Integrated Reporting Guide for SMEs

June 2021

A.1. INTEREST (INTEgrated REporting for SME Transparency) project

"Integrated Reporting for SME Transparency" (INTEREST) is funded by the Erasmus+ Programme of the European Union. Its objectives are to provide a framework, guide and practical training for small and medium-sized companies (SMEs) in how to introduce and use integrated reporting.

To compete and be successful, it is vital that SMEs work together with a large variety of stakeholders, including multinational companies, clients and customers, suppliers, banks and other creditors, agencies and citizens. They also need to secure investments from different providers of finance and communicate with their stakeholders. To meet these challenges, it is essential for SMEs to build understanding of their business both internally and externally. It is also necessary for them to create and deepen trust in their business with their stakeholders. Therefore, it is important for SMEs to develop and communicate a clear, concise story of the value creation process that underpins their business activities.

This is where a holistic corporate reporting approach, called integrated reporting, comes in. It can help them to understand and display their whole value creation process and to secure the confidence of investors and stakeholders.

According to the International Integrated Reporting Council (IIRC), integrated reporting is the concise communication by companies of how their strategy, governance, performance and prospects, in the context of their external environment, lead to the creation, preservation or erosion of value over the short, medium and long term. At the centre of this concept is the idea that companies should expand their reporting to include all the resources that they input into their business models and that they enhance, consume, modify and affect through their activities and outputs, thus shaping company outcomes. These resources or capitals consist of financial, manufactured, intellectual, human, social and relationship and natural capitals. Integrated reporting is a reporting tool that companies can use to communicate their value creation processes to finance providers and other key stakeholders.

However, in order to create such a holistic value creation process, it is important that the management tool of integrated thinking underpins integrated reporting. Integrated thinking involves companies actively considering the relationships between their various operating and functional units and the capitals that they use or affect.

In the European Union, since 2018, the "Non-Financial Reporting Directive" (NFRD) requires organisations with more than 500 employees to include a non-financial statement as part of their annual public reporting obligations. The directive does not currently apply directly to SMEs. However, in the framework of the "European Green Deal", proposals are currently being formulated to strengthen the provisions of the NFRD and expand its reach. Moreover, there are ongoing discussions at European level concerning non-financial disclosure and SMEs. Therefore, while the current Directive does not directly affect SMEs, they may face demands from large companies with whom they do business to engage in non-financial reporting. In addition, future regulations may make non-financial reporting for SMEs more likely.

In April 2021, the European Commission published a proposal for the new Corporate Sustainability Reporting Directive. The proposal introduces new reporting requirements that aim to make companies accountable for and transparent about their impact on people and the environment.

Integrated reporting has been designed primarily with large companies in mind. This project aims to adapt the concept for SMEs. In particular, it has three key objectives:

1. To devise a model integrated reporting **framework** that is tailor-made for SMEs and that they can therefore access easily
2. To compile a **guide** that gives practical instructions for SMEs in how to implement integrated reporting and integrated thinking in their organisations
3. To develop **curricula** based on the guide for two major target groups of the project: a) senior managers of SMEs and b) students (future managers of SMEs, accountants, mentors etc.).

The INTEREST project consists of a consortium of six university partners and three non-university partners:

University partners:

- Budapest Business School, Budapest (HU) - Coordinator
- Leeds Beckett University, Leeds (UK)
- Hochschule Rhein-Waal, Kleve (DE)
- University of Udine, Udine (IT)
- Wroclaw University of Economics and Business, Wroclaw (PL)
- Babes-Bolyai University, Cluj-Napoca (RO)

Non-University partners:

- MAC-Team aisbl, Brussels (BE)
- Business Hungary, Budapest (HU)
- EFAA – European Federation of Accountants and Auditors for SMEs, Brussels (BE)

A.2. Purpose and structure of the guide

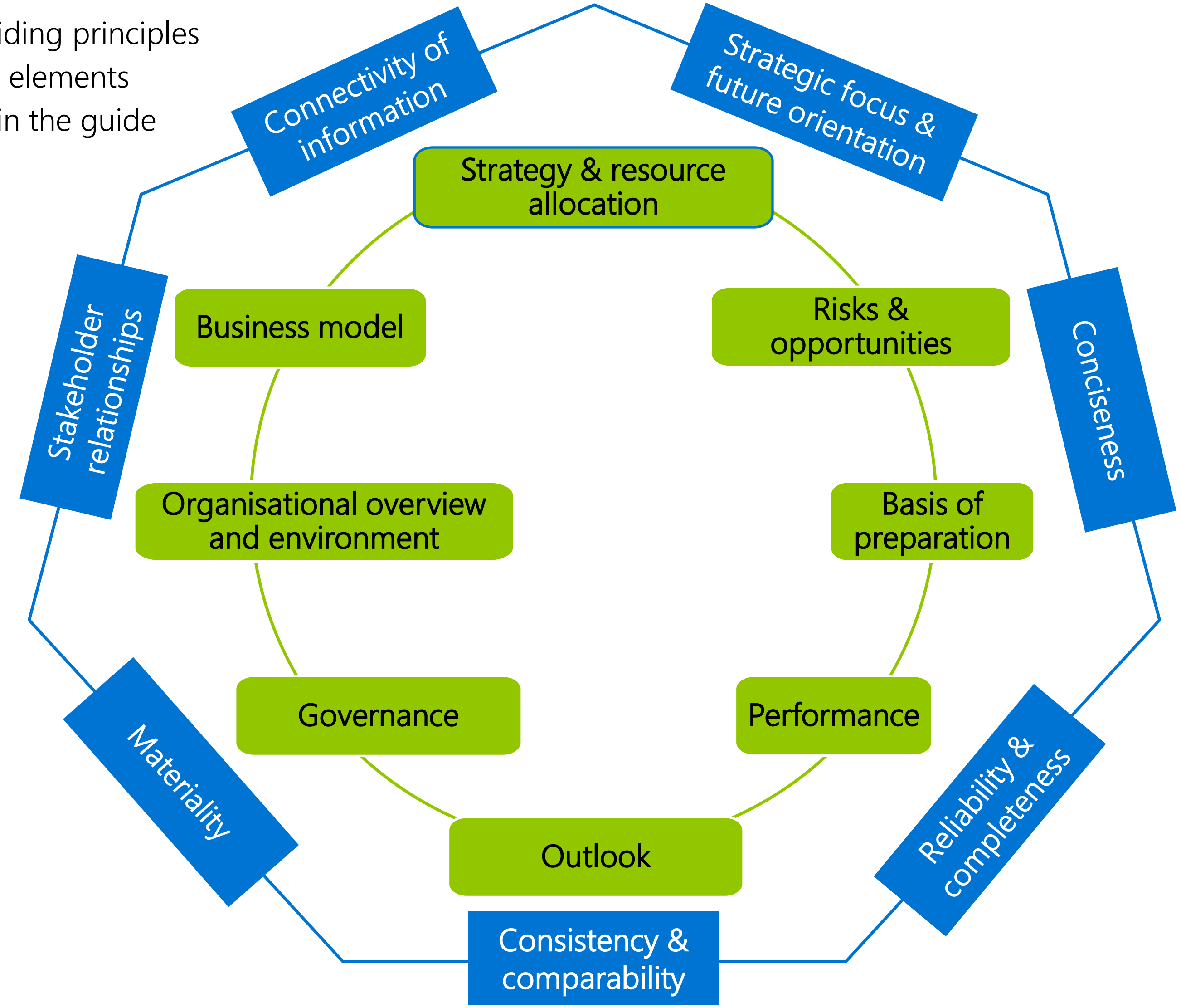
This guide is the result of the second objective of the INTEREST project. We have written it primarily for the senior management of SMEs who want to learn more about integrated reporting and how they can implement it within their companies. We address this target group directly in the guide.

We envisage that you, as SME managers, may use the guide to **implement integrated reporting in two stages**. If you are embarking on the journey towards integrated reporting, it may make sense to use integrated reporting firstly for internal purposes. This first stage can serve to build a better understanding within the company of your activities, decision-making processes, value creation process, use of resources and key stakeholders.

Once you have established this understanding, you can move integrated reporting to a second stage to communicate externally with stakeholders.

This guide builds on our publication "Integrated Reporting for SMEs: A framework for Action", which was the product of the first objective of our project. That publication sought to tailor the IIRC framework to the SME context. It therefore followed the structure of the IIRC framework closely. It firstly introduced the fundamental concepts of integrated reporting in detail and then outlined how the guiding principles and content elements of the IIRC framework can be applied to the SME context. In this guide, we show you how you can use these concepts, principles and elements to introduce integrated reporting into your companies. We focus particularly on the most important concepts, principles and elements that will aid you to implement integrated thinking and reporting.

Figure 1: Guiding principles and content elements focused on in the guide



Chapter B introduces you to **integrated reporting**. There are several standards and concepts of financial and non-financial reporting. The chapter provides concise explanations of the key concepts that characterise integrated reporting according to the IIRC. We then outline the relevance of integrated reporting for SMEs and highlight its key costs and benefits. The chapter also sets out key steps that you can take when implementing integrated reporting in your company. The subsequent chapters each centre on particular aspects of integrated reporting that you will need to consider when you implement integrated reporting in your company.

Chapters C to E focus on looking at different aspects of communication involved in integrated reporting. **Chapter C** centres on whom you communicate with, i.e. your key **stakeholders**. Stakeholder is a well-known term, not just confined to integrated reporting. We cannot provide you with a standard catalogue of key stakeholders as this depends on the nature of your business. However, this chapter serves to highlight different types of stakeholder relationships and the different information needs and expectations of stakeholders. It therefore aims to help you construct a stakeholder profile for your company and show how you can effectively manage and maintain relationships with your key stakeholders. In **chapter D**, the emphasis moves from whom to communicate with to what to communicate. When building a comprehensive picture of your company, whether for internal or external purposes, it is important to identify which information is relevant and **material**, i.e. can substantively affect your company's ability to create value over the short, medium and long term. This chapter describes how materiality assessment and analysis of information can help you to identify opportunities and risks and guide your decision-making. **Chapter E** considers sources of information. In particular, it highlights the **data sources** that you already have within your company that you can use and structure for integrated reporting. It also shows how you can supplement these with information from external data sources. Information technology (IT) requirements for integrated reporting are also discussed.

Chapters F to H each deal with a particular aspect of your company that is fundamental for integrated reporting. **Chapter F** centres on how you can provide a useful **overview of your organisation and the environment in which you operate**. Again, it is not possible to provide a standard catalogue of issues that you could use to portray this internal view of your company and the external conditions you face. It depends on the history and nature of your company, the products and services you offer and the markets in which you operate. However, the chapter gives you important pointers as to how to portray your organisation in terms of its legal and operating structure, its mission, culture and history and main activities. It also helps you to identify external trends and factors that are key to giving you and your stakeholders a better understanding of the markets in which you compete and your opportunities and risks. **Governance** is the focus of **chapter G**. Governance concerns the rules and processes that you use to steer and monitor your company. This chapter identifies two steps that you can take in analysing and communicating your company's governance.

The first centres on identifying the key governance structures of leadership, ownership and decision-making. The second focuses on helping you to assess how these governance structures impact on your business and your relationships with stakeholders. In **chapter H**, we turn to consider **value creation and the business model**. To create value, a company needs to have a clear **strategy** and to **allocate resources** to achieve this strategy. It also paramount that it is aware of the **risks and opportunities** it faces to create value over time. Chapter H commences by outlining how you can formulate and present your strategy in an integrated report. It also gives you pointers to identify risks and opportunities. Closely linked to the strategy of companies is their **business model**. A company's business model is the system through which it transforms inputs through its activities into outputs to fulfil its strategy, create value and achieve its outcomes. To help you to create and structure your business model, we draw on Osterwalder and Pigneur's Business Model Canvas. We show how you can use it to communicate how your company creates, delivers and captures value for its customers and stakeholders. We also highlight how it can be usefully linked to depict resources as capitals in integrated reporting.

Chapters I and J turn to focus on these capitals and the interrelationships between them. **Chapter I** helps you to **identify and measure capitals**. In particular, it breaks the identification and measurements of capitals down into four stages. It also provides you with a concise definition of each of the six capitals and illustrates them with examples and key performance indicators. **Chapter J** highlights the importance of not treating each capital separately, but of recognising the **interrelationships** between them. In particular, it helps you to identify the positive impacts and be aware of the trade-offs of using or increasing one capital or the other capitals.

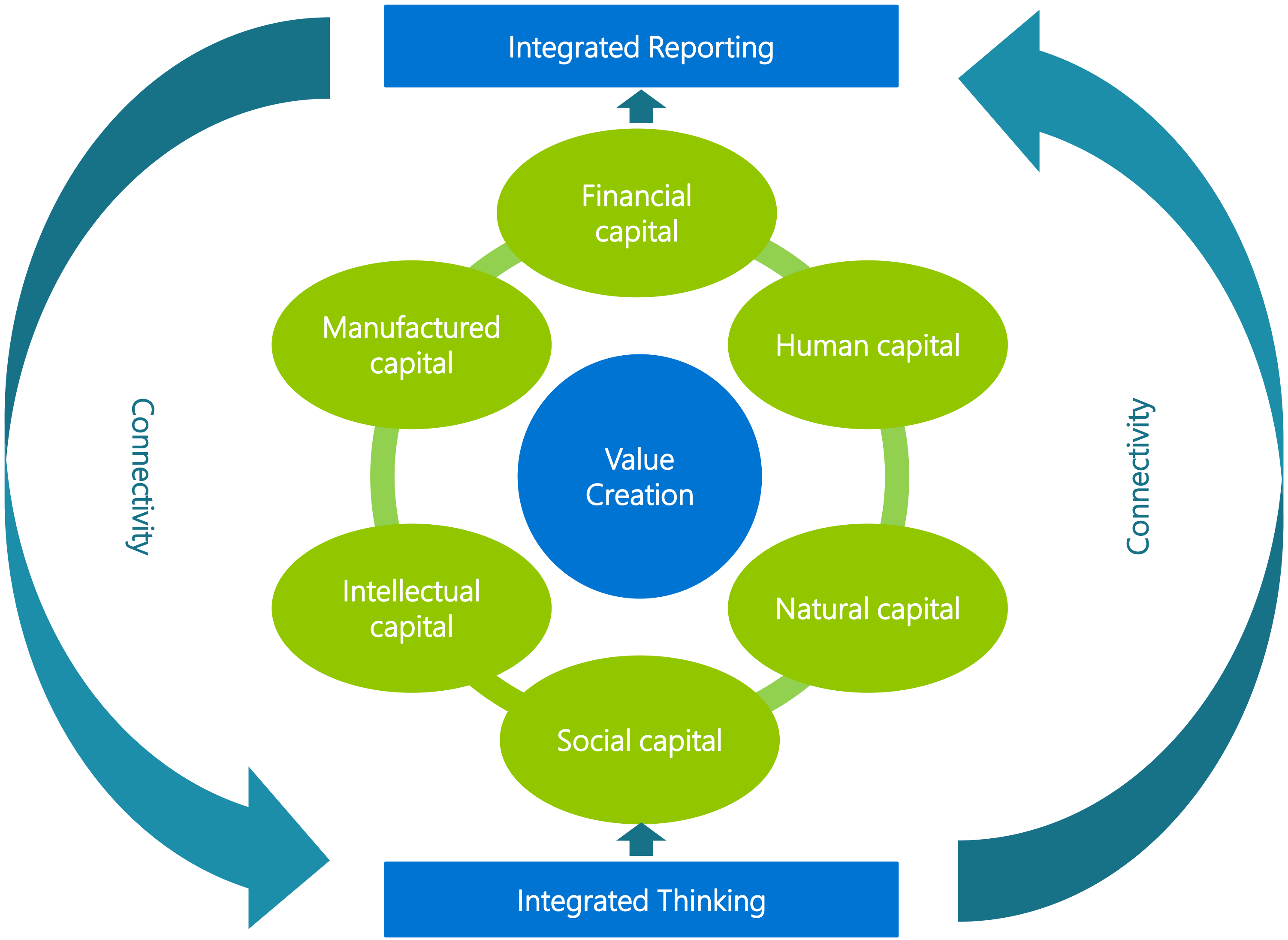
The guide concludes in **Chapter K** by providing you with pointers and best practices of how to **visualise** the value creation story of your company. Integrated reporting is not just about what information to communicate to whom, but also how to communicate this information to provide a clear and concise picture of your company.

B.1. Key concepts of integrated reporting

B.1.1. General overview

To help you start the journey towards integrated reporting, it is important to first introduce you to the **key concepts** of integrated reporting as developed by the IIRC and show you how they are interrelated. There are various standards and frameworks to aid organisations in reporting financial and non-financial information. Key elements of the concept of integrated reporting are **value creation, capitals, integrated thinking** and **connectivity**. These are depicted and outlined here.

Figure 2: Key concepts of integrated reporting



A central focus of integrated reporting is how a company **creates, preserves or erodes value** in the short, medium and long term through its activities. Integrated reporting captures value creation in terms of the ways a company increases, decreases or transforms stocks of value (inputs) in its activities (outputs). It defines stocks of value as **capitals** and distinguishes between six types of capitals – financial, manufactured, human, natural, intellectual and social and relationship. It also emphasises the interrelations between these capitals. So, it uses a wide conception of value creation that goes beyond traditional, narrow notions of a company's capital. It includes all capitals that a company utilises, including wider capitals, such as the environment (natural capital). Chapter I and Chapter J provide more information on the six capitals and the interrelations between them.

This comprehensive view of a company's activities, value creation and types of capital requires integration of a company at two levels. The first level is that of the organisation and is **integrated thinking**. It is essential to integrate processes, management and decision-making within the organisation. This is to ensure that value creation and the deployment of capitals is an integrated effort, rather than something that takes place separately and disjointedly in different departments. The second level is that of communication within a company and between the company and its stakeholders and is **integrated reporting.** Integrated reporting culminates in the end product of the process - an integrated report.

Integrated thinking is a prerequisite for effective integrated reporting. Before a company can communicate in an integrated manner internally and externally, it is important for its members to actively consider the relationships between different parts of the company and to evaluate how the whole company creates value and uses the various capitals. **Connectivity** underpins both integrated thinking and integrated reporting. Interconnecting processes, management, decision-making and communication in a company is a central element of the journey towards integrated thinking and integrated reporting.

Integrated reporting enables a company to communicate in a more interconnected way with its stakeholders.

B.1.2. Integrated reporting

An integrated report is the **end product** of the process of integrated reporting. It is a comprehensive way of communicating information about how your company creates value and utilises capitals in its activities. Companies can use an integrated report for both **internal and external communication purposes**. Using an integrated report for internal communication purposes can help you and the members of your company to better understand your company, your activities and the opportunities and challenges that you face. Using integrated reporting to communicate externally with your stakeholders can help to increase your understanding of stakeholders' needs and demands. It can also provide stakeholders with a more comprehensive picture of your company.

It may make sense to use an integrated report for internal purposes first, before using it to communicate externally with stakeholders. By focusing on how a company creates value and utilises capitals in its activities, a key goal of integrated reporting is to replace partial, retrospective and disconnected reporting. Common financial reporting rules for SMEs within the EU require only limited disclosure of information.

B.1.3. Integrated thinking

Effective integrated reporting requires **integrated thinking**. Therefore, whereas an integrated report is the end product of the integrated reporting process, integrated thinking is the **starting point**. Effective internal and external communication of how your company creates value through its activities and uses capitals requires integrated processes, management and decision-making. Integrated thinking means **overcoming communication barriers** between departments and people in your company.

It involves bringing together people with different expertise and different perspectives. For example, reporting on human capital and intellectual capital requires but also facilitates communication between accounting experts and human resources and research and development departments.

Integrated thinking can **promote a better understanding** by members of your company about the relationships between the various operating and departmental functions and the capitals that your company uses and affects. For example, saving money on employee training may reduce your financial costs and increase profit in the short-term. However, it may also reduce employee productivity, innovation, morale and employee retention that could have bigger negative financial implications in the longer term.

Integrated thinking can also help your company to better understand how value created in one part of the organisation can affect value creation elsewhere in the company. This in turn can help you to make **better decisions** through an improved understanding of the opportunities and risks your company faces and the needs of your key stakeholders

SMEs are by nature smaller and therefore generally have less separation between functions and departments than large companies. This means that the organisational and cultural changes necessary for integrated thinking are likely to be less challenging and time-consuming than for large companies.

