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Readability of chairman's statement in Malaysia

Suryani Abdul Raman, Siti Nabilah Mohd Shaari and Nurfarizan Mazhani Mahmud
Universiti Teknologi MARA (Perak), 32600, Bota, Perak, Malaysia.

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ABSTRACT

Chairman's Statement plays a significant role in communicating the corporate affair to the stakeholders and subsequently serves one of the tools to the stakeholders in making their economic decision. However, the usefulness of which will depends upon their readability and understandability (Courtis, 2004). Therefore, this study examines the readability of Chairman's Statement for companies under Main Board of Bursa Malaysia, starting from 2004 until 2006. The study employs Readability formula developed by Rudolf Flesch in 1949, Microsoft Word's Flesh Reading Ease (FRE) Score. The results show that all the chairman's statements in Malaysia are difficult to read.

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Introduction

Agency costs exist due to the conflict between the agents and principals where the agents are acting not in accordance to the best interest of principals (Jensen and Meckling, 1976). In order to reduce the agency costs, Morris (1987) stated that there is a need to monitor the agents' activities and to bond the agents to the principals. One of the medium used to monitor and to bond the agents to the principals is through periodic communications and reports.

Therefore, annual reports have always been the main medium to reduce the agency costs between managers (agent) and shareholders (principal). It communicates the activities that have been conducted by the managers to the shareholders so that the shareholders can make informed decisions regarding their future investments. Annual reports not only consist of quantitative information but also narrative disclosure as a part of full communication package (Courtis, 1998). Since narrative disclosure acts as a part of full communication package, it is imperative for those who are responsible for writing the narrative to write the disclosure in an understanding manner so that the readers of the annual report will not misunderstand the information that they are trying to convey.

In a usual annual report, it consists of the chairman's statement, the corporate governance statement, the audit committee report and the financial statements (Lazar and Tan, 2004). Courtis (1998) stated that the chairman's statement or its equivalent is the most read section in the annual report. Therefore, the ease of understanding is an important feature of effective chairman's statement. Chairman's statement is an important part in annual report even though it is a part of non-financial reporting and it is a collective view of the board of directors which includes a brief description of the industry trend and development, analysis of group performance, and the prospects of the listed issuer. In addition, the content of the chairman's statement is not governed by any statutory requirement or law and it is often written according to the chairman's styles and opinions. However, chairmen are able to exercise flexibility in both the writing style and the complexity of presentation. No matter what the presentation style, the

graphic used or the length of the statement, effective communication should be adhered to in disclosing this information. This is important in order to ensure that the stakeholders can understand and interpret the same way as that intended by the management.

However, previous studies have found that readability of annual report to be at difficult level (Courtis, 1995 and Smith, Jamil, Johari and Ahmad, 2006). In fact, Courtis (1995) states that there is no significant improvement in the annual report's readability over the course of five years. This suggests that annual report is not only difficult to read and to understand but also the company has made no effort to improve the reading-ease of the annual report. Since the chairman's statement is the statement which is wholly written by the chairman of the company, it is interesting to investigate the level of readability of chairman's statement in Malaysia.

Literature review

Annual Report Readability

Many studies that investigate the readability of narratives within annual report have been conducted and almost without exception, the studies corroborate that annual reports are being written at a reading-ease level which is classified as difficult to very difficult (Courtis, 1998).

By using Cloze readability procedures, Adelberg (1979) finds that users do not understand well accounting policy footnotes and management analyses of operations and narrative disclosures are not understood well by commercial bank loan officer trainees. Courtis (1986) uses Flesh and Fog readability formulas to measure 97 randomly selected chairman's address and footnote passages from the annual reports of some Canadian public companies for the year 1983 and finds that the report of 97 percent of the sample companies are written at a level of difficulty equivalent to academic or scientific literature. In Bangladesh, by using the Flesh readability index, Hossain and Siddiquee (2008) find that majority of the management reviews, i.e. the chairman's letter and directors' report of some selected companies listed on the Dhaka Stock Exchange Ltd. are more difficult to read except only a few companies such as companies in the industry of jute, service and paper packaging. Again there

are several studies such as Healy (1997); Lebar (1982); Courtis (1995); that investigating the same matter and the general conclusion from these studies is that corporate annual reports are quite difficult to read and the readability is beyond the population's fluent comprehension.

