Importance of non-financial data for investors and analysts

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How to effectively communicate non-financial data to analysts and investors - tips

It is quite obvious that modern business models are considerably different from those prevailing in the 1970s, '80s or even '90s when the rules of financial reporting were shaped. This obviousness, which we tend to forget, is a foundation of the changes in the current approach to non-financial data reporting that we witness and participate in today.

It is often repeated that business models undergo significant changes and this can be confirmed by a distribution of components that determine the company's value. For example, studies that have been carried out for years by Ocean Tomo LLC explicitly show this process. In 1975, the value of the S&P 500 index was in 83% determined by tangible assets. In 2015, the value of the index was in 84% determined by intangible assets. The fact that reporting on non-tangible areas is different from reporting tangible assets and requires a different quality approach is challenging for many.

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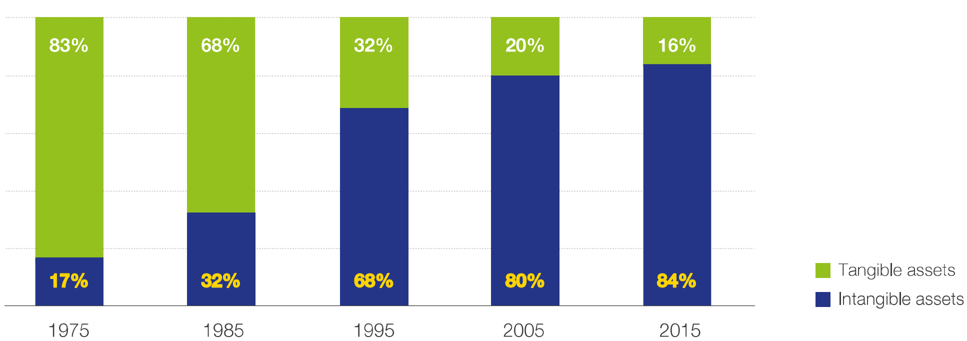
Changes in components proportion of S&P 500



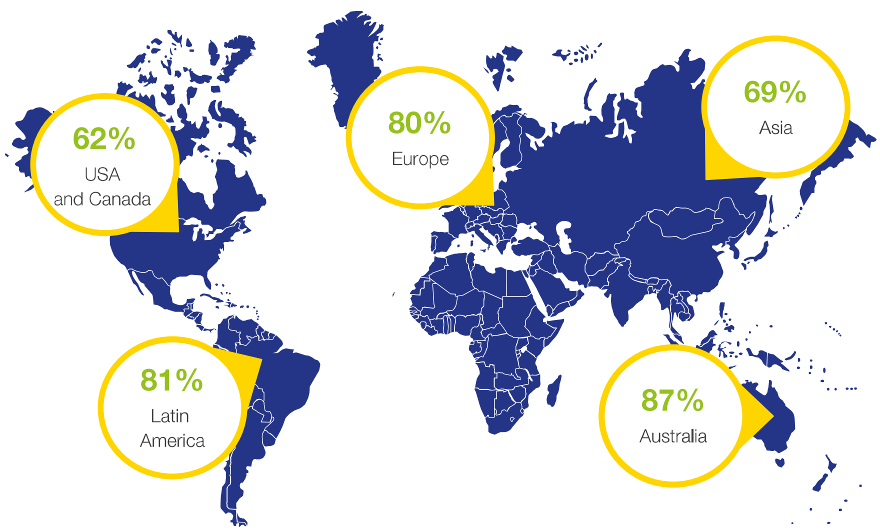
Source: Ocean Tomo LLC

Importance of non-financial data for investors and analysts

The change of components determining the value of present-day companies has not been unnoticed by investors and analysts. In the US and Western Europe it is already a standard for investors to include non-financial data in investment processes. Hence, more and more companies decide to publish reports with non-financial data or integrated reports that cover both financial and non-financial information. According to the report Tomorrow's Investment Rules 2.0 by EY from 2015, on average, 70% of global and 80% of European investors consider integrated reports to be essential or important in making investment decisions.

80% of investors in Europe consider integrated reports, that cover financial and non-financial information, to be essential or important in making investment decisions.

