Politics, populism and trust in business: discussions for the boardroom

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Building a better working world

Foreword

For all their obvious differences, the landslide election of Emmanuel Macron in France, the election of Donald Trump as US President, and Brexit all have something important in common. They all appealed to an overturning of establishment consensus and they all offered a diagnosis of a society or economy moving in the wrong direction. They all appealed to voters' desire for change, a desire to punish elites and an instinctive sense of a society or economy moving in the wrong direction. To a greater or lesser extent this element of dissatisfaction and unease is present in most western politics.

Why do these messages of dissatisfaction resonate with so many voters, and why now in particular? This is a complex question. The financial crisis and the subsequent recession clearly had a major destabilising effect on politics. But a longer process of economic, social and technological changes over the last five decades have also produced a deeper sense of grievance that is part of the problem.

These decades have brought profound change in the structure of the labour market and the skills it values; change in the tenure of employment and the sense of stability and security that comes with it; change in the perceived power of local politicians to make choices that matter; change in the outlook of those who own companies and who they are accountable to. None of these factors is purely negative – most have produced big positive changes too. But all have left their mark on public attitudes.

Clearly this matters for business. As agents of economic change, large companies in particular often find themselves part of this political debate. They are often accused of benefiting from greater work place insecurity, wielding unacceptable market power and profiting from job destruction. Critics often see a growing divide between a class of global managers and an increasingly insecure and undervalued workforce.

Increasingly, public debate and political challenge is focused on a set of fair play questions linked to the way companies conduct themselves not in the rainforests or distant factories, but 'at home': in their approaches to tax and pay, their treatment of their workforce and their attitude to their local commitments. Politics is now routinely reframing global economic rationality questions as local loyalty questions for businesses. What is legal, or even socially acceptable today, could easily fail the tests of a shifting zeitgeist tomorrow.

Populism is a slippery term that evades easy definition. The instinct of the EY team here is the right one: which is not to get distracted by definitions, but to distil the challenge of populism to the challenge of understanding the way public expectations of large businesses are evolving. Boards and management need to understand how their companies might be exposed to this political mood and the policy changes it will inevitably bring. And then they need to judge how to respond. In this report EY have drawn on long experience in advising boards on navigating risk to provide some useful and thoughtful suggestions.

What is striking about the interviews that EY and Global Counsel conducted for this report is that in almost every case, board directors saw this both as a question of commercial advantage but also as an exercise in sustaining or renewing a clear sense of social purpose and integrity in the companies they lead. With governments increasingly tempted to reach for legislation or regulation to try and impose their version of accountability on companies, there has never been a more important time for boards to think about their own response to this challenge.

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About Global Counsel

Global Counsel is an advisory firm that helps companies and investors to anticipate the ways in which politics, regulation and public policymaking create risks and opportunities, and to develop and implement strategies to meet these challenges.

Global Counsel work across a wide range of business sectors, including financial services, energy, technology, media, manufacturing and telecoms from offices in London, Brussels and Singapore. The team is made up of former policymakers and political advisors with experience at the highest level of public policymaking in national governments and the European institutions.

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Introduction

The world is changing more quickly than ever. In the UK, political change has increased uncertainty and trust in business is in the spotlight.

For many years, the Global Risks Report published by the World Economic Forum has been tracking long-term trends including deepening social and political polarisation.[1] Their latest report details how these trends came into sharp focus during 2016, with rising political discontent and disaffection evident in countries across the world and particularly in the UK and the US. As a source of economic power and an agent of economic change, big business is often a target for political movements driven by a feeling that the existing political system represents the interests of an elite class but not wider society.

To explore the implications of this for corporate governance in the UK and understand how boards can respond to this shifting mood, EY and Global Counsel interviewed a total of 20 senior politicians, business leaders and board directors across a range of sectors. The interviews were based on a series of hypotheses (as shown in the appendix) which were formulated to stimulate debate and provoke thought rather than necessarily representing the views and beliefs of EY and/or Global Counsel.

