

***Corporate performance:  
What do investors want to know?***  
Powerful stories through integrated reporting

September 2014





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# Introduction

## *The growing importance of integrated reporting*

Understanding the needs of investors and analysts is crucial if management teams are to maximise the effectiveness of their formal reporting to the capital markets. This report, the second in our series analysing the broader information needs of investment professionals, focuses on how management teams can best tell their performance story through more integrated corporate reporting<sup>1</sup>.

Over the last several years drivers of business value have changed. Market capitalisation is now largely determined by intangible values<sup>2</sup>. Business leaders now recognise the need to consider and report on wider business issues: 74% of CEOs say that measuring and reporting the total impact of their company's activities across social, environmental, fiscal and economic dimensions contributes to long term success<sup>3</sup>. This could encompass the company's social effect on the health and education of the communities in which it operates; its environmental effect on the air, land and water; its fiscal effect on public coffers; and its economic effect in terms of value added to the economy or jobs created. Meanwhile investment professionals consistently tell us that when they read company reports, the strategy, business model, risks and performance metrics are all important to their analysis, as are wider market factors, relationships and dependencies.

The majority of current reporting frameworks, however, are not set up to support the communication of such wide-ranging information – nor to link all the different elements of the corporate story, from strategy through to performance measures. They remain focused on historic, financial performance, with information on other topics often presented in silos.

Initiatives are underway to change this, such as the International Integrated Reporting <IR> Framework developed by the International Integrated Reporting Council (IIRC). Companies applying the framework may benefit from more integrated decision-making within their organisation, as well as more insightful reports to the market. Other organisations – such as the Sustainability Accounting Standards Board, the Global Reporting Initiative and Accounting for Sustainability – are also driving change. Evidence suggests global momentum behind more integrated reporting is building in boardrooms too. Many businesses say they have begun an integrated reporting journey, including Clorox and PepsiCo in the US, HSBC and Aviva in the UK, Bayer in Germany, Aegon in the Netherlands, DBS Bank in Singapore and Tata Steel in India.

More integrated reporting, supported by better disclosures about key business relationships and outcomes, should provide users of reports with a more comprehensive understanding of the risks and longevity of individual business models. Management teams who tell a clear business story – flowing from strategy, to business model, to risk management and cash generation – can anticipate greater market confidence in their company's resilience and ultimately an impact to cost of capital.

This report makes reference to the <IR> Framework. The underlying principles are fundamental to integrated reporting more generally.

We interviewed 85 investment professionals from around the world, gaining insights into how integrated reporting can deliver the most value to them – and potential areas for improving current reporting.

<sup>1</sup> See also the first in the series, [Reporting adjusted performance measures](#), and look out for our future publication describing investment professionals' views on financial statement note disclosures.

<sup>2</sup> [An analysis of the S&P 500 by Intellectual Asset Management magazine found that only 16.8% of market capitalisation was based on intangible book values in 1975. By 2005 that had become 79.7%.](#)

<sup>3</sup> [PwC's 2014 CEO survey](#).

# Executive summary

## *More integrated reporting could enhance investment professionals' analysis*

Investment professionals have a challenging job: gaining an understanding of how a company's business model operates, how management strategies are being implemented, and how that translates into performance and value creation is not easy. Management teams that provide high-quality, integrated reporting across all channels that tells a clear story not only help investment professionals but also enhance their own reputations and capital-raising potential.

With the growing momentum towards more future-orientated integrated reporting, we asked investment professionals around the world for their views on what constitutes useful corporate reporting and where they see opportunities for management teams to improve on today's reporting. They told us:

- The quality of a company's reporting impacts their perception of management quality. Reporting quality could even have a direct financial impact for companies: only 11% of survey participants disagree with the idea that annual report disclosures about strategy, risks, opportunities and other value drivers can have a direct impact on a company's cost of capital.
- Explaining the business model clearly is an important part of high-quality reporting. Most investment professionals primarily want business model explanations to focus on how a company generates cash and generates value that will become cash in the future. There is considerable scope for improving the effectiveness of company reporting in these areas, and on dependencies on key relationships and resources.

- In order to be meaningful, an explanation of a company's business model needs to link to its overall strategy. Reporting on strategy should then include key priorities and actions to allow the company to meet its objectives, and progress made against them. This need for management teams to tell an integrated and coherent story – across strategy, business model, risks, resource dependencies and performance – is raised regularly in our conversations with investment professionals.
- There are a number of 'effectiveness gaps' in the reporting of key risks to the business model. Investment professionals want to know how these risks are managed or mitigated. However, although understanding management's view of potential risks and their mitigation strategies is important, too much boilerplate disclosure is impeding that understanding.
- Operational Key Performance Indicators (KPIs) are almost as important as financial KPIs for company analysis and could be reported more effectively by many companies. The majority (75%) of investment professionals surveyed would like to see a clear link from KPIs to remuneration policies.
- They like to see linkage between different elements of company reporting. Among those we surveyed, 87% say that clear links between a company's strategic goals, risks, KPIs and financial statements is helpful for their analysis.
- The annual report remains a valuable source document, not only for financial information but also in relation to governance matters and environmental, social and human capital topics. It is also important for explaining strategy, risks and opportunities. The reliability and comprehensiveness of the annual report are its key strengths.

## Principles for higher quality, more integrated reporting

Management teams could potentially improve the usefulness of their reporting by applying some basic principles to the critical building blocks below. The goal is to present the story of your business in a way that maximises investor confidence in both the quality of information and the quality of management.

### Business model

- Explain your business model clearly and concisely at both group and segment level.
- Consider including a diagrammatic representation, accompanied by complementary narrative.
- Although there may be some sensitivity around competitive advantage, think about whether you have addressed the key elements that investment professionals want to understand – for example:
  - how cash and capital flow through your business model
  - dependencies on key relationships and resources
  - your company's position in the wider value chain
  - key dependencies on the future supply of resources, and your impact on that supply.

### Strategy

- Are you answering the questions investment professionals are likely to have? For example:
  - What are your strategic goals and priorities?
  - How are you going to achieve them?
  - How are you positioned in the wider market?
  - How far have you progressed against long-term goals?
  - If things are changing, why?

### Risk

- Be detailed and company-specific in your description of risks. Be clear that you are giving management's view, and explain your risk management and mitigation actions.

