Study | Management Consulting

Integrated Reporting and Integrated Thinking in Privately Owned Companies

Audit / Tax / Advisory

Smart decisions. Lasting value

Foreword

This study presents a pilot test performed in Spain and is intended to be a starting point for broader research, on a European scale, into the current status of Integrated Reporting and Integrated Thinking in private organisations and the extent of their impact in corporate strategy.

Private financial capital is crucial for sustainable value creation in Europe, where the largest economies make a substantial contribution to national wealth and particularly to employment. Additionally, the recent growth in both private equity and private debt transactions has multiplied, a process which seems to be a long-term trend.

The depth and breadth of non-financial information in public interest entities (PIE) – especially in those owned by public entities – has risen substantially in recent years as a combination of capital providers' needs for information; economic, environmental and political issues that make an integrated vision ever more necessary; and a consequent regulator's interest in broadening the corporate information perspective. However, those private entities which are not classified as PIE have been less exposed than their PIE peers to such external pressures. Thus, the evolution of broader forms of corporate reporting has not proceeded evenly.

Disparate evolution might well be due to multiple reasons such as the lack of mandatory frameworks, concerns about risks related to information disclosure, immature measurement systems, particularly of non financial variables, and others. However, beyond these reasons, what this study tells us is that the increasing complexity of private capital markets makes the trends towards better reporting irreversible.

We believe our work to be the proper representation of conversations that are beginning to arise, allowing us to open the way for more thorough research at a regional level and enabling us to understand the process of adoption of extended forms of reporting in all its magnitude and serving as a basis for policymakers and thought leaders as the subject gains momentum.

In analysing the results of this study, we focus our attention on the conversation dynamics to understand why and how the process of adoption occurs rather than trying to achieve a statistical confirmation of cause-effect hypotheses This study aims to research 'what is being spoken' inside organisations, one of the critical questions to understanding the importance of integrated thinking and reporting as the cornerstone of strategy execution.

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Introduction

The Integrated Report – like all other forms of broader corporate reporting, such as sustainability reporting, nonfinancial reporting according to EU directive, and carbon reporting, is in its early stages of implementation. For this reason, the quantitative research implemented through mass surveys about the reasons to produce or not these type of reports does not allow us to entirely understand its dynamics of implementation. Therefore, for our study we have chosen to carry out a series of in-depth interviews, looking for an interpretive approach to better understand the underlying conversation.

We believe a phenomenological approach is the best approach rather than anticipating numbers that confirm our beliefs. We want to enter into the conversations to understand the phenomenon, to engage in the discussion about the reasons that have delayed the implementation of multi-capital information systems, as well as to look for factors that trigger decisions towards the development of such systems.

The in-depth discussions have allowed us to analyse fourteen (14) case studies divided into two groups. Six (6) cases consist of organisations which have implemented some form of integrated reporting, committed to the purposes of the integrated thinking, and led by individuals duly trained in this field. The other eight (8) cases have not shown an explicit implementation or profound knowledge of broader forms of reporting. We call the latter a 'control group' [1]. The contrast between both group's perspectives have led us to better understand the existing worldviews on the issue.

Our interviews included mostly open-ended questions which have enabled us to adapt the talk to the different levels of knowledge on the topic. Some respondents have been interviewed several times and companies have been researched in detail, from the review of corporate communications to the analysis of other data we have been granted access to.

Finally, through a set of structured interviews conducted in collaboration with the University Pompeu Fabra in Barcelona, we have obtained thirty-four (34) surveys from different stakeholders (business people, academics, advisers and corporate employees) which have enabled us to validate concepts appearing in our conclusions.

Boundaries

The interviewees' sample can be characterised as follows:

- Private entities, including different forms such as family-owned business, proprietary-owned, some of them partially owned by private equity funds.
- Business size between 50-1,000m€ annual turnover,
- Headquartered in Spain (with local, international and global operations).
- Industries: FMCG, Logistics, Infrastructures, Food/Feed, Finance, Manufacturing/Processed Goods.

1. A control group is a technique used in research to validate the results of tests in a group exposed to certain treatment or input (the experimental group). Although the naming of the group may not be entirely correct in terms of scientific research, we have adopted that naming for labelling purposes.

Contents

The study . . . 6

Dimension one: Strategy and Planning . . . 9

Dimension two: Resources and Resilience . . . 15

Dimension three: Reporting, Disclosure, and Complexity . . . 20

Dimension four: The Relationship with Providers of Financial Capital . . . 23

Conclusions . . . 26

The four dimensions of integrated thinking in private-owned companies (hypothetical framework) . . . 28

Enabling integrated forms of thinking and reporting: what companies could do . . . 29

The Study

Engaging in conversations with private organisations

In recent years, several corporate and academic studies aimed to demonstrate the correlation between the adoption of extended corporate reporting and the economic benefits obtained. In general, these studies tried to explain a causal relationship between the establishment of a management system that allows the measurement of the various capitals and risks influencing an organisation and its long-term economic performance. Prestigious academic research groups such as the Long-Term Investment Initiative from Smith School of Enterprise and the Environment at Oxford University have developed extensive research on this matter[2].

2. https://www.smithschool.ox.ac.uk/research/long-term-investment/. Particularly interesting is the paper from Clark, Gordon L. and Viehs, Michael, The Implications of Corporate Social Responsibility for Investors: An Overview and Evaluation of the Existing CSR Literature (August 17, 2014). Available at SSRN: https://ssrn.com/abstract=2481877 or http://dx.doi.org/10.2139/ssrn.2481877

In this study, we aim to achieve something slightly different. It should be noted that economic performance and financial performance may not coincide in the timeframe. In this sense, we all know that building a resilient organisation might involve decisions which could cause some financial volatility at the start, so the measurement of share valuation can be bound to certain factors that do not necessarily reflect the strength of the economic entity in the medium and long term.

From our point of view, further longitudinal and phenomenological studies are required to reach a better understanding before determining causalities. In contrast, our study attempts to find explanations in terms of why and how companies engage or could engage in integrated reporting or other forms of broader corporate reporting.

