Deconstructing the Section 172(1) statement
Introduction

For more information on section 172(1) statement qualification criteria, see page 22.

New requirements

In the last two years, the UK corporate governance framework has undergone a comprehensive review, resulting, amongst other things, in a revised UK Corporate Governance Code (“2018 Code”) for premium listed companies and the Companies (Miscellaneous Reporting) Regulations 2018 (“MRR”). These reforms ultimately aim to restore trust in business, including by requiring that boards demonstrate how they have discharged their section 172 duties under the Companies Act 2006.

Section 172 imposes a general duty on all company directors to act in the way they consider, in good faith, would be most likely to promote the success of the company for the benefit of its shareholders as a whole. It also requires directors, in making their decisions and choices, to have regard to a non-exhaustive list of factors (e.g. the interests of employees) to ensure that, in promoting the success of the company for the benefit of its shareholders, broader implications of decisions are considered.

For years beginning on or after 1 January 2019, certain companies will have to include a separately identifiable section 172(1) statement in the Strategic Report within their Annual Report and Accounts (“ARA”), explaining how directors have had regard to the matters set out in Section 172(1)(a)-(f) of the Companies Act 2006.

Section 172(1)

Companies Act 2006

‘Duty to promote the success of the company’

1) 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 –

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.

For more information on section 172(1) statement qualification criteria, see page 22.
Deconstructing the Section 172(1) statement

The recent release by the Business Roundtable of its “Statement of the Purpose of the Corporation” – signed by the CEOs of 181 major US corporations – indicates a growing awareness by business of the broader role of companies beyond the maximisation of profits. Increasingly companies are reflecting on how to communicate their purpose to shareholders, and how their purpose is aligned to long-term corporate strategy and capital allocation. This brings benefits through improved engagement with increasingly active shareholders and the prospect of dialogue focused on strategic issues rather than the vagaries of short-term profits. Corporate reporting under section 172 of the Companies Act 2006 provides an opportunity for achieving these goals.

Andrew Parry (Member of the Investment Committee, Trafalgar House Pension Trust)

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EY viewpoint

In our view, the purpose of the section 172(1) statement is not to provide a justification or rationale for every principal decision made by the board, but rather explain how directors considered the matters within the section in reaching those decisions, including situations where boards may not have engaged on all such matters with impacted stakeholders.

The challenge facing companies, is to provide meaningful reporting that achieves the right balance between being succinct and not duplicating information that is already provided elsewhere, whilst bringing together all the relevant information in a separately identifiable statement. If companies don’t apply the spirit of MRR and report in a boilerplate manner, in our view, there is a risk that additional regulatory and reporting requirements will be imposed in the future.

Our conversations with investors have confirmed that they see the new disclosure as one, that if done well, can provide valuable insights and drive better engagement between the company and investors. So, whilst we recognise that companies will find the new requirement a challenge – at least to begin with – it is one worth rising to.

We expect that in the first year, companies’ reporting may not be fully developed as for many the processes to engage with stakeholders are new or if not, the scope of engagement may be different. Equally they may also find it difficult to articulate the impact that engagement has had on board decision making.

We expect that reporting will evolve over the course of three cycles and our aspiration is that over time and after a few cycles companies will start disclosing information on key stakeholder outcomes1 as well as the metrics used by the company or board to monitor how it delivers against those outcomes. This should facilitate an articulation of, not only the immediate impact of principal decisions on stakeholder groups, but also the impact on their long-term interests and help stakeholders get a better understanding of how the board has evaluated the impact of principal decisions on them.

A company does not operate in a bubble or a vacuum; it continuously interacts with a variety of stakeholders important to its success, such as customers and employees. The section 172(1) statement is an opportunity to evidence a company’s commitment to wider value creation, which is what investors are looking for in understanding how these stakeholders’ interests are managed in the pursuit of long-term viability and advantage.

Freddie Woolfe (Head of Responsible Investment and Stewardship, Merian Global Investors)

Overview of our approach:

Our conversations with ARA preparers have indicated, that companies are still working towards determining what the section 172(1) disclosure will look like and how information required to produce the statement needs to be captured.

