

Discussion of “Strategic Secrecy and Managerial Shielding”

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ABFER

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CHICAGO BOOTH



The University of Chicago Booth School of Business

A woman in a purple dress is holding a white hat, and another woman in a white dress and colorful jacket is listening to music. They are in a store with shelves of luggage and headphones.

2X miles on every purchase







DUNKIN' BRANDS GROUP, INC. AND SUBSIDIARIES
Consolidated Statements of Operations
(In thousands, except per share data)

	December 28, 2019
Revenues:	
Franchise fees and royalty income	\$ 604,431
Advertising fees and related income	499,303
Rental income	122,671
Sales of ice cream and other products	91,362
Other revenues	52,460
Total revenues	1,370,227
Operating costs and expenses:	
Occupancy expenses—franchised restaurants	79,244
Cost of ice cream and other products	75,771
Advertising expenses	506,755
General and administrative expenses	238,678
Depreciation	18,429
Amortization of other intangible assets	18,454
Long-lived asset impairment charges	551
Total operating costs and expenses	937,882
Net income of equity method investments	17,517
Other operating income (loss), net	1,188
Operating income	451,050

An important topic!

Central to financial reporting and disclosure

- ❑ GAAP determines recognition but has little to say about disclosure. Managers have some discretion over:
 - ✓ Income statement geography (e.g., operating vs non-operating)
 - ✓ How items are described (“unusual”)
 - ✓ Level of aggregation

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 - ✓ How items are described (“unusual”)
 - ✓ **Level of aggregation**
- ❑ Why advertising expenditures?
 - ✓ Creating brands is important → authors argue (assume) advertising expenditures are value relevant to investors.

