Greater expectations
The age of the stakeholder has arrived

Analysis of FTSE 350 corporate reporting trends in 2018

www.pwc.co.uk/corporatereporting

Contents

Introduction

Mark O'Sullivan
Head of Corporate Reporting,
PwC UK

I have pleasure in introducing the findings from our latest review of reporting practices in the FTSE 350. In over 15 years of performing such a review I cannot remember one where the governance and reporting agenda has been dominated by just a single topic – stakeholders – almost at the expense of all others. This year's review inevitably therefore explores what impact this topic has had on reporting while also looking at some of the more traditional areas of reporting.

After so many years of passing comment on reporting trends, this year we felt it appropriate to seek and provide the views of others. So you will find quotes throughout the document from a number of leading commentators[1] on topics as broad-ranging as the role of the annual report, trust and the importance of stakeholders to shareholder value.

Uncertainty rules

The backdrop to this year's reporting season has been one of uncertainty and this has clearly had an effect on the trends we've witnessed. While the emphasis on stakeholders and overall direction was clear, the detail was not yet in place, and indeed most of the changes were not going to be mandatory even for the next reporting season. All of which left companies with a bit of a conundrum for the main 2017-18 reporting – how far was it right to go to anticipate 2019-20? And how far would others go?

We now have pretty much all the pieces of the jigsaw in place. In particular, we have the 2018 UK Corporate Governance Code (2018 Code) and the new Companies Act reporting regulations on section 172 and stakeholder engagement. Now that those have been finalised, the FRC has been able to publish the final version of its revised Guidance on the Strategic Report – which itself has more to say about that other important piece of the overall jigsaw, the non-financial reporting regulations.

So while this survey reflects on what we saw in the 2017–18 reporting season it does so very much with an eye to the future.

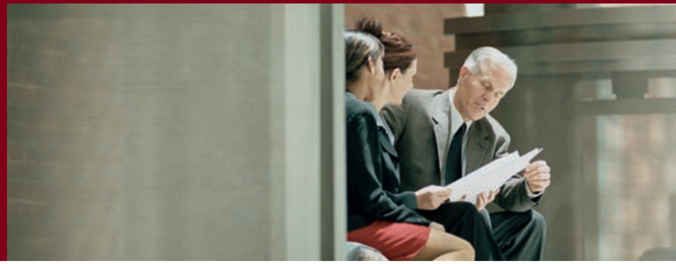
Reporting themes

Against such a backdrop the quality of reporting has continued to generally improve, albeit at glacial speed. We've seen emerging themes – **stakeholders and long-term considerations** – alongside the familiar challenge of **integration** underpinned by a growing recognition of the need for judgement and a **shift in mindset** if reporting is to remain relevant for the demands of the 21st century.

Stakeholders and long-term considerations

There's undoubtedly been a growing recognition of stakeholders in reports whether in the identification of key stakeholders and acknowledgement of their importance, presentation of business models, or in the statement of a clear purpose. Yet, while there have been a small number of examples of good reporting from companies willing and able to get ahead of what will be required in a couple of years time, overall we were left with the feeling that the market in general still has a lot to do.

1 For more information see P21



The need for companies to take a longer term view is a major, yet sometimes overlooked, underlying theme of the governance reform debate. It was therefore encouraging to find more FTSE 350 companies providing a more forward-looking orientation to their strategic report whether by being clearer about the period over which they discussed their strategy or discussing future market trends. However there is still a real lack of genuinely medium to long-term information in annual reports – a situation made more apparent since the arrival of the viability statement in recent years.

Integration

Stakeholder information, like the other key elements of a strategic report - strategy, business model and risks etc – needs to be properly integrated if it is to feel authentic and strategically relevant. Yet it's clear that, with ever more demands being placed on corporate reporting, companies continue to struggle to integrate all the relevant information and present a joined up picture. This year's review found the integration of some elements of reporting had improved, e.g. strategy with business model, while others had taken a step back e.g. strategy with KPIs. But undoubtedly it's the references to stakeholders that have felt most shoehorned into reports rather than integral to the narrative.

However, all is not lost. It's striking to me how the issues associated with stakeholders (and section 172) cast a whole new light on the other existing elements of the strategic report, and can in fact make it hang together more coherently. A good example of this is the business model. As noted business model disclosures and their integration to the rest of the strategic report have been improving but there remains a long way to go. Now the evident relationship between the business model and a company's stakeholders has the potential to put this right.

Change in mindset

While there has continued to be slow and steady improvements in the quality of reporting, as I reflect on the year ahead, it's clear to me that there's a real need for good judgements – who the key stakeholders are, how to engage with them, what to do in response, and then how to report on all of this – and a shift in mindset to one that recognises the importance of stakeholders in the delivery of enlightened shareholder value.

The alternative is boiler-plate, generic disclosures – and a mindset that throws in a 'kitchen sink' list of general risk factors rather than contextualising and explaining them well. An outcome that doesn't make the seismic improvements needed in the quality of reporting to reflect the impact on businesses of a society with a new attitude towards accountability.

Over the following pages you'll find more insights into current and emerging FTSE 350 reporting practices, top tips to improve the quality of reporting and good practice examples to inspire action and change. We also provide some thoughts on how companies and boards can make the necessary shift in mindset, drawing of course on the work of those who are already leading the way.

Why the annual report?

Technology is transforming every aspect of modern life however the reporting model has appeared relatively immune to this technological evolution. Ongoing efforts to reform the reporting model tend to be focused on what companies report, rather than how that information is sourced, distributed and consumed in the most accessible way by stakeholders.

Against this backdrop it is not surprising that the annual report – its content, format and timeliness – is constantly challenged.

Technological advances are already improving the quantity and quality of information available to stakeholders and the way investors forecast financial performance. So it is inevitable that they will disrupt and transform not just what is reported but the entire reporting system – including the annual report.

You can read more about our views on technology and what it means for the future of reporting in our publication – *Reporting reboot – How technology is transforming reporting today*. But our view is that in today's world, the annual report, and more importantly the information it presents, continues to play an important role as part of the suite of information that companies produce. Our commentators have their own views.

Our commentators views on the role of the Annual Report

"I think the annual report should have [another] role, to make boards understand and discuss what the business is about and where it is going. The annual report should be the compelling voice of the board and if it isn't then the board is not fulfilling its duty."

Paul Druckman, Chairman, The Clear Group, Chair of Corporate Reporting Council, FRC

"We use the annual report to understand the purpose of the company, what they are trying to achieve and their progress towards that purpose. It's also a good way of understanding the risks for potential investors – the viability statement in particular has proved that. It provides the opportunity for investors to understand successes over the year as well as, perhaps more importantly, what didn't go so well and what management can, and have, learnt from mistakes. We also feel the report is a good way of understanding the governance that is present in a business, the structures around the company and the internal audit."

