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Board briefing on the new Section 172(1) statement

September 2019

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Introduction

Dear Board Member,

This is a very interesting time to be a company director. We see daily pressure on boards to articulate a clear vision of their organisation's contribution to wider society, and there is now a clear expectation that the development of strategy and the related considerations of opportunity and risk should incorporate a much wider perspective. Philosophically and politically, the creation of value for owners sits alongside other objectives and engagement mechanisms across a company's eco-system – customers, suppliers, regulators, politicians, the younger generation and, of course, our planet. Consideration of these wider societal impacts needs to be embedded as part of a business' DNA in the operating model, alongside financial considerations, as many investors and other stakeholders are holding directors to account on these broader aspects, seeing these as a fundamental part of the fiduciary duties of directors.

The foresight of the authors of the 2006 Companies Act is commendable: in 2006 they provided a structure in the form of section 172, which, together with the 2018 UK Corporate Governance Code, has now become a central policy lever of the Government's trust in business agenda. The new requirement for calendar 2019 year ends to report on how the board has taken into account the factors set out in section 172 will bring real colour to board decision-making.

For some companies this new reporting requirement will not entail significant changes. However, others may have had to enhance policies and practices, or introduce new ones, to withstand public scrutiny. For example, most very large companies will already have clear stakeholder engagement programmes but the linkage of that engagement into the boardroom and to decision-making might not previously have been that clear.

This is a real opportunity for companies to paint an authentic picture of all the key messages on their business model, future strategies and engagement with the company's ecosystem and environment as well as their core values.

We hope that this briefing will support boards in developing a meaningful depiction of their section 172 activities in an already busy annual report. Many business decisions are not easy and carry with them enormous responsibilities. Done well, the Section 172(1) Statement represents a real opportunity for companies to show the complexity of business decision-making and the thoughtfulness of business leaders as they balance sometimes conflicting interests in the exercise of their duties.

Do get in touch with your Deloitte partner or email our governance team if you want to discuss any of these matters further.

Yours faithfully,

William Touche
Vice-Chairman
Leader, UK Centre of Corporate Governance
September 2019

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Purpose and content of this briefing

We have written this briefing primarily for the directors of the holding company of a group (listed or unlisted) on the basis that for group reports the new required statement is intended to be a reflection of how those directors have met their duty under section 172. The principles apply to all companies obliged to make the statement.

Recognising that effective stakeholder engagement is key to meeting the section 172 duty, in Appendix 1 we provide a number of questions which companies may wish to consider when assessing the impact of engagement activities.

Throughout this publication we make reference to the FRC's Guidance on the Strategic Report[1] issued in July 2018. This sets out the FRC's expectations for the new statement and this briefing is intended to build on that guidance. We also reference the GC100's useful Guidance on Directors' Duties: Section 172 and stakeholder considerations [2] issued in October 2018 (the GC100 Guidance).

Scope of Section 172(1) reporting requirement

All companies qualifying as large under the Companies Act 2006 - this means companies that have two or more of: turnover > £36m; balance sheet total > £18m; more than 250 employees. The requirements also apply to medium sized companies that are ineligible under section 467(1) of CA2006.

See **Governance in brief: BEIS issues legislation to deliver key corporate governance reforms** for detailed information on applicability.

How this briefing applies to you if your company heads a listed group

This publication is designed to help directors reflect on how they are fulfilling their duty under section 172 and how they might report on this in their new Section 172(1) Statement. It will help boards in assessing whether some existing disclosures are relevant for the statement and help determine new disclosures that will be needed.

How this briefing applies to you if your company heads an unlisted group

Some of the strategic report requirements already applicable to certain listed groups may not be required for unlisted groups. Unlisted groups may find that they need to introduce additional or more detailed incremental disclosure in order to meet the needs of their Section 172(1) statement, either in the statement itself or, with suitable cross-reference, in their strategic report. The nature of the disclosures that could be helpful in the context of the new statement is set out in the tables throughout this briefing.

How this briefing applies to you if your company is a subsidiary

As with a company heading an unlisted group, a subsidiary may well not have enough suitable material in the annual report to enable effective cross-referencing from the Section 172(1) statement and could need to develop new disclosure on a range of issues related to the matters set out in section 172. The nature of the disclosures that could be helpful in the context of the new statement is set out in the tables throughout this briefing.

Remember that medium-sized companies that are members of ineligible groups will need to prepare a Section 172(1) statement as they are treated as 'large' for this purpose in addition to large companies (all under CA2006 definitions) – meaning the requirements will fall on medium-sized entities where they are subsidiaries of listed groups.

To address some of the questions which may arise for entities such as wholly-owned subsidiaries or intermediate holding companies we have included in Appendix 2 relevant extracts from the Q&A document which the Department for Business, Energy and Industrial Strategy (BEIS) issued with the new regulations.

