

INTEGRATED REPORTING <IR>

# Integrated Reporting: The Need to Focus Capital on the Long- Term

Bob Laux, IIRC North American Lead

# Finding From McKinsey Study

- Short-term pressure on executives has increased since 2013
  - Share of respondents feeling most pressure to demonstrate strong financial performance within two years or less rose from 79% to 87%
  - Those who felt that pressure most acutely over 7 years or more fell to zero
  - Those who felt most pressure over a period of less than six months increased from 26% to 29%

## Short term vs longer term focus

- CEOs have faced mounting pressure to produce short-term profits, increasing the likelihood of management practices that reduce long-term value, such as scaling back R&D and training
- Corporations and investors tend to blame each other for this situation
- CEOs complain that investors don't ask about the long term
- Investors respond that corporate disclosures discourage engagement on long-term metrics, with quarterly calls exclusively focused on recent past performance

# Long-termism

## Why companies should disclose longer-term plans

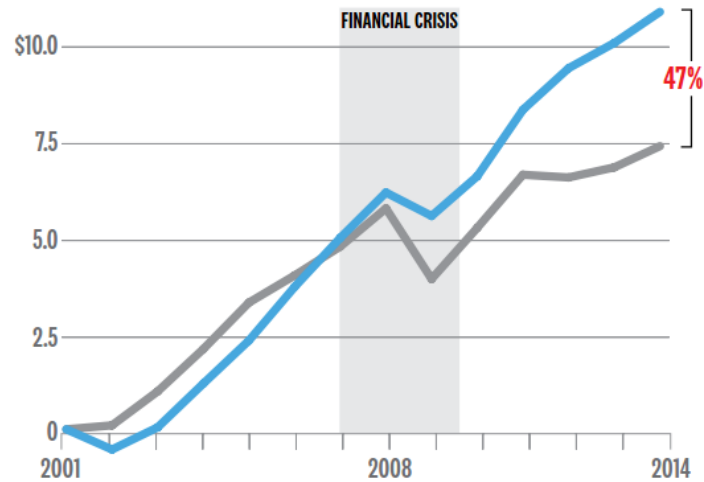
- To demonstrate that there is a long-term strategy
- To help investors understand long-term issues “through the eyes of management”
- To show that the company can anticipate and capitalize on megatrends
- To encourage the C-suite to reflect on the corporate ecosystem
- To help inspire — and retain — both employees and investors
- To foster leadership in corporate-shareholder communications

# The case for long-termism

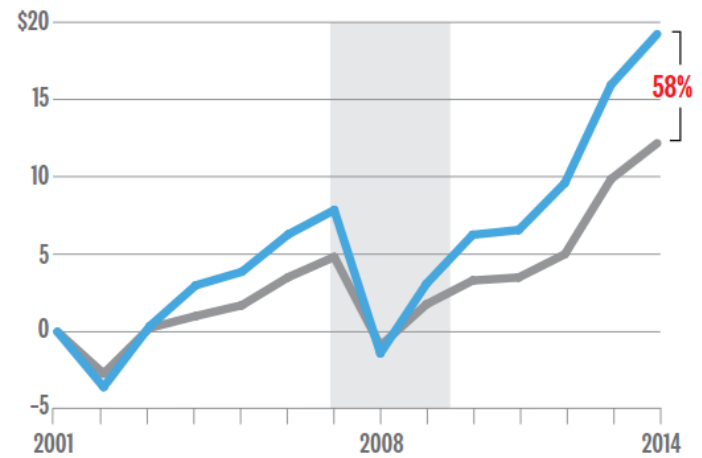
Study of 615 U.S. companies, representing 60% to 65% of total U.S. Market Cap by McKinsey

