BIS | Department for Business Innovation & Skills

Consultation response form: The Future of Narrative Reporting

A copy of the consultation available at: http://www.bis.gov.uk/consultations.

Responses to the Consultation by be received by 19 October 2010

Name: Anne Kirkeby

Organisation (if applicable): Governance for Owners LLP

Address: 26 Throgmorton Street, London EC2N 2AN

Email:

Return completed forms to:
Jane Leavens
Corporate Law & Governance Directorate
Department for Business, Innovation and Skills
1 Victoria Street
London
SW1H 0ET

Tel: 020 7215 1686
Narrativereporting@bis.gsi.gov.uk

Please tick the box from the following list of options that best describes you:

	Quoted company
	Other company
x	**Investor or investment manager**
	Business representative organisation
	Investor representative organisation
	Non governmental organisation (NGO)
	Trade Union
	Lawyer or accountant
	Other (e.g. consultant or private individual)

Value of narrative reporting

Question 1 : Are company directors providing useful and relevant information on the company's:

i) forward-looking strategy and
ii) principal risks and opportunities?

Comments
Disclosure has improved significantly in the last few years, and overall, we find that UK reporting is of a reasonable quality with some companies disclosing excellent information while a number of laggards still remain. However, we also find that a number of companies disclose too much information which is insufficiently focused and the use of boiler plate and corporate spin is a cause for concern. Investors are not seeking to increase the overall burden of reporting or the volume unless it can be presented in a way that allows for meaningful analysis and conclusions to be drawn. As investors we are more interested in targeted and effective reporting which must be joined up with a clear correlation between principal risk, stated objectives and strategy, and performance measures and indicators which are all a result of board level vision and direction. If the reporting of principal risks was more directly aligned with the company's strategic objectives and then linked to its Key Performance Indicators, it would provide greater insight for investors and increase the possibility of making peer group comparisons, adding a further dimension for assessing qualitative value creation.

Question 2: What are the constraints on companies providing information on these issues?

Comments
We have no comments to question 2

<u>Question 3:</u> Does the information provided re flect the issues discussed b y the directors in board meetings?

Comments
Unfortunately, we often do not find that information provided appears to reflect the issues discussed by the board. This is also supported by our findings from company dialog. As mentioned before, information with regards to strategy and objectives, principal risk, and performance and measures often appears disjoined and not a result of board level vision and direction. We also find that few companies in the directors' report provide a good quality overview of issues discussed by the board and that this overview rarely mentions issues that provides us with sufficient reassurance with regards to overall oversight by the board.

<u>Question 4</u>: Does the information help shareholders to press directors on key issues relating to strategy and risk, or inform their business decisions?

Comments
Information disclosed by companies does to some degree help shareholders to press directors on the most obvious issues. However we still find that shareholders need to have obtained a significant level of knowledge about the business and the industry elsewhere in order to indentify whether the company in its narrative reporting has addressed the most material issues, and in particular, if any are missing. Again, too much insufficiently focused information might in fact mislead the investor who might lose sight of what is material.

<u>Question 5</u> : If a compan y do es not provide sufficient or material information to you, do you challenge it? Is there anything which could help you to do so?

Comments
If a company does not provide sufficient or material information we will often challenge it. One way of aiding this process would be a provision requiring the company to justify: i) why information disclosed is material, ii) how and why KPIs were chosen and iii) how principal risk, stated objectives and strategy, and performance measures and indicators are interlinked by an overall vision and direction by the board.

<u>Question 6:</u> What other sources of company information do you use and how valuable are they (e.g. information provided on the website, analysts' briefings, dialogue with the company, corporate social responsibility report)?

Comments
We use a number of sources of company information including, website, analysts' briefings, CSR report and dialog with the company. However we find that a dialog with the company, by far, is the most valuable source. Websites tend to be too customer focused as well as have a substantial marketing aspect to them. CSR reports often try to cover too much and are insufficiently focused on issues material and/or relevant to the company. Analyst briefings, unless specifically tailored to so-called responsible investors, only cover a very small part of the area covered by narrative reporting.

<u>Question 7:</u> Is there scope to reduce or simplify the requirements on which companies report?

Comments
We strongly believe information should focus more on materiality and must be driven by the overall vision and direction in terms of coupling strategy and objectives, principal risk, and performance and measures. As a result some information is better suited for separate reporting. This could include information which is more anecdotal in nature and information which provides an extra layer of information.

<u>Question 8:</u> Is there scope to arrange the information in a more useful way?

Comments
We have no comments to question 8

Business Review

<u>Question 9</u>: Looking at an Operating & Financial Review and the existing business review (see Annex D), do you see value in reinstating elements of an OFR and if so what would they be? In particular, would a statutory reporting standard help to improve the quality of reporting?

