

The value of integration

Laura Leka explains the benefits of integrated reporting for SMEs in a challenging, changing and competitive business environment.



TEN SECOND SUMMARY

- 1 A large proportion of the value of an SME can lie in intangibles that are not reflected on the balance sheet.
- 2 SMEs are starting to recognise the benefits of integrated reporting, and with it integrated thinking, but there are barriers preventing its widespread adoption.
- 3 The transition to integrated reporting will take time and several reporting cycles to achieve.



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Small- and medium-sized entities (SMEs) are the growth engine of economies; they spur innovation, create new products and jobs, and are essential to a competitive and effective market. But for SMEs to succeed in a fast moving, technology driven, and continually changing competitive environment, it is critical that they build investor and stakeholder confidence in their business models to attract funding, staff and other resources essential to their survival.

For SMEs, particularly those that are emerging or small, a large proportion of their value can lie in intangibles that are not reflected on the balance sheet. For example, human resources, intellectual assets, customer and supplier relationships, and brand reputation all drive value creation, but are hidden from financial reports because they cannot be practically measured in monetary terms. The market values of relatively young companies with disruptive business models can be many multiples of their current profitability. This can also be true of well-established organisations; the more they invest internally in developing intangible assets, the less reported earnings are useful to investors in forecasting future profitability.

Increasingly, integrated thinking and reporting are being used by organisations to understand

and tell a better story of their business in a clear, concise and integrated way that explains, through a multi-capital lens, how they create value. For SMEs, communicating the key factors that affect their ability to create value through an integrated report can help build that much needed stakeholder trust around past and future performance.

The principles and concepts underpinning integrated reporting can be applied in a proportionate and scaleable manner and can therefore be used by organisations of any size and in any sector. But although the adoption of integrated reporting continues to accelerate worldwide, predominantly among large listed entities, early adoption by SMEs is currently only on a limited scale.

Overcoming the challenges

SMEs are starting to recognise the benefits of integrated reporting, and with it integrated thinking, but there are barriers preventing its widespread adoption.

Common issues range from resource constraints and a lack of in-house knowledge and expertise, to the perception of an increased reporting burden and uncertainty of the cost benefit. Implementing integrated reporting can be seen as a big commitment for smaller organisations with limited resources at their disposal.

It is, therefore, key for SMEs to first understand the strong business case for integrated reporting implementation and its potential impact on the business, particularly in terms of future performance and the ability to communicate the most important aspects of the business to others.

Integrated reporting is not just a reporting process. It is founded on integrated thinking, which involves understanding value creation in the context of trends in the external environment, various capitals and the business model. This can help SMEs to better understand

the key drivers of value in their business and link these to financial outcomes, resulting in more informed decisions and the implementation of a strategy and business model that will enable growth.

In a recent joint publication, *Creating Value for SMEs through Integrated Thinking: The Benefits of Integrated Reporting*, IFAC and the International Integrated Reporting Council (IIRC) set out the potential benefits of integrated reporting for SMEs which include the following.

- Improving internal management processes.
- Creating greater trust and credibility with customers, suppliers, society and other stakeholders.
- Maximising the potential to transfer, sell or hand over the business by providing a better basis of valuation.
- Securing financing at reasonable cost.

SME implementation plan

The transition to integrated reporting is often referred to as a journey that will take time and several reporting cycles to achieve. It would be unrealistic to expect to fully embed integrated thinking and reporting into an organisation's management processes, and incorporate a multi-capital perspective into decision making, all in one reporting cycle.

In practical terms, the implementation of integrated thinking and reporting by SMEs will differ to that of larger listed entities and, in some respects, could actually be easier because SMEs are likely to have fewer silos and perhaps a greater degree of integrated thinking already.

For a smaller organisation, an integrated report could even suffice as their primary form of strategic communication to the likes of funders such as banks and venture capitalists, as well as to other stakeholders such as customers or others in their supply chain.

An incremental step-by-step approach is a useful way for SMEs to get started. Some tips may help.

- Set up a cross-functional team or small working group with individuals from across the organisation – for example, finance, sales and marketing, operations, human resources – as well as external accountant advisers if needed. A shared understanding across departments or functions of objectives and strategies, and effective cross-function communication, will be fundamental.
- Think about how the organisation creates value, both for itself and for its stakeholders, and the related opportunities and risks. This might be through producing products or providing services to customers, creating employment, and contributing taxes.
- Consider the capitals or resources the organisation uses and affects. The six capitals model set out in the *International Integrated Reporting Framework* can be used as a guideline for completeness, to ensure no material capital is overlooked.

- Bring all of this together and consider the organisation's strategy and business model, connecting the capitals to broader value creation. To maintain relevance in the market, it is crucial that the strategy and business model are responsive to changes in the external environment, risks and opportunities, and stakeholder expectations.
- Assess existing reporting arrangements, processes and systems. Undertake a gap analysis of the information currently available against that which will be needed to support multi-capital decision making. The capture and interpretation of reliable financial and operational data will be essential.
- Learn from the experiences of other SMEs already adopting integrated reporting. A recent example is the technology group, Anglo African. The IIRC's Integrated Reporting Examples Database is also a useful resource, containing examples of emerging practice.

Producing an integrated report is an iterative process and organisations will learn through experimentation. The key is to just get started. It is not necessary to wait until all information or data is available. Evolving existing reporting and processes over time by introducing the concepts and principles of integrated reporting in stages can help reduce the perceived burden of additional reporting requirements. It is not about more reporting, but rather better reporting.

The role of SMPs

It is well recognised that professional accountants are often the preferred source of advice for SMEs, typically forming long-term relationships founded on trust and communication. According to the 2016 IFAC Global SMP Survey, 83% of small and medium-sized practices (SMPs) provided some form of business advisory and consulting service, including 14% that provided enhanced corporate reporting (which includes integrated reporting) as a service.

For SMEs without the internal capacity or expertise, a logical solution is to turn to their professional advisers for external support. In August 2017, IFAC published an article on the topic: *Integrated Thinking and Reporting Requires Trusted Advisors: Guiding Your SME Clients*. This explains why professional accountants are well placed to provide such support.

The guidance also includes illustrative examples of SME clients that might be receptive to integrated thinking and reporting, suggesting that those with a wide network of stakeholders, both external and internal, may be most interested. For example, local utility companies, professional services firms, freight companies, and not-for-profit organisations.

By engaging with clients on integrated thinking and reporting, SMPs can provide added-value, more strategic, proactive and future-focused advice.

FURTHER INFORMATION

Creating Value through Integrated Thinking, The Benefits of Integrated Reporting <IR>:
tinyurl.com/y9p8f5f6
The Case for SMEs to Consider Integrated Thinking and Reporting:
tinyurl.com/yasvzvuv
How Can SMEs Implement Integrated Reporting? A Starter Kit:
tinyurl.com/y8ojn2rc
Integrated Thinking & Reporting Requires Trusted Advisors: Guiding Your SME Clients:
tinyurl.com/y8p5ndoh
Anglo African case study (ACCA):
tinyurl.com/yaevjc9k
Integrated reporting for SMEs – Helping businesses grow: Case Studies (CIMA):
tinyurl.com/glvqecb
IIRC Integrated Reporting Examples Database:
tinyurl.com/ycjrjj6d
2016 IFAC Global SMP Survey:
tinyurl.com/y8kzh42e