulent times, making it interesting to examine the occurrence of changes or trends in the provision of forward-looking information by firms in their annual reports over a long-term period of 10 years, starting from 2004 until 2013. This period is chosen because of the willingness to keep this study as recent as possible.<sup>1</sup>

Lastly, the comparative approach aims to provide insights by comparing the observations from the static- and dynamic approach between companies. This serves to examine if observations are company-specific or if their appearance is more widespread and hereby a stronger base is created for drawing generalisable conclusions.

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<sup>1</sup> The annual reports of 2015 of both case companies were not yet available at the start of the research, which is the reason for not taking into account these documents in this entire study. Because this study is concerned with monitoring forward-looking information, it was not possible to take the more recent period of 2005 until 2014, since the statements made in 2014 could not be checked against actual performance. This makes 2004 until 2013 the most recent period possible.

Furthermore, this research can be roughly split into two parts. To formulate an answer to the main research question, first the forward-looking information provided by companies in annual reports is characterised and described. This is done in Section 5 and this section is basically concerned with mapping the forward-looking information. The second part of the research is concerned with the monitoring process in which individual pieces of forward-looking information are compared with backward-looking information on their realisation provided in later annual reports. The observations that follow from this process are described in Section 6. The next section specifies how these different parts are executed.

## **4 Methodology**

This section in detail explains the methodology used to carry out this research. A case study method forms the basis, for which two companies from the same industry are chosen as case companies. This method is described as well as the chosen industry and companies. After that, attention is paid to collecting the forward-looking information that is included as data in this research. Lastly, the process of monitoring the forward-looking information is outlined.

### **4.1 Case study method**

Since this study provides a first attempt to perform a thorough one by one check of corporate forward-looking information, a research method is chosen which can serve as being descriptive and exploratory. According to Yin (2009), a case study method is especially suitable for answering ‘how’ questions. Also, because the subject of this research is not directly quantifiable, a qualitative case study method seems appropriate. The ‘case’ in this study can be defined as the provision of forward-looking information over a period of ten years by a company in its annual report. Because the comparative approach is concerned with comparing observations between companies, it is necessary to include at least two case companies. Ergo, the basis of the research is formed by a multiple case study method. Since conducting this research is time-consuming, the decision is made to work with two case companies in order to facilitate a more in-depth analysis of the mostly narrative data, with attention for its diverse content.

Evidence shows that significant differences exist between companies from different industries with regard to their disclosure of forward-looking information (Beretta & Bozzolan, 2008; Wang & Hussainey, 2013). Beretta and Bozzolan (2008) state that this result points at some kind of ‘bandwagon effect’ and mention industry to be a driver of forward-looking disclosure. Taking this into consideration combined with the fact that only two companies are used as case companies in this study, the decision is made to choose two companies from one and the same industry. Companies from different industries are likely to be too different to be appropriate for drawing meaningful conclusions from the comparative approach, since a large part of the conclusions would then follow from differences between the industries’ general practice.

The fashion retail industry is selected to fulfil the role of ‘case industry’. As becomes clear from the description of this industry presented in the following paragraphs, fashion retail is

characterised by a high level of uncertainty regarding consumer demand, which makes it an interesting industry for examining the realisation of corporate forward-looking information.

The fashion retail industry went through a period marked by significant changes, especially starting from the 1990s (Bhardwaj & Fairhurst, 2010). Bhardwaj and Fairhurst (2010) mention the “fading of mass production” (p. 166) as one of such changes, caused by consumers becoming more sensitive toward fashion and style and less satisfied with basic standardised clothing manufactured using the mass production method. Furthermore, other than just offering two collections every year, one for the spring/summer and one for autumn/winter season, more seasons were added to create more variety in the fashion market. The industry transitioned to an approach that is more market-driven instead of production-driven, which made retailers realise the importance of flexibility and quick reactivity to the market (Bhardwaj & Fairhurst, 2010).

As a result of the transformation of the fashion industry a new concept emerged: fast fashion (Bhardwaj & Fairhurst, 2010). “Fast fashion describes the retail strategy of adapting merchandise assortments to current and emerging trends as quickly and effectively as possible” (Sull & Turconi, 2008, p. 5). Using this concept enables companies to offer affordable and trendy products to the masses and thereby to ‘democratise’ couture (Sull & Turconi, 2008). Fashion retailer Zara, which is one of Inditex’s brands, is seen as the pioneer in the field of fast fashion (Tokatli, 2008). Other examples of companies using this strategy today include H&M, Mango, Forever 21, and Primark (Loeb, 2015). To support the strategy, fast fashion retailers sell a greater amount of different products in relatively small batches throughout every season, thereby creating continuously changing product assortments (Caro & Gallien, 2010). Essential to fast fashion are short lead times to enable a quick response to changes in consumer demand. To achieve this, fast fashion retailers rely more heavily on pricier localised production instead of following the trend of outsourcing production to distant low wage countries. Furthermore, continuous and close monitoring of trends and consumer preferences is crucial (Cachon & Swinney, 2011). Nowadays, fast fashion is still an important concept in the fashion retail industry, which has proven to have great disruptive power by completely changing the industry (Loeb, 2015; Rosenblum, 2015).

Christopher, Lawson, and Peck (2004) define four characteristics that typify fashion markets. First, products tend to have short life cycles, which entails that often the period of saleability

is short and seasonal. Second, demand for fashion items is highly volatile, since it may easily be affected by the vagaries of the weather and other external factors that determine the ever-changing trends in fashion. Third, this volatility causes demand to be extremely hard to predict. Lastly, Christopher et al. (2004) mention the high impulse buying of consumers as a characteristic of fashion markets. Furthermore, the fashion market can be characterised as highly competitive (Christopher et al., 2004; Bhardwaj & Fairhurst, 2010). The typical features of fashion retail make it a complex business, especially with regard to inventory and logistics management (Christopher et al., 2004), and sales forecasting (Wong & Guo, 2010; Ni & Fan, 2011; Thomassey, 2014).

The world's largest fashion retailers are chosen as case companies: Inditex and H&M (Caro & Martínez-de-Albéniz, 2015). In fiscal year 2014 Inditex generated sales of €18.1 billion (Inditex, 2015), while H&M reported sales of €16.3 billion (H&M, 2015a).<sup>2</sup> Selecting the two largest companies further enhances the comparability and makes it likely that the needed annual reports are easily accessible. Moreover, it increases the chance of being able to extract a rich set of data. This is based on the finding from the literature review that bigger firms tend to disclose more forward-looking information. The following two subsections provide a description of Inditex and H&M respectively, by describing the companies from their own perspective but also from the perspective of outsiders.

#### **4.1.1 Description of Inditex**

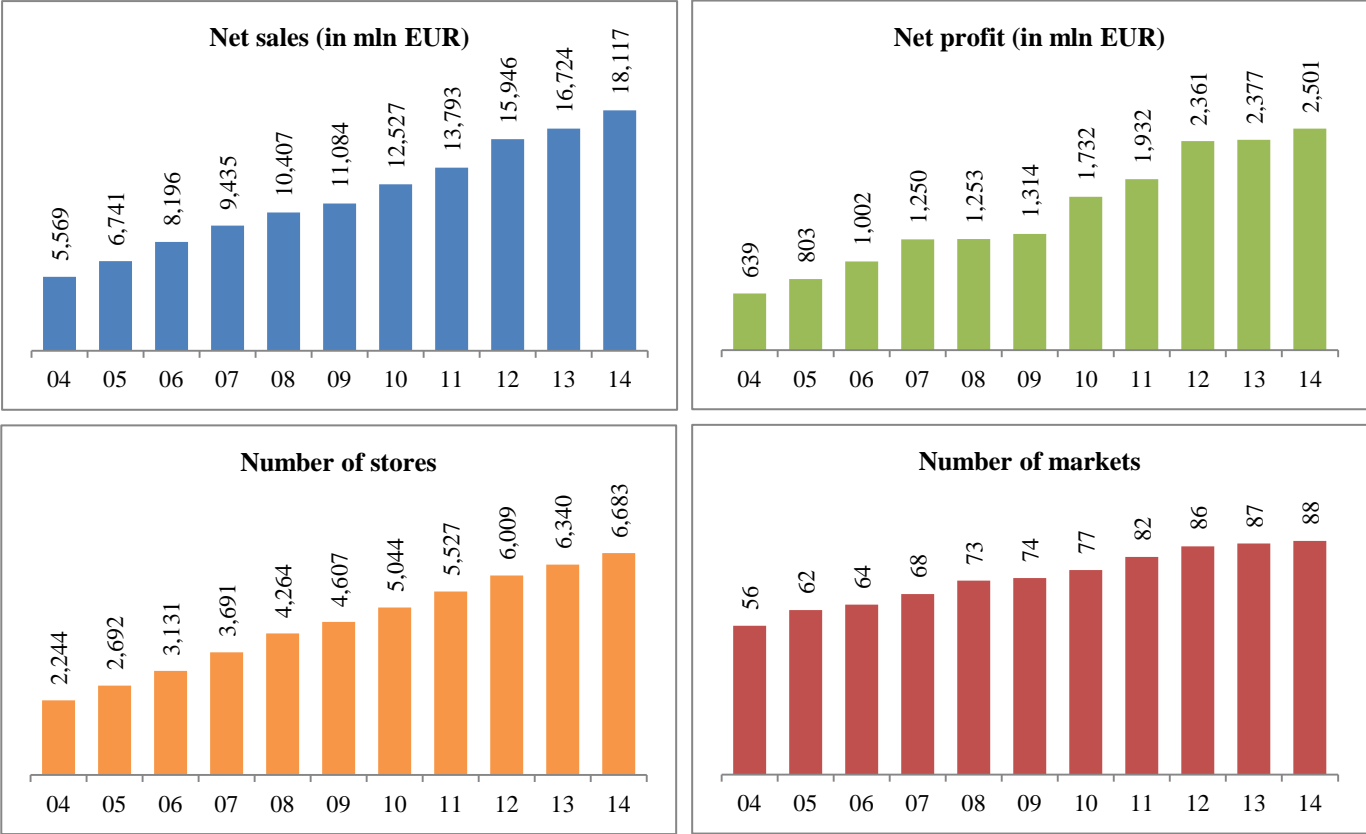
The history of the Spanish company Industria de Diseño Textil S.A., in short Inditex, started in 1963 when it was founded by Amancio Ortega Gaona. More than 50 years later, Inditex, still headquartered in Spain, is the parent company of a group of firms, which are primarily concerned with retail selling fashion items, mostly clothing, but also accessories, footwear, and household textiles. By the end of fiscal year 2014 it has grown out to a company with commercial activities in 88 markets all over the world. The products are sold in brick-and-mortar stores and online through eight commercial formats: Zara, Bershka, Massimo Dutti, Pull&Bear, Stradivarius, Oysho, Uterqüe, and Zara Home. These brands all have their own stores and online sales platform. With more than 60% of Inditex's total sales coming from

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<sup>2</sup> H&M's reporting currency is the Swedish Krona (SEK) and its fiscal year ends on 30 November (H&M, 2015a). In order to facilitate comparison of H&M's sales with Inditex's sales, H&M's sales of SEK 151,419 million were converted to EUR by taking the last exchange rate of November 2014. This was EUR 0.1079, resulting in sales of around EUR 16.3 billion. The exchange rate was retrieved from the website of the European Central Bank (<https://www.ecb.europa.eu/stats/exchange/eurofxref/html/index.en.html>).

Zara in 2014, Zara can be labelled as its biggest format (Inditex, 2015). Figure 1 gives an overview of the performance of Inditex based on four indicators.

