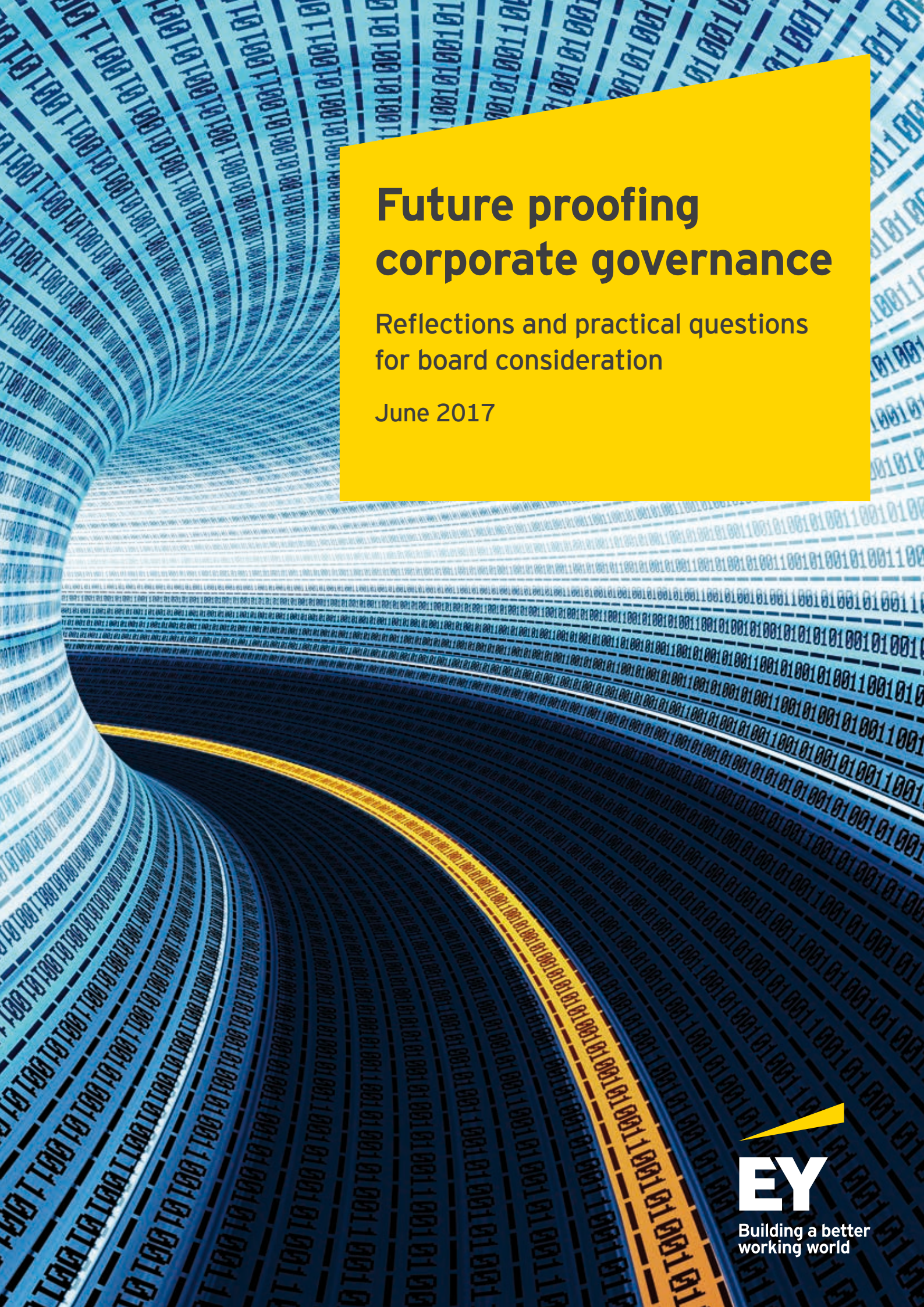

Future proofing corporate governance

Reflections and practical questions for board consideration

June 2017

EY
Building a better working world

Executive summary

This paper is based on a series of roundtables we held with FTSE 350 company secretaries between February and March 2017. We discussed first hand with them whether and how their boards are responding to the accelerated pace of change in the world and business environment, driven by technology, globalisation and public opinion. Our discussions spanned four themes:

1. Impact of disruption on business models
2. Challenging traditional governance processes and structures
3. Licence to operate amidst growing inequality
4. Accountability in the shareholding chain

We gained fresh perspectives and ideas from the roundtables which boards can use to start exploring whether their governance processes and structures ought to evolve to respond to these new challenges.

