Nicola Raimo

INTEGRATED REPORTING: STATE OF PLAY, THEORETICAL UNDERPINNINGS AND EMPIRICAL INSIGHTS

The Role of Corporate Governance Mechanisms

FrancoAngeli

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PREFACE

In recent decades, international accounting studies and those of *economia aziendale* in the Italian context have paid great attention to the non-financial dimension of reporting and disclosure. The great importance assumed by this issue can be traced back to two closely interrelated phenomena. The first relates to the expansion of the categories of recipients of disclosure, which can be ascribed to the growing criticality, within the scope of management activities, of stakeholders' engagement, both in terms of extension of the number and types of subjects involved, and in terms of strategic relevance of the contributions, of a non-financial nature, made by interlocutors other than shareholders. The second relates to the inability of traditional financial disclosure variables to represent the corporate management in an articulated manner.

Nicola Raimo's book is part of this scenario. He analyses the latest frontier of disclosure tools, represented by Integrated Reporting (IR), used to describe the value creation paths in the short, medium and long term of organizations. The peculiarity of the tool is the ability to capture, in a holistic way, the connections and interdependencies among the key factors underlying the company's success, even in the long term.

This work is valuable because it analyses the IR topic in an organic and systematic manner, offering a complete and articulate overview of the phenomenon under investigation. The strengths of the work can be summarised as follows. First of all, the systematic literature review allows the development of an effective framework of analysis able to classify, in an original way, the various contributions on the IR topic, according to a dual perspective: normative perspective (appreciations and criticisms) and descriptive perspective (determinants, process, and effects). Secondly, the theoretical anchorage of the existing literature represents an element of absolute novelty for scholars interested to the IR topic; in particular, the mapping of the literature, that highlights the relationship among theory, main purposes, main areas of interest, main issues and main recipients, allowing to link objectives and issues to the theoretical background, offers a clear picture of the philosophy underlying the scientific articles on the topic. Moreover, the empirical analysis, methodologically accurate, allows a deepening of a specific aspect, of great interest for the scientific community: the relationship between corporate governance mechanisms and IR quality. Even in this case, the author demonstrates a great ability to investigate the phenomena in an organic way, through the analysis of the presence and structure of a plurality of bodies: board of directors, audit committee and corporate social responsibility (CSR) committee. Finally, the innumerable implications of the empirical analysis, both theoretical and practical, make the book useful not only for academics but also for managers, entrepreneurs and policy makers.

Nicola Raimo's book is therefore certainly a reference point for all those who deal with the subject, both from a scientific point of view and from a more pragmatic perspective, allowing to consolidate and enrich significantly the literature on IR.

Filippo Vitolla
Full Professor at LUM University, Bari

PREFACE

It is always a satisfaction to preface a new monograph, a pleasure that is increased since the author whom I have in great esteem and who guarantees rigour and clarity in his approach. My professional relationship with Nicola Raimo allows me to attest to his certain degree of professional qualification and his admirable personal perseverance. All this, without forgetting the perception that the book will be valuable and exciting for the academic and professional field, both for its content and the structure and way it is written.

Throughout the four chapters in which this book is structured, the relevance that the Integrated Reporting (IR) is acquiring within corporate transparency policies aimed at improving accountability is addressed in an eminently balanced way. And trust, providing investors and other stakeholders with the information they need to make more efficient and effective decisions.

The first chapter introduces us to the conceptualization of the IR that ranges from the original proposal of the International Integrated Reporting Council (IIRC), an exciting exposition of its evolution and the major initiatives, to its inclusion in the Italian management thought. Content that favours the knowledge of this informative state, the guiding principles and the content elements.

In the following two chapters, with an academic vision, the author determines the state of the art through a bibliographic review of scientific publications in the period 2011 to 2020, using his classification based on two perspectives – normative and descriptive – and five main areas of interest – appreciations, criticisms, determinants, process, and effects –. To subsequently perform a mapping of the different theories used to frame the IR phenomenon according to this statement's orientation, characteristics, and content.

