Creating Value
The cyclical power of integrated thinking and reporting
Contents

Part 1

Introduction 3
Value of integrated thinking as an integral component of <IR> 4

Part 2

Vital benefits of the integrated thinking and reporting cycle 8

Part 3

A 21st century model for effective long-term management 18

Part 4

Enhancing the board’s governance role 24

References 32
Introduction

This issue of Creating Value looks at the central relationship between Integrated Reporting and its cyclical power and relationship with integrated thinking. We see reporting and thinking as two sides of the same coin – both necessary to enhance connectivity in the organization and enhanced communication on value creation. In combination, the benefits are rich and compelling:

• A shared understanding of strategy and how value is created throughout the organization with fewer silos.

• More cohesive management information and informed decision-making, enhancing accountability and performance.

• Boards can actively use a multiple capitals approach to make strategic decisions about resource allocation and value creation over time, communicating the trade-offs between the capitals and the outcomes for business and society. This approach gives greater meaning to decisions, building trust inside the business and with stakeholders.

• A greatly enhanced quality of dialogue between organizations and their providers of financial capital, helping to achieve greater accountability, a longer-term focus and more efficient capital flows to drive investment and productivity.

• World-class corporate reporting focused on material disclosures that assist decision-making, applying the principles of the International <IR> Framework.

We invite you to explore the benefits through this issue of Creating Value.
Value of integrated thinking as an integral component of Integrated Reporting

Since the release of the International Integrated Reporting (‘the <IR> Framework’), organizations have found the benefits of integrated thinking to be transformational. The discipline of making a deliberate and coordinated effort to connect the organization’s strategy, governance, performance and prospects unleashes the compelling and durable internal and external benefits of <IR>. When integrated thinking is applied, the integrated report becomes more than the output of a process but, rather, a critical milestone in the continuous journey of improvement in decision-making, accountability and communication.

However, integrated thinking is sometimes presented as a standalone concept rather than as part of a self-reinforcing cycle of improvement envisaged by the <IR> Framework.

It can be tempting to champion integrated thinking and play down reporting, especially if the latter is seen as essentially a compliance requirement. But to do so would be to misread the purpose and benefits of <IR>. As stated in the <IR> Framework:

“The IIRC’s long-term vision is a world in which integrated thinking is embedded within mainstream business practice in the public and private sectors, facilitated by Integrated Reporting <IR> as the corporate reporting norm. The cycle of integrated thinking and reporting, resulting in efficient and productive capital allocation, will act as a force for financial stability and sustainability.”

It is true that, for many organizations, integrated thinking is a real prize. As described in the <IR> Framework, integrated thinking is the active consideration by an organization of the relationships between its various operating and functional units and the capitals that the organization uses or affects. Integrated thinking leads to integrated decision-making and actions that consider the creation of value over the short, medium and long term. It is therefore essential to the development of strategy and provides a valuable connection to the board.
The more that integrated thinking is embedded into an organization’s activities, the more naturally will the connectivity of information flow into management reporting, analysis and decision-making. It also leads to better integration of the information systems that support internal and external reporting and communication, including preparation of the integrated report.

In terms of the journey towards enhanced reporting, some will start with integrated thinking and others will initially focus their efforts on their reporting. There is no one right way. The World Bank, for example, has dedicated its initial efforts to align strategy and performance across its organization as part of its <IR> journey, whereas Itaú Unibanco moved very quickly to produce its first external integrated report, in the expectation that this would drive strategic alignment and integrated thinking.

Not only are there multiple entry points to integrated thinking, it is a constant process of improvement, through systems, people, behaviours and governance. The benefit of the <IR> process is that it makes use of an annual cycle, which is mandatory for many organizations and where resources are already dedicated to specific outputs, to target enhancements that will bring about both better, more integrated thinking and reporting. For many organizations, as <IR> becomes a mainstream movement, innovating through the reporting process will provide clarity on specific steps that can be built into ‘business as usual’ working practices.
Publishing the integrated report

It is also important that organizations publish an integrated report. Integrated thinking on its own brings significant benefits to organizations internally, but there are powerful benefits to completing the cycle. Two dimensions illustrate this: influencing better capital allocation decisions, and addressing the demands and needs of stakeholders in an age of transparency.

• **Influencing better capital allocation decisions.**
  A key aim of <IR> is to produce decision-useful information that enhances decisions by providers of financial capital. Not to publish an integrated report misses a key opportunity to engage with providers of financial capital. A good integrated report is a signal of good management. The collective view from the organization’s board (or equivalent) as to its prospects for value creation over time, supported by a concise report on governance, strategy, performance and prospects, provides valuable insight to providers of financial capital.