1 https://www.frc.org.uk/getattachment/fb05dd7b-c76c-424e-9daf-4293c9fa2d6a/Guidance-on-the-Strategic-Report-31-7-18.pdf
2 https://uk.practicallaw.thomsonreuters.com/Link/Document/Blob/I59d0a3ddd47f11e8a5b3e3d9e23d7429.pdf?targetType=PLC-multimedia&originationContext=document&transitionType=DocumentImage&uniqueId=7f428e74-ea66-4317-b8b6-85b9766b3e56&contextData=(sc.Default)&comp=pluk&firstPage=true&bhcp=1

A reminder of the new reporting requirement

Section 172 itself is not new so boards should have been considering the factors set out in the duty already. The new requirement for the **strategic report** is set out in the Companies (Miscellaneous Reporting) Regulations 2018.

s414CZA(1) – Section 172(1) statement

A strategic report for a financial year of a company must include a statement which describes how the directors have had regard to the matters set out in section 172(1) (a) to (f) when performing their duty under section 172.

Scope: all UK companies qualifying as large under the Companies Act 2006 [1]

Section 172 – Duty to promote the success of the company

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 factors (a) to (f).

HAVE REGARD TO

Section 172 matters

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, and
f. The need to act fairly as between members of the company.

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[1] Companies qualifying as large under the Companies Act 2006 meet at least 2 of the following criteria:
- Turnover of more than £36m
- Balance sheet total of more than £18m
- More than 250 employees

See Governance in brief: BEIS issues legislation to deliver key corporate governance reforms for detailed information on applicability.

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In November 2018 BEIS issued some FAQs to assist in interpreting the new reporting requirement[2]. The key points from those FAQs regarding the content of the Section 172(1) statement are:

> Depending on the individual circumstances, companies will probably want to include information on some or all of the following:
>
> - The issues, factors and stakeholders the directors consider relevant in complying with section 172(1) (a) to (f) and how they have formed that opinion;
> - The main methods the directors have used to engage with stakeholders and understand the issues to which they must have regard; and
> - Information on the effect of that regard on the company's decisions and strategies during the financial year.
>
> Companies will need to judge what is appropriate, but the statement should be meaningful and informative for shareholders, shed light on matters that are of strategic importance to the company and be consistent with the size and complexity of the business."

In addition to this new **strategic report** requirement part of the Companies (Miscellaneous Reporting) Regulations 2018, there are two new **directors' report** elements which must be addressed. Where the board considers these directors' report disclosures to be of strategic importance, they may be included in the strategic report and incorporated into the directors' report by cross-reference.

Sch 7.11(1)(b) – Employee engagement

The directors' report for a financial year must contain a statement summarising:

i. how the directors have engaged with employees; and

ii. how the directors have had regard to employee interests, and the effect of that regard, including on the principal decisions taken by the company during the financial year.

Scope: all UK companies incorporated under the Companies Act 2006 where the monthly average number of UK-based employees exceeds 250

Sch 7.11B(1) – Business relationships

The directors' report for the financial year must contain a statement summarising how the directors have had regard to the need to foster the company's business relationships with suppliers, customers and others, and the effect of that regard, including on the principal decisions taken by the company during the financial year.

Scope: all UK companies qualifying as large under the Companies Act 2006

These requirements overlap with section 172 factors b) and c) respectively. For most companies, it is likely that these matters will be of strategic importance and will be covered in the Section 172(1) Statement. In these circumstances, at a minimum, there should be a heading included in the Directors' Report ('Employee engagement' and 'Business relationships') and then a cross reference to the Section 172(1) statement and/or other relevant disclosure.

[2] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/755002/The_Companies__Miscellaneous_Reporting__Regulations_2018_QA_-_Publication_Version_2__1_.pdf

What information should be included and what is already available?

The new requirement is not intended to be a compliance statement but rather to provide visibility of the considerations by the directors in the performance of their duties. In designing their statements, directors will be well aware that there is already relevant information elsewhere in the annual report - meaning that a decision needs to be taken early about how best to draw these elements together and provide the additional insights into board decision-making.

As explained in Section 8 of the FRC's Guidance on the Strategic Report:

> **The Section 172(1) Statement should focus on matters that are of strategic importance to the company. The level of information disclosed should be consistent with the size and complexity of the business."**

In the table below we have taken the three elements referred to by BEIS in their Q&A and set out our views on where there are relevant **existing** disclosures and what **new** disclosures will likely therefore be required. Companies will have to decide between either leaving existing disclosures intact and incorporating them by cross-reference, enhancing them where necessary or moving them wholesale into the new Section 172 (1) statement. The purpose of the strategic report is to provide shareholders with relevant information that is useful for assessing the effectiveness of the directors' stewardship.

In Appendix 1 we have set out a number of questions for each stakeholder group which management may wish to consider when assessing the impact of its engagement activities and which may also assist in constructing an insightful description of these activities and the board's role in them.

Areas for disclosure – from BEIS Q&A	Disclosure considerations
"The issues, factors and stakeholders the directors consider relevant in complying with section 172 (1) (a) to (f) and how they have formed that opinion."	Here the focus should be on explaining "how" the board has formed its opinion on which factors are relevant and how the activities described link not only to the business and its strategy but also to the board's deliberations and decision-making. Value creation activities have been changing in nature as industries have reshaped themselves and new ones have been formed. In particular, intangible factors such as innovation, software, business processes, leadership and the assembled workforce play a huge role in value creation. Companies therefore need to explain the drivers of their value creation process in a way that helps investors and others to understand how these sources of value are protected and managed.
(a) the likely consequences of any decision in the long term	The annual report already should contain a description of how the business generates long-term value, therefore linking decisions in the year to this longer term strategy will be helpful. Capital allocation and dividend policy decisions will also have a particular impact on the long term prospects of the business and will demonstrate how the board is considering the likely long term consequences of their decisions.

