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DIFFUSION OF INTEGRATED REPORTING IN AN EMERGING ECONOMY

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Abstract

Purpose – This paper investigates how integrated reporting (IR) as a managerial technology diffuses in an emerging economy taking Sri Lanka as the case. In this respect, the study specifically addresses the characteristics of early adopting Sri Lankan companies and the institutional forces that have influenced the rate of adoption of IR in these companies.

Design/methodology/approach – The study was based on two phases of analysis. In the first phase, the adopter groups of sustainability reporting (SR) and IR of the country's stock exchange were identified based on the latest annual reports published. In the second phase, the key personnel involved in the process of IR of early adopting companies were interviewed to identify the adopters' characteristics and drivers of adoption. Thereafter, a content analysis of these semi-structured interviews was carried out based on diffusion theory of innovations.

Findings –The study finds that the early adopting companies of IR in Sri Lanka have been engaged in SR in the past. These companies are characterized by their integrated business model, progressive work culture, and the supportive role extended by the top management on adoption of managerial innovations. The rate of diffusion of IR in these companies is driven mainly by the normative pressures stemming through the accounting profession of the country. The study finds a transitional approach to IR in these companies evolving through the incremental changes to systems and processes that are already established in them in relation to SR.

Research limitations/implications – The main limitations of the study are the small sample of organizations considered and the single country focus. Further, the study has focused only the personnel directly involved in the IR process in the

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organizations. The views of the supporting groups within these companies have not been taken into consideration.

Practical implications – This study contributes to shed light into the characteristics of early adopters of IR and the factors influencing the diffusion of IR in an emerging company.

Social implications – As IR is linked with the value creation process of corporate entities, the findings of the study will have wider social ramifications in terms of creating a dialogue on the need for IR in the context of an emerging economy.

Originality/value –As an emerging phenomenon, there is a dearth of studies as to the diffusion of IR in corporate entities in the context of emerging economies. Hence, this study provides some useful insights into IR in an emerging economy- Sri Lanka.

Keywords: Diffusion theory, Early adopters, Emerging economy, Integrated reporting, Managerial technology, Sustainability reporting

1. Introduction

Integrated Reporting (IR) has emerged as a new area of policy and practice in corporate reporting reflecting 'integrated thinking' within an organization. It also reflects how an organization creates and sustains value. Hence, IR can be considered as a contemporary managerial technology[2] that drives organizational change towards more sustainable outcomes (Eccles and Krzus, 2010). Though the relevance of this form of reporting has increased globally (Elkington and Renaut, 2010; Hespenheide, 2010), the ultimate focus is on the companies that adopt and implement IR as a new managerial technology. While there are few studies on IR as an emerging phenomenon (de Villars *et al.*, 2014), there are even fewer studies that have focused mainly on the outcomes and benefits of IR (Stubbs and Higgins, 2014). Jensen and Berg (2012) report that these few current studies on IR are mostly limited to theoretical investigations and stand-alone case studies. Hence, there is need for studies that focus on why and how the early adopters of IR are implementing this new reporting approach (Stubbs and Higgins, 2014).

In this context, this paper addresses the knowledge gap that exists as to the factors that had motivated early adopting companies to engage in IR in an emerging market's point of view. Hence, this study examines how IR as a managerial technology diffuses in corporate entities in an emerging economy using Sri Lanka as the case. Sri Lanka has been selected as the emerging economy considering a number of factors. These factors include the significance of the accounting profession in the country in general (Senaratne and Cooray, 2012), the support that the accounting profession has extended towards the adoption of IR in specific (Senaratne, 2013), and the interest that Sri Lankan listed companies have exhibited in this respect (Colombo Stock Exchange, 2014).

This study while contributing to address the knowledge gap that existed in Sri Lanka as to characteristics of adopters of IR in Sri Lanka and the institutional factors acted as the driving forces for the adoption of IR, it would provide important insights in

[2] Managerial technologies are those tools, devices and knowledge that mediate between inputs and outputs. Since IR combines the inputs, outputs and outcomes of the business models of an organisation in terms of various forms of capitals, it falls within the definition of a managerial technology.

these respects to the policy makers, the regulators and the accounting practioners of the country.

