

Creating Value

Value to the board

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Introduction

A number of forces at work in the world are combining to highlight the power and relevance of Integrated Reporting <IR>. In this publication – the first in a new <IR> *Creating Value* series – we aim to highlight these trends, share views of those already on the <IR> journey, and inspire others yet to begin.

There is a recognized need to promote financial stability and sustainable development. Much can be achieved if investment decisions are made on the basis of long-term value creation, especially if corporate behaviour is aligned to this aim. Demonstrating the link between investment decisions, corporate behaviour and reporting is one aim of this *Creating Value* series.

We also intend to highlight the practical value of <IR> in the context of today's fast-moving markets, and the international trends that are combining to encourage <IR> adoption. We draw on recent research, articles and case studies to demonstrate the relevance of <IR> as a 21st century solution for businesses seeking a means of reporting on performance and potential from a long-term value creation perspective.

Value to the board **Paul Druckman, Chief Executive, IIRC**

This first edition focuses on the board – deliberately so. Corporate reporting, and the thinking that has to accompany it, are boardroom issues. This is where strategy, performance and the development and communication of long-term value are best understood, aligned and led. This view is endorsed by the International Corporate Governance Network (ICGN) whose revised *Global Governance Principles* now include the recommendation that boards should produce an integrated report. Reporting is firmly placed among the responsibilities of top management.

Board members are best placed to ensure overall organizational and cultural alignment and to achieve the benefits that come from effective reporting practices. Investors may not yet routinely request integrated reports, but this should not be a reason for boards to delay starting their <IR> journey. Investors say they have more confidence in management when they gain a clear picture of the business from reporting. As PwC research shows,

investors clearly want the benefits associated with the broader reporting focus of <IR>¹. At the same time, boards are increasingly pursuing long-term strategies that integrate wider sources of value creation. This will incline them towards an <IR> approach; it will be a natural part of boardroom thinking to report organizational performance in relation to long-term value creation – a need and intent that is aligned with the International <IR> Framework.

There is increasing evidence too of the benefits boards can gain from adopting <IR>. The latest IIRC research conducted by corporate communications consultancy Black Sun identifies both external and internal benefits². Among organizations piloting the <IR> Framework, 91% have seen a positive impact on external engagement with stakeholders, including investors; 92% have a better understanding of value creation; and 79% report improvements in decision making.

In today's world, news travels fast. Big data, the internet and social media mean that hiding less favourable news is increasingly hard to do. We live in an age of transparency. <IR> is, at one level, a strategic response to the challenges of operating successfully within modern society. It is also about doing the right thing. The recent report *Tomorrow's Business Success*, poses the question, "Why would a company not want to be trusted?"³ It reflects in part the need for boards to recognize that they have a wider purpose extending beyond delivering financial success for shareholders. Many leading companies already understand this, and are embracing <IR> as a practical means of telling a compelling story about how they are creating long-term value and so contribute to the greater good, not only in pure business terms, but also for society at large. Their leading practices will inspire others to follow.

Building trust and reputation

Following the global financial crisis, the need for boards to build trust in their businesses with all their stakeholders and demonstrate their contribution towards long-term economic stability has become a high priority. <IR> has an important part to play.

In the wake of the global financial crisis, huge effort has been spent on analyzing its causes, dissecting weaknesses in capital markets and governance frameworks, and seeking ways to prevent a recurrence.

Now market participants are increasingly focused on rebuilding trust. The trust-building challenge facing boards is particularly important in the light of post-crisis analysis that has identified a widespread loss of confidence in the current capitalist model as a force for good for everyone in society.

Dominic Barton, global managing director of McKinsey, has called on business leaders to rise to the challenge of reforming capitalism for the long term. However, as he outlines in the recent report *Tomorrow's Business Success*, there are three major challenges to be faced in achieving reform: the need for businesses to focus on the long term; for executives to ensure their organizations serve the interests of all major stakeholders (employees, suppliers, customers, creditors, communities and the environment); and for the boards of public companies to govern like owners. He believes <IR> can help business leaders meet these challenges, stating, "<IR> enables companies to set out how they create value and can provide the shared language which enables boards, business executives and investors to more effectively engage to unlock future wealth."