Proportion of investors that use non-financial information

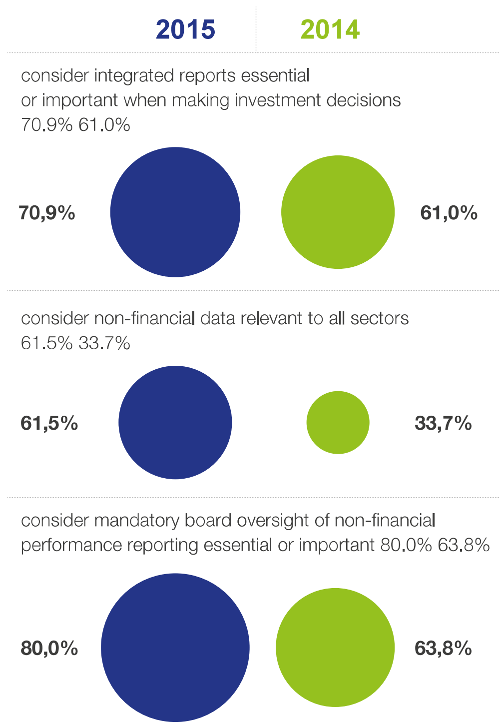


Source: EY Tomorrow's Investment Rules 2.0, 2015. The study was carried out among 211 institutional investors of which over 70% manage assets worth over USD 10 billion.

It is worth mentioning that in 2015 the percentage of investors who considered integrated reports to be a key source for making investment decisions increased by 10% as compared to 2014. It is also significant to note that the number of investors who think that non-financial data is important regardless the sector has risen by 50% and now reaches over 61%.

Understanding this trend helps us to learn more about investors' approach to non-financial data while making investment decisions on the operational level. The latest report published by Eurosif (2016), an organisation that analyses the socially responsible investment market, shows that investors in Europe most often use a strategy of excluding companies from industries that do not fulfill basic ethical criteria from their investment portfolios.

Proportion of investors that...

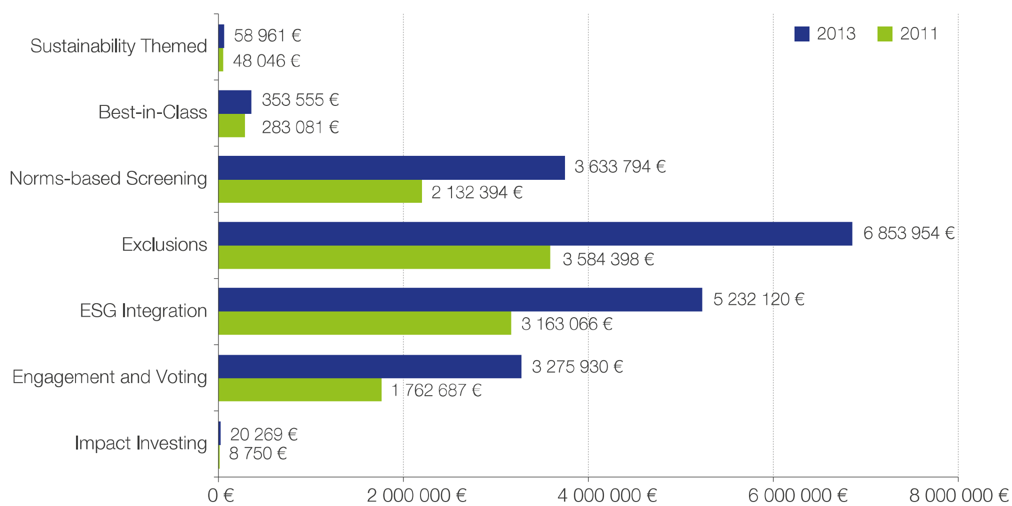


Source: EY Tomorrow's Investment Rules 2.0, 2015, survey on 211 respondents

However, it should also be noted that the value of assets managed in accordance with the ESG integration strategy is increasing dynamically. The abbreviation ESG comes from English and stands for the following: E – environment, S – social and G – governance. The very strategy is about considering both financial and non-financial data before making investment decisions. Analysts assign appropriate value to both types of data and then make final investment decisions.

Another strategy is investing in companies that meet international ethical standards, such as Global Compact, ISO 26000, OECD Guidelines for Multinational Enterprises or SA800, BSCI, EcoVadis, SMETA. Basing on the above-mentioned norms and standards, investors can create risk assessment models for non-financial areas of their investments.

Investment strategies based on non-financial data in Europe



Source: European SRI Study 2014, Eurosif

Let us take a closer look at non-financial factors that, according to investors, might impact investment stalling or withdrawals. In the first place, the respondents to the study presented in the EY report Tomorrow's Investment Rules 2.0 indicate that there is no clear value-building strategy. What is important to investors is the approach to risk management, especially in terms of supply chain and environmental risks management. Currently, nearly 82% of investors are willing to exclude a company from their investment portfolio or reevaluate it if they see a risk of breaching human rights.