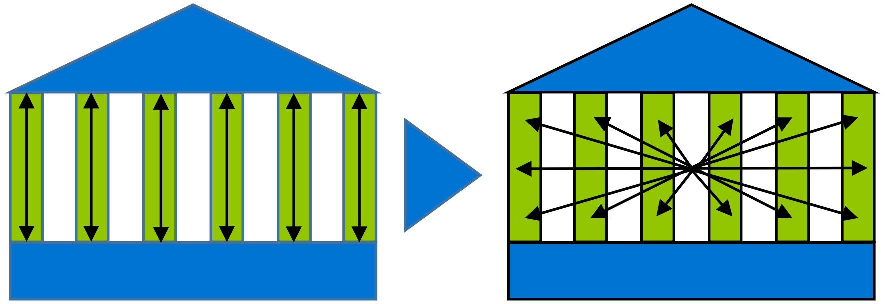
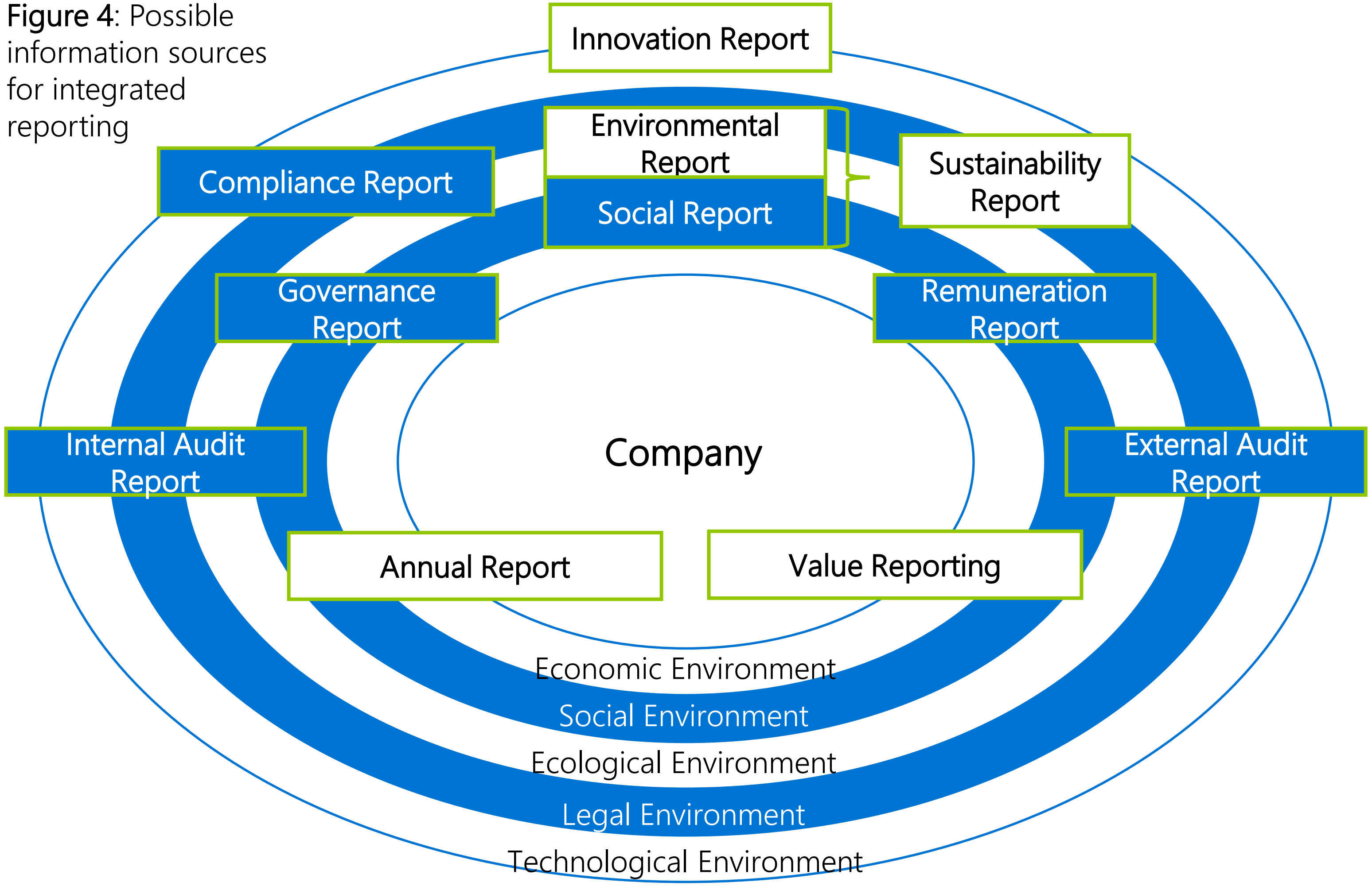


Figure 3: Organisational changes through integrated thinking

B.1.4. Connectivity

Connectivity of information is required to enable and execute integrated thinking in your business. Connectivity refers to **multiple dimensions** including connectivity of **sources of information**, **type of information** and **time horizons**. All content elements of integrated reporting need to be linked to each other. A special focus is placed on the link between financial information and other information as well as qualitative and quantitative information. It is important to link information on short-term perspectives and impacts to medium-and long-term perspectives. Hence, connectivity ensures that integrated reporting provides a **comprehensive insight,** not only into the economic situation of a company, but also insights on its social, environmental, legal and technical impacts. In essence, it is important to report not just isolated pieces of information on selected issues but instead to establish and display meaningful linkages between selected information to offer a clear picture of the impact of the business activities. The following illustration provides an overview of possible information sources to display the different elements of the business environment.

Figure 4: Possible information sources for integrated reporting



Source: own illustration based on Barmettler P. (2017) Chancen und Risiken des Integrated Reporting. In W. Funk & J. Rossmanith (eds) Internationale Rechnungslegung und Internationales Controlling. Springer Gabler, Wiesbaden, p.537.

To ensure connectivity of information in your business, it is important that you firstly identify the different required content elements as well as the required information sources. As a starting point, you can use your existing management information system and reports. Depending on the legal form of your business, you possibly already compile a lot of the required information in different isolated reports (e.g. financial statements, compliance reports, sustainability reports, audit reports etc.).

In a second step, it is necessary to establish linkages between the different information sources to allow a meaningful and comprehensive understanding of your business activities as well as of the environment in which your business is operating.

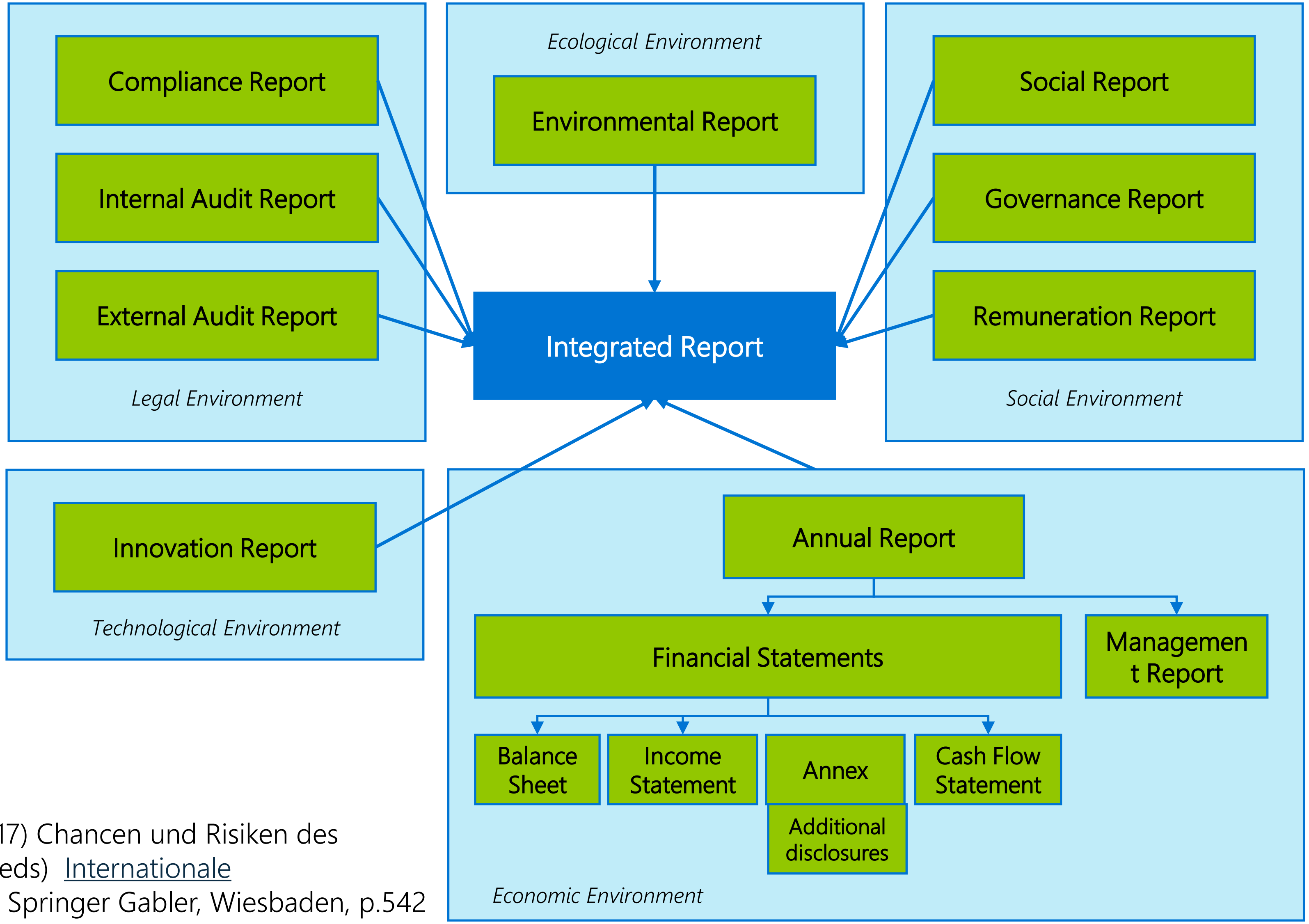


Figure 5: Existing reports of use for integrated reporting

Source: own illustration based on Barmettler P. (2017) Chancen und Risiken des Integrated Reporting. In W. Funk & J. Rossmanith (eds) Internationale Rechnungslegung und Internationales Controlling. Springer Gabler, Wiesbaden, p.542

B.1.5. Value creation

At the core of any business model is the aim to create value through business activities. Value in general can be viewed as any benefits claimed by a person/organisation resulting from a specific object or activity. It is common to follow an **economic value approach** where value is usually defined in monetary terms and linked to tangibles (value of tangible assets like goods or machines) or to a certain extent to intangibles (value of intellectual property such as patents and trademarks). Despite measurement being possible, it is important to note that value is a relative concept and dependent on the perspective of the assessment, i.e. who is the beneficiary. Furthermore, observable prices are only an indication of value as price is what you pay but value reflects the benefits you receive. The economic value approach usually only focuses on value created by business for the limited group of owners/providers of funding and hence is strongly linked to the concept of **shareholder value**.

Under traditional reporting frameworks, value is usually tied to the measurement of profits of a business and determination of dividends accruing to the owners of a company.

The **societal value approach** reflects a broader concept of value. In this concept, value is not just determined as value for a business but includes all benefits potentially accruing to a society as whole. Hence, this concept considers all assets and other sources to determine value. Typical examples for societal value generated by a business are the creation of knowledge or the attractiveness of geographical regions by creating jobs. Strongly linked to the societal value approach is the concept of **stakeholder value**. Under this approach, the value of all key stakeholders of a business are considered. As it is not usual to regard the environment as a stakeholder, environmental impacts of business activities are seldom considered under the stakeholder value approach.

Integrated thinking and reporting requires a **broad approach** to determining value and value creation, preservation and erosion, not only for the business itself (economic value) but also for all other stakeholders and society (societal value). Therefore, it both requires and enables you to consider and evaluate the overall impact of your business activities more precisely. For example, when designing new production processes, it is important to not only evaluate a reduction in production costs, but to also consider the impact of such changes on other stakeholders (e.g. employees) and on the environment. As most SMEs do not just focus on short-term value creation, but for example in case of family firms also consider the long-term impact of business activities on profitability and reputation, such a broad concept of value is not an entirely new exercise.

B.1.6. Capitals

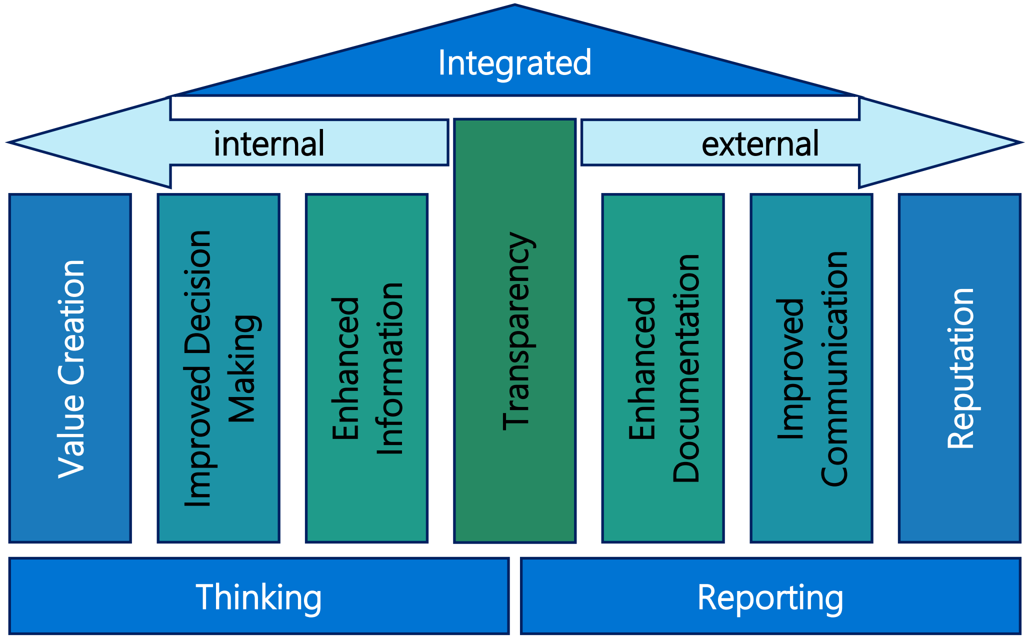
Following a broad approach to determine value, in integrated thinking and reporting, it is important that you consider all resources used or impacted to generate value. These **resources** are referred to as capitals. The concept of capitals is broader than the concept of assets and funds under financial reporting and contains all resources available to a business. In integrated reporting **six capitals** are distinguished: **manufactured capital** and **financial capita**l are closely linked to financial reporting and represent financial funds and tangible assets available to your business. **Intellectual capital**, **social and relationship capital** and **human capital** reflect all activities linked to humans. These capitals expand the notion of **intangible assets** and reflect resources that are not usually included in financial reporting (e.g. quality of management team, special relationships with suppliers etc.). The last capital is **natural capital**. Considering this capital allows you to consider the impact of your activities on the environment.

To **identify** and **measure** the capitals used by your company, you may want to use the positions and values from financial reporting as a starting point especially for financial and manufactured capital. You can identify all other capitals by using a documentation of your business model (for more information about the business model, see chapter H).

B.2. Relevance of Integrated Reporting for SMEs

You may pose the question 'why' to introduce integrated reporting in your company, as it seems to be relevant for large companies only. The answer is very simple: implementing integrated reporting and integrated thinking should lead to value and reputational benefits for your company.

Figure 6: Reasons for introducing integrated thinking and integrated reporting



Integrated thinking helps you to analyse your company more deeply and understand it better. Internally, this improved **transparency** gives you a better foundation for making decisions, thus creating value. Externally, it enables you to communicate more effectively and openly with your stakeholders, thus improving your **reputation**.

The success of implementing integrated reporting and thinking depends on the extent to which you can **transform** the increased understanding about your company into changes that can improve your business.

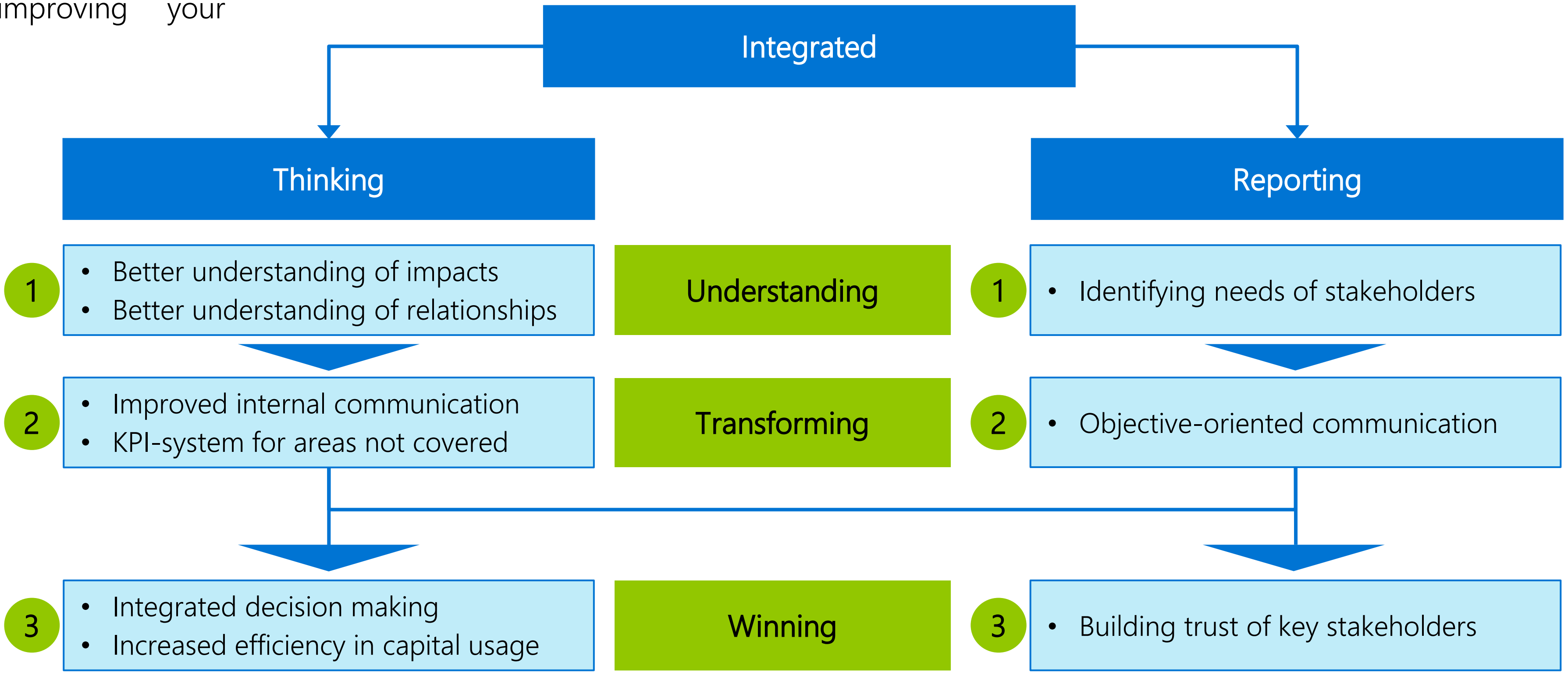


Figure 7: Success factors of integrated thinking and integrated reporting

Firstly, you can better **understand** impacts of decisions made and internal relationships – e.g. of employees, capital forms. Thus, you can take actions to **transform** status-quo weaknesses. Improved internal communication between teams can break down potential department silos, thus leading to a shared understanding in the company and more creative solutions. You can **define** key performance indicators (KPIs) in areas that have not been in the scope of existing management systems. A joint optimisation of many objectives improves results as you consider the interrelations between your objectives as well as unintended consequences in your integrated decision-making. Your company may have an IT-based tool that reports many KPIs to support the success of your company by a more efficient use of the capitals of your company.

