Investigation on the Value Relevance of Integrated Reporting and Organizational Capital: Evidence From Sri Lanka

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Abstract

Integrated reporting is a developing reporting aspect in order to assess problems relating to corporate reporting. It provides a comprehensive account of organizational worth. This paper aims to assess whether integrated reporting and organizational capital increase the value relevance of firms. A checklist containing 100 integrated reports of banks which are listed in Colombo stock exchange were used for the analysis. Data were collected over the period from 2010 to 2019. Statistical analysis was done using the EWIS. Finding reveals that the book value of equity, earnings before interest and taxation of the equity of the bank, leverage of the bank and Organizational capital have a direct effect on the market value of equity of the bank while return on equity and size does not have a positive impact on the market value of equity of the bank. And to the best of our knowledge, it reveals that there is a significant effect of integrated reporting on the value relevance of organizations. Future research avenues were identified and the suggestions for future research on integrated reporting were provided. The findings bring out different implications for managers, decision-makers and the research community as well. This study further expands the existing knowledge on integrated reporting and sets the foundation for future researchers.

Keywords: integrated reporting, organizational capital, value relevance

1. Introduction

The development of integrated reporting (IR) has attracted much interest from various potential users of the report in the company recently. IR is an innovative method of business reporting initiative to fix gaps and issues related to existing approaches of corporate reporting that are widely criticized for being complex in its nature of reporting (Mohd & Khan, 2020, Camilleri, 2018). Instead, the guideline drawn up by the International Integrated Reporting Council (IIRC) asserts that the Integrated Reporting offers companies the opportunity for a clear and concise, integrated presentation of their business. As a business model, IR consists of key concepts, guidelines and content, which shows how corporate strategy, administration, results and prospects contribute to the short-term, medium and long-term value creation of companies (IIRC 2013). As a result, additional information has drawn more interest from various stakeholders due to the growing relevance of environmental, social and governance issues (Cahan, De Villiers, Jeter, Naiker, & Van Staden, 2015; Mart ńez-Ferrero and Fr ás-Aceituno, 2013; Stewart, 2015). However, IR can not alone contribute to generate the value of the firm without the greater deal of the Organizational Capital (OC). IR thus differs in its capacity to create value by taking into consideration the various capitals. Thus, Integrated Reporting and Organizational Capital must be overlooked as an interrelated tool that contributes on the value creation of the firm. The IIRC framework classifies the following six types of capital in order to increase financial performance.

Financial Capital: The pool of reserves accessible to an entity is the financial capital. Debts and equity finances are examples of this. This pivot on sources of reserves than its application. Manufactured Capital: The man created as well as the tools for production-oriented are the manufactured capital. In here a difference is drawn among short term asset and tangible reserves. Intellectual Capital: This means the main element in an entity's ensuing earning prospective. There is a tight connection and contingency among funding in research and development, revolutions, livewire as well as outside link and it enables to ascertain an entity's competitive advantage. Human Capital: Human capital is made of someone's knowledge, potentiality, talents and experience of an entities' workers as well as

managers. Because they are the assets and capacity of the organization. Social Capital and Relationship Capital: Societal and relationship capital is made of the soundness of chain links, state connections, connection with rivalries as well as client loyalty. Building relationships is the key to an organization to operate. Natural Capital: This contains resources, such as timber, fish, water, minerals etc. Except for these resources, there are many other resources from which human benefits that are provided. Owing to the growing significance of OC, a large amount of literature centred on the role of OC which enhance the financial performance and value of the firm (Oll & Rommerskirchen, 2018).

For example, Andreeva and Garanina, (2016) found that OC has a direct and positive impact on the performance of the organization and enhance the value of the firm. Further, OC improves market efficiency, competitive advantage and potential for innovation (Martín-de-Castro et al., 2006; Lev, Radhakrishnan & Zhang, 2009; Carmona-Lavado et al., 2010; Chen et al., 2015). Very limited research attempt to investigate the organizational capital and value relevance of the firms. Hence, investigating OC in an environment where Integrated Reporting is highly adopted to give some new insights to the policymakers and practitioners. On the other hand, a large amount of previous literature on IR investigates the adoption of IR enhance the value relevance, the approaches of IR enhance the value relevance, effects of IR on the firm's value and IR adoption, its determinants and consequences on the generation of firm value. Tlili, Othman and Hussainey (2019), for example, found a positive and important impact on the value relevance of organizational capital of the integrated reporting adoption. Zhou, Simnett, and Green (2017) proved that IR provides useful information to the capital market. Meanwhile, Fernando, Dharmawati, Sriani, Shauki, Diyanty (2017) found that implementation of IR has no effect on the relevance of accounting information. In a world of rapid globalization, information inefficiency in the market, changing aspirations of the society, led to all the companies towards the challenging task of disclosing their working practices.

