Does more disclosure always create value?

Financial transparency can curb inefficiency and improve discipline, yet for firms with strong R&D capability, it can discourage game-changing innovation.

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Transparency is widely treated as an unqualified good. Regulators promote it, investors demand it, and executives publicly endorse it as a pillar of trust and accountability. But how much transparency is too much? And what sacrifices might be made in its name?

One area coming under increased scrutiny is the longstanding practice of quarterly earnings statements, which provide standardized updates on a firm's financial performance and keep investors informed of revenue, profit, cash flow and future strategy on a regular schedule.

So far, so good. But critics have also argued the practice can distort long-term investment decisions. Leaders from BlackRock's Larry Fink to former PepsiCo CEO Indra Nooyi have warned that frequent reporting mandates force a "quarterly capitalism" that defeats long-term growth in favor of quick wins.

With the U.S. Securities and Exchange Commission signaling a potential move from quarterly to semiannual reporting, new research by IESE's Giovanni Valentini, with coauthors Giacomo Marchesini and Raffaele Conti, suggests that there's a potential trap in transparency. It can be a double-edged sword, depending on the maturity of your firm's R&D capabilities.

Two diverging reactions to transparency

While the debate is ongoing in the United States, the researchers examine a natural experiment in Europe. They analyze EU-listed firms from 2003 to 2016, spanning the period when quarterly reporting was mandated under the EU Transparency Directive and subsequently amended in 2013, with policymakers explicitly citing worries about short-term thinking. This study examines the effects of transparency and identifies two starkly different strategic responses by firms to increased transparency.

For weaker innovators, transparency changes how much they invest by disciplining inefficient spending. For stronger innovators, it changes where they invest, narrowing the range of technological exploration.

- **Discipline for struggling innovators.** Firms with weak R&D capabilities often benefit from frequent reporting. The added visibility forces managers to confront inefficiencies and cut back on so-called zombie projects — projects with no real chance of success, due to lack of progress or initiative. When equipped with clearer information, investors can allocate resources more efficiently, even if overall R&D spending drops.
- **Myopia for innovation leaders.** On the flip side, for companies that are already strong at R&D, too much transparency can backfire. This is because it can push teams to play it safe and focus on small improvements with short-term results, instead of bold, breakthrough ideas. The uncertainty of radical innovation — the high failure rates, the long development times — becomes a liability in the public eye. To avoid market backlash, managers tilt their portfolios toward more familiar and predictable domains. Over time, this can erode long-term success.

The study also finds that the narrowing of technological scope is associated with lower long-term valuation for high-capability firms, while the pruning of inefficient R&D in weaker firms is associated with improved valuation.

Aligning transparency with innovation capacity

Transparency doesn't play the same role in every company. In some places, it exposes faulty decisions and forces tough but necessary decisions. In others, it can make leaders nervous and encourage them to make choices that are too safe.

For companies with weak R&D, the added scrutiny trims inefficiency and can improve long-term value.

But for firms that already excel at innovation, constant visibility can narrow ambition. Breakthrough ideas take time and don't deliver progress on quarterly deadlines.

To keep exploration alive, these firms need to buffer their innovation teams from short-term pressure and help outsiders understand the bigger picture. Clear, forward-looking explanations about where the work is heading, and why setbacks are part of the journey, allow bold innovation to continue without being mistaken for failure.

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