

# Financial Transparency as a Factor of a Company's Attractiveness in the Era of Change



Alena A. Stupina, Roman I. Kuzmich, and Irina R. Rouiga

**Abstract** In most cases the uncertainty of future business development makes it hard for an investor to opt for the one of many enterprises to invest. In conditions of uncertainty, it is recommended to invest in companies with a good reputation, because such investments are regarded as less risky. In such a situation the attention is increasingly turned to the companies which meet the consumers' needs: trade, food production, construction. It is known that the value of business is considered to be the main indicator of the company's reliability and attractiveness for investors. However, the financial transparency of the enterprise is an equally important factor in the investment attractiveness. The financial transparency is expressed in the availability of reporting information on the current state of the operation prospects. The aim of the paper is to suggest and test the financial transparency evaluation algorithm based on the selected criteria. This algorithm allows the investor to make a decision in favor of the companies with the high financial transparency, profitable for investment. The paper more specifically focuses on the investment attractiveness of construction companies in Krasnoyarsk, a major industrial center in the south-eastern part of Russia, though it should be mentioned that this algorithm can be used for companies in another manufacturing sector as well.

**Keywords** Transparency · Criteria · Construction companies · Investment

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A. A. Stupina (✉) · R. I. Kuzmich · I. R. Rouiga  
Siberian Federal University, Krasnoyarsk, Russia

I. R. Rouiga  
e-mail: [irina\\_rouiga@bk.ru](mailto:irina_rouiga@bk.ru)

A. A. Stupina  
Reshetnev Siberian State University of Science and Technology, Krasnoyarsk, Russia  
Krasnoyarsk State Agrarian University, Krasnoyarsk, Russia

## 1 Introduction

Transparency is a complex indicator of the openness of an economic entity. It reflects the degree of completeness of disclosure and the accessibility of reporting information, which includes information about a company's current state and its prospects of operating in a way that meets user expectations and requirements [6]. Its essence lies in the system of a company's relations with investors and other interested subjects on the basis of the principles of openness, reciprocal benefit, development, and loyalty.

Current literature focusing on the problem of transparency pays insufficient attention to the issues of reporting and finance. Transparent financial reporting is defined as reporting that completely reveals all important information about a company's operation necessary for users to make a correct judgment about its financial state and operation results in order to make decisions about their interaction with the company. Accounting reporting is the basis of financial transparency [12]. Nowadays, the principles of Russian accounting are similar to international standards to a large extent [5, 9].

In order to give a general description of the degree of transparency of a company's financial statements, the terms "formal" and "active" disclosures and "formal" and "active" accessibility have been introduced [7].

The concept of "active accessibility" can be interpreted using the following characteristics: publicity, openness, availability of infrastructure for access to information, and wide dissemination of company data. The access infrastructure allows users to easily and ergonomically obtain financial statements for any period, as well as information about the company as a whole, which are presented on its website.

"Formal accessibility" defines the practice of transferring reports by a company only to the statutory instances for its presentation.

Information disclosure is also classified as "formal" and "active."

"Active disclosure" means the disclosure of as many facts and operations as possible with a detailed explanation in the notes, as well as the publication of data that goes beyond the requirements regulated by the provisions.

"Formal disclosure" means disclosure of statements only in the instances established by law for its presentation.

Scientists systematized the basic principles of building transparent financial reporting: systematic, efficient, voluntary interest, accessibility, reliability, mutual trust, materiality, rationality, etc. [11].

The study of aspects of the preparation and submission of financial statements, as well as the requirements for its quality, made it possible to formulate the main qualitative characteristics of transparent information: completeness, materiality, clarity, reliability, and relevance.

The company's self-disclosure process will be most effective when there is a voluntary desire for transparency. To achieve the most acceptable level of transparency for clients working with information, a company must be predictable in all of its relations. That is, selective transparency in the framework of such interactions is unacceptable. The main stages of the company's self-discovery process are:

- Decision to increase the company's openness and inform all structural divisions of this change
- Creation of a center of transparency with the definition of the company's goals, objectives, functions, resources, etc.
- Development of an algorithm to maintain transparency in financial reporting
- Continuous monitoring by the management of the transparency process in the company, analysis of its results, and adjustments to the process as necessary

Despite the theoretical studies conducted, at present, there is no single approach to the quantitative evaluation of financial transparency. Consequently, two scientific problems arise:

- The selection of criteria for financial transparency evaluation
- Development of the financial transparency evaluation algorithm based on selected criteria

## 2 Materials and Method

Several conditions of financial transparency have been pointed out in the research both in Russia and abroad [3, 10]:

- Investors should get access to all information on time and without problems
- The organization must have a website where financial reporting and other important information for clients and investors should be posted
- Accounting reports and other information should be presented with clear language and performed at a high level.