This paper suggests a framework that will help boards and those involved in preparing for the new disclosure requirement focus on what a board has done, assist in collating the required information and, if completed early, identify any potential gaps in stakeholder engagement. We hope the framework will also be a useful starting point for drafting the section 172(1) statement.

With these in mind, our paper:

• Brings together the relevant regulatory requirements and guidance applicable to premium listed companies;
• Includes practical examples, which illustrate how decision making can be influenced by stakeholder engagement; and
• Covers the practical considerations for processes ahead of reporting.

We recognise that our approach is detailed and may not be entirely suitable to be deployed in private companies or at subsidiary level, but hope it provides a framework which such entities can customise appropriately should they wish.

1 Stakeholder outcomes are the fundamental dimensions of performance that matter to different stakeholders and are therefore most material to the business.
Deconstructing the Section 172(1) statement

The purpose of the strategic report is to inform shareholders how directors have performed their duty to promote the success of the company, while having regard to the matters set out in section 172(1)(a) to (f) when performing their duty under section 172.

The UK Corporate Governance Code 2018, Principle D states: “In order for the company to meet its responsibilities to shareholders and stakeholders, the board should ensure effective engagement with, and encourage participation from, these parties.” This elevates the importance of stakeholder consideration and engagement. The 2018 Code also introduced a requirement for the ARA to describe how the interests of a company’s key stakeholders have been considered in board discussions and decision-making. This requirement is aligned with that introduced by the MRR for the strategic report to include a section 172(1) statement, describing 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.

To assist companies in meeting the new MRR section 172(1) reporting requirements, we have considered the relevant legislative and other guidance sources namely: the 2018 Code, the MRR, the Department of Business, Enterprise and Industrial Strategy’s (BEIS) FAQs on the MRR (November 2018), the FRC’s Guidance on the Strategic Report, the FRC’s Guidance on Board Effectiveness, ICSA’s and the Investment Association’s (IA) The Stakeholder Voice in Board Decision Making and the IA’s guidance on Long Term Reporting.

We hope that our collective consideration of all these sources will be helpful to boards and company secretaries as they think about making this new disclosure. In particular, we draw attention to the following points:

- The purpose of the strategic report is to inform shareholders how directors have performed their duty to promote the success of the company, while having regard to the matters set out in section 172. BEIS confirmed that the section 172(1) statement required under MRR needs to be made as a separately identifiable statement. The use of cross-referencing within the statement to other sections of the ARAs will avoid excessive duplication, whilst meeting the requirement to be separately identifiable.

- BEIS clarified that the new information requirements introduced by MRR in respect of the directors’ report can be provided as part of the section 172(1) statement. In our view, if of strategic relevance, it is appropriate to incorporate certain of the MRR Regulation 13 requirements i.e. “Engagement with employees” and “Engagement with suppliers, customers and others in a business relationship with the company” into the section 172(1) statement. This would make the disclosures more meaningful and cohesive. We note however, that due to the applicability criteria, these may not necessarily be mandatory for all premium listed companies.

- The term ‘principal decision’ is not defined in legislation. We would therefore encourage reporters to clarify how they define principal decisions in their specific context, including whether they consider materiality from the perspective of the company, impacted stakeholder group, or both. We expect that the materiality threshold is likely to be more qualitative than quantitative in nature, taking into consideration not just the financial amounts involved but rather the strategic implications, including the wider impact on the company’s reputation and stakeholders.

We have split our analysis into two distinct sections:

- **Section 1 “Stakeholder engagement”** addresses the FRC’s and BEIS’ recommendation to provide information on stakeholders, issues and methods of engagement, which we consider is best disclosed by stakeholder group.

- **Section 2 “Principal decisions”** focuses on how the regard for stakeholders influenced decision-making, which we consider is best disclosed by principal decision.

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1. The UK Corporate Governance Code 2018, Provision 5
2. FRC’s Guidance on the Strategic Report, Summary point (a)
3. BEIS FAQ Q7 on MRR
4. FRC’s Guidance on the Strategic Report, paragraph 8.5
5. BEIS FAQ Q5 on MRR
Deconstructing the Section 172(1) statement

Guidance on Section 1
Stakeholder engagement

Who the material stakeholders are and the reasons why engagement with them is important should be clearly linked to strategy and business model and include an articulation of stakeholders’ interests.

