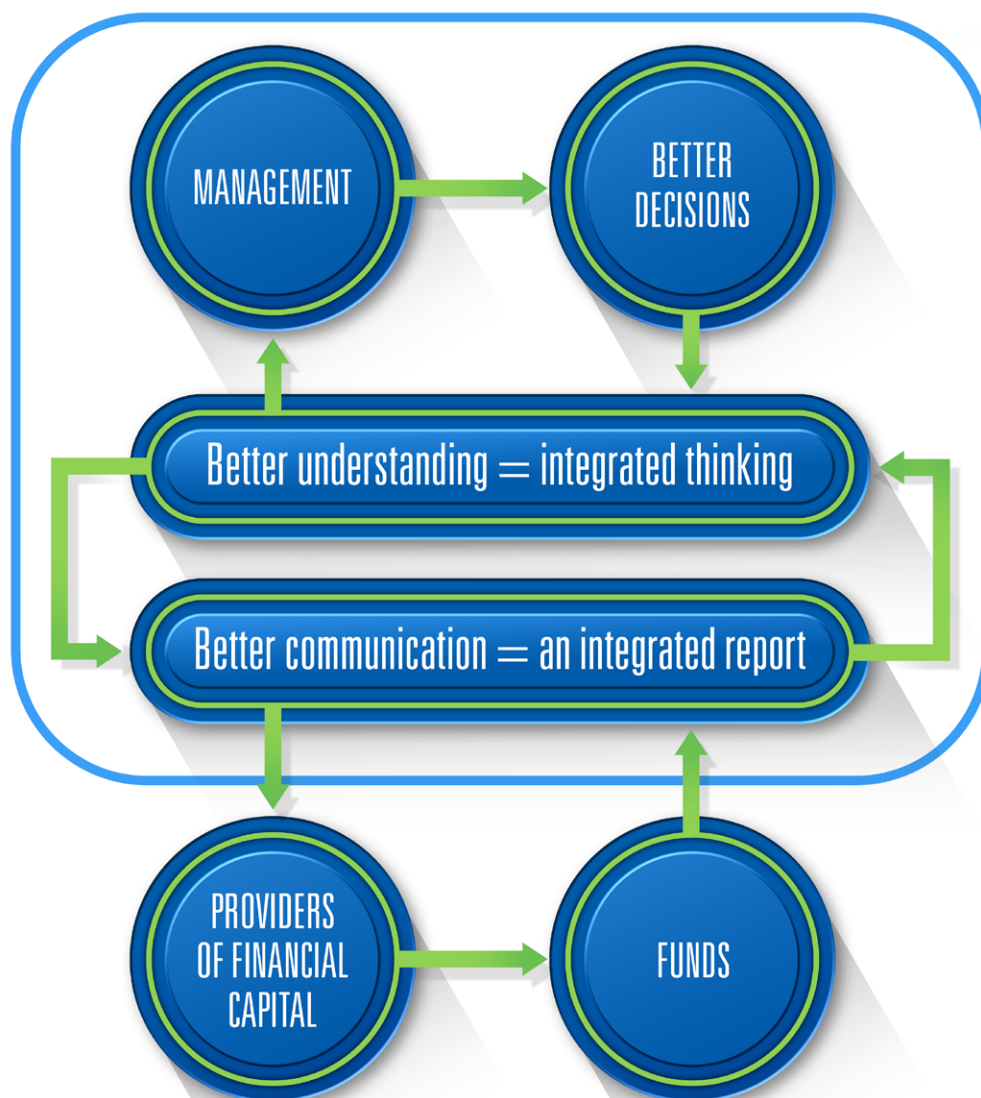


# CREATING VALUE FOR SMEs THROUGH INTEGRATED THINKING



## THE BENEFITS OF INTEGRATED REPORTING <IR>



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# OVERVIEW



Integrated Reporting (<IR>) enhances the way organizations think, plan, and report the story of their business. Many organizations use <IR> as an opportunity to communicate a clear, concise, integrated story that explains how value is created within these organizations. <IR> is an approach that helps businesses think holistically about their strategy and plans, make informed decisions, manage key opportunities and risks to build investor and stakeholder confidence, and help manage the organization's performance.