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Areas for disclosure – from BEIS Q&A	Disclosure considerations
(b) the interests of the company's employees	The business model section of the annual report of most companies is likely to reference "talent" or "workforce" as a fundamental asset of the business. Many commentators observe that annual reports could be considerably enhanced in this area, given the critical role of the workforce in the success of any business. This might be an excellent opportunity to introduce a new much fuller section of the strategic report on investment in and development of talent and how the directors have considered the interests of employees in key decisions.
(c) the need to foster the company's business relationships with suppliers, customers and others	The business model disclosures will already have some reference to customers and suppliers and many companies have recently enhanced their disclosures in the strategic report around customer and supplier engagement. In addition, there will be elements in the strategic report and sustainability sections on anti-bribery and corruption matters as well as various references to the supply chain including sustainability and responsible sourcing, supply chain resilience and supplier audits. Again, this might represent an excellent opportunity to introduce a much fuller section of the strategic report addressing all matters together.
(d) the impact of the company's operations on the community and the environment	Many companies refer to community matters, particularly where physical operations are concerned, and the level of engagement will likely vary from site to site, so this is an opportunity to express some broad principles and perhaps illustrate these with examples. Again a separate subsection of the strategic report could be used, with the new Section 172(1) statement referring to that by cross reference. Environmental disclosure requirements are evolving fast, and we would recommend a separate section on this area, taking into account both the UK's recent announcements (see our Newsflash on the Green Finance Strategy, dated July 2019) [1] and also the EU's guidance issued recently in relation to the Non-Financial Reporting Directive which encourages reporting in this area using the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD).
(e) the desirability of the company maintaining a reputation for high standards of business conduct	To address high values of business conduct, many companies could cross refer to their Corporate Governance Statements, where expressions of values and activities undertaken to promulgate these are often described. Alternatively, these aspects could be combined with the governance disclosures which describe the board's and management's activities to assess and monitor culture. The GC100 Guidance makes it clear that board decision making also involves delegation to and empowerment of management teams and therefore it is important to embed the section 172 factors in the culture of the business and decision making at all levels of management.
(f) the need to act fairly as between members of the company	The need to act fairly between members at public companies normally comes into play where there is potential asymmetry of information, due to some shareholders having board seats. These situations are normally explained in annual reports with any conduct agreements also referenced. There can also be asymmetry of information to consider between major shareholders and minority shareholders.

[1] https://www2.deloitte.com/uk/en/pages/audit/articles/frc-statement-on-the-governments-green-finance-strategy.html

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Areas for disclosure – from BEIS Q&A	Disclosure considerations
"The main methods the directors have used to engage with stakeholders and understand the issues to which they must have regard" Another way of stating this is "how does the board maintain the company's licence to operate"	In reviewing their activities and forming disclosures, boards may wish to draw out their role in engagement activities (compared to organisational engagement mechanisms) and how the information on key issues has been brought into the boardroom. Existing disclosures which could be relevant to this element of the statement include: **Business model** – identification of key stakeholders **Board workforce engagement mechanism** – description of the mechanism used by the board to meet UK Corporate Governance Code Provision 5 (a director appointed from the workforce, a formal workforce advisory panel, a designated non-executive director, or effective alternative arrangements). **Non-financial information statement –** explanation of the policies and due diligence procedures adopted to manage non-financial aspects of the company's performance, together with outcomes (this will usually include any TCFD disclosures). **The directors' report** – any discussion on employee engagement or business relationships to meet statutory requirements. **Shareholder engagement** – description of shareholder engagement activities undertaken by the board during the year, usually in the corporate governance statement. Some companies have started to describe this section as "stakeholder engagement" and also include details of engagement with stakeholders other than shareholders.
"Information on the effect of that regard on the company's decisions and strategies during the financial year."	The key decisions and strategic developments in the year are normally described in the CEO's and CFO's reviews, and to some extent in the letter of the Chair. The new element for directors is showing section 172 in action and how consideration of the factors and stakeholder engagement have impacted key decisions and strategies during the year.

Building the content of the statement

There is deliberately limited guidance from the FRC on how companies should design their Section 172(1) statement. As discussed in the previous section, it is likely that many companies are already making relevant disclosures that can be developed further.

The relationship with each stakeholder group will be different: the Section 172(1) Statement represents an opportunity to explain how the board gets comfortable that these relationships are managed effectively and that there is sufficient visibility of relevant stakeholder engagement activities in the boardroom to inform decision-making and delivery of strategy.

Businesses may already have a stakeholder map, but if not, this can be a useful tool to identify key stakeholder relationships and to show the dependencies of each part of the business on different groups of stakeholders, and the impact that the business has on each of those groups. Stakeholders can fall into two categories:

1. Those groups which are likely to be affected by the actions of the company; and

2. Those groups whose actions can affect the operation or business model of the company.

In this section we explore how a statement might be constructed and have suggested three main sections to the statement.

