Preface

Investors' expectations about the course of future economic processes are one of the key factors influencing investors' decisions. Apparently, expectations play a particular role because they constitute unobservable variables that can account for observable economic phenomena.

We should also highlight that this is quite a recent topic in research. The beginnings of the expectations theory date back to the 1930s, to I. Fisher's work, who described inflation as a difference between nominal and real interest rate. However, the problem of expectations sparked major interest only in the 1970s and 1980s. Today, expectancy theory on financial markets is one of the most dynamic areas in economic studies, although the research focuses mainly on the efficient-market hypothesis for capital markets and on the rational expectations hypothesis.

Getting to know the process of how investors' expectations are formed is the crucial element of description, interpretation and forecasting changes in the value of assets on financial markets, and especially changes in stock prices on capital markets which affect the value of publicly traded companies. It is obvious that the role of expectations as a determining factor in investment decisions on the capital market calls for an in-depth analysis. We should highlight the importance of expectations in managing value in contemporary companies and—in particular—in creating shareholder value, also in the context of the 2007–2009 crisis. Creating shareholder value involves surpassing investors' expectations about the rate of return on the invested capital. It means that managers need to understand how and basing on what information investors create their expectations. The more so that as T. Copeland and A. Dolgoff's research proves, there exists a strong and statistically important correlation between the return for the shareholders and two types of variables: changing expectations about future profits and changes in the level of noise surrounding information disclosed to the market. The greater the uncertainty, the less homogenous and stable the investors' expectations; a high level of uncertainty is frequently accompanied by crowd behaviour. In this context, companies' information policy—especially in the scope of investor relations and corporate governance—plays a major role; it is also important for a company to willingly disclose information the form, type and quality of which are adapted to investors' expectations. Moreover,

increasing the degree of disclosure decreases the information asymmetry on the capital market, i.e. it enables a more conscious forming of investors' expectations. The notion of information asymmetry on the capital market means that some participants of that market hold important information that influences market prices, and other participants receive the said information only later. Nowadays, the possibility to get hold of precise and reliable information at an appropriate time seriously affects decisions taken by business entities and households and it influences the profits they make, too. Important research into the functioning of the market in the context of information asymmetry was done already in the 1960s and the 1970s. Although in the beginning, researchers focused on real economy, in the times of globalisation and the dynamic development of financial markets, the issue of information asymmetry has grown particularly important. The problem has been addressed by J. E. Stiglitz, who believes the classic economic assumption—that market competitiveness is a sufficient condition for an efficient resource allocation—is false, since it does not take into account information acquisition cost. In the world of big information asymmetry, even the best informed investors find themselves in a disadvantageous situation. For this reason, they resort to services of external analysts who help them become "internal" investors, able to get more familiar with the factors decisive for the company's competitiveness and its future development. In other words, traders learn how to create their expectations about the rate of return from their investment in a more efficient way.

In this context, a question of major importance arises—do investors' expectations matter? The answer seems obvious. Value can be created only when the actual rate of return exceeds the expected rate, determined by the cost of capital. At the same time, we should bear in mind that the mass price increase of public companies' shares in the late 1990s was to a large extent determined by investors' expectations, and not by an improved performance of business. A study carried out by Boston Consulting Group between 1994 and 2000 revealed that while the annual increase of fundamental results of companies equalled 13 %, expectations premium grew on average 42 % a year. At the time of 2007–2009 crisis, the expectations still accounted for 30 % of a company's market value.

Investors' expectations, with the role they play, influence the process of managing a company, and more precisely the process of managing value of a joint-stock company. It seems possible to embed investor's expectations into value based management (VBM) so as to look for such a way of management that would guarantee the achievement of the goal, i.e. creating shareholder value. However, it requires from the company to, firstly, identify investors' expectations and the factors determining these expectations and, secondly, to pre-empt market expectations about the company's performance. Thus, measures commonly used in the VBM approach need to be modified because they constitute the core of the value creation strategy and enable an appraisal of the achievement of goals predetermined by the company.

