

## SECTION 3. General issues in management

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### How business reporting changed during the financial crisis: a comparative case study of two large U.S. banks

#### Abstract

Challenging times, such as the recent financial crisis, appear to cause organizations to change their business reporting. Yet, there is not much evidence of how changes in business reporting were enacted by banks, and there is only little discussion about the extent to which this can be seen and assessed as crisis communication. Using a comparative case study of two U.S. banks, we investigate how their way to report financial performance changed during the ‘troubled times.’ The investigation uses annual reports that cover years before and during the financial crisis.

The findings suggest that the two banks have substantially changed their business reporting due to new regulations, the unfavorable economic situation, as well as strategic challenges such as loss in customer satisfaction. We thus conclude that business reporting can be seen – at least temporarily – as a tool for crisis communication. We document our findings along the four perspectives the banks use for their business reporting and that reflect the banks’ main stakeholders: shareholders, customers, employees and the community.

**Keywords:** banks, financial crisis, financial reporting, banking regulation, crisis communication.

**JEL Classification:** M10, G21.

#### Introduction

Business reporting contributes to effective investment allocation in capital markets (AICPA, 1994). An effective allocation through transparent markets is critical for sustainable growth, and it ensures sufficient liquidity for traded securities. Nonetheless, non-transparent markets imply a flawed allocation process and prevent companies from accessing capital at fair, risk-adjusted rates. To help investors make informed decisions, traded companies in the U.S. are legally required to communicate adequate and accurate information on their financial and operational performance. At the same time, the annual report is an important pillar of the public relations strategy and thus corporate communication (Fearn-Banks, 2002). Containing for example financial statements, risk reports, Management Discussion and Analysis (MD&A), or letters to shareholders, annual reports are regulated by laws and accounting standards, which obliges corporate management to disclose material information that is relevant for the shareholders of these companies (Brown and Tucker, 2011). Despite these laws and standards, management has some discretion in tailoring the reports, e.g., relating to the balance of financial and non-financial indicators that are presented to shareholders (Pallisserry, 2012). This is necessary to keep the reported information up-to-date with the trends, regulations, and needs of market participants (Brown and Tucker, 2011; Hales et al., 2011). There is evidence of how companies adjust their reporting to changing environments. For

example, they change the language tone, refer to (neutral) market observers like the Security and Exchange Commission (SEC) as a proxy for quality, manipulate earnings, or change disclosure practices (Barron et al., 1999; Bartov and Mohanram, 2004; Brown and Tucker, 2011). Specifically, Keusch et al. (2012) find that non-bank managers make the deliberate attempt to present their work in a favorable light when the company is undergoing a crisis. However, little research has been done on reporting changes on financial and non-financial ratios in banks and how these changes relate to their environment. Therefore, publications on corporate communication or public relations in the banking sector are scarce (for a literature review see Gudlaugsson and Eysteinnsson, 2012) and a focus on banking reporting seems to be completely absent. While these aspects are of on-going interest for business reporting, the most recent financial crisis offers an excellent opportunity to follow up on some of these changes. In particular, the business reporting of banks during the crisis is of special interest, as the crisis originated in the financial industry, resulting in a controversial debate about the lack of transparency of the banking sector, dubious products such as subprime debt, and the disclosure of associated risks (Van der Stede, 2011). All these debate factors constitute a negative change, thus a crisis, not only for the public, but also for the banks themselves. Banks run reputation-sensitive activities (e.g. funding via deposits) such that they need a sufficiently good reputation and are forced to restore reputation lost during a crisis (Benoit, 1995). Crisis communication is defined as “*the dialog between the organization and its publics prior to, during, and after the negative occurrence*”

(Fearn-Banks, 2002, p. 2). Even though we cannot automatically assume that the banking report is a purposeful part of the crisis management process (Coombs, 1999), we can analyze it with regards to its dialogic potential.

Our study will thus discuss the recent developments in the communication of changing reporting behavior in the banking sector. In particular, we ask how banks re-balanced their reporting on financial and non-financial goals during the financial crisis. We employ a mixed-method strategy combining thematic analysis (Guest, 2012) with quantitative content analysis (Roberts, 2000) within the frame of a comparative case study in the country of origin of the crisis over a period of 15 years. We thus cover the time before and after the crisis, following the two U.S. banks 'Bank of America' and 'Wells Fargo'. We pose the following research question: *Do (non-)financial goals in corporate reporting become more important when financial performance deteriorates, regulatory uncertainty increases, or the bank's strategic priorities change?*

Our main findings are organized along four perspectives that the two banks use for their business reporting and that we use as our data-driven thematic analysis categories (Guest, 2012). These four perspectives – as themes – did not change over time. Thereby, they provided a stable framework for change analysis and comparison. These four themes are: the shareholder perspective, the customer perspective, the employee, and the community perspective. Though these themes are data-generated, they reflect well the number of both external and internal stakeholders necessary to be considered in crisis communication (Frandsen and Johansen, 2011). Literature on effective crisis communication, especially that of a company during the financial crisis, suggests that (at least) shareholders, employees as “one of the most important resources of a company” (Dumitru, 2013), and customers should be addressed or included. Depending on the company and its structure managers, auditors and creditors may be included as well. Concerning the shareholder perspective, we find that both banks are engaged in some smoothing of income. Also, they introduced new measures that made their poor performance look more favorable. In addition to this, they de-emphasized the financial perspective and shifted their focus towards more reporting of non-financial indicators from the other three perspectives. As to the customer perspective, banks tried to increase transparency for products and improve service for customers. Before the financial crisis, these measures were generally not linked to real initiatives. This deficit improved after the crisis. As to the employee and community perspective, the banks shifted from

measuring their commitment by monetary indicators towards non-monetary indicators, such as the hours donated by employees to community projects.

The remainder of the paper is organized as follows. Section 1 outlines the theoretical foundation of crisis communication and business reporting during the financial crisis. We explain our methodology in section 2 and present our findings in section 3. The concluding section highlights contributions and limitations of this paper and points to a future research agenda.

## 1. Theoretical background

Business reporting shapes investor and analyst expectations of the persistence of favorable or unfavorable performance. Beyond the financial information in the annual reports, the less regulated MD&A is specifically informative for the users of financial statements. Brown and Tucker (2011) argue that business reporting should change constantly with a company's environment in order to stay up-to-date and decision-relevant. Matsumoto et al. (2011) argue that managers will adjust reporting in both good and in troubled times to strengthen the credibility of their positive forecasts or to provide more explanation on the nature of unfavorable events. Yet, especially in troubled times, organizations that seek effective crisis management will adjust their entire communication to restore the damaged or endangered reputation and to seek the support of the texts' public (Fearn-Banks, 2002, p. 3). Hence, we expect clear changes of the business reporting of banks during the financial crisis. Specifically, changes in business reporting have been associated with pivotal factors like changes in regulation, window dressing during troubled times, and strategic challenges, e.g., customer satisfaction (Hales et al., 2011; Hussain and Hoque, 2002; Keusch et al., 2012). We will elaborate on these in the following.

**1.1. Regulation in the U.S. banking industry.** Financial services are the most regulated industry in most economies (Allen and Carletti, 2010). In the U.S., several institutions regulate the financial sector, e.g., the Office of the Comptroller of the Currency (OCC), the Federal Reserve, the Federal Deposit Insurance Corporation (FDIC), the Securities Exchange Commission (SEC), and the Consumer Financial Protection Bureau (CFPB). Especially, accounting bodies such as the Financial Accounting Standards Board (FASB) issue standards for business reporting (Keusch et al., 2012).

