The New Age of Increased Investor Due Diligence

BlackLine study of investor attitudes to financial data, risk and reporting

Getting into the minds of investors and understanding how they make their decisions is part-and-parcel of building a successful business – however, most business leaders would agree that this is easier said than done.

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When it comes to impressing investors, one might think that comprehensive market data or a detailed understanding of complex macro-economic trends would help give a company its edge. But the fact remains that some of the best ways to demonstrate business success and future potential can be found in the finance department.

After all, clarity over how a company finances its operations should be a crucial part of investment decision-making. Financial reports, data and metrics are all vital tools that can help investors understand company performance, as well as potential risk. But in the face of unpredictable geo-political events, economic conflicts, currency fluctuations and rumors of recession in several major economies, do investors actually scrutinize the books as closely as they should? Should CFOs and finance professionals worry about investors finding errors in their accounts? Or do investors simply have ‘bigger fish to fry’?

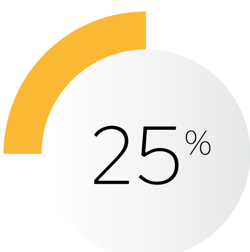
Against a backdrop of high profile misreporting and fraud scandals that have shaken trust in audit and accounting globally, investors should care about the minutiae of financial data now more than ever before. Surely, the best way to avoid nasty surprises is through a cold, hard look at the numbers and the story they tell.

We wanted to understand if this really was the case and, if so, what role Finance & Accounting can play in reinforcing investor confidence in business. To find out, we worked with independent research firm Censuswide and asked over 760 institutional investors* what they thought about the financial controls and processes at their portfolio companies, as well as how companies' financial practices impact their decision-making.

Here’s what we found.

Current Financial Practices are Undermining Investor Confidence

Although financial statements are a critical decision-making tool for investors, the vast majority of investors do not believe companies use them to present an accurate and realistic view of their accounts. As many as 8 out of 10 (82%) believe that finance departments often resort to legal, but 'creative' accounting tactics as the period ends in order to satisfy or attract investors.



Furthermore, a quarter (25%) of investors singled out evidence of 'creative' accounting as the factor that would make them the least likely to invest in a company, suggesting that investors not only believe finance professionals regularly fail to disclose**—or even deliberately distort—**the full picture, but also do not have confidence in businesses with opaque financial practices.

"In many ways the international business landscape is more complex, uncertain and challenging than it was a year ago. Companies are therefore under increasing pressure to perform and retain a competitive edge. It is concerning, however, that just 1% of the investors we surveyed did not think creative accounting tactics were used at any of their portfolio companies, suggesting that a general lack of transparency is undermining the perceived integrity of financial data globally. Better accuracy, control and visibility is going to be absolutely critical for companies to outlast their competitors and foster confidence with investors."

Therese Tucker, CEO, BlackLine

Poor Financial Controls are a Major Red Flag

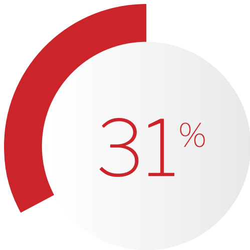
In addition to questionable accounting tactics, there are a number of other issues that raise red flags for investors – nearly all of which can be laid at the finance department's door. While management teams may believe investors are concerned about sector potential or who's on the board, in reality, avoiding unnecessary and unwarranted financial risk is a top concern.

Less than 1% of those surveyed said they would still invest in a company with poor financial controls without taking some form of corrective action first, evidence that bad controls don't just worry investors, they directly impact their behavior. This suggests that finance departments can contribute significantly to business success, simply by putting proper processes in place.

A third (33%) of investors said risk of internal financial fraud or financial non-compliance was the factor that would make them least likely to invest in a company

Over a quarter said that filing an adjustment post reporting (29%) or financial reports that often contain errors (28%) make them less likely to invest

Consistently late filings were also a red flag for a quarter (25%), while 29% said they are put off if a company shows no evidence of long-term financial planning



Almost a third (31%) said if an interesting investment opportunity arose, but the company showed bad financial controls, they would impose changes on the company before they invested

Over a quarter (29%) would investigate the company in much more detail if they saw evidence of poor controls – a similar number (25%) would recommend changes to the company's management team before investing

"With the uncertainty that exists today from all the change we're experiencing, investors and the capital markets in general like surprise disclosures and restated financial statements less than ever. In fact, they are quick to penalize companies that have these problems. Trust in the numbers and what we at EY call 'digital confidence' in business process are critical factors to maintaining growth and shareholder return. We believe products like BlackLine are key enablers of this capability providing for a resilient enterprise focused on building value with no surprises along the way."

Tony Klimas, Principal, Global Performance Improvement Finance Leader, EY

Real-Time Access to Financial Data Reassures Investors

It is likely that high profile examples of financial fraud, non-compliance and aggressive or murky accounting tactics have contributed to investor attitudes. Over half (58%) said they were increasingly worried by a lack of transparency in their portfolio companies' financial statements. However, technological innovation in finance, particularly through automation, also means there is now no excuse for poor controls or a lack of visibility over the numbers.

