



## Highlights

- More and more companies are viewing nonfinancial data as a management tool.
- Sustainability was second in importance only to concerns about the economy among survey respondents at a recent meeting of consumer package goods managers.<sup>1</sup>
- But there's a disconnect even at "sustainable" companies: Sustainability information isn't often factored into corporate strategy.
- Integrated reporting is part of a movement toward timely and transparent disclosure of nonfinancial data so it can be used to make real-time, strategic business decisions.

## Finding a sustainable edge

### Putting nonfinancial data to work for strategic growth

A quiet revolution has taken place in sustainability reporting. These days most management teams acknowledge the importance of collecting and reporting nonfinancial data, but companies vary in how they deploy this information as a tool for strategic growth.

#### Four approaches to nonfinancial reporting

In emerging markets many companies still don't publish sustainability reports, or they make a nodding gesture toward them without generating hard numbers. The more general trend, though, is for companies to produce annual sustainability reports separate and apart from their financial statements. Too often, however, valuable nonfinancial information gets trapped in a backward-looking sustainability silo and remains disconnected from overall management strategy.

A third and more recent dynamic has companies creating stand alone sustainability departments that gather nonfinancial data from across corporate divisions. While this gets the job done from a collection and analysis point of view, it still presents two unnecessarily artificial snapshots of a company: the financial picture and the nonfinancial picture. But a fourth approach to reporting nonfinancial information—integrated reporting—seamlessly integrates nonfinancial and financial data to provide the best information for stakeholders.

Four tips on how companies can achieve integrated reporting

- **Understand what kinds of nonfinancial information you want to collect.**
- **Define your materiality standards: Which nonfinancial metrics are most important to strategic decision making?**
- **Document the process flow of nonfinancial information in your organization.**
- **Make sure corporate decision makers receive relevant, timely and reliable nonfinancial information.**

<sup>1</sup> Consumer Goods Forum press release, "Economic Concerns and Consumer Demand Remain Top Priorities for Consumer Goods Industry, March 4, 2010.

## In brief

### What executives are saying about nonfinancial reporting

- “Investors are starting to ask about sustainability data and about how our approach to reporting compares with other companies’.”<sup>2</sup>
- “How do companies put in place risk management processes that help them stand behind nonfinancial numbers the same way they stand behind financial numbers?”<sup>3</sup>

—Steve Neil, CFO, Diamond Foods

—Bill Schumacher, CFO, Sunny Delight

- “Sustainability issues are fundamental to our strategy as our customers are demanding that we address these areas. This creates value drivers that should be presented as part and parcel of the Annual Report and Accounts. Moving forward, there is a need for sector comparability, built on information that is used to manage the business, much of which is already collected.”<sup>4</sup>
- “When I first started here at Ford Motor Company in the early 1980s, I don’t think ‘sustainability’ was part of our corporate lexicon. These days, sustainability governance and more traditional corporate governance overlap, maybe even to the point of merging.”<sup>5</sup>

—Darren Shapland, CFO, J Sainsbury plc

—Peter Sherry, Jr., Corporate Secretary and Associate General Counsel, Ford Motor Company

<sup>2</sup> GMA/PricewaterhouseCoopers CFO Share Group Meeting, June 17, 2010.

<sup>3</sup> *Ibid.*

<sup>4</sup> Connected Reporting: A Practical Guide with Worked Examples, The Prince’s Charities, August 2009. <http://www.connectedreporting.accountingforsustainability.org/>.

<sup>5</sup> Ford Motor Company website, <http://www.ford.com/microsites/sustainability-report-2009-10/issues-perspectives-sherry>.

## Why integrated reporting?

No one standard exists for nonfinancial reporting. Just as it took decades for financial reporting to evolve to where it is today, nonfinancial reporting will take some time to standardize as well. In the meantime, companies differ in their views on how much time and how many resources should be budgeted for gathering sustainability data, or where exactly sustainability professionals should reside in an organization.

Yet the thirst for nonfinancial information is very real, and external pressure from shareholders, customers, regulators and the media has companies focusing on ways to collect and use nonfinancial data.

In this issue of *R&C Worlds Express*, we'll look at how integrated reporting helps advance nonfinancial reporting as an equal partner with financial reporting when it comes to reflecting a company's business strategy and overall goals. Integrated reporting harvests nonfinancial data—information that is “relevant to the assessment

of economic value, but which does not fit easily into the traditional accounting framework.”<sup>6</sup> As companies move from passive to active corporate responsibility, from strict need-to-know compliance disclosure to right-to-know complete disclosure, they are aspiring to link corporate strategy with one comprehensive stream of nonfinancial and financial data.