However, regulation has been criticized as it did not prevent events like the most recent financial crisis. Several researchers argue that the ineffectiveness of the regulatory system and the failure of accounting frameworks in banks are among the major reasons

behind the current troubles faced by banks, especially in the U.S. (Evanoff et al., 2011). Allen and Carletti (2010, p. 11) summarize that the “*current structure of banking regulation is more a series of answers to accidents in the past rather than the implementation of a clear regulatory design.*” Wehinger (2012) notes that policy makers have not done enough to address the current crisis and to restore confidence in the market. At the same time, increasing the number of reports does not seem to be effective either. The director of the Financial Crime Enforcement Network, William Fox, calls for measures to deter banks that fill out unneeded reports to avoid criticism from regulators: “*The defensive filing of SARs frankly, in our view, is as big a failure as not filing in many respects [...] The problem with doing that is that we get flooded with information. It actually does distract our analytical capabilities and the capabilities of law enforcement and intelligence agencies as they try to trace down the really bad apples.*” (Blackwell, 2004, p. 3). Disclosure in risk measurement and management – one of a bank’s core competencies – is poor according to Linsley, Shrivies & Crumpton (2006), as the disclosures contain little quantitative information. And if it is quantitative, it often reads how much risk banks have been running instead of how much they are currently running. Regulators have identified this gap and regulated the risk disclosure of banks in Basel II, commonly referred to as Pillar III-reporting (Basel II, 2006, p. 228ff). However, the recent financial crisis revealed further opaqueness in risk reporting leading to undesired market freezes (e.g. in some interbank markets) triggering further, more recent risk reporting initiatives by the Financial Stability Board (EDTF, 2012) and the European Security Markets Agency (ESMA, 2013). Disclosure has some regulated and some non-regulated parts. Highly regulated is the accounting section, moderately regulated is the risk reporting as described before. The section that is less regulated is the one on performances, although the FASB-initiative also proposes minimum standards for (business) strategy reporting. Our study concentrates on the less regulated section, business reporting, where banks still have a substantial degree of freedom of what to disclose and how to present it. Our study analyzes what and how banks report on their performance during troubled times and how this compares to calm times. Higher transparency is not unconditionally desirable. As Goldstein and Sapra (2012) point out, the revelation of sensitive (stress test) information during times of crisis can have destabilizing effects. Moreover, information that is not sensitive in normal times might become sensitive in volatile times if investor’s risk aversion increases.

Finally, the same information could be sensitive to some stakeholders, but not to others. As customers are further recipients of the shareholder sections of an annual report, each section must serve its original target group but must keep in mind the potential impact if a different stakeholder reads it. Therefore, adjusting the reporting framework conditional on the performance appears rational.

**1.2. Economic trends and window dressing.** Keusch et al. (2012) compare business reporting in normal times and during a crisis. They find that top managers engage in impression management during times of crisis by directing their behavior purposefully at a selected public to receive positive perception (Gardner and Martinko, 1988). Specifically, they attribute the negative results on external factors, while positive results are presented as related to their managerial actions. In addition to this, top managers use legal manipulations to smoothen profits of a company, e.g., by using their discretion to decide whether or not assets, revenues, or costs should be accounted for in the old or in the new quarter (‘window dressing’). Specifically U.S. banks use these techniques to slim down their balance sheets before reporting their results (Story, 2010). Many of these practices that helped the collapsed investment banks like Lehman Brothers to temporarily mask their poor financial performance are still openly employed by other banks now in the wake of the financial crisis.: “*It’s an open secret on Wall Street that many big banks routinely – and legally – fudge their quarterly books*” (Story, 2010, p. B4).

**1.3. Strategic challenges (customer satisfaction).** The reputation among customers matters for the financial performance of a bank. Thus, customers can be conceptualized as external stakeholders of a bank. Banks offer very homogeneous products (like deposits), and the depositor’s decision to stay with one bank or another depends on the trust a customer has in a particular bank (Heffernan, 2005). Moreover, banking is subject to very high fixed costs, which makes large customer volume a pivotal success factor. Although important in commercial banking, this is even more important in investment banking where large players can reduce cost by pooling and netting.

Trust and corporate communication are strongly interconnected and interdependent according to Valentini and Kruckeberg (2011). From a social science perspective, to build this trust and to attract a large number of customers, banks need to communicate with customers. A proxy for this is the degree of transparency in the annual reports and specifically how detailed banks report on their

initiatives to increase customer satisfaction. In particular, large banks are losing customers to small banks and credit unions. On the one hand, these smaller banks score high on customer satisfaction, because they were able to give more personalized service (Index, 2011). On the other hand, customers of large banks expressed many sources of dissatisfaction, including the inability to obtain loans at fair rates, prolonging old loans, and the lack of transparency on how the credit scoring actually worked (Index, 2011).

## 2. Methodology

**2.1. Case study method.** Comparative case studies are an appropriate method for understanding complex issues that involve a nexus of organizational processes such as business reporting (Yin, 2009). Specifically, case-oriented analysis can successfully resolve paradoxes involving parallel cases (e.g., two banks) that yield different outcomes (e.g., business reporting or business models, cf. Larsen et al., 2014). Ragin and Zaret (1983) point out that comparative case-oriented methods can use mixed methods, in our case thematic analysis (Guest, 2012) and quantitative content analysis, to identify invariant relationships and explain the underlying patterns of association. A seminal example of this method is the study of Goutas and Lane (2009). They elucidate why the diffusion of shareholder value-oriented governance differs within two very similar German manufacturing organizations (Daimler Chrysler and Volkswagen), drawing on various sources of evidence.

**2.2. Sample selection.** U.S. banks are of particular interest in relation to our research question about business reporting during the financial crisis. The financial crisis originated in the U.S. financial industry and even challenged banks that were supposedly too big to fail. We opt to compare two listed banks as they are obligated to provide a wide range of data needed for a longitudinal, comparative case study. We deliberately limited the sample size to two cases to ensure a high level of detail and quality of our analyses.

Eventually, we selected Bank of America and Wells Fargo as our case examples. On the one hand, they

have much communality that makes them a suitable match for comparison: they are both based in the U.S., traded publically, located within the same institutional context, and have a similar customer base. Both banks rank among the largest in the U.S. Moreover, they share the same design of business reporting that is organized along the four perspectives: shareholders, customers, employees, and community. On the other hand, they obviously differ, as Bank of America performed substantially worse during the financial crisis than Wells Fargo. We found this to be an intriguing mix of similarities and differences, very suitable for a comparison of their changes in business reporting.

**2.3. Framework.** Comparative case studies first develop a framework against which the cases can be benchmarked. This way it is possible to compare two above or two below average cases with each other. Ragin and Zaret (1983) propose three steps by which to develop such a framework. The first step is to identify underlying similarities among members of a set, displaying any characteristics of interest. Secondly, these similarities should be shown to be causally relevant to the phenomenon of interest. Thirdly, a general explanation needs to be formulated on the basis of the common similarities identified.

Cheng and Humphreys (2012) argue that changes in information on the relevant external environment will reflect in the perspectives of business reporting. As a result, managers will re-evaluate the implications from their prior decisions and then attempt to use this set of information that makes the past course of event appear legitimate, i.e., window dressing. To be able to follow the managers' rationales for switching business reporting, we identified the perspectives along which the banks build their reporting by conducting thematic analyses, i.e., shareholders, customers, employees, and communities (Table 1, column 1). We list which contextual factors could impact manager's strategic judgments that would then reflect in the balancing of (non-)financial goals in the annual reports (Table 1, column 2). Consequently, we determined which data units we needed to look for to put our conjectures to a test (Table 1, column 3).

Table 1. Framework for analysis

Analyzed perspectives	Key performance indicators	Data sources
Financial ratios: <i>Shareholders</i>	Dividends Net income Retained earnings Word count Report themes	Financial highlights Letters to shareholders Industrial publications Video interviews
Non-financial ratios: <i>Customers</i>	Product change Reported turnover Report themes Language tone Word count	Satisfaction indexes Annual reports Industrial publications External analysts' reports

Table 1 (cont.). Framework for analysis

Analyzed perspectives	Key performance indicators	Data sources
<i>Employees</i>	Reported turnover Pictorial presentation Word count Reward/Benefit vs. results	Annual reports Industrial publications External analysts' reports
<i>Community</i>	Changes in donations Report themes Pictorial presentation Word count	Annual reports Other publications e.g. newspapers and magazines

**2.4. Data sources.** Table summarizes our data sources. Annual reports figure as the primary source. We review them with special emphasis on the letters to shareholders, as these are a pivotal medium of communication to investors and analysts for strategic investment decisions (Keusch et al., 2012). Furthermore, letters to shareholders reveal topics of major concern to management. A change in these topics suggests a change in management focus (Bradley and Baird Jr., 1977). We supplement data from annual reports by information from conference calls, external analysts' reports, financial/industrial publications, video interviews, and press interviews with CEOs, managers, regulators, and academics. Over the last decade, these non-mandatory communication channels have become a common form of voluntary disclosure. Matsumoto et al. (2011) argue that managers are able to provide more information in a less constrained fashion relative to financial statements and press releases.

