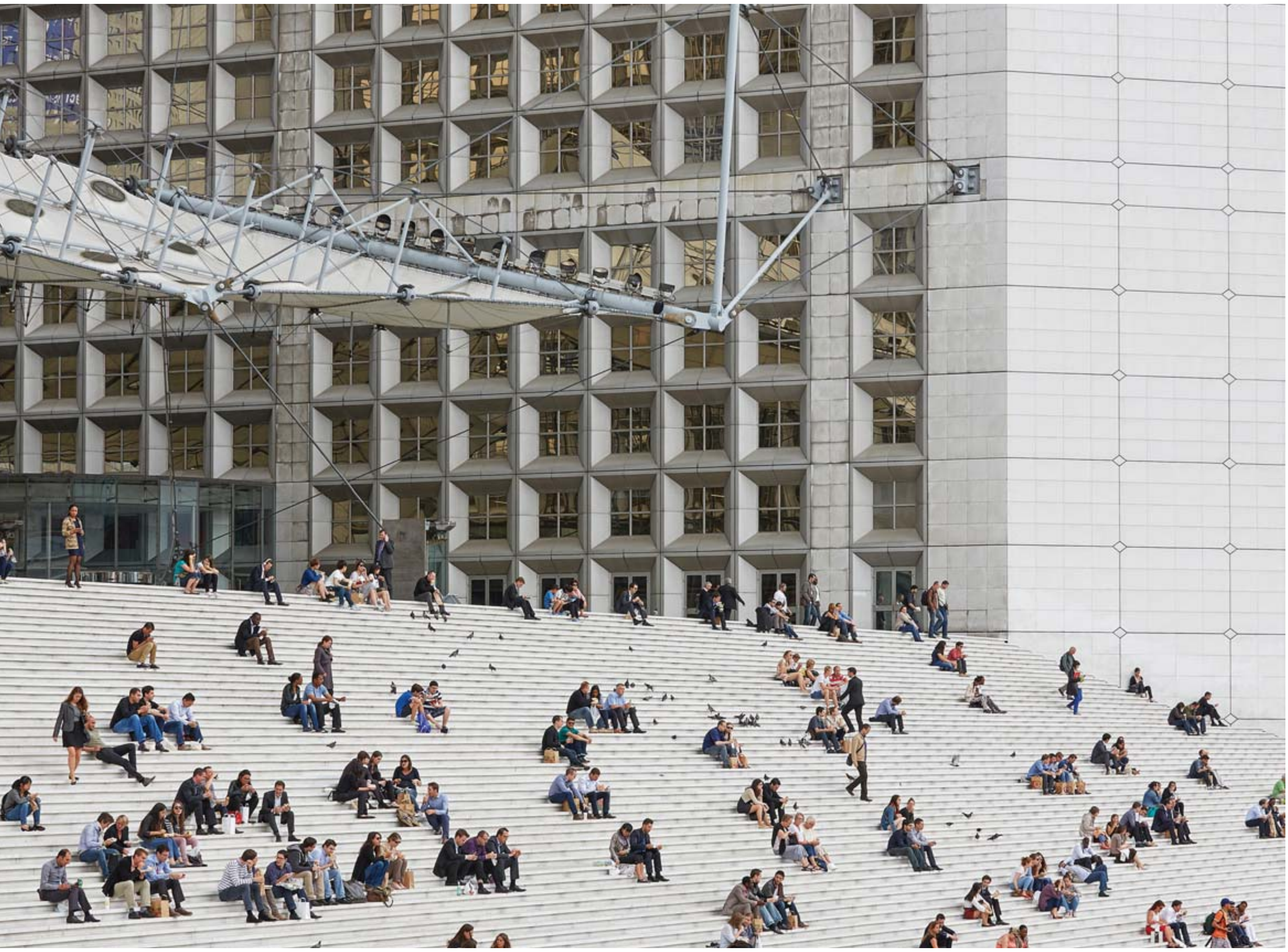
Integrated Reporting
Multi-capital reporting in India



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Background

Accounting practices have evolved through centuries to more complex financial reporting systems in place today. The focus has always been to report on the traditional definition of 'capital', which represents money and assets available for production. While till now this was adequate, the definition of value is shifting to become more inclusive of a multi-capital approach beyond financials into intangibles, non-financials or sustainability driven aspects. Corporate reporting is also evolving to become more holistic in capturing the ability of an organisation to create and impact value. Today more than 80% of the value of S&P 500 companies[1] can be attributed to intangibles such as brand value, human capital, technology-related assets and similar.