When calculating financial transparency, the information from two main sources—annual reports and websites—should be considered. The first group of sources includes annual reports that are prepared according to International Financial Reporting Standards (IFRS) and notes whether the organization indicates if they are an integral part of the annual report. It should be noted that the use of IFRS ensures the proper level of transparency, which is verified by the requirements of the world's largest stock exchanges [1]. The second group of sources includes all data posted on the company's website, including hyperlinks to documents belonging to the organization [4, 13].

The availability of information, specifically regarding open access regardless of the source of disclosure, gives 80% of the maximum score for each criterion of financial transparency. The other 20% is added if the necessary information is available in the second source as well. This method is based on the assumption that the availability of duplicate information in various sources is an undoubted advantage, as it increases its accessibility of information for investors. Although, the very fact of information duplication has less value in comparison to the fact of primary disclosure of information.

Information is processed in early August of the current year. All data provided after this date is considered insignificant for evaluation of the transparency level since it is given more than seven months after the end of the reporting year. Consequently, the information that appeared after this date is no longer of value to investors whose target is to assess the current state of the company on the basis of the previous year's data.

A list of evaluation criteria has been compiled. The research questionnaire consists of twenty-eight criteria of financial transparency evaluation related to the four components:

- Structure of internal documents
- Information about the participants
- Financial information
- Operating information

The list of criteria for each component is given below:

Component 1. Structure of internal documents.

1. Content of the Code or Corporate Governance Regulation
2. Content of the Code of Corporate Conduct and Ethics
3. Regulations of the Company's Charter (including changes)
4. Regulation on the internal audit service
5. Agreement on the establishment of the Company
6. Protocol on the establishment of the Ltd.
7. Full protocols of general meetings of the Company
8. Disclosure policy

Component 2. Information about the participants.

1. List of Company participants (surnames)
2. Data on current jobs, positions
3. If the founder(s) is/are in the list of Company participants
4. Data on the share of the participants in the authorized capital
5. Making of decisions by the general meeting participants on the distribution of the share in the authorized capital
6. Information on the meeting attendance by the participants

Component 3. Financial information.

1. Accounting policy of the company
2. Standards used in reporting
3. Annual financial statements (reports) in accordance with IFRS
4. Notes to the annual financial statements in accordance with IFRS
5. Publication of audited financial statements in accordance with IFRS
6. Name of the auditor of the company
7. The amount of remuneration paid to the auditor for audit services

Component 4. Operating Information.

1. Information on the Company's activities
2. Information on the production or services offered
3. Characteristics of the assets used (including licenses)
4. Performance indicators
5. Discussion of corporate strategy
6. Investment plans for the nearest years
7. Market share of some or all of the Company's activities

Based on the selected criteria, the financial transparency evaluation linear algorithm for the certain enterprise has been developed, which results in a total score (%) of financial transparency in the enterprise. The algorithm consists of the following steps:

1. Financial transparency ( $F_{transp}$ ) on each criterion is calculated, depending on the availability of information in the open access. Financial transparency is equal to 80% if the information is available in one source, 100% in two sources, and 0% in none.
2. Financial transparency on each component is calculated as the arithmetic mean on all criteria in the component:

$$F_{transp_k} = \frac{1}{n_k} \cdot \sum_{i=1}^{n_k} F_{transp_i}$$

where  $F_{transp_k}$  is the financial transparency of the k-component,  $n_k$  is the number of criteria in the k-component, and  $F_{transp_i}$  is the financial transparency of the i-criterion in the k-component.

1. The total score (%) of financial transparency in the enterprise is calculated as the arithmetic mean of the four components. The ratio of the number of criteria in the relevant component to the total number of criteria in the questionnaire is used as the weighting factor. The total score of financial transparency is calculated with the formula:

$$F_{transp_{sum}} = \sum_{i=1}^k \frac{n_i}{n} F_{transp_i}$$

where  $F_{transp_{sum}}$  is the total score (%) of financial transparency in the enterprise,  $F_{transp_i}$  is the financial transparency of the i-component, k is the number of components,  $n_i/n$  is the weighting factor,  $n_i$  is the number of criteria in the i-component, and n is the total quantity of criteria.

### 3 Results

The previous studies [8] offered the calculations of the business value based on the income approach using the modified model CAPM [2] for five construction companies in the city of Krasnoyarsk: Monolitholding, Restoration, Alfa, Economgilstroy, and Alexstroy. This paper contributes to an understanding of their financial transparency evaluations.

The evaluation of financial transparency is implemented on the basis of the data at the end of 2018 because it is the last available financial statement (balance sheet and profit-and-loss statement).

According to the afore-mentioned linear algorithm, financial transparency is calculated for each criterion used in the study, depending on the availability of information in the open access. The results of the calculations are provided in Table 1.

