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# 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*

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

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

The Institute of Practitioners in Advertising is the trade association and professional institute for over 260 marketing services and marketing communications agencies. All consumer facing businesses in the FTSE top 100 work with IPA member agencies.

Our interest in narrative reporting stems from our convictions that companies' narrative reports represent the best forum for developing greater understanding of the issue of intangible assets. Whatever the terminology – 'intangible assets', 'non-financials', 'extra-financials', 'sources of long-term value' – the subject matter is increasingly recognised as business-critical for companies, investors and stakeholders alike. The facts and processes which generate this intangible value inside companies are of commercial significance, and identifying them and reporting on them as become a new challenge. For some companies, mastering disclosure in this area represents a source of differentiation and advantage,

Against this backdrop, the IPA's specific interest lies in the are of brand intangibles, representing up to 12% of company market value on average, and a full 20% of intangible value (Brand Finance: Global Intangible Tracker GIT TM; 2006). In our view, one of the key purposes of the narrative report should be to explain its marketing investment strategy and its likely impact on the business going forward.

The Business Review presents IPA member agencies with a unique opportunity to contribute to the articulation of this intangible asset creation.

## 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 |
| --- |
| The IPA's own efforts to evaluate the quality of narrative reporting within the framework of our IR Magazine Award for Best Narrative Reporting among the FTSE 350 (2007/8) – see attached reports – included an item of analysis relating to 'Forward looking' which we defined as *'Identifies (expectations of) future business performance in the context of current performance and capabilities.'* Our guidance note to accompany this item was:<br><br>'By regulation, a business review must look at the past; to create value it should also look to the future. Investors are primarily interested in a company's prospects for generating long-term earnings growth, and targets and associated commentary build visibility and confidence. Ultimately, the strength of disclosure communicates management's ambition, and its |

confidence in its ability to deliver future earnings.'

The average score (-3 to +3 on a 7-point scale where +3 is excellent) was 2.13. (see page 15, Best practice in narrative reporting 2008).

Our expert panel of judges, convened by ICSA consultant Seamus Gillen, and chaired by IPA President, Moray MacLennan, was representative of financial institutions and pension funds and relevant think tanks. Their assessment of forward-looking reporting concluded, in 2008 (page 28, Best practice in narrative reporting 2008):

**Forward Looking**
The best companies appeared to do two things well. They provided specifics, in terms of dates and projected figures, and they grounded their marketplace information and strategy in the future. A good example of a company doing this well is GlaxoSmithKline, which explained key research and development, provided a detailed pipeline, and articulated a strong explanation of the evolving market in which they operate. The weaknesses of many companies in this area stemmed from either a failure to address the future, due to a traditional reporting format, or a failure to provide specific targets for the future, leaving the report vague and open-ended.

**High performers**
- Had a forward-looking focus to the report
- Gave specific predictions and targets for the immediate and mid-term future
- Included pipelines and completion dates where appropriate
- Had clear goals for the future, and expressed a means to measure their success

**Low performers**
- Reported only on past events
- Provided only vague and general objectives for the future ('increase the size of the business')
- Made no predictions

In addition to the IR Magazine Award for Best Narrative Report, the IPA has sought to educate the market about KPIs relevant to an assessment of sound brand management. In this context, while the future of corporate success is never certain, in the specific area of brand equity management, of most interest to the IPA and its membership, it is possible to identity 'lead' indicators, which are, more likely than not, predictors of future value generation.

In its publication – 'KPIs for Marketing Reporting' (April 2008) the IPA put forward 20 performance indicators for marketing reporting: relating to business value, customer value, brand value, A&P investment strategy,

promotional mix, innovation intensity, and return on marketing investment *(see pages 16-18 attached).*

Within this mix, three predictors of market success are identified *(see page 11):*

1. A&P investment strategy

i. there is a correlation between size of budget and dominant position in the market. Market leaders tend to spend most in their sector.
ii. Companies who spend consistently tend to do best. There is a correlation between consistency of spend and maintenance of a dominant position.
iii. Companies who spend relatively more than their position in the marketing would suggest tend to grow faster than the market.

Size and maturity of brand, and quality of campaign, can modify these findings at the margin.

2. Promotional mix

i. the relative balance between strategic investment in brand building and tactical investment in discounted price promotions is an indicator of business prospects. Discounted price promotions are rarely profitable for big or premium brands in mature markets and, in the long-term, promotions can erode brand value and exacerbate price elasticity. Promotional wars can commoditise whole categories. For big brands, shifting spend from discounted price promotions to brand communications increases both short- and long-term profit.
ii. The ability to deliver integrated marketing campaigns, to the same brand idea, across different channels and media, is a predictor of marketing success. Those companies who demonstrate management ability in building partnerships with a small group of trusted agencies tend to do this best.

3. Innovation intensity

i. Companies who create relevant and timely new news in established markets tend to do best. Examples of new news might be design innovation, product innovation or message innovation.
ii. Companies who created relevant new markets tend to do best. There is a correlation between first to market and brand leadership.
iii. Companies who set new trends in creative content or channel and media usage tend to do best. The networked society, enabled through web 2.0, presents new challenges and opportunities for content creators and producers.

An understanding of a company's profile on all of these dimensions of

marketing performance can help investors understand the likely future prospects for organic business growth and profitability.

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

**Comments**

From our qualitative research among company secretaries and investor relations professionals, linked to our involvement with ICSA and the IR Magazine Awards, we concluded that companies were unlikely to disclose information on these issues with clarity unless it was mandated by statute.

