

INTERNATIONAL JOURNAL OF RESEARCH IN COMMERCE & MANAGEMENT

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THE PRIMACY EFFECT: IMPACT OF INFORMATION'S ORDER ON INVESTORS' PERCEPTION**DIVYANG J. JOSHI****ASST. PROFESSOR****PARUL INSTITUTE OF MANAGEMENT AND RESEARCH****BARODA****ABSTRACT**

The annual report is the way to communicate about the business position to the stakeholders. The annual reports provide meaningful information regarding historical performance and prospective future opportunities. The president's letter or director's report is a report submitted by the directors of a company to its shareholders, appraising them of the performance of the company under its direction. It is an exercise of self-evaluation. The letter mainly summarizes company's performance and the financial results, discusses company's plans for expansion, diversification or modernization, tells about appropriation of profits, and elaborates company's future prospects and plans for investments. Apart from mandatory disclosure for annual reports to shareholders, it is used as marketing tools which is used to focus the firm's mission, objectives, strategies, and financial performance. The content of the letter is very important because it catches the attention of the readers like shareholders, investors, analysts, suppliers, government, banks, financial institutions etc. That is why it is very important to take care about the information, positive or negative, conveyed in presidents' letter. This paper tried to examine the impact of ordering (Primacy and Recency effect) of the positive and negative information in the president's letter on readers' perception. The study concludes that the Primacy Effect can be observed due to change in information's order.

KEYWORDS

Primacy effect, Recency effect, information order, chi square test.

INTRODUCTION

The annual report is the way to communicate about the business position to the stakeholders. The annual report provides meaningful information regarding historical performance and prospective future opportunities. The corporate can be rewarded with credibility through convincing stakeholders that they are pursuing sound strategy to run the business. Most of the annual reports include a letter from the president or CEO, vision, mission, BOD details, corporate governance, financial statements, auditor's report, stock performance, achievements, risk factors, SWOT analysis etc. CEOs consider annual reports as a communication tool representing the company's and own performance (Bowman, 1984). The president letter represents the financial and non-financial information to the stakeholders. The analysts rely on qualitative information more compared to quantitative information for taking investment decisions (Chugh & Meador, 1984). To understand or read a balance sheet it is required to study the balance sheet i.e., financial accounts of a company, with a view to knowing about the company's financial health, its intrinsic value and hidden risks or strengths. It is nothing but reading the unwritten. Reading a balance sheet is an art as well as a science and its perfection comes only when science and art both are blended. The science is study and analysis of balance sheet items and profit and loss account through various techniques including ratio analysis and the art is taking out inferences and decisions on the basis of the former^A.

The president's letter or director's report is a report submitted by the directors of a company to its shareholders, appraising them for the performance of the company under its direction. It is an exercise of self-evaluation. The letter mainly summarizes company's performance and the financial results, discusses company's plans for expansion, diversification or modernization, tells about appropriation of profits, and elaborates company's future prospects and plans for investments. It is a synopsis of the company's activities during the year and during the interim period between the date of the balance sheet and date of the annual report. Director's report should take the investors into confidence by providing useful insights into the activities of the business, more than what the financial statements provide^A. The annual report is statutorily produced (UNDER SECTION 220, companies Act 1956^B) document which contained financial information and other details with the usage of photographs and graphs. Empirical research in the US has demonstrated that both the inclusion and content of president's letters significantly affect the judgments of share prices in equity investment decisions (Stanton et al., 2004). Therefore, it is important that the information conveyed to users of accounting narratives reflect financial reality.

Apart from mandatory disclosure for annual reports to shareholders, it is used as marketing tools which is used to focus the firm's mission, objectives, strategies, and financial performance. While financial portions such as the income statement, balance sheet, and changes in financial position are subject to the scrutiny of the firm's auditors, the narrative portions of the document are a direct consequence of corporate communication decisions (Gary & Albert 1992). The letters to shareholders helped in communicating facts about a firm, implicit beliefs for the organization and its relationships with the surrounding world. The content of the letter is very important because it catches the attention of the readers like shareholders, investors, analysts, suppliers, government, banks, financial institutions etc. That is why it is very important to take care about the information, positive or negative, conveyed in presidents' letter. This paper tried to examine the impact of ordering of the positive and negative information in the president's letter on readers' perception.