For retail and consumer companies, in particular, sustainability issues like climate change, water scarcity, fair labor practices and the role of large multinational companies in local economic development have become high-profile concerns both in the pursuit of shareholder value and in the court of public opinion. Too, these issues may foreshadow a new era of legislation and regulation. The US Securities and Exchange Commission's recent guidance statement about climate change, for instance, made it clear that publicly traded companies are expected to disclose any potential broad risks to their business posed by climate change.

## A hypothetical case study: Using nonfinancial information strategically

Integrated reporting pushes nonfinancial data out of the sustainability reporting mechanism—which typically generates information simply for annual publication—and into the C-suite. Savvy managers now recognize the importance of nonfinancial information to a company’s business model and operations. The best part is that strategic nonfinancial data can be harvested without necessarily having to reinvent the wheel—often with existing financial data at hand.

It may just be a matter of connecting the dots that are already there. Indeed, *Connected Reporting*, a report copublished in 2009 by PwC in the UK, outlines three basic steps to achieving the goal of integrating nonfinancial data into corporate strategy.<sup>7</sup> A team from PwC created a scenario showcasing how a fictional supermarket chain—GRO Foods, with 700 stores in Europe, North America and Asia—did just that. **Step one** involved connecting GRO’s strategic objectives with the sustainability issues that might impact those objectives. GRO wanted to increase its

sales growth in part by expanding the number of its retail outlets. The company took this sales growth objective and examined it in the context of the sustainability issues that would emerge from building more stores: more stores would mean a bigger carbon footprint, more water use, etc. **Step two** involved establishing key performance indicators to measure the actions taken to address the sustainability issues. GRO analyzed the risk of a bigger carbon footprint and developed a sustainable strategy that included building only “eco-stores” that use at least 70% less energy than its standard stores. **Step three** involved tracking the progress of GRO’s store expansion and presenting a report that measured, among many other things, the premium to build the new eco-stores against the lifetime energy savings in energy costs for the stores.<sup>8</sup>

GRO Foods’ connected report—while entirely fictional—makes explicit the relevance of sustainability performance to business results.

<sup>7</sup> Connected Reporting: A Practical Guide with Worked Examples, The Prince’s Charities, August 2009. <http://www.connectedreporting.accountingforsustainability.org/>

<sup>8</sup> Connected Reporting, 2009, <http://www.connectedreporting.accountingforsustainability.org/gro-foods>

## The real world: Sustainability and strategy at three consumer packaged goods companies

While some might say that GRO's results had the advantage of being hypothetical, many real-world companies are already migrating nonfinancial data out of the reporting framework and into the boardroom.

### Coca-Cola Company

In 2009, Coca-Cola Company took the first step in combined reporting by officially linking its business strategy with sustainability objectives, requiring any major project or new investment to be assessed for its impact on each of five sustainability target areas: energy conservation/climate change; water stewardship; sustainable packaging/recycling; product portfolio/balanced and active lifestyle; and diverse and inclusive culture.

Coke also added sustainability objectives to its business-case development for new products, and sustainability performance has now become part of the compensation criteria for Coke's executive leadership team.<sup>9</sup> These steps were part of what led SAM, the Swiss sustainability investment group and publisher of the Dow Jones Sustainability Indexes (DJSI), to designate Coca-Cola Enterprises a "SAM Sector Mover" for 2009—a distinction given to the company that showed the biggest proportional improvement over the prior year from among the top 15% of its peers in the beverage sector.<sup>10</sup>

### Nestlé S.A.

Nestlé estimates that it works directly with roughly 540,000 farmers to produce its milk and chocolate goods, and that about 3.4 million people in developing countries earn their livelihoods from the Nestlé supply chain.<sup>11</sup> Rural development, then, became a natural key performance indicator for Nestlé, allowing the company to combine corporate interest with environmental and economic good. So far, the company's rural development programs include supporting 165,553 direct suppliers and providing microfinance loans totaling USD 43 million.

### SABMiller

One of the world's largest brewers, SABMiller has prioritized three key target areas that have the potential to globally impact its business: alcohol responsibility, water use, and enterprise development. The company's responsible-drinking program includes an industry-wide campaign against irresponsible drinking in developing markets, a web campaign, TalkingAlcohol.com, and a drunk-driving program.<sup>12</sup> In the realm of water use and water scarcity—significant long-term business risks—SABMiller, has, among other things, committed itself to reducing its water use per hundred liters of beer by 25% between 2008 and 2015.<sup>13</sup>

9 Clear on Our Commitments: Our Journey to 2020, 2009 Corporate Responsibility and Sustainability Report, Coca-Cola Enterprises, <http://crs.cokecece.com/publications/crs-report.php?g=2>.

