

# INTEGRATED REPORTING AS COMPETITIVE ADVANTAGE FOR UKRAINIAN COMPANIES: DETERMINANTS VS. BIASES

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## Petrakov Ya. V., Shulha S. V. Integrated Reporting as Competitive Advantage for Ukrainian Companies: Determinants vs. Biases

Article is aimed at the integrating reporting initiative and ongoing discussion among the parties concerned as to its conceptual framework. The aim of our research was to generalize opportunities and threats of adoption of the integrating reporting (IR) in search of additional competitive advantages by companies. The main question is whether the IR framework really helps to create additional value and to enhance the market structure in Ukraine? To answer the research question a methodology was used, which combined the cognitive theory and the theory of markets evolution with the Porter's competitive advantages approach. Novelty of this research is an interdisciplinary view on the integrated reporting challenges and opportunities. We found that the IR framework and voluntary practices demonstrate huge potential and mutual benefits for both the parties concerned and the reporters, even with regard on several biases. Cons of the IR originate from eventual cognitive behavioral inclinations, based on diminished financial data and additional space for manipulations, affecting expectations of the parties concerned. In order to minimize negative outcomes of the IR implementation we would recommend external oversight of the issued reports, deeper transparency of business structure and clear development strategy. Further research of the IR should be focused on correction of auditing procedures, common practices in the materiality enhancement, and sectoral opportunities for the IR implementation.

**Key words:** integrated reporting, competitive advantages, audit market structure, biased perceptions.

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## Петраков Я. В., Шульга С. В. Інтегрована звітність як конкурентна перевага для українських компаній: детермінанти проти викривленого сприйняття

Стаття присвячена ініціативі з інтегрованої звітності (ІЗ) та існуючій дискусії серед зацікавлених сторін щодо її концептуальної основи. Метою дослідження було узагальнення можливостей та загроз, що виникають внаслідок імплементації ІЗ компаніями для отримання додаткової конкурентної переваги. Ключове питання – чи дійсно концепція ІЗ дозволяє створити додаткову цінність та розширити структуру ринку в Україні? Для відповіді на питання було застосовано методологію, що поєднала когнітивну теорію, теорію еволюції ринків та підхід Портера щодо конкурентних переваг. Новизною дослідження є міждисциплінарний погляд на виклики та можливості інтегрованої звітності. Установлено, що концепція ІЗ та добровільні практики демонструють величезний потенціал та спільні вигоди для зацікавлених сторін і компаній, що звітують, навіть незважаючи на можливість існування зміщених оцінок. Негативні аспекти ІЗ виникають з можливих когнітивних поведінкових зміщень, обумовлених розмиванням фінансової інформації та додатковим простором для маніпуляцій, що впливають на очікування зацікавлених сторін. Для усунення негативних впливів, обумовлених імплементацією ІЗ, пропонуються зовнішній нагляд за виданими звітами, глибша прозорість бізнес-структури та чіткіша стратегія розвитку. Подальші дослідження ініціативи ІЗ слід сконцентрувати на корекції процедур аудиту, спільних практик у розширенні подання суттєвої інформації, а також на секторальних можливостях імплементації ІЗ.

**Ключові слова:** інтегрована звітність, конкурентні переваги, структура ринку аудиторських послуг, зміщення оцінок сприйняття.

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## Петраков Я. В., Шульга С. В. Интегрированная отчетность как конкурентное преимущество для украинских компаний: детерминанты против искривленного восприятия