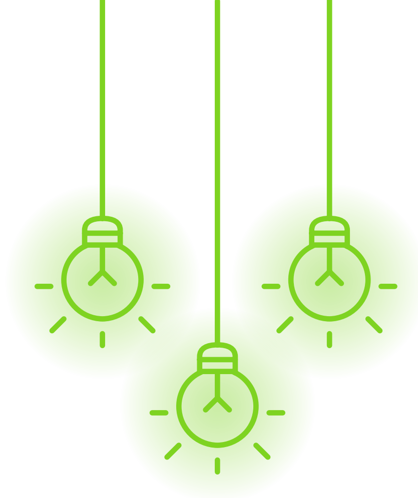
Perhaps as a result, many investors are now demanding a closer, more granular view of companies' financial data and want to understand how organizations are performing in near real-time.

When asked what the most important factors were when deciding whether to invest in a business:

A company's financial growth forecasts (46%) and access to real-time snapshots of its finances (42%) were two of the top considerations, suggesting that investors are forward-looking, but also want a clear picture of what's happening now

Close to half (46%) of those surveyed also said key metrics within a company's financial reports, such as audited statements of income or cash flow, were important when it came to deciding whether to invest

Real-time snapshots of data and key metrics in financial reports were even more important for investors than global or domestic market trends (41%) or economic outlook (39%)



"The business benefits of efficient and effective financial processes cannot be overstated. Real-time access to accurate financial data allows finance to deliver insights that support business growth, and also provides reassurance for stakeholders that they can trust the numbers. This is where finance can go beyond its traditional role as a transactional process or cost center. We know firsthand from working with BlackLine (and other cloud tech providers) how automation can help finance organizations remove the manual and time-intensive tasks, allowing us to become better business partners."

Carly Knoll
Director of Finance Technology and Strategy
Campbell's

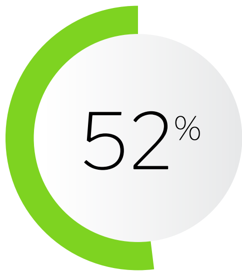
Evidence of Good Financial Management is Vital

Investors were unanimous in their appreciation for effective financial management. According to those surveyed, one of the best ways for a company to reassure its investors is simply to demonstrate that it can properly manage its finances. In fact, the majority of investors globally said that evidence of good financial management actually helped them make more informed decisions.

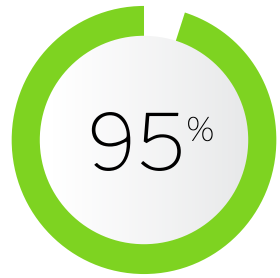
Nearly all (95%) investors either strongly agreed or agreed that clear evidence of good financial management was key to their decision-making process

“Competing in today’s business environment requires accurate data to support increasingly complex growth strategies. The demand for accurate financial information isn’t just each month, but weekly and for some companies daily. This is not a problem that can just be solved by adding more human resources to process more data and generate reports. Greater transaction volumes, more complex operating models, and demands for greater business insights needed to enable strategic decision-making will require improved application of data processing automation and improved data models.”

Ralph Canter, Managing Director
Financial Transformation
KPMG



Proof that a company has a good track record of accurate financial reporting was also crucial, with over half (52%) strongly agreeing they needed evidence of this in order to make informed decisions



Additionally, near real-time oversight of a company's financial data was important, with 95% of investors agreeing they need this to make well informed decisions about a company

"As businesses become more global and complex, the data volumes they need to handle, report on and utilize also become more complex. This creates additional challenges for accuracy and visibility, which extend far beyond internal reporting lines. Enhanced data models augmented with new cloud technology, such as BlackLine, can play a key role in helping to improve accuracy and transparency, providing executives with the information they need to dispel shareholder concerns and compete in today's environment."

Tom Toppen, Managing Director, Deloitte & Touche LLP

BlackLine's Take

Clearly investors are worried about a lack of control and transparency when it comes to the financial data and practices at large organizations. Evidently, the ripples of recent audit and accounting scandals are spreading far beyond finance departments or companies' management teams. It seems that a general lack of access to accurate, up-to-date financial data is making investors nervous, which will undoubtedly give CFOs pause for thought.

This picture is even starker when investor attitudes are viewed within the context of BlackLine's 2018 survey, which indicated that not only are reporting errors prevalent, but that many of these inaccuracies remain hidden until it is too late. These unseen errors increase the likelihood of misreporting, late filings and restatements – all of which carry reputational, regulatory and legal risks, in addition to undermining investor trust.

A lack of appropriate controls is creating an unacceptable and unnecessary level of risk for many companies, which is simply not sustainable in an increasingly complex and challenging business environment. Going forward, a crystal clear view of the numbers and the ability to analyze and interpret them will be absolutely vital. Otherwise, businesses may find themselves losing their competitive edge, as well as the confidence of the people who foot the bills.

The good news is that there is a clear opportunity for Finance & Accounting to lead the way when it comes to supporting business competitiveness and protecting investor trust. By embracing technology and automation, finance organizations can regain control over their data and processes, giving them access to the granular financial data that not only reassures investors, but also provides insights to support business growth.

Notes on methodologies and research criteria

The research was conducted by Censuswide, with 763 institutional investors in six markets (U.S., U.K., France, Germany, Australia and Singapore) at companies with $100M USD minimum (or equivalent) of assets under management. Sample sizes for respondents were as follows:

U.S.: 204 U.K.: 150 France: 101 Germany: 101 Australia: 107 Singapore: 100

The survey was conducted online between July 22nd and August 8th 2019.

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