The Stakeholder Voice in Board Decision Making

Strengthening the business, promoting long-term success
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Foreword

The UK has an internationally respected corporate governance framework that delivers high standards in a transparent and proportionate way. The Government and my Department are determined to build on these strengths, working in partnership with the business community and other stakeholders. As the response to the Government’s green paper of last November showed, there is strong support across business, investor groups and civil society for strengthening stakeholder voice at board level. As well as acknowledging a responsibility towards the society and environment in which they operate, most companies and their boards also recognise that effective engagement with key stakeholders – which may include employees, suppliers, customers, third sector organisations and regulators – is a key component of long-term sustainability and success.

The Government has announced that it will be taking steps to strengthen engagement: firstly by introducing secondary legislation that will require relevant companies to explain how their directors comply with the legislative requirement to have regard to employee and other stakeholder interests; secondly by inviting the FRC to consult on the development of a new Corporate Governance Code principle establishing the importance of strengthening stakeholder voices at board level. We are also bringing forward secondary legislation to require listed companies to set out and explain annually the ratio of CEO pay to that of average employee pay. This will be a valuable extra reporting tool for companies in meeting their existing obligations to take account of wider workforce pay and conditions when setting pay at the top, and something that I am glad that UK investors have also welcomed.

It is boards, however, that must take responsibility for deciding how best to identify, gather and incorporate stakeholder views in the light of their company’s circumstances. I warmly welcome this new guidance on stakeholder engagement by ICSA: The Governance Institute and the Investment Association (IA). It is a practical, industry-led initiative that should help companies – even those who believe that they are doing things well already – to reflect on their current engagement practices and consider further improvements.

I would like to thank ICSA and the IA for their valuable work. ICSA have considerable expertise in the area of corporate governance and standard setting and the IA provides a voice for the UK investment management industry. As such they are very well-placed to assist company boards in thinking through how to ensure they take account of the interests of their key stakeholders when taking strategic decisions. I encourage companies to draw on this guidance, to help them ensure that they are fully meeting their directors’ duties, and to strengthen their corporate governance framework, for their own long-term benefit and that of the economy overall.

Margot James MP, Minister for Small Business, Consumers and Corporate Responsibility
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Introduction

Stakeholder engagement is an essential activity for all companies. It should be used to inform the decisions that the company takes, whether about the products or services it provides, or about its strategic direction, its long-term health, and its relationship with its workforce and the society in which it operates.

If taken seriously, stakeholder engagement will strengthen the business and promote its long-term success to the benefit of stakeholders and shareholders alike. Paying lip service to engagement, by contrast, is of limited value to anyone.

The aim of this guidance is to help company boards think about how to ensure they understand and weigh up the interests of their key stakeholders when taking strategic decisions.

The guidance is designed to take boards through the different elements involved in understanding and assessing the impact on key stakeholders. It is divided into seven sections dealing with: directors’ duties; stakeholder identification; the composition of the board; induction and training of directors; how the board can ensure it takes account of the impact on stakeholders in its discussions; the mechanics of engagement; and reporting and feedback. Each of these different elements should be considered carefully, as failing to deal with any one of them effectively could undermine the potential benefits to be gained from the others.

While there are some key stakeholders that almost all companies will have in common, such as workers and customers, for each company the list will be different depending on factors such as their size, location and the nature of their activities and business relationships. For the same reasons, the mechanisms used by boards to gain an understanding of the views of their key stakeholders will also vary. Each company’s approach needs also to be informed by its purpose, culture and values.

The guidance does not, therefore, attempt to set out a comprehensive range of different approaches that should be considered. There are, however, some core principles that we believe should guide the way boards approach the issue. The guidance also contains illustrative examples of how some companies have gone about doing so.

In August 2017, shortly before the guidance was finalised, the Government announced a package of corporate governance reforms. These will include new regulations to require all companies of a significant size to explain how their directors comply with the requirements of Section 172 of the Companies Act, and possible changes to the UK Corporate Governance Code, on which the Financial Reporting Council will consult.

One of those potential Code changes would be to require listed companies to have either a designated non-executive director, a formal employee advisory council or a director from the workforce, or to explain why they do not.
The guidance covers these approaches, among others, but deliberately does not express a preference for one or any of them. Companies should choose whichever approach or approaches are, in the opinion of the board, most likely to lead to effective engagement and an enhanced understanding of the impact of their decisions on their key stakeholders.

The Government’s intention is that the various reforms will come into effect by June 2018. If necessary, this guidance will be updated then to reflect the new reporting requirements and potential code changes. In any event, we will review it in the second half of 2019 to learn from companies’ experience of applying the guidance.

We hope that this guidance will be of use to the boards of all companies, whether listed or privately owned and irrespective of their size or sector. While it has been written primarily from a corporate perspective, we believe that the core principles are also capable of being applied by a far wider range of organisations and their governing bodies.

Finally, we would like to thank everyone who contributed to the production of this guidance, whether by participating in round table discussions, providing advice and information, or agreeing to be used as examples. The guidance reflects their collective wisdom and experience.

ICSA: The Governance Institute
The Investment Association
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Core principles

1. Boards should identify, and keep under regular review, who they consider their key stakeholders to be and why.

2. Boards should determine which stakeholders they need to engage with directly, as opposed to relying solely on information from management.

3. When evaluating their composition and effectiveness, boards should identify what stakeholder expertise is needed in the boardroom and decide whether they have, or would benefit from, directors with directly relevant experience or understanding.