This report draws on the reflections gained from these interviews, as well as our own thoughts, covering the impact of recent political trends on business in the UK and providing practical considerations for boards on:

- Understanding and acting on political risk
- Risk and opportunity identification through stakeholder engagement
- Navigating uncertainty with broad business purpose
- Wider awareness of the business environment enabled by board diversity

In times of political uncertainty, boards need to understand how public and political expectations of business are evolving, and judge how to respond. This is a challenge of leadership, but also a test of a board's ability to read a changing landscape in which there are risks as well as opportunities. These are complex issues so this report is not a comprehensive analysis but reflections on what we have heard and some suggestions to prompt debate. We welcome your thoughts and comments on its content.

1. World Economic Forum, *The Global Risks Report 2017: 12th edition*, 2017.

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The impact of politics and trust in business in the UK

The World Economic Forum explains that 'despite unprecedented levels of peace and global prosperity, in many countries a mood of economic malaise has contributed to anti-establishment, populist politics and a backlash against globalisation'.[1] A variety of economic and social issues over the last few decades have been linked to this malaise. For example, economic recovery from the financial crisis and rising income and wealth disparity (although poverty has dramatically decreased in emerging markets). Technology and the rise of social media have also played a role in increasing fragmentation of sections of society and polarisation of attitudes and beliefs. As one interviewee put it, 'emergence of polarised political views has happened before in times of uncertainty but what's different now is how quickly ideas can gather momentum — populism becomes political very quickly and then politics interferes in governance and markets very quickly.'

The 2017 Edelman Trust Barometer found that in the UK, 60% of people currently feel that the system is failing them, which is above the global average.[2] To the extent that business is viewed as part of the 'system', business is considered by some as part of the problem. Critics point to a perception of a growing divide between a class of 'global managers' and an increasingly insecure and undervalued workforce. General popular support for and trust in business in the UK has ebbed and flowed but it is currently at a marked low. In 2017, only 33% of Britons said they trusted business. Even amongst high net worth individuals, levels of trust in business have declined.[2] Another recent survey, of 2,000 people in the UK, found that less than half of the British public (48%) believe that British business is behaving ethically.[3]

This has clear implications for business in the UK. Trust in business is a key enabler in creating investment. It affects consumer and other relevant stakeholder attitudes and builds licence to operate. Policy making during periods of low trust in business, anti-business rhetoric and political polarisation can represent a risk for many businesses. 7 in 10 respondents to the Edelman survey on trust, believed that the Government should impose trading restrictions to prevent job losses, and should protect jobs and local industries in the UK, even if the economy suffers. In Global Counsel's 2017 review of FTSE 100 annual reports, UK policy change in areas such as levies, data protection, tax policies and financial regulation stood out as the single biggest political risk identified by companies.[4] One non-executive director of two large multinational listed companies said she sees the impact of populism manifesting in different companies in different ways – it can come through on product pricing, political pressure, or executive pay, for example — but the genesis is the singular focus that most companies have had for many years on maximising shareholder value rather than taking a balanced approach. However, there are also opportunities for those businesses able to analyse political trends and find opportunities to rebuild trust.

There are some key issues that public perceptions of business have centred on in recent years. Most notably, tax avoidance and executive pay (which have ranked

1. World Economic Forum, *The Global Risks Report 2017: 12th edition*, 2017.
2. Edelman, *2017 Edelman Trust Barometer – UK results,* January 2017.
3. The Institute of Business Ethics, *Survey: Attitudes of the British Public to Business Ethics,* 2016.
4. Global Counsel, *Hard and soft political risk: what FTSE 100 companies have to say,* June 2017.

highly since 2012), as well as, exploitative labour, work-life balance for employees and data privacy. It is interesting to note that in these times of growing isolationist politics, the top rated issues affecting public perception of business have seemed to move further toward issues 'at home' rather than on global operations, where issues of corporate ethics have often historically been focused.

These public perceptions lead to questions for boards such as: what is a fair approach to employment contracts? How and to what extent should taxes be optimised? How do we weigh the impacts of automation, restructuring, and M&A beyond the bottom line? How can we be sure that what is legal, or even socially acceptable today, will not fail the tests of tomorrow? How do we adequately explain our decision making to our consumers and stakeholders on these issues?

One interviewee referred to a major company which has managed to introduce automation and grow jobs along the way for example, finding win-wins for a variety of stakeholders.

