

# FY2019 Integrated Report Evaluation with Investors' Perspective

Short Review  
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## 1. Current situation of the Integrated Report in Japan

The International Integrated Reporting Council (IIRC) describes the purpose of the Integrated Reports as "the communication about value creation." That is to say, it aims that the companies communicate to investors (i.e., providers of financial capital) what they are dealing with and seeking for in terms of value creation and provide the information that could motivate investors to analyze the company and promote dialogues between the company and investors<sup>1</sup>.

More than 500 listed companies prepare the Integrated Report in Japan. The scale has reached one of the largest in the world and still on the rise. Among those many Integrated Reports issued, however, some rough ones look like a mere combination of an annual report and a CSR report appear. Although it has the format of an Integrated Report, there are quite a few cases that it contains a considerable amount of information that does not necessarily contribute to investors for their analysis or evaluation of the company.

It results in a varied range of inclusion of the necessary contents in each Integrated Report for investors. Under such circumstances, not many securities analysts study promptly and proactively all the Integrated Reports issued by the companies in their coverage, although they are due to analyze those companies. Some securities analysts may not even recognize that the Integrated Reports contain the information that could help promote the understandings and support analysis of these companies.

## 2. Purpose to prepare an Integrated Report

The IIRC indicates that there have been significant changes in the way business is conducted, how a company creates value and the environment in which business operates since a variety of current reporting models designed. Although these are interrelated, the contents of the reports are disconnected as each one has evolved separately. Especially, vital connections of

<sup>1</sup> *The International <IR> Framework*

<https://integratedreporting.org/wp-content/uploads/2015/03/13-12-08-THE-INTERNATIONAL-IR-FRAMEWORK-2-1.pdf>

strategy, governance, operations, and financial and non-financial performance are not made clear<sup>2</sup>. It is the reason behind the IIRC requires to prepare the Integrated Reports. The IIRC also points out that critical gaps remain between the necessary information to analyze the company (or organization) and the disclosed information, while various reports of the companies are getting longer.

As such, the IIRC requires reporting the factors that materially affect the company's ability to create value over the short, medium, and long term through the integrated thinking approach, regardless of whether they are financial or non-financial factors. The "Integrated Thinking" is defined as follows: The active consideration by a company of the relationships between its various operating and functional units and the capitals that the company uses or affects. The IIRC also believes that the more the integrated thinking prevails in a company's activities, the more naturally the connection of information flow into management reporting, analysis, and decision-making.

The IIRC expects that the preparation of the Integrated Report base on such integrated thinking and improvements in the quality of information available to investors enable a more efficient and productive allocation of capital.

### 3. IIRC's Integrated Report Framework

The IIRC requires the companies to explain to investors "concisely" the elements such as management strategy, various capitals, stakeholders, and external environment in an interrelated way, i.e., based on the integrated thinking and how the company creates business value over time. The IIRC lists the six types of capitals, i.e., financial, manufactured, intellectual, human, social and relationship, and natural capital as fundamental factors for the value creation process as well as other various elements required for the Integrated Report as part of the framework (see Figure 1.)

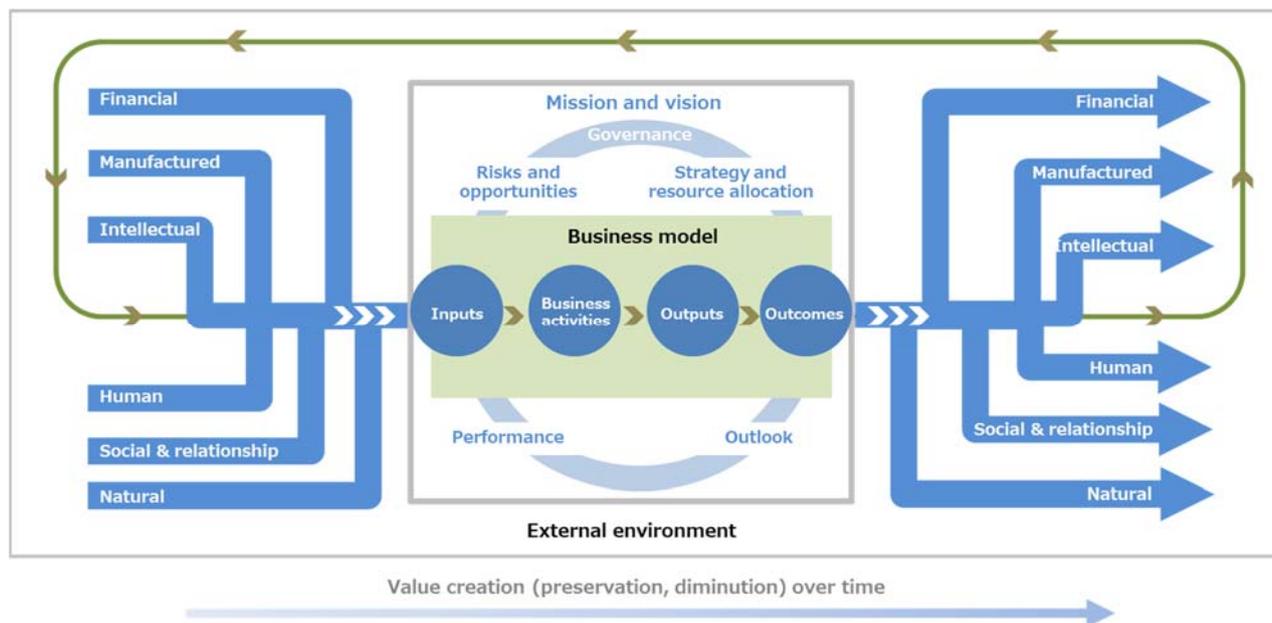
At the same time, the IIRC leaves the contents and the style of disclosure up to the company's discretion and does not require exhaustive provision of each element.

