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STRATEGY DISCLOSURE IN THE INTEGRATED REPORT

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Purpose: The aim of this paper is to present the way a company may disclose information on the strategy in an Integrated Report (IR) and explain the value creation. In this way the aim is also to determine the extent to which companies have actually embraced an integrated perspective of corporate reporting.
Design/methodology/approach: The study is an exploratory one. It considers the extent to which companies are dealing with strategy-related issue of value creation in their Integrated Reports. The article uses the method based on a textual analysis of an Integrated Report of a Polish company having the longest experience in the publication of IR focusing on the strategy disclosure.
Findings: Ex-ante information on a company's intended strategy is requested by investors but it is largely non-financial (describes management's projected course of action) and often not verifiable, therefore its credibility may be questioned.
Originality/value: The examination if the IR was prepared in accordance with the 10 elements of a long-term strategy, created by FCLT Global (2015).

Keywords: strategy, value creation, integrated reporting.

Category of the paper: Case study.

1. Introduction

In today's world, the story of the organization, the impact that it has on the surrounding and the value that it creates are the effect of multiple dimensional activities and a variety of resources that are interconnected. As it is underlined by the report of PwC (2012, p. 5): "In the future, the success of companies will depend more and more on their ability to create value without depleting resources of any kind, whether natural, social, human or financial. Stakeholders will increasingly look for information on how companies connect their business strategy with their financial and non-financial performance". Therefore, in order to disclose the complete picture of a company it is essential that the corporate reporting presents a broader perspective than the traditional financial information focusing on different forms of non-financial reporting (Fijałkowska et al. 2019). One of them is integrated reporting that fosters "'integrated thinking', including a greater appreciation within the company of the financial implications of the social and environmental issues and impacts that normally fall outside the scope of core business considerations" (GRI-CLG, 2016, p. 8). However, many studies underline that the disclosure presented in the IR does not give insight into how the issues concerning social and environmental engagement of companies impact their ability to generate returns in the short-, medium- and long-term (PwC, 2014; Atkins, and Maroun, 2015) therefore they do not refer to the information on strategy.

The aim of this paper is to present the way the company may disclose the information on the strategy in the IR and explain the value creation. In this way the aim is also to determine the extent to which companies have actually embraced an integrated perspective of corporate reporting. The study is an exploratory one. It considers the extent to which companies are dealing with strategy-related issue of value creation in their integrated reports. The article uses the method based on a textual analysis of an Integrated Report of a Polish company having the longest experience in the publication of IR focusing on the strategy disclosure.

This study responds to the request for more research at the level of a company to further understanding of reporting initiatives (Kolk, 2010). Studies of the determinants of qualitative disclosures, such as strategy disclosure, are comparatively few (Morris, and Tronnes, 2017) and with our analysis we add to the fledgling literature on this issues, and in particular to the strategy disclosure research.

2. Theoretical recommendations on strategy disclosure in the Integrated Reports

2.1. The importance of the strategy

'Strategy' can be defined as the management of a group of long-term unique activities and resources in order to enhance a company's value and maintain its position (Porter, 1996).

Sukhari and deVilliers (2018) underline that "a company's strategy relates to its future value creation plans and the business model (BM) can be described as an integral part of the strategy that provides additional information regarding the implementation of the strategy. As such, investors are interested in strategy and BM disclosures". Strategy is an important topic that should be disclosed by companies in their communication with stakeholders. Regulators and standard-setting bodies consider strategy disclosure as highly relevant information (Gu, and Li, 2007). The empirical research underlines that higher strategy disclosure levels are, on average, associated with lower cost of equity capital, lower bid–ask spreads and higher trading volumes (Sieber, et al., 2014). Disclosure of corporate strategy could allow a company to differentiate itself from other companies and provides strong incentives for the company's partners to undertake long-term strategy-specific investments (Ferreira, and Rezende, 2007). Dhaliwal et al. (2011) underlined that the increase in the level of strategy disclosure enhances the companies' market value. Therefore, the information on the strategy disclosed by the company may have a social value. A comprehensive disclosure of strategy information essentially encompasses prognostic information on businesses, strategic objectives, the resulting business strategies, and implementation priorities (Thompson, and Strickland, 2003). Strategy disclosure therefore constitutes a key element in linking historical information presented in the financial statements to prospective cash flow forecasting (e.g., Barron, et al., 1999). In the future there has to be an interconnectivity among organizational strategy, society and environmental thinking in order for organizations and society to prosper (Porter, and Kramer, 2011).

