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A Survey of Segmental Reporting by Indian Companies

by

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Abstract

Under a recent regulation Indian Companies listed on a stock exchange one required to publicly report their segmental financial results.

A survey of financial results for the quarter ended December 31^{st}, 01, published by 97 Indian companies reveals little impact of the regulation on these companies' segmental financial disclosures.

This paper reports on the results of the survey and presents some conjectures on how might segmental financial disclosures by companies evolve in the future.

A Survey of Segmental Reporting by Indian Companies[1]
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1. Introduction

Accounting Standard 17 (AS 17) of the Institute of Chartered Accountants of India deals with Segment Reporting. Read with Clause 41 of the Listing Agreement on Indian Stock Exchanges, the standard requires all Indian companies listed on stock exchanges to disclose segmental information.

This paper reports on survey of the segmental information disclosed by 97 Indian companies (Refer Appendix 1) in their published financial statements for the quarter ended December 31, 2001. These 97 companies published their quarterly results in The Economic Times between January 1 and February 15, 2002. In the next section we briefly review the regulatory requirement as a background to the survey. In Section 3 we report on the survey findings. The concluding section offers some possible explanations for the findings of the survey and closes with a discussion of the implications of the findings for users of financial statements and for future research.

2. The Regulatory Requirement:

What is a Segment?

AS 17 identifies 2 bases on which segment information may be presented.
a) Business Segment
b) Geographic Segment.

a. A business segment is a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products or services and that is subject to risks and returns that are different from those of other business segments.

a. A geographical segment is a distinguishable component of an enterprise that is engaged in providing products or services within a particular economic environment and that is subject to risks and returns that are different from those of components operating in other economic environment.

What is a Reportable Segment?

There are 3 tests to identify a Reportable Segment. These are Sales, Profits or Assets Test. A business segment or geographical segment should be identified as a reportable segment if it satisfies any of the following conditions:

a. Its revenue from sales to external customers and from transactions with other segments is 10 per cent or more of the total revenue, external and internal, of all segments; or
b. Its segment result whether profit or loss, is 10 per cent or more of-

    i. The combined result of all segments in profit, or

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ii. The combines results of all segments in loss, whichever is greater or absolute amount; or

c. Its segment assets are 10 per cent or more of the total assets of all segments.

If total external revenue attributable to reportable segments constitutes less than 75 per cent of the total enterprise revenue, additional segments should be identified as reportable segments, even if they do not meet the 10 per cent thresholds, until at least 75 % of total enterprise revenue is included in reportable segments.

What should be reported about segments?

An enterprise should disclose the following for each reportable segment:

a) Segment Revenues
b) Segment Result, usually the net profit or loss.
c) Total carrying amount of segment assets.
d) Total amount of segment liabilities.
e) Total cost incurred during the period to acquire segment assets that are expected to be used in more than one period i.e Segment Capital Expenditure during the period.
f) Depreciation and Amortisation expense included in Segment Results.
g) Other non-cash expense included in Segment Results.

3. Survey Findings

Table 1: Distribution of Companies by Number of Segments Disclosed

Number of segments reported	Number of companies	Average Revenue Rs.Crores	Average Profits Rs. Crores
1	54	1258.15	92.95
2	19	217.98	14.00
3	14	980.66	131.35
4	8	1851.40	385.71
5	1	660.81	226.11
6	0		
7	1	69.41	2565.13

The smallest number of segments under which financial results are reported is one. Companies reporting their results under a single segment treat the entire business of the company as falling under a single segment.

A majority of the companies in our sample (54/97) report their results under a single segment. These companies with average Revenue of Rs. 1258.15 crores and average profits of Rs. 92.95 crores are large relative to the rest of the companies in the sample. There are four large oil refining and distribution companies in our sample, all of which report their financial results under a single segment. The oil companies are a significant influence on the average revenues and profits of the 54 companies.

One company reports its financial results in 5 segments and another in 7 segments. The remaining companies in the sample report their financial results in 2,3,or 4 segments.

9 out of 11 banks in our sample report their financial results in a single segment. UTI Bank, a relatively new bank reports its results in 4 segments and State bank of India reports its results in 3 segments.

