What does your reporting say about you?

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What does your reporting say about you?

It should present a connected picture of the business, how it is managed and governed and where it is heading. But does it?

Does your reporting convey an organisation that is connected to:

- The external world?
- Key stakeholders?
- The right components of the business?
- The internal information system?

Why you should read this paper – one-minute view

At the core of this paper is a very simple question: What does your reporting say about you? Having read this paper we believe companies can look more objectively at their reporting and will understand the key areas where investment of effort can deliver substantial value.

Today, every management team needs to be able to review their reporting – stand back from the detail and put themselves in the shoes of a sceptical outsider, such as an investor, a new recruit, a customer or supplier.

Not giving a clear picture

The reason for posing this challenge is that, despite the significant effort being committed by many companies to their reporting, the end result is often unconvincing, lacks cohesion and critically leaves too many questions unanswered. What we know from talking to investors is that poorly conceived reporting is largely ignored and the quality of management is brought into question. When reports have substance, they are read and have an impact on decisions.

We recognise that reporting is not made easy by the regulatory demands imposed on all companies today, but sadly too many reports display the dead hands of compliance and the editorial committee. Too few companies have cut through the historic clutter and the short-term financials to create a strategic picture of the business that is informative and convincing.

Take a cold, hard look

When considering the picture that your current reporting creates, it is worth asking yourself:

- Is the market value a fair reflection of the business? If not, what information hasn't been properly factored into valuations?
- If the business were to be bid for, will your current reporting help or hinder your defence? The starting point for an attack on your competence, integrity and track record will be the company's own reporting.
- Is the external picture that you portray a fair reflection of the internal reality of how the business is run and governed? If it is, is it something you are proud of?

See next page and ask your PwC contact for further questions to help assess your reporting.

What is integrated reporting?

In this paper, we set out a picture of the information that can help present a cohesive and persuasive picture of a business, including the way it is managed and governed. We have described this as, 'what should your reporting say about you?' It may be obvious to say this, but in thinking about the implication of this question, the challenge that needs to be considered is an internal one: Do we have the information that we need to report?

We then explore each critical area of information in more detail, highlighting how the changing dynamics of business and societies' expectations are influencing the nature of the information needed internally and reported externally.

In summary, the critical elements of reporting considered in this paper are:

- Enhanced market insight – context is critical
- Delivering a long-term strategy – it has never been more important
- Revealing the behavioural triangle – governance, risk and remuneration
- How the business model works – its dynamics and the key relationships on which it depends
- Rethinking measurement and presentation – essential in an increasingly resource-scarce world

Finally, we consider what companies need to do to ensure that their business is understood. With so many sources of information, it is increasingly difficult to be sure that it is your picture of the business that is seen and believed by those who matter. Being the preferred information source needs to be a higher priority going forward.

Few companies cut through historic clutter and short-term financials to give a strategic picture of the business

Call to action on reporting

External reporting

True or false

- [ ] My external reporting is a fair reflection of what is going on inside the company.
- [ ] Key components of what makes my business successful are missing from our reporting.
- [ ] My reporting poses more questions than it answers.
- [ ] I would not invest in my company based on what is presented externally.
- [ ] My market value is not a fair reflection of the business.
- [ ] The presentation of the business and its performance is disjointed.
- [ ] Sustainability is not important enough to be included in our strategy.
- [ ] My reporting fails to show clear alignment between strategy, remuneration and KPIs.
- [ ] The quality of our reporting makes us more vulnerable than peers to a hostile takeover bid.

Internal reporting

True or false

- [ ] Our reporting is too dependent on historical financial information.
- [ ] Our reporting is not integrated or flexible enough to respond to changes in the business environment.
- [ ] I am concerned that we lack the market insight and non-financial information needed to stay ahead.
- [ ] Too much time is spent producing the numbers, rather than gaining real insight.
- [ ] I don't have a complete, timely picture of what's going on in the business financially and operationally.
- [ ] Our performance measures are not transparent and there is no clear accountability for them.
- [ ] I don't always trust the numbers when I first see them.

How does your reporting measure up against the competition and best practice?

Do you know where you want to be and how to get there?

What does your reporting say about you?

CEOs and others acknowledge that the information available internally in most businesses and the model of reporting that has evolved externally are falling substantially short of the mark.

Harsh light of a crisis

Shortcomings in reporting have not occurred overnight but have been in train for a number of years. The credit crunch has simply been a particularly sharp reminder that financial measurement alone cannot provide sufficient insight into corporate performance and business activity.

The smell of success

Words such as trust, reputation and the quality of management are terms often associated with successful and well run businesses. They typically reflect a complex mix of factors which together, over time, have built business credibility in the eyes of key stakeholders, from investors and non executives, to customers and employees.

One critical factor in this mix is the ability of companies to show that they can report the 'right information', sufficient to:

- Provide management with real business insight
- Allow non-executive directors to exercise effective governance
- Ensure key stakeholders, including shareholders, are informed and engaged

But is this the reality for most companies today and, if not, have recent events served as a wake-up call?

Competitive advantage

Reporting, in all its facets, can deliver competitive advantage in a variety of ways, if it is done well. It can secure capital and credit, help win the war for talent, and build strong business relationships. But the challenge will be to do so in an increasingly complex business environment, with changing consumer tastes, heightened awareness of climate change and other external factors. All these factors interact to shift society's needs and its expectations of business.

Survival and longer-term strategy

A short-term focus on business survival will remain important for many, but the shift to a longer-term strategic perspective will be essential in the battle to build trust and market value. Such a perspective allows shareholders, and other key stakeholders, to understand the quality and sustainability of performance by providing insights into external influences, strategic priorities and the dynamics of the chosen business model, as well as the key drivers of success.

New, better-integrated information

Management's ability to align and integrate the information used in the business from the top to the bottom, from external reporting to board and management reporting, will help create the environment where stakeholders can say with confidence, 'I understand this business – I can see how it is performing and where it is heading'.

Is your reporting a fair reflection of your business?

Effective stakeholder engagement

Effective governance and oversight

Effective management insight

The challenge is to create 'one integrated information set' that supports the business from top to bottom and presents a consistent picture externally

