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Introduction

Drawing on the latest research, this report serves to highlight the increasingly compelling evidence on the value of <IR> for investors, exploring its benefits for them and the information they deem important. The research compiled largely comprises investor surveys on their views of <IR> and wider information that goes beyond pure financial data, although studies are also included that demonstrate the value of <IR> in terms of the performance of a company.
Overview

The primary purpose of an integrated report is to improve the quality of information available to providers of financial capital by communicating broader and more relevant information that can assist in effective capital allocation decisions. It is duly recognized that investors form only a part of this system. However, much of the current research into <IR> and other relevant material data is focused on investors.

Investors have also noted that using such information plugs gaps and informs decision making. They also feel that utilizing a broader set of information leads to a greater understanding of the drivers of performance and value creation. Benefits recognized at the company level could also impact investors. For example, studies suggest that companies who adopt <IR> outperform those that do not and have more long-term investors.

Information that investors value includes an overall explanation of the business model, how the company generates cash, how the company creates value, a well-articulated strategy and anticipated future opportunities and vulnerabilities.

Studies have shown that investors are using this information in many ways, including to help manage investment risk, evaluate industry dynamics and the regulatory environment, validate an investment thesis and assess a company’s forward looking information.

The IIRC thank the writer of this report: Zoe Draisey, Reporting and Assessment Officer at the PRI.
Investors have signalled that important information:

- focuses on measurable performance factors such as regulation, cost and risk
- clearly explains the links between wider risks and expected performance
- allows comparisons to be made between companies in the same sector
- sets out a sustainable competitive advantage.
Perceived benefits of <IR> for investors

This section summarizes the benefits of <IR> for investors, such as gaining greater insight into a company’s strategy, business model and how it creates value over time, in turn supporting investment decisions and improving returns.
Research on IR in South Africa has shown that investors are benefiting from a clearer understanding of the risks companies face. But more than that, it helps to enhance engagement.

A report by the IIRC and Black Sun that surveyed 66 organizations (mostly companies) found that IR helps to build stronger relationships and a better understanding with providers of financial capital:

- 56% report a positive benefit in relations with institutional investors
- 52% report a positive benefit in relations with analysts
- 87% believe providers of financial capital better understand the organization’s strategy
- 79% believe providers of financial capital have greater confidence in long-term viability of business models

A study by KPMG applied the underlying concepts of the Framework to a group of 80 firms in the Asia Pacific. The report states that IR helps firms focus on aspects that materially affect their long-term ability to create value. The same study illustrates that through communication and transparency, the application of IR lets firms tell their own story, preventing analysts from making assumptions on their behalf. One of the main findings of the study is that companies that disclose more than just financial information, started outperforming their control group in mid 2010, at around the same time as the introduction of IR.

Risk-Adjusted Returns

IR + SR

Control Group

Source KPMG

1 of those organizations that published at least one Integrated Report
2 Which were either listed as reporting companies on the IIRC database or as the leading sustainability companies in APAC and were compared to a control group of 40 companies in the same country, sector, and industry that exhibited a similar asset size.
3 Sample period 2006-2013.
The report concludes that:

“Capital markets are likely to reward firms that adopt the International <IR> Framework. It helps firms rethink and integrate their strategies and business models in line with stakeholder expectations.”

Similarly, a study conducted by Nanyang Business School, looks at the association between Integrated Reporting and company valuation. A score was constructed based on the level of disclosure of <IR> and the market valuation of equity by investors was also measured, with findings showing that firms with a higher <IR> score have a higher market valuation.

Research by PwC among 85 investment professionals from around the world, aimed at gaining insights into how Integrated Reporting can deliver the most value to them and potential areas for improving current reporting concluded:

“Given the areas where investment professionals see room for improved reporting – particularly around cash creation, key risks, dependencies on key resources and relationships, and operational KPIs – more Integrated Reporting could perhaps provide the solution. 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.”

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*a The study used 100 South African companies listed on the Johannesburg Stock Exchange (JSE) – all JSE Listed Companies have to adhere to the King III Code of Governance to adopt <IR> on a ‘Comply or Explain’ Basis.