Hence, it could be evident that very hard to find literature that investigated the value relevance of the firm under the environment of Integrated Reporting and Organizational Capital are interrelated. This would bring a novel contribution to the existing body of knowledge. On the other hand, still, there are limited researches as to the examination of current reporting practice of companies as to compliance with IIRF according to (Ahmed & Anifowose ,2016; Kilic & Kuzry,2018). Therefore, this paper examines the IR practice and the use of Organizational Capital to enhance value relevance of firms based on Sri Lankan context concerning the banking industry. Sri Lanka as a country has witnessed a rapid diffusion of IR (Gunarathna & Senarathna, 2018). Moreover, Gunarathna and Senarathna (2017) reveal that though IR had been an efficient choice for early-adopting companies in Sri Lanka, for many late adopters, it had been a fashion choice. In particular, organizational capital was not examined under integrated reporting is completely practised. As a result, the recent question has been raised whether the current practice of IR and organizational capital as an interrelated tool contribute to enhance the firm value of Sri Lankan companies? This is an important empirical question that needs to be answered in line with integrated reporting and organizational capital are concerned.

2. Literature Review

In order to eradicate the restriction and the challenge of traditional corporate reporting methods, the International Integrated Reporting Framework (IIRC) has been developed. The breakthrough of advanced technologies, climate changes and volatile business environment have created an unprecedented expectation from shareholders. Hence, a globally accepted reporting framework is required to ensure that the reporting should encompass the integration of financial, social, environmental and government information in a straightforward, brief and similar way (GRI 2012). As a result, Integrated Reporting (IR) is defined as "a succinct communication on how, in the context of its external climate, a company's strategy, governance, success and prospects build value in the short, medium, and long-run" (IIRC, 2013). The integrated report simply and unambiguously tells the entire history of the company. It varies from the traditional annual report, it concentrates on the potential to generate profit in the short, medium and long term from the standard annual report. The report focuses on conscience, strategic focus and the orientation for the future, information connectivity and interdependence between the investors and managers. Therefore, IR contributes to the value creation of an organization through an integrated thought process which, eventually has to be communicated to all investors and shareholders about the value creation (IIRC 2013). Hence, the quality of information is essential that could be accessed by the potential investors and stakeholders, which is the primary objective of IR (IIRC, 2013).

The IIRC's fundamental approach is to report on "values of inventories that are raised, decreased or transformed through the operations and results of the company" on six capital products (IIRC, 2013). Furthermore, the discussion paper of September 2011 of the IIRC clearly indicates that an organisation's use of various resources and/or "capitals" on which it has access to them is evident and dependent. The 2011 discussion paper used the word

"capital" and the capitals are often called "tools and ties." These capitals together form the base of the value creation of an organization and the capitals are not fully autonomous (KPMG 2017, Lev, Radhakrishnan, & Evans, 2016). The precise essence of the relationship is based upon the concentration and values of the organization. While most organizations rely to a degree on all capitals to some extent, there are relatively limited or indirect dependencies that are immaterial for corporate reporting purposes (Levet al., 2016). In the meantime, Samaniego (2006) confirms that IR has always concentrated on the various capitals and on their ability to provide shareholders wealth. The aim is to demonstrate the use of capital by companies for input and transforming the outcomes that are expressed as asset impacts (IIRC, 2013). The IR framework divided capital into six main categories: industrial, financial, environmental, human, social and intellectual. Meanwhile, Samaniego (2006) states that organizational Capital (OC) relates to intellectual capital and confirms that OC relies on the information used in the information technology environment to be changed during changes. Hence, Integrated Reporting and Organizational Capital are interrelated concepts, both are value relevance to the shareholder as per the theories depicted in many empirical setting. Hence the following theories such as agency theory, stakeholder theory, institutional theory and stewardship theory, emphasise the integrated reporting and organizational capital on value relevance.