Table 2: Distribution of Companies by their Basis of Segments

Basis of Segments	Number of Companies
Business	34
Customer	3
Geography	3
Geography and Business	2
Miscellaneous	1

Of the 43 companies, which report their financial results in more than one segment, 34 adopt a business-based segmentation (Table 2).

Table 3(a): Distribution of Companies by % Revenues of Largest Segment by revenues to Total Revenues

% Revenues of Largest Segment to Total Revenues	Number Of Companies
> 90 %	15
80% - 90%	6
70% - 80%	5
60% - 70%	7
60% - 50%	6
Less than 50%	4

Of the 43 companies, which report their financials in more than one segment, for 15 companies the largest segment (measured on Revenues) contributes more than 90% of the Total Revenues. {Table 3 (a)}
Out of the 15 companies in category 1, 9 companies reported 2 segments and 6 companies reported 3 segments.

Table 3(b): Distribution of Companies by % Assets of Largest Segment by Assets to Total Assets

% Assets of Largest Segment to Total Assets	Number of Companies*
> 90 %	11
80% - 90%	5
70% - 80%	8
60% - 70%	3
60% - 50%	3
Less than 50%	10

*3 companies in our sample have not reported the capital employed under segmental results.

Likewise for 11 out of the 43 companies, the largest segment (measured on Assets) accounted for more than 90% of the Total assets of these companies. {Table 3(b)} Out of these 11 companies, 9 companies reported in 2 segments and 2 companies reported in 3 segments.

Table 3(c): Distribution of Companies by %Profits of Largest segment by Profits to Total Profits.

% Profit of Largest Segment to Total Profit	Number of Companies*
> 90 %	19
80% - 90%	5
70% - 80%	3
60% - 70%	3
60% - 50%	2
Less than 50%	10

*One company in our sample reported a loss in its largest segment.

In 19 out of the 43 companies, the largest segment (measured on Profits) contributes more than 90% of the total profit of these companies. {Table 3(c)}
Out of these 19 companies 12 companies reported 2 segments, 4 companies reported 3 segments, 2 companies reported 4 segments and 1 company reported 7 segments.

An analysis of companies (Refer Appendix 2) in the more than 90% category in Tables 3(a), 3(b), and 3(c) reveals 10 companies are common to this category across the three tables. In other words, for 10 of the 43 companies reporting their financial results in more than one segment, the largest segment accounts for more than 90% of the Revenues, Assets, and Profits. The segmental data of these 10 companies is unlikely to be any more illuminating than if these companies had reported their financial results under a single segment as 54 other companies in the sample have done.

4. Discussion:

According to AS 17 Segment Information would help users of financial statements:

a. Better understand the performance of the enterprise;

b. Better assess the risks and returns of the enterprise; and

c. Make more informed judgments about the enterprise as a whole

This is particularly true when enterprises provide groups of products and services or operate in geographical areas that are subject to differing rates of profitability, opportunities for growth, future prospects, and risks.

From a reporting company's perspective reporting segmental financial results is not without a cost. The costs of additional record keeping and information processing that reporting segmental financial results would engender is likely to be small compared to the costs that might arise from use of such of information by competitors or by potential entrants into the industry. Not surprisingly Bradbury (1992) reports that of 29 companies listed on the New Zealand Stock Exchange at that time, 14 made no segmental disclosures. This was at a time when segmental disclosures were not mandatory in New Zealand. Likewise McKinnon and Dalimunthe (1993) found that only 15 out of their sample of diversified, listed Australian companies voluntarily disclosed segmental information. Casual evidence shows that there were very few listed Indian companies which disclosed segmental information before it was mandated by AS 17.

Our survey suggests that even the mandating of segmental disclosures by AS 17 has not resulted in a substantial improvement in such disclosures by listed Indian companies. 64 out of the 97 companies in sample virtually disclose no segmental financial information. However, in doing so none of these companies have violated the provisions of AS 17!

