



Hearing the stakeholder voice

Effective stakeholder engagement
for better decision making

September 2018

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Foreword



In 2017, when Theresa May announced that boards should be giving a stronger voice to those outside the boardroom through effective engagement with the workforce and other stakeholders, it was one of the most eye-catching proposals on the Prime Minister's agenda for a more responsible and sustainable form of capitalism.

The resulting revisions to the UK Corporate Governance Code, along with the statutory reporting requirements for section 172 of the Companies Act were finalised over the summer of 2018. There is considerable work that premium-listed companies need to undertake to ensure not only that they meet the new requirements, but also that the board's engagement with the workforce and other stakeholders produces constructive and meaningful input to the board decision making process, rather than being merely a box-ticking exercise.

Current annual report disclosures on stakeholder engagement demonstrate that up until now, the majority of companies have not set up formal frameworks for ensuring the board is able to consider the interests of stakeholders within its decision-making process.

While most companies will not be starting from scratch on engaging with stakeholders, many will not have developed methods which foster genuine two-way dialogue between the company, its workforce and other stakeholders. Indeed, in the Guidance on Board Effectiveness, which accompanies the Code, the Financial Reporting Council (FRC) makes clear that the traditional go-to of annual employee engagement surveys alone will not be sufficient to demonstrate a company is satisfying the Code Principle on engaging with the workforce and other stakeholders.

This guide is intended to help companies identify the key actions which they will need to take in order to implement and report on effective engagement mechanisms, as well as exploring the challenges they may face along the way.

Fostering genuine and meaningful dialogue with stakeholders, which is embedded within organisational strategy and governance structures, cannot be delivered by companies overnight.

Successful relationships with a company's workforce, suppliers, customers and the wider community rely on honest communication, trust, mutual respect and the ability to compromise. It is well-known that these values are of great importance to the millennial generation. Companies which demonstrate a genuine desire to listen to stakeholders and consider their interests, are likely to benefit in the long run. Just like any other relationship.

"By giving a stronger voice to those outside the boardroom, we incentivise businesses to take the right long-term decisions and help restore the public's trust."

**Prime Minister Theresa May
Government Response: Corporate
Governance Reform**

The new requirements

UK Corporate Governance Code

At the Government's request, the FRC has incorporated significant revisions to the UK Corporate Governance Code (the Code). The new Code takes effect for financial years commencing 1 January 2019 onwards and applies to all premium-listed companies

In addition, the FRC has also published an updated edition of its Guidance on Board Effectiveness, which accompanies the Code. The Guidance sets out further detail on how companies can meet the requirements under the Code. Companies are not required to follow the Guidance, however it is seen as best practice.

Relevant Principle (Apply and Explain)

D. In order for the company to meet its responsibilities to shareholders and stakeholders, the board should ensure effective engagement with, and encourage participation from, these parties.

Relevant Provision (Comply or Explain)

5. The board should understand the views of the company's other key stakeholders and describe in the annual report how their interests and the matters set out in section 172 of the Companies Act 2006 have been considered in board discussions and decision-making. The board should keep engagement mechanisms under review so that they remain effective.

For engagement with the workforce, one or a combination of the following methods should be used:

- a director appointed from the workforce;
- a formal workforce advisory panel;
- a designated non-executive director.

If the board has not chosen one or more of these methods, it should explain what alternative arrangements are in place and why it considers that they are effective.

Statutory reporting requirements under section 172

In addition to the revised Code, a new amendment to the Companies Act means all large private companies will need to provide:

- A statement in the Strategic Report of how directors have complied with their duty under section 172
- A statement in the Directors' Report summarising how directors have engaged with employees, suppliers, customers, and others in a business relationship with the company.