Whilst MRR makes reference to employees, and the requirement under Regulation 13 applies only to companies with more than 250 UK employees, the 2018 Code makes reference to workforce engagement. Both the FRC’s Guidance on Board Effectiveness (see paragraph 47-60) and its Guidance on the Strategic Report (see paragraph 78.46) discuss this broadening to international workforce and not simply UK employees, encouraging companies to consider other forms of working arrangements such as contractors and agency staff rather than just those with a permanent employment contract.

The FRC’s Guidance on the Strategic Report provides the following example: “A company could disclose a stakeholder map, that identifies its key stakeholder relationships showing the dependencies of each part of the business on different groups of stakeholders and the impacts that the business has on each of those groups.” This example and paragraph 8.18 of the Guidance specifically note the following stakeholder groups:
- environmental and community resources that the company is dependent on;
- pension schemes and pensioners;
- the entire workforce.

The Government has asked the FRC to review how well payment practices are reflected in the first year of reporting on MRR Regulation 13 “Engagement with suppliers, customers and others in a business relationship with the company.”

Climate action and reporting is an area of increasing focus by regulators and investors. In its Green Finance Strategy, the Government sets out its expectation for all listed companies and large asset owners to report in line with the Task Force on Climate-related Financial Disclosures (TCFD) recommendations by 2022. For more information, see our TCFD practical guidance.  

Companies can reference a stakeholder issue materiality matrix to illustrate what matters are considered key on an on-going basis.

Whilst MRR Regulation 13 makes it clear that the methods by which directors have engaged with employees need to be disclosed, it does not include this requirement for other stakeholders. However, BEIS FAQ-D3 clarifies that the section 172(1) statement should set out “the main methods that directors have used to engage with stakeholders and understand the issues to which they must have regard.”

Boards should therefore consider aspects such as stakeholder materiality and whether a stakeholder is direct or indirect to determine whether they need to get involved directly in the stakeholder engagement or not. If not, the board should ensure that they get unbiased feedback from management.

The FRC’s Guidance on Board Effectiveness paragraphs 34 to 46 discusses relations with shareholders and other key stakeholders, including potential sources of stakeholder feedback and methods of engagement. Section 6 of ICSA’s and the IA’s publication “The Stakeholder Voice in Board Decision Making” also provides examples of engagement mechanisms.

The 2018 Code Provision 3 requires that shareholder engagement should not be limited to the chair’s interactions on governance and strategy; rather committee chairs should also engage directly on significant matters related to their areas of responsibility.

For workforce engagement, the 2018 Code Provision 5 states that one or a combination of the following methods should be used:
- a director appointed from the workforce;
- a formal workforce advisory panel;
- a designated non-executive director.

If the board decided on an alternative arrangement, that arrangement and reasons why it is considered to be effective, have to be explained.

The Government sets out its expectation for all listed companies and large asset owners to report in line with the Task Force on Climate-related Financial Disclosures (TCFD) recommendations by 2022. For more information, see our TCFD practical guidance.

8 Creating a Responsible Payment Culture: Government Response (June 2019), p25

9 EY’s Accounting for Climate Change Report (2017)
Guidance on Section 2
Principal decisions

There is no definitive list of principal decisions, as these are driven by the specific circumstances of the company. However, looking at the delegated authority framework and matters reserved for the board may be a useful starting point. In our view, the following should generally be considered, when material to the company (or to a material stakeholder):

• new strategy or a refresh
• capital allocation decisions, including payment of dividends and pension funding10
• material corporate activity including acquisitions and disposals
• large scale restructuring programmes
• board appointments
• decisions relating to major regulatory or legal matters, especially when in the public domain11

Principal decisions covered in the section 172(1) statement should be consistent with those discussed in the review of the business.