As 17 offers the management of a company the discretion to decide whether there are distinctive reportable segments in the company. A segment is distinctive from another if the two differ in their sources of risks and returns. As a guide, AS 17 suggests that companies use their internal organization and management structure in addition to the system of internal financial reporting to the Board of Directors in identifying reportable segments.

Our survey indicates that at least some of the companies in our sample are not applying these criteria in identifying reportable segments. The Oil Refining and Distribution companies typically view their regulated business (e.g. petrol and diesel) as being different from the unregulated business (e.g. lube) in terms of risk and return. This is also reflected in the Chairman's statements in the annual reports of some of the companies. Yet these companies choose to report their entire business in a single segment. Likewise hotel companies which view risks and returns as being distinctive in their luxury, business, and tourist and/or budget segment are found to report their financial results under just two segments: Hotels and Others.

The survey finds that segments in which financial results are reported differ across companies, which are seemingly similar. Nine out of eleven banks in our sample report their financial results under a single segment. UTI Bank reports its financial results in four segments, viz. corporate, retail, treasury, and others. State Bank of India reports its financial results under three segments viz. Domestic Banking, Domestic Treasury and International Banking. Infosys reports its results in Financial

Services, Manufacturing, Telecom Products, Retail, and Others. Wipro reports its results in Global IT services, India and Asia Pacific IT services, Consumer Care and Lighting and Others. Comparability of financial results across companies is likely to be vitiated by the choice of reporting segments adopted by companies. Regulation is unlikely to remove this problem.

For analysts and other users of financial statements, the mandating of AS 17 does not necessarily better and more detailed information in a company's financial reports. Even when a company reports its financial results under different segments, it is unlikely to be in a form that would allow easy comparisons with other similar companies.

Not surprisingly the evidence on the usefulness of segmental disclosures is limited. Horwitz and Kolodny (1977) and Twombly (1979) find that segment data has no information content. Simonds and Collins (1978) and Dhaliwal et al (1979) provide evidence that segment data may affect market's assessment of a firm's risk and return. The evidence on the predictive utility of segment data is likewise mixed. Kinney (1971) and Collins (1976) provide evidence that segment information improved forecasts. Silhan (1982) and Bradbury and Marsden (1988) find no or mixed evidence on the predictive utility of segment information.

In mandating AS 17 the regulators have done their job. For AS 17's objective to be achieved more listed firms must disclose segmental information and in a more meaningful way. How might this happen? Firms, which do not disclose their financial results under different segments, though other similar firms may be doing so, could face market pressures to conform. The market may interpret non-disclosures of segment information unfavorably. Of course, if firms in an industry act in concert, as the Oil Refining and Distributing companies and distributing companies in our sample seem to be doing, this pressure of the market is less likely to be felt.

The problem of segments that are not comparable across seemingly similar firms is likely to persist. Here again, if a firm has some "good news" about itself as presented under segments similar to those disclosed by competition, it might choose to disclose its financial results in such segments and invite comparison. This implies that firms would be using disclosures strategically, an idea that is finding increasing support in literature.

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Appendix -1

Sample Companies

Amara Raja Batteries Ltd
Apollo Tyres Ltd
Aksh Optifibre Ltd
Aft Industries Ltd
Birla Ericsson Optical Ltd
Bal Pharma Ltd
Bhushan Steel & Strips Ltd
Bharat Petroleum Corporation Ltd
Corporation Bank
Cg Igarashi Motors Ltd
Cosmo Films Ltd
The Dhanalakshmi Bank Ltd
Essar Shipping Ltd
Electrosteel Castings Ltd
The Federal Bank Ltd
Gujarat Ambuja Cements Ltd
Hindustan Petroleum Corporation Ltd
Hindalco Industries Ltd
Hindustan Zinc Ltd
Hero Honda Motors Ltd
Ip Rings Ltd
Indian Oil Corporation Ltd
Jaiprakash Industries Ltd
The Jammu and Kashmir Bank Ltd
Karnataka Bank Ltd
The Karur Vysya Bank Ltd
Kochi Refineries Ltd
Kaashyap Radiant Systems Ltd
LIC Housing Finance Ltd
Mahanagar Telephone Telephone Nigam Ltd
Morgan Stanely Mutual Fund
Morepen Laboratories Ltd
Moser Baer India Ltd
Nalco Chemicals India Ltd
Nuclear Power Corporation Of India Ltd
Oriental Bank of Commerce
The Paper Products Ltd
Porritis & Spencer (Asia) Ltd
Polyplex Corporation Ltd
Punjab Tractors Ltd
Punjab National Bank
Ransi Software India Ltd
Sun Pharmaceuticals Industries Ltd
Suprajit Engineering Ltd
Strides Acrolab Ltd