Selection of Interviewees

For the interviewee selection, we define two significant groups. The first group has already implemented for some time (more than three or four cycles of reporting) an extended reporting form, particularly the <IR> framework[3].

The second group includes companies which have not yet issued any broader form of reporting or are in a very early stage of discussion. As a result, while the former provides us with the causes and effects of the implementation, the latter helps us develop the explanations about beliefs and other reasons that prevent them from going beyond traditional mandatory financial reporting.

Discussion topics

Conversations with participating organisations were structured around four key aspects. Our primary goal was to understand how companies create a shared purpose, communicate value creation, and present the challenges in their internal conversations. These questions enable us to understand and outline how critical principles of Integrated Reporting (strategy, performance, and future outlook) are represented in corporate rhetoric.

In the first section, Strategy and Planning, we explore the understanding and shared vision of the business at the strategic level of the organisation. We mainly try to understand 'what is being talked about' when the organisation discusses its future.

The second section, Resources and Resilience, seeks to understand if the organisation has a broad vision of its critical resources and their potential scarcity, and how risk management, generational changes and trends in regulation that affect these are managed.

The third dimension, Reporting, Disclosure and Complexity focuses on the cost of establishing measurement and reporting systems. Also, it asks further questions on how transparency pressures play in allocating resources to such tasks.

Finally, the fourth dimension, Relationship with Providers of Financial Capital[4], explores the relationship of the organisation with stakeholders by exploring the dynamics of the conversation with them and its impacts.

3. Not all interviewees have prepared an Integrated Report, but all of them know the framework and have considered it, at least in part, to produce their corporate reports.
4. Providers of Financial Capital: Equity and debt holders and others who provide financial capital, both existing and potential, including lenders and other creditors. This includes the ultimate beneficiaries of investments, collective asset owners, and asset or fund managers (Source: Integrated Reporting Framework).

Strategy & Planning

Discussions on the first dimension of the study consider four significant topics at the strategic level of the organisation: planning horizons, talent, capacity to adapt to regulations, and management style.

1

Strategy & Planning

1. Horizons.
2. Talent.
3. Regulations.
4. Management Style.

1. Horizons in mind

Value creation as an integrated system of different capitals seems to be a characteristic of those who devote time to develop strategies for the long term: the longer the horizon, the more progressive their thinking. Our discussions reveal consistently that as Board Members and Executives invest time in thinking and reflecting, they acquire a long-term vision and adopt a more progressive approach. Although the conclusion may seem trivial, the phenomena are not.

The figure 1 depicting our analysis states that organisations where conversation at Board level includes elements related to diversity, climate change impacts or organisational culture (broader themes), often focus on long-term indicators, processes related to management succession, and some models to explain the impacts on company value.

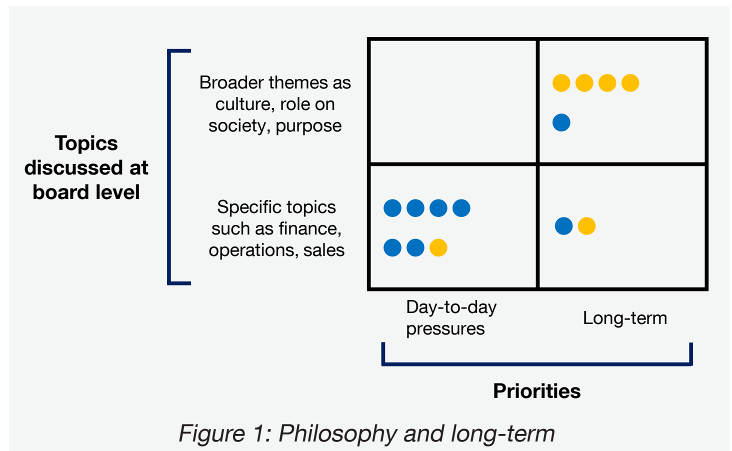

Figure 1: Philosophy and long-term

In our sample, organisations which have opted for some form of broader corporate reporting (Orange in the diagram) match the two characteristics of broader themes and long-term focus. Conversely, the organisations which have not yet implemented extended forms of corporate reporting coincide with the focus on day to day issues and discuss more on finance, operations and sales at board and executive level. Indeed, when a topic such as environmental aspects is addressed, they tend to prioritise measures that imply a reduction of consumption or direct costs.

We all know that executives work under pressure. However, the nature of the pressure appears to be slightly different depending on their belief systems: while executives in public capital companies feel pressured to obtain positive share value, private companies' pressure arise mostly from the role played by them in the organisation. In other words, in the public entity, pressure is on the delivery of results; in private ones, it seems to be a characteristic of the role itself. According to our conversations, we can think that pressure in this context could eventually represent a meaning rather than a concrete expectation. Furthermore, sometimes it seems that pressure perception is mainly due to the executive's beliefs rather than to the direct pressure of the governing bodies or owners.

Apparently, many executives, particularly those who are not company owners, impose on themselves an image of assertiveness and realism which is not really demanded by the board of directors, or the markets. In large, public entities' incentive systems sometimes trigger undesired behaviours against integrated thinking. Conversely, in our sample of private companies, the lack of robust systems intended to foster the desired behaviours sometimes free the executives to pursue their career objectives and beliefs, which causes silo-thinking and increases the weight of internal politics.

Of course, the conclusions above are based on small samples and through interpretive discussions oriented to understand beliefs. Having said that, further research could shed light on the repeatability of the findings.

As a further restrictor of the expected mindset, we note throughout the conversations that the habit of reflecting on company culture and philosophy could be culturally discouraged and perceived as a waste of time – a belief that could be interesting to confirm in larger sample sizes-. In some instances, even when interviewees accept that the purpose discussion is essential, the incentives are designed to perceive the soft discussion as not worthy.

2. Talent shortage

The second aspect of the strategy and planning dimension consists of the challenges of talent management as a strategic issue that crosses different industries. Many of the interviewed firms are carrying out M&A transactions as a potential solution to their need to innovate and grow. In many cases, the process has been facilitated by an excess of financial capacity and the increased activity of private equity funds. As a result of these expansive processes, several interviewees reveal that talent acquisition is one of the crucial aspects of growth.