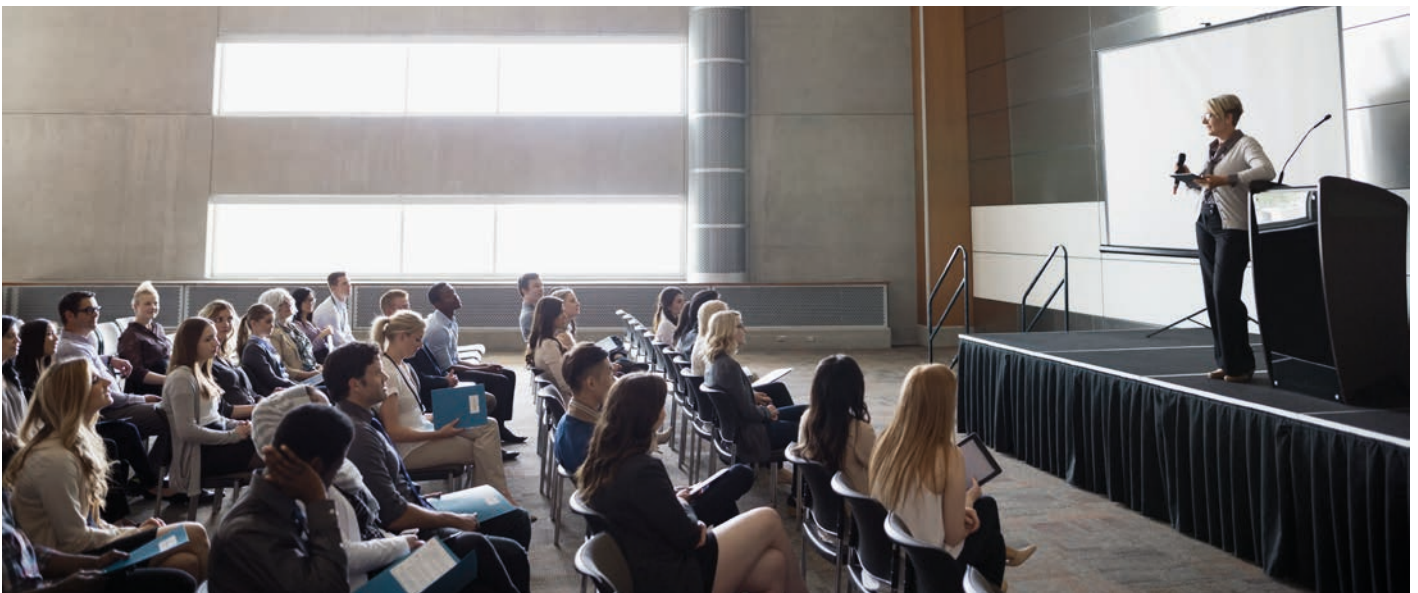
Companies Act 2006, Section 172

(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to –

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

Focus on: engaging with the workforce

The Code Provision and Guidance relating to the establishment of a method to gather the views of the workforce are particularly detailed. As such, this will be an area of significant focus for companies.



The three methods outlined in the Code

The three methods for gathering the views of the workforce outlined in Code Provision 5 (see page 3) may act as a starting point for companies in complying with the Code. As the methods each have distinctive characteristics, there are advantages and disadvantages for each method which companies will need to consider. Figure 1 (overleaf) sets out some of the key advantages and disadvantages for each of the three methods.

Effective engagement

The Code does not position the three options as off-the-shelf solutions for companies to adopt in isolation. The FRC has emphasised that companies should adopt an approach which satisfies the principles and provisions of the Code. Any approach which ensures *effective* engagement with, and encourages participation from, the workforce will represent compliance with the Code.

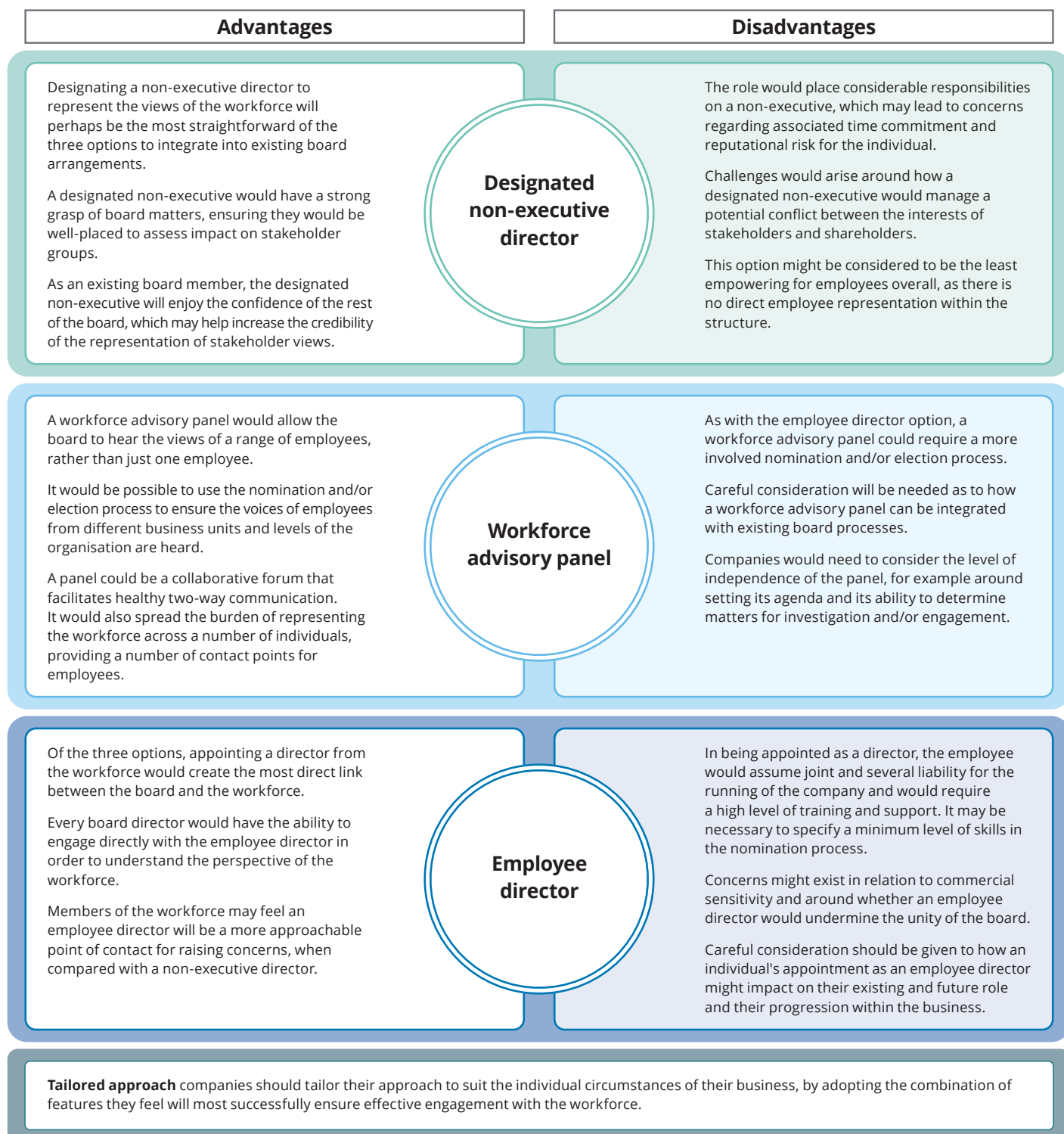
Companies will want to tailor their approach to the individual circumstances of their business. For example, where a company has designated a non-executive director as responsible for gathering the views of the workforce, methods such as a workforce advisory panel or regular workforce forums could provide a complementary mechanism through which the non-executive director engages with the workforce.

