



Connect and reflect

DIALOGUE IN CORPORATE GOVERNANCE
A THOUGHT LEADERSHIP INITIATIVE

*ICAEW is launching
a new series of
papers, challenging
companies to
address the growing
tension in their
relationship with
society by tackling
controversial issues.*

A new approach

Business is vital to the prosperity of any society. However, that does not mean that society will leave it alone to get on with creating wealth. Quite the opposite. Now more than ever business needs to connect with and reflect society. New technology has led to the liberalisation of communications, which are now immediate and uncontrolled. Deference towards establishment institutions, including businesses, has virtually disappeared. As a result, old-style corporate positioning and news management have become dated and ineffective. Companies need to adapt to the democratisation of communications and the power of modern media to influence attitudes.

There is a tendency to think that if a problem is big it belongs to someone else but it would be wrong to expect policy makers or regulators to address current systemic tensions in the relationship between business and society. All they can do is apply legal and regulatory solutions to problems that are either so acute that nothing else will do or so well understood that they are merely consolidating best practice. ICAEW recognises that relationships between companies and different parts of society are shifting and complex, and for this reason we feel strongly that solutions are best generated and sustained by those directly involved rather than being imposed from the outside. That is what Connect and Reflect is about.

A key determinant of the success of Connect and Reflect will be the willingness of companies to address challenging areas and make operational changes to change their behaviour. Companies which fully embrace Connect and Reflect will be in a position to demonstrate a positive corporate culture. Our new series of papers will tackle controversial issues and discuss in practical terms: how companies thrive on social media; how whistleblowing helps companies; how employee directors add value; how to end excessive pay; and how to mark governance out of 10.

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CONNECTING

Many existing approaches to corporate communication stereotype members of the general public as distrusting and cynical, and to some extent it has become a self-fulfilling prophecy. In order to overcome this polarisation, companies should connect by tailoring and even personalising their communications. In order to connect, the best companies are replacing caution with candour when responding to questions and challenges.

Companies need to dispel the mystique that surrounds business and finds expression in the view that the public simply doesn't and won't understand. Businesses will need to become more accessible. Connect and Reflect describes an approach to communications which will benefit all stakeholders and lead to operational changes which will support this change.

Connecting also imposes obligations on members of the public as well as companies. While companies should be willing to connect by providing open channels of communication, members of the public need to be prepared to interact and respond to genuine requests from companies ahead of them making decisions or taking positions.

'The best companies are replacing caution with candour when responding to questions and challenges.'

REFLECTING

As well as connecting with public audiences, companies should also reflect on the feedback that they receive in a way that is consistent and transparent. This will show members of the public that connecting has a point and is worth continuing as new needs emerge. Companies will reap benefits if they change their default positions, if they are more open, and if they demonstrate their willingness to change by reviewing operational areas and, where necessary, making changes. Companies should answer questions they are asked without being obtuse or attempting to distract attention towards unrelated good news stories. There needs to be reliance on plain language and plain ideas, and a rejection of the legalistic and compliance-orientated packaging of the past.

To be successful this cannot be a one-sided conversation or journey. Reflecting also imposes obligations on members of the public as well as companies. While companies should reflect seriously on the feedback that they receive and, if appropriate, take corrective action, the public also needs to consider the explanations provided by companies fairly and with an open mind and be receptive to reasoned and balanced arguments.

Benefits

BUSINESS LEADERSHIP

We challenge the view that companies should be defensive and exercise caution in their messaging and avoid at all costs putting their heads above the parapet. The principal benefit of this change should be that business leaders will be seen not just as leaders of their businesses but also leaders of public opinion who command public respect.

Legislation, regulation and codes provide important foundations which guide corporate behaviour, but they have limited influence on the way that companies and the public relate to each other. Imposing compliance requirements on companies has failed to slow or halt the deterioration in the relationship between the public and companies. This has been compounded by the impersonal approaches which typify corporate communications.

There is an inevitable tension between companies' need for stable but flexible legislation and regulation, and the public's appetite for companies to be held to account in black-and-white terms. That tension can be resolved in large part by businesses that are seen to apply their own demanding standards and anticipate and respond to the court of public opinion.

Everyone could benefit from Connect and Reflect helping companies to show leadership by tackling emerging issues. It could reduce the pressure for potentially disproportionate legislative and regulatory action resulting from a lack of trust in the ability of business to respond to concerns.

NEW NORMS OF BEHAVIOUR

Connect and Reflect should help to foster new norms of behaviour for public discussion about business, which in turn will help to overcome mutual hostility between business and society. Those who connect with a business could comprise the full range of its stakeholders including employees, shareholders, investors, suppliers, lenders, customers, public authorities, NGOs, local communities and other relevant interest groups. Bureaucratic hurdles to connecting need to be kept to a minimum.

