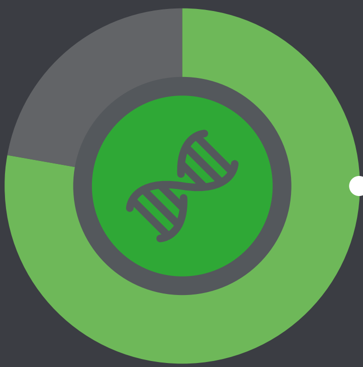
Annual report insights 2020 – Purpose

Surveying FTSE reporting

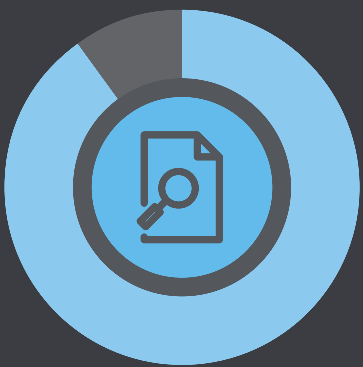
Contents

Purpose



78% gave a clear, prominent statement of their purpose beyond making profits for shareholders

90% of those statements referred to specific stakeholder groups beyond shareholders



90% provided a clearly identifiable s172(1) statement

84% drew out examples of decision making within their s172(1) statement

The concept of company purpose has come to the fore in recent years. Company purpose is an articulation of why it exists, typically capturing the way in which the company aims to create a positive impact on stakeholders. Purpose should therefore guide everything the company does, connecting through governance, strategy, risk, KPIs, and capital allocation decisions.

In the UK, consideration of company purpose must respond to the directors' duty under s172 to promote long-term success of the business while having regard to its reputation and stakeholders. In the US, the Business Roundtable, an association of chief executive officers of America's leading companies, made a statement in the summer of 2019 acknowledging that the purpose of a corporation reaches further than shareholder returns and that delivering value for all stakeholders is important to the success of that company[1].

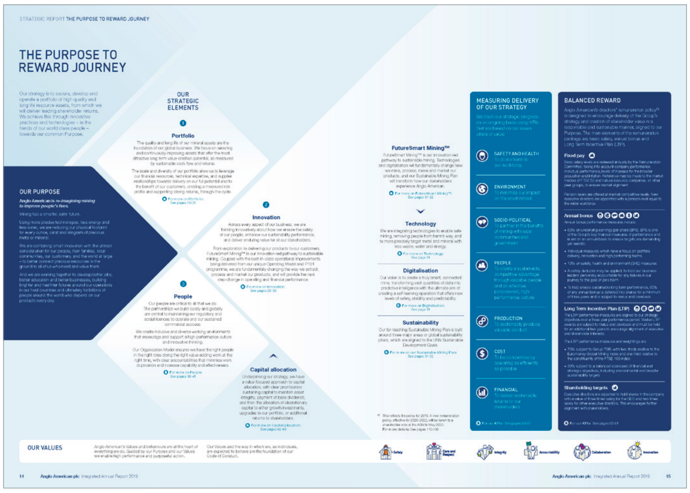
Larry Fink, CEO of Blackrock, emphasised the importance of company purpose in his annual letters to CEOs. He has described purpose as "the engine of long-term profitability", citing that "a company cannot achieve long-term profits without embracing purpose and considering the needs of a broad range of stakeholders"[2].

78% of companies (2019: 57%) gave a clear, prominent description of their purpose beyond making profits for shareholders upfront in their annual report. A handful of other companies referred to a company purpose much further on in the report within the corporate governance statement, which felt somewhat buried, giving the impression that perhaps 'purpose' was something that the board had considered or constructed without it then coming to life and giving the company as a whole a clear direction.

For many companies, which clearly stated their purpose upfront, that purpose acted as a driver for the rest of the annual report, demonstrating the authenticity of the purpose through examples of how it played out in daily operations. Vodafone Group Plc, for example, set out their strategic framework on an opening page, their purpose of "We connect for a better future" driving their principal aim which, in turn, directed their strategy and priorities.