The next section of the paper presents the extant literature on IR and the diffusion theory that was used as the theoretical basis of the study. Section three describes the methods applied in the study. Section four provides the analysis and discussion of findings of the study. The last section presents the conclusions.

2. Literature Review

2.1. Towards integrated reporting

Corporate reporting has undergone a dramatic transformation over time with the broadening of the accountability of companies towards different stakeholder groups inclusive of the environment and the society at large. This has led corporate entities to report on area such as governance, risk management and sustainability in addition to their financial performance (Gray *et al.*, 2001; Owen, 2006; KPMG, 2008; Eccles and Serafeim, 2011). As a result, new forms of reporting such as social and environmental reporting, triple bottom line reporting, and sustainability reporting were developed under the broad heading of social responsibility reporting. Despite these efforts, concerns have been raised as to whether a clear link of strategy, governance, performance and prospects of a company is reported to its stakeholders. This discussion intensified with the mega corporate scandals that took place in recent times in many countries. As a result, the need arose to develop a reporting model that could combine different strands of corporate reporting, namely; financial, governance, and sustainability, into a coherent whole to explain an organization's ability to create and sustain value (Eccles and Krzus, 2010; Mammatt, 2009).

This provided the impetus for the emergence of the concept of IR, which International Integrated Reporting Council (IIRC) (2011, page 3) describes as a form of reporting that "brings together material information about an organization's strategy, governance, performance and prospects in a way that reflects the commercial, social and environmental context within which it operates". The accounting profession considers that this movement towards IR potentially represents the most significant change to the corporate reporting seen in years (Deloitte, 2012) and the benefits of IR have been considered in the academic literature. Eccles and Krzus (2010) classify the benefits of IR under two classes - internal benefits and external market benefits where the former refer to better allocation of internal resources, greater engagement with stakeholders and lower reputational risk whilst the latter refer to the meeting the needs of investors who require environment, social and governance information, appearing on sustainability indices, and ensuring data vendors report accurate nonfinancial information of a company. Eccles and Armbrester (2011) extends these benefits to include a third class of benefit termed as managing regulatory risk covering the preparation for global regulations on IR and responding to local stock exchange requirements to report on IR.

The pioneering work towards IR was made by the Danish pharmaceutical company Novo Nordisk and the King III Report (King Code of Governance Principles for South Africa) produced in 2009 under the leadership of Professor Mervyn King, who championed the cause of IR in South Africa. Novozymes, a Danish enzyme company, spun off from Novo Nordisk in 2000, produced the first corporate integrated report in 2002 and Novo Nordisk began integrated reporting shortly thereafter (Eccles and Krzus, 2010). Since then, Novo Nordisk became a leader in the quest to measure and report social, environmental and financial performance within a single document (Villars, *et al.*, 2014). Following this, several Danish, US and Brazilian companies commenced issuing integrated reports during the period 2004-2008 (Eccles and Saltzman, 2011). On the other hand, King III urged the organizations to commit to the principles of integrated thinking, promoting the concept that strategy, governance and sustainability are intimately intertwined. These principles were subsequently integrated into the Johannesburg Stock Exchange, requiring the listed companies file an integrated report or explain why they were not doing so. However, IR rapidly gained prominence globally with the formation of IIRC in 2010[3] with the mission to create a globally accepted framework on IR with the intention of bringing together financial, environmental, social, and governance information of organizations into a clear, concise, consistent and comparable format (IIRC, 2013). The International <IR> Framework, the first complete globally accepted framework on IR, was

[3] The formation of IIRC took place in 2010 with the initiation of Prince's Accounting for Sustainability Project (A4s) and Global Reporting Initiative (GRI). It was initially named as International Integrated Reporting Committee and its name was changed as International Integrated Reporting Council in 2012.

published by IIRC in 2013. Hence, it is too early for most organizations to publish IIRC compliant integrated reports. However, over 100 organizations have become part of the IIRC pilot programme for reporters, which aim to provide an opportunity to discuss and challenge technical material, test its application, and share learning and experiences (IIRC, 2014).