Organizations of all sizes can use <IR> to build understanding and trust in their business. As a business owner or manager, securing your customers', suppliers', finance providers', and other external stakeholders' trust is paramount. Using <IR>, trust in the business is built by succinctly highlighting what drives value.

Understanding value creation is enabled by what is called integrated thinking, a central theme of <IR>, which is based on breaking down internal silos between people and departments so that the organization can collectively better understand the key elements of the business. This includes the governance, strategy, business model, and opportunities and risks in the context of trends and issues affecting the business. Integrated thinking also involves an organization considering the different resources consumed, and the relationships it relies on, leaving it in a better position to make decisions that help ensure its viability and resilience over time.

In addition to improving internal management processes, <IR> can also lead to other significant benefits, including:

- Creating greater trust and credibility with customers, suppliers, other stakeholders, and society. This is increasingly important in light of government agencies and not-for-profit organizations searching for commercial partners that can not only supply the goods and services that they need, but also do so sustainably;
- Maximizing the potential to transfer, sell, or hand over the business by providing a better basis for valuation; and
- Securing financing at a reasonable cost. Among other things, many lenders will want to know how financial capital has been deployed in the past and future intentions, based on a holistic strategy and a well-rounded business plan.

This publication is specifically for small- and medium-sized entities (SMEs), including those that are not-for-profit, that can achieve significant benefits from adopting <IR> and the International Integrated Reporting Council (IIRC)'s *International Integrated Reporting Framework*. The Framework is principles-based—affording SMEs flexibility in applying <IR> and using a personal approach. The IIRC is a diverse coalition that includes business leaders and investors shaping a global evolution in corporate reporting.

IFAC strongly supports the IIRC and the implementation of the Framework. IFAC's Policy Position Paper 8, *Enhancing Organizational Reporting: Integrated Reporting Key*, highlights that <IR> is a way achieve a more coherent corporate reporting system, fulfilling a need for a single report that provides a fuller picture of organizations' ability to create value over time. It can also be applied in a proportionate and scalable manner to all organizations regardless of size and sector.

# HOW DO SMEs CREATE VALUE?

A good place to start thinking about <IR> is with the question, how do SMEs create value?

SMEs create value in various ways. Accruing financial capital through profits and dividends for owner(s) and shareholders requires delivering value to others, including:

- customers, by delivering desirable products and services;
- employees, by providing a great place to work; and
- society, by creating jobs and contributing taxes.

For many SMEs, created value is not adequately captured or explained in financial reports, such as intellectual property, customer and supplier relationships, human capital, and brand and reputation. A balance sheet usually only shows a small proportion of the intrinsic and real value of an SME.

Whether young or established, high or low tech, in a well-developed or emerging economy, various aspects about how an SME creates value over time are common.

- **It needs financial capital.** An SME will not survive for long without financial capital: debt, equity, or, commonly, both. Whether it comes from family, friends, venture capitalists, crowdfunding, banks, the markets, or elsewhere, SMEs need money to create value.
- **It relies on other capitals, or resources and relationships.** Financial capital is only part of the value creation story. The extent to which an SME can create value over time will be affected to a greater or lesser extent by the continued availability, quality, and price of a full range of resources and relationships, or “multiple capitals.” For example, a manufacturer who has invested in training to develop its workforce in specific areas such as quality management will expect to see higher productivity on the factory floor, and greater efficiency.
- **It operates in the context of, and interacts with, the external environment.** SMEs exist within an ever-changing context and interact with innumerable external factors that together shape its economic, political, social, regulatory, market, and technological environment, which, in turn, affects its ability to create value. For example, technology presents opportunity as well as risk. For some SMEs, technology might be the key to their unique value proposition.



- **In creating value for itself, it creates, and may sometimes destroy, value for others.** Value is almost always co-created. Like two sides of a transaction, neither party will close the deal unless it perceives there is value in it for itself. For example, poor environmental practices, such as in water and waste management, may impact a factory’s ability to access the clean water needed for production in the future.

