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23<sup>rd</sup> March 2006

Dear Tunde Idowu

**Re: Narrative Business Reporting**

I am responding to the DTI's consultation on narrative reporting requirements for companies issued on 1<sup>st</sup> February 2006.

I am writing to state Traidcraft's support for the Corporate Responsibility (CORE) coalition's submission to this consultation. In addition to CORE's submission Traidcraft wanted to make the following points, based on Traidcraft plc's experience of producing social reports (a form of narrative reporting) for more than 12 years.

**Traidcraft**

Traidcraft is the UK's leading fair trade organisation, selling food, household products, soft furnishings and clothing from nearly 100 producer groups based in 31 countries in Africa, Asia and Latin America. Traidcraft was established in 1979 and is comprised of two operational organisations: Traidcraft plc and Traidcraft Exchange, a registered charity. Both parts of Traidcraft have the same mission statement of 'fighting poverty through trade.' Traidcraft plc is a medium-sized company, with a turnover in 2004/5 of £15.5 million and a profit after tax of £384,000. Traidcraft plc raised £3.25 million in a successful share issue in 2002.

***Traidcraft plc's social reporting***

Traidcraft's directors need to monitor and understand what Traidcraft's social impact is so that they are able to improve the company's social impact. Traidcraft collects this information through 'Social Accounts'. These involve consulting with stakeholders and feeding those views into Traidcraft's management decision making and reporting. Traidcraft publishes its social accounts in the form of an annual report available in print and on the web<sup>1</sup>. Traidcraft is a pioneer of social accounting in the UK - it published the first independently audited plc report in 1993<sup>2</sup> and recently won the ACCA award for the best social report of 2005.

***Cost/Benefit of Traidcraft's approach***

The Social Accounts measure Traidcraft plc's performance against the company's strategic objectives as well as against stakeholders' priority concerns. Putting in place measurement systems can improve management decision-making and can act as an incentive to influence behaviour. At board and senior management level Traidcraft plc's Social Accounts are a useful driver and source of information with which to better understand Traidcraft plc's effect on stakeholders, and monitor and improve the way the business is working. Using the social accounting indicators

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<sup>1</sup> [www.traidcraft.co.uk/socialaccounts](http://www.traidcraft.co.uk/socialaccounts) & attached to hard copy response

<sup>2</sup> The methodological approach (which Traidcraft developed initially with the New Economics Foundation) has been adopted and adapted by many larger organisations. It has also helped shape the AA1000 standard operated by the Institute of Social and Ethical Accountability (ISEA).

within Traidcraft's regular internal reporting mechanisms ensures that Traidcraft is able to keep managers and staff at all levels aligned with Traidcraft's long term objective of 'Fighting poverty through trade' and not become distracted by shorter term sales, turnover and profitability concerns. The publication of social accounts for more than ten years demonstrates that Traidcraft's management is good at balancing competing and diverse demands. This was acknowledged when Traidcraft was able to raise more than £3million in a share issue because it is perceived as being well run. Publishing Traidcraft's shortcomings and areas where targets have not been met reduces vulnerability to external criticism of Traidcraft's integrity, and gives added incentives to ensure that Traidcraft does meet its targets. The production of social accounts costs £25,000 (comprised of staff time and external audit fees).

### **Lessons from Traidcraft's experience can be taken wider**

Traidcraft plc has found significant management and commercial benefits from producing social accounts. In addition, developing country suppliers and NGOs working with Traidcraft Exchange (the sister organisation to Traidcraft plc) have indicated they would like UK businesses to disclose more information about how they operate and the impacts UK companies' cause.

Companies, including Traidcraft, are dependent on well functioning economies, society and environment. In recognition of companies' dependence on natural, human, social, manufactured, as well as financial capital it is appropriate for companies to know and manage their impact on those capitals. The collection and reporting of information through Traidcraft's social accounts helps Traidcraft's Board and senior team manage its impacts.

### **Purpose of Reporting**

Traidcraft believes that narrative reporting by large UK companies is important for two reasons. We see reporting as a management tool as well as improving communications about a company.