The extent of the challenge – internal

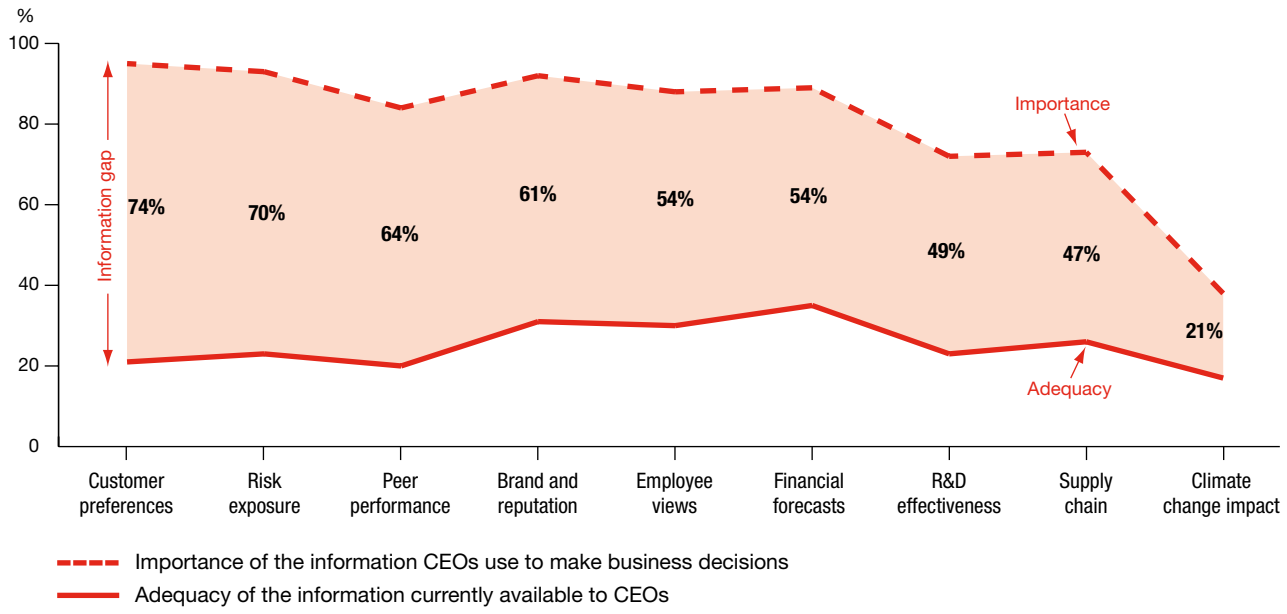
Recent events have exposed business dependencies and vulnerabilities as well as highlighted opportunities. They have left CEOs and their teams questioning the scope and quality of the information they have available for strategic and operational decision-making.

In February 2009, we published findings from a global survey of over 1,000 CEOs that hints at the extent of the challenge companies face as they set about enhancing this information.

Territory by territory, industry by industry, the same picture emerged. CEOs say they lack the information they need to support their decision-making. Gaps in data on many intangible assets (including customers, brand and employees) are particularly wide. However, even in the more traditional areas of financial reporting information is considered inadequate (see chart below).

The findings also highlight CEOs' perception that information about the impact of climate change on their business is not necessarily important to long-term decision-making. This picture changes by industry and it is not surprising to find that a larger gap appears in those industries where emissions have most impact today. We believe sustainability information will become more strategically important over the next decade as the interaction of climate change, population growth and resource scarcities start to impinge on most businesses operating internationally.

Information gap for CEOs



Source: CEO Survey 2009, PricewaterhouseCoopers

CEOs' needs for broader, non-financial information and analysis are not being met

What do investors want from senior executives?

More focused disclosures – GAAP is not designed for a crisis so disclosures are essential. But they must be focused and pragmatic and help to explain how that business achieves what it does.

More frequent reporting – investors want quarterly reporting with frequent timely updates.

Find the missing information – investors call for the scope of the information to be fixed, making sure it covers what's important to the business.

Source: Investors panel at Meet the Experts conference, London

Risks of current practice

When change is the only constant, it is perhaps not surprising that CEOs say the information they have to support their decision-making falls short of the mark. Re-evaluating corporate strategy in light of changing market conditions is tough enough. Adapting internal information systems to monitor and manage strategic priorities as they evolve is often a step too far in practice.

As a result, management teams often adopt a series of ad hoc 'workarounds' instead of building new information systems. Although these are often acknowledged to be short-term fixes, they easily become established practice. Critical business information is too often left in exposed spreadsheets or at the mercy of manual processes – a breeding-ground for risk.

Inadequacies in day-to-day management information can expose companies, leaving their boards to fly blind and inhibiting their ability to exercise effective oversight. And, because external reporting is incomplete, investors' reliance on other sources of information increases.

Not taking a long, hard look at your information set puts unnecessary risk into the business model

The extent of the challenge – external

Investors and other external stakeholders are not getting the information they need either. We have identified the shortcomings of external reporting through a decade of research with investors and insight from working with companies in all industries. The information gap undermines business and is a serious cause for concern.

Information gap undermines business

- **Effective management** is undermined by shortcomings in the scope and reliability of the information available. There is often too much historic financial data and insufficient market intelligence and business insight.
- **Effective governance** and oversight is undermined through a lack of strategic perspective from voluminous, often out-of-date financial information, and unreliable non-financial information.
- **Effective stakeholder engagement** and the creation of a clear and coherent picture of the business are undermined as external reporting is dominated by regulatory compliance and content development which runs in parallel to every day information-gathering processes.

What the research shows

Covering the bases		No clear picture	
85%	Disclose their KPIs	19%	Use strategy to underpin their reporting
94%	Disclose their principal risk	12%	Clearly align KPIs and strategy
80%	Outline strategic priorities	31%	Align sustainability with strategy
69%	Provide detail around cash flow/funding strategy	26%	Provide information on contractual arrangements

Our review of all FTSE 350 companies' reporting found that although most companies continue to cover the key bases of narrative reporting, the vast majority still fail to present a clear, credible and coherent picture of their direction of travel and short-term performance. For further information see *A snapshot of FTSE 350 reporting* (corporatereporting.com).

The following sections explain how you might get to an integrated information set and offer insight into a model of reporting that we believe could underpin a new, and more sustainable, way of doing business.

What *should* your reporting say about you?

It's time to develop one model for internal and external reporting that will support the complexity of business today and meet the needs of key stakeholders, while also having the flexibility to adapt to future challenges.

One integrated information set

The model set out below highlights the scope of the information set that we believe companies need to have at their disposal if they are to be on top of the dynamics of modern business and be in a position to rebuild trust.

The suggested model provides a logical structure for thinking about the information needs of a business and the critical links and interdependencies that exist between the various information sets – external, strategic, business and performance. The suggested model is grounded in years of PwC research and work with investors and companies.

None of the information that flows from each category of the model is new – the real insight and value comes when each category is considered in the context of another, rather than in isolation. It succeeds when governance interfaces with remuneration and risk; when strategy is designed to exploit a changing market environment; and when strategic priorities align with KPIs. It is this joined-up thinking that is so critical and that lies at the heart of the model.

Today, few companies excel in this space. But we believe that it is now a key determinant of corporate success.