Finally, Chapter 4 provides empirical analysis, focusing on the effect of the different board of directors´ characteristics and committees on the quality of the information in IR. Specifically, the results show that the features of the corporate governance mechanisms affect the quality of the IR and the level of alignment with the IIRC framework.

The critical level of implantation that the IR is reaching, the firm theoretical bastions of this monograph, and its author's knowledge and experience give high added value to researchers and professionals who can thus become graceful readers or users of this monograph.

Isabel Maria Garcia Sanchez
Full Professor at the University of Salamanca

INTRODUCTION

In recent years, a newly-created corporate communication and value representation tool has been emerging, capturing the attention of companies, standard setters, and academic literature. It is interesting to examine the novelties of this new information representation tool, known as integrated reporting (IR), as well as its prerogatives, how it fits into the heated debate about corporate transparency, and what governance structures are favourable for its correct implementation.

Corporate transparency is an increasingly critical issue for firms. They have perceived the need to demonstrate their orientation towards doing good in light of the growing tension related to corporate social responsibility (CSR). This undoubtedly requires redefining the principles and behaviours that companies adopt in compliance with financial, social, and environmental sustainability. This redefinition of principles and behaviours has an impact on corporate communication processes and on stakeholders' active participation in decision making.

Corporate documents such as financial statements or consolidated financial statements use financial language that can flatten the way a company's assets are represented. Furthermore, these documents are oriented towards the past and pay limited attention to the intangibles, complicating the understanding of firms' value creation. These circumstances highlight the inherent limits of exclusively financial data. On their own, these data do not provide an overall picture of the current and, above all, prospective conditions. Therefore, there has long been a need to include non-financial information in order to provide an overview of performance achievements and outline future prospects. Also in practice, there is a need to broaden the reporting perimeter to produce, alongside traditional financial statements, other types of voluntary disclosure that illustrate company policies and the actions taken to address environmental and social sustainability, the management of intangible resources, and corporate governance mechanisms. This is necessary to satisfy stakeholders' information needs and support a more efficient capital allocation process.

Recent regulatory interventions have been driving companies, particularly larger ones, to measure and report non-financial information. Companies must therefore account for their work and relate to all stakeholders, by virtue of their potential legitimate interest in evaluating and verifying the information, as well as the transparency and correctness of the conduct adopted. This different and broader form of corporate communication responds to various needs, ranging from the need to nurture trust between companies and stakeholders to the need to ensure greater information usability, including information that goes beyond the financial dimension.

One of the major risks of the intensification of communication processes, however, is attributable to the proliferation of uncoordinated reporting documents, which could confuse rather than inform users.

In light of this, some companies on the international scene have embarked on a new path towards integrating information using the so-called 'One report', which is an integrated report that allows for various information to be composed in a system. The integrated report is therefore capable of representing the various dimensions of firm performance – from financial, social, and environmental performance to performance related to intangibles – more satisfactorily and comprehensively than other communication tools.

International companies' growing adoption of IR has triggered a heated debate within the academic community. Among the scholars interested in the topic, there are discordant opinions about the potential and criticalities of this reporting tool. These opinions are worthy of in-depth analysis. In addition, the orientation, characteristics, and breadth of the content allow for an exploration of the IR through different theoretical perspectives, requiring proper systematisation in order to be fully understood.

This work therefore discusses the rise of IR and examines the academic literature in detail to identify, firstly, the different aspects scholars have investigated and, secondly, the different theoretical perspectives that have been used to frame the IR phenomenon. This work also analyses the role of corporate governance mechanisms in correctly representing integrated information. Governance mechanisms for internally monitoring managers' work prevent the adoption of discretionary policies aimed at altering results and hiding relevant data, and favour the disclosure of additional information, thus contributing to the reduction of information asymmetries. Therefore, it becomes important, in the current context, to better understand which characteristics of the different corporate governance mechanisms are able to improve the collection and representation of integrated information.

The treatment of the topic in this work follows a precise logic developed in four chapters.

Chapter 1 discusses the rise of IR in international accounting and management studies, frames IR in Italian management thought, and introduces the origin and structure of the International Integrated Reporting Council (IIRC), its Pilot Programme, and the International <IR> Framework. It, therefore, provides a complete overview of IR, its fundamental concepts, guiding principles, and content elements, all of which are useful for fully understanding the subsequent chapters.