The companies are at varying stages on their path towards integration of different facets of reporting in moving towards IR as revealed in the survey of ACCA and Net Balance Foundation (2011) in ASX 50 companies. Hence, several studies have addressed the potential of reporting practices employed by the early adopters of IR to foster transition to sustainable business practices. Stubbs and Higgins (2014), who investigated the internal mechanism employed by early adopters of IR in Australia, find that these organizations though have changed or claimed to have changed their processes and structures; these have not necessarily stimulated new innovations in disclosure mechanisms. Hence, this study suggests that currently IR represents rather a transition from sustainability reporting (SR) than an innovation driving transformation in organizations. Higgins *et al.* (2014), examined the business organizations in Australia that were first to adopt IR, drawing from institutional theory to explain how early adopters made sense of IR. They suggest that institutionalization of IR is unfolding and that isomorphism is likely to follow. However, this study also shares the view that this process is unlikely to deliver a fundamental change to organizational operations. Further, Brown and Dillard (2014) critically assess IR to broaden out the dialog how accounting and reporting standards assist or obstruct efforts to foster sustainable business practices. In this study, Brown and Dillard criticize the IIRC proposals stating that they offer few critical insights into the current ways of thinking, acting and reporting. Thus, drawing on natural science and technology research, they present the ways in which IR can be rearticulated. Hence, these studies in general have provided insights as to the thinking, policy and practice around IR posing many interesting issues to investigate further in future studies. Yet these few studies have mainly carries out in developed countries. Despite the global importance of IR, little is known about the adoption of IR in developing countries, especially emerging economies.

2.2. Diffusion of innovations

The outcomes of the previous studies indicate that IR can be viewed as a form of managerial technology because it combines knowledge, methodology and practice of corporate reporting. Abrahamson (1991) defines managerial technologies as those tools, devices and knowledge that mediate between inputs and outputs. As with any technology, IR also experiences an innovation diffusion cycle. According to Rogers (1983), diffusion is the process by which an innovation is communicated through certain channels over time among the members of a social system. Greenhalgh *et al.* (2004) distinguish among diffusion as passive spread and dissemination as an active and planned effort to persuade target groups to adopt an innovation. According to Volker (2011) and Greenhalgh *et al.* (2004) the major diffusion traditions described are anthropology, sociology, education, communication, marketing, and geography. Rogers (1983) while suggesting five adopter categories (innovators, early adopters, early majority, late majority and laggards) is of the view that innovators and early adopters are mostly venturesome.

Rikhardsson *et al.* (2005) suggest two broad reasons on why companies adopt certain (managerial) technologies and not others, as per various literature on innovation diffusion. These are *efficient choice* explanation and the *institutional* explanation. The efficient choice explanation suggests that adoption is done due to the improvements in corporate performance due to efficiency gains. As Stubbs and Higgins (2014) highlight, IR's focus on value creation may reinforce an organization's profit-maximization rationale. Institutional explanation on the other hand, provides sociological and psychological factors that determine the adoption or rejection of innovations (DiMaggio and Powell, 1983). According to Richardson *et al.* (2005) and Rogers and Schoemaker (1971) the innovation diffusion literature often focuses on three questions 1) what processes and contingencies affect the rates of diffusion, 2) what characterizes different adopter groups and 3) how these characteristics affect the sequence and speed by which innovations diffuse. In this exploratory study, the authors focus on the first two questions of the diffusion theory in the context of IR in Sri Lanka.

3. Research Method

The data collection of the study was carried out in two phases. In the first phase, the adopter groups of sustainability reporting and IR of the country's main stock exchange were identified based on the latest annual reports published by the companies (as at August 2014). After selecting all latest annual report, based on the industry sectors, it was identified whether they have prepared a sustainability report or an integrated report. In some cases, in order to identify whether these companies have prepared sustainability reports in the past, the prior annual reports were also analyzed. This was achieved by analyzing the 292 annual reports individually. If the annual report has not explicitly mentioned the term "integrated report", the terms such as "capitals" and/or value creation were sought for in determining whether the annual report is an integrated report or not. As suggested by Eccles and Serafeim (2011), since there is no universally accepted framework for IR, the authors had a problem of identifying what an IR is and hence resorted to the above treatment. Later on, the authors therefore doubled checked this analysis with an independent analysis done by an annual report preparing company for consistency.