Interbrand

Top 100



01
Apple



+4%
502,680 \$m

02
Microsoft



+14%
316,659 \$m

03
Amazon



+1%
276,929 \$m

04
Google




+3%
260,260 \$m

05
Samsung



+4%
91,407 \$m

06
Toyota




+8%
64,504 \$m

07
Mercedes-Benz




+9%
61,414 \$m

08
Coca-Cola




+1%
58,046 \$m

09
Nike



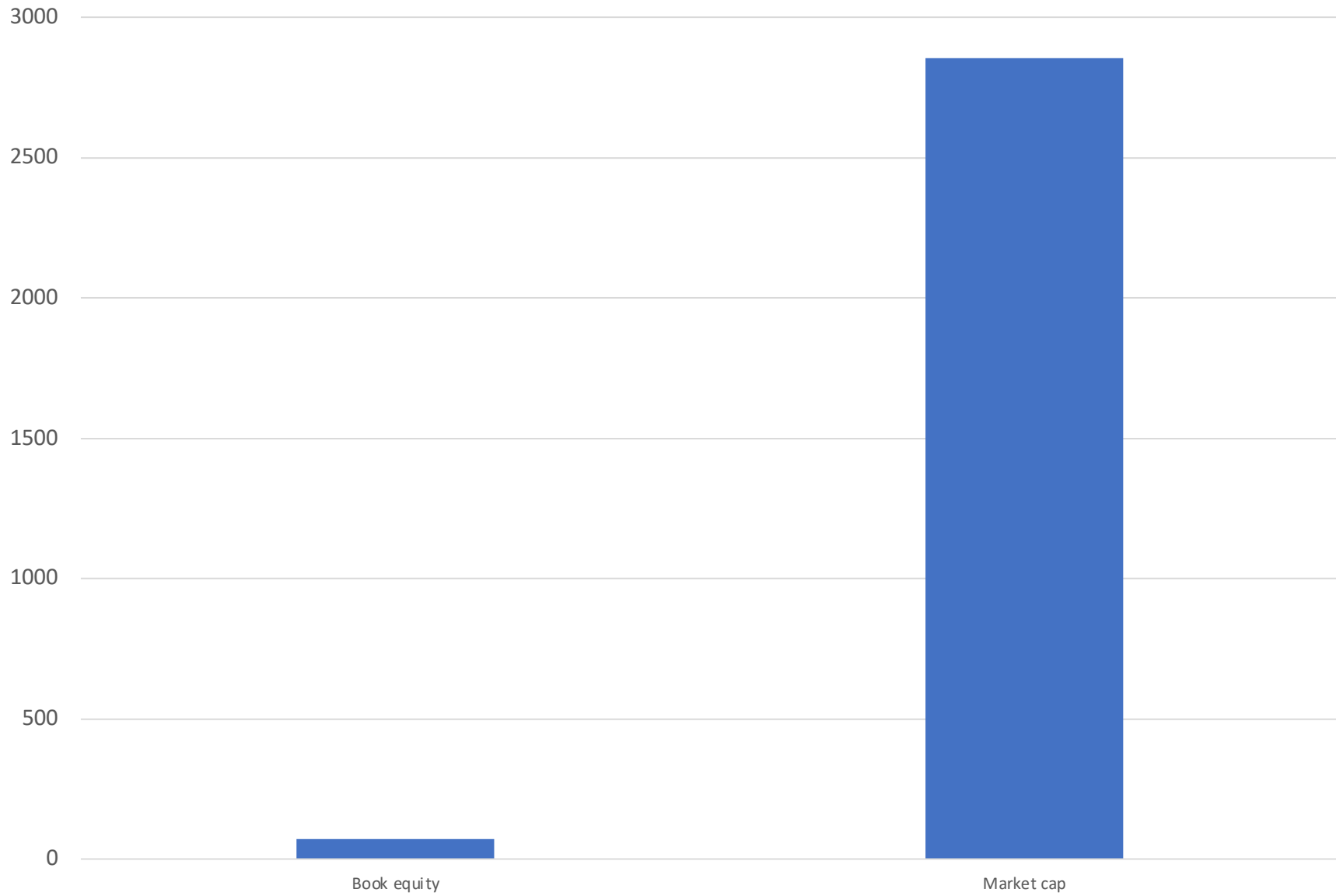
+7%
53,773 \$m

10
BMW



+10%
51,157 \$m

Apple: Book value vs. market cap. (\$M, at 5.10.24)



Apple: Book value vs. market cap. (\$M, at 5.10.24)



Apple Inc.

CONSOLIDATED STATEMENTS OF OPERATIONS

(In millions, except number of shares, which are reflected in thousands, and per-share amounts)

	Years ended		
	September 30, 2023	September 24, 2022	September 25, 2021
Net sales:			
Products	\$ 298,085	\$ 316,199	\$ 297,392
Services	85,200	78,129	68,425
Total net sales	383,285	394,328	365,817
Cost of sales:			
Products	189,282	201,471	192,266
Services	24,855	22,075	20,715
Total cost of sales	214,137	223,546	212,981
Gross margin	169,148	170,782	152,836
Operating expenses:			
Research and development	29,915	26,251	21,914
Selling, general and administrative	24,932	25,094	21,973
Total operating expenses	54,847	51,345	43,887
Operating income	114,301	119,437	108,949
Other income/(expense), net	(565)	(334)	258
Income before provision for income taxes	113,736	119,103	109,207
Provision for income taxes	16,741	19,300	14,527
Net income	\$ 96,995	\$ 99,803	\$ 94,680

Apple's advertising expenditures are included in \$25B of SG&A expense.

Moon et al. (2023) point to Apple as a company that reduced disaggregation (Apple would, I think, qualify as what the authors call “confidential” disclosers).

2015 10-K, p. 46:

Advertising Costs

Advertising costs are expensed as incurred and included in selling, general and administrative expenses. Advertising expense was \$1.8 billion, \$1.2 billion and \$1.1 billion for 2015, 2014 and 2013, respectively.

2016 10-K, p. 46:

Advertising Costs

Advertising costs are expensed as incurred and included in selling, general and administrative expenses.