Although these aspects are common to all SMEs, it’s how each organization considers, manages, and combines these factors in its particular circumstances that make it unique.

<IR> is an effective way to help an SME better understand and manage how it creates value, as well as report on that value creation. More integrated information and thinking should lead the organization to make better decisions about the key areas that affect its ability to create value that can then be communicated through an integrated report, which demonstrates a compelling business case to providers of finance, and others interested in the business. Collectively, the process of creating value and telling the story is integrated reporting.

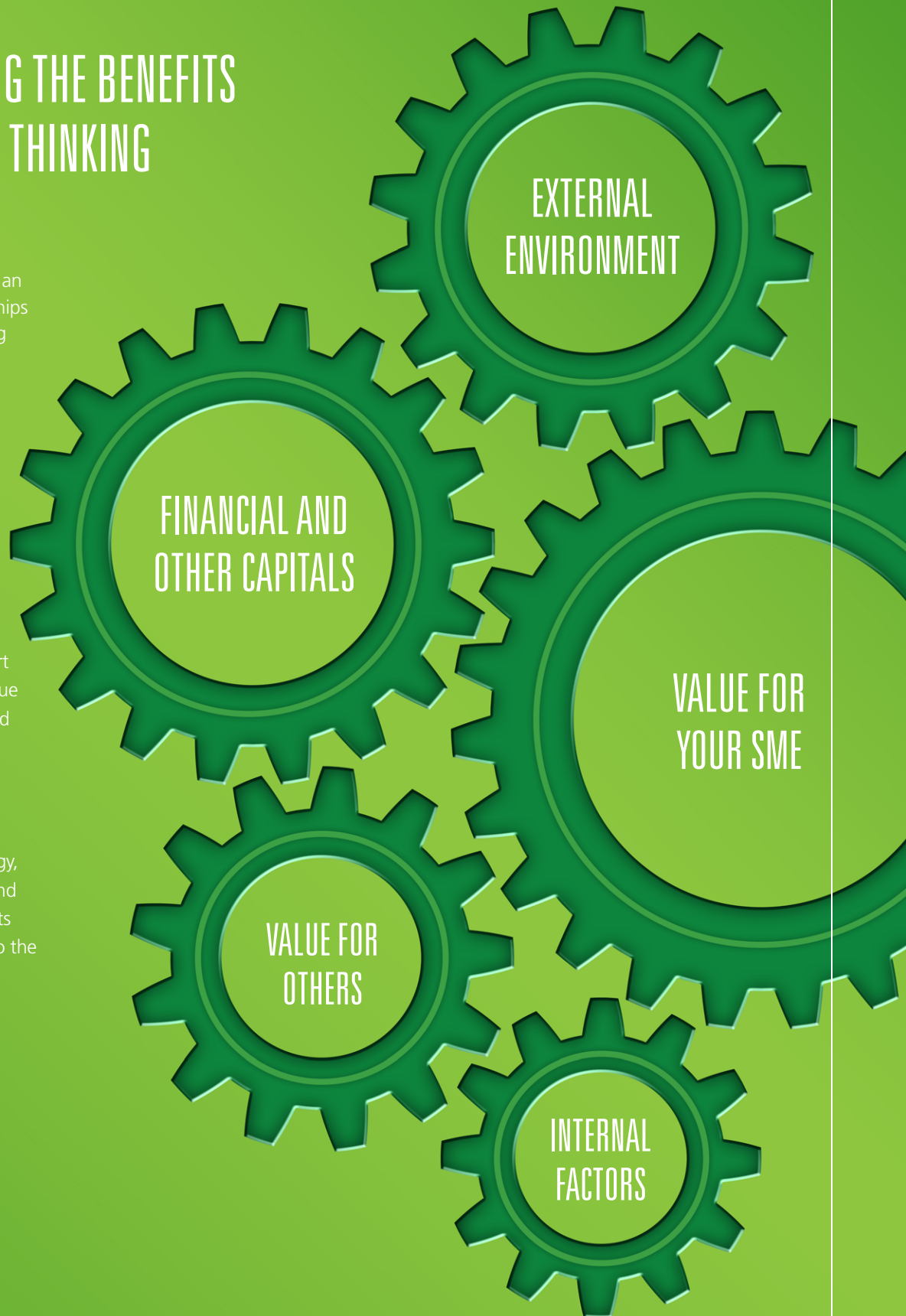


## UNDERSTANDING THE BENEFITS OF INTEGRATED THINKING

The Framework defines integrated thinking as:

“The active consideration by an organization of the relationships between its various operating and functional units and the ‘multiple capitals’ that the organization uses or affects. Integrated thinking leads to integrated decision making and actions that consider the creation of value over the short, medium, and long term.”

Integrated thinking results in a periodic integrated report by an organization about value creation over time and related communications regarding aspects of value creation. An integrated report is intended to be concise and highlight how an organization’s strategy, governance, performance, and prospects, in the context of its external environment, lead to the creation of value over time.





# Multiple Capitals

Through integrated thinking, <IR> can help an SME build a better, more concrete understanding of the factors that determine its ability to create value over the short, medium, and long term. It enhances an SME's business planning and development by taking a fully connected, holistic view, including its use of, and effect on, all capitals or resources that are important to its business model and future.

<IR> uses the term "capitals" and a multi-capital model to recognize the fact that value is not stored in financial capital alone, but in all sorts of capitals.

Just like financial capital, when these other capitals are properly understood and managed, they can continue to release value over time, while simultaneously growing in their capacity to continue to drive value in the future. <IR> identifies these other capitals as manufactured, intellectual, human, social and relationship, and natural.

## IN AN SME CONTEXT, THESE ARE:



**Financial capital**—the equity, debts, and grants available to an SME to be used in the provision of goods or services.



**Manufactured capital**—the tangible goods and infrastructure that an SME owns, leases, or has access to that are used in the provision of goods or services.



**Intellectual capital**—the knowledge, intellectual property, systems, and processes that an SME has at its disposal that provide it with a competitive advantage and positively affect its future earning potential.



**Human capital**—the skills, experience, and motivation that employees and management in an SME possess that provide the foundation for future development and growth.



**Social and relationship capital**—An SME's brands and reputation, including its relationships with the community in which it operates, its customers, and business partners and others in its value chain, such as various government agencies.



**Natural capital**—An SME's access to environmental resources that it can use to provide a return and/or that it affects through its activities or the goods and services it creates.

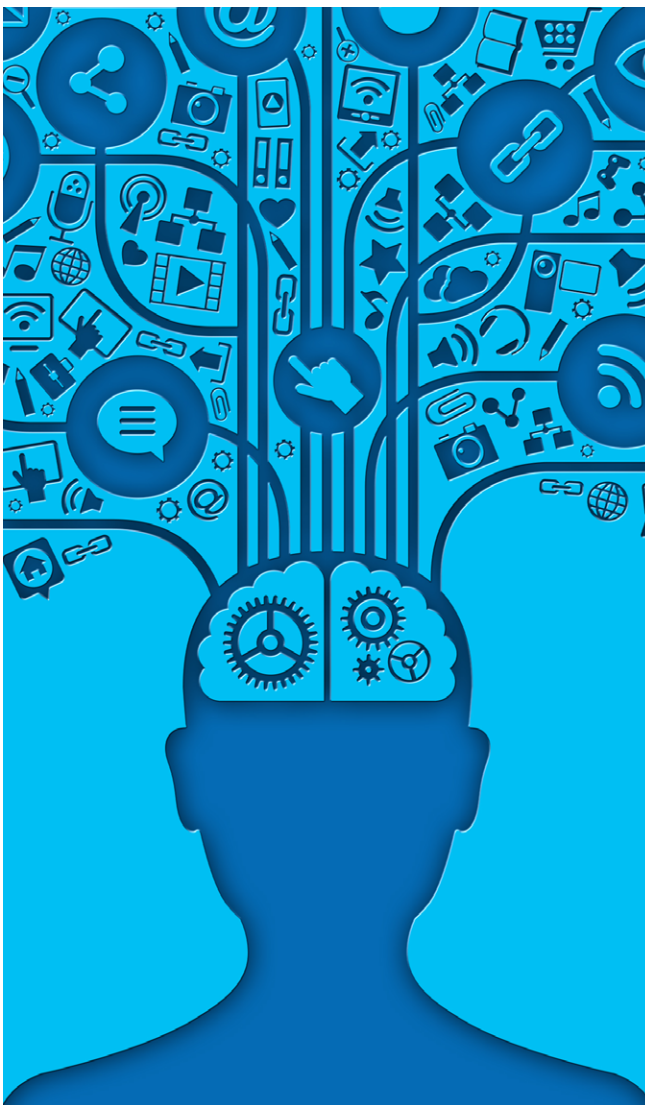
<IR> involves fully considering the many implications of connectivity between the capitals, the external environment, and internal factors through the lens of the business model.