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<sup>2</sup> *Towards Integrated Reporting – Communicating Value in the 21st Century*

[https://integratedreporting.org/wp-content/uploads/2011/09/IR-Discussion-Paper-2011\\_spreads.pdf](https://integratedreporting.org/wp-content/uploads/2011/09/IR-Discussion-Paper-2011_spreads.pdf)

Figure 1 Value Creation Process presented by IIRC



Source: Created by Nikko Research Center from the document of IIRC

Japanese companies often prepare their Integrated Report based on or referring to the framework of IIRC and "Guidance for Integrated Corporate Disclosure and Company-Investor Dialogues for Collaborative Value Creation"<sup>3</sup> formulated by the Ministry of Economy, Trade and Industry (METI.) However, there is no standardized format, and it is up to the company to select the contents of the Integrated Report and how to describe them. Besides, advisors' or consultants' views vary when they support companies for their preparations of the Integrated Report. It leads to the cases where the report does not necessarily focus on the communication about value creation with investors. Therefore, when a company prepared an Integrated Report with substantial effort, but the contents of it did not get on the table during the dialogue with investors or securities analysts, the company should re-examine the report whether its direction is in line with the needs of investors.

#### 4. NRC's Evaluation of the Integrated Report with investors' perspectives

The IIRC expects a "more efficient and productive allocation of capital" through an Integrated Report. It is investors who play a crucial role in it. Many Integrated Reports, however, do not satisfy investor needs, materializing discrepancy between them. Nikko Research Center (NRC), in an aim to fill the gap between contents and investor expectations, has been examining the

<sup>3</sup> *Guidance for Integrated Corporate Disclosure and Company-Investor Dialogues for Collaborative Value Creation*  
[https://www.meti.go.jp/english/press/2017/pdf/0529\\_004b.pdf](https://www.meti.go.jp/english/press/2017/pdf/0529_004b.pdf)

Integrated Reports prepared by companies to find out whether the materials could have been a communication tool with investors for value creation.

Again, the Integrated Report does not require full-scale information for numerous stakeholders. Thus, the companies should select the contents valuable for investors after thoroughly examined what they wish to appeal. They should also focus on the factors necessary for investors from the view of a "concise" Integrated Report and make each of them fruitful and noteworthy.

NRC has deliberated what is essential for an Integrated Report to satisfy investors' needs and derived the following six elements for evaluation, assuming the framework of IIRC as well as incorporating the view of NRC. The elements are: (i) Key message from the management, (ii) Business model, (iii) Mid-to-long term business strategy, (iv) Business risks, (v) Corporate governance, and (vi) ESG materiality (see Figure 2.)

Figure 2 Elements in Evaluating the Integrated Report by NRC



Source: Created by Nikko Research Center

## 5. FY2019 Evaluation Results

NRC has been evaluating the Integrated Reports and providing feedback on the results to the companies since mid-2018. In FY2019, 24 companies were evaluated in total, resulting in cumulative 35 companies since FY2018. NRC has set up four criteria from A to D to evaluate whether the contents of the report satisfy the needs of investors, with A as most satisfying (Only "Volume of the report" is judged by A or D.)