**2.5. Analysis.** We analyzed the changes in the business reporting of the two banks across two time periods. The first phase (pre-financial crisis) spans 1997 to 2007, while the second phase (post-financial crisis) covers the period from 2008 to 2011. We thereby follow the heuristic staged approach suggested by Frandsen and Johannsen (2011, p. 348), where “*a pre-crisis stage, the crisis event, and a post-crisis stage*” are distinguished. However, due to the frequency of the annual reports, only the pre- and the post-crisis stage can be examined on a comparative level. The first phase examines how these banks balance reporting on the four perspectives under ‘normal’ conditions. The post-financial crisis phase traces the adjustments in report balancing. It accounts for changes in the banks’ corporate governance approaches, structures, visions and goals, as well as strategic priorities. Since the banks kept on reporting performance indicators along the same four perspectives (shareholders, customers, employees, and communities), we are able to follow strictly any changes over this 15 year period.

We enhanced our analysis of the four main themes that became the categories for our analysis (Fereday and Muir-Cochrane, 2006) by including basic quantitative content analysis, i.e., we apply word

frequency counts (the number of times the signifiers constituting our themes are mentioned in the annual reports: customer, employee, community, and shareholder). By doing so we use content analysis as “*a research technique for the objective, systematic, and quantitative description of manifest content of communications*” (Berelson, 1952, p. 74). All words were traced back to their context sentences to control for changes in meaning as well as ambivalences (Weber, 1990). In a second frequency count, we also included synonyms. For instance ‘shareholders’ could be replaced with ‘owners’, and ‘employees’ could be replaced with ‘team’, ‘staff’, ‘people’, or ‘members’. We extended word frequency count by observing the choice of cover themes on the first page of the reports, the general tone, or pictorial, and result presentation. Our guiding units of information were always determined by our four themes from the thematic analysis. Thus we combined a qualitative and a quantitative approach to textual analysis (Oleinik, 2011). The cases are presented as follows: in alphabetical order we discuss Bank of America first and Wells Fargo second. For each bank, we distinguish the pre- and post-crisis phases. In each phase, we discuss the reporting targeting shareholders, customers, employees, and communities.

**2.6. Case study 1: Bank of America.** Bank of America was founded in 1998 after the merger of what were then Bank America and Nations Bank. Its vision is to become the world’s finest financial services company. It has operations in 40 countries, providing services ranging from investment and corporate banking to investing in equity execution services. With more than 57 million consumers and small business customers in the U.S. alone, Bank of America enjoys high credit ratings from rating agencies. As of 29 November 2011, Standard and Poor 500 gave the bank an A rating. Bank of America has also been ranked 1<sup>st</sup> in the Top 1,000 rankings for three years in a row; 2010-2012 and among the first 5 since 1999 by the Tier 1-capital based ranking of Bankers Database.

**2.6.1. Pre-financial crisis.** The Anglo-American corporate governance idea suggests that shareholders are the prime stakeholder of a bank (Goutas and Lane, 2009; Lueg, 2008) and that their

perspective would outweigh other goals. According to our word count analysis in Figure 1 ‘shareholders’ rank only second, and most of the reports

address customer issues. The general upward trend is due to the fact that reports increased in length over time.

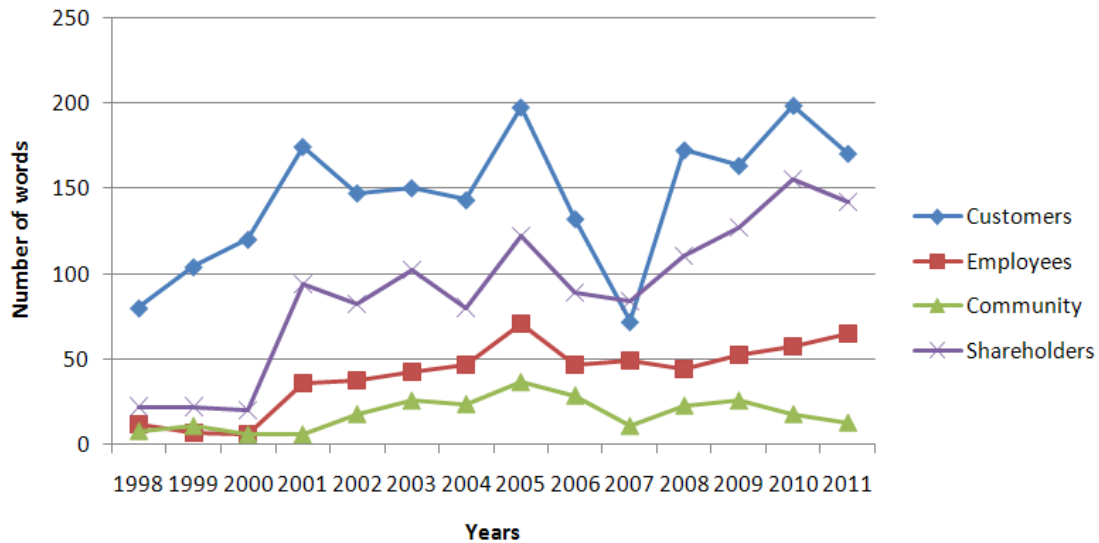


Fig. 1. Word count of search terms in the annual reports of Bank of America

We note two outstanding changes in Figure 1. In 2001, there is a steep increase in the number of times shareholders are mentioned. This is due to the fact that the new CEO Kenneth D. Lewis put more emphasis on them than his predecessor. Then in 2007, there is a sudden drop in the mentioning of customers. The

reason for this might be that Bank of America had poor financial performance that year (Figure 2). The board focused on explanations of poor financial performance and avoided mentioning shortcomings relating to customers, who are a main driver of this financial performance.

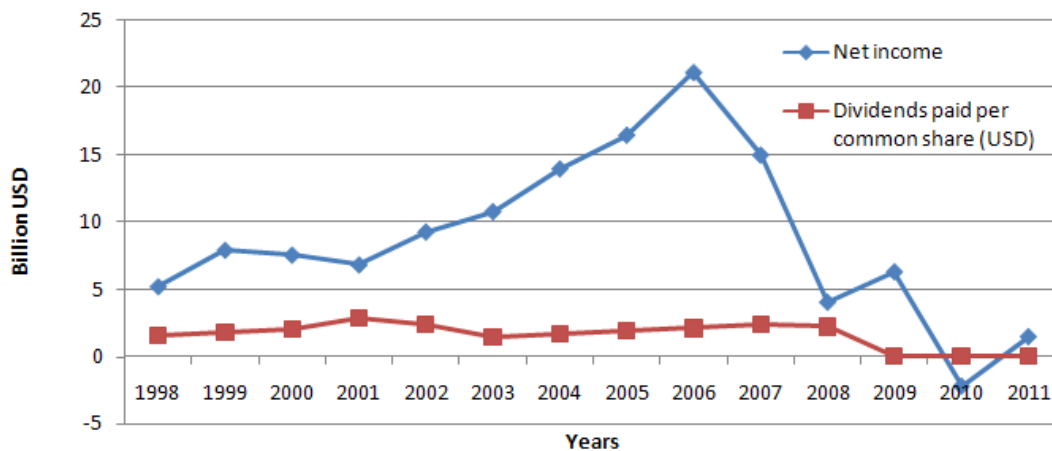


Fig. 2. Net income and dividends paid of Bank of America

*Shareholder perspective:* An indicator of the importance management attaches to each of its stakeholders is the bank’s choice of key performance indicators (KPIs). The relatively stable business reporting on shareholder-related indicators underscores the importance of shareholders. KPIs include net income, cash flows, (diluted) earnings per common share (EPS), return on average tangible assets, return on common shareholder’s equity, as well as efficiency ratios that are the operational drivers of financial success. A pivotal KPI that receives a lot of attention is the dividends paid, as they appear to be a hallmark of financial health in the eyes of Bank of America. In

2005, the bank proudly announced that it had raised quarterly cash dividends for the 28<sup>th</sup> time (Bank of America, 2005, p. 4).

Bank of America made a series of acquisitions in this pre-crisis time, especially Barnett Banks in 1998, 24.9% of Grupo Financiero Santander Serfin in 2002, and FleetBoston Financial in 2005. Its major merger was in 1998, when Bank of America merged with NationsBank. In relation to this, CEO Hugh L. McColl Jr. elaborated on three reasons for the merger in his letter to the shareholders: fixed cost digression, a larger product portfolio, and

deregulation that allows banks to grow to their optimal sizes. All three reasons are directed at increasing shareholder return: reducing fixed costs per unit increases profits; more products attract more customers and generate more revenue; and growth supports building of oligopolies and a 'too big to fail' guarantee against default.

