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Intellectual assets and corporate reporting: the situation of small caps

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In accordance with the decision of the Steering Group at its meeting on 13-14 November 2007, since no material comments have been received, the document is now declassified and available for publication.

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INTRODUCTION

1. The report "Intellectual assets and value creation: implications for corporate reporting" (DAF/CA/CG(2006)15), discussed by the Steering Group at its November 2006 meeting, documented the importance for intellectual assets-intensive companies to improve the non-financial reporting of their intellectual assets. These companies can boost their stock market valuations and lower their cost of capital through improved reporting of intellectual assets and value creation strategies that overcome the limits of accounting standards. The report argued that there is a role for policy makers and standard setters in improving disclosure, but that any guidance should remain principles-based and voluntary since the conditions faced by companies and their choices are often unique.

2. The stock-take of reporting practices indicated wide discrepancies in non-financial reporting of intellectual assets. In some sectors and markets, such as the pharmaceutical industry, both firms and investors have been very active in transmitting and in acquiring relevant information about intellectual assets and the success of value creation strategies, and these actions have improved the efficiency of capital markets. But in other market segments, notably small capitalised companies, much more could be done to improve the way firms report about their value drivers and main risks, supported by relevant key performance indicators. It concluded that "*competition is already encouraging companies to improve their reporting and managerial practices with respect to intellectual assets and strategies for value creation. This is usually done through narrative reporting. Where firms disclose more about their assets and value drivers they are rewarded by improved market valuations. This effect is even more pronounced for the small caps that suffer from lack of coverage by analysts and sector/branch publications"*.

3. Research indicates an important difference between large and small capitalised companies in dealing with the issue of intellectual assets. While for large caps there is often an army of analysts, sector specialists and institutional investors assessing the company's strategy and resources, this is much less the case for small caps. Poor coverage by analysts combined with the practice by large investors to keep information they have gathered confidential for their own proprietary investments leaves small caps open to the possibility that valuations may be low and the cost of capital consequently higher. The report concluded that "*Small listed intellectual asset-intensive companies face a particular challenge arising from poor analyst coverage. The lack of research coverage has been found to impact company valuation, liquidity and ultimately the growth of the company. Small listed companies can mitigate the problem of poor analyst coverage by taking a proactive stance in their corporate reporting and this can also encourage analysts to cover a company. The existence of special segments of stock markets might also improve the relationship between investors and the companies and thereby underpin valuations, innovation and growth*".

4. The report noted that the frameworks for reporting intellectual assets and their management that have been developed are often too general, thereby pointing to the need to develop sectoral frameworks oriented more to specific market characteristics. The meeting of the Steering Group on Corporate Governance in November 2006 agreed to follow-up the report in order to further explore how small listed innovative companies can benefit from enhanced non-financial reporting of their intellectual assets (DAF/CA/CG(2006)5). This follow-up report is part of a horizontal project (Intellectual Assets and Value Creation) with the Directorate of Science Technology and Industry and will contribute to a

report to Ministers next May. The PWB 2007-2008 notes that this project is funded through voluntary contributions.

5. This report first documents the problems facing small, listed intellectual asset-intensive companies caused by the lack of analyst coverage and then reviews efforts by, *inter alia*, stock exchanges to promote better coverage. However such initiatives face important economic barriers in modern capital markets. It is argued that companies can help improve their own situation and partially compensate for the lack of coverage through improved reporting but might be held back by the lack of a standardised reporting framework. Efforts to create such a framework are briefly discussed, especially the potential role of XBRL in both lowering data retrieval costs and by promoting a company comparative framework. Policy recommendations are briefly outlined.

INFORMATION ABOUT SMALL LISTED INNOVATIVE COMPANIES IS LIMITED

Small listed companies attract low analyst coverage…

6. Small listed companies[1] suffer from low analyst coverage and it has been shown that a lack of research coverage impacts company valuation, liquidity and ultimately the growth of the public company. Although small listed companies are particularly affected by the low level of analyst coverage as well as by its recent decline, all segments are concerned throughout OECD capital markets: in the US, 35% of all public companies receive no coverage at all including a number of NYSE and NASDAQ listed stock (37% of NASDAQ companies), and 50% of all public companies with analyst coverage have two or fewer analysts covering them[2]. However, low analyst coverage affects primarily small listed companies[3]: in the US, less than half of the small caps receive coverage by even a single analyst and analyst coverage for the microcap universe is virtually non-existent. In 2004, 52% of US companies with a market cap between $125 million and $750 million and 83% of US companies with a market cap less than $125 million had no analyst coverage. In Japan, the analyst coverage rate for JASDAQ companies is under 50% (except for the Jstock companies with coverage of 80%). On Euronext Paris, the analyst coverage rate is only 36% for companies listed on Eurolist C[4] (with a market cap under EUR 150 million) with half of them covered by a single analyst.