Appendix-1 (Continued)

Shree Cement Ltd
The South Indian Bank Ltd
TamilNadu Newsprint and Papers Ltd
Unistar Multimedia Ltd
Ucal Fuel Systems Ltd
V.S.T. Tillers Tractors Ltd
Vikas Wsp Ltd
Wockhardt Ltd
Yash Papers Ltd
Britannia Industries Ltd
Bharat Forge Ltd
Castrol India Ltd
Disa India Ltd
Diigital Global Soft Ltd
EIH Ltd
Fag Bearings India Ltd
Gati Ltd
Henkel Spic India Ltd
Himatsingka Seide Ltd
Ingersoll-Rand(India) Ltd
Indo Rama Synthetics (India) Ltd
J.K Industries Ltd
Orchid Chemicals & Pharmaceuticals Ltd
SSI Ltd
Tata Chemicals Ltd
Tata Tea Ltd
Vesuvius India Ltd
Vindhya Telelinks Ltd
Apollo Hospitals Enterprise Ltd
Bajaj Auto Ltd
Conour Technologies Ltd
Dredging Corporation of India Ltd
Gas Authority of India Ltd
Himachal Futuristic Communication Ltd
IDL Industries Ltd
Jindal Steel & Power Ltd
Khoday India Ltd
Mukta Arts Ltd
Mascot Systems Ltd
Neyveli Lignite Corporation Ltd
State Bank of India
Universal Cables Ltd
ITC Ltd
Larsen & Toubro Ltd
Mphasis BFL Group Ltd
Oil and Natural Gas Corporation

Appendix - 1(Continued)

PNB Gilts Ltd
Raymond Ltd
UTI Bank
Wipro Ltd
Infosys Technologies Ltd
Gujarat Mineral Development Corporation Development Ltd

Appendix 2

Companies Having % Revenue of Largest Segment to Total Revenues - > 90%	**Name of the Companies by % Assets of Largest Segment to Total Assets- > 90%**	**Name of the Companies by % Profits of Largest Segment to Total Profits- > 90%**
Bharat Forge Ltd	Bharat Forge Ltd	Britannia Industries Ltd
Digital Global Soft Ltd	Digital Global Soft Ltd	Bharat Forge Ltd
EIH Ltd	EIH Ltd	Digital Global Soft Ltd
Fag Bearings India Ltd	Fag Bearings India Ltd	EIH Ltd
J.K Industries Ltd	Gati Ltd	Fag Bearings India Ltd
Orchid Chemicals and Pharmaceuticals Ltd	Orchid Chemicals and Pharmaceuticals Ltd	Gati Ltd
Tata Tea Ltd	Tata Tea Ltd	Himatsingka Seide Ltd
Vesuvius India Ltd	Vesuvius India Ltd	J.K Industries ltd
Vindhya Telelinks Ltd	Vindhya Telelinks Ltd	Orchid Chemicals & Pharmaceuticals Ltd
Apollo Hospitals Enterprise Ltd	IDL Industries Ltd	Tata Tea Ltd
Bajaj Auto Ltd	Khoday India Ltd	Vesuvius India Ltd
Dredging Corporation of India Ltd.		Vindhya Telelinks Ltd
IDL Industries Ltd		Apollo Hospitals Enterprise Ltd
Khoday India Ltd		Dredging Corporation of India Ltd
Neyveli Lignite Corporation Ltd		Gas Authority of India ltd
		Khoday India Ltd
		ITC Ltd
		Wipro Ltd
		Gujarat Mineral Development Corporation Ltd