Integrated Reporting and Financial Performance:

Empirical Evidences from Bahraini Listed Insurance Companies

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Abstract

In Middle Eastern countries, Integrated Reporting <IR> concept is gaining momentum and companies are adopting it in non-standardize way however, it is not mandatory by law. The current study is aimed at exploring <IR> among five listed insurance companies in Bahrain and its effects on their financial performance (Return on Assets assumed). Content, descriptive and linear regression analyses were employed to analyze the collected data over a period of four years from 2012 to 2015. The research findings suggested that there is a wide variation of companies' compliance with <IR>, and the use of non-uniform disclosure formats. The content elements whose level of disclosures appeared to improve include the external environment and organizational overview, governance, and outlook, while there is a decreasing level of disclosures that are witnessed for risk and opportunities. The business model, strategy and resource allocation have a positive and significant relationship with Return on Assets (ROA), while risk and opportunities and performance elements negatively, but significantly related to ROA. This research will help the policy makers, regulators, investors, companies, researchers and analysts to understand the importance of <IR>. Further, it provides the broad understanding and application of <IR> to the researchers, academicians and students communities.

Keywords: integrated reporting, disclosures, sustainability reporting, financial performance, transparency, ESG, financial reporting

1. Introduction

1.1 Background

Sustainability is a major concern to companies of all sizes in an attempt to retain resources for next generations, whilst providing and maintaining the value for current generation (James, 2014). The concept of integrating companies' financial reporting with sustainability reporting is being endorsed across the world. Organizations have been reporting social and environmental matters over the past two decades in a separate stand alone report (Villiers, Rinaldi, & Unerman, 2014). In comparision to earlier reports, organizations kept advancing their reporting style, which started a move to combine financial with environmental, social, and governance (ESG) information. Integrated Reporting <IR> concept have resulted from these earlier practices and from the organizations' aim to create sustainable value in a way to minimize risks and to be able to protect the sustainability (Boonlua and Phankasem, 2016).

Since the formation of International Integrated Reporting Council (IIRC) in 2010, <IR> have grown rapidly and at a fast pace around the world. In some countries such as South Africa, Brazil, India and many other countries where <IR> becomes requirement to be listed in stock exchanges (Cheng, Green, Conradie, Konishi, & Romi, 2014). It combines six capitals such as financial, manufactured, intellectual, human, social and relationship, and natural capital. It merges different aspects of organizational performance to indicate how the vision and the value of an organization are incorporated in their internal and external activities as well as combines both long-term thinking and

collaboration between different functions (Morros, 2016). Phillips, Watson, & Willis (2011) stated that it reveals a more comprehensive view when assessing organizations' performance, values, financials, social, and strategic disclosures which allows stakeholders to view many aspects of the organization more holistically. James (2014) also suggested that <IR> will increase the organization's operational effectiveness and efficiency and will also lead to long run achievement of an organizations' goals and mission. Moreover, it will help stakeholders to comprehend the interrelationship between company performance and its impacts on the people and environment. Further, it enhances the understanding of internal decision makers' regarding the relationship between various functions, their nature, and likely effects.

1.2 Objectives of the Research

The objective is to explore and evaluate evolving trends of <IR> content elements as well as to investigate the compliance of five listed insurance compnanies of Bahrain with current <IR> framework over the period of four years from 2012 to 2015. The second aim is to examine whether <IR> content elements have any effect on companies' financial performance *i.e.,* Return on Assets (ROA).

1.3 Contribution of the Study

This study is one of the few studies that is conducted in the Kingdom of Bahrain about <IR>. It will help organizations' in capacity building of <IR> and other company can use it as benchmark. In addition, this study going to assist various stakeholders such as investors, regulators, accounting bodies and other academicians that are using <IR> for multiple purposes. Finally, the findings, outcomes and the recommendations from the research going to be useful for the policy makers and regulators in the Kingdom of Bahrain. Further, it will provide the broad understanding and application of <IR> to the researchers, academicians and students communities.