PRINCIPAL DECISION

Impact on the long-term sustainable success of the company

• Provide a brief summary of the decision
• Include cross reference to any further detail regarding the decision within the ARAs

Discuss the consequences of the decision on the long-term sustainable success of the company / resilience of the business model, if relevant, this might include:

• Changes to the business model
• Impact on risk management processes and principal and/or emerging risks (including climate change)
• Impact on the company’s reputation for high standards of business conduct
• Impact on the actual culture of the company
• Actions the company plans to / has implemented to mitigate any potential negative impact on the long-term success of the company

Stakeholder considerations

For each stakeholder impacted by the decision explain:

• How the interests of / issues raised by stakeholders were considered and their influence on the principal decision
• How impacts on that stakeholder group have been considered
• What actions the company plans to / has implemented in mitigation

FRC’s Guidance on Board Effectiveness paragraph 14:
“Boards have a responsibility for the health of the company and need to take a long-term view. This is in contrast to the priorities of some investors, not all of whom will be aligned with the pursuit of success over the long-term. An effective board will manage the conflict between short-term interests and the long-term impacts of its decisions; it will assess shareholder and stakeholder interests from the perspective of the long-term sustainable success of the company.”

Cross-referencing should be to areas in the strategic report that provide more information about the decision, but also to other areas of relevance within the ARA. For example:

• the decision to pay an extraordinary dividend can be supplemented with references to the company’s dividend policy and dividend note within the financial statements;
• the decision to dispose of a major asset can be supplemented with a reference to the viability statement, which explains the impact of the assumed inflows from the transaction on the viability modelling.

FRC’s Guidance on Board Effectiveness paragraph 46:
“In considering the impact of the company’s operations on the community and the environment, boards may wish to refer to a source of guidance or a voluntary framework to help identify social and environmental considerations that are relevant for the business and link these to company strategy. Boards may also find a commonly understood framework useful in informing and communicating business strategy. Guidance is provided by various internationally recognised sets of principles and guidelines (…).” Examples of such principles and guidelines include UN Sustainable Development Goals (“SDGs”) and ISO 26000 Guidance Standard on Social Responsibility.

These aspects should be a subset of considerations documented for the stakeholder in Section 1

Where decisions are likely to have an impact on the behaviours of the workforce, in light of the 2018 Code Provision 2, consideration needs to be given to disclosing how the Board has assessed and monitored the company’s culture to ensure that the desired standards of conduct and behaviour are being adhered to.

10 The Investment Association’s Long Term Reporting Guidance provides useful considerations relating to capital allocation disclosures.
11 Sections 414C(14) and 414CB(9) of the Companies Act clarify that for the purposes of sections 414C and 414CB the disclosure of information about impending developments or matters in the course of negotiation is not necessary if the disclosure would be seriously prejudicial to the interests of the company, even if that information is considered material.
We have created illustrative examples, to demonstrate how our proposed approach may work in practice. The intention of the examples is to provide an indication of potential content that reporters may consider. We have limited our illustration to three stakeholder groups and three principal decisions. We have chosen a tabular format in section 1. This is not required but in our view, it helps provide a clear structure and could aid a reader’s understanding of the information.

We expect that in practice, the degree of cross-referencing to other areas of the ARAs (rather than re-producing the information in this section) will likely be higher, however we wanted to ensure that our illustration provided meaningful suggestions, which would be difficult to achieve without including a certain amount of detail.
Deconstructing the Section 172(1) statement

The following disclosure describes how the directors have had regard to the matters set out in section 172(1)(a) to (f) and forms the directors’ statement required under section 414CZA of The Companies Act 2006.