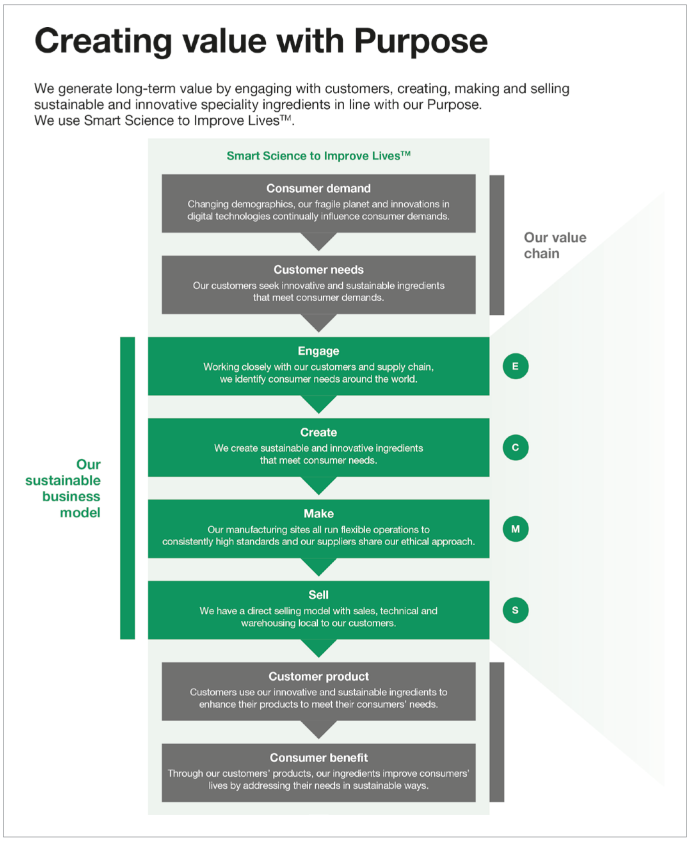
Other companies demonstrated authenticity of their purpose by linking it clearly to strategy and reward, such as Anglo American plc, or to their business model, such as Croda International Plc.

Anglo American Plc



A small number of companies appeared to struggle to articulate their purpose beyond simply making good products to sell, and for these companies it was difficult to see how their purpose resonated either within their business or within their reporting.

Croda International Plc



Of those without a clear purpose upfront, many had a 'vision' or 'mission' often encompassing an aim to be the best in their sector. A small number of companies appeared to struggle to articulate their purpose beyond simply making good products to sell, and for these companies it was difficult to see how their purpose resonated either within their business or within their reporting.

In the context of crisis management, such as during the COVID-19 pandemic, a company's purpose – supported ideally by a strong balance sheet – should drive it to make the right decisions for the longer term, both for its shareholders and for its wider stakeholders (see the Pandemic section, below).

Company purpose and broader stakeholders

Purpose should be connected to the desired impact on stakeholders (ideally specific stakeholder groups) to differentiate it from a broader company 'vision'. Of those companies clearly stating a purpose upfront, 90% referred to specific stakeholder groups beyond shareholders within that statement. For some companies which did not refer specifically to a particular stakeholder group, such as Rightmove plc whose purpose is "to make home moving easier in the UK", their purpose resonated throughout the report and it was through the business model and broader review of the business that it became clear which stakeholder groups were relevant.

Connectivity throughout an annual report, including linking relevant information in the financial statements to the strategic report, is hugely important given the volume and variety of information contained within today's annual reports. However, as the FRC Guidance recognises, it would be impracticable to highlight and explain all relationships and interdependencies that exist within the annual report while also ensuring the strategic report is both concise and understandable. In consequence, priority should be given to the relationships and interdependencies that are most relevant to the assessment of development, performance, position and future prospects of the business.