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Negative media coverage of companies and political attacks may demonstrate a healthy system of checks and balances that is important given the power that business has over society, and the fact that business leaders are unelected. However, the experience of such

public engagement can simply be too harrowing and forbidding for business people. Some members of the public may also be too cynical and entrenched to change their minds.

While there is always a risk that Connect and Reflect will be hijacked by single-issue pressure groups, businesses should accept that you can't convince all the people all the time. They should not use that as a reason for giving up on convincing anyone. Connect and Reflect will move companies away from being faceless corporations to become more personal and accessible.

It would show that companies are committed to answering real questions from members of the public using common language that everyone understands and allowing deeper probing if necessary. It would formalise what the best companies are doing already in speaking directly to individual members of the public in a way that acknowledges that their views are critical to the success of the business. Individuals should be provided with a platform to make their case on issues that are important to them, and companies should have an opportunity to obtain useful feedback and to explain their constraints and long-term strategies.

INCREASED TRUST IN BUSINESS

Fully rebuilding trust and sustaining it at the highest level may be too ambitious as a short-term goal. A commitment to Connect and Reflect needs to be backed up by behaviour and experience, particularly under conditions of stress. Increasing levels of respect and understanding may be more realistic stepping stones on the road to establishing real trust. Nonetheless, it is important to recognise that trust does not require businesses to be all things to all people and obtain the approval of all sections of society. It is possible to trust a person or organisation but at the same time disagree with them.

We would expect today's companies that enjoy high levels of trust to have demonstrated over a long period of time that they seek out and take proper account of the views of their stakeholders. Others need to be prepared to take a risk, discard old prejudices and try something new. Reasons for doing this are that the public will be more likely to recognise the value that trusted companies create - whether this is through providing jobs and opportunities for personal development, innovating, delivering the goods and services that people want, paying taxes that support public services or supporting communities and the environment. Negative relations between companies and the societies in which they operate waste company resources, destroy value and damage the economy. The changes we are suggesting should make companies sharper, more competitive and more attractive to work for or do business with.

The journey so far

EARLIER ICAEW PAPERS

The first series of ICAEW Dialogue in Corporate Governance papers, available at icaew.com/newchallenges, explored five fundamental questions affecting existing corporate governance frameworks: What should companies be responsible for? What are the overarching principles of corporate governance? When is comply or explain the right approach? Who should be covered by codes? How diverse should boards be?

Our outreach about these papers confirmed that individual investors and members of the public are intimidated when it comes to questioning many aspects of corporate behaviour. Corporate governance codes in particular are now mainly seen as detailed compliance exercises on which even boards, institutional investors and other stakeholders defer to the expertise of specialists. This can be perceived as defensive delegation or a shirking of responsibilities, but people cannot be technical experts in all of the areas for which they are responsible.

RESPONSIBILITIES AND PRINCIPLES

Our two papers on company responsibilities and overarching principles embraced simplicity and plain speaking. The first paper said that companies are responsible for four things: achieving a business purpose, behaving in a socially acceptable way, meeting legal and regulatory requirements and stating how they meet their responsibilities. The second paper said that board behaviour should demonstrate five principles: leadership, capability, accountability, sustainability and integrity. Our simple ideas were enthusiastically accepted by a wide range of people, including many who previously thought that corporate governance was something best left to specialists and experts. However, what we are doing now with Connect and Reflect is articulating how the responsibilities and principles we identified can be brought to life.

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For example, any member of the public should be able to ask a board a question and get a straight answer which reflects these responsibilities and principles. It might be about whether they regard their company's behaviour - for example supply chain practices or executive remuneration or differences between where it does business and where it pays tax - as socially acceptable. In response, boards should generally be able to say yes and

explain why. But, if questioners present matters of public concern which on reflection boards cannot address adequately, then they should say that and correct the matter.

BEYOND COMPLY OR EXPLAIN

Our two papers on when comply or explain is the right approach and the case for extending codes beyond listed companies investors attracted positive feedback. The current corporate governance approach is based upon the rights of listed-company shareholders, which means that those codes only support accountability where there are such shareholders. People broadly agreed that investors needed to be relieved of unrealistic expectations to act on behalf of society as a whole. In recent times politicians have seemed to expect institutional investors to exercise their rights to demand accountability from companies on behalf of the public at large. This has patently not worked in the case of perceived excesses in executive remuneration.