Santem et al. (2005) define 'strategy disclosures' as the release of information on the strategy a corporation is pursuing or planning to pursue in the future that it has decided to share with its stakeholders. The key elements of strategy disclosure are the mission, goals and objectives, and the assessment of the way corporate disclosure of the current results and future prospects is implemented (Botosan, 1997; Meek, et al.,1995; Santema, et al., 2005). Morris and Tronnes (2017) underline that "a firm's success is influenced by its strategy. Understanding a firm's strategy is important for users of financial reports, because strategy choices provide the context in which to understand and judge the financial performance and position of the company".

2.2. Strategy disclosure in the corporate reporting

Currently, many companies are required to conduct business realizing not only economic but also social and ecological objectives. The scope of responsibility for a business's actions is significantly expanded (Fijałkowska and Macuda, 2017). The most recent advance in the sustainable business practice and reporting movement is integrated reporting (Zijl, et al., 2017) defined as "a concise communication about how a company's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value over the short, medium and long term" (IIRC, 2013b). Moreover, IR should support integrated thinking, decision-making and actions that focus on the creation of value over the short, medium and long term. The reporting entity should illustrate how management uses financial, manufactured, human, intellectual, natural and social/relationship capitals in the value creation process (IIRC, 2013a) and this should be linked clearly to the entity's strategy, business model and key risks (Stubbs, and Higgins, 2014; Raemaekers, et al., 2016).

Some previous studies that refer to the strategy disclosure in IR examine the extent of the disclosure of strategy, strategic goals, strategic objectives, implementation plans, and effects on capitals and stakeholders (Marx, and Mohammadali-Haji, 2014; Padia, and Yasseen, 2011; Stent, and Dowler, 2015), and indicate that the strategy disclosure in IR is not satisfactory. De Villiers et al. (2014) state that only a minimal detail was provided on the business models of researched companies, on how they were integrated with strategy and how resources would be allocated to achieve the stated goals. None of these studies were carried out in Poland.

Druckman (2014) suggests 3 steps towards more forward looking corporate reporting, all of them referring to strategy. These steps are presented in the Table 1.

Table 1.
Three steps towards more forward looking corporate reporting

Steps	Description
Step one	Conduct a stakeholder mapping. This allows you to understand your principal stakeholders, who they are, their expectations of your organization today and in the future (Needs reflected in your strategy and business model? Risks or opportunities highlighted to be managed or exploited? To what extend does your strategy or business model need to be amended to reflect these expectations?
Step two	Now is the time to consider the resources required to implement potential changes to your strategy and business model. Are the different parts of your organization talking to each other to achieve the delivery of a coherent strategy across the organization? What more can you do as directors to break down silos to enable a better articulation and execution of your strategy?
Step three	Communicate your strategy clearly and concisely. How is it responding to changes in your operating environment or stakeholder needs and expectations, to enhance stability and build a clearer understanding about how your business model is creating value through the use of multiple resources and relationships – such as your people, their ideas, natural resources, the communities in which you operate?

Based on: "The stepping stones towards more forward looking corporate reporting" by P. Druckman. 2014 Published by IIRC on http://integratedreporting.org/news/the-stepping-stones-towards-more-forward-looking-corporate-reporting-2.

