Position Paper: Unlocking and revealing the value of intangibles in delivering Sustainable Development Goals

WICI Global and Value Reporting Foundation (VRF)
Input to Italy's Presidency of the G20 and B20
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This paper has been developed jointly by the World Intellectual Capital/Assets Initiative (WICI) *Global Network and the Value Reporting Foundation (VRF) for the purpose of articulating the importance of intangibles and communication thereon to help achieve the UN Sustainable Development Goals (SDGs).*

We are pleased to submit the ideas in this paper for B20 and G20 consideration during Italy's Presidency of the G20.

Value in the 21st century

The United Nations Sustainable Development Goals (SDGs) provide a global framework for action by governments, the private sector and civil society to address the world's interconnected economic, social and environmental needs. Mobilizing action to achieve the 17 goals is an urgent task which requires investment, commitment and innovation. In this paper, two global organizations dedicated to the public interest mission of improving corporate governance and disclosure to facilitate economic progress and sustainable development simultaneously, have come together to articulate how a conscious embedding of intangible value within business systems of governance and decision-making at both the individual business and national levels, can play a valuable role in meeting the SDGs.

Founded in 2008, the World Intellectual Capital Initiative (WICI) is a global network of companies, analysts, investors, the accounting profession and academia who collaborate in promoting better corporate reporting as a key tool of corporate governance by recognizing the role of intangibles/intellectual capital in the sustainability of an organization's value creation over the short, middle and long term. WICI Network is located in regional and country jurisdictions worldwide (WICI Japan and WICI Europe comprised in turn of WICI Italy and WICI France), and it addresses its activity and guidance to both large companies and SMEs.

The Value Reporting Foundation (VRF, the result of the June 2021 merger of the International Integrated Reporting Council and Sustainability Accounting Standards Board) is a global nonprofit organization that offers a comprehensive suite of resources designed to help businesses and investors develop a shared understanding of enterprise value – how it is created, preserved and eroded.

We seek the endorsement of policymakers and market participants for the ideas in this paper and encourage collaboration and dialogue in the spirit of SDG 17 (collaboration and partnership). This is in line with the universal nature of the SDGs. Unlike its predecessor Millennium Development Goals, the 193 countries have committed to their implementation. This unprecedented global commitment has led to sustained interest from capital markets, new products to support financing achievement of the SDGs and new business models that prioritize long-term value creation. We believe that WICI and the VRF provide useful measurement and communication tools to support this transition.

WICI's intellectual property includes the WICI Intangibles Reporting Framework, WICI KPI Concept, and industry WICI-KPIs which are oriented to the reporting of intangibles and value creation. WICI believes that these tools are critical success factors for fully **unlocking** and **revealing** the **value of intangibles** as a contribution to the delivery of the Sustainable Development Goals. In turn, the VRF has three principal resources, the International Integrated Reporting Framework, SASB Standards and Integrated Thinking Principles, which it believes are critical success factors, too, for the same aim of **unlocking** and **revealing** the **value of intangibles** as a contribution to the achievement of the Sustainable Development Goals. Accordingly, the 'intangibles missions' of WICI and VRF as they relate to the SDGs, are fully aligned.

Our vision for a more connected and comprehensive corporate reporting system

Evidence shows that corporate reporting influences behaviour but that the prevailing system of disclosure almost of necessity still prioritizes financial reporting over other forms of reporting on value creation (or erosion) as the required connected and comprehensive reporting system is still being shaped. This means that risks and opportunities, strategies, governance systems, and business models are being mispriced, and significant investments in potential future value creation not being optimally executed. The WICI and VRF share the view that corporate reporting reform must form part of a package of changes that will create the conditions for more sustainable investment.

Significant progress has already been made at unprecedented speed, for example by the IFRS Foundation (under the oversight of IOSCO) providing global leadership as it evaluates the potential for establishing an International Sustainability Standards Board (ISSB), complemented by regional and jurisdictional innovations, for example by the EU and US SEC.

WICI and the VRF are pleased with this increased commitment and will continue to advocate for the continued inclusion of intangibles within global public policy developments.

