INSTITUTE OF DIRECTORS
SOUTHERN AFRICA

Stakeholder Engagement – promoting a sustainable, transformative approach to Corporate Governance

Sustainable Development Forum

Standard Bank

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The dissemination of such guidance will typically take the form of position papers and roundtable discussions.

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Introduction

Corporate governance in Southern Africa presents extraordinary challenges – and opportunities – to directors, particularly as they grapple with the meaning of sustainability and its implications for creating value for their organisations. As governing bodies and directors shift to a mindset rooted in integrated thinking, they are seeing these challenges and opportunities from a more systemic and inclusive perspective. Fundamental to this is how they perceive their relationships with stakeholders in a turbulent, uncertain and interconnected world.

How an organisation understands its role in society greatly influences its approach to stakeholder engagement. An instrumental approach, focused narrowly on an organisation's own interests, is likely to treat both internal and external stakeholders, including the environment, as exploitable resources and potential risks. However, if an organisation recognises that its success is linked to thriving communities and a healthy environment, there is a chance that it will take a more transformative approach that creates shared and sustainable value for a range of stakeholders including the organisation itself.

This is a key component of ethical leadership which involves, at a minimum, "the anticipation and prevention, or otherwise amelioration, of the negative consequences of the organisation's activities and outputs on the economy, society and the environment and the capitals that it uses and affects"[1]. The King IV Report on Corporate Governance™ in South Africa 2016 (King IV™) deepens this ethical commitment by advocating for a "stakeholder-inclusive approach, in which the governing body takes account of the legitimate and reasonable needs, interests and expectations of all material stakeholders in the execution of its duties in the best interests of the organisation over time".

Proponents of stakeholder engagement[2] suggest that it addresses three key issues all of which have relevance for corporate governance and the role of a director. The first issue is understanding, strategising and managing for the creation of value. The second is related to questions of ethics, responsibility and sustainability. The third considers how to support managers to be successful in the current business world.

This paper considers how governing bodies and directors can use the insights from engagement to enhance their contributions to the organisations that they serve, in support of creating sustainable value. It concludes by making specific suggestions regarding the responsibilities, and possible actions, of governing bodies in relation to stakeholder engagement.

Sustainable Value Creation and Stakeholders

From a corporate governance perspective, sustainability can be considered an outcome arising from an organisation's strategic activities and its relationships with the society and environment in which it operates. Failure to look after these relationships has the potential to destroy value for the organisation, for society and for the environment. This destruction of value is likely to be unsustainable.

This suggests that governing bodies and directors need to consider that "the sustainability of a firm depends on the sustainability of its stakeholder relationships" [3]. The implications of this are that:

- Business sustainability refers to the longevity of an organisation which is derived from the relevance and benefit of its activities to society – hence a long-term perspective is necessary;
- Sustainability requires trade-offs, firstly, across time in terms of short-term and long-term plans and secondly, needs and expectations between different stakeholders and the organisation.
- There is therefore an implied choice for sustainability practice which means that the alternative may be "unsustainability"; through this lens, sustainability is a value, the choice of which has significant implications, both in the short term and the long term, for both the organisation and its stakeholders.

Organisations can thus be understood as a set of relationships, and it is these relationships that have the potential to create or destroy value for the organisation itself and for its stakeholders. From this systemic perspective it is suggested that shareholder value (return on investment) is not independent of the economic, social, relationship and environmental value that an organisation creates or destroys in its operations.