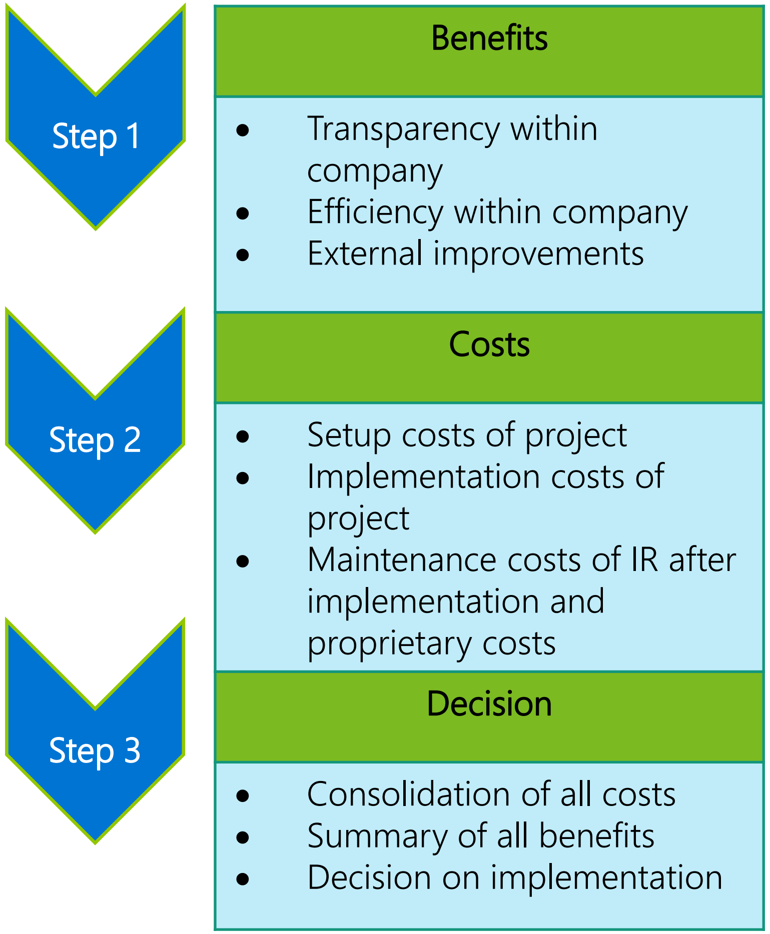
Secondly, you can **identify** the needs and requirements of your (key) stakeholders to start objective-oriented communication. You can provide further information to improve business activities (higher prices for higher quality, increased sales and satisfied customers).

In the long term, you can increase your competitive advantage by establishing reliable relationships with your key stakeholders based on trust. So, you can profit from better market conditions as a purchaser of materials, seller of products and debtor of loans. Overall, the investments you make in implementing integrated reporting and thinking will bring benefits in the future.

B.3. Benefits and costs of integrated reporting and thinking for SMEs

Before introducing integrated reporting, it is necessary for you to **weigh up the estimated costs and expected benefits** of this decision. Your company can only profit from potential benefits after having successfully completed implementation. One focus is on your IT systems and IT architecture that is a main driver of future viability. Today you may have to invest a lot of money in IT hardware and IT experts, which will pay off in the future, not only for integrated reporting. The following figure provides an overview of forecasted benefits and occurring costs to consider in the decision-making process.

Figure 8: Evaluating the benefits and costs of integrated reporting



Benefits

Your company can already benefit before having finished implementation activities. More value can be created in the longer term.

Figure 9: Benefits of integrated reporting

Transparency within company
• Data provision • Capitals • Business Model
Efficiency within company
• IT system • Automation • Documentation • Value Creation
External Improvements
• Reputation • Enhanced communication with stakeholders • Enhanced conditions with partners

Better data provision, understanding relationships and interdependencies between the capitals and of your own business model (integrated thinking) increase the **internal transparency** of your company (for employees and managers). Investments made in IT infrastructure, as well as improving your processes (leaner, faster, automated), save costs and **increase efficiency**, which supports your value creation. You can profit from **enhanced and objective-oriented communication with external stakeholders** (creditors, suppliers and customers). Providing better information to banks can lead to **more attractive loan conditions** (reduced transaction costs). Many companies demand more and detailed information from their suppliers, for example to prove that their total supply chain is "green" or sustainable. Providing more and focused information about the company improves the SME's **reputation** with external stakeholders, thus showing them the value-added of doing business with it. As your benefits are uncertain and may be non-monetary, the valuation of overall benefits is quite a challenge.

In the end, you have to decide whether (or not) to implement integrated reporting. You have to weigh the (estimated) costs against the potential benefits for a specified period.

Costs

Costs occur **before** (project setup costs), **during** (implementation costs) and **after** (maintenance costs) integrated reporting is introduced. They are relatively easy to determine as the tasks and required resources are part of the project plan for integrated reporting implementation. It is possible to differentiate costs further into costs that cause cash-outflows (monetary costs) and costs that are caused by using already available resources (**opportunity costs**). For example, you have to invest money in enhancing your IT infrastructure or hiring external support (consultants) to manage your integrated reporting project. Opportunity costs mainly result from your employees participating in the project by contributing their knowledge about the company and its processes. In the maintenance phase, your main costs result from running your given IT infrastructure and the required staff but also from changes.

Figure 10: Costs of integrated reporting

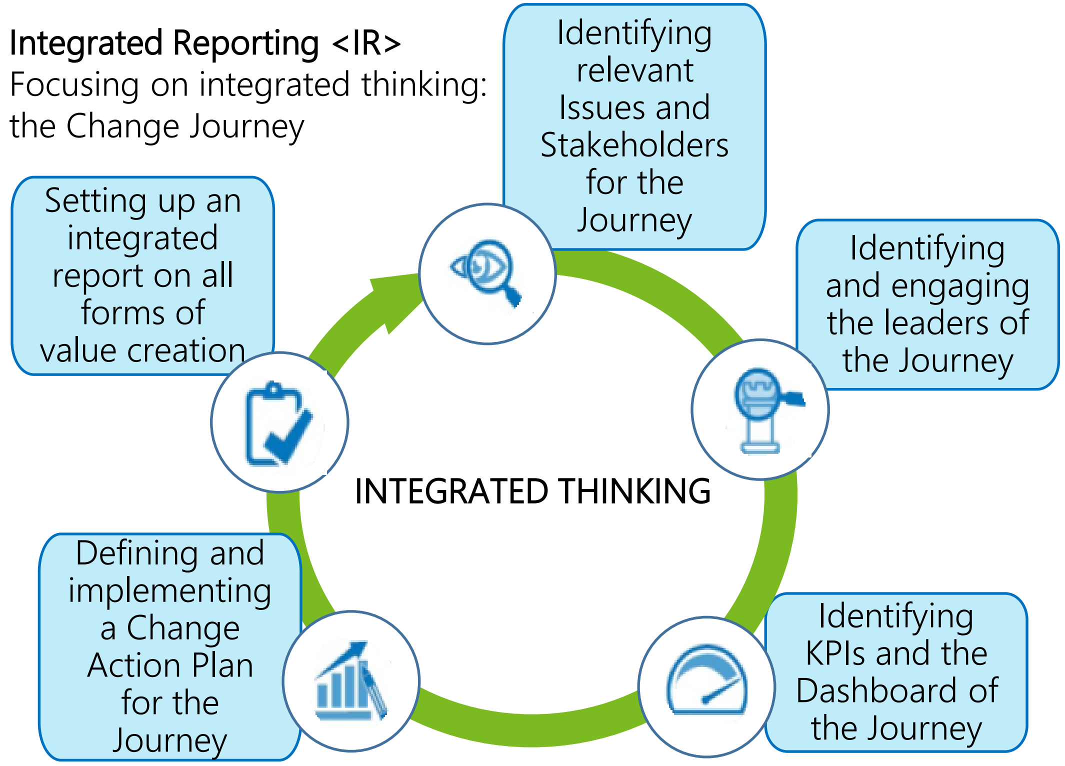
Set-up costs of project
• External consulting • Costs of employees' time
Implementation costs of project
• Investments in IT infrastructure • External consulting • Costs of employees' time
Maintenance costs after implementation of integrated reporting
• Running costs of integrated reporting • Change costs of integrated reporting • Proprietary costs

You should also consider hidden costs resulting from the intended greater transparency that integrated reporting brings. This can lead to **proprietary costs**, for example if your competitors use disclosed information.

B.4. Implementation process

First, it is important to stress that this will not be the first project in your company. You know your company well and you are a potential member of the working group. Therefore, the following ideas represent the experience of other companies, **on the journey towards integrated reporting**, but there is no universal concept that will fit for all companies. It is up to you to find the best way of implementation for your company. As in other publications, we utilise the image of a journey towards integrated thinking and integrated reporting. On this journey, we can identify some important stages and steps:

Figure 11: Journey towards integrated thinking and integrated reporting



Source: NIBR (2016), Integrated Reporting: Focus on Integrated Reporting. A Handbook for the Change Journey, Network Italian Business Reporting (NIBR)

Before you start your journey, think about the prearrangements. We recommend especially these three key aspects:

Figure 12: Key aspects of the implementation process

1. Define your business model and strategies
Are you sure about your business model and strategies or is there a need to redefine them? It can be helpful to write down your business model and ensure that all board members and managers have a common understanding of it.
2. Involve a team that represents the main business functions in your company
Make sure that the main functions are represented in your project team. Ask yourself whether all the necessary knowledge is present in your project team.
3. Set targets, time limits and costs for the implementation process
You can define and implement integrated reporting in one step or a corporate reporting evolution roadmap over three to four years with progress targets each year. Think about the different types of costs outlined in section B.3.

Because of the interrelations between integrated reporting and integrated thinking, we recommend that you follow the five steps of the change journey as presented above in figure 10. As a fast track to implement integrated reporting only, you could also follow just three steps:

1) Materiality Analysis - definition of areas of value creation and relevant risks
2) Value Creation - usage of the six capitals for creating value; identification of relevant KPIs
3) Impact Evaluation - measurement of the KPIs and implementation of a dashboard.

The longer version of the journey starts with:

Step 1

Identifying relevant issues and stakeholders

a) Map the relevant issues, opportunities, risks and areas of resistance for the journey
b) Map internal and external stakeholders

You may use the following grid to do so:

Figure 13: Grid to identify issues and stakeholders

Area	Issues	Decision Maker	Ownership	Internal stakeholder	External stakeholder
Sustainable and long-term business approach					
Governance					
Strategy					
Organisational setup and development					
Company culture					

The next step is:

Step 2

Identifying and engaging leaders of the journey

- Potential groups (depending on size of company) are board of directors, management team, change steering committee
- Ways to engage these groups may be elevator pitch on opportunity to refocus decision-making processes, off-site integrated thinking meetings, integrated thinking leadership coaching sessions

Afterwards we move more towards reporting by:

Step 3

Identifying KPIs and the dashboard

For each key area, you need to identify leading KPIs (how do we reach our goal) and lagging KPIs (how do we measure our results)

To give an example, if the organisational goal is to reduce energy consumption, leading KPIs monitor which actions have been planned and implemented, like re-engineering of manufacturing processes or increasing awareness about the benefits resulting from careful energy consumption behaviours. Lagging KPIs are for example monthly energy costs.

Just defining KPIs only leads to additional information, but not to a better performance of your company. Therefore, the next step is:

Step 4

Defining and implementing a change action plan

Identify actions that you can carry out for each of the critical issues. These actions are part of an organic and systemic change action plan.

Now, you have reached the last step of your journey:

Step 5

The integrated report

You have defined all types of value creation, the KPIs for measurement and have an idea about actions for future development. The report can be the starting point for the next circle of identification of changes in issues, KPIs and so on.

You should critically review these steps after some years as changes in your environment may require revisions in your integrated reporting.

Having introduced you to integrated reporting, in the next chapter we turn to stakeholders. In particular, we focus on highlighting how you can identify your stakeholders and their informational needs, in order to engage effectively with them.

C.1. Different groups of stakeholders

This chapter will help you to **identify stakeholders effectively** by recognising, analysing, and selecting those with a high or moderate influence and dependence on your company. **Stakeholders** are individuals, groups or organisations who provide your company with critical resources and expect their interests to be satisfied.

It is not possible to provide a standard list of stakeholders that applies to all organisations. You could identify your stakeholders independently, or in order to ensure that you do not miss critical groups, you can identify them by involving stakeholders in the process. It is important to carry out the stakeholder identification process systematically and revise it regularly.

There are three key reasons why identifying and maintaining relationships with stakeholders is important:

Figure 14: Key reasons for identifying and maintaining relationships with stakeholders

1. Stakeholders are the source of financial and other support

Examples: investors bring funding, connections, ideas and advice; suppliers provide raw materials and services to the business

2. Stakeholders deliver important and expert information

Examples: customers provide feedback on product quality; business partners may deliver expertise on new technologies; employees may share their knowledge in the workplace

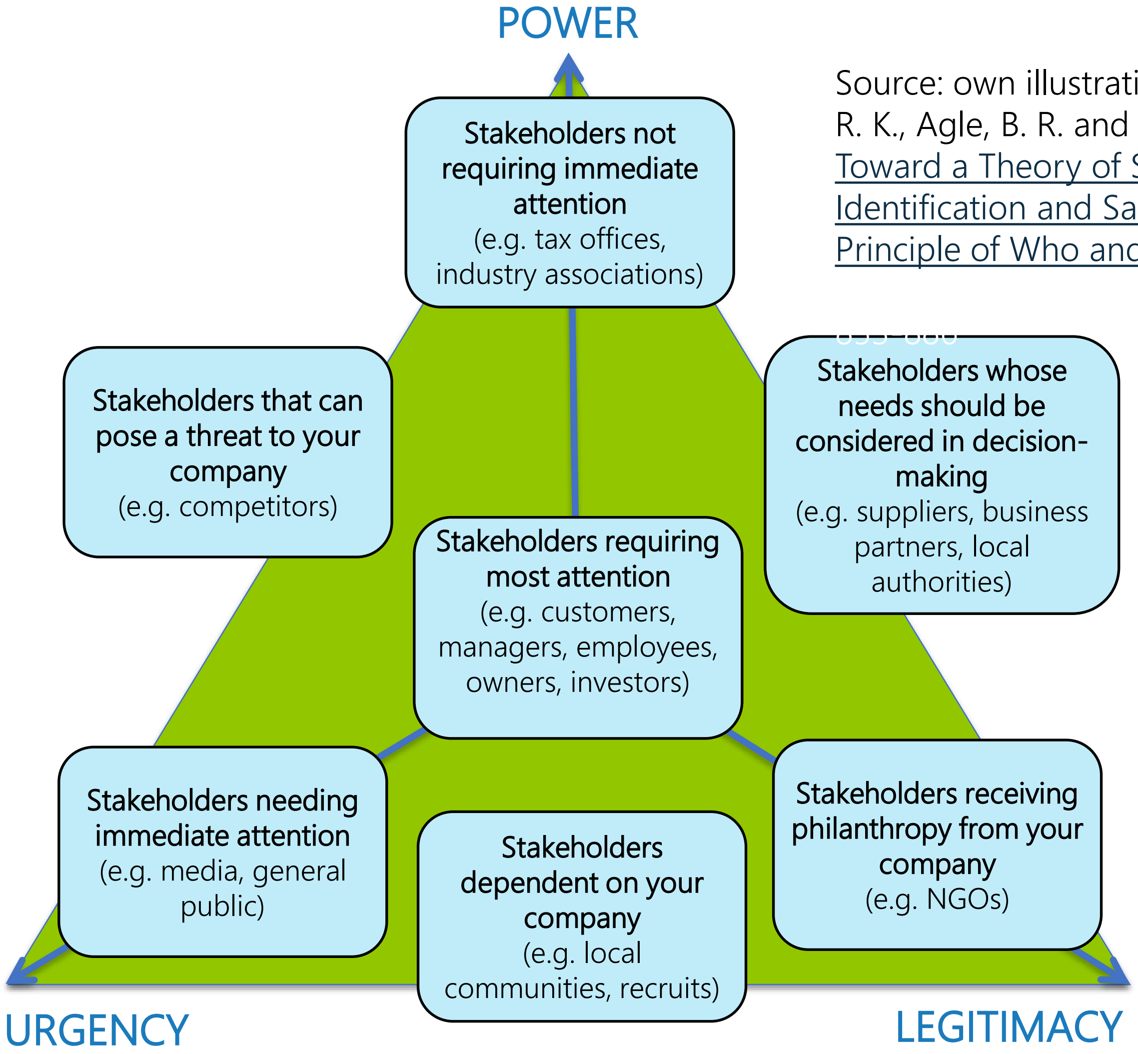
3. Stakeholders help improve company reputation in the long-term

Examples: NGOs acknowledge the support of a company to charity actions; local communities recognise efforts of a company towards being eco- and socially-engaged

To help you to think about different groups of stakeholders, power, urgency, and legitimacy of stakeholders are useful criteria to categorise stakeholders. **Power** has to do with the extent to which stakeholders have access to important physical, financial or intangible resources. **Urgency** exemplifies the degree to which stakeholder claims call for immediate attention. **Legitimacy** demonstrates the authority of stakeholders based on social acceptance.

For example, stakeholders with power, urgency and legitimacy, such as customers, owners, employees, investors, require the most attention. It is therefore necessary to manage relationships with them carefully. Stakeholders with power and legitimacy, such as suppliers and business partners, can exert influence on your company. Therefore, it is important to consider their requirements in your decision-making processes. The interests of stakeholders with urgency, such as the media or the general public, demand immediate attention. Other stakeholders may not require immediate attention. However, it is important to recognise that the needs of stakeholders may change over time.

Figure 15: Identifying stakeholder needs based on their power, urgency and legitimacy



Source: own illustration based on Mitchell, R. K., Agle, B. R. and Wood. D. J. (1997). Toward a Theory of Stakeholder Identification and Salience: Defining the Principle of Who and What Really Counts.

C.2. Information needs of stakeholders

To analyse the information needs of stakeholders, it can be useful to consider information in terms of its content, area, scope, timeliness, type, and character. It is also important to think about information granularity (general vs detailed data), information format (standardised vs unspecified) and frequency. To help you to identify information needs in this way, the following matrix illustrates the information needs of two types of important stakeholder groups - investors and employees.

Figure 16: Exemplary matrix of investors and employees' information needs

Stakeholder groups	Investors	Employees
Content (topics)	company value and growth, competitive position, customer base, innovations	career development opportunities, training programs, work-life balance, safety of business
Area (financial, environmental, social, governance)	financial, governance	social, financial
Scope (supply chain level, top management level, regional level, local level)	top management level	local level
Timeliness (past data, current data, real-time data)	current data	current data
Type (qualitative, quantitative)	quantitative, qualitative	qualitative
Character (financial, non-financial)	financial, non-financial	non-financial
Engagement method (personal contact, website, social media, meetings, workshops, questionnaires, surveys etc.)	personal contact	meetings, workshops
Communication frequency (permanently, daily, weekly, monthly, quarterly, annually)	Quarterly	annually

We recommend that your company engages groups of interest in the materiality determination process (see chapter D for more details on materiality) to recognise **stakeholders' information needs**.

The following actions may help you recognise relevant issues for stakeholders:

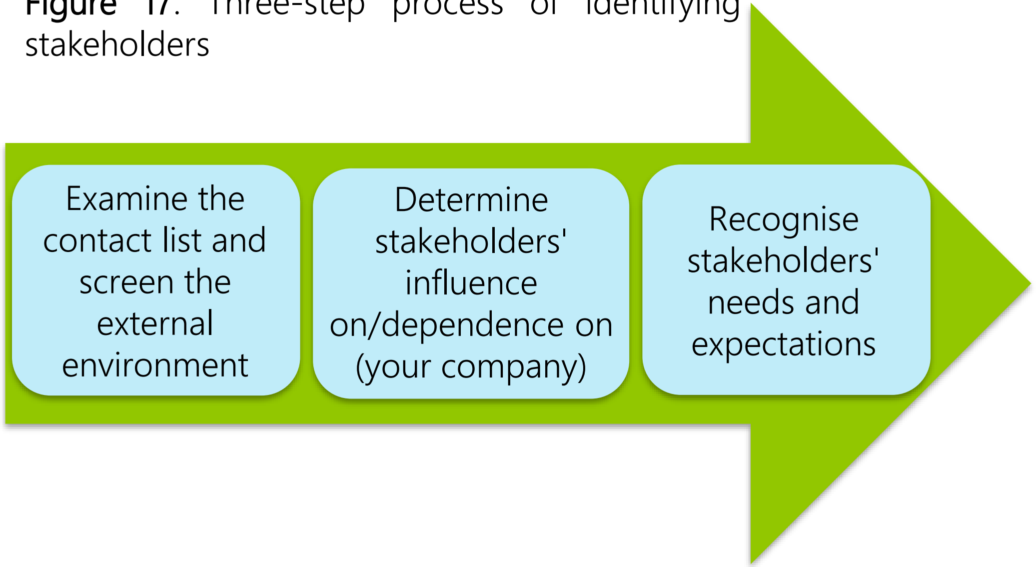
1. interview the representatives of key stakeholder groups, including employees
2. collect external stakeholders' priorities using online and social media tools;
3. conduct prioritisation workshops with external experts and internal leaders;
4. take an innovative approach and focus on megatrend analysis.

You may realise that your company may already have a lot of knowledge about stakeholders' everyday business. To keep the workload manageable, you may start by documenting your information about your stakeholders and their informational needs and then proceed to use more sophisticated tools where needed.

C.3. Stakeholder identification

To identify stakeholders effectively, it is important to recognise the relationship between your company and its stakeholders in terms of influence and dependence. This means the extent to which stakeholders have an influence on your company, and that extent to which they are dependent on your company. You can then follow a transparent and documented three-step process.