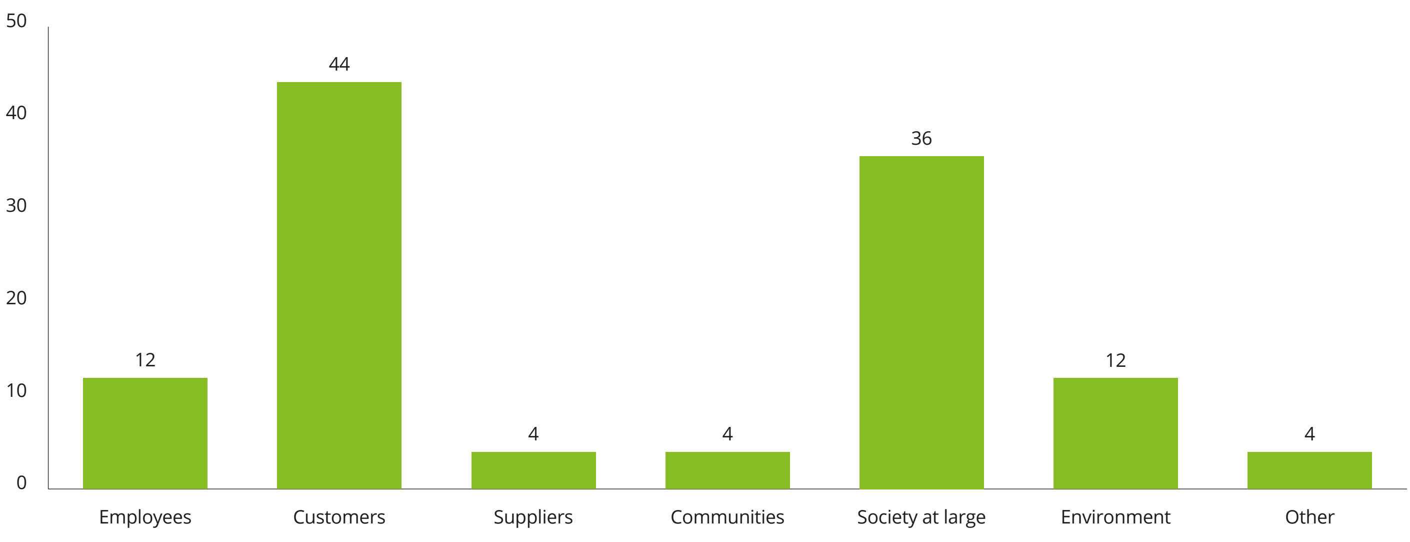
The connection between purpose and impact (i.e. a company's positive impact on people, planet and profit) is essential. It was pleasing to see, therefore, that 60% of companies whose purpose referenced stakeholders beyond shareholders had included all those same stakeholders within the business model as groups for whom value is created.

Similarly, 60% of companies whose purpose referenced stakeholders other than shareholders had a KPI for at least one of those stakeholder groups. Almost all of these were in respect of either customers or employees, such as customer satisfaction or employee engagement scores, and it was good to see that almost all aligned with the description of value creation in the business model (where this was provided). A number of companies without KPIs clearly linking to their purpose had referred only to broader society at large within their purpose; quantifying impact on society at large is unsurprisingly difficult, although more granular non-financial KPIs had been disclosed.

Disappointingly several companies with no KPIs relating to a stakeholder group identified in their purpose had omitted to include any non-financial KPIs at all. This raises the question of whether and how the board intends to track the company's impact upon, and outcomes relating to, those stakeholders, given the company purpose encompasses them. KPIs that align with purpose should also be linked through the business model to capital allocation (see the Profit section, below) and remuneration so that users of the annual report can see the holistic way in which purpose is embedded as integrated thinking.

The importance of company purpose and considering a broad range of stakeholders is reflected also in the Brydon review. Aiming to improve trust in capital markets and the corporate system, one recommendation is that the directors present an annual Public Interest Statement as part of the strategic report. This would essentially be a narrative which provides "an opportunity for directors to articulate in a holistic way how the company they govern serves the wider public interest" and how the company has managed this in the year under review. Corporate reporting is already heading this way, with the introduction this past year of the s172(1) statement and the 2018 Code.

Figure 1. Which stakeholders did companies refer to within their purpose statement?