Yet there was little enthusiasm for extending the scope and reach of comply or explain codes or, as a default, extending the scope and reach of regulation and legislation. That is why we have developed Connect and Reflect as a new approach to reach the places that comply or explain codes cannot reach. Connect and Reflect would help restore balance and relieve the investment community of a public obligation to police corporate behaviour by empowering companies at large and the full range of their stakeholders to work together to improve governance.

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Finally, our paper on board diversity was accepted as intellectually sound in articulating how diversity is crucial if boards are to be seen as effective, socially acceptable, rigorous and capable of understanding the business. But reaction to it also showed that readers wanted simple examples of what companies actually do in practice which would support the principles we articulated. We intend to meet this type of need in the next series of papers in support of Connect and Reflect .

We will look at governance issues that are arguably more controversial and intractable than diversity. These issues keep cropping up in public debate despite companies’ aversion to talking about them. Making changes in these controversial areas (or making no changes but explaining why) will signal that companies accept that there are problems, and that they have a responsibility to debate new solutions. We will use them as a testing ground for Connect and Reflect .

Future papers

HOW COMPANIES THRIVE ON SOCIAL MEDIA

Our starting point is that companies now have the power through technology to connect with society in a way that until recently would have seemed unimaginable. However, this positive stance needs to be resilient in the face of a host of daunting questions about applying Connect and Reflect in a digital world.

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The paper will consider how companies: make choices about which digital communication channels to use for different public audiences and different subjects; apply techniques to enforce norms of acceptable online behaviour so that channels of communication do not become discredited or hijacked; decide between what is public and what remains private in a way that maintains trust and does not look like retreating behind confidentiality; cope with the high velocity of digital communication; and respond to criticisms made on social media.

HOW WHISTLEBLOWING HELPS COMPANIES

Our starting point is that whistleblowing is the ultimate internal control and one that the public has high expectations of. Yet it is a neglected subject that is seen as a sign of failed governance and to put this right means answering some difficult questions.

The paper will see what companies do to be clear about: the scope, objectives and performance of whistleblowing arrangements; what makes a good whistleblower; policies for providing advice, information and fair treatment to whistleblowers and those they accuse; and reward and compensation arrangements.

HOW EMPLOYEE DIRECTORS ADD VALUE

Our starting point is that in an age when businesses largely rely on their people to create value, those people should have a major contribution to make in the boardroom. Despite this, in some countries, including the UK, mention of ‘worker directors’ can provoke an allergic reaction in the business community.

It would be helpful to share experiences of: the value employees can bring to the boardroom; selection and election procedures; what it means to be a representative on a board; and how employee involvement affects confidentiality, board effectiveness and decision-making.

HOW TO END EXCESSIVE PAY

Our starting point is that no company wants to be associated with any form of excessive behaviour and so in the area of pay where there is a perception of pervasive excess this needs to be addressed. Only acknowledging that there is a problem in egregious cases of 'rewards for failure' is insufficient.

It would be interesting to consider what can be learned from businesses that are not seen as having excessive pay, for example in relation to: payment packages and incentive and reward practices; use of consultants and benchmarking; remuneration committee arrangements; disclosure practices; and organisational and industry characteristics.

HOW TO MARK GOVERNANCE OUT OF 10

Our starting point is that if governance is an important driver of corporate performance then it would be good to measure it and have some leading indicators of what might lie in store for the future. Unfortunately, people mainly seem to decide that governance must have been bad only after a scandal has blown up and until such a time treat measures of governance as meaningless compliance scores.

It would be useful to summarise: who currently tries to measure comply or explain performance, how and for what purpose; any evidence of correlation between governance measures and corporate success; and how companies might measure their own implementation of Connect and Reflect .

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Summary and next steps

ICAEW is putting forward a new approach to corporate governance we call Connect and Reflect to give effect to the responsibilities and principles presented in our first series of Dialogue in Corporate Governance papers. It is intended to be a substantive step change, not a compliance or public relations exercise. It should enable businesses to show leadership, establish new norms of behaviour and increase trust so that business can play its vital role in delivering what societies value.

In the forthcoming second series of papers we will focus on helping companies translate Connect and Reflect into practice by tackling practical problem areas of corporate governance (social media, whistleblowing, employee directors, pay and measurement) which loom large in the minds of business and society. We know that this will not be easy, but we hope that our suggested framework of Connect and Reflect will provide a helpful structure for this ambitious programme.

JOIN THE CORPORATE GOVERNANCE DEBATE: CONNECT AND REFLECT .

Please share your thoughts, examples and anecdotes on ICAEW's Connect and Reflect blog: icaew.com/connectandreflectblog

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