GOVERNANCE LEADERSHIP CENTRE

Integrated thinking – a pathway to greater stakeholder engagement

DirectorsBrief Issue 1 2018

Our first DirectorsBrief for 2018 discusses integrated thinking and builds on the November 2015 DirectorsBrief on the evolving field of corporate reporting. Integrated thinking involves much more than changing the way organisations report – it is a change process that compels organisations to focus on how they create value over time. Integrated thinking results in better articulation of strategy organisation-wide, where everyone from the board to employees on the floor understands where the organisation is going and what it is trying to do, and where all can make a contribution.

Increasing consumer and stakeholder demands for clear communication about organisational performance and intentions, are driving more holistic reporting beyond the financial bottom-line. This requires organisations to think and engage more broadly with stakeholders.

This DirectorsBrief discusses developments and trends, and we are also pleased to share insights from Whaimutu Dewes, Chair of Moana New Zealand, on Moana's integrated thinking journey. We also profile Z Energy's approach to integrated thinking with CEO Mike Bennetts.

Integrated thinking

Integrated thinking connects purpose with performance, placing strategy and business plans firmly within the context of the organisation. It can break down internal silos, create alignment on strategy across the organisation, and change how people think and work together. Integrated thinking is critical to developing an integrated report and integrated reporting is how organisations communicate integrated thinking. However, integrated thinking does not need to result in a particular reporting framework.

By considering the activities and impacts of an organisation more broadly and holistically, boards can make better informed decisions and manage key risks more effectively by:

- better identifying resources and relationships essential to the organisation and its ability to create value
- more effectively allocating resources to align with long-term goals
- identifying the risks and opportunities that could detract from a sustainable business model
- aligning reporting to business models
- communicating and engaging with shareholders and stakeholders.

> *Integrated Reporting is not as much about the reporting – it is a paradigm shift into integrated thinking that starts in the boardroom.*
>
> **Warren Allen**, External Reporting Board CEO

As a key driver of sustainable value, integrated thinking must be led by, and have active involvement from, the board and senior leadership. If directors get it right, the culture of the organisation will live the values, focus on delivery against the strategy whilst managing their resources and relationships over the long-term. The main challenges in integrated thinking concern identifying useful, reliable indicators, reporting them consistently and gaining buy-in from internal and external stakeholders.

Tips for achieving integrated thinking

1. Secure the understanding, interest, and commitment of high profile organisation leaders who are willing to champion the adoption and effective use of integrated thinking and reporting.
2. Create a cross-functional work group led by enthusiastic internal “game changers” to ensure engagement, diversity, and inclusiveness while the concept of integration is being applied to planning, measurement, and reporting.
3. Clarify the difference between performing sustainability and sustainable performance early in the process, and bring the finance organisation on-board.
4. Focus on the purpose of the business and on the multiple objectives to be achieved, considering the various stakeholders that engage within the value chain.
5. Understand the financial and operating objectives as well as the expected targets that are linked into the strategic plan of the organisation.
6. Identify the resources, the activities, the drivers, and the stakeholders that are involved in the development and execution of the business model.
7. Recognize the trade-offs, interests and risks that characterize the value creation process — especially across and within the capitals.
8. Design a system of appraisal and performance evaluation that is able to reward connectivity and inclusiveness.
9. Implement a comprehensive system of data collection and analysis that supports integrated thinking and reporting, as well as fosters the validation and interrogation of the performance achieved.
10. Share the achievements of integrated thinking, management and reporting with the board and key organisation leaders to maintain sponsorship and to ensure that data and analysis are used for decision-making purposes.

Source: CIMA Research Executive Summary: Integrated Thinking – Aligning purpose and the business model to market opportunities and sustainable performance

Insights on values and increasing engagement

Whaimutu Dewes, Chair of Moana New Zealand, is also a current director of Contact Energy and Housing New Zealand. Moana New Zealand is the trading name of Aotearoa Fisheries Limited, the company set up following the 1992 Sealord settlement. One of the dominant players in the New Zealand fishing industry, Moana is the only Māori company to break into the Deloitte Top 200. Whaimutu explains Moana New Zealand’s motivation for integrated thinking.