The financial transparency of the companies in each component and the total score of the financial transparency (for 2018) are presented in Table 2.

The information provided in Table 2 has indicated Monolitholding and Restoration as the leaders, according to the total score. The lowest total scores of financial transparency are given to Alfa and Alexstroy.

### 4 Discussion

This study is unique in that it not only provides a comprehensive assessment of financial transparency by 28 criteria but also an aggregation of primary information (financial transparency values for each criterion) based on the proposed linear algorithm for assessing financial transparency into a comprehensive indicator (total financial transparency score). It becomes easier for an investor to make a decision about investing money in a company using this information.

The investor should be aware of not only the current financial state of the enterprise but also the dynamics and reasons for any changes for a certain period of time. It is also important to identify prospects for development of the enterprise as well. Considering both the value of the business and its financial transparency, the investor has a more accurate prognosis regarding the company's market position in the future. Consequently, the decision of the investor concerning investments in a specific enterprise can be more justified because it is based on public financial reporting.

**Table 1** Financial transparency of the company on each criterion for 2018, %

	Monolitholding	Restoration	Alfa	Economgilstroy	Alexstroy
<b>Component 1. Structure of internal documents</b>					
Content of the Code or the Corporate Governance Regulation	100	80	0	0	0
Content of the Code of Corporate Conduct and Ethics	100	80	0	0	0
Regulations of the Company's Charter (including changes)	100	100	80	80	80
Regulation on the Internal Audit Service	100	100	0	0	0
Agreement on the establishment of the Company	80	80	0	0	0
Protocol on the establishment of the Ltd	80	80	80	80	80
Full protocols of general meetings of the Company	0	0	0	0	0
Disclosure policy	80	80	0	0	0
<b>Component 2. Information about the participants</b>					
List of Company participants (surnames)	100	100	80	100	80
Data on current jobs, positions	100	100	80	80	80
If the founder (s) is/are in the list of Company participants	100	100	80	100	80
Data on the share of the participants in the Authorized Capital	80	80	80	80	80
Making of decisions by the general meeting participants on the distribution of the share in the Authorized Capital	80	80	0	80	0

(continued)

**Table 1** (continued)

	Monolitholding	Restoration	Alfa	Economgilstroy	Alexstroy
Information on the meeting attendance by the participants	80	0	0	0	0
<b>Component 3. Financial information</b>					
Accounting policy of the company	100	100	0	80	80
Standards used in reporting	100	80	0	80	80
Annual Financial Statements (reports) in accordance with IFRS	100	100	80	80	80
Notes to the Annual Financial Statements in accordance with IFRS	100	80	0	0	0
Publication of Audited Financial Statements in accordance with IFRS	100	80	80	0	0
Name of the auditor of the company	100	80	80	0	0
Amount of remuneration paid to the auditor for audit services	0	80	0	0	0
<b>Component 4. Operating Information</b>					
Information on the Company's activities	100	100	100	100	100
Information on the production or services offered	100	100	100	100	100
Characteristics of the assets used (including licenses)	100	100	0	80	0
Performance indicators	100	100	0	80	0
Discussion of corporate strategy	100	100	100	100	0
Investment plans for the nearest years	80	80	80	80	0
Market share of some or all of the Company's activities	100	100	0	0	0



**Table 2** Financial transparency of the companies on each component and the total score of the financial transparency for 2018, %

Company	Component				
	Component 1. Structure of internal documents	Component 2. Information about the participants	Component 3. Financial information	Component 4. Operating information	Total score
Monolitholding	90	90	97	97.1	93.3
Restoration	75	76.6	85.7	97.1	83.5
Alfa	20	53.3	34.2	54.2	39.2
Economgilstroy	20	73.3	34.2	77.1	49.2
Alexstroy	20	53.3	34.2	28.5	32.8

## 5 Conclusion

On the basis of the research, twenty-eight criteria of financial transparency evaluation related to the following four components have been selected:

- Structure of internal documents
- Information about the participants
- Financial information
- Operating information

Based on the selected data, the financial transparency evaluation linear algorithm for the designated enterprise has been developed. Results provide a total score (%) of financial transparency in the enterprise.

The financial transparency evaluation algorithm has been tested for five companies in the construction industry in the city of Krasnoyarsk: Monolitholding, Restoration, Alfa, Economgilstroy, and Alexstroy. The analysis of the data has identified Monolitholding and Restoration as financial transparency leaders.

These research results can be useful for investors to identify the enterprise as profitable for investment and the enterprise's executives to assess financial transparency and develop measures intended to improve it.

Future research will be focused on the development of the algorithm for sharing of business value and financial transparency for investment attractiveness with the purpose of increasing certainty in the decision-making process by investors.

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