Our strategy
Marjorie Scardino, chief executive

'Genius,' the inventor of the electric light bulb once said, 'is one per cent inspiration and ninety-nine per cent perspiration.'

We're keeping that in mind as we try to steer Pearson through the dark of this complicated economic environment. We think our strategy is strong inspiration (though 'genius' is certainly not a word we'd use to describe it). But we know that it's really the implementation of it that matters.

Our strategy wouldn't light up anything without the dedication and perspiration of the 34,000 talented people who work here. The strategy's success is up to them (and they are *not* disappointing us).

Our strategy has four parts:

1 Long-term organic investment in content

2 Digital and services businesses

3 International expansion

4 Firepower to invest through efficiency gains

Education (in the broadest sense of the word)

If you've followed this company for the past decade, you know that we've set out to become the world's leading 'education' company. By that, we mean that our objective is to help people make progress in their lives through more knowledge – to help them to 'live and learn'.

The part of Pearson that is our formal 'education' business – serving teachers and students through schools and colleges in more than 60 countries – now makes up a significant majority of our sales, earnings, capital and people. But our goals as an education company are much broader than that.

We aim to be an education company that serves the citizens of a brain-based economy whatever their circumstances – old or young, at home or at school or at work, in any pursuit, anywhere. We've reached more widely with our education strategy for several reasons:

1. Education institutions themselves are more complex than they used to be. Their success depends on many more things. Some of those things are not so new – trained teachers, engaging materials, efficient administration, interested parents. Some are very new – technology that powers it all; assessments and data and analysis to teach each child in his own way; bridges to the next stage of learning and on to the world of work.

Our strategy is not only to supply many of those parts, but also to make them all work together and work for everyone involved. The one-dimensional approach to education – textbooks only or a test only – is neither a good way to educate nor a good business for us now.

2. People don't just learn in school any more. (They never really did, but education was structured as if they did.) They learn everywhere. That learning is sometimes lost because it's not connected to academic achievement or work.

But they still learn – about their surroundings and the wider world; how to do a better job; how to be a better citizen; how to help others. They demand education that helps them get a leg up in life, and then education that helps them climb further. And often that education comes partly outside their degree or their certification or their job.

That's why our strategy extends to the kind of education that the FT has provided to its readers on the global financial crisis; or the kind of education that the Penguin Classics have given to generations of readers. It's the kind of learning the educator John Dewey might have had in mind when he said: 'Education is not preparation for life; education is life itself.'

A 'full-throated commitment'

We're as sure as we can be that this broad education market we've chosen to work in will be a good, long-term growth industry.

We believe that because the desire for learning, for self-improvement, for the knowledge and skills to achieve our dreams and goals in life, is a fairly universal human demand.

We believe it also because most *governments* understand that the education of their people is what makes their country competitive, and most *people* understand that education breeds economic and political self-determination.

America's new President often said during his campaign that his country needed a 'full-throated commitment to public education'. Britain's Prime Minister returned from a trip to China and India last year and said: 'A generation ago a British prime minister had to worry about the global arms race. Today a British prime minister has to worry about the global skills race.'

Changing Pearson

Being in good markets is crucial to our business strategy. But it's not enough. To meet our goals, we have to build something unique into each one of our businesses. We have to have a distinctive way of doing things – or *do* distinctive things – that set us apart.

Each of our businesses takes a slightly different approach to distinguishing themselves, but there are strong common elements across Pearson:

Content. An uncomfortable word, and not nearly poetic enough to describe the way we teach and inform and tell stories; but it *is* descriptive. All around the company we invest steadily in unique publishing of stories, lessons, information – and we keep replenishing it.

Technology and services. We often think that all our content stands alone and is beautiful and perfectly formed. But we realized some time ago that 'content' itself isn't enough in a world where you can pluck it off the web for free or join with your friends to make it yourself. We have to add something that makes it more valuable than those alternatives.

To make our content more useful and enticing, we often add *technology*. We now make about a third of our annual sales from technology-based products and services, and these are many of our fastest-growing businesses. Digital services of one kind or another are fundamental to every part of Pearson today. At the FT Group, digital services now make up two-thirds of our sales – up from a little over one quarter just eight years ago. This has been also especially important in education.

But as the educational rules have kept on changing, ways of doing the job and judging success are changing too. We're good at creating, selling and delivering education tools – a textbook, a test, a software application, a long-term contract. And we can do a lot with the automation technology can offer.

But our customers increasingly demand something more – *services* of a wider kind. Selling 'things' to help education is no longer the best approach. We have to do what's required to make each school and each student successful. They want us to solve their problems.