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<tr>
<td>Investors</td>
<td>Why it is important to engage</td>
<td>Continued access to capital is of vital importance to the long-term success of our business. Through our engagement activities, we strive to obtain investor buy-in into our strategic objectives and how we go about executing on them. We create value for our shareholders by generating strong and sustainable results that translate into dividends. We are seeking to promote an investor base that is interested in a long term holding in the company.</td>
<td>We discuss our programme for investor engagement on pages X - Y. The key mechanisms of engagement included: • AGM • Investor days • One-on-one investor meetings with the Chairman, Chair of the Audit Committee, Chair of the Remuneration Committee and Chair of the Nomination Committee</td>
<td>Other than our routine engagement with investors on topics of strategy, governance and, performance, below are specific matters on which we engaged on and that influenced outcomes and actions this year. Planned changes to LTIP: differing views between investors on the extent that non-financial metrics should be included. Included culture related metric within LTIP measures. See the remuneration report for more details. Chair succession planning: investors expressed an interest in hearing the board’s plans for finding a successor to the current chair who has been in post for 7.5 years, to ensure that the new 9-year tenure limit under the 2018 Code was being appropriately considered. Nomination Committee and Senior Independent Director (SID) to meet key investors to discuss the succession and recruitment plans with a view to potentially accelerating the search process. Plans for the utilisation of the high accumulated cash position: refer to principal decision 1 for further details. Agreement to make a special dividend distribution – refer to principal decision 1 for further details. Extension of our smart factories initiative: refer to principal decision 2 for further details. No actions were taken as a result of the engagement.</td>
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<tr>
<td>Suppliers</td>
<td>Our suppliers are fundamental to the quality of our products and to ensuring that as a business we meet the high standards of conduct that we set ourselves.</td>
<td>We provide all suppliers with access to a communications portal. We engage with local suppliers through working group initiatives that are run by regional management. We organise an annual conference for our largest international suppliers. The Board has agreed that a NED will attend the conference next year.</td>
<td>Liquidity challenges faced by local suppliers: local suppliers are faced with challenges in meeting our just-in-time delivery requirements due to liquidity issues. • A closer analysis of our supplier payment data. • Following the above, we have agreed on prompter payment terms for our local suppliers. This resulted in a negative impact on working capital, as discussed in the Finance Review section. • Extension of our local supplier finance programme. Impact of Brexit on business continuity in our UK factories: our suppliers shared the plans they are putting in place, including focus on increased local sourcing. Management continues to develop contingency plans, as discussed in our Principal Risk section on page XXX. These will be subject to testing by Internal Audit in the course of their next cycle of work. Other topics • Responsible procurement, trust and ethics • Supplier Code of Conduct No specific actions were undertaken in these areas.</td>
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Suppliers
- We have a limited pool of large international suppliers and at a local level, partner with a high volume of small, independent family run businesses, that often work exclusively for us.
- Key metrics
  - % of supplier code of conduct certification
  - % of payments made within payment terms
  - Perfect order rate % (i.e. the number of orders without incident, where incidents are damaged goods, inaccurate orders or late shipments)
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<td><strong>Workforce</strong></td>
<td>The company’s long-term success is predicated on the commitment of our workforce to our purpose and its demonstration of our values on a daily basis. We continue to expand our globally connected network of smart factories. To maintain our competitive advantage and meet the growing demands of the environment in which we operate, we need a workforce which is adaptive and whose skill base constantly evolves. We also value workers with long-term practical experiences. We engage with our workforce to ensure that we are fostering an environment that they are happy to work in and that best supports their well-being. We invest significantly in our workforce as we believe that maintaining low turnover rates across the entire workforce is the source of our industry-leading efficiency and productivity rates.</td>
<td>We discuss our workforce engagement activities on pages X – Y. To meet the new requirements of the Code, the board decided to appoint two designated NEDs responsible for workforce engagement, with June Smith responsible for workforce in the Americas and John Smith for our operations in EMEA. This is discussed in more detail on p X.</td>
<td>We present a materiality assessment of issues relevant to our workforce on page X. The most significant matters were:</td>
<td>Feedback from impacted workers is being considered in finalising the redundancy package – refer to principal decision 2 below.</td>
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<tr>
<td><strong>Customers</strong></td>
<td>[not fully completed, included for the purpose of principal decision cross referencing only]</td>
<td>[not completed]</td>
<td>Discontinuing the production of Product Y: refer to principal decision 2 for further details.</td>
<td>No actions were taken as a result of the engagement.</td>
</tr>
<tr>
<td><strong>Pension Trustees</strong></td>
<td>[not fully completed, included for the purpose of principal decision cross referencing only]</td>
<td>[not completed]</td>
<td>Plans for the utilisation of the high accumulated cash position: refer to principal decision 1 for further details.</td>
<td>We are in the process of agreeing a plan to increase the scheme funding over the next two years – refer to principal decision 1 for further details.</td>
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**Key metrics:**
- Total recordable injury frequency rate
- Total benefits and payments to employees
- Employee turnover rate

**Workforce**
We define workforce as the combination of employees and those contractors who work for us for periods in excess of 3 months per year.
Principal decisions

We define principal decisions as both those that are material to the group, but also those that are significant to any of our key stakeholder groups. For detail as to how we established and defined our key stakeholder groups see page X.