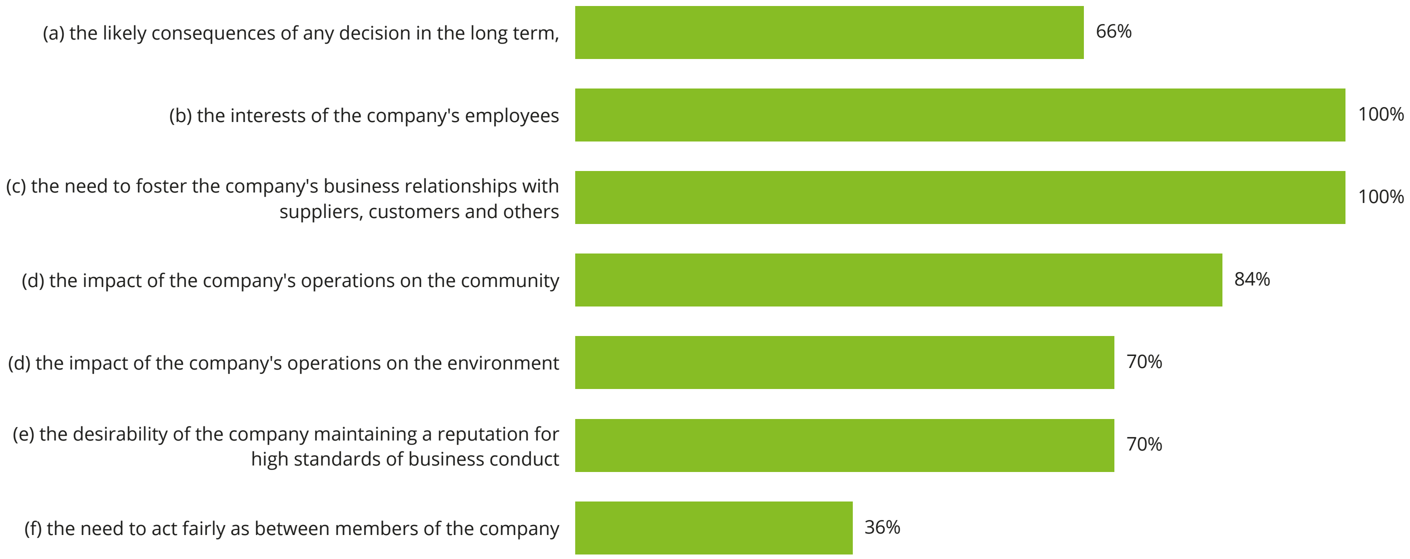
The new s172(1) statement

The s172(1) statement is an opportunity for companies to present in the strategic report how their directors have considered the matters set out in s172(1) of the Companies Act 2006 and how, through their mandatory duties, they are leading a responsible, long-term business. Companies were required to provide this statement for the first time this year. We considered that 90% of companies provided a statement that, as is required, was clearly identifiable as their s172(1) statement. Encouragingly, all companies provided disclosure that dealt with stakeholder engagement, even those companies that did not have a clearly identifiable s172(1) statement.

The UK Companies Act 2006 s172 sets the duty of each director to promote the success of the company for the benefit of the shareholders as a whole, however, the broader matters required to be considered as part of that drive for success make a clear link to a broader purpose as well as profit generation.

Many companies incorporate certain matters set out in s172 through cross-reference to elsewhere in the report. Generally companies avoided too much repetition between the s172(1) statement and the rest of the annual report, however this is an area that some companies could work on in subsequent years.

Figure 2. How many companies clearly discussed each of the matters set out in s172 as part of their s172(1) statement?



The s172(1) statement is an opportunity for companies to present in the strategic report how their directors have considered the matters set out in s172(1) of the Companies Act 2006 and how, through their mandatory duties, they are leading a responsible, long-term business.

Supporting the introduction of the s172(1) statement, the BEIS Q&As encouraged companies to explain the issues, factors and stakeholders the directors consider relevant and how they have formed that opinion, methods of stakeholder engagement, and information on how that affected decision making during the year. Figure 2 demonstrates that all companies have taken on board the need to discuss the most obvious stakeholders – employees, suppliers and customers. However, there is a more varied picture around the other s172 matters, which in some cases are harder to articulate, with only a third of companies drawing out how they act fairly between different shareholder groups and interests. Companies can explain the different types of shareholder and how the company achieves some equity of attention and information. For example, in addition to explaining how they engage with large investors, Tesco PLC provided a case study on opportunities given to private shareholders to meet and talk to the chairman and senior management.