The Board's approach — **Maintaining our licence to operate** — **Key decisions made in the year**

Noting that the FRC and the Investment Association consider capital allocation and dividend policy to be a principal decision, a short explanation of the disclosures they would like to see as part of the statement is also included.

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The board's approach to section 172 and decision-making

The role of the chair	• How does the chair ensure that decision-making is sufficiently informed by the section 172 factors to enable the discussion?
Strategy	• How are the section 172 factors being considered in the board's strategy discussions, and how do they underpin long term value creation and the implications for business resilience?
Information	• Do board papers include discussion regarding the section 172 factors when preparing documents for consideration and approval? • How are stakeholder engagement activities informing board decision-making? Is this documented adequately? • What due diligence does the board perform in relation to the quality of the information presented in these areas and is any assurance (internal or external) received?
Policies and practices	• Is consideration of section 172 addressed appropriately in the board's Schedule of Reserved Matters and (where relevant) each board committee's terms of reference? • How does the board identify key stakeholders and what are the procedures in place for keeping this under review? • Does the board have policies in place that ensure that where decisions are delegated, section 172 factors are taken into consideration as the board would apply them?
Training	• Does wider leadership and management training include reference to directors' duties so that broader leadership is cognisant of the board's responsibilities - and therefore their own responsibilities as the board's delegates in this area? • Do communications, company documents (such as the code of conduct) and training around corporate values need to be updated / revised to include reference to directors' duties?
Culture	• What steps have been taken to ensure that the embedded culture within the business, including overseas operations, is such that there is proper consideration of the potential impacts of decisions? • How is the culture and decision-making approach of the business promulgated where there are new acquisitions?

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Maintaining our licence to operate (section 172 in action)

A company's licence to operate will be dictated by the way it is perceived by its stakeholders. Explaining how the board manages and maintains its licence to operate through its relationship with stakeholders will therefore form a significant part of the new statement.

The reporting requirement specifically references factors (a) to (f) – factor (e) within section 172 is: "the desirability of the company maintaining a reputation for high standards of business conduct". Some would say that as long as a board is addressing this element of section 172 then the remainder will flow from that core concept of being seen to operate in an ethical and responsible manner in relation to all stakeholders.

Monitoring and assessment of the corporate culture, as required by the UK Corporate Governance Code, will help the board to build a picture of the standards of business conduct throughout the business. The establishment of corporate values and codes of conduct are all relevant here and directors may wish to take the opportunity to reinforce the board's commitment to these. It will also be relevant to make reference to workforce training on areas such as anti-bribery and corruption, anti-money laundering and ethics.

The executive summary of the GC100 guidance provides a helpful paragraph clarifying the responsibilities of directors when considering the various elements of section 172 in their decision-making:

> **Your job is not to balance the interests of the company and those of other stakeholders. Instead, after weighing up all the relevant factors, ask yourself which course of action you consider best leads to the success of the company, having regard to the long term. This can sometimes mean that certain stakeholders are adversely affected, but this does not call into question decisions made.**

In Appendix 1 we have set out a number of questions for each stakeholder group which management may wish to consider when assessing the impact of its engagement activities and which may also assist in constructing an insightful description of these activities and the board's role in them.

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Key decisions made in the year

Here is a selection of decisions and how the board might approach its considerations around disclosure with cross reference to further detail elsewhere in the annual report.

Approved the acquisition of ABC Limited	Disclosure of the board's considerations might include: • How the acquisition and financing the transaction fits with long-term value creation strategy – explanation or cross-reference • How the culture of the acquisition will be aligned to the culture of the existing business – explanation or cross-reference • Any other considerations regarding stakeholders, community, environment or other section 172 factors Deciding not to proceed with an acquisition can also be considered a key decision. *For example* *As described in the CEO's statement, in February we finalised the acquisition of ABC Limited. The acquisition supports our value creation strategy to expand our distribution capabilities, and fits with our geographic expansion in central Europe (see page x for a fuller description of this strategic priority). We financed the acquisition through additional borrowings. Extensive financial and operational diligence has shown that the management, values and culture of ABC Limited will fit well with the group and that the customer strategy is closely aligned with our ambitions*
Approved the disposal of XYZ Limited	Disclosure of the board's considerations might include: • How the disposal fits with long-term value creation strategy – explanation or cross-reference • Any consideration of purchaser's environmental record, investment in business and investment in business or communities • Any relevant assurances received from purchaser

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Approved the annual budget and three year plan	Disclosure of the board's considerations might include: • Long-term strategic considerations including regulatory or environmental factors • Consideration of supplier or customer considerations, such as product development plans, investment in supply chain • Investment in employees / workforce pursuant to information received at board level • Capital allocation decision-making and dividend policy *For example* *This year's budget and rolling three year plan were approved by the board following a comprehensive review of our strategic priorities and risks to our business. We considered the input from our customer focus groups about changing customer needs and our product plans, and we took into account both customer and community feedback about our impact on the environment. We took this feedback to our own suppliers to ensure that the demands of our customers are reflected in our engagement and contracts with our own supplier base. The input from our employer representatives was invaluable as we formulated our plans and the board took the opportunity to review and reconfirm the group's values, including our commitments to investment in training and skills development to support our change programme, to equal opportunities for all and to paying a living wage to all our people. Our customers are demanding considerable changes in the way we engage with them and our plans include a number of innovations and enhanced ways of working which will involve considerable change in our own organisation. This will provide colleagues with opportunities as well as transformation challenges. Our plans are demanding but will position the company well against our longer term value creation vision whilst honouring our commitments to our stakeholders. The material risks and how we are managing these are set out on page x.*
Approved a revised culture transformation plan and a training programme	Disclosure of the board's considerations might include: • Long-term strategic considerations / cross-reference to relevant sections on strategy • Feedback from employees / workforce received at board level • Culture dashboard considered at board level covering matters such as culture assessment or assurance obtained/ cross reference to people section of strategic report.

