THE BOARD REPORT:

Navigating the New World of Stakeholder Governance

BOARD INTELLIGENCE

THE DISCIPLINE OF FOCUS

Contents

Introduction

Discussion on stakeholder governance is often a tussle between the good and the bad, the purpose-driven custodians of the future and the profit-driven old guard. However, this false binary misses a fundamental truth:

Stakeholder governance is just governance.

We define governance as the discipline of a well-run organisation — the people, processes, tools, and conventions that comprise the "running" of an effective organisation. Stakeholder governance is simply governance that recognises that today's license to operate depends on a far larger system of stakeholders. Effective stakeholder governance shouldn't be seen as an exercise in compliance but as what's fast becoming the most important driver of short and long-term success.

2020 has brought this home to most boards in unimaginable ways. From Covid-19 to Brexit and Black Lives Matter, boards spend more time reacting to external stakeholder forces than influencing them. No board is ever fully in control of events – but stakeholder governance is an opportunity for boards to regain a far greater degree of control than most have today.

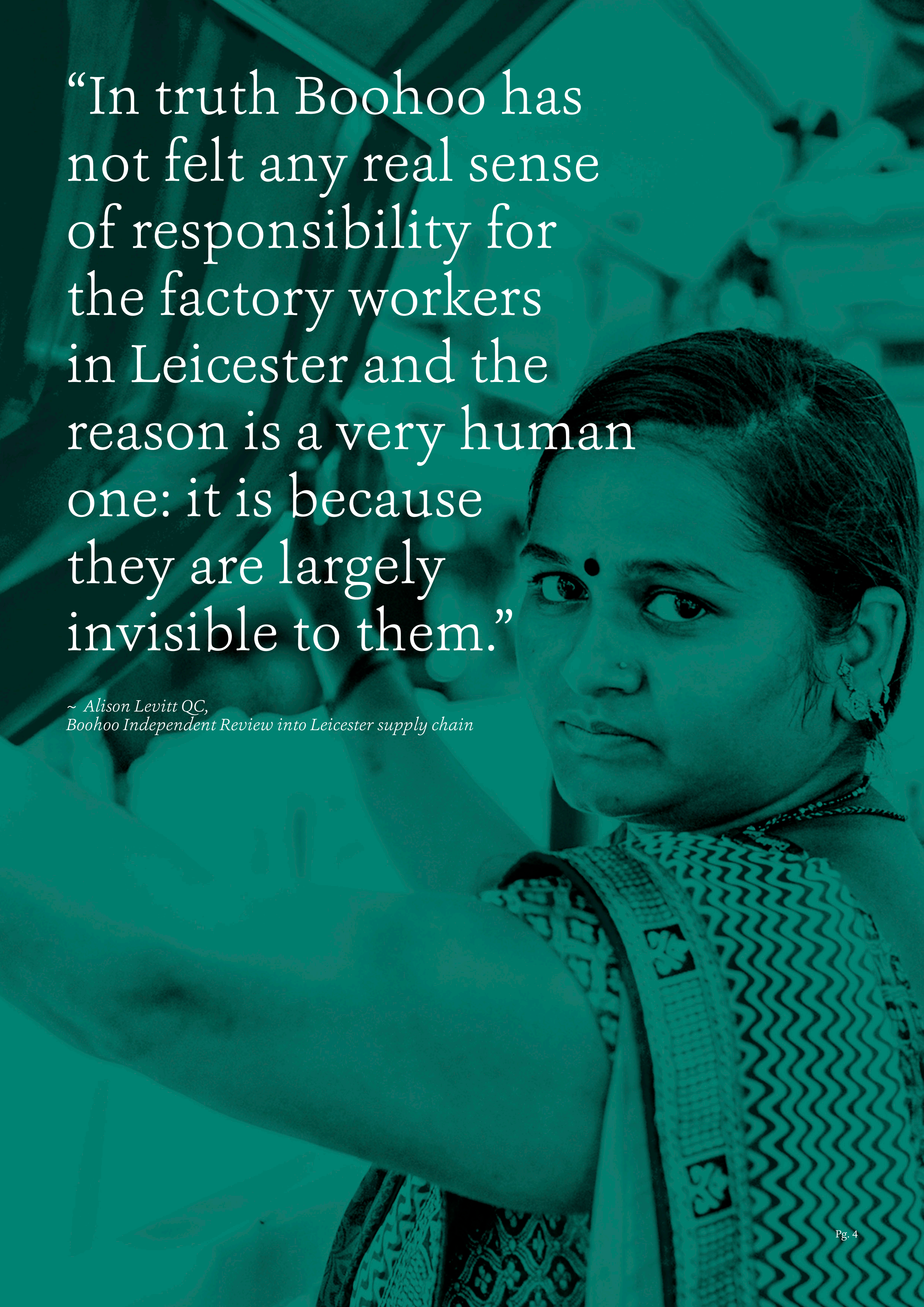
Our research reveals most organisations are largely unprepared to fully embrace this opportunity and are exposed to significant personal and organisational risk as a result. This report aims to underline the urgency of effective stakeholder governance, warn against common mistakes, and point you in the direction of successful strategies.