• **An age of transparency.**
  It is true that disclosure can influence behaviour. Transparency encourages management to focus on areas of governance and performance that contribute to value creation and gives attention to wider reputation, including through responsible and sustainable business practices. <IR> offers organizations a means to tell their story in the context of their aims, providing a balanced view from management to act as a counterweight to the torrent of information and data swirling markets and influencing societal expectations. For many organizations who are embracing <IR>, the connection to their ‘social license to operate’ is of great importance. For society, <IR> encourages better business through a multi-capitals approach to value creation.
Realizing maximum benefits

At the IIRC we are working to spread widespread understanding that the concept of Integrated Reporting <IR> includes the cycle of integrated thinking and reporting. While continuing to acknowledge that there will be different starting points and emphases as organizations adopt <IR>, embracing <IR> without integrated thinking, or vice versa will not lead to the realization of all the desired benefits to reporters, boards, providers of financial capital and society. We welcome the continuing research and illustration of leading practice in integrated thinking, which is of immense benefit to boards and preparers, and to furthering the intellectual underpinning of <IR>.
There is a growing realization that embracing the integrated thinking and reporting cycle envisaged by the <IR> Framework can improve long-term organizational success. This is achieved by breaking down internal silos and increasing the shared understanding of how value is created. This in turn supports improved decision making at management and board levels, more focused reporting and enhanced communication with stakeholders.
Organizations today have to operate in a challenging “VUCA” world – one characterized by volatility, uncertainty, complexity and ambiguity. They are under increasing scrutiny from a varied range of stakeholders, from investors to governments and the public, while the mass of data now generated internally and externally threatens to impede effective decision making.

Having investigated the effectiveness of C-level decision-making practices in large organizations across the globe, CIMA and the AICPA found that senior leaders are often struggling to make the right decisions: “The large majority find themselves battling against bureaucratic decision-making processes, siloed and short-term thinking, breakdowns in trust and collaboration inside the organization and difficulties with translating ever-expanding volumes of information into relevant knowledge.”

However, the researchers also identified a group of organizations that were “using high-calibre decision making to drive performance and bottom-line results, as well as making their organization an attractive and stimulating environment for talented people”. These “Integrated Thinkers” were delivering business performance that was consistently above their industry peers.

Based on its analysis, the researchers concluded that for other organizations, achieving the decision-making performance of the “Integrated Thinkers” would require wide-ranging change – to processes and tools, and to behaviours, cultures and leadership styles. A number of the required changes are particularly pertinent to <IR> and its vision for integrated thinking. For example, the CGMA report suggests that organizations need to:

- Balance both financial and non-financial information to capture a broad understanding of all the key value drivers, moving away from a solely traditional view of value in a business environment where that no longer makes sense.
- Drive greater collaboration to make sure that the people with the right knowledge and experience from different business units and functions are involved in making decisions.
- Place greater emphasis on engagement with external stakeholders to develop a broad perspective on stakeholder value, helping to ensure the organization’s strategy is sustainable for the long term in today’s fast-changing world.
- Create greater transparency into how and why decisions are being made, helping to develop a deep understanding of the organization’s business model and align all employees with the wider strategy so they can work towards a common goal, and to facilitate enhanced relationships across the organization.

“[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

“[The solutions to many of the decision-making challenges we have identified can be achieved through more integrated thinking – cutting through silos to connect the relevant people and information from across the organization.]”

Charles Tilley, Executive Chairman, CGMA Research Foundation and Barry Melacon, President and Chief Executive Officer, the American Institute of Certified Public Accountants, writing in Joining the Dots: Decision Making for a New Era
Decision-making impact

<IR> is a relatively young concept, so assessing its impact is challenging. However, some indicators from South Africa, where <IR> is required of companies listed on the Johannesburg Stock Exchange, show that it does have a positive impact on decision-making processes through the integrated thinking and management behaviours it encourages. The release of King IV in South Africa in November 2016 set a new global standard for corporate governance. It is the first outcomes-based governance code in the world. Modeled on the <IR> Framework, it is written through the prism of the six capitals and on the basis of the value creation process.

SAICA’s 2015 survey of executive and non-executive directors in South African companies recognised for the quality of their integrated reports found widespread belief that integrated reporting improved decision making, at both management and board level. At management level, respondents referred to “enhanced information” generated for decision-making, and that information was more accurate and spread across the capitals. “Some organizations mentioned that they were now considering the capitals specifically and this had greatly improved their appreciation of the role that these play in the business.” Some respondents also felt that integrated thinking had improved risk management, “as it broadened the lens through which risks were considered. Managements were taking into account the entire value chain and not just reviewing the business in terms of its financial and legal boundaries.”