2. Literature Review

The story of <IR> started in 1977 with the publication of the book titled "The social audit for management" by Clark C. Abt. In 2000, the Global Reporting Initiative (GRI) issued its first Sustainability Reporting Guidelines. In June 2000, the European Commission (EU) published "EU Financial Reporting Strategy: The Way Forward", which suggested that annual report should not be limited only to the financial facet of a business, but also that, "where appropriate, an analysis of environmental and social aspects necessary for an understanding of the company's development, performance or position" should be disclosed. The first Integrated Report was issued by Novozymes, a Danish pharmaceutical company, in 2002. In 2006, European Commission Directive 2006/46 mandated that all publicly listed companies in Europe had to include a corporate governance statement in their annual report. In 2010, the filling of <IR> becomes mandatory for the companies listed at the Johannesburg stock exchange (King III Report, 2009).

There are many international bodies involved in <IR> and working together "to provide for the growing demand for a broad information set from markets, regulators and civil society" (IIRC, 2013a): IIRC, GRI, The Prince of Wales' Accounting for Sustainability Project, Financial Accounting Standards Board, International Accounting Standards Board, Institute of Chartered Accountants in England and Wales, International Federation of Accountants, United Nations Global Compact, Sustainability Accounting Standards Board and so on. The IIRC was founded in 2010 with the mutual support of the A4S and the GRI. In 2011, IIRC released a Discussion Paper regarding the <IR> Framework and launched the Pilot Program Business Network. In July 2012 the Committee published the Draft Outline of the IIRF. On November 26, 2012 the Prototype of the IIRF was released, and in February 2013 the IIRF Consultation Draft was issued. The Framework's purpose is to assist organizations with the process of <IR> (IIRC, 2013a).

In order to do this, the Framework Consultation Draft establishes the Fundamental Concepts (the capitals, the business model, and value creation), the Guiding Principles (strategic focus and future orientation, connectivity of information, stakeholders' responsiveness, materiality and conciseness, reliability, comparability and consistency), the Content Elements (governance, business model, organizational overview and operating context, opportunities and risks, strategy and resource allocation, performance, future outlook) and the Preparation and Presentation (disclosure of material matters and the materiality determination process, frequency of reporting, time frames for short, medium and long term, reporting boundary, aggregation and disaggregation, involvement of those charged with governance, use of technology and assurance) that govern the <IR> process.

Organizations must report to a variety of stakeholders who mostly do not only look for financial data. Rather, they would be more interested in where, why, how organizations would add value, and the method they use to deal with sustainability and responsibility (Morros, 2016).

ACCA (2013) found that there is a growing interest from investors for non-financial information such as ESG information. Thus, organizations began to report non-financial information such as ESG in a separate report known as sustainability report (Athma and Rajyalaxmi, 2013). It supports combined and consultative thinking that facilitate informed decision-making. The content elements that must be included in the report include organizations overview and external environment, which provides information what the organization does and under what circumstances (Boonlua and Phankasem, 2016). Business model of the organization and the risks and opportunities that are available to the organization should be explained (Cozma and Diana, 2015). The report should explain how the organization is prepared to deal with the exposed risks.

While drafting the report, the following seven guiding principles must be considered: strategic focus and future orientation, connectivity of information, stakeholders' relationships, materiality, consciousness, reliability, completeness, consistency and comparability (KPMG, 2012). Integrated framework has seven guiding principles but the organization may establish specific bylaws and policies which can guide the management how the report should be developed (Abeywardana, 2016). <IR> ensures a collection of material information concerning the organization's strategy, performance, governance and prospects in a manner that captures the commercial and social environment under which it operates (Dumay, Bernardi, Guthrie, & Demartini, 2016).

3. Research Methodolgy

This research used a mixed approach which includes qualitative and quantitative methods. Content, descriptive and multi-linear regression analyses were employed. In analysing the descriptive results, we used MS Excel software, whereas, in the multi-linear regression SPSS version 25 software is used. The researchers followed Abeywardana (2016) checklist to measure the companies' compliance with <IR> content elements. Then, binary coding is used to indicate whether the item exist in the annual report or not. After the coding is complete, the researchers subsequently used the checklist filled to conduct multiple regression analysis to analyse the relationship between compliance with <IR> framework *i.e.,* did enhanced compliance had an effect on ROA ratio over four years' period from 2012 to 2015. <IR> content elements are used as explanatory variables and ROA is dependent variable.