7. The issue of low analyst coverage has become more critical with the recent decline in analyst coverage resulting from a series of regulations combined with the stock market downturn immediately after 2001. The SEC's Advisory Committee on Smaller Public Companies reported in 2006 that fewer companies were receiving analyst coverage than at any time since 1995. According to estimates by Reuters[5], between January 2002 and June 2006, 703 companies lost analyst coverage representing over 18% of the entire universe of public companies with coverage. A series of regulations and agreements in the United States have increased the costs and reduced the benefits for analysts, starting with Regulation

[1] There is no single definition of a small listed company. The Advisory Committee on Smaller Public Companies to the US SEC has proposed to use the total market capitalization of a company to define a smaller public company: companies with equity market capitalization placing them in the lowest 1% of total US equity market capitalization would be qualified as "microcap companies" and companies with equity market capitalization placing them in the next lowest 1% to 5% of total US equity market capitalization would be qualified as "small-cap companies". According to Euronext, a small cap has a market cap under EUR 150 million. Large international institutional investors have another threshold for small cap at EUR 400 million.

[2] www.nasdaq.com/newsroom/news/pr2005/ne_section05_056.stm

[3] While the lack of analyst coverage for small caps is often claimed, information about analyst's coverage rate is often lacking.

[4] Figures were provided by SFAF (Société Française des Analystes Financiers).

[5] www.nasdaq.com/newsroom/news/pr2005/ne_section05_056.stm

Fair Disclosure (FD) in 2000[6] and continued with the Global Research Analyst Settlement (GRAS)[7] in 2003 that required investment banking and equity research to operate as separate business units to avoid conflicts of interest. Although the Global Settlement was made with the ten largest firms, it resulted in a set of best practices for all brokerage firms. Both Regulation FD and GRAS have been instrumental in dealing with insider trading and restoring investor confidence in analyst recommendations, but they have had a side effect by reducing the amount of information flowing to the market via analysts.

8. Econometric evidence suggests that after Regulation FD was enacted, smaller companies lost analyst following[8]. Small companies experienced a 17% decline in sell-side analyst coverage, compared with a 5% decline for midsize companies. In contrast, large companies enjoyed an increase of about 7%. Regulation FD has contributed to a decline in the number of analysts for small and mid-caps by making it more difficult and less rewarding to provide research. The study also reports that the effect has been even more pronounced for small intellectual assets-intensive firms since they need to communicate more complex information for which the loss of "selective-disclosure channel" (a form of cross subsidisation)[9] apparently could not be easily compensated by other information transmission channels.

9. The GRAS also contributed to reduced analyst coverage, especially of small companies, and to a reduction in the number of analysts at sell-side firms (about 20% according to one study[10]) as it has become less profitable for the firms to employ analysts, especially those covering small firms. Analyst coverage depends on private benefits and costs of covering a firm and a major benefit of following a firm is to generate commission fees. With this agreement, which also spread to Europe with the enactment of

[6] Regulation FD, which took effect on October 23, 2000, was intended to stop the practice of "selective disclosure", in which companies give material nonpublic information only to certain selected analysts and institutional investors prior to disclosing it publicly.

[7] www.sec.gov/news/press/2003-54.htm.

On April 28, 2003, the SEC, NY Attorney General, NASD, NASAA, NYSE and State Regulators have concluded an omnibus agreement with the ten largest investment banking firms in the US to deal with issues of conflict of interest at brokerage firms. The Global Settlement intended to ensure that the research provided by financial analysts is independent and unbiased by investment banking interests. Sell-side analysts employed by integrated firms (affiliated research firms) have come under scrutiny because of allegations that in some cases they have misled investors through misrepresenting their own views on whether to buy sell or hold securities. They were suspected of issuing too optimistic forecasts and falsely favourable recommendations. Indeed, in integrated firms, corporate finance and other activities often provide a funding contribution that finances a portion of the research budget. Investment banking activity, such as underwriting issues of securities, and in particular IPOs, and advising on other types of corporate finance transactions, including mergers and acquisitions, has the potential to create significant conflicts of interest relating to the production and dissemination of research.