International markets. Though we make about 60% of our sales in the US, our brands, content and technology travel well. All parts of Pearson operate in most developed markets and are also investing in selected emerging markets, where the demand for information and education is growing particularly fast. Our 'international' (meaning 'outside North America') education business, for example, has almost doubled its sales over the past five years. Five years ago, it made 8% of Pearson's profits; today it's approaching 20%.

Efficiency. The businesses of Pearson have a lot in common, in costs, assets, and activities. Pooling those makes the company stronger and more efficient. It also allows our businesses to learn from each other and to collaborate to save money.

On that basis, we've invested for efficiency through savings in our individual businesses and through a strong centralised operations structure. We're integrated in areas where our businesses share the same needs – purchasing, warehousing, distribution, facilities and real estate, project management, people resources, finance and accounting, transactions.

Over the past five years we've increased our operating profit margins from 10.6% to 15.8% and reduced our average working capital as a percentage of sales from 29.4% to 26.1%, freeing up cash for further investment. Even so, we can go further.

Our strategy continued
Marjorie Scardino, chief executive

Measuring up

One of the most important measures of our strategy is, of course, our financial performance. Here, our goal is to produce hardy, consistent growth in three key financial measures – *adjusted earnings per share, cash flow* and *return on invested capital*. We believe those are, in concert, good indicators that we're building the long-term value of Pearson. So those measures (or others that contribute to them, such as operating margins and working capital efficiency) form the basis of our annual budgets and plans, and the basis for bonuses and long-term incentives.

Our performance on these measures was strong again in 2008, as you'll read elsewhere in this report, and we're very proud of that. But since our strategy is about *long-term* performance, not just last year, you need to look back a little further to see the trends.

Over the last five years:

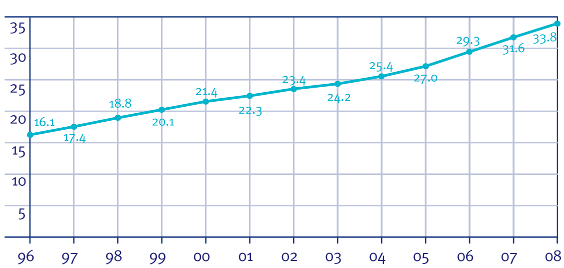
we've more than doubled our *adjusted earnings per share*, from 27.5p in 2004 to 57.7p in 2008, an annual growth rate of 20.4%;

we've almost doubled our *operating cash flow* from £418m to £796m;

we've increased our *return on invested capital* from 6.3% to 9.2%, a return above our cost of capital.

There's one other measure that's especially important to us, too. That's the cash we return to shareholders each year through our *dividend*. The dividend has grown by an average of 6% each year over the last 10 years, and our 2008 rise of 7 % will mean that Pearson has increased its dividend above the rate of inflation for every one of the past 12 years.

Dividend per share paid in fiscal year pence



Adjusted earnings per share pence

+24%

Adjusted operating profit £m

+11%*

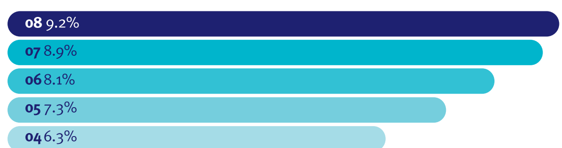
* CER growth

Operating cash flow £m

+16%

Return on invested capital %

+0.3% pts



The future

That financial record indicates that our strategy is working. But a strategy is really good only if it's flexible enough to adapt to changes in the battle. This year, we're going to face a tough test: while our objectives and our plans haven't changed, the world we're travelling in is now fundamentally different. We've watched the global financial system lurch from crisis to near-catastrophe, and the aftershocks are beginning to make large cracks in the 'real economy', that place where most of us live most of the time.

As we wade out into 2009, we're sloshing through events that were unimaginable a year ago and are hard to predict even now. Governments and regulators have become the centre of our attention, taking bold steps to stabilize banks, shore up whole industries, stimulate spending and investment and restore confidence and trust.

In that context, here's how I see Pearson's prospects now, and how we'll approach things through this year. It's not simple. The truth is, in all my time at Pearson I've never been so torn between feeling confident and feeling cautious. And I've never found our outlook for the coming year as hard to predict as I do today.

Some reasons to be cautious...

To state the blindingly obvious, a severe and worldwide economic contraction inspires caution. You can see the effects of the contraction pretty much everywhere you look: in the depressed prices of assets such as property, commodities and shares; in the sorry state of industries as diverse as financial services, automobiles and retail; in the wobbly financial state of corporations and governments; in the conservative spending decisions of companies, public bodies and individuals; in the confusion over what to do about all this by just about everyone.

In spite of those events, 2008 was another good year for Pearson. We distinguished ourselves through the quality of our publishing, the expansion of our service businesses, and our commitment to being the innovator in our industries. We also grew and made good profits.

But we knew as last year went on that the depressive forces in the economy would inevitably affect us too in some ways at some point.