Case study.

Store tours

During the year, the Chairman hosted three tours around the Orpington Extra store, which celebrated its 10th anniversary since opening. This store continues to be a focal point within the Orpington community.

The tour gave private shareholders the opportunity to meet and talk to the Chairman and senior management, receive a presentation on store operations and learn about its role in the local community. Feedback from attendees enables the Board to better understand what is important to our private shareholders and balance this with what our customers want.

Further examples of these different matters and how they have been disclosed can be found in our publication "The new section 172(1) statement – observations from first reporters"[3].

The examples of decisions the board has made are where the s172(1) statement really comes to life for the reader as they provide an avenue for the company to explain how the directors have balanced consideration of short-term benefit for shareholders against the s172 matters that help to drive long-term sustainable success. 84% of companies in our sample took the opportunity to draw out examples of decision making as recommended by the BEIS Q&As.

This case study from G4S plc (pictured right) demonstrates how companies can illustrate the way the directors consider different stakeholder groups.

The G4S plc disclosure also highlights the UK pension scheme members, a stakeholder group that is not explicitly called out in the s172 matters but which is relevant to decision making for some boards.

The best stakeholder disclosures we have identified as part of the s172(1) statement do not restrict the company to discussion of only the stakeholders listed in the s172 matters. Instead, they start from the specific perspective of the company, its business model and its purpose, and identify other stakeholder groups, among which pension scheme members and regulators are the most usual.

Case study: Cash Transaction

On 26 February 2020, G4S announced the sale of the majority of the Group's conventional cash businesses to The Brink's Company. In considering the Transaction and whether to approve it, the board considered the interests of G4S's key stakeholders and the impact of the Transaction was reviewed and discussed as part of the decision-making process.

Shareholders – The board believes the Transaction to be in the shareholders' best interest, as it helps reduce financial leverage and provides the Group with the flexibility to continue to invest.

Customers – Continuity of service and service quality following the disposal were key considerations for customers and the board felt confident that the buyer's experience and organised transition of the relevant businesses addressed these points.

Employees – In considering the Group's employees' interests, the board had to balance employees' natural preference for a process providing clarity and certainty with the confidential nature of the Transaction, with limited information, which could be shared in the period of negotiations. The board concluded that a sale to a market-leading cash solutions provider was in the best interests of employees working for the Cash Solutions businesses in scope of the Transaction who would be joining a provider whose business' entire focus is on cash solutions.

UK pension scheme members – The board considered the impact of the sale on the UK pension scheme members and concluded that it is in both their and G4S's interest that the UK Cash Solutions business is retained within the Group.

The board also considered the likely consequences of the Transaction over the long term and desirability of maintaining a reputation for high standards of business conduct.

Other considerations - The board concluded that the Transaction would allow the Group to focus on the growth of the core integrated security solutions business and the further development of the Retail Technology Solutions business, whilst providing an opportunity to simplify and streamline the Group and to capture cost efficiencies, which supports the board's goal of accelerating profitable growth. This would in turn enable the Group to focus on strengthening its position as an industry-leading global security company.

Stakeholder engagement

The s172(1) statement is intended to allow directors to explain their mechanisms for engaging with stakeholders such as suppliers and customers. In line with guidance, the best disclosures not only explain how the company engages at local or management level, but also where the directors engage themselves and how the information gained from stakeholder engagement reaches the boardroom and influences board decision making. The following example from Centrica plc explains how feedback from customers is obtained, how it reaches the board, and some of the actions the board has taken with that feedback in mind.

Customers

Listening to customers helps us to satisfy their changing needs and reduce costs. We seek feedback on a range of issues such as customer service, new products and pricing. This is done through various methods such as focus groups, listening sessions and surveys, as well as proposition and usability testing.

Action from insight
We track feedback from customer journeys and run customer experience surveys. The Board receives a quarterly customer dashboard with key performance and plans, and uses this insight to make decisions that serve our customers for the long term as well as foster stronger relationships with them. Feedback, for example, informed the Board that customers wanted a cost-competitive provider with market-leading customer service. The Board has consequently been involved in transforming our customers' experience which includes oversight of the digital transformation.