Ben Peters, Fund Manager, Evenlode

"I understand the dilemma of producing a clear and digestible report and trying to avoid the clutter but I don't think companies should back away from making the annual report a substantive document. Stakeholders need a 'one stop shop' – somewhere they can go and find all the information they need in one place."

Baroness Sharon Bowles, Former MEP and Chair of the Economic and Monetary Affairs Committee

Our commentators frustrations with the Annual Report

"Companies tend to tell us the good news but not the bad – they could be accused of 'putting lipstick on the pig!'. Too many focus simply on complying with regulation rather than telling their own story or they report information in silo so you don't get an understanding of how the pieces join up. Finally I think the whole reporting system is old fashioned and would like to see more being done to develop apps or intelligent databases to drive more accessible content."

Paul Druckman, Chairman, The Clear Group, Chair of Corporate Reporting Council, FRC

"For us the real tension is where information should go – yes the annual report should be comprehensive but too many aren't focused on what actually matters. Transparency is really important – we need the full picture not just the positives"

Ben Peters, Fund Manager, Evenlode

"Annual reports don't give us a balanced view – they often read like a manifesto for the company – and this means that most readers won't trust the content"

Baroness Sharon Bowles, Former MEP and Chair of the Economic and Monetary Affairs Committee

Understanding who you are and why you exist

- **Half of companies set out a purpose but it is not well integrated with the rest of the strategic report.**
- **Being explicit about purpose sets the tone of the whole report.**

"Without a sense of purpose, no company, either public or private, can achieve its full potential. It will ultimately lose the license to operate from key stakeholders."

Larry Fink, CEO, BlackRock

All companies start life with a purpose – the sense of direction that determines what type of business they will be and the values and beliefs they will abide by as they grow. However, traditionally annual reports have been quite limited in the information they provide.

But there is a new emphasis. Stakeholders want to know what a company really stands for, what it sees as it's core purpose, and how it is being embedded into the organisation and brought to life through the performance and progress in the year.

What we found

Unfortunately our survey suggests that only 51% of the FTSE 350 explicitly stated a purpose or mission, though within the FTSE 100 this rose to 69%. However, more often than not these disclosures sit in isolation rather than being the overarching thread that holds the report together.

For us, a company's purpose should be the starting position which drives strategy and the approach to how a business operates. Without a defined purpose it is hard for a company to measure success, in particular through the stakeholder lens we now see applied. Similarly, if the reader can understand what the company believes its ultimate goal is then they can begin to understand the relevance of other disclosures made – it really shows what's material.

51%

of companies set out explicitly a purpose or equivalent

30%

of companies have a stakeholder-led purpose

Stakeholder perspective

"Purpose can't just be about maximising profit it needs to be the optimisation of profit for a multitude of stakeholders"

Charles Bowman,
Lord Mayor of London

Furthermore, only 30% of companies have a stakeholder-led purpose. We believe that a company's purpose can be a useful tool to explain why certain stakeholders are integral to long-term strategic success and therefore why they form part of the strategy and discussion of activities and progress.

Our word-cloud, on the next page, captures the key words used in disclosures around purpose. The fact that the words 'customers' and 'people' (and even 'the world') are used so frequently indicates that companies are acknowledging and making connections to their "closest" stakeholder but not necessarily recognising their wider role.

The FRC Guidance on the Strategic Report says...

7A.7 – An entity's purpose, strategy, objective and business model are inter-related concepts…. A description of an entity's values, desired behaviours and culture will help to explain and put its purpose in context.

7B.7 – An entity's purpose is why it exists. It could encompass generating benefits for members through its economic success whilst having regard to the matters identified in section 172 and, in the broader social context, contributing to inclusive and sustainable growth.

The 2018 UK Corporate Governance Code says...

The board should establish the company's purpose, values and strategy, and satisfy itself that these and its culture are aligned.

Top Tips

3 things most companies could do to improve their disclosure in this area:

- Be explicit about what your purpose is, explain what it means and how this impacts on the company.
- Set your purpose in the context of what you are trying to achieve and be clear about who that impacts.
- Ensure that purpose aligns to other elements of reporting, for example business model, remuneration.

Figure 1: Key terms from purpose statements of FTSE 350 companies

Investor perspective

"We see too many companies reporting what they do but not why they do it. Even those companies that do report on their purpose often produce something that lacks real substance making it hard to understand what is really important to the business. We also find that companies that only consider one stakeholder group as part of their purpose tend to be too narrow in focus. We're not looking at companies in this respect to make a moral judgement, it's more about allowing us to assess risk."

Ben Peters, Fund Manager, Evenlode

Figure 2: Aggreko AR2017

CUSTOMER FOCUS

Providing solutions to our customers' complex problems

Customers rely on Aggreko to use our 55 years of specialist knowledge, combined with a detailed sector focus, to provide services above and beyond the competition. A customer in the Petrochemical & Refining sector learned the value of the Aggreko approach when their flagship facility on the Gulf Coast experienced a collapse in its cooling tower.

The collapse meant that the capacity of the facility fell by between 20% and 40%, costing the plant $5 million a day. In 6 days the Aggreko Cooling Tower Services team designed and mobilised a solution involving 9 miles of cable, 8 MW of gas power, diesel back-up generators and 30,000 tons of cooling tower capacity. Initial estimates were that 60,000 tons of cooling tower would be required, but despite the short timeframe the team managed to design a solution that cut this in half. So not only did the solution quickly prevent a $5 million a day loss, it did so efficiently.

Our markets are dynamic and always evolving. To make sure that we remain well placed to optimise these opportunities and deliver improved financial performance, we are focused on four strategic priorities.

Customer Focus

Tailoring solutions to improve customer experience

- Focusing on key sectors
- Developing and deploying engineered solutions
- Tailoring sales and service channels to customers
- Maintaining good relationships with other stakeholders

Our purpose

We believe in the positive impact of power and the ability to control temperature. We believe it opens up opportunity and creates potential for individuals, communities, industries and societies all over the world.

Together and over time, we believe our services make a massive difference.

Aggreko set out their purpose clearly from the front cover of their annual report. They do a great job of using their purpose through reporting, demonstrating clear links to the strategic themes and using case studies to bring the concept of "the positive impact of power" to life.

Bringing your business to life

- **Business model disclosures are becoming more comprehensive however they often still feel generic, indistinguishable across an industry, and isolated from other parts of the report.**

There should be an inherent connection between a company's purpose and its business model with both being explicit about the stakeholders that are key for the business. Unfortunately most annual reports fail to really use their business model to provide a distinctive overview of how their business operates and how that may impact it's stakeholders.