An initial discussion about public expectations and how and why they are shifting is a key starting point for understanding and acting on political risk. Most of the directors we spoke to, in the interviews for this report, were keen to proactively discuss these issues and address changing expectations and attitudes of stakeholders and the public with some directors already having had some of these conversations on their boards. As one interviewee said, 'as it seems that the societal shifts we have witnessed in recent years are here to stay, it's important for boards to be careful and unpick the trends'.

Key considerations

- What information does the board have about perceptions of the company, its culture or levels of trust in company leadership? Has this been used to help identify any areas of concern for stakeholders?
- In what areas is the business affected by public perceptions and has the board had a discussion about key issues that impact public trust and come to a collective view of how these issues should be approached?
- Does the board culture or tone create any pressures for executives toward short term behaviour or insufficient consideration of reputational and ethical issues?

2

Understanding and acting on political risk

How do boards incorporate assessments of political risk into their wider deliberations and strategy? How much of the company's political risk profile is the board being properly exposed to? For example, given the profile of employment conditions and work-life balance issues, and the exposure of companies to failings in these areas through social media, how aware is the board of the company's employment and human resources policies? What information does it get on these to enable it to ask the right questions? Similar questions might be asked about data protection, tax structuring and sales and marketing practices. Boards should be keeping a close eye on their principal risks and ensuring that they encompass any emerging trends that may impact the key risk areas for the business.

Political risk discussions are often event focused – for example, on the outcome of an election – rather than exploring deeper underlying trends and potential causes which help explain why the event occurred. This may mean boards don't fully evaluate their company's resilience to bigger shifts, since they focus on – for example — a change of government. Events can be easier to describe for the purpose of a risk register, but it is trends that ultimately matter most. Is the board's view of socio-political risk analysis event-driven, or trend-driven and if the latter, how does it monitor these trends including the speed at which they are evolving?

As one interviewee put it, 'populism itself would be unlikely to appear on a risk register anywhere but consider including the elements which add up together as populism and then dealing with them each separately in the boardroom'.

Another added: 'If you think complying with today's legal system is all you have to think about then it's very short sighted. We've seen time and time again that laws change through time and you can be punished for sins of the past very easily. It's best to think about your role in society and how you fulfil that role'. Another interviewee said: 'I've come across situations where the board have discussed a tax planning issue and asked not only whether it is fair and right for society but also thought about the risks to the company and its reputation. The company decided not to pursue the scheme – which was legal but perhaps on the aggressive end. We might get away with it today but we might find ourselves in trouble in two years' time so we won't do it. So the conversation is not couched in terms of what's right for society but the result is the same'. In other words, thinking about underlying trends rather than just the system or rules of the day, can help directors get ahead of the curve in their thinking and better manage risk for the long term.

Being engaged with regulators and the Government is also key. There was a desire amongst the interviewees for the Government to focus on advisory tools and guidance rather than legislation and for Government to also make sure that they are speaking to businesses and dealing with issues in a joined-up way. There was a clear view amongst many of our interviewees that the understanding of business within government could be improved in order that public policy changes are impactful and appropriate. Some mentioned that business should therefore get on the front foot by engaging more proactively with government and regulators. A good opportunity for business to help shape change in a way that provides sufficient flexibility and foresight of long term impacts exists as the Financial Reporting Council (FRC) is consulting on revisions to its Corporate Governance Code. This update will incorporate some of the FRC's recent work, for example on corporate culture and succession planning, as well as key issues raised in the Government's response to its Green Paper on Corporate Governance and the recommendations issued in April 2017 by the BEIS Select Committee inquiry on Corporate Governance – both of which stemmed from a desire to ensure that we have an economy that 'works for everyone'. There will also be a renewed emphasis on the duty for directors to consider the interests of a range of stakeholders, and report on how they have discharged this duty. This is discussed further in Section 3 of this report.

Several interviewees also referred to a lack of an effective collective business voice. As one interviewee said 'we don't have a collective business voice and no one business wants to stand out – so as a result we do nothing' and another pointed out that 'whereas populist activists agitate in a united way, have united aims – large companies don't always do that, so it is easy for populists to divide and rule. The bodies that exist to create this collective business voice are under challenge and haven't really dealt with this point and clearly shown the value they are delivering'.

Key considerations

- What is the board's risk appetite and exposure to political risk?
- Does a conventional approach to the risk register leave the board too exposed to dealing with political risk as a series of 'events', rather than a set of deeper and wider trends and expectations?
- What information is being presented to the board on political risk and does it make use of all potential information sources?