[8] Armando Gomes et al., (2004), SEC Regulation Fair Disclosure, Information, and the Cost of Capital, Rodney L. White Center for Financial Research, Wharton School, Working Paper N° 10567. The authors examine the impact of Regulation FD on the production and transmission of information in financial markets, on analyst following, on security prices and the cost of capital. They also ask whether these effects differ according to the size of the firms (they use quarterly NYSE and NASDAQ firm data for the 1997-2002 period and break it down into small, mid-sized and large firms).

[9] Revenues earned by analysts through their exclusive access to information is not the same thing as revenues earned through the value added by their analytical reports. A "monopoly rent" is therefore being used to subsidise the latter.

[10] Leslie Boni, "Analyzing Analysts after the Global Settlement", conference presentation, Brookings-Nomura Seminar, Brookings Institution, Washington DC, September 28, 2005, www.tcf.or.jp/data/20050928_Leslie_Boni.pdf

the MiFID[11] and the move to unbundle fees in, *inter alia*, the UK, the costs of research could no longer be covered by an analyst's work in investment banking. The cost/benefit balance has also become unfavourable to small caps as trading commissions have also fallen. A survey[12] of Europe's small and mid-sized brokers reports that economic and structural changes in Europe are further reducing average trade commissions and placing mid-sized and regional brokers at a disadvantage vis-à-vis large brokers, with a major impact on their capacity to provide research for small and mid-caps.

10. Although these regulations and agreements in the US and elsewhere have had significant unintended consequences on analyst coverage and caused a significant reallocation of information-producing resources, other factors came into play at the time they were enacted. In 2001, global stock markets began a decline lasting several years contributing to a shrinking of trading commissions. The downturn caused a reduction in the coverage of mid and small firms but not for large firms as analysts moved coverage to more actively traded stocks that generate more commission fees. Financial analysts have an incentive to follow firms with high trading volume which is usually correlated with firm size (Alford and Berger, 1999). Trading volumes in the secondary markets have become, in certain instances, insufficient to justify the on-going costs of research coverage of small caps. Evidence indicates that there has also been a substantial decline in the number of analysts at small securities firms further contributing to the decline in analyst coverage for small public companies. The decrease in analyst coverage has raised public concerns since there is a strong conviction that independent analyst coverage is critical to the success of smaller public companies and to the efficient operation of capital markets.

...with an impact on their cost of capital

11. The maintenance of an adequate provision of research covering small caps merits specific consideration when related to a company's cost of capital. Econometric studies indicate that lower analyst coverage increases a company's cost of capital (Healy et al., 1999; Lang and Lundholm, 1996). The effect is accentuated for small companies: according to a study measuring the impact of the adoption of Regulation FD, the decline in analyst coverage of small companies has cost those businesses 138 basis points per year, and the effect was even more pronounced for companies communicating complex information, such as intellectual-asset intensive companies (Gomes et al. 2004). The study indicated that the differences in changes in forecast error, volatility and cost of capital among high- and low-intangible asset intensive companies are only significant for small firms.

12. A lack of analyst coverage has several adverse effects, both for companies and for the capital markets: (i) companies with no analyst coverage are subject to higher financing costs when compared with their analyst-covered peers; (ii) a lack of coverage by analysts limits shareholders' and prospective shareholders' ability to obtain an informed outsider's perspective for identifying strengths and weaknesses and areas for improvement; (iii) the lack of coverage dilutes the entire "mix of information" made available to investment bankers, fund managers and individual investors, which make markets less efficient; and (iv) because analyst reports trigger the buying and selling of shares, the lack of such reports

[11] The Markets in Financial Instruments Directive (Directive 2004/39/EC of the European Parliament and of Council of 21 April 2004) addresses the issue of conflicts of interest relating to investment research. Financial analysis and research integrated into an investment firm are regulated and supervised together with the firm's core activities.

[12] Greenwhich Associates (2007), "Is there a future for Europe's Small and Mid-Sized Brokers?" The survey assesses the impact on brokers of the implementation of MiFID in November 2007, of the advance of self-directed electronic trading systems and portfolio trading which require huge up-front investments, and of the establishment and proliferation of commission sharing arrangements that tend to concentrate trading business in the hands of a relatively small number of large executing brokers.

frustrates the formation of a robust trading market. Therefore, a lack of analyst coverage impacts company valuation, liquidity and ultimately the growth of the public company.

13. There have been two responses to lack of coverage, one to directly promote analyst coverage and the second that is gaining traction, to more directly deal with the problem through better disclosure and a reduction in data retrieval costs.