In a recent survey of global CEOs and investors[2] by PwC, it was observed that the risks and challenges that investors are highly concerned about consist of geopolitical issues, social instability, climate change etc. It is apparent that investor concerns reflect the need for information that is more holistic and comprehensive and not just about the financial aspects, but also economic, policy, social and environmental aspects that impact company's growth prospects. Another PwC publication,[3] which surveyed investors globally, found that 80% of respondents' perception of the quality of a company's reporting impacts their perception of the quality of its management. In addition, 82% of investment professionals surveyed revealed that when companies present information clearly and concisely, they feel more confident in their own analyses.

Integrated Reporting (<IR>), is a market-led response to this growing expectation for evolution in corporate reporting. It aims to improve the quality of information available, by communicating a broader range of relevant information through a value creation and six capital approach that can help investors understand the company and its prospects better.

Climate change and scarcity of resources compelled a broadening of the term 'capitals' to include natural aspects such as raw material, water, energy and similar. Progressive reporting further broadens the understanding to include other 'capitals' that store value that can be enhanced, consumed, modified, destroyed or otherwise affected by an organisation and its activities. Therefore to get the full picture of an organisation's ability to create value, all the relevant capitals need to be clearly understood and reported on. <IR> provides a framework for companies to internalise and report on how a company creates value using these capitals. Globally <IR> has been adopted by 1500+ companies[4] either voluntarily or through regulatory requirements. In India, the Securities and Exchange Board of India (SEBI) issued a circular in February 2017 recommending top-500 listed companies to adopt the <IR> framework for reporting.[5]

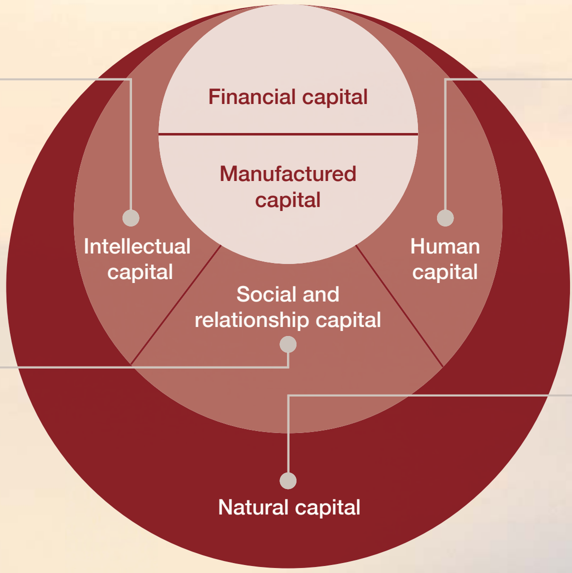
The **Six Capitals** are classified as financial, manufactured, natural, human, social and relationship, and intellectual capital. Globally, more than 1,500 companies[4] have adopted the <IR> principles to embed multi-capitalism in their internal thinking and external reporting. The figure provides the definition for each capital and highlights the relationship between various capitals, where in the environment encompasses all other capitals.

1. (2017). Intangible Asset Market Value Study, Oceantomo.
2. (2018). 2018 Global Investor Survey: Anxious Optimism in a complex world, PwC
3. (September, 2014). Corporate Performance: What do investors want to know, PwC
4. integratedreporting.org
5. (2017, February 6) Integrated Reporting by listed companies, Securities Exchange Board of India Circular CIRCULARSEBI/HO/CFD/CMD/CIR/P/2017/10

Depiction of capitals

This diagram[6] is one way to depict the capitals. Financial and manufactured capitals are the ones organizations most commonly report on. <IR> takes a broader view by also considering intellectual, social and relationship, and human capitals (all of which are linked to the activities of humans) and natural capital (which provides the environment in which the other capitals sit).