We would also encourage policymakers to endorse a multi-capital approach to value creation, where financial capital combines with broader forms of capital (intellectual/organizational, human, social and relationship, natural and manufactured) to provide a complete and comprehensive picture of value creation over time. This will achieve progress on two levels. First, it will drive the connectivity of information and integrated thinking within the organization so that the effect of one capital can be assessed in relation to other sources of value creation. Second, the broader view of capitals, which includes intangibles, is by nature future oriented, and holistic consideration of all capitals will enable a greater focus on medium and long-term performance. This discipline will attract more investors who want to remain invested for the long-term and open up investment opportunities in, for example, green finance products, sustainable infrastructure, pharmaceuticals and digitization technologies that have the potential to transform the life chances of populations in low-income countries (SDGs 1 and 10).

We believe that a comprehensive corporate reporting system, focusing also on intangibles, will achieve a broader understanding of value creation, better corporate governance and increased investment in business models that promote sustainable development and prosperity.

SDGs and the business model

The wide range of business, economic, social, environmental, human and governance issues represented by the 17 SDGs are interconnected. One important feature of the SDGs is that a business can contribute to one or more goals by utilizing its own unique way of carrying out economic activity through its business model. The inputs into the business model will be varied and not limited to financial assets. Indeed, intangibles today contribute a larger share of overall value creation and encompass employee skills and productivity, innovation, technology, design capacity, reputation and stakeholder trust.

By integrating these factors into the business model, intangibles play a significant role in achieving the SDGs, amplifying the need for formalizing their importance within the structure of corporate reporting frameworks and standards.

The unique contribution of intangible assets to value creation and sustainable development

Unlike assets recognized in the balance sheet (such as financial and manufacturing assets), intangibles can grow as a result of the integration of human activities over a period and use in other business activities. More importantly, the combination of intangibles deployable in one company will often be totally different from that in another. It is a source of competitive advantage. An organization's 'intangibles portfolio' is not easily imitated, and even if some standardized technology solutions can be purchased, techniques, know-how or organizational designs and procedures cannot be easily copied. Another characteristic of intangibles is that they may last longer than tangible assets as long as they are well tailored to the needs and features of 'The Business'. Intangibles are also often subject to constant investment over time, for example R&D, investments in people learning and development and market-led innovations.

The various intangibles can be categorized as human capital, organizational capital and relational capital that are critical for the organization's capability to create value. These three are aggregately called 'Intellectual Capital' in traditional academia. Organizational capital includes corporate philosophy, history, technology, know-how, teamwork capability, organizational design and procedures, R&D capacity etc. This specific form of intangible capital is named 'intellectual capital' in the International Integrated Reporting Framework. Relational capital covers relationships with customers or clients, cooperation with the region where the company operates, trust with business partners and so on. This is encompassed in the VRF's International Integrated Reporting Framework as 'Social and Relationship capital.'

Businesses require tangible assets to carry out their activities, including financial and manufactured capitals. By adopting a multi-capital view, it is possible to see how investment in intangibles helps to unlock tangible value over the short, medium and long-term. For example, it has been estimated that almost half the value of Coca-Cola is accounted for by its brand. Therefore expertise, attention and governance processes are needed to maximize the opportunities, and minimize the risks, associated with such a large proportion of value being accounted for by the brand alone. Investing in expertise to ensure businesses are equipped to handle intangible value are essential to ensure value is maximized from the full range of resources used to create value.

In general, intangibles can last longer than tangibles, but they cannot survive without proper sustenance and enhancement activities. If a company leaves intangibles in the situation where another company can easily utilize or imitate them, the core part of the company's value creation process may be diluted or even dispersed.

Since attaining the SDGs involves activity to create new sources of value in many fields, intangibles and their combination, which are the main source of value creation, are key factors for promoting the SDGs. Drawing on the innovative capacity of human endeavour is vital in this respect. In a scenario where a company contributes to addressing an SDG directly, it would need to use its own intangibles and a combination of resources from the viewpoint of long-term value creation.

