

## **Risk factors**

*You should carefully consider the risk factors described below, as well as the other information included in the rest of this document. Our business, financial condition or results from operations could be materially adversely affected by any or all of these risks, or by other risks that we presently cannot identify.*

***The pace and scope of our business transformation initiatives increase the execution risk that benefits may not be fully realised, costs of these changes may increase, or that our business as usual activities do not perform in line with expectations.***

We are currently engaged in restructuring the business. The pace and scope of change increases the risk that not all these changes will deliver within anticipated timeframes, or that the costs of these changes may increase. In addition, as a result of the increased pressure of transformational change, our business as usual activities may not perform in line with our plans or our level of customer service may not meet expectations. In parallel with the business transformation as we respond to the digital revolution and shift from a product to a services business, we will continue to look at opportunities to develop business models and further refine organisation structures.

***Risk related to data quality and integrity may lead to noncompliance with legal and other requirements which could damage our business.***

Unavailability of timely, complete and accurate data limits informed decision-making and increases risk of non-compliance with legal, regulatory and reporting requirements. Business change and transformation success is dependent on migration of a significant number of datasets.

***Global economy and cyclical market factors may adversely impact our financial performance.***

With the continued pressure and uncertainty in the worldwide economies, there remains a risk of a weakening in trading conditions, which could adversely impact our future financial performance. The effect of continued deterioration or lack of recovery in the global economy will vary across our different businesses and will depend on the depth, length and severity of any economic downturn. The education market can be affected by cyclical factors, which may lead to a reduction in demand for our products and service.

***Failure to successfully invest in and deliver the right products and services and respond to competitive threats could result in lower than expected revenues and profits.***

A common trend facing all our businesses is the digitization of content and proliferation of distribution channels, either over the internet, or via other electronic means, replacing traditional print formats. The digital migration brings the need for change in product and content distribution, consumers' perception of value and the publisher's position between consumers, retailers and authors.

This is a highly competitive market that is subject to rapid change. We face competitive threats both from large media players and from smaller businesses, online and mobile portals and operators in the digital arena that provide alternative sources of content. New distribution channels, e.g. digital format, the internet, online retailers, growing delivery platforms (e.g., e-readers or tablets), pose both threats and opportunities to our traditional publishing business models, potentially impacting both sales volumes and pricing.

Students are seeking cheaper sources of content, e.g. online discounters, file sharing, use of pirated copies, and rentals, along with open source. This change in behavior puts downward pressure on textbook prices in our major markets, and this could adversely impact our results.

If we do not adapt rapidly to these changes we may lose business to 'faster' and more 'agile' competitors, who increasingly are non-traditional competitors, making their identification all the more difficult. We may be required to invest significant resources to further adapt to the changing competitive environment.

***Changes in government policy and/or regulations have the potential to impact our business model and/or decisions across all markets.***

Our educational services and assessment businesses may be adversely affected by changes in government funding resulting from either trends that are beyond our direct control, such as general economic conditions, changes in government educational funding, programs, policy decisions, legislation and/or changes in the procurement process, or our failure to successfully deliver previous contracts.

The results and growth of our US educational services and assessment businesses are dependent on the level of federal and state educational funding, which in turn is dependent on the robustness of state finances and the level of funding allocated to educational programs. State, local and municipal education funding pressures remain, competition from low price and disruptive new business models continues and open source is promoted as a way to keep costs down for our customers. The current challenging environment could impact our ability to collect on education-related debt.

State and local government leadership changes and resultant shifts in education policy can also affect the funding available for educational expenditure, which include the impact of educational reform. Similarly, changes in the government procurement process for textbooks, learning material and student tests, and vocational training programs can also affect our markets. Political pressure on testing, changes in curricula, delays in the timing of the adoptions and changes in the student testing process can all affect these programs and therefore the size of our market in any given year. For our UK examination and assessment businesses, changes in UK government policy have had, and could continue to have, a significant impact on our present business.

There are multiple competing demands for educational funds and there is no guarantee that new textbooks or testing or training programs will be funded, or that we will win or retain this business.

***Failure to comply with anti-trust and competition legislation could result in costly legal proceeding and/or adversely impact our reputation.***

We are subject to global and local anti-trust and competition law and although we are committed to conducting business in compliance with local and international laws, there is a risk that our management, employees or representatives may act in a way that violates applicable anti-trust or competition laws. As a result, there is a risk of litigation and regulatory proceedings in the countries in which we operate. These legal proceedings could result in greater scrutiny of our operations in other countries for anti-competitive behavior and, in the worst case, incur a substantial financial cost. This would also have an adverse impact on our reputation.