REVIEW OF STUDIES ON PRIMACY AND RECENCY EFFECT

The order in which information is learned determines how reliably it will be recalled. The first item in a list is initially distinguished from previous activities as important (primacy effect) and may be transferred to long-term memory by the time of recall. Items at the end of the list are still in short-term memory (recency effect) at the time of recall^F.

The serial position effect, a term coined by Hermann Ebbinghaus through studies he performed on himself, refers to the finding that recall accuracy varies as a function of an item's position within a study list. When asked to recall a list of items in any order (free recall), people tend to begin recall with the end of the list, recalling those items best (the Recency effect). What you remember from what you read is dependent on what it is presented during the learning episode. In general it is observed that we remember more for particular time compared to other interval. During a learning episode, we remember best that which comes first, second best that which comes last, and least that which comes just past the middle (David A. Sousa).

The primacy effect, in psychology and sociology, is a cognitive bias that results in a subject recalling primary information presented better than information presented later on. For example, a subject who reads a sufficiently long list of words is more likely to remember words toward the beginning than words in the middle. Greg C Elvers (2003) studied the serial position effect by presenting a list of 30 words. The two conditions were framed and the participants read a list of 30 words. In one condition the participants perform a distracter task for 30 seconds after seeing the list of words. He found higher influence of the Recency effect the last several items cannot be rehearsed in working memory during the distracter task.

Prahlad Gupta (2005) made 3 experiments and found that experiment 1 obtained both primacy and recency effects. Experiment 2 and 3 showed that these effects were not due to the controlled duration of nonwords or the procedure by which non-words were created. In the material of learning of Primacy/Recency effect (David A. Sousa) explained that in 40 minute session first 10 minutes and last 10 minutes have highest information retention ratio compared to middle 20 minutes. The first explained or read item retain for longer duration compared to other information (Primacy Effect). Under the primacy effect the consumers that prefer a particular brand from the outset will never switch to the other brand. The firms compete for initially ignorant consumers, and, therefore, choose the same advertising intensities across both settings. Under the recency effect, on the other hand, each firm's advertising messages affect ignorant consumers as well as those who prefer the rival brand (Oksana Loginova). Glenberg, Bradley, Stevenson, & Gretz (1980) were found that participants repeat those items properly which comes first. It means, the primacy effect had a greater influence on information retention. The information explained at the last also repeated properly

compare to middle information. This allows items that are recently studied to have an advantage over those that were studied earlier, as earlier study items have to be retrieved with greater effort from one's long-term memory store (Marshall & Werder- 1972). It means, recency effect is at second influencing part of information set.

HOGARTH AND EINHORN (HE 1992) BELIEF ADJUSTMENT MODEL⁵

The readers have belief towards company and its performance. If the president's letter contains information which supports the readers' belief, it will translate into stock specific decision like buying or holding or selling. The Belief Adjustment model assumes that if information is provided with different order (recency), it can change the readers' perception towards the company. In other words, the information's order (Primacy or Recency) impact significantly on readers' perception. The Primacy effect means the information which read first have more impact on readers' perception compare to the later information. The Recency effect means the information which read recently or lastly has more impact on readers' perception.

According to Belief Adjustment Model the information can be classified as

1. Short: - Short information means in an information set 12 or less than 12 items are mentioned.
2. Long: - Long information means in an information set more than 12 items are mentioned.
3. Complex: - The information provided in quantity. It contains lot of information which can be familiar or non familiar.
4. Simple: - Here the information provided in quality and not in quantity. The characteristic of the information is short, simple and understandable.
5. Consistent: - The flow of information is in same direction. E.g. if information start with positive information it will continue with it. The negative information will come after the end of the positive information set.
6. Inconsistent: -The flow of information is directionless. The information set contains positive or negative information.
7. Probabilistic: - The information set provide information in form of estimation or probability of outcomes. These types of information generally come at first.
8. Evaluative: - The information set provide information in form of evaluation or result. These types of information come at last.