“ If businesses are not making, and seen to be making, a positive contribution to the societies of which they are a part then they will lose trust and value as a result. ”

Tomorrow's Business Success,
Tomorrow's Company, CIMA and the IIRC

“ The call for Integrated Reporting is beginning to rise in volume. With public trust in business undermined by scandal after scandal, we would do well to listen and act quickly. ”

Jean-Marc Huët, CFO, Unilever

PwC has been considering the importance of trust for some years. Its 2010 paper, *Trust: the overlooked asset*, opened with this stark statement: "In an era of increasing connectivity and intensifying public scrutiny, trust is the lifeblood of any organisation – a critical asset in ensuring a business's long-term survival and success. The aftermath of the recent financial crisis has demonstrated both the vital importance of trust, and the severe consequences to economic prosperity when it is undermined by perceived untrustworthy behaviour."⁴ But, as the report notes, because trust does not appear on the balance sheet, it is "widely overlooked". The paper poses some pertinent questions for businesses, such as:

- Do you focus solely on revenue growth or is it just as important to your organization how this wealth is created?
- To what extent do you look beyond financial performance to measure your stakeholders' experiences of your organization, through metrics such as employee engagement, customer loyalty and social responsibility?

“ In an age when intangible assets comprise so much of a company's value, trust is an essential currency of business – and yet it's never been more fragile or in shorter supply. The smartest investors will demand more transparency about non-financial elements of a company's business, and the attendant risks and opportunities. ”

Daniel Tisch, CEO, Argyle Communications (Canada),
and 2011-2013 Chair, Global Alliance for Public
Relations & Communication Management

Building blocks of trust

Building and sustaining trust in their organization is undeniably a core element of the board's role.

Public relations consultancy Edelman believes, “Unlike reputation, which is based on an aggregate of past experiences with a company or brand, trust is a forward facing metric of stakeholder expectation.” The 2014 Edelman Trust Barometer, based on a substantial global survey, found that trust in business has stabilized (while trust in government has fallen), but since 2008, the factors seen as building trust in business have changed. Survey participants now place greater importance on engagement and integrity-based attributes such as treating employees well (59%), listening to customers (59%) and exhibiting ethical and transparent practices (56%). These factors now carry more importance than operational-based attributes, including financial performance (36%). Edelman’s research suggests that CEOs can build trust in themselves and their companies by communicating clearly and transparently (82%), telling the truth regardless of how unpopular it is (81%) and engaging regularly with employees (80%).

One challenge in building trust concerns the need for businesses – many of which now have the financial power greater than some national economies – to be held accountable. Today’s giant corporations have more power to affect employment, finance and society than government bodies. As their power has grown, so has the call for greater accountability of businesses – not just to their shareholders, but to the communities in which they operate and which provide their “licence to operate”.

At the same time, however, there has been a general loss of confidence in the ability of corporate reporting to provide investors and wider stakeholders with the information they need in order to hold boards to account. A recent study, *Understanding Investors: Directions for Corporate Reporting*, by global accountancy body ACCA, revealed that more than two-thirds of investors have lost trust in company reports since the onset of the global financial crisis⁵.

Building trust through <IR>

PwC’s Building Public Trust awards shine a spotlight on the best reporting practices. The Netherlands-based financial services company Aegon won the 2014 category for international companies participating in the IIRC Pilot Programme. The judges considered Aegon’s Integrated Report to be “concise, with a simple and accessible depiction of the company’s value chain. Aegon’s disclosures on its non-financial priorities and performance are especially impressive.”



Transform Tomorrow

The board's response

How can boards respond? Many companies are already adopting <IR> as a means to build trust and communicate clearly with multiple stakeholders, with relevance to wider society as opposed to shareholders only.

As outlined in the September 2014 issue of Strategic Finance magazine, published by the Institute of Management Accountants (IMA), Japan-based convenience store franchise Lawson, Inc. produced its first integrated report in 2013, which “illustrates how the company’s business model is tied to possible solutions to the social and environmental challenges of the local communities”⁶. Local issues (such as an ageing population) and global issues (such as climate change) “are connected to the multiple actions that Lawson, Inc. has implemented as part of its mission to realize a sustainable business growth in harmony with society and the environment”.

<IR> is a key mechanism by which boards can present the full picture of their company’s use of all relevant resources (or ‘capitals’), and so help to address weaknesses in today’s capital markets. In their publication, *A Manifesto for Sustainable*

Capitalism, Al Gore and David Blood assert that Integrated Reporting encourages companies to integrate both their financial and environmental, social and governance performance into one report that includes “only the most salient or material metrics”. They state, “This enables companies and investors to make better resource-allocation decisions by seeing how ESG performance contributes to sustainable long-term value creation.”