*bFrom buy side, sell side and ratings agencies (roles included equity analysts, fixed income analysts, ratings agencies, portfolio managers, chief investment officers and heads of research).
The Six Capitals

Studies show that firms that adopt <IR> have more dedicated, long-term investors and fewer transient investors\(^\text{18}\). A likely reason for this is that integrated reports give investors information more relevant to decisions over the longer term – as opposed to quarterly snapshots of financial data that encourage investor churn\(^5\).

Research encompassing a small group of Australian\(^\text{vi}\) providers of financial capital about the significance of <IR> and the six capitals to investment decisions and the functioning of the market, found that the participants believe there are benefits for both the companies producing reports and the investment community\(^6\). Whilst the very small sample size should be noted, the research aimed to uncover how providers of financial capital are starting to perceive and interact with <IR> and the six capitals. Fund managers suggested <IR> could lead to better decisions about how they allocate capital. Some of the benefits highlighted by the participants are described below\(^\text{vii}\):

<table>
<thead>
<tr>
<th>Potential of &lt;IR&gt; to bridge the information gaps between company management and investors</th>
<th>Making clearer linkages between strategy, financial performance and ESG factors</th>
<th>Helping to clarify a company’s approach on its long term strategic opportunities and risks</th>
</tr>
</thead>
<tbody>
<tr>
<td>The belief that &lt;IR&gt; can lead to better engagement between the financial investment community and company management around material issues and the drivers for performance and value creation</td>
<td>&lt;IR&gt; can assist engagement and inform decision-making</td>
<td></td>
</tr>
<tr>
<td>A suggestion that the six capitals framework is helpful for understanding stocks and flows of capital-leading to better capital allocation decisions</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


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\(^{18}\) Members of the IIRC’s pilot programme investor network
\(^{\text{vi}}\) The report also notes the benefits of <IR> identified by others stating that “previous research has identified a number of benefits – it transforms corporate processes (Phillips, Watson & Wills, 2011); it breaks down operational and reporting silos resulting in improved systems and processes (Roberts, 2011); it improves decision-making about resource allocation (Frias-Acehuno et al., 2013a); and, it reduces reputational risk and enables companies to make better financial and non-financial decisions (Hampton, 2012)”\(^6\)
Investor demand for <IR> and for information that goes beyond pure financials

Studies have repeatedly demonstrated demand from investors for <IR> as well as clearer linkages between the various types of information presented, which <IR> can help to address. There is also evidence\textsuperscript{viii} to suggest that investors reject the notion that qualitative information is not useful\textsuperscript{vii}.

\textsuperscript{viii}Edelman 2015 survey of 158 investors (mostly portfolio managers and analysts from a range of fund types e.g. growth, value, hedge and GARP).
In their analysis of more than 200 institutional investor responses on their views about the availability and quality of wider information provided by corporates and on its usage in investment decisions, EY have found that 70% of respondents see integrated reports as essential or important, ranking them second in usefulness behind companies’ annual reports.

61.5% of investors consider wider information to be relevant to all industrial sectors today, noting that investors are demonstrating an eagerness to gauge issuers’ potential returns using expanded criteria.
Growing interest in non-financial reporting – significant shifts since 2014

EY’s study Tomorrow’s Investment Rules 2.0 reports on the % of respondents who:

<table>
<thead>
<tr>
<th>Requirement</th>
<th>2015</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consider non-financial data relevant to all sectors</td>
<td>61.5%</td>
<td>33.7%</td>
</tr>
<tr>
<td>Use a structured, methodical evaluation of environmental and social impact information</td>
<td>37.0%</td>
<td>19.6%</td>
</tr>
<tr>
<td>Consider Integrated Reports essential or important when making investment decisions</td>
<td>70.9%</td>
<td>61.0%</td>
</tr>
<tr>
<td>Believe companies are motivated to report non-financial information to demonstrate management of risk</td>
<td>42.1%</td>
<td>29.0%</td>
</tr>
</tbody>
</table>

Source: EY®
Interviews conducted by PwC with 85 investment professionals from around the world9 seeking their views on financial reporting show that 70% of investors would like to see clearer links between the financial results and the business model, risk and strategy information in the annual report/10-K/20-F10.

I would like to see clearer links between the financial results and the business model, risk and strategy information in the annual report/10-K/20-F.