A model for today and tomorrow

A number of key dynamics will influence strategy and the way businesses operate in the future. These factors will also change the information that management needs to make effective decisions and the external reporting needed to meet

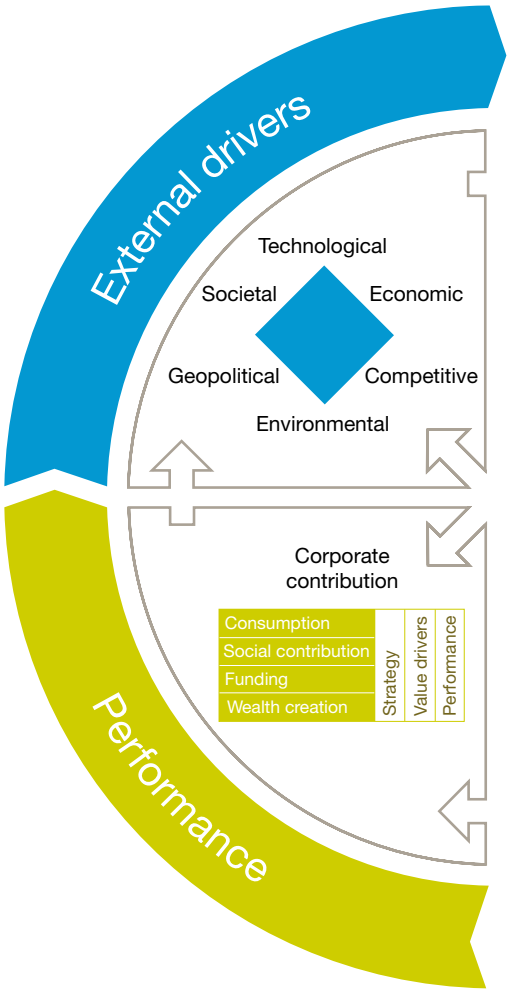
One integrated information set – to underpin a new and more sustainable way of doing business and reporting on your activity

1. External drivers

- Management's capability to understand and explain external market drivers is fundamental to effective decision-making and reporting.
- The credit crunch and subsequent economic downturn have highlighted the need for companies to understand, monitor, manage and explain emerging risks and opportunities.
- Processes must capture macro, competitive, regulatory and political factors shaping the market place, as well as changing societal expectations.
- Understanding sustainability 'mega trends' and their impact on the business model will shed light on risks and opportunities.

4. Performance

- The outputs of corporate activity need to be added to the other three categories in the integrated information set to complete the picture.
- Financial performance is currently the dominant output and it will remain critical, but we expect other outputs to play an increasingly significant role.
- Society's changing expectations will demand a more balanced assessment of corporate contribution. Resource consumption, wealth creation and wealth distribution, for example, can provide real insight into long-term sustainability of a business.



both society's and shareholders' expectations. These dynamics include:

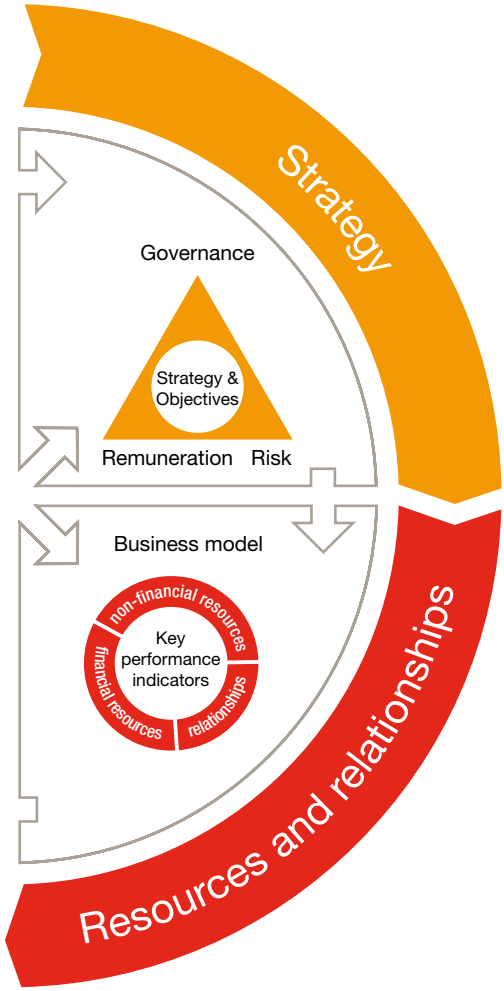
- **Macro trends** – the foundation-stones of capitalism are being re-examined. Emerging issues such as climate change, resource scarcity and demographics all mean that the business environment is becoming more challenging and more intrusive. This results in a changed 'licence to operate' for business – one driven more by the balance between consumption and contribution, fairness, trust and integrity.
- **Technological advancements** – the reporting environment is becoming more 'demand-pull' than 'supply-push'. This has clear benefits for companies that can collate a clear, consistent and integrated information set and use this consistently when tailoring their communications for different audiences.

In response to these and other dynamics, we expect businesses to be more collaborative in the development of business solutions. In this more integrated world, the ability to build and maintain key business relationships will be critical to long-term success and insightful intelligence will become a 'must-have' capability.

The four core categories in our model below are common to all industries and companies, but their relative importance and the information that sits beneath each category will need to flex depending on how these dynamics impact industries and influence corporate strategies and business/operating models.

In the next two sections we explore in more detail how these dynamics will affect:

- **What** demands will be placed on the reporting model and the information required to meet these demands; and
- **How** this information will be accessed and assessed.



2. Strategy

- A clear strategy is fundamental to business success and consequently should underpin reporting.
- Effective strategies are developed in the context of market drivers and are aligned with the core competencies of the resources and relationships of the business.
- Strategic priorities should be clearly aligned with remuneration policies and the risks assumed.
- An understanding of the culture/values and governance practices in place is increasingly important to determine how a strategy is embedded into the company and its risk appetite to pursue strategic success.

3. Resources and relationships

- Greater collaboration between businesses within the value chain means an understanding of the scope of the business model is key.
- Access to natural capital in a resource-constrained world will have profound implications for how business is carried out – understanding this will drive new business models.
- The relative importance of resources (financial, human and natural capital) and relationships (customers, employees, suppliers, etc) will flex, depending on changing market dynamics and strategies.
- Information on the relative strength of resources and relationships and how they are being managed, developed and protected, is critical.
- This information should go beyond qualitative statements to a clear set of KPIs – financial and non-financial – that help management monitor and report progress.

Getting the content right

Getting the content of internal information right and being in a position to engage key stakeholders with it requires a top-down understanding of the integrated information set needed to steer the business.

In this section, we explore further the key dynamics that will influence strategy, the way businesses operate, society's expectations and the subsequent demands being placed on the reporting model. Many of these dynamics will not be new, but their importance will come from a profound shift in the economic and social environment in which companies will need to operate and report. This will require a step change in thinking that will test even the best companies.

The overall objective must be to build one integrated information set that can flex with the changing dynamics and can deliver truly valuable strategic and operational insights to management. At the same time it must satisfy the more material interests and concerns of multiple-stakeholder groups.

A company's ability to use an integrated information set to respond to stakeholder demands (both internal and external) will differentiate the best companies from the pack. It will provide evidence of which companies are well run, well governed and sustainable businesses.

New influences, new information challenges

A profound shift in the economic and social environment will require a step change in thinking

Enhanced market insight – context is critical

Some shifts in strategy are the result of internal activities, but many are inspired by shifts in the external environment. The more a company can identify and respond to these shifts and then explain this process, including its connectivity to the market environment and the ecosystem on which it relies, the better able it will be to secure competitive advantage.