Getting practical: questions for boards to consider

To help provoke debate and discussion in board rooms on the four themes, we have posed key questions for boards to consider. These are captured on the next page as a useful aid to facilitate discussions with your own board.

The remainder of the report captures the key discussion points from our roundtables, and a number of case studies showcasing examples either used by attendees or that we have become aware of from our wider work.

1. Impact of disruption on business models

- As part of their risk assessment process, has the board explicitly considered the threats to the company's business model from disruption?
- Is the board proactively encouraging a culture of innovation?

2. Challenging traditional governance processes and structures

- Has the board assessed actual time being spent by Non-Executive Directors (NEDs) and whether it is sustainable for individual NEDs? If time commitment is increasing, how is that balanced with NED remuneration and independence?
- Are existing board and committee structures appropriate to facilitate challenge, debate and new thinking in light of the rapid pace of change?
- How frequently does the board challenge and reconsider strategy and the agility of the business model to deliver the strategy? Should this be done more frequently?
- Does the board have the right skills to identify threats and opportunities from disruption, and if not, where is this expertise being sought? If the board needs new skills, what is the plan for acquiring them?
- What criteria are used by the board to identify potential NEDs? Do the criteria foster diversity in experience and knowledge at board level? How is the board satisfied that they will not rule out individuals who have the necessary skills but may, for example, be lacking board or UK PLC experience?
- Does board succession planning need to evolve in order to adapt to new challenges quickly? For example, enabling NEDs to be brought on board in a shorter time or setting shorter periods of tenure for some board members to keep skills fresh?
- How is the company attracting talent and retaining knowledge in a world where the workforce is more transient/mobile?
- With the proliferation of data, how has the board reviewed and challenged the information provided to it by management on key matters? Has the board proactively driven the information and data it receives (rather than being a passive recipient) to aid decision-making?
- Has the board tapped into the 'richness' of data to help them to identify risks and opportunities facing the company more effectively? If so how? What more can be done?

3. Licence to operate amidst growing inequality

- Has the board debated the root causes from the recent populist backlash caused primarily by social dis-enfranchisement and its impact (if any) on how the company operates?
- Has the board recently discussed whether and how it is meeting the s172 duty[1] adequately and what more can be done at a board level to discharge this duty?
- Has the company clearly communicated its stakeholder engagement activities, the feedback heard and the actions taken/promised as a result of the activities in a fair and balanced manner? What could the company do differently?
- Has the board assessed the effectiveness of the external communication methods being used to engage with wider stakeholders? Should the board consider using different channels (e.g., social media, live reporting, informal site visits) to improve engagement?
- What is the role of business in educating the public and improving their understanding of what business does and how it benefits society?

4. Accountability in the shareholding chain

- How can AGMs be structured in a way to get the most effective input from shareholders? Or should AGMs be removed entirely?
- Is the board utilising technology to encourage more real-time engagement with shareholders?
- How can the board engage with investors to prevent their over-reliance on proxy agencies and to encourage greater participation in voting?

[1] Further detail is provided in section 3 of this paper

Introduction

The world and business environment are changing rapidly due to a range of connected developments. The exponential growth we are witnessing in new technologies involving big data and artificial intelligence has been dubbed as the Fourth Industrial Revolution by The World Economic Forum. At the same time, over the last few years, reputational issues impacting UK businesses, globalisation, the vote to leave the European Union and the US election results have been tied to a sentiment of social inequality and dis-enfranchisement. There are parts of society that feel left out and public debate is increasingly asking for businesses to rebuild trust and renew their social licence to operate.