- Make sure your risk reporting links to your business model, strategy and financial performance.

### KPIs

- Explicitly identify your KPIs.
- Explain why the KPIs you have chosen are relevant to understanding the performance of your business.
- Explain the link between your strategy, key risks and KPIs.
- Be clear about how KPIs link to remuneration policies.

### Linkage

- Step back: is there a clear information flow from strategy, business model and risks through to KPIs and financial performance?
- Consider the ease of navigation through your reporting documents. Could you add some linkage or colour-coding to help investment professionals find the information they need?
- Assess other forms of communication: does your investor presentation refer to relevant parts of your annual report? Could you go the next step and use electronic links in your reporting to the market?

### Annual report and other channels

- Make sure your annual report tells your story as clearly as possible. This story and your key messages should also be presented clearly and consistently across all other communication channels to the market.
- Consider how best to convince the users of the reports that the messages you are delivering can be relied upon.
- Consider your ability to control the data sources used by investment professionals. Could providing high-quality downloadable data help you improve the way you engage with your shareholders and analysts?



# Survey findings

*“We take a dim view of companies that report badly. It tends to be poorly governed companies that report badly, so we will be more sceptical when it comes to a capital-raising or debt issuance. Companies that report better are more likely to get long-term investment.”*

*“A long and rambling report can suggest a lack of management focus. Good reporting in my view shows management have good attention to detail.”*

*“Transparency of reporting is a credit ratings factor; poor transparency can have a negative effect.”*

It is easy to assume that, when assessing a business, investment professionals care only about the numbers – particularly the cash flows and financial performance. While these are important, high-quality contextual information is also crucial for gaining a real understanding of the business. Adding insightful context to the numbers enables management teams to communicate their company’s story, not only in relation to the past, but also in terms of where the business is heading in future.

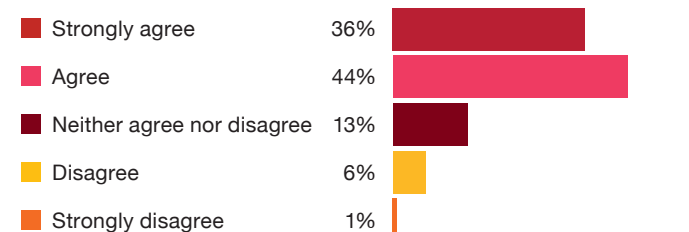
In this survey, we asked investment professionals to consider all elements of formal company reporting, including annual reports, investor presentations, websites and press releases – any information provided by the company to the market. Their responses highlight the information they find useful, the importance of an integrated approach, and ways in which current reporting could be improved. Management teams that get their reporting right can enhance their own reputation and their company’s capital- and debt-raising opportunities.

## Higher quality corporate reporting suggests higher quality management

Management teams have many demands on their time, so why prioritise corporate reporting? Because investment professionals tell us that the quality of a company’s formal reporting can have both a direct and an indirect effect on their investment decisions.

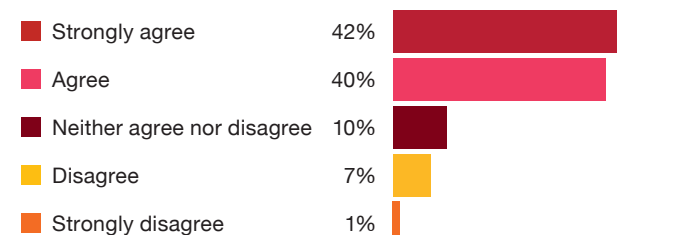
This impact is partly felt in relation to investors’ and analysts’ perceptions of management. In our survey, 80% of respondents say their perception of the quality of a company’s reporting affects their perception of the quality of its management. Only 7% disagree.

My perception of the quality of a company’s reporting impacts my perception of the quality of its management



The quality of reporting doesn’t only influence perceptions of management quality; 82% of investment professionals surveyed feel more confident in their own analysis when companies present information clearly and concisely. This could have repercussions for companies’ ability to raise finance over time. Those perceived as providing clear and concise information could benefit from a lower uncertainty or risk premium.

When companies present information clearly and concisely, I feel more confident in my analysis



Survey findings (continued)

*“The disclosures in an annual report about strategy, risks and opportunities and other value drivers] are important because they impact your view of management, and that impacts your decisions of whether or not you might invest. It can also impact any kind of risk premium that you want to apply when you are thinking about long-term cash generation.”*

*“It’s really more of an indirect impact; you need to understand these business model and strategy points in order to be able to make sense of the financials.”*

*“It might not directly inform the investment decision, but it definitely informs our process and it informs our understanding of the financial statements – so has an impact, in an indirect way.”*

Our survey findings suggest clear repercussions for the cost of capital: only 11% of survey respondents do not believe that disclosures in an annual report about strategy, risks and opportunities and other value drivers can have a direct impact on a company’s cost of capital.



Even when investment professionals don’t see a direct link, the quality of disclosures about strategy, risks, opportunities and other value drivers could have an indirect impact on the cost of capital. This may help to explain the 26% of survey participants who neither agree nor disagree that a direct impact is felt.

These results send a clear message to management teams: the quality and transparency of your external reporting is important. It affects not only investment professionals’ perception of you in terms of management quality, but can also have a direct impact on uncertainty premiums and your company’s cost of capital.

**Action**

Consider whether your reporting presents the story of your business in a way that maximises investor confidence in the quality of information and the quality of management.

*Business model disclosures should be detailed and linked to strategy*

Companies are required to report on business models under many reporting regulations. For example, in the EU, this information is required by the EU’s non-financial disclosure directive. Integrated reporting regulatory requirements have also been introduced in countries such as South Africa and Brazil. But what constitutes good business model reporting? What are the information points that really add value to investment professionals, and how effectively do companies report that information?

Our survey of investment professionals shows that they consider a company’s overall explanation of its business model to be important for analysis purposes. Investment professionals also place high importance on management’s explanations about how the company generates cash and how it creates value. The need for a broader understanding of the environment in which companies operate is indicated by the substantial importance placed on information about dependencies on key relationships and resources, the position of the business in the wider value chain, and the company’s dependency and impact on the future supply of resources. Investment professionals want a clear understanding of how a company is positioned in its market and its operating environment. They want to understand its impact on infrastructure, government tax revenues and communities, and its exposure to constrained resources such as water and to uncertain raw materials costs.