**Harvard  
Business  
Review**

**AVERAGE COMPANY REVENUE**



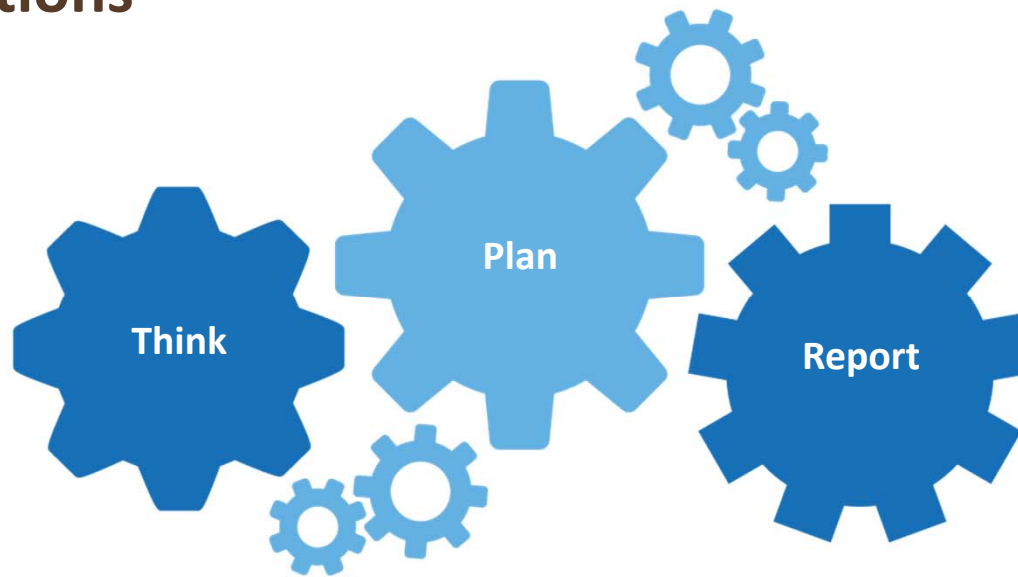
**AVERAGE MARKET CAPITALIZATION**



■ LONG TERM  
■ ALL OTHERS

NOTE ALL FIGURES US\$ BILLIONS INDEXED TO 2001

**Integrated Reporting is enhancing the way organizations**



**the story of their business**

# Multiple Capital Approach

---

## – FINANCIAL

(internal and external funds available to a business)

---

## – MANUFACTURED

(e.g. buildings, equipment and infrastructure)

---

## – INTELLECTUAL

(knowledge-based intangibles, e.g. brands and patents)

---

## – HUMAN

(people and their capabilities and experience)

---

## – SOCIAL AND RELATIONSHIP

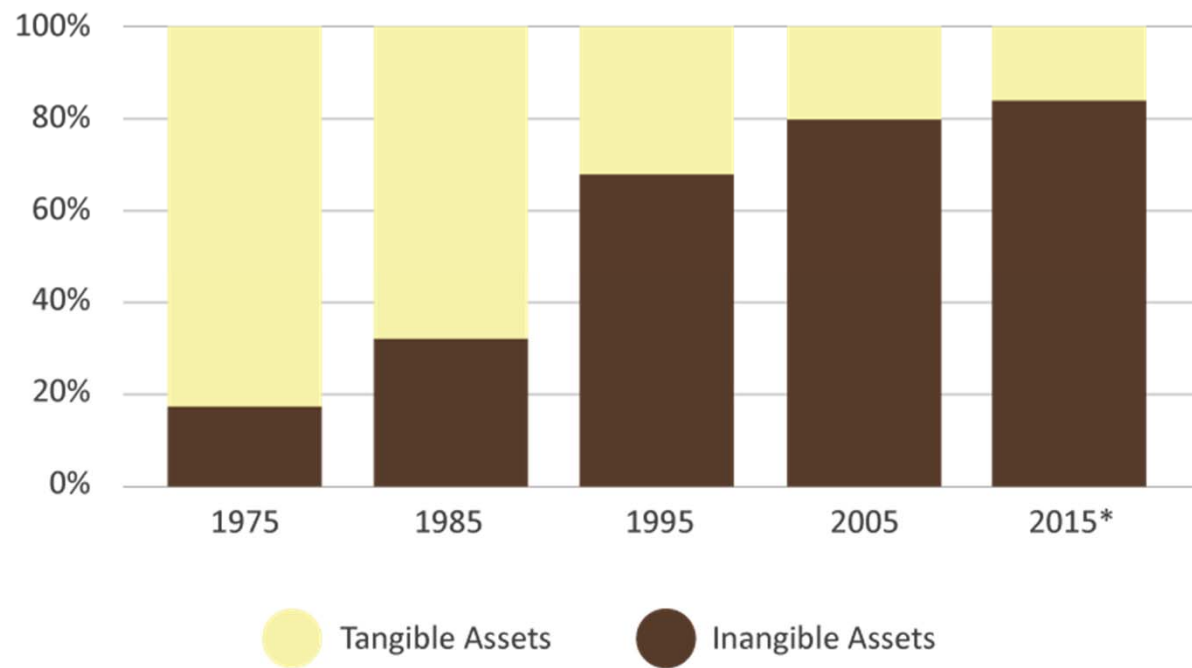
(stakeholder and network relationships)