Contrary to the incentives that boosted inorganic growth in the past (market expansion, assets, technologies, scale), companies are beginning to prioritise M&A looking for acquisition of talent rather than other assets.

Among our interviewees which experimented M&A processes (figure 2), the ones which maintained the existing management after the acquisition tended to experience better results.

Indeed, the discussion about the long-term leads us to discuss talent as the primary source of concern. Assets are depreciated faster than ever as technology evolves, so specific 'talent stacks' or new skills collection are crucial to navigating the turbulent waters ahead. Interestingly, an identical reflection comes up in several conversations: wider forms of reporting allude to human capital management through static variables and retrospectives (quantities, gender quotas, rotation), while in practice it is evident that communication of management approaches for human capital is still a challenge. This phenomenon is not limited to the operational workforce, but it becomes more important to explain what happens with talent management at the leadership level, particularly in the succession chequerboard, something we will discuss later in this study.

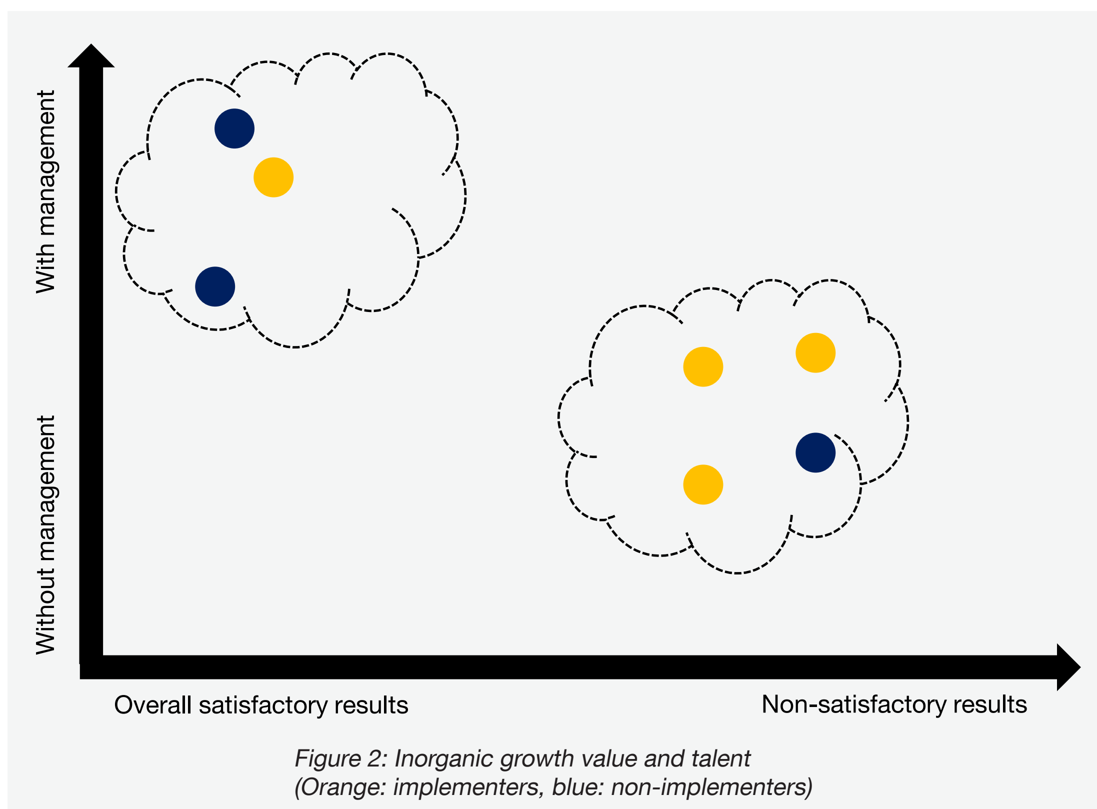

Figure 2: Inorganic growth value and talent
(Orange: implementers, blue: non-implementers)

3. Regulations

There is no doubt that the increase in the number and depth of regulations is a matter of concern for companies as it affects their capacity to develop and execute strategies. The need for greater transparency and the growing regulations on business activities exert increased pressure on corporate mechanisms while standardising and homogenising business activities across industries and countries. However, the predictable nature has a downside: what is homogeneous in business could make the individual value proposition vulnerable. Even worse, time pressure for implementation of these measures force companies to execute 'best practices' of which effectiveness may be unproven.

For instance, the recent changes in the Spanish Criminal Code have led many entities to implement their compliance programs quickly. At the time of writing this report, most of our respondents are not sure about the effectiveness of this measure because of their lack of experience. So far, the only result of this regulation is the perception that the measures increase the administrative burden and are difficult to reduce due to the strict positioning of corporate counsels. In this sense, in Spain, as in other European countries, there is continuous pressure resulting from new regulatory aspects; in many cases, the impacts of external influence in the corporate structure may hinder the execution of some strategic initiatives, notably by limiting innovative capacity. Innovation requires taking risks which are necessary to achieve differentiation. Therefore, companies will grapple with their structures and procedures if these are dictated by law.

4. Management Style

Due to the small sample size, we cannot conclude about causality in this study, although our observation suggests that certain styles of management are typically associated with welcoming integrated thinking in the organisation.

What an organisation talks about is closely related to its management style. In other words, management style creates the boundaries to set an agenda, what can be spoken, and what is taboo. At this point, we might ask ourselves whether integrated thinking is a characteristic of a particular style or even a management style in itself. From our perspective, Integrated Thinking – as an approach that holistically considers all resources and relationships, the needs of stakeholders, the business model and future strategy, and its outcomes – could be in itself a healthy management style, which allows the conversations to flow, beyond individual agendas and corporate taboos, while also providing an enriched picture for decision makers.

Besides the concept of 'what is being said,' there is a further aspect to consider: the meaning conveyed in the talks, beyond the words used. For example, an organisation could be permeable to the needs of its stakeholders quite often, but what happens when decisions imply conflicts between the corporate and the stakeholders' agenda? One of our respondents says, 'we do not have any doubt: we do what is more convenient for our stakeholders, and we know the banking sector do not usually agree with this approach.' This is, beyond rhetoric, 'what is being said' translated into a management style, even at the cost of harming the sources of financing.

