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: Seb Beloe

Organisation (if applicable): **Sustainable and Responsible Investment, Henderson Global Investors**

Address: 201 Bishopsgate, London EC2M 3AE

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
✓	**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

<u>Question 1</u>: Are company directors providing useful and relevant information on the company's:

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

Comments
Narrative reporting in the annual reports of UK listed companies has improved substantially in recent years. In particular the inclusion of a 'Business Review' in annual reports has provided many companies with the opportunity to provide significant additional information that provides investors and other stakeholders with a clearer perspective on the underlying value drivers of a particular business and its outlook. **While progress has undoubtedly been made, it is our view that narrative reporting could be further improved to provide higher quality information on the company's management of its principal risks as well as how the company is equipping itself to exploit business opportunities.** **There has been a tendency among some companies to produce 'boiler plate' type reporting which does nothing to inform investors and merely adds to the significant volume of existing reporting. Such boiler plate reporting includes listing generic risks that face the company such as the 'economic cycle' and 'competition'. Far from improving reporting, such an approach undermines the quality of dialogue between investors and companies.**

<u>Question 2:</u> What are the constraints on companies providing information on these issues?

Comments
The constraints on companies providing quality information are in our view principally related to excessive risk-aversion – for example not wanting to disclose meaningful information that might later be used to hold the company to account - and a lack of effective guidance on what investors and other stakeholders are looking for in narrative reporting. **In addition, there may also be a further barrier to effective disclosure resulting from companies choosing not to report meaningful information about their business because such questions are not asked by investment analysts, and those analysts do not ask appropriate questions, because companies to not disclose the information.**

<u>Question 3:</u> Does the information provided reflect the issues discussed by the directors in board meetings?

Comments
-

<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
The investment community is made up of different types of investors that deploy a wide variety of different investment styles and objectives. While many investors, as a result of their investment time-frame, attitude to macro versus micro factors and reliance on third-party analysts, do not regularly review the content of an annual report themselves, many long-term and SRI investors as well as sell-side analysts do review the reports. However, equally important channels for information distribution are the regular results statements that companies typically publish at regular intervals to update investors on their performance. **Whatever the information source used by investors, it is our view that information that relates to a company's outlook, it's process for determining its principal risks and opportunities as well as its management of those risks and opportunities is information that shareholders would find useful in their investment decision-making.**

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

Comments
Yes. We have an active engagement approach at Henderson Global Investors and if we do not feel that we are getting adequate information on these issues, we engage with management to encourage them to provide additional disclosure. **Our impression is that Board-level understanding of these issues is typically fairly poor. Consequently, guidance for Board Directors on the business relevance of these issues could be helpful in encouraging**

companies to communicate more effectively.

Company management will often claim that while non-financial issues including many social and environmental issues are the subject of active management and monitoring, they choose not to disclose this information because it is not actively asked for by investors. Investors and analysts for their part may not ask appropriate questions because they are unaware of the attention that such issues demand from management.

We believe that light-touch interventions, such as additional guidance to companies, case studies and training could help to break this impasse.

<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 whatever data sources that are available to us in analysing a given company. This can include among other things, corporate data including sustainability reports, meetings with management, media articles, third-party analysis and perspective (eg NGOs, Trade Unions, independent experts etc.) and broker research. **Much of this information is not verified and can contain significant errors or bias. An additional source of information that we use wherever it is available comes from regulators. For some industries this can be a source of comprehensive, independent data (eg OFGEM data on customer services/complaints in the power sector), but our view is that this could be considerably enhanced. For example data on environmental and health and safety performance currently collected systematically by relevant authorities such as the Environment Agency and the Health and Safety Executive. This data is not publicly available for use by investment analysts or other stakeholders, but would we believe be extremely valuable in enhancing our understanding of company positioning and performance on these issues.**

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

Comments

Much of the information that companies produce, for example relating to policies and systems, changes relatively infrequently. This information should be taken out of Annual Reports and posted on websites with appropriate links provided in the Annual Report.

We would also advocate that government does not get involved in trying to determine what specific issues the company should be focus on. Sectors and businesses vary too much for any such list to be relevant to anything more than a handful of companies. Instead, *we would suggest that companies be required to explain how they determine what issues are important (including the time horizon they use), what those issues are and how they perform on them.*

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

Comments
A major challenge in current Annual Reports is the disconnect that exists between the 'front end' and 'back end' of annual reports. In particular, there needs to be better linking between the two. For example, narrative reporting could complement the accounts by articulating business risks that are not adequately captured in the accounts.

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
More important than the relevant strengths of the OFR versus the business review was the connection between the OFR and the OFR Reporting Standard. The standard included a number of provisions (for example as regards the reporting of Key Performance Indicators) which provided guidance and served to encourage companies to provide more and more meaningful disclosure on their performance on key non-financial issues. We would be in favour of such a statutory reporting standard which we believe would help companies to improve the quality of their reporting.

<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 information is potentially useful to us as we believe that a company's performance on social and environmental issues can have a significant bearing on the future success of that company. However, in order to be useful, the company needs to provide significant additional context and detail including: • **An explanation of the process (including the time horizon used in the analysis) used to determine the social and environmental issues that have a bearing on the company's performance** • **A description of the issues and an explanation of how these issues affect business performance (for example in enhancing operational efficiencies, increasing productivity, providing**

barriers to entry, as a source of innovation and product differentiation etc.)

- **How the company manages the issues and how it assesses the quality of its management (including how performance is incentivised)**
- **The company's performance – ideally through the use of quantified key performance indicators with time series data and comparisons with appropriate benchmarks.**

We use this information to, among other things, assess the quality of a company's management team, and to determine whether we wish to invest in the company.

Disclosure could be enhanced by ensuring that it addresses all the points highlighted above.

<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
Yes we think guidance would be more helpful. The original ASB reporting standard guidance was a very useful document and should be updated and re-released.

<u>Question 12:</u> Should there be a shareholder's advisory vote on the Business Review?

Comments
-

<u>Question 13</u>: Are there non-regulatory solutions to increasing quality through better guidance or publicising excellence in business reports? If so, what?

Comments
As above, the publication of guidance to accompany the business review/OFR would, we believe, help to increase the quality of business reporting.

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
In general, we believe that there is too much 'boiler plate' disclosure and, where performance has been weak, there is insufficient information explaining why the performance targets were not met. We would argue that additional disclosure needs to be provided on: - **the logic behind the selection of performance targets and how they connect to the company's long-term strategy** - **performance delivered versus the targets that were set** - **the company's relationship with remuneration consultants (for example who chooses them and who do they report to, as well as what other services they provide to management).**

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
-