Further, we used secondary data such as companies' annual reports, ratios extracted from Bloomberg Terminal, refereed articles, and publications of IIRC. The sample included all five listed insurance companies of Bahrain namely, Al Ahlia Insurance Company (AHLIA), Arab Insurance Group (ARIG), Bahrain & Kuwait Insurance Company (BKIC), Bahrain National Holding Company (BNH), and Takaful International Company (TAKAFUL) (only Islamic insurance company).

4. Findings & Analysis

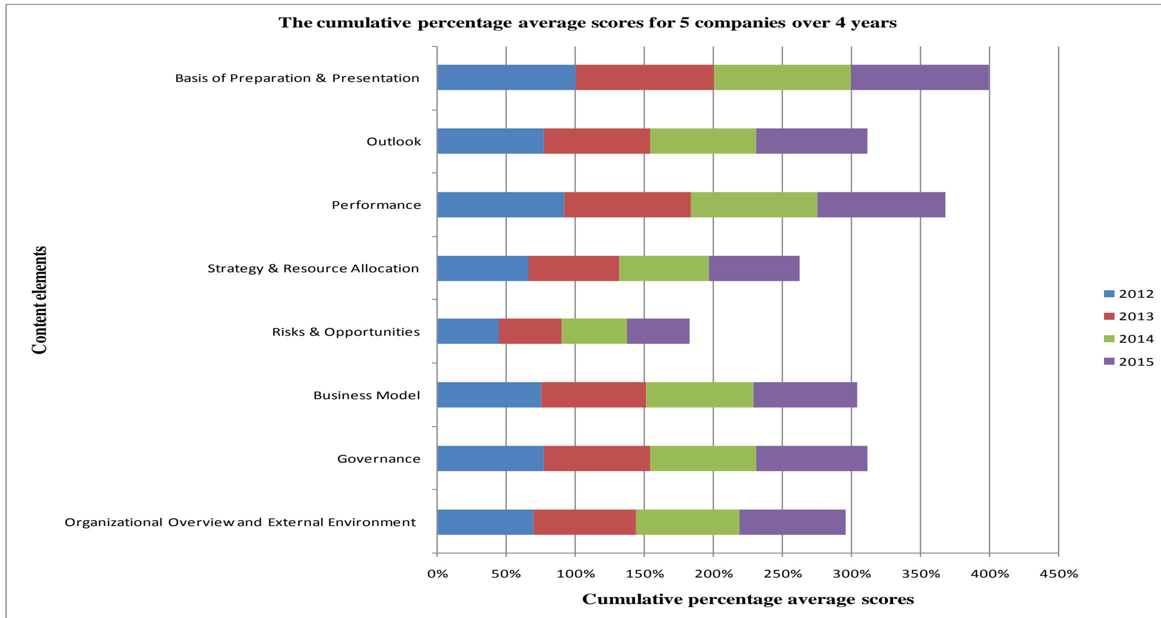
The table 4.1 provides total scores for five listed insurance companies over the four-year period:

Content Elements	No. of items	Maximum score	Total score	% score
1. Organizational Overview and External Environment	20	400	296	74%
2. Governance	7	140	109	78%
3. Business Model	9	180	137	76%
4. Risks & Opportunities	8	160	73	46%
5. Strategy & Resource Allocation	7	140	92	66%
6. Performance	5	100	92	92%
7. Outlook	7	140	109	78%
8. Basis of Preparation & Presentation	3	60	60	100%
Total scores	**66**	**1320**	**968**	**73%**

From inference of the table 4.1 (above) and figure 4.1 (below), we found <IR> is still evolving in Bahrain and as such, insurance companies have not fully adopted <IR>; as <IR> is not mandatory by law and companies have the liberty to choose what to disclose beyond the mandatory content elements. This voluntary and non-uniform reporting impedes comparability, and the investors have to exert extra effort in establishing the existence of certain items in reporting.