Aiming to frame these behaviours, we propose a classification according to how the context could imprint what is being said, what is being done. In the diagram below, we identify four type of companies with four different approaches to these relational trade-offs. One's position in the diagram is determined according to the company's orientation to operationalise 'what is new,' particularly the degree of regulatory compliance (vertical axis), put against the leadership perspective of how permeable management is to change their views given new external information (horizontal axis). As a result, we obtain four mindsets, in four classifications that exaggerate the behaviour and potential reactions to the 'new matters' affecting business model.

Some of our interviews give a voice to these labels. One of the respondents, whose company is involved in a transformation process towards innovation, stresses the value of the talks. She explains that the executive team meets every two weeks. In such meetings, the CEO provides a detailed breakdown of the relevant aspects for the business model and his analysis of the political context to help his team understand what matters. He often provides the team with exhaustive detail, topics for client understanding, the status of the relationships with banks and reflections about technology, among others. This is not perceived as micromanagement by the team, but rather as a model that considers the integrated thinking from a progressive outlook. As a result, the team feels that the 'what is being said' crafted by the leadership, provides the appropriate context to cascade down that ethos.

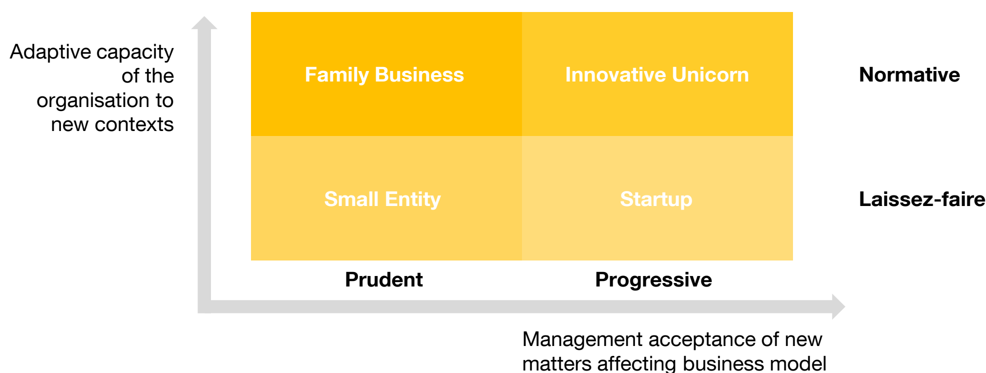

Figure 3: Context and reactions

The non-implementing group and the survey

Findings from our second group, the non-implementers, confirm the outcomes that emerged from the discussion with the first one. In this group, we notice that Corporate Social Responsibility is seen as an ethical matter linked to long-term vision yet dissociated from strategy execution and, in practice, detached from the business model. Indeed, although the value of reputation to potential and current clients is considered relevant, the significance of their impacts is not directly appraised as a business matter.

In general, for this second group, environmental aspects are mostly related to compliance rather than to climate adaptation, gender policy is an adjustment to times, and corporate governance is an advance of Anglo-Saxon legal structures more than concrete steps towards better transparency. There is not an intended pejorative meaning in the description; conversely, these definitions aim to describe the way interviewees approach the conversation, use some words, and provide their explanations. It seems that from these organisations' belief systems, the most progressive global trends are perceived as continuously impacting events which require them to adjust the company rhetoric, rather than signals sparking profound transformations.

According to interviewees in both groups, in Spain, there is still a bias which causes CSR policies to exist only where the top leaders have strong CSR values. Even in those cases, the concept seems sometimes too linked to philanthropic, discretional, decisions. To some extent, these views confirm the diagram we depicted above, suggesting that even with the same message, the underlying concepts can differ dramatically based on management beliefs.

At this point, we observe that the concept of integrated thinking is still associated with CSR or sustainability aspects, due to the inadequate involvement of the finance and corporate areas in the broader forms of reporting. However, as the quality of corporate governance evolves, the discussion becomes richer, and companies in both interviewed groups begin to understand the essential differences between integrated reporting and other disintegrated mechanisms such as parallel financial and nonfinancial reporting. Our practical experience with the implementation of the Spanish transposition of the nonfinancial directive in the European Union, suggests that these pathways of financial reporters and corporate communicators are bound to a junction. However, we are probably in the nascent stages of alignment.

Our survey reveals that 67% of respondents believe Integrated Reporting is a step towards a better understanding of value creation. Such a statement confirms that the philosophy behind the concept is acknowledged, whereas the challenge might be to focus on a clear understanding of the implementation, rather than explaining the benefits of it.

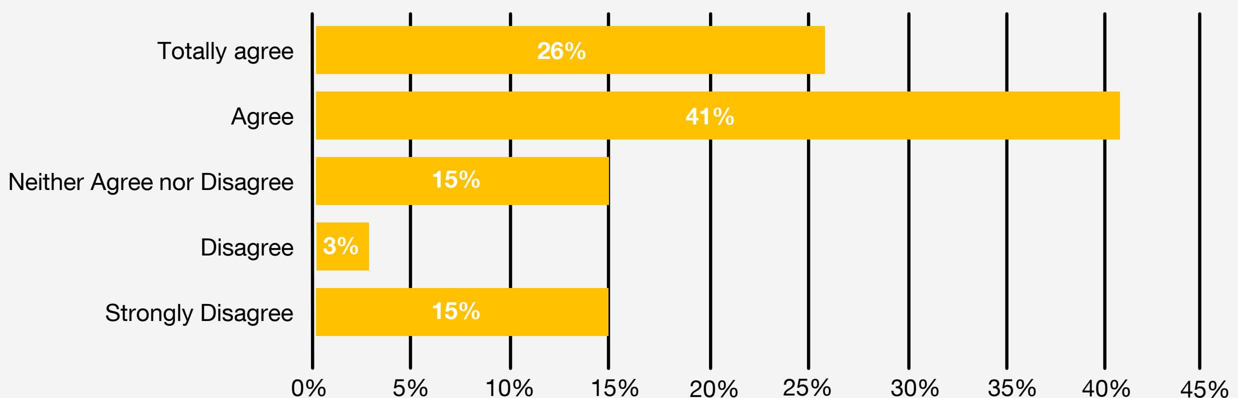

Figure 4: <IR> is a step towards a better understanding of value creation

Resource & Resilience

The discussion about resources and resilience explores the fact that some resources which were not perceived as scarce in the past could be scarce either now or in the future. The questions posed in this section are intended to ask if companies are taking measures in making themselves resilient to expected shortages of resources or not. The answers obtained lead us to define four sub-dimensions analysed in detail in this section.

