Evolution not revolution:
Getting started with
Integrated Reporting
In an attempt to find a broader approach to the measurement and management of business performance, more and more companies around the world are turning to Integrated Reporting <IR>. But despite increased traction and growing evidence in support of <IR>, barriers to engagement remain.

In a second white paper on the subject, Stratton Craig looks at the process of adopting <IR> and addresses some of the questions and concerns voiced by those looking to transition to an Integrated Reporting model. We consider the crucial first steps for companies on this journey, and argue that evolution, not revolution, is the best way forward for <IR> first-timers.
Progressive, market-led reporting

Integrated Reporting <IR> is a progressive, market-led form of corporate reporting with a core focus on brevity, relevance and future orientation. As defined by the International Integrated Reporting Council (IIRC) – the global coalition whose aim is to establish Integrated Reporting within mainstream business practice – an integrated report “is a concise communication about how an organisation’s strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value”.

As explored in our first white paper, The Business Benefits of Integrated Reporting: Lessons from South Africa, the origins of <IR> can be traced back to the early days of Nelson Mandela’s presidency in post-apartheid South Africa. Looking to increase his country’s focus on transparency, equality and disclosure of information, in 1994 President Mandela asked Professor Mervyn King to establish a national commission for corporate governance. Over the course of three reports and 16 years, Professor King urged companies to take a “balanced view” of their operations. He advocated an “integrated approach” that would take account of corporate interactions with society and the environment. These developments led, in 2010, to the mandatory adoption of Integrated Reporting for all companies listed on the Johannesburg Stock Exchange.

In 2011, following the powerful precedent set by South Africa, the IIRC began working with market participants to test and develop the International Integrated Reporting Framework. With the concepts at the heart of the <IR> Framework also being incorporated into regulation in Brazil, other jurisdictions are now encouraging Integrated Reporting to support financial stability and sustainable development.

Multiple business benefits

In the words of EY’s Global CEO and Chairman, Mark Weinberger, an integrated report provides “a more complete picture of strategy, business model, governance and performance and how they link together...help[ing] stakeholders to make better informed decisions about where to allocate their capital.”

Indeed, companies already implementing <IR> claim that the business benefits are significant, including: increased understanding of how they create value; improvements in management information and decision making; the breakdown of internal silos; the incorporation of sustainability into a company’s business model; the creation of a strong corporate narrative; and better engagement with investors and other stakeholders.

Furthermore, at a time when corporate behaviour is under intense public scrutiny, Integrated Reporting helps to show that management is taking a holistic view of the future viability of a business and its ability to create value.
Gaining global momentum

Since the official launch of the <IR> Framework in 2013, Integrated Reporting has gained momentum. More and more companies around the world are using the Framework voluntarily to tell their value creation story, build investor and stakeholder confidence and improve future performance. And in September 2014, the IIRC launched the Integrated Reporting Business Network, signalling a shift from its test phase to global implementation.

In Brazil, Singapore, Australia and Japan, businesses, investors and industry associations are beginning to engage with the principles and processes of integration. There are now over 800 participants in Integrated Reporting networks worldwide; and in the EU, recent legislation has extended requirements for large companies to disclose non-financial information within their management reports. Thanks to the recent evolution of <IR>, a positive step-change in corporate reporting is underway in a number of global markets.

Brave new world

Compared to other forms of corporate reporting, however, Integrated Reporting is still in its infancy. And despite the encouraging trends in uptake and participation, in some quarters doubt and uncertainty still hamper efforts to engage fully with <IR>.

An initial distrust of the new and the unknown is only natural – particularly among risk-averse and time-poor global executives. But as outgoing IIRC CEO, Paul Druckman remarks, embracing innovation is vital for businesses today. Modern companies, says Druckman, have to “anticipate the needs of a changing and overlapping stakeholder community” in everything they do – particularly in how they measure and report on their business performance.

Citing the “startling fact” that around 60% of Apple’s revenue in 2013 was “generated from products that did not exist four years ago”, Druckman reflects on “the speed and pace of change we are seeing in today’s globally interconnected economy”. For businesses that want to succeed in this fast-paced global environment, <IR> presents a great opportunity to embrace change and demonstrate a sophisticated grasp of their social, economic and environmental impacts.