**Figure 1: Inditex’s performance on four indicators (2004-2014)**



**Data source: Inditex (2010) & Inditex (2015)**

What has not changed throughout the years is the position of the customer in Inditex’s strategy. Inditex has stayed focused on carefully listening to the customer in order to be able to produce desirable fashion (Inditex, 2016), which it offers at competitive prices. Essential for the working of Inditex’s business model is the daily transmission of information coming from the customer’s voice from stores to the design department, which enables the company to constantly and quickly update collections. Stores get new supplies between two and six times on a weekly basis. This is realised by Inditex’s logistics system, which mainly relies on centralised logistics centers that are spread across Spain. From there, products are constantly distributed to stores all around the world (Inditex, 2015). Furthermore, “the business model encompasses all the phases of the value chain: design, manufacturing and supply, distribution, logistics and retail sales” (Inditex, 2015, p. 237). This vertical integration of the supply chain allows Inditex to be more flexible in order to respond quickly to changes in market demand



(Inditex, 2015). Regarding sustainability, the eco-efficient store project stands out, which started in 2008 with the openings of the first such store (Inditex, 2009). In subsequent years, a number of stores received demanding certification for their sustainable architecture and the aim to reach 100% of the stores being eco-efficient by 2020 emerged (Inditex, 2015).

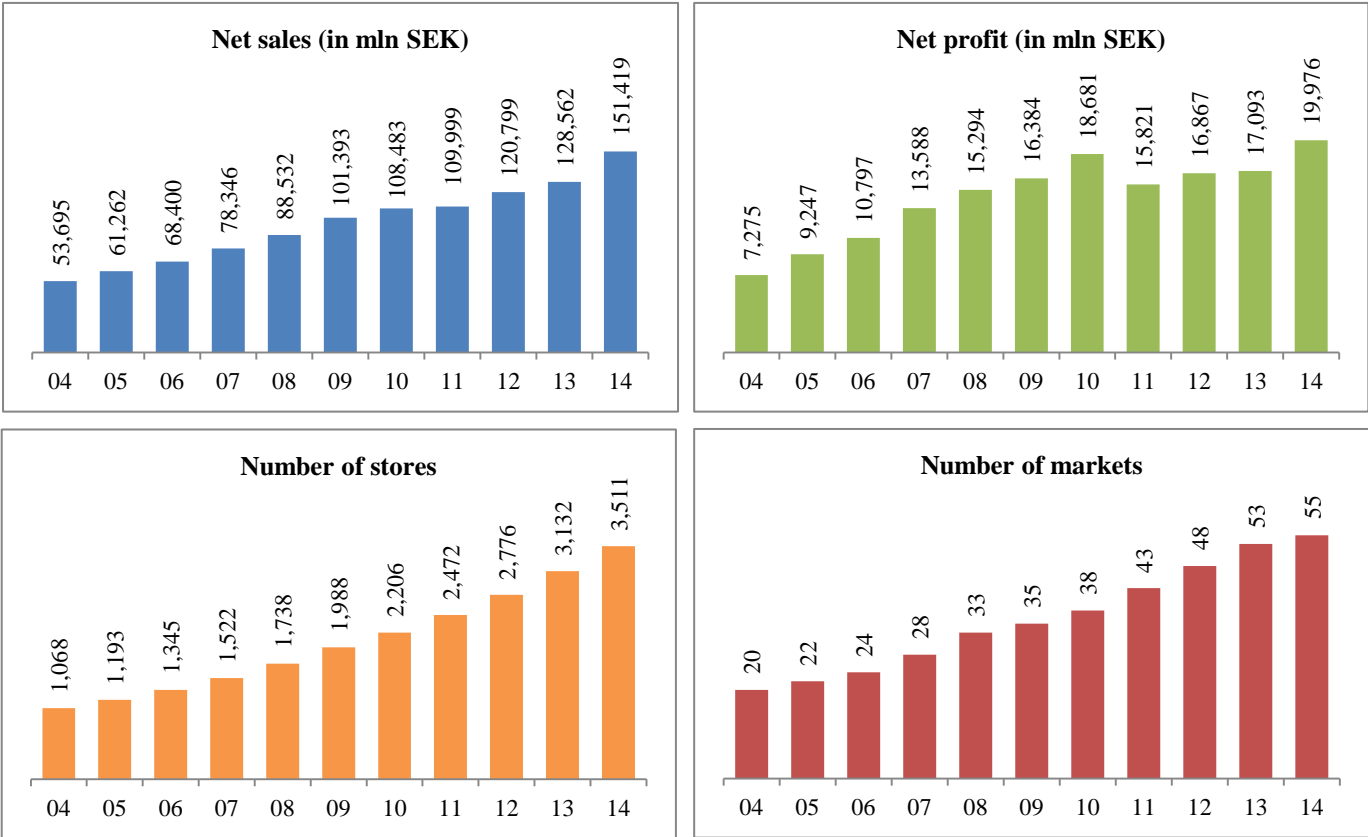
Inditex's business model is also extensively analysed by others, mainly caused by its success. Buck (2014) labels Inditex as one of the most outstanding stories of corporate success of the past few years. From such analyses some additional characteristics that typify Inditex's business become evident. Given the aforementioned information on Inditex's business model, it is obvious that it is based on a strategy of fast fashion. Although Inditex itself does not use that term in the annual report of 2014 to describe their strategy (Inditex, 2015), by others it is called a fast fashion leader (Hansen, 2012; Buck, 2014). A remarkable fact about Inditex, which is in contrast with most of its rivals, is that it hardly does any advertising. Instead, it tries to attract customers by its well-designed stores for which appealing locations are chosen (Crofton & Dopico, 2007; Hansen, 2012; Buck, 2014). Another business choice of Inditex is to produce most pieces only in relatively small quantities, and to refrain from reproduction, even of very successful items (Butler, 2013; Buck, 2014). This forces people to immediately buy the product they like. Furthermore, it is important to note that Inditex deviates from the industry norm by producing over 50% of its products in proximity to its headquarters, in countries such as Spain, Portugal, and Morocco (Inditex, 2015), where labor is relatively costly (Hansen, 2012). Inditex is a company that not only outsources manufacturing, but it also owns production facilities, which are all located in Spain (Hansen, 2012; Inditex, 2015). Speed to market is Inditex's most important motivation of keeping production close to home (Spinks, 2014). In some cases the design to retail cycle is merely two weeks (Buck, 2014). The preference of Inditex for speed over low wages allows it to save costs on inventory. Since restocking stores is done frequently but only with small amounts of products at the same time, inventory can be kept relatively low (Crofton & Dopico, 2007).

#### **4.1.2 Description of H&M**

The history of H&M Hennes & Mauritz AB goes back to 1947, when Erling Persson opened 'Hennes', a store selling clothing for women, in Sweden. When in 1968 Persson decided to acquire the store Mauritz Widforss, the name Hennes & Mauritz was born and it marked the start of the addition of selling mens- and childrenswear. As of 2007 H&M started to expand its brand portfolio, whereby nowadays it not only sells products through H&M, but six other

brands are added: COS, Weekday, Monki, Cheap Monday, & Other Stories and H&M Home (H&M, 2015a). Also, the product range is extended: “the H&M group’s business consists mainly of sales of clothing, accessories, footwear, cosmetics and home textiles to consumers” (H&M, 2015a, p. 60). These products can be bought by customers in stores, online or via catalogues. Except for H&M Home, which sells through H&M, all formats have their own stores and online shop. As for the stores, more than 90% belonged to the H&M brand at the end of fiscal year 2014. The growth that H&M has experienced during past decades ensured that the company at 30 November 2014 had a presence in 55 markets, some of them far away from Sweden, where the company has its headquarters (H&M, 2015a). Figure 2 provides an overview of H&M’s performance by looking at four indicators.

**Figure 2: H&M’s performance on four indicators (2004-2014)**



**Data source: H&M (2009b), H&M (2010b), & H&M (2015a)**

In its annual report H&M clearly highlights its business concept that has been in place since the beginning: “offer fashion and quality at the best price” (H&M, 2015a, p. 8). They state that this concept has ensured that H&M nowadays is one of the leading global companies in fashion business. Part of the strategy is that no factories are owned by H&M, but instead they rely on a large number of independent suppliers, mostly located in Asia and Europe, that

manufacture H&M's in-house designed products. Efficient logistics and flexible planning make sure that the product range can be continuously adapted to consumers' preferences. Furthermore, H&M tries to establish itself as being the more sustainable pick, caused by more and more awareness among customers. Concrete examples of sustainability initiatives are the significant use of organic cotton and 'Garment Collecting' (H&M, 2015a). The latter was launched globally in 2013 and offers customers the possibility to hand in used clothes in H&M stores, so that these can be recycled or reused. Customers are rewarded for their participation by receiving a discount voucher for their next purchase. H&M was the first company in the fashion world to realise such initiative (H&M, 2014a), labelled by Stock (2013) as brilliant green marketing.

H&M is mentioned as one of the major players in fast fashion (Loeb, 2015; Sherman, 2015). In order to be responsive to trends, its European suppliers generally produce products with short lead times, i.e. trendy items from sub-collections, while longer-lead products are sourced from Asia, i.e. items from less frequent primary collections. Furthermore, H&M's production offices, that are located near the suppliers in order to manage the sourcing, enable a quick response (Petro, 2012). The fact that most of H&M's products come from low-wage Asian countries supports H&M in offering cheap fashion, but it also represents a disadvantage as customers are increasingly critical towards the use of cheap labour, which they link with poor working conditions, especially since the collapse of a Bangladeshi garment factory that killed over 1,100 people (Thomasson, 2014). Another aspect discussed by outsiders are H&M's marketing tactics of which the annual collection made in collaboration with a well-known high-end designer is one example. H&M started this tradition in 2004 and, although it makes up only a small percentage of total sales, it generates significant media attention for the company (Rodionova, 2015; Sherman, 2015).

## **4.2 Data collection**

In this study the 'data' consists of forward-looking information that Inditex and H&M provide in their annual reports of 2004 until 2013. At first sight, collecting this data seems straightforward, since it can be obtained from easily accessible annual reports. However, this process proved to be not free from difficulties. Therefore, this section in detail describes the data collection process.

Since 1974, H&M's shares are listed on the Stockholm Stock Exchange (H&M, 2015a). Inditex is listed on the Spanish Stock Exchanges as from 2001 (Inditex, 2015). Because both are listed companies, their annual reports can easily be obtained from their company websites.<sup>3</sup> In several cases, specific parts of the companies' annual reporting are provided in separate documents. For example, H&M provide their sustainability report in a separate document, while for Inditex this part is integrated in their annual reports for most years. In such cases the different documents are merged into one document, which makes them comparable and much easier to work with, especially for the monitoring process. Table A and Table B in the Appendix provide an overview of the documents that have been merged per year for Inditex and H&M respectively.<sup>4</sup>

At first, it has been tried to gather the data by searching through the entire annual reports for keywords that are likely to indicate a unit of forward-looking information, such as 'expect', 'future', 'will', and 'forecast'. Using keyword searches to gather forward-looking information is not unusual, since it is applied by multiple other scientists in the field (e.g. Hussainey, Schleicher, & Walker, 2003; Li, 2010; Wang & Hussainey, 2013; Muslu et al., 2015). However, it did not seem to work for the purpose of this study. A countless number of forward-looking information units was found using this method and considering the time-consuming nature of the rest of the research it was not feasible to include all these units as data. Moreover, it could be argued that lots of the statements found were likely to be labelled as irrelevant by investors. The following citations from Inditex's annual report of 2013 serve as examples to illustrate this point:

*"The 2013 Report shows a positive evolution of the level of commitment to reporting on this indicator with the publication of information on training hours in the form of country-level statistics. Thus, this indicator is expected to be fully incorporated by 2017."* (Inditex, 2014, p. 289)

*"In 2014, another two workshops will be performed focusing on efficient water use and sustainable waste management, respectively."* (Inditex, 2014, p. 80)

The above justified changing the data source from the full text to only some relevant sections of the annual report. Important in the selection of the specific sections is that it must be likely that they contain forward-looking information. In addition, they have to focus mainly on

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<sup>3</sup> Inditex: <http://www.inditex.com/home>. H&M: <http://about.hm.com/en/About.html>.