Last year, Prime Minister Theresa May, in the wake of the Brexit vote, pledged to make changes to the corporate governance regime to ensure that business works for everyone, and not just the select few. The Government issued a Green Paper on Corporate Governance Reform[2] to gather wide-ranging feedback from stakeholders on options to strengthen big business through better corporate governance. The Business, Energy and Industrial Strategy (BEIS) House of Commons Select Committee also conducted, in parallel, its own inquiry on the subject and published their report and recommendations in April 2017. In addition, the Financial Reporting Council (FRC) has announced that it will undertake a 'fundamental review' of the UK Corporate Governance Code over the course of 2017. Having heard the new Government's legislative agenda as set out in Queen's Speech on 22 June 2017, it is unlikely, given the outcome of the recent General Election, that any legislative changes will be made to implement suggested proposals in the Green Paper or the Select Committee's Report. However the FRC may implement some proposals via revisions to the Code and underlying guidance. Outcomes and timings are currently uncertain, but there may be some activity from the FRC late in the autumn.

However, many of the reforms consulted on by the Government and the BEIS House of Commons Select Committee are not new ideas. They have been proposed previously and address issues that are perceived to have led to historical corporate failures and waning trust in business, rather than looking holistically at the system, examining how it can be improved and how it needs to evolve for the future.

Many of the issues facing boards in the years to come, such as technological shifts, disruption risks, social and economic movements, were not included in the government consultation.

We sought to find out how boards are thinking about these challenges and dynamics through a series of roundtables with company secretaries from FTSE 350 companies, over the course of February and March 2017. In particular we wanted to understand how boards are, or should be, responding proactively to harness these developments as opportunities and what they mean for the practice and regulation of governance in the years to come.

We thank all of those who gave us their time and insights.

The key issues discussed as part of the roundtables are shown in the figure alongside.

[2] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/584013/corporate-governance-reform-green-paper.pdf

What we heard from roundtable participants

The majority of attendees said their companies – and boards – were alive to the shifts occurring, with some taking active steps to understand, skill up and get ahead. Others were yet to completely grasp the pace of change or consider the potential impacts on their business, business model and governance over the longer term. We have summarised key points from our discussions under four key themes:

1. Impact of disruption on business models
2. Challenging traditional governance processes and structures
3. Licence to operate amidst growing inequality
4. Accountability in the shareholding chain

1. Impact of disruption on business models

Key issues we explored

- Digital disruption is affecting the world of work and society as a whole – it poses both opportunities and challenges to business. For example at EY, we think about the rise of analytics and artificial intelligence and what it means for the profession in the not too distant future. Our leadership has been open that this may significantly impact how we do business and make money.
- For companies, what are the technological (and societal) changes that will impact business models? Do boards themselves need to be disrupted?

What we heard

- Whilst disruption is most commonly associated with technological change, we heard that it was important that boards think more broadly about the potential sources of disruption, for example:
  - Regulation (or the lack of it) is also a primary driver of disruption. A good example provided in the course of our discussions was from the telecommunications sector – coined as the 'JIO effect'. Reliance JIO stormed the Indian mobile market and amassed 100mn mobile subscribers in the space of months by offering its early users free voice calls and other free services for several months. There was no regulatory intervention to stop this – and in fact it forced other telecommunication companies in an already hyper-competitive market to slash their own prices to keep up.
  - Behavioural change, for example the saving patterns of millennials. An asset management company told us during the roundtable that they had to develop a different business model to suit the needs of this new group of customers.
- Through our roundtables, we found that the business to consumer (B2C) sector was seen to be more immediately impacted by disruptive forces than business to business (B2B), and hence the boards of companies operating in B2C have generally debated (to varying extents) the impact of disruption and many have indeed experienced disruption to their business models. There is also a broader recognition by companies in the B2C sector that 'every industry may become their industry'.
  - A roundtable participant from a B2C company shared that the robust board discussions in preparation of making their first viability statement in their 2015 Annual Report and Accounts (ARA) had prompted further reflection on how much their business model is subject to disruption.
  - The lack of consideration by B2B companies could quite easily leave them a step behind their competitors or even a new entrant.
- In line with the theme of 'every industry may become your industry' a participant shared how their board was thinking about a post-fossil fuel economy and what it means for their businesses. In fact they were disrupting themselves from within to remain ahead of the curve. In particular, with the concept of distributed energy, energy companies are fast turning into technology companies.