3

Risk and opportunity identification through stakeholder engagement

Sir Adrian Cadbury, pioneer of the UK Corporate Governance Code, observed that although boards are tasked with stewardship on behalf of shareholders and stakeholders, they have a tendency 'to look inwards at management rather than outward to the owners and how best to govern on their behalf'.[5] This is a risk for boards, particularly when operating in an increasingly uncertain environment. Stakeholder engagement can be an effective tool for navigating socio-political risk as well as identifying opportunities.

A key area for discussion with interviewees for this report was around shareholders, customers, employees and government as potential agents for change or sources of pressure on business. Some of this pressure comes through the channels as shown in Figure 1.

However, the business leaders we spoke to were generally sceptical about the extent to which any of these sources will be a consistent and strong enough voice to impose sufficient pressure on their business to create change. For example:

On customers: We heard that with a low wage inflation outlook it was unfair to ask customers to bear the burden for holding business to account. And in any case, interviewees emphasised the need for boards to respond long before there is an impact on sales, as at that point, it can be too late. Whether it is about responding to customer needs or customer values, it is always best to stay ahead of the curve.

On shareholders: We heard that with the change in shareholder classes, holding patterns and objectives, it was not appropriate to treat shareholders as a homogenous group. In general, short term holders (e.g., hedge funds) are less interested in a company's environmental, social and governance (ESG) activities. Therefore boards needed to make a judgment to balance these interests and 'promote long term success' in a way that takes account of the varied shareholder and stakeholder interests.

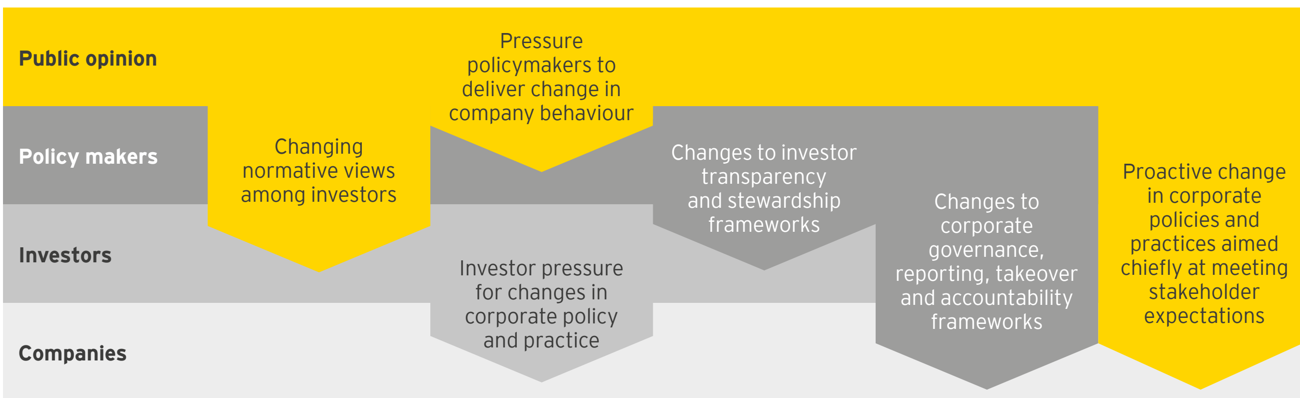

Figure 1. Channels for changing expectations

5. Sir Adrian Cadbury cited in: Carver and Oliver, *Foreword: Corporate boards that Create Value,* 2002.

On employees: Interviewees noted the increasing power of employees to influence boards. However, they largely felt that this should not extend to employee representation on boards, citing the need to maintain the unitary board and wider director responsibilities to all stakeholders, not just representation of one group (more on this in Section 5).

On government: It was also widely felt that, especially in the recent past, the Government does not have the understanding of business necessary to make regulation that is suitable and useful. Politics is on a relatively short term cycle itself, making the Government prone to 'knee-jerk' reactions to public outcry. All of the interviewees felt that the existing regulatory regime was sufficient in terms of allowing flexibility for business to make the decisions that work best for them whilst also being responsive to changing expectations. Although there are areas where the Government could help create change on a greater scale by levelling the playing field, as one of our interviewees put it, 'the question is, what can we all be doing in our corner?'.