“The drive for integrated thinking comes from our values”, says Whaimutu, “Manaakitanga (looking after our people our way), whakapapa (knowing where we are from), whakatipuranga (prosperity for future generations), and kaitiakitanga (custodians for our future generations).”

“As a Māori-owned organisation, we have a responsibility to care for our resources and make sound investments for future generations. As such, we have formed a sustainability working group with representatives from across our entire business.”

Whaimutu explains, “This group collectively considered our challenges and opportunities to design our sustainability strategy. This strategy outlines the key areas and projects we’ll be focusing on. Getting our people to design the strategy, means they have pride in what they have developed and take ownership for delivering against the strategy. Ultimately it increases engagement. This is an example of us living and breathing our values. For Moana New Zealand, our values are not written on a piece of paper and filed away, they guide our thinking every day.”

Whaimutu Dewes

Mike Bennetts

Mike Bennetts, CEO of Z Energy Limited, has led Z since its inception in 2010. Prior to this, he spent 25 years with BP in a variety of downstream roles in New Zealand, China, South Africa, the UK and Singapore. Mike is also a director of New Zealand Refining, Loyalty NZ and chair of Punakaiki Fund Ltd.

Z Energy adopted the Integrated Reporting (<IR>) framework after several years of using Global Reporting Initiative (GRI) standards. Mike says integrated thinking has assisted Z to fully describe Z’s value creation model from investment-led to productivity-led, rather than simply focussing on the results over the previous year.

“The shift was not so much about building integrated thinking into business strategy but rather about pulling that thinking together and being able to communicate it through a clear reporting framework.

More focus on a framework that considers impacts across a range of capitals has assisted our day-to-day thinking. For example, we have successfully negotiated commitment from our key suppliers to reduce the environmental impact of their activity with us, in areas like carbon emissions and waste.”

Continued over

Insights on values and increasing engagement continued

Embedding integrated thinking throughout the organisation has also required approaching stakeholders differently. “The reporting required by <IR> drives a particular style of thinking. <IR> requires organisations to demonstrate the process used to determine what the most material issues and risks are for inclusion in the Annual Report. This means we need to be deliberate and ask a range of stakeholders about this and in doing so, it drives a deeper listening.”

The value from integrated thinking has been clear. Mike comments, “We talk more openly about the value we can create. We understand that ‘how we do things around here’ contributes to the long-term value of our business – through increased engagement of staff, increased customer loyalty, and increased shareholder value.”

Stakeholder engagement and social licence

Without a sense of purpose, no company, either public or private, can achieve its full potential. It will ultimately lose the license to operate from key stakeholders. It will succumb to short-term pressures to distribute earnings, and, in the process, sacrifice investments in employee development, innovation, and capital expenditures that are necessary for long-term growth.

Larry Fink, Blackrock CEO in his 2018 annual letter to CEOs

Social licence is the level of support, approval or acceptance of organisations and their activities by stakeholders and communities, over and above meeting any legal requirements. Unspecified and informal, understanding an organisation’s social licence to operate is a key component of integrated thinking. It needs to be discussed by boards, and managed, documented and reported by management, in order to understand stakeholder and community expectations about an organisation’s operations. Integrated thinking helps boards to assess non-financial impacts by bringing understanding and discussion of social acceptability into the boardroom.

Being transparent and developing trust are crucial in gaining social licence. It must be earned and maintained, as it is dynamic and intangible, subject to change as the opinions and perceptions of stakeholders are influenced by societal norms and the flow of information.

An example of failure to maintain social licence to operate is Cadbury’s substitution of palm oil for cocoa butter in their chocolate in 2009. In the 2010 Reader’s Digest Trusted Brands survey, it toppled to 36th on the list after six years of holding the top spot. In a statement in response, Cadbury’s said, “It’s no secret that the past year has been a challenging one. We know that some decisions we made caused us to lose that trust.”

Undertaking stakeholder mapping including analysis of stakeholder needs, structures, and issues, is an essential component of social licence. Most organisations will have mechanisms in place to engage with stakeholders, whether informing, consulting or collaborating. These may include:

- social media and digital platforms
- surveys
- site visits and community meetings
- brochures, newsletters and mailers.

