Pearson: The whole truth

Pearson's recent response to our Pearson Shareholders Resolution indicates just how significantly the company fails to grasp the gaping holes in its business strategy that inspired the resolution in the first place. By cherry-picking carefully selected facts and omitting pertinent data, we believe that Pearson fails to give its shareholders a complete and unfettered assessment of what's gone wrong.

We have responded below to help shareholders make an informed decision about the merits of the resolution, which will be voted on at Pearson's annual general meeting in late April. Full details of the resolution along with supporting materials can be accessed at pearsonres.org.

Claim: Throughout its response, Pearson denies the growing erosion of trust between its brand and its customers.

Response: The market for any company's product shrinks when the end users of your product do not support the strategic direction of your business. Pearson's embrace of high-stakes testing and low-fee private schools in the developing world has severely damaged its brand. When a company has an entire story in the business press dedicated to why "everyone hates" you, it is time to play close attention to your corporate strategy. And when the popular media alleges your company is a leading cause of misguided school reform, it behooves the leadership to reflect on their role in backing those reforms. Bottom line: The Pearson brand must be urgently rehabilitated to create long-term growth and rebuild shareholder value in the United States and around the world.

Claim: Pearson says it has "carried out a rigorous review" of its business, culminating in a business plan published on its website in January.

Response: Pearson's plan is lacking a real strategy, an alarming fact given the rigorous re-evaluation that ought to come in the wake of its substantial financial challenges. The plan is focused instead on a drastic cost-cutting exercise designed to buy CEO John Fallon more time to calm the market. Management continues to blame cyclical factors for the bulk of the company's challenges, downplaying the significant risk from structural shifts in the education business. And it is largely silent on the reputational and financial damage Pearson is sustaining from its mishandling of the public backlash against the politically poisonous high-stakes testing trend in the United States.

Leading analysts were unimpressed with the scope and depth of Pearson's review and remain unconvinced the promised restructuring will get the job done:

"[The restructuring] looks more of an exercise in delaying the inevitable than tackling the true causes of their deep-rooted problems." (Liberum Capital, Jan. 26)

"It's another three years of minimal growth even on their optimistic scenario. There's still no sign of the long-term vision of education growth coming through." (Panmure Gordon, Jan. 21)

"A turnaround is unlikely to be as simple as embarking on another cost-cutting plan." (Kepler Cheuvreux, Jan. 22)

"This leaves investors grasping at rather hollow assurances that things will get better." (Macquarie, Jan. 21)

"We find it difficult to build confidence that [the new restructuring] will deliver." (Barclays, Jan. 22)

The plan is "not exactly what we wanted, but it is a plan—would prefer a new 'five point' type plan to reinvigorate organic growth." (Investec, Jan. 22)

"Given the group's poor margin performance post its last restructuring plan, we are not as of yet fully convinced the group will be able to achieve these costs savings." (Credit Suisse, Jan. 21)

Claim: Pearson says its share price is on the rise and links it to the publication of its business review.

Response: This is a disturbingly nonchalant response to a dramatic stock decline, and is tone deaf to the pain felt by shareholders. Even given Pearson's recent "dead cat" bounce, the stock is still down 40 percent over the past 12 months and 25 percent over the past three. This reflects the company's poor economic fundamentals: the company has failed to beat its cost of capital for the past three years and is unlikely to do so for at least another two years. Five years of negative economic profit is a pretty good working definition of poor management.

Pearson is taking false hope from the recent stock movement if it believes this is an endorsement of its plan. As Deutsche Bank (Jan. 21) noted, the positive reaction to the restructuring was largely a reflection of the "kitchen sinking" of bad news, which relieved a number of uncertainties (many analysts had anticipated further restructuring would be necessary). It also reflected relief that the dividend was preserved.

Claim: Pearson suggests implementation of the Every Student Succeeds Act will not have a material impact on its business plan.

Response: Any suggestion that the passage of ESSA is not an effort to reduce testing and the use of related preparation materials in the United States is disingenuous. Even though the new law does continue to require annual assessments, it also allows states to adopt much simpler and less expensive assessments. The new law also prohibits the federal government from mandating that test scores be used in teacher evaluation. These two facts alone will significantly reduce the demand for Pearson products, both tests and the preparation materials.

Response: Conspicuously absent from Pearson's response to the shareholders' resolution are two other ESSA facts that will affect its market in the United States: ESSA prohibits the federal government from advocating or suggesting a core curriculum, which means the products and assessments developed for the Common Core standards will no longer be required in many states. And ESSA allows states to use funds to end testing procurement contracts that Pearson maintains in multiple states.

Claim: Pearson brags about administering 50 million high-stakes tests last year while simultaneously downplaying their proportion of its global business.

Response: The Pearson statement clearly shows that even after its recent restructuring, management continues to support using test results for purposes they were not designed for—one of the core reasons behind the shareholders' resolution. A growing consensus of research in the United States and beyond shows that using test scores for high-stakes decisions regarding students, teachers and schools is not supported by the evidence and can cause inaccurate and sometimes damaging outcomes.

As the Organization for Economic Cooperation and Development noted in the latest version of *Lessons from PISA for the United States*, assessments in the United States are often used purely for accountability purposes, when most other higher-performing countries tend to use the results to guide intervention, reveal best practices and identify shared problems. These are the research-based uses of assessment the makers of the resolution want Pearson to support, not only in words but in deeds.

The resolution is not an anti-testing resolution. It is saying only that the company should review its strong support for using test results for high-stakes decisions for students, teachers and schools. Any inference that this resolution is against constructive assessment practices is wrong and, we believe, an attempt to mislead shareholders.

Further, the nature of high-stakes testing requires an obsession with test security that has led to the monitoring students' social media accounts and contractual gag orders for teachers and schools. This leads to distrust and questions the company's motives, which only serves to diminish Pearson's brand and its bottom line.

Claim: Pearson suggests that it is filling a market for education in the developing world by supporting low-fee private schools.

Fact: Contrary to its statements, we believe that Pearson's efforts in the "global south" to make education a commodity that can be bought and sold is a serious threat to democracy that will increase segregation and marginalization. These efforts are also a threat to creating larger markets for Pearson products. The public perceives education as a right, not a privilege, and there is a growing backlash in the developing and developed world against the privatization of education pursued by Pearson. Furthermore, there is weak evidence that low-fee private schools have any actual learning benefit for children in the developing world.

The Omega Schools in Ghana operate on a "pay as you learn" system in which parents must pay approximately 65 cents per day per child for school. This means low-income families in Ghana have to spend 25-40 percent of their income on daily fees to send one child to an Omega School. By supporting the expansion of low-fee private schooling and other competitive practices, Pearson is essentially ensuring that a large number of the world's most vulnerable children have no hope for a free, high-quality education. As reported by Kishore Singh, a U.N. Special Rapporteur on the right to education, to the United Nations General Assembly in September 2014, "States should put an end to market-driven education reforms that provide subsidies to private education. They should not allow or promote low-cost private schools and the provision of school vouchers, nor should they allow for-profit institutions in education."

By investing in low-fee private schools in Africa and Asia, we believe that Pearson is helping deny millions of citizens the free education they deserve. An urgent strategic turnaround is necessary to avoid the company becoming further entrenched as a global education pariah.