

Chief executive's strategic overview

John Fallon
Chief executive



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Dear shareholders,

2015 was a year of change and challenge at Pearson, which ultimately will leave us better placed to meet the huge unmet demands in global education.

The biggest change was that, with the sale of the Financial Times Group and our stake in The Economist, we completed Pearson's exit from the financial news and information market. We thought long and hard about these disposals. It is not easy to part with such globally respected brands, which have been an important part of Pearson for many years. After careful consideration, the board concluded that these transactions made strategic sense, achieved a good financial return for shareholders, and were in the best long-term interest of both The Economist and the Financial Times.

The pace of disruptive change in new technology – in particular, the growth of mobile and social media – poses a direct challenge to how leading news organisations produce and sell their journalism. The best way to ensure continuing success is to be part of a global, digital news organisation that is completely focused on the business of journalism. We concluded that new owners with strong track records in media would help grow the FT and The Economist's global reach and reputation in a digital age, just as we secured Penguin's creative and commercial future by combining it with Random House to create the world's largest consumer publisher, Penguin Random House. That business, of which we own a 47% stake, continues to perform well, as you can read on page 33.

Our strategy

Short-term priorities

Deliver transformation

Simplify our business

Stronger cash generation

A growing company

Strategic growth drivers

1 Digital & services: Build on our global strength in educational courseware and assessment with leading digital products and services, where we see the greatest potential for growth, scalability and impact on learner progress.

2 Market presence: Our strategy to build on our leading presence in developed markets, and the opportunity to meet growing global demand for education.

Challenges in 2015

These disposals enable us to focus more fully on our education business, which was where we faced our biggest challenge last year. The cyclical and policy related headwinds we face in our major education markets – which we have described in previous years and which we cover later in this report – are persisting for longer than we anticipated. They are also having a more pronounced impact on our profitability than we expected, reducing our annual operating profit by approximately £230m from its peak. These headwinds are largely cyclical and, over the next two years, they should finally abate.

This means that, although operating profit and earnings per share were only down marginally in underlying terms on the previous year, they fell short of the goals we set at the start of the year.

Our strong competitive performance

Pearson's competitive performance remains strong. We held or increased our market share in higher education courseware, school courseware, and in UK general qualifications. In professional testing, virtual schooling, online higher education and other areas we increased our capabilities, our reach and our commercial success substantially. You can read more about our operating performance on pages 16-33.

We are also confident that education remains an attractive investment opportunity with the growth potential to enable us to serve more students around the world and deliver good, sustainable returns to our shareholders.

A clear strategy

Our strategy to capitalise on this opportunity is clear. As the world's learning company, Pearson has world-class capabilities and products in educational courseware and assessment, powered by learning technology. By combining these capabilities with teaching and learning services, we help schools, universities and others to scale online, reach more people and ensure better learning outcomes. As we do so, we provide Pearson with a larger market opportunity, a sharper focus on the fastest-growing education markets and stronger financial returns.

This approach recognises that education is undergoing a number of structural changes. The economic value of an education remains large. In the US, for example, the earnings premium of a university degree has never been higher. However, the cost of education is going up faster than inflation – and public funding for education is under real pressure. This presents our customers – university presidents, school superintendents, teachers and faculty, students and their parents – with a real challenge.

It is compounded by the fact that rising costs have not brought any real increases in learning outcomes – which remain uneven and variable – and there is an alarming mismatch between the expectations of educators and employers. For example, according to Gallup research from 2014, 96% of chief academic officers in the US rate their institution as somewhat or very effective at preparing students for the world of work. Yet only 11% of business leaders agree.

3 Measurable outcomes: Our efficacy programme is our long term commitment to delivering measurable impact. It informs all strategic decision making across Pearson, including our product and services strategy. We will begin reporting formally on this impact from 2018.

Our constant goals

Generate sustainable returns by:

- Delivering long-term growth
- Extending our global presence and reach
- Building on our leading education position

To deliver measurable impact

Chief executive's strategic overview continued

Helping teachers to be more effective and students more successful

We know that technology can help to address these challenges, by making learning more accessible, flexible, personal and affordable. For example, we are drawing on the latest digital advances to develop products which further customise and personalise learning. So we are embedding learning analytics in our new courseware offerings, such as Revel, to help teachers use data to teach students more effectively.

For students themselves, we are using adaptive learning technologies to focus their studies on concepts which require more time and attention.

We are developing new qualifications and certifications that help students to translate education into employment by assessing career-relevant knowledge and skills, providing quality assurance to schools, universities and employers. For example, last year we ran nearly 50 million practice or actual assessments for students on digital devices in the US using our TestNav application, aligning these new tests to higher standards for career and college readiness.

Online degree and virtual online school programmes represent 10% of Pearson today, from nothing five years ago – and are growing at double-digit rates each year. With a solid platform and market position in the US, we are now growing these businesses globally. With the global online programme management market set to double in the next five years, there will be many more opportunities for Pearson to partner with universities to improve learning.

This opportunity is highlighted through our long-standing partnership with Arizona State University, where we are helping to recruit, retain and teach several thousand online students. As more and more universities and students embrace the possibilities for improving access and success in education using technology, there will be many more opportunities for Pearson to partner with institutions on course design, student recruitment and online tuition.