In making the following principal decisions the Board considered the outcome from its stakeholder engagement as well as the need to maintain a reputation for high standards of business conduct and the need to act fairly between the members of the company:

Principal decision 1:
Special dividend

- The Board has decided to pay a total dividend of £XXX in respect of the year.
- Details of the dividend policy are included on page XXX, where we explain our long-term approach to dividends in the context of profitability.
- During our engagement with investors, we were questioned on and debated the high level of cash maintained by the company. After due consideration, the directors decided to exercise their discretion and return some of the cash to the shareholders by declaring a special dividend of XXX.
- The directors took into account whether it would impact the on-going strategic investment in the new green energy plant, which is considered critical to the long-term success of the company and achievement of our strategic objectives, and concluded it would not in light of the strong cash position net of the special dividend payment. The directors also considered the net liability position of the Group’s pension scheme and are in the process of agreeing a plan with the Pension Trustees to increase the scheme funding over the next two years (see note X to the financial statements).
- Details of the capital allocation policy are included in XXX; where we explain our priorities and the framework we use to decide between them.
- The models supporting the going concern assessment and viability statement factored in the higher than normal cash distribution in the current year. However, future payments have been modelled in line with the basic dividend policy.

Principal decision 2:
Discontinuation of production of Product Y

- As discussed in the CEO’s statement and in the business model disclosure, for the last three years we have been modernising our production facilities in line with our smart factories initiative. Three factories have been modernised this year.
- The Board has decided to close five factories next year, representing all of our Product Y facilities. The investment required to modernise these factories in line with our smart factories initiative was considered uneconomical in light of the falling demand for Product Y.
- This decision followed extensive feasibility reviews and studies aimed at identifying alternative outcomes, however the Board concluded that closure was necessary to ensure long-term sustainability of our business model.
- The CEO discussed these plans during our interim investor call, the financial impact is disclosed in Note X: Discontinued Operations.
- Through a variety of workforce engagement mechanisms, including focus groups at the impacted factories, we explained the reasons for the decision and informed our workforce about the impending redundancies. We shared our redundancy package plans and listened to the workers’ feedback. As a result, we will be expanding the package to include a re-training programme.
- The Board recognises that this is the first major redundancy programme in over two decades. The Board will monitor the impact of this decision on the culture of the company, specifically focusing on adverse changes to turnover rates. Management is in the process of initiating a series of engagement activities with the remainder of the workforce to respond to the concerns this decision is likely to raise.
Practical considerations ahead of reporting

Principal decision 3: Greenhouse gas commitment

- As a major manufacturing company, we recognise the impact we have on the environment. In the prior year, we engaged extensively with our large, international suppliers on the topic of greenhouse gas emission targets and our expectation that our suppliers will commit to tangible reductions in their emissions. In the current year, the Board has decided that it will not work with those of our large, international suppliers that do not show a demonstrable commitment to achieving a ‘net-zero’ greenhouse gas emissions target by 2050, in line with the UK’s commitment under the Paris Agreement.
- This decision aligns with our commitment to achieve ‘net-zero’ scope 1 greenhouse gas emissions by 2040, set out on page X of our Corporate Responsibility report.
- In reaching this decision the Board debated the following aspects with management:
  - The consequences for the suppliers that we will no longer work with;
  - The increased reliance on a reduced pool of International suppliers and the potential consequences on business resilience and continuity;
  - The impact on the profitability of the business, given the expected short term significant cost increases detailed in the CEO’s letter.
- The Board is in the process of agreeing with management the additional monitoring activities that will need to be implemented to ensure the resilience of our supply chain in the context of a reduced pool of suppliers. Management is reassessing the existing supply chain risk management processes and these will be updated accordingly.
- The Board intends to engage directly with international suppliers going forward, to have visibility over their progress against the ‘net-zero’ target.

The GC100\textsuperscript{*} published its “Guidance on Directors’ Duties – Section 172 and Stakeholder Considerations” in October 2018 (“GC100 guidance”). This includes recommendations of practical steps directors can consider when discharging their section 172 duty.