Top management in Bank of America had very different styles when explaining why shareholder value creation was below or above expectations. For instance, management explained poorly performing stock prices in 1999 exclusively with reference to external factors (Bank of America, 2000, p. 3): (1) tightening interest-rate spreads that lowered earnings, (2) speculation against Bank of America as several competitors had declining performance and this bank was expected to be next; and (3) skepticism against the recent merger. Contrary, CEO Lewis related good performance to his own actions (Bank of America, 2001).

*Customer perspective:* Bank of America normally defined some KPIs ('what to measure') for the customer perspective as well. The bank listed what it intended to do and not do for the customers. But unlike the shareholder perspective, the customer perspective does not define initiatives or exact targets (how much it should be). If it did, these were normally not followed up on, which led to inconsistent business reporting. For instance:

1999: "We are integrating our businesses to make broad customer relationships easy and convenient for customers and profitable for the bank. We are rewarding broad customer relationships with enhanced products and services" (Bank of America, 1999, p. 3).

Instead of documenting the achievements of the 1999 initiative, the report in 2000 announced a new initiative.

2000: "To enhance customer awareness of our investment capabilities, we expect to expand the number of investment sales officers in banking centers to more than 3,500 by year end 2001, up from 2,500. We also plan to continue to grow our team of full-service investment consultants by 25% per year over the next three years" (Bank of America, 2000, p. 14).

Again, the announcement of the initiative in 2000 is not followed up/benchmarked against actual achievements although the objectives are easily measurable.

2001: "[...] attract, retain and deepen customer relationships and to improve customer and client service throughout the company" (Bank of America, 2001, p. 1).

2002: "For the year, the number of customers rating their satisfaction level a 9 or 10 on a 10-point scale – those we refer to as "delighted" – rose 10.4%, or 1.2 million customers across the franchise" (Bank of America, 2002, p. 4).

*Employee perspective:* The number of employees grew steadily before the crisis (2003: 133,500; 2004: 176,000; 2005: 176,638; 2006: 203,000; 2007: 210,000). Most of the reporting on employees relates to customers, e.g., that an increasing number of employees could serve customers better, or that more bilingual staff had been hired to appeal to different customer groups. Yet, there was no change in reporting on outcomes such as well being, training, professional career development, employee stock option plans, retirement benefits, or health care plans over the period. This demonstrates that employees are seen as a tool to achieve the strategic objectives of the customer perspective. The reporting is not for but about employees. This perception is further supported by the fact that the evaluation of this perspective is carried out using third party data. Instead of voicing the opinions of its own employees and making them thereby part of the reporting, Bank of America lists awards from Women's Business Enterprise National Council or refer to CEO Hugh McColl winning an award for being the "Most Supportive Person of the Latin American Community" (Bank of America, 2000, p. 4).

*Community perspective:* Bank of America's corporate philanthropy involves a number of community development initiatives supported over different periods. Most of this support though is expressed in terms of investment in activities and businesses that support community development. In 1999 the bank announced a plan to make at least 180 billion USD in community development loans to small businesses over the next decade (Bank of America, 1999). In 2003, the bank announced a set of new 10-year goals for community development banking (Bank of America, 2003). The bank would increase its community lending and investing goal from 350 billion USD to 750 billion USD over 10 years, starting in 2005. Indeed in 2005, the 10-year community lending and investment programme kicked off: in the wake of Hurricanes Katrina and Rita, the bank reports to have committed up to 100 million USD to rebuilding neighborhoods along the Gulf Coast (Bank of America, 2005). In 2007, in another 10-year program, 20 billion USD were earmarked for the support of environmentally sustainable business activity as an effort to build green partnerships with environmental groups. And through the neighborhood excellence initiative, the bank reports to have spent another 200 million USD overall (Bank of America, 2007). In summary, the



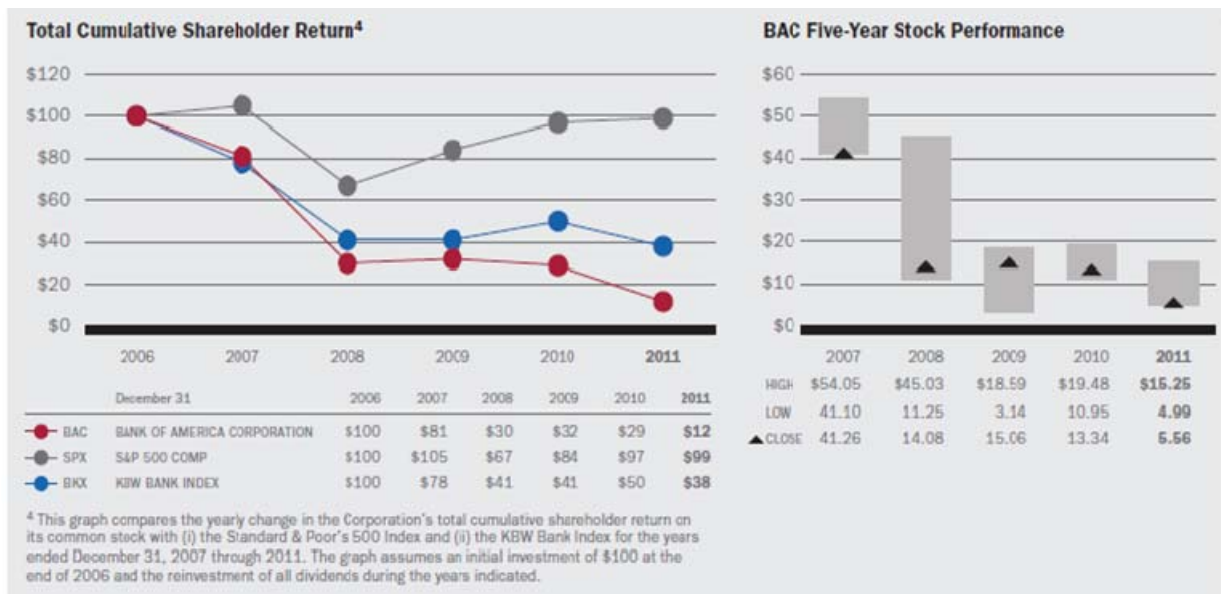
bank reports on both strategies and actions taken in relation to financial KPIs.

*Summary:* First, the business reporting of Bank of America primarily addressed shareholders during the first phase (pre-financial crisis). Although the customer perspective is mentioned more frequently, customers were just seen as the main driver of shareholder value. In the same manner, employees and image in the community were treated as operative drivers for achieving strategic goals of the customer perspective. Second, the bank expressed most of its achievements with financial KPIs. For instance, steady dividends – irrespective of the bank’s actual performance – were a pivotal KPI. Top management put a lot of commitment into explaining, improving (their own merit), or declining (external factors) financial performance. At the same time, they do put emphasis on following up on or explaining any of the changes in the underlying non-financial drivers.

*2.6.2. Post-financial crisis.* We now analyze how Bank of America adjusted its business reporting in the second phase (post-financial crisis). Bank of America experienced declining net income with a

loss in 2010 (Figure 2). This led to changes within the bank. For instance, CEO Brian T. Moynihan’s incentive system was altered by eliminating his cash bonus in 2009 and 2010. From 2011 onwards, 85% of his total compensation took the form of equity-linked awards such as performance contingent restricted stock units whose value depends on the bank’s future achievement of diverse performance goals. Declining performance also coincides with notable changes in the bank’s business reporting.

*Shareholder perspective:* Bank of America abandoned the cash basis ratios in favor of a cumulative comparison of several financial KPIs. In a 5-year illustration (Figure 3), the bank compares its total shareholder return on common stock with the S&P 500 index, the S&P 500 commercial banks industry index, and the KBW Bank index. This comparison gives the impression that the poor financial situation is closely linked to the financial industry as a whole. This convenient disclaimer dissociates top management with the bank’s poor performance and establishes that it is beyond their control.



Source: Bank of America (2011, p. 16).