According to Krzus and Advisor (2017) mapping the International Integrated Reporting Framework to the "10 elements of a long-term strategy" created by FCLT Global (2015), indicates that companies should:

1. Express a clear statement of purpose, mission, and vision.
2. Explain how the company's business model creates long-term value by identifying key value drivers at the reporting unit level.
3. State management's view of the market, major trends impacting the market, potential for growth, the company's relative positioning, and underlying assumptions (e.g., macroeconomic factors).
4. Highlight sources of competitive advantage such as talent, access to resources, or other assets that enable the company to execute its strategy and win in the marketplace, clearly substantiated by fact.
5. Disclose strategic goals ultimately tied to drivers of value creation (e.g., returns on invested capital, organic revenue growth) in the context of current and future market trends, and the company's competitive advantage.
6. Layout a detailed execution roadmap that defines short-, medium-, and long-term actions linked to key milestones and strategic goals targeted at long-term value creation.

7. Provide medium- and long-term metrics and targets that indicate the company's ability to deliver on its strategy, such as customer satisfaction over time, brand strength, and product pipeline investment and returns. Explain how the selected metrics will be measured and tracked consistently.
8. Explain how capital and non-capital investments, including the mix of resource allocation, will yield sustained competitive advantage and the creation of long-term value.
9. Provide an overview of risks and their mitigation plans, including sustainability (environmental, social, and governance) issues.
10. Articulate how executive and director compensation tie to long-term value creation and strategic goals.

The implementation of these 10 above-mentioned elements of a long-term strategy should be examined in practice.

3. Strategy disclosure in the Integrated Reports – empirical research

3.1. Objective and method

The research embraced IR prepared by the LOTOS Group (LOTOS) for 2017 and published in 2018. LOTOS is the first company in Poland to publish IR and continue this practice every year from 2010. Therefore, the experience in developing IR is significant.

This IR reflects the guidelines recommended by IIRC, GRI (GRI G4 and 'GRI 4 Sector Disclosures Oil & Gas') and the latest EU legislation regarding the disclosure of non-financial and diversity information.

3.2. Results and conclusions

The case study was aimed to examine if the IR was prepared in accordance with the 10 elements of a long-term strategy, created by FCLT Global (2015), mentioned in Paragraph 2 of this article. The study results are contained in Table 2.

Table 2.
The 10 elements of a long-term strategy by FCLT in the Integrated Report of LOTOS

Elements of a long-term strategy	LOTOS
1. Purpose, mission and vision	Continue generating profits for shareholders, providing high quality products and services, and ensuring energy security for Poland. Satisfying consumer requirements and maintaining competitive edge, remaining focused on innovation projects. Become the leader of the Polish next-generation fuel market. LOTOS Foundation' s mission is 'the comprehensive social activity, which makes a positive contribution to the development of the social and natural environment'.
2. Business model	Guided by the principle of sustainable development in all business areas, which translates into building value for shareholders, environment and diverse stakeholder groups. Business based on the Value Creation Model in three business segments (extraction, refining, trading) by improving and optimizing efficiency, innovativeness, security and responsibility to realize the 2017-2022 strategy – to guarantee stable and safe development.
3. Market trends	In 2017: The growth of the global economy and demographic changes in the world - positive influence on the global fuel sector (increase in the demand for crude oil) and optimistic forecasts; The price increase of Brent Dated crude oil, raw material, natural gas; Decrease in operating costs; Regulations regarding hydrocarbon production and other environmental regulations, "grey economy" and "fuel package" in Poland and other listed general macroeconomic factors and development of geopolitical situation that will affect in the future.
4. Competitive advantages	Diversification of sources of materials (balanced and diversified portfolio of assets), realization of innovative projects and including research on new generation biofuels, hydrogen technology and electromobility by technological modernization of the refinery and using the experience, knowledge and potential of LOTOS Petrobaltic; specialization and expansion into the areas of international concessions; Strategic placement of the refinery (access to raw materials and product sales channels compared to the competition in the region); A leading position on the domestic market of roads; Employees and all other stakeholders as the essence of business (constant source of inspiration and innovative ideas and whose safety, health and satisfaction are key priorities).
5. Strategic goals	1. effective use of assets, 2. successive and repeatable reduction of operating costs and optimization of margin, 3. readiness to develop and implement innovations, 4. flexibility in responding to emerging risks, 5. care and development of talents, improving broadly understood security (work, infrastructure and information systems) and greater social responsibility.
6. Execution roadmap	Two time horizons: 2017-2018 – 'stabilizing cash flows, reducing debt, and continuing launched investment projects'. 2019-2022 – 'the implementation of a new investment program'.