According to Jensen and Meckling, (1976) agency theory suggests that managers and their owners are driven by personal benefit opportunities (Eisenhardt 1989). The primary problem of agents is the separation of ownership and control mainly between external shareholders and management. According to the IR framework (2013), the pivotal role IR's is to fulfil principles objective which maximizes their wealth, however, it depends on the value of the firm. Hence, agency theory is one of the important theories behind IR and its relevance to the value creation of firms. On the other hand, the stakeholder theory of organizations creating value for all stakeholders (Freeman 1984), which takes account of stakeholders ' expectations regarding the disclosure in question. In fact (Hill & Jones 1992) developed a new stakeholders theory that the organisation, which includes all contract relations between different stakeholders, can be seen as "an annexed to resource holders." This theory considers contracts between business and society in a broader context.

On the other hand, an important theory in relation to integrated reporting is Stewardship Theory formulated by Donaldson & Davis (1991) both leading experts in organizational behavior, inspired by philosophy and psychology. The theory says that the manager would use cooperatives, unions and collectivists rather than individualists in his attempt to achieve the goals of the organization, which he recognizes as an agency in the entity (Bucholtz , Brown & Schabana, 2009). As described above, the Stewardship Theory elaborate on those circumstances in which the behavior of the manager is not guided by personal goals but in line with the objectives of the owner. The performance of managers should therefore be measured accordingly benefit to reach social goals and thus reporting this viewpoint should also be adopted. Hence, the empirical setting in line with IR and OC is significantly increasing for the last two decades. As a result, it should be important to overview the empirical results which has been conducted in a different context.

Previous studies in connection with IR suggest that the relationship between integrated reporting and market value is significant (Lee and Yeo, 2015; Barth et al., 2016). In accordance with the above Mohd & Khan (2020), literature examined the way in which IR is linked with the value generation of a company in the Malay company, especially intellectual capital (IC). Recent IR adoption study, its determinants, and its effect on firm valuation (Fr ás-Aceituno et al., 2013, Jensen and Berg, 2012). Previous papers assert that the significant gap between the book value and a company's market value is due to the non-reported information on financial statements intellectual capital (Lev and Zarowin, 1999). On the other hand, Camilleri, (2018) indicate that investors and other financial stakeholders remain the primary players in many companies and that they continue to be the main beneficiaries of the corporate reports. Accordingly, his findings imply that investors and financial stakeholders are key human capital. His finding also validates the theory of stewardship in an empirical setting. However, integrated information also allows practitioners to enhance their management of the enterprise and to strengthen their reputation in relation to organizations and other stakeholders of society by integrating information in their IR (Mohd & Khan, 2020). For the meantime, (Oll & Rommerskirchen, 2018) the critical issues that will probably need to be dealt with before integrated reporting have a time test. The key concepts and guiding principles of the integrated reporting framework are identified by the design of the key problem areas for integrated reporting. In the meantime (Wang, Zhou, & Wang, 2019), traditional governance arrangements have a positive relationship with IR reporting quality.

A considerable amount of literature studied the importance of OC as part of the business and financial results improved in a substantial stream of works, recently researchers have shown an increasing interest OC as it has a significant impact on value creation (Mar á D éz et al., 2010; Andreeva and Garanina, 2016). Indeed, research shows that OC has an immediate and positive effect on company value development and organizational performance

(Andreeva and Garanina, 2016; Díez et al., 2010). OC also improves industry, competitivity, and creativity (Carmona-Lavado et al., 2010; Martín-de-Castro et al., 2006; Chen et al., 2004). On the other hand, Lev et al., (2016) argued that the measurement of OC is necessary for management to make strategic decision-making which affects both internally and externally. Moreover, OC valuation enables investors to measure the return on investment's success (Lev et al., 2016). The value importance of OC investments to capital providers has been evaluated by researchers. The minimal evidence in the literature shows that OC is an investment-related value (Eisfeldt & Papanikolaou, 2013). The OC investigation is therefore as interesting as it is useful for practitioners and academics in a highly established reporting environment. Another study conducted by Tlili, Ben Othman, & Hussainey (2019) found that after the mandatory adoption of IR, it has a positive and significant impact on the value relevance of OC. Further, they suggest that there has been an increasing interest-driven from OC, one of the most significant discussions on investment on OC is not considered. The effect of the intellectual capital divulgation quality was contrarily examined (Vitolla, Raimo and Rubino 2019) empirically in the Integrated Corporate Performance Reports. The findings indicate that disclosure quality of intellectual disclosure and company performance is significant and positive.