According to an analysis done by Edmond de Rothschild AM, some of the issues picked up in the 169 targets under the 17 SDGs have clear links with intangibles. For example, the majority of the issues included in the targets related to 'good health and well-being,' (Goal 3) 'quality education,' (Goal 4) 'gender equality' (Goal 5) and 'decent work and economic growth' (Goal 8) have close and evident relationships with organizational and human capitals as components of intangibles in the context of the International Integrated Reporting and WICI Intangibles Reporting Frameworks.

However, even if a specific connection is not apparent in a certain category amongst the 17 SDGs areas, intangibles can still play an essential role in attaining SDGs. For example, the target 'end hunger and ensure access by all people' in the category 'zero hunger' (Goal 2) seems to show little connection with intangibles. Yet, imagine a company which collects spare foods from restaurants or a food processing company that gets information on food shortage in a certain country or region, matches those needs and seeds, transfers the food to where it is requested, and raises funds for doing so by utilizing micro-funding, virtual currency or an advertising model. In this case, a business network or business partnership (Goal 17) is created, which falls under the category of relationship capital, to collect information about excesses of food, shortage of foods, as well as supporters for raising funds needed for the success of the business. Some key persons, components of human capital, who have passion, intention and vitality, are indispensable. Needless to say, knowledge and/or IT technology is needed for realizing the matching system and handling a large amount of data.

Unlocking **unrealized intangible value**

This case illustrates the necessity of understanding the connection between intangibles and attaining the SDGs. Therefore, more focus is needed to highlight the role of intangibles in realizing the vision of the global goals. In many instances, the full **value** of intangibles needs to be **unlocked**, even internally, if intangibles are to be fully linked to the relevant SDGs. The VRF's Integrated Thinking Principles, which are broadly devoted to improvements in business productivity, are well suited to make a contribution here. This attaches specifically to Goal 8, 'Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all.'

In spite of the importance of sustaining value creation by an organization utilizing its own intangibles, company specific business models rooted in the connection of resources (or capitals) has not been the traditional method of disclosing information about a company due mainly to inherent short termism in the system, resulting in a focus on quarterly reporting or annual financial results and prospects in the immediate short-term.

Although the majority of the value of businesses today lies in intangibles, regulators and accountants have been slow to recognize their true importance; while businesses and investors have not fully factored them into their decision-making in a meaningful way, as their true value has not always been fully **unlocked** *internally* (and so by definition cannot find its way to market capitalisation), let alone **revealed** *externally* to investors - and other stakeholders - so that investors can build information about that **unrealized** value into their assessments of WACC and future cash flows. Since 2007, WICI has been pointing out and advocating the relevance of intangibles for value creation and the associated necessity for their measurement and reporting. The advent of integrated reporting confirmed this need for a change as to the consideration and representation of intangibles.

Since 2013, the VRF (then as the IIRC) has been advocating the importance of reporting on all aspects of value creation through integrated reports in accordance with the International Integrated Reporting Framework. WICI's concept of intangibles fits naturally with the intellectual, human and social & relationship capitals within the International Integrated Reporting Framework. A distinctive contribution of this Framework is how it is driving integrated reports to be based upon a foundational description of 'The Business' – in short, a description of its strategy, resources and relationships, governance system and business model.

Making judgements about the design and preparation of that foundational description of 'The Business' is one of the most important contributions of Boards of Directors to value creation. The integration of the relevant SDGs within the business model can be specifically drawn out in the description of 'The Business' in the integrated report as a 'material matter'.

If the vital role intangibles play in the company's value creation process and their contribution to meeting the SDGs is not recognized, the company could become exposed to risks that harm its value creation potential. On the other hand, if that vital role is *unlocked* by management and the Board through more integrated thinking, and *revealed* to capital markets in the integrated report, it should lift market capitalization. Further, if revealed to those focused on the less financial aspects of the SDGs, it should result in greater recognition of those companies and the countries in which they operate for their contributions to the SDGs.

The current situation where the value of intangibles is to a greater or lesser extent unrealized is a reflection of the prevailing attitude of the financial system focusing only on the financial value created from a short-term perspective. However, the system is somewhat constrained. Investors and those focused on the SDGs can only reward what is revealed to them. In order to change this situation and promote the SDGs, we need to highlight the long-term value creation capability of a company, which is closely related to the outcomes generated and therefore the contribution of the company to achieving the SDGs. One of the most straightforward ways to do so is to adopt a model of corporate reporting based on the company's long-term value creation, focusing on the utilization of its own intangibles, as well as the other resources used by the company to create value.

