KEY PERFORMANCE INDICATORS DISCLOSURES BY THE INTEGRATED REPORTING

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Abstract

We are in a new era of corporate reporting where the corporate reporting landscape was changed. Institutional and small investors, financial analysts and other key stakeholders are demanding more information about long-term strategies and profitability of companies. Also, the increasing complexity of business models, growing awareness of climate change and resource scarcity and communication are expectations of the role of business in the 21st century and which the key of performance indicators (KPIs) is.

The companies must change the way these KPIs are being incorporated throughout the annual report and how these are linked to the company's strategy and business model, their risks and risk mitigation, and their incentive schemes.

Regarding this, integrated reporting, continue to gain momentum, the spotlight on the depth, breadth and quality of KPIs being reported will only strengthen.

The aim of this discussion paper is to describe which are the most important key performance indicators in sprit of integrating reporting. A good and very known example for the integrated reporting is Philips Electronics, the Dutch healthcare and lighting company, a pioneer that embrace this concept, and the paper make an analysis of the most important key performance indicators.

Keywords: *corporate reporting, integrated reporting, key performance indicators*

JEL Codes: *M40*

1. Introduction

Integrated Reporting is the big new development in corporate reporting. It is the evolution of financial reporting and promotes long term thinking about value-creation and stewardship across a broad base of interdependent capitals- financial, manufactured, human, intellectual, natural, and social and relationship. According to Eccles, integrated reporting has evolved in the context of greater investor scrutiny about the value-creating processes of business organizations, and a new appreciation of the governance risks associated with sustainability. (Ecless, 2010).

The most important proponent of integrated reporting, the International Integrated Reporting Council (IIRC), regards integrated reporting as "a process founded on integrated thinking that results in a periodic integrated report by an organization about value creation over time and related communications regarding aspects of value creation. An integrated report is a concise communication about how an organization's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value in the short, medium and long term".(IIRC, 2013a)

In recent years, a major increase in interest in integrated reporting and narrative reporting. This plays an important role in improving communications with all categories of shareholders. It explains financial performance and provides a broader analysis of a company activities, any surrounding risks, objectives, prospects and strategies. Thus, it increases the relevance of corporate reporting by complementing the role of key performance indicators.

Managers, executives and others stakeholders need the right information at the right time to be able to manage and to understand company's performance and activities. As part of this business performance management, this growing information needs seemingly force managers to create "Key Performance Indicators" (KPIs) and to disclose more: operational information, quantitative analysis and forward-looking data.

Key Performance Indicators (KPIs), as part of integrated reporting, are crucial measures of performance that are disclosed by the company in order to help the stakeholders to analyze the company performance. These KPIs could be financial (e.g. operating profit, cash flow, and earnings per share), or non-financial (e.g. new product launches; emissions; total energy). KPI information is one of the main narrative disclosures that could be useful to the users of annual integrated report.

Several studies argue that the companies should select their key performance indicators according to their activity domain. The Global Reporting Initiative, the EFFAS and DVFA or the Sustainability Accounting Standards Board issued guidelines on different activity domains. (Ecless, Krzus, 2010)

The aim of this study is to describe and analyze the most important key performance indicators of company Philips in order to assess which are the organization's abilities to create value on a short, medium and long term, based on annual integrated report published for year 2014.

2. Literature review

Key Performance Indicators, also known as KPI or Key Success Indicators (KSI), help an organization define and measure progress toward organizational goals. Once an organization has analyzed its mission, identified all its stakeholders, and defined its goals, it needs a way to measure progress toward those goals. Key Performance Indicators are those measurements.

The recent changes regarding new reporting have had a positive impact on the content of the narrative element of annual reports and have encouraged greater alignment between strategy, risks and KPIs. This has resulted in an increase in the number of companies explicitly linking their strategy to KPIs in integrated reporting.

The most important challenge for the reporting period is how to build and produce annual reports with even greater connectivity between a company's strategy, risks and KPIs, providing the all categories of stakeholders a more holistic picture of company performance.

According to Matthews, key performance indicators (KPIs) help an organization define and evaluate how successful it is, typically in terms of making progress toward its long-term organizational goals. (Matthews, 2011)

Although there are a lot of different definitions of what KPIs are, but the most important definition is given by Michael Brooks: "KPIs are quantifiable and strategic metrics that measure an organization's critical success factors". (Michael, 2005)

In last time, a growing number of companies describe their non-financial KPIs, and the majority of those that have included them have integrated the reporting of their financial and non-financial KPIs, signaling a better understanding and management of non-financial thinking and decision making.