4. When recruiting any director, the nomination committee should take the stakeholder perspective into account when deciding on the recruitment process and the selection criteria.

5. The chairman – supported by the company secretary – should keep under review the adequacy of the training received by all directors on stakeholder-related matters, and the induction received by new directors, particularly those without previous board experience.

6. The chairman – supported by the board, management and the company secretary – should determine how best to ensure that the board’s decision-making processes give sufficient consideration to key stakeholders.

7. Boards should ensure that appropriate engagement with key stakeholders is taking place and that this is kept under regular review.

8. In designing engagement mechanisms, companies should consider what would be most effective and convenient for the stakeholders, not just the company.

9. The board should report to its shareholders on how it has taken the impact on key stakeholders into account when making decisions.

10. The board should provide feedback to those stakeholders with whom it has engaged, which should be tailored to the different stakeholder groups.
1. Directors' duties

Taking account of the impact on the company’s stakeholders when reaching decisions is not an optional extra for directors. In relation to certain stakeholders, they are legally obliged to do so.

Directors’ general duties are set out under Sections 171–181 of the Companies Act 2006 (the Act). These general duties are owed to the company, and there are civil consequences if they are breached. Companies may, through their Articles of Association, go further by placing more onerous requirements on their directors, but they may not dilute the duties except to the extent that this is permitted in the Act.

The requirement to have regard to the interests of certain stakeholders is expressly set out in Section 172 of the Act, which contains the duty to promote the success of the company. It states that a director is required to act in the way he or she considers, in good faith, will be most likely to promote the success of the company for the benefit of its members (the shareholders) as a whole.

Section 172 goes on to state that in carrying out this duty directors must have regard (amongst other matters) to the following factors:

- the likely consequences of any decision in the long term;
- the interests of the company’s employees;
- the need to foster the company’s business relationships with suppliers, customers and others;
- the impact of the company’s operations on the community and the environment;
- the desirability of the company maintaining a reputation for high standards of business conduct; and
- the need to act fairly as between members of the company.

In addition to the specific requirements in Section 172, other general duties on directors in the Act may also be relevant to the way the board addresses the interests of the members and other stakeholders. These include, for example, the duties to comply with the company’s constitution (Section 171), to exercise independent judgement (Section 173), and to exercise reasonable care, skill and diligence (Section 174).

These requirements are complex and, in the event of doubt, directors should seek the advice and guidance of the company secretary.

It should also be borne in mind that, in addition to the statutory general duties, there are other legal duties imposed on directors by other legislation, for example, in terms of accounting and reporting, some of which will be relevant to at least some of the company’s stakeholders. Examples include those duties imposed by the Bribery Act 2010, the Modern Slavery Act 2015, and health and safety and employment legislation.
2. Stakeholder identification

Principles
Boards should identify, and keep under regular review, who they consider their key stakeholders to be and why.

Boards should determine which stakeholders they need to engage with directly, as opposed to relying solely on information from management.

Introduction
Stakeholders are those groups which are likely to be affected by the actions of a company, or whose actions can affect the operation or business model of the company. Companies who do not treat their stakeholders appropriately are unlikely to enjoy success in the long term, and there may be adverse consequences on their ability to operate the business.

There are many groups which a company will interact with or which are directly or indirectly affected by the company’s activities. This guidance does not provide an exhaustive list of stakeholders with which boards should be engaging. Companies will have different responsibilities to different groups which will vary based on their size, industry, location and many other factors.

Companies will understandably need to prioritise their stakeholders in order to determine how extensively to engage with them. Boards need to have a framework for defining and identifying key stakeholders so that they have a clear and justifiable basis for doing so.

Identifying and prioritising stakeholders
Boards should identify the groups which have a positive or negative impact on the company’s ability to operate or are potentially impacted by the company’s activities.

In order to prioritise these stakeholders for the purpose of engagement, the board could lead a mapping exercise such that they are able to identify the key stakeholders and/or the issues or activities with the most material impact on a range of stakeholders.

The mix of groups identified as key stakeholders will vary from company to company. The workforce is clearly an essential stakeholder for all companies, and for most companies the same will be true of customers, suppliers and providers of financial capital (including lenders and bondholders as well as shareholders), and the communities in which they operate.

The list of key stakeholders should also include other groups that are core to the company’s ability to generate long-term value, and those groups on whom the activities of the company could have a significant negative impact. The board may wish to prioritise within stakeholder groups as well as between them.
Once the prioritisation exercise has been completed, it should lead to a discussion of the extent to which the board needs information on and from those stakeholders, how extensively the company should engage with them, and how best to do so. This should include a decision on which stakeholders or issues are of sufficient importance to the long-term success of the company that the board should engage with them directly, rather than relying solely on information from management.

Example: Royal Bank of Scotland Group

The Royal Bank of Scotland Group (RBS) has developed a matrix which identifies the significant issues that impact on different stakeholder groups, divided into three categories:

- long-term and emerging considerations of growing importance;
- current priority considerations; and
- critical considerations that will always determine the company’s ‘licence to operate’.

RBS publishes a summary of the matrix in its annual report.
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Contact points
Boards should consider in this identification process the types of individuals or groups that they will use as points of contact for a particular stakeholder group.

For those stakeholder groups that already have a direct relationship with the company this may be relatively straightforward. For the workforce, for example, many companies will have trade unions or other existing representative structures. Other examples of direct relationships might include members of the company’s pension scheme, suppliers, shareholders, business partners and – for companies in regulated industries – the regulator.