At board level, SAICA’s survey found some evidence of an improvement in the quality of information presented to company boards. Some respondents thought there was an improved focus on value creation and on the longer-term horizon, and that the quality of debate had improved because of the better quality information. Other factors mentioned included:

- Enhanced risk identification and management.
- Improved performance measurement through linkages to value creation.
- A clearer relationship between remuneration and value creation.
- More efficient allocation of resources.

Respondents also suggested that integrated thinking had “assisted in improving efficiency in many areas, including optimization of skills, supply chain management, energy usage and enhanced information systems. Several respondents felt that governance processes had improved because organizations had developed a more inclusive culture that made employees feel empowered.”
Integrated thinking improves decision making...

74% of executives and 93% of NEDs thought integrated thinking had improved decision-making at management level.

72% of executives and 86% of NEDs thought integrated thinking had improved decision-making at board level.

Source: SAICA, Integrated Thinking: An exploratory survey, February 2015
The cycle of integrated thinking and reporting

Awareness is growing of the linkage between good quality integrated reports and integrated thinking – and the fact that the two depend on each other. High quality reporting is enabled by integrated thinking, which then stimulates more integrated management and connectivity across organizations. The business benefits that result stem from the cyclical activity over time.

In Deloitte’s view, based on its research among Netherlands companies adopting <IR>, “In the long run <IR> can have a positive effect on the company’s performance because <IR> maps the core values of a company3. Embedding <IR> is a phased process and so the link with performance can only occur over time.”

SAICA’s 2015 survey concluded that:
"... among those organizations that produce high-quality and authentic integrated reports, there is a strong awareness of the concept of integrated thinking and how it benefits the organization."

Most of Deloitte’s interviewees believed that “there is considerable value from <IR> for a company and many of the aspects described have a direct or indirect connection to business performance or financial performance. They all would like to further embed integrated thinking into their business because that would be the main driver for better management decisions.”

As a result, <IR> is now being seen as a genuine agent for internal change within firms4. This is the view of Steve Kennedy, Assistant Professor of Business-Society Management and Paolo Perego, Associate Professor of Management Accounting, both at the Rotterdam School of Management, Erasmus University.

Although they note that <IR> is frequently viewed as an exercise in corporate accountability, they comment, “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.”

Further evidence of the link between <IR> and improved decision making has come from recent research by academics at Stanford University, the University of Auckland and the University of Pretoria5. Using South African data, because of the mandatory nature of integrated reporting there, the researchers found “a positive association” between integrated report quality and both stock liquidity and firm value (represented by expected future cash flows and cost of capital). They determined that “on balance, our evidence suggests that integrated reporting affects firm value mainly by increasing expected future cash flows, consistent with investors revising their estimate of future cash flows upwards because they have a better understanding of the firm’s capitals and business strategy or with integrated reporting leading to better decisions being made by managers as a result of ‘integrated thinking’.”

The researchers concluded: “Our results suggest that these [economic] benefits arise not only from a more holistic and comprehensive presentation of information but, perhaps more importantly, from changes in the decision-making processes within firms.”
The following model shows how the various aspects of <IR> could be linked to integrated thinking and better business performance. Different aspects influence multiple drivers, which in turn lead to better business performance:

Source: Deloitte Netherlands
<IR> enables integrated thinking which supports reporting...

78% of executives and 68% of executives

71% of NEDs thought integrated reporting had been a driver towards achieving integrated thinking.

71% of NEDs thought integrated thinking had helped organizations to develop a more cohesive approach to reporting (such as systems, internal controls, regular management review, etc).

Source: SAICA, Integrated Thinking: An exploratory survey, February 2015
More focused reporting

The cycle of integrated thinking and reporting is not intended to generate more reporting, but instead result in more focused and relevant reporting – internally and externally. SAICA’s survey respondents saw positive benefits to their reporting from embracing integrated thinking2. “The executives and non-executive directors felt that integrated thinking had led to internal reporting becoming more focused and succinct. It was also suggested that dialogue between management, the board and board committees had improved.” Periodic reporting was also thought to be more in line with matters reported in the annual integrated report, and the integrated report was no longer viewed as a separate, unrelated exercise carried out at the end of the year.

"The process of developing an integrated report promotes or even ‘propels’ integrated thinking in a company, by building and strengthening relationships across company segments and functions, and by improving decision making. At the same time, <IR> reporting fosters better understanding of material issues; creates links between strategy, risks and business models; highlights the capitals on which a business relies; and focuses company thinking on its long-term perspective.

Assembling an integrated report promotes integrated thinking, by breaking down silos of business activity and introducing a new way of assessing value."

WBCSD, Integrated Reporting in South Africa: From Concept to Practice, 2014
Enhanced investor relationships

Corporate reporting that presents a more holistic view of value creation, and that is aligned with internal reporting and decision-making processes, can only strengthen relationships with investors and other stakeholders. Many companies, for example, are reporting that their investors “recognize a relationship between sustainability management, <IR>, and financial performance and valuation of a company.”