Статья посвящена инициативе по интегрированной отчетности (ИО) и существующей дискуссии среди заинтересованных сторон о ее концептуальной основе. Целью исследования было обобщение возможностей и угроз, возникающих в результате имплементации ИО компаниями для получения дополнительного конкурентного преимущества. Ключевой вопрос – действительно ли концепция ИО позволяет создать дополнительную ценность и расширить структуру рынка в Украине? Для ответа на вопрос была применена методология, объединившая когнитивную теорию, теорию эволюции рынков и подход Портера к конкурентным преимуществам. Новизной исследования является междисциплинарный взгляд на вызовы и возможности интегрированной отчетности. Установлено, что концепция ИО и добровольные практики демонстрируют огромный потенциал и общие выгоды для заинтересованных сторон и компаний, подающих отчетность, даже несмотря на возможность существования смещенных оценок. Негативные аспекты ИО возникают вследствие возможных когнитивных смещений, обусловленных размытием финансовой информации и дополнительным пространством для манипуляций, воздействующих на ожидания заинтересованных лиц. Для устранения негативных воздействий, обусловленных ИО, предлагаются внешний надзор за выпущенной отчетностью, более глубокая прозрачность структуры бизнеса и четкая стратегия развития. Дальнейшее исследование ИО следует сконцентрировать на коррекции процедур аудита, совместных практиках в расширении подачи существенной информации, а также на секторальных возможностях применения ИО.

**Ключевые слова:** интегрированная отчетность, конкурентные преимущества, структура рынка аудиторских услуг, смещение оценок восприятия.

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**I**ntegrated reporting in Ukraine is not so widely accepted practice comparing to developed countries. It looks to be underestimated by potential users and underperformed by reporters. Thus, discussions on it are already on track with number of companies (preferably large transnational firms with (out) Ukrainian roots) making first voluntary reports since 2010 [1, p. 25].

IR is regarded as an alternative to traditional financial reporting practice, as it includes both wide range of financial and non-financial (social, environmental, and sustainability) data, with disclosure reference to opposite features: extra value creation vs. additional costs for data compliance and analysis. Balance between them pose minimal stimulus for IR existence. Thus, Ukraine as developing country still can make a positive catch-up in business investments' environment with IR.

IRI's institutional base analysis, provided by Jensen and Berg, provides clear determinants of IR publication in different countries:

- ✦ strong investor protection laws,
- ✦ weaker employment protection laws;
- ✦ stronger market orientation of reporting firms;
- ✦ less equity ownership concentration;
- ✦ higher trade union density;
- ✦ higher levels of environmental and social development;
- ✦ more valued self-expression practices;
- ✦ higher level of general economic development [2].

At the same time, Global Reporting Initiative survey generalized reporter's and expert's interests in IR:

1) reporters are interested in embedded reports (that comprise one-third of all self-declared reports in the GRI database);

2) government and stock exchange support IR initiatives across certain sectors (financial services, mining, energy and utilities) in South Africa, Australia, The Netherlands and Brazil, helping to encourage or mandate greater information disclosure;

3) sustainability as basis for business models gives reporters positive and appropriate impulse for development;

4) enhancement of company's narrative toward its approach to value creation, leading to more creativity and joined-up thinking across the organization [3].

Additionally, IR gets strong support from experts' cohort. «An integrated report is not intended to be a compendium of every single piece of performance information... it shows the relationships between these material financial and non-financial performance metrics», – mentions Robert Eccles [4, p. 59], identifying 3 possible classes of benefits from IR:

- 1) *internal* – such as better resource allocation decisions, stakeholder engagement and lower reputational risks;
- 2) *external market* – sophisticated coverage of mainstream investor's need in data on sustainability;
- 3) *external regulatory* – creating common regulatory background and thus lowering underreporting risks [4, p. 59–60].

Cheng emphasizes on IR ability to stimulate new thinking and action toward major business model adaptation, and necessity for providers of financial capital to fo-

cus on long-term company goals and performance, as their preferences on short-term financial performance may hamper organization's ability to implement fundamental business model changes [5].

EY in its report on IR mentions, that over last 35 years the concept of value has fundamentally changed from price-based largely on tangible assets, to greater emphasis on intangible assets [6].

Shared value and company's choice over the long-term ability to value creation should be regarded with several considerations:

1) value creation potential depends on company's ability to identify all the resources available to it, and to align them with its corporate strategy;

2) created value has the potential to impact on the organization's value and profitability;

3) organizations' benefits itself from better strategy communication, however, information to stakeholders must be credible [6].