STOCK-TAKE OF CURRENT INITIATIVES TO PROMOTE ANALYST COVERAGE

Improving the visibility and liquidity of small caps has become a key concern for stock exchanges

14. With the tremendous growth of the private equity market in the last decade, small listed innovative companies have found alternative ways of financing to the stock market. Although public- to-private operations have attracted most attention from policy-makers, the bulk of the private equity transactions are private-to-private operations that do not immediately utilize the stock market. Indeed, over the last fifteen years, exit strategies for private equity-backed firms have changed according to the prevailing economic conditions and trade sales (sales to other companies0 have become the most common form of exit[13] instead of IPOs, the preferred path in the late 1980s. The popularity of private-to-private transactions is enhanced by the private equity corporate governance model that is seen as being more efficient that the one found in public companies to drive companies' growth and create value[14]. Small intellectual asset-intensive companies have even more incentives to look for private equity financing as they often obtain a better valuation of their assets together with knowledge and managerial inputs from the private equity partners that underpins innovation (Hellman and Puri, 2000). Public equity markets therefore currently face a real challenge from private equity and some stock exchanges (such as Euronext, NASDAQ, JASDAQ) have launched programs to improve the visibility and liquidity of small and mid-caps listed on their markets. An important target of these programs is to promote analyst coverage for this segment of companies. Despite a limited success for some of them, these initiatives demonstrate the stock exchanges' efforts to tackle the issue of low and decreasing analyst coverage of small listed companies.

15. To improve the visibility and liquidity of small and mid-caps, Euronext has created in 2005 a new status for financial intermediaries that (i) set up a team dedicated to research, marketing and sale of small and mid-caps; undertake to track mid-cap stocks as well as small caps (for example, on Euronext Paris, experts must track 60 mid-caps including 20 with market cap under EUR 150 million); (3) commit to publish an annual as well as a semi-annual review per company, with special updates after major events. When awarded this "small and mid-cap expert" label, intermediaries are supported by Euronext through a dedicated marketing program. Although 20 such intermediaries have been operating on all Euronext markets since 2005, their impact on increased trading in small and mid-caps is still unclear.

16. In order to provide independent analysis of under-covered US listed companies, Nasdaq and Reuters created in 2005 a joint-venture, the Independent Research Network (IRN). Nasdaq has been particularly concerned by the increasing difficulty of smaller companies to get research coverage since the

[13] According to EVCA, trade sales have represented 22.7% of exits in 2006, sale to another private equity house or to a financial institution around 25%, IPOs 9% (against app.5% between 2002 and 2005) and sale of quoted entity 7.2%.

[14] Beroutsos, A., A. Freeman and C. Kehoe (2007), Mc Kinsey on Finance, "What public companies can learn from private equity". This research indicates that the top 25% of private equity-backed firms do outperform the relevant stock market indexes. They do so by a considerable margin and persistently. The source of success of the top 25% companies is said to be the governance model that private equity funds apply to them.

2002 reforms as it affects their decision to go or remain public on this stock market. The goal of this initiative was thus to help companies abandoned by big brokers by acting as a broker between research providers and companies and guarantee that research is free of investment banking conflicts. However, due to weaker than expected demand from investors (as of September 2007, IRN connected 35 research providers with some companies for a significant subscription fee of $100,000 paid by companies), Nasdaq and Reuters decided to shut down IRN in October 2007.

17. Although the effect of low analyst coverage on listing of small caps and on their cost of capital are well-known and have triggered several initiatives from stock exchanges, financial analysts still lack incentives to make additional efforts to cover small listed companies with a high level of intellectual assets. Other initiatives may pave the way more efficiently such as those coming from the investor community as well as the development of a new technology, XBRL[15], that is expected to decrease the costs of information acquisition for financial analysts.

[15] For more information on what is eXtensible Business Reporting Language (XBRL) about, see DAF/CA/CG (2006)15. XBRL labels companies' financial data with codes from standard lists called "taxonomies" so that users such as investors and analysts can more easily locate and analyze desired information in a company's financial statements. XBRL makes income statements, balance sheets and footnotes completely interactive.