Companies should also assess and review the engagement activities already taking place within their business at present in order to identify if and how these can act as a foundation for developing a method which will connect that pre-existing engagement activity with boardroom decision-making.

“The three methods specified in the Code are not the only ways of engaging with the workforce... provided the board’s approach delivers meaningful, regular engagement with the workforce and is explained effectively; the Code provision is met.”

**Guidance on Board Effectiveness,
Financial Reporting Council**

Figure 1. Advantages and disadvantages of the three methods outlined in the Code for gathering the views of the workforce



What constitutes *effective engagement*?

The Guidance on Board Effectiveness states that Code Provision 5 will be satisfied so long as the approach adopted by the board delivers *meaningful, regular dialogue with the workforce* and is communicated effectively to the workforce. When developing and agreeing an approach, the board must ask itself 'is this meaningful?' and 'will it be effective?'.

Is the method chosen going to be effective?

Regardless of which method is established, the workforce needs to know:

- What the mechanism is
- How they can engage with it
- What the outcomes were/are

Above all, setting up a method for engaging with the workforce will require clear communication.

As an example, in order for the designated non-executive director method to be effective, companies will need to:

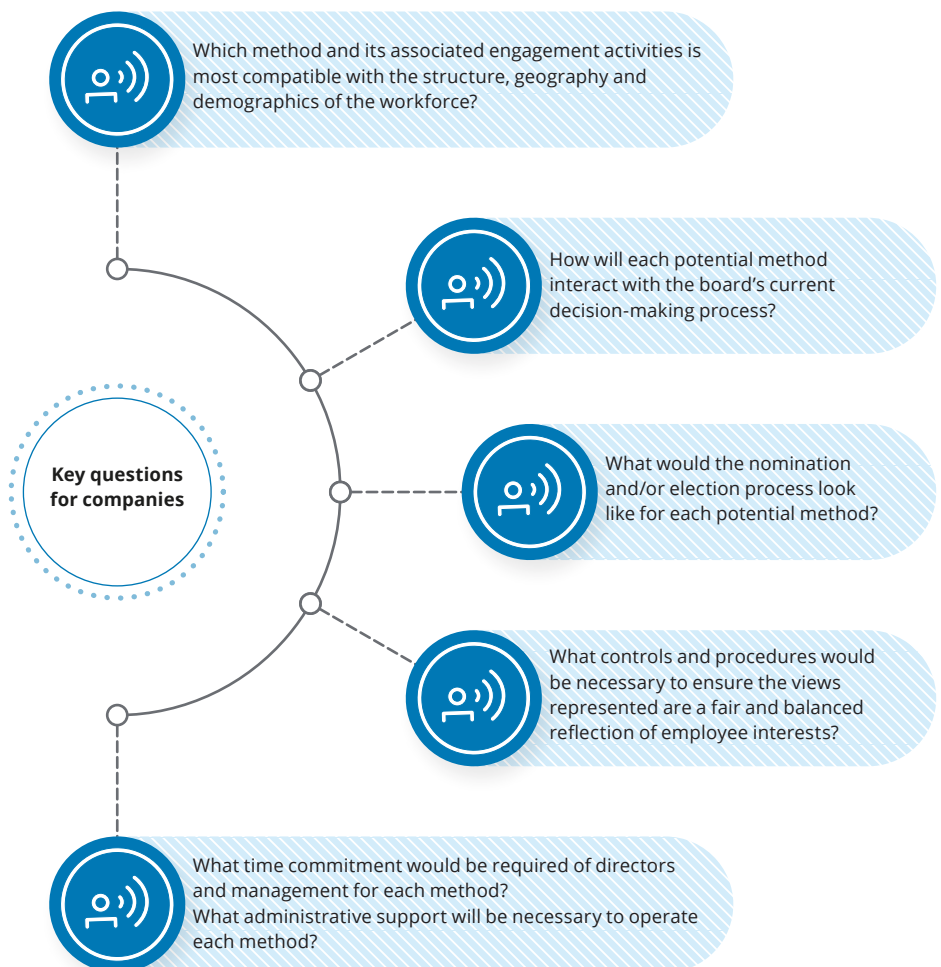
- Identify the most suitable or qualified individual
- Agree and publish formal terms of reference
- Ensure the designated individual is accessible to the entire workforce
- Identify and provide the individual with the appropriate resources and support to be able to perform their role
- Ensure board agendas provide the designated individual with the opportunity to feed back
- Communicate the outcomes of engagement back to the workforce.



Remember to think about...

The Code requires companies to engage with external stakeholders, however it does not prescribe the method for gathering the views from these stakeholders. Companies may therefore want to consider what methods for employee engagement could be adopted, in part or in full, to facilitate the board's engagement with external stakeholders.

The methods for boards to gather the views of the workforce suggested in the Code are unlikely to be effective as standalone options. Companies are likely to find a combination of different approaches will be most effective.



Is the method chosen going to be meaningful?

What constitutes meaningful engagement is clearly subjective. The best test for ensuring an approach is meaningful is considering how the approach would fare when reported publicly.