Similarly, global insurer Aviva’s white paper, *A Roadmap for Sustainable Capital Markets*, argues that capital markets do not incorporate companies’ full social and environmental costs, and therefore that capital is not being allocated correctly⁷. The paper states, “Integrated reporting by companies is fundamental to the ability to execute responsible investment strategies.” It warns that without <IR>, investors cannot integrate the environmental, social and governance performance measures of corporate sustainability into their valuation work. “As a result, a company’s cost of capital does not reflect its sustainability.” Investors are not able to take account of a company’s ability to continue as a viable business.

Darryl Button, Aegon’s CFO and a member of its management board, said,

“Trust is at the heart of what Aegon does: deliver financial promises to millions of customers across the world. Integrated Reporting has helped us to better explain our business and communicate how we create value for our customers, employees, investors and other stakeholders.”

Widespread consensus

Regulators and other bodies are thinking along similar lines. The Financial Stability Board (FSB) and the International Organization of Securities Commissions (IOSCO), for example, are among those taking a greater interest in <IR> as a route towards achieving more cohesive reporting and financial stability.

The Brazilian National Development Bank (BNDES) has a keen interest in supporting financial stability. Vânia Maria da Costa Borgerth, senior advisor on market transparency to the bank's president, sees strong benefits from encouraging <IR>. In the *IIRC Pilot Programme Yearbook*, she said, "We understand that improving transparency will create more stable capital markets that are better prepared to grow," she says. "We're involved in Integrated Reporting because we think it is a much more transparent way to see a company as a whole, not just as a profit entity.

"As an accountant, I think financial information is no longer enough to provide the market and investors with information they need in order to make decisions. Investors, suppliers, clients and society will generally benefit; transparency reduces uncertainty. Having a more transparent way of presenting a company so that the whole market understands it better can help avoid drastic decisions and systemic risk, even during a crisis."

The ultimate aim is that by applying <IR> to achieve greater transparency of material information and present a clearer value creation story, boards can build and sustain trust not only in their own companies, but also in the capital markets as a whole.

“ Whether Integrated Reporting should happen or not is no longer a question. We should look at how to implement it in a manner that is not disruptive. ”

Mr U.K. Sinha, Chairman of the Securities and Exchange Board of India (SEBI)

“ The Securities Commission, together with professional bodies and other stakeholders, is exploring avenues to enhance the quality of information available to the capital market. One of the options being considered is the eventual introduction of Integrated Reporting. ”

Datuk Seri Najib Tun Razak, Prime Minister of Malaysia

Articulating strategy and the business model for better investor dialogue

Telling the company's performance story is an important part of the board's responsibilities. Explaining strategy and the business model is essential to present clearer and more complete information to investors and other stakeholders.

Net assets of
S&P 500 companies
represented
only around

19%

of market
capitalization
in **2009**

compared to

90%

in the 1970s

One problem with traditional investment decisions is that they are based on financial metrics alone. But according to global consultancy Interbrand's 2013 survey of brand values,⁸ Coca-Cola's brand value amounted to around 48% of its market capitalization.

This is no isolated example. Research in 2010 by US merchant bank Ocean Tomo, an intellectual capital specialist, looking at trends over four decades, found that net assets of S&P 500 companies represented only around 19% of market capitalization in 2009, compared to 90% in the 1970s. In other words, intellectual capital and other intangible assets not captured on the balance sheet now drive market value.

Boards need to address this information gap, to express clearly and concisely how their strategy creates value over time, and how they generate profits and manage risks. The process of <IR> enables organizations to do this by taking into account the relationships between different areas of a business, its use of capitals and the business model.