"The massive pace of change has meant that organisations have had to get a lot better at dealing with stakeholders – it's a business imperative. During this time, focus on what is critical to your business and defend what you prioritise."

~ *Founding Partner, Board Evaluation Firm*

"Jean-Sébastien Jacques has been forced to quit as chief executive of Rio Tinto after failing to quell an investor backlash over the destruction of a 46,000-year-old Aboriginal site in Western Australia. The company said two other senior executives – Chris Salisbury, the head of iron ore, and corporate affairs leader Simone Niven, who had responsibility for indigenous affairs – would also leave Rio, as the miner battles with the fallout against its decision to destroy the ancient site."

~ Financial Times

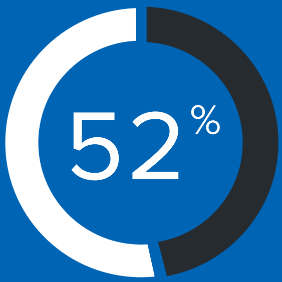


"In truth Boohoo has not felt any real sense of responsibility for the factory workers in Leicester and the reason is a very human one: it is because they are largely invisible to them."

~ *Alison Levitt QC,*
Boohoo Independent Review into Leicester supply chain

Positive, financials aside

84% Despite financial woes, believe they're weathering the crisis well



feel confident about their 2021 outlook & 34% remain neutral

With 43% forecasting to miss their 2020 numbers, it's heartening to see that people's interpretation of "weathering the crisis well" is not necessarily linked to financial performance.

Stakeholders are on the mind

82% of boards say improving stakeholder governance is something they've discussed

...and Covid-19 is accelerating progress

50% of boards believe Covid-19 brought their commitment to their stakeholders into focus

But mainly for those who cared to begin with ....

Purpose-driven organisations were nearly 3 times more likely to focus on their stakeholders as a result of the COVID-19 crisis than companies who don't identify as purpose-driven

> *"When lockdown first struck, we went back to our mantra – look after people."*
>
> ~ CEO,
> UK Building Society

However, dig a bit deeper & the picture for stakeholders is far less rosy

57% of boards say their biggest stakeholder governance challenge is a strong focus on one or two stakeholder groups (customers & employees) and not enough time spent on other stakeholders

A failure of imagination

A failure to connect the dots between some stakeholders & financial performance is leaving them out in the cold

Only 32% see a clear connection between their suppliers & their financial performance

16% see a clear link between the environment & their financial performance

18% of boards see a clear connection between

COMMUNITY & FINANCIAL PERFORMANCE

"Ask yourself 'What is the opportunity to engage stakeholders to help us prosper?' Companies that are doing well have the strongest narrative about their strategy."