Questions for companies include:

- If the company's approach was described in the media, would the board feel comfortable in defending the approach taken?
- How is the company addressing the differing needs of the workforce throughout the organisation?
- How will feedback be gathered on whether the workforce believes the approach represents effective and meaningful engagement?

Any workforce engagement method should, as a minimum, possess the following characteristics:



Two-way communication: the approach should facilitate a dialogue between the board and the workforce. In practice, this means allowing the board and members of the workforce to understand each other's views on any given topic, to ensure the information feeding into the board decision-making process reflects the views of the workforce. The approach should also feature communications back to the workforce on how the board has considered and acted on the feedback received.



Regular engagement: the frequency of engagement will depend on the individual circumstances of company and the matters it is consulting on. However, it is unlikely that engaging once per annum will satisfy the Code provision. To ensure directors understand the interests of the workforce on matters being discussed by the board, as required by section 172, it is necessary to ensure the frequency of engagement activities aligns with board activity during the year.



Reflecting workforce views fairly: the approach adopted by a company should represent a genuine attempt to gather a representative range of views of the workforce for the board to consider. An attempt should be made to engage with different populations within the workforce, with appropriate weight being given to the views of these different populations. This is one aspect of ensuring engagement is meaningful.



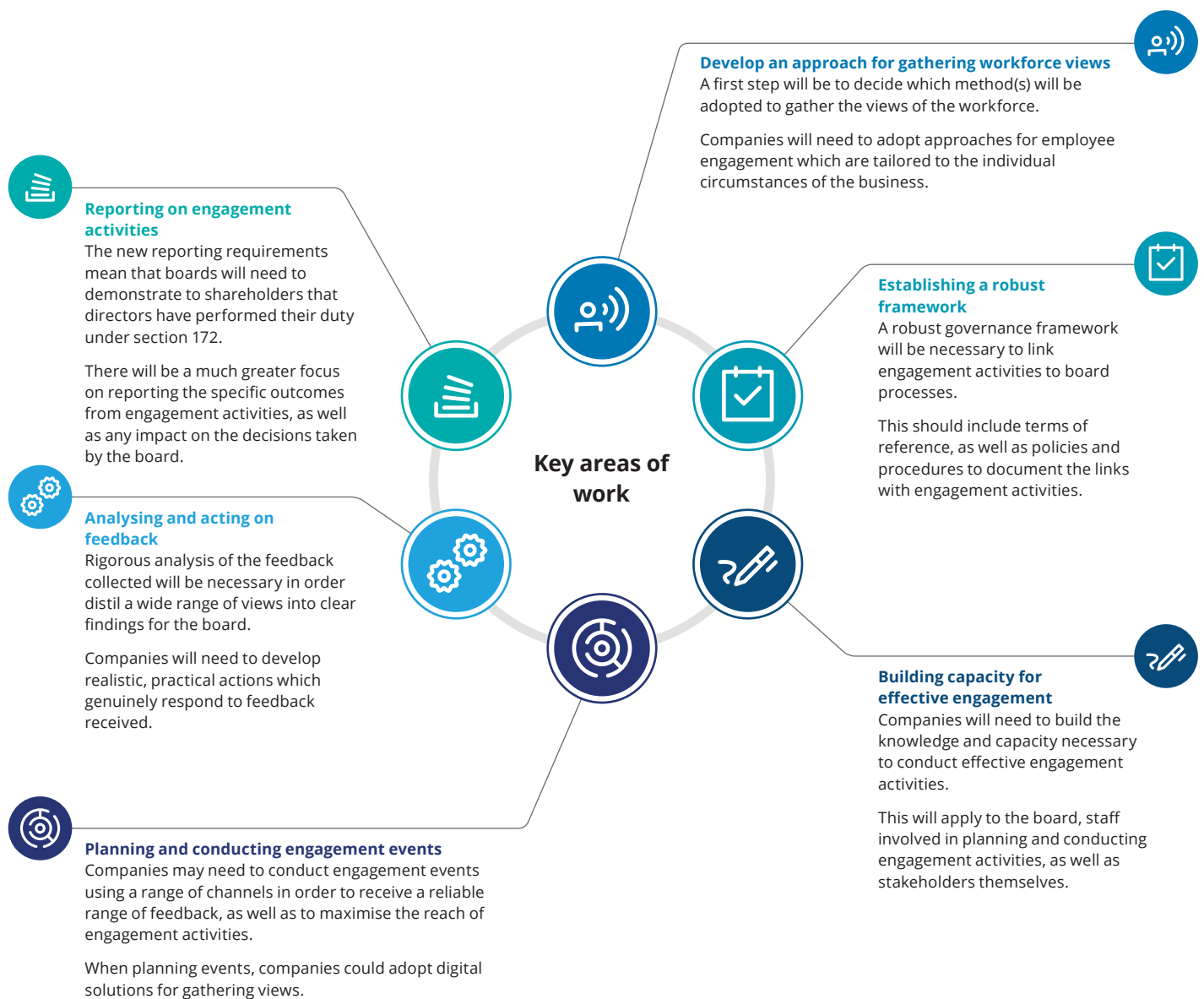
Feeds into decision-making process: ensuring meaningful engagement is dependent on how feedback is considered and acted upon. The board will require a sufficient level of information in order to understand the interests of the workforce and apply this when making decisions. The approach must deliver feedback which the board itself considers to be reliable and accurate management information which adds value to the decision-making process.



Encourages participation: the requirement for companies to encourage the participation of the workforce clearly establishes, as a minimum, a need for internal communications around the engagement method selected by the board. However, ultimately, employees may only participate if they believe that the board is genuine in its efforts to set up an effective method for gathering the views of the workforce.