The business model is a pivotal component of <IR>. An increasing number of organizations are developing innovative ways to integrate information about their business model into a management report as it can be a key element of investors' analysis and understanding of a company. Transparency on business models is potentially even more important for young and emerging businesses.

## Better Understanding

<IR> helps break down any internal silos and ensure that information flows fully and freely between different parts of the business to promote more creative cross functional thinking. Even in micro businesses where there are fewer people sharing the load, silos can develop inadvertently, if only because people don't have the opportunity to stop, think, and share information in a deliberative way. Adopting an <IR> approach can create opportunities to improve information flow and a shared understanding of value creation within an SME.

<IR> helps organizations consider creating value over a longer time frame through a deeper understanding of how the various capitals that impact it affect how value is created and preserved, giving the necessary insights to act.



## Better Communication

SMEs are often judged by their recent financial performance, which can be limiting and an impediment to long-term value creation. On the other hand, having access to audited financial statements is important to providers of finance. But funders and other stakeholders, including customers and employees, are as much interested in other areas, like strategy and business model, that will drive the organization forward to meet its objectives. To meet this need, a concise integrated report provides the information required to understand the business and its future outlook.

The integrated report includes key financial information, but that information is kept in context alongside, and connected to, significant "non-financial" measures and narrative information. This provides context to current and prospective equity investors, banks, and other providers of financial capital who can appreciate "the full picture" of how an SME creates value, and its capacity to continue creating value over time.

<IR> is not about more reporting or endless detail. While it's important for an integrated report to include sufficient context for a reader to understand an SME's strategy, governance, performance, and prospects, it should not be burdened with irrelevant information. Where appropriate, an integrated report can link to information elsewhere, like more detailed information on financials (e.g., audited financial statements), environmental or social performance (e.g., a sustainability report), or external sources (e.g., assumptions about future economic conditions and market trends on a government website).

It is important to recognize that an <IR> approach is not "just adding another report." Rather, the flexibility of <IR> means it can be used to move beyond the limitation of short-term financial results. It is a possible springboard to rationalize and harmonize other reports and communications and focus on integrated thinking about long-term value creation.

# Using <IR>: All Things Considered

By taking a holistic, or “integrated,” approach, <IR> provides a pathway for the organization to properly consider the full range of factors, such as multiple capitals, that make up the SME’s value creation story.

The Framework has a number of helpful guiding principles:

- strategic focus;
- future orientation;
- conciseness in reporting; and
- stakeholder responsiveness to provide insight into the nature and quality of an SME’s relationships with key stakeholders, including how and to what extent it understands, takes into account, and responds to their legitimate needs and interests.

But perhaps the most important guiding principle, and the one that really sets <IR> apart, relates to connectivity and more creative, dynamic thinking.

If a compelling and candid story of an SME’s value creation is to be understood and communicated, then the capitals, the external environment, and the significant internal value and performance drivers need to be considered together.