1 The King IV Report on Corporate Governance for South Africa 2016. Copyright and trademarks are owned by the Institute of Directors in Southern Africa and the report can be accessed on the IoDSA website at: http://www.iodsa.co.za/?page=AboutKingIV
2 (Bonnafous-Boucher & Rendtorff, 2016; E. Freeman, Kujala, & Sachs, 2017; R. E. Freeman, Harrison, & Wicks, 2007; R. E. Freeman, Harrison, Wicks, Parmar, & De Colle, 2010)
3 Perrini, F., & Tencati, A Sustainability and stakeholder management: the need for new corporate performance evaluation and reporting systems Business Strategy and the Environment, 2006, 15(5), p. 298 https://onlinelibrary.wiley.com/doi/abs/10.1002/bse.538

Stakeholders

The notion of stakeholders is sometimes interpreted extremely narrowly as the shareholders of the organisation and the focus of value creation is articulated as profit maximisation for these shareholders. The International Integrated Reporting Council[4] define stakeholders as "those groups or individual that can reasonably be expected to be significantly affected by an organisation's business activities, outputs or out comes, or whose actions can reasonably be expected to significantly affect the ability of the organisation to create value over time." Providers of finance (including shareholders), customers, suppliers, employees, communities and in a sense the environment are often essential to the existence and interests of an organisation. This broader definition of stakeholders suggests that the governing body and executives must take a far broader, but also contextually sensitive, understanding of "stakeholders" into consideration in terms of strategy and value creation. This broader definition may also encompass the media, government, competitors, consumer advocacy groups, and a range of specific interest groups. These "secondary stakeholders" may have an influence on "primary stakeholders" or have a more direct relationship with the organisation, as shown in Figure 1. The web of relationships between an organisation and its stakeholders means that the duty of a director to act "in the best interests of the company"[5] "cannot nowadays mean anything other than a blend of all these [stakeholder] interests[6]...".

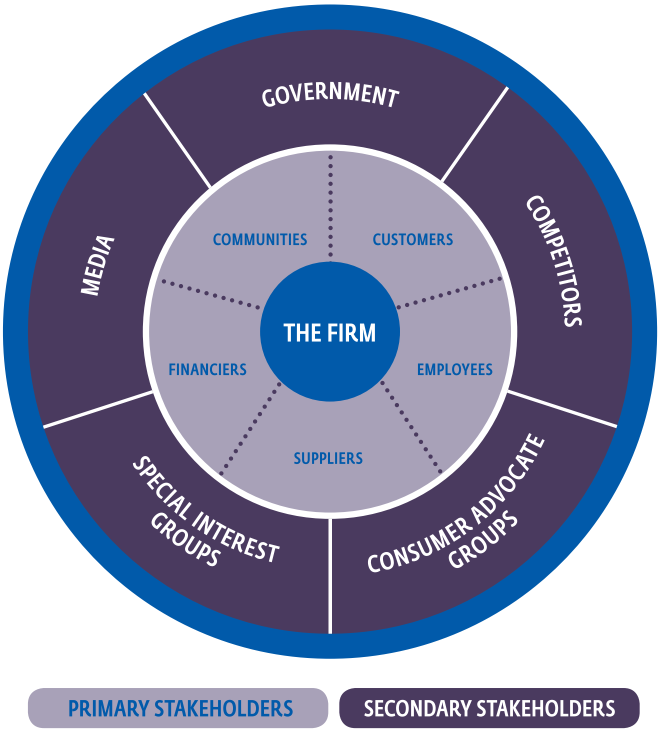

Figure 1: Broader notion of Stakeholders. Source: Freeman et al 2007

When a governing body decides to identify stakeholders, it needs to

- view the organisation as a separate legal entity with a strategy for which the governing body is ultimately responsible;
- locate the firm within a network of relationships that include individuals, groups and the environment; and
- understand how the stakeholders affect and/ or are affected by the organisation's strategy and operations and thus how value may be created or destroyed for different stakeholders including the organisation.

Due to the dynamic nature of the relationships and the interests, values and expectations of the various stakeholders, this identification and prioritisation needs to be reviewed periodically by the governing body. It will also require that the governing body has the ability and diversity within its structures to recognise how power structures influence voice, legitimacy and perceived urgency within stakeholder relations.

4 Preparing an Integrated Report. Integrated Reporting Committee. Retrieved from http://integratedreportingsa.org/ircsa/wp-content/uploads/2017/05/IRCSA_StartersGuide.pdf
5 Companies Act 71 of 2008, Section 76 (3) (b)
6 The King IV Report on Corporate Governance for South Africa 2016.