**Fig. 3. Total cumulative shareholder return and five-year stock performance of Bank of America**

In addition, Bank of America introduced new KPIs in its ‘financial highlights’ at the beginning of the annual report. For instance, “fully taxable-equivalent basis” KPIs like revenue net of interest expense presented the poor performance in a favorable light (Bank of America, 2011, p. 6). Hereby, the bank avoided the presentation of (poor) net income as the first line-item on the financial highlights as it was the case before the financial crisis. Another change in how the bank

reports on financial KPIs was a new treatment of some line-items in the financial highlights according to U.S. GAAP. Examples are “Net Income excluding goodwill impairment charges” and “tangible book value per common share” (Bank of America, 2011, p. 16). These examples show a favorable picture of performance because they are slightly increasing, as opposed to “book value per common share” which included goodwill and had been constantly falling (Figure 3).



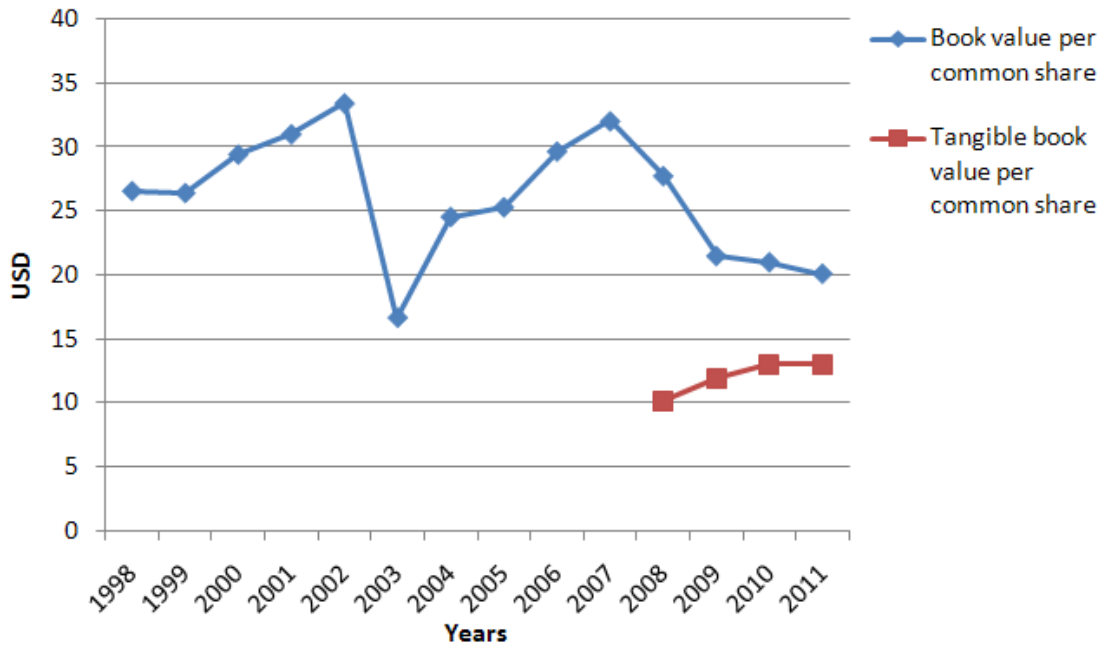


Fig. 4. Per common share values: book vs. tangible

The bank’s decision to include these presentations shows that management sought to use the financial reporting flexibility of U.S. GAAP to smoothen its performance volatility. As a reminder, the option not to amortize goodwill according to FAS 142 had already existed since June 2001.

Dividends were another financial KPI that revealed interesting findings. The bank maintained a cash dividend pay-out (Figure 5) even when its net income was evidently falling to the extent of recording net

losses in 2010 (Figure 2). Still, top management wanted to signal to shareholders that the bank continued to be able to pay out dividends. This was at the expense of retained earnings (and therefore creditors) that needs to be reduced in order to pay out this dividend (Figure 6). Under the new regulatory framework, labelled Basel III, dividend payments are limited for banks that have a capital base that is only slightly higher than the regulatory minimum base (Basel III, 2010, p. 54ff).

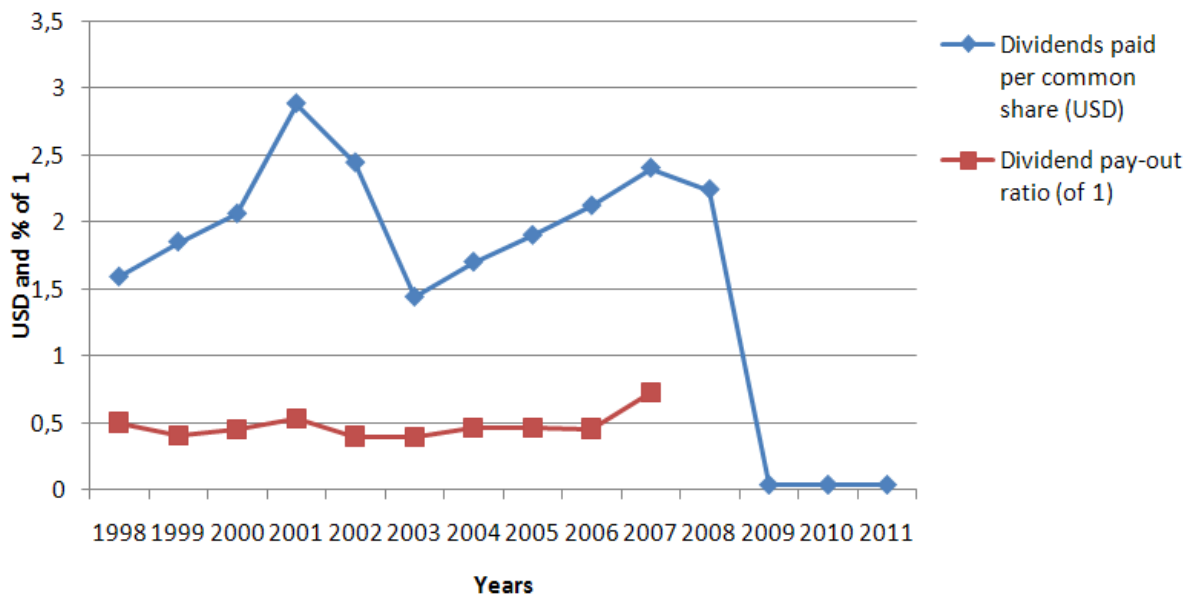
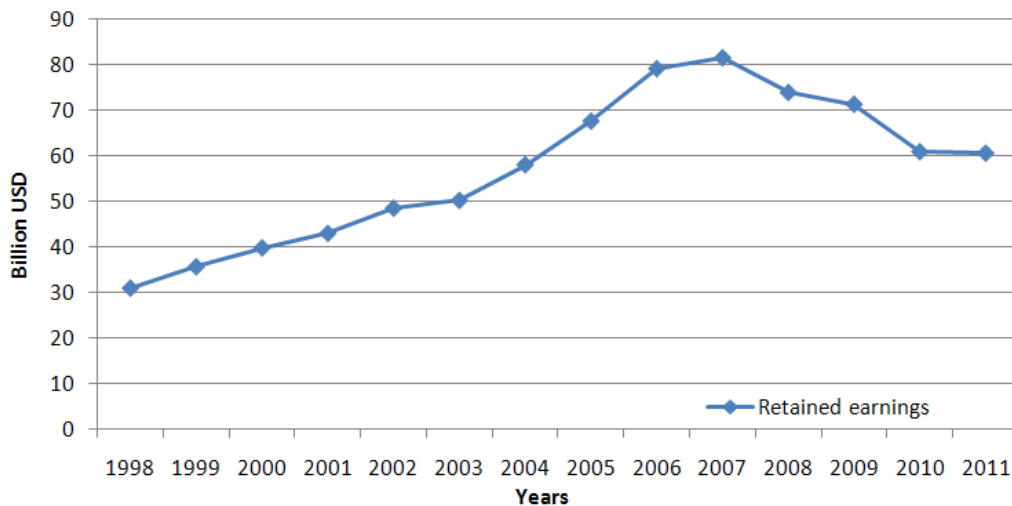


Fig. 5. Dividends paid vs. pay-out ratio at Bank of America



**Fig. 6. Development of retained earnings at Bank of America**

*Customer perspective:* The customer perspective seems to have more actions than strategies in the second phase. Bank of America has undergone structural reorganizations. The most recent one was in 2011 where the corporation created two new executive roles as co-chief operating officers with the intent of better aligning operating units so as to serve the different customer groups better. The bank further reported about the introduction of clarity commitment statements which clearly spell out the benefits and obligations of each product for customers. This change could have been a strategic management initiative or a response to regulatory compliance demands.

