

# How to reinvent the external-affairs function

Working with outside stakeholders is a rising priority for company leaders. But in a new survey, most executives say their organizations still lack the external-affairs capabilities they need to succeed.

Engaging with external stakeholders is more important than ever to company leaders, according to the fifth McKinsey Global Survey on external affairs.<sup>1</sup> Yet while most executives believe outside stakeholders will be increasingly involved in their industries in coming years, few say their companies have taken an active approach to engaging with stakeholders or that they have found success in their external-affairs efforts. The results suggest that to step up their game, companies should start by strengthening their capabilities—many of which aren't any stronger now than they were a few years ago. The companies that, according to respondents, are most successful at external affairs not only have better overall capabilities than their peers but they also are particularly skilled at organizing their external-affairs functions.

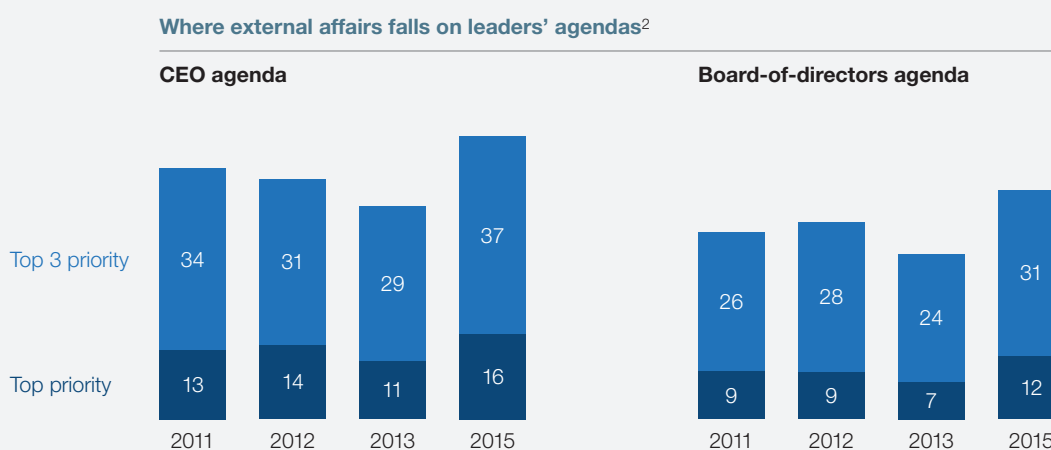
## A rising role for stakeholder engagement—and the business value at stake

After several years of surveys on engaging external stakeholders, respondents now say the topic is a higher priority than ever before for their companies' leaders (Exhibit 1). External affairs now ranks as a top or



## Exhibit 1 External affairs is a rising priority for both CEOs and boards.

% of respondents<sup>1</sup>



<sup>1</sup> Respondents who answered “top 10 priority,” “not a top priority,” “not on the agenda,” or “don’t know” are not shown.

<sup>2</sup> In 2011, n = 1,396; in 2012, n = 3,525; in 2013, n = 2,186; and in 2015, n = 1,334. In the 2009 survey, these questions were not asked.

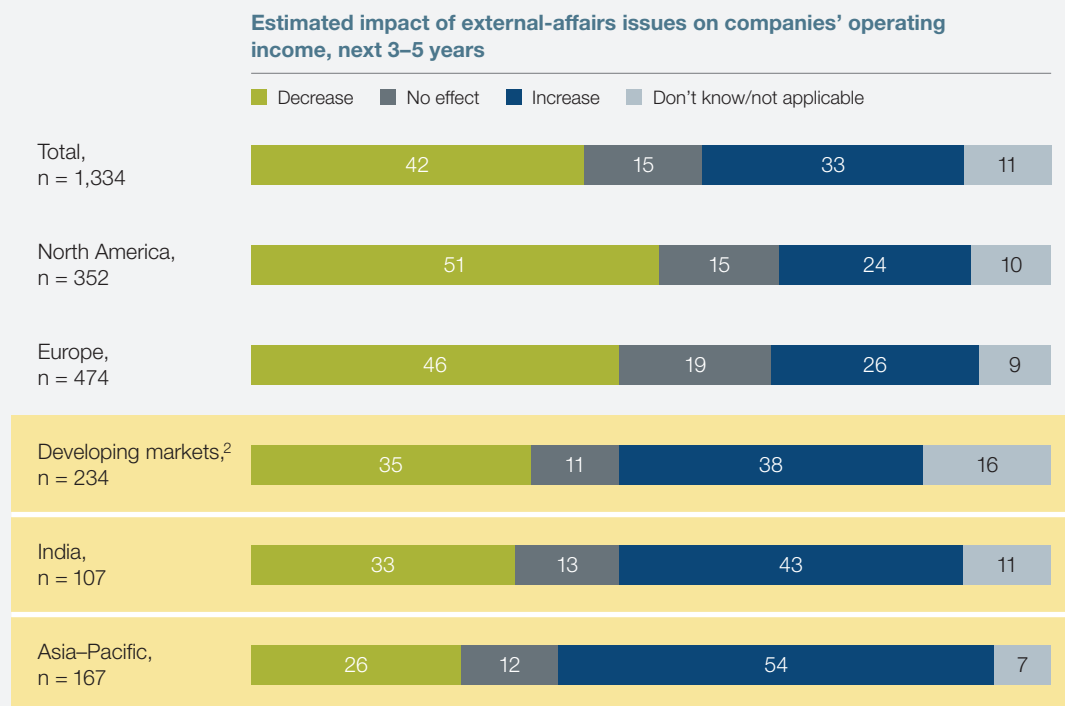
top three priority for more than half of CEOs, and boards also are paying more attention than they have in past years.