Having critically reviewed the previous studies in relation to Integrated reporting and Organizational capital to the value relevance of firms. Interrogations have been established to ask a question which capitals do stakeholders value more within IR decision? and Are organizations succeeding in understanding their impact on all of the six capitals in IR practice which in turn increase the value of the firm?. There could be a dearth of published research, as per the researcher's knowledge, in the context of organizational capital encompassing all six capitals and value relevance of firms under the Integrated Reporting is completely practised. Therefore, the aim of this study is to investigate the value relevance of firms' organizational capital in the environment of Integrated Reporting is completely practised. This would bring a novel contribution to the existing literature in the context of value relevance and organizational capital and Integrated Reporting

3. Research Method

3.1 Conceptual Framework

An accounting measure of performance can be studied in the relationship between information on the market reaction accounting and the high-value literature of the Ohlson model (1995, Hassel et al., 2005; Hirschey et al., 2001). In the fundamental model, it links the organization's market value to its earnings and book value. In the first step, the researchers expanded their assessment by examining the relationship between market value and organizational capital. The researcher thus adds OC to the model to test the principal hypothesis. For the purpose of this research we used organizational capital (OC), the book value of equity (BVS), earnings before interest and taxation of the equity of the bank (EPS), return on equity (ROE), leverage of the bank (LEV) and Size as independent variables and market value of equity of the bank (MVS) as the dependent variable.

The researcher uses the following formula to measure OC using the law of motion according to Gourio and Rudanko., (2014)

$$OCit = (1 - \alpha 0)OCi\ t, -1 + \frac{SGAit}{cpi_t}$$

In here the consumer price index is depicted by cpi_{it}, α_O is the depreciation rate of 15% based on the rate used in R&D estimation, and SGA_{it} stands for selling general and administrative expenses for the year t and figure 1 depicts the conceptual framework of the research study.

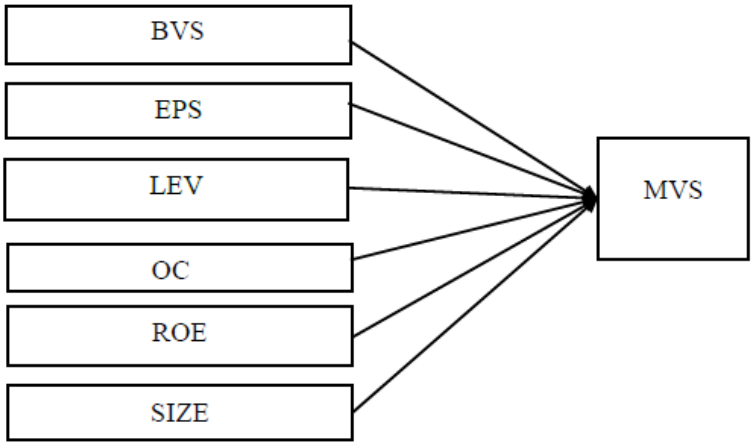

Figure 1. Conceptual framework

3.2 Hypothesis Development

The financial accounting standards board stated that the preeminent features of pecuniary statements are reliability and relevance. The above literature review illustrates the relevancy of organizational capital outlaying to equity suppliers. The value pertinence of OC is studied by Lev et al., (2009) by using the monetary OC measure of an entity. It depends on the sale, overall and administrative costs. The detections suggest that there is a favorable strong connection between the measure and future operating presentation. Organizational capital is related to favourably with the performance of the stock. Eisfeldt and Papanikolaou (2013) investigated the association between organizational capital and expected returns. Findings reveal that when the OC is higher, the expected returns also higher. With the increase in the number of companies adopting in Sri Lanka, it has become a key consideration to assess whether and to what extent these companies have complied with IIRF in the preparation of integrated reports. Therefore, based on previous literature, we hypothesize that:

H1: BVS is positively related to MVS

H2: EPS is positively related to MVS

H3: LEV is positively related to MVS

H4: OC is positively related to MVS

H5: ROE is positively related to MVS

H6: Size is positively related to MVS

3.3 Methodology

The study has developed an extensive IIRF-based divulgation review list that is similar to the Stent and Dowler (2015) and Kilic and Kuzey (2018) procedures. This checklist was used to analyze the integrated reports of banks listed on the Colombo stock exchange (CSE). A longitudinal analysis was carried out based on 100 integrated reports of 12 banks from 2009 to 2019. The final sample is reduced to 100 years of observations representing 12 distinctive banks following the exclusion of observations containing missing data. Using the disclosure checklist, the scores were analyzed statistically. All the results were analyzed using EWIS software.