On business to business: This can come in the form of companies asking suppliers about standards and ethics. This may be increasing with the introduction of, for example, new regulations on *Transparency in supply chains* (which requires companies to make a public statement on steps taken (or that none were taken) to ensure that modern slavery and human trafficking is not taking place in any part of the business or supply chain).

There was a consensus amongst interviewees that pressure from any of these sources is unlikely to be consistent.

In this context, the boardroom is a key locus for balancing interests and demonstrating leadership. Many of the interviewees echoed the idea that 'the antidote to populism is leadership' and, in particular, leadership that engages with stakeholders and adapts to feedback.

It was felt that many business leaders speak privately about a desire to improve long-termism and consideration of a variety of stakeholders, but that there is no collective voice of a generation of business leaders taking this public stance.

Identifying key stakeholders

Interviewees echoed the idea that 'boards need to have a clear idea of their stakeholders and the priority with which their needs should be addressed'. Every large company has a wide set of relationships and interdependencies, including financial, legal, as well as moral responsibilities. To get to a broad picture of all of these, it can be useful to ask: What would happen if our company disappeared tomorrow? Who would be impacted? Who would start the company again because they value the broader contribution the company provides for society? This can challenge boards and management to think in the widest sense about the effects of the company's activities and its position in a wider network of interests and values. There are a variety of tools for stakeholder mapping and analysis that boards can use, including matrices that help differentiate between influence and interest, power and impact etc.

While boards cannot always act on every part of such an analysis, companies and boards that have an embedded understanding of who they operate on behalf of, who depends on them and who they depend on, will have a clearer sense of the consequences of their actions.

This kind of broad stakeholder mapping can also help a company to more easily identify win-wins for society and business by having better sight of the variety of interests and where these align or compete. They will have a clear framework for thinking about stakeholder engagement and the networks of communication needed to build understanding, respect and investment. In a period of falling trust in business and concern for the 'unrootedness' or global, ubiquitous nature of some large businesses, such engagement can be an important way of sustaining rootedness.

Key considerations

- Who are the key stakeholders of the company? Has the board conducted a stakeholder mapping exercise?
- Is the board's understanding of stakeholders sufficiently specific to understand which groups are relied upon or impacted by the company the most?
- How does the company create value for and engage with stakeholders?
- How well can the board articulate how it has fulfilled its duties to take the interests of a variety of stakeholders into account (as per Section 172 of the Companies Act)?
- As well as relying on traditional investor relations mechanisms what is the board doing itself to get its own sense of stakeholder perspectives?
- Is the board's approach to engagement proactive or reactive?
- When making strategic decisions how does the board demonstrably use and consider both shareholder and stakeholder feedback?

Stakeholder engagement and reporting

Many large companies already have comprehensive and active stakeholder engagement programmes and some report on their engagement. However, from our reviews of FTSE 350 narrative reporting, this is often limited to shareholder meetings and an employee engagement survey. Disclosures on engagement tend to provide high level descriptions of what the engagement was or how it was conducted and what types of value the company creates for different stakeholders (e.g., local employment, taxes paid etc.). There is often less evidence of two-way communication, i.e., gathering the input, feeding back the company's response and then the board integrating and taking it into account as part of their strategic decision making. One interviewee made a distinction between open-mindedness and 'active open mindedness'. That is, where directors and CEOs actively ask their employees and stakeholders "what do you think we should be doing/what are your ideas/how would you balance these priorities?". In these fast moving times, it's important to have some active solicitation of views, and not just passively wait for feedback. In addition, one interviewee commented: 'Does the way that companies communicate about the good they are doing need to change? Is it outdated? They broadcast it but it tends to be done corporately and it's too packaged. Some companies that do it well engage their staff and customers as a channel for communicating external messages, for example having staff at investor presentations'. A considered approach to stakeholder engagement should encompass the following elements:

- Identification of the sub-sets or categories of stakeholders you plan to engage with and how you plan to gather input from them. Surveys are useful, but there is often merit in direct engagement e.g., focus groups which can be used to follow up on survey findings with a sub-set of respondents, or other fora. Use the variety of different methods available depending on what is most suitable for each stakeholder group.
- Gathering views on what may impact the overall long-term future direction and priorities of the company, and not just the stakeholders' issues and concerns of today. Be as transparent as possible about the dilemmas/choices the board faces and the pertinent information that needs to be considered.
- Balanced input. Engagement should help identify risks, overlooked opportunities and potential weaknesses. It's important not to suffer from confirmation bias when collecting feedback, which is a human instinct.