This information is highly valued by investment professionals, but it is not necessarily communicated clearly by companies. Our research identifies some substantial ‘effectiveness gaps’ – particularly in relation to how companies create value and



Survey findings (continued)

“An organization’s business model is its system of transforming inputs, through its business activities, into outputs and outcomes that aims to fulfil the organization’s strategic purposes and create value over the short, medium and long term.”

IIRC’s International Integrated Reporting <IR> framework

“It’s incredibly important for an analyst to understand the company’s business model.”

“Sometimes with a complicated business you can’t understand it well because the way they make money is sort of hidden. Understanding cash generation over time is critical.”

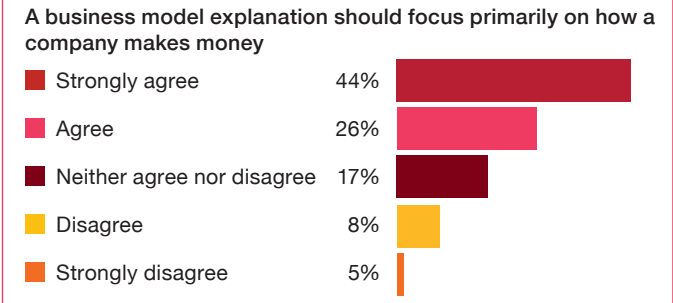
“How the capital allocation works, how capital flows through the business, and the strategy and metrics used to appraise that are vital.”

“You can get a general idea of the dependencies, but rarely of who the other key parties are. From a strategic perspective, where the company is in its wider value chain is very important.”

generate cash, their dependencies on key relationships and resources, and how well they articulate their overall business model. Such gaps may reflect the evolving nature of these disclosures as management teams experiment with content, definition and format.

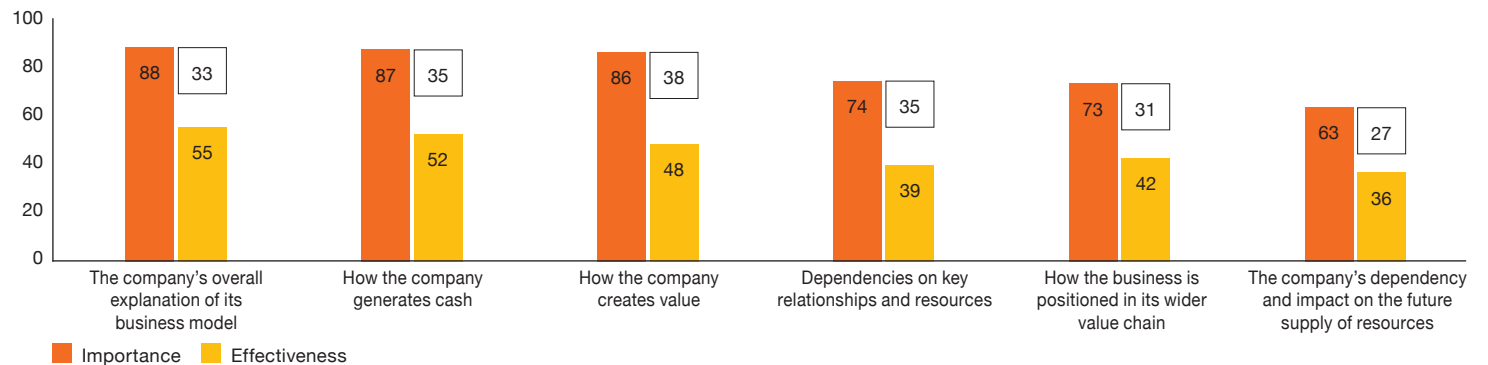
So, how could business model disclosures be improved? 70% of the investment professionals surveyed want management to focus primarily on how the company makes money, both in terms of cash today and value that will convert to cash in the future. Investment professionals who don’t feel this way tell us they find other factors also important, such as capital allocation, how cash flows through the business and the company’s dependencies

on other key inputs. This is the kind of contextual picture that integrated reporting seeks to present.



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’.

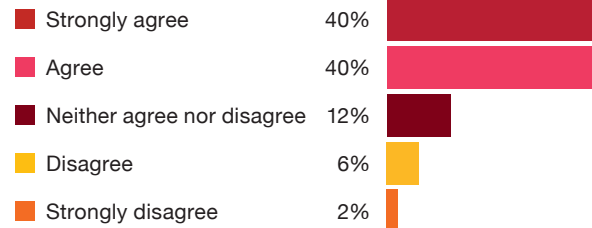
Survey findings (continued)

*“My overarching philosophy is that there shouldn’t be a cookie-cutter approach; a key skill of management should be explaining their business model and strategy clearly and concisely.”*

Four out of five (80%) of the investment professionals we spoke to feel that, in order to be meaningful, an explanation of a company’s business model needs to link to its overall strategy. This again emphasises the importance of linkage and integration in delivering high-quality reporting. Company reporting that clearly integrates operational actions and financial outcomes can be of real value to users of a company’s reports.

*“Ideally, I would like to see both group and segment level business models; I want see how it all fits together.”*

**An explanation of a company’s business model needs to link to its overall strategy to be meaningful**

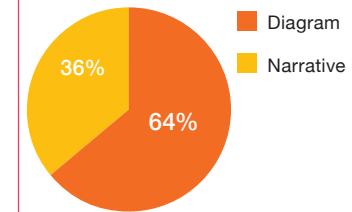


*“Clear, segmented information on how they make money is really important. It’s a foundation of my analysis.”*

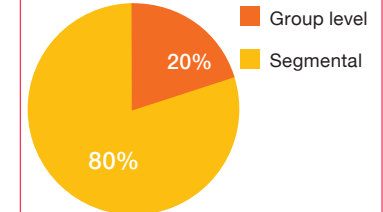
At what level should management teams provide business model descriptions? Among the investment professionals we surveyed, only 20% like to see group-level explanations. We found a strong consensus (favoured by 80%) that segment information is most useful. This desire for detail is also reflected in the finding that 60% of investment professionals surveyed want business model explanations to give details of how a company’s various discrete businesses work together in a group. This call for granularity of disclosure is consistent with previous research into the information needs of investment professionals<sup>1</sup>. Granularity is critical because those who build their models from the ground up have a fundamental need for segment or business unit information<sup>2</sup>.