The bank reported on helping distressed customers by modifying loans to create sustainable, long-term solutions or helping them through a transition to new housing. Opening up regional customer assistance centers where distressed mortgage customers could meet face to face with bank employees who then help them get started with the loan modification process is another action highlighted by the bank. However, the same question can be asked about whether this move was management’s strategic initiative or a response to external pressure from calls by authoritative bodies like the CFPB whose report indicates that 43% of customer complaints were mortgage related.

The bank also makes efforts to revamp customer satisfaction and confidence by improving their existing products. They are reinvesting in more sophisticated ATMs with new technology that will allow customers to interact with a live teller during working hours. With mobile transactions being cheaper than bank teller transactions, banks were expected to improve their margins and revenue growth (Hickins, 2013).

*Employee and community perspectives:* Employee and community-related non-financial KPIs maintained lower priority and had the least changes in business reporting. Most notably, the bank introduced a new form of reporting on the community perspective. Earlier, the bank reported their donations in USD. After the financial crisis, the bank’s donations were accounted for by the number of employee volunteer hours as well as updates on old pledges. For instance, the bank reported that its associates donated more than 800,000 volunteer hours in 2010, contributing their time and expertise to meeting critical community needs. In 2011, employees volunteered two hours of company time weekly to community activities. “Our employees donated 1.5 million volunteer hours globally, we made nearly 6 million USD in emergency safety net grants” (Bank of America, 2011, p. 15). No further donations were announced.

*Summary:* The two key changes in Bank of America’s business reporting are the financial highlights as well as the general tone of the reports after the financial crisis. First, the financial highlights had always been on the first pages of the annual reports, sometimes even on the covers (i.e., 1998 to 2009). This clearly indicated that the bank wanted to emphasize the prevalence of the shareholder perspective to the readers. In 2010, there was a drastic change that re-positioned the financial highlights behind the letter to shareholders. This can serve as an indication that top management tried to provide explanations and preparation for the poor financial results to follow. Second, the tone of the written language changed. Top management presented weak results in passive voice. Moreover, the reports from before the crisis used figures of speech that did not need a reference to earlier years. After performance worsened after the financial crisis, the reports used figures of speech that

referred to the better previous years (like ‘down from’ or ‘a year earlier’). It appears that the authors of the reports tried to remind the reader that Bank of America had had excellent performances in the past, which might be indicative of better, future performances.

**2.7. Case study 2: Wells Fargo.** The bank Wells Fargo was founded in New York in 1852 to extend banking and express services to the west. Its vision is to satisfy all its customers’ financial needs and help them to succeed financially. Its main operating segments are community banking, wholesale banking and wealth, brokerage, as well as pension funds. The bank has undergone several mergers and acquisitions, which has made it one of the largest U.S. mortgage

lenders. The most notable merger took place in 2008 with the Wachovia Corporation. Wells Fargo was not so strongly affected by the financial crisis due to its conservative approach to home lending. This makes Wells Fargo an interesting comparative case, contrasting Bank of America that was financially more troubled. In the following, we mainly highlight the notable differences to Bank of America.

*2.7.1. Pre-financial crisis.* According to our word count, the customer perspective appears to dominate the others as it did with Bank of America (Figure 7). Contrary to what was the case with Bank of America, the Wells Fargo count of ‘employees’ and ‘community’ rank before ‘shareholders’ (and their synonyms).

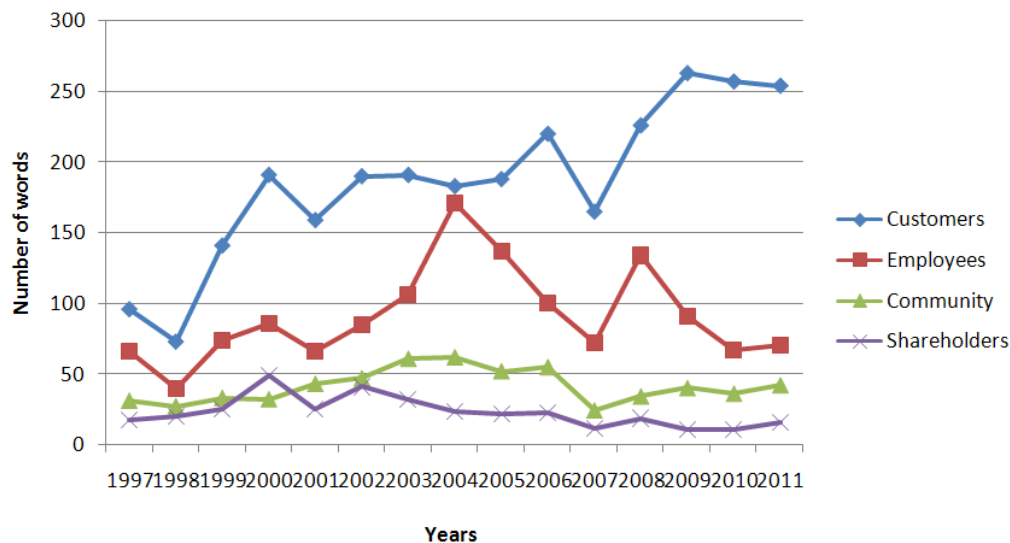


Fig. 7. Word count of search terms in the annual reports of Wells Fargo

*Shareholder perspective:* Business reporting for shareholders is quite consistent at Wells Fargo during the phase prior to the financial crisis. Although shareholders are far less frequently mentioned than in the annual reports from Bank of America, their perspective prevails. The reports mainly emphasize financial KPIs, i.e., net income, net income applicable to common stock, dividends declared per common share, and book value per common share. These KPIs are almost identical to the ones we identified at Bank of America.

Similar to what we observed with Bank of America, top management makes efforts explaining dips in performance before the crisis. Yet, they do not point strongly to factors that are external to the bank. For instance, they attribute the decrease in net income in 1998 to the merger that the board itself accomplished. When earnings per share decreased by 15% in 2001, management openly addressed the issue that poor performance was tied to accounting rules that resulted in a non-cash charge of 1.1 billion USD related to the venture capital portfolio.

*Customer perspective:* The report of Wells Fargo puts an emphasis on KPIs related to customers. These involve customer satisfaction measures including initiatives that are attached to them (as opposed to Bank of America). By 2003, Wells Fargo reported 15 KPIs. While 8 of these relate to the traditional financial perspective, 4 focus on customers. The bank highlighted that they saw these as indicators of future performance and expressed their creed that such measures can substantially contribute to a better understanding of future prospects of a bank. This is an indication that the bank weighted customers second after shareholders.

However external data sources gave a different picture regarding the bank’s claims for archiving the customer goal. In 2007, Wells Fargo was fined 6.5 million USD by the SEC for selling troubled mortgage investments without fully researching and disclosing the risks involved to its customers. In another incident, an investigation by the department of civil rights found that the bank had charged higher mortgage fees to black and Hispanic

borrowers than to white borrowers with similar credit risk profiles between 2004 and 2009. As a result, the bank agreed to pay at least 175 million USD to settle accusations (Savage, 2012).

*Employee perspective:* The weight assigned to the employee perspective in business reporting is stable before the financial crisis. Wells Fargo put more emphasis on reporting to employees than about them. The bank highlights the importance of the individual within the bank by stating that “Products and technology don’t fulfill the promise behind a brand, people do – people who are talented, motivated and energized” (Wells Fargo, 2013). Another example is that the bank reports on the recognition it gives to its employees. After the merger with Norwest in 1998, Wells Fargo awarded stock options to selected employees (Wells Fargo, 1998, p. 8). In 2002, the bank reported that, “in eight years the corporation made five company-wide stock option grants – a total of 1,350 option shares for virtually every full-time member who served during that period” (Wells Fargo, 2002, p. 21). In spite of what is explicitly stated, this could also be interpreted as an attempt to align shareholders’ interests with those of the employees.

*Community perspective:* The community perspective has the lowest weight in this phase of the analysis. Mostly, it relates to cash contributions

and updates about older pledges met, just as it was the case with Bank of America. Forbes Magazine (2003) ranked Wells Fargo 8<sup>th</sup> on America’s largest corporate cash givers in 2002, one rank better than Bank of America which came in 9th.