In South Africa executives and NEDs believe that integrated thinking has increased the quality of organizations’ dialogue with providers of financial capital and other stakeholders. Integrated Reporting is thought to have helped to improve stakeholder relationships because information contained in integrated reports was well organized and the reports easy to read. “Unlike before, these [integrated reports] provided a useful and holistic picture of the organization’s performance and prospects. It was also suggested that integrated reporting brought greater transparency and therefore stakeholders could make more informed assessments.”

PwC’s worldwide work with both investors and business leaders suggests that the former may be more interested in non-financial information than the latter think. In its recent survey report comparing the views of investment professionals and business leaders, the firm suggests CEOs might be surprised by “the strength of the investment community’s interest in drivers of long-term business performance that go beyond those covered in traditional financial statements. Issues of trust, company purpose and values are on some investment professionals’ radar. For some investment professionals, metrics related to environmental impacts now appear fundamental to their assessment of a company’s future value-creation potential, as well as their assessment of risks. Investment professionals want CEOs to ‘walk the walk’, not just ‘talk the talk’, when it comes to running long-term sustainable businesses.”

PwC also states that “Investment professionals ... want more measurement of innovation and more communication of business strategy. And that business strategy is increasingly expected to take account of social, environmental and economic impacts.”

Institutional investors that don’t currently take an interest in longer-term, non-financial indicators are likely to come under more pressure to do so. Dominic Barton, Global Managing Director of McKinsey & Company and Mark Wiseman, President and CEO of the Canada Pension plan Investment Board, have identified how asset managers’ focus on short-term returns results in “corporate boards and management making suboptimal decisions for creating long-term value”. They call on institutional investors to take action by investing after defining long-term objectives and risk appetite, becoming more active owners and engaging with companies, demanding “long-term metrics from companies to change the investor-management conversation” and structuring institutional governance to support a long-term approach. They also call on asset owners to work with industry coalitions that “seek to foster wise investment”, including the IIRC.
Addressing regulatory concerns

Awareness of the importance of non-financial factors in determining long-term financial stability is growing among regulators. For example, UK regulator the Financial Reporting Council in July 2016 published a major study exploring the relationship between corporate culture and long-term business success\(^8\). It reflects the widespread desire among many stakeholders to define success in a broader way that goes beyond short-term profit – as <IR> helps organizations to do.

Many of the FRC’s findings align with <IR> concepts, such as the importance of connectivity and alignment between the business model and strategy. For example, having identified that a “healthy corporate culture is a valuable asset ...vital to the creation and protection of long-term value,” the FRC asserts that “It is the board’s role to determine the purpose of the company and ensure that the company’s values, strategy and business model are aligned to it. Directors should not wait for a crisis before they focus on company culture.”

The FRC also highlights the importance of assessment, measurement and engagement. “Indicators and measures used should be aligned to desired outcomes and material to the business. The board has a responsibility to understand behaviour throughout the company and to challenge where they find misalignment with values or need better information. Boards should devote sufficient resource to evaluating culture and consider how they report on it.”
A 21st century model for effective long-term management

<IR> firmly establishes the cycle of integrated thinking and reporting as a core requirement for long-term organizational success. Developed through comprehensive consultation with business leaders, shareholders, regulators and other stakeholders, the <IR> Framework is a 21st century model designed to support sustainable business and financial stability.
The IIRC’s long-term vision is of a world in which integrated thinking is embedded within mainstream business practice in the public and private sectors, facilitated by <IR> as the corporate reporting norm. This vision is outlined in the <IR> Framework, which anticipates that “The cycle of integrated thinking and reporting, resulting in efficient and productive capital allocation, will act as a force for financial stability and sustainability.”

An important aim of <IR> is to “support integrated thinking, decision-making and actions that focus on the creation of value over the short, medium and long term.” For individual organizations, the <IR> Framework serves as a fundamental reference point as they seek to achieve the cyclical benefits of integrated thinking and reporting.

**What is integrated thinking?**

“Integrated thinking is the active consideration by an organization of the relationships between its various operating and functional units and the capitals that the organization uses or affects. Integrated thinking leads to integrated decision-making and actions that consider the creation of value over the short, medium and long term.”

Source: <IR> Framework

---

**Guiding Principles**

The <IR> Framework contains a number of Guiding Principles which underpin the preparation and presentation of an integrated report, and which bring out the fundamental importance of integrated thinking.

For example, the Guiding Principle on Connectivity of information highlights that an integrated report should show a holistic picture of the combination, interrelatedness and dependencies between the factors that affect the organization’s ability to create value over time. It notes that, “The more that integrated thinking is embedded into an organization’s activities, the more naturally will the connectivity of information flow into management reporting, analysis and decision-making, and subsequently into the integrated report.”

