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IGNORE STAKEHOLDERS AT YOUR PERIL

By Terrance M. Booysen

Recent local and international headlines have been explosive in their exposure of the involvement of large organisations in the perpetuation of political instability and increased racial tensions in South Africa, as well as the alleged facilitation of so-called 'state capture'. These headlines have brought into sharp focus the importance of strong, ethical leadership within organisations such that the organisation is not only seen to be, *but is* operating an ethical business. Moreover, any 'lethargic' stakeholder communication being exercised by the organisation's leadership -- especially where ethical matters are concerned -- has the power to rapidly undermine trust and legitimacy not only within the organisation's stakeholders, but indeed with the greater public at large. In just the last few weeks, KPMG, McKinsey, SAP, Software AG, Eskom, Transnet, SAA, SABC and Trillian are just a few examples where the trust between organisations and their stakeholders have been shaken to the core.

The legitimacy of an organisation can no longer be linked solely to its purpose of creating financial returns for shareholders and investors. While this may be a defensible and certainly a reasonable purpose for any profit-generating business, it is one which has undoubtedly played a part in eroding the legitimacy of many modern-day organisations, and has resulted in decreased public trust in them. This is true for several reasons.

The demise of the shareholder as King

While the importance of the shareholders of an organisation remains key, it is no longer acceptable to consider *only* shareholder and investor returns as a legitimate purpose and a criterion for success. Historically, it was the norm for organisations to be run using a *shareholder-value* driven business model, where maximum profit was pursued, often at any cost. However, it has been demonstrated time and again that, to be sustainable, organisations need to look far beyond their shareholders, and must consider the reasonable and legitimate needs of *all* their material stakeholders. While shareholders are a significant stakeholder in any organisation, so are the likes of employees, customers, the media, government, local communities as well as the natural environment. Each of these components affects and is affected by, an organisation to varying degrees and their needs and requirements are very often interdependent.

The rise of the informed stakeholder

The modern business landscape interacts very closely with the media and the public at large. Most people have increased access to information, and the credibility of such information -- often circulated on social media -- is not necessarily of primary concern to those consuming it. What is key is that the public, and thus a large

"Instead of prioritising the interests of the providers of financial capital, the governing body [the board] gives parity to all sources of value creation, including, among others, social and relationship capital as embodied by stakeholders. Consequently, this is an inclusive, stakeholder-centric approach which stands in contrast with a shareholder-centric approach"

– King IV Report on Corporate Governance for South Africa 2016™

portion of an organisation's stakeholders, are becoming more aware of the operations and outputs of the business.

These informed stakeholders no longer blindly accept the premise that a business exists and is legitimate insofar as it fulfils the demands of its shareholders. These stakeholders are far more interested in how an organisation has created real value for all of its stakeholders, as well as how it has adopted good corporate governance and sustainable business practices.

In addition to the profit which an organisation has generated in any given period, informed stakeholders are concerned with that organisation's overall impact on people and the planet. As a result, modern organisations must ensure that the 'triple-bottom line' considerations of People, Planet & Profit (PPP) are reflected in their strategic planning, operations and reporting.

Informed stakeholders want to know how an organisation's Board has demonstrated ethical and effective leadership as an outcome of its business strategy; as well as how the ethics of the organisation is given practical application in its policies which have consequences for non-compliance. In the case of KPMG as an example, who have been implicated for being complicit in the 'state capture' activity in South Africa, the media and other key stakeholders have been relentless in their crusade to expose the exact nature of the firm's relationship and involvement with the Guptas.

As a stakeholder, the media (and those individuals using the media as their platform) initiated the drive for transparency and accountability of the firm through the exposure of alleged wrongdoing. There are now many client-stakeholders of KPMG who have cancelled their use of the firm's services, or refused to be associated with the firm in the future. While eight senior executives have resigned from the South African branch of KPMG, much of the damage to the reputation of the firm, and indeed to the reputation of South Africa, has already been done. In this case, it may be that stakeholder activism against alleged wrongdoing surfaced too late, but the principle remains, and the immense power of informed stakeholders, who are willing to risk the *status quo* for the sake of good governance, is clear.

