A snapshot of FTSE 350 reporting

Compliance mindset supresses effective communication

Reporting, if done well, can deliver competitive advantage in a variety of ways. It can help secure capital and credit, win the war for talent, and build strong business relationships.

With continued uncertainty in the economy, trust and confidence are in short supply. Unwelcome surprises are likely to have a dramatic impact on the market and on a company’s reputation. Clear, engaging and informative reporting is currently even more critical to management credibility and to meeting the challenges of rebuilding trust and share price.

The challenge, and the opportunity, is to ensure that the quality and sustainability of corporate performance is well understood by all key stakeholders.

Our annual review of the narrative reporting practices of the FTSE 350 shows that the vast majority of companies continue to cover the key bases of reporting.

However, few provide the depth of understanding or a clear and coherent picture of performance which we consider necessary in the current economic environment.

Put simply, we believe that a compliance mindset is often suppressing effective communication.
Our review of FTSE 350 narrative reporting

What we looked for

Our review had three main areas of focus:

1. CONTENT OF REPORTING
   We considered the requirements of the Enhanced Business Review legislation taken together with the integrated information set illustrated previously.

2. QUALITY OF REPORTING
   We were looking for quantified data as well as qualitative explanations, a forward-looking orientation to the reporting and clarity in presentation of information.

3. LINKS ACROSS REPORTING
   We looked for alignment between elements of reporting, such as strategy, performance and remuneration.

For each company we assessed the effectiveness of their communications using these three focus areas to consider eight aspects of reporting spanning the integrated information set shown on page 6 of this paper:

External drivers
Market context on which strategy is built and performance assessed, (eg, competitors, regulatory impact, macro-economic environment).

Strategy
A summary of strategic priorities that deliver objectives and how these align with the business / operating model, risk, remuneration policies and key performance indicators.

Risks
Principal risks of the business – those that keep management awake at night. How they align with strategic priorities and are identified, monitored and managed.

Resources
Key resources and relationships used to achieve the company’s specific strategic objectives and how they are managed and performance assessed.

Performance – KPIs
Key financial and non-financial measures used to assess performance and how these are aligned with strategic objectives and priorities.

Performance – fundamentals
Information that helps provide greater insights into the quality and sustainability of financial performance eg, segment reporting, cash flow / funding analysis and non-GAAP measures.

Sustainability
Management’s response to business critical ‘sustainability’ risks and opportunities, how they are embedded into strategic decision-making and day to day operations, and how performance is measured.

Look and feel
Structure and navigation, narrative flow and use of graphics, tables and design to make the report easy to understand.

What we reviewed

This data is based on the results of a desk-top research project undertaken in the first half of 2009 to review the narrative reporting sections of the FTSE 350 companies’ annual reports.

We looked at reports for years ended between 1 April 2008 and 31 March 2009. Six companies were not reviewed because they did not report in this period, for example because they were taken over, or because they did not publish their annual report during the period of the review. The final sample size was therefore 344 companies.
Trends in corporate reporting

What we found

Set out below is a summary from our review. The statistics indicate the proportion of companies that currently report different aspects of the integrated information set, (prior year comparatives are in brackets where available) and hint at the size of the challenge facing many companies.

Covering the bases

The findings from our review illustrate that companies continue to cover the key bases of narrative reporting. Nowhere is this more evident than in the communication of KPIs and risk.

Perhaps unsurprisingly, the economic downturn has played its part in reducing the number of management teams who feel comfortable with outlining their company’s key strategic priorities. Similarly, given the uncertainty, fewer companies feel comfortable with explaining the trends and factors likely to impact the future development, performance and position of the business – a requirement of the Enhanced Business Review that came in last year.

It is encouraging that nearly 70% provide some detail around their company’s cash flow and funding strategies – but this still leaves a third who provide the bare minimum for this critical area.

Failing to tell a clear story

Despite covering the key bases of narrative reporting, our review shows that companies still fail to present a clear, credible and coherent picture of the direction of travel and short-term performance. This is a particular issue in the current uncertain economic conditions when public trust in the market has declined. Many struggle to use their strategy to underpin their reporting or to clearly align it with their risk assessment, KPIs and remuneration. For external observers, such a lack of clarity can pose questions, perhaps unfairly, about whether the stated strategy reflects the internal reality, including how strategic progress is driven and assessed.

Companies also struggle, or are understandably reticent, to provide clear information about the key dependencies in their business model – their ‘material contractual arrangements’ – despite this being a requirement introduced by the Enhanced Business Review. We expect that insights into these dependencies, and their relative health and strength, will become increasingly important given the growing complexity of business.

Finally, although the number of companies aligning their sustainability objectives with strategic goals has increased, many companies appear to pay lip service to this area of reporting. With a growing recognition of the realities of climate change, stakeholders will increasingly seek evidence that companies have considered, and are responding to, the potential risks and opportunities this presents to their business.
Does size matter?

How do the narrative reporting practices of the FTSE 100 and FTSE 250 companies compare? Do the resources at their disposal result in a better standard of reporting from FTSE 100 companies? Or does their greater complexity present a far bigger challenge to presenting a clear and coherent picture of performance? The answer is not necessarily straightforward.

Communication effectiveness

It is clear from our findings, as demonstrated in the table left, that while there are companies that excel in certain elements of reporting, as indicated by the good practice column shown here, no single company shows excellence across all of the key aspects of our integrated reporting model.