Comments
Much has been said with regards to how the Business Review and the OFR are practically identical, however, we do not agree with this conclusion. While the business review requires companies to disclose much of the same information, in our view, the ethos of the OFR is very much on companies providing information which will enable investors to assess not only the adopted strategies but also the potential for those to succeed. In that sense we find the Business Review requirements are too disjointed in requiring information without actually emphasising the central purpose for doing so. We believe that a statutory reporting standard might help to improve the quality of reporting but would welcome also the inclusion the comply or explain principle and thereby allowing companies the option of explaining any non-compliance with the statutory reporting standard.

<u>Question 10</u>: The business review provisions require quoted companies to report, to the extent necessary, on:

- **main trends and factors likely to affect the future development, performance and position of the company's business**
- **information on environmental matters**
- **information on employees**
- **information on social and community matters**
- **persons with whom the company has essential contractual and other relationships**
  - **i) is this information useful to you? How do you use it?**
  - **ii) Could disclosure be improved? If so, how?**
  - **iii) Are there key issues which are missing? If so, please explain?**

Comments
The Business Review can, at its best, provide investors with a clear picture of how the company is positioned to deal with future challenges well as its ability to take advantage of the opportunities identified. We use the Business Review as an indicator of how well a company is governed which we see as the principal requirement for future success. However, we often find that Business Reviews lack a coherent analysis that link the different aspect of the review. This in particular includes insufficient

narrative on a company's ability to take advantage of the opportunities mentioned, lack sufficient analysis of the external environment and macroeconomic factors, weak strategy discussions, lack of a link to the operational review, lack of clear KPIs, lack of a resource discussion and the lack of a description of how to manage the specific risk factors identified beyond the generic risk management process.

As mentioned before, we believe that a fundamental reporting requirement would be for companies to report on how principal risk, stated objectives and strategy, and performance measures and indicators are interlinked by an overall vision and direction by the board. We believe that a focus on the link between these factors will force companies to focus their reporting and that this will improve the quality of disclosure.

We also find that that the Business Review does not require companies to be sufficiently forward looking in their reporting and would also recommend that a future reporting standard includes a requirement for companies to explain what their forward looking time period is as this will dictate the types of issues we could expect them to cover.

With regards to employees, environmental, social and community matters as well as CSR matters in general we believe companies should be required to report on how, and how often, they are dealt with by the board, who determines the strategy, the line of communication to the board on the development of these issues and whether an individual at board level has special responsibility for these issues or why that is not the case. In short, we would like the company to disclose more on the governance of these issues by the board which is, after all, directly accountable to shareholders.

<u>Question 11:</u> Would more guidance be helpful? If so, what form should this take? For example, best practice example, sample Key Performance Indicators, etc?

Comments
More guidance would probably be helpful for companies and both best practice examples and sample Key Performance Indicators would fulfil that purpose effectively. However, we believe it is paramount that both types of guidance seek to illustrate how narrative reporting must be joined up with a clear correlation between principal risk, stated objectives and strategy and performance measures and indicators. Equally guidance in terms of sample Key Performance Indicators should illustrate why a specific KPI has been chosen, why it is material to the future success of the company in terms of objectives and strategy and should make a point of demonstrating the

usefulness of KPIs of varying time horizons.

Question 12: Shoul d there be a shar eholder's advisor y vote on the Business Review?

Comments
We would welcome an advisory vote on the business review as we believe that a vote would force the board of directors and senior management to take more direct responsibility for the Business Review. We believe this will help drive the agenda from the top down in the organisation which appears rarely to be the case currently.

Question 13 : Are there non- regulatory solutions to increasing qu ality through better guidance or p ublicising excellence in business reports? If so, what?

Comments
One of the suggestions given in the consultation paper proposes an annual ranking as a means to drive up reporting standards. While this could work in principle we fear that this space is already too crowded with several rankings and indices which benchmark companies against their peers and thus ranking fatigue could be an issue.

Directors' Remuneration Report

Question 14: Do the current disclosure requirements provide clear and usable information about:

- **the total remuneration paid to directors, and how this is made up;**
- **the performance criteria for payments to directors, and how these relate to the company's strategic objectives;**
- **company performance against these criteria, so that there is a demonstrable link between pay and performance.;**
- **the process by which directors' remuneration is decided?**

Comments
The current disclosure requirements provide clear and usable information about the total remuneration paid to directors and how this is made up. Equally, performance criteria for payments to directors are generally disclosed in a good level of detail and so is the performance against these. However, it is far from always evident how these relate to the company's specific strategic objectives and therefore that there is, in fact, a demonstrable link between pay and performance. The process by which directors' remuneration is decided is generally described in satisfactory detail with some variation in quality. Again, however, there is very limited narrative on the process by which performance criteria are determined to be the best suited for a specific company.

Costs

Question 15:

If you can provide any information on costs associated either with the existing narrative reporting requirements eg preparing your business review or your views on potential costs and benefits in relation to any of the ideas in this consultation, please give details

Comments
We have no comments to question 15.