Other stakeholder groups, for example customers and local communities, may be less clearly defined and greater effort or imagination may be required to establish lines of communication. Intermediaries such as representative bodies or civil society groups may be good starting points for facilitating discussion with stakeholders, but they may not necessarily be sufficient proxies for the views of the end stakeholder.

Regular review
The impact and materiality of different stakeholder groups will not always remain static over time. The stakeholder mix may be affected by changes in strategy, the requirements of the business, or changes in legislation. Therefore it is important that boards have a process in place for reviewing the groups identified as key stakeholders to make sure that engagement remains appropriate for the relevant audience.

Even between reviews, key stakeholders may well not be a single clearly defined list. A company’s key stakeholders may change from one board meeting to the next and even from one item of business to the next. For example, the key stakeholders in a decision to expand into a new overseas market may be very different from those in a decision to close a particular site.

Example: Intu Properties
Intu Properties conducted a review of its stakeholder programme in 2016 by conducting engagement sessions with both external and internal stakeholders to seek feedback on their stakeholder relationships and engagement programme. They disclosed the results of this review in their 2016 Corporate Responsibility Report.

One of the key outcomes of this review was to clarify the difference between their different stakeholder groups in their stakeholder strategy, specifically the definitions ‘communities’ and ‘relationships’, which are used in their pillars of engagement. This feedback will be incorporated into the company’s review of its strategy.
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3. Board composition

Principles
When evaluating their composition and effectiveness, boards should identify what stakeholder expertise is needed in the boardroom and decide whether they have, or would benefit from, directors with directly relevant experience or understanding.

When recruiting any director, the nomination committee should take the stakeholder perspective into account when deciding on the recruitment process and the selection criteria.

Introduction
A company’s long-term interests are most likely to be served by a board that has the skills and expertise needed to understand the business and the environment in which it operates, and can bring a diversity of experience and thinking to its decision making.

Given the significant influence that a company’s key stakeholders have on its future prospects and its licence to operate, the board’s knowledge and understanding of the interests of those stakeholders should be among the factors that are considered when assessing the overall composition and balance of the board and whether there is a need to recruit new directors. It will be for the board to decide how much weight should be given to these factors.

The approach to acquiring expertise
There are two broad approaches that boards could consider:

- reserving one or more board positions for directors drawn from a stakeholder group, such as the workforce; and

- extending the selection criteria and search methods for non-executive directors to identify individuals with relevant experience or understanding of one or more stakeholder groups.

Both these approaches have their merits. On the one hand, in cases where the contribution and buy-in of a particular stakeholder group is crucial to the company’s continuing success, there may be benefits in formalising that relationship by having one or more members of that group on the board as a director. On the other, expertise in understanding and engaging with a key stakeholder group does not necessarily have to come from within that group, and there are potentially many other individuals with relevant experience and expertise.
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The two approaches need not be mutually exclusive. Even when a company considers that one or more individuals should be appointed specifically in order to bring the perspective of a particular group to the board’s discussions, there may be benefits in having other directors with experience of the same or other stakeholders. This can reduce the risk of the board becoming over-reliant on individual directors, or of other groups of stakeholders being inadvertently overlooked.

In considering these issues it is important to remember that – whatever the reason for their appointment – all directors share collective responsibility for the actions taken by the board, and have the same legal responsibilities and liabilities. Specifically, they are all required under Section 172 to promote the success of the company in the interests of its members (the shareholders).

In addition, for companies, all directors’ appointments are subject to the approval of, or ratification by, the shareholders, irrespective of the process by which they were identified and nominated.

For these reasons it is recommended that, unless there are exceptional considerations, the terms of appointment for these directors – such as length of appointment, fees and other matters covered in their letter of appointment – should be the same as for other directors.

Whichever approach is chosen, the chairman and company secretary should also consider what can be done to ensure that the other directors do not become overly reliant on the perceived expertise of the new board member. This can already happen, for example, where a director is appointed for their specific technical or regional expertise.

Selection and search

The board’s starting point should be a consideration of the skills, experience and range of perspectives that it requires, now and in the future, and an assessment of whether or not it possesses them. That will vary depending on the company, its circumstances and who it considers its key stakeholders to be.

The board should consider whether the company’s normal recruitment processes are appropriate, or whether a different approach or additional actions are needed in order to identify suitable candidates. Relying purely on search firms, for example, may not be adequate when seeking to identify candidates with a different background from ‘typical’ non-executive directors, while relying purely on personal networks also limits the field.

If it is decided that one or more new directors are needed to bring an understanding of particular stakeholders, these questions should be considered:
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• What criteria should be specified?
This will depend on the company's needs, but care should be taken to avoid criteria that narrow the field unnecessarily, such as a requirement for prior board experience. While there can be risks associated with appointing individuals who are 'unknown quantities', concerns about the lack of prior board experience can be overstated and can be mitigated through training, support and having a balanced board.

• Who leads the process?
This responsibility will normally fall to the chairman or the nomination committee, where there is one. However, they should ask themselves whether they have the necessary expertise to assess the suitability of candidates with the particular skills or experience being sought. If not, they should consider whether and, if so, how to bring in expertise to assist them in making the assessment, or whether the composition of the nomination committee itself should be reviewed.