<table>
<thead>
<tr>
<th>Response</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strongly Agree</td>
<td>33%</td>
</tr>
<tr>
<td>Agree</td>
<td>37%</td>
</tr>
<tr>
<td>Agree nor Disagree</td>
<td>23%</td>
</tr>
<tr>
<td>Disagree</td>
<td>6%</td>
</tr>
<tr>
<td>Strongly Disagree</td>
<td>1%</td>
</tr>
</tbody>
</table>

Source: PwC10

9 Investment professionals from the buy side, sell side and ratings agencies (and roles including equity analysts, fixed income analysts, ratings agencies, portfolio managers, chief investment officers and heads of research).
Why investors are using a broader set of information and what they are using it for

Current research suggests that investors are viewing IR and broader information as a way to ensure robust decision making, using this information in several ways such as risk management.
Al Gore and David Blood state that Integrated Reporting encourages companies to integrate all relevant aspects of performance into one report that includes only the most salient or material metrics, enabling companies and investors to make better resource-allocation decisions by seeing how the relevant performance factors contribute to sustainable long-term value creation.11

In a 2014 EY survey of 163 institutional investors 89% said that, in the last 12 months, assessing other performance indicators had played a pivotal role in their investment decision-making process.1 In a separate study, of the 73% (967) of respondents who stated that they do take wider information (in this instance, ‘environmental, social and governance’ issues) into account, the CFA Institute found that 63% indicated that they take these issues into account in investment decisions to help manage investment risks.13

Furthermore, research by EY shows that 59% of respondents view reporting on broader areas of value creation as essential to investment decisions.8 The report notes that it is evident that <IR> can help businesses meet investor needs, giving them vital insight into business strategy, performance, governance and prospects, supporting better investment decisions.8 The same research also indicates that more than 45% of respondents say they frequently consider wider information (in this instance, ‘environmental, social and governance’ issues) when determining the risk and holding period of prospective investments, when evaluating industry dynamics, and when examining the regulatory environment.8

According to the PRI, investors use enhanced information in the following ways:

- Economic analysis: to understand trends and externalities that could affect the economic outlook, value creation and capital formation
- Industry analysis: to understand factors driving competitiveness and the potential for sustained value creation in an industry
- Company strategy: to understand management quality and corporate strategy and evaluate a company’s ability to respond to emerging trends
- Valuation: to adjust traditional valuation parameters and assumptions, including cash flow and weighted average cost of capital to reflect performance on material sustainability issues.
Findings by Edelman\textsuperscript{xii} suggest that a strong story is critical to filling out the value equation and giving investors confidence to overlook short-term misses\textsuperscript{vii}. The study finds that 59\% believe qualitative information is essential to understanding opportunities and vulnerabilities and when making an investment decision more than 85\% view intangible/soft information as a critical element to the investment process:

\begin{align*}
\textbf{87\%} & \text{ said qualitative information helps them evaluate forward-looking information and guidance} \\
\textbf{86\%} & \text{ said qualitative information helps them validate an existing investment thesis for a particular company/security\textsuperscript{v}}
\end{align*}

Edelman suggest that investors rely on qualitative information to fill out their investment thesis and create a valuation model, viewing qualitative information as essential to analyzing a company as it provides context investors use to: validate their investment thesis; understand historical results and gauge expectations for future capital allocation and expenditure; and evaluate guidance and track performance against strategy\textsuperscript{vii}.

\textsuperscript{xii} A survey completed by Edelman of 158 investors (mostly portfolio managers and analysts from a range of fund types e.g. growth, value, hedge and GARP) was conducted to explore the use of qualitative information in investment decision-making, and to discover how investors use this information in their roles.

\textsuperscript{vii} Analysis of more than 200 institutional investor responses on their views about the availability and quality of corporate non-financial information and on its usage in investment decisions.
What information is important to investors?

According to EY\textsuperscript{[iii]}, investors want higher-quality, more transparent disclosure of a broader set of issues that affect companies’ risk, performance, and valuation\textsuperscript{[8]}. They surmise that investors most value information that:

- comes directly from issuers, rather than from third parties;
- focuses on measurable performance factors, such as regulation, cost, and risk;
- relies on standard, industry-specific criteria that allow comparisons between companies in the same sector – almost three-quarters of respondents consider sector-specific reporting criteria and key performance indicators to be very or somewhat beneficial to their investment decision making, and more than 70% see metrics that link wider risks to expected performance as equally beneficial;
- clearly explains the links between wider risks and expected performance;
- has a company’s top-level verification by, for example, its board or audit committee – 80% consider mandatory board oversight important\textsuperscript{[8]}.