Six capitals model

As the understanding of value creation has expanded from a narrow focus on profit to a multi-dimensional construct encompassing both synergistic and conflicting interests of many stakeholders, so models have developed to support better decision-making. The Six Capitals model developed within the Integrated Thinking and Reporting Framework is a useful and commonly used example[7]. This model highlights the fact that one or more stakeholders have an interest in each capital (financial, manufactured, intellectual, social and relationship, human and natural).

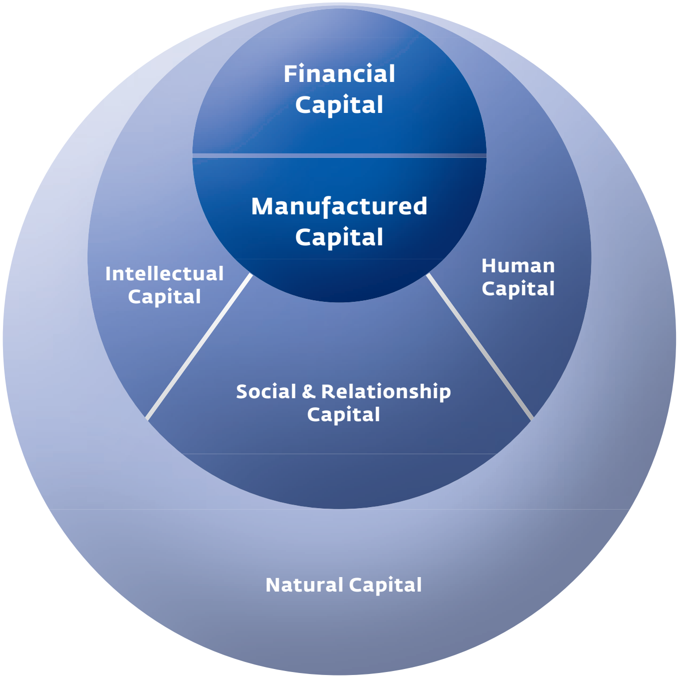

Figure 2: Six Capital. Source: www.integratedreporting.org

Social and relationship capital

Within this integrated framework, social and relationship capital plays a pivotal role in stakeholder engagement. It encompasses the institutions and the relationships within and between communities, groups of stakeholders and other networks, and the ability to share information to enhance individual and collective well-being.
It typically includes:

- shared norms, and common values and behaviours;
- key stakeholder relationships;
- intangibles associated with the brand and reputation that an organisation has developed; and
- an organisation's social licence to operate.

7 www.integratedreporting.org

Putting these principles into practice

The role of the Governing Body and the Social & Ethics Committee

Under King IV™, the Social and Ethics Committee has a role of oversight and reporting on organisational ethics, responsible corporate citizenship, sustainable development and stakeholder relationships. Furthermore, the intent is to encourage leading practice by having the Social and Ethics Committee play more than a compliance role; rather it should actively contribute to the organisation's value creation. This makes it the logical structure through which the governing body could work to drive congruence between developing a sustainable competitive advantage and long-term, healthy and harmonious relationships with the organisation's stakeholders. However, one of the Social and Ethics Committee's challenges can be that it functions in a silo, separately from the governing body. Here the role of the chair of the governing body and the chair of the Social & Ethics Committee comes to the fore; they need to be aligned in terms of the Social and Ethics Committee's importance to the organisation's sustainability.

The governing body should ensure that the Social and Ethics Committee has the mandate and authority to carry out this role effectively. Factors to consider to empower the Social and Ethics Committee include choice of members (considering stakeholder representativity – given that King IV™ recommends the Social and Ethics Committee consist of a majority of non-executive members of the governing body), role of the chair in the Social and Ethics Committee operations as well as the chair's skill at giving this committee a voice at governing body meetings.