Of course, the transition to an Integrated Reporting model will not be easy. But nor will it be as complex as many seem to assume. To demonstrate this point, we address some of the questions and concerns frequently raised by companies considering <IR> for the first time:

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What are the core concepts and components of an integrated report?

Integrated Reporting looks beyond compliance to take a more holistic view of how a company creates and sustains value. Whereas more traditional annual or corporate reports look at ‘value creation’ primarily in the context of financial returns, an integrated report also assesses how a company creates value in a non-financial context.

In support of this broader interpretation of value creation, the <IR> Framework sets out six ‘capitals’, or what it also refers to as the ‘stocks of value’.

The six capitals are: financial, manufactured, human, intellectual, natural, and social and relationship.

An integrated report should provide narrative around how a company creates value in those areas of capital that are relevant to its business. It should also discuss how a company’s business model supports, nurtures or negatively impacts those capitals as interrelated parts of the value creation process.

In fact, how these capitals or ‘stocks of value’ link to a company’s business model and strategy is a core component of good Integrated Reporting. And with many companies still failing to make vital connections within their annual reports, there is clearly a ‘gap in the market’ – a gap which <IR> looks to fill – for fully connected and cohesive corporate reports.

The multinational life insurance company Aegon is considered one of the leading practitioners of Integrated Reporting. Its 2014 report provides a good example of how the six capitals can be used to organise and connect relevant company information. Using the prefix ‘how we create and share value’, subsections within Aegon’s report are arranged as follows:

• ...As a provider of financial services
• ...As an employer
• ...As an investor
• ...In our local communities
• ...As a socially responsible company

Each section foregrounds company performance within the relevant capitals/categories. More detailed information is then provided on how the company draws on ‘capital inputs’ through its business model and transforms them into ‘outputs’ through its activities. This approach is considered best practice by the IIRC.
The six capitals sound like elements of a sustainability report. So is an integrated report just an annual report and sustainability report combined?

No. And it’s not about simply including an extended sustainability section within your annual report. The emphasis is on ‘integration’, not ‘insertion’ – on demonstrating how non-financial information connects with a company’s business model and strategy.

Doesn’t the shift to an integrated model involve huge amounts of time, work and resource?

As with any change in corporate system or process, the transition to <IR> will involve a degree of thought, effort and application. But it needn’t be as onerous as many people think. Most companies, if they are serious about engaging with <IR>, often find that a lot of the prerequisites are already in place. For UK companies of a certain size, for example, the preparation of strategic reports in line with Financial Reporting Council (FRC) requirements demands a focus on quality and materiality not dissimilar to that of the <IR> Framework.

In addition, the UK reporting requirements set out under the Companies Act 2006 contain discussions around ‘capital’ that resonate with <IR>’s value creation categories. The FRC also states that it aims to encourage high-quality corporate governance and reporting by urging “entities to...provide shareholders with a holistic and meaningful picture of their business model, strategy, development, performance, position and future prospects” – a statement that echoes the <IR> Framework’s focus on relevance and future orientation. And elsewhere, the FRC claims that the principles of the UK strategic report “are consistent with an integrated report”.

So, for those companies already reporting in line with the Companies Act 2006, it’s likely that the foundations for Integrated Reporting are already well established. What’s more, any business that has engaged seriously with sustainability will most likely have considered the ways in which its non-financial performance and commitments connect with its overall business model and strategy. And this again is another key step on the way to integration.
The tangible benefits of <IR> are often internal. Doesn't the lack of quantifiable evidence for external benefits undermine the validity of <IR>?

No. It’s true that so far the internal benefits of <IR> are the most tangible, but there is evidence supporting claims for external benefits. The IIRC’s Realizing the Benefits research quotes a number of <IR> practitioners on this subject. For example, Gold Fields in South Africa says that “...one of [our] largest investors is South Africa’s government pension fund, which has a long-term view and asks questions around safety policies, carbon emissions and social investments... [We] build our integrated report around the information needs of [these] long-term investors.”

Meanwhile, the Royal BAM Group, a European construction firm, claims that “embedding and increasing sustainability helps us to become more efficient and to improve our reputation, which helps us get invitations for tenders for new projects”. And Novo Nordisk asserts that “integrated thinking has had an impact on [our] sales...”, while setting and reporting on long-term treatment targets has “created internal pressure to complete more transactions in developing countries, even at lower margins”.