On a scale of 1 to 9 with 1 meaning “disagree completely” and 9 meaning “agree completely”, to what extent do you agree with the following statements?

<table>
<thead>
<tr>
<th>Statement</th>
<th>Somewhat agree (6-7)</th>
<th>Agree completely (8-9)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Qualitative information helps me evaluate a company’s forward-looking information and guidance</td>
<td>43%</td>
<td>44%</td>
</tr>
<tr>
<td>Qualitative information helps me validate an existing investment thesis for a particular company/security</td>
<td>35%</td>
<td>51%</td>
</tr>
<tr>
<td>Qualitative information helps me understand and interpret historical results</td>
<td>36%</td>
<td>48%</td>
</tr>
<tr>
<td>Qualitative information helps me to develop a valuation model for a particular company/security</td>
<td>43%</td>
<td>34%</td>
</tr>
</tbody>
</table>

Source: Edelman\textsuperscript{[7]}
Research by PwC\textsuperscript{15} among 85 investment professionals\textsuperscript{xiv} from around the world found strong demand for the reporting of operational, as well as financial, KPIs, and clear linkage between different elements of company reporting. On a scale of 0 to 100 where 0 is not important at all and 100 is highly important, investors indicated the importance of information provided by a company for analysis. Most valued was ‘the company’s overall explanation of its business model’, followed by ‘how the company generates cash’ and ‘how the company creates value’.

<table>
<thead>
<tr>
<th>Information</th>
<th>Importance</th>
</tr>
</thead>
<tbody>
<tr>
<td>The company’s overall explanation of its business model</td>
<td>88</td>
</tr>
<tr>
<td>How the company generates cash</td>
<td>87</td>
</tr>
<tr>
<td>How the company creates value</td>
<td>86</td>
</tr>
<tr>
<td>The company’s overall explanation of its strategy</td>
<td>83</td>
</tr>
<tr>
<td>The key priorities and actions to allow the company to meet its objectives</td>
<td>82</td>
</tr>
<tr>
<td>Progress made against key priorities and actions</td>
<td>80</td>
</tr>
<tr>
<td>How the company’s long-term strategy relates to their current business model</td>
<td>77</td>
</tr>
<tr>
<td>Dependencies on key relationships and resources</td>
<td>74</td>
</tr>
<tr>
<td>How the business is positioned in its wider value chain</td>
<td>73</td>
</tr>
<tr>
<td>The company’s dependency and impact on the future supply of resources</td>
<td>63</td>
</tr>
</tbody>
</table>

Note: The analysis has been prepared using a Likert model. A score of 100 would be equivalent to every respondent giving a score of 5/5 for importance. Source: PwC\textsuperscript{15}

The same research by PwC also indicates that investment professionals do not feel that companies disclose enough information on future strategic plans to make comfortable judgements and 87% also state that clear links between a company’s strategic goals, risks, KPI’s and financial statements is helpful for analysis.

I think companies generally disclose enough information on future strategic plans to allow me to feel comfortable with the judgements I need to make

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Strongly Agree</td>
<td>1%</td>
</tr>
<tr>
<td>Agree</td>
<td>13%</td>
</tr>
<tr>
<td>Agree nor Disagree</td>
<td>37%</td>
</tr>
<tr>
<td>Disagree</td>
<td>37%</td>
</tr>
<tr>
<td>Strongly Disagree</td>
<td>12%</td>
</tr>
</tbody>
</table>

Source: PwC\textsuperscript{15}

\textsuperscript{xiv} From buy side, sell side and ratings agencies (and roles including equity analysts, fixed income analysts, ratings agencies, portfolio managers, chief investment officers and heads of research).
Clear links between a company’s strategic goals, risks, key performance indicators and financial statements is helpful for my analysis

<table>
<thead>
<tr>
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<th>Agree nor Disagree</th>
<th>Disagree</th>
<th>Strongly Disagree</th>
</tr>
</thead>
<tbody>
<tr>
<td>56%</td>
<td>31%</td>
<td>13%</td>
<td>0%</td>
<td>0%</td>
</tr>
</tbody>
</table>

Source: PwC15

Edelman15 surveyed investors on their appetite for types of qualitative information7. Respondents were asked, to what extent they agreed with statements on their investment process7. The top statement with 92% of respondents saying they agree or somewhat agree was “a well-articulated, forward-looking strategy helps us to better understand and value a company.”7

On a scale of 1 to 0 with 1 meaning “disagree completely” and 9 meaning “agree completely”, to what extent do you agree with the following statements on your investment process?