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Approved the final dividend	Disclosure of the board's considerations might include: • Importance of meeting dividend policy and thus shareholder expectations • Capital allocation decision-making • Interactions with providers of finance • The extent of pension fund deficit reduction *For example:* *Meeting shareholder dividend expectations is a high priority as it supports our growth strategy. Our three year plan indicates that our progressive dividend policy is able to be met while meeting our obligations to pensioners as well as making the investments we need to make in our product suite and our business transformation. We borrow the funds to pay our final dividend after the AGM as our free cash flow is tilted towards the second half of our financial year. Further details on capital allocation and dividend policy can be found on page x.*

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Capital allocation and dividend policy

The FRC's Guidance on the Strategic Report includes the following comments in relation to capital allocation and dividend policy:

> On a year-to-year basis, directors will decide how to apply the company's capital allocation and dividend policies given events and circumstances that have arisen during the period. In both the setting of the policy and the application of that policy in any given period, directors are encouraged to consider the interests of the company's shareholders as a whole, while having regard to, for example, the long-term viability of the company, the need for research and development or capital investment and the interests of other stakeholders, such as the pension fund or current employees.
>
> If the setting and application of the capital allocation and dividend policies are principal decisions, the section 172(1) statement could explain how directors have had regard to the long term and the interests of stakeholders, both in the setting of the capital allocation and dividend policies and then in the application of those policies each year.

In May 2017 the Investment Association published Long Term Reporting Guidance [1].They made the following recommendations on the disclosures on capital management, which could helpfully be cross-referred to from the s172 statement.

> The Strategic Report should include:
>
> - a discussion of the significant capital allocation decisions made during the past year;
> - an explanation of the nature of the dialogue with key shareholders on capital allocation decisions during the past year, including a commentary on how these discussions have influenced the company's decision-making process;
> - the outcomes of those significant capital allocation decisions, with reference to how those expenditures have led to productivity improvements and supported the delivery of the company's long term strategy; and
> - where appropriate, an explanation of any significant cancellations or withdrawals from past capital allocation decisions that have been made in the past period.

1 https://www.theia.org/sites/default/files/press-releases/document/Long%2520Term%2520Reporting%2520Guidance%2520%2528v1%2529.pdf

The Investment Association's Long Term Reporting Guidance also suggested some quantitative disclosures to facilitate a comparative analysis of previous performance:

- Working capital
- Investment Capex
- Research and development
- Capital distribution, including debt servicing, dividends and buy backs and pensions; and
- Investment in skills and training

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Examples of board decision-making disclosures

Although we have not yet identified a company that has produced a full Section 172(1) statement, some companies have taken steps towards the disclosure requirements of the new statement. There are already some examples that boards might find useful as a reference when preparing their annual report disclosures. Deloitte's annual survey, Annual Reporting Insights includes detailed analysis of how far companies have gone towards meeting the new requirements in advance of the regulations becoming effective.

The ones highlighted below include elements of demonstrating how input from stakeholders have influenced board decision-making.

Croda included examples of how the board considered the interests of its key stakeholders when making decisions.

Case study: Examples of how the Board considered the interest of its key stakeholders when making decisions

The Board reviewed the Company's contributions to the UK defined benefit pension scheme. Balancing the funding risks that are inherent in maintaining an open defined benefit scheme with the material benefits for UK employees, the Board reached the decision that it was in the Company's best interests to increase its contribution rates.

During the Board's consideration of a potential acquisition of a company in an adjacent market, management presented its due diligence findings, which highlighted certain risks that could have an adverse reputational impact. The Board considered the importance of Croda's reputation with its customers and employees and, notwithstanding the financial benefits of undertaking the acquisition, it concluded that it was best for the success of the Company not to proceed with the acquisition.

The Board approved a capital expenditure request to open a new warehouse in the North of England. The Board took account of a number of stakeholder factors in reaching this decision, including that existing warehouse employees would not be made redundant and would be relocated to the new facility; the positive impact on customer service; and the benefits of the investment to the local community. The Board also took account of the financial returns in the project and considered it was in the best interests of the Company to approve the expenditure.