There appeared to be three principal reasons for companies' failure to provide more information:

i. the risk of revealing issues of material importance which companies might prefer not to disclose;
ii. the risk of providing information which might be deemed to be competitively sensitive, and which might enable competitors to steal competitive advantage;
iii. uncertainly about what information and data was expected by the term forward-looking strategy.

In workshops with IR professionals, it became apparent that, while the financial accounts came under intense scrutiny from the Board, the narrative report was not treated with the same rigour. It was often delegated to a relatively junior corporate communications or PR person, who either drafted it themselves, or took responsibility for briefing and coordinating responses from a number of relevant members of staff before providing the final edit for the Chairman's approval. Typically, marketing personnel would not be consulted in this process.

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

| Comments |
| --- |
| No evidence. |

**<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 |
| --- |
| No evidence. |

**<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 |
| --- |
| Equity analysts we have dealt with need still need educating about what questions to ask when it comes to questions relating to brand equity management.<br><br>In independent research, conducted for the IPA by Populus, among 50 analysts from five different business sectors – 'How Analysts View Marketing' *(July 2005)* - the overwhelming finding was that analysts did not feel that they have enough real understanding or knowledge of marketing issues to be able to express truly informed views *(see page 5)*. The phrase used to describe this area was 'a big black hole'.<br><br>In terms of the significant non-financial measures they would like to have a better understanding of, the main factors mentioned were *(see page 10)*:<br><br>i. market share, market growth and market position;<br>ii. brand awareness, brand health, brand empathy; |

iii. management direction, management strategy and management quality;
iv. customer satisfaction, sales performance, service performance, distribution and customer churn.

**<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 |
| --- |
| Brand equity analysts tell us that they benefit most from the annual briefing meetings provided by a number of the companies they track; which provides the opportunity for face to face discussion and more in-depth investigation of current performance and future plans. There is a general belief that the annual report should provide more detailed commentary on business and brands stewardship, to help shareholders get a better impression of prospects for organic business growth. |

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

| Comments |
| --- |
| The judging panel for our IR Magazine Award for Best Narrative Reporting marked down those reports which were over elaborate or wordy in their use of language. They expressed a desire to reduce volume of content in favour of value; and to centralise content in a single document rather than publishing a number of different reports by topic e.g. Corporate Social Responsibility. |

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

| Comments |
| --- |
| Clarity and focus should be the objective. Use of data tables, graphs and diagrams to illustrate the narrative are to be commended. It is important that the data is comparative over time. |

## 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 |
| --- |
| It is the IPA's considered view that the statutory reporting standard would raise the quality and relevance of narrative 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 IPA's view is that anything of 'material' importance should be explained in detail. Given the central importance of brand equity, both to corporate reputation and at a product and service level, it is desirable that the performance and position of the company's brands, and strategies for investment in brands are understood better by shareholders.

For marketing reporting, specifically, the IPA recommends three developments to improve practice in 'KPIs for Marketing Reporting' *(April 2008):*

1. Standardisation of A&P reporting.
   There is currently no obligation, under IFRS, for the budget allocation to A&P to be broken out, be it in the narrative report of the Profit and Loss account in the financial section, We would like to campaign for change in this area to bring greater clarity to A&P reporting.

2. A 'Marketing' section in the narrative report.
   Headings give focus, and we would like to proposes that preparers of business reviews include a heading entitled 'Marketing' to act as a reminder of the need for enhanced coverage of this business critical topic. This might be included, for examples, with the Resources and Relationships section of the narrative report.

3. Marketing reporting to the Board
   We have tracked, with interest, the growth in the number of sub-committees on the board with special responsibilities e.g. audit, remuneration. While formal auditing of marketing investment may be unlikely, in order to encourage better reporting and sound stewardship of marketing investment, we would like to recommend that boards of companies where marketing is a significant budget item should always receive a formal marketing report, linked to KPIs, at their meetings. If this is a regular part of board meetings, it is much more likely that it will become a regular feature of the business review.

We recommend that companies be mandated to include a Marketing section in their annual report and that there be a non-executive director responsible for overseeing the quality of marketing reporting.

**<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 |
| --- |
| It is the IPA's view that more guidance would be helpful. Examples of best practice and discipline-specific advice on KPIs would be meaningful and helpful.<br><br>In our own small way we have begun this journey. Our most recent publication in the series 'Best practice in narrative reporting 2009 – an international perspective' (September 2009), provides key learning and recommendations from a research project into narrative reporting by international consumer-facing companies (see attached). Using research from previous reports and studies, the following five topics are selected to guide evaluation, comparison and commentary, from Europe, the USA and Asia:<br><br>i. CEO and Chairmen messages<br>What do they reveal about the culture and ethos?<br>ii. Narrative structure<br>Does it coherently explain how brands fit the business model?<br>iii. Differentiating material<br>Are there any items of narrative which stand out?<br>iv. Intelligent data<br>Does it use KPIs effectively to track performance?<br>v. Marketing narrative<br>Does it give a sense of the quality of marketing and brands management? |

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

| Comments |
| --- |
| The IPA's view is that this would be helpful, in order to build market expectations of the need for clarity, focus and consistency in this area of reporting. |

**<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 |
| --- |
| The IR Magazine award for best practice in narrative reporting was our item to keep the topic alive and companies interested. On the basis of this experience we feel that take-up of best practice will always be limited to a few thought leaders, who gain first mover advantage, unless it is legislated for. |

## Directors' Remuneration Report

**<u>Question 14:</u> 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 |
| --- |
| Although this is not our area of expertise, the knowledge we have gleaned suggests that this area is reported in relatively more depth. |

## 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 |
| --- |
| The growing use of online for the full report, frees up funds for other initiatives. |