Building and measuring sustainable and productive relationships

Stakeholder relationships develop over a spectrum and over time. Sustainable stakeholder relationships can be characterised by an increasing level of trust, resulting in different forms and structures of relationship, as illustrated in Figure 3[8]. This development is however seldom linear as many complex interactions between both stakeholders and the issues they are addressing shift constantly across space and time. A transparent and principled approach to these processes builds trust and strengthens the relationships.

Governing bodies are increasingly using a range of tools to build on the power of stakeholder engagement to anticipate and mitigate potential material risks through relational means. These tools can assist the organisation to adopt an evidence-based approach to assessing the health of its stakeholder relationships.

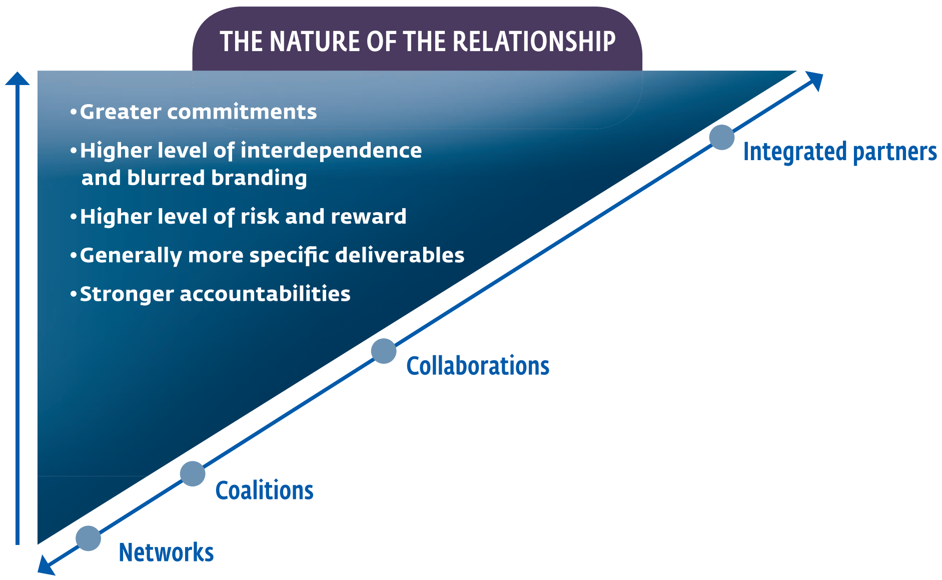

Figure 3: The spectrum of the stakeholder relationships. Source: Adapted from University of Cambridge

8 Cambridge Institute for Sustainability Leadership. Retrieved November 26, 2018, from https://www.cisl.cam.ac.uk/executive-education/learn-online business-sustainability-management-online-short-course

One such tool is the Relational Proximity Model[9], inspired by the work of Schluter and Lee[10], which encapsulates five objectives of business relationships through a relational lens as follows:

Domains of Relationship	**Objectives for Business Relationships: greater…**
Communication	Directness
Story/time	Continuity
Knowledge	Breadth of relationship
Power	Parity
Purpose	Commonality

Source: Schluter and Lee, 2009

The impact of improving the five relationship domains is in turn to enhance the relationship between stakeholders, which can also be understood as developing trust between organisations and their stakeholders. These relationships have the potential to increase the competitiveness of the organisation through greater directness, continuity, parity and recognition of diversity with a broad range of stakeholders. Figure 4 illustrates how these relationship domains have been translated into a tool which can be used by management and governing bodies to assess their relationships, allowing for comparison over time and with other organisations. As a governing body becomes confident assessing relational matters through qualitative and quantitative mechanism, it can consider asking selected stakeholders to also use both qualitative and quantitative methods to assess their stakeholder relationships in order to provide a basis of comparison, learning and change.

Having identified their stakeholders and material risks, the governing body is then responsible for ensuring that the organisation maps these to each other to assess those issues which are important for the organisation's sustainability in which identified stakeholders have some level of influence.