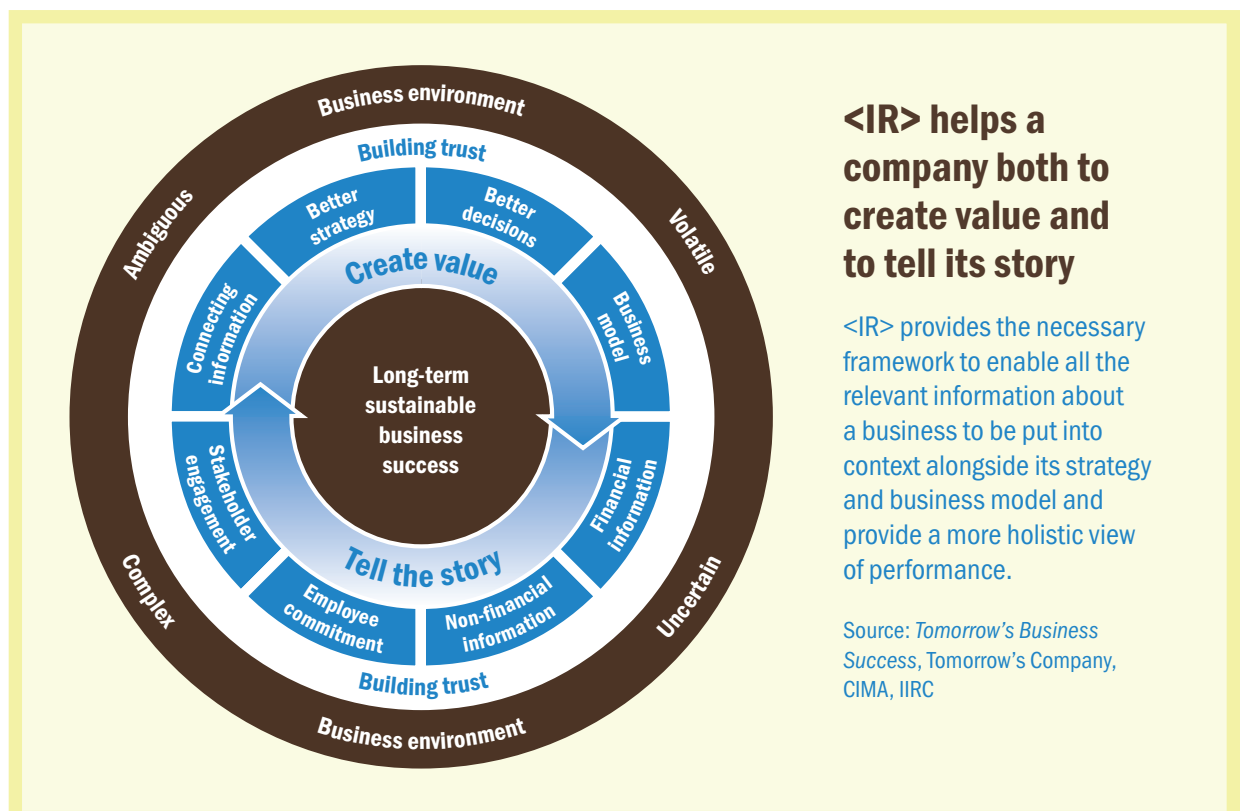
Holistic reporting

According to Bob Laux, Senior Director of Financial Accounting and Reporting at Microsoft Corporation, <IR> helps organizations to articulate their performance and future potential. He says, “<IR> provides a holistic method for explaining how the organization is doing, and how the management team thinks it will do in the future... It takes into account the connectivity and interdependencies between the range of factors that have a material effect on an organization’s ability to create value over time.”

Dimitris Lois, Chief Executive Officer at Coca-Cola HBC, also sees benefits. “Integrated Reporting reflects how our company thinks and does business,” he says. “This approach allows us to discuss material issues facing our business and communities and show how we create value, for shareholders and for society as a whole.”

It is precisely the board’s view of how the organization’s strategy, governance, performance and prospects – in the context of its external environment – lead to the creation of value in the short, medium and long term that investors want to know. A recent survey⁹ among investment professionals by PwC found that a large majority (87%) of respondents felt that clear links between a company’s strategic goals, risks, key performance indicators and financial statements was helpful for their analysis.

Nearly two-thirds (63%) believed that the quality of a company’s reporting – including information about strategy, risks and other drivers of value – could have a direct impact on its cost of capital, according to the report – *Corporate performance: What do investors want to know?* However, substantial gaps are perceived between the importance of these topics and the effectiveness with which companies report on them. The PwC report concluded, “Developing more integrated reports could potentially better meet the needs of investment professionals, while also encouraging more cohesive decision-making within companies to support longer-term value creation.”



Filling information gaps

Sonja Simon, Head of Group Accounting and Reporting at SAP, the enterprise application software company and a participant in the <IR> Business Network, believes <IR> can help investors to understand the business better, by filling some important information gaps.

“I have heard a number of times that analysts and investors don’t have the necessary information and have to guess, which carries a risk premium,” she explains. “The more transparent we are about how we plan to meet challenges, and provide information showing how we actively manage not only our short-term financial numbers but also take steps to safeguard the future, the less risk premium there will be. Integrated Reporting can help communicate this.”