The Stakeholder Voice in Board Decision Making: 10 Core Principles for Boards

1. Identify, and keep under regular review, who you consider your key stakeholders to be and why.
2. Determine which stakeholders you need to engage with directly, as opposed to relying solely on information from management.
3. When evaluating board composition and effectiveness, identify what stakeholder expertise is needed in the boardroom and decide whether you have, or would benefit from, directors with directly relevant experience or understanding.
4. When recruiting directors, the nomination committee should take the stakeholder perspective into account when deciding on the recruitment process and the selection criteria.
5. The chair should ensure there’s adequate and ongoing training for directors, including on stakeholder-related matters, as well as induction of new directors, particularly those without previous board experience.
6. The chair should determine how best to ensure that the board’s decision-making processes give sufficient consideration to key stakeholders.
7. Ensure that appropriate engagement with key stakeholders is taking place and that this is kept under regular review.
8. In designing engagement mechanisms, companies should consider what would be most effective and convenient for the stakeholders, not just the company.
9. Report to shareholders on how the impact on key stakeholders has been taken into account when making decisions.
10. Provide feedback to those stakeholders with whom it has engaged, tailoring to different stakeholder groups.

Adapted from ICSA: The Governance Institute

THOUGHT POINT

For all organisations, whether listed or not, ESG reporting can be a powerful way to measure and communicate the economic, environmental and social impacts of your organisation’s activities.

Corporate transparency

There's a growing global trend from consumers, stakeholders and investors for greater transparency about corporate activities and for more holistic reporting. Financial information alone doesn't tell the whole story, and scrutiny is extending beyond the bottom-line to examine what businesses are doing, how they're doing it, and their impact on the environment and society.

Consumers want to know about the origins and composition (including supply chain) of products, employee conditions and treatment, and corporate practices. They want to know that they are not buying products of child labour or environmental damage, and that their choices may contribute to social good.

These are not just ethical drivers but commercial drivers. It's about understanding how organisations create value and the sustainability of business models, particularly in our world of major environmental, social and technological change.

Focusing on key strategic, social, governance and environmental risks, and long-term business sustainability, is fundamental to good governance. So too is understanding and responding to the evolving expectations of investors, consumers and other stakeholders. Transparency of corporate activities and intentions helps build trust, and aids business resilience and long-term sustainability.

In the 2017 IoD-ASB Director Sentiment Survey 69% of respondents deemed environmental and social issues very important to their business and 75% said their boards consider the long-term sustainability of their business model at least every two years.

NZX guidance on ESG reporting

The introduction of the 2017 NZX Corporate Governance Code and ESG guidance note (released December 2017) aims to improve corporate disclosure encouraging broader reporting of material exposure to environmental, economic and social sustainability risks. Businesses are urged to measure their sustainability through the three elements of ESG, and the ethical impact of investment in their business.

The three ESG elements and relevant reporting factors and issues include:

- **Environmental**, eg water use, deforestation, land degradation, waste management biodiversity, climate change.
- **Social**, eg health and safety, human rights and supply chain management, product safety and liability, labour standards.
- **Governance**, eg business ethics, executive remuneration, whistle-blower protection, succession planning, risk management.

ESG may be a relatively new term, but it is not a new concept as this 1995 quote from Michael Porter and Claas van der Linde shows:
How an industry responds to environmental problems may be a leading indicator in its overall competitiveness … Only those companies that innovate successfully will win. A truly competitive industry is more likely to take up a new standard as a challenge and respond to it with innovation.

KPMG Survey of Corporate Responsibility Reporting 2017

The global KPMG Survey of Corporate Responsibility Reporting 2017 covers corporate responsibility and sustainability (CR) reporting by the top 100 companies from 49 countries including New Zealand. The research assessed areas such as strategy, governance, materiality, stakeholder engagement and supply chain impacts, and found:

- Globally, CR reporting is mainstream business practice with reporting by:
  - 75% (up from 71% in 2013) of respondent companies
  - 78% of Asia-Pacific respondents companies, a continued increase up from 49% in 2011 and 71% in 2013
  - 93% of the top 250 companies listed in the Fortune 500 ranking (the G250), same as 2013.
- Companies are increasingly connecting their sustainability activities to the UN Sustainable Development Goals – 39% of respondent companies, 43% of G250 companies and 25% of New Zealand respondent companies
- New Zealand is catching up to the global reporting average with 69% of respondent companies disclosing CR information, and recorded the second largest increase in reporting since 2015. However, it is worth noting that 24 of our 100 companies report via their global parent and do not have New Zealand specific disclosures. KPMG says the growth of CR reporting in New Zealand over the last two years can be attributed to increased consumer awareness and investor pressure, as well as a broader appreciation among businesses that non-financial risk management is key to long-term value protection and creation.

