

The investor conundrum

Companies already practising integrated reporting complain that investors show little interest. So what is to be done, asks Professor Bob Eccles

The recent publication of the International Integrated Reporting Council's (IIRC) international framework marks a milestone in integrated reporting. Many people and groups – including investors – have helped create the framework, which can be used by companies to 'improve the quality of information available to providers of financial capital to enable a more productive and efficient allocation of capital'. While financial capital can take many forms, the main target audience, at least initially, is equity investors. So, how excited are investors about the framework? Or, to ask the question in a more cynical way, will they even notice or care?

Some will – particularly the big pension funds that have a long-term investment horizon given the long tail of their liabilities since the framework aims to promote in companies 'actions that focus on the creation of value



standards for information on such things as intangible assets and environmental, social and governance (ESG) performance. The US Sustainability Accounting Standards Board (SASB) is making progress on this front but is still at the very early stages.

Logically, companies should practise IR out of self-interest because of the benefits in doing so. The IIRC argues that IR fosters integrated thinking, which facilitates integrated decision-making, leading to better resource allocation decisions for short, medium and long-term performance. This begs the question of whether the market will recognise the value implications of these resource allocation decisions. Many executives are rightly sceptical that it will given the market's short-term focus and obsessive attention to financial performance metrics like earnings and revenue growth.

Yet it is a company's responsibility to make the case to its investors for the value to them

The conundrum is this: while investors are defined as the main audience for integrated reporting, their level of interest is modest at best. Little evidence exists that they will be a driving force any time soon to encourage companies to adopt integrated reporting

over the short, medium and long term'. These pension funds are asset owners. The asset managers hired by asset owners typically have a much shorter timeframe often because of the way they are evaluated and compensated by the asset owners, typically on an annual basis. Sell-side analysts have even shorter timeframes, about a quarter.

So, much as I would like to believe otherwise, I don't expect the market today will be a driver for voluntary IR adoption without regulation. This is what has to change. Although regulation has happened in South Africa, for a variety of unique historical reasons, it is not likely to happen in any other country any time soon. In places like the US, it is hard to imagine the Securities and Exchange Commission (SEC) transforming the 10-K annual performance summary to conform to the framework's guidelines. And even if IR were mandated, it would likely result in a box-ticking approach given the lack of

in their own investment decisions of the information provided in an integrated report. Companies believe they have to do this for such things as major acquisitions or mergers, entry into high-risk/high-opportunity markets, and expensive R&D and product development efforts. Why shouldn't the same be true for investments that build intellectual, human, social, and relationship capital?

Up until recently, and somewhat immodestly, I had thought that there was no question about IR I hadn't heard before. Then I interviewed a fellow academic, who said that one of the companies he'd investigated in his research had told him it didn't support IR 'because it's the investor's job to figure out the things that are supposed to be in the integrated report'. Apparently, the company didn't want to explain its strategy because that would tip off its competitors.

I've heard variations on this for years and think it's a silly or naive point of view and not worth



addressing here. The more interesting issue is the company's assertion that it is not its job but the investor's to figure out everything that should be in an integrated report. I guess the argument here is that investors, as either asset owners investing on their own account or as asset managers paid by an asset owner, have a big incentive to seek out information that reveals market inefficiencies in a company's stock price. Thus the company needn't provide an integrated report and can trust the market to ferret out relevant information to ascertain its true value. And all the while companies complain that their stock is undervalued!

So where does that leave us? If investors don't care about IR and companies believe it's the investor's job to pull together the information that would go into an integrated report, does that mean all the work of the IIRC is for naught? The answer to this must be an emphatic 'no!'. What this conundrum means for me is that the work of the IIRC goes beyond the important benefits of better resource allocation decisions by both companies and investors who have a long-term view.

The IIRC's work shines a spotlight on the duplicity of both companies and investors. Companies should quit complaining about the lack of investor interest or saying that investors should figure out for themselves



how the company is creating value without the benefit of the company's point of view. It is the company's responsibility to make the case for its decisions if it truly does have a long-term view and wants to attract investors who do as well.

Investors, in turn, need to take greater responsibility for shaping the corporate reporting environment. They must recognise that their competitive advantage lies less in finding information that other investors haven't, and more in developing the deeper insights that can come from more holistic reporting. Yes, regulation has a role, but it will be most effective when companies and investors alike recognise that markets work best when they want them to and take responsibility for this.

The pioneer professor

Robert G Eccles is professor of management practice at Harvard Business School. He has been studying and working to change corporate reporting for 25 years and was awarded honorary ACCA membership in December 2013. His books on corporate reporting include *One Report: Integrated Reporting for a Sustainable Strategy* (with Michael P Krzus). He is a member of the IIRC steering committee, chairman of the SASB, and co-founder of the Innovating for Sustainability social movement.

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