Figure 3 shows the evaluation results in FY2019. For "Key message from the management," 37% were rated A of the Integrated Reports evaluated in FY2019. In the backdrop of

commendable evaluation, the top management's intention to convey the message to investors through an Integrated Report lies.

For the "Business model," more than 30% were rated A or B while 66% were rated C. The business model could have known to existing investors who are familiar with the companies in their coverage. However, it should contribute to deepen understanding for investors newly interested in or relatively have had a little time of interview or dialogue with the company.

For the "Business strategy," 83% were rated C. The contents were often limited to the outline of mid-term business plan and the qualitative description on the direction that the company is heading for over the medium-term, resulting in the cases where investors' understanding on the purpose and background of the business strategy were hardly deepened only through the Integrated Report.

For the "Business risks," C or D accounted for 75%. While investors require enhancement in risk information disclosure, the Integrated Reports often display only the common risks in line with annual securities reports in many cases. Therefore, the discrepancies with the disclosure required by the investors remains.

For the "Corporate governance," 83% were rated C and 12% were rated D. Most of the Integrated Reports mainly described the form of the board of directors and the outline of the executive compensation system. More than a few reports described atmosphere of the boardroom or its evolution through the message or interview of outside directors. While NRC does not evaluate the inclusion of these contents, they give a glimpse into the air of the boardroom, which is not usually shown outside.

For the "ESG materiality," C and D in total accounted for more than 90%. While descriptions considering the ESG keep increasing, many Integrated Reports often show them in the latter part with a CSR-like viewpoint.

Figure 3 FY2019 Evaluation Results of the Integrated Reports by NRC

Evaluation items	A	B	C	D	Number of reports
Key message from the management	37.5%	20.8%	41.7%	0.0%	24
Business model	4.2%	29.2%	66.7%	0.0%	24
Mid-to-long term business strategy	4.2%	12.5%	83.3%	0.0%	24
Business risks	0.0%	25.0%	12.5%	62.5%	24
Corporate governance	4.2%	0.0%	83.3%	12.5%	24
ESG materiality	0.0%	8.3%	45.8%	45.8%	24
Volume of the report	25.0%	–	–	75.0%	24

Source: Created by Nikko Research Center

Figure 4 Cumulative Evaluation Results of the Integrated Reports by NRC

Evaluation items	A	B	C	D	Number of reports
Key message from the management	28.6%	22.9%	48.6%	0.0%	35
Business model	11.4%	28.6%	60.0%	0.0%	35
Mid-to-long term business strategy	5.7%	31.4%	62.9%	0.0%	35
Business risks	0.0%	25.7%	17.1%	57.1%	35
Corporate governance	2.9%	5.7%	71.4%	20.0%	35
ESG materiality	0.0%	8.0%	44.0%	48.0%	25
Volume of the report	25.7%	–	–	74.3%	35

Note: As "ESG materiality" is an additional item from the 11<sup>th</sup> company, the number of reports evaluated is smaller than other items.

Source: Created by Nikko Research Center

### 5.1 "A" ratings for "Key message from the management"

NRC rated nine companies A in FY2019 in terms of the "Key message from the management." Figure 5 shows them in the order of securities code, not indicating the relative merits of its contents. The feature of the A rating for this element is the composite descriptions of (i) Present business environment and future business opportunities, (ii) Vision on capital efficiency and measures to enhance it, (iii) Concrete policy on capital allocation for growth strategies and returns to shareholders, (iv) Initiatives to narrow the discrepancy between Mid-term business plan and actual performance, (v) Management philosophy based on their career, and (vi) Intention of human resource development, from the top management's standpoint. Note that NRC does not merely consider the exterior factors such as "the report contains the top

management message in the form of an interview" or "it is written in the spoken version" in evaluating the "Key message from the management." Instead, we focus on how the top management delivers a message-oriented report.

Figure 5 "A" ratings for "Key message from the management"

Code	Company Name	Company Report
4555	Sawai Pharmaceutical Co., Ltd.	Integrated Report 2019
4902	KONICA MINOLTA, INC.	Integrated Report 2019
5715	FURUKAWA CO., Ltd.	Annual Report 2019
6473	JTEKT CORPORATION	JTEKT REPORT 2019
6856	HORIBA, Ltd.	HORIBA Report 2018
7532	Pan Pacific International Holdings Corporation	Integrated Report 2019
7915	Nissha Co., Ltd.	Nissha Report 2019
8218	KOMERI Co., Ltd.	Integrated Report 2019 (Japanese version only)
9143	SG HOLDINGS CO., LTD.	Annual Report 2019

Note: Companies are listed by securities code.