Non-financial data impact on investment stalling

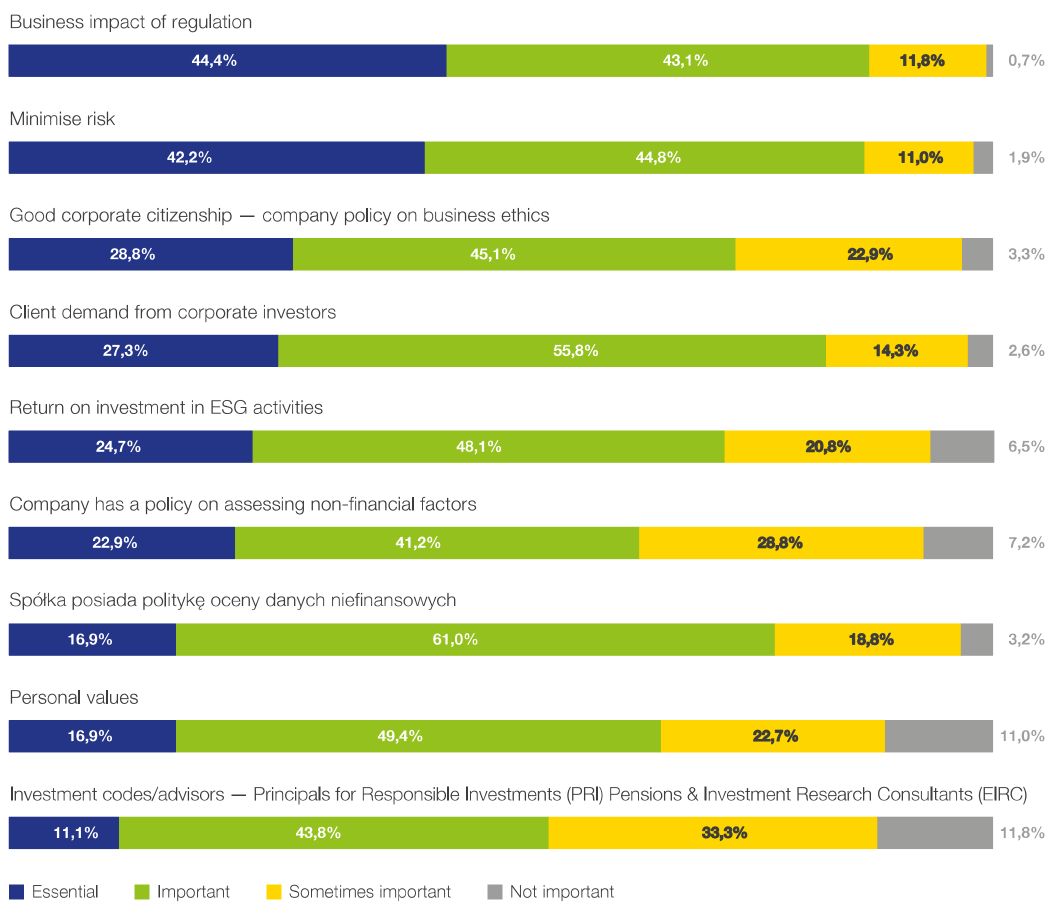
How would the following disclosures about a prospective investment affect your investment decision?

Source: EY Tomorrow's Investment Rules 2.0, 2015, survey on 211 respondents

What are the reasons why investors consider non-financial data in their investments? The first and the most obvious reason is related to regulatory impacts. 87% of investors consider non-financial data to be essential or important information to estimate the company's future performance. 75% of investors think that it is essential or important to include the company's approach to social responsibility, especially business ethics, in their analysis processes.

Non-financial issues – impact on performance

How important are each of the following non-financial issues to you as an investor?