Figure 17: Three-step process of identifying stakeholders



Firstly, your company should **analyse the stakeholder contact list** and explore whether you have interacted with them frequently or occasionally in the recent period. The reasons and outcomes of these interactions should also be determined. It is important that you also **screen the external environment** to search for those stakeholders who could be potentially affected by what your company is doing or who could make a considerable input to the company.

Bear in mind local authorities, businesses and communities, as well as charity organisations.

Secondly, your company can map **stakeholders** in terms of their influence and dependence. Note that your stakeholder groups may be in different positions in your matrix and that you may need to consider other groups.

Figure 18: Matrix for mapping stakeholders

INFLUENCE OF STAKHEROLDER ON SME	LOW	MODERATE	HIGH
HIGH	Banks, (influential) competitors	Customers	Investors, owners, business partners, managers, employees
MODERATE	Tax offices	Local authorities, local communities	Suppliers
LOW	The general public, industry associations, media	NGOs	Recruits

DEPENDENCE OF STAKEHOLDER ON SME

Stakeholder mapping involves a prioritisation process. In this respect, you may consider the following dimensions:

Figure 19: Dimensions to consider in stakeholder mapping

1. Stakeholder relevance to material issues
Advice: Focus on stakeholders who have the potential to impact material issues.
2. Degree of stakeholder influence
Advice: Assess how much impact stakeholders have on your enterprise and how they can support its reputation, operations, sales or other functions.
3. Degree of impact on the stakeholder
Advice: Assess to what extent your company affects the stakeholders and focus efforts on the most critical relationships.
4. Diversity
Advice: Be aware of a wide range of perspectives to gain the best insight. Consider particular sectors or groups of relevance (e.g. public sector, private sector, voluntary groups, academics, researchers) or specific roles or functions (e.g. data users, funders, policymakers, local communities) while exploring diverse stakeholder groups.
5. Openness to engage
Advice: Identify whether stakeholders support or oppose your company's positions and ideas. It may be necessary to allocate resources to stakeholder relationships that are more likely to generate value for the company and stakeholders.

Source: based on O'Neill R. (2018) Common Threads: Designing Impactful Engagement, SustainAbility, November 2018

Thirdly, once you have created the stakeholder matrix, your company should **recognise the needs of the most significant stakeholders** – those who strongly influence your company, or are dependent on it to a high degree, or are at least at moderate levels in both dimensions. In further steps, you may consider the needs of other stakeholder groups.

Stakeholders	Needs	Dependence	Influence
Investors	A sound return on investment, increase in equity, information transparency	high	High
Owners	Building a trustworthy and reputable company, long-term financial stability	high	High
Business partners	Stable co-operation, mutual trust, involvement in development projects	high	High
Managers	Self-fulfilment, responsibility for strategic projects, attractive remuneration	high	High
Employees	Employment stability, personal development, fair remuneration and incentives	high	High
Customers	Product and service quality, fair price and terms of co-operation, reliable deliveries	moderate	High
Suppliers	Stable and reliable co-operation, timely payment of liabilities	high	Moderate
Banks	Timely repayment of loans, use of investment instruments, financial stability	low	High
(Influential) competitors	Maintenance of good industry-wide and market practices and standards	high	Low
Recruits	Employment opportunities, possibility to learn and acquire competencies	low	High
Local authority	Protection of local jobs, responsible taxation policy, infrastructural investments	moderate	Moderate
Local communities	Creation of workplaces, involvement in social and environmental projects	moderate	Moderate

Figure 20: Exemplary identification of stakeholder needs

On this basis, you can build up a **stakeholder profile** regarding their expectations, influence, dependence, and preferred engagement approaches. Your company should develop an **engagement plan** that shows which groups of stakeholders it is important to engage with and what your company wants to achieve.

Stakeholders may be engaged in four various ways contingent on their influence and dependence on your company.

Figure 21: Engagement with stakeholders

INFLUENCE ON SME	LOW	MODERATE	HIGH
HIGH	Involve	Collaborate / Involve	Collaborate
MODERATE	Inform / Involve	Involve / Consult	Collaborate / Consult
LOW	Inform	Inform / Consult	Consult

DEPENDENCE ON SME

Stakeholders with whom your company should **collaborate** are essential and you should therefore fully engage with them. They may supply relevant information, permissions, and resources or be significantly impacted by the outcomes. Your company should work with these stakeholders in partnerships to ensure that they remain fully satisfied. New technologies, including digital tools, play a significant role in engagement.

Stakeholders who you should **involve** are highly influential but have little dependence on (or interest in) what your company is doing. Therefore, it is necessary for you to work directly with them to ensure that you understand and consider their concerns and needs, and where appropriate, incorporated into your decision-making.

Stakeholders who should be **consulted** are highly dependent on (or interested in) what your company is doing, but their influence is low. They may be supportive and form alliances with other more influential stakeholders. You should provide adequate information to these stakeholders on relevant business aspects and may expect some feedback.

Stakeholders that should be **informed** have both little dependence (interest in) or influence on your company's activities. There is less necessity to consider them in much detail or to engage with them intensively. Your company should update these stakeholders with balanced and objective information tailored to their stakeholder needs in regular intervals (e.g. at latest for each integrated report).

This chapter has focused on helping you to identify whom it is important for you to communicate with and what information needs your stakeholders may have. It has also outlined how you can engage with stakeholders depending on their influence and dependence on your company. In the following chapter, we turn to consider what to communicate and show you how to conduct a materiality analysis.

D.1. Prerequisites for integrated reporting

Relevance and materiality are the key to effective **communication**.

In a small company where the manager and the owner are often the same person, communication primarily involves dialogue with employees and the accountant. Both of these partners will have an important role in integrated reporting. Employees have crucial information and knowledge about internal operations and value creation in the company. Together with the owners (and managers), they can identify those matters that create, preserve or erode current value. Of course, they can also jointly identify key risks and inefficient operations.

In medium-sized companies, the organisational structure is more complex and therefore communication occurs between more functional areas. This can be an advantage as more information is available, but only if communication is effective (regular meetings of different managers and departments, open and honest discussions, feedback is considered and corrective steps are taken, etc.)

The other important element is to **know and have a comprehensive view** about the company, i.e. being aware of its markets, risks and opportunities. In some SMEs, this kind of knowledge is more instinctive in nature, the owner and the manager have a good comprehension of their markets and the gaps in the markets that the company can enter and sell its products and services. They do not have detailed internal and external data; they trust in and build only on financial-accounting data that come from the external accountant. Of course, it is reasonable to have an external accountant, but in most cases, it implies that the owner/manager does not understand the company's financial statements and the "numbers". We do not suggest that an owner/manager should have deep finance-accounting knowledge, but without having a certain level of understanding of these data, it is very difficult to create a reliable strategy and operational plans. In this understanding, again, communication is very important, in this case with the accountant.

He/she can help to explain the contents and the consequences of transactions, resulting in the owner/manager having a better awareness of their company, the risks and the business.

Effective communication and having an understanding of business data will support decision-making processes, reduce operational risks and provide a sound basis for the next steps. These steps are preparing a materiality matrix, identifying stakeholders, developing a strategy and a business model. We present these in following sections.

D.2. Relevance and Materiality

"Relevant matters are those that have, or may have, an effect on the organisation's ability to create value. This is determined by considering their effect on the organisation's strategy, governance, performance or prospects." IIRC Framework, 2021, p. 30)

Not all relevant matters are material. You can consider a relevant matter to be material if it is sufficiently important in terms of its known or potential effect on value creation in your company.

Depending on the size, activities, industry, strategy, etc. of a company, the relevant and material matters need to be tailored to the company and determined by the company's responsible internal group.

Keep in mind that:

1. In integrated reporting there is the so-called **double-materiality approach,** meaning that businesses should report on topics that are material for the company itself and can be material at societal and economical levels, so at the same time have an impact on enterprise's economic, social and environmental value. This can be solved by using; combining and prioritising the six capitals (see chapter I and chapter J).
2. The focus is on longer-term value-creation, not short-term every-day operational decisions.
3. The materiality approach shall be a dynamic one, material issues can change continuously over time.
4. The company needs to know its external and internal stakeholders to be able to identify relevant and material issues. Therefore, materiality analysis is not the first stage.

The materiality determination process for the purpose of preparing and presenting an integrated report involves:

Let us take some examples of relevant issues - these can differ significantly from one company to another depending on the nature of the company's business.

Figure 22: Materiality determination process

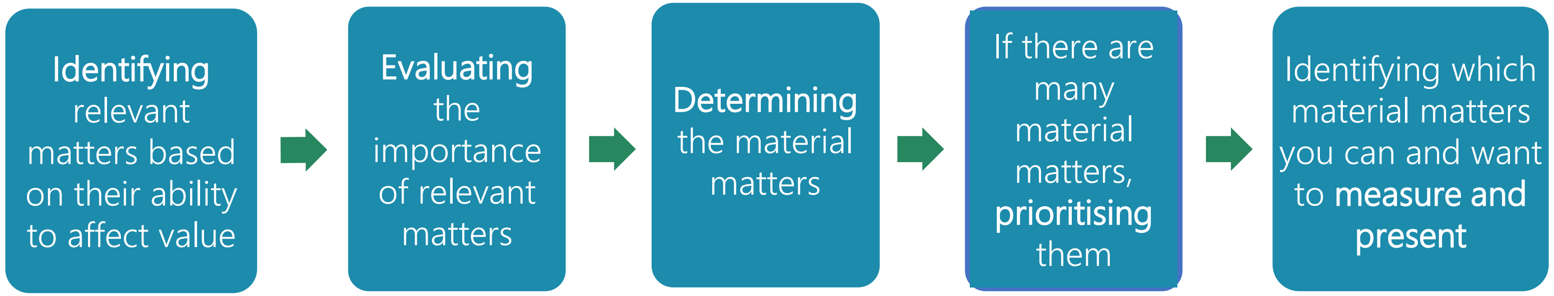
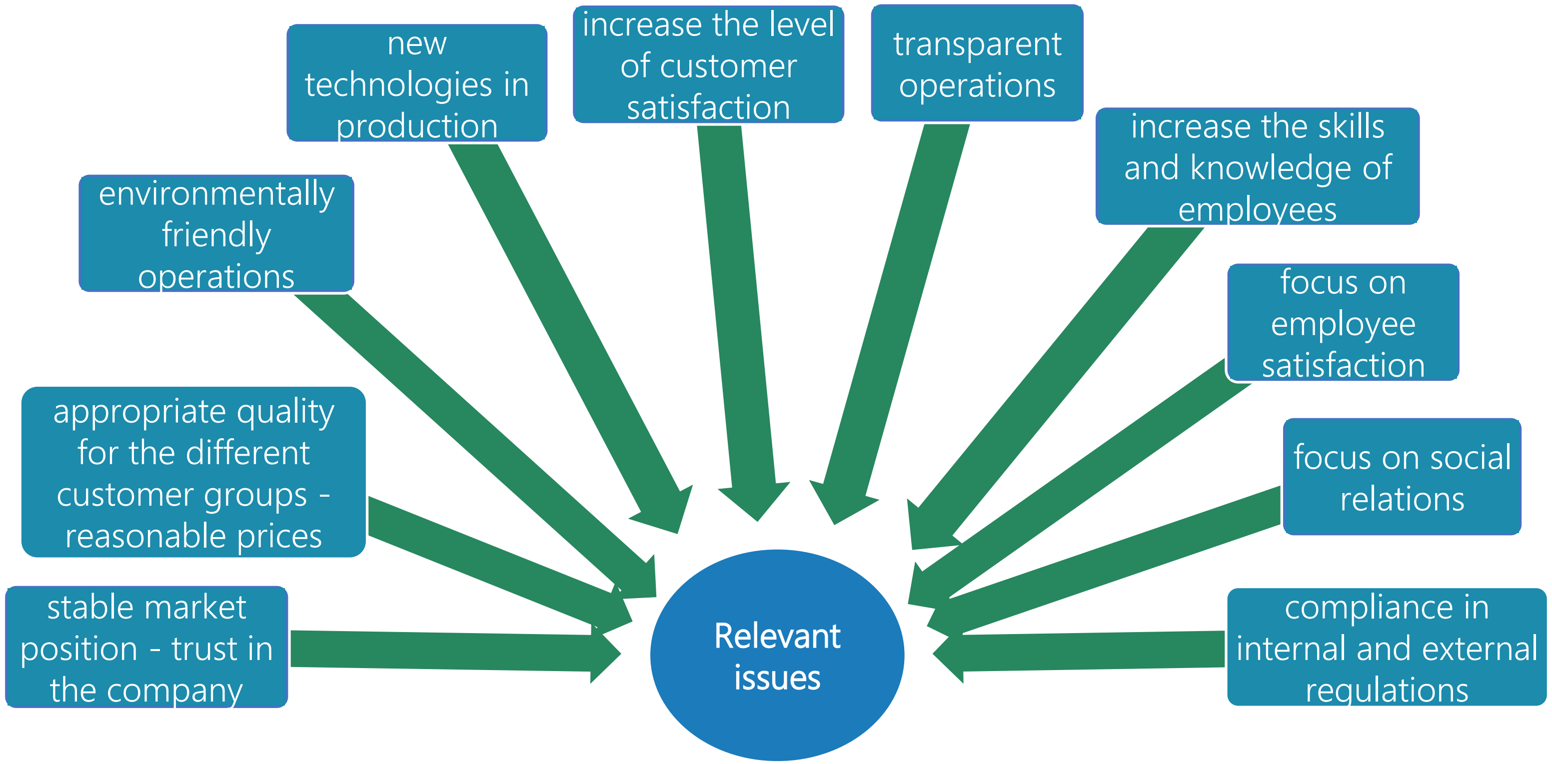


Figure 23: Examples of relevant issues



In financial reporting, it is generally accepted that materiality is determined by using different thresholds and quantitative materiality. For example:

- x per cent change in revenue or expenses, tangible assets, long term liabilities, inventories, etc. can reflect the material items and several relations and consequences can be drawn from these.
- if a major part of total assets are tangibles or inventories, or a large share of the liabilities are long term loans, etc. again, it can point the company's attention to the relevant issues.

Each company should set its own materiality rates and thresholds based on its size, activities, and risks. It is possible to express materiality in quantitative and qualitative thresholds. The latter is very popular nowadays and reasonable for non-financial information. However, it is important to set qualitative thresholds very carefully as their verification and assurance can be more difficult.

D.3. Materiality assessment

Once your company has identified the relevant matters, the next step is to identify the material issues, that is, those areas that, according to responsible groups in your company can and should be improved to create value.

For example for the **relevant issue**: stable market position – trust in the company, **material issues can be the following**:

Figure 24: Examples of material issues

Business environment	• competitor analysis to assess market position and prices • company history and background (existing clients, turnover tax positions, diversification, innovative company using new technologies, etc.,)
Product and production	• product quality (measure of quality, claims, their solution) • assessment of logistics (speed of production, delivery) • focus on environmentally friendly technologies and other operations solutions
Financial aspects	• increase in revenue and/or operational profit • decrease in costs • compliance in taxation • optimum financing of company

When you have selected material matters, it is important that you make an assessment of which matters your company has the capacity and knowledge to improve.

The benefits of materiality assessment and analysis can be the following:

Figure 25: Benefits of materiality assessment and analysis

Clarity	• opportunity to understand where an organisation is creating or reducing value for society • provides knowledge and means to measure different aspects of performance (financial, social, environmental) • inherently means spotting trends and therefore anticipating emerging issues • allows an organisation to focus efforts of allocating resources better
Improvement	• opportunity to analyse business risks and opportunities and to eventually readjust and improve business strategies • assessing future opportunities allows for development of new products or services, and therefore to stay ahead of the competition • analysis allows a company to meet sustainability expectations of their stakeholders • increases chances of better satisfying stakeholder demands

A useful first step in the materiality assessment and analysis is to conduct a **materiality survey**. Ideally, this should be concise, structured, and sent to the identified stakeholders. In the survey, the stakeholders can rate the importance and impact of each indicator you have identified on a numerical scale, such as 1 to 5. This will generate quantitative data that can be analysed and explained visually. Of course, it is useful to allow respondents to insert written comments. To process the materiality assessment survey, different survey tools can be used, such as Survey Monkey, Alchemer, Google Forms, etc.

Once the results, i.e. list of important elements have been analysed, it is best to discuss the results with your stakeholders, possibly by way of a focus group. It can serve as a starting point for continuing the conversation and maintaining engagement with your stakeholders.

When the materiality assessment is ready, it can be analysed using a materiality matrix. There are different ways of preparing a materiality matrix including:

Simple format: a table presenting the different stakeholders in columns and the material issues in rows. A symbol is placed in each row/column combination if an issue is material for the relevant stakeholder.

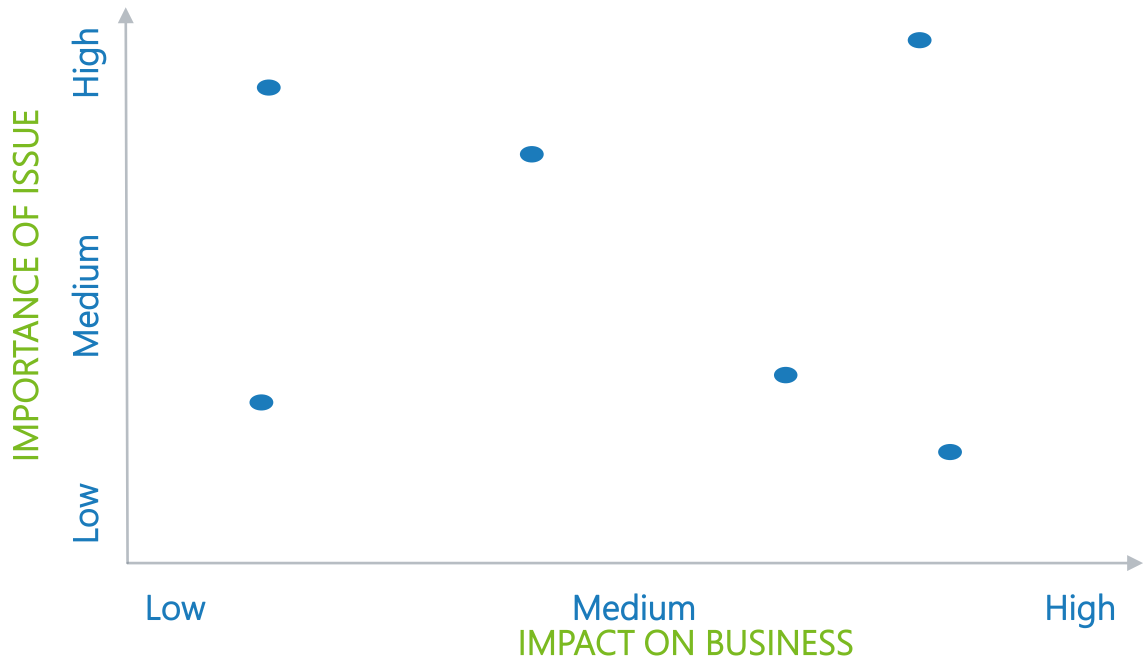
Figure 26: Example of simple materiality matrix format

Material issues	Stakeholders			
	Investors	Customers	Employees	...
Material issue a	✓			
Material issue b		✓		
Material issue n	✓	✓	✓	

Complex format: a chart presenting the level of importance of an issue on the y-axis and the impact of an issue on the business on the x-axis, each ranging from high to low. Issues that are important to stakeholders and have high impact on the business are displayed in the upper right corner.

Issues of lower importance to stakeholders and lower impact on the business are shown in the lower left corner of the graph.

Figure 27: Example of more complex materiality matrix format



On completion of the materiality assessment and analysis, the findings should form the basis for your company's strategy in the pursuit of value creation (see chapter H).

In the last two chapters, we have focused on the important questions of who to communicate with (stakeholders) and what to communicate (materiality). We now turn in the next chapter to showing the data sources that you have internally or can draw on externally for your integrated reporting.

E.1. Internal data sources

In most SMEs, IT-based information systems are relatively simple and external reporting requirements are limited. Of course, as a company grows, the requirement to collate, analyse and report data increases.

Usually, at a small company, internal data sources mainly serve financial and tax purposes. As a company grows larger, there is an increased need to provide information and the company may start to develop a basic level of management accounting (controlling), using software such as Excel. When necessary, this can be further extended by creating a complex accounting information system that supports both financial and managerial purposes.