IMPROVING DISCLOSURE AND LOWERING THE COSTS OF INFORMATION

Companies can improve the situation by better disclosure

18. With the objective to improve their coverage and to directly inform investors, small intellectual asset-intensive companies can proactively enhance their disclosure so as to reduce the information asymmetry component of the cost of capital. Evidence indicates that when costs of information acquisition decrease, there are more analysts following a firm (Graham et al., 2005), which in turns increases stock liquidity and lowers the cost of capital (Core, 2001; Healy et al., 1999; Verrechia, 2001). Indeed, academic research documents that greater analyst following is associated with an improvement in the flow of information into prices (Bushman et al., 2005) that is reflected in, inter alia, smaller bid-ask spreads and greater liquidity for well followed firms (Brennan and Subrahmanyam, 1995; Roulstone, 2003). There is also a direct effect independent of analyst coverage through better informed investors (DAF/CA/CG(2006)15). Greater disclosure is associated with a lower cost of capital for firms with low analyst following (Botosan, 1997) and this appears to be particularly important for intellectual asset intensive companies (Barth, et al, 2001).

19. The importance of improved reporting has been recognised by some exchanges. For example, with a view to improving corporate reporting on intellectual assets for companies listed on its stock market, Jasdaq has launched a series of initiatives. In 2006, it set up a self-assessment tool (documented in DAF/CA/CG (2006)15) which has been distributed to 200 companies in 2006 as well as in 2007. In August 2007, Jasdaq has gone further by establishing a new market segment, New Entrepreneurs' Opportunity (NEO) dedicated to companies with new technologies. Its listing requirements are less stringent than those of Jasdaq stock market, allowing businesses with cutting-edge technologies to be listed even if they have posted losses. However, disclosure requirements include a document explaining in detail the technology, which will be reviewed by a Technology Evaluation Advisory Committee. The first company, Ubiquitous Corp (communications software developer) will be listed in November 2007.

20. Nevertheless, the question remains why so many companies have not used the advantages conferred by improved reporting about their intellectual assets and their strategies for creating value with them. One reason might include factors normally associated with large firms. A recent survey conducted by PWC[16] in 2007 on Fortune Global 500 companies, reports that current reporting practices regarding contextual and non-financial information about company's performance and prospects do not meet investor needs, although top companies provide a great deal more than average ones. Improvement is notably expected on lead indicators and forward-looking information: only 15% of companies specifically define their KPIs and use them to report on progress towards strategic medium and long-term operating objectives. The survey highlights the point that, regardless of the communication channel used by

[16] PriceWaterhouseCoopers (2007), *Corporate Reporting- A Time for Reflection. A Survey of the Fortune Global 500 Companies' Narrative Reporting*. The survey had two main areas of focus: (i) the narrative information provided by the G500 was first assessed against a framework for corporate reporting focusing on the breadth, depth and linkage of contextual reporting (the Value Reporting framework); (ii) the assessment of four critical areas of information cited as important by investors: the drivers of revenue growth and margins, past and future; uses of capital; reporting of segment performance; and reporting of KPIs.

companies, there appear to be important elements of contextual information which some companies do not report externally. The greatest barriers to further transparency, according to Black Sun's survey[17], are competitive sensitivity and the threat of liability even though competitors are often well informed by participants in the market. Confidentiality arguments might be more significant for small intellectual asset intensive companies.

21. Another reason for small caps not improving their reporting might be the absence of an international reporting framework, as evidenced by the 2006 OECD report. By ensuring comparability and consistency, disclosure and reporting standards represent an externality reducing costs for analysts and market participants alike. Current efforts to develop business reporting frameworks covering intellectual assets and business models for some sectors should be beneficial for small caps.

XBRL could enhance the efficiency of corporate reporting through standardisation

22. An important development in capital markets is the increasing adoption of XBRL by regulators including the SEC[18], stock exchanges and accounting organisations worldwide.[19] XBRL technology is viewed among others as an instrument to increase the productivity of analysts, since they will spend less time on data collection and should be able to examine several companies at once, highlighting differences, gaps or inconsistencies that previously may have gone unnoticed. This is expected to decrease the cost of research for sell-side firms and, therefore, increase the number of public companies covered by independent research and reduce their cost of capital[20]. Whether it will lead to improved coverage of small caps remains open as they will still suffer from relatively high costs and lower revenues.

23. The most important aspect of XBRL might, however, be the required emphasis on taxonomies: the definitions and classifications that enable contextual tags to be applied to every item in a company's financial and non-financial statements. Although focused on the financials, taxonomies are being progressively extended to non-financial information and to KPIs organized by industry. According to a US SEC staff person, "*XBRL goes beyond the financials and in fact many in the accounting world believe that*

17 Black Sun (2007), *From the Inside Out*. Black Sun, a consultancy firm, surveyed FT 350 companies and found that 80% of those surveyed felt competitive sensitivity was the greatest barrier to further transparency, with the threat of director liability next.