Voice of the customer
The Board wanted to empower customer-facing teams with real-time customer service insights, to help them understand the root causes of issues and shape improvements. This led to the 'Discover' platform launching in UK Home and UK Business, which hosts survey feedback from over 20,000 customers a month. Insights from the platform have stimulated Board approval on new ways of working and key customer journeys, such as easier-to-understand bills and pricing renewal policies.

Read more about the benefits of the digital transformation on
Page 21

Read more about our customer service experience on
Pages 22 and 25

Reputation

A clear purpose embedded throughout an organisation and good governance underpin and strengthen company reputation.

Reputation is enhanced by companies dealing well and transparently with each of the matters set out in s172. It is also enhanced when boards live the culture and values of the business, act with integrity and embed that approach within their companies. The annual report provides companies with an opportunity to reflect on their reputation and how they are maintaining or enhancing it.

Aside from the common references to reputation risk within the discussion of principal risks, 48% mentioned company reputation in passing, while 28% had a more thorough discussion. These discussions were generally within the broader context of corporate responsibility, often focusing on safety of employees and customers and reputational impact of supply chains, while one company discussed its reputation as an innovator within its industry within the context of its strategic objectives.

The annual report provides companies with an opportunity to reflect on their reputation and how they are maintaining or enhancing it.

As described above, 70% of companies discussed their reputation for high standards of business conduct clearly in their s172(1) statement. These companies included explicit reference to maintaining their reputation. For some companies the drive to maintain and build reputation for high standards of business conduct shone through in the s172(1) statement and elsewhere in the strategic report. This was particularly noticeable in the supermarkets in our sample, which of course sell directly to the public and face close scrutiny from government and media.

Purpose and broader ESG matters

It is good to see many companies acknowledging how crucial broader ESG matters are to the success of their business, with the chief executive of Essentra plc stating "ESG is crucial to our ability to maintain stability, deliver our strategies and ensure growth. Good management of this topic is therefore critical to meeting the increasing expectations of all our stakeholders including employees, customers and investors."

Other chief executives are clearly considering broader ESG matters. The chief executive statement in Persimmon Plc, for example, covered a number of their non-financial highlights, including ESG factors, referring to them as key highlights and linking back to the commentary about their stakeholders covered in the purpose statement and business model.

What to watch out for

- [ ] Set out your company's purpose in a clear and prominent manner, and consider how you demonstrate its linkage to impact through both strategy and business model disclosures.
- [ ] Where your company purpose references stakeholders, check that the key stakeholders are identified consistently with other disclosures, such as stakeholder engagement in the s172(1) statement.
- [ ] Ensure your s172(1) statement addresses all parts of the director's duty, particularly how the board has acted fairly as between members of the company, considered the likely consequences of decisions in the long-term and maintained a reputation for high standards of business conduct.
- [ ] When describing stakeholder engagement, describe the stakeholder concerns identified through the engagement activities and the board's understanding of those concerns (for example, through activities ongoing or planned).

Appendix – Survey methodology

For many years the Annual report insights series has presented the findings of a survey of 100 annual reports of UK companies with a premium listing of their equity on the London Stock Exchange, both within and outside of the FTSE 350. This year we have adopted a different approach to facilitate a deeper look into key areas where regulators and investors are increasing their focus.

Purpose, people, planet and profit chapters

In four key areas – purpose, people, planet and profit – the publication presents the findings of a survey of 50 UK companies with a premium listing of their equity on the London Stock Exchange. The population comprises 21 FTSE 100 companies and 29 FTSE 250 companies across a range of industries. All companies had financial years ending between 31 December 2019 and 31 March 2020 and had more than 500 employees, and were therefore required to disclose both an NFI statement and s172(1) statement and were in scope of the 2018 Code. As many of these companies as possible were included within the sample used in the previous survey.

Pandemic chapter

A large number of the annual reports surveyed for the four previous chapters that were approved in February or early March 2020 made little or no reference to COVID-19. As such, in this section we look at some of the emerging trends in annual reporting regarding COVID-19 for a sample of 20 FTSE 350 March year-ends.