Even in the smallest companies, it is possible to identify **the following financial data and information**:

1. Different **tax reports and social insurance reports** submitted to the tax authorities; useful and basic data can be gained from these reports, like net sales revenue, total purchases, number of employees, wages and the different taxes and contributions on wages.
2. If a company **raises loans**, it is good practice to maintain records detailing the principal amount, repayments and interest to ensure cash-management.
3. Related to **cash-management**, it is important to follow cash-ins from customers and cash-outs to suppliers; that means that very basic records are kept about **trade receivables, trade payables and trade suppliers.**
4. The company will have up-to-date information about cash movements from **bank statements** and petty cash reports.
5. As the company pays **wages**, analytical data are available on payrolls.
6. If a company purchases **assets**, the purchase cost, depreciation and net value of these assets can be elements required in some tax reports; so again, it is useful to keep data about them.
7. Depending on the activity of the company, in a manufacturing company, recording the type, quantity and value of purchased and sold **inventories** is required.

If a company is obliged to publish **financial statements**, the above-mentioned data and information can be found in the balance sheet, income statement and supplementary notes. However, please keep in mind that in financial statements, data can be presented in a very shortened and not-detailed way. Their usefulness in preparing an integrated report can therefore be low. More detailed analytical financial and non-financial information and data will be necessary to prepare a good integrated report.

If a company has a **management accounting system**, this can provide more complex information and data about the company's budget, actual performance, future outlook, forecasts etc. It can include analyses for sales, production, human resources, machinery, costs, marketing, logistics, finance and investments, cash-management, etc.

Besides financial data, **non-financial information** plays an even more important role in integrated reporting. Even in larger companies, obtaining non-financial information can be difficult as data systems for non-financial information are still evolving. If the company has any kind of exposure to environmental risks and obligations, it should collect data about these activities. Most companies derive their value from their employees, so skills, motivation and knowledge are crucial in considering value creation and performance. Further, some SMEs may collect non-financial information if they have to meet regulations and provide data to authorities. See in chapter I how to measure natural, intellectual, social and human capitals.

E.2. External data sources

For sound decision-making, you may require additional data that is provided by external sources, e.g. for price determination, cost forecasts, market trends or development on financial markets (interest and foreign exchange rates).

Sources can differ by mode (direct or indirect, i.e. processed data) and cost of provision (publicly available or with fees to be paid). Possible external data sources are shown below.

Figure 28: Examples of external data sources

	Publically available data providers	Costly data providers
Direct	National office of statistics (Central) banks National tax office Eurostat	
Indirect	Studies by consulting company Chambers of commerce Employers' associations	Data providers (e.g. Bureau von Dijk) Market research organisations

E.3. Information Technology (IT) Requirements

When a company decides to prepare an integrated report, it is important to think about the IT environment. If the accounting, managerial and other subsystems of the whole IT system are integrated, contain much data in a closed system and have well-defined control points, from the system-requirement side, the company is ready to collect the basic data and supplement this with the other required information. Nevertheless, you should first use the information of existing IT systems.

There are many basic and more complex **IT systems** that are worth using to minimise risks and create a closed system, where the data cannot be modified and/or deleted without the system storing and saving data about these. Based on our experience, this is the most typical solution for SMEs. Usually, the basic **IT systems are supplemented with Excel charts and other analytical software**, like payrolls, inventory registration, etc.

Typically, an SME might have different IT systems for different purposes, such as for bookkeeping, merchandise information systems, HR management or just payroll accounting. Depending on the activities of the company, for example, **customer-managed relationship (CMR)** can also be used for integrated reporting. CMR is a relationship in which a business uses a methodology, software, and perhaps internet capability to encourage the customer to control access to information and ordering. CMR can be viewed as an alternative or as a possible approach to **customer relationship management (CRM)**. CRM is a technology for managing all of your company's relationships and interactions with existing and potential customers. A CRM system helps companies stay connected to customers, streamline processes, and improve profitability.

The highest level of an information system is the **integrated IT system**. It includes financial and management accounting (controlling) parts that have several connections with the other processes at the company, such as production, HR, sales, etc.

For an SME, it can be costly and depending on the complexity of the activities and the size of the company, it can be unnecessary.

One aspect you should keep in mind: there is only **one** source of truth for your data. Otherwise, severe harmonisation issues may occur if there are two or more sources for the same data.

The last three chapters have looked at different aspects of communication involved in integrated reporting. Each of the next three chapters focuses on a particular aspect of your company that is fundamental in integrated reporting. The first chapter centres on factors that help you to provide a useful overview of your organisation and the environment in which it operates.

For organisational overview and external environment, the key questions are "*what does your organisation do*" and "*what are the circumstances under which it operates*" (IIRC Framework, 2021, p.39.) So, it concerns a general introduction to your company, which involves two perspectives. The first is the **internal perspective** of your organisation and gives you the opportunity to provide a general overview of your company. The second is the **external perspective** of the environment, in particular the market conditions in which your company operates. These conditions shape the ability of your company to create value. Ideally, you start by compiling the information for the internal perspective before shifting your focus to the external perspective.

Figure 29: Internal and external perspectives

Step 1 — **General overview (internal perspective)**

- Key information on legal and operating structure
- Information on organisational structure
- Key facts about company

Step 2 — **External environment (external perspective)**

- Factors affecting a company's ability to create value
- Information on how a company proactively manages these factors

F.1. Identification of organisational elements

The organisational elements of your company should provide a **general overview of your company**. How is your company organised? Who are your owners? What are your main activities? Most of this information is readily available.

Certain items like a special legal structure or a family ownership may however deserve more scrutiny and may provide valuable insights for all stakeholders. The following figure provides an overview of relevant topical areas to be considered.

Figure 30: Overview of relevant topics for the internal perspective

General overview (internal perspective)

1. Legal and ownership structure (formal)
2. Operating structure (formal and informal)
3. Mission, vision, culture, values and history
4. Main activities (main products/services, markets
5. Key facts (number of employees, customers, amount of sales

These individual topical areas may overlap. When you select information, you need to keep in mind the purpose of this information – i.e. to provide a general understanding of the formal and informal aspects of your company. The following figure provides a list of possible aspects to consider.

Figure 31: Possible aspects to consider in the organisational overview of your company

1. Legal and ownership structure
• Legal form • Location of headquarters • Listing status • Existence of majority shareholders • Family ownership of company
2. Operating structure
• Type of organisational structure • Supply chains • Extent to which key processes are outsourced
3. Mission, vision, culture, values and history
• Key facts on corporate history • Mission and vision • Corporate culture
4. Main activities, products/services, markets
• Description of company activities • Main products/services and markets/sectors served
5. Key Facts (primary quantitative information)
• Number of employees • Revenues • Total number of operations

In giving a general overview of your company, it may be appropriate to commence by outlining its **legal structure**, as well as **ownership and operating structure**. While the legal structure will be formal and fixed, your operating structure may contain both formal and informal (i.e. less fixed) elements. Even if some elements are informal, they may still be fundamental to the successful operation of your company. In addition, your company may have key **transactional relationships** with other entities (e.g. a sister company managed by another family member). These relationships are not necessarily reflected in ownership relationships, but may be central to the success and viability of your organisation.

Providing **information on the history, mission, culture and values** of your company is also important in communicating your company's story to your stakeholders. It helps them to understand why and how your company operates and seeks to create value. Your company may not have a formal, written mission statement.

However, it can still be appropriate to outline the vision that your company has to achieve its goals and the culture and values that shape how it operates and achieves these goals. The **history** of your company, i.e. when, by whom and how it was founded, as well as the key milestones in its development, are likely to have had an important influence in shaping its mission, culture and values. You can therefore also outline them in your report.

Further important elements to include in the general overview of your company are the **key activities** of your company, the **main sector(s) and market(s)** in which you operate, including the **radius of your operations** (local / regional / national / international), and the **key products** and/or **services** that you offer.

A final important part concerns **key quantitative data**, in particular number of employees, revenue, number of customers/clients and suppliers, as well as significant changes in these over time if appropriate.

F.2. Identification and impact of external environments

The external perspective analyses the **conditions** in which your company operates. What are current and upcoming trends in your industry? Which markets and their development do you have to consider? What are the areas in which your company competes with others? Therefore, the challenge is to identify which trends and factors are most relevant in helping you and your stakeholders to better understand the markets in which you compete and the opportunities and risks that your company faces.

The following figure provides an overview of the most important topical areas to be covered:

Figure 32: Overview of relevant topics for the external perspective

External environment (external perspective)	Topics to be covered include all factors affecting a company's ability to create value and how a company proactively manages these factors: 1. Key trends of industry/sector in which company operates 2. Market conditions 3. Competitive environment

In considering the conditions in which your company operates, the key focus is on factors that have or may have an **effect on your company's ability to create value**. The figure below provides come key examples of such factors. Some of these factors may not affect your business, while others that we have not listed may be important for you.

So, it is advisable to decide about the factors and the degree of detail that are appropriate for your company. Keep in mind your aim: to inform stakeholders about the key trends, markets and competition in the sector(s) in which your company operates and how this affects your company's ability to create value.

Figure 33: Possible aspects to consider in relation to the external environment

1. Key trends of industry/sector

- Political trends (changes in government, developments in EU legislation)
- Commercial trends (economic cycle, interest rate developments)
- Environmental trends (de-carbonisation, trends towards green energy, emission thresholds)
- Social trends (employees/freelancers, outsourcing, shared services)
- Technological trends (innovation of products/processes, new trends in sales)
- Legal trends (regulation, enhanced reporting/disclosure)

2. Market conditions as opportunities and risks

- Competition
- Market development and growth (volumes, sales prices)
- Substitution of products
- Substitution of input factors
- Financing
- Employment (war for talents)

3. Competitive environment

- Competitors (number, size)
- Suppliers (number, size)
- Capital provision (number/size of capital providers)
- Labour market (number of applicants, number of open positions)
- Innovation (number of patents, innovative products)

Key sectoral trends can be important political, commercial, environmental, technological, social, or legal developments that shape and affect the way in which you develop, produce, market and distribute your products and services.

These factors may affect your organisation directly or indirectly, for example by influencing your access to the capitals you use, or the quality and cost of these capitals. Such trends may both create **opportunities** for and present **risks** to your company. It is therefore also important for your company to recognise and report on how it is adapting, or can adapt its **strategic decisions** to these developments. By doing so, you are signalling to important stakeholders that you are firstly aware of the most important **environmental factors** affecting your organisation, and secondly how your company is proactively adapting its strategy and business plan to meet new challenges. For example, the availability of skilled labour may be a key factor affecting the success or expansion plans for your company. If your company faces a skilled labour shortage in the region in which you operate, a strategic cooperation with local universities or schools to recruit future employees early would be important information to communicate to stakeholders to indicate how you are overcoming this challenge.

Which of these developments are most important for your company will depend on the sector(s) in which your company operates, the geographical radius in which you are active and what are your products and services. For example, digitalisation and a shift to online selling may be a key trend affecting companies in the retail sector. This may make it necessary for them to change their marketing and distribution strategies, but also open up opportunities to reach new customers. Stricter environmental regulations may for example be a key factor affecting how agribusinesses operate.

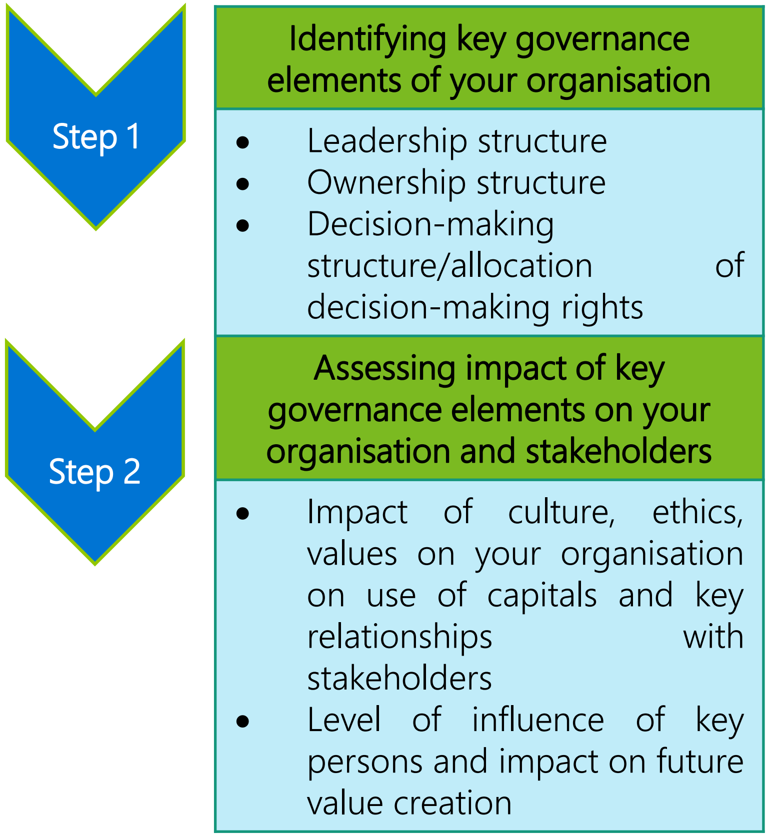
It is also appropriate to outline the most important **market conditions** in which you compete and how your organisation is positioned in these key market(s). This concerns in particular the intensity of competition and the key existing competitors you face, as well as the risks to your organisation from potential substitute products or services. It can also include information about how your organisation differentiates itself from its competitors.

Other important points concern the bargaining power of your key suppliers and customers/clients.

The next chapter builds on the organisational overview that has been the focus of this chapter. It considers the key governance structures that shape your company and how these structures affect your business and your relationships with your stakeholders.

Governance is the organisational system for steering and monitoring a company, which comprises (legal and individual) rules and the processes of a company. With regard to integrated reporting, the key question to consider regarding governance is "how does the organisation's governance structure support its ability to create value in the short, medium and long term" IIRC Framework, 2021. p.40). As depicted below, it is possible to subdivide this into two sections – identifying the key governance elements of your organisation and then outlining their impact on your business and stakeholders. We take account of the fact that family ownership and management is a prevalent feature of many SMEs and can therefore fundamentally affect their governance.

Figure 34: Identifying governance elements and assessing their impacts



G.1. Identification of key governance elements

You may have already collected and presented some information on governance elements when analysing your organisation (organisational review), but now it is important to see this information from a **leadership and decision-making view**. The key governance elements of your organisation concern in particular the **leadership**, **ownership** and **decision-making structures** of your company. In outlining your leadership structure, important points would be to present your company's management, which may or may not overlap with ownership, and the profile of key decision makers. Ownership structures have to do in particular with firstly whether company owners are active in the company, i.e. whether they take on a management or a supervisory role as board members. Secondly, it concerns the extent to which owners are known to the company, or are more anonymous and thus have a more distant relationship with the company, focusing mainly on their yield of investment in the company.

Decision-making structures have to do with the key orientation of decision-making within your company, for example, the extent to which decision-making is family-oriented versus formally oriented. They also concern **where key decision-making takes place** in a company, for example, through company management, a supervisory board, or general assembly. Related to this is whether decision-making power is concentrated with one person or whether there is a spread of power to several key decision-makers. Generally, it is important to balance two dimensions here – speed of decision-making (pro centralisation), versus range to operational business (pro decentralisation). A further feature of decision-making in organisations, which you can include, is **hierarchical and reporting structures** within your company. SMEs may have different degrees of documentation of their governance structures. It depends whether there is documentation of the roles of decision-makers and decision processes in job descriptions or process manuals. Hierarchical structures as well as reporting lines can also be fixed or 'lived' within the company.

Documented governance rules ensure assigned accountability by defined roles and processes, but may hinder speed and flexibility in decision-making. If applicable, it can also be appropriate to outline the existence of **employee representation structures**, for example works councils, in your company.

Finally, **successor provisions** are very important for the future viability of SMEs. Therefore, information on how leadership of your company will be secured in the future, for example through provisions to hand over leadership to the next generation, is of paramount importance to stakeholders and key providers of financial capital.

G.2. Impact of governance on business and stakeholders

How governance affects your business and your stakeholders concerns in particular how the **culture, ethics and values of your company** are reflected in its use of key capitals and its relationships with key stakeholders.

It also has to do with the **level of influence** of key people in your company and its implications for current and future value creation in your company. Their influence may derive from different sources, for example from their formal position of power in the company, their knowledge and skills that are of vital importance to the company, or their important relationships with key customers, suppliers or other stakeholders (e.g. sales or procurement managers). SMEs face risks if one of these key people leaves the company because this has implications for the ability of the company to continue to create value, and closing the gap left by that person may be a challenging process. In contrast, it may be easier to introduce change to a company's governance if the influence of single key persons is limited. Especially from an external view, a one (wo)man show, when one person is considered to be at the heart of the company, may cause challenges in adapting the company's culture, ethics and values towards new ways of creating value and developing new avenues of stakeholder management.

This is particularly important when a company needs to adapt to new challenges in its environment, or when it is undergoing (generational) governance transition processes.

In a nutshell, governance of SMEs comprises many dimensions: number of hierarchical levels, documentation of roles and processes, power of key persons and the public image of the SMEs and its governance. The speed of decision making and the power of key managers has to be balanced as rapid decision making may not have reflected the careful consideration of risks, and a concentration of power in one person can have important consequences for a company in adapting to new challenges or when it is undergoing fundamental transitional processes.

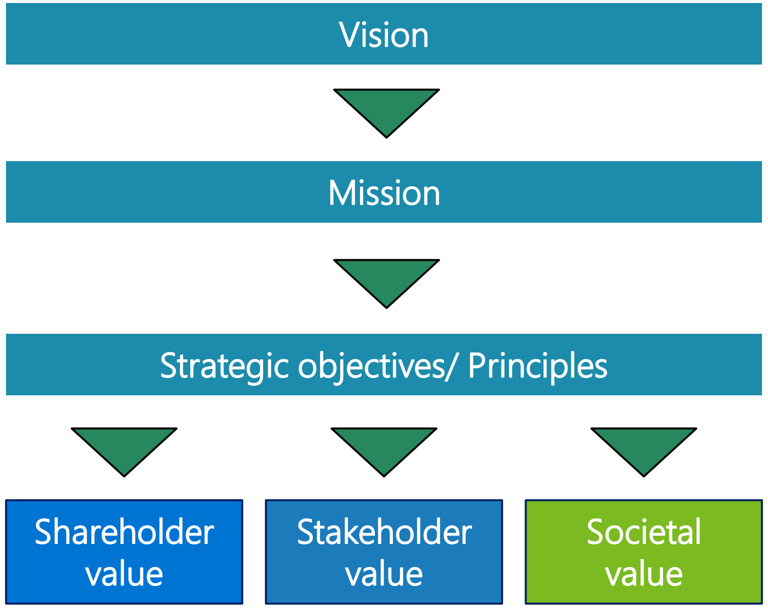
The organisation and governance of your company and the environment in which it operates have been the focus of the last two chapters. The next chapter turns to consider how you can communicate the value creation process and business model at the heart of your company through integrated reporting.

H.1. Strategy and resources

Integrated reporting focuses on showing the **connectivity of strategic objectives, risk and performance** to demonstrate how organisations create value for themselves and their key stakeholders. This means that companies need to understand and report on all areas of performance and not just focus on short-term financial results. In general, SMEs try to remain flexible, adjusting over time to market opportunities as they appear. While flexibility is certainly important, it is dangerous if the lack of a clear sense of direction. Therefore, it is important for SMEs consider which capitals the company should utilise for value creation, which markets it should primarily serve, with which business partners should it collaborate with and which stakeholders are critical for the future of the company.

In an SME, the essence of the strategic thinking process is to identify, safeguard and nurture the sources of sustainable competitive advantage and the company's value creation process by setting strategic objectives.

Figure 35: Strategic process from vision to values



The six capitals framework can frame the value creation process, but there are some more elements that can help clarify your strategic planning:

- **Vision**: outlines the possible and desirable future state and position of the organisation, so it is the desired purpose of the company.
- **Mission**: the purpose of your organisation's existence, the values it represents, the principles upon which it operates. Answer the questions of what, when, for whom, where, for how long, why do we do what we do?
- **Corporate Values**: A compass that influences the thinking and behaviour of company members and defines the company's objectives (for shareholder value, stakeholder value, and societal value)

Based on these elements, there is a tight link between strategy and the firm's **current and future resources, its capitals**. Firstly, strategies must build on existing resources, as inputs and activities should be harnessed in such a way to support execution.

Secondly, strategy implementation may require changes to the deployment of inputs and business activities to tackle future challenges (not only in terms of manufactured capital, but targeted for instance to the strengthening of intellectual capital, or of relationship capital). Thirdly, once implemented, strategies can affect the future stock of resources positively or negatively.

The **strategy and resource allocation** part of an integrated report should therefore present the firm's short, medium- and long-term value creation objectives as well as outline the strategies it has in place, and plans to achieve these objectives. For obvious reasons, it is important to connect this part closely to the **business model** and to the **risks and opportunities** parts of a report: considering the current and expected features of the external environment, changes to the business model might be needed to achieve the value creation objectives the firm is pursuing.

