



Financial Reporting Council
8th Floor
125 London Wall
London EC2Y 5AS

By email: narrative@frc.org.uk

24 October 2017

Dear Sirs,

Re: BVCA Response to Draft Amendments to the Guidance on the Strategic Report

1. We are writing on behalf of the British Private Equity and Venture Capital Association (“BVCA”), which is the industry body and public policy advocate for the private equity and venture capital industry in the UK. With a membership of over 650 firms, the BVCA represents the vast majority of all UK based private equity and venture capital firms, as well as their professional advisers. Our members have invested over £27 billion in nearly 3,800 UK-based companies over the last five years. Companies backed by private equity and venture capital in the UK employ around 448,000 people, and 87% of UK investments in 2016 were directed at small and medium-sized businesses.
2. We welcome the opportunity to comment on the Draft Amendments to the Guidance on the Strategic Report (“the Guidance”). As our members primarily invest in private companies, our comments relate specifically to the elements of the Guidance related to such companies.
3. As you will be aware, private equity / venture capital firms are long-term investors, typically investing in unquoted companies for around three to seven years. This is a commitment to building lasting and sustainable value in business. They typically seek to introduce and strengthen existing corporate governance arrangements that are in place in the companies in which they invest.
4. One element of good corporate governance which we believe our industry does particularly well is disclosure and transparency, in particular through reporting under the Walker Guidelines, which is now in its tenth year. The Walker Guidelines (“the Guidelines”), which apply to the largest private equity-backed companies with a significant presence in the UK, require such companies to produce disclosures that are legally required by quoted companies in their strategic report per Companies Act 2006 (“the Act”). The Private Equity Reporting Group, the body that monitors compliance with the Guidelines, will be considering whether the Guidelines should be updated in line with the Act to include disclosures required by the EU non-financial reporting directive. Hence the Guidance will be relevant to companies which comply with the Guidelines.
5. We are supportive of improved disclosure to shareholders and believe that the FRC’s Guidance on the Strategic Report continues to play an important role in this. Our comments on the specific questions are set out below.



Question 1

6. We support the general approach taken to the amendments to the Guidance, which is to continue to focus on principles. We also believe that the addition of a number of new examples will be helpful to companies in applying the principles in practice.
7. The Guidance places significant emphasis on the potential for the strategic report to be useful for wider stakeholders. Whilst we agree that the contents of the strategic report will likely be of interest to non-shareholder stakeholders, we believe that it would be helpful in certain places in the Guidance to reiterate that (i) the section 172 Companies Act 2006 (“section 172”) duty to “promote the success of the company” is owed to the “members as a whole” and not to other stakeholders (see for example, summary paragraph (x), section 1 paragraph 2 and section 3 paragraph 4 where the latter words are omitted); and (ii) the purpose of the strategic report is to inform members of the company and to help them assess how the directors have discharged their section 172 duty. We are concerned that the emphasis given to stakeholders in the Guidance – for example, the removal of the word “only” from paragraphs 3.13 and 5.2 - has potential to confuse market participants about the current legal purpose of the strategic report.
8. When the paragraphs referred to above are read in conjunction with, for example, summary paragraphs (xi) and (xii), paragraph 5.4 and paragraph 7.10, we are concerned that there could be a suggestion that there has been a move away from the current shareholder primacy model and that there is a duty to consider stakeholders as recipients of the strategic report to whom duties are owed (rather than, as is the case under section 172, being factors in the decision making itself). Whilst the BEIS Green Paper on Corporate Governance Reform considers whether reporting requirements relating to stakeholder engagement should be strengthened, this is not the current position under section 172 and we believe that the interests of non-shareholder stakeholders are often best served by other legislation designed specifically to protect them (for example, in relation to pensions or consumer rights). We believe that until that legislation around disclosure of stakeholder engagement and other stakeholder matters is in final form the Guidance should not cover that area any more than is required under the existing law.