~ Founding Partner,
Board Evaluation Firm

CEO compensation is not turning the dial

7% OF CEO REMUNERATION SCORECARDS INCLUDE AN ENVIRONMENTAL ELEMENT

4% OF CEO REMUNERATION SCORECARDS INCLUDE A COMMUNITY ELEMENT

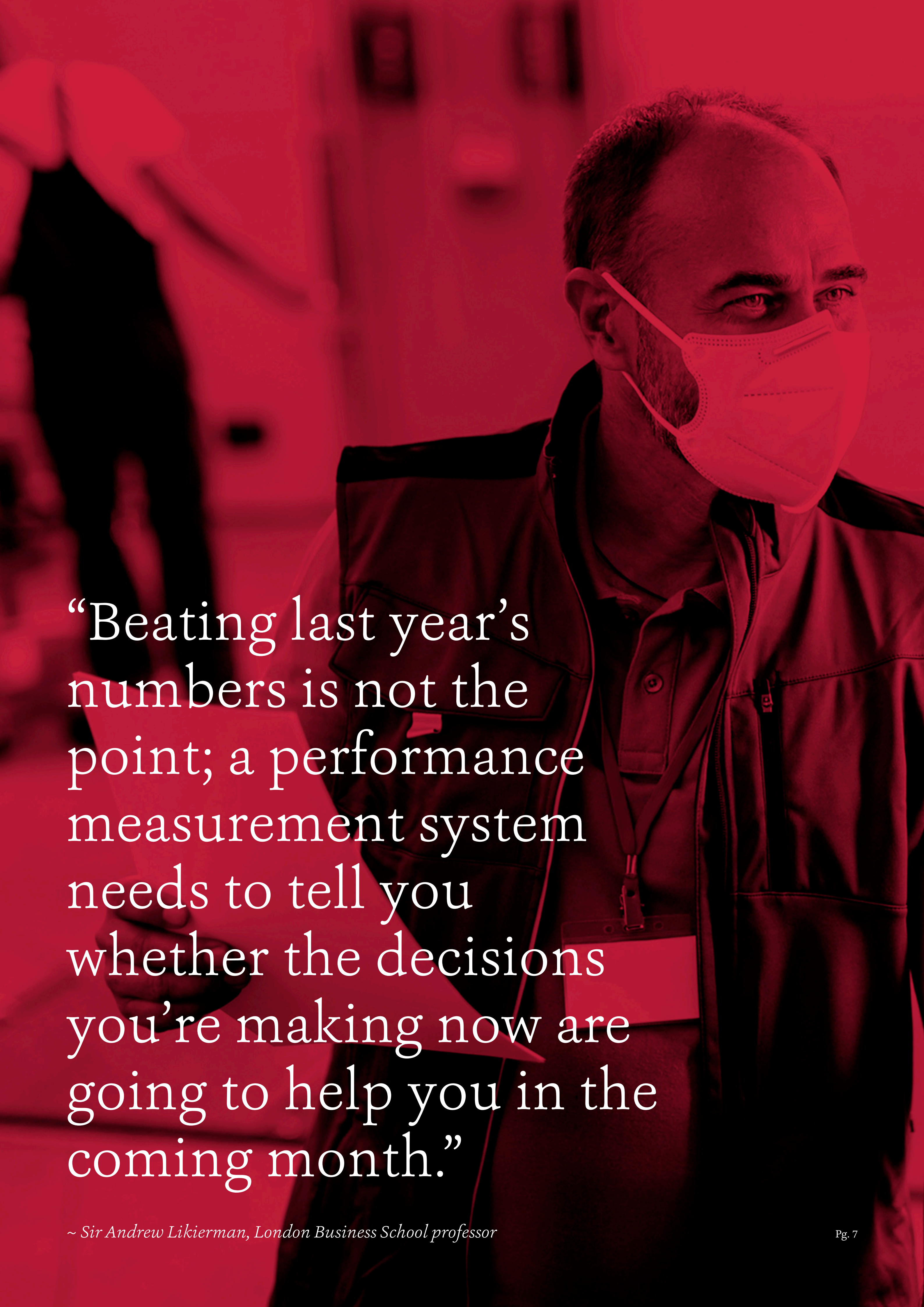
0% OF CEO REMUNERATION SCORECARDS INCLUDE A SUPPLIER ELEMENT (EXCEPT AS A FUNCTION OF DRIVING FINANCIAL METRICS)