• How will potential candidates be identified?
If it is the intention to use an executive search firm, whoever is leading the process for the company should first ask the search firm to explain the means by which they intend to identify the candidates, so that they can take a view on whether this is adequate, and should remain responsible for setting the criteria. The company should also consider other approaches, such as advertising through publications and online resources used by the stakeholder group being targeted, or contacting professional bodies or other intermediaries. The networks or stakeholder groups used to provide views to the company may also be a useful source of information on potential candidates.

Worker representatives
If it is decided that one or more directors should be appointed to represent the views of the workforce, the board should consider the following questions:

• How many representatives should there be?
It could be argued that having just one director makes it difficult for the individual to be effective and creates the risk of their view being marginalised. Against that, it is necessary to consider the impact on the size and balance of the board, and the need to ensure that the other necessary skills and experiences are not squeezed out as a result.

One aspect of board composition that would need to be considered is the balance of independent and other directors. The UK Corporate Governance Code states that a director would not normally be considered independent where they have been an employee of the company or group within the last five years, although this is subject to the 'comply or explain' principle.
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- What process should be followed for appointing them?
  Where organisations have the workforce represented on the board, they are usually selected through some form of election or nomination by the workforce. Options include election by the workforce as a whole, individual business units or nomination by trade unions or some form of representative committee.

  Where the company has recognised trade union representatives, it would be sensible to seek their advice on the approach to be taken.

  As noted, the appointment of all new directors needs to be ratified by shareholders. This should be borne in mind when deciding on the timing of elections or other appointment processes.

  If it has been decided to appoint more than one representative, the company might wish to consider staggering their appointments – particularly if appointed by election – in the interests of continuity and succession planning.

Example: FirstGroup
FirstGroup has a non-executive Group Employee Director on its board of directors. They are nominated by an Employee Directors’ Forum, which itself consists of representatives from each of the Group’s UK subsidiaries. The candidate is then put forward to the Nomination Committee which, following an assessment, decides whether to recommend the appointment to the Board and shareholders.

Example: John Lewis Partnership
In the John Lewis Partnership the three independent non-executive directors act as informal mentors to the five directly elected employee (partner) representatives on the board, meeting with them and being available before board meetings to discuss matters on the agenda and how any concerns or issues might be addressed.

- What support will they need to fulfil their duties?
  In many cases it is likely to be the individual's first experience of sitting on a board. This should be factored into the induction and training that they are offered. Other members of the board may also be able to provide them with support.
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- What arrangements should be put in place for them to communicate with their colleagues? These should cover both arrangements for receiving input and views from colleagues in advance of board discussions – for which some of the considerations set out in Section 5 of this guidance in relation to designated directors may be relevant – and also arrangements that would enable them to provide those colleagues with feedback without breaching board confidentiality.

Other stakeholder representatives
Companies may also wish to consider whether there is a case for appointing one or more non-executive directors with specific responsibility for other key stakeholders. The questions outlined above would need to be considered in these cases as well. In addition, there may be some specific considerations to be addressed depending on the nature of the relationship with the stakeholders concerned, for example, managing potential conflicts of interest in the case of suppliers and customers.
4. Induction and training

Principle
The chairman – supported by the company secretary – should keep under review the adequacy of the training received by all directors on stakeholder-related matters, and the induction received by new directors, particularly those without previous board experience.

Introduction
Directors will be more effective in their role if they have benefitted from a well-thought-out and effective induction programme, introducing them to their role and enabling them to:

- build an understanding of the nature of the company, its business and its markets;
- build a link with the company’s people; and
- build an understanding of the company’s main relationships.

An understanding of the company’s key internal and external stakeholders should therefore be an integral part of the induction process. This understanding needs to be kept up to date throughout the director’s time on the board. This will primarily be done through the processes described in subsequent sections of this guidance, but training – either for individual directors or the board as a whole – will also be required.

Designing a directors’ induction programme
Directors should, on appointment, devote time to a comprehensive, formal and tailored induction which should extend beyond the boardroom. Previous ICSA guidance recommends that at least ten days be set aside for this in the first year following the director’s appointment.

Each new director will bring a specific set of competencies and skills to the work of the board and will consequently need a specific and individually tailored induction programme, albeit that there are likely to be a number of common factors for most directors. For example, a director taking their first board appointment is likely to need more detail on the statutory duties of a director than one who has previous board experience, although a refresher will still usually be appropriate.

Following recruitment, the chairman and company secretary should meet with the new director as soon as possible to establish their needs. This meeting will also be helpful in establishing preferred methods of delivery and agreeing appropriate timescales.

It is important to plan the timing of the induction process so as not to overload the new director and to ensure that the various elements of the programme can be prioritised appropriately. It will also be helpful to review the process with the director throughout the induction programme.
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Stakeholders
In order to ensure the induction programme gives the new director an understanding of the role and nature of the company’s principal stakeholders, the following, non-exhaustive, list of activities should be considered:

• meetings with operational and functional senior management;

• meetings with staff committees or trade union representatives;

• site visits;

• briefings on the company’s local, regional and/or global operations and any impacts that these have on local communities;

• meetings with the company’s principal external advisers; and

• meetings with key customers and suppliers.

Ongoing training
If the company has in place the necessary engagement mechanisms and information flows to the board, this will go a long way to ensuring that the board remains up to speed and well-informed on the issues affecting the company and its stakeholders. However, there may be occasions where some bespoke training would be appropriate as a means of plugging gaps in their knowledge.

The chairman should regularly review and agree with each director their training and development needs. Taken in conjunction with regular board evaluation, this should help to address any gaps that are identified in the board or individual director’s knowledge.
5. Board discussion

Principle
The chairman – supported by the board, management and the company secretary – should determine how best to ensure that the board’s decision-making processes give sufficient consideration to key stakeholders.