All of our new products and services are underpinned by our efficacy approach, launched three years ago, which is designed to ensure that we help teachers to be more effective, and students to be more successful. We are committed to reporting on the learning impact of our individual products from 2018 onwards, through independently audited evidence and reports. We are making good progress towards this target, as you can read later in this report (pages 46-53).

Our success in helping our customers address these structural changes in education should enable Pearson to increase our average revenue per customer, and access larger markets as we provide educational services far broader than just stand-alone content or assessment. To make the most of the opportunity, we are making Pearson a simpler, better integrated, more cost-efficient company.

Sharpening the future

In January we announced a series of actions that will help us to achieve this goal.

We are creating a single global product organisation, combining our three previously separate lines of business. We are integrating our school, clinical and professional assessment operations in North America. We are reducing our exposure to large, direct delivery operations to focus on online, virtual, and blended services in a much more scalable, and profitable way. Each of these changes will help us invest in fewer, bigger opportunities, and ensure that our world-class capabilities can be scaled to customers around the globe.

We are also making productivity improvements across all our enabling functions like Technology, HR and Finance – as our product offering and customer and employee support becomes more digital. We plan to rationalise our property portfolio and consolidate major supplier agreements to drive greater cost efficiency.

As a result of these changes, we expect to reduce Pearson's global workforce by around 4,000 roles, 10% of our headcount. These are decisions that we never take lightly and we are committed to supporting our colleagues during the transition. These actions will be complete by the end of 2016, and will reduce our annual running costs by around £350m. Importantly, they will also create a more focused, integrated business, better able to create and sell products across our markets to improve learning outcomes. This restructuring will give us the improved operational and financial flexibility to invest in growth areas and underpin shareholder returns.

Our reach and impact

Big changes in the education landscape will create big opportunities for Pearson to grow our reach and impact.

There are huge unmet demands in global education that need to be addressed.

In higher education, the number of students going to university worldwide is expected to increase by more than 50 million to 260 million by 2025. Every one of those students wants a degree that is more affordable, more accessible and more likely to lead to a good job. One billion people will soon be learning English worldwide. School students and teachers increasingly expect to learn digitally.

So we plan to increase access to high quality education; ensure the success of all our learners against measurable outcomes; and to help more people around the world make progress in their lives – giving them the ability to secure a better job and a better life.

As well as measuring the impact of individual products, we should also be measuring Pearson's total impact on learning. We are committed to ambitious goals to expand our reach and impact over the next decade. We currently reach around 75 million learners each year. By 2025, our aspiration is to reach 200 million learners each year – more than doubling our reach. These ambitious goals will contribute not only to Pearson's success, but to the societies of which we are a part.

In 2015 Pearson joined other businesses and world leaders in committing to the UN's Sustainable Development Goals (SDGs). The SDGs represent global challenges, many of which can be alleviated through better literacy and better education. In particular, Goal 4 of the SDGs, to *'ensure inclusive and equitable quality education and promote lifelong opportunities for all'*, is central to the work of every Pearson employee and the millions of teachers and students we work with around the world each year.

To help maximise our contribution towards these goals, in 2015 we continued our strong commitment to sustainability, built new relationships with partners like Save the Children and supported a new coalition called Project Literacy. (Read more about Pearson's social impact on pages 54-67.)

We also invested in the Pearson brand in 2015 and it continues as an area of focus in the year ahead. Building a stronger brand will give us a better platform to reach more students and teachers, and act as a mark of quality as we develop and deliver new services across education. We have introduced a new visual brand capturing the curiosity and excitement of learning, which will unify Pearson's portfolio of products and services over time. The new brand is represented in this annual report for the first time.

Our long-term opportunity

It's clear that 2016 will be a tough year as we work through the substantial change programme outlined above. Our plan focuses on operational execution, tight cost management and a sharper strategy to return to growth. We will be faster, leaner and more agile as a result of the changes we are making. We expect our business to stabilise into 2017 and return to growth in 2018.

We remain committed to the long-term opportunity for Pearson to provide high quality, affordable and accessible education that leads to a better job and a better life. For many people, learning is the route to a job to support their family or to acquiring the skills to help them progress in their career. For others, it's simply a passion for discovery that enriches their lives. All over the world, we hear parents say the same thing: they want to see a greater return on their investment in education, so that their children can gain skills, get better jobs and succeed in their lives. That remains a very compelling and exciting opportunity.

This powerful motivating purpose is what drives Pearson's business, which carries with it great responsibilities to learners as well as to you, our shareholders. In 2016, we are focused on delivering these responsibilities, and the plans laid out in this report explain how they will be achieved. We are confident that they will ultimately make Pearson a simpler, stronger company, and that they set the company up for a sustained period of growth. We'll keep you updated on our progress.

Thank you for your ongoing support.



John Fallon
Chief executive

My executive team

Coram Williams Chief Financial Officer

Michael Barber Chief Education Advisor

Tim Bozik President Global Product

Rod Bristow President Core Markets

Giovanni Giovannelli President Growth Markets

Albert Hitchcock Chief Technology and Operations Officer

Kate James Chief Corporate Affairs Officer

Don Kilburn President North America

Bob Whelan President Pearson Assessments

Melinda Wolfe Chief Human Resources Officer