Stakeholder interests in any organisation are varied and potentially conflicting, thus raising the dilemma of making choices about which stakeholder needs take precedence. This is exacerbated by significant differences in understanding, access to information and the capacity needed to articulate and lobby for particular positions. In a South African context, profit versus inequality is a persistent issue in stakeholder management. The governing body needs to carefully consider how to acknowledge and address potentially conflicting needs of internal and external stakeholders. Increasing the diversity on the governing body may at the very least enhance the sensitivity of a governing body to such issues and thus support a more proactive engagement with stakeholders.

Relational Proximity® measures the elements that drive corporate outcomes

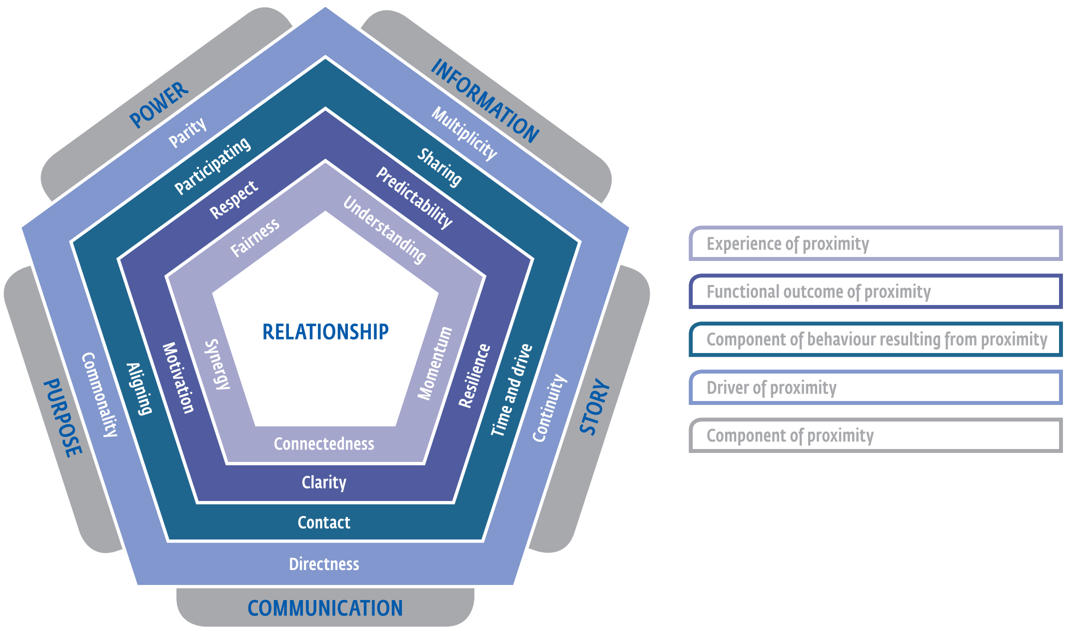

Figure 4: Example of stakeholder relationship representation. Source: Relational –analytics cited in Guptara 2016

9 https://www.relational-analytics.com
10 Ashcroft, Childs, Myers, & Schluter, 2016; Schluter & Lee, 2009

Deepening Stakeholder Engagement

Governing bodies in particular have a responsibility to set the tone for managing risk, building trust and relationships and enhancing the possibilities for innovation and the creation of new business opportunities that meet the needs of society and the environment in which the organisations that they lead operate.
Stakeholder engagement encompasses a number of interrelated processes all of which are important for governing bodies to consider in the execution of that responsibility. Three overriding considerations have implications for how governing bodies lead and reflect processes of stakeholder engagement:

- The identification of stakeholders and the relations among stakeholders and between the organisation and different groups of stakeholders;
- The types of communication and dialogue that are taking place or could take place and their implications for the interests of the organisation. Linked to this second consideration is a deepening of the engagement to support learning and change that creates value for multiple stakeholders including the organisation; and
- Last but not least, is an emerging challenge within the stakeholder theory that questions whether the processes of stakeholder engagement are being undertaken for instrumental reasons or are underpinned by more transformative agendas, particularly in relation to social justice and environmental sustainability.