What we found

Just under a third of FTSE 350 companies used their business model as an opportunity to demonstrate that the outputs of their business go beyond financial profits and have started to delve into the impact the business has on their wider stakeholders. This type of disclosure remains in its infancy, however, with most companies discussing simple outcomes such as employee numbers or contributions to charity. Over time, we will be looking for companies to go further and consider the impact that they have on their employees – what impact their training has had on the skills profile of their employees, how they have contributed to employment in local economies etc.

Stakeholder perspective

"Trust in business is at an all time low, but companies have a great opportunity with their business model to really set out a clear overview of how they are different and the impact they have on their key stakeholder groups"

Charles Bowman, Lord Mayor of London

83%

companies highlight stakeholders as part of business model

30%

companies talk about stakeholder outcomes in the business model

Another key area of focus for us when looking at business models is understanding how a company creates value and what makes a company distinctive or unique. For example, we see far too many companies reporting that one of their differentiating factors is their customer relationships but the reality is that every company says that and the reader is no clearer on what makes them unique. Investors often compare companies within industry groups – they are looking to understand the differences and the business model is the ideal place to be explicit about this.

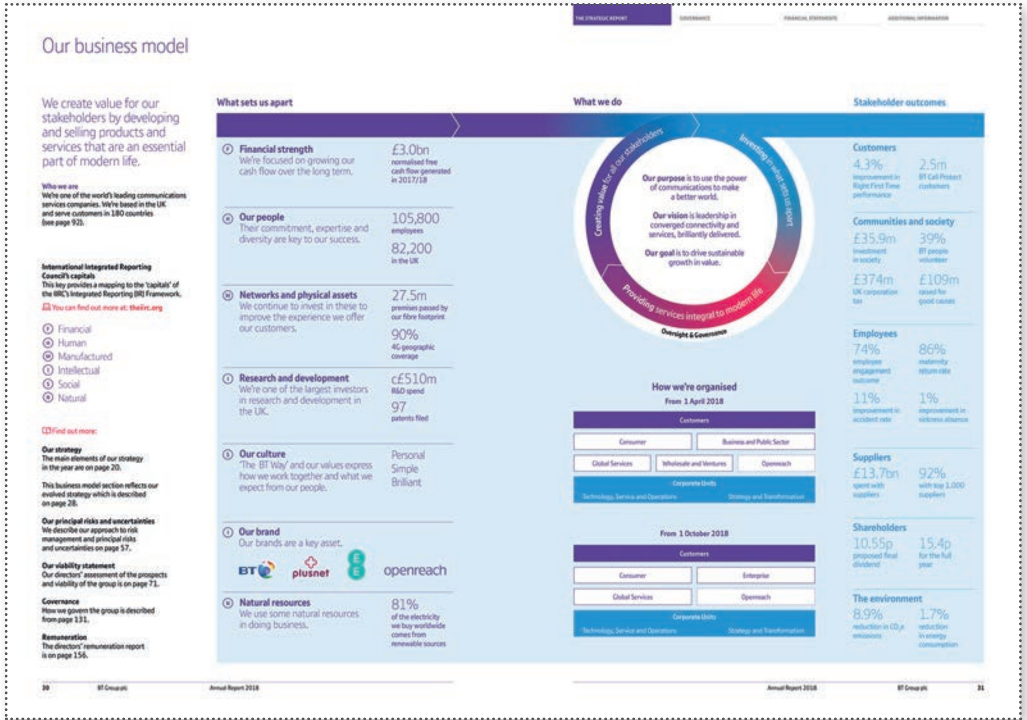
Top Tips

4 things most companies could do to improve their disclosure in this area:

- Be clear about the role stakeholders play in the business.
- Explain how they create value and what makes them unique.
- Explore outcomes or impacts of the model.
- Challenge yourself on how the content of the business model can be integrated elsewhere in the strategic report. If it can't, can it really be considered a critical element of the business model?

BT Group provide a comprehensive overview of their business model with a real focus on what makes them distinctive. The model also highlights stakeholder outcomes underlining that their purpose is wider than financial profits.

Figure 3: BT Group AR2018



64%

of investors said that "what a company is in business to do and how it makes money" is one of the top 3 factors that are most important to them when deciding whether to invest in or recommend an investment in a company

PwC 2018 Investor Survey

The FRC Guidance on the Strategic Report says...

7.A7 – An entity's purpose, strategy, objectives and business model are inter-related concepts.

7.A15 – The description of the entity's business model should explain how it generates and preserves value over the longer term. The business model should be consistent with the entity's purpose.

7A.16 – A critical part of understanding an entity's business model is understanding its sources of value, being the key resources and relationships that support the generation and preservation of value.

7A.18 – The description of the business model should include a high-level understanding of how the entity is structured, the markets in which it operates, and how the entity engages with those. It should also make clear what makes it different from, or the basis on which it competes with, its peers.

Looking to the future

- **More clarity on periods covered but a serious lack of medium to long-term information.**

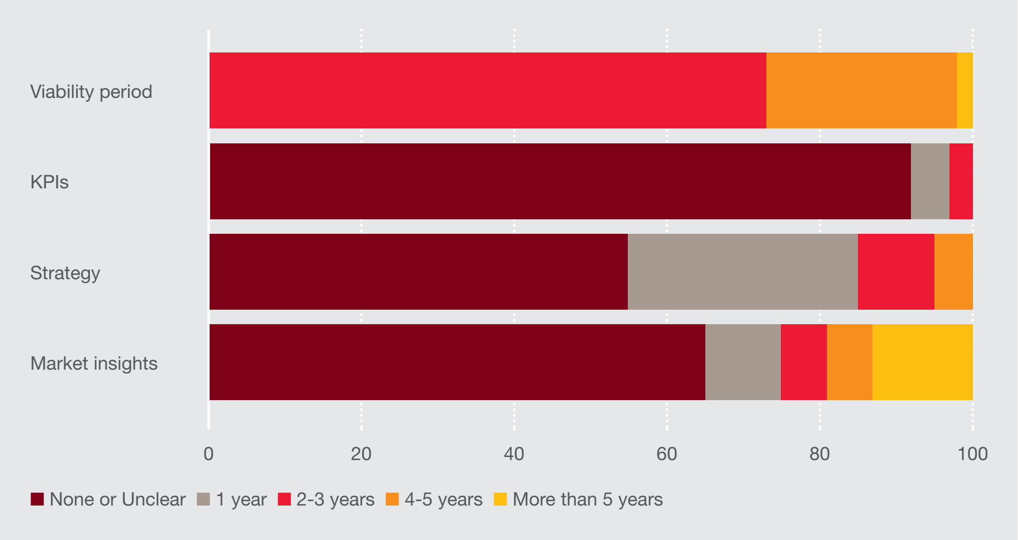
The need for companies to take a longer term view is a major underlying theme of the governance reform debate connected with the Government's goal of fixing the UK's perceived productivity issues. Groups such as the Investment Association have also been calling on companies to provide them with reporting that allows them to support the long-term decision making that section 172 calls for.