<sup>4</sup> 2014 is also included in these tables since the annual report for that year is used to check the forward-looking statements made in previous annual reports.

highlights instead of focusing on minor details. This raises the chance that the forward-looking information to be examined is relevant to investors in their decision making. Furthermore, the sections have to contain narrative content, since it is more likely to find forward-looking information in narratives (Wang & Hussainey, 2013; Athanasakou & Hussainey, 2014), which sounds plausible when recalling the prevailing qualitative nature of this type of information, as discussed in the literature review. It is also essential that the chosen sections are present at both Inditex and H&M and are consistently included in every annual report from 2004 until 2013.

Based on above criteria, two sections are selected to examine. The first one is the chairman's letter.<sup>5</sup> This is "an almost universal, and widely read, feature of the annual report. It is used to provide an overview of the company's activities and performance during the year" (Clatworthy & Jones, 2006, p. 495). The letter also generally contains information regarding the future (Clatworthy & Jones, 2006). Schleicher and Walker (2010) concluded that the narrative outlook sections they found in annual reports are almost always situated in the chairman's letter and this is consistent with the finding of O'Sullivan et al. (2008) that most forward-looking statements they detected in annual report narratives are made in this part. For all of the twenty firm-years the letter covers two pages of the annual report. The second section that is selected can be characterised as giving a concise overview of the business, not only by looking back but also by looking ahead. The chosen section for Inditex is the 'consolidated management report'<sup>6</sup> and for H&M the 'administration report' is picked. Although not completely comparable, they do show considerable similarities which make them appropriate to include in this study. Corresponding topics often discussed in these sections include among others: sales, profits, financial position, dividends, and outlook. Given their conciseness and wide coverage of relevant topics, it could be argued that the business overview sections might be useful to investors. It has to be noted that the length of these sections has changed over the years. The two start in 2004 with having roughly the same length, but over time H&M's administration report became larger by extension of the number of topics covered, so that by 2013 it is considerably longer than Inditex's consolidated directors' report.<sup>7</sup> For Inditex holds that, compared to 2004, the section is remarkably shorter from 2008 until 2012 and in 2013 significantly longer. The longer business overview section

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<sup>5</sup> Different names can be used to refer to this section. Inditex uses 'letter from the chairman'. H&M uses 'report of the managing director', 'letter from the managing director', 'CEO interview', and 'CEO letter'.

<sup>6</sup> As of 2012 Inditex uses 'consolidated directors' report' to denote this section.

<sup>7</sup> Measured by the number of words in the narratives.

of H&M also means that it can contain more forward-looking information. However, the qualitative nature of this study limits the problems caused by differences in length.

Before gathering the data from the specific sections, it is necessary to define forward-looking information. In literature, no standardised definition of the concept is present. Because this research aims to monitor the realisation of forward-looking information, a definition is developed that fits this purpose, which resulted in the following definition:

*Forward-looking information provides readers with information that shows the company's expectations or intentions regarding its future, thereby potentially creating an expectation at the side of the reader. By nature this information involves some level of uncertainty. Forward-looking information can be present in different forms, including objectives, plans, and forecasts.*

Subsequently, collecting data is done by reading through all narrative content of the chairman's letter and business overview section from the ten annual reports of both companies to search for information that meets the aforementioned definition.<sup>8,9</sup>

To give an impression of the information that fits the definition and the different forms, the following examples of forward-looking information are shown:

*"H&M's objective is to increase the number of stores by 10 to 15 per cent each year while increasing sales at existing stores." (H&M, 2006a, p. 39)*

*"Under current circumstances, 53.5% is the Group's best estimate for the 2005 gross margin." (Inditex, 2005a, p. 78)*

*"We have already signed a contract for our first store in Bratislava, Slovakia, which is planned to open in spring 2007." (H&M, 2006a, p. 20)*

Clearly, all three examples provide information showing an expectation or intention regarding the company's future. The examples respectively represent examples of forward-looking

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<sup>8</sup> In some cases, non-narratives that serve as a supplement to the narratives in the selected sections of Inditex's annual reports also represent forward-looking information. In such cases these non-narratives are also included as data. This causes the data set to be mainly existing of narratives, however not solely.

<sup>9</sup> For some years, parts of the business overview section are excluded from further research, because of the detailed information they contain on, for example, internal policies and regulations. For Inditex this are the subsections with the headings 'other information' and 'other subjects'. For H&M this are the subsections on 'guidelines for remuneration', 'changed currency hedging policy', 'share split' and 'H&M Incentive Program (HIP)'. Additionally, forward-looking information on internal rules regarding the board of directors and regarding publication dates of other corporate reports are excluded, as they are judged to be inappropriate to be included as data for the purpose of this study.

information in the form of an objective, a forecast, and a plan. A notable difference between the three particular examples can be found in the level of uncertainty involved in making the statement. The level is higher in the first two compared to the last one. In the last statement it is mentioned that a contract has already been signed, which makes it quite certain that the plan of opening a store in Bratislava will indeed be realised. Though, in all information that is forward-looking some level of uncertainty is present, since no one knows how the future will look.

However, as could have been predicted by the discussed literature in Section 2.2, in not all cases the decision of qualifying some piece of information as being forward-looking information is as easy as for the three aforementioned examples. The following represents an example of a questionable case:

*“The Reduce 3 plan to improve the operational efficiency of the Group is on track to meet the target set by Inditex.”* (Inditex, 2007, p. 145)

At first sight, this sentence gives information about the present, namely that currently the plan is on track. However, the second part of the sentence reveals the existence of Inditex’s intention of reaching a certain target in the future, which makes it forward-looking information. In contrast to this, the following quote represents a questionable case that does not qualify as being forward-looking information for the purpose of this study:

*“The effect will be greatest if there are major deviations at the beginning of a season.”* (H&M, 2008a, p. 53)

With this sentence H&M discusses the possible effect on sales that might follow from abnormal weather. The sentence has a forward-looking orientation, though it is stated in such a hypothetical way that it does not show an actual expectation of H&M regarding its future, which makes it unlikely that it creates an expectation at the side of the reader. Therefore, this text unit will not be included in the data set.<sup>10</sup> Because this study is conducted by only one researcher, it could happen that sentences carrying forward-looking information are not interpreted as such and therefore are wrongly excluded from the data set. Of course, it can also be the other way round. Aware of these possibilities, all sections are read twice to minimise the chance of overlooking or wrongly including data.

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<sup>10</sup> It turned out that a lot of text in paragraphs that are specifically concerned with discussing risks are too hypothetically stated to be classified as forward-looking information in this study.

### **4.3 Monitoring forward-looking information**

After collecting the predominantly narrative data from the annual reports of H&M and Inditex, the actual monitoring of forward-looking information can be started. This is done by first characterising and analysing the data, in order to give a description of how the forward-looking information provided by the two firms looks. Because of largely lacking regulation, the data set could in fact be very diverse. Many studies that are concerned with examining narrative corporate disclosures, of which forward-looking information can be one form, are conducted using a content analysis method (e.g. Bozzolan, Favotto, & Ricceri, 2003; Beattie et al., 2004; Li, 2010; Schleicher & Walker, 2010). Content analysis is a research method that is used specifically for systematically analysing textual material. It involves classifying units of text into categories (Weber, 1990). Lancaster (2005) summarises the method as follows: “essentially, the researcher decides in advance what is being looked for and measured through the qualitative research, and then develops frameworks of classifications for assessing the content of the data with regard to these measures” (p. 162). Thereby, content analysis provides a means of turning qualitative data into quantitative data (Weber, 1990). However, by using this method other possibly interesting features that are not captured by the predetermined classification dimensions may be lost. This study attempts to distinguish itself from the existing body of literature by taking a broader stance, so that observations that are hard to detect by a method of pigeonholing also get attention. Also, it is necessary to not lose sight of the actual content of the information, because the second part of the research is concerned with monitoring it. Therefore, content analysis is not strictly used in this study, but instead some parts of the method presented hereafter are inspired by content analysis. Hereby, this research aims to facilitate deductive as well as inductive reasoning.

For each of the twenty firm-years a data overview is set up in which all forward-looking information retrieved from the relevant annual report is displayed. In these overviews, every unit of forward-looking information is labelled according to several dimensions that support the description of the data as well as dimensions regarding its comparison with backward-looking information about its subsequent realisation. The unit of measurement, or recording unit, chosen for this study largely corresponds to the one used by Beattie et al. (2004). Based on content analysis the recording unit can be words, sentences, paragraphs, or themes (Weber, 1990). In line with Beattie et al. (2004), the dimensions on which the data is labelled mostly determine the recording unit. More specifically, they largely determine where some forward-looking information has to be split from other forward-looking information, thereby



separating into different units. This might lead to units shorter than one sentence. However, the starting point here is the theme, which can be longer than one sentence, while Beattie et al. (2004) start at the sentence level. Themes are chosen because in some cases multiple succeeding sentences do not have to be separated as they provide information about the same topic or theme and can be labelled the same on the different dimensions.

So, for the first part of the research the units of forward-looking information are being labelled according to characterising dimensions that support the description of the data. The dimensions include the topic and period that the forward-looking information covers as well as whether it has a qualitative or quantitative nature. Besides, practicalities such as the page number and location in the annual report are listed. To illustrate, a unit of forward-looking information included in the data overview of H&M’s annual report of 2013 is presented in Table 1, where it is labelled according to the aforementioned information. Table 2 explains and operationalises the columns shown in Table 1.

**Table 1: Illustrative example from H&M’s data overview of 2013, first part**

Page	Location	Forward-looking information	Topic	Period	Nature
54	BO	“For full-year 2014 a net addition of around 375 new stores is planned.” (H&M, 2014a)	Net addition of stores	2014	QN

**Table 2: Explanation of the content of the columns shown in Table 1**

Column	Explanation of content
Page	Page number of the page on which the unit of forward-looking information is displayed in the annual report.
Location	Section of the annual report that contains the unit of forward-looking information. <i>CL</i> = Chairman’s letter. <i>BO</i> = Business overview section.
Forward-looking information	Displays the unit of forward-looking information.
Topic	Description of the topic the forward-looking information covers.
Period	Description of the period the forward-looking information refers to.
Nature	<i>QL</i> = The forward-looking information has a qualitative nature. <i>QN</i> = The forward-looking information has a quantitative nature.

Through this process of labelling all units of forward-looking information, a clear impression of the data can be formed. After completion, observations can be described. The different characterising dimensions provide guidance for describing the forward-looking information. Thereby, observations can be seen as responding to questions related to the dimensions, such as: are the forward-looking information units mostly qualitative or quantitative in nature?; which periods are the units frequently referring to?; which topics do they cover? However,

because the original content of the forward-looking information remains under attention, distinctive observations that are made during labelling and analysing the data, but are not captured and visualised by one of the dimensions, are also described. Besides describing static observations, it is also described whether changes or trends can be identified over time, in order to support the dynamic approach to answering the main research question. The description of the data concludes with mentioning differences and similarities that are identified by comparing the static- and dynamic observations between the two companies. Where appropriate, specific examples of forward-looking information are discussed to illustrate and clarify observations.