*Summary:* We observe that business reporting at Wells Fargo is quite similar to the business reporting of Bank of America before the crisis: dividends are a pivotal signal of financial health in the shareholder perspective, and they are strongly emphasized. Already before the crisis, Wells Fargo put more weight on the customer perspective than Bank of America by using several KPIs to monitor customer satisfaction with internal data. Similarly, Wells Fargo put a little more emphasis on reporting on their employees and highlighted the stock option plan for all employees after a merger. Last, the community perspective is also quite similar to the one from bank of America.

*2.7.2. Post-financial crisis.* We now analyze how Wells Fargo adjusted its business reporting in the second phase (post-financial crisis). Contrary to Bank of America, Wells Fargo only experienced a ditch in net income in 2008 and then had increasing net income again after that (Figure 8). The financial crisis also coincides with notable changes in the bank’s business reporting.

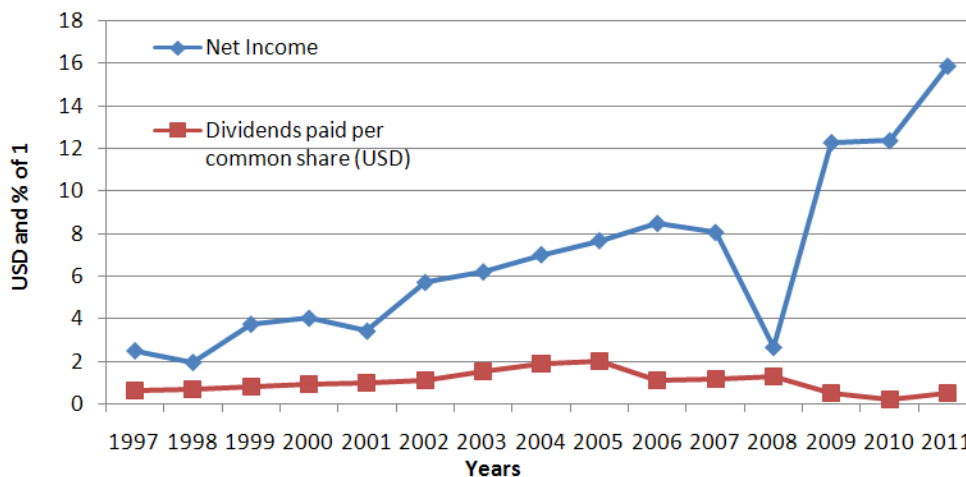


Fig. 8. Dividends paid vs. pay-out ratio at Wells Fargo

*Shareholder perspective:* The CEO opened his letter to the shareholder with the apologetic phrase: “Our 2007 results were disappointing. They were not what you, our owners, expect from Wells Fargo. They were not what we expect of ourselves.” (Wells Fargo, 2007, p. 2). The report further elaborates on “what did we do wrong” and “what did we do right”. This tone of language attributes importance to the shareholder perspective and hence the need for management to provide an explanation. One year later, top man-

agement decided to realize historically low results in 2008 and engage in window dressing to make the results from 2009 onwards look better. For instance – after the acquisition of Wachovia Corporation – the bank registered Wachovia’s assets and liabilities in the year of acquisition (2008) but chose to recognize its revenues in 2009. This increased revenues in 2009 and suggested a more favorable situation of Wells Fargo. This timing and choice of accounting treatment helped to window-dress the financial performance of the bank.

There were also substantial changes in the choice of financial KPIs: *revenue growth* and *products per customer* were the most important measures of success in 2003. Already when the market started to overheat, *Risk Management and Credit Quality* became one of the most important KPIs. The bank admitted: “*Our risk management performance in 2007 was not perfect. We made some mistakes. We took on too much risk – and did not price sufficiently for it*” (Wells Fargo, 2007, p. 5f). This move could be

a way of trying to pre-empt harsh reactions from investors, which as well shows the weight given to the shareholder perspective during reporting.

Dividends kept playing an important role for Wells Fargo. Wells Fargo initially did not cut dividends during the crisis, but then did so from 2009 onwards. Contrary to what was the case in Bank of America, dividends have not been paid at the expense of retained earnings (Figure 9).

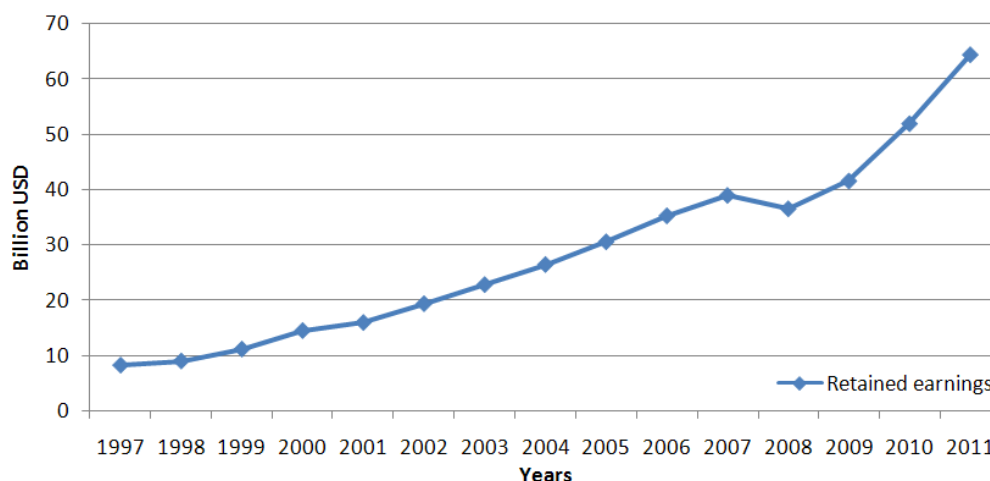


Fig. 4. Development of retained earnings at Wells Fargo

*Customer and employee perspectives:* Quite notably, there was also an increase in the word count of customers and employees (Figure 7). Reporting on customers at Wells Fargo changed already on the eve of the financial crises in 2007. Traditionally, the covers of the annual reports of Wells Fargo feature pictures of cowboys and the Wells Fargo horse carriage that undeviatingly storms toward the unexplored and ferocious lands in the west<sup>1</sup>. 2007 was the first year in which the bank changed from this venturesome, romanticized image toward real, personal relationships. The 2007 cover showed a customer and an employee of Wells Fargo with their actual names written next to them (Troy Ledo and Alicia Moore). Consistent with this change, Wells Fargo featured 12 pages of customer success stories. The bank also reported on their new service guarantee. An example is the Five Minutes Max pledge that customers will get through teller lines in five minutes or less or get their accounts credited with 5 USD.

In 2008, Wells Fargo started to differentiate its customers by mentioning “our credit-worthy customers” and not just customers as was the case in the past years (Wells Fargo, 2008, p. 3). The report of that year has 13 themes for measuring the customer

aspect vs. 5 themes for the community perspective (Wells Fargo, 2008, pp. 11-23).

*Community perspective:* Just as at Bank of America, reporting on the community activities changed. Besides donations, Wells Fargo now also started reporting on employees’ volunteered hours (Wells Fargo, 2008, p. 30). In the 2009 report, the CEO’s letter to shareholders opens with the bank’s contribution to community development as the most important issue. This post-crisis reporting is in stark contrast to the reports from 2007 that first addressed shareholders.

*Summary:* In the shareholder perspective, Wells Fargo kept an emphasis on dividends. But contrary to Bank of America, its financial situation was not so deteriorated that it had to use retained earnings over a longer time period to finance these pay-outs. To a smaller extent, Wells Fargo also changed the most important KPIs in the financial perspective to reflect the new regulatory focus on risk. In the explanations of poor performance, Wells Fargo is quite open about the partly internal nature of factors that led to this weak performance during the crisis. As to the other three perspectives, Wells Fargo also initiated a shift toward a more non-financial business reporting. A remarkable example is that it replaced its romanticized cover picture on the annual reports with a picture of actual customers and employees.

<sup>1</sup> 2003 was an exception where another Western-style motive was displayed.



### 3. Discussion

**3.1. Comparison of the two banks' reporting changes due to the financial crisis.** This study addressed the question of how the re-balancing of (non-)financial goals in corporate reporting relates to two banks' environments. We discuss the two case studies, perspective by perspective. In general, both banks shifted their business reporting toward more non-financial KPIs, probably to enhance trust. This is a reaction to the crisis in order to restore their image by means of communication. In doing so, top management avoided the unpleasant discussion about the deterioration or slowing down of financial performance. Yet, the banks also showed some remarkable differences. The performance of Bank of America was worse than that of Wells Fargo after the crisis. This led to stronger reactions in business reporting at Bank of America.