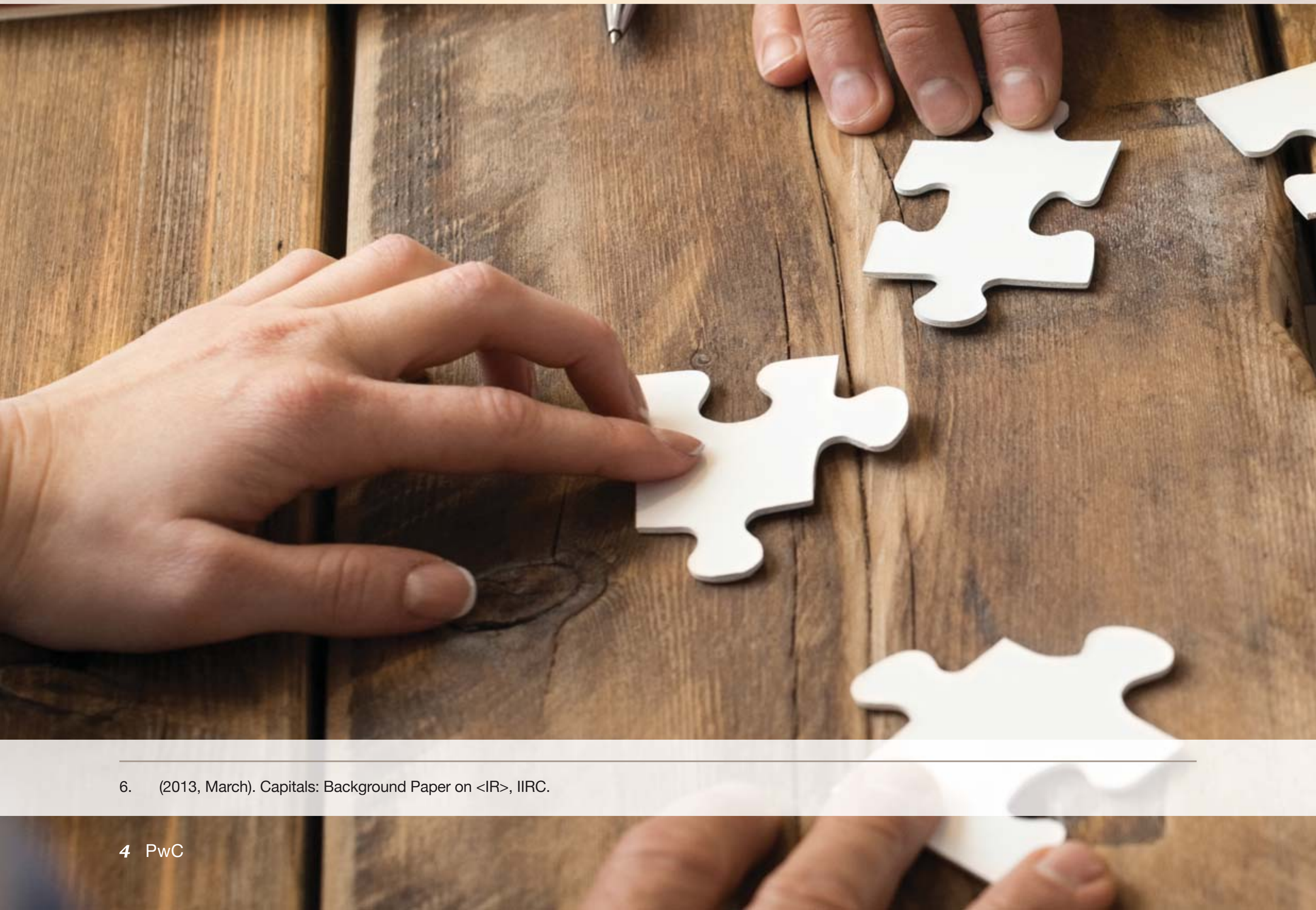
Intellectual capital is a new key element that broadly includes organisational knowledge-based intangibles such as intellectual property (like patents, copyrights, and licenses), investment in R&D and innovation.



Human capital is a competitive intangible asset. It embodies competencies, capabilities and experience. It is an opportunity to value the diverse cultural attributes and strengths of employees and people associated with the organisation.

Social and relationship capital of the organisation with other institutes, with communities, groups of stakeholders and the society at large.

Natural capital includes all renewable and non-renewable environmental resources and processes that provide goods or services which includes air, water, land, minerals, forest, biodiversity and eco - systems.



6. (2013, March). Capitals: Background Paper on <IR>, IIRC.