- Feedback channels for the stakeholders you engage with such that engagement becomes a dialogue. Be clear on how the company will demonstrate its responsiveness to the feedback elicited. Use the stakeholder dialogue to build the trust you will need to secure support for change.
- Clarity on what information from these activities will filter to the board and how, including how this will inform board debates and conversations and how the outcomes will be fed back. From time to time board members themselves should be actively engaged in participating in the company's engagement activities.

Across all of the interviews we conducted was the clear view that for boards to exercise this type of leadership does not require change to the corporate governance regulatory framework. In the UK, Section 172 of the Companies Act already provides a framework for broad stakeholder consideration.

However, as one interviewee put it, 'it requires a willingness for transparency and accountability – you have to behave your way into trust'. The Government and the FRC are focused on improving boardroom behaviours and reporting in line with this Section 172 duty.

To help articulate long term value creation for a variety of stakeholders, based on rigorous research and stakeholder consultations, EY have proposed a proof of concept framework – The Long Term Value Framework – to understand, measure and communicate the broader value companies create through their investments in their purpose, brand, IP, products and employees, environment and communities.[6] This framework is being further developed by The Embankment Project for Inclusive Capitalism, led by the Coalition for Inclusive Capitalism in collaboration with EY.

Section 172 – a licence for leadership?

Duty to promote the success of the company

1. A director of a company must act in the way he or she considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to–

   (a) the likely consequences of any decision in the long term,

   (b) the interests of the company's employees,

   (c) the need to foster the company's business relationships with suppliers, customers and others,

   (d) the impact of the company's operations on the community and the environment,

   (e) the desirability of the company maintaining a reputation for high standards of business conduct, and

   (f) the need to act fairly as between members of the company.

2. Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.

6. EY, **http://www.ey.com/uk/en/services/assurance/ey---long-term-value**, 2017.

4

Navigating uncertainty with broad business purpose

Alongside stakeholder engagement, broad corporate 'purpose' was another consideration raised by interviewees as a tool for navigating political risk, anti-establishment and anti-business sentiment. A clear purpose can be an anchor in uncertain times and a way of affirming social licence to operate amidst political uncertainty and declining trust in business. Businesses are increasingly being asked to define their purpose as something that encompasses shareholder value but also societal value, which includes economic and social value. Many of the directors we interviewed expressed a desire to see their companies playing a wider social and economic role and a desire to inspire employees — and investors — with the same sense of purpose. One interviewee suggested 'you have to give a company a personality, make it a human concern, make it a personal thing'. Another said: 'What has happened over the last decade is that charities can't operate without commercial aims and commercial companies can't operate by just obeying the law. The contract has changed – to have a successful business you must engage and do more. Expectations have changed dramatically'. It's important that this is led by business however. On the topic of purpose, one interviewee said: 'There are a number of businesses working on the hypothesis that purpose is linked to performance and I don't think you can legislate for that. You've got to let the market manage it and I think the market will'.

In a recent survey of 1,500 global business leaders conducted by EY's Beacon Institute, 73% of respondents said that having a well-integrated purpose will help their company navigate disruption.[7] Broad purpose can help with navigating uncertain, disruptive times, for example, by providing agility to adapt to changing customer needs without being limited to a narrow objective or short term target, which creates more sustainable long term performance. The survey also found that the more integrated a company's broad purpose was, the more value the company was able to create for all stakeholders.

A 'capital P' purpose is one that articulates value for a broad set of stakeholders including society and the environment and/or an aspirational reason for being that is grounded in humanity and inspires a call to action. Business leaders that understand the need for a broader purpose and can communicate this may be the ones best equipped to anticipate and manage political demands and express their company's value in a way that resonates with stakeholders, humanises their business and inspires support. One interviewee said that 'in tech, there is definitely a sense that if you are not purpose/value driven then you are behind the times'.