Introduction
Having relevant expertise on the board is only of use if that expertise is deployed; and engaging with important stakeholders is of only limited value unless the results of that engagement are used to inform the decisions the board has to take.

Many boards suffer from a shortage of time and an excess of information. This section aims to help them think about how they can make best use of both. It deals in turn with:

- the management of the board’s agenda;
- the form and frequency of the information the board wishes to receive, including any relevant performance measures; and
- whether any board committees or individual directors should have specific responsibilities for some stakeholder-related issues.

These matters are all closely inter-related, and the board and management should consider them all together in designing a process that works for them.

Agenda management
The chairman, supported by the company secretary, should consider how to ensure the board receives the necessary information on issues affecting its key stakeholders and has time to discuss the issues at its meetings. This should cover the future schedule of meetings as well as the detailed agenda for each meeting.

Depending on the issues the board needs to consider and the sources of the information it requires in order to do so, some or more of these approaches might be appropriate:

- incorporating prompts such as ‘impact on stakeholders’ in all strategy and policy papers requiring a decision, to ensure that they are not overlooked;
- standing agenda items at all meetings; for example, to hear reports from board committees and/or individual directors with designated responsibilities in relation to key stakeholders;
- recurring agenda items, of a frequency to be determined by the chairman; for example to review key policies or performance indicators or significant issues raised through the company’s grievance mechanisms;
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- a rolling programme of meetings with key stakeholders, either in regular board meetings or as part of a programme built around board meetings held off site; and

- building flexibility into the agenda so that the board has the time to debate urgent or emerging stakeholder issues if required, or if requested by directors representing specific stakeholders.

Board information

Many boards already receive a considerable amount of information relevant to an understanding of their stakeholders, even if it is not labelled as such. It might be contained, for example, in reports on non-financial KPIs or risks, on the company's external reputation or internal culture, or on the outcomes of its CSR programmes or specific pieces of engagement.

The board should take a view on the totality of the information that it requires for these purposes, and agree with the executive a high-level plan for how it is to be sourced, how often it is to be reported, and in what format. Sources might include reports from individual directors, board committees or directly from stakeholders, as well as management reports.

This discussion should be informed by the board’s view of which stakeholders and issues require its direct involvement, and which require it only to be satisfied that management is taking appropriate action.

Boards and management should agree which performance measures and other data are appropriate. They should also consider whether they should identify ‘red flags’ that might trigger the need for board discussion or action.

Use of board committees

While understanding and taking account of the impact on stakeholders is a board level responsibility, boards should consider whether there would be merit in having one or more committees whose remit includes assessing the impact on, or engaging with, key stakeholders.

Possible benefits of doing so might include enabling a more in-depth assessment than the board itself has time for, and providing a means of identifying emerging stakeholder-related issues that should be brought to the attention of the board.

An increasing number of listed companies now have board committees with remits that cover issues such as corporate responsibility, ethics and sustainability. Others have established risk committees that focus on the significant non-financial risks facing the company.

Many of these committees will already be assessing the company’s impact on at least some key stakeholders and – where they exist – may therefore be a natural forum for considering its relations with stakeholders more broadly.
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An alternative approach could be to extend the remit of existing committees to address specific stakeholder issues. For example, the remit of the remuneration committee could be extended to take an overview of pay and benefits throughout the company. Shortly before this guidance was published, the UK Government announced that it had invited the Financial Reporting Council to consult on whether this practice should be recommended in the UK Corporate Governance Code.

Even if the board concludes that there is no need for a committee with a specific stakeholder remit, it should still consider how to ensure that existing committees give due weight to stakeholder considerations.

Where certain functions have been delegated to board committees, some of the issues identified in relation to designated directors (see below) are also relevant, in particular:

- Is it envisaged that the committee will engage directly with the relevant stakeholders? If so, how will this fit in with existing engagement mechanisms?

- Will the committee members be expected to report formally to the board as a whole on how they have fulfilled their brief – and if so in what format – or just expected to feed what they have learnt into the board’s discussions as and when relevant?

The means by which the committee chooses to carry out its functions will depend on the nature of its remit. As with the board itself, its role may fall anywhere on the spectrum between pure oversight of activities undertaken by the executive and direct engagement with one or more stakeholder groups, either on a regular basis or on an issue-driven basis.

Finally, in establishing or extending a committee with a remit to consider the impact on specific stakeholders, the board should contemplate whether its membership should be drawn purely from the board itself, or whether there would be merit in having a mixed membership. Consideration could be given to involving either other senior executives or external members, including stakeholders themselves.

If considering a mixed membership, it would need to be made clear in the committee’s terms of reference for which matters it had delegated authority and for which it had purely an advisory role.

**Designated directors**

One approach that boards could consider is designating to one or more individual directors the task of understanding the views of, and impact on, key stakeholders and ensuring these are fed into the board’s discussions.

If adopting this approach, it will be important in defining the role to draw a distinction between designating the function and delegating responsibility. In law, the board retains collective responsibility for its decisions and how they are reached, including taking account of the interest
of stakeholders. The chairman should try to ensure that directors without designated functions continue to take an interest in their views and contribute to the discussion.

One way of alleviating that risk would be to designate different directors to different stakeholders. This might also have practical benefits of spreading any resulting additional workload between directors. Against that, it could be argued that this would risk complicating the arrangements required at executive level to support the board, and encourage a siloed rather than holistic approach.