Overview: key steps in engaging with stakeholders

The key areas of work, which companies will need to address in order to achieve effective engagement with the workforce and other stakeholders, are outlined below.





Establishing a robust framework

It is imperative that companies establish a robust governance framework around engagement activities in order to facilitate meaningful input to the board decision-making process.

A robust framework will ensure there is a link between the processes and activities for engaging with stakeholders on the one hand, and the work of the board on the other. Companies will need to ensure they address these areas with integrity, as they will be quickly exposed (via social media for example) if their statements do not ring true to stakeholders.

As a minimum, any framework should feature:

- Terms of reference for engagement methods
- Clear designation of ownership and resources for the day-to-day responsibility for engagement activities, as well as oversight at a higher level
- Policies and procedures for documenting how engagement activities interact with the board, other management functions and business units.

A robust framework will ensure there is a link between the processes and activities for engaging with stakeholders on the one hand, and the work of the board on the other.

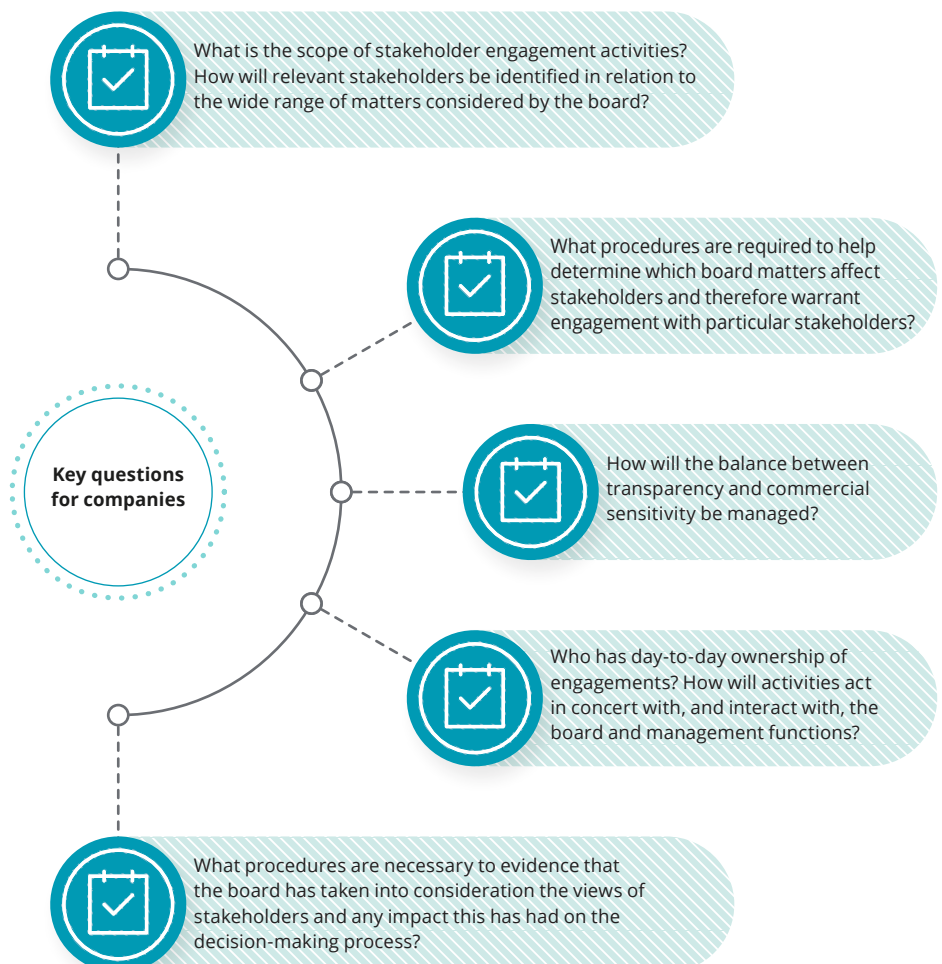


Remember to think about...

The impact of business activities on stakeholders might not be immediately obvious.

There may be challenges in defining stakeholder groups and identifying appropriate representatives. It is important to remember that different representatives might be most appropriate, according to the matter subject to engagement.

Careful consideration should be given on an ongoing basis to determine the most appropriate point for engaging with stakeholders. Usually this will be prior to the proposal reaching the board. Where decisions are taken at short notice, companies should use engagement channels to explain the rationale behind the decision and how stakeholder interests were considered.



Building the capacity required for effective engagement

Board competence

It is important to note that every board director is required to discharge their duty with regard to section 172. Directors should understand the purpose of engaging with stakeholders and the practical application of the company's engagement framework.

Supporting and facilitating engagement

Given that the regulations represent a step change in the level of engagement that most companies have with their key stakeholders, it is likely that many will want to review and enhance their capacity for facilitating engagement activities, analysing feedback and developing action plans.

For participants

In order to develop honest and constructive dialogue, companies need to ensure there is the capacity for all participants to engage on an equal footing. As such, a need may arise for some participants to receive proper training and briefing.

The areas where companies will need to develop expertise broadly align with each of the sections outlined in this guide.