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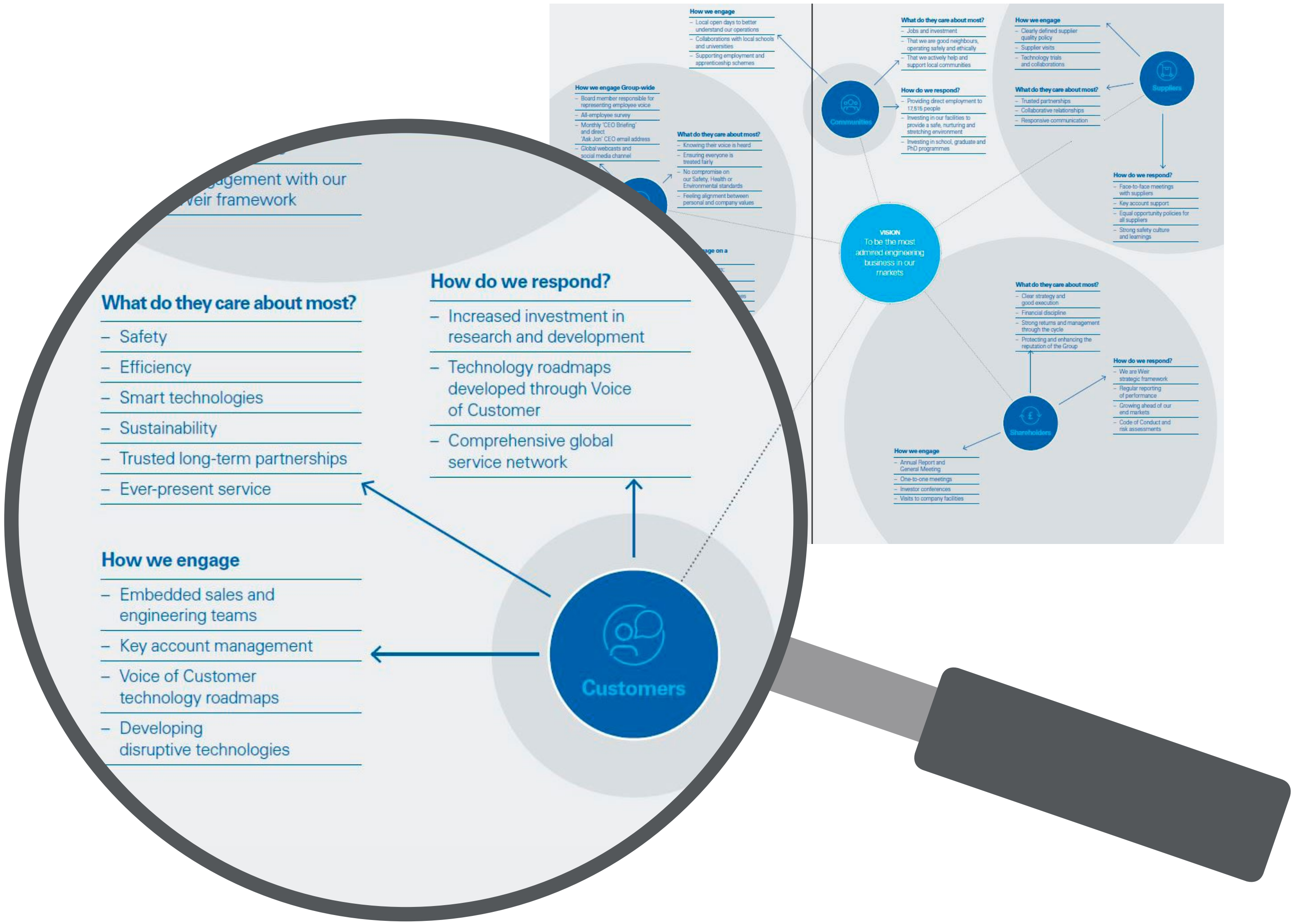
Weir Group identified their 5 key stakeholder groups, summarised how they engaged with them, what their stakeholders care about most and how the company has responded.



Pages 54 and 55 of the National Grid Annual Report and Accounts 2018/19 provide another example of disclosure explaining how the board creates value for stakeholders.

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Cobham provides a case study on its engagement with its suppliers.

Strengthening the supplier base

There has been continuing development to improve the Group's supply chain. The aim is to increase the strength of the supplier base as Cobham works towards achieving a target of 80% of its spend with 20% of its suppliers. Consolidating the supply chain with a focus on quality provision gives more confidence in the ability to deliver, and can offer economies of scale. There have been internal and external efforts towards this target.

Within Cobham, there have been many actions to support a closer and improved relationship with suppliers across all the business units:

- Improving and refining supplier management information systems;
- Introducing dedicated managers for electrical, mechanical and indirect spending to make procurement more effective and efficient;
- Entering long term agreements with key suppliers; and
- Introducing quarterly business reviews with key suppliers.

Supplier conferences were also held in the UK and US to share the Group's vision and strategic direction with key suppliers. Priorities included introducing suppliers to developments in the supply chain strategy, show them potential new areas of business, and develop stronger relationships.

Presentations on the Sectors were given with positive feedback. The majority of suppliers had little knowledge of the breadth of Cobham's business and commented on areas where there could be further development in our partnership. There was also positive feedback regarding the current supply chain strategy, which addressed areas of improvement identified in a survey undertaken with suppliers. These will be a focus in 2019.

The survey also showed that the majority of suppliers had long-standing relationships with Cobham, with 95% satisfied with the relationship overall.

A proposal to introduce supplier awards was received positively. This aim of this is to motivate suppliers to deliver products to higher quality standards, and to reward those that meet the highest standards. Overall, the conferences were a success, and the focus on motivating our suppliers will continue.

