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INTEGRATED REPORTING - CONCEPT AND IMPACT ON PERFORMANCE OF CROATIAN COMPANIES

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ABSTRACT

Integrated reporting is a combination of financial and non-financial information intended primarily for external stakeholders. However, it is also an effective management control tool, as it promotes integrated thinking, strengthens the company's reputation and overall success. The aim of this paper is to investigate the extent to which The International <IR> Framework (IR) is recognized in Croatian companies and whether a higher level of efficiency encourages companies to socially more responsible performance. The starting point is The International <IR> Framework whose concept is analytically expound with a critical review of the distinction between reporting on social responsibility and the concept of integrated reporting. The empirical research included companies from Zagreb Stock Exchange and those companies that are members of Croatian Business Council for Sustainable Development (HR BCSD). The research is based on the data collected from Amadeus base, Annual Financial Statements Registry of FINA and company's websites. A content analysis of 138 companies is conducted according to their repots and performance by selected relevant indicators. The results confirm that companies that more transparently report about their results through data on economic, environmental and social aspect of business have greater efficiency measured by financial results. Furthermore, the results show that these same companies, in addition to the economic aspect pay more attention to ecological and less to social indicators in their reports.

Key words: *integrated reporting; performance; Croatian companies*

1. INTRODUCTION

The aim of this paper was to investigate the extent to which The International Integrated Reporting Framework (IR Framework) was recognized in Croatian companies and whether a higher level of efficiency encourages companies to more accountable socially responsible business and transparent reporting. Therefore, the paper first summarizes the concept of integrated reporting with reference to the differences on the basis of reporting on corporate social responsibility, and the results of the empirical research prove that companies which have better performance score based on selected indicators report more transparent and comprehensive on their business results. In addition, the research confirms which aspects of the Triple Bottom Line (TBL) concept are most often used in the practice of large Croatian companies.

Integrated or comprehensive reporting is a reflection of global trends in business relation risk mitigation by more transparent reporting on business results. Transparency is one of the principals of corporative management which stands out over the last ten years and more, through variety of principals, guidelines, laws etc. Thus, the concept of integrated reporting is a product of a global association called The International Reporting Council-IIIRC.[1] Aim of this project was to raise the level of information quality through a more comprehensive reporting approach. Therefore, innovations in reporting were implemented primarily for the purpose of investors' protection. Namely, detailed and comprehensive information about how single organizations create their value through time enables efficient decision making for potential investors. Hence, the intent is to show "integrated thinking" about how management with the help of other stakeholders create value for investors. Integrated thinking takes into account the interconnectedness and interdependence between a whole set of factors that influence on the process of value creation of an enterprise, including the capital that the company uses, the capacity it possesses, the way of creating a business model and strategy, and other activities and business results as well as the outcomes of past, present and future capitals.

Integrated reporting is important for nowadays managing system, which should be based on sustainable social responsible business activity. Sustainability presumes "development that meets the needs of the present without compromising the ability of future generations to meet their own needs" (WECD, 1987). The concept of sustainability is very complex, dynamic and requires establishing balance between economic, environmental and social goals. From the aspect of

1 IIRC is a global coalition of regulators, investors, companies, standard setters, the accounting profession and non-governmental organization, whose main mission is to establish integrated reporting and thinking within mainstream business practice as the norm in the public and private sectors, with emphasis on creating added value.

businesses, sustainability is referred through the concept of socially responsible business, which means that business policy of decision making and planning has to be within the environmental and social requirements. That simultaneously imposes guidelines for sustainable business and the need for a single, global reporting methodology.