If considering this approach, boards should assess whether the roles are best carried out by executive or non-executive directors.

Consideration could be given, for example, to appointing one or more of the HR director, the chief risk officer or chief ethics officer, where they exist, as full board members. In any event, the chairman should ensure that these individuals and/or other members of senior management with relevant responsibilities have regular access to the board (and vice versa).

If a decision is taken to designate one or more non-executive directors, boards will need to consider the following points:

- What support will the director(s) need to receive from the company secretary and the executive in order to carry out their role?

- Is it envisaged that the director(s) will engage directly with the relevant stakeholders? If so, what authority will they have to speak on behalf of the board or company? How will this fit in with any existing engagement mechanisms?

- Will the director(s) be expected to report formally to the board as a whole on how they have fulfilled their brief – and if so in what format – or just expected to feed what they have learnt into the board’s discussions as and when relevant?

- Are there implications in terms of expected time commitment and/or fees?

- For how long should the director(s) have the role designated to them? Is there an argument, for example, for rotating the roles relatively regularly to ensure all non-executives benefit from the additional insights they might gain?

- How will director(s) report back to the relevant stakeholder group(s) on how their input has been communicated to and considered by the board?

- How will the company demonstrate to shareholders how the director(s) have fulfilled their role as designated non-executive directors? This is important as it will inform the views of shareholders when they vote on the re-election of the director(s).
6. Engagement mechanisms

Principles
Boards should ensure that appropriate engagement with key stakeholders is taking place and that this is kept under regular review.

In designing engagement mechanisms, companies should consider what would be most effective and convenient for the stakeholders, not just the company.

Introduction
Many companies already engage extensively with important stakeholders such as the workforce, customers and suppliers in the normal course of business. They use a variety of means, and do so for a variety of purposes.

While there will be cases where the board judges that it should engage directly with certain stakeholder groups or on certain issues, the majority of engagement will take place at the operational level. The board should, however, have an overview of the totality of the engagement the company undertakes so that it can decide whether or not it is sufficient for the purpose of informing discussion at the board.

When considering what form(s) of engagement to use, companies should be flexible and willing to deploy whatever method is most likely to secure the desired participation. It should, as far as practicable, be designed with the convenience of the stakeholders concerned in mind, not just that of the company.

This section of the guidance gives some illustrative examples of approaches already being used, with the aim of prompting companies to review their own existing mechanisms and to consider whether there would be value in adopting alternative or additional ways of engaging with the stakeholders concerned.

Assessing and reviewing engagement
As many of these mechanisms are likely to be co-ordinated at executive level or below, the board should satisfy itself that appropriate engagement with key stakeholders is taking place, and that it is receiving sufficient and timely feedback on the outcome of that engagement.

The key questions that the board should consider when assessing the overall engagement carried out by the company are:

- Do operational mechanisms for stakeholder engagement cover the breadth of the stakeholder groups that the board considers most important to its decision making or are most affected by the company’s activities?
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• Is the amount of engagement with specific stakeholder groups compatible with the relative priority the board places on them?

• What are the lines of reporting from these activities up to senior management and ultimately the board?

• Who is responsible for designing and carrying out this engagement? Boards should not be designing engagement mechanisms for all levels of the business. However, oversight is important to make sure that the processes are robust and regularly reviewed.

• Is there a need for the board to be directly involved in engagement with particular stakeholders or on particular issues?

The board should carry out such an assessment at regular intervals to determine whether the overall arrangements remain effective, and make changes if not.

Engagement mechanisms

The appropriate mechanism for engagement will depend on the stakeholder group concerned and the nature of their relationship with the company, and different approaches are likely to be needed. Approaches that can work well for groups with an existing direct relationship, such as workers and shareholders, may be less well suited for those groups that are less accessible or less clearly defined.

Forums and advisory panels

Forums and advisory panels of different types already form part of many companies’ engagement mechanisms with stakeholders, as they can be tailored to the needs of different groups. Some of these report to the board while others engage with management; some meet regularly while others are convened on an ad-hoc basis to provide views or advice on specific issues.

Example: Marks & Spencer

Marks & Spencer has recently introduced a shareholder panel, to help the board to understand the view of retail shareholders. The panel will meet several times a year with the Chairman, CEO and members of management to discuss issues and update these stakeholders.
Panels reporting to management can play a valuable role in the company’s overall engagement strategy, and establishing a forum with direct access to the board is not the only means by which the board can gain an understanding of stakeholders’ views. However, such forums are unlikely to be seen as effective by stakeholders unless they are confident that their views will be heard by the board. It is therefore important to ensure that appropriate feedback mechanisms are in place.

The two guiding considerations in thinking about whether to set up one or more panels that engage directly with the board should be:

• What is the purpose of the desired engagement?
  For example, it might be a means of establishing a regular dialogue with a particular group of stakeholders, or it might be in order to enlist the views or support of stakeholders in tackling a specific issue. For either of these, a panel might be an appropriate approach, but is not the only one and alternatives should be considered.

• With which stakeholders do we wish to engage?
  A forum or panel might be a suitable vehicle for engaging with, for example, workers, shareholders or NGOs. The UK Government has identified formal employee advisory councils as one of the approaches it believes companies should consider. Forums and panels are less likely to be suitable for engaging with, for example, customers or local communities affected by the company’s activities.