The Primacy effect can observed when the information is consistent and long information set is there. It can also observe when the information is short and simple information is there. The Recency defect can observe when the information is complex, short information is there. For the study purpose the president's letter was formed in such a way that the primacy effect can be observed from the mixed (positive & negative), short and simple information.

OBJECTIVES OF THE STUDY

1. To study the Primacy and Recency impact.
2. To study the impact of change in information's order on readers' perception.

HYPOTHESIS

H1₀: - There is no presence of a Primacy Effect in respondents' perception.

H1₁: - There is presence of a Primacy Effect in respondents' perception.

H2₀: -The perception of respondents' of Section A and B is independent of information's order. (Positive Information only)

H2₁: -The perception of respondents' of Section A and B is dependent of information's order. . (Positive Information only)

H3₀: -The perception of respondents' of Section A and B is independent of information's order. (Negative Information only)

H3₁: -The perception of respondents' of Section A and B is dependent of information's order. . (Negative Information only)

H4₀: -The perception of respondents' of Section A and B is independent of information's order. (Opinion Information only)

H4₁: -The perception of respondents' of Section A and B is dependent of information's order. . (Opinion Information only)

RESEARCH METHODOLOGY

For this study the article (Jane E. Baird & Robert C. Zelin) was taken as base. The president's letter was taken from Indian Blue Chip Company having rank in top 3 highest market Capitalization Company as on 11/04/2012 and it modified as per requirements. To make it short the necessary changes had been made. To make a letter short and consistent, the whole letter was converted into 12 sentence letter. And the information were classify into two paragraph one with positive information and other with negative information. The primacy effect can be observed from the mixed (positive & negative), short and simple information. The whole information was arranged in two sections. Section A represent the first paragraph with all positive information (Annex. 1) and second paragraph with all negative information. Section B represents the same information but first paragraph with all negative information and second paragraph with all positive information.

The list of scale items for questionnaire survey were taken from Jane & Robert (2000) and modified as per requirements. The respondents were asked to rate the factors on the base of Highly Disagree (Score 1) to Highly Agree (score 5). The respondents were divided into tow group. Each group represents 40 students and seated in different class room. Both the group were asked to read the president's letter carefully and ranked the 38 factors (Annex 2). To avoid the sequential effect the factors were not arranged in sequence. The positive factor followed by negative or opinion factor. There were 12 positive, 11 negative and 15 opinion based factors.

SAMPLE

For the research purpose 80 students of MBA Semester IV were selected. All students were with sound accounting knowledge because they already studied *Accounting for Managers* in Semester I. The 40 students were in one class who were given Section A and other 40 students were in other class with Section B.

ANALYTICAL TOOL

To know the difference between the perceptions of respondents, *chi square test* was applied. A chi-squared test is statistical hypothesis test in which the sampling distribution of the test statistic is a chi-squared distribution. A test of independence assesses whether paired observations on two variables, expressed in a contingency table, are independent of each other or not. For this study the chi square test helped in testing the differences of two variables (Section A and Section B) were significant or not (Ken Black-2009).

DATA ANALYSIS METHOD

The whole responses were divided into 3 parts as per table 1. The purpose to divide the factors under the heading of positive factors, negative factors and opinion factors was to check out the differences in perception of the respondents towards company after reading the letter. After that the chi square test was applied to know that, is there any significant difference between Section A and Section B?

*TABLE 1: FACTOR CLASSIFICATION

| Factor title | No in Factor list | Total Factors |
|----------------------|---|---------------|
| Positive factors | 1,2,3,4,15,16,17,23,26,30,32,36. | 12 |
| Negative Factors | 5,9,10,11,13,14,24,25,28,33,35. | 11 |
| Opinion Base factors | 6,7,8,12,18,19,20,21,22,27,29,31,34,37,38 | 15 |

DATA ANALYSIS AND INTERPRETATION

HYPOTHESIS 1

To check the Primacy and Recency effect, the mean rating of the responses were found and it can conclude that- "There is a presence of Primacy Effect in respondents' perception."