H.2. Identification of risks and opportunities

A hard look at risks and opportunities is very important to appreciate the ability of a company to generate and distribute value over time. This step is even more important for SMEs, since the limited amount of financial, manufactured, human, intellectual, social and natural capitals they can mobilise entails a higher degree of vulnerability. Further, SMEs tend to invest less in the systematic monitoring of external trends or early warning systems, thus reducing their ability to anticipate and prevent risks and harness opportunities.

The risks and opportunities section of an integrated report serves to disclose any hazard, danger, harm, threat or exposure, or any opportunity or prospect, that has already impacted or may impact upon the firm in the future that are fundamental to its ongoing ability to generate value. It also includes the specific steps taken to mitigate or manage key risks or to create value from key opportunities. Some examples of business risks are:

- Market risk (change of consumer preferences or the structure of the competition, dependency on one main supplier)
- Operational risk (problems with a supplier in time or quality or lack of appropriate human resource, strikes)
- Legal compliance risk (failing to obey a new accountancy regulation, product liability)
- Economic-financial risk (volatility of exchange rates, raw material/ commodity prices)
- Reputational risk (the effects of shared negative customer reviews, product quality issues)

For integrated reporting, companies are expected to identify and disclose forward-looking information on risks and opportunities that are specific to the company, including those concerning the company's effects on, and the continued availability, quality and affordability of relevant capitals in the short, medium and long term.

Once risks and opportunities have been identified, a simple way to understand the relevance of opportunities and threats is to quantify with numbers their likelihood as well as the magnitude of their expected impact. For instance, taking into account ongoing trends we might evaluate the prospect of more stringent environmental regulations as very likely, and assign therefore 80 per cent as the likelihood; taking into account our business model, their consequences for a given firm can be considered moderate, and assign therefore 40 per cent as the magnitude of the expected impact. If we multiply likelihood by impact (i.e., 0.8 x 0.4 = 0.32), we obtain a proxy useful to help understand the relevance of more stringent environmental regulations for that firm. It is then possible to analyse whether these regulations would represent a risk or an opportunity, and develop possible interventions meant to prevent the former or harness the latter. As one can easily notice, the advantage of this approach is to trigger sensitivity to risks and opportunities the impact of which is expected to be large.

H.3. Business model in practice

A firm's business model is how it turns inputs, through its business activities, into outputs and outcomes to fulfil its strategic purposes and create value over the short, medium and long term. Osterwalder and Pigneur - on whose work this section is largely based – define the essence of a business model as describing the **rationale of how an organisation creates, delivers, and captures value**. It is important to emphasise from the perspective of integrated reporting that this value is multi-dimensional, not just value for customers and owners. In your integrated report, you can present your business model to show how your company uses internal and external inputs to generate value for your company, your customers and other stakeholders. Business modelling serves to:

- explain why the company exists – what does it do and what is its vision and mission?
- describe the concept of value creation;
- systematise processes and activities;
- identify key resources (inputs), value (outputs and outcomes) and activities;
- convince stakeholders that company management and employees have a clear, authentic concept of the enterprise;
- redesign and revise plans if necessary.

Thus, the business model is related to planning, strategy, risks and opportunities. The core of the business model – the value proposition - is about strategy, vision, mission and corporate values.

A framework suitable to help you to identify both your current and desired business model is the Business Model Canvas (Osterwalder and Pigneur, 2010). The Business Model Canvas (BMC) is a strategic business-planning tool to help create and structure the business plan and business model. BMC, in its original form is highly focused on customers, but it is also possible to integrate other stakeholder groups into the framework.

As the business model is a summary of how a company does business, BMC identifies nine building blocks to summarise the main variables. These building blocks can be categorised into four main areas. The following figure visualises the relatedness and interconnections of the different areas:

At the centre of the model is the **value proposition**. This has to do with the raison d'être of the firm, the products and services it offers. The **customer model** (right area) is about market connections: who buys a company's products and services, how can it reach out to customers, who are the most important customers, for example in co-creation of value.

The left area, **infrastructure** has to do with the processes of operation and the fundamental assets and processes for value creation. The bottom area is about **financial** aspects – costs and revenues. We will turn to look at each of these areas separately to show how you can construct and develop your business model.

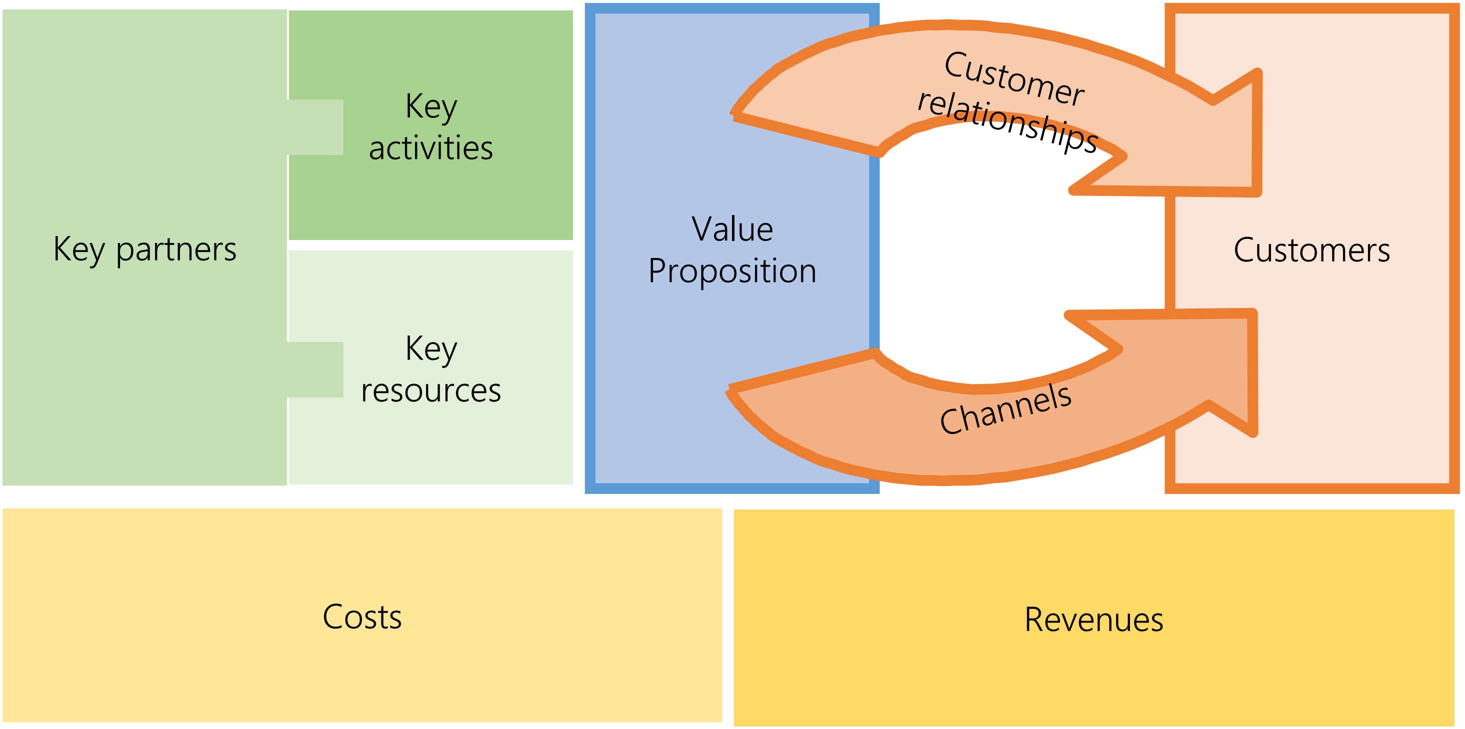


Figure 36: Business Canvas Model

Source: own illustration based on American Society for Engineering Education (ASEE) https://www.asee.org/i-corps-l/resources/business-canvas-model

Same reference for Figure 37, 39, 40 and 41

H.3.1. Value Proposition

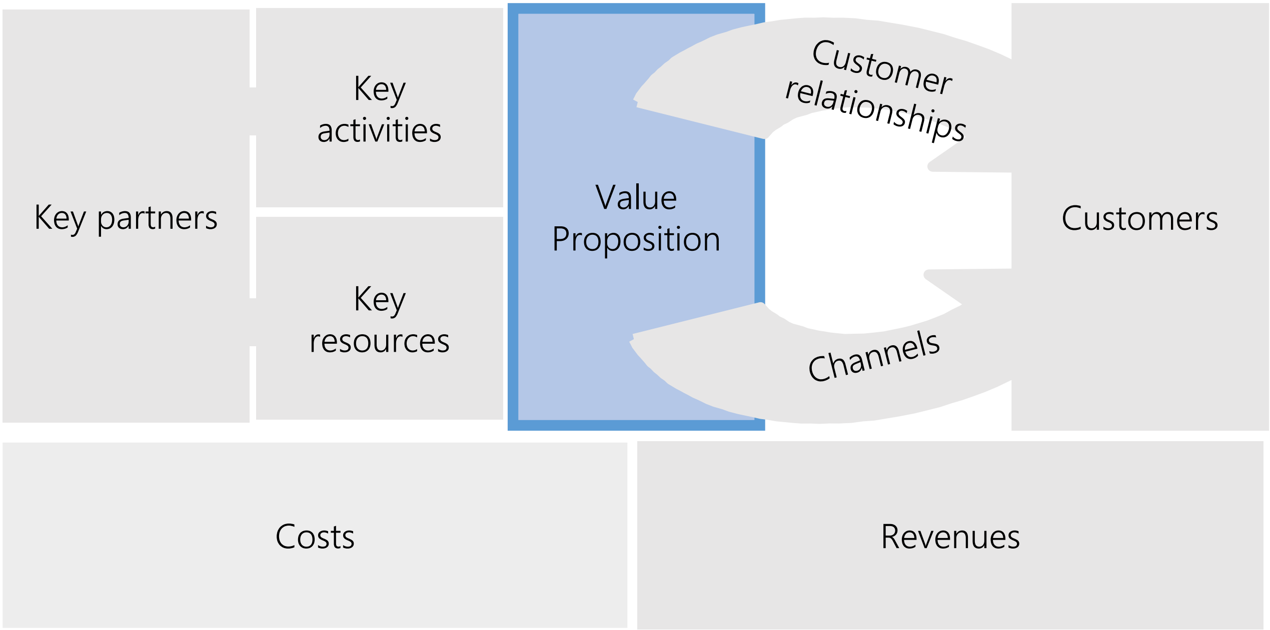


Figure 37: Value Proposition

To create and develop your own business model, it is useful to start at the centre with the **value proposition**. This defines the products and services that your company offers to meet the needs of its customers and that represent value for a particular customer segment. The value proposition of a company is its distinguishing feature.

It is through its products and services that a company differentiates itself from its competitors. In integrated reporting, this is what is referred to as outputs and outcomes (see IIRC Framework 2021, p. 42-43).

In the extended sense relevant for integrated reporting, value proposition is not only about the outputs and outcomes a company offers to its customers.

It is also about the outputs and outcomes it offers to all its stakeholders, including employees, business partners, institutions, local community etc. Some examples of value proposition are:

Figure 38: Value proposition examples

Product related	• the power of novelty (e.g. emergency of smart phones) • performance (more developed PCs, less polluting manufacturing processes) • serving individual needs (mass personalisation) • design (e.g. new earphones) • brand/status (e.g. Rolex)
Price cost related	• price-value (low-fare airlines) • cost-cutting (ready to use company software) • risk reduction (guarantee for used cars
Customer related	• help with customer tasks (full rental service of Rolls-Royce airplane factors) • access (Netjets, Grameen Bank) • comfort and feasibility (iTunes) • convenience (home delivery service)

Thanks to these distinguishing features:

- a product or service can fulfil customer/stakeholders needs,
- a product or service is able to solve the problem of the customer/stakeholder, and
- customers choose that company in place of a competitor.

H.3.2. Customer Model

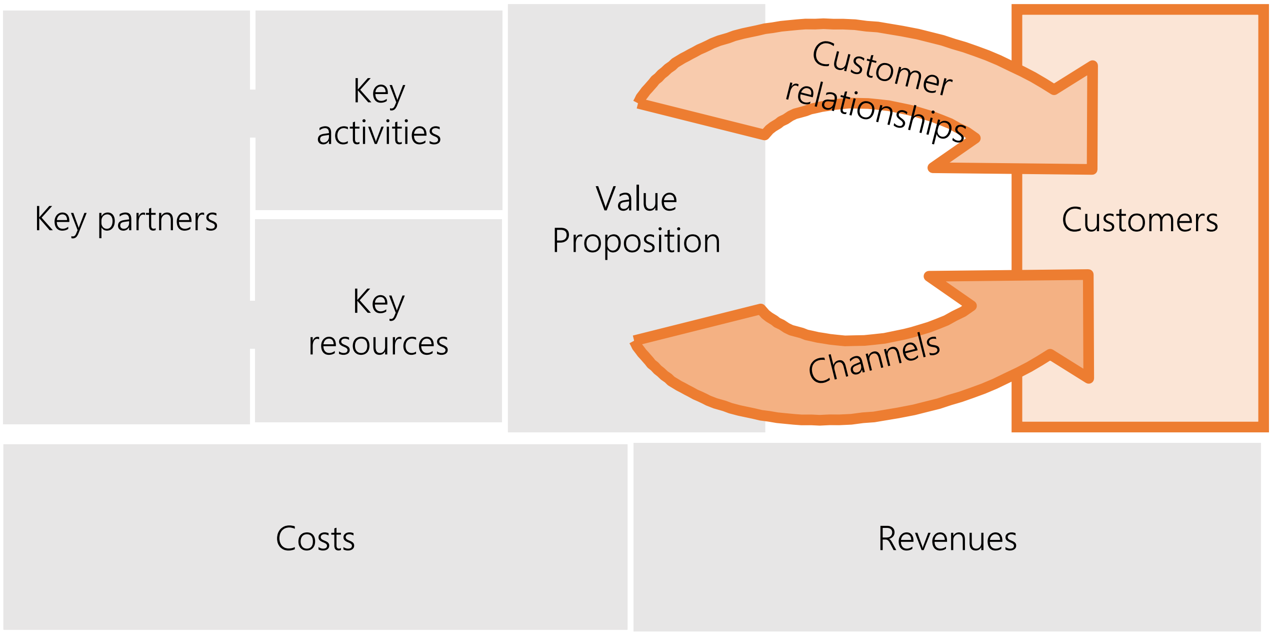


Figure 39: The customer model

The market side of the business model, called the customer model, concerns the values a company believes in, what it offers its customers and stakeholders, and how it communicates with them. This is about value creation for customers and stakeholders, so social and relationship capital is important here. Three elements are important to consider here – customer segments, channels and customer relationships.

Customer segments are the different groups of people or organisations that a company aims to reach and serve with its products and services. Customers should be at the heart of any business model, as without profitable customers, no company will survive for long. To serve the needs of your customers more effectively, it is important that you cluster your customers into segments and groups and then decide which groups you want to prioritise.

Inspired by the 4Ps of marketing (product, price, place, promotion), customer groups can be organised into separate customer segments if:

- their needs can be met with different products and services (product related);
- they can be reached through different channels (distribution channel related);
- they require different customer relationship activities (communication channel related);
- their profitability differs significantly (premium or standard segment);
- they are willing to pay for different specifications of the service (price related).

Channels describe how a company communicates with and reaches its customer segments to deliver its value proposition. Distribution and sales channels, and communication with customers, define the relationship between customers and the company. They also play a key role in shaping the consumer experience. Channels should be cost-effective and appropriate for reaching customers.

Channels have a number of functions, including:

- directing customers' attention to a company's products and services;
- assisting clients in judging the value proposition;
- allowing customers to access certain products/services;
- helping to deliver the value proposition to customers;
- providing after-sales customer service.

Customer Relationships are the types of relationships that a company establishes with specific customers (segments). It has to do with how a firm acquires, grows and maintains its customer basis. When defining your business model, it is important to clarify to what extent your company's relationships with your customers are personal or automated. This defines the closeness and nature of the relationships with your customers.

There are several categories of customer relationships. These can even be simultaneously present in the relationship between a company firm and its specific customer segments:

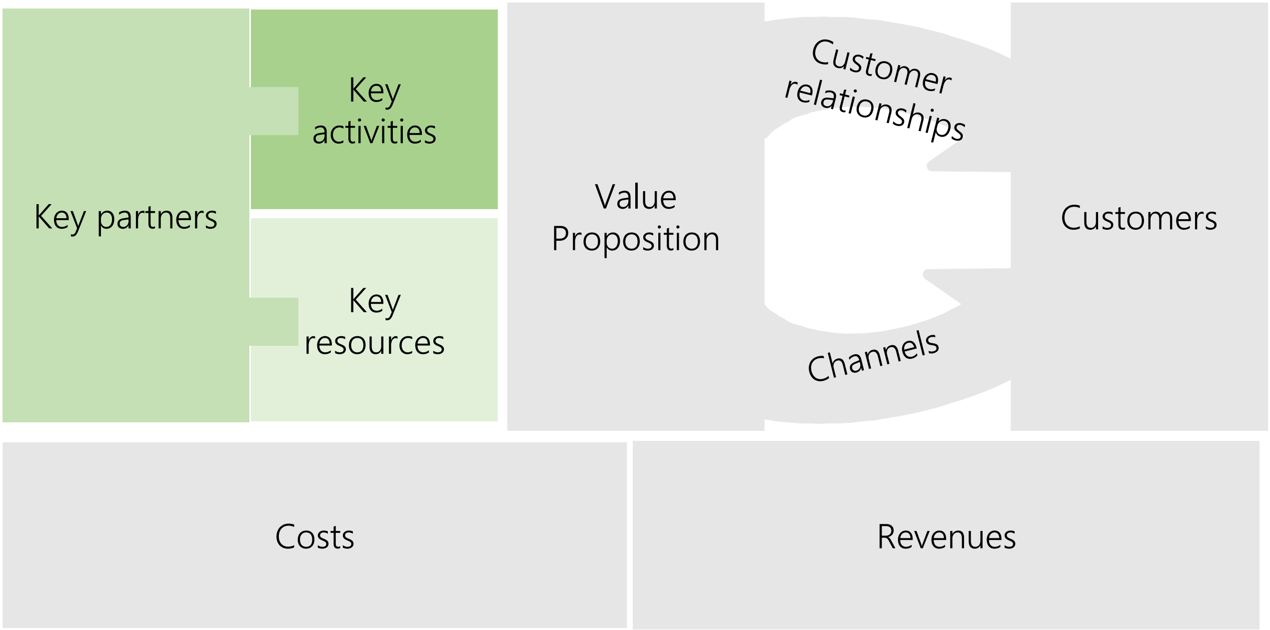
- Personal contact (can happen at the place of business, via telephone or electronically)
- Priority customer relationship support (e.g. private banking services)
- Self-service (customers serve themselves)
- Automated services (e.g. vending machines recognise customers based on personal online profiles and provide personalised offers); communities (e.g. the Facebook page of a firm)
- Mixed services (mainly automated/self-service but in case of problems personal contact (e.g. bank hotline))
- Creating shared values (e.g. YouTube encourages users to create content and provides an opportunity to share such content)

In summary, for the customer model area of your business model, the following questions are important:

- Does your company offer value to all desired customer segments/stakeholders?
- Is this value attractive to them? Would/do your customers buy your products/services? What can you do to achieve and maintain your reputation?
- Can you really deliver this value? Is it profitable for you to do it?
- Are your customers satisfied? How do you manage customer complaints?

H.3.3. Infrastructure

Figure 40: Infrastructure



The third area of the business model is **infrastructure** used during the value creation process. It consists of key resources, key activities and key partners.

Key resources refer to the key tools that your company requires to put its business model into operation. Every business model requires priority resources.

These allow a company to create and offer value propositions, be present in the market, connect with customer groups and generate revenue. Different business models require different priority resources.

Resources are the inputs in the terminology of integrated reporting. It is important to focus on the key resources, i.e. those resources that are crucial for your company in creating value, enabling distribution of your products and services and generating revenue.