Chapter 2 offers a systematic literature review of the theoretical and empirical contributions published from 2011 to 2020 on the subject of IR in order to provide a general overview of the state of the art and identify ideas for future research. Academic contributions are classified according to two perspectives (i.e. normative and descriptive) in five main areas of interest: appreciations, criticisms, determinants, process, and effects.

Chapter 3 offers a general overview of the different theories used to frame the IR phenomenon. In this chapter, academic contributions published from 2011 to 2020 are analysed to identify the theory that best suits the orientation, characteristics, and content of IR.

The final chapter, Chapter 4, provides an empirical analysis aimed at examining the effect of the corporate governance mechanisms' (i.e. the board of directors, the audit committee, and the sustainability committee) different characteristics on the quality of the information in integrated reports. To this end, it is based on manual content analysis of integrated reports and a regression model using a sample of 125 international companies that published an integrated report in 2017.

The four chapters are linked by a simple but original thread. Chapter 1 accurately presents and describes the IR tool as the object of this work's analysis. Chapter 2 analyses the state of the art in academic literature on IR and identifies gaps in the literature to demonstrate the need for further studies on the relationship between corporate governance and IR. Chapter 3 examines the different theoretical perspectives underlying IR and identifies the theory that is best suited to analysing the relationship between corporate governance and IR. Finally, Chapter 4 fills one of the main gaps identified in Chapter 2 by analysing the relationship between the different corporate governance mechanisms and IR quality through agency theory, which is identified in Chapter 3 as an ideal theoretical perspective for this kind of analysis.

I want to thank those who, in various ways, have supported the realisation of this research.

Firstly, I want to thank my mentor, Prof. Filippo Vitolla, for his affectionate support, valuable suggestions, stimuli and ideas that continually feed my desire to conduct new research. I also want to thank Professor Isabel-María García-Sánchez for the valuable advice and teachings she passed on to me during my experience at the University of Salamanca. My colleagues also provided useful insights through discussions about the most critical aspects of IR implementation, both within the university and during national and international events dedicated to the topic.

A heartfelt thank you goes to my family. Without their understanding and unfailing support, this work would not have come to fruition. This work is dedicated to the memory of my Aunt Ornella, a woman of great culture, a tireless supporter of mine, and an unforgettable person. Destiny did not leave her time to read it, but from the very beginning, she followed the progress of my academic career with her usual affection.

The Author

1. THE RISE AND CONTEXTUALISATION OF INTEGRATED REPORTING

1.1. Introductory notes

This chapter discusses the rise of IR in international accounting and management studies, frames IR in Italian management thought, and introduces the origin and structure of the IIRC, its Pilot Programme, and the International <IR> Framework.

Over the last few years, the debate concerning disclosure, particularly non-financial disclosure, has been considerably heated. It has led to developments and considerations regarding the traditional financial statement's role and ability to provide stakeholders with exhaustive information about companies' business dynamics (Pozzoli, 2018). The company's role has, in fact, changed over the last few decades, so much so that the corpus of corporate literature conceives corporate organisations as social bodies (Pozzoli, 2018) aimed at generating value, not only for shareholders, but also for the reference community (Porter & Kramer, 2011).

With regard to the aspects relating to disclosure, financial data alone, while essential for assessing company activity, do not provide recipients with prospective information. This results in a lack of information regarding the strategy, intangibles, and consequences related to decision making (Pozzoli, 2018). The 2008 financial crisis caused specialists, analysts, and public opinion to reflect on the need to revise the corporate disclosure model, due to the fact that monetary quantities alone often cannot illustrate company dynamics and, above all, do not allow for the assessment of the impact of business activity on the reference community (Pozzoli, 2018).