***If we do not adequately protect our intellectual property and proprietary rights our competitive position and results may be adversely affected and limit our ability to grow.***

Our products and services largely comprise intellectual property delivered through a variety of print and digital media, online software applications and platforms. We rely on trademark, patent, copyright and other intellectual property laws to establish and protect our proprietary rights in these products and services.

Our intellectual property rights (IPR) in countries such as the US and the UK, jurisdictions covering the largest proportion of our operations, are generally well established with the exception of patents, for which we only have a nascent portfolio based largely in the US. However, we also conduct business in other countries where our protection efforts have been limited or inconsistent and the extent of effective legal protection for intellectual property rights is uncertain, and this uncertainty could affect our future growth. Where we have registered or otherwise established our IPR, we cannot guarantee that our such rights will provide competitive advantages to due to: the challenges and costs of monitoring and enforcement in jurisdictions where competition may be intense; the limited and/or ineffective IPR protection and enforcement mechanisms available

to us in many countries; the potential that our IPR may lapse, be invalidated, circumvented, challenged, or abandoned, or that we may otherwise lose the ability to assert our intellectual property rights against others. Moreover, despite trademark, brand and copyright protection, third parties may copy, infringe or otherwise profit from our proprietary rights without our authorization. The loss or diminution in value of these proprietary rights or our intellectual property could have a material adverse effect on our business and financial performance.

***A control breakdown or service failure in our school assessment and qualification business could result in financial loss and reputational damage.***

Our professional services and assessment businesses involve complex contractual relationships with both government agencies and commercial customers for the provision of various testing services. Our financial results, growth prospects and/or reputation may be adversely affected if these contracts and relationships are poorly managed or face increased competitive pressures.

There are inherent risks associated with our assessment and qualification businesses, both in the US and the UK. A service failure caused by a breakdown in our testing and assessment processes could lead to a mis-grading of student tests and/or late delivery of test results to students and their schools. In either event we may be subject to legal claims, penalty charges under our contracts, non-renewal of contracts and/or the suspension or withdrawal of our accreditation to conduct tests. It is also possible that such events would result in adverse publicity, which may affect our ability to retain existing contracts and/or obtain new customers.

***Our investment into inherently riskier emerging markets may deliver returns that are lower than anticipated.***

To take advantage of international growth opportunities and to reduce our reliance on our US and UK markets we have invested in a number of emerging markets, some of which are inherently more risky than our traditional markets. Political, regulatory, economic and legal systems in emerging markets may be less predictable than in countries with more developed institutional structures. Political, regulatory, economic, currency, reputational and corporate governance and compliance risks (including fraud, bribery and corruption) as well as unmanaged expansion are all factors which could limit our returns on investments made in these markets.

***Failure to effectively manage risks associated with compliance to global and local anti-bribery and corruption (ABC) legislation could result in costly legal investigations and/or adversely impact our reputation.***

Although we are committed to conducting business in a legal and ethical manner in compliance with local and international statutory requirements and standards applicable to our business, there is a risk that our management, employees or representatives may take actions that violate applicable laws and regulations prohibiting the making of improper payments for the purposes of obtaining or keeping business, including laws such as the US Foreign Corrupt Practices Act or the UK Bribery Act. Responding to investigations is costly and requires a significant amount of management's time and attention. In addition, investigations may adversely impact our reputation, or lead to litigation and financial impacts.

***Failure to generate anticipated revenue growth, synergies and/or cost savings from acquisitions, mergers and other business combinations, could lead to goodwill and intangible asset impairments.***

We continually acquire and dispose of businesses to achieve our strategic objectives and we will continue to consider both as means to pursue our strategic priorities, although we do not plan to make any significant acquisitions in the short term. We for instance hold a 47% equity interest in Penguin Random House, the world's leading consumer publishing company. This investment and associated return are subject to the continuing success of this venture, in a competitive global market. In 2015, we divested the Financial Times and our equity interest in The Economist in order to increase our focus on the opportunities we see in global education.