2. TBL CONCEPT – BASE FOR INTEGRATED REPORTING

The concept of TBL, also known as People, Planet, Profit concept (3P), starts from the premise that in the terms of sustainability, economic or commercial aspects are not sufficient for evaluation of business but preferably reporting and acting upon environmental and social aspects of business. Broader comprehension of this concept includes values, strategy and practice and the way to use it for accomplishing economic, environmental and social goals (Elkington, 2006). Due to the diversity of understanding the TBL concept, in the past decade the practice has generated a whole line of reports under different names such as: "report on sustainability". "report on social responsibility", "reports on corporate governance", "social reporting", "triple bottom line report", "3P report", etc. Beside general economic, mostly financial data and indicators, all these reports have in common the inclusion of more environmental, social and governance data (ESG- Environmental, Social and Governance). Reporting based on the triple bottom line concept was first established by Elkington (1997). His main aim was to connect profits through the word "bottom line" and to get the respect of and connect environmental and social performance through the word "triple". Demands of today are that the system of measuring business performance should consider all effects that companies have on the society, including human rights, freedom, equality etc. (Vitezić, 2010).

The concept of integrated reporting is based on the TBL concept and the current practice of informing on financial results of businesses, but requiring a full disclosure of financial and nonfinancial information (Oliver i sur., 2016). It should be emphasized, however, that Corporate Social Responsibility (CSR) reporting differs from integrated reporting on two bases: first, the content is not equal, and second, the intention is different (Velte i Stawinoga, 2016). Reporting on social responsibility includes economic, environmental and social aspect of business and is intended to all direct and indirect stakeholders. The IR Framework goes beyond these aspects and broadens its reporting on to the process of creating value. That way the investors, to whom the reports are intended, and the rest of the stakeholders could get insights into the companies' way of creating create added value over time, and based on the insight into performance indicators and plans, subjectively estimate how they will create value in the future. The main goal is to achieve the highest quality of reporting based on linking strategy, management and creating corporate results in the context of economic, ecological and social requirements. Although integrated reporting is directed to everyone, investors are still most interested in seeing this kind of reporting as a key innovation that will enhance long-term investment. Benefits for the management structure are better understanding strategy in terms of ecological, social and economic impacts; a greater overview of risk reduction, dealing with resource constrains; greater opportunity for investments; lower costs. On the other hand, it is important to point out the benefits for shareholders: better knowledge of business, greater number of long-term sustainable performance indicators, increased trust on the basis of transparency, etc. A research (IIRC, 2014) showed that the largest number of respondents, 92% of them, think that IR results in better understanding of enterprise value creation. Another 84% of respondents believe that companies profit from the new concept of reporting, while 71% of respondents believe that IR brings more competitive strategic benefits.

2.1. REASERCH METODOLOGY AND RESULTS

The concept of integrated reporting is relatively new and in his beginning stage, as the Framework was adopted only in 2013 and is applied on a voluntary basis. Therefore, reporting in Croatian companies is mainly based on a narrower understanding of the TBL concept, using mostly Global Reporting Initiative (GRI)[2] guidelines or companies own forms of reporting on social responsibility. Consequently, in the empirical part of this paper under integrated reporting we consider reports that include economic, environmental and social aspects of the business.

2.1.1. Sample and methodology

In order to establish how much Croatian businesses recognized the global framework of integrated reporting and how much the efficiency of business effects the level of its implementation, an empirical research was conducted on the sample of 138 companies in a period from 2011 to 2015. To test the impact of business performance, five indicators were selected, i.e. statistically there were 690 observations. The sample included companies whose active securities were listed on Zagreb stock exchange[3] on June 28, 2017, and companies who were members of Croatian Business Council for Sustainable Development (HR BCSD)[4],

[2] GRI guidelines are a unique handbook for encouraging sustainability reporting based on the triple bottom line concept, and periodically revised to provide actual guidance on effective sustainability reporting.

[3] Banks, insurance companies, investment funds, cities, companies in bankruptcy and liquidation, ministries and the Zagreb Stock Exchange d.d. were excluded from the sample.

[4] The total number of members of HR BCSD on June 28, 2017 was 36, but in the sample were taken 34 companies in total, as one member was a bank and another one did not have available data in the Amadeus Bureau van Dijk database.

on the same date, and whose five year financial data (2011-2015) could be found on Amadeus Bureau van Dijk data base. Certain lack of data for the calculations of selected indicators of efficiency were supplemented from Annual Financial Reports Registry of Croatia (RGFI). The sample includes two groups of companies: first, companies who use GRI guidelines for reporting or create their own forms of reporting on sustainability (41 businesses) and second, companies who report only on financial results of business or eventually some other non-financial business data, mostly number of employees (97 businesses).