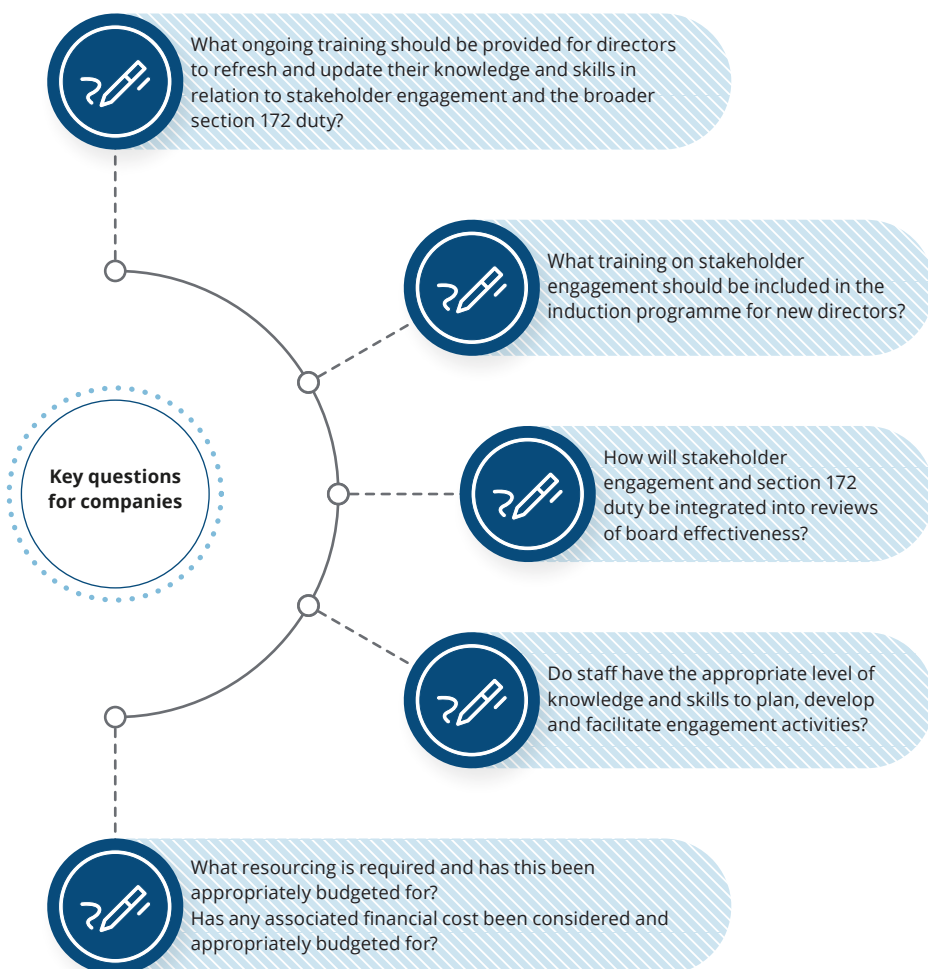


Remember to think about...

Levels of expertise, confidence and experience will vary within stakeholder groups and subsets of stakeholders. It may therefore be necessary to adapt training and support for different sub-groups of stakeholders, for example for differing populations within the workforce.

Where individual stakeholders assume a specific role or responsibility through an engagement method, it may be necessary to ensure there is sufficient capacity to protect the integrity and value of engagement activities.

In such circumstances, companies may wish to specify role requirements, outlining the necessary attributes or behaviours required of individual stakeholders, without representing obstacles to individuals participating.



Planning and conducting engagement activities

Companies will need to:

- Identify, profile and map the stakeholders who are relevant to the topics on which the company is seeking to engage
- Plan and conduct engagement activities in a way which helps stakeholders feel empowered to give honest feedback and collaborate to produce outcomes which suit the needs of all parties.

Focus on: types of engagement activities

Examples of engagement activities that companies could use include:

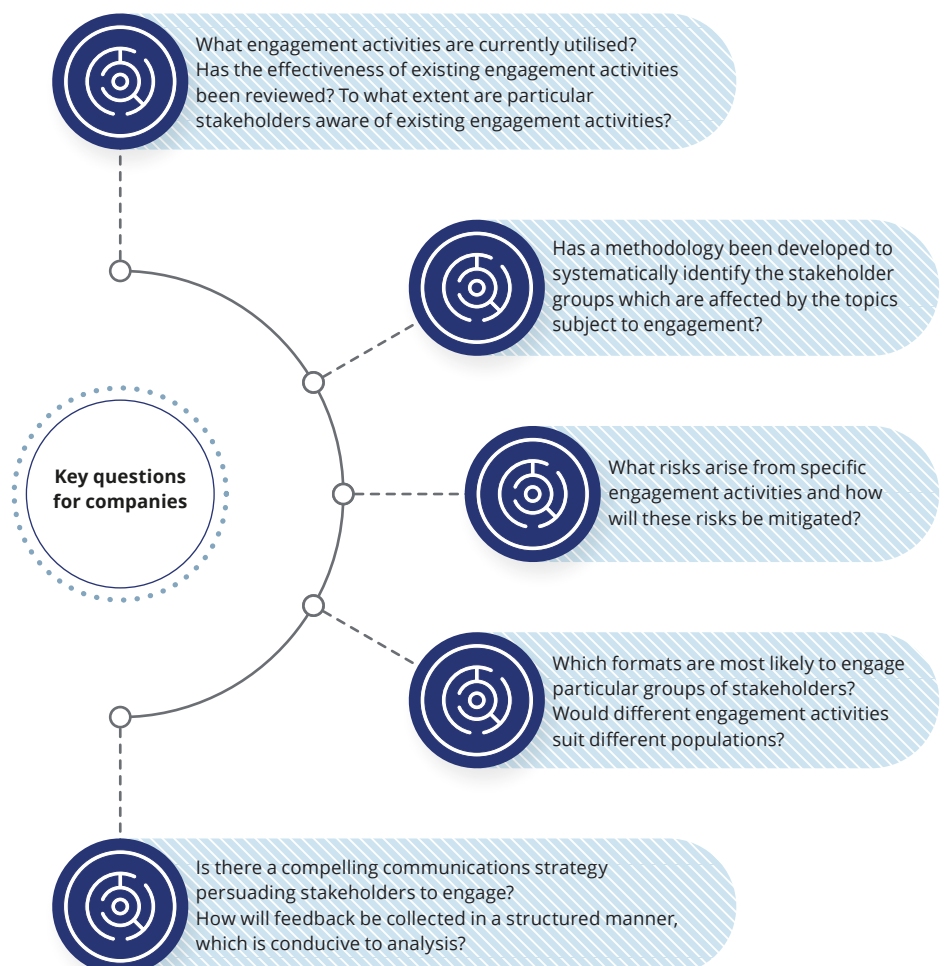
- Director breakfasts
- Focus or listening groups
- Groups of elected workforce representatives
- Stakeholder forums
- Stakeholder/employee AGMs/conferences
- Site visits
- Town halls and open door days
- Surveys (including employee surveys and pulse surveys)
- Digital engagement tools/platforms.