With the above background, PwC analysed 20 top-tier publicly listed companies (sectoral representation in figure) in India to understand the prevalence of reporting of aspects that go beyond traditional accounting practices. The concept of six capitals that form the <IR> framework[7] was used as the basis for this study. Annual reports, sustainability reports and/or integrated reports (early adopters) were reviewed to see how these companies internalised and communicated on different capitals.

Sectoral representation of the study sample

7. (2013, December) International Integrated Reporting Council, The international <IR> framework, IIRC.

Reporting across capitals

Review of top-tier reports suggests that companies have made significant headway on non-financial aspects, which has been driven by various regulatory expectations such as:

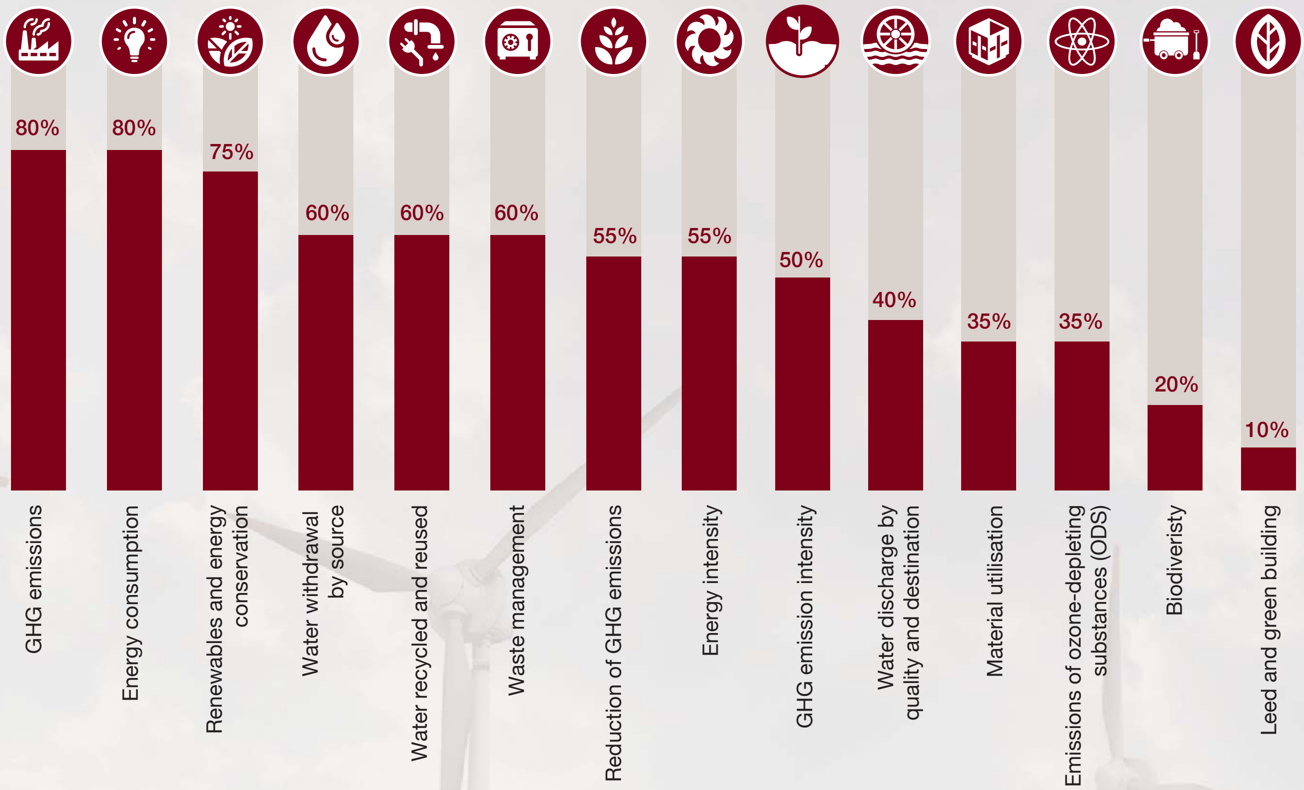
- Governance reporting pursuant to SEBI listing requirements
- CSR reporting driven by Companies Act 2013
- Environmental and social principles driven by Business Responsibility Reporting for top-500 listed companies
- Securities Exchange Board of India (SEBI) recommendation that top-500 listed companies to consider using the IIRC Integrated Reporting <IR> framework[8]

Beyond this, some companies have also voluntarily adopted sustainability reporting. Consequently, this research identified non-financial aspects that are being reported on frequently as well as some newer indicators being used across sectors.