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Appendix 1: Questions to consider for each stakeholder group

For each stakeholder group we have set out a number of questions which management may wish to consider when assessing the impact of its engagement activities and which may assist in constructing an insightful description of these activities and the board's role in them. It is likely that you are already engaging in a number of different forms of communication to your various stakeholder groups, e.g. internal web forums, social media, town halls etc. All of these help to reinforce the stakeholder engagement aspects of s172 throughout the year and can also be referenced in the Section 172(1) Statement.

Employees

Area	Matters to consider
Population	• What population is the board referencing when it is considering "employees" – is it just those with a formal employment contract or is it the more accepted wider definition of "workforce" which includes a broader range of talent used within the company?
Engagement mechanisms	• Where following the UK Corporate Governance Code, what mechanism has the board adopted for workforce engagement? • What are the terms of reference for the chosen mechanism and what activities have been undertaken during the year? • What workforce engagement forums are used? What topics are discussed? Who sets the agenda? • Is the board seen as accessible to the workforce and does the workforce feel confident that their voice is being heard? • Are there opportunities to help the workforce understand what the board's responsibilities are? • How visible is the board to the workforce? How many site visits are undertaken per year? How much is overseas? • What board engagement is there with trade unions? • How is the engagement feedback loop completed to ensure that the workforce can understand the impact of engagement activities?

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Employees (continued)

Area	Matters to consider
Information	• What does the board do with the output of employee engagement surveys? • Is there a mechanism for the board to be able to access data from platforms such as Glassdoor and other social media avenues to understand what these reveal about what is important to the workforce? • Is there a clear view of what drives productivity and what the optimum levels should be? What information is the board receiving around productivity within the business? Is the board able to direct appropriate resource to address any issues identified? • Is the board being made aware of trends in attrition levels across the business and also the outputs from exit interviews? • How does the board use output from the company's whistle blowing or speak up processes?
Workforce policies and practices	• What is the board doing about gender equality and reducing any gender pay gap within the business? • Are there other relevant diversity issues which the board has asked management to address, e.g. ethnic diversity and any ethnic pay gap? • What is the level of investment being made in training and skills for the workforce? Is enough being done to develop future skills? • What information is provided to the board on working conditions and consistency across the business? • What is the board's policy on funding of the pension scheme? • Where there has been a recent merger or acquisition, what efforts are being made to ensure effective workforce integration? • What engagement is being undertaken in relation to the potential future impact of technology and automation on the workforce?

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Customers

Area	Matters to consider
Information	• What reporting does the board receive about customer feedback? • Is the board made aware of other indirect forms of feedback for example from internet scraping? • What reporting does the board receive on the customer profile of the business? Is it clear to the board where the business is exposed to dependency on a few large customers and to the health/viability of those customers?
Market expectations	• How much is being spent on innovation and understanding where the next big market disruption is going to come from and how much visibility does the board get on that? • What trade-offs are being made to balance price and quality considerations? • How is the company engaging with its customers to understand how the product/service could better do what customers want? • How are customer sustainability objectives being addressed? • How is competitor activity tracked and reported back to the board?
Engagement mechanisms	• What is the reporting line and accountability arrangements for customer complaints/returns? • Is there a clear feedback loop from customers to board and back to customers? Does the board get sight of customer satisfaction surveys and other output from account management processes?
Consumer protection	• Do the company's sales processes comply with appropriate regulation and reflect high standards of business conduct? • What mechanisms are in place to ensure that use and protection of customer data is appropriate? • What policies are in place to consider the appropriateness of post-sale obligations, e.g. guarantees, warranties and end of product disposal?

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Suppliers

Area	Matters to consider
Supplier terms	• How much attention does the board pay to the agreement of supplier terms? Is it able to understand how favourable or unfavourable the company's payment terms are compared to others in the industry/market? • Does the board understand the company's policies around compliance with the Modern Slavery Act and the General Data Protection Regulation (GDPR) as it relates to the company's suppliers? • Are differentiated terms considered for smaller members of the supplier eco-system? For example, extended payment terms or other forms of support for innovation?
Information	• Is the board made aware of the company's payment performance? What is the percentage of invoices made within standard terms? How does that compare to industry peers? • Does the board review any supplier feedback to determine how well the relationship is operating? • How much information does the board receive about other suppliers available to the company? • How does the board get confident about the full supply chain which could be associated with its company? Where could reputational exposure lie? Where is the risk in the supplier eco-system, e.g. values and climate policies of suppliers? What assurances are received on compliance with all relevant laws and regulations? • What reporting does the board receive on the supplier profile of the business? Is it clear to the board where the business is exposed to dependency on a few large suppliers and to the health/viability of those suppliers? Are there risks arising from the suppliers to the suppliers (fourth party risk)?
Engagement	• Does the board ever attend meetings with key members of the company's supply chain? • Is the board satisfied that relationships with suppliers are taking place at the appropriate level? • Are supply chain engagement practices promulgating high standards of business conduct and keeping pace with legislation on supply chain regulations, modern slavery and transparency?