It recommends directors consider five specific things to help embed their section 172 duty into the decision-making. These are:
- reflecting on the section 172 duty when setting or refreshing strategy;
- establishing and attending training;
- considering and requesting the information that will be needed to help satisfy the duty;
- putting in place appropriate policies and processes;
- considering the company’s and board’s approach to engaging with stakeholders.

Overarching these, it also recommends that as directors deliberate company culture, they consider how section 172 considerations can be embedded in the behaviours of the board, management and employees.

We encourage management and boards to read the GC100 guidance. EY’s Entity Compliance & Governance team has summarised below the key aspects of the GC100 guidance and included additional recommendations.

\textsuperscript{*} GC100 is the voice of the general counsel and company secretaries of FTSE 100 companies.
Assess which entities are in scope

The first step is to understand which companies within the group are in scope by reviewing the qualifying conditions. The criteria are:

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<th>Reporting requirement</th>
<th>Qualification criteria</th>
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<td>Regulation 4 MRR:</td>
<td>UK incorporated companies already required to produce a Strategic Report, except for those qualifying as medium within a financial year. The size criteria are that a company meets at least two of the following: • turnover of more than £36m; • balance sheet total of more than £18m; • more than 250 employees. It should be noted that companies, that qualify as medium-sized under the Companies Act 2006, will be required to produce a Strategic Report and therefore a section 172(1) statement if they are part of an ineligible group, as will companies that are ineligible companies in their own right irrespective of their size.</td>
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<tr>
<td>Regulation 13 MRR:</td>
<td>UK incorporated companies with more than 250 UK employees. If the company is a parent company it is the number of employees in the group and not just the company itself that is used.</td>
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<tr>
<td>Regulation 13 MRR:</td>
<td>UK incorporated companies which meet at least two of the following: • turnover of more than £36m; • balance sheet total of more than £18m; • more than 250 employees.</td>
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It should be noted that even though companies may not be required to provide a section 172 statement, they may still be required to provide a statement in the directors’ report on how they engaged with employees under Regulation 13.

Consider and document key stakeholders

As mentioned in section 2, understanding who the company’s key stakeholders are and why they are important, as well as what matters to them will help directors bear in mind their interests when making principal decisions.

In a group context it is important to remember, that stakeholders may vary between subsidiaries.

Understand principal decisions

An understanding of the likely principal decisions will assist in determining whether adequate engagement mechanisms exist and identifying any potential gaps. Useful starting points to consider in making this determination are the matters reserved for the board or the delegations of authority matrix. In addition, input from the Chairman and CEO will help identify what the one-off major decision areas are likely to be in a given year.

Consideration needs to be given whether decisions made at group/divisional level impact a subsidiary and how the directors of that subsidiary have discharged their section 172 duties in this respect. An example of this may be a situation, where the parent company’s dividend policy requires reserves are passed up the group by a subsidiary, leading ultimately to a subsidiary’s pension plan being in deficit.

Subsidiary directors have to focus on the success of the subsidiary, however the interests and decisions of the parent company are usually important and should also be taken in account with regard to section 172 reporting.

Include stakeholder considerations into strategic decision-making

Companies can consider inviting to strategy days or off-site meetings some key stakeholders to present their views to the board and senior management. This will enable stakeholder interests to be incorporated effectively into the long-term planning and allow the board to get first hand exposure to certain key stakeholders.

Provide training on Section 172

As GC100 guidance notes, it is key that suitable training and guidance on section 172 is provided. This can include:

i. Induction training for all directors (including subsidiary directors), covering for example:
   • what the section 172 duty is;
   • who the key stakeholders of the company are;
   • what principal decisions are likely to be made by the directors;
   • what policies and processes are in place to ensure that stakeholder considerations are included in the decision-making process.

ii. Refresher courses at least annually to ensure that directors are aware of their duties on an ongoing basis. E-learning is often an efficient and effective way of achieving this.