If a decision is taken to set up a forum or panel, then there are a series of further questions that should be considered before it is established. These include:

• What will be the formal remit of the panel?

• How will members of the panel be selected?
  For example, if the panel is intended to be representative of the stakeholder group(s) involved – as opposed to members being selected solely as individuals able to contribute to resolving a specific issue – companies may wish to take advice from relevant representative bodies.

• Will a single panel with a wide range of stakeholders be effective, or would a number of panels for different stakeholders be needed?
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- Will the panel engage directly with the board or through management? If direct engagement is planned, what form will it take? For example, will the panel meet with the whole board on a regular or one-off basis, or only with individual board members, such as the chairman or a designated director?

- How frequently should the panel meet?

- Will the panel be permanent or time limited and, if permanent, how often should its membership be refreshed? This may depend, for example, on whether its purpose is to provide a regular dialogue or to address a specific issue.

- What administrative, financial or other support will the panel and its members need from the company?

Other engagement mechanisms
Engagement can take many other forms, including – but not limited to – surveys, use of social media, and bespoke engagement programmes on specific issues.

- Surveys – These can be a good way to gather views and present them at board level and are widely used, particularly for engagement with the workforce. However, they need to be robust and targeted if they are to provide valuable insights for the board. Additionally, over-reliance on engagement surveys as a single method of gathering information can obscure other avenues of information.

- Social Media – Companies and boards are increasingly using social media to understand the sentiment of their stakeholders, be they customers, staff or wider communities.

Example: Social Media
Companies who were consulted in preparing this guidance noted particularly the increase in the use of Twitter and Facebook for customer relations and engagement, while data from Glassdoor was used by some companies (and some investors) to understand past, current and prospective staff perspectives on the business.

- Issue-specific engagement – this is usually conducted when a company's business interacts directly with a stakeholder group, for example, when companies in the extractive sector are seeking to engage with the local community when they are proposing a new mine or plant.
Staff engagement mechanisms
Boards usually have greater opportunities for engaging directly with the workforce than they do for most other stakeholders, and the different approaches open to them should not be thought of as mutually exclusive.

In addition to forums and panels of the sort described above, other approaches that companies have adopted include:

- site visits;
- employee ‘AGMs’ and annual open meetings;
- ‘Town Hall’ meetings; and
- comment boxes and email equivalents.

In addition, whistleblowing policies provide an important means by which employees can raise concerns.

Example: Rolls Royce
In 2017 Rolls Royce held its first ‘Meet the Board’ event for employees. All employees were invited to apply and 350 were selected by ballot to attend the meeting, which was held on the same day as the shareholder AGM. The Chairman, Chief Executive and Irene Dormer, a NED who has assumed the role of ‘Champion of Employee Engagement’ on the board each gave a presentation, following which questions were answered both from the floor and from those submitted in advance by employees who could not attend in person. A full recording was made available on Rolls-Royce’s intranet site a few hours after the event for all employees to view. Written responses to all questions raised that were unable to be answered in the time available were also posted on the intranet.
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7. Reporting and feedback

Principles
The board should report to its shareholders on how it has taken the impact on key stakeholders into account when making decisions.

The board should provide feedback to those stakeholders with whom it has engaged, which should be tailored to the different stakeholder groups.

Introduction
Many companies already undertake significant engagement programmes with their stakeholders, but the results of this engagement are not always communicated sufficiently to the stakeholder groups in question, to shareholders, or to the public.

Reporting on how boards have considered the impact of their actions on stakeholders is key to establishing trust and demonstrating transparency and accountability.

This section considers both how companies should report to shareholders and to their other stakeholders.

For shareholders, the main focus of reporting is understandably the annual report. They want directors to demonstrate how they are fulfilling their duty under Section 172 to promote the long-term success of the company through robust mechanisms for hearing and understanding the views of stakeholders.

Stakeholders in general want to know how their interests have been taken into account. Stakeholder engagement must be a two-way process. It is important that companies establish effective and targeted feedback loops to show stakeholders how their views inform board decisions. This will help them to secure the ‘license to operate’ by establishing a degree of trust between the board and their stakeholders, who in turn will believe it is worth the effort of engaging with the company as the board takes stakeholder engagement seriously.

In August 2017, the UK Government announced it intended to bring into effect by June 2018 legislation to require all companies of significant size to explain how their directors comply with the requirements of Section 172. After that date, this section should be read alongside the legislation and any guidance that the Government issues on how it is to be applied. The guidance itself will also be updated as necessary.
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Reporting to shareholders

Reporting to shareholders will primarily be done through the annual report and accounts and through subsequent ongoing or specific engagement, such as meetings or discussions at and before the annual general meeting. However, shareholders – along with other stakeholders – are also one of the audiences for other reporting such as separate CSR reports and the company website.

In the annual report, stakeholder identification and engagement should be put in the context of the company’s reporting on its business model and governance arrangements, to provide a picture to shareholders of how it contributes to the long-term success of the business and how directors have performed their duty under Section 172 to promote the success of the company. It should not be treated as a separate activity which can be ‘tacked on’ to existing reporting.

As the Financial Reporting Council’s ‘Guidance on the Strategic Report’ notes: ‘the components of an annual report should not be drafted independently. It is only through an integrated approach to drafting the annual report that relevant relationships and interdependencies between items of information disclosed in it will be properly identified and appropriately highlighted through linkages and signposting.’ This is particularly important for the issue of stakeholder engagement.