Integrated reporting is all about showing to the providers of financial capital, how the business will create value in the short, medium and long term. According to the International Framework of the IIRC, is value creation equal to increase, decrease or transformation of the six capitals caused by the organization's business activities.

The International framework of integrated reporting does not provide any specific measurement methods or performance indicators. The framework does give guidelines about how the KPIs should be reported. They have to be presented for multiple consecutive years, against peer group performance from the market and it should be linked to previously reported targets and future targets. An integrated report should contain qualitative and quantitative reporting about how their performance leads to value creation. The quantitative part mainly consists of performance indicators and the qualitative part should contain an explanation about the performance indicators, the measurement methods and their relevance for the organization.

Performance indicators have to be measurable and controllable by the company. Moreover, they have to be consistent, reliable, relevant and in line with the strategy of the company. This last aspect is important because the strategy determines how the company aims to create value.

Although the <IR> framework does not provide clear and specific KPIs, it does contain a list of characteristics for suitable KPIs (Table 1). What is known is that an integrated report should contain a combination of qualitative and quantitative information. This information should include targets, past and current performance, the state of key stakeholder relationships and the effect on the capitals of the organization (The IIRC, 2013). Presenting targets against past and current performance increases comparability and are inevitably quantitative.

Table 1 : Characteristics of suitable quantitative performance indicators according to the International <IR> Framework

Relevant to the circumstances of the organization
Consistent with indicators used internally by those charged with governance
Connected (e.g., they display connectivity between financial and other information)
Focused on the matters identified by the organization's materiality determination process
Presented with the corresponding targets, forecasts or projections for two or more future periods
Presented for multiple periods (e.g., three or more periods) to provide an appreciation of trends
Presented against previously reported targets, forecasts or projections for the purpose of accountability
Consistent with generally accepted industry or regional benchmarks to provide a basis for comparison
Reported consistently over successive periods, regardless of whether the resulting trends and comparisons are favorable or unfavorable

Presented with qualitative information to provide context and improve meaningfulness. Relevant qualitative information includes an explanation of: - measurement methods and underlying assumptions - the reasons for significant variations from targets, trends or benchmarks, and why they are or are not expected to reoccur.

Source: Section 4.53 of the International <IR> Framework

3. The research methodology

This research analyses the extent to which key performance indicators are disclosed by the company Philips. It is based on the annual report published for year 2014. (Philips Annual Report, 2014). Performance analysis is traditionally based on a set of key performance indicators disseminated to stakeholders in a direct/indirect way by using several structured/unstructured frameworks. According to the principles, performance of a company should be explained in an annual report by both qualitative and quantitative information. The qualitative aspect is often a textual explanation of the initiatives the firm took over the last year and what results that has given. In other words, it is mostly about explaining of strategic and management choices. In an integrated report, those explanations have to be more focused on how the strategic choices and business activities relate to value creation of the capitals. The quantitative aspect of external reporting is more focused on performance reporting. Quantitative performance information is often presented by a table of key figures. Those important quantitative performance measures are called Key Performance Indicators (KPIs). An organization can choose what KPIs they want to report and what they think is important performance information. To comply with the principles, the KPI framework that a firm reports probably has to be categorized by capital to show an integrated view. Choosing KPIs on separate capital performance is a challenge, because indicators generally reflect organization-wide performance and overlap with more than one capital.

4. Findings

The best example to highlight the relationship between integrated reporting and KPIs is Philips' integrated report (Philips Annual Report, 2014). Philips Annual Report is a good example for other entities interested in applying the integrated reporting because this company already has a history in integrated reporting and it is interested in finding the best practices in order to provide all information for its stakeholders.

Philips has published an integrated Annual Report since 2008. The report links its business strategy with environmental and social trends; combining financial performance disclosures with sustainability performance data. Embedding sustainability into Philips' strategy and reporting helped demonstrate the unified approach that the company has to its products which often have a direct impact on societal well-being.

The drive to publish an integrated annual report came from senior management in sustainability and control, supported by the top of the organization. As with the other case studies, this is a crucial foundation for organizations to start to adopt integrated reporting.

There were three key factors behind the adoption of integrated reporting at Philips:

- It was important to convey the extent to which sustainability is ingrained in the business strategy
- It helped with improved communication to stakeholders, particularly analysts and investors, through the simplicity of having one report where both financial and non-financial information could be found
- Reduced cost

Based on the above factors, the decision was taken to integrate the two separate reports into one. Initially the integrated reporting work involved the company chief accountant and the global head of sustainability. As the report then developed more functions became involved such as group control, design and IT.