This guiding principle is about the interplay between these three aspects of value creation. It prompts the organization to consider the effects of connectivity between, for example:

- quantitative and qualitative factors, including both financial and non-financial considerations;
- the particular capitals the SME uses and affects, and the critical interdependencies, including the tradeoffs, between them;
- past performance, present resource allocation, and future outlook and prospects;
- the SME’s strategy, business model, and the specific opportunities and risks it faces;
- the nature and rate of change in external factors—for example, competitors’ activities, economic conditions, demographics, technology, natural capital availability, and stakeholders’ legitimate needs and expectations—and how they can affect the SME’s ability to continue creating value in the future.

<IR> also provides a significant opportunity to establish, or enhance, processes and systems for identifying, measuring, and analyzing essential data in various capitals. Important areas driving value creation can then be built into setting objectives and targets, managing opportunities and risk, undertaking project and investment appraisals, and aligning performance to objectives with relevant performance measures.

SMEs can also build trust in the information they report by being transparent on where the business currently is in terms of how it measures, manages, and discloses performance. SMEs can usefully reveal how far they are in measuring different aspects of their performance, and speak to their professional accountant and business advisor about how an assessment and subsequent intervention can help plug in-house competence gaps in preparing non-financial information, and communicate progress to internal and external audiences. This can be done in stages.



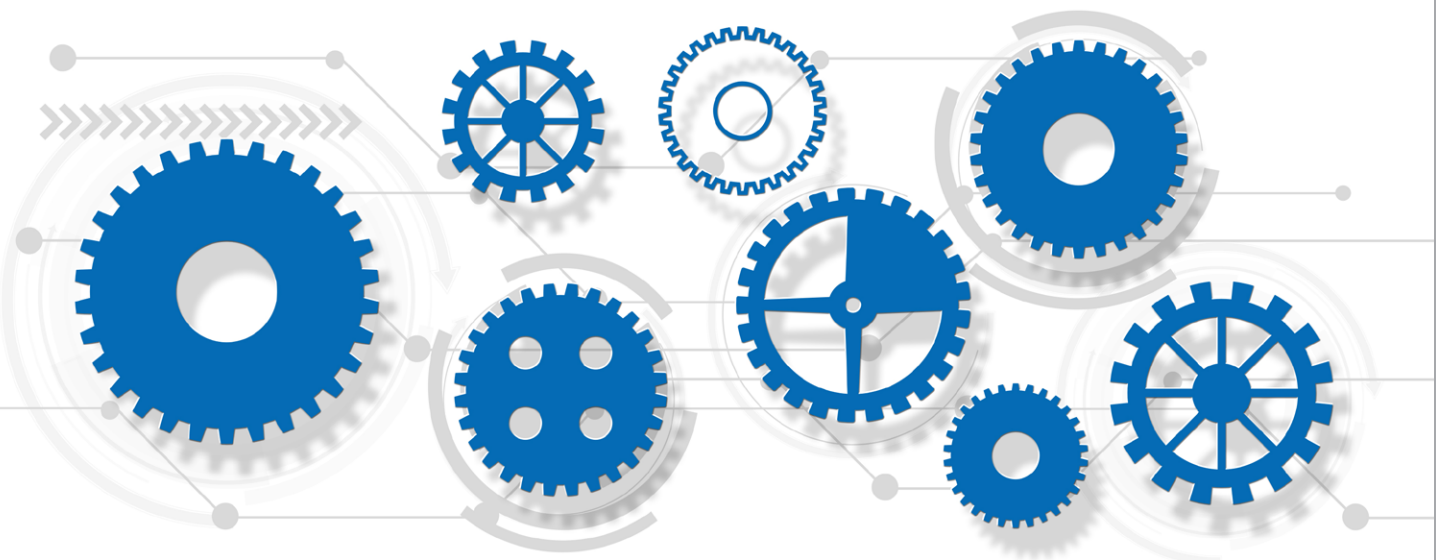


## CONTENT ELEMENTS

<IR> includes eight content elements that frame the approach to understanding and communicating how an SME creates value over time.