ACCA's in research of IR determinants stresses on investor's demand for traditional reporting development, due to:

1) insufficient information for financial health assessment within reporting-business strategy-risk chain;

2) partial irrelevance of non-financial data and its disintegration with financial information;

3) need for better combination of qualitative policy statements and quantitative KPI (key performance indicators);

4) accountability mechanisms should be part of non-financial reporting, either through new board oversight mechanisms, third-party assurance and/or shareholder approval at annual general meetings [7, P. 4].

IR Framework includes organizational overview, governance, business model, risks and opportunities, strategy and resource allocation, performance, outlook, basis of preparation and presentation.

**D**ebates on IR in Ukraine are considered to be less intensive and engaged by the main groups of stakeholders. The most recent publications are concerned about absence of normative structure of report and basic indicators (despite the fact that IR Framework is already a Standard which is not publicly accepted by any accountant organization or regulatory body as on obligatory for execution).

Davyduk T. suggests to develop IR with several groups of KPI on social issues (with regard to weak public reporting of Ukrainian companies on labor), that would enhance human capital analysis [8].

Ryadska V. regards IR as a new object of audit with focus on risks analysis and assurance of multiplicative reliability of its local components, as a result of objective institutional and economic evolution of business processes [9–11].

Iefymenko T. supports IR introduction as this would enforce further accountancy regulations development and improve the European Integration processes in Ukraine in order with existing arrangements (specially Directive 2013/43/EC) [12].

**Methodological background.** To answer the research question we combined cognitive theory with the Porter's competitive advantages comparative approach.

Cognitive theory will help us to identify possible biased perceptions and expectations on IR initiative.

Porter's competitive advantages approach will explain the impetus of reporting shifts to IR, based on opportunity and threats analysis.

In previous publications we explained influence of long-term business strategies on global competitiveness of service-oriented companies, what is strengthened by IR framework on strategy and governance reporting [13]. As information requires user's judgments on material issues, enhanced approach to materiality and sophisticated vision of market prospects in IR will balance companies profile and minimize data gap for decision-making [14; 15].

Criteria, chosen for analysis, were: alternative opportunity costs, disclosure for perceptions to favor general expectations, stakeholders' mutual shift towards coherent data for decision-making [16, p. 550–551].

**D**espite mainly positive opinions and comments on IR Framework it can lead to several cognitive traps and biased perceptions that should be necessary recognized and understood by actors:

1) experience-based successes in IR are correlated with sustainability reporting practices of mid 1990–2000<sup>th</sup> reporting case studies, that are irrelevant now due to exponential growth of open sources and market data flows, essentially augmenting the base for decision-making process;

2) possible development of fraud practices within IR (due to weak institutional background) is likely to change the overall perceptions of stakeholders;

3) compliance challenges remain strong for both supply and demand sides: IR requires additional costs for data coverage and interpretation. Excess data would matter in timing challenge, materiality blurring, misstated or misused improper and irrelevant statements affecting expectations and value creation assessment;

4) different starting points seriously affect the efficiency of the IR – overstated supply-side expectations can lead to unexpected outcomes [16, p. 551–553].

Country-specific features can also impede IR Framework implementation, pursuing stakeholders to biased expectations, and entirely evaporating additional benefits and positive features of IR, among them:

- ✦ overwhelming corruption in the public sector with societal ignorance of legal norms;

- ✦ extreme overregulation and bureaucracy (rising hidden costs and authorities' regulatory rent, making businesses price uncompetitive, and causing costs redistribution between shareholders and consumers);
- ✦ income inequality and poor consumer spending potential, bending market structure and segmentation (demand-oriented traditional vs. supply-oriented innovative sectors);
- ✦ absence of efficient capital market and sustainable institutional base, that are important prerequisites of IR implementation [16, p. 552–553].

Determinants and possible biases for Ukrainian companies (*Table 1*) concerning 3 fundamental essentials of IR: value creation, materiality of information and enhance governance, can help to estimate opportunities and threats of IR implementation in Ukraine.