Neither is board composition

16% of boards have discussed changing board composition to better represent stakeholders. The two stakeholders most likely to drive discussions around board composition are community and customers

Boards need to work hard to connect their long-term success to stakeholders that could be described as more intangible.

Failure to see a connection between suppliers and financial performance, or the environment and long-term performance is simply a failure of imagination. Connecting the dots takes time but is at the heart of effective stakeholder governance.



"Beating last year's numbers is not the point; a performance measurement system needs to tell you whether the decisions you're making now are going to help you in the coming month."

~ Sir Andrew Likierman, London Business School professor

Stakeholder Metrics

Are Boards Missing a Trick?

A well-known frustration for boards with their KPIs is that they give an assessment of the past, rather than look at the drivers of the future. For many boards, pipeline numbers are the biggest predictor of future sales success — so what is the stakeholder equivalent of a pipeline number?

Boards undervalue the power of perception

It's not news that consumers vote with their wallets and will cast their vote based on how they are treated. What's changing is that they increasingly do so according to their perception of how organisations treat other stakeholders — their workers, suppliers, community, and the environment.

Stakeholder perception can be a valuable indicator of future prosperity. Employee sentiment drives customer experience, customer perception can be driven by sentiment on how you treat the environment, or your supply chain, and brand sentiment can impact valuation and access to capital.

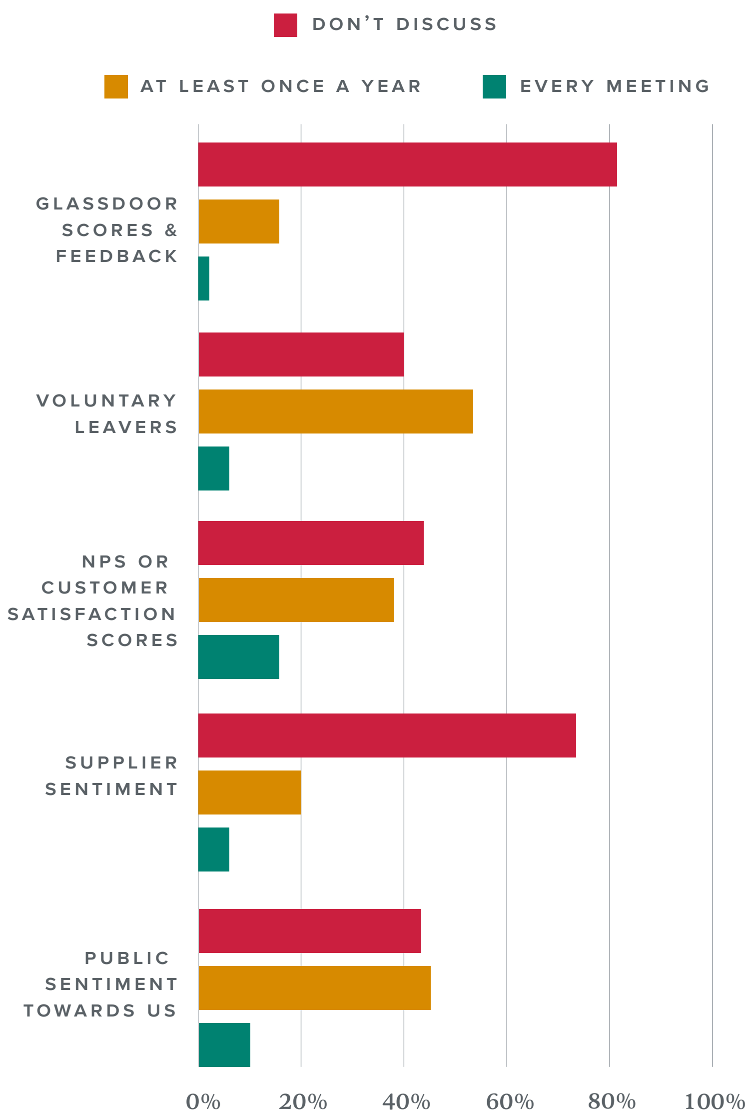
"We have a sentiment tracker (how are you feeling today?) on the intranet that's monitored hourly and the CEO has direct access to see whether sentiment is going up or down throughout day."