Identifying 'emerging risks'

The ability to identify the main 'emerging' risks to which companies are increasingly exposed is key. Many of these risks are already recognised: new competition from emerging economies; energy and resource security; or ageing populations. But it is how these are taken into account in strategic planning and how this process is demonstrated externally that will be key. For example, as companies become more collaborative, stakeholders will increasingly demand reassurance that the potential for systemic disruption, as witnessed by the credit crunch, is being considered and kept in check.

Emerging risks can be opportunities rather than threats if they are identified, assessed and managed for competitive advantage. This should also be reflected in the way companies communicate.

A whole new ball game – understanding the impacts of external market drivers

Feast to famine: Twenty years ago, there were 15 oilfields able to supply one million barrels of oil a day. Now there are only four.

The post-war era can, for developed nations, be characterised as a time of plenty. Raw materials, from ores to food to water, have been treated as an infinite resource. We now know that we were wrong.

Many base metals critical to the manufacture of components ranging from microprocessors to catalytic converters are close to running dry. Recent food price rises are, it is thought, just the tip of the iceberg as soil degradation and a growing population base combine to squeeze our access to cheap produce. We might argue whether we have already reached the point where oil production exceeds oil discovery, or whether that point is still a year or two away. Either way, the longer-term message is clear: commodity prices will rise.

Climate change: Stern predicts that, given current trends, there is a 50% chance of temperatures rising by 5°C by 2100. In economic terms, a 2-3°C temperature rise equals 3% annual global GDP loss and a 5°C temperature rise, a 10% annual global GDP loss. Sea levels are expected to rise by 18-59mm by 2100. With almost half of the world's population living within 200 kilometres of a coastline, the consequences of this development are potentially disastrous and will have ramifications for all aspects of the supply chain and the way we work.

The war for talent: By 2050, people over 60 years old will outnumber the under-14s. With an ageing population in the west and a rapidly growing population in a number of emerging markets, there may be plenty of people out there to employ. But the base of experienced, skilled practitioners will shrink dramatically. The war for talent is set to intensify.

A shifting powerbase: At US$50 per barrel, new petrodollar investments in global markets is estimated at $1m per day. China invested $7bn in infrastructure projects in Africa in 2006. Between 2005 and 2008, the UK invested $20m in such projects in Africa (including 'in-kind' funding). In May 2008, the Indian telco network added 8.61m new mobile phone subscribers.

Emerging risks can be opportunities rather than threats if they are managed for competitive advantage

How to respond

In responding to these challenges and opportunities, companies will need to focus on enhancing their market intelligence, leveraging it in their decision-making and making this visible in their stakeholder engagement and reporting. Keeping abreast of market developments and ensuring that a longer-term perspective is brought to this process will require most companies to rethink their current processes.

Scenario planning and stress-testing will become more commonplace and using the information gleaned from these processes to build trust will differentiate companies from their peers.

Given the change in environment envisaged in this document, creating formal processes to challenge established thinking will need to be approached differently.

Challenge established thinking:

- A longer-term horizon will be required for strategic planning.
- Sufficient resources will need to be allocated to help understand and anticipate strategic and historically low-probability risks.
- Understanding the cross-organisational impact and potential scale of the risks, as well as the interdependencies with other risks, will be critical.
- External stakeholders will need to be incorporated in these new processes, increasingly through open-access environments.

The ultimate test will be a company's ability to present its own picture of the external environment and risk exposure, like the one set out below, and to link it to the development of a sustainable business strategy.

Proposed identification and assessment of emerging risks

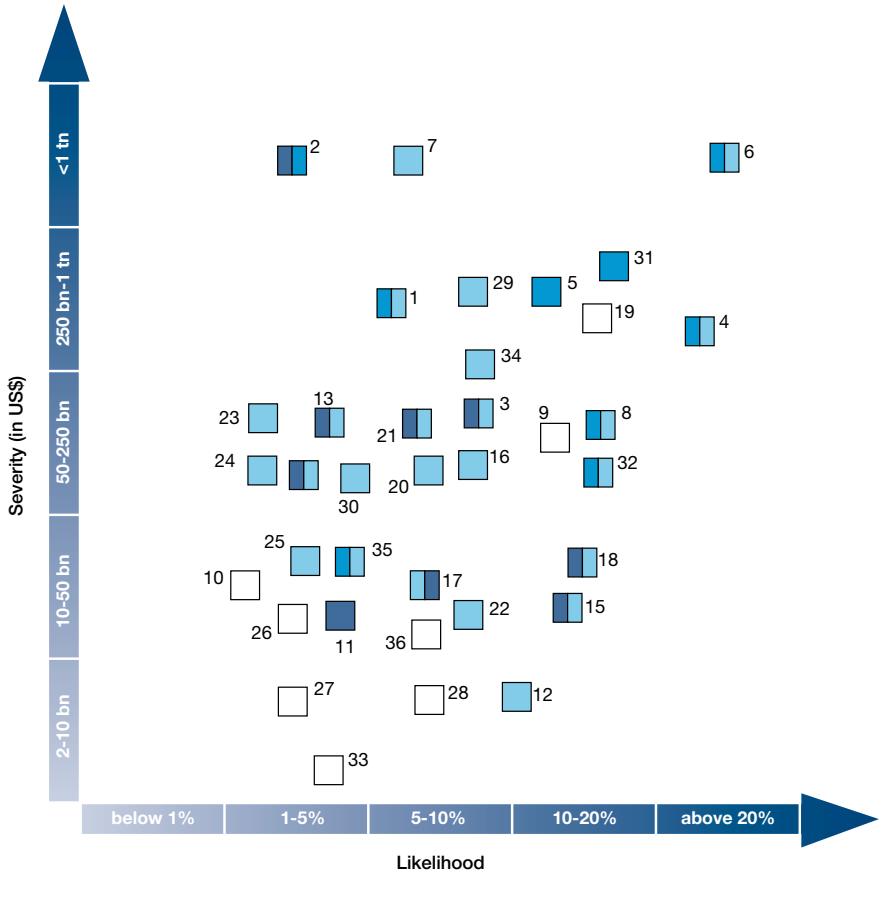
Economic
1 Food price volatility
2 Oil and gas price spike
3 Major fall in US$
4 Slowing Chinese economy (6%)
5 Fiscal crisis
6 Asset price collapse
7 Retrenchment from globalisation (developed)
8 Retrenchment from globalisation (emerging)
9 Regulation cost
10 Underinvestment in infrastructure

Geopolitical
11 International terrorism
12 Collapse of nuclear non-proliferation treaty
13 US/Iran conflict
14 US/Korea conflict
15 Afghanistan instability
16 Transnational crime and corruption
17 Israel/Palestine conflict
18 Violence in Iraq
19 Global governance gaps

Environmental
20 Extreme climate-change related weather
21 Droughts and desertification
22 Loss of freshwater
23 Cyclone
24 Earthquake
25 Inland flooding
26 Coastal flooding
27 Air pollution
28 Biodiversity loss

Societal
29 Pandemic
30 Infectious disease
31 Chronic disease
32 Liability regimes
33 Migration

Technological
34 Critical information infrastructure breakdown
35 Emergence of nanotechnology risks
36 Data fraud/loss



Key: Boxes indicate change since last year's assessment

Increased | Decreased | Stable | New risk for 2009 | Likelihood | Severity

Based on an assessment of risks over a 10-year time horizon by the Global Risk Network

Source: World Economic Forum Risk Network 2009

STRATEGY

Delivering a longer-term strategy

Strategy reporting should constitute the backbone around which both internal and external reporting is based. The quality of companies' current strategy disclosures varies.