***We operate in markets that are dependent on Information Technology (IT) systems and technological change. Failure to maintain and support customer facing services, systems, and platforms, including addressing quality issues and execution on time of new products and enhancements, could negatively impact our revenues and reputation.***

All our businesses, to a greater or lesser extent, are dependent on information technology. We either provide software and/or internet services to our customers or we use complex IT systems and products to support our businesses activities, including customer-facing systems, back-office processing and infrastructure. We face several technological risks associated with software product development and service delivery, information technology security (including virus and cyber-attacks), e-commerce, enterprise resource planning system implementation and upgrades. Although plans and procedures are in place to reduce such risks, from time to time we have experienced verifiable attacks on our system by unauthorized parties. To date, such attacks have not resulted in any material damage to us, but our businesses could be adversely affected if our systems and infrastructure experience a significant failure or interruption.

***Failure to comply with data privacy regulations could result in an incident or other issue potentially causing reputational damage to our brands and financial loss.***

Across our businesses we hold large volumes of personally identifiable information including that of employees, customers, students and citizens. Any perceived or actual unauthorized disclosure of personally identifiable information, whether through breach of our network by an unauthorized party, employee theft, misuse or error or otherwise, could harm our reputation, impair our ability to attract and retain our customers, or subject us to claims or litigation arising from damages suffered by individuals, and thereby harm our business and operation results. Failure to adequately protect personally identifiable information could potentially lead to penalties, significant remediation costs, reputational damage, cancellation of some existing contracts and difficulty in competing for future business. In addition, we could incur significant costs in complying with the relevant laws and regulations regarding the unauthorized disclosure of personal information. Changes to data privacy legislation must also be monitored and acted upon to ensure we remain in compliance across different markets.

***Failure to prevent or detect a malicious attack on our systems could result in a breach of confidentiality, integrity and/or availability of sensitive information.***

Across our businesses we hold large volumes of personally identifiable information including that of employees, customers, students and citizens. Despite our implementation of security measures, individuals may try to gain unauthorized access to our data in order to misappropriate such information for potentially fraudulent purposes. A significant breach can result in a devastating impact on Pearson's reputation, finance and student experience. Inability to prove due diligence can result in severe penalties and loss of business (existing and future).

***Our reported earnings and cash flows may be adversely affected by changes in our pension costs and funding requirements.***

We operate a number of pension plans throughout the world, the principal ones being in the UK and the US. The major plans are self-administered with the plans' assets held independently of the Group. Regular valuations, conducted by independent qualified actuaries, are used to determine pension costs and funding requirements. As these assets are invested in the capital markets, which are often volatile, the plans may require additional funding from us, which could have an adverse impact on results.

It is our policy to ensure that each pension plan is adequately funded, over time, to meet its ongoing and future liabilities. Our earnings and cash flows may be adversely affected by the need to provide additional funding to eliminate pension fund deficits in our defined benefit plans. Our greatest exposure relates to our UK

defined benefit pension plan, which is valued every three years. Pension fund deficits may arise because of inadequate investment returns, increased member life expectancy, changes in actuarial assumptions and changes in pension regulations, including accounting rules and minimum funding requests. As of the end of 2015, the UK defined benefit plan continues to show a surplus on an IAS19 basis and following the latest valuation is expected to be in surplus on a technical provisions basis following funding payments made during 2015. Following discussions with the plan trustee in 2015, we have committed to a funding program with the target of the plan becoming largely independent of Pearson within five years. However the plan's ability to achieve and maintain this standard remains subject to market conditions, meaning that additional funding could still be required from Pearson in the future.

***Operational disruption to our business caused by our third party providers, a major disaster and/or external threats could restrict our ability to supply products and services to our customers.***

Across all our businesses, we manage complex operational and logistical arrangements including distribution centers, data centers, and educational and office facilities, as well as relationships with third party print sites. We have also outsourced some support functions, including information technology, warehousing and logistics to third party providers. The failure of third parties to whom we have outsourced business functions could adversely affect our reputation or financial condition. Failure to recover from a major disaster, (e.g. fire, flood, etc.) at a key facility or the disruption of supply from a key third party vendor or partner (e.g. due to bankruptcy) could restrict our ability to service our customers, and meet the terms of our contractual relationships with both government agencies and commercial customers. Penalty clauses and/or the failure to retain these contracts at the end of the contract term could adversely impact our future revenue growth. Similarly external threats, such as flu pandemic, terrorist attacks, strikes, weather etc., could all affect our business and employees, disrupting our daily business activities.