8. (2017, February 6) Integrated Reporting by listed companies, Securities Exchange Board of India Circular CIRCULARSEBI/HO/CFD/CMD/CIR/P/2017/10

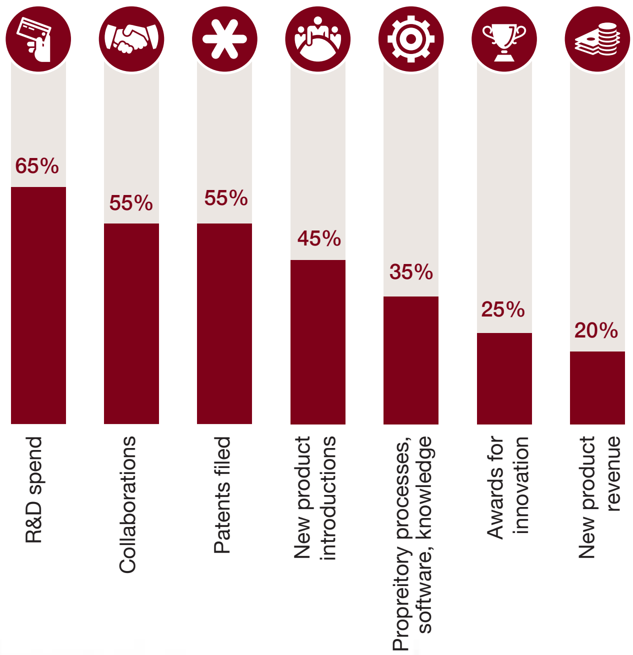
The following charts present frequently used indicators across each capital and the percentage of companies (out of 20) reporting on those indicators. While financial capital and manufactured capital continues to be of predominance in reporting, this study primarily focuses on aspects beyond that, which based on the <IR> framework, are natural, social and relationship, human and intellectual capitals.