In the second phase, the adopters of IR were interviewed to identify the adopters' characteristics, internal systems and processes of diffusion. The interview process was conducted from June to September, 2014. The authors first contacted these companies to identify the key personnel involved in preparing the integrated reports and they were contacted subsequently. With prior appointment they were interviewed face to face. All participants were in middle management positions such as "manager" or "head" as part of their job title, as once did by Stubbs and Higgins (2014), with the exception of two cases in which the respondents were the Vice President - Finance and Finance Director. In this ongoing study, so far, total of five companies were interviewed. As Crane (1999) suggests and Stubbs and Higgins (2014) carried out, the study therefore engaged directly with "insiders" involved in IR to examine the phenomenon in the context in which it occurs. At least two authors were present when these interviews were conducted. They represent three in Diversified, three in Banking, Finance & Insurance, one in Hotels and one in Motors sectors of the stock exchange. These interviews were semi-structured in nature and conducted based an interview checklist (refer Appendix 1). On average these interviews lasted for forty five minutes to one hour. In order to improve respondent triangulated at least two or three persons who are in charge of IR were interviewed in each company. All the interviews were electronically logged with the consent of the interviewees and transcribed later for analysis. As secondary sources of data annual reports, sustainability reports, online documents, etc were used. Moreover, one of the authors of the study served as a judge in the annual report committee of the country's main professional accounting body that selected the best integrated report. This too served as an important reference point in this study. In addition, the key personnel in some annual report preparing companies were also interviewed.

Thereafter, using the diffusion theory of innovations the data collected were analyzed thematically.

4. Analysis and Discussion

This section first provides the sectorial analysis of the adopters of IR based on the first phase of analysis. Then it presents the characteristics and systems of the early adopters of IR, and the factors affecting the rate diffusion of IR based on the second phase of analysis.

4.1. Sectorial analysis

The first phase of the analysis revealed that out of 292 companies listed on the stock market by August 2014, it is only 32 companies (11% of the total) that prepare integrated reports while 101 companies (35%) prepare sustainability reports (refer Table 1). The past individual company report analysis revealed that the companies that have gone for IR, have been preparing the sustainability reports in the past. The analysis reveals that companies in only 11 out of 20 sectors have moved towards IR and 6 sectors currently practice SR are yet to move towards IR. The study identifies that many early adopters of IR (Rogers, 1983) are from the diversified, banking, finance and insurance, and plantation sectors. Telecommunication, health and construction sector companies have the highest rate of adoption of IR, but due to the low number of listed companies in these sectors, the percentage analysis does not allow meaningful comparisons. No company in the Information Technology, Store Supplies and Services has prepared even a sustainability report.

Table 1: Adopters of SR and IR

Category	Total	IR		SR	
		No.	%	No.	%
Diversified Holding	19	4	21%	8	42%
Footwear	4	0	0%	2	50%
Hotels	39	3	8%	12	31%
Information Technology	2	0	0%	0	0%
Beverage & Food	21	0	0%	11	52%
Chemical	10	1	10%	3	30%
Construction	4	1	25%	3	75%
Health	6	2	33%	3	50%
Banking, Finance & Insurance	61	13	21%	27	44%
Trading	8	0	0%	2	25%
Telecommunication	2	1	50%	0	0%
Power & Energy	8	1	13%	3	38%
Plantations	19	4	21%	9	47%
Oil farms	5	0	0%	1	20%
Motors	6	1	17%	1	17%
Manufacturing	37	1	3%	11	30%
Land & Property	19	0	0%	3	16%
Investment Trusts	10	0	0%	2	20%
Store Supplies	4	0	0%	0	0%
Services	8	0	0%	0	0%
Total	**292**	**32**	**11%**	**101**	**35%**

Source: Author constructed

4.2. Characteristics of the adopters and systems are in place to promote

This section describes some of the salient features of the early adopters and some internal mechanism in place to adopt IR.