Considerable evidence has been amassed in recent years to indicate that traditional corporate reporting has not been meeting the needs of investors – it fails to provide them with the information they need to understand future value creation potential. For example, *The KPMG Survey of Business Reporting*, published in May 2014, looked at reporting by around 90 companies in 10 countries over a five-year period.¹⁰ It found that, while 56% of audit committees (surveyed separately) name customer focus as a top three value driver, only 7% of companies provide performance data on customer focus or satisfaction. The report notes that “boards have an essential role to play in ensuring that the content of their reports addresses what they consider to be the most important drivers of their business”. It finds that “at present, the weight of reported information does not reflect the drivers of business value, and therefore could align better with investor perspectives of value.”

“ Integrated Reporting that shows the entirety of corporate activities makes investors and other stakeholders come to fully understand the overall value to be created by the company. ”

The conclusion of Japan’s Expert Committee on Desirable Market Economy System, led by high profile business leader Yoshimitsu Kobayashi, President and CEO of Mitsubishi Chemical Holdings

“ State of the art Integrated Reporting provides us with information on corporate performance across the full spectrum of financial, social, intellectual, and natural capital that is necessary for value creation.

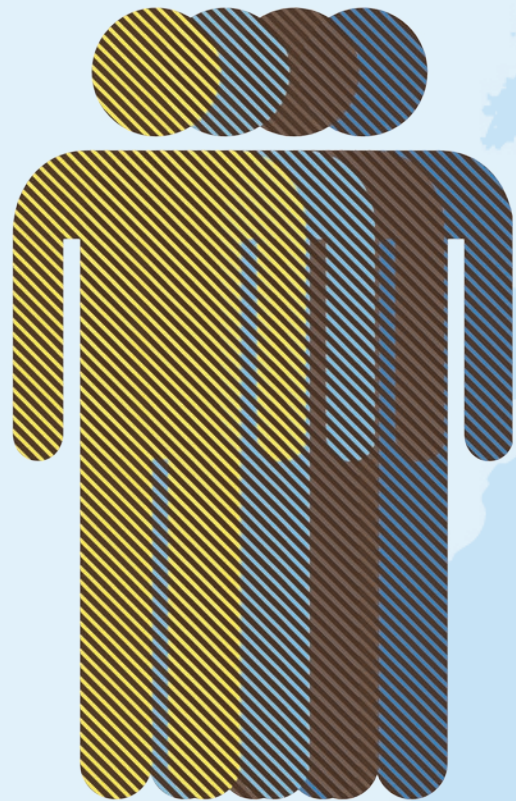
This gives us a much more complete picture of the long-term prospects of the business, and helps us make better investment decisions. ”

Euan Munro, Chief Executive Officer,
Aviva Investors

<IR> improves stakeholder relationships

Recent IIRC research has been conducted by corporate communications specialist Black Sun.

The September 2014 report, *Realizing the benefits: The impact of Integrated Reporting*, based on the experiences of IIRC Pilot Programme organizations indicates that <IR> has an impact on external stakeholders, including investors.



Importance of the business model

KPMG's report (as referred to on p. 15) makes a strong case for the importance of describing the business model. First, explanation of the model is the starting point for building a business-focused picture of the business – and should encourage the more complete provision of relevant operating performance measures. Second, the business model provides an essential context, helping readers to begin to assess the potential impact of future events.

Providing clarity on the business model, for both board members and external stakeholders, is one outcome of <IR>. “All stakeholders will benefit from <IR> because of its focus on future orientation and ensuring a clear understanding of the story of value creation through developing one organizational business model,” comments Sandra Guerra, Chair, Instituto Brasileiro de Governança Corporativa and IIRC Council Member. “Investors alongside other stakeholders will benefit from <IR> as embedded in its Framework is a culture of transparency and stability.”

Companies already adopting <IR> are seeing improved communication with their stakeholders. “<IR> enables us to better communicate how we are executing against our strategy and in doing so create value for our key stakeholder groups,” says Mikkel Larsen, Managing Director and Head of Tax & Accounting Policy at DBS Bank Ltd.

91%

of all respondents have seen a positive impact on external engagement with stakeholders, including investors.

Of those that have published at least one integrated report,

87%

believe that investors better understand their strategy.

70%

of those that have issued an integrated report believe that financial capital providers have greater confidence in the long-term viability of their business model.