• Section 172 training should be considered not just for board level directors, but for key individuals below board level too. This could include for example those with delegated authorities at certain thresholds and those one to two levels below the board who are often involved in providing information and submitting papers to the board and its committees.
Deconstructing the Section 172(1) statement

7

Assess the adequacy of existing engagement mechanisms

- Once an inventory of engagement mechanisms has been prepared, it is important to assess whether these are fit for purpose or any improvements are needed. Matters to consider include:
  - the breadth and variety of the mechanisms, as each method will have its own merits;
  - whether they create a meaningful and genuine dialogue with key stakeholders;
  - the degree to which the methods provide the board with open and direct feedback from stakeholders, as opposed to potentially filtered views from management;
  - any cultural considerations, for example the likelihood that employees will speak up at formal meetings attended by senior management and/or the board.
  - Methods for gathering information obtained through the mechanisms as well as tracking any actions should also be evaluated.

- Equally important is to assess whether sufficient feedback loops exist to inform stakeholders how their feedback influenced the actions of the board. For engagement to continue to be effective and to help build trust, it is critical that stakeholders see evidence that their feedback matters in the boardroom.

Examples of stakeholder engagement include:

- employee forums
- feedback forms and surveys
- annual general meetings
- investor days
- one-to-one discussions with majority shareholders
- employee town halls
- external reviews and benchmarking

8

Consider section 172 when providing information to the board

- Management should support directors by highlighting how their activities are likely to impact not just the company but also its stakeholders, including in the long-term.
- Those involved in writing board and committee papers and sponsors for key matters need to understand how to address section 172 considerations in the information they provide to the board and its committees.
- The metrics and reports the board receives should incorporate how section 172 duties have been considered. This requires that information beyond financial data is provided. Considering how extensive board packs already are, it is necessary to critically assess the structure of board papers to determine if it needs to be changed, so as to reduce information overload. Dashboard reporting by stakeholder can be a means of achieving this objective.
- There also needs to be an effective audit trail of how section 172 considerations were factored into principal decisions made.

9

Update governance framework, and related policies and processes

- Companies need to determine how to embed section 172 within the governance framework of the company and document this appropriately. Areas to consider include:
  - allocating responsibility to appropriate management functions;
  - incorporating the section 172 duty into the terms of reference of the board and relevant committees to help ensure that it is embedded in the decision-making process;
  - reflecting section 172 factors in remuneration policies and incentives; the GC100 guidance suggests including appropriate metrics and performance measures.

10

The company secretary’s role

- Acting in their role as the conscience of the company, the GC100 guidance recommends the company secretary attends all board meetings to advise as necessary on matters relating to directors’ duties and responsibilities under section 172.
- When taking minutes, the company secretary should document the relevant discussions on section 172, such as challenges raised to principal decisions as a result of section 172(1)(a)-(f) factors and the actions arising from stakeholder engagement.

Document existing engagement with stakeholders

- Documenting in one place how the company engaged with stakeholders, the topics of engagement and feedback received will help identify any gaps in existing processes. The table in section 2 can be used as a template to collate this information, even if it is not used as an ARA disclosure.
- When going through this process, companies need to consider information flows within the group context. Stakeholder engagement activities are likely to take place both at the group and subsidiary levels. It is important that there is clarity on the governance processes between the group and subsidiary and that the outcome of any overlapping engagement is utilised to benefit both.
For queries relating to sections 2 and 3, contact EY’s Corporate Governance team. Based on our research and engagement with investors, boards and regulators EY’s UK Corporate Governance team provides guidance and thought leadership on governance issues and related reporting to help management and boards and to contribute to wider discussions on good governance.

Authors:

Maria Kępa
Director | UK&I Assurance | Corporate Governance
mkepa@uk.ey.com

Samantha Chew
Senior | UK&I Assurance | Corporate Governance
schew9@uk.ey.com

Team leader:

Maia Shah-Coulin
Associate Partner | Corporate Governance
mshahcoulon@uk.ey.com

Marco Murray
Senior Manager | Entity Compliance & Governance
Marco.Murray@uk.ey.com

Emily Grant
Manager | Entity Compliance & Governance
Emily.Grant@uk.ey.com

Team leader:

James Menzies
Associate Partner | Entity Compliance & Governance
jmenzies@uk.ey.com

To gain further insights into corporate governance developments, our latest publications, events and webcasts, sign up to our Spotlight e-bulletin. For queries relating to section 4, contact the EY Entity Compliance & Governance Services team. The EY Entity Compliance and Governance Services team provides wide ranging support to enable companies to comply with statutory law, regulation and legislation.
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