What do the authors do?

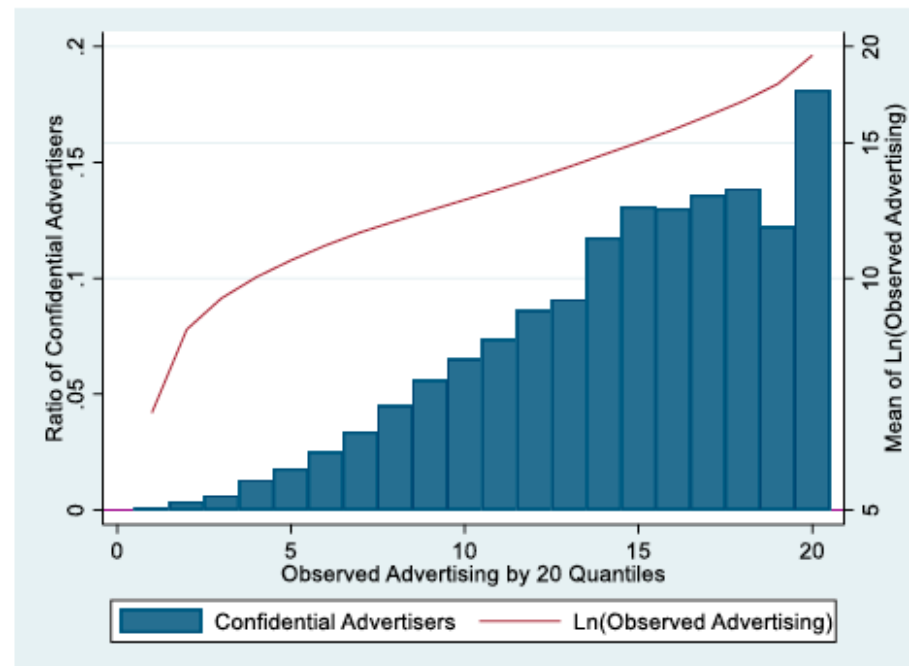
- Use *Kantar* data to obtain advertising spend.
 - This is compared to Compustat XAD.
 - Classify firms as “confidential” if *Kantar* advertising spend $\geq 5\%$ of pre-tax income and advertising not reported on Compustat; otherwise “transparent”
- raises a couple of questions:
- What if ad spending is bundled with marketing costs?
 - What if ad spending is disclosed in a different way that is not captured by Compustat?

Could it be, as with Apple, that firms are naturally less likely to disaggregate specific types of expenditures as they grow and become more complex? Why would it be that firms' disclosures become less transparent as they get bigger?

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Figure 2: Confidential-expenditure Ratios by Observed Advertising Quantiles

This figure depicts the confidential-expenditure ratio by twenty quantiles of observed advertising reported by Kantar Group, sorted by spending amount. The left-hand Y-axis reports the proportion of confidential-expenditure firms, while the right-hand Y-axis depicts the natural log of the mean observed advertising per quantile. We define confidential-expenditure firms as firms whose advertising expenditures are not disaggregated while appearing in Kantar with advertising of at least 5% of pre-tax income.