These early adopter groups of IR already had integrated business models when IR was popularized. They have seen the IR frameworks as a vehicle of reporting their business model. As Stubbs and Higgins (2014) put it, IR enables the organizations to better tell the company story about how the company creates value. This has been made possible mainly due to the availability of SR for a long period of time. The Head of Sustainability of a conglomerate mentioned the following statement to prove this point;

"We already had SR and that thinking in our organization, so it was simply a measure of reporting some other aspects"

The Finance Director of one of the early adopters of SR company has a similar view;

"We have already been preparing SR for couple of years, we found it easy to prepare IR"

Stubbs and Higgins (2014) being critical of this extending SR models to IR suggest that many organizations do not uncover second order, transformative change, but rather first order incremental changes to processes and structures that previously supported SR.

The adoption of IR has been made easier for those who have been preparing SR due to several reasons. The main reason is the availability of information capturing system for environmental and social aspects of the business. The Vice President- Finance of a large banking institution said;

"We already had templates to gather information for the SR. So we had a mechanism to capture information needed for IR to a greater extent".

The availability of SR means that these companies have been seeing the importance of sustainability into their core business model already. Therefore, the concepts in IR have not been alien to them. Also these companies, mostly, have dedicated staff to prepare the integrated reports. For example one large conglomerate has a separate Sustainability and Planning Unit while another diversified organization has a separate Sustainability and Business Development Unit. In support of this argument , Head of Sustainability of a diversified conglomerate said;

"We already have key personnel in each business unit who have collection and information provision for IR/SR in their JDs [job descriptions], so it is a part of their main responsibility"

Head of Sustainability and Business Development of another diversified organization has a similar view;

"We have established sustainability champions in each sector, who have been given the responsibility of heading the sustainability matters... they pioneer IR in their divisions"

Reflecting a similar situation, Adams and Frost (2008) highlighted the importance of sustainability steering committees in developing performance indicators and analyzing the data that goes into the report by studying four British and three Australian sustainability reporting leaders. Moreover, Adams (2002) and recently Stubbs and Higgins (2014) suggest that organizations have some form of sustainability committee when preparing SR or IR.

Another factor that has influenced the IR adoption is the high public visibility of these companies. These companies are from the country's stock exchange. Therefore, they have many stakeholder pressure especially the pressures from international investors and buyers. One manager in support of this said;

"we have quite a lot of foreign investors and they are very careful on our sustainability and governance aspects when making investment decisions."

It is also revealed that the progressive organizational culture coupled with the top management support been another internally driving force for the preparation of IR. There has been a top manager who is personally motivated or dedicated for sustainability aspects and hence they are keen on the developments in corporate reporting. In support of this, the Sustainability Head of a diversified organization said;

"The drive to adopt IR came from the top, ... and it is always needed to successfully adopt something new"

In respect, the role of organization culture, Finance Director of the motor company said;

"The progressing mind of the company and aspiration to thought leaders in corporate reporting together led to discover IR and follow IIRC guidelines on IR"

Similarly, Adams (2002) identified the chairperson influence as a contextual factor in determining the in SR in Germany.

While the analysis and the discussion of this section is based on characteristics of early adopters, the next section of the paper discusses the factors affecting the rate of diffusion of IR, mostly from a meso level.

4.3. Factors affecting the rate diffusion of IR

These factors are mainly identified in relation to institutional theory. Out of the three isomorphic forces discussed in institutional theory (DiMaggio and Powell, 1983), normative isomorphic pressures have been very important. In this regard, institutional developments in the corporate reporting environment and support of the professional accounting bodies and universities have been the key. The country's main professional accounting body and another foreign affiliated professional accounting body have taken considerable amount of initiatives in providing the guidance as to the adoption and implementation of IR. Seminars, workshops and even award ceremonies have been arranged in order to promote the adoption of IR. Even in the academic support is gaining momentum in this respect with some Sri Lankan universities incorporating SR and IR into the curricular of the accounting degree programmes. The Finance Director of a Motor company mentioned the following statement that affirms the contribution of professional institutions in promoting IR:

> *"The IR award is a motivating factor for us. It gives some sense of achievement for the staff who are working for IR. When we win an award there is motivation for the staff to follow it vigorously in the next time also."*

As mentioned above, Sri Lanka has shown a keen interest on promoting IR through various means. Therefore, this is contrary to what Jensen and Berg (2012) observed in Germany that due to the newness of the concept, still business schools have not yet adopted IR in the German curricula exerting very negligible pressure on the profession.