However, it is important that businesses go beyond 'statements' of purpose and truly align their strategy, key performance indicators and reporting to ensure that statements are backed up by action. In this increasingly transparent world, corporate behaviours inconsistent with public statements can become public knowledge very quickly and have a significant impact on reputation, trust and investment.

A number of interviewees discussed the need for more entrepreneurial, inspirational leadership from UK business. As one interviewee said 'there is still a lot of short term pressure from the financial community which is difficult to side step' however, it was also emphasised that courageous business leaders are able to bring

7. EY, *How can purpose reveal a path through disruption?*, 2017.

shareholders with them on their journey to a more purpose-driven business and inspire support. There are examples of this being done in some well-known companies already. For those not yet on the journey, directors may find themselves 'knocking at an open door' as many shareholders are increasingly focused on ESG issues and viewing the proper management of these as a differentiator.

Key considerations

- Does the company have a capital 'P' purpose?
- Has the board gathered buy-in from stakeholders on the purpose and long term direction of the company?
- Is the strategy and culture of the company aligned with the stated purpose?
- Do the designed measures of performance link to progress on the achievement of strategy and allow the board to get insight into the achievement of the company's purpose? Are the measures focussed on outcomes rather than activities?
- Are the non-financial metrics used by the board appropriate for getting a good picture of the culture of the company?

5

Wider awareness of the business environment enabled by board diversity

Another challenge in governing companies through a period of political and social polarisation is ensuring that the board has the right diversity of thought. Boards need a collective sensibility capable of accurately assessing public perceptions and stakeholder interests.

In 2016, the Peterson Institute for International Economics, with support from EY, released a study of more than 20,000 firms in over 90 countries which found a significant correlation between women in leadership and company profitability. It found that companies with at least 30% female leaders had net profit margins up to 6% higher than companies with no women in senior ranks.[8] Another study from the Center for Talent Innovation of more than 40 case studies and 1,800 employee surveys, found that companies with multi-dimensional diversity were 70% more likely to have captured a new market in the last year. In addition, teams that had one or more members who represented a target end-user were up to 158% more likely to understand their end-users and innovate accordingly.[9]

Over the last five years gender diversity has been in the spotlight and encouraging progress has been made, with more work still to do, particularly at the executive level. However, interviewees also highlighted a need to consider broader aspects of diversity, including social background.

How many boards and management teams in large companies, populated by educated, internationalist women and men found themselves surprised by Brexit and the rise of President Trump? Perhaps more than would admit it. If boards consist of directors who have only ever experienced one part of the overall system businesses exist in, then they are operating on partial information and might only be used to one way of thinking which can lead to group think, missed opportunities and unrecognised risks.

Boards cannot be microcosms of society, but the processes that produce individuals equipped to fulfil director roles may also have a homogenising effect on their worldview or leave them 'out of touch' with wider public opinion unless this is actively challenged and tested. Perhaps consideration of diversity of social and economic background is an area that needs future focus. Given the more intangible and broader nature of this aspiration, the means to achieve it may indeed be very different to what was done to improve female representation on boards. One interviewee also highlighted the need to get more young people on boards and EY supported the Parker Review into ethnic diversity of UK boards which is also an important area of focus.

Successive UK governments have proposed at various times that there should be better mechanisms for boards to hear the 'voice' of certain stakeholders — employees in particular — in the boardroom. Yet the aim for boards should not necessarily be to appoint representatives of stakeholder groups, but to build (or have access to) a group of people capable of providing input and challenge. Varieties of perspective can also be brought in to the board through research, presentations or external advisors. All directors on the board have the same responsibilities to all stakeholders and should not be there only to voice concerns or 'fight the corner' of one group. However, it is vital for boards to bring the outside world and a variety of perspectives into the boardroom in one way or another.

8. Noland, M., Moran, T., and Kotschwar, B., *Is Gender Diversity Profitable? Evidence from a Global Survey*, February 2016.
9. Center for Talent Innovation, *Innovation, Diversity and Market Growth*, September 2013.

Key considerations

- Does the board have sufficient diversity of perspectives around the board table (and if not, the ability to access these perspectives) to inform judgements?
- Is the board sufficiently aware of issues and trends across different sections of society and how these might impact the business or where risks and opportunities might lie?
- Does the culture of the business support diversity and inclusion?