10 *The Sustainability Yearbook 2010*, SAM Group, List of Sector Movers, [http://www.sam-group.com/html/yearbook/downloads/SAM\\_Sector\\_Movers\\_2010.pdf?CFID=2114889&CFTOKEN=5e88aea9a345267f-60E948BB-BEC0-0182-E49CB0F796CEE1CA](http://www.sam-group.com/html/yearbook/downloads/SAM_Sector_Movers_2010.pdf?CFID=2114889&CFTOKEN=5e88aea9a345267f-60E948BB-BEC0-0182-E49CB0F796CEE1CA).

11 Creating Shared Value Summary Report 2009, Nestlé SA, pg 20, [http://www2.nestle.com/Common/NestleDocuments/Documents/Reports/CSV%20reports/Global%20report%202009%20\(Summary\)/CSV\\_2009\\_GB.pdf](http://www2.nestle.com/Common/NestleDocuments/Documents/Reports/CSV%20reports/Global%20report%202009%20(Summary)/CSV_2009_GB.pdf).

12 SABMiller Sustainable Development Report 2010, pg 14, [http://www.sabmiller.com/files/reports/2010\\_SD\\_report.pdf](http://www.sabmiller.com/files/reports/2010_SD_report.pdf).

13 SABMiller Sustainable Development Report 2010, pg 17-20.

## Nonfinancial reporting, stock price, and performance



More companies than ever are submitting voluntary sustainability reports—66% of S&P 500 companies submitted voluntary disclosures to the Carbon Disclosure Project in 2009, up from 56% in 2007 (PricewaterhouseCoopers serves as global adviser and report writer to the Project). But does this reporting affect strategic decision making and, thus, performance? PricewaterhouseCoopers' own five-year study of companies that consistently report nonfinancial data versus those that don't suggests a correlation between sustainability reporting and improved performance in the following areas<sup>14</sup>:

- Over the past five years, reporting companies' gross margins have been on average 10 percentage points higher than those of nonreporting companies.
- Strong gross margins of reporting companies continue to drive substantially higher return on sales.
- Higher margins helped reporting companies produce more cash than their non-reporting counterparts did, as evidenced by their notably

higher free cash flow to sales performance. This trend is also sustained over the three- and five-year time frames.

- On average, reporting companies have generated higher shareholder return than have nonreporting companies over the past three- and five-year periods.

It can't be determined for certain, of course, whether companies perform better *because* of their sustainability reporting efforts or whether they're just good companies to start with. What is clear, however, is that investors, other stakeholders and consumers are paying attention to companies that report on sustainability. The SAM Group publishes and licenses the Dow Jones Sustainability World Indexes, a series of global sustainability benchmarks launched in September 1999. The scoring and ranking of companies from among their peers in addressing sustainability issues are becoming significant leverage points for addressing stakeholder and shareholder questions about sustainability risk.

## Timing is everything

When it comes to using financial information, companies act quickly on quarterly earnings reports, and they pursue or abandon initiatives based on return on investment, sometimes even on a monthly basis. Similarly, integrated reporting can present nonfinancial data in the same actionable light. But, like external stakeholders, internal decision makers need ready access to sustainability data.

Enter the Web. Web-based sustainability reporting is helping increase the relevance, transparency and due diligence performed around nonfinancial reporting. Indeed, updating corporate progress is easier, less costly, more timely, uses fewer resources and is likely to reach a broader range of internal and external stakeholders than the traditional annual sustainability report is. Symantec, for example, published its first sustainability report in the fall of 2009 and plans to publish additional updates online, with online tools provided for stakeholder feedback.<sup>15</sup> The company adopted online reporting because of the limited readership for printed material and because the online medium offers greater flexibility and timeliness.

### Three steps to connecting financial and nonfinancial information

- **Step one:** Connect strategic objectives to sustainability issues that may affect those objectives.
- **Step two:** Establish key performance indicators to measure the actions taken to address the selected sustainability issues.
- **Step three:** Provide assurance over key material nonfinancial information.

### Other issues to consider in reporting

- Understand nonfinancial reporting requirements
- Assess whether the financial reporting organization can, with a few tweaks, provide the information
- Evaluate the need for a new IT system geared toward producing nonfinancial data.

## Resources

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