In a rising market, many companies felt able to pay lip service to this important element of reporting. High-level references and a focus on short-term strategic priorities were often all that was reported. However, faced with low economic growth, systemic risks and society's changing expectations, this will not be sufficient in the future.

We believe that over the next decade there will be a shift to business performance being redefined (see page 15) and assessed in the context of a longer time-horizon. This will have implications for the way companies think, make decisions and report information externally.

Timeframes and issues will differ from one industry to another, but some areas will influence all companies.

How does your company demonstrate:

- Receptiveness to employees' changing mindsets and career expectations
- Ingenuity in harnessing intangible assets (brands, licences, IP and know-how)
- Ability to establish and maintain critical relationships
- Ability to mitigate and adapt to the impacts of climate change

Beyond doubt, those that can provide clear strategic thought around these issues and support their actions with hard data will gain important airtime, trust and competitive advantage.

Tasked with explaining how their future strategies have been created, companies may choose to adopt a multiple time-horizon approach to planning and reporting. This will help achieve two objectives:

- Create a blueprint of the long-term positioning of the business and the drivers of business success (10-year timeframe).
- Provide a short-term context (3-year timeframe) against which current performance can be assessed.

Reporting performance will become less dependent upon the previous six months' financial numbers and will be more about how the company is delivering on its multi-year plan.

Reporting performance will be less dependent on financial numbers and more about delivering the strategy

Hard-wiring sustainability

One example of how longer-term strategic considerations will impact the way strategy is considered and reported is the area of sustainability.

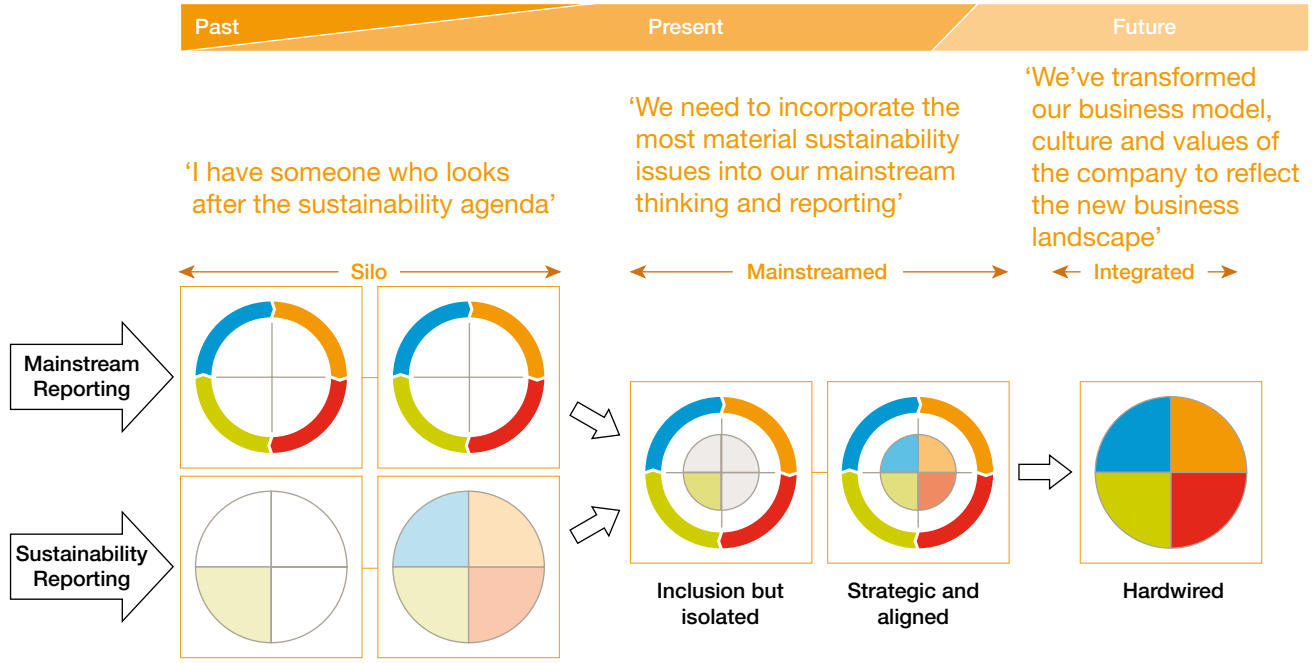
Ask ten people what they mean by 'sustainability' and you will get 20 different answers. For some, it is inextricably linked to the environmental agenda. For others, it also includes the social agenda. For PwC, its implications transform the way in which we manage our human capital, our use of resources and our risk framework.

However, until now, most of the focus of companies' sustainability efforts has been directed at meeting the information needs of external stakeholders. As a result, it has operated in a separate silo away from day-to-day business operations.

As companies become aware of the strategic implications that issues such as climate change, population growth and resource usage have for their future business success, this situation is beginning to change. In fact we expect that in the future 'sustainability', and other similar terms, will disappear as the issues it covers are consumed into normal business thinking. This will create a number of challenges:

- **Determining what is business critical** – few companies have fundamentally re-examined their value creation process in light of the resource challenges to come. This will call for some tough decisions and may result in substantial strategy shifts.
- **Greater collaboration** – no company is an island and consideration of the most business-critical issues will require ongoing communication with all stakeholders and possibly collective action to develop solutions, (eg, within industry groups or between stakeholders).
- **Integrating sustainability reporting** – having 'hard-wired' sustainability thinking into business, the challenge will be to report on the more material issues in an integrated way. This does not mean slamming the sustainability report together with the annual report. The process demands a much more fundamental rethink. Set out below is a diagram showing the evolution in reporting, which we believe will assist you in determining where you are on this journey.

The evolution of sustainability reporting – where are you today?



STRATEGY

Revealing the behavioural triangle

A rethink in the way risk and governance are viewed within companies is essential. This has been triggered by the recent economic turmoil, growth in the retail shareholder base and change in the agency role played by management on behalf of shareholders.

Many companies are focused on how regulatory responses may influence the 'critical triangle' of governance, risk appetite and remuneration. But we believe the bigger challenge is how to leverage all three to enhance business performance, respond to changing behavioural norms (both internal and external) and make these visible externally to underpin trust and corporate reputation.

Culture and values

The importance of the 'tone from the top' has been recognised for many years, but it has not been a focus area for external reporting. This will change in the future. The current crisis has clearly demonstrated that more regulations and a culture of box-ticking do not necessarily drive the right behaviours.