Question 2

9. We are broadly supportive of the enhancements that have been made to sections 4 and 7 of the Guidance to strengthen the link to section 172. We have the following comments on certain specific amendments:
 - a) The new paragraphs 4.2 to 4.4, 4.7 (with its reference to “sufficient information”) and 7.14 and the revised paragraphs 4.5 and 7.13 are broadly drafted and we are concerned that companies may feel that they oblige them to disclose sensitive information about their strategies and commercial considerations. Such disclosure may not be in the best interests of members of the company (for example, if specific details about arrangements with key suppliers were disclosed which led to a loss of supply or a disadvantageous change in terms). Whilst we appreciate that the derogation in sections 414C and 414CB of the Companies Act 2006 refers specifically to impending developments and matters in the course of negotiation, we would be supportive of an additional paragraph in the relevant

paragraphs in sections 4 and 7 highlighting that companies should use their judgment as to the level and nature of disclosure in respect of detailed sensitive commercial information and should seek to find a way to disclose applicable information in as transparent a way as possible, whilst not disclosing information that would be to the detriment of the company's members. An example might be useful in this regard.

- b) We would propose that the reference to “competitive position” be removed from paragraph 7.14. We believe that this is likely to lead to either very generic information being provided (which will not be useful) or, in the case of less experienced companies, information being disclosed which ought not to be disclosed from an antitrust perspective. The inclusion of this information is also likely to require companies to involve their external antitrust advisers, which seems to us to be a disproportionate cost of compliance.
- c) We are concerned that the new “encouraged content” element in paragraph 7.10 could lead to companies feeling that they need to list all strategic decisions in the relevant period and running through section 172 against each one. We believe that this runs counter to the desire for annual reports to be concise and could lead to a significantly increased administrative burden and additional disproportionate expense for companies that may not have a large number of people within their reporting functions. At the same time, it would not add substantively to the level of information disclosed since it could lead to a check-box type approach. We believe that the example given in paragraph 7.10 is sufficient to give guidance as to what is required and that the “encouraged content” box could be deleted.

Question 3

- 10. One further improvement that could be made would be to add some specific guidance on what comprises a “social matter”.

Question 4

- 11. We are supportive of the draft amendments to section 5 of the Guidance. The points in paragraph 9a above are also relevant to this section.

Question 5

- 12. We believe that the communication principles set out are a good analysis of the characteristics of good communication. We believe that the addition of the words “clear and concise” in paragraph 6.7 is helpful as the Guidance potentially widens the matters to be covered. There is therefore a risk that strategic reports could become significantly less concise and correspondingly less useful to shareholders.

Question 6

- 13. We are in general agreement that the drafting and articulation of sources of value contained in paragraphs 7.13, 7.15 and 7.18 are sensible and helpful.



Question 7

14. We are also in general agreement that disclosure of how value is generated is helpful. However, we note that a feature of private equity ownership of a portfolio company is that this is typically for a discrete period of (often in the UK) between three and six years culminating in an exit transaction that crystallises financial value for shareholders (and other participants in the capital structure, for example debt instrument providers). Therefore, any disclosures made in respect of value progression in the Strategic Report throughout the period of ownership need to be validly and carefully considered in the context of not being prejudicial to the interests of the company and the ability of value to be realised by its shareholders through an exit transaction.
15. Furthermore, we note that there could indeed be circumstances where these disclosures, that may more broadly apply to public companies, may be helpful to a privately owned portfolio company if, for example, the exit route is through an Initial Public Offering where these disclosures may become a continued feature of public ownership.
16. We also note that there is the need to keep an appropriate balance in the total level of reporting burden placed onto the often small teams of people within a private company responsible for the overall reporting within the Annual Report and Accounts, both financial and non-financial, so as to keep it focussed and relevant and avoid boilerplate type reporting.

Question 8

17. We are supportive of the fact that reporting on strategic matters will increase the importance of non-financial information. We emphasise the importance of clearly stating the source of non-financial information, for example the extent to which it is derived from sources internal to the company or whether it is derived from, or validated by, sources external to the company.
18. The points made in our response to question 7 above in respect of the balance of the total burden of reporting placed onto company teams responsible for reporting matters also apply here.

Question 9

19. We welcome the additional examples included in the Guidance and believe that any further examples that could be provided, without being prescriptive, would be helpful. Otherwise and save as suggested above, there are no specific areas of the Guidance that we believe would benefit from improvement.



The BVCA would, of course, be pleased to discuss this submission further. If you wish to do so, please contact Gurpreet Manku.

Yours faithfully,

A handwritten signature in purple ink, appearing to read 'Amy Mahon'.

Amy Mahon
Chair, BVCA Legal & Accounting Committee