The production of an integrated report brought about business process improvement, especially related to sustainability reporting as it helped to speed up the reporting timelines of the non-financial functions to bring them into line with the finance teams' reporting timelines which were faster and more well-established. This exercise in streamlining was challenging as it involved many stakeholders, some of whom were not used to the monthly and quarterly reporting "drumbeat" at first. But it developed over time. Next, the control procedures needed to be enhanced for the non-financial data.

Philips found that integrated reports attract a larger audience than annual financial reports, and have also helped to improve employee engagement as the reports highlight to employees what is happening in relation to the organisation's strategy and they are proud that Philips takes sustainability seriously.

The company also continues to improve the interactivity of the annual report website with each integrated report that is issued. The website's interactivity can be demonstrated for example by value creation in relation to the six forms of 'capital' - the user can click on each capital which then drills down into further detail on how the company creates value. Philips were also able to track user experience of the website which helped them understand what users thought was important and relevant.

Philips has shaped its own reporting framework, which it has developed further year by year by increasing the standard of sustainability assurance to match financial audit. This grew from a starting point of only providing limited assurance on sustainability. In 2008, KPMG, the external auditor, provided limited assurance on the non-financial information in the first integrated report.

The difficulty in providing higher levels of assurance around non-financial data lies in the lack of robust and reliable underpinning software. In 2010 Philips started a project with KPMG – 'The road to reasonable assurance' - which looked at getting higher levels of assurance on controls around non-financial information. For the environmental, health and safety and carbon footprint information they introduced a new system, Credit360, to manage the sustainability data to enable audit trails etc. From the 2011 annual report onwards it shows where reasonable assurance has been provided on non-financial data.

In 2014, internal audit became involved for the first time as the company hired an auditor with sustainability experience from PwC as a full-time employee to help with the function's assurance work in this area. As time goes on they hope that much of the work that the external auditors provide assurance on will be able to be covered by internal audit.

Phillips is a successful company known its innovative electronics products. But like all companies large and small, it's facing a dramatically changed consumer marketplace compared to a decade ago. With technology and online advancements, it's also facing competition from emerging companies across many industries and locations.

To help stay ahead of its competition while meeting consumer demands, Phillips established key performance indicators (KPI's) for review volume and average ratings. Following its KPI establishment, traffic to Phillips product pages from organic search increased to 2.5 %. Consumers who read reviews on the Phillips website were also found to spend 73% more time on the site, which led to a purchase increase of 180%. In order to monitor the progress of its sustainability efforts, Philips used Global Reporting Initiative (GRI) guidelines. These guidelines laid down indicators pertaining to economic, environmental, and social performance. Philips decided to enhance its reporting standards by setting new key performance indicators (KPIs).

The company aimed at measuring its performance on these indicators. The KPIs covered three broad areas namely, social, business, and communication. On the social front, the KPIs measured health and safety by reporting on 'Number of Lost Workday Injury Cases per Year.' Social indicators also measured 'Diversity and Inclusion' in the company. The KPIs under the business category covered the number of new business initiatives taken. Under this category, the company also reported the number of products designed that consumed less energy. A part from these KPIs, the company also kept track of various HR performance indicators such as working hours, HIV/AIDS, remuneration, non-discrimination, child and forced labor, training and education, and attraction & retention.

The current EcoVision program is a main driver to realize company's vision and the main elements of the program are:

- Green Product sales

Philips Green products are products with improved environmental performance often supported by a recognized eco-performance label. Philips products are categorized as green products when they are outperforming existing products, competitor products or surpass minimum legislative requirements by at least 10% in one or more of the six key Philips Green Focal Areas. The six key green focal areas identified by Philips are: Energy, Packaging, Substances, Weight & Materials, Circularity and Lifetime. These areas were developed through our EcoDesign process, introduced in 1994, which considers all aspects of product development and design.

In addition to the EcoDesign process, Philips use the life cycle approach to determine a product's overall environmental optimization and improvement. The Life Cycle Assessment calculates the environmental impact of a product over its total life cycle (raw materials, manufacturing, product use and disposal). Green products are designed with the environment in mind, of course and with you too.

- Improving people's lives

Philips try to make the world healthier and more sustainable through innovation. The goal of company is to improve the lives of 3 billion people a year by 2025.

Through Philips products and solutions that directly support the curative or preventive side of people's health, improved the lives of 670 million people in 2014, driven by our Healthcare sector. Additionally, well-being products that help people live a healthy life, and Green Products that contribute to a healthy ecosystem, improved the lives of 290 million and 1.5 billion people respectively.