Similarly, the Guiding Principle on Stakeholder relationships highlights that, “The more integrated thinking is embedded in the business, the more likely it is that a fuller consideration of key stakeholders’ legitimate needs and interests is incorporated as an ordinary part of conducting business.”
Connectivity in many forms

As the <IR> Framework explains, integrated thinking takes into account the connectivity and interdependencies between the range of factors that affect an organization’s ability to create value over time, including:

- The capitals that the organization uses or affects, and the critical interdependencies, including tradeoffs, between them.
- The capacity of the organization to respond to key stakeholders’ legitimate needs and interests.
- How the organization tailors its business model and strategy to respond to its external environment and the risks and opportunities it faces.
- The organization’s activities, performance (financial and other) and outcomes in terms of the capitals – past, present and future.

The more that integrated thinking is embedded into an organization’s activities, the more naturally will the connectivity of information flow into management reporting, analysis and decision-making. It also leads to better integration of the information systems that support internal and external reporting and communication, including preparation of the integrated report.

Deloitte’s Directors’ Guide to <IR> emphasizes the better connectivity that <IR> encourages. It notes that “Embedding integrated thinking into an organization’s activities requires better connection of external reporting and the information used for management reporting, analysis and decision-making. For example, the concept of connectivity within an integrated report is a reflection of the integrated thinking within an organization, with all the parts of the organization acting and moving together. This goes further than simply cross-referencing different sections of an external report.”
The conscious and systematic integration of all of the most critical value creation factors in the investment process is an absolute imperative if we are to optimally deploy the world’s capital for progress. A form of capitalism defined by transparency, collaboration, accountability and inclusiveness will prove to be a powerful driver of profitability and sustainable global economic growth. In this way, capitalism can again be a force for good.

Erika Karp, Founder & Chief Executive Officer, Cornerstone Capital Group

Deloitte’s 2015 study of <IR> maturity in the Netherlands, the fourth in the series, describes the <IR> Framework as “one of the best ways to explain the process of value creation with financial and non-financial capitals.” It continues, “The <IR> Framework enables companies to start to make [sic] more holistic business decisions (based on ‘Integrated Thinking’) and as such companies – but also society at large – will be impacted positively.” Deloitte “strongly believes the <IR> Framework will be an important driver for better business management and reporting, ultimately resulting in better performance and greater impact.”

IMA, the association of accountants and finance professionals in business, also endorses <IR>. It believes that <IR> presents “an inviting opportunity for organizations to adapt to more sustainable business models and strategies and create value over the long term”12. It also suggests “it has the potential to bring innovation through ‘integrated thinking’ and value creation, which would certainly enhance productivity, profitability and sustainability.”
Integrated thinking transcends individual frameworks

As the importance of integrated thinking for long-term success becomes more widely accepted, the concept is increasingly being incorporated in relevant related frameworks, tools and guidance documents.

The importance of integrated thinking, for example, is understood in the Natural Capital Protocol published in July 2016, which aims to help organizations generate trusted, credible, and actionable information on the natural capital they use and affect—such as water, land, air and minerals. One of the Protocol’s aims is to help “connect different functions within your organization—providing a coherent way to compare results, identify synergies, and support more integrated thinking, while also linking everyday project management decisions to long-term strategy.”

The Global Management Accounting Principles (GMAP), published in December 2015 by the AICPA and CIMA, also emphasize the value of integrated thinking. GMAP was developed using the concepts of IR which has ensured close alignment with the IR Framework and therefore makes an ideal starting point for organizations seeking to develop and further integrated thinking. As stated, “The Principles have been designed to help organizations cut through silos and encourage integrated thinking, leading to better decision making.” The first Principle, that “Communication provides insight that is influential”, includes the concept that “Good communication of critical information allows management accounting to cut across silos and facilitates integrated thinking. The consequences of actions in one area of the business on another area can be better understood, accepted or repaired.”

Another initiative, The Board Charter For Sustainable Success developed by accountancy firm Mazars is aimed at boards of companies who are “striving for sustainable success for their stakeholders and wider society”. Designed to be used alongside existing corporate governance codes, it sets out 10 principles for boards to consider, bringing out the importance of factors such as a long-term strategy, supportive business culture, stakeholder engagement and appropriate board and management structures.