4. Results and Discussions

4.1 Descriptive Statistics

As the first measure of central tendency, the researcher calculates the mean. One of the types of measures of central tendency is the mean. In order to measure the central tendency, the mean or average is the most used method. Mean is the average of all values in distribution according to (Krishnaswamy & Ranganatham, 2005). The second type of measures of central tendency is the median. Median is the midpoint of diffusion of values is called the median. The largest value of a numeric variable is the maximum while the smallest value of a numeric variable is called minimum value. The square root of the variance is the standard deviation. Skewness is a measure of the symmetry of data

dispersal. Kurtosis measures the peakedness of data distribution. The Jarque-Bera test identifies whether sample data, regression residuals, or ANOVA residuals have a normal distribution. In general, if the J-B value is higher and it indicates that errors are not normally distributed. In here no any data can be seen as 0 and therefore the data is not normally distributed.

Table 1. Descriptive analysis of the data

	BVS	EPS	LEV	MVS	OC	ROE	SIZE
Mean	162.531	39.116	6.594	912.879	61.377	0.135	22.243
Median	70.687	1 9.655	0.802	76.600	2.777	0.151	22.431
Maximum	2637.513	672.675	88.800	78429.210	4424.727	0.256	24.832
Minimum	0.058	-0.322	0.012	1.781	0.283	0.001	18.844
Standard Deviation	404.123	87.429	17.501	7834.851	446.994	0.058	1.114
Skewness	4.680	5.221	3.806	9.831	9.465	-0.498	-0.431
Kurtosis	24.670	33.523	16.458	97.764	92.669	2.517	2.682
Jarque-Bera	2321.707	4336.290	996.016	39028.520	34995.580	5.102	3.517
Probability	0.000	0.000	0.000	0.000	0.000	0.078	0.172
Observations	100	100	100	100	100	100	100

4.2 Correlation Analysis

Normally, the population coefficient ranges from +1 to -1 and there is a stronger negative linear relationship if it is closer to -1. There is a better positive relationship if it is closer to +1. If it is close to 0, the weaker the relationship. Based on (Cohen & Manion, 1989) criterion values more than 0.3 are considered to be sizable. Based on the research findings there is a strong positive connection between EPS and BVS, MVS and BVS, MVS and EPS and as well as size and ROE are sizable. As well as there is a negative relationship between LEV and BVS, MVS and LEV, OC and LEV, ROE and BVS as well as ROE and OC.

Table 2. Correlation matrix

	BVS	*EPS*	*LEV*	*MVS*	*OC*	*ROE*	*Size*
BVS	1.000						
EPS	0.934	1.000					
LEV	-0.006	0.126	1.000				
MVS	0.636	0.748	-0.034	1.000			
OC	0.434	0.179	-0.046	0.009	1.000		
ROE	-0.039	0.085	0.145	0.031	-0.128	1.000	
Size	0.131	0.210	0.136	0.070	0.076	0.502	1.000

4.3 Regression Analysis

The hypothesis can be tested through the regression analysis. The results can be present as follows. The researcher used multiple linear regression analysis in order to help to understand the association between more than two quantitative variables. Regression analyzes by means of an independent variable are known as single regression analysis, and multivariable regression analysis is known as one-on-one regression analysis (Tabachnick, 1996; Buyukozturk, 2002). The findings concerning multiple linear regression is shown in Table 3 and Table 4.

Table 3. Regression Analysis

Variable	Coefficient	Standard Error	t-Statistic	Probability
C	19735.350	10873.820	1.815	0.073
BVS	-25.426	6.134	-4.145	0.000
EPS	179.225	26.478	6.769	0.000
LEV	-115.424	30.750	-3.754	0.000
OC	3.684	1.829	2.014	0.047
ROE	-8354.237	9796.293	-0.853	0.396
SIZE	-900.822	514.408	-1.751	0.083

Table 4. Model Fitting

R-squared	0.59913
Adjusted R-Square	0.577807
Standard error of the regression	5090.802
Sum squared	2.44E+09
Log-likelihood	-992.3192
F-statistic	28.09799
Prob (F-statistic)	0.000
Mean dependent variance	912.8793
S.D.dependent variance	7834.851
Akaike info criterion	19.96638
Schwarz criterion	20.12269
Hannan-Quinn criterion	20.02964
Durbin Watson stat	1.45247

The table shows that 57.7% of the variation in MVS is explained by other independent variables. The P-value of BVS, EPS and LEV is less than 0.001 and therefore they can be used to predict MVS. The correlation among the residuals can be quantified using the Durbin Watson statistics where values around 2 indicate no problem of autocorrelation and according to the results of the research, there is no problem of autocorrelation.