TABLE 2

| Details of Groups | Mean Rating | |
|-------------------|-------------|-----------|
| | Section A | Section B |
| Positive | 3.68 | 3.62 |
| Negative | 2.67 | 2.81 |
| Opinion | 3.30 | 3.16 |

From the table it can reveal that the mean rating of all 3 groups revealed Primacy effect. Because Positive group and opinion group had higher mean rating in Section A compare to Section B. In section A, first paragraph contain only positive information and second paragraph contained negative information. That is the reason for higher mean rating for positive group and opinion group.

Negative group had higher mean rating in Section B compare to Section A because Section B contain first paragraph with negative information and second paragraph with positive information. That is the reason for having higher mean rating in Section B compare to section A.

HYPOTHESIS 2

The Chi Square test was applied to test hypothesis 1, 2 & 3 respectively. The Chi Square generated following results for positive factors.

TABLE 3

| *Ranks given for Positive factors | | | | | |
|-----------------------------------|----|----|-----|-----|----|
| Positive | HD | D | N | A | HA |
| Sec A | 1 | 14 | 197 | 192 | 76 |
| Sec B | 9 | 50 | 115 | 244 | 62 |

TABLE 4

| Calculated Chi-Square | Degree of Freedom | Alfa | P-Value |
|-----------------------|-------------------|------|---------|
| 55.823 | 4 | 0.05 | 0.000 |

Here, the P value is less than significance level 0.05. So, the null hypothesis was rejected and it can conclude that- "There is significant effect of order change on the perception of two groups for positive factors."

HYPOTHESIS 3: - For Negative factors

TABLE 5

| *Ranks given for Negative factors | | | | | |
|-----------------------------------|----|-----|-----|----|----|
| Negative | HD | D | N | A | HA |
| Sec A | 40 | 167 | 143 | 78 | 12 |
| Sec B | 39 | 151 | 127 | 99 | 24 |

TABLE 6

| Calculated Chi-Square | Degree of Freedom | Alfa | P-Value |
|-----------------------|-------------------|------|---------|
| 8.257 | 4 | 0.05 | 0.83 |

From the above table it can interpret that P value is more than significance level 0.05. It means, the null hypotheses is accepted and conclude that- "There is no significant effect of information's order change on perception of 2 groups for negative factors."

HYPOTHESIS 4: -For opinion Factors

TABLE 7

| *Ranks given for Opinion factors | | | | | |
|----------------------------------|----|-----|-----|-----|----|
| Opinion | HD | D | N | A | HA |
| Sec A | 21 | 105 | 204 | 213 | 57 |
| Sec B | 41 | 138 | 162 | 198 | 61 |

TABLE 8

| Calculated Chi-Square | Degree of Freedom | Alfa | P-Value |
|-----------------------|-------------------|------|---------|
| 16.436 | 4 | 0.05 | 0.002 |

The P value is less than the significance level 0.05. So, the null hypothesis is rejected. It can conclude that -"Due to change in information's order the respondents' opinion got changed towards the company."

CONCLUSION

The Primacy effect can be observed in study. The perceptions of all the respondents' were affected due to change in the order of information. The respondents were affected due to change in first paragraph. The letter with first positive paragraph show higher mean rating for Section A and the letter with first negative paragraph show higher mean rating for Section B. These prove the presence of Primacy Effect.