4.1 Average Scores on <IR> Elements

The average score on <IR> elements was computed for each of the content elements. The results are shown in below figure 4.1:



When all the years are accounted for, the highest average level of compliance is in presentation and preparation (100% compliance across the years), followed by performance, outlook, governance, business model and the organizational overview and external environment. The least complied content elements were risks and opportunities, and strategy and resource allocation. The content elements whose level of disclosures appear to improve include the organizational overview and external environment, governance, and outlook.

On the other hand, there was a decreasing level of disclosures for risk and opportunities. The three that appear to improve could be due to institutional pressures that force organizations go beyond compliance. However, decreased disclosure in the area of risk and opportunities could be due to increased competition across markets that are causing companies to endeavor to protect their internal policies and strategies.

4.2 <IR> Compliance and Financial Performance

Due to a lack of significance for the entire model containing all content elements, three content elements were removed from the research; including organizational overview and external environment, governance and basis of preparation and presentation. Therefore, the regression analysis was used to assess the impact that disclosures of other five <IR> content elements have on the management's capability. The model summary is displayed in the below table 4.2:

Model	R	R Square	Adjusted R Square	Standard Error
1	0.728	0.530	0.362	3.88540

The R square value is mediocre (0.530) indicating that 53% of the dependent variable can be explained by the independent variables and as such, it indicates that there are some content elements that have a relationship with performance. To examine the significance of this relationship with regards of each element, the analysis of variances was conducted. The results are displayed in the table 4.3 below.

Model		Sum of Squares	*d.f.*	Mean Square	F	Sig.
1	Regression	238.561	5	47.712	3.161	0.041
	Residual	211.349	14	15.096		
	Total	449.910	19			

Table 4.3 showed the *p value* 0.041, which is statistically significant ($p<0.05$). Further, the individual content elements, their unstandardized coefficients and individual significances are shown in the table 4.4 below.

	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error	Beta	B	Std. Error
(Constant)	66.128	20.666		3.200	0.006
Business Model (BM)	9.926	4.255	3.392	2.332	0.035
Risks & Opportunities (RO)	-11.986	4.173	-2.562	-2.872	0.012
Strategy & Resource Allocation (SR)	5.351	2.297	2.631	2.329	0.035
Performance (PF)	-13.990	5.198	-2.360	-2.691	0.018
Outlook (O)	-8.991	4.484	-3.520	-2.005	0.065

As per the above table, one element is not significant in explaining the changes in performance, that is, the outlook. However, the factors that significantly explain performance include business model, risks and opportunities, and resource allocation and strategy. Their influence on performance based on the table 4.4 is given in the multiple regression equation below:

$$ROA = 66.128 + 9.926(BM) + 5.351(SR) - 11.986(RO) - 13.990(PF)$$

The factors that positively affect performance include the increased disclosure of the business model, strategy and resource allocation. On the other hand, factors that negatively impacted on financial performance include the disclosure of risk and opportunities, and the disclosure of financial performance. The findings indicated that increased risk and opportunities disclosure negatively, but significantly impact the financial performance. This implies that better performing firms do not reveal their possible risks and opportunities. This can be explained by the withdrawal argument explained, but it can also be viewed in other perspectives.

The disclosure of risk has the capability of giving power to the competitors through risk leaking (Kaspina and Molotov, 2016). In the case of a highly competitive market, larger and more successful competitors can use the information revealed as marketing campaigns against the disclosing organization; or may instigate further deterioration of the situation of risk into an actual happening as a way of gaining market share. Another view is that the disclosure of opportunities may cause an aggressive organization to launch their products in the area disclosed ahead of the disclosing company leading to the loss of the opportunities itself. Therefore, the costs associated with increased disclosure of opportunities and risks outweigh the benefits, thus explaining the negative relationship established in the results.

4.2.1 Business Model Disclosure and the Financial Performance

The business model is representative of the activities and the processes of organization, in which the organization enable the conversion of inputs into outputs for the achievement of business objectives. While the inputs are defined as the six capitals as per <IR> which enable the company to differentiate itself, activities include the core activities of the business that ensure its short term, medium term and long term success, such as employee training, innovation, as well as relationship management, while outputs can be defined as the internal and the external consequences of the capitals which emanate from the activities of the company. In our study, we found the positive relationship between business model disclosure and the financial performance.