After mapping and describing the data, the second part of the research may start. In this part, the forward-looking information is monitored by determining whether it matches with its subsequent realisation. This takes place through comparison with relevant backward-looking information from later annual reports that shows whether or not the unit of forward-looking information is realised. So, this part is concerned with finding answers to the main research question. Regarding the monitoring, the data overviews also label each unit according to some dimensions that indicate the findings from this process. It starts with determining for every unit of forward-looking information whether it is verifiable. That is to say, whether it is specific enough to be able to monitor it. The use of vague terms or too general language may lead to the provision of information that is multi interpretable, which makes it impossible to determine when the piece of information is realised and when it is not. Thus, for units labelled as unverifiable monitoring cannot take place. Subsequently, for all verifiable units of data, the backward-looking information that is needed to determine realisation is searched for in the relevant annual reports. The reports of 2005 until 2014 as denoted in Table A and Table B in the Appendix fully serve as sources of information that can be used to monitor the data. For some units it is clear where this information can be found, but for others it is tried to find the information by scanning the annual reports using keyword searches for keywords that are related to the forward-looking information, and therefore are also likely to be included in the needed backward-looking information. This method of searching through annual reports is chosen because it represents a more efficient and feasible manner of searching than reading through all information provided in the extensive annual reports. When the needed information cannot be found using the searching method, in this research the assumption is made that this information is not provided by the company in the annual report. Regarding the searching process the data overviews list whether the needed backward-looking information

could be found or not. When the needed information could not be found then monitoring cannot take place. In contrast, when the needed information could be found then the information is compared with the forward-looking information. Subsequently, the data overviews label whether the information confirms the forward-looking information, i.e. the forward-looking information is realised, or if things turned out to be different than stated in advance, i.e. the forward-looking information is not realised. Lastly, where possible the direction of the deviation is denoted for units that are being labelled no on the realisation dimension. To illustrate the above, Table 3 shows how the data overviews are extended by the second part of the research. The aforementioned dimensions are included as well as some related practicalities. Table 4 explains and operationalises the columns regarding the monitoring process.

**Table 3: Illustrative example from H&M’s data overview of 2013, first and second part**

<b>Page</b>	<b>Location</b>	<b>Forward-looking information</b>	<b>Topic</b>	<b>Period</b>	<b>Nature</b>
54	BO	“For full-year 2014 a net addition of around 375 new stores is planned.” (H&M, 2014a)	Net addition of stores	2014	QN

<b>Verifiable</b>	<b>Information found</b>	<b>Report of proof</b>	<b>Page of proof</b>	<b>Realisation</b>	<b>Direction of deviation</b>
Yes	Yes	Annual report 2014	9	Yes	X

**Table 4: Explanation of the content of the columns regarding the monitoring process shown in Table 3**

Column	Explanation of content
Verifiable	<i>Yes</i> = The forward-looking information is specific enough to be able to monitor it. <i>No</i> = The forward-looking information is not specific enough to be able to monitor it. If 'no' than monitoring process stops here.
Information found	<i>Yes</i> = The needed backward-looking information to determine realisation could be found in subsequent annual reports. <i>No</i> = The needed backward-looking information to determine realisation could not be found in subsequent annual reports. <i>No*</i> = The forward-looking information refers to a period after 2014 and therefore the needed backward-looking information could not be found in the reports that are available to this study. <i>X</i> = Not applicable. If 'no' or 'no*' than the monitoring process stops here.
Report of proof	The report that contains the backward-looking information needed for monitoring the forward-looking information. <i>X</i> = Not applicable.
Page of proof	The page of the report that contains the backward-looking information needed for monitoring the forward-looking information. <i>X</i> = Not applicable.
Realisation	<i>Yes</i> = The forward-looking information is realised, i.e. it matches with its subsequent realisation. <sup>11</sup> <i>No</i> = The forward-looking information is not realised, i.e. it mismatches with its subsequent realisation. <i>Not yet</i> = The forward-looking information is not yet realised. <sup>12</sup> <i>X</i> = Not applicable. If 'yes' or 'not yet' than the monitoring process stops here.
Direction of deviation	<i>Higher</i> = Reality appears to be higher than according to the forward-looking information. <i>Lower</i> = Reality appears to be lower than according to the forward-looking information. <i>Slightly</i> is added when the deviation does not exceed 10%. <i>Not applied</i> = This dimension is not applied. <i>X</i> = Not applicable.

When the monitoring process is completed for all units of forward-looking information, the results can be described. In line with the first part of the research, the dimensions regarding the monitoring process provide guidance for describing the observations that can be inferred from it. For example, it is discussed whether unverifiable data is present, if subsequent reports tend to disclose the needed backward-looking information, and whether forward-looking information appeared to be often matching with its reality. Again, because the original content of the forward-looking information remains under attention, the context and circumstances under which labels are given can also be taken into account, which is useful given the diverse content of the data. This allows for the inclusion of observations that go beyond the

<sup>11</sup> For quantitative forward-looking information a deviation of 10% is allowed when uncertainty regarding the exact number is expressed. For example, by including the words 'approximately' or 'around'.

<sup>12</sup> This may apply to cases in which the forward-looking information refers to a period that is not specified. When such information is not realised until 2014, it can still be realised after 2014. This makes it impossible to label such information as 'no' on the realisation dimension and therefore it is labelled as 'not yet' realised.

dimensions. Besides describing static observations that follow from the monitoring process, also observed changes or trends over time are described as well as observations that follow from comparing the static- and dynamic observations between the two companies. Also in this part of the research, illustrative examples of forward-looking information are added where appropriate.

As this research is not designed to make quantitative inferences from the forward-looking information, the observations regarding both parts of the research, that is to say the description of the data as well as the monitoring process, are described in a qualitative manner. Words used to express the rate of occurrence of specific phenomena therefore aim to be indicative instead of being backed by strict quantitative measures. Insights are provided by describing observed patterns in the data and where appropriate illustrating them with examples. A qualitative approach was chosen as it is judged to better fit the widely ranging data dealt with in this research in combination with the fact that this study serves as being explorative and likely representing a starting point for further research.

## **5 Description of the data**

As explained earlier, this research, which is concerned with answering the research question *how does forward-looking information provided by companies in annual reports relate to backward-looking information on its corresponding realisation provided by companies in subsequent annual reports?*, consists of two parts. The aim of the first part, of which the findings are presented in this section, is mapping and characterising the forward-looking information that is provided by the two companies in the selected sections of their annual reports of 2004 until 2013, by giving a description of it. The data description presented in this section is facilitated by labelling each unit of forward-looking information according to characterising dimensions that indicate the topic, the period it refers to, and its nature. The observations made regarding these dimensions are described in this section as well as distinctive observations that appeared that are not captured by one of the dimensions.

The observations are described in a qualitative manner, thereby serving as being indicative. The underlined sentence at the start of each paragraph contains a summary of the observations which are described in the paragraph and these thus represent self-made interpretations from the data. Words expressing the dominance of an observation, such as ‘most’ or ‘predominant’, are used when it applies to more than half of the relevant units. At the end of this section a recap is made by providing an overview of the underlined pieces of text. This is done since the obtained knowledge might be useful in the second part of the research. More specifically, the described characteristics of the forward-looking information possibly underlie some of the findings that follow from monitoring the realisation of the forward-looking information, which are discussed in Section 6. The remainder of this section is structured as follows. First, the data of each case company is described individually according to the static- and dynamic approach, starting with Inditex, followed by H&M. After that, the comparative approach, which compares the data descriptions of the two companies, is dealt with. The section concludes with a recap of the description of the data.

### **5.1 Description of Inditex’s data: static- and dynamic approach**

#### Presence of recurrent topics and abandonment of some forward-looking disclosure practices over time

When looking at the forward-looking information provided by Inditex in the selected sections, some topics can be identified as being recurrent, that is to say, as being covered in every or nearly every annual report between 2004 and 2013. These topics include: capital expenditure,

dividend proposal, number of store openings, objectives with regard to corporate social responsibility (CSR) issues, and plans regarding expansion. Although the aforementioned topics represent constant factors over time, it also appears that some information on specific topics was part of Inditex's forward-looking disclosure practice in the early years, though these practices are abandoned in the selected sections at some point in time. This applies to the gross margin forecast as well as the detailed openings forecast, which is discussed in more detail below.

#### Forward-looking information mostly refers to the first subsequent year

The period dimension shows that the forward-looking information mostly refers to the first year after the year which is covered by the annual report. For example, when looking at the data of 2013, it can be concluded that most units contain information about 2014, so about the first subsequent year. When looking at the other years, the data presents a similar image. Also of frequent occurrence in Inditex's overall data set are cases for which it is not specified to what point in the future the information refers. This for example applies to the following forward-looking information provided in the annual report of 2004:

*“The Group of the future will be essentially European, as sales in the rest of the continent are likely to exceed sales in Spain, but with an important presence in other areas of the world.”* (Inditex, 2005a, p. 5)

Herein, Inditex makes a prediction without specifying a time frame for it. Furthermore, forward-looking information that refers to a specific period further than one year ahead is present in the overall data set. Such information for example includes plans and objectives regarding CSR.

#### In early years forward-looking information is mostly quantitative in nature due to detailed openings forecast overview, however, the proportion of quantitative forward-looking information is decreasing over time, so as of 2010 forward-looking information is mostly qualitative in nature

When taking in mind the finding from the literature review that an often reached conclusion by studies about the nature of forward-looking information is that it is predominantly qualitative, it is remarkable that the forward-looking information extracted from the selected sections of Inditex's annual reports can relatively often be classified as quantitative. This is especially true for the early years that are included in this study, in which most units are

labelled as quantitative. The detailed openings forecast for the next year that is given by Inditex in its selected business overview section, in which for every store chain the expected amount of net store openings and the percentage of these openings that are expected to be located outside Spain are listed, has a significant role in this observation. Over time, the extent of forward-looking information displayed in the openings forecast overview decreases. The business overview sections from annual report 2004 until 2009 contain an openings forecast overview with information as outlined before. To illustrate, Figure 3 shows such an openings forecast overview, which is retrieved from Inditex's annual report of 2004. However, as of 2010 Inditex stops to provide an expectation of the percentage of net openings that will be internationally located, and only provides the range of expected net openings per concept. Inditex continues this practice until 2012. Starting from 2013 the openings forecast overview is completely eliminated from the business overview section and the company only provides a range of expected total openings, without subdividing this amount per concept. In line with this, Inditex's practice of providing quantitative information about next year's gross margin expectation in the business overview sections of the annual report of 2004 until 2007 stops as of 2008. These changes make that over time a large part of the standard quantitative forward-looking information disappears, so that by 2010 the data shows a predominant qualitative character, as would be expected based on the literature review. By searching through the entire annual report, it can be concluded that the openings forecast overview and gross margin prediction from the business overview section are not moved to other parts of the annual report. So, these forward-looking disclosure practices are completely abandoned by Inditex.