Source: Created by Nikko Research Center

## 5.2 "A" rating for "Business model"

The "Integrated Report 2019" published by Pan Pacific International Holdings Corporation (7532) was only rated A in terms of "Business model" in FY2019. The points highly marked by NRC in the report include detailed descriptions on (i) how the management philosophy is familiarized with the employees, (ii) what kind of measures they take for the creation of "consumption-of-time typed store," one of the differentiating factors with other companies, and (iii) specific approach and achievement of the delegation of authority to store staff was coherent.

Figure 6 "A" rating for "Business model"

Code	Company Name	Company Report
7532	Pan Pacific International Holdings Corporation	Integrated Report 2019

Source: Created by Nikko Research Center

### 5.3 "A" rating for "Business strategy"

The "Integrated Report 2019" published by KONICA MINOLTA, INC. (4902, Konica Minolta) was only rated A in terms of "Business strategy" in FY2019. The report informs of what the company sees as business opportunities, especially for new businesses. Potential demands and or mid-to-long term targeted revenue and the number of customers were explained. The break-even number of customers was also referred to, depending on the business the company plans. NRC evaluated favorably such points.

Figure 7 "A" rating for "Business strategy"

Code	Company Name	Company Report
4902	KONICA MINOLTA, INC.	Integrated Report 2019

Source: Created by Nikko Research Center

### 5.4 "A" rating for "Corporate governance"

Only the "Integrated Report 2019" of Konica Minolta was again rated A in terms of "Corporate governance" in FY2019. We favorably evaluated the report for the following reasons: (i) The policy for executive compensation, and the reason why stock remuneration had not been applied to outside directors were described in a comprehensible way, (ii) The concept of the necessary skills and experience to be a member of the board of directors as well as the skills and the background required for the newly appointed outside directors were described in details, and (iii) How the CEO and the outside directors engaged in the decision making during the discussion on strategic investment at the Board of Directors' meeting.

Figure 8 "A" rating for "Corporate governance"

Code	Company Name	Company Report
4902	KONICA MINOLTA, INC.	Integrated Report 2019

Source: Created by Nikko Research Center

### 5.5 No company was rated A for "Business risks" and "ESG materiality"

In FY2019, two and six companies were rated B, respectively for "Business risks" and "ESG materiality." No company was rated A for these elements.

## 5.6 FY2019 Best Practice

NRC believes that the "Integrated Report 2019" of Konica Minolta was the best practice to suit the investors' needs among the reports we evaluated in FY2019. The report was assessed highly as a whole with three As and three Bs for six elements except for "Volume of the report" in the evaluation by NRC. Furthermore, it is in an orthodox manner, reflecting the points of attention by investors while showing the direction of its strategy and background of various initiatives. As such, NRC selected the report as one of the models of the Integrated Reports.

NRC has recently established the "Integrated Report Award" intending to raise recognition of the distinguished Integrated Report. NRC gave the Best Practice Award to the "Integrated Report 2019" of Konica Minolta in FY2019 for the reasons mentioned above.

Figure 9 FY2019 Best Practice Award



Source: Created by Nikko Research Center

## 6. Conclusions

NRC selected the "Integrated Report 2019" of Konica Minolta as the best practice out of the 24 companies evaluated for FY2019. It has the orthodox style, reflecting the points of attention by investors while describing the direction of its strategy and background of various initiatives. Thus, the report is considered one of the models of the Integrated Report. If the Integrated Reports in such manner increase, more investors would read carefully to use them as a tool of analysis and communication with the company. Accordingly, it will create a circulation in which the companies improve their Integrated Report to be more fulfilling the investors' needs. As a course, it is expected that the "more efficient and productive allocation of capital" through the Integrated Reports, which the IIRC envisages, would be further developed.

NRC believes that proactive commitment of the top management is the crucial element to make the Integrated Report a communication tool with investors about value creation. It is because the Integrated Report which lacks engagements of the top management does not provide information to find out whether the management is credible enough for investors to entrust the conduct of business. As such, many investors expect direct messages from the top

management for the Integrated Reports. NRC found the cases where the top management proactively engaged while in other cases, the company tries the best in a situation where the top management's recognition lacked when we provided the feedback regarding the evaluation results of the Integrated Report.

The more the Integrated Reports in which the top management explains their initiatives toward the value creation of the company proactively and profoundly to communicate with the investors, the more the investors pay attention to Japanese companies and the Japanese equity market. NRC expects to contribute to such movements through the evaluations of the Integrated Reports.

(END)