IR policy brief: Changing market dynamics

Implications for the board of the new Corporate Governance Code

The UK Corporate Governance Code has recently changed to include more about culture and engagement. Here **Fergus Wylie** offers his thoughts on what this will mean for companies.

Much has been written about the changing perspective of value creation for companies. Though still in its early stages, we are entering a new era, where the board and the company will be judged not purely on the creation of financial value. External pressure and expectations from society, the increase in transparency, the ability for stakeholders to raise their voice, and the increase in regulation, are all impacting the way business must operate and communicate.

Fergus Wylie is co-founder and director of SIFA Strategy. fergus.wylie@sifastrategy.com

As well as financial value, companies must now consider areas such as human capital value, consumer value and societal value. When distilled down, businesses that for decades have been managed from an 'inside out' viewpoint must now move to an 'outside in' perspective where the levels of support and perception of internal and external stakeholders will greatly influence corporate strategy, exposure to risk and performance.

The recent changes to the UK Corporate Governance Code have been a tangible example of how this influence is changing. The Code, when combined with the growth in ESG factors within the investment decision-making process, means that every board of every primary listed company and large private company must demonstrate how it is assessing, monitoring and being influenced by its culture and workforce engagement. Many boards are currently considering, as part of the Code requirement, which route they intend to adopt in response to Provision 5 of the Code – appointing a director from the workforce; establishing a formal workforce advisory panel; or designating a non-executive board member. However, this decision is only the first and easiest step.

BOARD IMPLICATIONS

- **Boards must begin to assess and monitor long-term intangible value.**
- **Each company will require a tailored approach, based on business type and sector.**
- **Most boards will have to revisit their agenda, with different insight and reporting.**

Workforce representation

The real implications of the Code are in how each company intends to put workforce representation into its board practice and management processes and this includes how culture impacts the business. It is relatively simple to explain, for example, why the board has chosen the non-executive representation route as being most suitable to their business and strategy. It is something else entirely to be able to explain how the board will continue to monitor and measure culture and workforce engagement and outline the resulting decision-making and how this is changing the business.

The Corporate Governance Code is very clear on its objectives – for the board to understand the views of the company's workforce and other key stakeholders and to describe in the annual report how their interests have been considered in board discussions and decision-making. This is a significant move away from current best practice where the board has reported on the process the company has followed to engage with the workforce and other stakeholders and made reference to the importance of culture to the business.

The new requirements from the Code are going to have to drive a change in board practice and the information necessary for effective management.

Long term value?

The reality is that each company will require a different approach. This will be determined by their type of business, their sector, board processes, current levels of insight, and level of resources within the business to manage the change. It will also be driven by the current culture of the board. Is it the natural position of the board to embrace these changes and see them as an opportunity to create competitive advantage and long-term value? Or, will the board see this as another example of regulatory interference and an unnecessary cost that distracts the management from generating short-term financial return?

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If the former, each board and senior management team must decide what data and insight they will need to empower their decision making. If the latter, then the board can expect increasing pressure and questioning in the future, and a potential change to their share register. We are only at the beginning of seeing how these changes are going to impact companies. The next step will be the conclusion of the consultation period on the proposed revision to the UK Stewardship Code. It is too early to comment on the direct implications of these revisions, however, it is safe to say that the increased focus on creating sustainable value for beneficiaries, the economy and society and the likely emphasis on the importance of ESG issues will feed directly through to corporate boards.

This all means that most boards are going to have to revisit their agenda, data and reporting. Their insight will need to be regular, measurable, concise and linked to different performance criteria of the business and risk exposure. For many companies this will mean moving away from data that is generated in operational silos, static and past its sell by date. Future best practice will embrace new data approaches that enable regular insight to be tailored to each board's requirements, unified across and through the business and across stakeholders. This will then be clearly communicated through a revised corporate narrative and reporting structure. ■