Corporate reporting evolution

According to the *Annual Report on Annual Reports 2014* by ReportWatch, integrated reports represent the evolution of corporate reporting.

“Integrated Reporting is the logical consequence of the growth of sustainability and corporate responsibility as issues... One report out of three in the *Annual Report on Annual Reports 2014* top 50 may qualify, partly or fully, as “integrated”.” ReportWatch also notes that a third of investment decisions are based on non-financial attributes, commenting, “Companies must now report to a broader audience than shareholders – themselves often looking beyond numbers too – and speak to several categories of stakeholders. These expect more than accounts, financials and business indicators, and want to know why, where and how companies create and add value, and how they deal with responsibility and sustainability.” The study also refers to a survey among buy-side investors worldwide by US-based Rivel Research showing “clarity of business strategy” and “growth potential” as the two major aspects considered for long-term investment.

Damien Walsh, Managing Director at Australia’s bankmecu, sums up the views of many about the communications benefits of <IR>. “This approach to reporting recognizes that companies do not exist and operate in a vacuum – but rather in a complex interdependence between economic, social, cultural and environmental inputs, performance and impacts,” he says. “Ultimately it is improved and more complete communication which will help forge stronger connections between our bank and its customers – and that’s good business.”

Enhancing the board's governance role

The modern corporate is increasingly seen as having a wider purpose in society beyond delivering value to shareholders. As the board's governance role expands accordingly, so <IR> is increasingly being used as a tool to understand and communicate value creation in its broadest context.

Recent business theory has been dominated by the idea that maximizing shareholder value is the only corporate goal. New thinking is now challenging this assumption, arguing the case for a far broader corporate role and with it the need for a broader governance perspective by the board.

Steven Pearlstein, in *Social Capital, Corporate Purpose and the Revival of American Capitalism*, a 2014 paper published by non-profit public policy organization the Brookings Institution, claims that there is little basis in history or law for the idea that the sole purpose of a corporation is to maximize profits for its shareholders.¹¹ He argues that the idea only took hold in the 1990s – through a combination of hostile takeovers, increased stock-based compensation for executives, and quarterly earnings guidance. In contrast, he states, “well into the 1960s, corporations were widely viewed as owing something in return to the community that provided them with special legal protections and the economic ecosystem in which they would grow and thrive.”

Social capital

Pearlstein writes of the lack of emphasis on ‘social capital’ in capitalist systems, compared with financial, human or physical capitals.

His paper states, “Social capital is the trust we have in one another, and the sense of mutual responsibility for one another, that gives us the comfort to take risks, make long-term investments, and accept the inevitable dislocations caused by the economic gales of creative destruction.

The importance of social capital and creating value for wider society is being embraced by businesses implementing <IR>, as is the role that <IR> can play in supporting associated governance needs. Christie B. Kelly, Chief Financial Officer of Global real estate services provider JLL, a participant in the <IR> Business Network, says, “Our aim is to create value for our clients, shareholders, employees and the global community. At JLL, we recognize that this value creation story also includes a focus on environmental, social and governance issues.”

Mervyn King, Chairman IIRC and Leigh Roberts, Project Director: Sustainability and Integrated Reporting at The South African Institute of Chartered Accountants (SAICA), explore the implications of the wider corporate role in their book, *Integrate: Doing business in the 21st Century*, suggesting that <IR> can help boards meet the complex governance challenges they face. The authors state, “Good corporate governance in the modern world is the understanding of the inseparability of the company’s strategy, risks, opportunities and financial performance and the impacts it has on society and the environment.

“This requires effective leadership by the board with an integrated thinking approach to setting integrated strategy, performance and reporting. It requires an integrated and inclusive governance approach in considering the needs of key stakeholders. It requires that decision-making aims at making business judgement calls that result in the company continuing to create value in the long term.”

Interconnected risks

Generating long-term value depends on effective risk management. As the World Economic Forum highlights in its *Global Risks Report 2014*, global risks are interconnected. It notes that to manage global risks effectively and build resilience to their impacts, “better efforts are needed to understand, measure and foresee the evolution of interdependencies between risks, supplementing traditional risk-measurement tools with new concepts designed for uncertain environments.”

As businesses operate in uncertain environments, so they increasingly need to understand the interdependencies that affect them. So do investors, who need a full understanding of the risks facing businesses in order to allocate capital appropriately. However, there is a lack of capacity within the established network of standards and legislation to “join the dots” in a meaningful, concise and comparable way. In this context, <IR> becomes a valuable risk management tool.