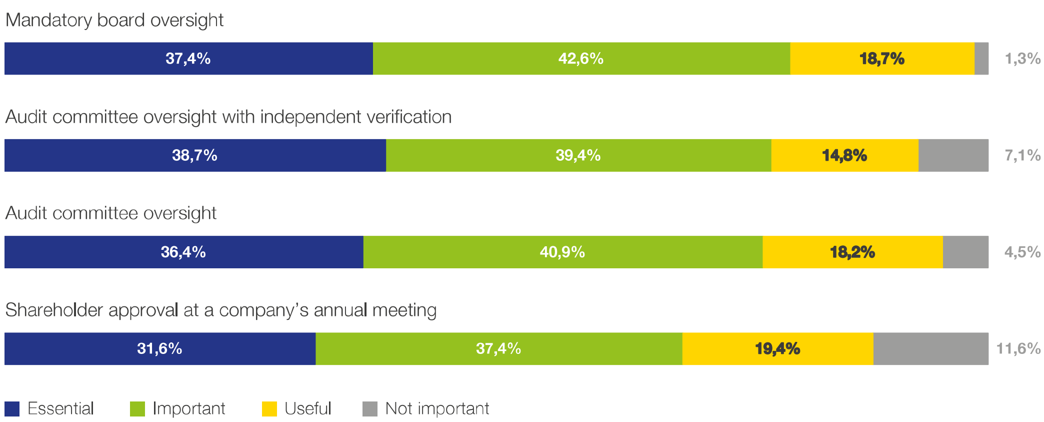


Source: EY Tomorrow's Investment Rules 2.0, 2015, survey on 211 respondents

The study clearly shows that investors' expectation towards companies taking high-level responsibility for non-financial data rises together with the increasing importance of such data. 80% of investors expect the management board to assume formal and real responsibility for non-financial data reporting. In the opinion of over 78% of respondents, it is essential or important that the audit committee takes responsibility for non-financial data reporting and that disclosed data undergoes independent verification before it is published.

Investors expect top management oversight over non-financial data

How important are the following levels of accountability in non-financial performance reporting?



Source: EY Tomorrow's Investment Rules 2.0, 2015, survey on 211 respondents

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Responsible investment market

Not only percentages but also asset value plays an important role in investments, and the value of assets managed with consideration of non-financial data increases every year. According to the Global Sustainable Investment Review covering data for 2014, the value of assets managed with consideration of non-financial data was USD 21 trillion. The number accounted for over 30% of all professionally managed assets world-wide. Investors from Western Europe are the leaders in this kind of investments. Additionally, the Principles for Responsible Investment (PRI) organisation, integrating financial institutions that follow responsible investment strategies, shows in its Principles to Performance report how dynamic the responsible investment trend is. In 2006, PRI gathered 100 members who managed assets worth USD 7 trillion. Currently, it has over 1,500 members that manage assets worth over USD 60 trillion.

Tips for companies

As shown above, investors' growing interest in non-financial data is specific and business-related. That is why the key challenge that companies face when preparing reports with non-financial data is, firstly, to indentify material non-financial indicators and, secondly, to show how non-financial indicators resulting from the company's actions in these areas impact the company's value.

Many companies in Poland have just begun their adventure with non-financial data reporting. Below we provide some tips on how to start and improve non-financial data reporting process.

Tips for companies that communicate non-financial information to investors and analysts:

1. **DO NOT GROPE YOUR WAY.** Ask investors and analyst what non-financial information they expect. In this way you will avoid spending your time and money on reports that will not be of any use for that particular recipient group.

2. **BE SPECIFIC.** It is a myth that investors do not care about non-financial data. It is true that they are not interested in pictures taken during team-building events and, in most cases, in the company's charitable activities. They are, however, interested in the company's employee turnover rate, number of accidents, reductions in emissions, number of hours spent on anti-corruption and anti-bribery training, percentage of suppliers screened for risks of breaching human rights.

3. **SHOW LINKS TO YOUR STRATEGY.** Your investors will surely be interested in learning how non-financial areas influence your company's value and how they support the implementation of your business strategy.

4. **INTEGRITY BUILDS TRUST.** By giving colour to non-financial parts of your report, you will lose credibility and your investors' trust. It is worth to consider tips on the quality of defining data to be reported that have been created by the Global Reporting Initiative guidelines. They are as follows:

   - **Balance** – the report should reflect positive and negative aspects of your organisation's operations and thus enable an accurate valuation of your overall performance.
   - **Comparability** – the information included in the report should be presented in a way that enables stakeholders to analyse changes in the company's performance over several years and compare them with your peers' results.
   - **Accuracy** – the reported data should be adequately precise and detailed, considering both the qualitative and quantitative nature of information.
   - **Timeliness** – reports should be prepared in appropriate time that is linked either to the reporting cycle or legal obligations.
   - **Transparency** – information should be presented in a way that is easy to understand. An advanced technical language used to describe environmental or HR issues might be discouraging for analysts or investors.
   - **Credibility** – the organisation should collect, register, compile, analyse and disclose both information and processes used when making the report in a way that facilitates their verification and ensures a high quality and materiality of presented information.

5. **EDUCATE YOUR INVESTORS.** It is beneficial to find time and way to explain to investors and analysts, when they first come across non-financial data, how important non-financial data reporting is to the company's current and future values. Such investments may bring quick returns.

6. **LEARN THROUGH FEEDBACK.** The market, just like your company, learns how to disclose non-financial data effectively. Collecting feedback from analysts and investors is priceless and it is currently an underestimated tool for improving disclosure of non-financial data. By spending time on asking investors about their opinions, you will receive valuable tips and maintain good relations with that particular group of recipients.