Moreover, including investors' expectations into the process of value based management brings up two important questions concerning strategic decisions made by the managers of a company. The first question—concerning the existing assets—is related to the probability of exceeding market expectations as to the rate

of return. The second question—concerning new investments—raises the issue of a company's ability to generate shareholder value from capital newly invested in the company's operations.

For the reasons presented above, in this book we will make an attempt to include investors' expectations into the VBM approach and into the appraisal of the results of creating shareholder value. In order to achieve this objective it is necessary to:

1. Define the influence uncertainty has over the process of company management and to define challenges the new economic perspective presents to value based management in contemporary companies. In this context, a return to the strategic dimension of VBM and to the new approaches to formulating a strategy—the issue of strategic resilience and strategic readiness of intangible value drivers—are of primary importance. So is the question of creating value in different contexts, especially complex and chaotic ones (sub-goal G1).
2. Verify the usefulness of the traditional model of investor relations and identify information gaps—especially when it comes to openness with information in companies and disclosure of information on intangible value sources as factors determining investors' expectations. Carrying out such an analysis seemed very relevant in the face of the 2007–2009 crisis, which lead to a dramatic drop of companies' and their management's credibility. Investors' optimism, characteristic of the last decade of the twentieth century transformed into scepticism, fear, uncertainty and lack of trust that companies would serve their shareholders' interests (sub-goal G2).
3. Identify the factors that influence the creation of investors' expectations and analyse their influence on a company's value on the capital market—with particular focus on the investors' motivation and keenness to learn—which can make a difference in the description of the capital market, small as it might be (sub-goal G3).
4. Verify the existing methods of measurement which are commonly used in value based management. For this purpose we will incorporate investors' expectations into the equation and—more importantly—drawing from the research, we will discuss the following issues: investors' expectations versus systemic risk; investors' expectations versus risk premium, or more broadly speaking investors' expectations versus cost of capital (sub-goal G4).

This book puts forward the following hypothesis: firstly, that there exists a statistically significant correlation between information asymmetry and the degree of openness with information of the companies listed on the Warsaw Stock Exchange (H1) and secondly, that there exists a statistically significant correlation between the asymmetry coefficient in investor relations and the creation of investors' expectations (H2).

The book comprises of eight chapters, the order and structure of which have been subordinated to the main goal and the verification of the main hypothesis.

Chapter 1 presents an introduction to the issues discussed in this book. It is focused on the influence that soaring uncertainty has on corporate management. The chapter also argues that the uncertainty factor should be indispensably embedded in the

creation of economic strategies, including the strategy of value creation. All this inspired the idea that the approach to value management needs to be revised, especially with respect to extending the opportunities of acquiring capital and taking over the value created on the global market. The question becomes even more significant, if we bear in mind that the very concept of value based management becomes increasingly fragmented and that the focus has shifted from strategic to operational management, which makes the whole concept incomplete. As a result the concept takes into account the current architecture of the global market to a small degree. Moreover, value creation extensively used and developed various instruments of financial engineering which, on the one hand, broadened the perception of the value creation process, but on the other, it did not help to understand the real problems troubling organisations and distracted researchers from more serious concerns.

With the above in mind, in Chap. 1, we also discuss approaches to strategy creating that really strongly highlight changes on markets and the process of flexible adaptation to the operating conditions in the global economy. Last but not the least, we tackle the growingly evident evolution of sources of value in business which shift towards intellectual capital and the challenges this tendency presents for value management and for reporting the created value, which in turn directly affects investors' expectations. Some dysfunctions in the measurement of performance and value of companies are also pointed out. It appears that in Chap. 1 the first sub-goal (G1) of the book is successfully achieved.

Chapter 2 is focused on the place of expectations in the economic theory. In guise of introduction to the problem, the origins of the economic theory of expectations are described, with greatest attention to the hypothesis of rational expectations and its criticism. The reason for this is that the introduction of this hypothesis significantly affected the development of economics, mainly as regards financial market modelling and behaviour of entities in this market.

