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Value creation through integrated reporting

By ***Steve Kennedy and Paolo Perego***

The phenomenon of Integrated Reporting is slowly but surely making its mark as not only an external communications tool but above all a genuine agent for internal change within firms. However, academics and business practitioners need to keep working in tandem to ensure that this new approach to financial and non-financial corporate reporting continues to have an impact on in-house strategy and processes and not run the risk of becoming a mere PR stunt.

It has only been in the past few years that Integrated Reporting has begun to be embraced by companies, with multinationals like Novo Nordisk, SAP, Tata Steel and more recently General Electric as early adopters. Comprising a financial and non-financial report on business performance for internal application and external publication, this new approach brings together not just the financial capital coming in and out of organisations but also the social and natural capital it affects and depends upon in order to illustrate with complete transparency the level of success of a company's strategy.

Legislation is starting to come into place to make this practice a more formal obligation, most notably in South Africa under the King IV report. Statistics indicate that about 10 per cent of corporate reports published in 2015 by large firms provided some form of integration in their external reporting. However, some firms engaging in Integrated Reporting are yet to make the very most of what it offers in-house.

Internal reporting drivers

Integrated Reporting offers numerous potential benefits to firms, ranging from facilitating better allocation of capital, easier access to financial capital and a way to break down internal functional silos in order to unlock previously hidden understandings of strategic risks and opportunities. Yet firms need to weigh these advantages against the reality of an onerous exercise in data collection, validation and assurance, and ultimately raising stakeholder expectations of multi-faceted performance.

Research points to the size of the overall organisation and its board and the degree of gender diversity within as important factors to Integrated Reporting being adopted and effectively applied. Firms backed by investors with a longer-term, less opportunistic working relationship are also more likely to buy into the concept, the human-hours that it involves, and reacting to the outcomes. Geographical position and the legislation in place within the country in question are also important aspects in determining whether a firm will be at ease with the transparency issue.

In general, countries where higher investor protection is common practice and where stronger indices of law and order exist offer the most conducive conditions to encourage firms to go down this route.

> *"Asset-intensive firms will benefit from the 360-degree vision this form of reporting provides in order to mitigate the risks attached to capital investment decisions."*

Clarity is the key

Positive signs of uptake are emerging in some parts of the world, namely South Africa and the EU. In the former case, multinationals are now obliged to perform fully integrated reporting whilst in the latter case non-financial reporting will be mandatory for large companies by 2018. In addition, work is underway to pull together and give

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greater clarity to the plethora of reporting guidelines currently available. The World Business Council of Sustainable Development is due to release a beta version of their comprehensive data mapping initiative *The Reporting Exchange* in December 2016, which will present and explain current and expected legislation on a country-to-country basis. Clarity is the key and, at present, one of the biggest hurdles to firms voluntarily engaging.

Hurdles to overcome

The current pitfalls linked to Integrated Reporting concern not only the content of the reports produced but also the nature of the firms involved and the in-house use made of report findings upon publication. By definition, Integrated Reporting represents a higher-than-normal level of information disclosure, one that the boards of some participating firms may not be entirely comfortable with. Consequently, a good many reports tend to veer too much towards the investor perspective at the expense of other stakeholders, resulting in a less complete picture of a firm's activities and how they link in with the overall business model and strategy.

In addition, firms are inevitably competing for funding, meaning the level of objectivity and completeness of such reports is potentially under threat. Moreover, even in the case of comprehensive integrated reports, it is the use made of them that can tip the balance between an external PR exercise designed to paint a firm in a responsible, sustainable light (so-called "greenwashing") and a genuine tool to bring about change within.

Agent of change

The challenge for academic researchers and business practitioners is to spread the word and therefore encourage adoption of Integrated Reporting as a serious tool serving to highlight required organisational overhauls, and better align the interests of the firm as a whole with its shareholders, potential investors and wider stakeholders.

Integrated Reporting is often referred to as a "value creation story", where the ability to accurately and openly tell the story depends upon a firm's desire and capacity to present and analyse its performance from all perspectives. The long-term view involved is also of great potential use to firms of all shapes and sizes. Asset-intensive firms will benefit from the 360-degree vision this form of reporting provides in order to mitigate the risks attached to capital investment decisions. Firms from lower-resource industries can learn from the findings of such reporting when faced with social and environmental capital problems. This calls for companies to ensure a minimum level of separation between reporting channels and strategic decision making, so reporting outputs such as integrated risk assessments and materiality exercises are utilised internally and provided at the right timing and frequency to support decisions.

what kind of concrete changes this can bring about within firms and who are the members of firms genuinely calling out for this new way of analysing and presenting business performance and strategy.

The workload involved in such a process is inevitably more complex than the more traditional, long-established and standardised financial approach to corporate reporting.

"Research points to the size of the overall organisation and its board and the degree of gender diversity within as important factors to Integrated Reporting being adopted and effectively applied."

Avenues for exploration

Given its relatively novel status, Integrated Reporting still has some way to go before being accepted and practiced by the majority of firms. Academics, through research and executive education, and business practitioners, by adopting, diffusing and making full internal as well as external use of such reports, have key roles to play. However, both of these populations are faced with major theoretical and practical issues that require exploration and application in order to bring Integrated Reporting forward. In real terms, it needs to be established

However, what this new alternative offers among many benefits is to encourage business theorists and practitioners to re-think how firms are performing on issues related to sustainability. Integrated Reporting is frequently viewed as an exercise in corporate accountability. This is true but only part of the story. It is above all a means of getting the many players within a firm to connect with stakeholders more effectively, take a more global perspective on operations across the whole chain, and better understand their business model and the capitals affected and needed by a firm.

Getting on board

Firms wishing to get involved should start by concentrating on the required internal processes before moving on to the second step of external diffusion. Communicating results externally is a valuable opportunity not to be missed, especially if assured to be "investor-grade" information, but not to be taken until the participating firm has got its house in order. It is for these reasons that the term "Integrated Thinking" is often used as it reflects much more the internal repercussions it can have on strategic and tactical decisions than the final extra-firm publication. However, to push this agenda forward, academics and managers have a responsibility to work together to clarify guidelines, defragment the way in which Integrated Reporting is being practiced and harmonise the vocabulary and processes required to fully embed sustainability in business. ■

This article draws inspiration from the paper *A Lot of Icing but Little Cake? Taking Integrated Reporting Forward*, written by Paolo Perego, Steve Kennedy and Gail Whiteman and published in the *Journal of Cleaner Production* (2016). DOI: 10.1016/j.jclepro.2016.01.106

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