**Figure 3: Openings forecast overview from Inditex's annual report of 2004**

FY 2005 Openings forecast			Total 2004
Concept	Range	% International	
Zara	100 -110	85%	97
Kiddy's Class	20 -25	10%	26
Pull & Bear	35 -45	40%	21
Massimo Dutti	30 -40	55%	29
Bershka	40 -45	60%	49
Stradivarius	25 -30	30%	36
Oysho	20 -30	40%	28
Zara Home	30 -35	30%	36
<b>Total net openings</b>	<b>300-360</b>		<b>322</b>

Source: Inditex (2005a)



Last year seems to contain less forward-looking information compared to the years before

Furthermore, it is hard to draw conclusions about the extent of forward-looking information and whether it changes over time or not, since no clear trends can be identified. Of course, the disappearance of the openings forecast overview as of 2013 has some effect, since it provided a lot of information. This makes it look like Inditex provided somewhat less forward-looking information in the two selected sections in 2013 compared to the years before.<sup>13</sup>

## **5.2 Description of H&M's data: static- and dynamic approach**

Presence of recurrent topics and the list of recurrent topics expands over time

From examining the forward-looking information gathered from the selected sections of H&M's annual reports, it can be inferred that the following topics are covered in all of the years: net addition of stores, largest expansion markets, dividend policy and proposal, their financial goal and plans related to expansion. Also recurrent every year is their growth target:

*“The goal is to increase the number of stores by 10 to 15 per cent per year while at the same time increasing sales at existing stores.” (H&M, 2005a, p. 8)*

This goal for expansion, which is extended as of 2008 by also including the maintenance of high profitability as being part of the goal, is repeated in every annual report of H&M included in the sample. Over time, the list of recurrent forward-looking information topics being addressed in the selected sections is extended with the tax rate as of 2007, and also by forward-looking information concerning CSR issues, which is lacking in the early years included in the sample. This extension of forward-looking topics is not remarkable recalling the fact already remarked in the data collection section that H&M's business overview section became longer over time by discussing more topics in this part of their annual report.

Forward-looking information on expansion plans is presented in detail

For all years applies that a considerable part of the forward-looking information is dedicated to H&M's plans regarding the expansion of the business. More specifically, these include plans about the expansion into new markets, brick-and-mortar as well as online, but also about further expansion into existing markets, the launch of new store chains, and notable new stores. Noteworthy is the level of detail of such plans. For example, when expansion into a new market is planned, H&M regularly not only mentions the name of the country and the

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<sup>13</sup> This research makes no attempt to measure the extent of forward-looking information, however an image of the extent can be obtained by it. Therefore, the observation discussed in this paragraph is mentioned with caution.

planned year of expansion, but also the city in which the first store will be opened and/ or in which season or month of the year this opening will take place. To give an example:

*“In the autumn H&M will also open its first store in Riga in Latvia.”* (H&M, 2012b, p. 7)

#### Forward-looking information mostly refers to the first subsequent year or the period is not specified

By looking at the period dimension it can be inferred that the forward-looking information provided by H&M mostly deals with the first subsequent year or it does not mention a specific period to which it refers to. This image is constant over time. In few cases the data gives information about a period more than one year ahead. Included herein are some concrete expansion plans, however these do not go further ahead than the second year after the reporting year. In case of forward-looking information about the first subsequent year, H&M tends to be very specific in a sense that it is not uncommon that reference is made to a period shorter than a year, such as a certain season or month. The quote in the previous paragraph shows one such example.

#### Forward-looking information is mostly qualitative in nature

The conclusion that can be drawn about H&M’s data when looking at the nature dimension is in line with the finding from the literature review: that the nature of forward-looking information is predominantly qualitative. For all years it can be stated that a larger part of the data is classified as qualitative compared to quantitative. Topics on which H&M does provide quantitative forward-looking information for example include the net addition of stores, tax rate, dividend proposal, and part of their growth target. The following example from H&M’s annual report of 2007 might serve as an indication that H&M is cautious on providing quantitative forward-looking information:

*“The proportion of renovations of existing stores will remain the same as in 2006/2007.”* (H&M, 2008a, p. 52)

This ‘proportion’ likely is a quantitative measure. However, H&M presents the forward-looking information in a qualitative manner, without quantifying this proportion. Also, no quantitative information could be found on the proportion by searching through the whole annual report of 2007. Forward-looking information on store renovations is also provided in

the business overview sections of 2008 until 2011, where it is again presented as qualitative information.

#### The extent of forward-looking information seems to be increasing over time

The extent of H&M's forward-looking information provided in the two sections seems to be increasing over the ten year period from 2004 until 2013, which is mainly caused by the business overview section.<sup>14</sup> This is not remarkable, since the overall length of this section is increasing over time. Also playing a role in this observation is the fact that the number of brands of H&M has expanded over the examined period from one to seven. Understandably, presenting expansion plans for seven brands instead of one brand makes the forward-looking information on this topic more extensive.

### **5.3 Description of the data: comparative approach**

#### Existence of corresponding topics as well as deviating topics of forward-looking information and H&M adds forward-looking disclosure practices over time while Inditex terminates some

From comparing the recurrent topics on which the two fashion retailers provide forward-looking information it follows that some specific topics are covered by both companies, making them look important issues for the industry. Arguably, this includes information on the expected amount of store openings and plans for business expansion, but also objectives regarding CSR issues. Other topics of forward-looking information can be seen as company-specific in the sense that one company made the decision to provide forward-looking information on it, while it looks like the other did not. For example, this applies to the tax rate, which is forecasted by H&M, and capital expenditure, which is forecasted by Inditex. By searching through their entire annual reports, consistently provided forward-looking information on capital expenditure and the tax rate could not be found for H&M and Inditex respectively. This suggests that although part of the subjects are covered by both companies, differences in forward-looking reporting practices within the industry do exist. Furthermore, while the list of recurrent topics on which H&M provides forward-looking information in the selected sections of the annual reports expands over time, Inditex terminates some of their standard forward-looking disclosure practices.

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<sup>14</sup> This research makes no attempt to measure the extent of forward-looking information, however an image of the extent can be obtained by it. Therefore, the observation discussed in this paragraph is mentioned with caution.

Frequent reference to the first subsequent year applies to both H&M's and Inditex's forward-looking information

Regarding the period dimension the forward-looking information gathered from H&M's and Inditex's annual reports shows similarities, in the sense that the units often refer to the first subsequent year after the reporting period. Based on this finding it could be argued that the firms are either focussing mainly on the first subsequent year or they do plan and predict the later future, but are more reluctant regarding information provision on such plans and predictions. Possibly the last point has to do with the generally higher uncertainty when looking further into the future, which makes the point from the literature review come into play about reputation concerns following from companies' fear of providing inaccurate forward-looking information.

H&M's forward-looking information is in all years mostly qualitative in nature while for Inditex this only applies as of 2010

While H&M's data in all years supports the expectation emerged from the literature review that forward-looking information is mostly qualitative in nature, a relatively large part of Inditex's data consists of quantitative forward-looking information, making it only meets this expectation as of the annual report of 2010. In the years before that, Inditex's forward-looking information retrieved from the selected sections shows a predominantly quantitative character. That at Inditex a considerable part of the data comes from their quantitative openings forecast overview and at H&M a lot of forward-looking information is dedicated to qualitative expansions plans plays a role in the aforementioned observation.

The extent of H&M's forward-looking information seems to be increasing over time while the extent of Inditex's forward-looking information seems to decrease in the last year

Lastly, the two companies differ in that the extent of forward-looking information provided by H&M in the selected sections seems to be increasing over time, while for Inditex holds that the last year included in the sample seems to contain somewhat less forward-looking information than the years before.

#### **5.4 Description of the data: recap**

Table 5 provides an overview of the underlined pieces of text, which represent the summarised observations regarding the description of the data outlined in this section. Recall from the introduction of this chapter that words expressing the dominance of an observation

are used when it applies to more than half of the relevant units. The aim of this section was mapping the forward-looking information included as data in this study, as the knowledge obtained about the characteristics of the data possibly underlies some of the findings that are discussed in the next section regarding the monitoring of forward-looking information. The information in Table 5 therefore serves as a foundation to better understand the findings presented in Section 6.

**Table 5: Recap of the description of the data**

<b>Description of Inditex’s data: static- and dynamic approach (Section 5.1)</b>	<b>Description of H&amp;M’s data: static- and dynamic approach (Section 5.2)</b>
<ul style="list-style-type: none"> <li>• Presence of recurrent topics</li> <li>• Abandonment of some forward-looking disclosure practices over time</li> <li>• Forward-looking information mostly refers to the first subsequent year</li> <li>• In early years forward-looking information is mostly quantitative in nature due to detailed openings forecast overview</li> <li>• Proportion of quantitative forward-looking information is decreasing over time, so as of 2010 forward-looking information is mostly qualitative in nature</li> <li>• Last year seems to contain less forward-looking information compared to the years before</li> </ul>	<ul style="list-style-type: none"> <li>• Presence of recurrent topics</li> <li>• List of recurrent topics expands over time</li> <li>• Forward-looking information on expansion plans is presented in detail</li> <li>• Forward-looking information mostly refers to the first subsequent year or the period is not specified</li> <li>• Forward-looking information is mostly qualitative in nature</li> <li>• The extent of forward-looking information seems to be increasing over time</li> </ul>
<b>Description of the data: comparative approach (Section 5.3)</b>	
<ul style="list-style-type: none"> <li>• Existence of corresponding topics of forward-looking information</li> <li>• Existence of deviating topics of forward-looking information</li> <li>• H&amp;M adds forward-looking disclosure practices over time while Inditex terminates some</li> <li>• Frequent reference to the first subsequent year applies to both H&amp;M’s and Inditex’s forward-looking information</li> <li>• H&amp;M’s forward-looking information is in all years mostly qualitative in nature while for Inditex this only applies as of 2010</li> <li>• The extent of H&amp;M’s forward-looking information seems to be increasing over time while the extent of Inditex’s forward-looking information seems to decrease in the last year</li> </ul>	

## 6 Results of the monitoring process

After mapping and describing the data in the previous section, in this section the results that follow from the second part of the research are discussed. As explained before, the second part is concerned with monitoring the forward-looking information provided by the two case companies in the selected sections of their annual reports of 2004 until 2013, by determining whether it matches with its subsequent realisation. This was done through comparison with backward-looking information from later annual reports that proves whether or not the forward-looking information is realised. Related to this monitoring process the forward-looking information units have been labelled according to some dimensions. These monitoring dimensions list if the forward-looking information is verifiable, if the backward-looking information needed to determine realisation could be found in later annual reports, if the forward-looking information is realised (i.e. whether it matches with its subsequent realisation), and the possible direction of deviation. Hereby, the dimensions reveal information about the relation between forward-looking information and corresponding backward-looking information. Therefore, the results obtained from the monitoring dimensions that are described in this section provide answers to the main research question: *how does forward-looking information provided by companies in annual reports relate to backward-looking information on its corresponding realisation provided by companies in subsequent annual reports?* Furthermore, observations regarding this relation that appeared during the monitoring process but are not captured by one of the dimensions are also described.

Also in this section, the findings are described in a qualitative manner, thereby serving as being indicative. The underlined sentence at the top of each paragraph represents a summary of the observations regarding the monitoring process which are described in the paragraph. Words that express the dominance of an observation, such as ‘most’ or ‘predominant’, are used when it applies to more than half of the relevant units. ‘Some cases’ is used to describe the occurrence of remarkable observations appearing more than once, that are not captured and therefore also not visualised by one of the dimensions. The remainder of this section starts with describing the results of the monitoring process following the static- and dynamic approach for Inditex and H&M separately. Thereafter, the findings from the comparative approach, in which the results of the two companies are compared with each other, are described. Finally, a recap of the results is given in which the underlined pieces of text are

gathered and bundled to give an overview of the answers that are found to the main research question.