~ Company Secretary, UK Building Society

Perception isn't necessarily reality, but it's easy for gaps to appear between how directors view these relationships and how the wider public does. Given this, it's surprising how many boards don't keep a close eye on what their stakeholders think of them.

- 41% of boards fail to discuss voluntary leavers.
- 82% of boards are not reviewing Glassdoor — despite offering a direct, unfiltered view of employee sentiment.
- 45% of boards aren't looking at customer satisfaction scores.
- 73% ignore suppliers' sentiment.
- 43% don't cover how their community feels about them.

How often do boards discuss what their stakeholders think of them?



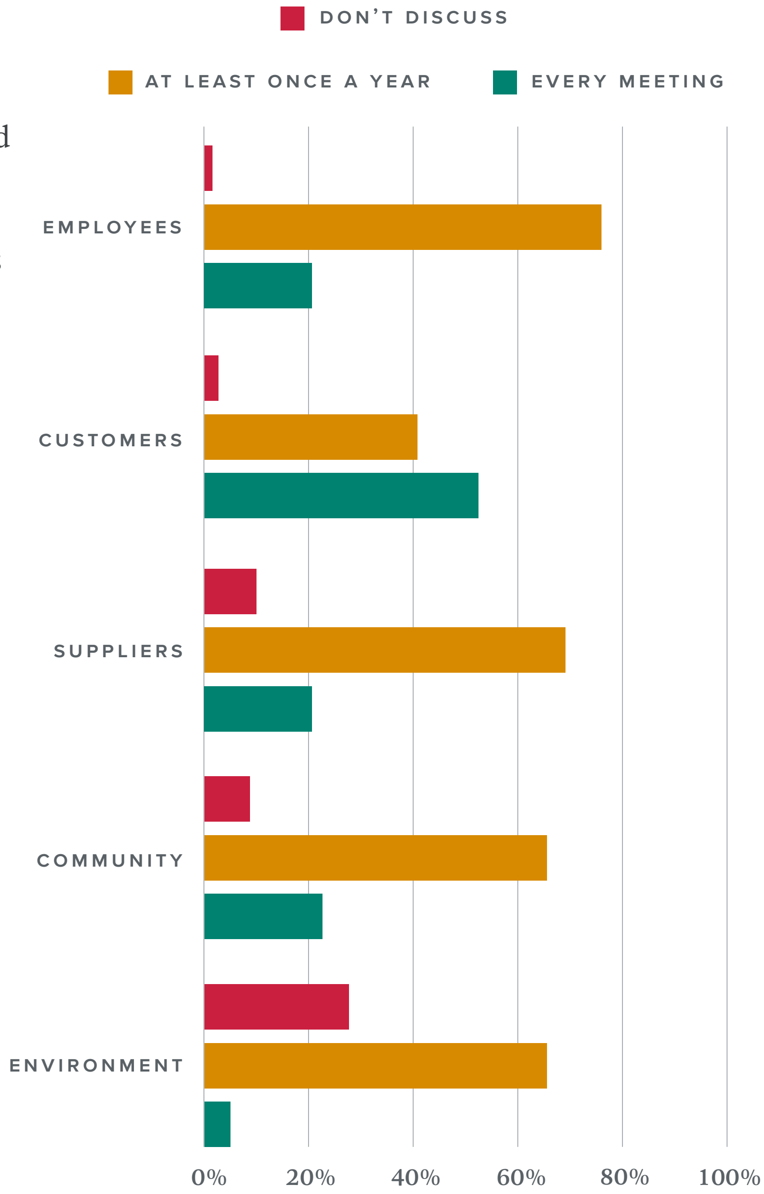
Boards don't care frequently enough

"What gets measured gets managed"

Boards are time-poor and few have made it standard practice to hold discussions around their stakeholder metrics every time they meet. With the exception of customer-focused KPIs, which just over half of boards cover at each meeting (55%), every other stakeholder-specific metric is primarily discussed on a yearly basis — or, in some cases, not at all.

- Despite being widely considered a key stakeholder group alongside customers, employee-focused metrics are only discussed at every meeting by 20% of boards — no more than supplier and community-specific metrics.
- Supplier and community KPIs are reviewed at a near-identical frequency, suggesting boards rank these two stakeholder groups a similar level of importance.
- A worrying 27% don't track their environmental metrics even once a year — the most ignored stakeholder by far.

How often do boards discuss stakeholder-specific metrics?



Given how quickly sentiment changes to cause the demise of organisations, an annual review of how stakeholder groups are feeling is simply not sufficient.

“2021 is about cash and survival but longer term, our stakeholders will expect us to be a more responsible business.”

~ *Chair, UK Family Business*

What Steps Can Boards Take to Accelerate the Pace of Change?

Our focus is not on the mindset required to become a good custodian (we believe most boards have this already), but on the toolset and the processes that will enable this mindset to become a reality.