*Shareholder perspective:* Both banks showed tendencies to practice window dressing techniques. For instance, Wells Fargo chose to use a different treatment for recording the acquisition of Wachovia in 2009, while Bank of America chose to introduce non-GAAP measures claiming they measured more accurately the value created by the bank. The timing of these changes is very convenient for the banks as they coincided with the financially difficult years. So it can be questioned why they took place at that point in time; especially since the choices were introduced much earlier in U.S. GAAP.

With respect to dividends, Bank of America tried to maintain dividend payments even when it realized losses in 2010. The bank always reported on its dividend pay-out ratio alongside cash dividends paid. As this information became meaningless during times of losses – as dividends were paid out from retained earnings – Bank of America omitted information on this KPI in future reports. Contrary to this, Wells Fargo reduced the dividends when it realized its worst performance in 2008 – even though it did not suffer any actual losses like Bank of America. After a short dip in 2008, the retained earnings rose again. However, part of this quick recovery of earnings is the accounting treatment of the merger with Wachovia Corporation.

*Customer perspective:* When its financial performance worsened, Wells Fargo assigned higher importance to this perspective, e.g., by introducing new KPIs for reaching strategic customer goals and by replacing the landscape by a customer/employee motif in the annual report in 2007. As performance improved, the bank switched back to its usual motif of the horse carriage in 2009. Bank of America mainly reported on strategies in the pre-financial crisis phase but only emphasized related actions

after the financial crisis. Given the connection between customer loyalty and the corporate image of banks (Cengiz et al., 2007; Cohen et al., 2007; Flavián et al., 2004), it is surprising that the visible change in focus was not clearer and more sustained.

*Employee perspective:* More than Bank of America, Wells Fargo kept a relatively high emphasis on employees. This could have been due to the fact that its financial results were not so poor. Yet, the overall orientation seems to be towards external stakeholders, even though crisis communication should comprise addressing internal stakeholders, foremost employees as “key stakeholders” of organizations, in established channels such as the annual report (Schmidt, 2010). This seems to be a strategic pitfall: By monitoring social media postings, Coombs and Holladay (2014) have shown that employees can become “informal crisis managers”. Providing target-group relevant content and sensitive information in the annual report might contribute to a governance process of employee communication.

*Community perspective:* Neither bank prioritized the community perspective very strongly before or after the crisis. The remarkable similarity was that both banks stopped reporting on this perspective in financial terms (e.g., the amount of donations) and switched to KPIs such as the hours that their employees invested in humanitarian projects. This might be in response to recent scientific and best practice publications to account for and to include the appeal to emotions and not only mere ‘facts’ in crisis communication (Holladay and Coombs, 2005) and to credit the employee contributions to foster trust (Schmidt, 2014). It might however also indicate an immediate U-turn to traditional emotional appeals, used before the crisis: in the field of advertising, within the time of the crisis (2008-2009), informational appeals have been used far more frequently than emotional ones (Lee et al., 2011b; Lueg et al., 2013).

**3.2. Contributions.** This research contributes to the literature on business reporting and crisis communication by studying how banks change their business reporting in times of crisis. By analyzing reports across the four stakeholder perspectives and splitting the time into two phases (pre-financial crisis ‘normal’ and post-financial-crisis ‘troubled’), we identify and compare these changes. We find that as soon as performance worsened during the crisis both banks rebalanced their reporting from financial to non-financial KPIs.

We argue that the banks' new report balancing is attributable to three major factors. The banks desired to regain customer confidence; they faced

external pressure from regulatory authorities; and they faced – most importantly – an adverse economic situation. This is in line with previous studies. Magnan and Markarian (2011) find that troubled companies failed to account for the uncertainty of their ventures in the accounting numbers, which made financial statements of little use or even misleading decision aids for supervisory boards (also cf. Lueg and Borisov, 2014). This confirms our observation that banks shift their reporting focus during the crisis. Keusch et al. (2012) find that the changes of business reporting around the financial crisis are not random but a result of conscious decisions made by top managers to let their performance appear in a favorable light ('self-serving bias'). Their article backs our interpretation that the change in business reporting was caused mainly by external factors. In the same vein, Brown and Tucker (2011) show that MD&A changes more strongly after economic (i.e., external) changes and that these discussions are useful information for investors. Hales et al. (2011) investigate the effect of language tone on investor judgments and find that the tone has relevance for investor decision making in several instances. This issue was also pivotal in our investigation.

Our findings also carry implications for other businesses beyond the banking industry in the U.S. We have uncovered a wide array of techniques that management can use for overly favorable business reporting during a crisis. These include, for example, taking credit for favorable developments while attributing unfavorable developments to temporary external impulses, changing financial performance measures over time, or even substituting them with non-financial measures. Such techniques are applicable in other industries and other countries as well. Thus, our study can generally serve the users of business reporting to get a more realistic picture of any company's performance.

Since the stakeholders targeted in the business report are or can easily become information and opinion multipliers and managers of communication themselves, we refrain from recommending the use of such transparent techniques. This does not only apply for banks: other companies are confronted with the same challenge to "create a positive corporate image to external stakeholders even when negative performance occurs" (Tessarolo et al., 2010) and communication tools are more accessible than the business report (e.g. short, easy-to-share contents for social media). We alert that choosing a more 'informational' strategy of communication might be more beneficial and rewarding in certain contexts. Stakeholders might feel more appreciated and on eye-level when being addressed via plain

information than by a shift of focus towards non-financial, emotionally appealing factors. Such strategy has been used by banks in regards to product advertising (Lee et al., 2011a) during the crisis. Even though it is recommended to integrate emotions and qualitative factors in crisis communication, we wonder whether the annual banking report is the most appropriate tool to meet these demands. One can assume that the readership of the annual report is actually better informed than the broad target group of public advertising – thus, an information-based, quantitative oriented, eye-level strategy might be applicable for this of all publics (Morgan, 2009). In cross-culturally operating companies with stakeholders, it might be fruitful to apply a culture sensitive perspective (Tsang, 2002).

**3.3. Limitations and suggestions for further research.** The limitations of our study provide opportunities for future research. First, our approach is a comparative case study. In order to provide an interpretation, we used subjective judgments on the data. Future studies could use our case study as a ground for developing hypotheses that can be tested on a larger scale. Second, our work is exploratory in nature. Therefore, more work is needed to generalize our findings. An interesting avenue for research would be to compare our findings to the changes in business reporting that happened in jurisdictions other than the U.S. Third, our conceptual model sees the external event of the financial crisis as a cause for the changes in business reporting. Future studies could consider further variables that offer alternative explanations, such as organizational factors (e.g., changes in organizational design) or personal factors (such as top management characteristics).

## Conclusion

In conclusion, this study has helped us to better understand in which ways negative impulses can alter business reporting of banks. Based on our comparative case study of two major U.S. banks during the recent financial crisis, we identify three negative impulses that led to a change in business reporting: the economic downturn in the banking industry, the resulting stricter regulations, and the strategic challenges like a loss of customer satisfaction and trust. We observe that top managers shift the 'standard' weighting in business reporting from financial (pre-financial crisis) towards non-financial indicators in 'troubled' times (post-financial-crisis) in order to appear in a more favorable light. In this sense, we can conclude that business reporting is used as a tool for crisis communication. Specifically, we conclude that there



were changes in the reporting toward the main four stakeholders. Targeting the shareholders, the banks smoothed their income during the crisis years, introduced new performance measures that fit their current circumstances, and shifted their reporting emphasis toward non-financial indicators. With respect to the customers, the banks improved their services, increased transparency of their products, and linked strategic customer goals to measurable initiatives more often. Concerning employees and community, the banks reported less on performance indicators that could be measured in monetary terms.

Instead they started using non-monetary indicators such as the hours employees donated to charitable community projects. This seems to contradict observations that relate to emotional advertising strategies before and informational strategies during the financial crisis (Lee et al., 2011a). The business report, with its four targeted stakeholders, especially employees and the community, thus seems to represent a special instrument of communicating during and after an economic crisis. It can neither be developed nor assessed by the same standards as other communication tools.

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