The New Zealand supplement explores New Zealand reporting in more detail and how it compares to international good practice. This report found that more New Zealand companies are including CR data in their annual financial reports, with 55% of our top 100 financial reports including non-financial information. However, KPMG NZ Director of Sustainability, Erica Miles says that for the moment, the quality of CR reporting by New Zealand business is often lacking in balance, objectivity and transparency. Over the next two years, the introduction of the NZX Corporate Governance Code will likely act as a catalyst for better business reporting by raising the bar on what is expected. Erica hopes that the onset of this more holistic approach will see box-ticking compliance consigned to the side lines and frameworks such as Integrated Reporting and GRI being used as critical business tools to understand, define and enhance corporate value.

Reporting frameworks

The frameworks and metrics are still evolving and includes reporting on selected corporate social responsibility (CSR), environmental, social and governance (ESG) or sustainability metrics, triple or quadruple bottom-line or adopting one of the established frameworks such as the Global Reporting Initiative (GRI) or Integrated Reporting (<IR>).

Global Reporting Initiative

The GRI sustainability reporting standards are the most widely adopted global standards for sustainability reporting (KPMG, 2017). An updated version of the standards comes in to effect from 1 July 2018 and the standards are able to be incorporated into integrated reports by providing effective sustainability metrics. The modular interrelated standards include three universal standards and three series of topic specific standards (economic, environmental and social impacts).

Reporting principles cover materiality, management approach, and the organisation's involvement with impacts including whether it causes, contributes to, or is linked to an impact through a business relationship. This ensures that organisations assess and report on impacts up and down the value chain, not just those directly caused by their own organisation.

Integrated Reporting

Ultimately corporate reporting is not an end in itself, but a means to an end – which is better business. Therefore we put equal emphasis not just on the reporting, but on the 'integrated thinking' which is integral to changing the mind-set in business and in society about what truly constitutes successful business.
Richard Howitt, CEO, International Integrated Reporting Council (IIRC)

The International Integrated Reporting Council (IIRC) was established in 2010 out of accounting for sustainability and other corporate reporting initiatives. It is a global coalition of regulators, investors, companies, standard setters, the accounting profession and NGOs. South Africa was the first country to mandate an integrated reporting standard, including sustainability metrics, for listed companies.

Integrated reporting guiding principles

1. Strategic focus and orientation
2. Connectivity of information
3. Stakeholder relationships
4. Materiality
5. Conciseness
6. Reliability and completeness
7. Consistency and comparability

In December 2013 the IIRC released The International <IR> Framework – a reporting framework designed to create a more complete and holistic picture of how a company creates value. The Framework introduces the concept of six capitals (financial; manufactured; intellectual; human; social, cultural and relationship; and natural) whose values increase or decrease as they are transformed through the organisation's business model.

The primary purpose of an integrated report is explaining to stakeholders the focus on value creation across the six capitals, rather than value extraction.

For more detail and examples of integrated reports from around the world see the IIRC website.

THOUGHT POINT

Directors should know that the Integrated Reporting Framework assigns responsibility to them ('to those charged with governance') for the integrity of the report. Directors have to acknowledge they have applied their collective minds to its preparation and presentation.

It's important that the board is actively engaged and involved in the reporting process. The report should be consistent with the board's knowledge and understanding of risks and opportunities, including about broad themes and topics covered during the year.