Remember to think about...

Companies should aim to gather the views of stakeholders through a range of channels, in order to ensure detailed feedback is complemented by an understanding of the broad sentiment of a wider group of stakeholders.

Companies may wish to consider how digital solutions can be deployed as one pillar of their engagement strategies, as these can act as valuable platforms to enhance the opportunity for a diverse range of individuals to collaborate on engagement activities.



Analysing feedback and developing a response

The value of the feedback collected through the engagement process can only be unlocked if feedback is subject to rigorous analysis and informs insightful management information.

Even with a robust framework for considering the views of stakeholders, the board will still require support in understanding the key messages arising from engagement activities. It is therefore important for the board to receive succinct, yet accurate, summaries of feedback.

It may also be necessary to develop proposals which accompany the feedback, for the consideration of the board. Those responsible for conducting engagement activities will need to collaborate with teams from across the business to communicate the key messages accurately, and ensure any actions will genuinely respond to feedback.

As companies should be aiming to engage with stakeholders on proposals either in advance of reaching, or undergoing, board discussion, it will be important for companies to adopt an approach which is flexible and open to alternative perspectives. This will ensure stakeholder interests and views can be built into proposals as they are being developed, which is preferable to proposals requiring amendment later in the process.

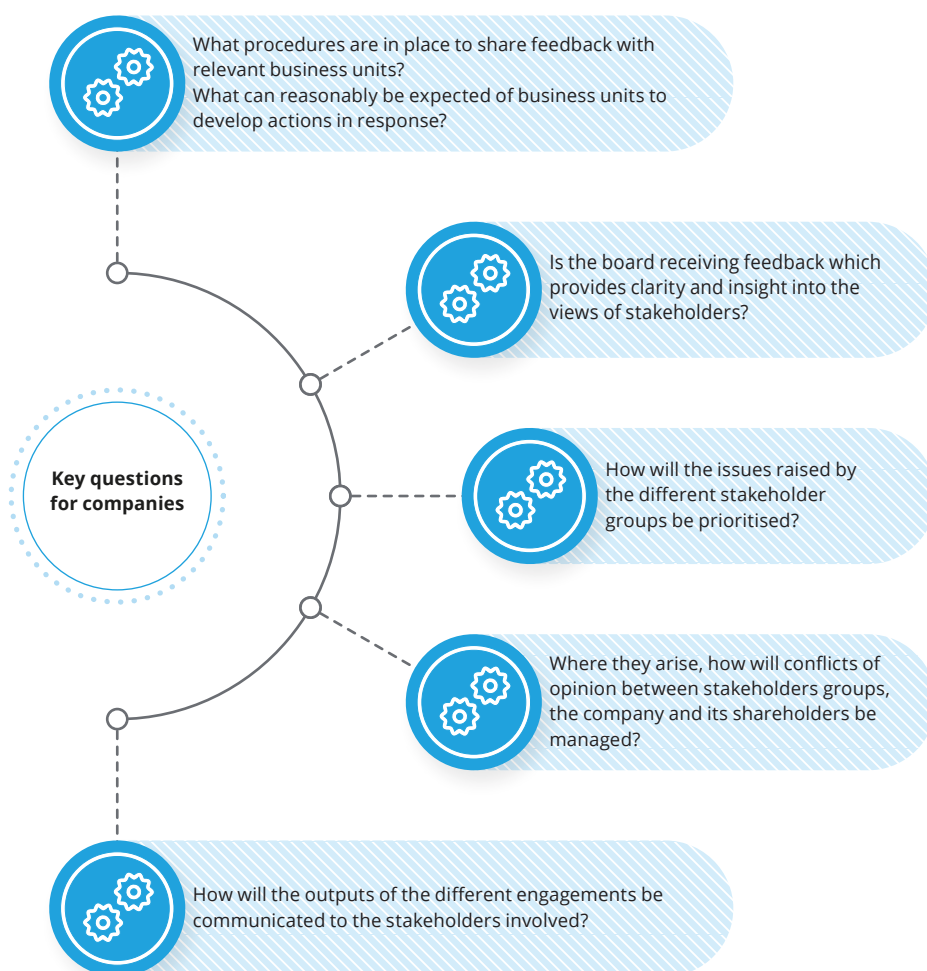


Remember to think about...

Much of the feedback collected will be qualitative in nature. Robust analytical methods are therefore necessary to ensure this feedback is interpreted correctly.

