Integrated Reporting: Learning from industry leaders

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The Dow Jones Sustainability Index (DJSI) 2016 results came out last month[1] giving companies around the world an opportunity to reflect on their progress and assess areas for improvements. Whilst this can be a frustrating moment for those that were not recognised as part of the top 10% performers in their sectors, it also provides a chance to identify emerging good practices. In particular, how are integrated reporting practices evolving amongst companies that have been recognised as industry leaders?

We focus on this question because our previous data analysis has shown that integrated reporting is strongly correlated with overall sustainability performance and can therefore be used by investors as a lead indicator for quality of management[2]. Furthermore mainstream investors are more likely to look at sustainability initiatives in the context of the firm's overall strategy and therefore expect to find this information integrated in the relevant sections of the companies' annual reports.

Looking through the 2015 annual reports of several recognised industry leaders[3], we identified some interesting examples from different industries and regions which illustrate how companies are incorporating relevant sustainability information in their standard reporting to investors.

Selected industry leaders:

- *Siam Cement* - Thai company operating in the construction sector
- *Svenska Cellulosa* - Swedish company producing household and personal products
- *CNH Industrial* - Italian company producing agricultural and construction equipment
- *BMW* - German auto manufacturer

Including the most material environmental, social and business ethics issues in the annual report

Evaluating companies' approaches to reporting material sustainability issues directly to investors through their annual reports has been part of the RobecoSAM's corporate sustainability assessment performed for the DJSI since 2009. Last year this aspect was given more prominence in the assessment and became a standalone criteria in the Economic dimension. This suggests that the topic is of growing interest to investors

[1] http://www.robecosam.com/en/sustainability-insights/about-sustainability/corporate-sustainability-assessment/review.jsp

[2] For more information, please see "Integrated Reporting, Quality of Management and Financial Performance" published by Cecile Churet and Prof. Robert Eccles in the Journal for Applied Corporate Finance (Winter 2014).

[3] http://www.robecosam.com/en/sustainability-insights/about-sustainability/corporate-sustainability-assessment/industry-group-leaders.jsp and RobecoSAM Sustainability Yearbook 2016.

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interested in understanding the financial relevance of companies' sustainability strategies.

Selected examples of materiality reviews:

Svenska Cellulosa, BMW and CNH Industrial communicated the results of their materiality analysis to investors in their annual report, identifying the most material social and environmental issues that could impact the long-term performance of their business.

CNH Industrial and BMW indicated that the most focus of their R&D strategy is on improving safety and energy efficiency of their fleet. In its review of business operations, Siam Cement highlighted key sustainable development initiatives relating to manufacturing processes and product development, alongside operating results, general market developments and organisational developments, giving investors a more complete picture of the way it manages key aspects of the business.

Whilst corporates across industries and regions are paying more attention to this trend and stepping up their efforts to supply investors with integrated reports[4], there is still some room for improvements to deliver this information in a useful way to analysts and portfolio managers.

The new DJSI "Materiality" criterion was one of the criteria where companies scored the lowest in the entire 2016 assessment. According to the <IR> example database, only 4 annual reports had a focus on materiality in the 2015 reporting cycle, and so far none have been identified for the 2016 reporting cycle[5].

Highlighting key environmental and social risks in standard risk management discussions

Because environmental and social issues represent new sources of risks and opportunities for companies, the most material ones should be included in standard risk management sections of the annual report. By demonstrating their understanding of these emerging risks and the measures they have adopted to mitigate their risks, companies can improve investors' confidence in their ability to protect their license to operate, innovate and grow.

Selected examples of integrated risks management frameworks:

In its combined management report on outlook, risks and opportunities, BMW discussed their ongoing efforts to reduce the carbon emissions of their fleet through its investment in Efficiency Dynamics technology, implement a strategic approach to the management of its human resources and reduce purchasing risks by ensuring that

[4] The GRI has tracked 627 companies publishing "integrated reports" for the 2014/15 reporting cycle, and 147 so far for the 2015/16 reporting cycle. This figure may sound impressive but it can be misleading as it includes sustainability reports, as well as annual reports, whereas the concept of integrated reports usually applies only to the integration of sustainability information in annual reports. http://database.globalreporting.org/search – accessed on 13 September 2016.

[5] http://examples.integratedreporting.org/home - accessed on 13 September 2016.

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suppliers comply with BMW's Group Sustainability Standards.

Siam Cement included a comprehensive review of 10 ESG issues in their risk management discussion, discussed key risks, mitigation plans and related long-term business opportunities.

Alongside business and economic risks, Svenska Cellulosa also reviewed environmental risks, employees- and suppliers-related risks, and business ethics risks in its Risks Management report and provided an overview of the company's policies and actions in these areas.

Besides highlighting the risks related to environmental and social issues, companies should also focus on the opportunities and help investors understand the importance of managing these long-term driving forces to securing and growing their market share, improving their costs base and maintaining their competitiveness.

Quantifying sustainable value creation

Measuring the impacts of their sustainability activities and how it contributes to their revenue growth and cost savings initiatives provides investors with valuable information that can be integrated in their financial analysis and valuation models.

Selected examples of quantified impacts:

Svenska Cellulosa and BMW, for instance, provided a breakdown of the economic value they created for each stakeholder group (including for employees through salaries and social security contributions and society through taxes).

Thanks to its CREATE ideas management system, BMW estimated that it saved € 17.5 million in 2015 by implementing employees' ideas on how to improve the sustainability of the group's business operations.

More companies are experimenting with triple bottom line accounting approaches and are trying to quantify some aspects of their sustainable value creation so it can be linked it to their standard financial reporting. Few however are able to offer a comprehensive picture of the aggregated savings and share of revenues growth generated by their sustainability-oriented business strategies.

Next steps for Investors Relations teams?

Developments in integrated reporting are welcome in that they help improve the information flow and the dialogue between companies and investors. A recently published engagement guidebook for investors[6] suggests that the material environmental and social issues included by industry leaders in their annual reports are clearly relevant for asset managers assessing investment opportunities in these sectors. Investor Relations teams, and more importantly CEOs, CFOs and Chairmen

[6] SASB Engagement Guide for Asset Owners and Asset Managers (July 2016)

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of the Board, should therefore proactively communicate these issues and develop an effective communication strategy to improve their dialogue with investors on long-term issues.

As they develop their communication strategy for 2017, the following practical steps could enable companies to review of the effectiveness of their current communication approach and identify areas for improvements:

(1) Ensure that the most material issues identified by investors are included in an integrated manner in their annual report and main communication vehicles

(2) Assess whether communication activities have proved effective so far to reach a clearly identified target group of investors who value this type of information to inform their investment decisions.

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