In the following sections we've identified four ways in which boards can move forward. At the heart of all of these is the principle that it is unrealistic for boards to simply add more to the agenda. The opportunity is to embed stakeholders into everything you already do.

The opportunity is not only how to get stakeholders *on* the agenda – it's about how to get them *in* the agenda.

Put Stakeholders on the Agenda – and Keep Them There

"Stakeholders are an integrated part of how we plan – what's changed is how we communicate to these groups. We're now proactive, making sure we share what's happening, and how it will affect them (or not) so they feel reassured."

~Chair, Global Derivatives Trading House

The three most important decisions any board makes is what to put on the agenda, how often to discuss it, and for how long. After all, you can't govern what you don't see.

Our research indicates that, even with key stakeholders, a worrying number of boards leave potentially dangerous blind spots in their thinking and decision-making by looking at stakeholders and stakeholder-related metrics infrequently, if at all.

That's not to say stakeholders aren't implicitly a regular part of key conversations, but the job of those that plan and manage the agenda is to ensure that all stakeholders are present – and that *evidence of their presence on the agenda is available.*

But if today's board agenda is already overwhelmed, and pressure is going nowhere but up, then what's the solution?

To explore practical ways to make room for stakeholders on your agenda *access our Tips on balancing stakeholder groups on the board agenda.*

"We need to move from 'do no wrong' to 'do good'."

~ Chair, UK Social Enterprise

Reflect All Stakeholders in Decision-Making

"External drivers come first when we do strategic planning, then we look at how it impacts our 6 stakeholders – are we missing any co-dependencies? Has everyone that's going to be impacted been reflected in our thinking?"

~Chair, Global Derivatives Trading House

Decision-making sits at the heart of any discussion on stakeholder governance. That isn't necessarily a simple narrative of trade-offs, although these are natural consequences of more stakeholder governance – it's more fundamentally, about stakeholder awareness. In other words, do boards have the information to understand the impacts of a particular decision in relation to all their stakeholders? Often the answer is no.