2

Resource & Resilience

1. Talent.
2. Intangibles and Externalities.
3. Money.
4. Technology.

1. Talent again, but from a resource perspective

When we hear large companies talking about resources, the discussion tends to focus on the impacts of climate change or the procurement of physical resources. However, in our conversation with private companies, we find an interesting, alternative perspective: the concept of talent shortage appears not only as a strategic discussion for what we can expect in the long-term but is also a conversation about present needs and scarcity of resources associated with converting their value proposition into cash flows.

Even when the discussion recognises the impact of a technological revolution and the related innovation imperative as a central theme, all interviewees agree that innovation is more of a cultural challenge than a technological one. This is explained by the fact that technology is not currently constrained by scientific development or technological improvement, but by the organisation's ability to implement such innovations in shorter periods and sometimes without enough time to test these before market launch. Finally, it seems clear to the interviewees in the first group that the innovative profile of a workforce is not only characterised by a set of skills but also by a distinctive mindset.

In the conversation about resilience and physical management of resources, there is another critical point related to talent management which is repeatedly mentioned: succession planning is as important as the capacity to face rapid technological change. The skills needed to take over the leadership roles most often require new role models and abilities, and our respondents envisage that these skills will become scarce.

2. Valuation techniques: intangible assets and externalities

As might be expected, topics related to physical resources quickly appear in the conversation; however, these do not arise from an expected concern about price volatility influencing financial performance but from the potential impact of unexpected externalities not considered in cost planning, such as costs of greenhouse gas emissions or constraints due to water usage in processes which require high volumes of water. In this sense, we observe complex visions of reality that go beyond the procurement which consider the potential emergence of externalities in prices.

From these conversations, we can also observe that large corporations are often detached at governance and top management level from the day-to-day issues where unexpected forms of resource scarcity are more evident. Companies must ask their front-liners about potential impacts derived from scarcity as they could well provide the organisation with valuable input. This phenomenon is more frequent in smaller, family-owned structures.

As stated before, the principal interviewee's concern is focused on the lack of measurement tools to assess externalities and other intangibles. To them, the commonly used decision-making tools and techniques are limited to financial valuation models in which the incorporation of externalities is still experimental or too complex through unintelligible econometrical methods. Some better-informed interviewees mention some of these models – such as the valuation of real options, scenario planning, and impact analysis – but at the same time, they admit that not all the involved decision-makers might feel comfortable with these models.

At this point, we see that business models change, as well as the resources linked to them. Therefore, most resources that were taken-for-granted are becoming scarce – as seen in the case of concerns about water availability – and, despite academic deliberations, there are no (mature enough) models out there to practically embed these concerns and valuation models into current decision frameworks.

3. Money as a resource

For family-owned companies, money was traditionally conceived as an output rather than an input. Capital structures used to be simple: inflows minus outflows determined the available amount to be either reinvested (including debt repayment) or distributed among the shareholders. Over time, more complex capital management systems have emerged, due to the advent of Private Equities, the development of simplified paths to trading publicly in secondary markets, and the expansionary strategies of transnational companies; even when there were still some members of the owning family in the company.

These 'new habits' lead structures into a conflict situation; however, not all conflicts have a negative connotation. In fact, companies mature as they overcome that confrontation. The integration conflict enables them to update their structures and to gain positive aspects of the old and the new. In private capital, the new capital structures allow companies to retain culture and values while adding value creation processes for more sustainable and large-scale expansion. Hence, money is no longer a mere result of trading; it becomes a resource, of which effective management allows – or equally prevents – the efficient administration of other resources.

Note: At this point, it becomes crucial to refrain from the approach of addressing corporate reports to a broader range of stakeholders and to focus instead on providing specific responses to the providers of financial capital. The provider of financial capital is one of the weakest links in the chain, whose go or no-go decisions affects the rest of the stakeholders. When money is no longer a 'family affair' but is accountable to others as per the nature of the ownership, it is time to rewire the corporate rhetoric in order to align communication, strategy, and decisions.

4. Technology and new forms of resources

For one of our respondents, technological adaptation needs to be part of the CAPEX planning. Thus, CAPEX should not be merely intended as a physical, fixed capital investment. Companies should get used to having a budget for technological and cultural adaptation. As technological transition periods become shorter, that CAPEX effect is more significant, although sometimes overlooked.

This phenomenon implies a mindset change to identify new resources in a new landscape and to plan how financial resources must be deployed. Indeed, this requires new ways of thinking. However, it is not only a mindset issue; to match their financial needs deriving from adaptation, private entities must resort to providers of financial capital to execute these strategies. In other words, a faster adaptation implies a more significant financial deployment leading to the emergence of new capital suppliers.

Perhaps that capital requirement is one of the most challenging aspects since it requires a mindset change: some time ago, external funds (either in form of debt or equity) could be kept outside the decision framework recurring in the deep pockets of the founding families, but nowadays the extent of the needs requires greater sophistication. Curiously, one of our interviewees who is in charge of a Family Office stated that start-ups are not only more flexible from their creative way of thinking, but also in their financial capacity to absorb external funds.

This is perceived as prohibitive by the private company – the question from that interview is interesting: '¿Why do angel investors not invest money in mature companies to foster innovative projects?' Although there are no absolute answers in business, corporate mindsets, structures, and beliefs are enough deterrents for business angels not to invest in mature companies. It is worth mentioning that the same Family Office started to invest in start-ups to explore innovative solutions for the major Family business outside of its corporate boundaries.