When values define behavioural norms and companies have a collective view of what 'doing the right thing' means, boards of directors should feel more confident that their expectations are driving front-line operations. In this environment, the actions of boards and senior management will fundamentally influence the way companies think, act and engage with their key stakeholders.

Looking ahead, and regardless of where regulations go, companies will be challenged to be transparent around the following areas:

- Their culture and values
- How the values are lived and the way they link to decision-making
- Whether management leads by example in its decision-making
- The appropriateness and impact of remuneration and incentive structures
- The nature of the oversight exercised by non-executive directors

Companies need to be more open about the information used by the board

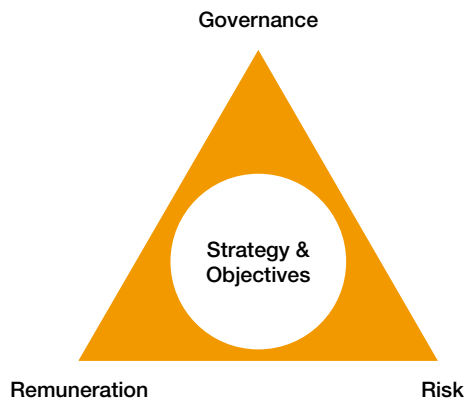
Informed governance

The quality and scope of available information is a critical determinant of how well companies are managed, whether non-executives can exercise effective governance and whether shareholders can have confidence in their investments.

Companies need to be more open about the information used by the board to oversee short-term progress towards strategic objectives. An excessive dependency on financial information will reflect badly on a company, raising questions about the quality of management insight and suggesting that it is failing to engage effectively with stakeholders.

Boards will also need to be able to explain how they reassure themselves that their thinking is in synch with the rest of their company, as well as how the outside world views their business. Whether this 'external perspective' comes from the company, or from external sources, is something boards will need to determine carefully. This insight will be critical to future corporate reporting.

The behavioural triangle



How the business model works – its dynamics and key relationships

The growing complexity of business coupled with companies' desire to increase operational flexibility has given rise to many new business models over the past decade. In particular, we have seen a trend towards outsourcing, off-shoring, and more recently a reversal to on-shoring, elements of the business.

Companies are increasingly using open web environments to develop business solutions in areas as diverse as R&D and marketing. This trend, which is heavily dependent on collaboration, will continue into the next decade as technology extends further into business routines.

As stakeholders adopt a more active and intrusive approach to monitoring business activity, companies will have to be able to explain elements of their business and operating models. This will extend to explaining the key dependencies on which companies rely and giving insight into the health and development of the key business relationships deemed to be critical to long-term success.

When considering the impact of this trend on management information and external reporting, companies will need to be in a position to clearly explain the following key factors:

Importance of key resources and relationships

For leading companies, stakeholder engagement is not simply about guarding reputation. It is seen as part of the value-creation process, with customers, suppliers and the broader community increasingly brought in to help management to design products or resolve problems.

In these circumstances, reporting can influence behaviours. It can help to create and then harness the goodwill of various stakeholder groups; goodwill that can be leveraged to help management deliver specific corporate objectives. The relationship between the Japanese car manufacturers and their suppliers re-wrote the books. But they are not alone. Companies are increasingly using diverse media channels to bring customers into the product development process, to harness community efforts in addressing local infrastructure questions, and so on. But for that to work, stakeholders need to understand and engage in management's ambitions and management needs to keep a close tab on the health and strength of these relationships and the issues that influence behaviour.

Flowery words and a dominance of financial information cannot deliver

Lead indicators of success

A hallmark of success, and a driver of trust in the future, will be a company's ability to align its performance reporting with an explanation of how it manages, protects and develops key resources and relationships. The information needs, both internally and externally, will therefore lie in understanding the dynamics, strength and robustness of these relationships. Hard evidence will be expected. Flowery words and a dominance of financial information cannot deliver.

To address this gap, companies will need to invest further in relationship programmes and the monitoring systems necessary to provide insightful and reliable intelligence. They will also need to invest more time in determining the most appropriate non-financial measures that can truly inform business decision-making as well as having value to external stakeholders. Cutting through the 'noise' and understanding what is insightful, strategic and material will be critical.

Spheres of influence

Greater collaboration and companies' changing 'licence to operate' are blurring company boundaries. As some companies already understand, it will no longer be enough for companies to rely upon the regulatory definitions of control or influence when determining how to talk about the risks/rewards of business activity.

Explaining the scope of the business model will become increasingly important. From now on, companies need to move towards presenting the spectrum of business activity and the impact on key resources and relationships of outright ownership, legal control, the ability to influence and exposure to risk.

PERFORMANCE

Rethinking measurement and presentation

The key insights increasingly being demanded of companies set out in the previous sections capture the dynamics of business activity that need to be made more transparent – both within the business and externally. To complete the picture, the outputs of corporate activity need to be added.

Currently these outputs are dominated by financial performance, the model for which is well developed and understood. However, as the foundation stones of capitalism flex to meet a changing environment, companies will need to rethink the scope and nature of the outputs of corporate activity which they need to make visible to the outside world.

Shifts towards a more stakeholder-orientated business rationale are already taking place. Many of these have been touched on in this paper. Business success will require a more strategic and balanced assessment of management actions and performance and indicators that can provide real insight into long-term sustainable performance.

As part of this new 'licence to operate', greater emphasis will be placed on explaining corporate contribution 'in the round'.

Need to explain corporate contribution

- **Actions taken to create new products and services** that are relevant to the companies' markets. The impact they have on people's lifestyle, health and security. The **benefits of employment** created both directly and indirectly through the supply chain.
- **Impact on the environment, directly and indirectly**. As the world comes to terms with resource shortages, the concept of how business consumes resources is likely to be central to the process of redefining value. The challenge for companies will be to re-engineer their businesses to ensure they are seen as part of the consumption solution, not part of the problem. Companies will be challenged if they are perceived to be 'selling landfill'.
- **How is the wealth created, distributed and used?** Companies need to remind society how the wealth created is used, through the payment of taxes, to fund schools, hospitals, defence etc, and that dividends and interest payment ultimately go to fund pensions, and other returns to savers and investors, where the electorate is the ultimate beneficiary.

If companies do not present this balanced picture of performance, they will expose themselves to the challenge of sophisticated single-issue campaigns on employment, tax contribution, supply chain integrity, ethics, corruption and environmental impact.

How the explanation might look

On the next page we have mocked up an example of a 'Value Analysis Statement' to illustrate the nature of information that needs to be given more thought and how it might be presented.

Some companies already report a number of these elements today. However, what matters most is how companies present their broader contribution and the tone and style of engagement.

The challenge is to retain the hard edge of commercial success while still recognising that each business is part of a broader ecosystem with shifting expectations and needs.