The guidance also states that the annual report should only contain information that is material to the economic decisions of shareholders. Companies may wish to discuss with shareholders what information they consider relevant. In general, however, investors will want to understand both the process and infrastructure for stakeholder engagement, and what the outcomes are in terms of impact on board decision making.

Reporting should therefore cover the following three questions:

• Who are the key stakeholders?

• How does the board hear from its key stakeholders?

• What were the outcomes of the company’s engagements with its key stakeholders, and what impact did that have on the board’s decisions?

Key stakeholders

As discussed earlier in this guidance, each company will have different key stakeholders and these may vary over time. One approach to disclosing this is for the board to set out who it considers to be the most significant stakeholders, based on its assessment of impact and materiality, and to outline the process it went through in order to make this assessment. The report could also comment on whether the stakeholder mix has changed during the year or over time.
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Engagement processes
The annual report should explain concisely the processes that the board has in place to receive input and information from stakeholders. This might cover not only the mechanisms normally used for each of their key stakeholder groups, but also how the board approaches more ad-hoc engagements in response to specific events.

This is also an opportunity for the board to report on any assessment that it has carried out on the effectiveness of its stakeholder engagement processes and on any changes it intends to make as a result.

Engagement outcomes
To demonstrate how the directors have fulfilled their duties under Section 172, the annual report could explain how information gathered through engagement with stakeholders has informed the board’s decisions during the year.

Disclosure should be specific and relevant to the company. Shareholders are wary of companies that rely on boilerplate language in annual reports. Disclosures should also follow the ‘fair, balanced and understandable’ principle, and present an honest appraisal rather than being treated as a PR opportunity.

The information on outcomes can be a mixture of qualitative and quantitative data. Narrative around the outcomes is important, but it can be enhanced by the careful use of quantitative data, for example data from staff or customer engagement surveys or other KPIs.

Example: SSE
In its overview of board activity for the year, SSE notes which stakeholders were considered for key decisions at both business unit and group level. For example, in 2016 the impact on employees, environment and the supply chain was considered in relation to investment decisions on new windfarms, and customers were considered in relation to tariff changes. The report also outlines how the board engages with each of their different stakeholders including, for example, customer forums. It also notes that the company plans to introduce an engagement system for the chairman and chair of the remuneration committee with employee representatives in 2017/18.
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Reporting to other stakeholders
While the primary audience for the annual report is the company’s shareholders, much of the information it contains will also be of interest to other stakeholders. However, as the Financial Reporting Council’s ‘Guidance on the Strategic Report’ emphasises, ‘the annual report should not be seen as a replacement for other forms of reporting addressed to other stakeholders’.

Companies should therefore consider what other reporting and feedback mechanisms might be necessary. The same methods will not always be equally suitable for different key stakeholders, so companies should consider how best to report to each group. As with engagement, the intention should be to develop arrangements that are effective and convenient for the stakeholders as well as for the company.

Publications and online resources
Many companies produce additional reports, either on a broad range of CSR activities or on specific issues such as workforce and community engagement. Where such reports are produced, they should follow the same reporting principles as set out for the annual report. They should be relevant, balanced and avoid boilerplate.

Good signposting on websites is important to show where stakeholders can find information relevant to them.

Examples: Vodafone and Rolls Royce
Vodafone has a stakeholder engagement page on its website, which points out where further information on each of its stakeholder groups can be found.

Rolls Royce also has a table published on their website which outlines for each of its stakeholder groups what types of engagements were undertaken, why the company considers that stakeholder group to be important, and what issues are relevant to that particular group.

Other forms of reporting and feedback
Many of the engagement mechanisms described in Section 6 of this guidance can be used to provide feedback to stakeholders on board activities in this area. Boards should consider using a range of reporting mechanisms tailored for the different types of stakeholders.

Some examples of mechanisms that have been used are:

- Newsletters and other publications can be used to develop feedback loops with stakeholders.
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Example: John Lewis Partnership
John Lewis Partnership publishes a weekly gazette which keeps employees (partners) up
to date on the business. This includes a substantial letters section, in which partners raise
questions which receive a guaranteed response from management.

- Forums and councils – the types of forum, councils and panels described in the previous
  section can be communicated to wider audiences through livestreaming council meetings via
  company intranet systems, or on public sites, depending on the sensitivity of the content.

- Shareholder updates – a number of companies hold shareholder engagement days in
  addition to the AGM, to update investors on governance and strategy issues. This allows
  a two-way flow between shareholders and the board. Companies such as GSK, HSBC,
  National Grid and Marks & Spencer hold these events, typically on an annual basis.

- Social media and technology – social media provides a good outlet for communicating with
  a wide group of stakeholders.

Example: Aviva
Aviva has a mobile app to allow staff to stream live question and answer sessions with
senior managers (#Uncut).

Timing of feedback
Different stakeholders may want or require reporting on different timescales. Annual reports
on the work of the board may be appropriate for groups such as shareholders, but the board
should consider how to update other stakeholders and whether more regular updates or more
immediate feedback would be appropriate. Social media and other forms of communication
could be used in these cases.
ICSA: The Governance Institute
Saffron House
6–10 Kirby Street
London EC1N 8TS
Phone: 020 7580 4741
Email: info@icsa.org.uk
Web: www.icsa.org.uk
Twitter: @ICSA_News

The Investment Association
Camomile Court
23 Camomile Street
London EC3A 7LL
Phone: 020 7831 0898
Email: enquiries@theia.org
Web: www.theinvestmentassociation.org
Twitter: @InvAssoc