*“I think a picture speaks a thousand words. We don’t need more and more, we need the right information.”*

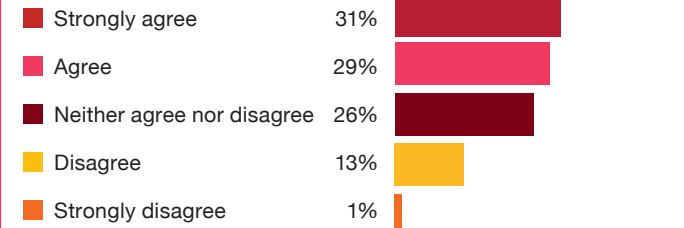
**How do you prefer a company to describe its business model?**



**At what level do you prefer a company to describe their business model?**



**A business model explanation should give details of how multiple discrete businesses work together in a group**

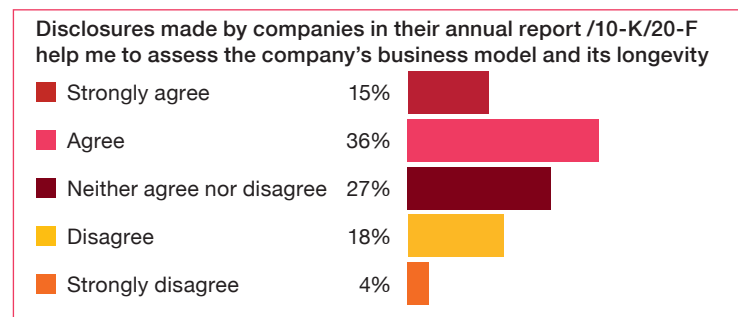


Alongside the content and granularity of business model reporting, the format is also important. Nearly two-thirds (64%) of investment professionals surveyed prefer business model information to be presented in a diagram rather than through narrative description. In conversation, however, many investment professionals tell us that combining both a diagram and narrative is the best way to explain clearly the detail of a business model and the underlying value drivers.

<sup>1</sup>See our 2007 survey, [Corporate reporting: Is it what investment professionals expect?](#)

<sup>2</sup>This point was also raised in the CFA Institute’s July 2013 report, [Financial Reporting Disclosures: Investor Perspectives on Transparency, Trust and Volume.](#)

Only 51% of investment professionals surveyed told us that disclosures made by companies in their annual report (or 10-K or 20-F) help them to assess the company's business model and its longevity. This indicates substantial room for improvement in the way that management teams address longer-term aspects of business model reporting. For example, improvements can be made in descriptions of how the business model might need to adapt to a changing macro-economic environment or future resource constraints. Improving the quality of such disclosures in the annual report could be particularly appropriate given that information on company strategy and the business model is not time-sensitive and annual reports are often used as an ongoing source of reference.



### Actions

Explain your business model clearly and concisely:

- Provide specific details relevant to your company.
- Consider including a diagrammatic representation, accompanied by complementary narrative, to explain your business model in an accessible and transparent way.
- Where relevant, present a business model explanation at the segment level, including information on how those segments work together in a group.

Although there may be some sensitivity around competitive advantage, think about whether you have addressed the key elements that investment professionals want to understand, such as:

- How cash and capital flow through your business model
- Dependencies on key relationships and resources
- Your company's position in the wider value chain
- Key dependencies on the future supply of resources, and your impact on that supply.

Think of the business model more broadly than simply how the company makes money today. Link your business model explanation clearly to your strategy, making sure to focus on the longer-term factors that could influence your business model and its evolution in future.

“An integrated report should answer the question: Where does the organization want to go and how does it intend to get there?”

*IIRC’s International Integrated Reporting <IR> framework*

### Information on strategy should include key priorities and actions – and progress made

An understanding of a company’s long-term strategy is crucial for investment professionals. It provides a link between a company’s historical financial information, its present situation and its future performance potential, which investors and analysts are trying to predict in their models.

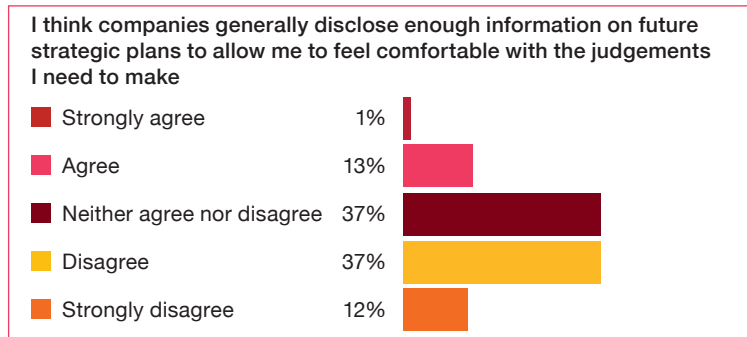
Investment professionals have many data sources available to them, but what company-generated information on strategy do they value most? And how effectively are management teams providing this information?

Our survey respondents place high importance on a company’s overall explanation of its strategy, of key priorities and actions for meeting objectives, of progress made against those key priorities and actions, and of how the long-term strategy relates to the current business model. There are clear effectiveness gaps, however. Investment professionals tell us they would like greater