There is an endeavour to synchronize in multiple linear regressions the variations of the independent variables in the dependent variable (Unver & Gamgam 1999). The regression equation can be developed accordingly from the table above.

$$MVS = \beta0 + \beta1 + \beta2 + \beta3 + \beta4$$

MVS = 19735.350+ -25.426 BVS+ 179.225 EPS + -115.424 LEV+3.684 OC+-8354.237 ROE+-900.822 SIZE

According to the equation above, every step in BVS improves, MVS should be reduced by 25,426, so long as the other variables remain unchanged. Each step in the EPS will improve by 179.225 if other variables remain fixed. Each step will improve in LEV and MVS will be reduced by 115.424 if the other variables are revised. Every step of OC will improve MVS by 3,684 as the other variables continue to remain the same. In ROE, MVS should be reduced by 8354.237, so long as the other variableness remains fixed. According to the equation, SIZE improves every step by reducing MVS by 900.822 if the other variables are not altered. The variance inflation factor is used to predict the multicollinearity problem. The situation of Multicollinearity involves the higher association of the independent variables. This violates the assumption that the predictors are independent. If the VIF value is greater than 10 (VIF>10), it is problematic according to Vittinghoff et al., (2012) and James et al., (2017) explains that VIF values which are greater than 5 or 10 (VIF>5 or VIF>10) is problematic. Menard (2001) recognized that VIF values greater than 5 is a cause for concern and VIF values greater than 10 indicates a serious collinearity problem. The VIF values greater than or equal to 2.5 indicates considerable collinearity according to Johnston et al., (2018). The results of the research are mentioned in Table 6.

Table 5. Multicollinearity Test

Variable	Coefficient Variance	Uncentered VIF	Centered VIF
C	1.18E+08	534.766	NA
BVS	37.630	32.013	27.517
EPS	701.084	28.846	23.994
LEV	945.566	1.483	1.297
OC	3.345	3.050	2.993
ROE	95967358.000	9.376	1.458
SIZE	264616.000	593.594	1.471

According to the results, the VIF value is less than 5 for LEV, OC, ROE and Size. Thus, there is no problem of multicollinearity. But for BVS and EPS, the VIF value is greater than 10 and therefore it indicates a serious collinearity problem in BVS and EPS.

Table 6. Hypothesis Testing

Hypothesis	**Results**
H1: BVS has a positive impact on MVS	Supported
H2: EPS has a positive impact on MVS	Supported
H3: LEV has a positive impact on MVS	Supported
H4: OC has a positive impact on MVS	Supported
H5: ROE has a positive impact on MVS	Not supported
H6: SIZE has a positive impact on MVS	Not supported

5. Conclusion

The above results show the research hypothesis and analysis results. The results reveal significant relationships between BVS (β = -25.426, $p < 0.05$), EPS (β = 179.225, $p < 0.05$), LEV (β = -115.424, $p < 0.05$), OC (β = 3.684, $p < 0.05$), ROE (β = -8354.237, $P > 0.05$), SIZE (β= -900.822, $P > 0.05$). So H1, H2, H3, H4 are respectively supported in the model. Moreover, the results do not show a significant path between MVS and ROE as well as MVS and SIZE thus H5 and H6 are not supported in the model.

So according to the finding of the study, Can indeed be finalized that integrated reporting in banks in Sri Lanka affects and enhance the value relevance of organizational capital to a certain extent. But in gaining this result there were some limitations. First, the researcher considers only the banks which have been listed in the Colombo exchange. As well as there were limited data available. Several future research opportunities are arising through the findings of the research. First, this study only focuses on the banking sector in Sri Lanka. So in the Future research should consider other types of companies which are listed in Colombo stock exchange. Second, this research benefits from Sri Lanka's dynamic location. However, this framework can limit the prevalent outcomes to many other nations. The research includes cross-country comparative analysis in other countries. It's going to be effective.

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