Natural capital*

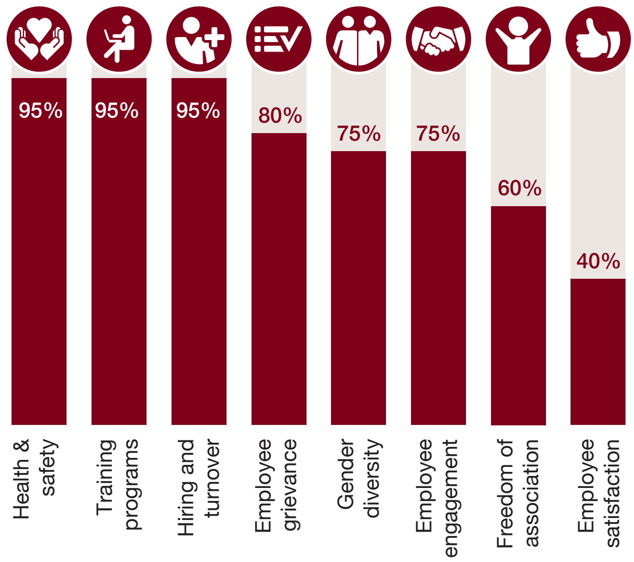


*Percentage of sample companies reporting on the different indicators

Intellectual capital*

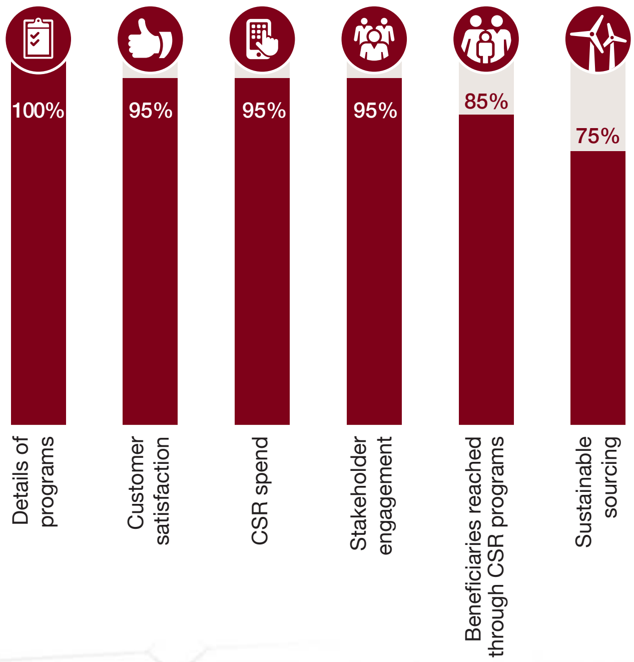


Human capital*



*Percentage of sample companies reporting on the different indicators

Social and relationship capital*



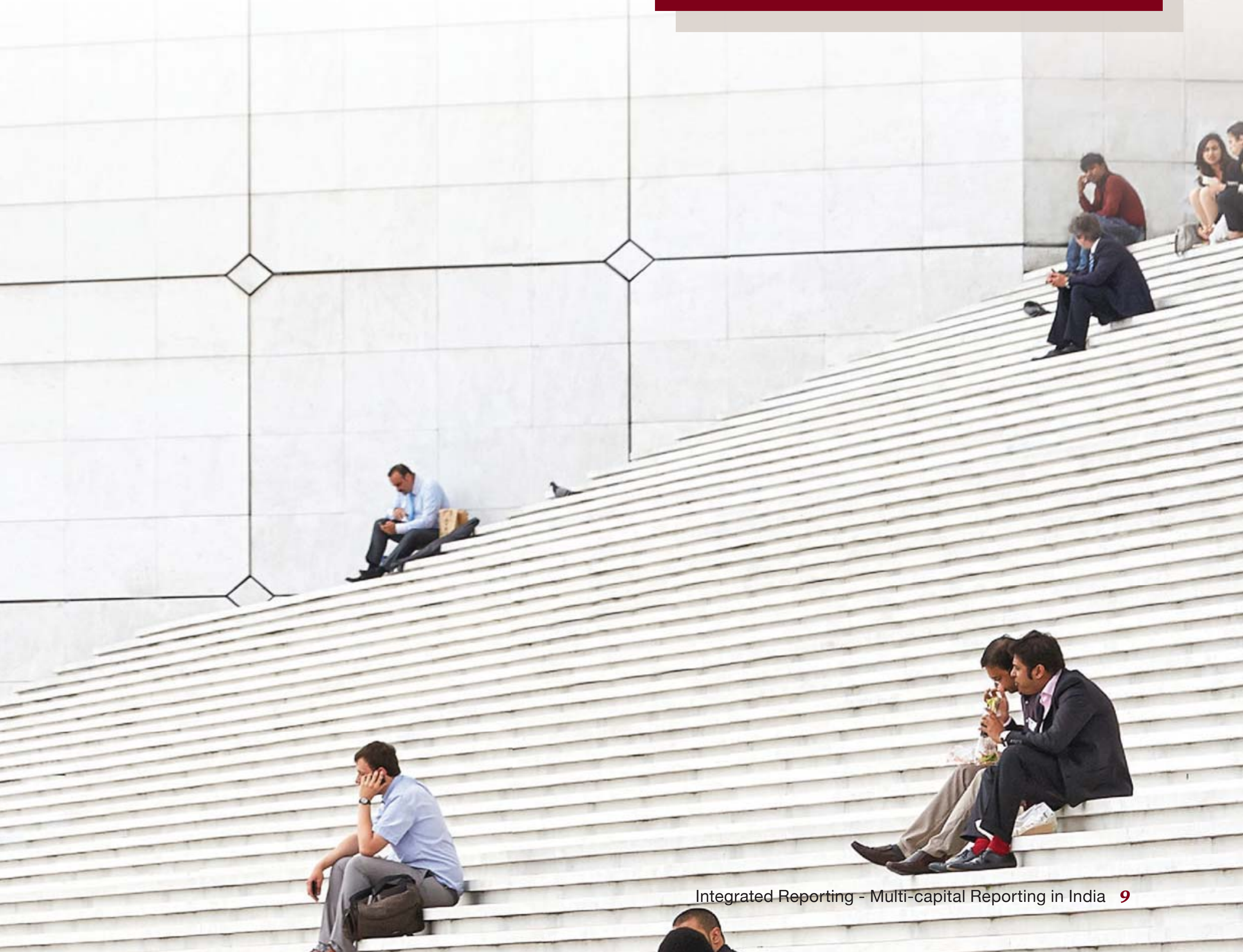
*Percentage of sample companies reporting on the different indicators