As the foundation stones of capitalism flex, companies will need to rethink which outputs to make visible to the outside world

Rethinking corporate value and the information that builds public trust

'What is strategically important'	Corporate contribution						
	Value drivers	Financial performance					
		Historic cash flow			Prospective		
		2008	2009	2010	2011	2012	2013
The focus of what's reported should be driven by the strategy and issues material to business success	**Customer impact**						
	• Revenues (segmental analysis)	(1,277)	(1,294)	(1,501)	↗	↗	↗
	• New customer revenues	(98)	(102)	(120)	→	↓	→
	Brand						
	• Advertising	30	31	30	→	→	→
	• Promotion	25	22	20	→	→	→
	• Marketing	30	31	31	→	→	→
	Innovation/products & services						
	• R&D expenditure	150	161	170	↗	↗	→
	• Cost of research alliances	70	72	96	→	→	→
	• Revenues from potential sales	(5)	(9)	(12)	↑	↗	→
	• Revenues from new products introduced in last four years	(830)	(854)	(1035)	↗	↗	↗
	• Knowledge management experience	25	28	35	→	↗	↗
	Human capital impact						
	• Wages and salaries ($)	7,142	7,922	8,695	→	→	→
	• Average salary ($000)	69	77	90	→	→	→
	• Training and development expenditure ($)	220	205	194	↗	↗	→
	• Health and safety expenditure ($)	382	295	309	↗	↗	→
	Supply chain impact						
	• Cost of sales	715	720	840	→	→	↗
	• Distribution costs	40	39	50	↗	↗	↗
	• Outsourcing expenditure	5	45	60	↑	→	→
	• System costs	25	30	40	↗	↗	→
	• Sustainable new materials						
	• Packaging use and disposables						
	Climate, waste and resource impact						
	• Greenhouse gas emissions	12	14.5	19	→	↘	↘
	• Water	5	10	12	↑	↑	↑
	• Waste	1,700	2,100	2,600	→	↘	↘
	• Energy use	15,500	19,000	20,700	→	→	→
	• Environmental compliances and levies ($)	700	600	200	↘	↘	↘
	Total tax impact						
	Taxes paid:						
	• Capital ($)	3,652	4,208	5,752	↗	↗	↗
	• People ($)	601	667	754	→	→	→
	• Product ($)	1,810	2,207	2,967	↗	↗	↗
	Capital provider impact						
	• Dividends (cents per ordinary share)	25.5	27.7	34.9	↗	↗	↗
	• Net cash provided by operating activities	16,303	23,378	26,721	↗	→	→
	• Operating capital employed	101,397	111,142	110,061	↗	→	→
	• Capital expenditure ($)	19,623	16,651	14,149	↗	→	→
	• Interest paid ($)	532	340	145	↘	↘	→
	• Replacement cost profit ($)	18,724	24,385	30,038	↗	↗	↗
	Other social indicators						
	• Charitable and social expenditure ($)	74.4	87.7	95.5	↗	↗	↗

↑ Significant increase ↓ Significant decrease → Steady state
↗ Moderate increase ↘ Moderate decrease

Corporate contribution						A new tone and style of engagement
Risk indicators	Non-financial performance					
		Historic trend				
		2008	2009	2010	Objective	
• Price competitiveness • Fashion trends • Consumable income/savings ratio • Product availability	• Market share • Market growth • Customer satisfaction (1996=100) • Customer retention • Complaints • Product defects	20% 4% 103 87% 537 265	20.5% 5% 104 87% 557 253	22% 4% 103 87% 590 207	25% by 2013 NA 110 by 2013 90% by 2012 300 by 2012 50 by 2012	'We've had a successful year creating products and services and enhancing people's lifestyle, health and security'
• Fashion trends • Seasonality	• Brand awareness (1992=100) • Responsible advertising*	127	128	131	150 by 2013	
• Technical obsolescence • Staff retention • Product development cycle time	• Patient portfolio (No.) • Percentage of revenues from new products • Ideas generated • Relationship with universities	110 65% 1,240	112 66% 1,253	140 69% 1,372	10% annual increase 80% 2,000 by 2012	
• Competitive remuneration • Health and safety • Work/life balance • Personal development	• Number of direct employees • ROW and minority employees in leadership • Number of recordable safety incidents • Average training hours per employee	103,700 134 1,604 21	102,900 140 1,513 22	96,200 151 1,471 18	 300 by 2050 1000 by 2050 25 by 2050	'We have created employment directly and indirectly'
• Political uncertainty • Unit cost inflation • Product quality • Order fulfilment • Processing efficiency • Human rights in Asia • Animal welfare	• Number of indirect employees (FTE) • Average order handling time/hours • Deliveries on time (%)	1,200 6 90%	1,220 6.5 93%	1,360 5.5 93%	 4 hours by 2013 98%	'We have reduced our impact on the environment, both directly and indirectly'
• Carbon market prices • Dwindling oil and gas reserves • Availability of green energy resources • Increased environmental legislation	• Greenhouse gas emissions (tonnes) • Transport impacts (emissions, congestion etc) • Waste (thousand tonnes) • Energy consumption (per million boe) • Barrels produced per day (thousand)	78.5 15 600 18 3,606	76.8 18 700 21 3,997	73.2 17 800 23 4,014	29 by 2050 12 by 2012 670 by 2050 19 by 2050 4,000 by 2050	
• Environmental taxation • Charging employee tax rates • Different royalty tax regimes	• Tax paid per $ capital expenditure (cents) • Tax paid per employee ($) • Tax paid per barrel of oil equivalent	0.20 5,796 1,375	0.25 6,482 1,512	0.41 7,838 2,025		'Through taxes paid, we are funding schools, hospitals and social care'
• Shareholder expectations • Increased difficulty in reserves replacement • High costs in new technology development • Inflationary increases in interest rates	• Return on average capital employed (%) • Debt equity ratio • Net income barrel of oil equivalent ($)	14.7 32 8.0	16.4 30 8.5	19.9 24 12.5		'Our profits have provided returns to savers, funded pensions, medical cover and more'
	• Number of actions against the company by third parties	2,350	3,100	3,025	<2,000 by 2011	'We support community activities'

Getting the story to stick

Companies need to re-establish themselves as trusted sources of relevant and reliable information. This means becoming better connected to what their internal and external stakeholders really want to know.