In fact, opportunities exist for improvement across the narrative reporting practices of all FTSE 100 and 250 companies, with the potential size of the opportunity greater for the FTSE 250.

Content, quality and cohesion of corporate reporting

From digging deeper into the findings, it is also clear that, while the better communicators in the FTSE 250 are on a par with the FTSE 100, there continues to be a large gap between the best and worst communicators across the FTSE 350 as shown in the graph left.

While this gap is more pronounced for the FTSE 100 companies, the majority of the mid-cap companies have further to go in presenting a joined up picture of the business and its performance.
Opportunities for improvement?

Behind the picture presented by our summary findings, some areas for continued focus are clear.

For the FTSE 100 companies, the areas where the greatest opportunities arise for improving narrative reporting are around external drivers, risks and sustainability reporting – all of which show around 40% of companies have significant progress to make.

Given current demanding market conditions, the resulting focus on companies’ approaches to risk-taking and the increasing importance of longer-term sustainability issues, providing greater insight across these areas is critical in helping key stakeholders understand the quality and sustainability of corporate performance.

The FTSE 250 companies show an even greater opportunity for improvement in those same elements of narrative reporting – external drivers, risks and sustainability – with 60-70% of companies having significant scope to enhance their reporting in those areas.

Perhaps of more concern is that 65% of FTSE 250 companies are struggling to present a cohesive picture of their overall strategic ambitions, goals and targets. Some 50% also show a need for significant improvements in the overall clarity, look and feel of their reporting.

With typically fewer analysts following a larger population in the FTSE 250, it is arguably more important that these companies clearly present a cohesive and aligned picture of long term strategic plans, shorter term priorities and performance to help them stand out from the crowd.
One integrated information set

What picture should reporting present?

The credit crunch has been another reminder that statutory financial statements alone may not provide sufficient insight into business activity and performance.

Demanding market conditions have focused attention on companies’ ability to explain their business models, the key relationships that they rely on, and how remuneration structures influence corporate behaviour and risk taking. The effectiveness of governance over these areas has also been questioned – particularly around risk and the alignment of strategy, key performance indicators (KPIs) and remuneration.

As the economy begins to recover, the ability to present a joined-up picture around these issues will be increasingly important to investors’ assessment of the quality of management and governance and the longer-term prospects of the company. To deliver this joined up view of the business, we believe it is time for companies to develop an integrated information set with a clear line of sight between management information, board reporting and external communications.

The model set out here is grounded in years of PricewaterhouseCoopers research and work with investors and companies. It highlights the scope of the information set that we believe companies need to have at their disposal if they are to be on top of the dynamics of modern business and in a position to rebuild trust in business after so much economic uncertainty.

This model provides a logical structure that will support the complexity of business today and the needs of key stakeholders. It also has the flexibility to adapt to future challenges.

“One information set

External drivers

- Economic
- Societal
- Technological
- Environmental
- Geopolitical

Strategy & Objectives

- Remuneration
- Risk

Corporate contribution

- Consumption
- Social contribution
- Funding
- Wealth creation

Key performance indicators

- Strategy
- Value drivers
- Performance

Resources and relationships

- Financial resources
- Non-financial resources
- Relationships

Performance

- Consumption
- Social contribution
- Funding
- Wealth creation

“IT’S TIME FOR AN INTEGRATED INFORMATION SET WITH A CLEAR LINE OF SIGHT BETWEEN MANAGEMENT INFORMATION, BOARD REPORTING AND EXTERNAL COMMUNICATIONS”
How should companies respond?

Key questions for consideration

Blogs, twitters and the new media environment in general have turned the brick walls of corporate offices into glass. Gone are the days when different images of a company, and its performance, could be conveyed to different audiences and management could control how and when information was distributed.

In this environment key stakeholders will increasingly be in a position to form a view, perhaps wrongly, of whether the quality, breadth and depth of companies’ reporting is indicative of a conscious decision by management or reflects the challenges they face internally in pulling the information together. To consider how effective your reporting is and how aligned it is with your internal reporting, ask yourself the following questions:

External Reporting

- What does your reporting say about you?
- Strategy, risks, remuneration and performance – is your reporting clear and aligned?
- What non-financial and contextual information supports your financials? Does this information include quantified data?
- Who controls your company’s story – you, the competition, the media?
- What is the role of the Annual Report?
- Are the messages in your Annual Report consistent with your other communication channels?

Internal Reporting

- What is the breadth of information made available to your board for enabling effective oversight?
- Do you have the right information in the right dimensions/lens at the right time to run the business?
- Is too much time spent producing the numbers rather than gaining real insight?
- Do you have transparency and clear accountability for performance measures?
- Do you trust the numbers when you first see them?

Research, practical guides and good practice

For over a decade, PricewaterhouseCoopers has invested significant resources in understanding the information needs of preparers and users, the economic benefits of transparency, along with current and best reporting practices worldwide.

Our focus has been on aligning the interests of those who report on performance with those who use the information to make critical investment decisions.

Based on our research we understand what effective reporting looks like and can provide practical insights into the critical building blocks of one integrated information set and effective corporate reporting.

To help make your reporting more accessible and effective we would encourage you to visit www.corporatereporting.com for all our research, practical guides to reporting and insights into good reporting practice. For hard copies email info@corporatereporting.com