*Need for trust and transparency.* Companies can get additional tool to promote their business among stakeholders, but they should deliver more transparency onto these relations by more detailed explanations of goals, governance, business model and resource management.

*Extra data vs. additional costs.* This is the most obvious issue that can mislead Ukrainian business: as additional costs paid now will be compared with future engagement of extra financial flows. However, intangibles (value, created by various sources of capital) usually generate more profit, than traditional tangibles (as resources are used only once). At the same time, stakeholders' costs on IR analysis will be covered by gains from more precise decision-making on financial capital allocation.

*Attempt on materiality enhancement.* Materiality is specific subjective category that depends on circumstances and background for assessment. Detailed data can cover existing gap in defining absolute and relative numbers of material indicators, give explanations for reporters' choice of the relevant background.

At the same time, weak institutional background and less competitive market environment in Ukraine may result in expected by reporter's perception biases, thus affecting expectations.

*Shift away from core activities: following signs, not rules.* Markets in developing countries are more volatile and shock-inclined, so intentional manipulation with key events, operations or indicators can mislead stakeholders.

*Space for manipulations by extra data.* As financial data will be complemented with non-financial information, the last can shift readers attention away from some weak per-

**Table 1**

**Determinants and possible biases of IR for Ukrainian companies**

Determinants	Essentials of IR	Biases
1) Stakeholders' need for trust based on entities' transparency; 2) exponential growth of operational data posing additional costs on users to accumulate, process and analyze information; 3) need for materiality enhancement	1) Value creation; 2) material information; 3) enhanced governance	1) People usually follow signs, not rules, in shifting away from core activities; 2) extra data give space for manipulations, thus, affecting stakeholders' analysis and future cash flow expectations

Source: designed by authors.

formance indicators (or give alternative explanation on ineffective corporate governance and/or resource management).

So, what could be the possible measures to prevent IR users from the fraud and cognitive threats? They should be focused on essentials: value creation, materiality and governance.

To provide perceptions-neutral information reporters can use third parties oversight on prepared IR (before issuance) or apply traditional audit procedure. Such measure will keep management away from exaggerating its successes (Table 2).

Taking into account abovementioned measures, further research of IR initiative should be focused on auditing procedures correction, common practices in materiality enhancement, and sectoral opportunities of IR implementation. ■

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Table 2

Actions to minimize threats, imposed by IR implementation

Action to minimize the threat	Details
Better understanding of IR data without biased perceptions, arising from manipulations	External "proof-reading" (e.g. audit, external members of supervisory board) before public announcement to avoid misstatements and exaggerations
Objective value chain and governance description without formal notes	Deeper transparency of business structure as already existing peers can give possible notions. It's value that matters, not the know-how
Focus on fundamentals that keep business running	Clear development strategy to attract long-term investors and strengthen sustainability

Source: designed by authors.

Value creation disclosure should be more than convincing; it must be pervasive (but concise). More transparent business structure and model will give better understanding of companies' performance (and potential for competition).

Since Great Recession, many investors became risk-averse, reversing capital flows to more predictable and stable jurisdictions. To cover existing risk gap Ukrainian enterprises should demonstrate fundamentals that are able to keep business running during long-term period. Going concern principle for reporting must be opposed by well-designed and disclosed information on strategic development of a company.

#### CONCLUSIONS

Literature analysis shows that IR framework and voluntary practices demonstrate huge potential and mutual benefits for stakeholders and reporters, even with regard on several perception biases.

Value creation is the main, but not last argument in favor of gradual shift from traditional financial reporting to combined, as IR concept meets stakeholder's needs for trust based on entities' transparency, materiality enhancement, and elimination of «silo» effect of several types of reports issuance.

At the same time, stakeholders' threats posed by IR derive from cognitive behavioral inclinations, based on possible diminished financial data and additional space for company management manipulations, affecting stakeholders' expectations.

In order to tackle negative outcomes of IR implementation, that can further decline competitiveness of Ukrainian companies, we recommend external oversight of issued reports, deeper transparency of business structure and clear development strategy, that would lead to more trust on stakeholders part and attract investors to Ukrainian companies.

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