In this context it was good to find FTSE 350 companies being clearer about the period over which they discussed their strategy: this year we could tell what the relevant period was in 45% of companies (up from 24% last year).

However there is still a real lack of genuinely medium to long-term information in annual reports (only 15% of companies went beyond twelve months in their discussions of strategy). This situation has been made particularly noticeable since the introduction of the viability statement. The vast majority of these disclosures refer to a strategic plan covering three or five years but the viability statement is usually the only place that this is discussed (if at all).

Returning to the business model, one of the most significant changes in the 2018 Code is the requirement for companies to report on the sustainability of their business model. It will be interesting to see whether this drives more discussion of long-term strategy and risks or explores how the business model may change over the medium to long-term in order to respond to market developments and support the strategic ambitions than the viability statement itself has generally done so far.

Figure 4: Length of forward looking information in reporting



Forward looking disclosures on market insights have stayed broadly consistent year on year with 34% quantifying the future market direction. We believe that this is a real missed opportunity for companies to provide a perspective on expected future market conditions and more importantly, how this will be likely to impact the strategic priorities that management have decided on. This information tends to be widely available through other sources and it can be frustrating for investors when management won't provide their perspective.

In many ways, the sustainability of the business model and evaluation of future market conditions align to another missed opportunity in reporting – the articulation of emerging risks. Whilst the focus of the last few years has been on current key risks, the 2018 Code includes a reference to emerging risk. Investors are interested to understand whether board's are really considering what else is on the radar and that may become a key risk in the future.

The FRC Guidance on the Strategic Report says...

6.11 – Where appropriate, information in the strategic report should have a forward-looking orientation.

6.12 – The provision of this information does not require disclosure of a forecast of future results.

6.13 – The strategic report should not concentrate solely on a single timeframe.

6.14 – Entities should communicate relevant information that enables shareholders to assess the matters that may have an impact of the long-term success of the group.

The 2018 UK Corporate Governance Code says...

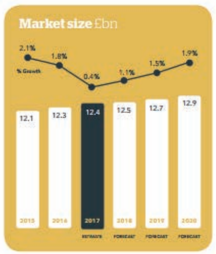
The board should describe in the annual report how opportunities and risks to the future success of the business have been considered and addressed

The board should confirm in the annual report that it has completed a robust assessment of the company's emerging and principal risks, and describe its principal risks, what procedures are in place to identify emerging risks, and how these are being managed or mitigated.

Dunelm's annual report provides a clear perspective on future market conditions supported by quantitative charts. The disclosure also provides balance by setting out growth drivers and inhibitors – things that may prevent the growth.

Figure 5: Dunelm AR2017

The Homewares Market*



Headlines

The UK homewares market is worth over £12bn per year. Based on estimated GlobalData research for calendar year 2017, growth has been minimal and driven by price, not volume. Our internal analysis, based on actual weekly sales data for our trading period, suggests the market may actually have been in decline. The market is expected to return to stronger growth in 2018.

Online penetration is still growing, to 13.6% in 2017 (2016: 12.6%), and is forecast to reach 16.2% by 2020. Improved convenience through shorter delivery times and cheaper deliveries will support growth.

Stores continue to play a key role in the shopping journey with research highlighting an increasing importance of the in-store experience to consumers.

Most consumers purchase homewares every four to six months and the most frequent and highest spending shoppers are 25-34 year-olds. Younger shoppers especially are influenced by trends and design-led ranges.

Key growth drivers and inhibitors

+ Store space and new formats improve experience
+ Fashion and design-led ranges increase visit frequency
+ Online provides more choice and convenience
– Economic uncertainty, inflation and price competition
– Leisure favoured over retail

Figure 6: Stobart Group AR18

Stobart Group's strategy is driven by two key financial outcomes: to deliver on £2 bn+ market valuation by December 2022 from our operating divisions, and to provide income to shareholders via dividends supported by our non-operating assets.

2018/19 objectives

- Sustain EBITDA of over £10 per tonne during calendar year 2018.
- Work towards target renewable energy fuel supply of 3 million tonnes p.a. by calendar year 2022 through development of our Full Service Solution and entering new markets.
- Rebuild supply chains impacted by long delays and extreme volatility in new renewable energy plants.
- Due to the impact of the Environment Agency's Fire Prevention Plan guidelines/regulations develop increased storage options.

- Drive sales on the new LSA routes.
- Increase food and beverage offer, increasing revenue per passenger.
- Conclude agreements with new airlines to materially increase passenger numbers.
- Develop commercial operations at CLDA.
- Achieve 2,000 private jet movements at Stobart Jet Centre.
- Strengthen relationship with Aer Lingus, Stobart Air's key franchise partner.

Stobart Group set out two clear quantified long term targets which are supported by clear short term targets against each priority for the next period.

Top Tips

3 things most companies could do to improve their disclosure in this area:

- Be clear about the timeframe over which strategy is being presented and ensure messaging in consistent with the viability statement
- Provide a view of future market trends supported by quantified data
- Consider the balance of lead and lag performance indicators

Presenting a joined up strategic narrative

- **Good evidence of gradual improvement in linkage to business model, risks, sustainability and market insights.**
- **Still a significant number of companies who provide no linkage at all and therefore aren't creating a compelling and joined up strategic narrative.**

Strategy is the bedrock of all Strategic Reports and should be considered the key to which all other elements of reporting link to. Investors care about progress against strategic priorities, about what is going to impact on that progress, how it is being measured and what the risks are, yet too often we are faced with reports that don't answer these questions clearly.