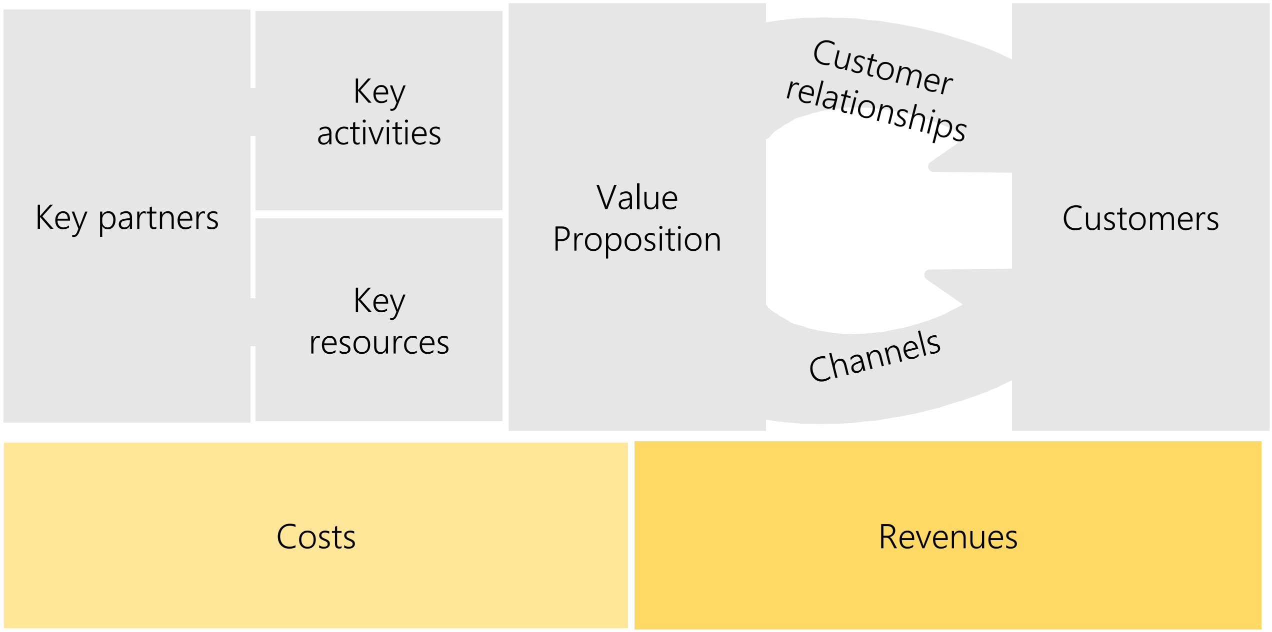
It is possible to link the key resources used in the Business Canvas Model to the capitals used in integrated reporting:

- Tangible resources (manufactured capital): physical assets such as machines, buildings, vehicles, systems, networks fall into this category;
- Intellectual resources (intellectual capital): includes brand names, intellectual property, patents, copyrights, partnerships, customer database;
- Human resources (human capital): the human factor is very important, especially in creative and knowledge-based industries and in the service segment; and
- Financial resources (financial capital): some business models are characterised by the need for financial resources and/or guarantees, which can be debt (e.g. credit facility) or equity (possibility to increase paid-in capital (e.g. issue new shares)).

Key partners include suppliers and partners who contribute to the operation of a company's business model. Companies can form partnerships for a number of reasons, and these partnerships have become the cornerstone of many business models today. Companies form alliances to optimise their business model, reduce risk, or gain resources. Here we can include all the capitals that were left out of key resources: first social and relationship, and natural capital, but parts of other capitals over which the company does not have a control can be indicated here. It is important for you to cooperate and collaborate with your partners to improve your value creation process, for example through optimisation (e.g. with shared infrastructure), risk mitigation (e.g. joint development of new technologies), or acquisition of certain resources (e.g. raw materials, components, knowledge, licenses or customer access).

H.3.4. Financial Model

Figure 41: Financial model



The final area of the business model is the **financial model**. It provides an answer to how you can turn your business idea into profit, and how and from what sources you will cover your company's starting and operating costs. Therefore, it has to do with your **cost structure** and **revenue streams**.

It is important to understand and manage the **costs** of your company as they have a huge influence on your profit and so on your value creation.

Costs can be sub-divided into fixed costs and variable costs. Fixed costs do not vary with the volume of produced goods and services (e.g. contribution to chamber of commerce) whereas variable costs increase with higher produced volumes (e.g. raw materials). Many costs have both characteristics, e.g. leasing rate of a rented machine. For volumes below a certain threshold, these costs remain constant, but with increasing volume, the costs increase sharply due to required additional units. You should carefully analyse changes in your costs with varying production volume.

You can split costs into payment-based costs (costs causing cash outflows) and so-called imputed costs, which caused past but not current payments (e.g. imputed depreciations after a machine purchase) or consider economic necessities not covered by bookkeeping transactions. For your company's equity, no yield is considered in bookkeeping, the company-owned house is free of rental charge and as a sole proprietor, you do not receive a salary.

You have to consider these aspects in your cost accounting and price calculations by imputed equity costs, imputed rent and imputed entrepreneurial profit. These fictive costs lead to higher calculated per-unit costs and prices that your clients pay. Through the resulting higher profits, you can cover these costs.

Revenue streams concern questions of how much, how often and in what ways a company receives revenue from offering its products and services. So, there is a close link to the customer building block of the business model.

Some common revenue models are:

- Direct sales
- Subscription model (monthly or annually, pre-arranged)
- Usage fee (flat rate or charges on demand (per-volume or per-unit charges))
- Rent
- Matchmaker model (e.g. sharing economy apps)
- Freemium model (free basic service, revenue from extra services)

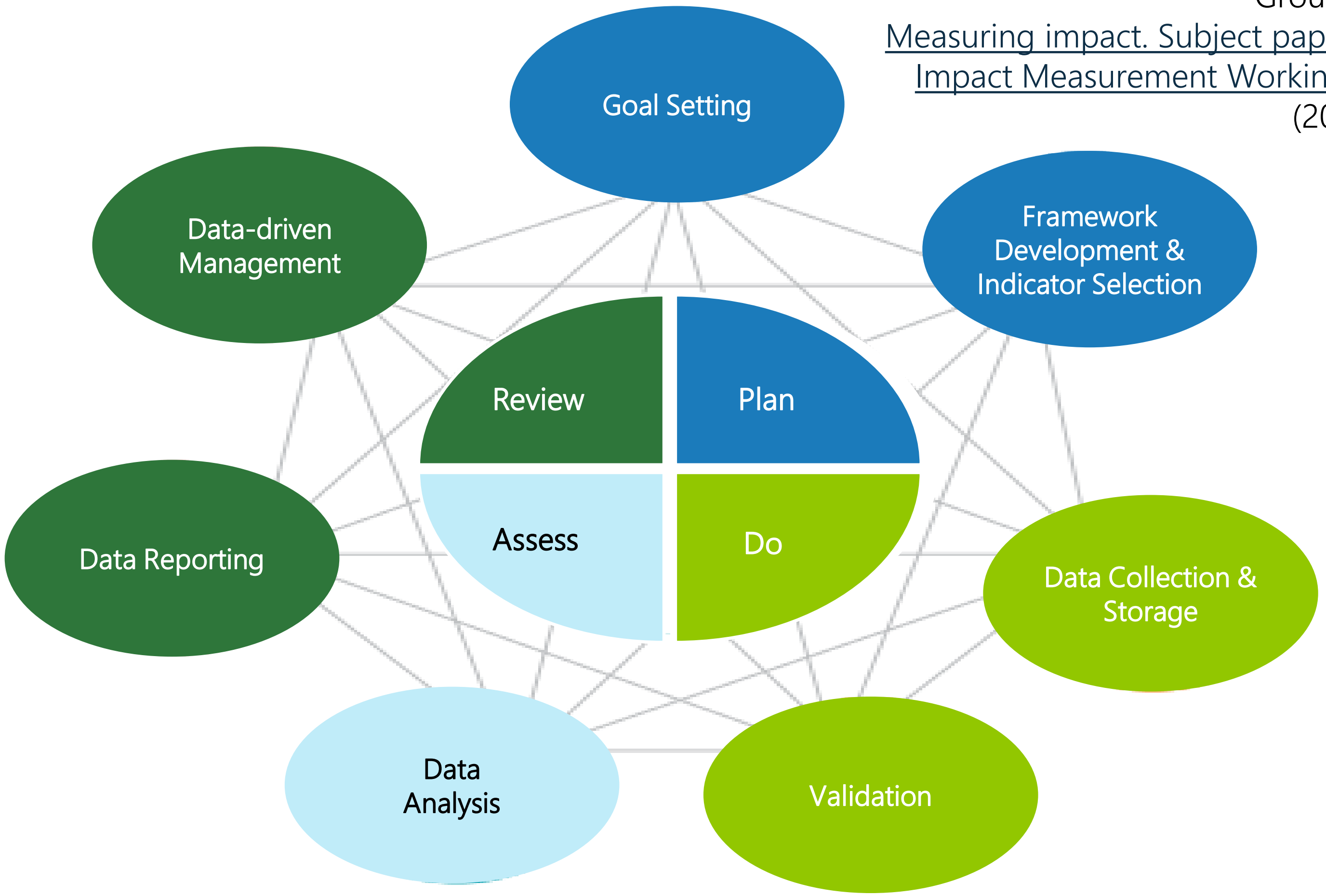
The business canvas model is logically compatible with integrated reporting and the six capitals. It is important in this respect to broaden the scope of key resources to encompass both outputs and outcomes in the definition of the value proposition and to interpret cost structure and revenue streams not only in terms of financial capital, but in any change in inputs and outcomes, accruing either to a company or to society.

In this chapter, we have discussed how you can communicate value creation and your business model to stakeholders. A vital part of value creation is the resources that your company uses. In integrated reporting, these resources are referred to as capitals. The next chapter helps you to identify and measure these capitals. It also provides you with concise definition of the six capitals delineated in integrated reporting and illustrates them with examples and key performance indicators.

The identification of capitals and their measurement follows the typical (iterative) management process of "plan", "implement" (do), and "change" (assess and review).

Figure 42: Capital identification and measurement circle

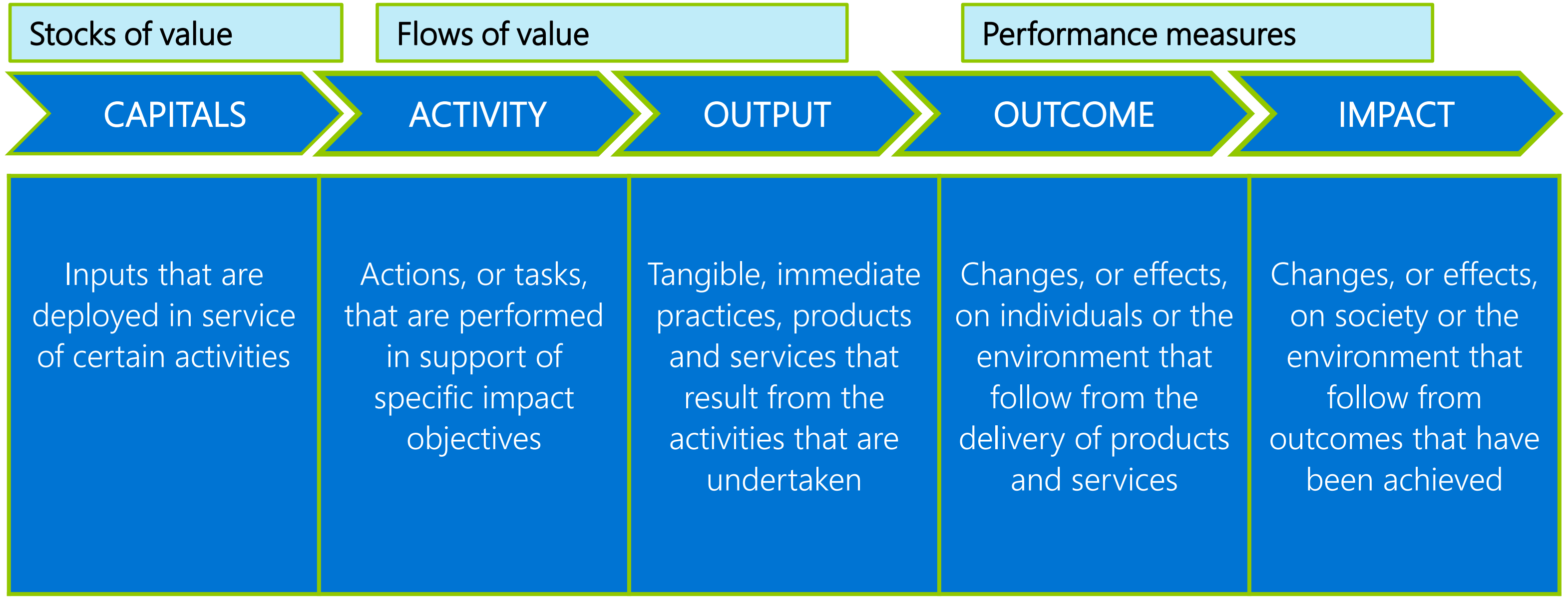
Source: Impact Measurement Working Group (2014), [Measuring impact. Subject paper of the Impact Measurement Working Group](#) (2014, p. 7)



Goal setting: The capitals (inputs) are stocks of value that can be increased, decreased or transformed through your company's activities and outputs. The identification of the capitals may be determined by your business activity or sector in which your company operates. Being aware of the capitals your company employs in its business activities enables resource planning and related decision-making. A company may use tangible and intangible resources. Raw materials, land, labour and financial resources are the tangible inputs, whereas ideas, information and knowledge are the intangible inputs.

Framework development and the selection of indicators: Determine what you want to examine and define the scope of measurement. Develop an effective framework that integrates metrics and outlines how you collect and use data. It is important to quantify the stocks and flows of value. You should also measure performance by referring to the company's achievements relative to strategic objectives or outcomes concerning their effects on the capitals.

Figure 43: Inputs, outputs, outcomes



Source: own illustration based on Impact Measurement Working Group (2014), Measuring impact. Subject paper of the Impact Measurement Working Group (2014, p. 6)

While establishing KPIs, you can distinguish between lagging and leading indicators. The first group looks back to assess whether the intended results were achieved. The other group looks forward to setting targets for future outcomes and events. It is recommended to map all your KPIs to obtain a heat map of the measurement system. Pay attention to the cold spots, which represent areas that are insufficiently controlled, as well as overheated spots with a high level of information redundancy.

Figure 44: KPI heat map (exemplary metric – customer satisfaction level)

Perspective / Criterion	Specific	Intermediate	Balanced	Intermediate	General
Business range	a single task	a process	a business function	interaction with a close environment	interaction with macro-environment
Organisational scope	Individual	a team	department / project	a company	a supply chain
Time orientation	Past	recent period	current data	next period	long-range
Economic sense	operational efficiency	performance	operationalisation of strategy	business potential	market opportunities
Perspective	internal, subjective	internal, objective	Mixed	external objective	external subjective

Data collection and storage: It is important to reliably collect, organise, and store qualitative or quantitative data, which is a critical step in understanding the organisation's outcomes and impacts on the internal and external environment. The following steps are useful:

1. **develop criteria and policies for data collection** - think about the ways and frequency of data collection.
2. **identify relevant data sources** - consider data extracted from existing IT systems, data obtained from surveys and interviews.
3. **collect, organise and store data in a timely and organised fashion** - note that quantitative data extracted from databases will typically require transformation and aggregation. Qualitative data deriving from surveys and interviews may need to be organised and coded into categories.

Validation: To validate your data and ensure sufficient quality you should:

1. **verify that data is complete and transparent** by cross-checking calculations and assumptions against known data sources, where applicable
2. **consider a trade-off** between insufficient information to make the right decision and the time of obtaining additional data
3. ensure that the collection and processing of the data are **not time-consuming and costly**.

Data analysis: When the system of KPI is installed, and the data collected, it is recommended to review and analyse the metrics to understand how your business is progressing against goals.

Data reporting: The results of the analysis of your KPI system should be shared with your key stakeholders. It is important to disclose KPIs coherently, credibly, and reliably to effectively inform about decisions to relevant and affected stakeholders.

Data-driven management: The final step is to assess stakeholder feedback on reported data and address recommendations to make operational changes or adjustment to the very KPI system. This process should be reviewed in regular intervals to identify whether changes in your integrated reporting are necessary. In the next subsection, we describe the six capitals in detail.

Definition

The pool of funds available to a company to produce the goods and provide the services in its value creation process. It is obtained through financing, such as debt, equity or grants, or generated through operations or investments in the form of retained earnings. Financial capital is a medium of exchange that releases its value through conversion into other forms of capital.

STRATEGIC OBJECTIVES

Examples

Available capital
- cash on hands
- short-term financial investment
- long-term financial investment

Reinvested capital
- cash surplus on business operations
- return on investment
- return on financial activities

Growth potential
- R&D investment fund
- venture investment fund

VALUE DRIVERS → FINANCIAL CAPITAL ← OUTCOMES

Stocks and flows

Stocks of value
- cash on-hand
- short-term financial investment at their maturity
- long-term financial investment at their maturity
- available funds from loans, grants, equity paid

Flows of value
- net cash flows from business operations
- new loans, grants, equity
- interest and dividend paid
- capital expenditure on development project (facilities, technology, resources)
- capital expenditure on hr and social projects

CAPITAL MEASUREMENT

Key Performance Indicators

Lagging indicators
- liquidity ratio
- cash ratio
- quick ratio
- average collection period
- average payment period
- sales revenues
- trade receivables
- cash conversion cycle
- return on invested capital (ROIC)

Leading indicators
- financial standing (credibility)
- weighted average cost of capital (WACC)
- net debt to equity (%)
- net debt to cash (%)
- CAPEX
- market share

Definition

All human-created physical objects, distinct from natural physical ones, available to the organisation for use in producing goods and providing services that contribute to value creation. It includes buildings, equipment, and infrastructure owned, leased or controlled by an organisation.
Manufactured capital can include elements of intellectual property, which is a component of intellectual capital.

STRATEGIC OBJECTIVES

Examples

Physical infrastructure

- buildings
- production sites
- warehouses
- distribution centres
- retail stores

Equipment

- machines and tools
- vehicles

Technological infrastructure

- networks
- systems

Access to shared infrastructure

- road networks

VALUE DRIVERS

MANUFACTURED CAPITAL

OUTCOMES

Stocks and flows

Stocks of value

- number of production lines
- number of stores
- number of distribution centres
- warehouse capacity
- production line capacity
- network flow

Flows of value

- equipment purchased
- equipment modernised
- equipment leased
- licence access to public properties
- owned equipment engineered in-house
- objects connected to the network (IOT)

CAPITAL MEASUREMENT

Key Performance Indicators

Lagging indicators

- production capacity used
- productivity of assembly line
- overall equipment effectiveness ratio
- storage space used
- mileage of a vehicle
- load capacity of a vehicle

Leading indicators

- automation level of the manufacturing process
- downtime periods
- equipment failure rate
- maintenance time
- age of equipment

Definition

Knowledge-based capabilities of a company that provide a competitive advantage, including intellectual property, such as patents, copyrights, software and organisational systems, procedures and protocols, and intangibles that are associated with the brand and reputation that an organisation has developed.
The carrier of intellectual capital is an organisation itself.

STRATEGIC OBJECTIVES

Examples

Intellectual property
- trademarks, designs, copyrights, brands, patents

Technologies and licenses
- software, network resources, proprietary and licensed technologies, resale rights license

Procedures and protocols
- know-how, recipes, algorithms
- policies and manuals, operational management systems
- tacit knowledge

VALUE DRIVERS

INTELLECTUAL CAPITAL

OUTCOMES

Stocks and flows

Stocks of value
- number of patents
- number of licenses available
- registered trademarks, copyrights
- quality certifications
- on-going R&D projects
- types and functional scope of software licenses

Flows of value
- new licences
- extended licences
- new certificates
- renewed certificates
- new production standards (or procedures) implemented
- developing intellectual capital via enhanced technologies

CAPITAL MEASUREMENT

Key Performance Indicators

Lagging indicators
- R&D as a percentage of revenue
- success rate of R&D grant application
- brand value

Leading indicators
- number of innovation initiatives per employee
- annual workload on R&D projects
- investment in acquiring innovations

Definition

Individual competencies (tacit and implicit knowledge), capabilities, skills and experience of employees and managers, their ability to understand and implement a company's strategy, motivation for improving processes, goods and services, including their ability to lead and collaborate to create value.
The carrier of human capital is an individual employee or collaborator or a group of these.

STRATEGIC OBJECTIVES

Examples

Human resources
- managers, employees, freelance contractors, trainees

Skills and competencies
- technical and managerial skills
- work experience
- performance or customer orientation

Work conditions
- health and safety
- employee wellbeing
- strong ethical culture
- organisational behaviour

VALUE DRIVERS

HUMAN CAPITAL

OUTCOMES

Stocks and flows

Stocks of value
- number of employees
- number of freelance contractors
- number of trainees

Flows of value
- professional certificates obtained by employees
- number of job promotions
- retirement rate

CAPITAL MEASUREMENT

Key Performance Indicators

Lagging indicators
- employment structure (experience, education, gender, age)
- employee turnover rate
- absenteeism rate (parental leave, health, accidents)
- work accident rate
- zero-accident period
- overtime rate

Leading indicators
- training time per employee
- training costs per employee
- employee satisfaction rate
- retention of trainees

Definition

Ability to secure or obtain assets or resources, knowledge, and information by an individual, group, organisation or community for its benefit through social networks, trust, shared norms, and license to operate.
The carrier of social and relationship capital is a network of organisations.