## **6.1 Results of the monitoring process for Inditex: static- and dynamic approach**

### Most forward-looking information is verifiable, though unverifiable forward-looking information is also present in every year

From the knowledge that has been gathered during the monitoring process, it can be inferred that for all years from 2004 until 2013 applies that the largest part of the forward-looking information units provided by Inditex in the selected annual report sections is marked as being verifiable. However, it also appears that in all years forward-looking information is given that is not verifiable, because of it being not specific enough, thereby making it multi interpretable. To illustrate this, the following example is given:

*“In the year ahead, we will make further progress on all the aspects that have made the Group one of the benchmark international players in the world of fashion.”* (Inditex, 2012, p. 7)

Because it is not specified what ‘the aspects’ are that have made Inditex such an important player, the statement can be interpreted in so many ways that it is not possible to monitor whether further progress has indeed been made. Overall, it can be inferred from the data overviews that most unverifiable forward-looking information is located in the chairman’s letter, which might be explained by its purpose of giving a summary of the firm’s performance and activities (Clatworthy & Jones, 2006). Furthermore, all of Inditex’s unverifiable data concerns data that is marked as qualitative, which in turn means that all quantitative forward-looking information is verifiable.

### In some cases of unverifiable forward-looking information reference is made to an unspecified target

What also stands out when looking into unverifiable forward-looking information is that in some cases Inditex refers to certain targets, but that these targets are not specified, as in the following statement from Inditex’s annual report of 2013:

*“FY2014 space growth and conversion rates are expected to be in line with long-term targets.”* (Inditex, 2014, p. 226)

Although this information is marked unverifiable since the long-term targets are not specified, when searching through the annual report of 2014, backward-looking information that

confirms or rejects the above mentioned statement could not be found. In line with the previous is the scarce information provision regarding the ‘Reduce 3’ plan, on which forward-looking information is present in the annual report of 2006 and 2007 that stated that the plan was on track to meet an unspecified target. It was found that the plan started as of 2006 and would last for three years. However, a specification of the Reduce 3 plan’s target Inditex is referring to could not be found by searching through the annual reports. Also, searching for the keyword ‘reduce 3’ in the annual report of 2008 did not yield any results. This is a remarkable finding since one would expect a review of the plan in the year it concluded. Though, when looking further into the forward-looking information of 2005, the following statement was found in the business overview section:

*“INDITEX aims to reduce the spread between Operating expenses growth and Sales growth over the next 3 years, (...) thus aligning operating expenses growth and sales growth by FYE2008.”* (Inditex, 2006c, p. 119)

Since the Reduce 3 plan is about improving operational efficiency this could be the target they refer to in the statements made in the annual report of 2006 and 2007. The statement above is specific enough to be able to monitor it. Direct information to determine the realisation of this statement could not be found, but indirectly the spread could be calculated by subtracting the sales growth from the operating expenses growth. However, this spread is higher than zero, meaning the two are not aligned by fiscal year-end 2008. An explicit explanation for not reaching this aim could not be found in the annual report of 2008.

#### Needed backward-looking information for monitoring could be found for most verifiable forward-looking information

For the majority of the forward-looking information units that are labelled as verifiable, the needed backward-looking information to determine whether the forward-looking information matches with subsequent reality could be found in later annual reports.<sup>15</sup> This image is shown by all of the ten years under consideration. Some notable observations follow from examining whether or not the needed information to monitor the verifiable units could be found, which is discussed in the following.

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<sup>15</sup> For this observation the verifiable units that scored ‘no\*’ on the information found dimension are excluded, since for these units the needed backward-looking information could not be found because of the fact that they refer to a period beyond 2014, which is the last year covered by the annual reports used as a source for backward-looking information in this research. Thereby, this no-label is no result of the reporting practices of the company.



In some cases the needed backward-looking information for monitoring is only indirectly provided

First, for some units the required backward-looking information could be found, however this information was only indirectly provided. That is to say, multiple pieces of information had to be combined to be able to get the right information. This applies to the next year forecast of the percentage of net store openings per store concept that are expected to be located internationally (i.e. outside Spain).<sup>16</sup> Although this information is part of Inditex's standard forward-looking information disclosure in 2004 until 2009, it is not part of their standard backward-looking information disclosure in 2005 until 2010. In none of the annual reports of 2005 until 2010 an overview could be found that exhibits the percentage international net store openings for each store concept for the year. It was only found that the annual report of 2006 provides these percentages, randomly spread in narratives, for four of the eight store formats. In most other cases the actual percentages could be calculated by using the information that Inditex provides on the number of stores by concept and by country, making it still possible to indirectly determine realisation.

In some cases forward-looking information is more detailed than corresponding backward-looking information

Second, for some units it is noted that the forward-looking information appears to be more detailed than the subsequent backward-looking information, making them score 'no' on the information found dimension. To illustrate, Inditex's data retrieved from the annual report of 2013 does not contain an indication of next year's net store openings, as was the case in the previous years, rather it gives the following forward-looking information related to store openings:

*"In FY2014 INDITEX expects 450-500 gross openings and the selective absorption of 80-100 small units (mainly non-Zara concepts) into neighboring stores."* (Inditex, 2014, p. 226)

However, in the annual report of 2014 only the number of realised net store openings could be found. So, Inditex does provide some information related to the topic of the earlier given forward-looking statement, but the information is not specific enough to determine whether the above statement is realised. In this specific case Inditex made an adjustment to their forward-looking information disclosure practice, by going from forecasting net openings to

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<sup>16</sup> This information is included in Inditex's openings forecast overview, of which an example is shown in Figure 3 on page 37.

forecasting gross openings and closings, but it appears that their backward-looking disclosure practice was not adjusted accordingly.

In four years the openings forecast overview contains more forward-looking information that mismatches with subsequent realisation than forward-looking information that matches with subsequent realisation

When looking at the realisation of Inditex's data, it stands out that regarding the forward-looking information present in the openings forecast overview it was found that for four of the nine years in which this overview is included in the business overview section of the annual report holds that more units provided by it are labelled as not being realised compared to realised units.<sup>17</sup> These four years include 2004, 2006, 2010, and 2012. It might be called remarkable that just the years that mark the starting years of the crises do show predominantly forward-looking information that appeared to be realised. Especially the forecasts made in the reports of 2004 and 2012 show large deviations, with 88 more openings in 2005 than the 360 openings that were forecasted and with 109 less openings in 2013 compared to the forecasted 440 openings. The fact that, overall, in the openings forecast overviews from annual report 2004 until 2009 most 'no'-labels on the realisation dimension apply to the percentage international net store openings forecast, might serve as an explanation for Inditex's termination of this practice after the annual report of 2009. However, regarding the remaining forward-looking information that Inditex provides through the openings forecast overview in the reports of 2010, 2011, and 2012, applies for two out of the three overviews that this information mostly appeared to be mismatching with reality. In turn, this possibly played a role in Inditex's decision to completely terminate this forward-looking disclosure practice as of 2013. The above shows that it might be difficult to persistently provide such detailed quantitative forward-looking information.

Actual performance in relation to unrealised net openings forecasts shows deviations upwards as well as deviations downwards

Furthermore, it should be emphasised that for the unrealised net openings forecasts from the openings forecast overviews actual performance in relation to the forecasts shows deviations upwards as well as deviations downwards. This does not point at attempts of misleading the

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<sup>17</sup> Recall from Section 5 that only nine annual reports include an openings forecast overview, since as of the 2013 annual report Inditex no longer provides this overview. Figure 3 on page 37 shows an example of an openings forecast overview.

reader, something that would be questionable when the forecasts repeatedly turned out to be more positive than actual performance. That is to say, when Inditex repeatedly predicted a higher number of store openings than would eventually be opened in reality, since a high number of openings is arguably preferable over a low number of openings.

To eight years applies that most forward-looking information for which realisation could be determined matches with subsequent realisation, in 2004 and 2012 mismatching forward-looking information predominates and forward-looking information that mismatches with subsequent realisation is present in every year

As regards Inditex's forward-looking information other than the information provided by the openings forecast overviews it applies to all years that the units mostly got the label 'yes' on the realisation dimension in relation to 'no' labels. This makes that, when taking all forward-looking information units into account, in eight of the ten years the units for which realisation could be determined mostly appear to be matching with subsequent reality. The forward-looking information retrieved from the selected sections of the annual report of 2004 and 2012 shows more unrealised units than realised units, which is thus caused by the forecasting performance of the openings forecast overviews in these years. However, in all ten annual reports the selected sections include forward-looking information that later on appeared to deviate from reality. For example, the expected capital expenditure for 2010 of approximately €570 million presented in the annual report of 2009 turned out to be more than €180 million higher. But also the forward-looking information regarding Inditex's planned expansion to South Korea in 2006, for which uncertainty seemed to be relatively low as they indicate that an agreement has already been signed for it, appeared to mismatch with its realisation, as the first store opening did not take place until 2008.

Indications for non-existing connection between forward- and backward-looking disclosure practices

A remarkable observation that stems from the monitoring process is that there seems to be no connection between Inditex's forward- and backward-looking disclosure practices. The above discussed observations regarding the in some cases only indirect provision of backward-looking information that is needed for monitoring the forward-looking information, the specific example of the changed forward-looking disclosure practice on the number of store openings whereby the corresponding backward-looking disclosure practice was not adjusted accordingly, and the lacking information regarding the conclusion of the 'Reduce 3' plan all

underlie this observation. Another specific example that supports a missing connection is the aforementioned plan of expansion to South Korea in 2006, which was presented in the annual report of 2005. In fact, this expansion did not take place until 2008. However, by searching through the annual report of 2006, 2007, and 2008 no explanation for not opening in South Korea on the planned date could be found as well as no indication of reference to this unachieved plan, for example, by indicating that it has been postponed. This causes that it looks like Inditex makes no attempt to report back on the forward-looking information they provided in the selected sections of previous annual reports.

## **6.2 Results of the monitoring process for H&M: static- and dynamic approach**

Most forward-looking information is verifiable, though unverifiable forward-looking information is also present in every year

During the monitoring process for H&M it became clear that for all years from 2004 until 2013 applies that most of the forward-looking information units are labelled as being verifiable, which gives an indication about the specificity of H&M regarding its forward-looking information. However, unverifiable forward-looking information is also present in every year. In all cases the unverifiable data concerns data that is labelled as being qualitative in nature, which thus means that all quantitative forward-looking information is verifiable. Looking at the content, unverifiable forward-looking information regularly conveys some sort of (positive) feeling regarding the future, without going too much into detail. To illustrate, the following example is given, retrieved from H&M's chairman's letter section from annual report 2009:

*“There are many new cities and countries to take H&M to and I feel very optimistic about the future.”* (H&M, 2010a, p. 15)

The presence of such generic language in the chairman's letter is not remarkable recalling the purpose of this section. However, also H&M's selected business overview section contains such information. To give an example:

*“H&M continues to take a positive view of future expansion and development opportunities.”* (H&M, 2008a, p. 52)

As of the annual report of 2007 every annual report in the sample includes this sentence, or equivalent, in its business overview section.

In some cases forward-looking information is unverifiable through the inclusion of a subjective element

Furthermore, it stands out that in some cases the forward-looking information is unverifiable because of the inclusion of a subjective element. For example, their growth target, cited in Section 5.2, as of the annual report of 2008 also includes the maintenance of high profitability as part of their target. However, ‘high’ profitability is a subjective concept, which might have different meanings to different persons, making this part of H&M’s growth target not sufficiently specified to be verifiable.