What we found

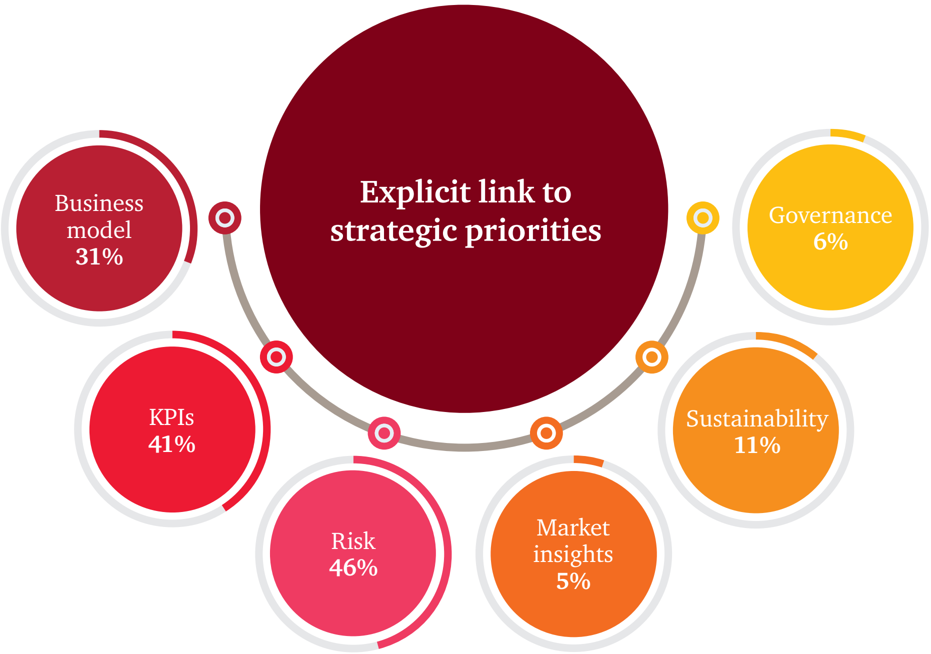
2018 has shown an improvement in companies linking their information to strategy – 46% of companies now link risks up from 39% last year, 31% are linking strategy to business model disclosure up from 20% and 5% are explaining how market insights relate to priorities up from 1%.

However, 37% of companies still fail to explicitly link their strategic priorities to any of these other key elements of the report leading to a piecemeal narrative that the reader is left to link for themselves.

The problem also remains that many of the companies highlighting explicit linkage are simply ticking a box. A closer examination of their reporting often shows good use of symbols or design to indicate linkage but the relevance of the information to strategy, such as the KPIs, doesn't stack up. More often than not, KPIs used by companies don't seem to actually measure the priority they are being linked to and there is little explanation as to why the measure is being used.

Annual reports are an exercise in their own right and often a distraction from the day job. So it is understandable that the development of content for annual reports is often divided up between different departments and divisions to complete their section – but this can be a real hindrance to the creation of a coherent narrative that helps tell a compelling story. Too often we see strategic themes introduced that are then distorted throughout the document – and into other communications such as investor presentations – as different writers interpret them leading to the overall message getting lost. We would encourage companies to make better use of a single editor who has oversight of all sections and is charged with guaranteeing that key messages remain consistent throughout.

Figure 7: Linkage of other elements of the report to strategy in FTSE 350 Annual Reports



The FRC Guidance on the Strategic Report says...

6.17 – The strategic report should highlight and explain linkages between pieces of information presented…

6.21 – may involve the use of cross-referencing or signposting

6.23 – It may be necessary to repeat certain pieces of information, although this should be limited to circumstances when this would tell the company's story more effectively

It is also worth noting that the guidance provides many linkage examples throughout to emphasis the importance of this

The 2018 UK Corporate Governance Code says...

High-quality reporting will include signposting and cross-referencing to those parts of the annual report that describe how the Principles have been applied.

Figure 8: Intu AR18

Strategy overview

Our four strategic objectives were the means by which we put our business model into action effectively in 2017

1 Optimising asset performance

2 Delivering UK developments

We achieved this by
— making our locations the most desirable for shopping and socialising
— astutely managing the assets to take advantage of new trends and occupiers
— building long-term partnerships with local authorities and communities

Progress in 2017
— delivered growth in like-for-like net rental income
— improved rental levels on new leases and rent reviews
— upsized key retailers such as Next, Primark and River Island as well as introducing exciting new names to our centres, including Paul Smith and Inglot

KPIs we use to measure our success
— optimising asset performance encompasses our whole business and as such is measured by all KPIs

Managing risk
— property market
— operations
— brand

Key stakeholders we engage
Customers, retailers, suppliers

Link to our 2018 objectives
— growing like-for-like net rental income
— delivering operational excellence
— optimising our flagship destinations

We achieved this by
— delivering the required planning approvals
— generating the level of demand to commence a project that delivers our required returns
— having the funding to progress the pipeline

Progress in 2017
— on target and on budget with the major extension at intu Watford
— commenced the Nickelodeon-anchored leisure extension at intu Lakeside
— signed Primark to anchor the transformational redevelopment of Barton Square at intu Trafford Centre
— achieved planning approval for the retail and leisure extension at intu Milton Keynes

KPIs we use to measure our success
— shareholder return
— total financial return
— prime property assets
— GVA

Managing risk
— property market
— financing
— developments and acquisitions
— brand

Key stakeholders we engage
Customers, investors, suppliers, local and national government

Link to our 2018 objectives
— optimising our flagship destinations
— making smart use of capital

Intu's strategic disclosure summarises nicely on one page how each priority is linked to KPIs and risk as well as explaining the stakeholders engaged in each priority. The linkage is also shown in reverse on the KPIs, risk and business model pages.

This type of strategy progress table acts as a helpful tool to connect elements of a report together and works best when used as an index to more comprehensive discussion elsewhere in the document.

Top Tips

3 things most companies could do to improve their disclosure in this area:

- ✔ Start your report planning by setting out strategy on a page and linking other elements to it. If you can't find a link then this suggests you'll have a gap in your disclosure.
- ✔ Put strategy at the heart of reporting.
- ✔ Make use of symbols or numbers to reference strategic priorities through the report and be consistent with the language you use to describe your priorities.

Non-financial reporting – demonstrating your impact

- **First year response has been limited, but the areas covered by the Regulations will become more significant as reporting in this area comes into play.**

14%

Only 14% of companies explicitly refer to the non-financial reporting regulations

Earlier this year we carried out a review of how companies had responded to the new non-financial reporting regulations ('the Regulations'), December 2017 year ends being the first companies impacted.

The initial response has been fairly low key, with many companies continuing to report well against the previous guidance, which had been emphasised and expanded on by the new Regulations. Against the backdrop of the stakeholder agenda, companies held back on making major changes, preferring instead to wait for the FRC's revised Guidance on the strategic report and the new 2018 Code to understand the wider context.

Our view has always been that the areas addressed in the Regulations will play a much bigger part in reporting going forwards because they are largely the issues that are of most direct relevance to stakeholder groups. The emphasis in the regulations on the 'impact' that businesses have also makes the stakeholder connection. Worryingly, our review showed that up to 30% of companies did not even acknowledge that they may have an impact that was not purely financial.