STRATEGIC OBJECTIVES

Examples

Key relationships
- stakeholder trust
- positive relations with employees and trade unions
- strategic relations with service providers and suppliers
- constructive relationship with authorities and regulators
- social licence to operate

Reputation
- high levels of customer satisfaction and loyalty
- relations with industry peers
- cooperation with civil society bodies, NGOs and media

VALUE DRIVERS

SOCIAL AND RELATIONSHIP CAPITAL

OUTCOMES

Stocks and flows

Stocks of value
- number of social programs supported
- number company social events
- number of business partners
- number of memberships in professional bodies
- references list
- value of sponsoring contracts
- number of projects with universities or research units

Flows of value
- renewed contracts with customers or suppliers
- new collaborative initiatives
- new social programmes

CAPITAL MEASUREMENT

Key Performance Indicators

Lagging indicators
- corporate social investment percentage of revenue spend of social projects
- number of employee-voluntary working hours
- number of active (accounts of) customers
- number of loyal customers

Leading indicators
- high position in employee professional rankings
- number of incoming CVs to the company
- articles about company in press
- company experts in industry panels

Definition

Natural capital refers to all the renewable and non-renewable resources in the natural environment that create value for a company as an input to the production of goods or the provision of services.
An organisation's activities also affect positively or negatively natural capital. It includes water, land, minerals, air and forests, as well as biodiversity and ecosystem health.

STRATEGIC OBJECTIVES

Examples

Access to natural resources

- natural materials depleted in the manufacturing of merchandise and packaging materials
- consumption of fossil fuels in the supply chain
- electricity and water consumed in operations

Low environmental impact

- use of green energy (solar, water, wind)
- low carbon footprint
- low waste (recycling)

VALUE DRIVERS

NATURAL CAPITAL

OUTCOMES

Stocks and flows

Stocks of value

- area used (land, forest, water)
- water access rights
- mining permits
- emission rights

Flows of value

- decrease in electricity consumption per unit of production output
- reduction in water used per unit of production output
- reduction in petrol consumption by the company's fleet
- reduction of material waste
- reduction of office paper

CAPITAL MEASUREMENT

Key Performance Indicators

Lagging indicators

- electricity consumption
- water consumption
- carbon footprint
- percentage of recycled material used

Leading indicators

- energy from renewable sources used
- reportable cases of environmental incidents

J.1. Identification

In the last chapter, we presented each capital separately. However, it is important to recognise the interrelations between then. It is to these that we turn in this chapter. Each of the six capitals undergoes **changes** over the lifetime of a company. In the integrated thinking model, none of the changes should be considered in isolation, without analysing **all the relations and interdependencies between the capitals**.

The typical changes in each of the capitals are as follows:

- **financial** – positive: generating cash surplus from (re-)investments of equity or operating surplus, as well as pooling external funds (loans, subsidies, grants), or negative: by incurring costs or settling liabilities;
- **manufactured** – positive: by buildings facilities, purchasing equipment, getting access to any external infrastructure, or negative: when assets are sold or liquidated;
- **intellectual** – positive: by securing own intellectual property in the form of patents, copyrights, trade secrets or trademarks, or negative: when control over intellectual property or access to it is lost;
- **human** – positive: when employees of a company gain knowledge, competencies, skills and experience, both hard and soft ones, or negative: when key employees leave and the organisational knowledge pool is affected;
- **social and relationship** – positive: when a company obtains certain benefits through its networks of partners and supporters, or negative: when it loses reputation or even a license to operate;
- **natural** – positive: when a company gains access to such resources like water, land, minerals, air and forests, or negative: when it negatively impacts the natural environment.

J.2. Examples

Relations and interdependencies between the six capitals can be seen in **two ways**:

- as positive influences, when use or increase of one capital stimulates the growth of another capital (see examples in figure 45),
- and as negative trade-offs, when use or increase of one capital leads to depletion of another capital (see examples in figure 46)

Figure 45: Interdependencies between the six capitals – the positive influences

	FINANCIAL CAPITAL	Purchase of assets or leasing resources	Investment in research and development	Recruiting and paying employees	Financing social initiatives and charity	Financing ecological projects
	Generating a long-term return on investment	MANUFACTURED CAPITAL	Providing facilities for R&D projects	Increased productivity of employees	Sharing assets with other organisations	Replacing or reducing the use of natural resources
	Securing financial returns by protecting IP	Providing technology for operations	INTELLECTUAL CAPITAL	Increased effectiveness of intellectual tasks	Sharing know-how and educating	Introducing sustainable technologies
	Private financing and unpaid service	Building and maintaining facilities	Sharing knowledge and experience	HUMAN CAPITAL	Involvement in community projects	Involvement in ecological projects
	Mutual investments or crowdfunding	Co-funded or shared investments	Open-source knowledge sharing	Co-funded training programmes	SOCIAL AND RELATIONSHIP CAPITAL	Lobbying on sustainable solutions
	Benefiting on natural resources and ecosystems	Using natural resources in operations	Inspiring engineering solutions	Creating good working conditions	Creating space for social leisure activities	NATURAL CAPITAL

Figure 46: Interdependencies between the six capitals – the negative trade-off

	FINANCIAL CAPITAL	Selling facilities and reducing investments	Closing expensive R&D projects	Looking for a cheap labour force	Withdrawing from social projects	Excessive exploiting of natural resources
	Generating high overheads	MANUFACTURED CAPITAL	Replacing innovations with mass alternatives	Replacing manual work with automation	Industrialising neighbourhoods	Polluting the environment
	Overinvesting in R&D projects without results	Abandoning industrial buildings	INTELLECTUAL CAPITAL	Reduced requirements for low-skilled staff	Overprotecting knowledge transfer	Legally monopolising natural resources
	Pressure on increasing remuneration	Pressure on restructuring work facilities	Relocating funds from R&D to salaries	HUMAN CAPITAL	The pressure of trade unions on stakeholders	Overexploiting ecosystems for human benefits
	Stakeholders' pressure on profit sharing	Influencing investments by community	Uncompensated use and sharing of knowledge	Public pressure on company executives	SOCIAL AND RELATIONSHIP CAPITAL	Pressure on the company's eco actions
	High costs of environmental investments	Liquidation of eco-unfriendly production plants	Relocating funds from R&D to eco-projects	Reduction of workplaces in heavy industry	Acting against heavy industry lobbyists	NATURAL CAPITAL

J.3. Disclosure

The changes in related capitals do not need to be proportional in the case of positive influences or equivalent in the case of negative trade-offs. There exists no principle of retaining the total amount of capital – where one capital could be transferred into another one with no added value. On the contrary, **the cumulative increase** of capitals indicates **business growth**, and **the cumulative decrease** of capitals signals its **downturn**. Therefore, the managers' role in SMEs is to find the best ways to build up existing capitals by **triggering positive relations** and **mitigating effects of negative trade-offs**, having the sustainable growth of the entire business in mind.

Since the six capitals may be challenging to capture with a uniform measurement system, the disclosure of interrelations can take a **descriptive form** with the **support of metrics** that attempt to quantify the capitals. An SME should report in this respect:

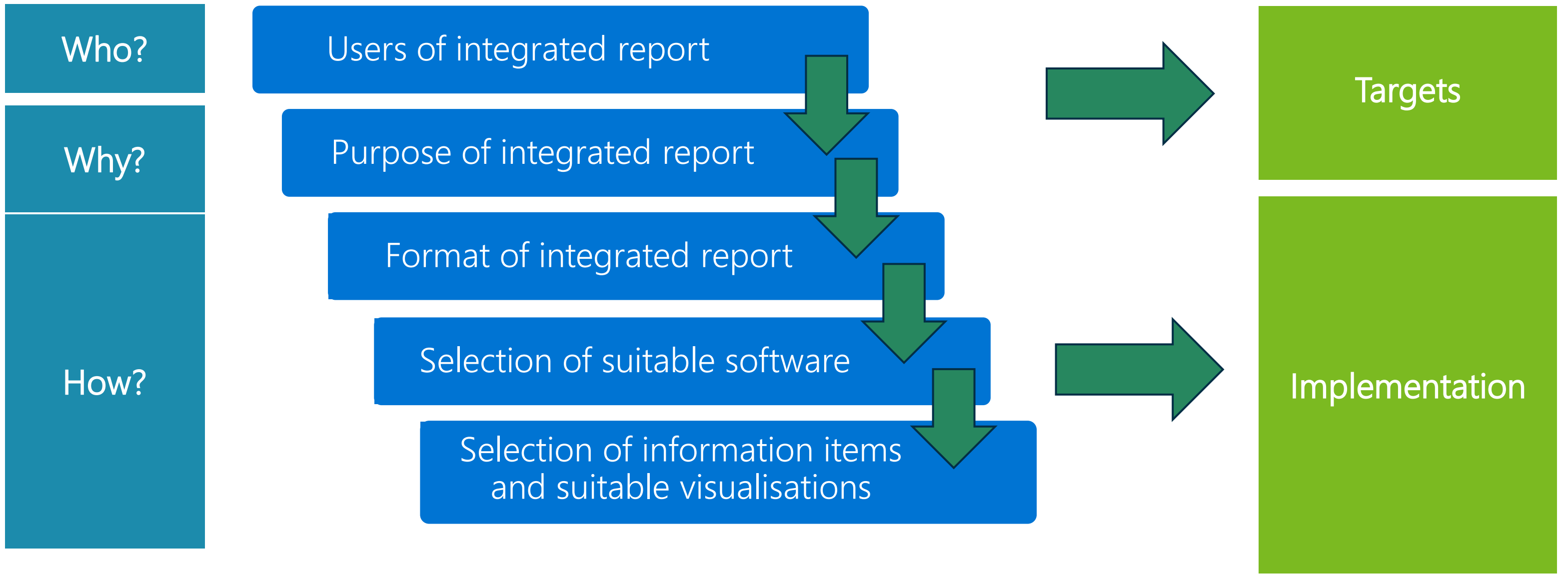
- its **general policies** and goals related to the six capitals,
- positive influences and negative trade-offs between capitals that are typical for the **industrial sector** and **size** of a company,
- its **ongoing projects** related to any of the capitals (e.g. financial investments, building infrastructure, patenting know-how, staff training, establishing relations with interest groups or conducting environmental projects) with expected results, ways of achieving those results and methods of documenting those,
- expected **changes** in one capital and their **short-term effects** (resulting from ongoing projects) and **long-term impacts** (resulting from policies) on other capitals, by providing reliable ways of measuring or capturing those influences,
- unexpected **events** that cumulatively affect the capitals, particularly those leading to depletion of the capitals (e.g. natural disasters, industrial breakdowns, social instabilities etc.)
- any other **relevant information** that may help to understand changes in the six capitals that have occurred or are likely to happen and may contribute to value creation, preservation or erosion over the short, medium and long term.

Having focused in the last two chapters on the capitals and their interrelationships, this guide concludes in the next chapter by providing you with pointers and best practices of how to visualise your company and its value creation in your integrated report.

After having brought together all the information you require, it is now time to compile your integrated report. Important decisions to make in this phase are selecting the information items to include in your report, the software and tools you want to use, the format of your report and the type of visualisations you wish to employ. Instead of providing an extensive list of possible best practice graphs and report items, this chapter discusses **key principles and aspects** to consider.

The process of combining all relevant and material information into an integrated report requires you to consider the following key aspects:

Figure 47: Aspects to consider when compiling your integrated report



In order to produce an informative and useful integrated report, it is necessary to focus on the targets: expected **users** and their **informational needs**. Closely linked to this question of who are the users is also the issue of the **purpose** of the report:

- Is the report primarily a **source of information for external stakeholders** or do you intend to also use it as an instrument for **accountability**?
- Do you intend to create an integrated report to **support decision-making** of your employees or the management of your company?

When answering these questions, it is important to think about your overall communication strategy because an integrated report can serve as a **strategic communication tool**. As such, you also need to consider whether you want to voluntarily disclose a stand-alone integrated report or to have your integrated report meet your legal disclosure requirements.

Closely linked to the questions of the user and purpose of an integrated report is how to implement the integrated report, i.e. the desired **format**. A detailed **printable report** with many narratives publishable on a web page may be a suitable format for informing stakeholders and fulfilling legal disclosure requirements. Such a report is however costly to produce and not very useful for internal users within your company. For internal users, a **customisable reporting tool** with easy-to-export information is more suitable. A **web-based report** allowing different formats for different user groups may be a good solution for a report that serves both internal and external users.

Once you have chosen the format of the report, you also need to decide which software to use to compile your report. For simple formats, standard office desktop publishing software is sufficient. If you desire to use a web-based format that enables customisation of information as an interactive tool for the user, you need to check which software packages offer these solutions and you may think about hiring an external consulting company for customising and formatting.

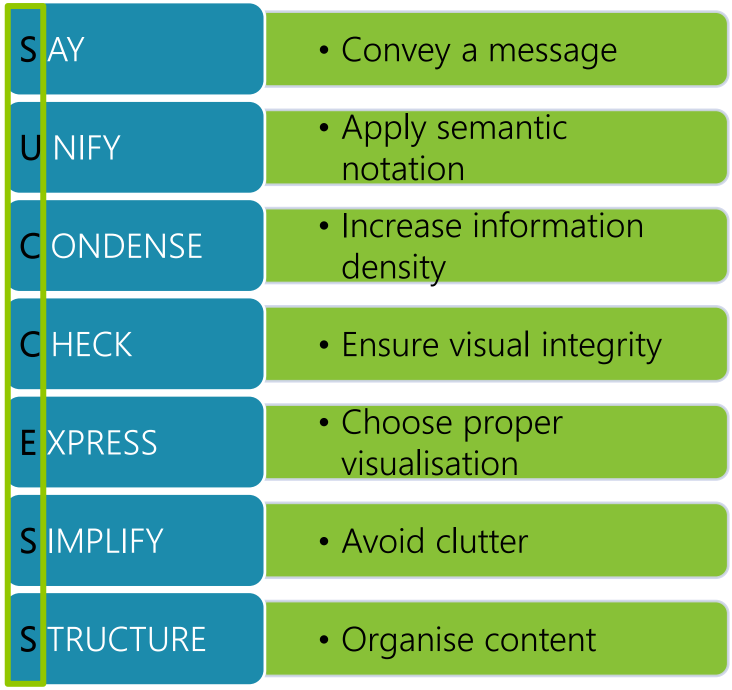
In a final step, you should determine how the information in the integrated report is to be **visualised**, bearing all prior aspects in mind:

- Do you intend to rely more on narrative information?
- Do you wish to use graphs?

Depending on the users of the report and their informational needs, it is important to determine how you can communicate the relevant and material information in an easily comprehensible manner.

There are several frameworks to aid organisations in the development of user-oriented reporting systems and to provide guidelines for the selection of suitable visualisation tools. When drafting your report, you may want to adhere to the International Business Communication Standards, a framework backed by the IBCS Association and rooted in the work of Dr. Hichert and McKinsey&Company. At the core of these rules is the application of the **SUCCESS rule**:

Figure 48: SUCCESS rule



Source: own illustration based on the International Business Communication Standards

An integrated report needs to convey a clear message (**say**) that is directed towards the users. Your message should be easy to understand and implies that key insights are presented directly to the user. Employ short sentences and precise wording and use graphical elements to highlight very important aspects in your report.

It is important that you develop clear visualisation and style convention (e.g. language, but also scales in graphs) up-front and over time to ensure consistency within a report but also over several years. **Unifying** your reporting conventions make your reports more accessible, recognisable and understandable for your recipients.

When displaying information, do not lose yourself in details. You need to **condense** information to enable efficient reporting and help report users to grasp the big picture.

Check that all presented information is correct and unambiguous, especially by using common scales and currencies.

To select the appropriate visualisations, you need to **express** your information properly in graphs and tables.

It is important to follow standard conventions for selecting appropriate graphs as well as visual elements (e.g. pie charts, bar graphs, and line graphs). Consider that time series usually run from left to right and pie charts showing percentages of a total should add up to the total (i.e. 100%).

In your report and in all visualisations, exclude aspects that have no relevance or are of no meaning. **Simplifying** your report is an important aspect to ensure that you do not distract your user's attention. This rule also implies that your visualisation should only include required elements. Unnecessary colours, avoid shading or the extensive use of elaborate graphical elements. Keep your graphs and diagrams plain and simple.

The **structure** of your report should focus on the information needs of your users. Make sure your report does not have gaps nor overlaps. Applying a consistent structure when reporting to several different stakeholder groups may be a challenge.

These seven rules combine into the pillars of the IBCS standards:

Figure 49: Three pillars of the IBCS standards

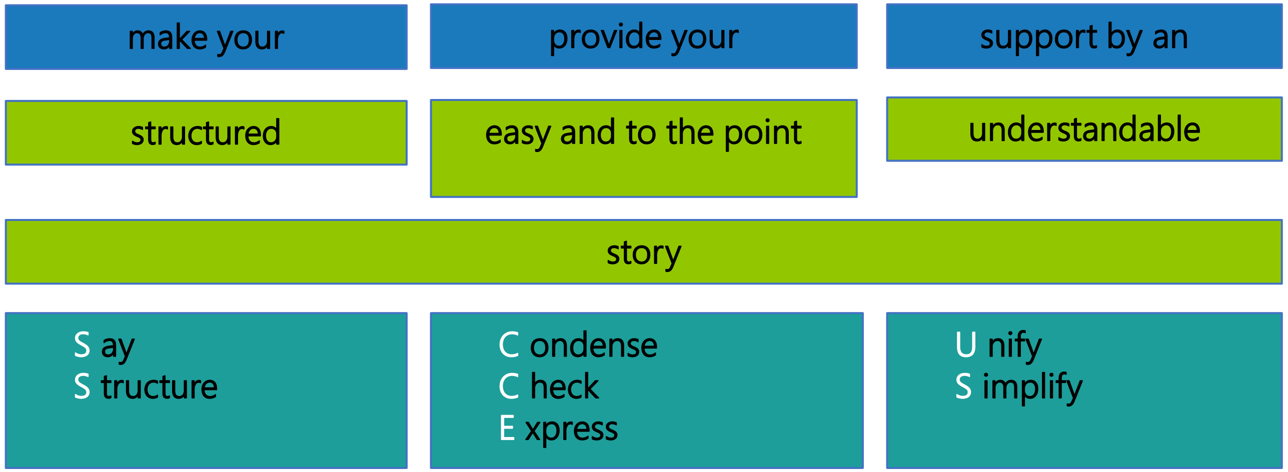
THREE PILLARS OF IBCS (INTERNATIONAL BUSINESS COMMUNICATION STANDARDS)		
Conceptual rules	Perceptual rules	Semantic rules
SAY STRUCTURE	CONDENCE CHECK EXPRESS SIMPLIFY	UNIFY

Source: International Business Communication Standards

The first pillar is about creating an appropriate story line, the second pillar concerns the use of appropriate visualisations, and the last pillar relates to the use of language in the report.

In a nutshell, your integrated report should match the following guiding principles:

Figure 50: Guiding principles for compiling your integrated report



Additionally you should keep in mind that your integrated report is not a one-off publication, but disclosed periodically. Therefore, it is also advisable to consider these further aspects:

- **Consistency**: the layout of your report, the structure of the dashboard and defined KPIs should be consistent over time for easier and quicker understanding and recognition.
- **Efficiency**: The report should be created quickly with a high degree of automated data supply and processing.

  Input data should be reliable and documented. Standardised processes help you to reduce time and effort needed to create your integrated report.

This guide has provided you with practical instructions to help you to implement integrated reporting and integrated thinking in your organisation.

It has introduced you to integrated reporting and delivered tools for you to use in putting into practice three key aspects of communication involved in integrated reporting – who to communicate with (stakeholders), what to communicate (materiality) and where to source the necessary information (data sources). It has shown you how you can communicate about central dimensions of your company – your organisation and the environment in which you operate, your governance structures and value creation and your business model. The guide has also specified how you can identify and measure capitals and be aware of the interrelationship between them. It has concluded with giving you pointers to how to effectively present and visualise your company in your integrated report.

Your feedback and comments on the guide are welcome.

The contents of this guide are further elaborated in the third output of the INTEREST project – training curricula for SME managers and students. For more details, please see the INTEREST website.

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