Most US states, seeing their own incomes from corporate and personal taxes dwindle, had to tighten their girths and rein back their spending on education. Financial institutions, normally important advertisers in the *Financial Times*, didn't have much to shout about (or much spare cash to shout with).

Bookstores were caught up in the same consumer spending gloom that hovered over Main Streets around the world.

We have to expect those kinds of pressures – and possibly others – to continue in 2009. That's why we're being cautious. We've planned for tough economic times and we're making tough choices to stay fit for them.

...and some reasons to be confident...

But – and this is a very big 'but' – we do have real grounds for confidence, too.

The lessons of the dot.com bust and the advertising and technology recession that accompanied it are still fresh in our minds. Many of us still remember the pain some of our businesses went through in 2001–2003. We all learned some things from that period about our vulnerabilities and about acting sooner and more radically.

So over the past few years, we've worked hard to make Pearson more reliable. We aren't immune to ructions in the economy, but we're very different today than we were eight years ago. Today we're more dependent on repeating subscription or contract revenues and less dependent on cyclical advertising sales; stronger in faster-growing digital and services markets; much more geographically diverse. These changes give us confidence.

And we have other reasons to be confident, too:

We're in a strong financial position (having unfashionably resisted the idea that we should take on a lot of cheap debt during the credit bubble).

We're benefiting from the weakness of the UK pound against the US dollar, primarily because we make most of our sales and profits in dollars but report our results in pounds.

We're now a global rather than a largely US or UK company, so our geographic diversity gives us wider markets and less exposure to two challenged economies.

We're in a very strong position relative to our competitors, in industries that face both cyclical challenges and structural change.

We make real products and essential services that meet two genuine consumer needs: the need to understand what's happening in this fast-moving and inter-connected world and the need to be educated (and re-educated) to make the most of its opportunities.

Our strategy continued
Marjorie Scardino, chief executive

But this year, more than ever, we can't afford to be complacent or think that things will continue to go our way. We've planned that the tough market conditions we saw in the closing months of 2008 will last for all of 2009. And we're continuing to prepare for the possibility that our customers and our markets may very well feel worse before they begin to feel better.

Here are the few principles that are guiding our decisions this year:

1. We've tried to act pre-emptively to get ourselves in a strong position to weather the economic storm. That has included the last few years' work, and a raft of recent measures to tighten our costs across the board.

We have, just as one example, taken a decision to award a 2009 pay increase to only those people who are currently earning less than $50,000 (or £30,000) a year. That decision about salaries, as well as other efficiencies, will help keep as many Pearson people as possible working, earning and contributing to the economy.

2. We'll continue to invest in our businesses, no matter what the market environment. Each one of them has been remarkably successful in the past few years – largely as a result of sustained and targeted investment in high quality content, digital innovation and international expansion.

We'll continue to challenge our investment plans, and we'll continue to expect strong returns from them. But our general attitude is that we are in our businesses for the long term and we won't let any short-term disruption undermine our goals.

3. We're tackling this uncertain world as one company. This downturn will likely have a sharp impact on some parts of Pearson, while others will be more impervious, even contrary, to the pressure. So we'll use our strength in some places to shore up momentary weakness in others. The important point is that all the people in Pearson are trying to pull in the same direction.

Though that effort is about 34,000 individuals, we have one in particular to thank for it. His name is David Bell, our director for people, and he is stepping down from our Board at our annual meeting and retiring from Pearson at the end of this year.

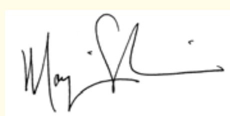
David has dedicated his entire, 39-year working life to us – first as a journalist at the Oxford Mail, which Pearson owned, and then at the Financial Times; then as the FT's advertising director, marketing director, chief executive and finally (since 1996) chairman. And, for the past eleven years, he's been our director for people.

David has played an enormous role in defining the company that Pearson aspires to be today: commercially successful, intellectually courageous, socially responsible. He's passionate about the craft of publishing and the social function of business. Over the next few months, I'm sure hordes of people inside and outside Pearson will want to thank David for the role he's played in their careers, because he has helped many of us along the way. I'll be the first in line.

We will continue to develop and take good care of both the talent in our company and the idea that Pearson is a special place to work.

This is a complicated and challenging time, and caution and confidence are finely balanced. The economic and business environment is worse than many of us have seen in our lifetimes. But people will still go to school, still need information about markets, still want to escape from their present through other people's stories. Those are the things we do to help people make the most of their lives.

Our company is strong and prosperous, and our task is to make absolutely sure it stays that way. I'm as confident as I can be that the inspiration of a sound strategy, together with the talent and perspiration of 34,000 people, will enable us and our shareholders to emerge even stronger from this very difficult time.



Majorie Scardino Chief executive