Measurement of Readability and Readability Formulae

According to Clatworthy and Jones (2001), there are two main approaches to the measurement of readability level. The first involves sophisticated psycholinguistic and socio-linguistic techniques such as Cloze, multidimensional scaling, association analysis, and classification analysis. The first approach, in particular the cloze procedure, is associated with understandability. The second approach, which involves the use of readability formulas, is associated primarily with syntactical complexity, where an increase in syntactical complexity indicates narratives which are more difficult to read and vice versa. Readability formula is a quantitative method of predicting whether prose passages are likely to be readable by a target audience. It attempts to provide the same kind of the information about comprehension ease that a writer would have to judge through experience and feedback from readers, or measure through a comprehension test on the materials. Courtis (1986) stated that the success of the formula in providing meaningful predictive information depends on its ability to measure elements in the writing that are related to reader comprehension. These elements could be content, style, format and organization. However, according to Courtis (1986), only style factors have been found to be conveniently measurable within readability formulas.

There are numbers of readability formulas have been developed since 80 years ago (DuBay, 2004). Several formulas have also been recalculated and revised, as well as versions applicable to computer programs. In developing the formulas, three goals should be paramount (Smith and Smith, 2001). These are 1) the discovery of those factors that validly distinguish easy from hard materials, 2) a reliable means of measuring such factors, and 3) an expression of some combination of them in terms of reading ability essential to comprehension. Progress and research on the formulas was something of a secret until the 1950s. Writers like Rudolf Flesch, George Klare, Edgar Dale, and Jeanne Chall brought the formula and research supporting them to the marketplace (DuBay, 2004). Now, the formulas have been applied to a variety of fields including education, business and industry, journalism and mass communication, legal and governmental writing, psychological tests and questionnaires, and foreign language (DuBay, 2004 and Smith and Smith, 2001).

One of the most popular readability formulas is The Flesch Reading Ease Formula that was developed by Rudolf Flesch. According to Hossain and Siddique (2008), Flesch diagnose the difficulty of writing style by depending on principally two things: 1) syllable density (the average number of syllabus per 100 words) and 2) the average sentences length. A high syllable density is an indicative of word complexity and therefore of reading difficulty. A large number of words per sentence are also a symptom of materials which is difficult to read. The Flesch formula is straightforward and easy to apply, thus it becomes the most widely used formula and one of the most tested and reliable (Smith et al. 2006, DuBay 2004, and Courtis 1986). It generates the readability score ranging from 0-100, where the higher the score, the easier it is to understand the passage.

DuBay (2004) stated that Farr, Jenkins and Paterson further simplify the Flesch Reading ease Formula, and their formula correlates better than 0.90 with the original Flesch Reading Ease Formula. In 1976, a study by the U.S Navy modified the Reading Ease Formula to produce a grade-level score (Hossain and Siddique, 2008). This popular formula known as Flesch Kincaid formula, the Flesch Grade Scale formula or Kincaid formula. It is calculated based on the average number of syllabus per word and the average number of words per sentences. The Flesch-Kincaid Formula translates the 0-100 score to a U.S grade level. For example, a score of 8.2 would indicate that the text is expected to be understandable by an average student in 8th grade. The formula was first used by the US Army for assessing the difficulty of technical manuals in 1978 and soon after became the Department of Defence military standard. The commonwealth of Pennsylvania was the first state in the US to require that automobile insurance policies be written at no higher than a ninth grade level of reading difficulty, as measure by the Kincaid formula.

Another well known readability formula is Fog index. This formula is developed by Robert Gunning in 1952 (Li, 2008). It used two variables, average sentences length and the number of words with more than two syllables for each 100 words. The index indicates the number of years of formal education a reader of average intelligence would need to read the text once and understand that piece of writing with its word-sentences workload. The ideal score is 7 or 8, if the score is more than 12; it means it is too hard for most people to read.