These reflections have given way to a new reporting model, IR, developed by the IIRC. IR represents a process based on integrated thinking. It translates into a periodic integrated report that illustrates a company's ability to create value in the short, medium, and long term (IIRC, 2013). It is therefore a report aimed at combining financial and non-financial information, such as information relating to environmental, social, human, intangible, and governance aspects. However, IR does not represent the mere sum of the traditional financial statement and the social or sustainability report. Rather, it is an innovative communication method that integrates information of different natures and shows the interconnections. In this regard, it is necessary to note that the IIRC does not use the term 'sustainability' (Churet & Eccles, 2014) in order to avoid implying a connection with this type of disclosure. This is so even though it has been shown that companies that prepare sustainability reports enjoy an advantage when transitioning to IR (Idowu et al., 2016).

The objectives of this chapter are therefore to present the rise of IR, frame IR in Italian management thought, provide a general overview of the process that led to IR, and discuss the content of the International <IR> Framework developed by the IIRC. To this end, this chapter is structured as follows. Section 1.2 presents the rise of IR in international accounting and management studies; Section 1.3 frames IR in Italian management thought; Section 1.4 illustrates the birth and structure of the IIRC; Section 1.5 describes the IIRC Pilot Programme; Section 1.6 analyses the International <IR> Framework; and finally, Section 1.7 draws conclusions.

1.2. The rise of IR in international accounting and management studies

The rise of integrated communication is based on two lines of evolution that are sometimes interconnected (Eccles & Serafeim, 2011).

The first line is connected to the limits of financial disclosure (Eccles & Serafeim, 2011). In recent decades, awareness has spread regarding the difficulties associated with using traditional financial disclosure to fully represent the complexity that characterises companies (Lev, 2001), justify the value of grants awarded to companies (Andriessen, 2001), and support stakeholders' judgment of a company's overall performance (Kaptein & Wempe, 2002). Some scholars have highlighted how the changes that have slowly but surely taken place in the last twenty years have eroded the value of the information provided by financial disclosure (Lev & Zarowin, 1997; Collins, 2001; Francis et al., 2002; Klein & Marquardt, 2006). Furthermore, over time, financial statements have revealed growing inadequacy in responding to increasingly complex information requests. The main limitations are related to their orientation towards the past, myopia regarding the heterogeneity of resources, and insufficient consideration of risks (Adams & Simnett, 2011).

Regarding the first limitation, according to Eccles and Serafeim (2011), financial information is a lagging indicator or a ‘rear-view mirror’ of firm performance and an imperfect predictor of future financial performance. From this perspective, backwards-looking financial information does not meet shareholders’ and stakeholders’ information needs, as they are also concerned with firms’ future objectives, strategies, and expectations (Adams & Simnett, 2011).

Another limitation of financial disclosure is represented by the difficulty in highlighting and measuring the descriptive–qualitative aspects of business management. These cannot be translated into monetary quantities, but they take on considerable importance due to the weight they have in value formation. In summary, the information offered by financial disclosure seems insufficient to evaluate a company’s set of competitive advantages in terms of both heterogeneous corporate resources and competitive positioning. Thus, financial disclosure does not facilitate an understanding of the real possibilities of defending this advantage, especially in the future (Lado et al., 1992; Barney, 2001). In particular, it does not allow for the judgment of companies’ intangible resources, which, although essential for the possibility of sustaining good performance over time, are allotted limited space in the document (Aaker, 1989; Adams & Simnett, 2011). This difficulty risks bringing attention only to performance achievements, thus distracting users from future growth opportunities, which are crucial for business success (Hamel & Prahalad, 1994). This limitation is demonstrated by the constant growth of the market-to-book value, which is the main measure of financial disclosure’s inability to fully represent the value of the intangible resources available to a company (Lev, 2001).

A further limitation that distinguishes financial disclosure is the limited importance attributed to corporate risks. This shortcoming does not allow for a full understanding of financial, operational, compliance, and health and safety risks, and of the broader set of risks that a company is called upon to manage and face (Rayner, 2003). This limit clashes with the growing importance of jointly considering performance achievements and the risks incurred when evaluating a company (Orlitzky & Benjamin, 2001).