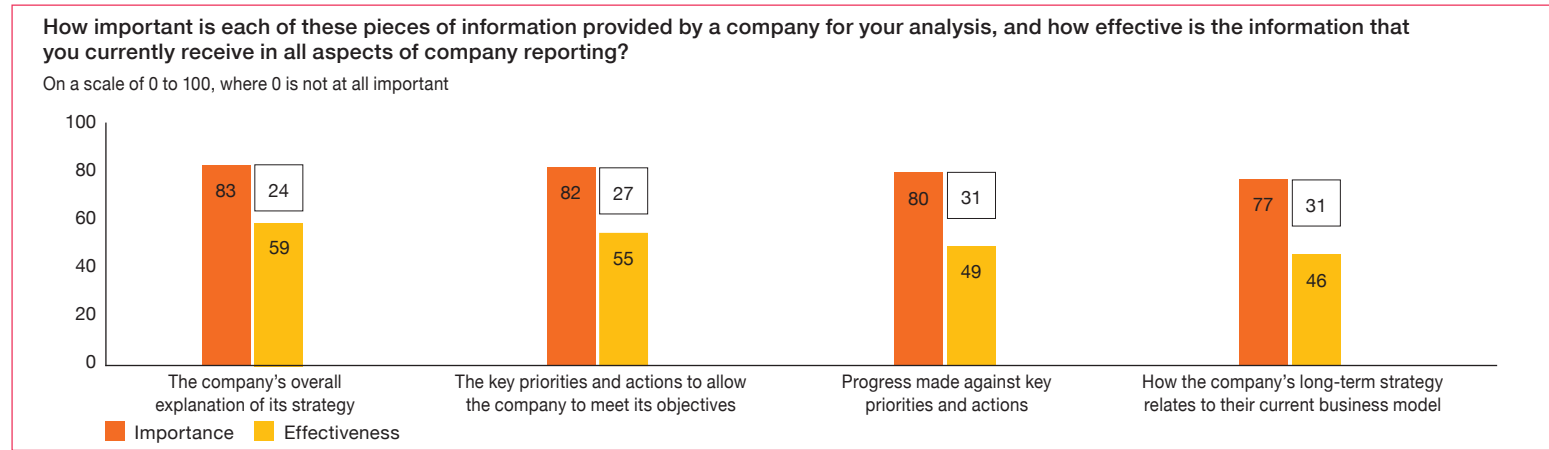
clarity in this area, particularly on performance against strategic targets and how strategy relates to the overall business model. They would also like management teams to provide the wider market context to the company’s strategic plans.

“I really need clarity on progress made on key strategic goals so I can assess performance against remuneration.”

“Companies don’t do a good job of following up on the statements they made in previous years’ annual reports. I need an update on what has happened since last year.”



Worryingly, only 14% of the investment professionals we spoke to feel that companies generally disclose enough information on their future strategic plans to allow them to feel comfortable with the judgements they need to make for their analysis.



### Actions

Put yourself in your investors' shoes: what information would you need if you were assessing whether to invest in your company?

Think about how an investment professional might use what you tell them about your strategy. Are you answering the questions they are likely to have? Such questions could include:

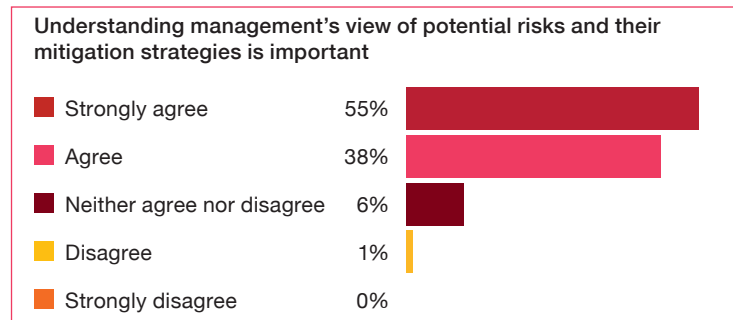
- What are your strategic goals and priorities?
- How are you going to achieve them?
- How are you positioned in the wider market?
- How far have you progressed against long-term goals?
- If things are changing, why?

If the answers to those questions are clear in your reporting, investment professionals should be able to make a more accurate assessment of your current performance and gain a better understanding of your future direction.

### Effective risk reporting is specific, relates to strategy and gives management's view

The reporting of risks has historically received much attention from accounting standard setters, governments and regulators. Many different risk-reporting regimes have been established around the world. Some of the best company reporters challenge themselves to produce innovative and insightful risk reporting. Not everyone is best-in-class, however, so what do investment professionals think about the current state of risk reporting?

We found that investment professionals place extremely high importance on information concerning key risks to the business model and their management or mitigation. Only 1% of respondents say that understanding management's view of potential risks and their mitigation strategies is not important to them.





Survey findings (continued)

“An integrated report should answer the question: What are the specific risks and opportunities that affect the organization’s ability to create value over the short, medium and long term, and how is the organisation dealing with them?”

IIRC’s International Integrated Reporting <IR> framework

“I want management’s view of their risks, not just their lawyer’s advice.”

“I often wonder if they are really revisited each year or if they are just rolled forward.”

“More emphasis needs to be put on the real risks to the company, business or industry; some companies are specific but others far too generic.”

“Risk reporting is too process-based; I see very little linkage to strategy, which really reduces its usefulness.”

“I need to know what the possible outcome is of the risks, and I need to see numbers. When you never get any data, you are left to second-guess.”

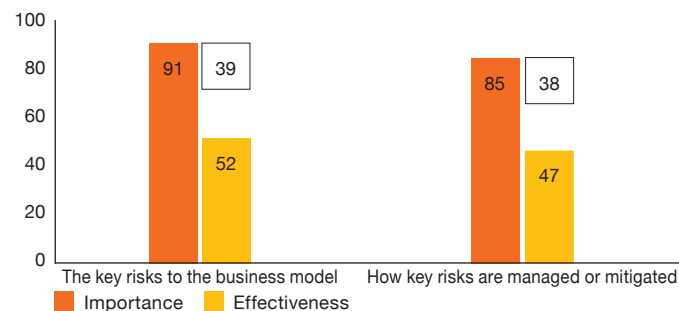
However, we also found large gaps between the perceived importance and effectiveness of company reporting on these topics – in fact these are some of the largest ‘effectiveness gaps’ identified in this research across all elements of company reporting.

A major reason appears to be a lack of specific (i.e. not boilerplate) risk disclosure – over three-quarters (76%) of investment professionals surveyed believe that today’s disclosure is too boilerplate. In fact, a number of investment professionals tell us they often look at bond issue prospectuses to get a more detailed view of potential risks. Such documents usually contain more detailed risk disclosures than the annual report<sup>1</sup>.

In our survey conversations, investment professionals sometimes expressed doubt about whether they are reading management’s view or that of their lawyers, as well as frustration about the lack of linkage between a company’s risks, business model, strategy and financial information. This is a recurring theme of this research: linkage is an important characteristic of high-quality reporting.

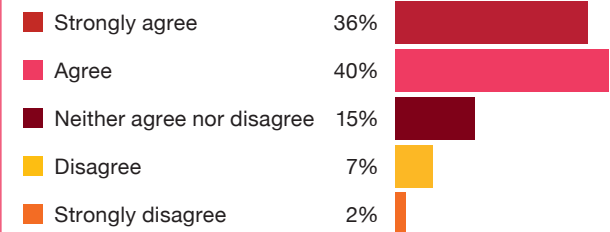
How important is each of these pieces of information provided by a company for your analysis, and how effective is the information that you currently receive in all aspects of company reporting?