The main stress in this chapter is on the criticism of the assumptions behind the hypothesis of rational expectations, especially in the context of investment decisions. We also highlight the conviction that the expectations theory should not be considered solely from the perspective of normative studies, but also from the vantage point of psychology of actions taken by market participants. It seemed natural to introduce the assumption of bounded rationality which originates mainly from limited perception or cognitive abilities of the participants and from systemic mistakes present in human behaviour. The latter means that many decision makers, in an identical situation, make the same kind of mistakes, which can lead to the usage of heuristics in decision-making or to the perception of probability distribution that diverges from the theoretical one. In other words, if market participants are unable to judge probability in an accurate way, they are unable to maximise utility. Moreover, we should remember that the participants often lack analytical skills to draw conclusions from available information. Gaps in information or perception and resorting to simplifications undoubtedly affect the forming of expectations which by nature will be different for different market participants, considering the disparities of experience and knowledge of economic processes.

Questioning the hypothesis of rational expectations called for an attempt to include irrational behaviours of investors in the model of the financial market. That is the topic of Chap. 3. Behavioural models of the financial market discussed in that chapter aim at clarifying phenomena which classic financial theories fail to account for; i.e. we will try to make the traditional models of financial markets more real, because completed with psychological aspects. This chapter focuses mainly on understanding investors' expectations and the factors that influence those expectations. We discuss the issue of signals and noise forming the expectations. At the same time, we refer to research that highlights the importance of investors' expectations in creating market value of joint-stock companies. It was an argument in favour of including expectations in the process of value management in a company.

The deviations from the rule of rationality present in investors' behaviour with respect to both opinions and coherence of preferences—which we discuss in Chap. 2—proved helpful in identifying psychological tendencies (both in the cognitive and motivational–emotional domains) that influence the creation of expectations. The considerations led to the inescapable conclusion that firstly, there exists a correlation between the psychological mindset of an investor and behaviour of financial markets and secondly, that apart from fundamental factors, biological factors affect the prices of shares on the capital market. Chapters 2 and 3 jointly achieve the third sub-goal (G3) of the book.

The correlation between investors' expectations and prices on the capital market brought up the question whether companies can consciously form investors' expectations. Chapter 4 attempts to answer this question—it highlights the significant role of investor relations and a company's information policy. The chapter presents considerations dedicated to the development of principle of corporate governance as a reaction to financial crises and the growing awareness on the part of investors. Due to the present economic conditions, due to changes that happened in companies, among investors and companies' environment in the broad sense, and especially due to changes on the global capital market, the traditional model of information policy of companies and of investor relations is starting to fail, because it cannot fulfil its role efficiently and it needs to evolve towards value reporting. Indeed, investors' expectations concerning information have grown significantly, in particular as regards intangible aspects of a company's operation. There is a pressing need for change, or even a complete reorganisation of investor relations, as well information and reporting policies, especially in the area of voluntary disclosures, because they constitute the basis for investors' expectations. We can affirm that companies have an important potential to form investors' expectations, the more so that investors and stock-exchange analysts suggest they are ready to pay a premium for a company's transparency (in the case of stock-exchange investors the premium varies from 10 to 80 %, in the case of analysts from 5 to 20 %). It appears that an appropriate information policy can enable a company to form long-term expectation of their investors, in this way inducing the capital market to react more to fundamental information. Thus, there appears an opportunity to include investors' expectations in the process of value management and for a shift from value management to expectations management.

The above considerations, presented in Chap. 4, achieve the second sub-goal (G2) of this book.

Chapter 5 attempts to include investors' expectations in the value-oriented approach to management. This chapter features a proposition of a modification of measures used in value based management so as to have them take into account investors' expectations. The need for such modification emerged with the clear distinction between creating value of a company and creating value for shareholders. The latter requires both generating economic profit (i.e. establishing a rate of return that exceeds the cost of capital) and managing the created value, for example through an increase in the share value, which is linked to results higher than those expected by investors. If a company can meet the expectations, every shareholder will receive the expected return and their wealth remains safe. Failure to meet the expectations triggers the prices to adjust, and shareholders' wealth suffers. So, the Chap. 5 proposes to use surplus EVA, surplus MVA and surplus TSR for measuring shareholder value.