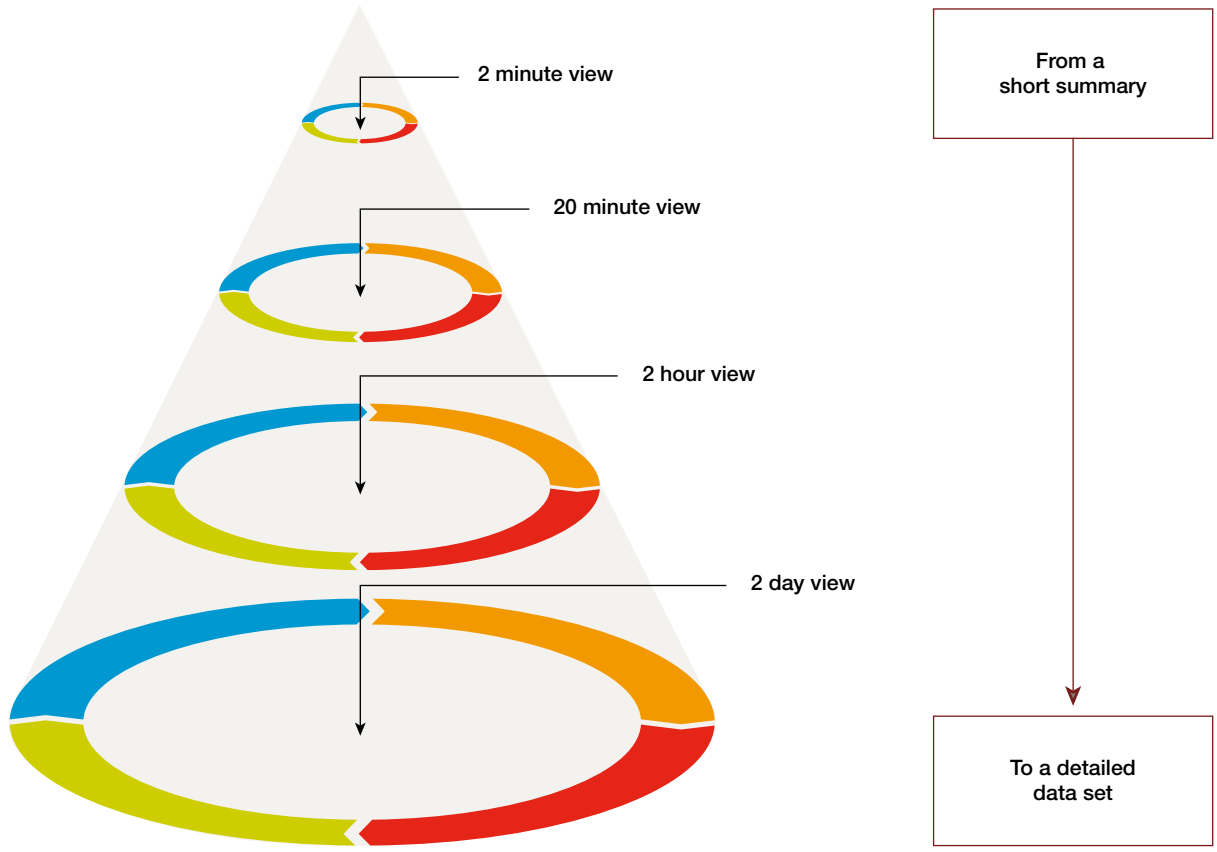
Not only should the content of corporate information be powerful, it should also be effectively distributed. It is the combination of the two that builds trust. However, until now, most companies have failed to make this happen. Board papers and annual reports typically weigh in at several kilos, yet they frequently fail to provide relevant insights into performance.

In this paper we have focused on getting the content right. But as management teams seek to win external stakeholders' hearts and minds, they must not ignore the distribution challenge. The old model where companies 'pushed' information out into the market is being superseded by a demand 'pull' from different stakeholders. New technological developments, more collaborative business models and greater stakeholder awareness mean that there is much more open access to information. Blogs, twitters and the new media environment in general have turned the brick walls of our offices into glass.

With so many sources of information available to users, companies must become better connected to what their external and internal stakeholders want to know. They must be comfortable in collating and presenting a consistent picture of their business across multiple channels, and be more attuned to the risks that flow from ignoring stakeholder needs. Gone are the days when customers could be told one story and suppliers another. The greatest risk to a company's reputation and credibility is to pretend otherwise.

Whether we like it or not, corporate transparency that joins the dots and communicates an integrated picture of the business is set to be the key to successful stakeholder engagement from now on. And for the companies that get this right, enhanced business relationships and renewed trust will be the prize. Adopting the mantra of 'we do what it says on the tin' should be the goal – if it is not already.

Building an effective communication hierarchy



Fit for purpose

How do different stakeholders use information? How can we develop a communication hierarchy that reflects time, dependency and the interests of users? We expect that companies will have to devote much more attention to these questions in future.

Increasingly, mainstream regulatory reporting will be relegated to a support act where primary corporate communications are concerned. Instead of purely financial data, the primary focus will be the top slice of information needed to understand the business – its direction of travel, performance, business model, risks and relationships. This top slice will capture the essence of the business, and will be structured so that users can select headline 'information' and perform 'data dives' if they need to know more.

Companies need to stand back and ask themselves: shall I continue to produce lengthy, often redundant documents? Or is there a case for developing a single information set to provide stakeholders with succinct, insightful and consistent summaries of performance across many channels of communication?

To address this, companies will have to think more carefully about the information they provide, making greater use of exception reporting and the separation of standing data from operational information. As the new information architecture is developed, companies will be inclined to provide a one-stop shop for users that will include features such as on-line analytical tools, important links to market data and facilities to help users learn more about the strategy, operating model and key relationships.

The usability of information

Within the decade, judicious use of visualisation tools will transform today's static reports into an environment for active learning. Management will be able to 'play' with data to understand the relationships between, say, training, customer loyalty and transactions. As new data comes in from on-line 'street' intelligence, they will be able to flex existing assumptions to modify existing strategies. Similarly, investors will have access to sufficient financial and non-financial data to gain true insight into the quality and sustainability of performance.

Although, as yet, very few companies have developed an environment where data can truly be transformed into knowledge, we believe that this will become a prerequisite for corporate survival. Successful companies will shift from data dumping to a single, integrated information set that provides sufficient insights to understand the quality and sustainability of performance. The essence of this information set has been explained in this paper.

Gone are the days when customers could be told one story, and suppliers another

Conclusion: embracing change, winning trust

Are you ready to start building trust in your business?

To rebuild stakeholder trust, companies must ensure that it is their own high quality, relevant information that is the primary and trusted source of data. If they don't, stakeholders will turn to the myriad of alternative information sources now available via the media and the web. Management has no control over the veracity of these alternative sources, so companies will effectively hand over the right to manage their reputations to others.

However, there is evidence to suggest that when faced with a smorgasbord of information sources, the user will eventually revert back to the sources it trusts. From now on, the question for many companies will be whether or not they want to become a trusted source of information?

If the answer is yes, the information communicated will need to be comprehensive, display the right tone and present a consistent, coherent and aligned picture across all key stakeholders and channels of communication. Corporate reporting will only play its part in rebuilding public trust if it is robust and meets stakeholder expectations.

Gone are the days when different images of a company, and its performance, could be conveyed to different audiences and management could control how and when the information was distributed. Reporting and communication will instead become an extension of the core management information processes. The challenge is now more concerned with determining where the line of transparency should run, rather than trying to determine what story should be told.

After all, the label should describe the contents of the tin. Stakeholders want to know what's really going on for the business, not 'a story'.

Questions for consideration

What does your reporting say about you?

Who controls your company's story – you, the competition, the media?

Are the messages that you give to all your shareholder groups aligned?

Do the messages you convey reflect the reality of your company internally?

Does your business say on the tin what it actually does?

Next step notes

Contact us

To discuss any of the issues raised in this paper, please talk to your usual PwC contact or email us at **info@corporatereporting.com**.

PwC has a stong and effective network of people worldwide who can advise you on how to integrate reporting to best meet the needs of your business, the board and external stakeholders.

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