Integrated reports provide a more complete picture for investors and other stakeholders, and because <IR> requires business units and functions to communicate with each other, it challenges internal silo mentality, so management information becomes more cohesive. This provides an early warning system that alerts boards to significant risks earlier, and triggers decisions that otherwise may not have been taken. <IR> therefore plays an important role in strengthening governance frameworks.

Politicians and regulators are looking for ways to encourage long-term, stable growth for their economies. Increasingly, <IR> is being positioned

as an important building block of an effective governance framework. For example, the July 2014 report of the UK Commission on the *Future of Management and Leadership, Management 2020: leadership to unlock long-term growth*, makes a range of recommendations designed to enhance the quality of management. Corporate reporting is the focus of one key recommendation for government. The Commission’s report calls on government to “encourage employers to expand annual reports to include both social purpose and broader people metrics.” It specifically refers to the <IR> Framework as providing a good starting point for many organizations.

The Singapore Stock Exchange, together with professional bodies and other stakeholders, is also exploring avenues to enhance the quality of information available to the capital market. Magnus Bocker, Chief Executive Officer of the Singapore Stock Exchange, stated, “We support having a continued dialogue and discussion on Integrated Reporting as we want to participate to help shape the future.”

Mutual benefits

The encouraging news for boards that embrace their broader governance role through <IR> is that corporate performance and investor support should both be strengthened.

A 2014 Harvard Business School report drew from a sample of 1,066 US companies practicing degrees of Integrated Reporting, and concluded that “more <IR> is associated with a more long-term investor base” and that “<IR> is positively associated with percentage of shares owned by dedicated investors and negatively with percentage of shares held by transient investors”. This suggests that “firms practicing <IR> not only attract dedicated investors but also become unattractive for transient investors”.

“Integrated Reporting is far more than just the process of publishing better annual reports,” says Thomas Kusterer, CFO of EnBW. “Besides being a powerful communication tool, Integrated Reporting can be used as an effective governance tool for performance-oriented management.”

ICGN support for Integrated Reporting

The importance of Integrated Reporting is acknowledged by the International Corporate Governance Network (ICGN) in its revised *Global Governance Principles* (published 2014). These describe the responsibilities of boards and shareholders and form the ICGN's standard for well governed companies. Principle 7.5 in the 2014 edition addresses the need for non-financial information. It states, “The board should provide an integrated report that puts historical performance into context, and portrays the risks, opportunities and prospects for the company in the future, helping shareholders understand a company's strategic objectives and its progress towards meeting them.” The Principle calls for such disclosures to be linked to the business model, and “appropriately integrated with other information that enables shareholders to obtain a picture of the whole company”. It also calls for use of KPIs that are linked to strategy.

Corporate reporting in Australia

The Australian Stock Exchange recently updated its Corporate Governance Principle 4, bringing all corporate reporting (rather than only financial reporting) within the realm of director oversight. The July 2014 report by KPMG in Australia, *Oversight of corporate reporting by company directors*, discusses the opportunity this brings to develop a “flagship” report at the centre of the corporate reporting portfolio, which “explains how the company has created value to date, and importantly how it is set to deliver value over the short, medium and long term”. Under such a model, this flagship report would be based on the <IR> Framework. KPMG's report says, “The integrated report will be the initial report for investors, analysts and other key stakeholders to use in understanding the company's view on its value creation story.”

Supporting better decision making through integrated thinking and <IR>

Integrated thinking is increasingly seen as a necessary requirement for delivering long-term value creation by businesses building connectivity across organizations, breaking down internal barriers and enhancing decision making.

The challenges facing company boards in terms of building trust, communicating strategy to shareholders and fulfilling their broadened governance role are significant. As companies grapple with these challenges, the need for integrated thinking is increasingly being identified.

In their book, *Integrate: Doing business in the 21st Century*, Mervyn King and Leigh Roberts consider the concept of integrated thinking. They explain that integrated thinking by the board involves “understanding the company’s dependency on its various resources and relationships, along with the associated risks and opportunities”. They state, “In the board’s ongoing decision-making, integrated thinking means it will assess whether a considered action adds worth to the company, its effect on key stakeholders and company reputation, and its impact on the future availability and affordability of the resources the company relies on.”