In this chapter, we also discuss the strategic implications of investors' expectations and the influence they exercise over strategic decisions made in a company. In the context of studies described in this book, it seems that expectations management is the crucial element affecting a company's value, to a large extent due to the psychological factors behind investors' decisions.

When discussing investors' expectation and a purposeful forming of these expectations through conveying credible and comprehensive information to capital markets, we cannot forget such important problems as asymmetry and informational efficiency of the capital market; these topics are the focus of Chap. 6. That chapter outlines the views on asymmetry of information of the most prominent researchers, such as G. A. Akelrof with his theory of negative selection, M. Spence with his signalling model or J. E. Stiglitz with asymmetry as the reason for the fragility of financial instruments and for a strong tendency to lack of stability of financial markets. The problem of information asymmetry is described not only from the point of view of disadvantages of the market mechanism but also from the perspective of uncertainty, which is an inescapable element of the contemporary world.

Chapter 6 discusses three types of the efficient market hypothesis: strong, medium and weak. Results of selected analyses and studies which constitute an empirical verification of the theoretical description of the problem of informational efficiency are also revoked. They have also allowed for an identification of the divergences from the efficient market hypothesis, also known as anomalies of the capital market, i.e.: time anomalies (dressing window effect, January effect, Monday effect), anomalies stemming from the psychological aspects of investment (that have been discussed in Chap. 3) or anomalies caused by the influence of new information on the evaluation of the capital market. The latter cover: the influence of announcement of forecasted results, information content of analysts' opinions, the influence of shifts in management boards, the influence of information concerning the dividend policy.

Undoubtedly, the issues related to asymmetry and informational efficiency of the capital market significantly affect the forming of investors' expectations and a

company's value. Efficient market hypothesis is important for our considerations because it raises the question whether it is possible to obtain exceptional profit (what investors' expect) basing on a given collection of information about a company. It also evokes anomalies of the market mechanism which to a large extent are caused by psychological factors on the part of investors and by the usage of heuristics which influence investors' expectations. Asymmetry does not have to be confined to a situation when one party holds more information about the transaction object; it can also refer to a situation of uncertainty concerning profits expected from the transaction, which undoubtedly affects the process of forming expectations. It would seem that the level of information asymmetry between investors and joint-stock companies should decrease along with greater openness and more frequent disclosures. At the same time, there should be a strong correlation between openness and disclosures and the forming of investors' expectations; the more true, reliable and important information is made available to investors and adapted to their expectations, the more accurate the expectations concerning the rate of return of the invested capital. Those correlations are discussed in Chap. 7. Chapters 4, 5 and 7 achieve the fourth sub-goal (G4) of the book.

Verifying our hypothesis required fulfilling several tasks, among others: identifying the variables representing the level of information asymmetry which are used in global research; creating an indicator of a company's readiness to disclose information; and studying the correlations between variables representing the level of asymmetry and measures describing the value of expectations.

The study was based on stock-exchange data, financial reports, and on an analysis of information content available on websites of companies listed in the continuous trading system on Warsaw Stock Exchange which provided all data necessary for the calculations. In total, 277 companies were analysed from June through September 2011 with respect to information asymmetry and from 2009 through 2010 as regards financial indicators. In order to calculate and analyse the collected information, a dedicated database was created (including financial reports for particular years, share prices, number of shares on the market, the amounts of dividend per share, beta values, profitability of 52-week treasury bills, expected inflation rates, number of analysts, shareholding structure, payment of dividend) and systems of spreadsheets.

Some assumptions of the research project may seem controversial and raise doubts. It is due to the fact that many of the issues outlined above and discussed in this book have not been unequivocally resolved on the theoretical level. For this reason it can be assumed that although some assumptions are arbitrary, the conclusions of the study enable us to verify the main hypothesis of the book.

The book draws from Polish and global literature in this subject area. Several analyses carried out by leading specialists in the field and by consulting companies are also evoked; in numerous cases these studies illustrated the theoretical issues discussed in particular chapters.

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