---

## – NATURAL

(environmental resources, e.g. air, water and land)

## Why <IR>? More than financials



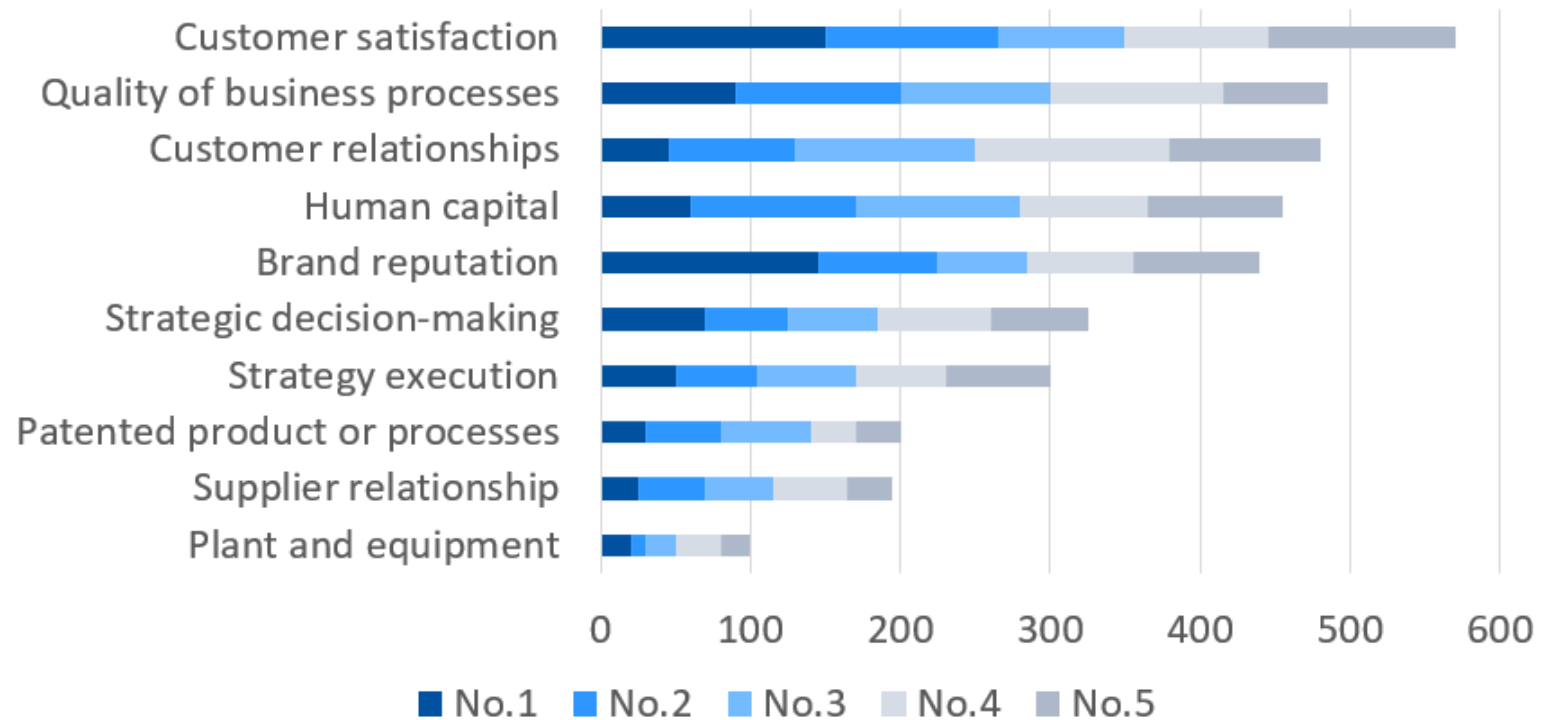
Source: OCEAN TOMO LLC  
 January,1,2015



