January 2020

Stakeholder Engagement and Reporting

From rhetoric to reality!

Introduction
The UK Corporate Governance regime has been significantly strengthened with the introduction of additional legal and regulatory requirements, for listed as well as large private companies, including reporting and Corporate Governance Code changes.

Section 172 of the Companies Act 2006 already places duties on directors, including consideration for the company's stakeholders in strategic decision making. Added to this, in August 2017 the Government announced a package of governance reforms which led to new corporate governance reporting requirements in the Companies (Miscellaneous Reporting) Regulations 2018, as well as the UK Corporate Governance Code 2018. Companies in scope (see below), as of the beginning of 2019, are required to provide reported evidence on how they have engaged with their stakeholders, including the workforce; and in doing so, how this has influenced the board's decision making.

A summary of the regulatory framework relating to stakeholder engagement is as follows:

1. Section 172 of the Companies Act 2006 applies to the directors of all medium and large companies (not just listed ones) - when deciding what would be most likely to promote the success of the company, a director must have regard for the interests of the company's employees, as well as foster the company's business relationships with suppliers, customers and others.

2. The Companies (Miscellaneous Reporting) Regulation 2018 means that all large UK companies, with financial year's starting on or after 1 January 2019, are required to include a section 172 statement in their strategic report to demonstrate how they have complied with the Act; including stakeholder and workforce engagement, and how this has influenced board decisions.

3. The UK Corporate Governance Code 2018 (Principle D), applicable to all companies with a premium listing stipulates effective engagement with, and encourages participation from, shareholders and stakeholders. Provisions 5 and 6 within the Code requires the Board to understand the views of wider key stakeholders and include in the annual report how their interests (and matters set out in Section 172 CA06) have been considered in board discussions and decision making. This includes engagement with the workforce via various methods.

4. The 'Wates Principles' (for large private companies), have been published in line with new reporting requirements. Six principles have been designed to help boards of such companies to undertake meaningful engagement with material stakeholders.

For the most part, these apply to all companies apart from those which are medium sized; or which are entitled to the small companies' exemption. All companies with more than 250 employees in the UK must **include in their directors' report a statement on employee engagement**, which describes steps taken by the company to engage with their workforce.
.
Changes are in response to past corporate failures, adding to the political and societal debate as to whether companies and boards have had proper regard to their key stakeholders in the way their businesses are run. The changes aim to improve the overall quality of governance within businesses.

What is Stakeholder Engagement?
Fundamentally, it is a process to involve people or organisations who may be affected by the decisions a company makes, or can influence the implementation of its decisions, at macro and micro levels. Stakeholder engagement should be a balance of interaction between the company and its stakeholders; consisting of communication and engagement on a topic(s), asking for and gaining feedback, analysing the feedback and taking action.
To complete the circle, companies should engage with the stakeholders on the decisions made, and actions taken, based on the feedback received. They should also report on their stakeholder activities through their annual Responsible Business/Sustainability reports. It is not a new concept, though it has previously been mainly associated with Responsible Business and Sustainability, for example on social and environmental issues. Although Stakeholder engagement is an existing requirement of Section 172 of the Companies Act 2006, the new regulations place further reporting requirements now in the directors' report.

Stakeholder engagement is also a requirement of the Global Reporting Initiative (GRI) and other standards such as the AA1000 Stakeholder Engagement Standard, which sits alongside the AA 1000 Assurance Standard. Over the past few years, Stakeholder Engagement has been considered essential to Integrated Reporting; and it is one of the Guiding Principles of the International Integrated Reporting Council (IIRC).

Continued Over >

Stakeholder Engagement and Reporting

From rhetoric to reality!

Complying with the new regulatory framework might seem daunting to even the most mature and experienced corporate companies. This is especially so at the time of year when the majority of companies in the UK (with YE 31st December), are well advanced in collating and writing their annual reports and sustainability/responsible business reports. With this in mind, companies will need to think now about the direct impacts on their company from the new legislation and what, specifically, they need to include in future corporate communications. We would like to share some thoughts as we work through the changes with our current clients.

What do companies need to think about at corporate level?
All companies should first check which parts of the legislative framework apply to them, including whether there is any additional new sector related governance, or other requirements, e.g. financial. Company Secretaries will play a significant role in this and in developing a process to deal with the implications of new requirements, including accessing existing employee and other stakeholder engagement mechanisms, risk management, additional training for directors, as well as other employees, e.g. HR, Communications, Investor Relations and Responsible Business teams.

The company's governance framework should be reviewed in relation to current stakeholder engagement, including the workforce. One of the provisions within the Corporate Governance Code includes the requirement for companies to engage with the workforce, through one or a combination of the following methods:

- 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 three methods, then they must explain the company's alternative process and why it is more effective.

The roles of Board Committees should also be reviewed, alongside any implications for their Terms of Reference. Consideration also needs to be given to how the changes and new requirements will be implemented, with designated responsibilities at all levels through the company, including an internal communications strategy.

There will, inevitably, be some financial implications in implementing and maintaining the new requirements. There will also be other resource issues which need to be identified and factored in, such as designating responsibilities throughout the company, any external support required and staff training etc.

Materiality and Stakeholders
For company's to really embed the above, boards should work with their executive teams to identify which issues are most material to the company's long-term success and undertake a review of their current stakeholder strategy and stakeholder groups. It is for companies to identify not only which are their material issues but, based on this assessment, to define who their key stakeholders are.

An expectation from some stakeholders, e.g. the investor indices, is for companies to undertake and report on these reviews annually; though this is not always the case nor may it be practical – however, the new changes make such reviews and reporting all the more crucial.

Whilst there are stakeholders which all companies have in common such as employees, customers/consumers and suppliers, there are others based on specific sectors, location, size and scale of operations etc.

The importance of understanding the views of the investment community should not be under-estimated. In May 2019, we reported on our Institutional Investor Survey - 'Corporate governance, what investors think', which focused on The Companies (Miscellaneous Reporting) Regulations 2018, and the publication of the UK Corporate Governance Code.

Here are some of the key findings:
Workforce Engagement: Only 20% of investors believe that companies take sufficient account of workforce views when making business decisions.
Stakeholder Engagement:
Progress must continue - in particular, in the areas of stakeholder prioritization, board oversight of the process, and definition of scope for board's direct engagement with some stakeholders.
Stakeholder Reporting: Only 20% of investors say that they are satisfied with the current level of reporting on stakeholder engagement activities within annual reports.

What options are there for undertaking stakeholder engagement?
There are a variety of options for undertaking stakeholder engagement which include surveys, face-face interviews, focus groups and independent stakeholder panels. Any stakeholder exercise should be carried out alongside a formal Materiality review, which identifies the most important issues for the business and the impact this has on both the business and their stakeholders. The engagement of key stakeholders in the Materiality process is, therefore, critical.

What does this mean for reporting?
Formal reports can be one of a company's best communication tools, and a way to demonstrate how the business model, strategy and objectives join up. Companies need to think about how they can report on the changes now, regardless of what stage they are at in terms of complying to with the new regulatory framework. If your business is 'future ready' and good practice is in place, you can be seen as taking a lead. If not, positive steps should be taken to develop a plan of action, to avoid risks and to demonstrate in reports that there is real commitment.

There are many challenges for companies faced with the changes, but also opportunities to show that businesses are responding to the issues which led to the new regulatory framework, to work towards leadership; and to respond to the needs of their stakeholder groups.

For further information contact: Caroline McCarthy-Stout, Director of Stakeholder Engagement and Reporting
caroline.mccarthystout@asesoria-group.com