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



<sup>1</sup> With the exception of the US, where SEC rules require all risks to be listed in the 10-K.

There is too much ‘boilerplate’ risk disclosure in company reports, so I don’t find them very effective



**Actions**

Critically assess the quality, clarity and transparency of your risk reporting.

Be detailed and company-specific in your description of risks. The leading reporters we see give detail on risk appetite and their company’s risk profile, and it is clear to see how these factors change over time.

Be clear that you are giving your view as management, and explain your risk management and mitigation actions.

Make sure your risk reporting links to your business model, strategy and financial performance. Linkage across all elements is vital for communicating your company’s story in an integrated way.

*“An integrated report contains qualitative and quantitative information about performance that may include matters such as: Quantitative indicators with respect to targets, and risks and opportunities, explaining their significance, their implications, and the methods and assumptions used in compiling them.”*

IIRC's International Integrated Reporting <IR> framework

*“A little colour on why the KPIs have been chosen is really helpful.”*

*“KPIs really need to link to strategy, otherwise the clarity about why the KPI matters isn't there and you start to question whether they really are the right KPIs.”*

### *KPIs should be explained and linked to strategy, risks and remuneration*

Management teams around the world produce key performance indicators (KPIs), either to meet regulatory requirements or to help tell the story of their business and its performance.

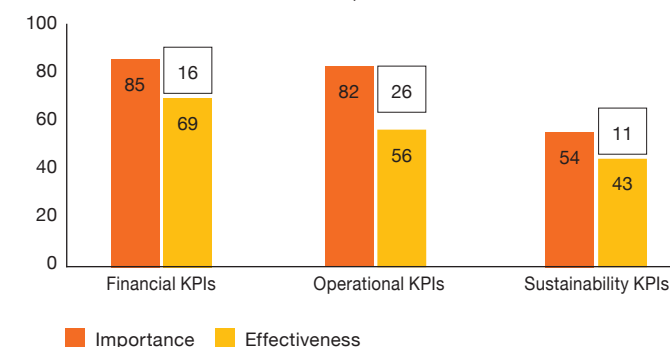
Our July 2014 survey on the reporting of adjusted performance measures looked in detail at investment professionals' views on how alternative performance measures and where it could be improved<sup>1</sup>. In this report we consider investment professionals' views on opportunities to improve KPI reporting.

A key finding is that investment professionals want to know why management has chosen particular measures. Such an explanation may help users of accounts to understand the importance of a particular KPI and helps to put the company's performance against the target in context. Perhaps even more importantly, companies need to demonstrate a link between their KPIs and their strategic priorities, as well as their business model.

The investment professionals we surveyed place almost as much importance on operational KPIs as they do on financial KPIs. The greatest scope for improved reporting appears to arise in relation to those operational KPIs – this is where we found the biggest gap between the importance investment professionals place on this information and the perceived effectiveness of the information they receive.

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



This provides food for thought for management teams. From our observations, many companies report more financial than operational KPIs – despite the fact that operational risks often make up a large proportion of risk disclosures. Better linkage between the business model, strategy, risks and KPIs might help to close the effectiveness gap that investment professionals perceive around KPI reporting.

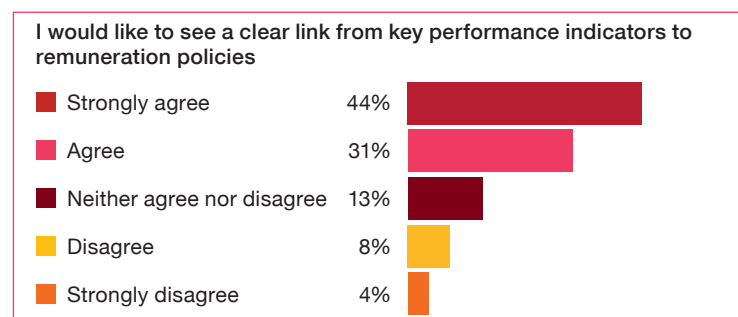
Sustainability KPIs (which relate to issues such as local community engagement, environmental impact, natural resource use and employee engagement) scored more highly with investment professionals than we have seen in the past. This may reflect an increasing awareness of the importance of such measures: they relate to factors underpinning a company's ongoing 'licence to operate', reflecting key dependencies to the business model and are therefore highly relevant for long-term investment decision-making.

<sup>1</sup> See our previous report: [Reporting adjusted performance measures, July 2014](#)

*“Operational KPIs need to be presented more like financial KPIs, we need more information on targets, goals and trends, and I always seem to be asking questions to get more information.”*

*“Absolutely I would like to see a clear link between KPIs and remuneration policies, and it’s good that the trend seems to be heading in this direction, although for many companies it is still hard to see this link clearly.”*

We also found a lot of interest in the way that KPIs link to executive remuneration. Three out of four (75%) investment professionals we surveyed would like to see a clear link drawn between KPIs and remuneration policies.



### Actions

Explicitly identify your KPIs, which should be aligned clearly to your overall strategy.

Explain why the KPIs you have chosen are relevant to understanding the performance of your business.

Explain the link between your strategy, key risks and reported KPIs.

Be clear about how KPIs link to remuneration policies.

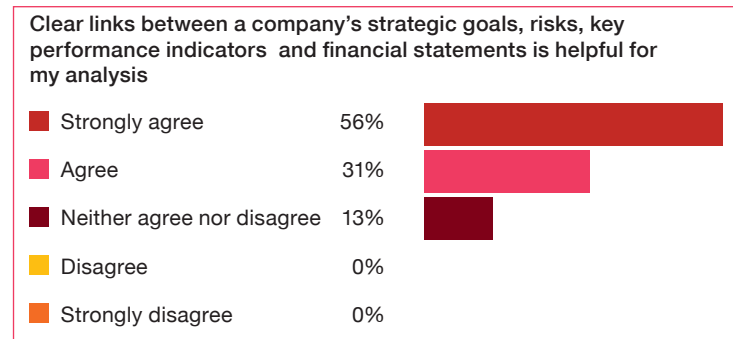
Provide targets for KPIs and performance against those targets.