# Value drivers



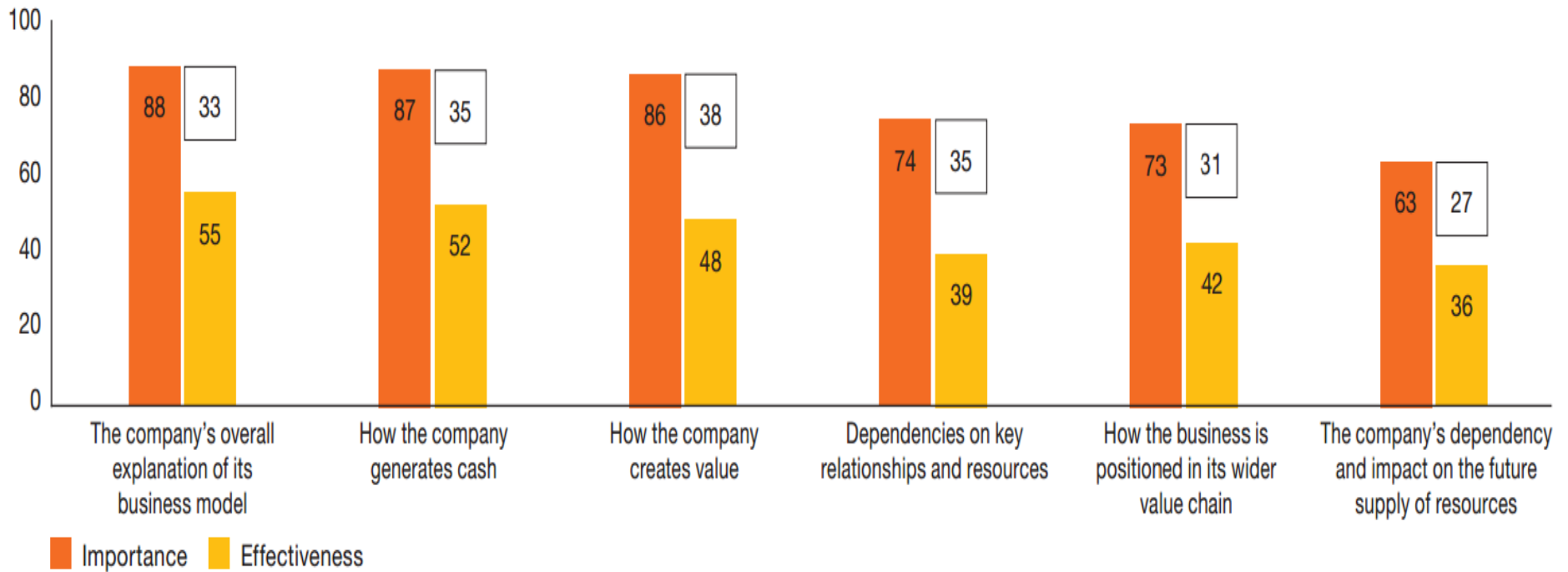
Survey of 744 finance executives across 34 countries



# What investors are calling for

How important is each of these pieces of information provided by a company for your analysis, and how effective is the information that you currently receive in all aspects of company reporting?

On a scale of 0 to 100, where 0 is not at all important



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 or effectiveness. The number in the box next to each column is the 'effectiveness gap'.

# What investors are saying

"We are asking that every CEO lay out for shareholders each year a strategic framework for long-term value creation. Additionally, because boards have a critical role to play in strategic planning, we believe CEOs should explicitly affirm that their boards have reviewed those plans. BlackRock's corporate governance team, in their engagement with companies, will be looking for this framework and board review."

Larry Fink, CEO, BlackRock

"Efforts by the International Integrated Reporting Council to develop a framework for reporting value creation seem very much in-line with what Mr. Fink is suggesting."