Increased consideration for, and protection of, stakeholders

It is not simply the case that stakeholders are becoming increasingly informed and savvy in their dealings *vis-à-vis* organisations and their operations; stakeholders have in recent years become more empowered and protected by law and regulation. In South Africa, which has followed similar measures enacted by its international counterparts, the rights of stakeholders are given credence in the likes of the Protection of Personal Information Act, 2013 (POPI), which -- once fully enacted -- will give consumers (stakeholders) heightened control over who is allowed to gather, store and use their personal information. The Consumer Protection Act, 2007, gives protections to consumers as stakeholders of organisations, and employment and labour legislation protects employees as stakeholders. Ultimately, the Constitution of the Republic of South Africa, 1996, gives all people of South Africa, as stakeholders of organisations, and of the country itself, a range of fundamental powers and rights, which they are free to exercise and enjoy.

As informed, empowered stakeholders are demanding more and more from the organisations with which they are involved, it is becoming essential for organisations to actively interact and engage with all their stakeholders.

Reporting is only one means of engagement, and while it is generally a one-way process, it remains an important tool for communication. Reporting to stakeholders has evolved over the years. Where the publication of annual financial reports was once considered to provide sufficient information on the organisation to its shareholders (who were considered the most important stakeholders), the King Code on Governance for South Africa, 2009 (King III) introduced the concept of annual Integrated Reporting.

The motivation for an Integrated Report was to demonstrate to stakeholders that organisations were concerned with far more than simply their shareholders' return on investments. Through these annual reports, organisations are expected to disclose certain aspects of their strategies and operations, demonstrating to their stakeholders how the organisation creates sustainable value beyond the broader context of the organisation itself.

The King IV Report on Corporate Governance for South Africa™ ('King IV™') has taken the concept of an Integrated Report even further, moving away from a 'tick-box' approach and requiring organisations to demonstrate that they apply the universal outcomes of good governance. Each of the principles in King IV™ sets out specific disclosure recommendations, in order to foster a culture of transparency between organisations and the stakeholders which they serve.

"…[organisations] need to temper stakeholder expectations by being more transparent and providing a balanced view of operations by explaining both what they have done well and what has failed. [Organisations] should show stakeholders that they are thinking deeply about stakeholder concerns and how to address them."

– Beyond Compliance - Stakeholder Engagement Under King IV™ (2016)

Principle 2 of King IV™ states that "[t]he governing body should govern the ethics of the organisation in a way that supports the establishment of an ethical culture". Furthermore, Recommended Practice 2.7 requires that the codes of conduct and ethics policies of the organisation should provide for arrangements that familiarise employees and other stakeholders with the ethical standards of the organisation, for example, by publishing them on the organisation's website.

Organisational legitimacy though stakeholder engagement

It is no longer enough for an organisation to satisfy stakeholder interests or address potential concerns through a one-way type communication model, or even a static report meant to emulate an Integrated Report as advocated in King IV™. Organisations increasingly are being called upon to engage actively with all levels of their stakeholders, and more frequently too. Long-term and enduring relationships must be cultivated with stakeholders to bolster an organisation's legitimacy and ultimately to improve public trust. The quality and the authenticity of the organisation's stakeholder engagement will influence the organisation's reputation, viability and ultimately its long-term sustainability.

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Stakeholder engagement is an opportunity for organisations to communicate and develop the *stakeholder-inclusive* driven business model which forms a part of the framework within which they operate. It provides an opportunity for them to demonstrate *how* they have operated in an ethical manner and how they have *created value* for all stakeholders, contributing to the legitimacy of the organisation and ultimately, to the sustained success of the community in which it operates. Ignoring or simply down-playing the importance of the organisation's stakeholders and their legitimate concerns has dire implications, and evidently this been the case with KPMG South Africa.

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