Revealing unrealized intangible value - tools to meet today's corporate reporting needs

The corporate reporting model which most fits the purpose is of ***unlocking*** and ***revealing*** **unrealized value of intangibles in relation to the SDGs** is integrated reporting, as set out in the International Integrated Reporting Framework which was released in December 2013 and updated in January 2021.

The Framework introduces six capitals as elements of company value creation, within which intangibles are a core component. The Framework also focuses on value creation over the short, medium and long-term.

The WICI Global Network has contributed to the development of integrated reporting from the beginning. Moreover, in 2016 WICI produced the WICI Intangibles Reporting Framework that can be utilized as a guide to the implementation of the International Integrated Reporting Framework as it relates to intangibles. These Frameworks are natural companions. When integrated reporting by companies is widely adopted, as is already the case in contexts such as Japan, The Netherlands, South Africa, France Italy, and Australia, it will be easier to understand which companies have the capability or intention to contribute to the delivery of the SDGs and to what extent, through leveraging their own intangibles.

Reporting on Performance and Prospects in relation to SDGs

Emerging forms of corporate reporting (see further resources) are also important for investors in an SDG context, because they enable them to assess which companies can succeed over the longer term. Moreover, for investors, sustainable growth is a critically important issue for companies in terms of their business resilience, with the reporting envisaged enabling them to respond to responsible investment principles with conviction and credibility. Thus, integrated reporting is essential also to advance investors' own interests, as well as those of their beneficiaries.

In this situation, it is appropriate that companies communicate with stakeholders through integrated reports about their own long-term value creation strategy based on the full range of resources used or available, including intangibles. In turn, this will result in a company expressing its capabilities and intentions towards contributing to the SDGs as well as its actual contribution. That is why we would ask governments to support this approach to corporate reporting, which encompasses intangibles and is value creation-based, as a very direct and effective way to promote the achievement of the SDGs.

Conclusion

We believe the ideas outlined in this paper are consistent with the goals of Italy's G20 Presidency and the three pillars it has outlined of people, planet and prosperity. As the world builds itself out from under the shadow of the Covid-19 pandemic it is essential that inclusive and sustainable economic development is encouraged, utilizing proven systems and tools to accelerate progress.

WICI and the VRF will continue their efforts to encourage more businesses to focus on long-term value creation in their communications with stakeholders, based on utilizing their own assessment of the resources used, focusing on intangibles.

This paper is a contribution to the public policy debate, and we encourage its endorsement by all those with an interest in advancing long-term value creation and the achievement of the ambitious sustainable development agenda.

Further resources:

International Integrated Reporting Framework (released: January 2021):
https://integratedreporting.org/wp-content/uploads/2021/01/InternationalIntegratedReportingFramework.pdf

The International Integrated Reporting Framework assists companies in designing a Basis of Preparation and Presentation for their integrated report which explains how they have used the various frameworks (e.g., International Integrated Reporting Framework, WICI Intangibles Reporting Framework), reporting standards (SASB Standards and IFRS) and guidance (WICI KPI Concept) in preparing and presenting the integrated report.

The Sustainable Development Goals, integrated thinking and the integrated report:
http://integratedreporting.org/wp-content/uploads/2017/09/SDGs-and-the-integrated-report_full17.pdf

WICI Intangibles Reporting Framework:
http://www.wici-global.com/framework

The WICI Intangibles Reporting Framework sets out example metrics in relation to intangibles. These are not standards, but along with the WICI KPI Concept, provide useful example KPIs and guidance for selecting KPIs. Again, a specific link can be made to relevant SDGs. Accordingly, the use of WICI KPIs also strengthens integrated reports.

SASB Standards

SASB Standards set out industry-specific metrics for 77 industries in relation to social & relationship and natural capitals, with a specific link being possible to relevant SDGs. Accordingly, the use of SASB Standards strengthens integrated reports.

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