	Year Ended December 31,		
	2019	2018	2017
<i>(Dollars in millions, except per share-related data)</i>			
Interest income:			
Loans, including loans held for sale	\$ 25,862	\$ 24,728	\$ 23,388
Investment securities	2,411	2,211	1,711
Other	240	237	123
Total interest income	28,513	27,176	25,222
Interest expense:			
Deposits	3,420	2,598	1,602
Securitized debt obligations	523	496	327
Senior and subordinated notes	1,159	1,125	731
Other borrowings	71	82	102
Total interest expense	5,173	4,301	2,762
Net interest income	23,340	22,875	22,460
Provision for credit losses	6,236	5,856	7,551
Net interest income after provision for credit losses	17,104	17,019	14,909
Non-interest income:			
Interchange fees, net	3,179	2,823	2,573
Service charges and other customer-related fees	1,330	1,585	1,597
Net securities gains (losses)	26	(209)	65
Other	718	1,002	542
Total non-interest income	5,253	5,201	4,777
Non-interest expense:			
Salaries and associate benefits	6,388	5,727	5,899
Occupancy and equipment	2,098	2,118	1,939
Marketing	2,274	2,174	1,670
Professional services	1,237	1,145	1,097
Communications and data processing	1,290	1,260	1,177
Amortization of intangibles	112	174	245
Other	2,084	2,304	2,167
Total non-interest expense	15,483	14,902	14,194
Income from continuing operations before income taxes	6,874	7,318	5,492

Is Capital One really “concealing” their ad spend?

Non-interest expense:	
Salaries and associate benefits	6,388
Occupancy and equipment	2,098
Marketing	2,274
Professional services	1,237
Communications and data processing	1,290
Amortization of intangibles	112
Other	2,084
Total non-interest expense	15,483

DRAFTKINGS INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(Amounts in thousands, except per share amounts)

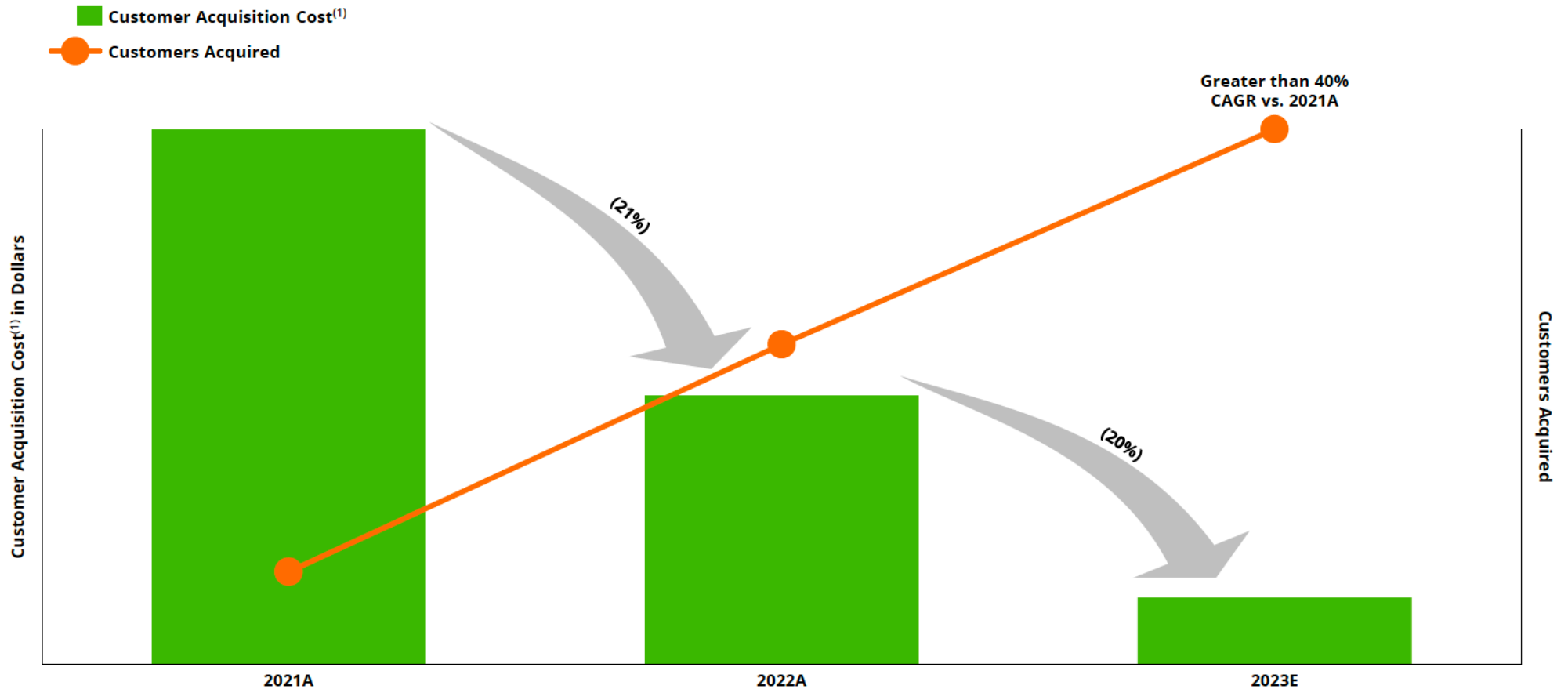
	2022
Revenue	\$ 2,240,461
Cost of revenue	1,484,273
Sales and marketing	1,185,977
Product and technology	318,247
General and administrative	763,720
Loss from operations	(1,511,756)
Other income (expense):	
Interest income (expense), net	18,702
Gain (loss) on remeasurement of warrant liabilities	29,396
Other income, net	20,700
Loss before income tax provision (benefit) and loss (gain) from equity method investment	(1,442,958)
Income tax (benefit) provision	(67,866)
Loss (income) from equity method investment	2,895
Net loss attributable to common stockholders	\$ (1,377,987)