- **Organizational overview and external environment:** what the business does and the circumstances under which it is operating.
- **Governance:** how the governance structure supports the business's ability to create value in the short, medium, and long term.
- **Business model:** the business model, including an identification of its key elements, which may include a simple diagram showing business input, activities, outputs, and outcomes.
- **Risks and opportunities:** the specific risks and opportunities that could affect the business's ability to create value over the short, medium, and long term, and how it is dealing with them.
- **Strategy and resource allocation:** the direction in which the business is heading and how it plans to get there.
- **Performance:** the business's journey in achieving its strategic objectives for the period and what the outcomes are in terms of the effects on the various capitals.
- **Outlook:** the challenges and uncertainties that the business has encountered in pursuing its strategy, and the implications for the business model and future performance.
- **Basis of presentation:** how the business determined which matters are to be included in the integrated report and how these were quantified or evaluated.

More information on these content elements can be found in the [Framework](#).



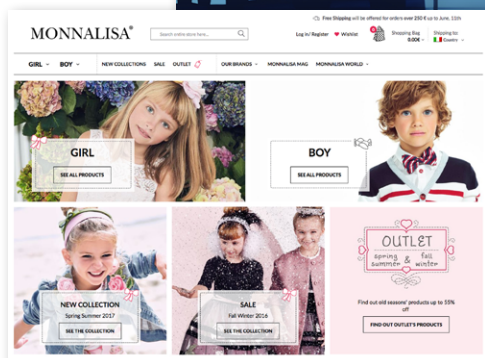
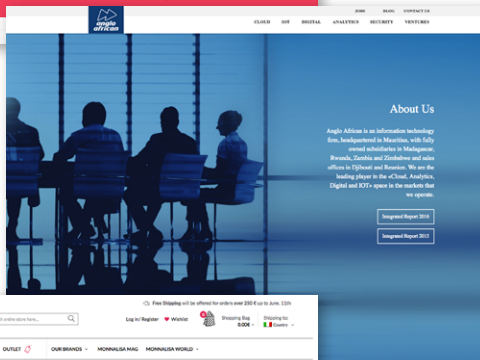
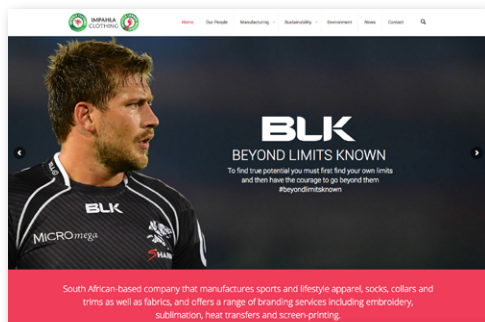
# NEXT STEPS

To help assess, and build on, where an SME is now to a more integrated approach, management can speak to a professional accountant offering business advisory services and discover how to realize value creation potential over time. Now is the time to act.

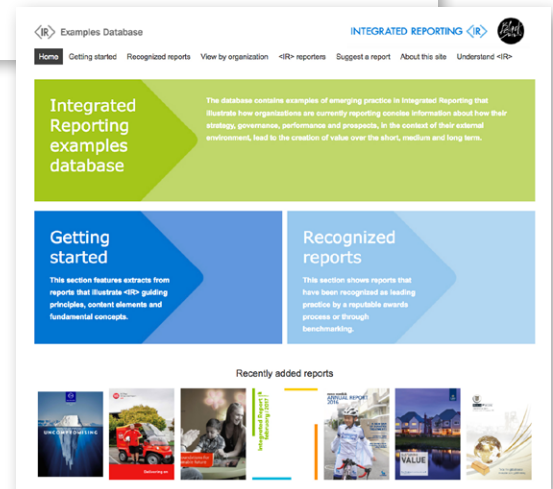
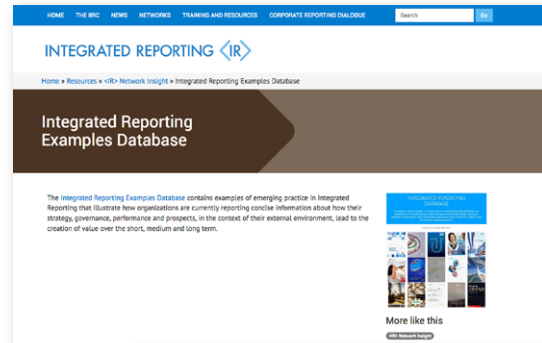
## INTEGRATED REPORTING IN SMES

Integrated reporting examples

- [www.impahla.co.za](http://www.impahla.co.za)
- [www.angloafrican.com](http://www.angloafrican.com)
- [www.monnalisa.eu/en/](http://www.monnalisa.eu/en/)



Additional examples are available in the IIRC's [Examples Database](#).