The Charter “recognises that there will be difficult decisions to be made and it sets out ten essential elements of sustainable success to help boards identify, prioritise and address them in an open manner. For those boards moving towards an integrated reporting framework, adopting the Board Charter will facilitate the process by applying an ‘integrated thinking and action’ approach.”
A deepening pool of resources

Integrated thinking requires the participation of many functions across the business. Supporting guidance for business leaders and specialist functions is being developed to help embed integrated thinking. For example, IFAC’s report Creating Value with Integrated Thinking focuses on the role of professional accountants. It notes that “CFOs and finance functions need to develop a respect for an integrated perspective…” It states: “As the finance function embraces and takes action to restructure its activities to support integrated thinking and the principles of integrated reporting, its actions in reaching out to improve planning and management sends a powerful message to the organization as a whole. A proactive, thoughtful, and supportive move toward integrated thinking by the CFO and finance function is a critical step in bringing about integrated thinking more widely across the organization.”

Cross-functional support is also being developed, such as guidance from the Italian Network on Business Reporting (NIBR) in the form of a Handbook for the change journey that organizations undertake when seeking to embrace integrated thinking and <IR>. Drawing on insights from around the world, including South Africa and India as well as Italy, the Handbook focuses on integrated thinking and the steps organizations will typically need to follow in order to win the engagement of business leaders, implement a change action plan and monitor progress towards embedding integrated thinking in decision-making processes.

Management and boards can also gain inspiration from Deloitte’s Directors’ Guide to <IR>, which highlights that integrated thinking is at the heart of integrated reporting and that it “challenges and enables companies to ‘live their story’, rather than merely tell it.” It is, in essence, the means for an authentic presentation of the organization and how it is creating value.
Business experiences of integrated thinking and reporting in action

As organizations begin to experiment with <IR>, so they are finding that the cycle of integrated thinking and reporting is improving decision making, influencing strategy and strengthening stakeholder relationships. Benefits emerge and deepen over time, as the examples here show.
Unilever insight

Unilever is an early adopter and strong advocate of <IR>. Charles Nichols, Former Group Controller at Unilever, shared his thoughts on the value of <IR> in a PwC interview16. He said: “The fact of the matter is we live in a very volatile world where businesses such as Unilever face issues which need long-term solutions. It’s just natural that we should be thinking in terms of the way that we tell our story externally, and indeed the way that we think internally, in a much more integrated, long-term perspective.”

He also noted that <IR> had “made us think carefully about our business model...what assets we have deployed available to our business, what are the value-added activities that we apply to those assets and then what are the outcomes we are looking to achieve in terms of our financial performance...”

Communicating strategy to investors

Industrial giant General Electric continues to innovate in the way that it applies <IR> principles and reports integrated information. For example, in March 2016 the company released its first Integrated Summary Report, giving investors what GE describes as “a comprehensive and concise view of GE using the lens of the Board and management”. It links strategy, performance, board oversight, compensation and sustainability in a single document. It thus helps investors to understand how the Board and management are working to achieve strategic goals in an integrated manner.

Writing in the GE 2015 Integrated Summary Report, Jeff Immelt, GE Chairman and CEO, says: “Public company reporting has become so complicated that what matters to investors can get lost. Our priority is to provide meaningful information that all investors can readily access. For investors to make investment and voting decisions, we don’t believe that more information is necessarily better. Instead, we’ve challenged ourselves to provide better information.”

GE has also redesigned its annual report, adding an introduction and summary that places the company’s financial information in a strategic context16. Similarly, its 2015 10-K contains a summary upfront presenting key information, such as major portfolio changes and performance against operating goals, using numerous charts, graphs and infographics to help readers digest it all. Christoph Pereira, chief corporate, securities and finance counsel at GE, says that a key principle for compiling the summary report is to “tell investors what we think is the most critical information from an investment standpoint, using the lens of management”. Feedback from investors on GE’s revamped disclosures has been “very positive”, including favourable comments on its summary reports from passive institutional investors. Pereira told CFO Magazine that summary reports were “a good tool to quickly bring them [investors] up to speed on what’s been going on at the company, what’s the strategy.”
A natural process

Insurance company Generali began experimenting with <IR> in 2011 and its reporting and approach continues to evolve. “It’s amazing that every year we see improvement in the process and in the reporting,” says Massimo Romano, Head of Group Integrated Reporting. “The beauty of the process is that it’s really natural. It’s natural to involve different departments in the reporting process and in sharing information and really leveraging what is already available in the corporation without reinventing the wheel.”

A key slogan within Generali is “Rethink, Reuse, Reduce”. On the theme of “Rethink”, Romano says: “Thanks to integrated thinking we continuously rethink the way we are performing our activities and our processes, and in particular in the reporting space, which is a critical point.” Romano believes this is vital for organizational survival. “It’s critical to rethink the processes, to have a proactive approach to regulation and always to try to get value added activities from the current regulatory framework,” he says.