<table>
<thead>
<tr>
<th>Statement</th>
<th>Somewhat agree (6-7)</th>
<th>Agree completely (8-9)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A well-articulated, forward-looking strategy helps us to better understand and value a company</td>
<td>32%</td>
<td>60%</td>
</tr>
<tr>
<td>If a company is able to articulate a long-term strategy that meets my investment thesis, I am willing to look past one or two quarters of misses</td>
<td>35%</td>
<td>54%</td>
</tr>
<tr>
<td>I find little value in a CFO reciting the income statement and would prefer a more high-level discussion of what took place during the quarter</td>
<td>21%</td>
<td>66%</td>
</tr>
<tr>
<td>On quarterly earnings calls, I would prefer that a management team give their highlights for the quarter and reserve the bulk of the time for Q&amp;A</td>
<td>20%</td>
<td>61%</td>
</tr>
<tr>
<td>It is acceptable for a company to provide a piece of forward-looking information that articulates a strategic point that it does not intend to provide on an ongoing basis</td>
<td>38%</td>
<td>41%</td>
</tr>
<tr>
<td>A company has to give me quantitative guidance for me to consider the investment</td>
<td>26%</td>
<td>15%</td>
</tr>
<tr>
<td>The numbers are the numbers: We prefer that a management team present their unvarnished operating and financial data and not give us their investment story</td>
<td>22%</td>
<td>17%</td>
</tr>
</tbody>
</table>

Source: Edelman7

*A survey completed by Edelman of 158 investors (mostly portfolio managers and analysts from a range of fund types e.g. growth, value, hedge and GARP) was conducted to explore the use of qualitative information in investment decision-making, and to discover how investors use this information in their roles.
Recent studies clearly show demand from investors for wider information that goes beyond pure financial data and <IR> appears to be well placed to assist the providers of financial capital in their information needs. So, why are some investors not considering this information as relevant to their decision making?
Of respondents to a 2015 EY survey\textsuperscript{xvi} that do not consider wider information (in this instance, ‘environmental, social and governance’ issues) in decision making: 46.4% are unclear whether such disclosures are material or have a financial impact; 28.6% state that such information is inconsistent, unavailable, or not verified; and 14.3% state that the measurements are inconsistent and incomparable to those of other companies\textsuperscript{8}. Park and Ravenel (2015) support this notion, suggesting that barriers to the integration of wider information in investments include the fractured, inconsistent and incomplete data sets presented\textsuperscript{16}. The International <IR> Framework\textsuperscript{17} confronts such inadequacies by the inclusion of the ‘guiding principles’ (such as ‘materiality’, ‘connectivity of information’ and ‘reliability and completeness’) which underpin the preparation of an integrated report.

A report by the Harvard Business School\textsuperscript{18} summarizes the criticisms of the decision usefulness of sustainability data for investors including the absence of placing the data in context of the strategy and business model; the lack of materiality assessment of the different sustainability issues; and the lack of a link to financial issues and the credibility of separate sustainability reports. The report also notes that information asymmetry between managers and investors is an issue, leading to higher monitoring costs for investors\textsuperscript{18}. These shortcomings are addressed by the International <IR> Framework\textsuperscript{17} by the inclusion of the eight content elements deemed critical to an Integrated Report, therefore facilitating greater connectivity between differing sets of information, with an emphasis on materiality.

In summary, Integrated Reporting aims to improve the quality of information available to providers of financial capital\textsuperscript{17}. It enables the provision of a clearer picture of the business’s management, strategy, business model, use of resources, and all other relevant aspects of the business that affect and drive value creation, for investors to factor into their investment decision making. The International <IR> Framework encourages greater engagement with report users and should ultimately lead to reports that are more aligned with investors’ own cash flow valuation models\textsuperscript{19}.

\textsuperscript{xvi} Analysis of more than 200 institutional investor responses on their views about the availability and quality of corporate non-financial information and on its usage in investment decisions.
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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.integratedreporting.org.