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Community

Area	Matters to consider
Awareness	• How does the company identify the key communities where it has the most impact? • Is there adequate consideration of the different ethnic groups within the community? • Does the board have a good understanding of how important the business is to the communities where the company has a large presence?
Engagement mechanisms	• How does the board have an engagement strategy in place and make itself accessible to the community? • Has the board established relationships with local organisations? • Is there a programme of outreach to the community?
Investment	• What investment is being made in the community? • Is the board ensuring that community investment is making the best use of the relevant business skills and experience?
Alignment	• Is it clear that the company's dealings and involvement in the community are in alignment to the company's stated purpose and values?

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The environment

Area	Matters to consider
Governance arrangements	• How does the board ensure that its composition has the appropriate knowledge, skills, experience and background to take decisions informed by an awareness and understanding of environment-related threats and opportunities? • Have environmental considerations been integrated effectively into governance arrangements including the activities of board committees? • How does the board ensure that considerations about the environment and climate change have informed the development of strategy and is embedded into the management of risk across the company? • How is the board kept aware of developments in environmental legislation in all the relevant jurisdictions for the business?
Climate change	• In relation to climate change specifically, how does the board consider both the potential impact on the development, performance and position of the company and the company's impact on climate change? For example, the carbon footprint of products, infrastructure, travel policies, waste management and water usage. • Where does the board get its information on climate change? • How does the board go about accessing climate change expertise? • Is there a specific director or group of directors who take particular responsibility for climate? • Do discussions occur at board level or is there a sustainability and risk committee whose chair reports to the main board? • Is climate change a standing item on the Board agenda? If not - how does the board ensure there is sufficient and sustained attention to the subject? • Is the company's management incentive scheme designed to promote and reward sustainable value creation over time and does it take account of climate factors? • Where applicable, what exercise is undertaken by the board to consider carbon pricing and the potential impact of any carbon tax?

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Other stakeholders to consider

Area	Matters to consider
Pensioners	• Has the board considered the funding of the scheme, security and performance management. Are there community forums for pensioners with former employer? How valued engagement is by pensioners?
Providers of finance	• Has the board identified stakeholders for other providers of finance? • Is there a description of who the bondholders are, the nature of debt, plans for repayment, financing strategy, relationship management activities? • Is there anything in the bank's own strategy that would lead to the company no longer being able to access finance, e.g. industry type?
Regulators	• Does the board consider it has sufficient understanding of regulatory strategy, price caps, lobbying activity, relationship with regulators, policies around revolving doors, when is next regulatory review expected/due,etc? For consumer products – consumer health trends, protection and link to impact on community (H&S)?
NGOs	• Does the board understand the motivations of these special interest groups, where relevant to the company's industry, and their influence on key policy makers?

Appendix 2: BEIS frequently asked questions

How much detail should companies include in their section 172(1) statement?

Companies will need to judge what is appropriate, but the statement should be meaningful and informative for shareholders, shed light on matters that are of strategic importance to the company and be consistent with the size and complexity of the business.

Does the new section 172(1) statement need to be provided in a separately identifiable statement within the strategic report?

Yes. This clarity is important in ensuring that shareholders and wider stakeholders have a clear understanding of how directors have performed this aspect of their duty under section 172. Where appropriate companies can cross-refer to other parts of the report.

Unquoted companies must ensure that disclosures made by cross-referencing other parts of the annual report are included with the statement if published on a website without the rest of the annual report. This will ensure that it can be understood as a standalone statement.

Can the requirement to make the section 172(1) statement available on a website be discharged by publishing the complete annual report or the whole strategic report?

Yes. Ensuring that the statement itself is accessible on a website is the minimum legal requirement, but a company can choose to discharge the obligation by publishing its whole annual report or the entire strategic report.

Do subsidiary companies have to comply with these new reporting requirements?

Yes. All qualifying companies, including subsidiaries, need to meet the new reporting requirements.

Can a parent company or holding company fulfil the reporting obligation for subsidiaries?

No. All qualifying companies, including subsidiaries, need to report. This is the case even where the parent company is required to produce a consolidated "group strategic report" or "group directors' report".

Can a subsidiary company provide less information in its own statement in circumstances where policies are set by the parent company and applied throughout the group?

Judgement will be needed in deciding what is appropriate.

In practice, decisions and policies affecting employees, the environment, suppliers and so on will sometimes be made or set at the group level (with directors of each company in the group ensuring when applying those policies that they are meeting their duties to their respective companies).

Where this is the case and the parent provides a full explanation of the policy or strategy in its statements in the group reports, it may be acceptable for the subsidiary to provide less detail in its own report, where it is possible to make references to accessible parent company statements. In all cases, however, the subsidiary will need to explain how its directors have applied or reflected the policies or decisions taken at group level.

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The Deloitte Academy

The Deloitte Academy provides support and guidance to boards, committees and individual directors, principally of the FTSE 350, through a series of briefings and bespoke training. Membership of the Deloitte Academy is available to board directors of listed companies, and includes access to the Deloitte Academy business centre between Covent Garden and the City.

Members receive copies of our regular publications on Corporate Governance and a newsletter. There is also a dedicated members' website www.deloitteacademy.co.uk which members can use to register for briefings and access additional relevant resources.

For further details about the Deloitte Academy, including membership, please email enquiries@deloitteacademy.co.uk.

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