4.2.2 Disclosure of Risks and Opportunities and the Financial Performance

Roth (2014) stipulates that although the enhancement of corporate communication is one dimension in the management of risk, the reporting of the particular risk that an organization faces have the capability of enabling the enhancement of the reputation of management. The argument here is that <IR> increases integrated thinking, which aligns corporate arms and such increasing coordination. This, however, is a change process that may not be successful, if not well managed. Therefore, it is not guaranteed that merely reporting risks will result in increased positioning of the company in terms of better reputation.

On the other hand, disclosure of risk can instigate key stakeholders including customers, investors and suppliers to withdraw from an organization and thus accelerating its fall. As such, companies have the increased tendency of decreasing the information available with regard to the possible risks faced by a firm. In our research, we found that risks and opportunities disclosure negatively, but significantly impact the financial performance. This implies that

better performing firms do not reveal their possible risks and opportunities. Another view is that the disclosure of opportunities may provide competitors to launch their products early. Therefore, the costs associated with increased disclosure of opportunities and risks outweigh the benefits, thus explaining the negative relationship established in the results.

4.2.3 Resource Allocation and Strategy Disclosure and Financial Performance

This content element addresses the direction of the company and the manner in which it intends to achieve its objectives (Cheng et al., 2014). Strategy and resource allocation was found to have a positive and significant relationship with ROA. Similar to the concept of governance, formulation of strategy and the allocation of resources within a firm is a management function.

For a management that discloses, there is an incentive towards portraying efficiency and effectiveness in their management duties and as such, an increase in the strategy and resource allocation is likely to lead to an increase in performance. Past researches showed that when the organization strategy is right, and when the resources are efficiently allocated across business functions, it is expected to result in improved performance.

4.2.4 Performance Disclosure and Financial Performance

Performance is defined by Cheng et al. (2014) as the degree of achievement of the company's strategic objectives and the outcomes pertaining to its capitals. However, <IR> does not provide guidelines for reporting performance indicators. It is expected that the increase in the level of disclosure as it pertains to the elements that make up performance ought to lead to increased performance. The explanation of the negated relationship can be attributed to the legitimacy theory. According to this theory, companies tend to disclose more information when their legitimacy is threatened as a way of gaining a better reputation and communicating otherwise to their stakeholders (Palazzo and Scherer, 2006).

In this case, it can be argued that companies that have negative ROA have the tendency of gaining favor with investors through increasing their level of disclosures. These disclosures, therefore, does not function as a presentation of the ways through which the company continually aligns its profitability to key strategies, but an attempt by the management to explain how much they are trying to make the business succeed through the difficult investment environment.

4.4.5 Outlook Disclosure and Financial Performance

According to Cheng et al. (2014), the future outlook element seeks to answer the uncertainties and challenges that the companies have to face as they pursue their strategy and the potential implications on their future performance and the business model. The organization ought to disclose its preparedness to meet these future challenges and may have sensitivity analysis and lead indicators. Moreover, forecasts need to have clearly stated assumptions. All these denote the disclosure of the firm's probable future and the probability that the objectives set in the future will be met.

Although the disclosures of future outlook had a negative impact on performance, however, this impact is not statistically significant. One can argue that the variation in the financial performance aspect that comes with the disclosure of outlook emanates from the dilution of the investor expectations of the firm's future. Given that investors evaluate the value of a firm based on its future prospects, the explanation of risks and challenges can be interpreted as a way of excusing future failure. Therefore, the perception of investors regarding such firms would, therefore reduce the price of shares in the stock market.

The argument may, however, change in the case that firm, with more disclosures, is a poor performer. The management of such firms already suffers investor lashing. Therefore, to make investors believe that they are putting efforts to increase performance, they are likely to disclose more and also include potential risks and challenges as a way of rationalizing those expectations.