The latest readability formula that has been used in previous study is Bullfighter Composite Index (BCI). This formula was developed by Deloitte Consulting in 2003. This index measures the readability and the usage of jargon in corporate narrative. This software can be run in Microsoft word or Power point on Office 2000 or XP system, works like familiar spell-check and grammar check program. The software detects what it calls bullwords, suggests alternate terms, and assigns a 'Bull Composite' score based on the clarity of the writing in the document. It generates a score ranging from 0 to 10, where a score of 10 indicates the text as jargon free. Sheikh Abu Bakar and Ameer, (2010) reported that there is no difference in the explanatory power between the Flesch Readability Score and BCI score since their correlation is very high.

Even the readability formulas have been used widely, their limitation are also well documented. According to Redish and Selzer (1985), there are at least, five significant problems with readability formulas and the way there are used in technical writing for adult; 1) readability formulas have been applied to technical and business writing with no research basis, 2) the formulas are not reliable and valid predictors of how understandable a technical, scientific, or legal documents for adults, 3) shortening sentences and words does not necessarily make a passage easier to understand, 4) the underlying assumption of readability formulas that any text for any reader for any purpose can be equation does not mesh with our current understanding of how people process information, and 5) readability formulas did not take into account many features that are critical to people's ability to understand and use documents.

Dreyers (1984) notes that formulas exclude from consideration factors which relate to syntax and complexity of sentences, such as unusual positioning of sentences components or clauses and the number of dependent clauses. They do not measure textual factors such as word frequency, concept density,

level of abstraction, or whether there is appropriate organization, coherence and logical presentation of ideas. Courtis (1985) explain that formulas do not examine the way new concepts are introduced, nor do they consider how motivational the materials seem. Moreover, they do not examine other factors necessary for reader retention, such as organization and reinforcement.

Notwithstanding these limitations, readability formulas have been used extensively by researchers in predictive study. They justify the technique through an examination of validity data, especially the ability of formulas score to predict an 'outside criterion of readability. DuBay (2004) notes that the proper used of readability formulas, will help writers aware of the limited reading abilities of many audience.

Research methodology

Sample and Data Collection

The sample includes all companies that listed in the Main Board of Bursa Malaysia that covers the fiscal year of 2004 - 2006. However, companies that are listed later than the year 2004 or delisted during the period 2004-2006 are excluded. Finance-related companies and companies under REITS industry are also excluded due to their unique characteristics, different compliance and regulatory environment. This study focuses on chairman's statement and its equivalents in the annual report. The chairman's statement will be copied and then pasted in Microsoft word to get the readability index. Companies, whose chairman's statements cannot be copied, are also excluded. There are 590 companies listed in Main board Bursa Malaysia in 2004, but only 296 sample left for final sample. Table 1 shows the detail of the sample.

Table 1. Sample classification by industries

Industry	Listed in 2004	Missing data/ delisted	Total
Construction	42	17	25
Consumer product	73	26	47
Finance	52	18	34 (excluded)
Hotel	5	-	5
Industrial product	120	58	62
IPC	8	3	5
Mining	1	-	1 (excluded)
Plantation	39	20	19
Properties	97	44	53
REITs	3	3	0 (excluded)
Technology	17	8	9
Trading and services	133	64	69
TOTAL	590	296	294

Readability definition and Measurement

Readability in this study means quantitative measure of the ease of the comprehension or understanding of written matter. There are numbers of readability formulas have been developed. In this study we use Microsoft Word's Flesh Reading Ease Score that is based on a formula developed in 1949 by Rudolf Flesch. It is computed using the average number of syllables per word and word per sentence. Syllables per word are a measure of word difficulty. Words per sentence are an indicator of syntactic complexity (Stockmeyer, 2009). This formula is chosen because it is widely used by previous studies (Smith et al., 2006, Linsley and Lawrence; 2006, Hossain and Siddiquee; 2007, Sheikh Abu bakar and Ameer; 2010). Further, as suggested by Sheikh Abu Bakar and Ameer (2010), since this formula is widely accepted, it is possible to compare the findings with previous studies.