Even more importantly, Stakeholder governance and Section 172 of the Companies Act* requires the board to be confident that decisions taken in all layers of the organisation were mindful of stakeholders.

After all, for every decision a board takes in a meeting, a thousand decisions are made elsewhere in the organisation at the same time.

For practical advice on how to balance your stakeholders in decision-making *read our Tips on How to embed stakeholders into your board's decision-making.*

"Responsibility sits with the board, but the bulk of decision-making at the coalface is within management – there's a disconnect."

~ Chair, UK Pension Fund

**Section 172 of the Companies Act requires directors to act to promote the success of their company for the benefit of its members as a whole. All large organisations are required to provide a Section 172 statement as part of their strategic report.*

Create Stakeholder Reporting That Guides the Future

“Often stakeholders aren’t worried about talking to you when all is well, so the engagement tends to happen when things go wrong. It’s important the board invests in engagement throughout the cycle.”

~Chair, UK Pension Fund

Board members base their decisions on the data given to them and as we’ve seen in our research, data can be worryingly absent.

When boards rely on limited and backward-looking stakeholder metrics, they are in danger of missing an opportunity to predict future success — and mitigate future risks. When they review those metrics too infrequently, they could be missing key warning signals about coming problems.

Tackling this issue means looking at board dashboards (are they as balanced as you believed?), sourcing external data that look at performance from the outside in, and reviewing how data is presented to the board.

To find out how to find the most telling stakeholder metrics and reflect them in board reporting *read our Tips to ensure you’re measuring the stakeholder metrics that matter.*

“The current corporate contract is not fit for purpose, we need to look beyond profit. Stakeholders are fundamental to an alternative way.”

~ Non-Executive Director & Chair, Investment Banking

Embrace the Spirit of Regulation

"Section 172 is a great piece of British competitive advantage. Those who choose to only tick the box will suffer. We don't need regulators to impose it, market conditions are such that those that live and breathe the spirit will thrive."

~ Non-Exec Director & Chair, UK

In the UK, much of the discussion around stakeholders and stakeholder governance is dominated by the statutory duty imposed upon boards by Section 172 of the Companies Act.

However, it was clear from our interviews that views on Section 172 are diverse, to say the least. They range from those that see it as something to be grasped for competitive advantage to those that see it as an irrelevance or a failure.

Regardless of where you come from in this discussion, Section 172 should be seen as the leverage company secretaries and chairs have to become the driver for effective stakeholder governance. Grabbing this opportunity opens up the board to greater transparency and can be one of the most important levers boards have to drive stakeholder perception.

For actionable advice on how to use external reporting as an opportunity to drive better stakeholder governance *read our Tips to support Section 172 reporting, the annual report and open Boards.*

"Those for whom Section 172 doesn't apply are doing some of the most profound and interesting things with stakeholders – it's rooted in their philosophy and values, not legislation."

~ Chair, NHS Trust

Conclusion

We started this report by claiming that too many discussions on stakeholder governance are dominated by the false binary between those who believe "the business of business is business" and those who believe business has a responsibility to be a force for good.

We believe the vast majority of directors set out to do a good job for everybody, not just themselves or their shareholders, and our mission has always been to ensure they are equipped with information to do exactly that.

Failure to embrace stakeholder governance could be the most significant risk factor, outside of liquidity, facing most businesses over the next ten years. After all, stakeholder governance is just governance, through another prism. At a minimum, effective stakeholder governance is best compared to the installation of a smoke detector. You don't need to be a passionate Fire Marshall to wish to avert the consequences of a conflagration.

Good stakeholder governance is as much about pre-emptive management of risk, revenue, and reputation as it is about building a better world.

For more information or to request a demo, contact us on:

+44(0) 20 7192 8200

BOARDINTELLIGENCE.COM
info@boardintelligence.com

BOARD INTELLIGENCE
THE DISCIPLINE OF FOCUS