Needed backward-looking information for monitoring could be found for most verifiable forward-looking information

For the majority of the verifiable forward-looking information units, the backward-looking information needed to monitor their realisation could be found in later annual reports.<sup>18</sup> This applies to all years included in the sample. A remarkable example of a case in which the needed information could not be found revolves around H&M’s growth target. In the annual report of 2005 and 2014 backward-looking information on the year’s sales in comparable units or, stated differently, sales in existing stores, is lacking. This can be called remarkable since increasing these sales is part of H&M’s clearly stated growth target and is mentioned in all H&M’s annual reports from 2004 until 2013. The data gathered from the selected sections of the 2004 annual report also includes the following statement:

*“Our greatest challenge for 2005 is to increase sales in existing stores.”* (H&M, 2005a, p. 9)

This forward-looking statement makes it even more remarkable that no information could be found on sales in existing stores in 2005. In the annual reports from 2006 until 2013, providing information on these sales seems to be part of H&M’s standard reporting practice, since this information has the same location every year: the ‘sales and profit’ subsection of the administration report. This raises questions about why this information is lacking in the annual report of 2005 and 2014.

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<sup>18</sup> For this observation the verifiable units that scored ‘no\*’ on the information found dimension are excluded, since for these units the needed backward-looking information could not be found because of the fact that they refer to a period beyond 2014, which is the last year covered by the annual reports used as a source for backward-looking information in this research. Thereby, this no-label is no result of the reporting practices of the company.

### In some cases forward-looking information is more detailed than corresponding backward-looking information

For some cases in which the needed information could not be found holds that H&M does provide some backward-looking information related to the specific topic in later reports, but not detailed enough. Such cases, in which forward-looking information seems to be of higher level of detail than corresponding backward-looking information, regularly have to do with H&M's expansion plans. As already indicated in Section 5.2, these tend to be presented in detail and the extent has been growing over time due to the increased number of H&M's brands. However, it appears that the information on completed expansion activities is not always of the same level of detail. For example, in the annual report of 2012 H&M provided the following forward-looking information:

*“In addition to this, online shopping at stories.com will be launched in Belgium, Denmark, Finland, France, Germany, Italy, the Netherlands, Spain, Sweden and the UK.”* (H&M, 2013a, p. 45)

This statement is about 2013, however, the annual report of 2013 only confirms that the online shop of & Other Stories was launched in ten European countries, but no information could be found on the names of the countries.

### Most forward-looking information for which realisation could be determined matches with subsequent realisation

By looking at the forward-looking information units for which realisation could be determined it can be inferred that most forward-looking information corresponds with actual performance, which makes them score 'yes' on the realisation dimension. So, in these cases the backward-looking information on actual performance confirms the forward-looking information that was given in earlier reports. The predominance of achieved realisation over unachieved realisation applies to every year included in the 10-year sample. An example of consistently realised forward-looking information is the part of the every year recurrent growth target about increasing the store count. From 2005 until 2014 the store count grew every year by a percentage ranging between 11.0 and 14.4, which exactly lies within H&M's target of growing by 10 to 15 per cent.

Forward-looking information that mismatches with subsequent realisation is present in every year

Though, every year also includes forward-looking information that later on appeared to be mismatching with reality, thereby scoring ‘no’ on the realisation dimension. Continuing with the growth target, this applies to the part that is less controllable by H&M itself, namely the aim to grow sales in existing stores. As indicated before, for two years this target could not be monitored because backward-looking information on it is lacking, but for four of the eight remaining years it is established that this target was not achieved. However, the monitoring process also revealed that forward-looking information that seems to involve a relatively low level of uncertainty, might deviate from actual performance. The following citation serves as an illustrative example to this:

*“From autumn 2007 onwards, we will also be dressing homes. We are introducing a brand new home textiles brand, H&M Home, (...)”* (H&M, 2007a, p. 13)

This statement was made in the chairman’s letter of the 2006 annual report, and at first sight H&M does not seem to be doubting about its realisation. However, the launch of H&M home did not take place until February 2009, which is almost one and a half year later. A similar example is the forward-looking information about the launch of H&M Shop Online in the United States, which appeared for the first time in the data retrieved from the 2010 annual report. At that time the launch was planned to take place around the turn of the year 2011 to 2012, but eventually it was launched in August 2013.

Some cases show the existence of a connection between forward- and backward-looking disclosure practices

While monitoring the data, some cases are found that show that H&M’s backward-looking disclosure practices are connected to their forward-looking disclosure practices. These cases suggest that the company is aware of the forward-looking information it provided in earlier reports and takes it into account when preparing backward-looking information. For example, the backward-looking information from annual report 2011 that is related to H&M’s planned amount of net store openings disclosed in the report one year before states the following:

*“A total of 266 new stores net were opened in 2011, which was more than the originally planned 250 stores. The fact that more stores than planned were added was mainly due to greater expansion opportunities in China and the very positive reception in H&M’s new markets of Romania and Croatia.”* (H&M, 2012b, p. 6)

But also in the annual report of 2010, when actual openings turned out to be lower than planned, reference to the earlier disclosed amount of planned openings was made by indicating that the net addition indeed turned out to be lower than intended and by explaining its cause. Furthermore, the backward-looking information related to the unrealised plan of launching H&M Home in autumn 2007 provides another indication:

*“To assure the quality of the concept the launch of H&M Home was deferred until autumn 2008.” (H&M, 2008a, p. 51)*

These examples show that H&M reports back on its earlier provided forward-looking information. However, there are also cases that prove the opposite, such as the absent information on sales in existing stores in the annual report of 2005 and 2014, as discussed previously. This raises questions about how H&M determines where to act upon earlier provided forward-looking information through backward-looking disclosure and where not.

### **6.3 Results of the monitoring process: comparative approach**

For both H&M and Inditex holds that most forward-looking information is verifiable, but unverifiable forward-looking information is also present in every firm-year

For both H&M and Inditex holds that for each reporting year from 2004 until 2013 most of the forward-looking information retrieved from the selected sections of the annual report is verifiable, which gives an indication about the specificity of the forward-looking information provided by the two companies. It also holds that the data set of every firm-year includes forward-looking information that is marked as unverifiable, because the information is not specific enough to be able to monitor it. The unverifiable data of both companies is solely qualitative in nature. This suggests that quantifying contributes to the specificity of forward-looking information.

Needed backward-looking information for monitoring could be found for most verifiable forward-looking information applies to both H&M and Inditex and cases in which forward-looking information is more detailed than corresponding backward-looking information are present at both H&M and Inditex

To H&M's data as well as Inditex's data applies that for most verifiable forward-looking information units the needed information for monitoring them could be found in subsequent annual reports. This holds for all firm-years. Since the annual report mainly serves to discuss the preceding year's performance, which is also reflected in evidence produced by Beattie et



al. (2004) showing that 73% of all voluntary narrative disclosures of their examined sample of annual reports have a historical time orientation, it might be called remarkable that at both Inditex and H&M cases are present in which forward-looking information is observed to be more detailed than the corresponding backward-looking information found in later reports. That is to say, some information related to the earlier given forward-looking information could be found, but it is not detailed enough to determine the realisation of the forward-looking information. It thus shows that in some cases the firms paid more attention to the provision of information that looks ahead than to the provision of information that looks back on it. This might indicate that firms find it more important to provide certain information in advance than discussing it afterwards in annual reports.

That most forward-looking information for which realisation could be determined matches with subsequent realisation applies to all years for H&M, but to eight out of ten years for Inditex, and forward-looking information that mismatches with subsequent realisation is present in every firm-year

While for H&M it applies to all years that most of the provided forward-looking information for which realisation could be determined matches with subsequent realisation, for Inditex this only applies to eight of the ten reporting years. Inditex's forward-looking information retrieved from the annual report of 2004 and 2012 shows more units labelled as mismatching with reality than units labelled as matching with reality. However, it must be noted that the more quantitative nature of Inditex's data possibly underlies this difference between the two companies. The predominance of unrealised units in the two years is caused by the forecasting performance of the detailed quantitative openings forecast overview that Inditex provides. H&M's data set does not contain forward-looking information similar to that and is mostly qualitative in nature. The companies are similar in that every report contains forward-looking information that appeared to be mismatching with subsequent reality. Such forward-looking information not only includes information on topics over which the companies are known to have limited control or information that is stated in such a way that it is clear that uncertainty regarding its realisation is indeed present, it also includes information of which its future realisation seems to be certain.

At H&M some cases show the existence of a connection between forward- and backward-looking disclosure practices while such connection seems to be lacking at Inditex

While at H&M some cases prove that a connection is made between its forward-looking information from the selected annual report sections and backward-looking information in later annual reports, observations that follow from the monitoring process for Inditex seem to point at the non-existence of such a connection. However, it has to be noted that, since this observation was not anticipated up front and therefore not a pre-specified research goal, the statement regarding the missing connection between forward- and backward-looking information at Inditex is made with caution. However, still the fact remains that noticeable examples are found that provide indications for a non-existing connection at Inditex which at least seem to point at differences between the companies in effort made to report back on earlier provided forward-looking information. This seeming difference asks for further research into the subject and into companies' reasons to do link back in their annual report to forward-looking information given in earlier annual reports or to not link back.

#### **6.4 Results of the monitoring process: recap**

Table 6 shows an overview of the underlined pieces of text, which represent the summarised observations outlined in this section regarding the monitoring of the forward-looking information provided by H&M and Inditex. As this section described the observations that followed from examining the relation between units of forward-looking information and backward-looking information on their subsequent realisation, Table 6 consequently gives an overview of the answers that are found to the main research question. Recall from the introduction of this chapter that words expressing the dominance of an observation are used when it applies to more than half of the relevant units and that the denotation of 'some cases' is used in case of a remarkable observation appearing more than once, that is not captured by one of the dimensions.