Reusing information is also important. “We are recycling information in the company and therefore reducing the number of requests to the business units,” Romano says. “We can reuse the information we have in one department in another department. So integrated thinking is also streamlining the way we work, by connecting information between different departments. This is critical in the current environment where information overload affects every organization.” Finally, on the theme of “Reduce”, Romano says: “Thanks to materiality and conciseness [two guiding principles in <IR>] we always try to reduce the number of pages in our corporate reporting portfolio. The traditional tendency in finance is to increase the pages of data and KPI reported to stakeholders. But by doing that you are killing the added value of the information. In our view, numbers must talk.” Generali has, by a determined effort, reduced the pages produced in its quarterly reporting (in its press release and interim report – now combined in one document) from around 110 pages to 15.

In summary, Romano believes <IR> and integrated thinking helps organizations communicate their approach to value creation more effectively to stakeholders. “Corporations are dealing with the corporate reporting puzzle, made up of the annual report, the notes, the remuneration report etc.” he says. “All these pieces of the puzzle are on the table. Thanks to integrated thinking, management and the board are able to solve the puzzle and connect all the different pieces, providing an effective way to communicate the value-creation story in relation to all the different capitals the organization is dealing with. They also call on asset owners to work with industry coalitions that “seek to foster wise investment”, including the IIRC.
Dramatic strategic impact

Sanjeev V. Manrakhan, Chief Executive Officer of Anglo African, a fast-growing IT firm headquartered in Mauritius, says that integrated thinking as part of the integrated cycle has “definitely” affected the management team’s thinking of how the business creates value. In fact, the experience of working on the company’s first integrated report, issued in 2015, led to a radical change in strategy.

“We have terminated some profitable lines of business which we believe would not add value in the next two years,” Manrakhan says. “We have also introduced new lines of business which we believe will be major value creators in the next few years.”

This change of direction was triggered when the company was working on its 2015 integrated report and thinking about its existing strategic plan for 2015-2018 in the context of the <IR> Framework’s capitals and applying a forward-thinking approach. “We found a number of discrepancies and disconnects,” Manrakhan says. For example, in relation to intellectual capital, the company owned little intellectual property (IP) of its own – systems and applications used in its data centre were owned by third parties. This would make it hard to achieve the valuation multiples the business was aiming for. Similarly, in terms of human capital, the company had a vision of attracting top talent, but in fact this would be difficult. “Locally we don’t have this level of talent,” Manrakhan says. “So our human capital strategy wasn’t making sense. We needed to move towards a business that is less human capital intensive and more technology intensive, and we needed to develop intellectual capital for ourselves.”

Such insights led to the creation of a new business strategy, which includes exiting from traditional IT infrastructure elements and building up expected growth areas, such as IT security. “In two years’ time we believe the organization will look quite different,” Manrakhan says. “We believe that by the end of 2018, what represents 70%-80% of our business today might not exist.”

The way the board and management team now take decisions has also completely changed. There is now more interaction between technical and non-technical divisions and between finance and international teams. The <IR> Framework’s principles and the impact of potential actions on value creation and the various capitals are always considered. “This has become hard-wired in our company now,” Manrakhan says. “It’s embedded in our thinking processes. Our people have the <IR> Framework in their minds when we look at different projects. They see how intensive the human capital requirement is, or what it means for our IP. We would never look at lines of business today where we don’t own more than 50% of the IP. A year ago, in most of our business we would not even have owned 10%-20% of the IP.”
Cyclical benefits of <IR>

Businesses increasingly see a close and clear interrelationship between financial reporting and wide-ranging business activities and issues, including decision-making and the determination of risks and strategic opportunities. South African Airways’ Integrated Report 2014 emphasizes this linkage, stating that, “The report reflects the connectedness and interdependence of the SAA Group’s financial reporting with its strategic framework, operations, decision-making, global and local industry contexts that affect it, the risks it faces, the opportunities it discerns and the social investment it undertakes, and presents these factors as a comprehensive whole approached through integrated thinking.”

The company also explains that the content of the report is underpinned by the integrated thinking that takes place in the business: “It is the integrated thinking evidenced in the Group’s Long-Term Turnaround Strategy (LTTS), as well as its dual Shareholder mandate that form the basis for the content and material aspects of this report.”

Japanese company Omron, which manufactures and sells sensing and control products around the world, explains in its Integrated Report 2015 that the <IR> process has improved its integrated thinking and helped it to bring its management philosophy to life. Omron issued its first integrated report in 2012 and its subsequent three integrated reports have all won the Award for Excellence in Integrated Reporting from the World Intellectual Capital Initiative Japan (WICI-J). However, the company is still seeking to improve its integrated reporting, most recently focusing on how it visualises its business model and tells its value creation story.

“We believe that issuing integrated reports over the past three years has led us to better practice our management philosophy: Provide the products and services that society requires, thereby contributing to the development of global society while growing as a company.