Appendix 1 of consolidated publication – additional findings

This appendix presents various statistics from surveying the larger sample of annual reports that includes 100 UK companies spread across the whole of the FTSE. 91 of the 100 companies are the same as those used in the previous year's survey. The population comprises 20 FTSE 100 companies (2019: 19), 39 FTSE 250 companies (2019: 37) and 41 companies outside the FTSE 350 (2019: 44). Investment trusts, other than real estate investment trusts, are excluded from the sample due to their specialised nature. The reports analysed are for financial years ended between 28 September 2019 and 31 March 2020.

Although our survey data uses only companies from our samples, when selecting examples of good practice we have used material from companies that, in our view, best illustrate a particular requirement or innovation, regardless of whether they are in our sample.

Each chapter also includes a short list of items to watch out for in the reporting season ahead, reflecting areas of changing requirements or practice and areas of regulatory focus.

Glossary of terms and abbreviations

Term	Definition
2018 Code, or the new Code	The 2018 UK Corporate Governance Code
Acc Regs Sch. 7	Schedule 7 of *The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410)*, as amended
the Act	UK Companies Act 2006, as amended
BEIS	The Department for Business, Energy and Industrial Strategy
BEIS Q&As	A set of frequently asked questions published by BEIS regarding *The Companies (Miscellaneous Reporting) Regulations 2018 (SI 2008/860)*
Brydon review	An independent review by Sir Donald Brydon into the quality and effectiveness of audit
Climate Action 100 +	An investor initiative encouraging large corporate greenhouse gas emitters to take necessary action on climate change
ESG	Environment, social and governance matters
ESMA Guidelines	Guidelines on Alternative Performance Measures (APMs) for listed issuers published by the European Securities and Markets Authority (ESMA). Since original publication, ESMA has published several questions and answers on the guidelines to promote common supervisory approaches and practices in the implementation of them
FCA	Financial Conduct Authority
FRC	Financial Reporting Council
FRC Guidance	The FRC's Guidance on the Strategic Report published in July 2018
FRC Lab	The Financial Reporting Lab was launched in 2011 to provide an environment where investors and companies can come together to develop pragmatic solutions to today's reporting needs. Latest reports can be found here.
FRC's Annual Review of the UK Corporate Governance Code	See this link
FRC's Annual Review of Corporate Reporting 2018/2019	See this link
GHG	Greenhouse Gases
IASB	International Accounting Standards Board
IBC	The World Economic Forum's International Business Council
Investment Association	A trade body and industry voice for UK investment managers
IPCC	Intergovernmental Panel on Climate Change, the United Nations body for assessing the science related to climate change
KPI	Key performance indicator
NFI Statement	the Non Financial Information Statement as required by s414CB of the Act
NFR Regulations	*The Companies, Partnerships and Groups (Accounts and Non-Financial Reporting) Regulations 2016 (SI 2016/1245)* which implement the EU Non Financial Reporting Directive into sections 414CA and 414CB of the Act
Parker Review	An independent review by Sir John Parker into the ethnic diversity of UK boards
R&D	Research and development
s172	Section 172 of the Act which sets out certain directors' duties
s172(1) statement	The statement required by s414CZ of the Act, under which the directors must explain how they have fulfilled their duty under s172(1) of the Act
SASB	Sustainability Accounting Standards Board
SDGs	Sustainable Development Goals, a set of targets set out by the United Nations
SECR	Streamlined Energy and Carbon Reporting, as set out in *The Companies (Directors' Report) and Limited Liability Partnerships (Energy and Carbon Report) Regulations 2018 (SI 2018/1155)*
TCFD	Task Force on Climate-related Financial Disclosures
TCFD recommendations	Recommendations as set out by the TCFD which promote voluntary, consistent climate-related financial risk disclosures for use by companies in providing information to investors, lenders, insurers, and other stakeholders
TCFD 2019 Status Report	An overview of current disclosure practices as they relate to the TCFD recommendations
WEF	The World Economic Forum

Endnotes

1. https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans
2. https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter
3. https://www.iasplus.com/en-gb/publications/corporate-governance/s172-1-first-reporters

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