Stakeholder perspective

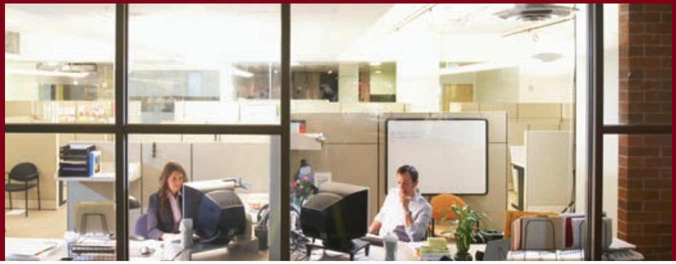
"It's fine to report on outcomes but that shouldn't be the only focus, companies need to be realistic about the impact they have – both positive and negative. Whilst their wider impact on society may not have an obvious near term impact on share price, at a higher level, for example, it may have reputational impact and provide clarity for stakeholders about what sort of company you are. That in itself will impact financially at some point in the future."

Paul Druckman, Chairman, The Clear Group, Chair of Corporate Reporting Council, FRC

Need for a non-financial reporting statement

There has been much debate about whether companies need to reference the new Regulations or provide an explicit section 172 statement. However, the revised FRC Guidance on the Strategic Report [para 7.38] states that the requirement in the Regulation for a non-financial information statement "can be met by cross-referencing to where the relevant information is included in the strategic report". The 'statement' can therefore effectively be an 'index' to where the relevant areas are addressed but, if they choose to take this approach, companies will need to consider whether the linked content covers all the required aspects of each area (such as policies, outcomes and risks), and explains its relevance to an appropriate extent. Where this is not the case it may be that additional context needs to be provided in the non-financial information statement.

In the 2017-18 reporting season, a number of reporters adopted the 'index' approach, and some provided additional information alongside the index. Many others were not so explicit about how they had met the requirements, however. Only 14% of FTSE 350 companies actually referred to the Regulations by name, for instance. We think that quite a few companies would do well to reconsider their approach in year two.



The FRC Guidance on the Strategic Report says...

5.11 – When considering the application of materiality to non-financial information, entities should as a first step consider whether the particular matter is material to the business and then, if it is, determine the appropriate level of information to disclose in relation to that matter. The disclosure requirements for non-financial information in the Act should not be applied as a checklist.

7A.5 – In particular, relevant non-financial information should be considered as integral to the strategic report and should be linked, when appropriate, to other content elements.

7B.4 – The strategic report must contain a non-financial information statement.

The 2018 UK Corporate Governance Code says...

The directors are responsible for the annual report and accounts being fair, balanced and understandable, and providing the information necessary for shareholders to assess the company's position, performance, business model and strategy.

BT Group have clearly set out a statement of their compliance with the NFR regulations and where in their reporting this information can be found. This makes it easy for the reader to identify these key disclosures.

WPP have included a very interesting overview summary of their impact which includes both their positive, negative and indirect impacts, which have been quantified in all cases.

Figure 9: WPP AR 2017

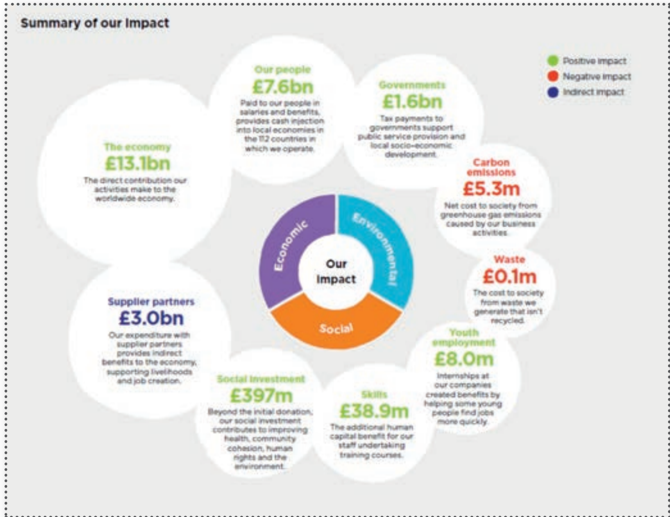


Figure 10: BT Group AR 2018

Non-financial information reporting

New regulations on non-financial information mean we must report on the following topics:

- P41 Respect for human rights
- P54 Environmental matters
- P43 Employee matters
- P57 Anti-corruption and bribery
- P47 Social matters

There are references to our policies in these areas, along with how we've done against various measures, throughout the Strategic Report. Some of the outcomes feature in the business model graphic on page 31. We've listed others in the summary of our non-financial performance on page 26.

Read more in our Delivering our Purpose report.

Top Tips

3 things most companies could do to improve their disclosure in this area:

- Be upfront and acknowledge the Regulations and consider them in light of what is being demanded around the stakeholder agenda.
- Explore the policies you have in place and how your monitor these in your reporting.
- Provide transparent narrative around your impact and ongoing steps to monitor and improve where needed.

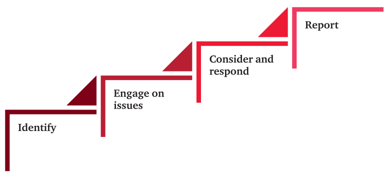
The publication of the BEIS legislation, 2018 Code, and FRC Guidance has provided more substance and certainty. So over the following pages, and with one eye on the future, we explore what implications the stakeholder agenda may have on expectations, board considerations, and reporting.

The board's role in shaping the stakeholder agenda

- **Boards are starting to show how they are engaging with and considering stakeholder views.**
- **Few companies yet addressing how stakeholders have affected decision making.**

Impact of stakeholder engagement

Moving on to reporting specifically on the 'stakeholder agenda', we found that the bulk of stakeholder reporting lacked prominence with references simply to company activities rather than the stakeholder consideration. With the changes to the 2018 Code it's important that boards show that they have considered the extent to which they need to be involved in this area. Cross-referencing may be needed between the governance and strategic reports to cater for this.



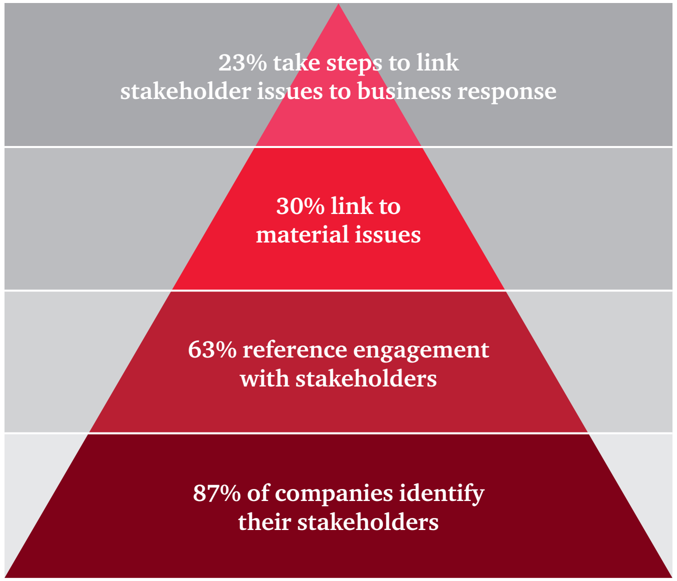
In our earlier document *Navigating the stakeholder agenda > Tackling the reporting challenge*, we set out a three-step process that boards need to go through in order to make decisions about where and when to get involved and what to report.