Of course, these examples are anecdotal, but there is a firm belief that the external benefits of integration are real. It’s also worth remembering that these benefits will take time to realise. Many companies are not yet in a position to quantify the impact of <IR>, as this will only come after several reporting cycles and as <IR> processes and reports mature.

For those looking for more academic analysis of <IR>, in December 2015 KPMG and the National University of Singapore applied the underlying concepts of the <IR> Framework to a group of 80 firms in the Asia Pacific region. The report, Towards Better Reporting: Integrated Reporting and Value Creation, found that <IR> helps companies focus on aspects that materially affect their long-term ability to create value. It also found that companies whose disclosures extend to non-financial information started outperforming their corporate peers from mid-2010, coinciding with the introduction of <IR>.
The first steps towards integration

If you’re thinking about engaging with <IR> for the first time, ‘evolution not revolution’ is a useful mantra to adopt. By shifting to <IR> slowly over two or three reporting cycles, rather than trying to do it overnight, companies can embrace change in a way that does not cause undue disruption or disorientation. An extended period of transition will enable you to put processes and systems in place and engage with the broader range of stakeholders required.

As part of this process, the following first steps could help set the would-be <IR> practitioner on the path to integration:

Step 1  Issue a ‘statement of intent’:
Let your stakeholders know of your intentions; set out your aims and ambitions and your reasons for making the switch. As part of this statement, you could reaffirm your commitment to good governance, transparency, long-term strategic thinking and corporate sustainability. You should also scope out your anticipated journey towards integration; how long you expect it to take and anticipated milestones along the way.

Step 2  Conduct stakeholder mapping and engagement:
Cast your net wide to identify your principal stakeholders. You need to understand who they are, what they expect of your company, and what they consider the most material issues for you to address and report on. As Integrated Reporting looks beyond the investor community, your report will need to reflect a broad range of stakeholder opinions.

Step 3  Think about value creation:
In addition to the financial aspect, what are the different ways in which your company creates value? Does it manufacture goods? Does it invest in the local community? Does it look after its employees? Does it provide important advisory services? Try to match up these value creation points with the ‘six capitals’ mentioned earlier.

Step 4  Consider your business model:
How well does your business model support value creation, and how well does it link to your company strategy and connect to sustainability? Does your business model reflect your stakeholders’ expectations? Do you need to adjust your business model and strategy in light of your stakeholder mapping/engagement and value creation analysis? If your business model is too narrowly focused, if it doesn’t yet take account of your non-financial resources and relationships, it needs reworking.

Step 5  Embrace integrated thinking and behaviours:
Integrated Reporting is dependent on, and helps to achieve, integrated thinking. An integrated report is all about making connections; in order to provide connected and cohesive information, you need a connected and cohesive workforce and set of systems. Are the right people talking to each other internally? Are you doing enough to break down silos? Are you encouraging cross-organisational communication and engagement with your strategy?
Step 6 Call Stratton Craig:
At Stratton Craig, we have been helping companies tell their story for over 25 years through corporate communications, annual and sustainability reporting and, more recently, Integrated Reporting.

We know that companies are under increasing pressure to provide transparent information on corporate governance and performance. And as regulation and public scrutiny intensify, corporate reporting is becoming more challenging and complex for businesses.

But we believe corporate reporting is an opportunity. An opportunity to tell your company’s story in a credible and compelling way, and a chance to build understanding, trust and confidence among investors and other key stakeholders. Integrated Reporting can enhance these prospects and your credentials as a responsible, forward-looking business.

Over the last decade we’ve written corporate reports for a range of clients, some of which have gone on to win prestigious awards. Drawing on our experience and expertise in this area, we work with clients to plan their reports, conduct interviews and gather information. We project manage the whole process and deliver final copy that’s compliant, engaging and clear. In recent years, we have also worked with some of the companies in the IIRC’s Pilot Programme and its <IR> Business Network to support their journey into Integrated Reporting. And we can do the same for you.

Further information
If you’d like to find out more about our work in corporate and Integrated Reporting, please contact us on +44(0)203 301 3300 or email copy@strattoncraig.co.uk

You can also find out more about the IIRC and its International <IR> Framework at: www.integratedreporting.org