Case study: Centrica plc

(For further details, see Centrica plc's 2016 Annual Report and Accounts: Strategic Report)

- Following its strategic review in 2015, Centrica has re-oriented its relationship with business customers and other large-scale energy users, giving them the power to operate and optimise their energy.
- This is achieved by bringing together flexible and local renewable generation, storage and energy efficiency measures alongside smart building management systems.
- Centrica will also start a pioneering trial in Cornwall, which will see the installation of new technology which participants will use to connect to a 'virtual marketplace'. Through this they will sell their flexible energy capacity to both the electricity grid and the wholesale energy market.

- Some forward-thinking companies are investing in initiatives such as start-ups, innovation labs, digital hubs or acting as incubators to explore how different emerging technologies and innovative ideas can be used to disrupt their business models.

Case study: Aviva plc

(For further details, see Aviva plc's 2016 Annual Report and Accounts: Strategic Report section)

- Aviva wants to be a 320-year old disruptor. Their aim is to deliver outstanding customer service in a simpler and more cost-effective way – through digital channels.
- They have created dedicated digital spaces (known as 'Digital Garages'), which act as catalysts for digital innovation, where creative minds from across Aviva and the industry collaborate to turn innovative ideas into real products and services for the customers.
- They have also established Aviva Ventures, which operates as a corporate venture capital fund. It looks for cutting edge tech start-ups that can help shape the future of insurance and invests in them.
- They have partnered with businesses like Cocoon (which uses smart technology to deliver next generation home security, and also announced partnerships), Opun (a home improvement's service), AppyParking (a free app and website that allows you to see when and where you can park based on information it has collated on off and on street parking in London and 11 of the UK's biggest cities) and Founders Factory (a company that helps launch tech startups).

- There are companies who invite entrepreneurs who are looking for funding to pitch their business ideas to them (similar to Dragons' Den).
- We also heard that some companies carry out 'innovation sprint' days, which involve senior management sponsors and selected employees from different divisions and levels being in the same room brainstorming different ideas together. It encourages employees to come up with innovative solutions which work for the business as they are closer to the day-to-day operations.
- Nonetheless, companies in regulated sectors which have invested in start-up companies or digital hubs, expressed that there were challenges around striking a balance between autonomy for the start-ups to innovate and experiment versus some central control over their operations to ensure that they meet regulatory requirements.

Questions for boards to consider:

- As part of their risk assessment process, has the board explicitly considered the threats to the company's business model arising from disruption?
- How is the board proactively encouraging a culture of innovation?

2. Challenging traditional governance processes and structures

Key issues we explored

- In light of the fast paced and changing environment in which companies are operating in, do the current governance structures and processes remain appropriate? How should these changes impact the role and structure of boards? This is not a new topic[3], yet it took up a fair amount of air time during our roundtables.
- Do existing NEDs have the right skills to carry out their roles effectively?
- On average, other than at very large PLCs, NEDs work around three to four days a month. However, given the growing scale and complexity of business as well as accelerating pace of change, is this adequate? Should they be more involved in the business in future?
- With access to more data than ever there are risks in terms of data security but also opportunities as boards can better understand buying patterns, risks and behaviours. How is big data being used by boards to support decision-making?

What we heard

Role of a NED

- The role of the NED as a 'guardian of governance' needs to be strengthened. It is difficult for executives to take NEDs seriously when they are primarily 'outsiders' to the business and the role could be extended.
- More liaison between executive committees and the board would be helpful. NEDs being more immersed in the business on a regular basis would mean they were not parachuted in at the last minute and could have a more meaningful impact.
- However, this raises questions of what constitutes a suitable time commitment for NEDs and how any increased time in the business should be balanced with their independence and remuneration.