18 In the US, XBRL is currently used for EDGAR filings. In April 2005, the US SEC began its voluntary interactive data filing program, which allows public companies to voluntarily submit XBRL documents as exhibits to periodic reports and investment company act filings: as of September 2007, more than 40 companies have participated in this program

19 Many governments and regulators are now accepting and requiring the submission of financial statements and reports in an electronic form via XBRL. There are now hundreds of active XBRL projects globally in different stages of development. Over the past year, a number of developments have reinforced this growth such as the on-going adoption of XBRL by stock exchanges (such as the Korean and Shanghai Stock Exchanges, Tokyo Stock Exchange's plan to introduce XBRL reporting for all companies in 2008) or government agencies (such as the UK Tax Authority mandating the use of XBRL for all companies' tax filings), the increased endorsement and lobbying by the US SEC and other regulatory authorities (such as Japanese FSA mandating the use of XBRL for all companies for the Japanese 10K by April 2008) and the continuing initiatives by numerous professional organisations (International Accounting Standards Committee Foundation, Committee of European Bank Supervisors). Singapore has a comprehensive XBRL project: all companies are expected to file only one set of financial statements that can be used by several different government agencies, including the Singapore Inland Revenue Authority, The Singapore Monetary Authority, and the Singapore Exchange.

20 www.sec.gov/news/speech/2007/spch061407cc.htm

XBRL will deliver the most value when it comes to non-financial reporting"[21]. Taxonomies covering financial, non-financial information and KPIs are currently being developed for six pilot industries: oil and gas, software, life insurance, pharmaceuticals, automobile and electronic parts. Private sector initiatives should follow in other sectors. The development of international corporate reporting frameworks for some industries supported by KPIs and associated XBRL taxonomies are expected to support efforts by small listed companies to proactively report information needed by investors to get the full picture of their key assets and of their long-term strategy as well as to reduce the costs of coverage for sell-side firms and increasing the benefits of covering small caps.

[21] www.sec.gov/news/speech/2007/spch052407jf.htm

POLICY CONSIDERATIONS

24. Small caps, especially ones that use intellectual assets intensively, have been on the policy agenda for quite some time and more recently concern has come to include how they are treated in the capital markets. In particular, concern has been expressed that the low level of analyst coverage raises their cost of capital and reduces their growth prospects. This has led to several initiatives to encourage analysts without an appreciable effect.

25. Policy in this area is not self-evident and needs to recognise that the business model for analysts has changed since the drive for more efficient and transparent markets (especially through structural measures to control potential conflicts of interest) has removed cross subsidies for analysts that encouraged them to cover, inter alia, small caps. A new business model to finance analysts is still on the agenda since small caps are costly to cover and potential revenues in many cases insufficient. On the other hand, small caps and potential small caps do have other sources of funding with private equity that deals directly with asymmetrical information issues and offers other exit paths than public markets through IPO's . The competitive threat to public markets is thus encouraging stock exchanges to consider innovative approaches and there are also other private sector initiatives that deserve the support of the authorities.

26. Institutional investors that value the work of financial analysts might have to find new ways to compensate them and needs to be encouraged by policy makers. In this regard, the experience of the EAI[22] is valuable and could be replicated in order to increase the economic benefits for analysts from covering small caps. To stimulate innovative research on how to incorporate extra-financial and forward looking information into their analysis for long-term investment decisions, EAI members provide a commercial incentive to research providers by allocating at least 5% of their brokerage commissions to institutions that are judged to meet high standards by incorporating new sources of information about growth prospects. Independent sell-side firms awarded by EAI report that the money they received had more than covered the costs of the research. It is not always for policy makers to change the incentives facing financial analysts but it is important that they support investor initiatives.

27. Small firms suffering from low analyst coverage should also be encouraged to disclose more proactively non-financial information about their intellectual assets and value creating strategies but might suffer from the current lack of a suitable reporting framework. The development of business reporting frameworks by the private sector with industry-specific KPIs combined with the increasing use of XBRL should help small caps fill the information gap and thus needs to be supported by policy makers. The regulatory authorities are already in many instances supporting the development of XBRL taxonomies for non-financial information and the development of sector specific Key Performance Indicators but there is still a long way to go before they are fully operational and thereby contributing to the development of new mechanisms to complement the move to more transparent capital markets.

[22] For further information on the Enhanced Analytics Initiative (mission, functioning, membership), see DAF/CA/CG(2006)15.

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