Integrated thinking can be contrasted with “silo thinking” in that it takes into account the connectivity and interdependencies between the range of factors that affect an organization’s ability to create value over time. The more that integrated thinking is embedded into a company’s activities, the more naturally will the connectivity of information flow into management reporting, analysis and decision making.

KPMG has studied the experience of applying <IR> in South Africa, including the need to develop integrated thinking. “Applying Integrated Reporting principles to identify and assess a consensus view of the material issues required “integrated thinking” through involvement of all relevant disciplines in the business,” comments Mark Hoffman, Integrated Reporting, KPMG in South Africa.

“ The biggest benefits of integrated reporting will not come from being compliant or from attracting investors. They will come from the discipline of needing to think, plan, and manage in a more integrated way. This will help companies achieve the agility and flexibility they need to respond to change – and seize opportunities – in an increasingly transient world. ”

Paul Barnett, founder and CEO of the Strategic Management Forum, writing in *Corporate Finance Review*, July/August 2014

“ [Companies are] driving <IR> because of the business performance improvements that adopting it brings. One of the most mentioned benefits of <IR> is the opportunity it provides to connect teams from across an organization, breaking down silos and leading to more integrated thinking. ”

Oversight of corporate reporting by company directors, KPMG Australia, July 2014

Integrated decision making

This experience appears to be replicated elsewhere. Many companies find that, as they move towards <IR>, they need to develop integrated thinking across the organization.

This leads to more integrated internal management reporting and is also having an impact on decision making, according to latest IIRC research conducted by Black Sun. The September 2014 report, *Realizing the benefits: The impact of Integrated Reporting*, notes, “Decision making is changing as organizations understand their own value creation processes differently, and make changes to the way that they measure and manage performance. Our research found that a large majority of organizations experienced improvements in decision making. In this case, significant improvements were seen at every stage of the reporting journey.”

SAP’s 2013 integrated report draws attention to the connections between the financial and non-financial performance of the business, as measured, for example, by revenue and margin, and customer

loyalty and employee engagement. It explores the “cause-and-effect relationships” between the financial and non-financial indicators. Having studied companies already implementing <IR>, academics Cristiano Busco, Mark L. Frigo, Paolo Quattrone and Angelo Riccaboni note, “Understanding integrated cause-and-effect chains within the process of value creation... helps the company manage processes and activities in a more effective way and, most importantly, build awareness of the heterogeneous capitals, resources, and relationships used and affected.”¹²

SAP’s report, supported by specific analysis, suggests that a company culture with engaged employees enhances the company’s employer ranking, helping it to attract top talent, spurring innovation and ultimately boosting revenues.

<IR> improves

The IIRC’s latest research conducted by Black Sun among 66 organizations that have already started to implement <IR> found that:

65%

see a current benefit of better long-term decision making

92%

believe they have increased understanding of value creation

79%

report improvements in decision making

78%

see a current benefit of more collaborative thinking about goals and targets by the board, executives and strategy departments

Given the impact that <IR> can have on decision making, the benefits of its adoption clearly extend beyond pure reporting. This is certainly the view of Bertrand Badré, Managing Director and World Bank Group Chief Financial Officer. “Integrated Reporting does more for an organization than just facilitate the creation of a holistic report of overall performance,” he says. “It fosters and embeds integrated thinking – everyone has a common understanding and speaks the same language.

“At the World Bank Group, in addition to being a global development institution we are also a financial institution, and see the International <IR> Framework as a tremendous tool to help us align our performance with our strategic developmental objectives.”

“<IR> has helped us make better decisions. We had found that with stand-alone sustainability reporting there was a push for more reporting from some areas of the business. With an integrated approach, it is easier to stay focused on what is related to value creation.”

Emma Sweet, CPA Australia

“Our financial people are learning how non-financial issues impact financial performance. We are really learning from each other.”

Carla Neefs, EY Netherlands

Source: *Realizing the benefits: The impact of Integrated Reporting*, Black Sun, September 2014

decision making

Among organizations that have already issued an integrated report:

82%

have made changes in performance information

84%

believe the process has had benefits for their board

84%

have experienced benefits in collaboration between the board and executives

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The International Integrated Reporting Council (IIRC) is a global coalition of regulators, investors, companies, standard setters, the accounting profession and NGOs. Together, this coalition shares the view that communication about value creation should be the next step in the evolution of corporate reporting.

The International <IR> Framework has been developed to meet this need and provide a foundation for the future.

Further information about the IIRC can be found on its website www.theiirc.org

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