At the same time, writing these reports has helped deepen our critical integrated thinking. It has helped us manage with an eye fixed on long-term, sustainable corporate value improvement.

Our Integrated Report 2015 conforms to the integrated reporting framework recommended by the IIRC and the World Intellectual Capital Initiative. At the same time, we worked harder on our coverage of materiality (important management issues) and connectivity (between financial and non-financial information). Specifically, we have described our process for selecting material information to disclose, as well as visualizing our business model. Now, we can tell a much more effective story of how Omron keeps creating unique corporate value.”

Satoshi Ando, Managing Executive Officer, Senior General Manager, Global Investor Relations & Corporate Communications HQ, Omron, writing in the company’s Integrated Report 2015
Better decision making processes

Sanofi, one of the world’s leading healthcare groups headquartered in France, expects <IR> to help it cope with the mass of complex data organizations face when taking business decisions. In its 2015 Corporate Social Responsibility Report it notes that all CSR topics are interconnected in one way or another, giving as an example “the way in which interconnections between financial and non-financial data are becoming increasingly apparent for decision makers within corporations, as well as for regulators, investors and other stakeholders. In terms of both volume and speed, data and information flows are growing ever more complex, and thus, an integrated thinking approach will help enable better decision making. This is one of the reasons Sanofi decided to use the International Integrated Reporting Council (IIRC) framework to move gradually towards an integrated report.”

New Zealand Post, a state-owned enterprise owned by the New Zealand government, has found that the integrated thinking and reporting process has helped to shape and drive its strategy. And because the <IR> process and the related efforts to embed integrated thinking have helped the organization think more strategically, <IR> has led to better decision making. “Our CFO developed a business plan using the six capitals model,” says Dawn Baggaley, convener of the organization’s integrated thinking and reporting steering group. “It is helping people internally understand the long-term non-financial impacts of certain decisions.”

“\[This year we have combined our statutory financial information with an assessment of our performance in relation to a broad range of factors, or ‘value enablers’. Reporting in such a manner reflects that our ability to perform sustainably on a financial level is only made possible by our performance in relation to our people, operational capacity, access to market, and critically, the sustainability of our raw materials.\]”

Extract from JG Todd’s Chairman’s statement in Sanford’s Integrated Annual Report 2014
Integrated thinking: part of a company’s DNA

In a World Congress of Accountants presentation, Thomas Kusterer, CFO of European energy supply company EnBW Energie Baden-Württemberg AG, told delegates that the concept of IR including integrated thinking constitutes a logical next step for corporate value creation on the 21st century.

In Kusterer’s view, integrated thinking leads to better holistic performance management, connecting financial and non-financial information. He highlighted that integrated thinking is a pre-requisite for long-term value creation – to be successful and sustainable in the long run, integrated thinking has to become part of a company’s DNA. EnBW’s integrated thinking approach includes a holistic target-based performance management system, including financial and non-financial KPIs.

Integrated Thinking leads to better holistic performance management
– connecting financial and non-financial information
Conclusion

Organizations are finding Integrated Reporting (IR) to be a powerful tool – not only for communicating effectively with investors and other external stakeholders, but also for supporting the integrated thinking and management that ultimately leads to improved performance.

Integrated thinking offers multiple benefits. It helps the board to develop long-term strategies that take account of the many different capitals used in the business model. It helps management teams to take decisions based on a more complete understanding of the trade-offs between different courses of action, capital allocations and resource usage. It encourages the consideration of value creation over the short, medium and long term and impacts on society and the environment as well as on the entity itself.

The experiences of those adopting IR indicate that integrated thinking and reporting develop naturally together. Integrated thinking both flows from and enables integrated report preparation. When organizations consider the content of an integrated report, they look at their business model in new ways and find that previously segregated teams begin working more closely together – moving towards more integrated management and thinking. At the same time, as integrated thinking becomes embedded into an organization’s activities, so management information becomes more connected and this in turn supports the preparation of more insightful integrated reports for external users.

Over time, the cycle of integrated thinking and reporting supports sustained business performance. Individually, each element has its strengths and brings valuable benefits. Applied in combination, they can be transformational.
INTEGRATED REPORTING (IR)

References

1. CIMA, Joining the Dots: Decision making for a new era, February 2016
2. SAICA, Integrated Thinking: An exploratory survey, February 2015
8. FRC, Corporate Culture and the Role of Boards, July 2016
10. CIMA, CGMA Briefing: Integrated Thinking: The next step in integrated reporting, 2014
11. CIMA, Global Management Accounting Principles©: Effective management accounting: Improving decisions and building successful organizations, December 2015
15. IFAC, Creating Value with Integrated Thinking: The Role of Professional Accountants, November 2015
17. Teach, E., Rethinking Disclosure, CFO Magazine, 7 April 2016
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 integratedreporting.org