

## The Annual Report

# Look Both Ways

A vision of the future rooted in an analysis of the past can help rebuild confidence.

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# Look Both Ways in Your Annual Report

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Investor relations officers and corporate communications directors in Canada and the United States have had a couple of rough years. New accounting regulations, intense media scrutiny, expanded MD&A disclosures, the *Sarbanes-Oxley Act* – for many companies, it’s enough to turn what may have been forward-looking communication into exhaustive navel-gazing.

That’s an understandable reaction. When demand for greater transparency bumps up against shrinking budgets for the annual report, the pages that get cut more often than not are those that provide the reader with context and insight into the corporation’s business strategy. And with the growing regulatory requirements for board oversight of financial communications, it’s easier to get a sign-off on mandated MD&A disclosures than it is for more visionary statements.

That’s a pragmatic approach to preparing the annual report, but it misses a fundamental truth about investor perceptions. While detailed analysis of past results is crucial to understanding your company, investment decisions are made on the expectation of future performance. Investors need a view of the prospects for your business, as well as its past successes, in order to invest, or stay invested, with confidence. The same can be said of other audiences for the annual report – employees, suppliers, partners, bankers, regulators – each of which has an investment in your business in one form or another.

Despite the need for a meaningful forward view, many public companies insist on “walking backwards into the future,” as Marshall McLuhan famously put it. We think this rear-view-mirror approach limits understanding. More concerning, it may also limit the renewal of trust and confidence in the post-Enron, post-bubble world in which we live. Still, many CEOs and CFOs have concerns

about using the annual report to expand the messaging of their investor and corporate communications programs. Let’s deal with three of those concerns here.

## 1. Our CEO and IRO do a good job of telling our story throughout the year.

PowerPoint presentations, conference calls and Webcasts are effective communication tools in the hands of most corporate executives. While presentations and Webcasts can be very useful in providing a broader context for investor understanding, they are targeted primarily to investment analysts and fund managers. A wide variety of other important audiences may not have access to the proceedings, let alone the knowledge required to decipher messages intended for sophisticated professionals. A fully developed annual report can present your story completely to all audiences and allow the reader time to reflect on its messages about your business context and strategic positioning.

## 2. We put our forward-looking analysis in the MD&A.

The MD&A is a legal document requiring precision of language and intent. Unfortunately, the requirement of precision usually casts a chill over the quality of discussion, despite the Canadian Institute of Chartered Accountants’ guiding principle that the MD&A should focus on management’s strategy for generating value for investors over time. In practice, “over time” typically means over 12 months, not the three to five years during which corporate strategies typically unfold. Our view is that corporations should encourage investors to focus on the long term by providing a section in the annual report that deals with the business context, management’s vision of market opportunities and its strategies for enhancing competitiveness. This section – not necessarily an operational review – should marry compelling messaging to

attractive design to create a clear vision of the future. In our experience, such quality of prospective discussion in attractive graphic presentation falls well outside all but the most innovative MD&As.

### **3. Our printed report consists of the Letter and the MD&A. Everything else can go on the Website.**

Thanks to Regulation Fair Disclosure, timeliness is next to godliness in corporate disclosure, and it's impossible to beat the Net for fast, fair communication. In the best of all worlds, we would have instant dissemination, and receipt, of all material information to all interested investors. But the fact is we live in a multi-channel world of communications. Some – especially investment professionals – value the immediacy and scope of what's available on-line. But many investors seem to have little inclination to sit hunched over their computers in order to scroll through a lengthy, though important, discussion. Increasingly, people go to the Web to get exactly the information they need. In a recent analysis of its Website metrics, for example, Verizon found that 75 percent of visitors accessed the site for current news, stock prices, financial analysis or regulatory filings. Just 16 percent looked at the quarterly and annual reports or corporate profile, typically the source for forward-looking perspective.