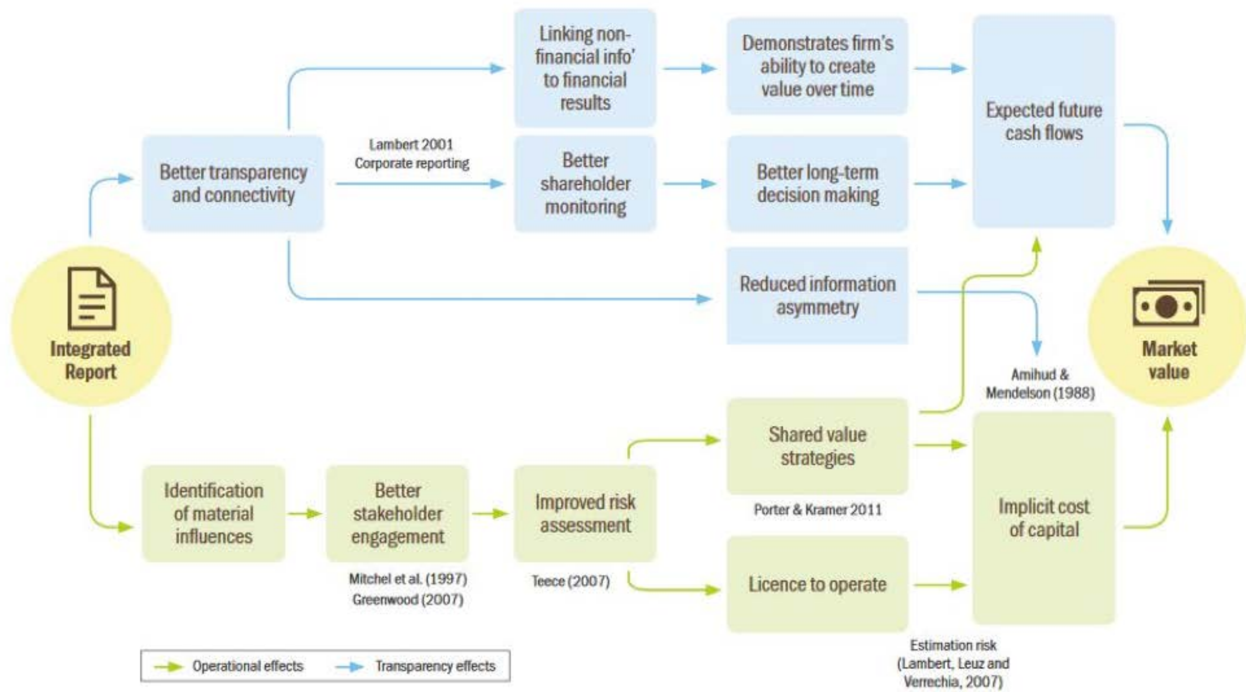
Strategic objectives need to be sufficiently covered, including significant risks, opportunities and dependencies related to the organisation's business model and value creation.

And consider materiality – what's in and what's out, what's relevant and what's not. Provide consistent and comparable information (eg quantifiable measures and indicators) for non-financial as well as financial information. Cover the relationship between past and future performance and the balance between short, medium and long-term interests.

Make the information and its presentation real and relevant for stakeholders and shareholders.

Evidence of benefits of using <IR>:

Martinez's 2016 paper on organisations that adopted integrated reporting suggested that these businesses showed greater improvement in future estimates of cashflow and higher market-to-book ratios than comparative non-adopters.



Adapted from: Martinez, Effects of Integrated Reporting on the Firm's Value: Evidence from Voluntary Adopters of the IIRC's Framework 2017

UN Sustainable Development Goals

In 2015 New Zealand joined other UN member states in adopting the 17 Sustainable Development Goals (SDGs) setting a global development agenda to collectively end poverty, protect the planet and ensure prosperity for all – by 2030. The goals are aspirational and require long-term thinking. The IIRC has developed a guide to support organisations wishing to contribute to the SDGs through the <IR> reporting framework with a five-step process:

1. Understand sustainable development issues relevant to the organisation's external environment.
2. Identify material sustainable development issues that influence value creation.
3. Develop strategy to contribute to the SDGs through the business model.
4. Develop integrated thinking, connectivity and governance.
5. Prepare the integrated report.

There can be no plan B, because there is no planet B.
Ban Ki-moon, United Nations Secretary General (2014)

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