We have all heard that technology disrupts all industries. One of our interviewees in the logistics industry wondered: 'What would the impact of 3D printing be in the volume of shipping of our company and industry?' Another respondent said 'to produce food we consume water and 20-25 calories of energy to produce one calorie of food. Will technology help us fix that?' In the media industry, channel digitisation is entirely changing the competitive landscape and, in cities, new paradigms on the built environment are transforming the infrastructure business. As we can see, innovation goes far beyond technological and scientific advances. For instance, in the case of infrastructures, the new funding strategies of public works such as PPP (public-private-partnerships) are changing the sector on a global scale.

The aspect of Technology Management from a resource point of view to develop solutions against scarcity becomes crucial not only from a resource management perspective but also to explain the value-creation process to report readers, something that could not be explained with neither traditional financial reporting nor with sustainability reporting.

Worldviews common to the non-implementers group

Our ‘control’ group reveals to us that companies which do not allow themselves to reflect on their fundamentals, struggle to make a business case for the impacts derived from resource scarcity. The initiatives so far are mostly related to events perceived as unlikely, which implies a relatively relevant narrative consideration but limited budgets on the flip side. For example, it is common to see agricultural business talking about climate change, but strong, well defined, reliable business cases to tackle it are not yet the most common.

Indeed, given the lack of both scenarios and a clear picture of potential outcomes, the actual consequences related to resource availability and other types of scarcity are neither developed nor properly appraised, hence neither monetised nor translated into action. In fact, our interviewees recognise that customers tend to perceive such impacts earlier than the company, making the responses more reactive than proactive.

Finally, it seems that even Family Offices with a prudent profile acknowledge that the trends regarding increasing regulations help to develop the discussion about possible impacts and the value of externalities. Whether they like it or not, some externalities will sooner or later put pressure on the operating margins.

Reporting, Disclosure & Complexity

Our third dimension asks for reasons to engage in broader forms of reporting, particularly seeking to understand how integrated thinking could play a role in terms of reporting quality. We have found two essential topics in the discussion, which we classify under pressures and reasons, and quality and usefulness perspectives.

3

Reporting, Disclosure & Complexity

1. Pressures and reasons for engaging in a reporting endeavour.
2. Quality and usefulness of reporting.

1. Pressures and reasons for engaging in a reporting endeavour

In our inquiries about what has led companies to engage in broader forms of reporting, our interviewees agree that the market is the primary trigger. Curiously, the conversation on providing extended corporate reports is rarely initiated by a provider of financial capital in the cases we surveyed.

To our respondents, transparency of information has a positive impact on productivity. Clear information flows often contribute to conveying the corporate strategy messages, making a big difference in the quality of management. Conversely, pressure from capital providers are mainly focused on the clarity of the business model rather than on the characteristics of integrated thinking or other appraisals of how the company works internally.

A lesson learned from the conversations is that companies of a certain size like to mimic the behaviours of listed companies, even when they intend to remain private. The perception in this sense is homogeneous: good governance is good for business.

2. Quality and usefulness of reporting

Progressing through the conversation, the quality and usefulness of content in integrated forms of reporting reveal a series of comments which deserve attention.

The first finding tells us it is imperative to simplify. A basic set of KPIs is crucial to managing processes strategically. Companies struggle to gather reliable nonfinancial data, mainly due to immature management systems and certain budgetary constraints that hamper taking the quality of information to a higher level.

Perhaps for the same reason, many interviewees say that mandatory disclosure could be double-edged. Such recurring comments indicate that many initiatives deployed in the past ended in mere box-ticking exercises. For certain respondents, the public sector may be an exception, and effectively some of them made the point that Government-owned entities should be required to use more comprehensive forms of reporting including their performance on further capitals, as a way of leading by example – while fulfilling their nonfinancial mandates.

As an interviewee says, ‘It is difficult to understand why an Integrated Report is not the standard corporate reporting yet.’ The sense is that sustainability reporting is a response to social and economic demands, boosted by the events in the markets, and <IR> is its evolution when it comes to corporate information, as it aims to improve decision making.

To one of our respondents, working for a company planning to go public shortly, some form of integrated reporting is a must. A Strategic Approach to extensive corporate reporting is required as a de facto standard by any reasonable investor; although they might not be familiar with the specific formats, they want to see more than financial statements. However, for the same respondent, simplification is still a challenge. As it becomes more relevant to attract the interest of providers of financial capital, clear and concise reporting is imperative. Of course, these dynamics will bring up new issues: because of information disclosure, some new covenants could arise in contractual reviews. ‘We need to get used to it,’ another respondent tells us, ‘we need to depart from the naïve idea that Enterprise Risk Management is a closed-boundaries’ process.’ Contextual information becomes increasingly relevant to appraise risks, and this will spark revised terms and negotiations with stakeholders.

The views from the non-implementers

Among reporting practitioners in both groups, there is a feeling annual reports are rarely read thoroughly. Therefore, the challenge to track interest has yet to be addressed. In our 'non-implementers' group, the concept of Integrated Reporting still seems to many, overly sophisticated.

Furthermore, there is a general belief that Private Capital (both managing owners and private equity funds) are educated to analyse financial data for decision-making, and like a child with a hammer, everything seems like a nail. In our 'non-implementers' group, this feeling is even stronger and respondents – as expected – seem more sceptical about an imminent change from the notion that 'cash is king.'

Nevertheless, they also agree that, over time, institutional stakeholders and international business partners assign a higher value to more comprehensive forms of understanding value in organisations. To some extent, respondents in this group perceive that something is changing in the way they communicate, particularly with institutional, world-class stakeholders.

In our surveys, 70.6% of respondents believe <IR> is the best form of wider corporate reporting compared to the CSR and Sustainability Reporting frameworks which do not involve the financial information as part of the story. To 88% of respondents, <IR> is an improvement in the information management systems of any enterprise.

On the flip side, the current status receives a different perspective. Many respondents still believe – or do not have a clear position – that reports are not reflecting the clearer view about the company and, conversely, are prepared only to tell positive stories.

To what extent do you believe the reports you have read have been prepared for cosmetic purposes?