What's going on here? We believe it's basically human nature. When we consider the “have-to-know” immediacy of press releases and earnings reports, investors seek out the most efficient form of communication, like corporate Websites, the on-line editions of major news organizations or the nightly TV business report. But for most investors, longer-term decisions to buy or retain your company's stock take reflection on past results and future prospects. That kind of consideration is more likely to take place in the comfort of a favourite armchair than it is in front of a computer monitor. Ask yourself: when faced with reading a long document on-line, do you read it on

the screen or do you send it to the printer? Answering the “why” of that question may give you an insight into the use of your IR Website. It may also tell you why the printed annual report, after an initial rush to the Web, is beginning to reassert its dominance as a corporate communications medium.

Whatever its goals in providing transparency of reporting, the annual report, like most corporate communications, is intended to influence the perception of readers. In our experience, there is value in the annual discipline of identifying and shaping messages about the business context, its evolution, and the corporate strategy designed to create value from change. It is not critical that the annual report leads or responds to the overall communication objectives of your company. More important is the opportunity to speak in a compelling manner to a wide variety of audiences, and to do so with a document that in many cases is the only complete picture of the business.

The effectiveness of the forward look in the annual report is limited only by the creativity of those charged with the messaging – and those charged with approving it. While we are advocates of a balanced view in the Letter to Shareholders, we don't believe it is the place to discuss, for example, industry conditions of individual business segments. The Letter should offer the high-level view of the future as seen from the CEO's perspective. But many audiences will require a deeper understanding of your business context and prospects before taking action. That demands a layered approach to the communication and a set of reinforcing messages that are woven throughout the entire document.

The first task of your communications team, then, is to decide on the messaging for your annual report, with an emphasis on the impressions you want to leave in the minds of readers.

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As communications professionals, you are well aware of required disclosures. But is the communication of those disclosures sufficient, and sufficiently interesting, to promote the impression you would like to leave? Or more specifically, to present compelling reasons for buying or retaining your company's stock? If you have questions about how well you're communicating with this important and costly document, there are some ways we think the messaging in your annual report can be enhanced.

### The Look Back

An understandable reaction to the call for far-reaching disclosures in Management's Discussion and Analysis has been to make this section of the annual report appear more sober and legalistic. Our view is that clarity and impact do not have to be sacrificed for accuracy. All three can cohabit very effectively in your report – as they do in recent reports by Canadian Tire and George Weston – to present a compelling set of messages to readers. Some ideas for improved communication in the MD&A include

- Using a detailed table of contents or, if appropriate, an annotated table of contents.
- Delineating sections clearly, with an easily recognizable hierarchy of information.
- Using headers and subheads – possibly as qualitative statements on results or financial condition – to break up long narratives.
- Employing bullet points where appropriate for easier, quicker reading.
- Adding depth and interest by including operational imagery, management commentary and / or profiles.
- Presenting information graphically where appropriate, using the narrative to discuss the implications of year-over-year changes.
- Considering call-outs to reinforce key messages and add visual interest.

Identify a theme that will both focus the messaging and act as an organizing principle for the content.

### The Look Forward

Because readers should have some context for strategy, the theme section or operations review of the annual report is typically a look back as well as a look forward. (In the "look back," it's important to keep focused on high-level messaging in order to avoid redundancy with MD&A content.) The thematic section of IBM's 2002 report is an outstanding example of communicating future strategy in the context of past accomplishments.

Here are some tips on using this section of the annual report to convey your company's story with clarity and impact:

- Identify a theme that will both focus the messaging and act as an organizing principle for the content.
- Package the story in a clear and accessible way for two kinds of readers – those who scan and those who read in depth.
- Use proven design techniques such as type design, headlines, call-outs and imagery that reinforce the key messages and theme you're intending to communicate.
- Keep the messaging as high-level as is appropriate to your company and industry.

A balanced, accurate and compelling view of both the past and future for your company should be a key objective of any corporate communications or investor relations program. A thoughtfully designed annual report is still your most effective medium for communicating that view to the greatest number of stakeholder audiences.

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