Cont. table 2.

7. Metrics and targets	Strategic: 1. LIFO EBITDA doubled to PLN 4 billion to 2019-2022, 2. debt ratio: net debt / LIFO EBITDA reduction - not higher than 1.5x, 3. investment projects for the total amount of PLN 9.4 billion within 6 years, 4. possession of the 2P crude oil and gas reserve base - not less than 60 million boe, 5. hydrocarbon production at the level of 30-50 thousand boe per day, 6. expanding the sales network to 550 petrol stations, 7. keeping the LTIF (Lost Time Injury Frequency) below 3. CSR: • 'minimizing the negative effects of operations and limiting the associated risks • maximizing the opportunities for sustainable development of the company in the long-term perspective, • compliance with legal and ethical standards of conduct, • increasing the positive contribution to social development'.
8. Investments	Capital and non-capital investments in three business segments, innovations, and capitals (human, intellectual, social and natural).
9. Risks	Awareness of the impact of activities on people, natural environment and the economy and managing it; investing in the sustainable development of LOTOS and the environment, caring for the growth of the company's value, which will translate into benefits for the stakeholders. Risks divided into: strategic, operational, financial, reputation and compliance with regulations. The Enterprise Risk Management (ERM; in accordance with the ISO 31000 standard) implemented and supported by an internal IT tool.
10. Compensations	Remuneration of: members of the Management and Supervisory Boards. other members of key management staff.

Based on "Integrated Annual Report of the LOTOS Group for 2017" by the LOTOS Group.

The IR of LOTOS review leads to detailed conclusions:

1. Purpose, mission and vision are placed in The letter from the President of the Management Board.
2. Business model is not presented in a manner recommended by IIRC. Inputs and outputs are not specified. The use of the capitals is not disclosed. The value creation model is described in a laconic way. Explanation of how the company's business model creates value is general.
3. Market, trends and potential growth are disclosed. Relative positioning with respect to 2016 or longer period is done.
4. Resources and capitals to execute strategy are presented clearly and comprehensively.
5. Strategic goals tied to drivers of value creation are listed, detailed implementation in the context of the market and competitiveness is disclosed.
6. Goals refer to two time periods of the strategy.
7. Financial and non-financial targets with their metrics are defined and explained.
8. Capital and non-capital investments in the context of value creation are explained widely and deeply.
9. Overview of risks and their mitigation was described.

10. A statement of remuneration of the members of the Management and Supervisory Board and management staff is without linkage with value creation of strategic goals.
11. Basically, the content of the IR is arranged in accordance with the 10 elements of a long-term strategy by FCLT.

Generally speaking, major objection to the content of IR of LOTOS can be formulated in the field of the business model, which is poorly focused on value creation and confused with disclosures about strategy. There is no clear identification of business model components (other than business segments, goals and operations) and their influence on the company value. It confirms conclusions of Bek-Gaik (2016) regarding the disclosure of a business model in organization reporting.

4. Summary

Ex-ante information on a company's intended strategy is largely non-financial and describes management's projected course of action (Sieber et al., 2014). Moreover, such information is often not verifiable therefore its credibility may be questioned. Nevertheless, this information is requested by investors. The appropriate presentation of the strategy is among the main challenges concerning the future development of companies' reporting. ACCA (2018) states that strategic focus and future orientation – linking strategy to the way organisations use and manage their resources (called 'capitals' in the IR Framework); and linking strategy to how they create value over time – is the improvement requested to be introduced to IR to make them really useful for stakeholders. The LOTOS Group may be treated as an example of the good practices in this case.

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