- Management Tool. Collecting information to produce a report provides management information which is not collected by some companies. Companies need to know what impacts they are having if they are to better manage their impacts (and reputations). A reporting obligation forces them to collect that information.
- Communication. Presenting information on a company's economic, social and environmental impacts on an annual basis, drives change. Companies want to be able to report improvement compared to the previous year.

### **Audience for narrative reports – Who is the report communicating to?**

The narrative report with information about economic, social, environmental and supplier impacts will be of interest to Government, Investors/Shareholders as well as civil society.

- (i) Investors/Shareholders – reporting is essential for corporate governance. Traidcraft produces its social accounts at the request of Traidcraft's governance structure. Transparency about how a company is managing diverse aspects of companies' operations is a good indicator of a company's overall ability to manage itself. Some investors therefore regard management of social, and environmental issues as a measure of good corporate governance.
- (ii) We think Government has an overall role to assess its delivery against its public policy commitments, such as Sustainable Development (World Summit for Sustainable Development), Millennium Development Goals, and UN Universal Declaration of Human Rights. UK companies have a significant impact on the UK's contribution to realising these goals. Public

- reporting by companies would help HMG assess UK companies' impact on these public policy goals.
- (iii) Employees, suppliers, customers, neighbours, communities impacted by companies' activities, and civil society would have an improved basis of information about a company. Dialogue between companies and civil society will be more effective if informed. Public reporting will also highlight gaps where companies are failing to collect the management information about their impacts that they need. Good relations with stakeholders is better for business – in anticipating future events and improving resilience of a company.

In the light of the benefits of public reporting which are set out above, Traidcraft is concerned that the U-turn on the OFR in November 2005 was prompted because HMG viewed the OFR's narrative reporting requirements as too costly. Traidcraft believes the benefits of gathering and producing social accounts far outweigh the cost of producing its social report. In addition 85% of FTSE 350 are already producing diverse forms of OFR, which indicates the benefits of increased narrative reporting has already been recognised. Traidcraft thinks that what is needed now is for the government to improve the consistency of corporate narrative reporting.

### **Recommendations to HMG on Narrative Business Reporting**

1. Traidcraft welcomes the inclusion of narrative reporting into the Company Law Reform Bill. Reporting is the vehicle that directors use to demonstrate that they have exercised their duties. Narrative reporting is needed to complement the Company Law Reform Bill's proposal that Director's duties include considering 'the effect of their decisions on employees, communities, suppliers and the environment'.
2. To improve the usefulness of narrative reporting directors need to act on the information gathered for their report. In particular it would be appropriate for directors to 'take reasonable steps to minimise the significant negative social and environmental impacts of their business policies, operations and products.'
3. Traidcraft recommends that HGM not only reinstates the OFR legislated on in March 2005 but goes beyond it to require all companies to report on the economic, social and environmental impacts which are significant not only to the company but also to the company's stakeholders. We see the OFR as a step in the right direction both in terms of helping companies improve their own business as well as providing information publicly.
4. The legislation for improved narrative business reporting should cover both medium and large companies, and both publicly listed companies and private companies. The significance of a company's impact is determined by the scale and type of business operations, and is irrespective of whether a company is listed or private.
5. Narrative business reporting needs to include a comment on key business relationships, including key suppliers and on the company's policies and management of its purchasing. No business is able to deliver its goods or services without its suppliers previously delivering. Good relationships with suppliers are therefore crucial for all companies. A significant economic impact of a company is how it relates to its suppliers. The suppliers in turn have an economic, social and environmental impact in the communities in which they operate and source from. Understanding the style of those business relationships is therefore not only of significance to the business but also to stakeholders.

Traidcraft's submission was prepared following previous submissions to the DTI about company law and OFR, and to the Financial Services Authority on listing rules. These submissions were prepared following internal discussions with Traidcraft management and a workshop held with social enterprise directors, including Traidcraft's directors.

I look forward to hearing your response in due course,

Yours sincerely

Tim Morgan  
Finance Director