Any meaningful responses to the feedback gathered are likely to be embedded within wider strategy and operations and, as such, tend to take longer to develop and implement. Companies will need to balance this with a desire to demonstrate responsiveness.

Actions which represent only a superficial response to feedback will quickly be exposed as ineffective and will undermine the relationship between the company and the relevant stakeholder group.



Reporting on engagement activities

Reporting on engagement activities in the annual report is an essential means for demonstrating to shareholders that board directors have performed their duty under section 172, and have complied with the spirit of the Code.

The guidance accompanying the Code, as well as the expectations of shareholders and stakeholder groups, means companies will need to focus their reporting on the outcomes of gathering the views of stakeholders, as well as any impact on the decisions taken by the board.

It is important that companies 'close the feedback loop' by reporting back to stakeholder groups on the eventual outcomes relating to the matters which were subject to engagement. Disclosures in the annual report will form one medium through which this can be achieved, particularly with regard to external stakeholders. Generally, however, it will be necessary to communicate outcomes in a more direct, targeted manner, to ensure stakeholders can access and understand the impact of engagement activities.

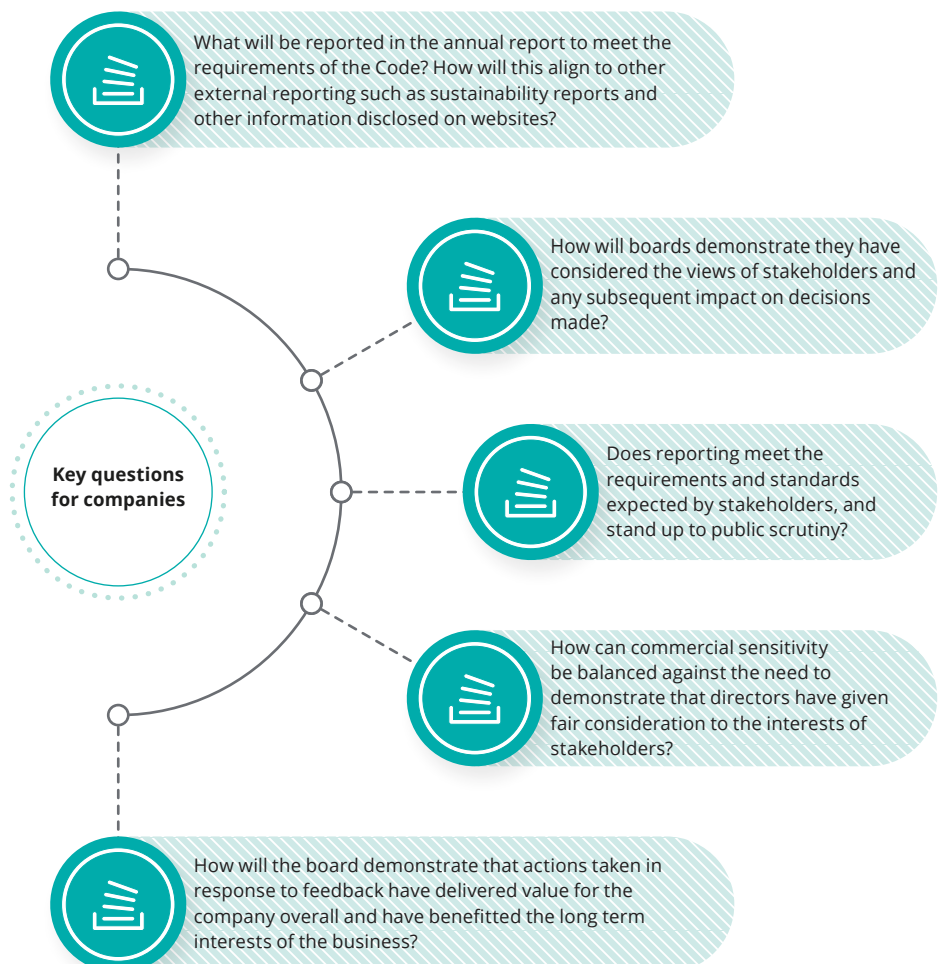
Where companies produce compelling communications that demonstrate to stakeholders that the board has listened and acted upon feedback, they will benefit from stronger relationships with stakeholder groups. This, in turn, will lay the foundation for improved engagement in the future.



Remember to think about...

It will not always be possible to actively reconcile the interests of the workforce and other stakeholder groups on the one hand and the commercial interests of the company on the other. The approach to annual report disclosures will need to pay careful consideration to this, to show a desire to act on stakeholder views without seeming disingenuous.

Warnings from the FRC and institutional investors that disclosures should be genuinely informative for readers rather than featuring non-specific boiler-plate text will be particularly true for stakeholder engagement. Companies should aim to demonstrate through their disclosures that they have a comprehensive strategy for considering and acting on stakeholder views.



Next steps and contacts

As outlined in this guide, there are a number of areas which companies will need to address in order to meet the new requirements on engaging with the workforce and other stakeholders.

Companies who approach stakeholder engagement as a box-ticking exercise without careful consideration or planning are likely to find the process onerous relative to the eventual output. As part of setting up and implementing methods and processes on stakeholder engagement, boards and management will need to consider questions which require a value judgement about the purpose and values of the company. Companies who embrace stakeholder engagement as a worthwhile activity and robustly debate these questions are likely to strengthen their relationships with the stakeholders on which they ultimately depend.

Deloitte has both the breadth of capabilities and the depth of experience to help companies as they seek to better understand the views of their stakeholders and generate greater value through stronger relationships.

If you have any questions about the issues covered in this report, the contacts listed here would be very happy to assist.



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