When asked about the most influential stakeholders, executives expect government entities and regulators—as well as customers—will have the greatest effect on their companies’ value. Even outside the financial sector (where, in earlier surveys, executives have consistently ranked regulators more often than their peers as an important group), growing shares of respondents note the impact of this group. Among all respondents, 42 percent cite regulators as an important stakeholder, up from 30 percent in the previous survey. What’s more, about two-thirds of all executives predict that government and regulator involvement will increase in the coming years. In financial services, in energy, and in healthcare and pharma, more than 80 percent of respondents say the same.

On average, respondents tend to expect the impact of this involvement will be negative. More than 40 percent (and a plurality) say the actions of governments and regulators will hurt their companies' future operating income.<sup>2</sup> Across regions, executives in Europe and North America are even more bearish than their peers. Some, though, view external-affairs issues as an opportunity for growth rather than a threat to income. In developed Asia and in developing markets, executives are more likely than others to believe external-affairs issues will boost their operating income in the coming years (Exhibit 2).

**Exhibit 2 Executives in developing markets and in Asia are likelier than others to see external affairs as an opportunity rather than a risk.**

% of respondents,<sup>1</sup> by region



<sup>1</sup>Figures may not sum to 100%, because of rounding.

<sup>2</sup>Includes China and Latin America.

### The struggle to succeed

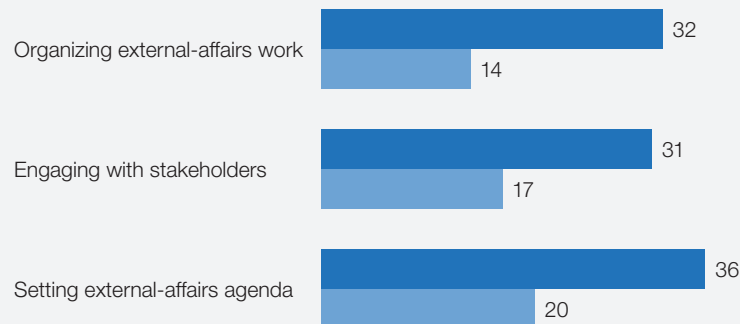
Despite the growing focus on external relations and the recognition of the value at stake, responses suggest that success is rare. Only 11 percent of executives say their companies frequently succeed at shaping government and regulatory decisions, and there are no regions or industries where more than one in five respondents report success. Managing the corporate reputation is challenging as well: just 22 percent of respondents say they frequently succeed at this.

Even among the most successful companies that excel at both shaping decisions and managing their reputations,<sup>3</sup> many have a long way to go toward strengthening their capabilities in three areas: organizing the company's external-affairs work, engaging with stakeholders, and setting the external-affairs agenda (Exhibit 3). Overall, respondents report little progress—and even some declines—in the strength

#### Exhibit 3 The companies that are most successful at external affairs have stronger capabilities than others, but even they have room to improve.