Our survey showed that FTSE 350 companies are addressing the first step in this process with 87% of companies identifying their stakeholders. However as we look for more details less companies deliver. 63% of companies reference engagement with stakeholders however there is a broad spectrum of responses here with some companies giving comprehensive details about the type and frequency of engagement, and others simply acknowledging that they engage.

Although they are interdependent, the last step in our process is the most significant one, in that an engagement process is pointless if the outcomes of that engagement are then not considered and the material issues identified. Our review suggests that only 30% of companies are showing any linkage between which the issues that stakeholders highlight and the material issues of the business. Even fewer – 23% – then take steps to action these issues within their strategic or business response. Some governance reporters have started to use case studies to show how the section 172 factors were considered by boards in relation to the major developments in the business.

Our view is that most companies in fact do not take enough credit in their reporting for the engagement activities that they carry out, so to some extent the changes to the 2018 Code should drive an improvement in reporting instead of a change in behaviour.

Figure 11: Tracking stakeholder engagement in FTSE 350



New Companies Act reporting requirements

Section 172 reporting – The regulations state that a company's strategic report must include a statement which describes how the directors have had regard to the matters set out in section 172 in performing their duty as directors.

A director must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole and in doing so have regard (amongst other matters) to:

- The likely consequences of any decision in the long term
- The interest of the company's employees
- Fostering business relationships with suppliers, customers and others
- The impact of operations on the community and the environment
- Maintaining a reputation for high standards of business conduct
- The need to act fairly as between members of the company

Stakeholder engagement reporting – The requirements for reporting on stakeholder engagement are split between engagement with employees and engagement with 'suppliers, customers and others in a business relationship with the company'. This is a requirement within the directors' report but is expected to refer to existing content in the strategic report.

Dunelm have made a number of references to their engagement with stakeholders in their governance report. As well as providing a comprehensive table about how engagement takes place, they have also included a case study that talks more specifically about how they have thought about different stakeholders in their business activities.

Figure 12: Dunelm AR17

How the Board engages with its other stakeholders

Our "Business Principles" identify customers, colleagues, suppliers, the environment and communities as our principal stakeholders in addition to our shareholders, and our Corporate Responsibility report sets out more detail on how we manage our relationships with them. The table below sets out how the Board engages with each of these:

Customers	• Customer insight report in Board packs • Customer KPIs in Board pack • CEO / Deputy Chairman reply personally to a number of high level customer contacts • All Directors visit stores regularly
Colleagues	• People Director updates the Board twice a year including the results of our colleague engagement survey • Colleague KPIs in Board pack • Annual conference for Store Managers and senior support colleagues, attended by Chairman, Chief Executive, Chief Financial Officer and Company Secretary • All Directors visit stores regularly accompanied by a member of the Executive or Senior Management Team • Non-Executive Director presentations to the Senior Management Team on leadership topics • Executive Directors and Company Secretary attend a selection of Colleague Council meetings
Suppliers	• Annual supplier conference held, attended by Deputy Chairman and Chief Executive • Key suppliers attend the annual Store Managers conference • Chief Executive and Deputy Chairman meet regularly with key suppliers • Annual Board presentation on ethical trading / modern slavery
Environment/community	• Chief Financial Officer and the Company Secretary attend the Sustainability Committee, which considers matters relating to the environment, community and other topics • A representative of the Company-sponsored charity attends the annual Store Managers conference • All Directors visit stores regularly

Figure 13: Dunelm AR17

Developing our supply chain proposition for our stakeholders

Our Colleagues

Our commitment to Stoke-on-Trent has resulted in Dunelm becoming a significant employer in the city with over 600 colleagues working in our two DCs and our local store. During peak times, additional colleagues are engaged to support the volume of activity in the DCs.

Our Customers

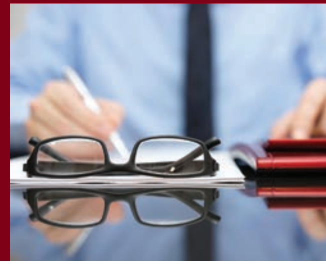
Making shopping experiences easy for our customers is a big focus for Dunelm. The new DC2 was developed with a range of customer benefits in mind:

- We have been able to improve availability in store and reduce lead times for Reserve & Collect from 24 to 3 hours due to improved replenishment from our DCs and better store processes
- Locating our Home Delivery fulfilment in Stoke has improved online availability and enabled quicker delivery to customers' homes

Our Suppliers

Great supplier relationships have been key to supporting Dunelm's growth. During the development of DC2 we were able to draw on the broad experience of our suppliers to help:

- Many of our committed store development suppliers were able to support us with the build and fit-out of DC2
- Supporting our Home Delivery fulfilment partner's relocation into DC2, by helping them relocate existing colleagues and recruit new colleagues locally



Investor perspective

"We like the thrust of the stakeholder agenda…, however we are disheartened by the tendency of many companies towards boilerplate reporting… What we would like to see more of is clearer and more constructive feedback to companies by stakeholders, regulators and advisors, to ensure a constructive dialogue is had on these stakeholder issues, which of course should then be reported on."

Sawan Kumar, Stewardship Analyst, Evenlode

Stakeholder relevance

One of the chief concerns about the new emphasis on the views of stakeholders is that the balance will be tipped away from shareholders – who, after all, are the primary audience for directors under section 172. The FRC has been clear that its intention is not to override the legal duties in section 172 and that doing the right thing by stakeholders ultimately aligns with the interests of shareholders – as the 'enlightened shareholder value' model suggests.

It's important though that companies move away from casual references to stakeholders and instead are clearer on their relevance to strategic decision-making and financial success.

Our review of the FTSE 350 showed a small number of companies recognising this link between the stakeholder agenda and the delivery of strategy, as well as the impact on risks and KPIs. Only 3% of governance reports included an explanation as to how stakeholders had been considered in key decision making. This sort of detail and explanation of the relevance on strategic decision-making will be key in looking at stakeholders through a shareholder lens. To be clear though – it's not about putting more information on stakeholders in the report – companies must continue to use their judgement on which ones are material and be clear on their strategic relevance.

3%

Only 3% of governance reports explain how stakeholders have been considered in key decision making

63%

of companies have strategic priorities that link to stakeholders

60%

of companies have at least 1 KPI that links to a stakeholder

Interestingly, 90% of companies reference stakeholders as an element of principal risk which does suggest that boards are recognising the issue but grappling with articulating the strategic relevance of it, what they're doing about it and what progress they're making. Perhaps this might suggest that the impact of the stakeholder agenda will be greater transparency rather than fundamental changes in behaviour?