Examples of products in the 'well-being' category that help people live a healthier life are juicers, blenders, air fryers, but also mother and childcare products. Examples of Green Products, products offering a significant environmental improvement in one or more Green Focal Areas, can be found in Green Product sales. Further details on this parameter and the methodology can be found in the document 'Improving people's lives'.

- Green Innovation

Green Innovation is the Research & Development spend related to the development of new generations of Green Products and Green Technologies. In 2010, the plan was to invest a cumulative EUR 2 billion in Green Innovation during the coming 5 years. In 2014, Philips already achieved this EUR 2 billion target a year ahead of schedule as invested some EUR 463 million in Green Innovation, excluding Lumileds and Automotive. Lighting continued to be the largest contributor, mainly as a result of investments in LED. The impact of Lumileds and Automotive on Green Innovation is significant at EUR 105 million in 2014 and EUR 104 million in 2013.

- Green Operations

Green Operations program, related to improving the environmental performance of our manufacturing facilities, focuses on most contributors to climate change, but also addresses water, recycling of waste and chemical substances.

In the course of 2013 was implemented an improved process to report chemicals used in processes in more detail. New chemicals on which will focus reduction efforts and new reduction targets will be incorporated in the next Green Operations program.

- Health & Safety

Philips strives for an injury-free and illness-free work environment, with a sharp focus on reducing the number of injuries and improving processes. The Lost Workday Injury Cases (LWIC) rate is defined as a KPI, on which set yearly targets for the company and our individual sectors.

- Employee Engagement

Employee engagement is key to competitive performance. Engaged employees help meet business goals and help make Philips a great place to work. Philips has used employee engagement surveys for over a decade to gather feedback and focus areas and have seen tangible results along our journey.

As announced in 2012, survey Employee Engagement on a bi-annual basis, starting in 2013. In 2014 was implemented a brief, complementary, team-focused survey called My Accelerate! Survey (MAS).

Philips has observed and shown via research the correlation between the Employee Engagement Index and the Net Promoter Score question "How likely is it you would recommend Philips as a great place to work?" (the measurement that cumulatively covers emotional commitment, pride and active recommendation). Philips used the Net Promoter Score as a proxy for the EES results in 2014 which was based on survey results of some 17,000 employees.

- Supplier Sustainability

Many of Philips products are being created and manufactured in close cooperation with a wide range of business partners, both in the electronics industry and other industries. Philips needs suppliers to share our commitment to sustainability, and not just in the development and manufacturing of products but also in the way they conduct their business. Philips require suppliers to provide a safe working environment for their workers, to treat workers with respect, and to work in an environmentally sound way. The Philips programs are designed to engage and to support suppliers on a shared journey towards continuous improvement in supply chain sustainability.

As a leading company in sustainability, Philips acts as a catalyst and supports your suppliers in their pursuit of continuous improvement in social and environmental performance. Philips recognizes that this is a huge challenge requiring an industry-wide effort in collaboration with other societal stakeholders. Therefore, Philips take a leading role, together with peers in the industry, in the Electronic Industry Citizenship Coalition (EICC) and to encourage strategic suppliers to join the EICC too. In 2014, Philips initiated a new EICC taskforce on process chemicals in the supply chain. Philips will also continue to seek active cooperation and dialogue with other societal stakeholders including governments and civil society organizations, either directly or through institutions like the EICC, the multi-stakeholder programs of the Sustainable Trade Initiative IDH, and the OECD.

In the EcoVision program, leadership is profiled with three Key Performance Indicators (KPIs), which track activities in the areas of Green and Social Innovation, the building blocks for Sustainable Innovation.

Green Innovation focuses on reducing the Environmental or Ecological Footprint of its products. Social Innovation comprises contributions to the improvement of the Human Development Index (HDI), for instance by delivering products and services for accessible and affordable healthcare in emerging markets.

Leadership KPIs-In the EcoVision5 program, the first leadership KPI – 'care' – drives Social Innovation, while the other two – 'energy efficiency' and 'materials' – drive Green Innovation.

Greening operations -Philips uses energy, waste, water and emission reduction as performance indicators to drive reduction of its environmental footprint in operations. Philips was recognized as a leader in carbon disclosure and carbon performance by the Carbon Disclosure Project (CDP) 2010 Global 500 report. Operational energy efficiency increased 2% from 1.17 terajoules per million euro sales in 2013 to 1.14 terajoules per million euro sales in 2014 as a result of energy efficiency programs in industrial sites.

