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

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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
	Business representative organisation
X	**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
Reports vary considerably from company to company, but are often of limited use. What investors and organisations like us that work with them are usually interested in is quantifiable and comparable information.

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

Comments
Companies appear to have concerns about disclosing too much 'strategic' information that might be commercially sensitive. In practice we think any constraints are largely self-imposed.

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

Comments
No, company reporting in general (ie beyond just the Business Review) typically fails tor provide much detail of the actual business of meetings.

<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
It helps in the sense that on occasion there is an obvious gap between the story that companies tell in their narrative reporting and the understanding that shareholders have of where the business is heading. This may subsequently lead to engagement. **For PIRC specifically, we utilise the information provided in companies' Business Reviews, alongside other disclosures, to inform our analysis. We also seek to apply our analysis to actual engagement. For example we sometimes recommend shareholders oppose a company's report and accounts because we believe their reporting on social or environmental issues is poor or misleading.** **We believe it would be preferable if shareholders were able to vote directly on the content of Business Reviews, rather than using the annual report and accounts, as this would enable them to send companies a more focused signal. We discuss this is more length in the answer to question 12.**

<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, as noted above on occasion we recommend that shareholders oppose the report and accounts. PIRC believes that the provision of a separate vote on Business Reviews would make this engagement over the nature and extent of reporting more effective.

<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

Websites: These have their own distinctive structure which may vary considerably across companies, making it difficult to assess companies on a short time scale. Also, information might be published in a way that makes it hard to find – indirectly jeopardising the transparency score of companies. However interactive content on website is very promising and at times has proved to deliver more information than downloadable reports.

Corporate Social Responsibility Reports: This is the main report used to assess company's environmental and social performances. Directors will most of the time talk about their strategy relating to the above in this specific report. Some companies seem to have tried to stay focused on where they publish particular information and avoid any duplication. For example, disclosing KPIs in the Business Review section of the annual report may be viewed as being duplicate of the same information being reported extensively in the CSR report.

PIRC believes that a summary of the CSR objectives need to be included in the Business Review. Most investors will avoid the CSR report altogether and will focus on the one area that is relevant for them to read, and this is the BR/OFR.

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

Comments
We would not wish to see any reduction in what companies are required to report. However companies could themselves put more thought into how they report. We do not consider reporting in Business Reviews/OFRs to be a compliance issue – it should be an opportunity to talk the company's owner about the future. Too often companies fail to take advantage of this opportunity.

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

Comments
Yes, but this is principally a challenge for companies. There is a danger that greater prescription in how information is arranged will be used by companies as a way to produce even more boilerplate reporting.

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
There were elements of the OFT that were preferable to the Business Review. For instance there was an emphasis on reporting on the implementation of company policies (ie not just reporting that policies were in place). This is important because we have experience of engaging with companies which have impressive sounding policies, but where evidence on the ground suggests they are not implemented. **A good example of this in recent history was FirstGroup, where policies on workplace rights did not seem to be applied in its US operations, leading to sustained shareholder engagement. Subsequently – as a result of shareholder pressure – the company began to report on the implementation of the policy.**

<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
In general reporting on workplace issues is very limited in nature. In PIRC's view employee engagement and motivation are extremely important, and companies themselves claim that 'people are our greatest asset' yet typically report little about in this area. **As such we believe that consideration should be given to revisiting the recommendations of the Kingsmill Report, to see what improvements could be made in this area.**

<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
One area where there is a failing in respect of KPIs is in the lack of feed through to other relevant considerations. For example there is often no link between what the company describes as 'key' performance indicators and the way that executive performance in measured, and thus remuneration determined. **Companies sometimes argue that financial metrics effectively capture everything, so there is no need for such granularity, particularly in long-term incentives. Nonetheless the failure to link these two areas seems to demonstrate a lack of joined-up thinking. It would be helpful if BIS encouraged companies to ensure that if performance indicators are considered 'key' then they ought to appear in appraisals of executive performance.** **More generally on occasion we come across companies that list a whole string of KPIs. Once again this calls into question the extent to which some companies understand the objective of disclosing such data. Companies may monitor any number of data points, but 'key' indicators ought to be limited in number.**

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

Comments
Yes, PIRC supports the introduction of an advisory vote on Business Reviews for two reasons. **Firstly, where shareholder do have concerns about company reporting they do not have a specific outlet for this. For example, where PIRC believes that company reporting is inadequate, we sometimes recommend that shareholders oppose the report and accounts. We know some investor do likewise** **However, unless the reasons for such a vote are disclosed to the company concerned (which PIRC always seeks to do) then such voting could be interpreted as dissatisfaction with the accounts. A separate vote on Business Reviews could aid more targeted voting and engagement by shareholders.** **Secondly, we believe that an advisory vote on Business Reviews would encourage shareholders to pay more attention to the content.** **To use a very current example, we believe that if Vedanta had put the content of its Business Review to a vote at its most recent AGM this would have been used by a number of large shareholders to express concern. We note that Liberal Democrat MP Martin Horwood has queried whether the company's Business Review actually met the requirements of the Companies Act.**

<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

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
There are two areas in which company reporting on remuneration is currently lacking. The first is in relation to disclosure of directors' pensions entitlements. We note the joint initiative this year by the NAPF and LAPFF to encourage greater disclosure of directors' retirement provisions, and we agree with the list of information that they suggest companies disclose (accrual and contribution rates, retirement ages etc). Our own shareholder voting guidelines promote similar disclosure. **We believe it would be helpful in the short-term if the Department signalled its support for this initiative, perhaps in response to this consultation, in order to encourage companies to take it seriously. In the longer term if company disclosure does not improve we believe that consideration should be given to amending the DRRR to make disclosure of the information sought mandatory.** **Secondly it is clear that almost all companies provide very little information on how they take into account pay and conditions across the group when setting directors' pay. We believe further disclosure might be helpful here. For example, we note that under the Dodd-Frank Act requires the disclosure of internal pay ratios. We see no reason why the UK should not seek to institute something similar.** **More generally, we are concerned by the increasing complexity of remuneration reporting. This is not principally a concern because we believe that companies are providing opaque disclosures (though this is certainly true in some cases) but because we believe that it is providing a false impression of what is important.** **PIRC has detailed recently its belief that the focus on performance-related rewards is mistaken because it is based on an at best partial view of human motivation. We note the apparent interest within the Coalition in the potential applications of behavioural economics and social psychology to policy. We therefore believe that consideration**

should be given to a broader review of the effectiveness of typical remuneration policies.

Costs

<u>Question 15:</u>
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