Governance processes and structures

- Despite the rapid speed of change in the business environment, some boards have not adequately considered how governance processes and structures should evolve to respond to the opportunities and threats from these changes.
- With the increasing pace of change, boards should ask themselves whether their deliberations on strategy:
  - Are frequent enough – more often than not, many boards tend to have an annual or bi-annual strategy day.
  - Involve the right people, with the right skills to provoke the right discussions – is there enough of a 'rogue element' to provoke different and new thinking on strategy?
- Boards and senior executives may not have the appropriate skills and knowledge of certain emerging topics to provide challenge and pose the right questions – particularly in new areas such as blockchain, robotic process automation, augmented reality etc., – and consider their impact on company strategy and operations. We heard that some companies invite external subject-matter experts to their strategy events to provide a different dimension to the discussions or as part of the normal board calendar to provide briefings to the board on emerging trends, which then serve as an input into ensuing strategy discussions.
- In order to access skills in new and evolving subjects, there is also an emerging trend for companies to form advisory boards which consist of external representatives with specific subject matter expertise. The individuals usually do not sit on the main board or the executive committees. For example, some large financial institutions have recently set up advisory boards.

Case study: HSBC plc, Technology Advisory Board

(For further details, see HSBC Group plc's 2016 Annual Report and Accounts and HSBC website, http://www.hsbc.com/news-and-insight/insight-archive/2017/hsbc-appoints-technology-advisory-board)

- In January 2017, HSBC announced the appointment of a newly formed 'Technology Advisory Board' chaired by the Group's Chief Operating Officer.
- It consists of a panel of experts to help the bank to take advantage of innovations in technology. The board comprises CEOs, scientists and entrepreneurs from China, India, Israel and the US.
- It will provide advice and guidance on HSBC's technology and digital strategy, helping the bank to capitalise on opportunities in areas such as artificial intelligence, biometrics, blockchain technology and data science.
- In particular it will focus on new trends in financial technology, cybersecurity and IT infrastructure.

[3] EY looked at board composition and the role of NEDs, in two recent reports *The nomination committee – coming out of the shadows* (May 2016) and *Board effectiveness – continuing the journey* (April 2015)

Board information

- Whilst boards may have considered big data from a business standpoint, its impact within the board room on board information has not been fully explored. Boards should reflect on whether the quality of board information (e.g., presented in board packs) has evolved over the last two to three years to take advantage of the insights that big data can now offer and to aid discussion and board decision-making.
  - For instance, management could present holistically to a board the output from data analysis on various metrics e.g., employee attrition rates, number of whistleblowing/ hotline calls, customer satisfaction scores, internal audit findings, health, safety and environment incidents etc., segmented by geography or division to help the board form a picture of potential underlying cultural issues.
  - Such data points usually exist in organisations at a functional level, but are rarely brought together in a composite manner.
  - Caution has to be exercised, however, to ensure boards are not bombarded with a plethora of data points that do not aid decision-making.
- Additionally, participants discussed and questioned whether technologies which can facilitate/help with monitoring and oversight are being used effectively at board level.
- One participant mentioned that to enhance board members' understanding of technological terms or product offerings (e.g., public cloud vs. private cloud) used in their board packs, there was an interactive link in the packs to a short three minute video featuring someone in the business explaining the term and its relevance.
- Some boards have also visited Silicon Valley to meet innovators and thought leaders, and experience new technologies first-hand. The learnings from those visits were fed directly into the business strategy discussion.

Skills and experience of NEDs, and accessing board room talent

- Accessing different expertise is more important than ever. The speed of transformation may leave companies with a huge skill gap to fill at the board level. We also heard that many talented individuals with sought-after skill sets are more attracted to working in less regulated areas (e.g., private equity), which poses a further challenge on accessing the right talent.
- One participant shared that they have recently on-boarded a new NED with no prior PLC board room experience but extensive digital experience. Whilst there was a fairly steep learning curve for this individual in terms of how a board operates and the role of a NED, the questions posed by this new member on the digital and technology front have provided an entirely different dimension to the board room debate.
  - Although some may challenge the lack of prior boardroom or UK PLC experience, there needs to be a shift in this mindset. The value of experience may be overstated and with the right induction, training and ongoing mentoring candidates can become effective boardroom contributors.
- There was also a discussion about enhancing the skills and knowledge of existing senior leaders.

Case study: Vodafone plc

- An attendee from Vodafone plc mentioned a reverse mentoring initiative whereby millennial 'digital ninjas' have been paired with individuals from the senior leadership team to help the latter upskill on technology matters, for example, with social media.