Sandra Peters, Head of Global Financial Reporting Policy, CFA Institute



## New <IR> Academic Database

- Launched on August 8 2018
- Content: Over 200 academic studies highlighting the potential positive ramifications of adopting integrated reporting, as well as commenting on emerging best practice
- Conclusion of research included in the database: Integrated reporting leads to increased stock liquidity, better performance, higher market valuation and a longer-term investor base for the businesses that adopt it
- A freely available resource: <http://www.iracademicdatabase.org>




# One Example of Academic Research

- The Economic Consequences Associated with Integrated Reporting Quality: Capital Market and Real Effects by Barth, Cahan, Chen, and Venter (2017, *Accounting, Organizations and Society* 62: 43-64)
- Addresses the question of how integrated report quality (IRQ) is associated with firm value
- Objective is to shed light on the extent to which, and how, integrated reporting achieves its dual objective of:
  - Improving the quality of information available to outside providers of financial capital to enable a more efficient capital allocation (capital market effect)
  - Supporting integrated internal thinking, decision-making, and actions that focus on value creation for the firm (real effect)

# One Example of Academic Research

- Evidence is based on IRQ scores determined by a team of professors at the University of Cape Town for the purpose of supporting EY's annual Excellence in Integrated Reporting awards is South Africa, which currently is the only country that mandates integrated reporting
- Findings:
  - A positive association between IRQ and liquidity (capital market effect)
  - A positive association between IRQ and expected future cash flows
    - No evidence of an association between IRQ and target price forecast accuracy
    - IRQ positively associated with ex-post realized operating cash flows and investment efficiency (real effect)
  - Evidence is consistent with the dual objective of IR of improving information quality and promoting integrated thinking

**Alignment to integrated reporting globally**

-  Corporate governance code reference/alignment to integrated reporting
-  Stock exchange adoption/encouragement
-  Government body report encouragement



Integrated reporting adopted by 1,600 organizations across 65 countries including every G20 economy

<IR> networks  
2,000 participants including 500 in Brazil

**Mainstream adoption in South Africa and Japan**

**Academic evidence**  
shows that integrated reporting improves conditions for long-term investment, reduces cost of capital, improves performance and improves liquidity

## Hierarchy

### Level 1 – Focusing Capital on the Long Term

- Institutional Investment Mandates, Quarterly Earnings Guidance, Executive Compensation, **Reporting**, etc.

### Level 2 – Integrated Reporting

- Multiple Capital Approach to Internal and External Reporting - Financial, Manufactured, Intellectual, Human, Social and Relationship, **Natural**

### Level 3 – Key Performance Indicators

- SASB, GRI



# IASB Management commentary

- “Key part of the Board’s work under the Better Communication in Financial Reporting theme”
- November 2017: project to update IFRS Practice Statement 1 Management Commentary added on IASB agenda
- July 2018: Composition of the Management Commentary Consultative Group announced
  - Appointment of Lisa French, IIRC Chief Technical Officer, as a member of this group
  - Aim: provide the Board with access to practical experience and expertise in developing, implementing and using management commentary regimes, and to advise the Board as it develops proposals for updating the Practice Statement
- First half of 2020: Exposure draft publication expected

**Through integrated reporting, organisations can ‘address more clearly resources that are not included in financial statements. The increasing awareness that environmental and societal restrictions have an impact on long-term value creation is also clear’.**

*Hans Hoogervorst, Chairman IASB*

# Resources

HOME THE IIRC NEWS NETWORKS RESOURCES CORPORATE REPORTING DIALOGUE

Search

Go

## INTEGRATED REPORTING <IR>

Welcome to the IIRC's new website, the home of Integrated Reporting.

<IR> is enhancing the way organizations think, plan and report the story of their business.

Organizations are using <IR> to communicate a clear, concise, integrated story that explains how all of their resources are creating value. <IR> is helping businesses to think holistically about their strategy and plans, make informed decisions and manage key risks to build investor and stakeholder confidence and improve future performance. It is shaped by a diverse coalition including business leaders and investors to drive a global evolution in corporate reporting.

Be part of the <IR> movement.

Why? The need for change

What? The tool for better reporting

How? Practical advice and tools

When? Advocate for global adoption

[www.integratedreporting.org](http://www.integratedreporting.org)

## Integrated Reporting Examples Database

Sharing real examples of leading practice in Integrated Reporting to help organisations on the <IR> journey

## The International <IR> Framework

Providing the principles and concepts for organisations adopting <IR>

## <IR> Network

Bringing together organisations worldwide to enhance the way they think, plan and report.

[examples.integratedreporting.org](http://examples.integratedreporting.org)

# INTEGRATED REPORTING <IR>