***A significant deterioration in Group profitability and/or cash flow caused by prolonged economic instability could reduce our liquidity and/or impair our financial ratios, and trigger a need to raise additional funds from the capital markets and/or renegotiate our banking covenants.***

To the extent that worldwide economic conditions materially deteriorate, the Group's revenues, profitability and cash flows could be significantly reduced as customers would be unable to purchase products and services in the expected quantities and/or pay for them within normal agreed terms. A liquidity shortfall may delay certain development initiatives or may expose the Group to a need to negotiate further funding. The proceeds from the divestments of the FT and the Economist have significantly improved liquidity. While we anticipate that our existing cash and cash equivalents, together with availability under our existing credit facility, commercial paper program, cash balances and cash from operations, will be sufficient to fund our operations for at least the next 12 months, we may need to raise additional capital to fund operations in the future or to finance acquisitions. If we seek to raise additional capital in order to meet various objectives, including developing future technologies and services, increasing working capital, acquiring businesses and responding to competitive pressures, capital may not be available on favorable terms or may not be available at all.

Our access to capital is influenced by, among other factors, the credit ratings assigned to our debt by the credit rating agencies. At the year-end our long-term ratings were Baa1 from Moody's and BBB+ from Standard & Poor's. Both ratings were on negative outlook. The short-term ratings were P2 and A2 respectively. In February 2016, Moody's changed Pearson's long-term rating to Baa2 (Stable) and in March 2016 Standard & Poor's changed Pearson's long-term rating to BBB (Stable). The short term ratings are unchanged at P2 and A2.

***We generate a substantial proportion of our revenue in foreign currencies, particularly the US dollar, and foreign exchange rate fluctuations could adversely affect our earnings and the strength of our balance sheet.***

As with any international business, our earnings can be materially affected by exchange rate movements. Our main exposure is to movements in the US dollar to sterling exchange rate as approximately 60% of our total revenue is generated in US dollars. We also have exposure to a range of other international currencies including emerging market currencies. Sales for 2015, translated at 2014 average rates, would have been £137m or 3% lower.

***A lack of sufficient capital resources could adversely impact our ability to operate.***

If the global economy weakens further and/or the global financial markets collapse, we may not have access to or could lose our bank deposits or customers may fail to pay us in time or may be unable to pay us. Lack of sufficient capital resources could significantly limit our ability to take advantage of business and strategic opportunities. If replacement funds are not available, we may be required to delay, reduce the scope of, or eliminate material parts of our business strategy, including potential additional acquisitions or development of new products, services and technologies.

***Changes in tax law or perceptions on tax planning strategies may lead to higher effective tax rate or negative reputational impact.***

Changes in corporate tax rates and/or other relevant tax laws in the UK, US or other jurisdictions could have a material impact on our future reported tax rate and/or our future tax payments. We have been subject to audit by tax authorities. Although we believe our tax provision is reasonable, the final determination of our tax liability could be materially different from our historical income tax provisions, which could have a material effect on our financial position, results of operations or cash flows.

Our tax strategy reflects our business strategy and the locations and financing needs of our operations. In common with many companies, we seek to manage our tax affairs to protect value for our shareholders, in line with our broader fiduciary duties. We are committed to complying with all statutory obligations, to undertake full disclosure to tax authorities and to follow agreed policies and procedures with regard to tax planning and strategy.

***If we fail to attract, retain and develop appropriately skilled employees, our business may be harmed.***

Our success depends on the skill, experience and dedication of our employees. If we are unable to attract, retain and develop sufficiently experienced and capable personnel, especially in technology, product development, sales and management, our business and financial results may suffer. When talented employees leave, we may have difficulty replacing them, and our business may suffer. There can be no assurance that we will be able to successfully retain and attract the personnel that we need.

***Failure to adequately protect learners could result in significant harm to one or more.***

Incidents may occur that could cause harm to learners. For example, where we have direct learner contact via online learning, or in our direct delivery businesses where we are operating, either ourselves or in partnership with schools, colleges, universities, testing and assessment centers. These incidents can cause harm to learners, which is something we take extremely seriously, and could also have a negative financial, legal and reputational impact to the business.

***Failure to adequately protect the safety and security of people and assets could increase our costs and adversely impact our reputation.***

We have implemented policies to safeguard the health, safety, well-being and protection of our employees, learners and stakeholders. However, there may be accidents or incidents that occur due to unforeseen risks, for example due to changing local and global threats, causing injury or harm to individuals and impacting our business operations.

***Social, environmental and ethical risks may also adversely impact our business.***

We consider social, environmental and ethical (SEE) risks no differently to the way we manage any other business risk. These include ethical business behavior, compliance with UN Global Compact standards, environmental impact, people and data privacy.