Our recent survey, [Reporting adjusted performance measures](#), highlights useful ground rules for presenting adjusted performance measures that can be applied easily to KPIs.

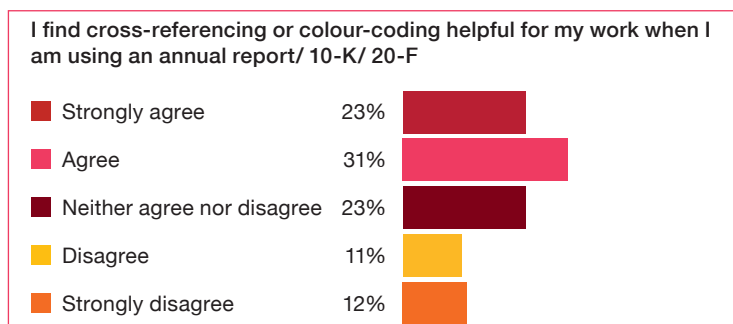
## Clear linkage between reported information supports investor analysis

There is consistent demand from investment professionals for better linkage throughout company reports. Better linkage is about promoting cohesion, reducing repetition and highlighting interdependencies within the business as well as between different elements of corporate reporting. For example, a clear link between strategy and KPIs allows investment professionals to understand how management measures its progress against its strategic objectives. This ability to navigate through information is crucial to the effectiveness of increasingly integrated reporting.

A large majority of investment professionals surveyed (87%) agree that clear links between a company’s strategic goals, risks, KPIs and financial statements are helpful for their analysis. We found mixed views, however, on exactly what those links should look like. Some investment professionals prefer cross-referencing (using clear references or links to navigate between similar topics or to access further information) and colour-coding. Others tell us that changing placement or using electronic linkage in documents would be useful.



*“Cross referencing is really critical.”*



*“An electronic link would be even better than colour coding.”*

### Actions

Take a step back: is there a clear information flow between the strategy, business model and risks through to KPIs and financial performance? Could you tell your story in a clearer way?

Consider the ease of navigation through your reporting documents. Could you add some linkage or colour-coding to help investment professionals find the information they need?

Assess other forms of communication. Does your investor presentation refer to relevant parts of your annual report? Could you go the next step and use electronic links in your reporting to the market?

### Users value annual reports for reliability and comprehensiveness

When investment professionals seek to understand the operations of a business, they not only have increasingly rich information being generated through more integrated reports, but also a variety of communication channels through which to receive it. We know that investment professionals use a variety of sources of information for their analysis, but which do they consider most important? We asked survey participants to name their top sources for five different categories of information, from financial information through to information on environmental, social and human capital issues.

The results may interest management teams who spend time preparing annual reports<sup>1</sup> but doubt whether investment professionals actually look at them. Across all our conversations with investment professionals in this survey, the annual report was consistently cited as important in every information category. In contrast, cited data sources that did not reach the top three for any category include sell-side research, data providers and ad-hoc company press releases.

<sup>1</sup> Or 10K /20F equivalent documents

Survey findings (continued)

*“If a company is stable and I am planning to hold the shares long term, then I wait for the annual report rather than focus on the preliminary earnings announcement. The annual report has more of a long-term perspective.”*

*“I spend a lot more time with annual reports than with broker research.”*

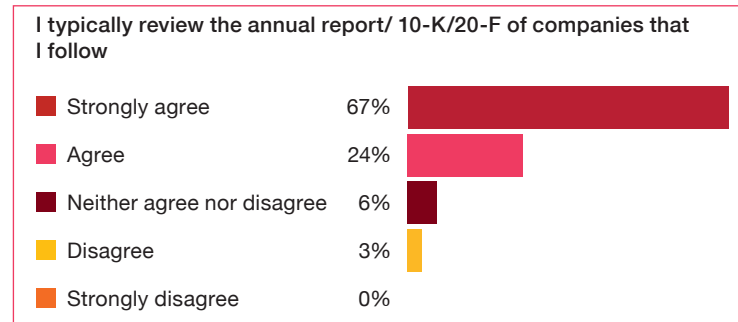
*“I go to the annual report to get the granularity on financial information.”*

*“The annual report is really a point of reference; it’s the place you go for the detail, or to refer back to when you need to. It might not be the first port of call for the financials – the market moves on the prelims – but it is a very important document.”*

The table below shows the three most commonly cited data sources for each information category.

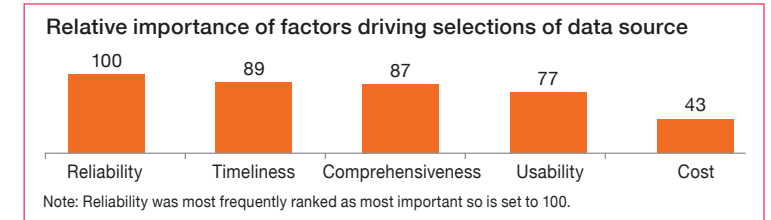
| Top information sources |                                  |   |  |                          |   |
|-------------------------|----------------------------------|---|--|--------------------------|---|
|                         | Financial information            | Information about a company's strategy, and resource allocation | Information on risks and opportunities | Governance information   | Environmental social and human capital info |
| 1                       | Annual report                    | Investor presentations  | Dialogue with management               | Annual report            | Annual report                               |
| 2                       | Preliminary results announcement | Dialogue with management  | Annual report                          | Proxy statements         | Sustainability report                       |
| 3                       | Investor presentations           | Annual report   | Investor presentations                 | Dialogue with management | Website                                     |

Only 3% of investment professionals – all from the buy side – told us they do not typically review the annual reports of companies they follow. This may be because they often rely on sell-side analysts or data aggregators to provide detailed analysis of the numbers.

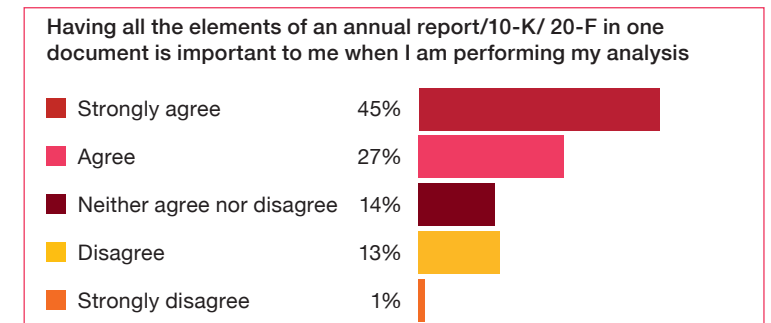


We wanted to understand the factors that influence where investment professionals go for information, so we asked them to

rank five factors in terms of their importance. Reliability emerged as the most important factor, followed by timeliness and comprehensiveness. Reliability and comprehensiveness are core strengths of the annual report, which would explain its popularity as an information source. Timeliness is an obvious weakness of the annual report, and many of the investment professionals we spoke to note the frequent trade-off between timeliness and reliability.