The biggest part of the sample includes large (73) and medium companies (40), while only 25 are small companies. Manufacturing industry has the biggest share (33%), followed by accommodation and food service activities (21%), professional, scientific and technical activities (11%), wholesale and retail trade; repair of motor vehicles and motorcycles (9%), transportation and storage (8%). Other services participate individually with less than 4%. Companies that present their business results by integrated reporting make a sample of 78% large companies, 12% medium and 10% small companies, mostly represented in the manufacturing industry (49%). Data for defining level of incorporation of economic, social and environmental indicators were selected form internet pages, precisely from annual financial reports from selected companies. Results are shown by using appropriate analytical methods. Impact of efficiency on integrated reporting and socially responsible business is determined on the base of descriptive statistics, tested with parametric (T-test) and non-parametric statistic methods (Mann-Whitney U test).

2.1.2. Results of research

The aim of this paper was to determine the development of integrated reporting as a way of positive practice of responsible business governance in Croatia, and to prove that companies with higher levels of efficiency are more inclined to the integrated way of reporting. Precisely, the research confirms thesis of previous researches (Waddock & Graves, 1997, Weber et.al. 2008, Vitezić, 2011, Tuareta, 2015), that there is a positive connection between business performance and integrated way of reporting. Therefore, following hypothesis was formed: *greater level of efficiency encourages companies to implement integrated reporting and socially responsible behavior.*

In order to confirm the hypothesis several indicators of efficiency were selected. Indicators that are most commonly used to show business performance of individual companies are: return on assets (ROA), return on equity (ROE), earnings before interests and taxes (EBIT), earnings before interests, taxes, depreciation, and amortization (EBITDA) and profit margin (PRMA). For gathered five-year data, descriptive statistics was performed using software package Stata 14, and these results were given:

Table 1.: Descriptive statistics of the whole sample

Variable	Number of observations	Mean	Standard deviation	Minimum	Maksimum
ROA	690	3.65987	8.131343	0	111.6
ROE	690	7.436793	19.98132	0	219.042
EBIT	690	47457.64	318266.8	-1712000	3200449
EBITDA	690	135796.2	587273.3	-432150.3	6935000
PRMA	690	8.116335	17.34235	0	159.63

Source: authors

Table 2.: Descriptive statistics of companies with IR

Variable	Number of observations	Mean	Standard deviation	Minimum	Maksimum
ROA	205	5.00401	7.503443	0	48.548
ROE	205	8.26659	11.01722	0	67.734
EBIT	205	132068.1	535586.6	-1712000	3200449
EBITDA	205	386497.3	1013754	-432150.3	6935000
PRMA	205	6.84481	8.728014	0	68.252

Source: authors

Table 3.: Descriptive statistics of companies without IR

Variable	Number of observations	Mean	Standard deviation	Minimum	Maksimum
ROA	485	3.091728	8.324929	0	111.6
ROE	485	7.086054	22.73287	0	219.042
EBIT	485	11694.46	137761.7	-427734	2644947
EBITDA	485	29829.72	141190.8	-365801	2646346
PRMA	485	8.653784	19.87615	0	159.63

Source: authors

According to descriptive statistics it can be concluded that companies which apply the integrated reporting, in average have much better results on most of the selected indicators, that companies which do not use the concept. For example, average value of return on assets is 5,0% in companies with integrated reporting, while companies that do not apply the concept have 3,1% return on assets with larger standard deviation. Four out of five indicators have considerably larger statistical means in companies that implement IR, i.e. only profit margin shows larger average value in companies that do not have any kind of integrated reporting. This can indicate that revenue gain still does not depend on the orientation of companies towards sustainability, as well as there is no sufficient spending towards those purposes. Larger performance measured by indicators of profitability is an outcome of large value of assets and equity (in average over 7 and 8 times for companies with IR) as a base for creating profits. Amortization is in average 14 times larger than in companies which do not report on other aspects of business, which implicates on large values of material assets engaged in the process of creating business effects.