Besides the ones represented in the graphs, there are some notable new indicators such as:

- Circular economy
- Internal carbon pricing
- Number of patents granted
- Social returns
- Technological advancements such as artificial intelligence, block-chain, cloud-based energy management and data analytics

Companies on the <IR> journey fared better at integrating the capitals with other aspects of the business such as:

- Defining materiality with an investor perspective
- Linking key capitals with business model and strategy
- Linking key capitals with risks and opportunities
- Providing future targets for key capitals



Connecting capitals through <IR>

Materiality and connectivity of capitals

An organisation creates value through a proper execution of its business model. The inter-relationship between the business model, capitals, external and internal environment impacts the ability to create and sustain value. Traditional reporting follows a linear model wherein relevant information on business, risks and opportunities, sustainability aspects and similar are provided in silos. Therefore, despite the deluge of reports and data, there is still a perception of gap in reporting.

<IR> Framework is based on the value creation model that links capitals across the entire business process as inputs, outputs and outcomes. Materiality and connectivity are two key guiding principles of the <IR> Framework, which can be used to make investor communication more comprehensive and concise. Companies can use this framework to adequately assess, understand and communicate these interrelationships.

Materiality enables:

- Looking at material matters from an investor perspective
- Prioritising strategic issues that are materially more important
- Reporting on those capitals that are materially more relevant

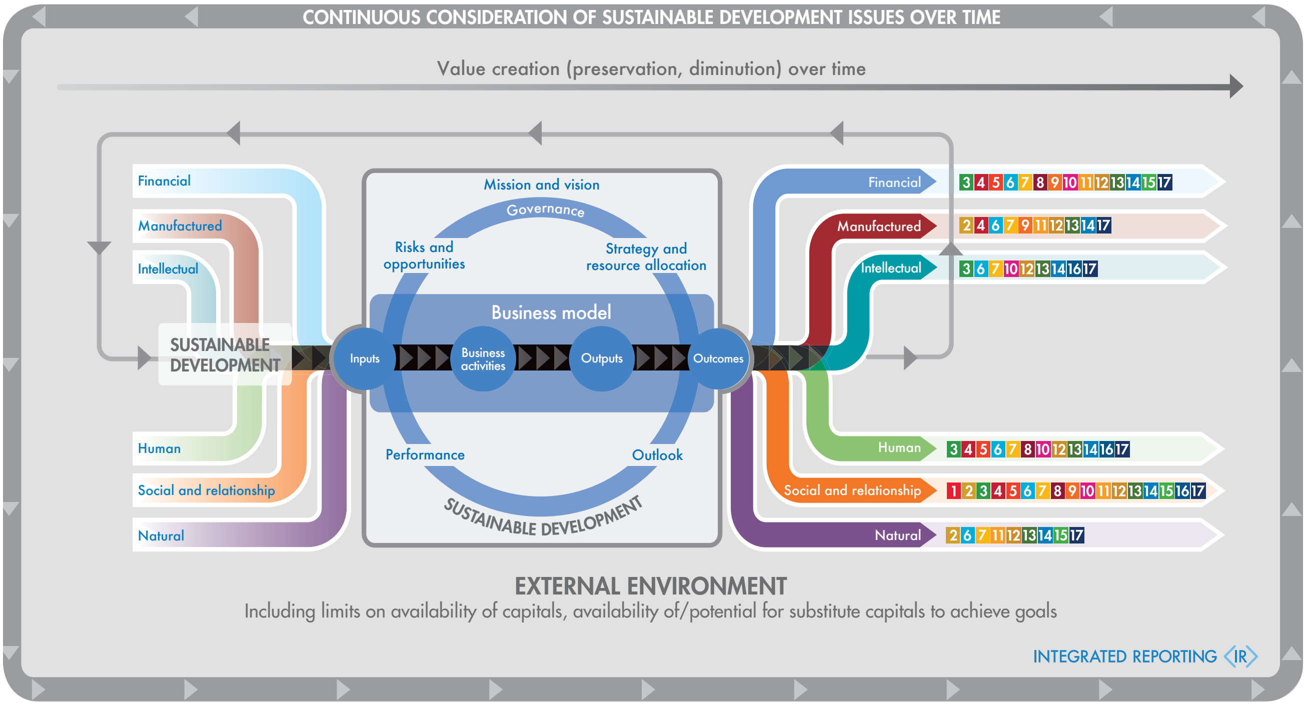
Connectivity enables:

- Exploring relationships between the capitals, that is, how a change in one can impact another
- Understanding impact of capital on business model and strategies
- Linking capitals to key performance indicators
- Effectively linking risks and opportunities

Connecting capitals to Sustainable Development Goals

Capitals are also relevant to deliver on the new trends on reporting such as the **Sustainable Development Goals** (SDGs) and provide information to investors on broader aspects of global risks. SDGs are 17 interconnected goals that are a universal call to action to end poverty, protect the planet and ensure all people enjoy peace and prosperity. The six capital framework can provide businesses the opportunity to communicate their impacts on these SDGs.[9]

Aligning the SDG's with the value creation process[9]



The UN Sustainable Development Goals

9. Adams, C A (2017) 'The Sustainable Development Goals, integrated thinking and the integrated report', published by the IIRC and ICAS

Connecting capitals to business risks

Capitals can also help companies understand and manage risks that is critical for both CEOs and investors. The 2018 PwC survey of global investors[10] highlighted risks such as technological advancements, cyber threats, climate change, trust, demographics and similar. It should be noted that capitals interact and impact each other. The chart below is a suggested mapping of various risks across different capitals. For this mapping, only those risks, which are relevant to the intellectual, human, natural and social and relationship capitals have been included.

Linking business risks with the capitals

	Intellectual	Human	Natural	Social and Relationship
Business risks	• Cyber threats • Protectionism • Speed of technological change	• Availability of key skills • Readiness to respond to crisis • Rising employee benfits and persion costs • Unemployment • Changing working demographics	• Climate change and environmental damage • Supply chain disruption • Volatile energy costs	• Activist investors or other campaigners • Changing consumer behaviour • Geopolitical uncertainty • Lack of trust in business • New market entrants • Over-regulation • Populism • Potential ethical scandals • Social instability • Terrorism

Disclaimer: The above chart categorises business risks (from the 2018 PwC Global Investors Survey) to the most relevant capital and is for illustration only. It should be noted that in real business situations, risks may impact more than one capital.

10. (2018). 2018 Global Investor Survey: Anxious Optimism in a complex world, PwC

Integrated thinking to drive a multi-capital approach

Connecting capitals across the report helps communicate the bigger picture by identifying the most significant considerations for value creation. It enables consistent message that minimises disclosure gaps by showing a comprehensive picture of the organisation in a dynamic model, with due consideration to the interests and needs of report users. To visually connect elements of a report, the organisation should utilise technology, navigational icons, cross-referencing and similar. As Indian companies move forward, reporting across capitals is expected to become multi-dimensional to present a more holistic picture to the user.

An active and transparent board is the core of good business reporting. Directors of a company occupy their positions in a fiduciary capacity and are vested with the responsibility to maximise a company's overall economic value to ensure best use of enterprise capital. Accordingly, it's the governance team, which needs to take the overall responsibility for driving the agenda for the integrated report to meet the information need of capital providers. To do this, the board needs to embed **integrated thinking** into every decision made by them and in the organisation's management and in its staff who have an active role to play in accumulation and dissemination of information.

Integrated thinking[11] takes into account the connectivity and interdependencies between various factors affecting the value creation model of an organisation. Embedding a multi-capital approach to integrated thinking into an organisation's activities would facilitate uninterrupted flow of information required for management reporting, analysis and decision making. It also leads to better integration of information systems that support internal and external reporting and communication, including preparation of the integrated report. Integrated thinking helps in embracing a culture shift required for cross functional collaboration.

Embedding the concept of integrated thinking requires organisations to embrace changes to behavior, culture and leadership support, and may require them to make changes to its process and tools. It pushes for a balance between financial and non-financial capitals to capture a broader understanding of all key value drivers. Companies can institute the right incentive structure to encourage decision-makers to take choices that will create value for the short, medium and long term. Only a holistic long-term perspective on stakeholder value will help ensure that the organisation sustains for a long term in today's fast-changing world.

11. (February, 2016). Joining the Dots, CGMA.

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