Almost three-quarters (72%) of those surveyed think that having all the elements of the annual report in a single document is important. This may be because investment professionals view the annual report as a longer-term reference source, like a corporate encyclopaedia to which they can return to access information on a variety of topics when they need it.



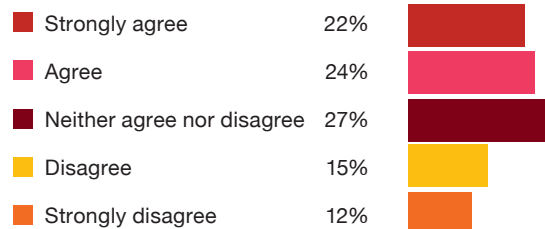


Survey findings (continued)

*“Governance and strategy issues can be much more qualitative, so you really want to have that dialogue with management.”*

We also asked them whether they would spend more time analysing an annual report when they felt management had made an effort to tell the story of the business in a clear and transparent way. While some feel that they would, others said they would spend more time on the less clear and transparent reports – thinking that these perhaps indicate the companies where more problems could be hiding.

I am more likely to spend time analysing an annual report / 10-K/20-F when I feel management has made an effort to tell the story of the company in a clear and transparent way



*“Management dialogue is key; it is good to hear it straight from them.”*

This reinforces the message that investment professionals associate the quality of reporting with the quality of management. Among those that neither agreed nor disagreed, many said they spend time looking at annual reports in any case – another endorsement of the value that investment professionals place on this cornerstone of corporate financial reporting.



Relative numbers of citations of each data source across all interviews and all information categories are shown in the ‘word cloud’. The bigger the font, the more the citations.

**Actions**

Your annual report is perceived by investment professionals as an important piece of the reporting suite; it therefore needs to tell your company’s story as clearly as possible. Make sure this story and your key messages are presented clearly and consistently across all other communication channels, recognising that investment professionals draw on many sources of information and at different times. Given that reliability is the most important factor for investment professionals when choosing a data source, consider how best to convince them that the messages you are delivering can be relied upon.

# Conclusion

## *Building value for investment professionals through more integrated reporting*

Investment professionals see a clear link between the quality of reporting and the quality of management. They recognise that management teams want to maintain competitive advantage and therefore have concerns about disclosing too much information on business models, strategy and risks. Nevertheless, they tell us that such disclosures (including relevant KPIs) can directly impact a company's cost of capital. Management teams need to find the right balance in terms of disclosing just enough information to be useful without giving away competitively sensitive insights.

The effort required for delivering such high-quality reporting is worthwhile. Investment professionals tell us they place particular value on annual reports for their reliability and comprehensiveness. Although they use a wide variety of other sources of information in their company analysis, messages must be communicated consistently and clearly across all channels in order to present a coherent message to the market.

Some companies could do more to improve the quality of their formal reporting – perhaps providing more detail about their business model, describing a longer-term view of value generation and explaining more clearly how capital

flows through the business. They could work harder to avoid boilerplate disclosures and provide more specific information on risks and risk management, clearly framed as management's view (not the view of the company's lawyers).

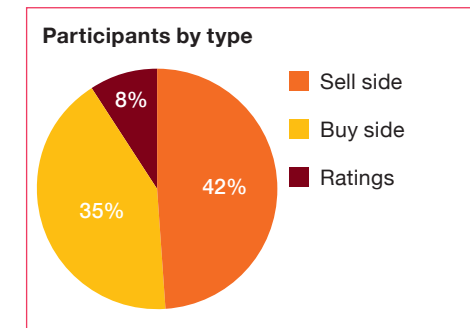
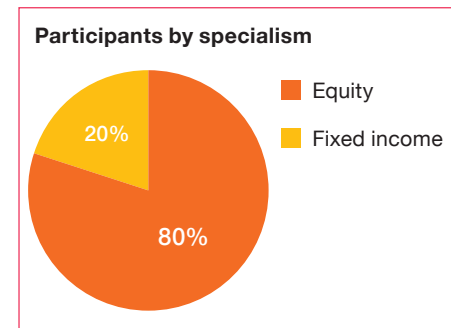
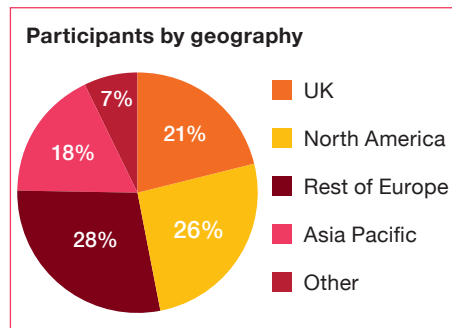
Our discussions with investment professionals also highlight the importance of linkage – a core theme of this report. Linking the explanation of the business model to a well-defined strategy, supported by clear performance goals and progress reports, is important. The KPIs that are used must not only be those that management considers important for understanding business performance (and introduced accordingly); they must also be linked to strategy, risks and, ideally, remuneration. This is all part of telling a coherent, comprehensive story about the business.

Momentum behind greater future orientation and linkage in company reporting is being generated through current initiatives including integrated reporting. These are designed to enhance, rather than replace, reporting as we know it today. Given the areas where investment professionals see room for improved reporting – particularly around cash creation, key risks, dependencies on key resources and relationships, and operational KPIs – more integrated reporting could perhaps provide the solution. Developing more integrated reports could potentially better meet the needs of investment professionals, while also encouraging more cohesive decision-making within companies to support longer-term value creation.

## Appendix: Survey population

We conducted interviews with 85 investment professionals from the buy side, sell side and ratings agencies. Their roles included equity analysts, fixed income analysts, ratings agencies, portfolio managers, chief investment officers and heads of research.

Survey participants were drawn from key markets across the world.



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