Green Products and Green Innovation-Starting with 2010, Green Products represented 38% of Philips global revenues, compared to 20% in 2007, as a result of investments of more than EUR 1 billion in Green

Innovation during the past three years. In 2010 it set a target to further increase the share of Green Products to 50% of Group sales by 2015. It uses the Philips Green logo to identify an increasing number of Green Products. Green Products offer a significant environmental improvement in one or more Green Focal Areas: Energy efficiency, Packaging, Hazardous substances, Weight, Recycling and disposal and Lifetime reliability. Sales from Green Products, excluding the Lumileds and Automotive business, increased to EUR 11.1 billion in 2014, or 52% of sales (50% in 2013), thereby reaching a record level for Philips.In 2014, Philips already achieved this EUR 2 billion target a year ahead of schedule as invested some EUR 463 million in Green Innovation, excluding Lumileds and Automotive. Lighting continued to be the largest contributor, mainly as a result of investments in LED. The impact of Lumileds and Automotive on Green Innovation is significant at EUR 105 million in 2014 and EUR 104 million in 2013, as we can see the Figure 1. Philips Group-Green Innovation per sector in millions of EUR, 2010-2014

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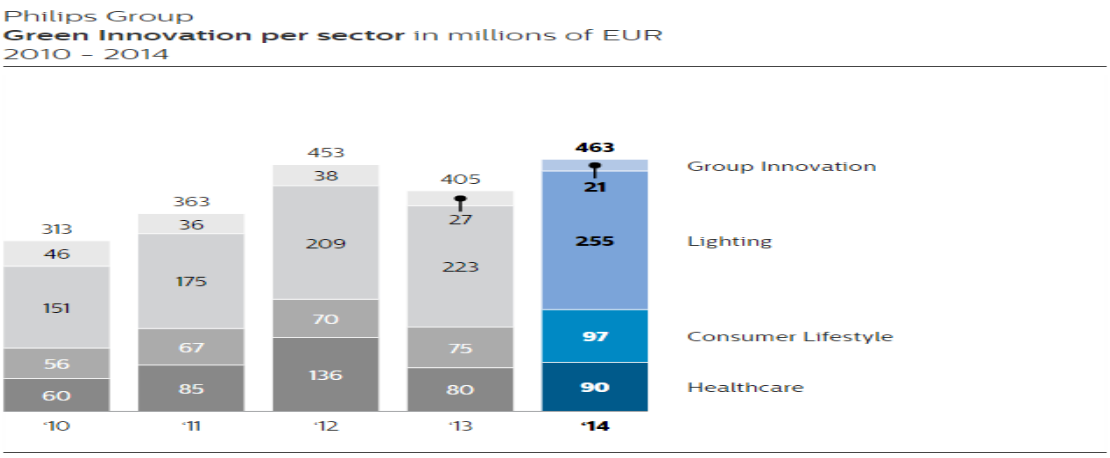

5. Conclusions

The performance indicators are tools to compare actual results with targets that has been set. Organizations are always trying to outperform competitors and to accomplish that they need to adjust their strategy to their external environment and improving continuously. To accommodate this improvement, companies need to measure their performance and follow the progress that the organization makes, in order to improve processes, or parts of processes. The performance indicators must be aligned with the business strategy and are useful to see the consequences of an organization's actions. KPIs are the performance indicators that a company actually uses to assess their performance. The principles of aligns with the idea of Neely (1999) that a company should not only use financial measurements, but also non-financial measurements such as social and relationship aspects.

Integrated reporting is all about showing to the providers of financial capital, how the business will create value in the short, medium and long term. An integrated report should contain qualitative and quantitative reporting about how their performance leads to value creation. The quantitative part mainly consists of performance indicators and the qualitative part should contain an explanation about the performance indicators, the measurement methods and their relevancy for the organization.

The performance indicators have to be measurable and controllable by the company. The performance indicators must to be consistent, reliable, relevant and in line with the strategy of the company. It is important because the strategy determines how the company aims to create value.

Since the main purpose of this article and also the above, the integrated reporting is the management tool for KPIs. For understanding this, it is necessary to read an integrated report, for example Philips Annual Report. Philips Electronics is a leader in integrated reporting, after its first report in 2008, Philips' integrated reports and its integrated reporting website had a continuing evolution, and every new report it was much improved, so 2014 it produced its seventh generation report. Continual measuring of organizational performances via Key performance indicators is a newer concept that uses companies of today. KPI helps organization to testify how successful they are in their business. KPI performance measurement importance could also be expressed by next statement: „KPI tells you where performance has been in the past, where it is now, and perhaps more useful, where performance is likely to be in the future". (Smith, 2001)

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