Another argument can be based on the information bias. While good news may many times go unnoticed, bad news spreads faster and is discussed longer. In the situation of better performing firms, the highlighting of risks and challenges can be the 'bad news' aspect because it casts doubt on the likelihood of attaining future desired achievements and especially if the management is unable to properly deal with such issues. As a way of protecting the 'good news' brought about by their improved performance, high performance firms may have the tendency of managing the information they release lest it turn out to be 'bad news', eroding the confidence and the pride of a better performance.

As aforementioned, the relationship between outlook and financial performance lacked statistical significance. This can be attributed to two likely factors. First, the cases may not have been sufficient enough to establish a significant

trend. This can apply especially when there are very few contents within the elements, where disclosure is sensitive and along which firms ought to have significantly varied their disclosures. Secondly, there may be no relationship between outlook and financial performance. A lack of relationship can also be argued for. This is due to the concept that the management of different companies, whether better performing or worse performing are likely to provide information that is inaccurate and which is purposefully meant to manipulate investor beliefs regarding the firm. This leads to a scattered disclosure based on the attributes of the audience that the disclosing company addresses. Also, the investors are likely to concentrate on the historical performance as opposed to outlook as their bases for forming expectations. Therefore, in this context, there is no relationship between organizational outlook and financial performance.

5. Conclusion

Research inferred that there are a wide variations of disclosures in terms of companies' compliance with. While, some insurance companies only present financial results and other disclosures mandated by law, others were found to disclose more non-mandatory elements, for instance, their involvements in corporate social responsibility. Moreover, disclosure formats were not uniform. It is observed that there are costs associated with disclosures of certain content elements, leading to the choice of disclosure based on the company's communication strategy.

With regard to disclosures, when all the years are accounted for, the highest average level of compliance is in presentation and preparation (which is mandatory by law), followed by performance, outlook, governance, business model and the organizational overview. The lowest disclosed items were risks and opportunities, and strategy and resource allocation. The degree of disclosure of certain elements is dependent on their sensitivity to business model. Moreover, it was also established that insurance companies' management avoid creating expectations and prefer the traditional reporting of past performance.

Additionally, the content elements whose level of disclosures appears to improve include the external environment and organizational overview, governance, and outlook. On the other hand, there is a decreasing level of disclosures that is witnessed for risk and opportunities. The three that appear to improve could be due to institutional investor pressures that force organizations to go beyond compliance. However, decreased disclosures in the area of risk and opportunities could be due to increased competition across the markets that are causing companies to endeavor protecting their internal policies and strategies.

The content elements of <IR> that positively affect financial performance include the increased disclosure of the business model adopted and strategy & resource allocation. On the other hand, content elements that negatively impact on financial performance include the disclosure of risk and opportunities, and financial performance. The findings indicate that increased risk and opportunities disclosure negatively, but significantly impact the financial performance. This implies that better performing firms don't prefer to reveal their possible risks and opportunities.

5.1 Limitations of the Study

One limitation of the research is subjectivity and possible researchers' bias, although it also has the advantage of increasing the level of contextualization of findings. As regards to the possibility of subjectivity and bias, the researchers limited themselves examination of phrases that either directly undeniably implied various content elements and thus coded them as '1' or '0' and as such, if exists, the level of risk of bias does not threaten the validity and the reliability, however, this method has a problem of assuming that each item has equal importance.

As it pertains to the contextualization of the findings, although this is an advantage as it enables the thorough examination of a case, it leads to the reduction of the capability of generalizing the results of the study, as the sample size was small. The current study entailed five listed insurance companies in Bahrain and as such, the explanation of the findings was limited to the insurance sector of Bahrain. Lastly, quality of disclosures is not judged in the study.

5.2 Recommendations for Future Research

Based on the abovementioned limitations, the researchers recommend that future research ought to concentrate on: (1) examining companies across countries or regions in order to dilute the aspect of contextualization, (2) changing the coding method where items are scaled based on their importance and supported through conducting interviews with professionals in the industry, and (3) add some controlling variables to the analysis as it can help in producing more consistent results that is not effected by company-size, profitability, governance, concentration of stockholding , age of the company, and leverage.

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