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ANNEXURE

ANNEXURE 1: PRESIDENT'S LETTER

To the shareholders of ABC company:

In 2010-11, ABC attained largest profit growth in its history with record operation and financial results from each of the 3 core segments of petrochemicals, refining and marketing and oil and gas. ABC achieved a record turnover exceeding Rs. 258,000 crore and higher net profit of Rs. 20,286 crore. This landmark performance was a result of strong global economic recovery, India's consumer demand for product and services linked to a better quality of life and best in class manufacturing achievements at all our plants. We are among the 100 most profitable companies in the world. Cash flow from operations and collections reached the second highest level in the history of the company while, at the same time, the percentage of debt to total assets remained unchanged. Improved demand in major markets, along with the results of ongoing cost reduction programs and diligent efforts to improve our products, marketing programs and service to customers should produce increasing future profits. Our company today is broadly diversified with a strong technological foundation and is committed to development of new and better products through a broad research and development effort directed toward emerging businesses that promise high growth rates and proprietary product positions. An additional source of corporate strength can be found in our hardworking and dedicated employees, they are truly our greatest asset.

In the oil and gas business, deep water exploration and development operations presents technological challenges and operating risks. The challenge for ABC is to ensure optimum level of production, safe and reliable operations while maintaining the highest level of health, safety and environment standards. Over the past three years, a large number of new low cost ethylene capacities have come on stream in the Middle East region, which has resulted in margin pressure. The length and severity of the recent recession has caused an increase in the level of receivables and also increase in decline in product demand to the point where some of our customers have not recovered from pre-recession levels. In addition to the above situation, old, inefficient facilities at several of our production location have handicapped our ability to produce acceptable results for the items manufactured. An explosion at one of these facilities has resulted in a lawsuit being filed against the company. The depreciation of the Indian Rupees against other currencies continued to affect adversely both our domestic and international business.

The President

ANNEXURE 2 - FACTORS FOR RESPONDENTS

| Sr. No | Details | Highly Disagree | Disagree | Neutral | Agree | Highly Agree |
|--------|--|-----------------|----------|---------|-------|--------------|
| 1 | The company appears growth oriented | | | | | |
| 2 | The performance of company seems good. | | | | | |
| 3 | The details mention about Company is true | | | | | |
| 4 | The company Focuses on CSR | | | | | |
| 5 | In past the company had some hard-hitting | | | | | |
| 6 | The company appears to have goals and objectives that are compatible with my values. | | | | | |
| 7 | The company is concerned for employees' welfare | | | | | |
| 8 | The company required to be more aggressive. | | | | | |
| 9 | The management has made some poor decisions in the past. | | | | | |
| 10 | The company had a poor year. | | | | | |
| 11 | The president is not telling the truth about company. | | | | | |
| 12 | They required being more aggressive for competitive environment. | | | | | |
| 13 | The company is not concerned for employees' welfare. | | | | | |
| 14 | This company is not being socially responsible | | | | | |
| 15 | The company seems to have a good reputation | | | | | |
| 16 | The company's management has made some wise decision in the past. | | | | | |
| 17 | The company appears to be aggressive in its competitive environment. | | | | | |
| 18 | The goals and objectives of this company are not well matched with my own. | | | | | |
| 19 | It would be risky to invest in this company | | | | | |
| 20 | I will buy the stock of this company | | | | | |
| 21 | The president seems over pessimist in letter | | | | | |
| 22 | The current economy will not favor this industry. | | | | | |
| 23 | The company's future seems bright. | | | | | |
| 24 | The company's prospects appear weak | | | | | |
| 25 | The company is over diversified | | | | | |
| 26 | The company appears to be positioned to face any downturn in the economy. | | | | | |
| 27 | If I owned stock in this company, I would sell it tomorrow. | | | | | |
| 28 | The company's stock appears to be risky. | | | | | |
| 29 | I am ready to invest in this company immediately. | | | | | |
| 30 | The company's prospects look strong. | | | | | |
| 31 | If I had stock in this company, I would be confident in my investment. | | | | | |
| 32 | This company appears to be a safe investment. | | | | | |
| 33 | The company's future is uncertain | | | | | |
| 34 | The president's letter is overly optimistic. | | | | | |
| 35 | Investing in this company is a gamble. | | | | | |
| 36 | The company's stock appears to be good investment. | | | | | |
| 37 | The company needs to branch out into new industries | | | | | |
| 38 | If I owned stock in this company today, I would be dissatisfied with my investment. | | | | | |

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