KPMG

Breakfast with Alison Kay & Victoria Whyte

Thursday 4 July 2019

KPMG Board Leadership Centre

Alison Kay, Group General Counsel and Company Secretary at National Grid, and Victoria Whyte, Company Secretary at GSK, joined our FTSE350 breakfast to share their thoughts on one of the key board questions of the day – "who are the board accountable to?" As Vice-Chair and Executive member of the GC100 group respectively, Alison and Victoria drew on the 2018 GC100 Group report (Guidance on Directors' Duties: Section 172 and Stakeholder Considerations) as they explored directors' responsibilities and section 172 of the Companies Act 2006.

As in the past, directors continue to be duty bound to "promote the success of the company", typically considered to be long term value creation – but in these times of disruption, both economic and political, can long term success only be considered an accumulation of short term events?

And if so, as the architects of these events, directors must be prepared to be firmly, and harshly judged with 20/20 hindsight, by an increasingly informed population of stakeholders; from activist investors to regulators.

Proportionate action

While s172 references the importance of having regard to various stakeholders, the responsibility of the directors is not to attempt to balance stakeholder interests with those of the company, but rather to consider them in the context of how they impact the company over the long-term.

> *Your ultimate arbiter is the rulebook – you don't need to consider every stakeholder – but act in good faith based on your own experience."*

Section 172 is not new (it dates back to 2006), nor does it create any obligation to the stakeholders (other than the company's members), but it does require directors to have regard to a potentially broad group of stakeholders when making board decisions.

Identifying and balancing stakeholders

When identifying stakeholders, directors need to be thoughtful and think beyond the immediate employees and suppliers. Beyond even the local community, as global topics, such as climate change, rise ever faster to the top of the agenda in so many arenas.

> *Our shareholders are telling us "if a director can't tell me about the ESG issues then that's a big cross for that director, and hence for that company".*

Directors need to consider how any decision impacts all stakeholders – not just a subset – and then weigh up all factors in order to reach a conclusion.

For many decisions, culture can serve as a backstop. When we ask ourselves 'what is the *right* thing to do' we rarely go far wrong.

Documenting the journey

Minutes are crucial to support the decision making journey: acting as a challenge to ensure a robust process; and as evidence at times of retrospective challenge.

Balancing the need for a digestible summary of decisions taken with the merits of a complete record of boardroom debate can be a challenge, so company secretaries and directors need to ensure that board minutes reflect the decision making journey, whilst remaining precise and relevant.

Ensuring the right process

A robust board ensures the requirements of s172 remain front and centre when exercising their duties:

- Do we have the right strategy – are we lining up to promote the success of the company?
- Do we have a robust induction process for new directors – are they familiar with s172 from the start?

- Do we have the right policies and processes – are the right issues making their way to the board and are inputs being captured?
- Are we engaging with the business – does the board understand what the stakeholders want?

> *If the culture is right, we can have confidence that what is being delegated down is being done well."*

Temperature checking the culture

If boards want to rely on the culture of the company then they need to really understand it, but getting that close to the business can be a challenge for non-executive directors.

Most boards will already have some awareness of the annual employee survey, but directors are encouraged to enrich their view through personal workforce interactions. These could be site tours, meetings, breakfasts, etc. and could be open door or for a predetermined group,

> *One non-executive director would sit in the cafeteria for the morning so anyone could come along and have a coffee with him."*

Whatever the arena, directors should ensure that they are approachable across all levels of the business.

Directors should also be looking externally to better understand the culture within the company. For example, it would be remiss to ignore the views expressed on social media.

Reporting on directors' responsibilities

The UK Corporate Governance Code has changed and management and the board now need to describe what they are doing in relation to s172 on an annual basis.

To really engage with stakeholders, boards should avoid the boiler-plate reporting option and take the opportunity to communicate thoughtfully. Balancing the board's desire to do the right thing, to be transparent, while remaining faithful to the company's legal team can be a struggle.

Directors are counselled to be brave and robust in their commentary, condensing their thoughts and actions into something digestible.

> *You could track one issue through it's board journey: documenting how it was reported and debated; the considerations around impact on the company, employees, the environment; etc."*

Talking through in detail, the considerations made and how the impact on different stakeholders is assessed, is powerful. There's no need to talk about monetary values but the facts should be explicit. It is absolutely clear that investors will be very interested to read s172 statements and there's a real opportunity to engage with them.

Managing how others report you

A significant challenge for boards looking to measure the temperature of the company is filtering the data available to ensure the right weight is given to opinions.

And they are not the only ones. Investors are always looking to differentiate between investment opportunities and are increasingly looking to rating agencies and published indices for information and assistance.

> *Demonstrating to investors that we are taking ESG indices seriously supports that we take our actions seriously."*

Directors need to remain alert to the risks of ignoring unfriendly information, and combat it with clear messaging on policy and current issues. Particular focus should be paid to the indices most linked with the company strategy.

The advice to company secretaries is to not quote section references at directors but focus on the substance.

While directors' responsibilities, as encapsulated in the Companies Act, are unchanged, the release of the GC100 Guidance on s172 does shine some light on both the expectations placed upon directors and some of the practical steps to be taken in discharging those duties.

Directors remain answerable only to the company: required to act, in good faith, in a way that they believe would be most likely to promote the success of the company for the benefit of it's shareholders as a whole. While directors may not be answerable to individual stakeholders, these groups will be the ones to bring action if mistakes are made.

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