At present we find that most companies simply focus on traditional stakeholders – customers and employees. Very little reference is made to other key stakeholder groups, or how these stakeholder groups have been identified.

In KPI disclosures in particular, 60% of companies have at least 1 KPI that links to a stakeholder but for half of companies with a 'stakeholder KPI' it was employees and this was quite often a generic indicator that gave little real insight into the issue that the stakeholder group is most interested in.

As with all reporting – what is most material and relevant to the business is key so our advice is to focus on the stakeholder groups that help to drive strategic success and be clear on why they matter, how they are managed and how your business will impact on them. Currently 63% of companies have a strategic priority that links to stakeholders which demonstrates that for the majority of companies the starting point is already established, they just need to build on their narrative.

Corporate perspective

"The annual report is basically a report for shareholders of the company but issues other stakeholders are interested in should also be included. How a company manages its relationships and resources are key to how it is going to stay a good long term investment for shareholders. However, solely producing a report for your employees, for your customers, or environmental groups could mean that the report gets diluted and loses focus on what matters most to long term success."

Susan Swabey, Company Secretary, Smith & Nephew

Rentokil have been explicit about using their stakeholders alongside strategic themes to emphasise the importance and integration of the different groups in all aspects of the business.

90%

of companies reference stakeholders as an element of a principal risk

Figure 14: Rentokil Initial AR17

Key performance indicators

Measuring achievement in 2017

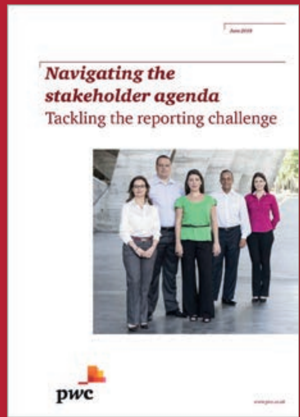
Priorities and principles	Link to strategy	How we measure performance
Colleagues Ensuring 'Everyone Goes Home Safe'	• As a service organisation, our people make our company what it is. • Our priority is ensuring 'Everyone Goes Home Safe'. • Health & Safety (H&S) is the first agenda item in all senior management meetings (including Executive Leadership Team and Board). • We hold an annual Board review of H&S Policy.	**Lost Time Accident (LTA) rate** LTA rate defined as number of lost time accidents per 100,000 standard working hours. **Working Days Lost (WDL) rate** WDL rate defined as number of working days lost as a result of LTAs per 100,000 standard working hours.
Employer of Choice	• We invest in training and development to ensure our colleagues' expertise is unrivalled. • We recruit, appoint and promote on merit. • We listen to our colleagues via 'Your Voice Counts' (YVC) surveys and act on feedback to make improvements.	**Sales and service colleague retention** Defined as total sales and service staff retained in year as a percentage of sales and service headcount at start of year. YVC trend score analysis.
Customers Keeping our promises to customers	• We are passionate about delivering excellent service to every customer and keeping our promises to them.	**State of Service** Defined as total number of service visits performed as a percentage of total number of visits due.
Delivering outstanding customer service	• Our business model depends on servicing the needs of our customers in line with internal high standards and to levels agreed in contracts. • Measuring customer satisfaction allows us to identify unhappy customers, reduce customer attrition and increase revenue, profit and cash.	**Customer Voice Counts (CVC)** Measured by implementation of an average Net Promoter Score across all branches, including in-year acquisitions. CVC score represents the net balance of those customers promoting our service compared with those neutral or not promoting.
Retaining our customers	• Customer retention is crucial to our long-term success. • Benefits include: increased purchasing and cross-selling; lower price sensitivity and terminations; positive customer recommendations and a strengthened unique selling point.	**Customer retention** Defined as total portfolio value of customers retained as a percentage of opening portfolio.
Shareholders Driving higher revenue	• We aim to drive shareholder value through higher revenue by focusing on our Pest Control, Hygiene and Protect & Enhance businesses, supported by M&A investment and divestment of non-core or poorly performing businesses. • Medium-term financial target: 5% to 8% Ongoing Revenue growth.	**Ongoing Revenue growth** Defined as revenue growth (at CER) from the continuing operations of the Group (including acquisitions) after removing the effect of disposed or closed businesses.
Achieving greater profitability	• Our objective is to deliver sustainable profit growth through reductions in central/regional overheads and restructuring costs, and by improving service productivity pricing and margin improvement. • Medium-term financial target: Ongoing Operating Profit growth of c. 10% per annum.	**Ongoing Operating Profit** Defined as operating profit (at CER) from the continuing operations of the Group (including acquisitions) after removing the effect of disposed or closed businesses. Ongoing Operating Profit is an 'adjusted' measure and is presented before amortisation and impairment of intangible assets (excluding computer software) and one-off items.
Delivering sustainable Free Cash Flow	• We aim to generate sustainable Free Cash Flow through managing working capital, bringing capex in line with depreciation and significantly reducing restructuring costs. • Medium-term financial target: Free Cash Flow conversion of c. 90% per annum.	**Free Cash Flow at AER** Defined as net cash flows from operating activities, adjusted for cash flows related to property, plant, equipment and software, the interest element of finance lease payments and dividends received from associates.

Contacts and further information

For further information on any of the themes discussed within this report, please contact us using the details below.

Mark O'Sullivan
mark.j.osullivan@pwc.com
07730 304057

Elaine Forrest
elaine.j.forrest@pwc.com
07798 705347



Navigating the stakeholder agenda – Tackling the reporting challenge

We have developed a framework to help companies consider how stakeholders map to the different parts of the annual report, and how to engage with them in the relevant areas.

The stakeholder agenda will be a focus area for reporting going forward.

Insights on corporate reporting – interviews with commentators

After so many years of passing comment on reporting trends we felt it appropriate to seek and provide the views of others.

With this in mind we conducted a series of interviews from across the reporting spectrum, ranging from investors to the regulator to the political space. You will have seen some of the quotes and commentary from these interviews across this document. Thank you to all involved for their time and frank opinions.

Look out for our upcoming series to read the full interviews and understand the differing views on the purpose of corporate reporting, and what the direction of travel looks to be.

Paul Druckman
Chairman, The Clear Group Chair of Corporate Reporting Council, FRC

Susan Swabey
Company Secretary, Smith & Nephew

Baroness Sharon Bowles
Former MEP and Chair of the Economic and Monetary Affairs Committee

Ben Peters
Fund Manager, Evenlode

Sawan Kumar
Stewardship Analyst, Evenlode

Charles Bowman
Lord Mayor of London

www.pwc.co.uk/corporatereporting