However, another manager had a different view regarding the institutional support and award competitions:

> *"we do not actually care about the awards. Our main focus is to get our business model right. The support of the Institute [professional accounting body] is encouraging, but we need more guidance"*

Some companies believe that in the future IR will be made mandatory and they are of the opinion that preparing IR now itself would help them mitigate the hassle/risk in the future as suggested by Krzus (2011). The eminent cohesive pressures through foreign partners and regulatory bodies have also been influencing the IR adoption in Sri Lanka. This reflects again a contrary situation to the idea of Jensen and Berg (2012) who are of the opinion that owing to the newness of IR, the impact of related rules, norms or laws is extraordinarily low. Yet in the Sri Lankan context the impact of coercive isomorphism on the adoption of IR is important.

It is also identified the influence of some mimetic pressures that compel the adoption among the Sri Lankan listed companies. The actions of the competitors have influenced them to mimic these practices. It was noticed that companies in different industries that have been competing for different awards (for example for the sustainability report) are simply adopting IR due to mimetic pressures. In support of this the Vice President- Finance of a large banking institution said;

> *"We want to be the leader in the banking sector always. Therefore we attempt to follow what the leaders in other industries do before any ban starts doing those"*

The influence of mimetic pressure in Sri Lanka is contrary to what Jensen and Berg (2012) observed in Germany and they are of the view that IR is too new and the number of organizations having adopted it is too low to cause such a bandwagon effect. This different observation in Sri Lanka can be sometimes attributable to the time gap between the two studies during which many companies have followed IR.

This analysis indicates that all three forms of isomorphic processes are in operation in driving the Sri Lankan listed companies towards IR. However, among these, normative pressures have been the most critical factor.

5. Conclusions

This study examined the characteristics of early adopting Sri Lankan companies of IR and the factors influenced the rate of diffusion of IR as a managerial technology. This study was carried out based on the companies that are listed on the stock exchange of Sri Lanka. It is revealed that that the early adopting companies have been practicing SR in the past and the companies in some industries have gained prominence over others in diffusing IR as a managerial technology. The study reveals that the rate of diffusion of IR has been high in the companies that already have given high priority to sustainability in their business agenda and these companies are characterized by integrated business models and systems, progressive organizational culture, and presence of supportive top management towards managerial innovations. However, the study also identifies that some early adopters follow IR for more of rhetoric purposes and they have not realized the meaning of IR than to view it as another reporting mechanism. The factors affecting the rate of diffusion in Sri Lankan companies can be interpreted through all three forms of isomorphic processes – coercive, mimetic, and normative of the Institutional Theory. However, among these, the normative pressures exerted by the accounting profession have played a dominant role in driving Sri Lankan companies towards IR.

As most of the Sri Lankan companies have progressed from SR to IR, it is visible more incremental changes to processes and structures that previously supported sustainability reporting (first-order change) in them. This confirms the view of Stubbs and Higgins (2014) that since IR is in its early adoption stage, it displays a 'transition' (Laughlin, 1991) from SR rather than a radical, new innovative initiative that is driving 'transformation'. Hence, this posses an interesting question for future research in IR in the Sri Lankan context –whether IR has changed the way organizations are doing the business. In this ongoing study, the limited number of cases poses the main challenge which calls for more respondent companies in the adopting as well as non-adopting categories. Further, the study is limited to the analysis of adoption of IR only in a single emerging market.

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Appendix 1 – Interview check list

What are the motivating factors/drivers for you to adopt IR?

Efficient choice explanation

- (Company specific – key personal, strategic link, experience of the previous reporting, efficiency gains, management attitude, public profile)

Institutional explanation

Externally triggered

- Institutional support
- Awarding mechanisms
- Training and development
- Eminent regulatory pressure
- Industry specific characteristics
- Influence of other business organizations/competitors
- Stakeholder demands (shareholder, customers, suppliers and any other)
- Professional organizations (accounting bodies, professional service providers)