Conclusion

Based on discussions with senior politicians, business leaders and board directors across a range of sectors, we found that with political uncertainty on the rise and trust in business in decline, there are risks and opportunities for business and some key considerations for boards:

- Socio-political risk analysis that goes beyond an 'event' lens is important for ensuring broad oversight of the public perceptions underlying political trends.
- Stakeholder mapping and engagement can be useful as a tool for identifying risks and opportunities further ahead.
- Articulation of, and alignment with, a broad corporate purpose can help to affirm social licence to operate and navigate disruption.
- And finally, board diversity, in its broadest sense and including a variety of social backgrounds, can equip a board with an improved collective sensibility for assessing and balancing public perceptions and navigating political risk.

Our many thanks to all those who participated in the interviews for this report.

Appendix

List of hypotheses used for interviews for this report

The interviews EY and Global Counsel conducted for this report were based on a series of hypotheses which were formulated to stimulate debate and provoke thought rather than necessarily representing the views and beliefs of EY and/or Global Counsel. Directors looking to discuss these issues in further depth within the boardroom can use these hypotheses to frame a discussion, prompt debate and gather diverse views and perspectives.

Politics, populism and corporate governance: pitchforks at the gate or passing storm?

First, do you think that we are seeing – or will see – growing pressure in the UK (or elsewhere) to change the way large companies are run, or to re-define their responsibilities in certain ways?

Would you agree that:

1. "Populism matters for boards because it is contributing a wider political debate about how accountable large companies should be to their wider communities and for what. It will produce growing pressure to change the way large companies are scrutinised, regulated and run."
2. "Large companies are broadly failing to win strong public support because they are perceived as having become too detached from the societies in which they operate and their interests no longer fully aligned with those societies."
3. "There is a social and political contract between business and society that extends beyond obeying the law – and many people feel that this contract is not being honoured."
4. "Many boards have thought about 'populism' through an 'event lens', for example, Brexit and Trump, but have not been spending as much time thinking about the underlying causes of/forces behind these events and how they could impact the companies they govern."

Second, assuming you do see this potential for change, how do you think it might ultimately be brought to bear on companies and boards?

Would you agree that:

5. "Investors are not ultimately going to be a consistent channel for this sort of pressure for social responsibility (except in areas such as carbon disclosure where it is framed as risk exposure), because they do not see its link to their return or fiduciary duty."
6. "Customer pressure can be strong on sourcing issues around products and conduct issues in specific situations, but it is unlikely to ever be applied in a focused way on issues of employee treatment, tax structuring or executive pay. Customers care most about cheap, reliable, quality products and services."

7. “It is inevitable that governments will now move to redefine the obligations of boards/companies in new areas such as tax structuring, takeovers, working conditions and executive pay. Governments no longer believe either managers or investors are ultimately able to show this form of engaged leadership.”

If you agree that demand for change from consumers and investors for change is likely to remain uneven and inconsistent, do you think this is evidence that there is no real consensus that change is needed, or an invitation for company leaders to step in and exercise their own judgement? Can they do this?

Finally, as they look ahead, boards clearly need to consider how they engage with these questions and how far they are required to change.

Would you agree that:

8. “The problem for boards is that many of the ‘fair deal’ issues driving political discontent exist in a grey area that is not clearly defined by law. This is a very problematic area for boards to try and go.”

9. “Board members need a clearer mandate to direct the companies they govern to take decisions based on judgements of social responsibility. At present, they are too often asked to weigh ‘soft’ notions of stewardship against ‘hard’ notions of fiduciary responsibility. This is not tenable.”

10. “Boards cannot be asked to take responsibility for the social impact of practices such as zero-hours contracts or increasing automation if these things represent efficiency and profitability gains for a company. The costs of asking boards to subordinate these things to questions of fairness is ultimately paid by the economy as a whole.”

11. “S172 of Companies Act 2006 provides all of the scope we need to engage with these problems – it is largely about how boards interpret their responsibilities and how confident and engaged they are in ‘auditing’ company behaviour against social expectations.”

12. “We need a new notion of corporate citizenship that covers more clearly the duties that boards have to the societies their companies operate in. This needs to eliminate some of the grey area between the ‘spirit’ and the ‘letter’ of the law in areas such as tax.”

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