Aforementioned results confirm that companies with greater efficiency spend more for environmental and social components of sustainability and are more socially responsible. It is presumed that because of efficient performance those companies have larger possibilities for environmental and social expenditures, and thus monitoring of achieved results through the implementation of integrated reporting.

In order to determine significance of selected indicators, the hypothesis was tested with parametric test (T-test) and non-parametric test (Mann-Whitney U-test). T-test determined statistical significance of difference between means of companies which report outside the financial framework and those who do not. Two-tailed test with 95% interval of reliability, determined that ROA, EBIT and EBITDA are statistically significant with assumption of equality and inequality of variances, while ROE and PRMA are statistically insignificant for both assumptions. Non-parameter test, which presumes equality of variances, detriments that all indicators are statistically significant, i.e. there is a significant difference in the sum of ranges between companies with integrated reporting and those without it.

Table 4.: Significance tests

Indicator		T-test (two-tailed; 95%)							Mann-Whitney test	
		Diff. of Mean	Diff. of Std. Err.	t	df	Lower tail	Sig.	Upper tail	Z	Sig.
ROA	equal variances	-1.912282	.6739507	-28.374	688	.0023	.0047	.9977	-6.517	0.000
	unequal variances	-1.912282	.6461718	-2.9594	423.216	.0016	.0033	.9984		
ROE	equal variances	-1.180537	1.665167	-.70896	688	.2393	.4786	.7607	-6.879	0.000
	unequal variances	-1.180537	1.287488	-.9169	676.065	.1798	.3595	.8202		
EBIT	equal variances	-120373.6	26132.93	-4.6062	688	0.0000	0.0000	1.0000	-9.613	0.000

Indicator		T-test (two-tailed; 95%)							Mann-Whitney test	
		Diff. of Mean	Diff. of Std. Err.	t	df	Lower tail	Sig.	Upper tail	Z	Sig.
	unequal variances	-120373.6	37926.42	-3.1739	215.498	.0009	.0017	.9991		
EBITDA	equal variances	-356667.6	47032.77	-7.5834	688	0.0000	0.0000	1.0000	-11.435	0.000
	unequal variances	-356667.6	71093.32	-5.0169	207.353	0.0000	0.0000	1.0000		
PRMA	equal variances	1.808974	1.444127	1.2526	688	.8946	.2108	.1054	-4.435	0.000
	unequal variances	1.808974	1.08911	1.6610	687.074	.9514	.0972	.0486		

Source: authors

This research also determined which aspects of TBL concept i.e. indicators of GRI G4[5] (2013) guidelines for reporting on sustainability, are mostly present in the practice of Croatian companies. According to analysis of reports based on GRI guidelines, it has been found out that the following indicators are mostly used:

- *Economic aspect* – economic impact (economic value retained[6], financial implications, risks, investments amount, subventions and financial stimulation etc.), market presence and procurement practices (share of local work force, ratio of wages towards minimum wages in Croatia and minimum local wages), indirect impact (investments in local infrastructure).
- *Environmental aspect* – used materials towards the volume or weight, quantity of produced dangerous and non-dangerous waste, percentage of used materials that belong to recyclable input materials, intensity (% decrease) of emission of greenhouse gas and energy consumption, total extraction and emission of water, percentage and level of recycling and usage of water, total expenses for environmental protection, number of vehicles and fuel consumption, significant real and potential negative effects of supply chain on environment and measures taken, value of significant fines and total number of non-financial penalties for not following the low and directives from segments of care, etc.

5 G4 are the latest revised GRI guidelines adopted in 2013.

6 According to GRI G4 guidelines, it is calculated as 'Direct economic value generated' represented by revenues, less '"Economic value distributed ", which includes operating costs, employee wages and benefits, payments to providers of capital, payments to government (by country) and community investments.