Stakeholder engagement suggests more than merely communicating to stakeholders through, for example, annual reports. It suggests communicating with stakeholders through structured interactive and proactive processes aimed at creating sustainable strategies and ultimately sustainable value for diverse individuals and groups including the organisation itself. Recent literature[11] suggests that these processes should allow stakeholders to take part in stakeholder dialogues that create opportunities for stakeholders to participate in organisational decision-making processes. This will require capacity building on all sides to develop the emotional and institutional maturity to engage productively in this level of collaborative decision making.

Stakeholder value creation is a long-term outcome of a systematic approach by organisations to work with identified stakeholders and manage how stakeholder interests and power impacts the strategy, operations and reputation of the organisation. Strategic Stakeholder Management seeks to build social and relational capital across a diverse set of stakeholders through a gradual change in the nature and form of interaction as suggested in Figure 3.

Stakeholder engagement should provide opportunities for learning with and from stakeholders. This in turn will involve using criticism, feedback and dialogue as value creation opportunities for all stakeholders involved. Organisations that are ready to learn through the processes of stakeholder engagement create the possibilities of finding new ways of doing business and creating value through the relationships and networks that develop through this engagement. This is what King IV™ alludes to when it notes that a business "operates in, and forms part of, general society[12]"

Governing Body Responsibilities with regard to Stakeholder Engagement

Within the broad responsibilities of acting in the interests of the organisation that they serve, governing bodies and individual directors need to set the strategic direction of the organisation, approve policy that gives effect to the strategy, oversee and monitor implementation of strategy and policy by management, and ensure accountability for the organisation's performance through transparent reporting. Given the interdependence between the organisation and its stakeholders and the implications that this has for value creation and thus the interests of the organisation, governing bodies and directors are advised to play an active leadership role with regard to stakeholder relationships.

To deepen its sustainable, transformative approach to corporate governance, the organisation's governing body should consider incorporating the following initiatives within its own value creation and stakeholder engagement activities:

11 Boesso, G and Kumar, K, Examining the association between stakeholder culture, stakeholder salience and stakeholder engagement activities: An empirical study. Management Decision, 2016, 54(4), 815–831. https://doi.org/10.1108/MD-06-2015-0245
12 The King IV Report on Corporate Governance for South Africa 2016.

- Set the direction of how stakeholder relationships should be approached and conducted, within the context of the organisation's culture of ethical leadership;
- Ensure, through the nominations processes, that the governing body has the diversity and expertise to understand and engage with the interests of diverse stakeholders (including environmental issues) that have the potential to affect or be affected by the operations of the organisation;
- Approve stakeholder engagement policy;
- Include monitoring impact of stakeholder engagement on the governing body's agenda;
- Delegate responsibility, monitor implementation and ensure accountability for stakeholder engagement and the potential for value creation that it creates; and
- Regularly review:
    - The methodologies used for identifying stakeholders and their prioritisation within value creation and broader ethical considerations;
    - The mechanisms for engagement and communication with stakeholders;
    - Monitoring and evaluation of the quality of stakeholder relations particularly in relation to shared value creation and the potential for learning, innovation and transformation; and
    - The quality and transparency of reporting on stakeholder engagement and the potential for stakeholders and the organisation to destroy or created value across the six capitals[13].

Sustainability can be achieved through effective leadership that includes an internal focus on effective and efficient business operations but extends to external relationship building, legitimacy and the creation of new growth trajectories. It will also require ethical leadership that considers the positive and negative impacts of both the organisation's operations and the broader history of power and exploitation and seeks to move beyond narrow instrumental engagement of stakeholders to more transformative approaches that support broader sustainability and shared value creation. The governing body thus needs to play an active role in setting the strategic direction and tone with regard to stakeholder engagement.

13 The King IV Report on Corporate Governance for South Africa 2016.

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Notes

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