Board succession planning

- The environment companies are operating in is changing very quickly but the board succession process has not changed much at all. It takes roughly a year to appoint a NED and they tend to stay on the board for four to five years on average. Does this need to change?

Boards overseeing executive talent

- There is general recognition that workforces have become more transient/mobile and that the traditional workforce model has changed – i.e., over the last few years, companies are more reliant on contractors, outside specialists, part timers (who may have multiple jobs) etc. We posed a question as to whether boards have thought about how this might impact their ability to access the right talent, and nurture, develop and retain it. Whilst the challenge was accepted, some said many companies have historically been using the service of external consultants, and this could therefore be viewed in a similar vein.
  - However it was acknowledged that what has become more vital is the need to ensure that there was a proper knowledge transfer/retention process as individuals are now more likely to work flexibly across different platforms and companies.
- Attendees discussed the rise of alliances/partnerships with other companies (even in the same industry) on selected projects to access and share talent. Nonetheless, companies need to be mindful of the challenges with this, for instance minimising risk of data leakage and maintaining the same culture across the alliances/partnerships. Failure to deliver on both aspects could lead to reputational damage.
- There are a lot of work place initiatives focussing on the millennial generation which we heard places a different value on work – some termed this generation as being less loyal/committed. Some participants raised that this focus needed to be balanced appropriately to ensure that there isn't a 'forgotten middle' whose talent isn't being tapped into. With the right experience and targeted activities (e.g., job rotations, training etc.), there was great potential to upskill rather than have a layer of employees which felt overlooked.

Questions for boards to consider:

- Has the board assessed actual time being spent by Non-Executive Directors (NEDs) and whether it is sustainable for individual NEDs? If time commitment is increasing, how is that balanced with NED remuneration and independence?
- Are existing board and committee structures appropriate to facilitate challenge, debate and new thinking in light of the rapid pace of change?
- How frequently does the board challenge and reconsider strategy and the agility of the business model to deliver the strategy? Should this be done more frequently?
- Does the board have the right skills to identify threats and opportunities from disruption, and if not where is this expertise being sought? If the board needs new skills, what is the plan for acquiring them?
- What criteria are used by the board to identify potential NEDs? Do the criteria foster diversity in experience and knowledge at board level? How is the board satisfied that they will not rule out individuals who have the necessary skills but may, for example, be lacking board or UK PLC experience?
- Does board succession planning need to evolve in order to adapt to new challenges quickly? For example, enabling NEDs to be brought on board in a shorter time or setting shorter periods of tenure for some board members to keep skills fresh?
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- With the proliferation of data, how has the board reviewed and challenged the information provided to it by management on key matters? Has the board proactively driven the information and data it receives (rather than being a passive recipient) to aid decision-making?
- Has the board tapped into the 'richness' of data to help them to identify risks and opportunities facing the company more effectively? If so how? What more can be done?

3. Licence to operate amidst growing inequality

Key issues we explored

- Current political rhetoric suggests that the status quo does not work for society as a whole. Many analysts have concluded that the results of the EU referendum and the US election were partly influenced by a sentiment amongst many voters of feeling left behind by globalisation, whilst a select elite reap the majority of the benefits.
- There is a perception amongst much of the public that they should be sharing the benefits of growth more fairly; they perceive companies are too focussed on generating returns for shareholders, and minimal returns are 'invested' in employees' pay packets. We asked participants whether business feels it has a collective responsibility with governments to help achieve better income equality and whether it has been successful at that.
- Proposals in the Green Paper of strengthening the employee, customer and wider stakeholder voice, and shareholder influence on executive pay are designed to respond to these issues – however many the proposals have been explored previously.
- The Government seems to be seeking to use corporate governance as a public policy tool to address broader societal issues – can this work or are different measures needed?
- Are boards thinking differently to address these challenges? Is there more that business can do to demonstrate the greater good they deliver for the community and economy as a whole?
- If business must work for everyone, does more need to be done to help with a better understanding of how business works?