**Table 6: Recap of the results of the monitoring process**

<b>Results of the monitoring process for Inditex: static- and dynamic approach (Section 6.1)</b>	<b>Results of the monitoring process for H&amp;M: static- and dynamic approach (Section 6.2)</b>
<ul style="list-style-type: none"> <li>• Most forward-looking information is verifiable</li> <li>• Unverifiable forward-looking information is also present in every year</li> <li>• In some cases of unverifiable forward-looking information reference is made to an unspecified target</li> <li>• Needed backward-looking information for monitoring could be found for most verifiable forward-looking information</li> <li>• In some cases the needed backward-looking information for monitoring is only indirectly provided</li> <li>• In some cases forward-looking information is more detailed than corresponding backward-looking information</li> <li>• In four years the openings forecast overview contains more forward-looking information that mismatches with subsequent realisation than forward-looking information that matches with subsequent realisation</li> <li>• Actual performance in relation to unrealised net openings forecasts shows deviations upwards as well as deviations downwards</li> <li>• To eight years applies that most forward-looking information for which realisation could be determined matches with subsequent realisation, in 2004 and 2012 mismatching forward-looking information predominates</li> <li>• Forward-looking information that mismatches with subsequent realisation is present in every year</li> <li>• Indications for non-existing connection between forward- and backward-looking disclosure practices</li> </ul>	<ul style="list-style-type: none"> <li>• Most forward-looking information is verifiable</li> <li>• Unverifiable forward-looking information is also present in every year</li> <li>• In some cases forward-looking information is unverifiable through the inclusion of a subjective element</li> <li>• Needed backward-looking information for monitoring could be found for most verifiable forward-looking information</li> <li>• In some cases forward-looking information is more detailed than corresponding backward-looking information</li> <li>• Most forward-looking information for which realisation could be determined matches with subsequent realisation</li> <li>• Forward-looking information that mismatches with subsequent realisation is present in every year</li> <li>• Some cases show the existence of a connection between forward- and backward-looking disclosure practices</li> </ul>
<b>Results of the monitoring process: comparative approach (Section 6.3)</b>	
<ul style="list-style-type: none"> <li>• For both H&amp;M and Inditex holds that most forward-looking information is verifiable</li> <li>• Unverifiable forward-looking information is also present in every firm-year</li> <li>• Needed backward-looking information for monitoring could be found for most verifiable forward-looking information applies to both H&amp;M and Inditex</li> <li>• Cases in which forward-looking information is more detailed than corresponding backward-looking information are present at both H&amp;M and Inditex</li> <li>• That most forward-looking information for which realisation could be determined matches with subsequent realisation applies to all years for H&amp;M, but to eight out of ten years for Inditex</li> <li>• Forward-looking information that mismatches with subsequent realisation is present in every firm-year</li> <li>• At H&amp;M some cases show the existence of a connection between forward- and backward-looking disclosure practices while such connection seems to be lacking at Inditex</li> </ul>	

## 7 Discussion

The findings that followed from this research presented in the previous sections provide explorative insights into the relation between forward-looking information provided by firms in annual reports and backward-looking information from later annual reports that provides prove regarding the realisation of the forward-looking information. Thereby, the research goal was to examine whether the forward-looking information that firms provide in annual reports matches with subsequent actual performance. By carrying out a thorough one by one check of broadly defined forward-looking information, this research tries to contribute by adding something new to the existing literature. However, it must be emphasised that, because of the explorative nature of the present study, the results are tentative and inevitably subject to limitations. Further research is needed that extends and builds on the findings produced by this study. This section discusses limitations as well as suggestions for further research.

By monitoring the realisation of forward-looking information this research provides insights into its accuracy and reliability. However, it must be noted that, since annual reports are the only source of information used for monitoring, not all forward-looking information could be monitored as in some cases the needed backward-looking information appeared to be lacking in annual reports. Potentially, the lacking information is deliberately withheld by the company as it deviates from the earlier provided forward-looking information in order to protect their reporting reputation. So, the results might have been different when all forward-looking information could have been monitored. Although the effect is likely to be limited since for all firm-years applies that the needed backward-looking information for monitoring could be found for most verifiable forward-looking information, including additional sources that can be used to monitor the forward-looking information forms a suggestion for further research.

Furthermore, disregarded factors regarding firms' reporting policies might have influenced the outcomes of the research. One of such factors is the publication date of the annual report. In particular, the length of the period it takes until the annual report is published after fiscal year-end. Understandably, a firm reporting after half of the new fiscal year already passed by possesses more information about the new fiscal year and therefore might be better able to produce forward-looking information than a firm that publishes its annual report faster. This is especially true since this research pointed out that firms frequently refer to the first subsequent year in the forward-looking information they provide.

Another disregarded factor concerns firms' reporting channels other than the annual report. Besides the annual report, firms have multiple other means for transmitting corporate information to stakeholders (Healy & Palepu, 2001). Annual reports of firms that, for example, make use of extensive interim reporting possibly omit information that is judged as being redundant as it has already been transmitted through more timely interim reports. Thus, other reporting channels could influence the content of the annual report, thereby affecting the findings of this study, for example, regarding the connection between forward- and backward-looking disclosure practices. The aforementioned factors represent points of attention for future research.

A further limitation revolves around the generalisability of the results, which still remains questionable as merely two companies from one industry are examined. Preferably, future research should carry out a similar study using a larger sample of case companies, in order to further examine the scope of the findings of the present study, and also by including companies from multiple industries, so that differences and similarities between industries can be identified.

As predicted, this explorative research raises additional questions, which might be addressed in future studies. It might be interesting to set up interviews with managers in order to gain insights into how they are dealing with the provision of forward-looking information and subsequently reporting back on it, as the findings in this study have raised questions regarding the disclosure practices of firms. In Section 5 it was found that the topics on which the two case companies provide forward-looking information are showing similarities but also deviations. Furthermore, in Section 6 it is described that at some points the needed backward-looking information was lacking, not detailed enough or no link back was found to the earlier provided forward-looking information. By conducting interviews with managers the reasons underlying the provision or non-provision of certain information could be traced, thereby possibly clarifying the aforementioned phenomena.

## 8 Conclusion

This study is concerned with monitoring the realisation of forward-looking information provided by companies in annual reports, which is done through comparing it with relevant backward-looking information from later annual reports. Thereby, the goal is to find answers to the following main research question: *how does forward-looking information provided by companies in annual reports relate to backward-looking information on its corresponding realisation provided by companies in subsequent annual reports?* Obviously, the only certainty regarding the future is that it is uncertain, so users of corporate information have to take into account that the chance of unexpected circumstances changing the future that the company envisioned is always present. However, examining the realisation of forward-looking information may produce insights into its reliability.

H&M and Inditex, both active in the fashion retail industry, were chosen as case companies from which the forward-looking information they provided in selected sections of their annual reports of 2004 until 2013 has been examined. Gathering the forward-looking information turned out to be less straightforward than one might expect, as the boundaries of forward-looking information are not always as clear-cut. The following definition was used to gather the data: *forward-looking information provides readers with information that shows the company's expectations or intentions regarding its future, thereby potentially creating an expectation at the side of the reader.* From describing the units of forward-looking information that fit the aforementioned definition it can be concluded that, although both companies are from the same industry, differences in forward-looking disclosure practices within the industry do exist as differences are found in the topics they cover. An important difference between the forward-looking information retrieved from Inditex's annual reports and H&M's annual reports is that Inditex's data has a more quantitative nature, as H&M's data shows to be persistently qualitative in nature. Table 5 on page 42 exhibits a summative overview of the description of the data.

The results of monitoring the forward-looking information units produced knowledge on the relation between forward-looking information and backward-looking information on subsequent realisation. The findings are summarised in Table 6 on page 56, which gives an overview of the answers that are found to the main research question. It can be concluded that for some forward-looking information it was not possible to assess the relation because the information was judged to be unverifiable. Some other information was specific enough,

though the needed backward-looking information was found to be missing in subsequent annual reports. In such cases the relation between forward- and backward-looking information was non-existing or incomplete, which both made it impossible to determine the realisation of the forward-looking information. These observations led to additional questions regarding the disclosure practices of firms concerning forward-looking information and reporting back on it, that serve as suggestions for further research.

Regarding the cases in which backward-looking information enabled the determination of the realisation of forward-looking information, it can be concluded that for eighteen out of twenty firm-years the units matching with subsequent realisation dominate over the units mismatching with subsequent realisation. A predominant mismatching relation with information on subsequent realisation was found for the data retrieved from the annual report of 2004 and 2012 of Inditex, caused by its detailed openings forecast overview. This might be an indication of the difficulty involved in providing such quantitative forward-looking information. Furthermore, it must be emphasised that every firm-year includes forward-looking information that was found to be mismatching with backward-looking information on actual performance. This might indicate the difficulty for firms to exactly predict and plan their future. Regarding the aforementioned result, it must be taken into account that uncertainty is inseparably linked to information about the future and it highlights that investors should be aware of this characteristic. Also, it was found that the level of uncertainty that is seemingly involved in forward-looking information, which can be inferred from the manner in which the information is presented, provides no guarantee regarding the realisation of it. Hopefully, this explorative research stimulates future research that extends the findings produced by it.

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## Appendix

**Tabel A: Annual reports Inditex 2004-2014, as used in this study**

Year	Consisting of the documents:
2004	<ul style="list-style-type: none"> <li>• Annual report (Inditex, 2005a)</li> <li>• Sustainability report (Inditex, 2005b)</li> </ul>
2005	<ul style="list-style-type: none"> <li>• Contents and GRI indicators (Inditex, 2006a)</li> <li>• Corporate performance (Inditex, 2006b)</li> <li>• Economic and financial performance (Inditex, 2006c)</li> <li>• Letter from the chairman (Inditex, 2006d)</li> <li>• Social and environmental performance (Inditex, 2006e)</li> </ul>
2006	<ul style="list-style-type: none"> <li>• Annual report (Inditex, 2007)</li> </ul>
2007	<ul style="list-style-type: none"> <li>• Annual report (Inditex, 2008)</li> </ul>
2008	<ul style="list-style-type: none"> <li>• Annual report (Inditex, 2009)</li> </ul>
2009	<ul style="list-style-type: none"> <li>• Annual report (Inditex, 2010)</li> </ul>
2010	<ul style="list-style-type: none"> <li>• Annual report (Inditex, 2011)</li> </ul>
2011	<ul style="list-style-type: none"> <li>• Annual report (Inditex, 2012)</li> </ul>
2012	<ul style="list-style-type: none"> <li>• Annual report (Inditex, 2013)</li> </ul>
2013	<ul style="list-style-type: none"> <li>• Annual report (Inditex, 2014)</li> </ul>
2014	<ul style="list-style-type: none"> <li>• Annual report (Inditex, 2015)</li> </ul>

**Tabel B: Annual reports H&M 2004-2014, as used in this study**

Year	Consisting of the documents:
2004	<ul style="list-style-type: none"> <li>• Annual report (H&amp;M, 2005a)</li> <li>• Sustainability report (H&amp;M, 2005b)</li> </ul>
2005	<ul style="list-style-type: none"> <li>• Annual report (H&amp;M, 2006a)</li> <li>• Sustainability report (H&amp;M, 2006b)</li> </ul>
2006	<ul style="list-style-type: none"> <li>• Annual report (H&amp;M, 2007a)</li> <li>• Sustainability report (H&amp;M, 2007b)</li> </ul>
2007	<ul style="list-style-type: none"> <li>• Annual report (H&amp;M, 2008a)</li> <li>• Sustainability report (H&amp;M, 2008b)</li> </ul>
2008	<ul style="list-style-type: none"> <li>• Annual report: in words and pictures (H&amp;M, 2009a)</li> <li>• Annual report: in figures (H&amp;M, 2009b)</li> <li>• Sustainability report (H&amp;M, 2009c)</li> </ul>
2009	<ul style="list-style-type: none"> <li>• Annual report: in words and pictures (H&amp;M, 2010a)</li> <li>• Annual report: in figures (H&amp;M, 2010b)</li> <li>• Sustainability report (H&amp;M, 2010c)</li> </ul>
2010	<ul style="list-style-type: none"> <li>• Annual report: in words and pictures (H&amp;M, 2011a)</li> <li>• Annual report: in figures (H&amp;M, 2011b)</li> <li>• Sustainability report (H&amp;M, 2011c)</li> </ul>
2011	<ul style="list-style-type: none"> <li>• Annual report: in words and pictures (H&amp;M, 2012a)</li> <li>• Annual report: in figures (H&amp;M, 2012b)</li> <li>• Sustainability report (H&amp;M, 2012c)</li> </ul>
2012	<ul style="list-style-type: none"> <li>• Annual report (H&amp;M, 2013a)</li> <li>• Sustainability report (H&amp;M, 2013b)</li> </ul>
2013	<ul style="list-style-type: none"> <li>• Annual report (H&amp;M, 2014a)</li> <li>• Sustainability report (H&amp;M, 2014b)</li> </ul>
2014	<ul style="list-style-type: none"> <li>• Annual report (H&amp;M, 2015a)</li> <li>• Sustainability report (H&amp;M, 2015b)</li> </ul>