## ABOUT IFAC

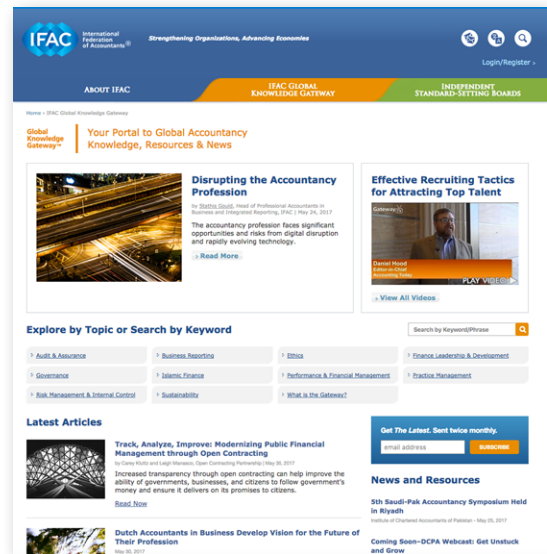
IFAC is the global organization for the accountancy profession dedicated to serving the public interest by strengthening the profession and contributing to the development of strong international economies. IFAC is comprised of **over 175 members and associates** in more than 130 countries and jurisdictions, representing almost 3 million accountants in public practice, education, government service, industry, and commerce.

IFAC supports the small- and medium-sized practices sector through initiatives that raise the profile and build the capacity of SMPs globally. With input and guidance from its SMP Committee, IFAC represents SMPs' interests to standard setters and regulators, facilitates sharing tools and resources to help them compete in the global marketplace, and raises awareness of their role and value, especially in supporting small- and medium-sized entities.

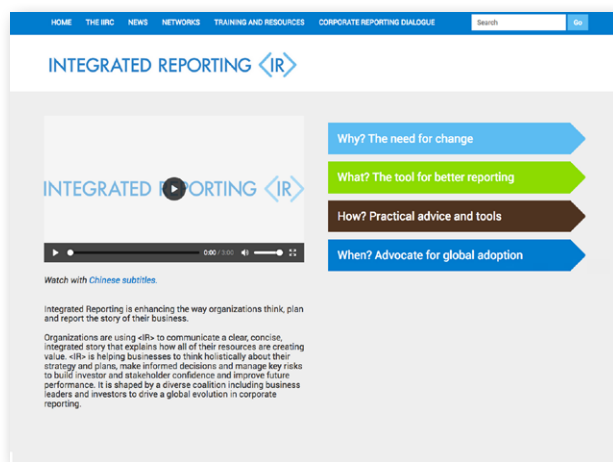
The IFAC **Global Knowledge Gateway** now hosts over 400 original articles and videos, and links to approximately 10,000 related resources and news from around the world. The Gateway includes a number of articles and resources on integrated reporting. Sign up for *The Latest*, our twice monthly Gateway digest, to receive updates in your inbox.



**Your Portal to Global Accountancy Knowledge, Resources, and News**



## ABOUT IIRC



The International Integrated Reporting Council (IIRC) is a global coalition of regulators, investors, companies, standard setters, the accounting profession, and NGOs. The coalition is promoting communication about value creation as the next step in the evolution of corporate reporting. The IIRC's mission is to establish integrated reporting and thinking within mainstream business practice as the norm in the public and private sectors. Its vision is to align capital allocation and corporate behavior to wider goals of financial stability and sustainable development through the cycle of integrated reporting and thinking.

For more information, please see [www.integratedreporting.org](http://www.integratedreporting.org).

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