Reading ease Rating	Difficulty	Educational level	Typical magazine style
0-30	Very Difficult	Postgraduate	Scientific
30-50	Difficult	Undergraduate	Academic
50-60	Fairly difficult	Grade 10-12	Quality
60-70	Standard	Grade 8-9	Digest
70-80	Fairly easy	Grade 7	Slick fiction
80-90	Easy	Grade 6	Pulp fiction
90-100	Very easy	Grade 5	Comic

Descriptive Analysis

Table 3 shows the frequencies of the companies rating in Flesch Reading Ease Index. As shown below, almost 75% of the companies' chairman's statements are very difficult to read. Only 25.6% of the companies classified as difficult and 0.1% which represents only one company classified as fairly difficult. As mentioned previously, low FRE indicates difficult reading ease. This shows that all the chairman's statements in Malaysia are difficult to read. Our findings clearly support the findings of Smith et. al. (2006) and Sheikh Abu Bakar and Ameer (2010).

FRE Rating	Difficulty	Frequencies	Percentage
0-30	Very Difficult	655	74.3%
31-50	Difficult	226	25.6%
51-60	Fairly difficult	1	0.1%

Courtis (1995) states that readability of Asian companies is difficult due to fact the most managers obtain education from England. He has conducted readability index to Hong Kong companies and finds that the mean readability index of Hong Kong is 37.6 which is in the level of difficult. He further compares it with Western readability index and finds that Eastern companies has readability index significantly more difficult as compared with Western companies. He suggests that the reason for this is due to the fact that the most of managers in Hong Kong companies have England-based education background, which may contribute to the low readability index score. Since most of Asian-based readability index has low score, it may suggest a cultural factor that causes Asian companies to have difficult readability score. Similarly, our study also reveals Malaysian companies' readability level is difficult. As Malaysia is also one of Eastern countries, it may be suggested that the readability index score may relate to the chairman's qualification factor.

Conclusion

Chairman's statement regards as a significant section of an annual report. As mentioned earlier, it acts as an important tool for companies to inform their current and future stakeholders regarding the companies' performance and prospects such as the history, products or services, research and development activities, stakeholder's policy, past and current achievements and its future plan or strategy for the company's growth and shareholders' wealth. As such, companies must ensure that discussions in the statement are well communicated and transparent to their readers at large as to avoid agency problem. This is because the length of the statement could be strategically manipulated by the preparer to make it less transparent or to hide adverse information to the readers (Hossain and Siddiquee, 2008) which may subsequently drive to misleading and inaccurate action of decision making.

This study measured the readability level of chairman's statement of companies that listed in the Main Board of Bursa Malaysia that covers the fiscal year of 2004 - 2006. Viewed

collectively, the results in this study reveal that all the chairman's statements in Malaysia are difficult to read. The findings are consistent with the findings of other studies mentioned earlier, which reported that chairman's statement of public companies in general is difficult to read. By turn to the study conducted by Curtis (1995), it may be suggested that the causes for Malaysian companies to have difficult readability score is due to the cultural factor.

Limitations and recommendations

Our study only takes into account the sample from Main Board companies. Curtis (1995) states that size do play important in preparation of annual report. Not only that, age is another factor that affects the readability of annual report. Companies that are listed in Main Board companies are often of large sizes and have been longer players as compared to Second Board companies. Besides than that, the readability formula itself has some limitations (Curtis, 1986). First, the readability formula adopted does not match the contents of the text with the readers' background. It means the measurement of readability is measuring the text itself rather than the level of understanding of the readers. The formula has also weakness as it only focus on the style of the writing itself and it ignores other factors that may affect the understanding of the readers. This study also does not include the identification of jargons as part of readability measurement.

For suggestion, this study can be further expanded by adding the companies in Second Board as part of sample selected. As stated before, size and age play important role in determining the readability of annual report (Curtis, 1995). Companies in Second Board are usually companies with smaller market capitalization and often in infancy stage. Thus, by adding Second Board, the result may yield to different conclusion. We also would suggest the inclusion of identification of jargons in measuring the readability index since annual reports are written by managers who have strong accounting and business background. By including the identification of jargons, the measurement of readability will be more accurate.

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