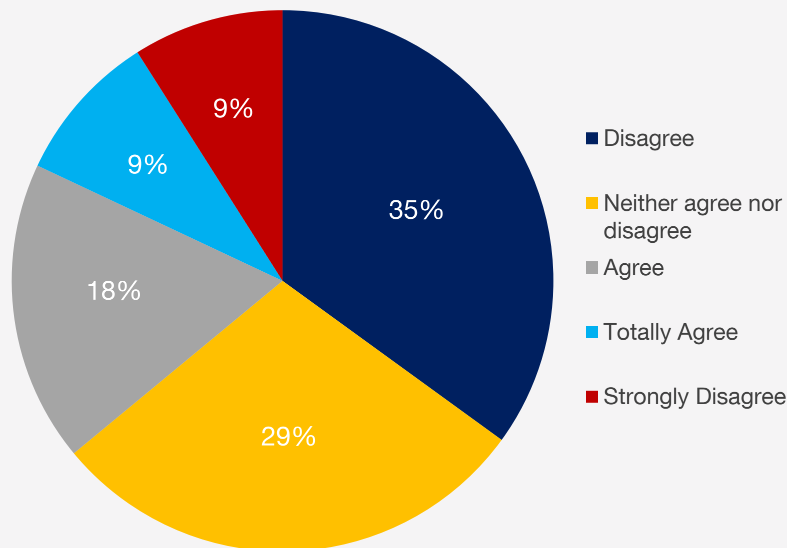

Figure 5

The Relatonship with Providers of Financial Capital

Our last dimension reflects the highlights of the conversation between corporations and providers of financial capital in the private landscape. In our conversations, two aspects appear as the most relevant: the real motivations behind the conversations between them, and some regulatory aspects – limited to Spain – which do not contribute much to proper corporate dialogue.

4

The Relationship with Providers of Financial Capital

1. Real motivations.
2. Minority investors.
3. Worldviews common to the control group.

1. Real motivations

Informed interviewees agree that providers of financial capital sometimes have high aspirational rhetoric at a communications level, but at the operational level, they do not change very much. Interviews suggest that providers of financial capital still pose the same questions because they are still governed by identical risk models they have been using for a long time, those solely based on financial data.

The most drastic suggest that corporate communicational artefacts are in many cases just pomposity, but it is challenging to distil practical insight from them. As per the insights collected, we can hypothesise there is a belief that providers of financial capital are not entirely using the right tone to engage in a productive, straight, conversation. From the moderates, we hear that since banking institutions follow regulatory rules, they could be somewhat constrained in the way they make decisions.

A specific respondent puts it clear: *So far, Banks do not put pressure on nonfinancial reporting, even when they should, as it is convenient for them. That said, if regulation does not put pressure on them, it is not going to happen spontaneously.'*

Finally, when it comes to Private Equity funds, there is a consensus that they mostly focuse on their carried interest rather than on any other perspective. Sometimes, financials are their entire focus, and the conversation about sustainable value seems uncomfortable to them. Even when PE invest in the medium or long-term, they are still unable to connect the dots between integrated thinking, ESG (Environmental, Social, and Governance) stewardship and Internal Rates of Return. As a respondent says regarding Private Equities: *'if the discussion goes beyond compliance, they quickly lose interest.' Another states: 'yes the stewardship positions are growing exponentially, but the relationship between stewards and asset volume remains miserable.'*

2. Minority investors

Our study in Spain indicates that regulations sometimes push this long-term, value-creation message backwards. Due to recent changes in legislation, minority-holders can now claim dividends or, in the case of receiving a negative, they can exercise a right of separation. Such measures could be dangerous as they feed the short-termism instead of a more long-term discourse.

However, the problem is not limited to family businesses. Entrepreneurial businesses looking for Venture Capital investment – this is the case of a technology company we interviewed – could be in a delicate situation if an investor exercises that separation right. Such regulatory interventions respond to specific issues recently seen in court but are not necessarily balanced from an economic perspective and are caused by 'legislative patches.' Measures like this put higher pressure on those who have their skin in the game while favouring those who focus on yearly rents.

3. Worldviews common to the control

The group of companies not applying forms of wider reporting generally recognises that, despite the operational constraints exposed above, some banks are starting to walk the talk, particularly in significant investments where the legal compliance framework is not satisfactory. Some precautionary measures start to appear, in light of events that foster such kinds of thinking (say, corporate scandals, sanctions on unethical R&D, among others).

This group also agrees that the Private Equity sector only follows compliance, and even tolerates some risk-taking in compliance boundaries. Concerning integrated thinking, despite some specific exceptions, they agree they probably never heard about it – particularly when referring to the small-scale companies.

Owning families tend to cultivate a low-profile. Family Offices and similar structures appear not so ‘eager-to-divulge’ first-hand. Although developing corporate offices have informed individuals – many of them well-trained in the current wider reporting views and current economic challenges – they contend with strong beliefs and archaic premises based only on a cash flow rationale.

In our survey, when asked about the capacity of broader corporate reporting to explain the financial results, 85% of respondents believe that the nonfinancial view is essential to understand the ‘what happened’ question and formulate the ‘what could happen’ one.

Conclusions

As the reader may have already noticed, our case study was not oriented to establishing mathematical cause-effect relationships, but to understanding the phenomena through our observations. The conversations held, backed by surveying, allowed us to go deeper into the case, and to pose questions on feelings and beliefs, instead of rationalising inputs that produce outputs through black boxes.

Reputational aspects matters

To our interviewees, reputation is a critical aspect which is not privative of large listed entities. Thus, to some extent, Corporate Social Responsibility and Sustainability are relevant although sometimes a source of confusion with the integrated paradigm proposed by Integrated Reporting. They recognised that the rhetoric of incumbents in their industries is aligned with corporate citizenship values, which allow them to match the 'tone' of what is being said in their industry. Accordingly, that 'tone' is a signal to the rest of the market players to refine messages, although sometimes it ends in overuse of CSR reporting as a mere communicational artefact. Eventually, that bias on the communications' side could divert what is expected to be a frank discussion about value to a simplified version limited to positive stories. To steer the conversation towards a candid business discussion, increased involvement of C-level roles is crucial.