What we heard

Board engagement with wider stakeholders

- Roundtable participants told us that many boards are aware of the changing socio-political landscape and they recognise the importance of listening to wider stakeholders. Nonetheless many boards have not yet considered deeply enough the root causes behind recent political events and debate in the boardroom has predominantly used an 'event lens'. Boards have examined the impact of Brexit on the company, or the US election on the operating model rather than thinking about underlying socio-political trends that led to these outcomes and what the impact is more generally for their companies and boards.
- Following some corporate scandals over the last two years, recent political rhetoric has alluded to wider stakeholder voices not being heard in the board room. In fact the Government took to examining this issue in its Green Paper. It proposed several ideas, including strengthening reporting requirements related to stakeholder engagement, creating stakeholder advisory panels and appointing individual stakeholder representatives to company boards.
- However, there was a consistent message during our discussions that, in general, companies do put in a lot of effort to engage with their wider stakeholders. Many boards are indeed using different methods and channels to engage with various stakeholders:
  - Employees: as well as the common use of employee surveys, we heard that boards are increasingly in direct contact with the employee population e.g., through site visits which are not pre-orchestrated in a 'red-carpet' manner. Feedback from such visits is generally very positive from both the boards and the employees that they met; boards get to hear from and observe employees at the 'coal face', whilst employees feel that senior management and the board are open and they feel more connected.
  - Customers: we heard that boards are keen to meet with customers and understand their views through net promoter scores, customer panels, and site visits. One roundtable attendee also shared that the brand directors invited vocal customers in for lunch to meet them. Such initiatives can help the board see a problem coming down the line.
  - Stakeholder advisory panels: some companies have set up stakeholder advisory panels to ensure stakeholders' interests and views are considered in the decision-making process. The members on the panel are usually independent from the main board.
- The real challenges are:
  - How the information on various engagement initiatives is filtered up to the board, considered holistically by the board and the link drawn to their duties under s172[4] of the Companies Act 2006.
  - How information on such initiatives is communicated holistically to the outside world using the appropriate media without being seen as a cynical public relations exercise.

[4] 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.
f. The need to act fairly as between members of the company.

- Even for those companies that provide information on their stakeholder engagement activities, there was broad consensus that they could do much better at communicating them holistically. Participants voluntarily cited Marks & Spencer plc's 'Plan A' as a good example of how it had effectively consolidated all its social and environmental activities with clear integration to its strategy.
- We heard about potential practical issues with the proposed solution of appointing individual stakeholder representatives to company boards. There are concerns that they may not be able, or wish, to fulfil their wider duties as directors as opposed to solely representing their stakeholder group. Instead, boards can gain access to the various stakeholders via regular forums. This method of interaction encourages live debates and open discussions, and boards are able to listen to feedback directly from the stakeholders.

Media and publicity

- Compared to a few years ago, businesses are increasingly challenged/criticised on social media — as individuals have the ability to very easily disseminate their views and build public campaigns. These individuals may be unlikely to read the documents put out by the companies to understand the broader contribution a company is making.
- Many roundtable participants said that the media has contributed to the lack of trust in business as perceived unethical behaviour by certain companies makes better headlines than positive behaviour.
- For these reasons, it is critical for businesses to engage with wider stakeholders and communicate across multiple channels, such as social media, websites and blogs to ensure that the public is getting the full picture.
- Companies should also consider doing live reporting of initiatives on websites or social media to provide real-time information rather than reporting on past events.
- As well as the point on 'packaging' up holistically all stakeholder outreach activities, we discussed that much of the information currently communicated is event/activity based and companies could do better at relaying the feedback heard, actions taken/to be taken and in future years the outcomes reached as a result of these stakeholder activities in a fair and balanced manner. This would go some way to allaying concerns that stakeholder voices aren't being heard in the board room.

Education

- Attendees discussed that there would be benefit in an improved societal understanding of what big businesses do, how they operate and how they contribute to the economy.
- Some participants felt that business should have a role in educating the public from a relatively young age on how business works, including the inter-dependency between a healthy economy with flourishing businesses, wealth creation and personal savings/pensions. Some banks and other companies — predominantly in the financial sector — have programmes and online resources to help school students and young people gain the skills, knowledge and confidence to make informed financial decisions and also introduce them to the business world. More of this needs to take place.