- *Social aspect* – labor practices and decent work (fluctuation and structure of employees, average number of hours and annual expenses for training, ratio of wages, average wage, etc.), human rights (total number of discrimination cases), society (confirmed cases of corruption) and product responsibility (customer satisfaction and number of complaints).

It canbe concluded that socially responsible companies in addition to the economic aspects pay greater attention to environmental indicators in their reports, while the level of social aspect is still predominantly focused on labor practices and decent work, although according to the GRI G4 guidelines that aspect has 157 indicators[7].

3. CONCLUSION

Over the last twenty years, the concept of sustainable business increasingly penetrates the consciousness of management structures. Due to the growing emphasis on transparency, it also includes information pointing to the attitude and policy of the management and owners about ecological and social aspects of the business. By using integrated reporting as a concept, foremost intended for investors but also all interested stakeholders, economic, environmental and social aspects of business are widened by additional information which can determine how companies create their value. With a comprehensive overview it is possible to analyze and evaluate business more securely and thus reduce business risk. On the sample of 138 Croatian companies it has been confirmed that the greater levels of efficiency performance encourages companies to implement integrated reporting and socially responsible behavior. Furthermore, companies which apply some of the forms of integrated reporting have in average better results: greater return on assets, greater return on equity and greater gross profit, compared to companies which do not apply the concept. In addition, most companies report not only on financial but also on environmental and social aspects of business, while environmental indicators are dominating. In Croatian companies integrated reporting, in accordance to the IR Framework, is still not completely accepted, although considering all the recommendations and guidelines about the need for comprehensive reporting about sustainability, it can be expected that in the future more and more companies will except the broader concept of reporting with emphasis on creating value, relationship towards environment and society.

7 In the GRI G4 guidelines in the aspects of social category are in total given 157 indicators, of which 52 refer to sub-category labor practices and decent work. In the environmental aspect are given 168 indicators, and in economic 49.

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INTEGRIRANO IZVJEŠTAVANJE - KONCEPT I UTJECAJ NA USPJEŠNOST HRVATSKIH PODUZEĆA

SAŽETAK RADA

Integrirano izvještavanje kombinacija je financijskih i nefinancijskih informacija namijenjenih prvenstveno vanjskim akterima-dionicima. No ono je i učinkovit alat upravljačkog nadzora jer potiče integrirano tj. cjelovito razmišljanje, jača reputaciju i ukupnu uspješnost poduzeća. Cilj ovog rada je istražiti koliko je globalni okvir za integrirano izvještavanje (IR) prepoznat u hrvatskim poduzećima i da li veća razina efikasnosti potiče poduzeća na društveno odgovornije poslovanje. Polazište je Okvir za integrirano izvještavanje (IIRC) čiji koncept se analitički razlaže s kritičkim osvrtom na razliku između izvještavanja o društvenoj odgovornosti i koncepta integriranog izvještavanja. Empirijsko istraživanje obuhvatilo je poduzeća sa Zagrebačke burze te ona poduzeća koja su u Hrvatskom poslovnom savjetu za održivi razvoj (HR PSOR). Temeljem podataka iz Amadeus baze, Registra godišnjih financijskih izvještaja FINA i internet stranica poduzeća analizirao se je sadržaj izvještavanja te, odabirom relevantnih pokazatelja, uspješnost poslovanja na uzorku od 138 poduzeća. Istraživanje je potvrdilo da poduzeća koja transparentnije izvještavaju o svojim rezultatima kroz podatke o ekonomskom, ekološkom i društvenom aspektu poslovanja imaju veću efikasnost mjerenu financijskim rezultatima. Osim toga utvrdilo se da ta ista poduzeća pored ekonomskog aspekta u svojim izvještajima veću pažnju posvećuju ekološkim, a manje društvenim pokazateljima.

Ključne riječi: *integrirano izvještavanje; uspješnost; hrvatska poduzeća*