Business Case

Largely, our interviewees considered that understanding their own capital interactions is essential to formulate scenarios. However, due to inadequate training and lack of practice, companies often struggle with designing their capitals model by themselves. Moreover, most respondents confirm they are under pressure to find a business case to integrate fundamental material aspects such as diversity and climate change, but results are disenchanting. On the other side, respondents also reflected that the sole intent of thinking about these issues generates several positive outcomes. For instance, some of them recognised that to cope with these issues, they have learned to make small changes in their nearby ecosystems rather than global, exponential impacts.

Conclusions

We believe this perspective was a suitable alternative since the discipline of broader corporate reporting is still immature, and many of the effects and characteristics cannot be measured without seeing inside that black box. In the following paragraphs, we outline the significant conclusions distilled from our talks.

The challenge of a balanced reporting

As a respondent said, ‘if it is true, it cannot be too positive’. Business life swings like a pendulum, always combining the good with other things that do not go so well. Also, we know that companies learn from making mistakes rather than from success, making it impossible that a ‘good company’ does not have any failure in its record.
In this context, there is no doubt that balanced reporting is critical to managing trade-offs between capitals: taking one capital to the upside represents on many occasions a downside in other capitals. In short: thinking in a perfectly synchronised picture in business is naïve.
Going into more in-depth detail, we realised that deploying a corporate culture proud of its ups and downs is not a trivial issue. One of our interviewees, seasoned in corporate communications at listed companies in the past, told us: ‘*An integrated way of thinking is a challenge for internal and external communications, but the challenge is even more prominent to leaders: corporate character and maturity is what ultimately will decide if the organisation can accept its mistakes in public.’*

What we learned from the non-implementers

The contributions from this group were more rewarding than expected. For our respondents, the direction of corporate reporting is definitively towards integrated ways of thinking and increasing complexity in organisational management, because of increased innovation, a transition of generations in tenure and a continuous flow of new regulations.
On the flip side, companies in this group also perceive that the pace of change – with its effects – is not as urgent as the advocates say it is.
For private companies, cultivating a low-profile still appeared as a dominant aspect, particularly for the family-owned businesses. However, that belief did not seem to be a confirmed fact; unquestionably – as they themselves recognised – it is not the best approach for internal communications, and it is very likely to change as the business and transparency of information grows.

The four dimensions of integrated thinking in private-owned companies (hypothetical framework)

In our study, we explored Integrated Thinking across four dimensions, under which we can find certain aspects to bear in mind for proper strategy execution and reporting.

Through the framework, we were able to outline the conversations and discover what is working for companies, what is still a question, and how we can propose different ways of thinking for the privately-owned entities.

As a result, in the following points, we include some recommendations for private companies to embrace integrated thinking and integrated reporting more effectively, contributing not only to engage in reporting but also to enhance the quality of reporting as a whole in their business ecosystems.

Figure 6: The Four Dimensions

Enabling integrated forms of thinking and reporting: what companies could do

From our talks with implementers, we can distil some ideas which may evolve as this research progresses. With the aim of offering a clear perspective, we have narrowed our scope to three aspects which stand out more than any others.

1. Experiment and put the organisation in learning mode

One of the most common traps when envisioning the organisation's future is the illusion that there is a blueprint. Organisations that have achieved integrated thinking and effective transmission of their strategy seem to have little in common regarding blueprints. Conversely, they show similar behaviours such as a high learning capacity and eagerness to experiment, plus a great ability to get through difficult conversations within the company.

Risk management theories probably do not help companies create new spaces to expand their curiosity, which explains why innovation is a concern and integrated thinking sounds idealistic to many. Even when the phrase talent management repeatedly soars as imperative, many of the reflections collected tell us that a high amount of undesired behaviours are still being rewarded, namely, excessive aversion to risk, lack of entrepreneurship, red-tape, and bad habits, among others.

2. Tone at the top makes the difference

To generate a framework for the organisation to focus on what matters is a leadership responsibility. Perhaps the first lesson we learnt from these dialogues is that a good leader can make the information flow and deliberately create spaces for discussion and reflection, transforming it into a habit.

The building of 'corporate silos' hides a mindset of 'divide and conquer,' which does not match with current times. Although specialisation produces the proper context for addressing complexity and developing mastery, we need to balance from leadership the mechanisms to harmonise both shared value and expert knowledge.

3. Changing to an integrated thinking mood requires CAPEX, OPEX and STRATEX

Throughout the conversations, we noticed that the approach of integrating reporting and strategy is not equipped with enough resources. In some cases, the focus is almost entirely set on institutional communication. However, the real intervention in the corporate structures that put under scrutiny the value creation process requires investment.

Change requires energy, which in business means three things: CAPEX, OPEX and STRATEX. To develop an adequate organisational change, structured capital (CAPEX) investment in intangible assets is required, and this necessarily relates to the adoption of technology needed to ensure proper information and communication flows.
Although integration mechanisms require specific resources to match reporting deadlines, we should not be reductionist and think only of the 'reporting season'; instead, such mechanisms shall be included in the cost structure (OPEX).

Finally, STRATEX, investment in strategy, involves several 'assets' which are hard to record in the balance sheet. Examples of these 'assets' are the time spent on the strategic debate, experimentation and decision-making, as well as the effort involved in exploring best practices outside the corporate limits. This may include, open innovation processes and participation in business ecosystems. Strategic investments like these are vital to understand and activate the interaction between capitals and management systems.

The future outlook and the private-owned companies

As a final remark, in this study, we learned that private companies have high expectations from providers of financial capital as promoters of this integration process of reflection and reporting.

This situation produces (particularly in the Private Equity industry) a growing need for processes and mechanisms of stewardship that contemplate the new trends, not only ESG (Environmental, Social, and Governance) but also the proper management of relationships with stakeholders.

Improvement in this way will only be possible through effective mechanisms for dialogue, direct talks followed by concrete action plans that allow the previously mentioned 'experimentation mood' and, during this process, a hefty dose of collaboration to develop understandable value-creation models considering the scenarios characterised by scarcity of resources, emerging forms of risks, and integrated strategy.

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