The second line of evolution refers to firms’ obligation to integrate information related to environmental, social, and governance (ESG) performance into their disclosure to shareholders and stakeholders (Eccles & Serafeim, 2011). In the first phase, this integration was considered to respond to the need to provide stakeholders (and not just shareholders) with further reports that contain information related to the non-financial aspects of business management. This perspective frames the production of documents such as the social and environmental report. As supplementary information, these reports were coupled with the financial statement. In a social report, one can find information related to aspects such as human rights, education, ethics, and labour (Gunardi et al., 2016), while environmental reports contain information pertaining to pollution, climate change, and waste production (Hibbitt & Collison, 2004). The need to provide governance-related information has recently been added to the disclosure of social and environmental information.

Elkington (1997) recorded the first real attempt at integration that goes beyond the mere addition of non-financial information in a supplementary report. He coined the 'triple bottom line', according to which a firm should report on its economic, environmental, and social performance. In this regard, the need to observe—within a single document—the effects each company operation produces on overall performance has favoured the extension of communication according to the triple bottom line (Clarkson, 1995; Elkington, 1997). In fact, only the joint assessment of the economic, environmental, and social performance dimensions, according to their extended meanings, allows for the measurement and evaluation of a company's sustainability (Kiernan, 2001; Funk, 2003).

The most important event that transformed the idea of the triple bottom line into a reality was the creation of the Global Reporting Initiative (GRI) (Eccles & Serafeim, 2011). It is a non-profit organisation founded in Boston in 1997. Its main goal was to create an accounting and traceability method for companies that want to show their dedication to social and environmental aspects. More specifically, its mission was 'to make sustainability reporting standard practice by providing guidance and support to organizations' (Eccles & Serafeim, 2011, pp. 75-76). The birth of the GRI represented an important push to integrate social and environmental information with economic information and then also with governance information. However, the framework developed by the GRI did not explicitly require representation of the interconnections between the different types of information. Despite this, as early as 2010, 1,861 firms issued sustainability reports following the GRI's principles and guidelines (Eccles & Serafeim, 2011). By 2011, 95 percent of the world's 250 largest firms had reported on their ESG performance either by issuing standalone ESG reports or by publishing ESG information in a traditional annual report (KPMG, 2011; Maniora, 2017).

A disassociated disclosure strategy, which does not provide for the integration between financial and non-financial information (Maniora, 2017), leads to an isolated partial approach to sustainability (Eccles & Krzus, 2010;

Jensen & Berg, 2012) that does not allow for a full understanding of value creation processes. Therefore, awareness of the integration of ESG issues into the core business model has led companies to reflect on the partial effectiveness of producing separate financial and non-financial reports, thus favouring the visions behind the 'One report' (Eccles & Krzus, 2010) and the integrated bottom line report (Sroufe & Ramos, 2015). These visions promote the publication of a single document that is capable of providing information relating to the different aspects of corporate management (Maniora, 2017) to offer an accurate, comprehensive picture of a firm's true value (Sroufe & Ramos, 2015). In light of this, by 2000, firms such as Novozymes began to publish integrated reports (Sroufe & Ramos, 2015), followed in the next years by numerous other firms that decided to join this global corporate disclosure trend by voluntarily publishing integrated documents (KPMG, 2013; Mervelskemper & Streit, 2016). Among them, it is important to underline Novo Nordisk's pioneering role in the field of integrated communication (de Villiers et al., 2014, 2017).

The rise of IR therefore represents the convergence of the two evolutionary lines expounded above. On the one hand, the limits of financial reporting highlighted the inability of financial reporting alone to meet shareholders' and stakeholders' information needs, making it necessary to expand the scope of the information disclosed. On the other hand, the obligation to provide ESG information in an integrated way has led to reflection on the ineffectiveness of providing separate documents, which favoured the birth of IR.

1.3. IR in Italian management thought

The Italian scholars of *ragioneria* and *economia aziendale* have beat the rest of the world to investigating the purpose of the financial statement in order to understand its potential and limits. They pointed out how summary documents aimed at considering the financial aspects of a company's existence were primarily created to meet companies' internal information needs and only later became mandatory for the purpose of providing information to external parties (Azzali, 2015). From the Italian perspective, in the first phase of accounting history, investigating the growth of corporate assets was the financial statement's fundamental purpose. In fact, the financial statement, was intended to be purely internal, as it was considered a useful tool to help personnel running the company understand the growth of entrepreneurial wealth.