Sales and Marketing. Sales and marketing expense increased \$204.5 million, or 20.8%, to \$1,186.0 million in 2022, from \$981.5 million in 2021. The increase was primarily attributable to an increase of \$133.9 million in advertising costs spent to acquire users, as well as an increase in compensation and technology costs associated with analyzing, developing and deploying those advertising campaigns.

For DraftKings, advertising is part of sales and marketing costs, primarily incurred as part of customer acquisition costs – the company provides a lot of disclosure about this.

Over the past two years, we have dramatically increased customer acquisition while simultaneously decreasing CAC

Customer Acquisition Efficiency



(1) Customer acquisition cost (CAC) is defined as external marketing spend divided by new customers. We include all external marketing spend allocated to OSB and iGaming, including national spending, team and league deals, and product-agnostic spending, and divide by new OSB and iGaming customers. We do not credit customer acquisition for customers who were previously acquired to DFS.

Source: DraftKings Investor Day deck, November 2023.

The role of analysts

- *Kantar* data is apparently available to sell-side analysts (presumably it sits behind a paywall and so is not “publicly-available” in an efficient markets sense).
- Nice example of how sell-side analysts can add value for capital market investors.
- If this is effective, do companies also need to disclose separately?

Some thoughts on authors' hypotheses.

- We generally observe firms making the minimum level of disclosure in SEC filings (external financials).
- Analysts always want more disclosure, typically greater granularity (disaggregation).
- There is a longstanding literature on the benefits and costs of voluntary disclosure.
- The authors identify a setting that can help add to this literature. But – as I have indicated – we need to better understand how this actually works.
- For example, where are the benefits likely to be largest? The costs the smallest? Do proprietary costs really matter?

Some thoughts on authors' hypotheses.

- Need more specificity on agency cost story – managers choose not to disaggregate for their own purposes, even if disaggregation maximizes shareholder value.
- Authors argue that managers are concerned they will be punished for advertising expenditures that destroy value – if this is important, will they choose not to disclose or disclose more?
- If advertising is positive NPV, seems the best strategy is to convince shareholders.
- If not, the implication is that advertising has private benefits for managers – need to understand this better.

In sum:

- A super-important topic – disclosure around intangibles is clearly of first-order economic importance.
- Authors identify a nice setting; encourage them to think through the mechanisms (and so tests) a bit more.
- We generally believe that managers' voluntary disclosures (e.g., guidance) are responsive to analysts' demands for information, especially if it can increase stock price. Seems likely to be operating here as well.