Questions for boards to consider:

- Has the board debated the root causes from the recent populist backlash caused primarily by social disenfranchisement and its impact (if any) on how the company operates?
- Has the board recently discussed whether and how it is meeting the s172 duty adequately and what more can be done at a board level to discharge this duty?
- Has the company clearly communicated its stakeholder engagement activities, the feedback heard and the actions taken/promised as a result of the activities in a fair and balanced manner? What could the company do differently?
- Has the board assessed the effectiveness of the external communication methods being used to engage with wider stakeholders? Should the board consider using different channels (e.g., social media, live reporting, informal site visits) to improve engagement?
- What is the role of business in educating the public and improving their understanding of what business does and how it benefits society?

4. Accountability in the shareholding chain

Key issues we explored

- Our system of corporate governance relies on the feedback loop from investors, but we continually hear about the challenges companies face getting this engagement, partly due to resource constrained investors. On the other hand, some investors tell us that companies do not proactively reach out to them.
- Where engagement does occur, remuneration has dominated interactions in recent years, leaving little time for discussion on other governance issues. Whilst investors and companies both tell us that they do not want this situation to continue, unfortunately with the continued concerns expressed in the media and by stakeholders, the focus will remain.
- Does the current system of investors policing corporate governance work? Is there an alternative?
- Are companies doing anything differently to get better engagement from investors?

What we heard

- Companies and their boards want shareholders to broaden the discussion to cover matters other than remuneration, and also for this discussion to be more focused on the long-term. Other than very few investors, short-termism remains a problem, and this needs to be changed. Investors need to be more committed to companies and businesses.
- The purpose of the Annual General Meeting (AGM) was heavily questioned in our discussions. The standing items on the agenda, for example, approval of the ARA, re-election of directors and appointment of auditors are very procedural and voting on such items could be done wholly electronically before the AGM, leaving the AGM to be a meaningful dialogue between the investors and board.
- More real-time engagement using technology would also be helpful. For example, some companies have developed specific shareholder apps and websites (particularly helpful where there are large retail holdings) to encourage real time consultation, and some engage their shareholders through social media.
- One large asset manager who attended our roundtables also explained that often their mandates specify that they should not vote, because of the administrative cost (to the underlying asset owner) associated with voting. This seemed not to be a well understood issue by the corporates present, and needs to be de-mystified. The power of technology should also be considered to reduce the administrative costs of active engagement e.g., voting.
- A high proportion of shares in UK listed companies are held by overseas investors and they rely on proxy advisors to vote. Many feel that proxy advisors do not sufficiently engage with companies and stick to their voting policies too rigidly.

Questions for boards to consider:

- How can AGMs be structured in a way to get the most effective input from shareholders? Or should AGMs be removed entirely?
- Is the board utilising technology to encourage more real-time engagement with shareholders?
- How can the board engage with investors to prevent their over-reliance on proxy agencies and to encourage greater participation in voting?

Defining a 'smart board'

Given the advent of 'smart' – smart apps, smart appliances, smart devices, smart cities – during the roundtables, we asked attendees what they thought a 'smart board' would look like in light of the rapid changes in the business environment and the other changes captured in our diagram on page 4. Participants offered the following reflections:

- 'Doesn't look in the mirror but looks out'
- 'An ability to react quickly and know when to call upon an expert. It is about knowing where the answers lie'
- 'An ability to take a step back, talk to people in the business and see the big picture'
- 'Agility and open-mindedness'
- '... visionary, forward-looking nature whilst also understanding and managing risks effectively'
- '... diversity in experience, skills and background; having the right people (with varying points of view), at the right time, to stimulate ideas and challenge the norm'
- '... we won't get to it in our generation – we are still talking about women on boards, ethnic representation on boards etc., as discrete initiatives. When and if we get to the point where these are just considered the norm and actually we stop talking about them, we may start getting to the concept of a smart board.'

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EY's Corporate Governance team provides practical insights on:

- Perspectives and trends in governance
- Board composition and effectiveness
- Leading practices in corporate reporting
- Future developments in governance and reporting

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