Average % of respondents who say their companies are very effective at given capabilities<sup>1</sup>

■ Respondents at most successful companies,<sup>2</sup> n = 79  
■ Respondents at all other companies, n = 1,255



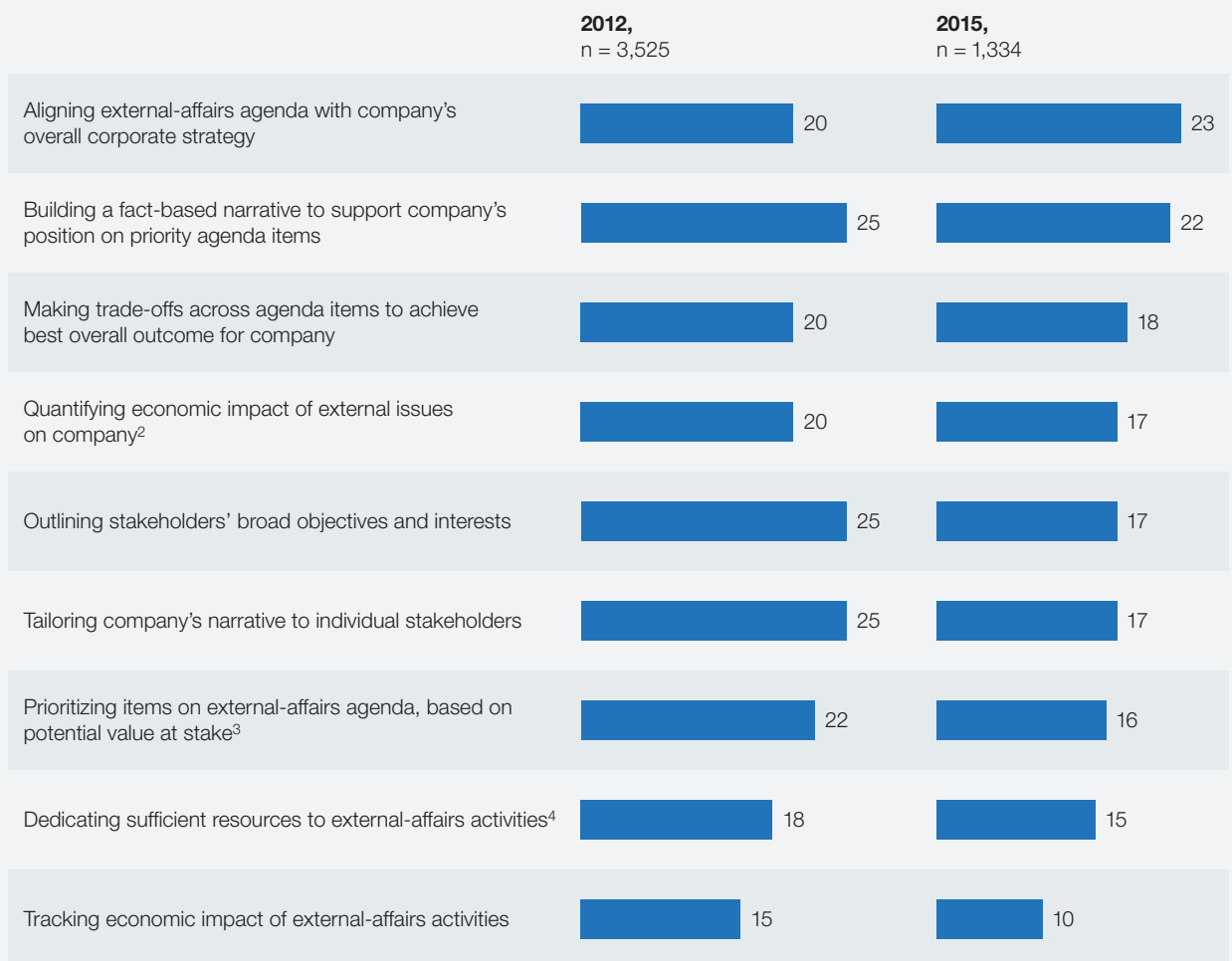
<sup>1</sup> Respondents were asked about 10 organization-related capabilities, 8 stakeholder-engagement capabilities, and 9 agenda-setting capabilities and how effective their companies are at each one. The figures above are the average percentages of “very effective” responses within each set of capabilities.

<sup>2</sup> Respondents who say their companies are frequently successful both at shaping government policy and/or regulatory decisions and at managing their corporate reputations among civil-society groups.

of their organizations' external-affairs capabilities since the 2012 survey (Exhibit 4). When asked how well their companies tailor their narratives to individual stakeholders, only 17 percent of respondents say they are very effective, down from one-quarter of respondents in 2012.

**Exhibit 4      On average, respondents report little progress—and even declines—in the strength of their companies' capabilities since 2012.**

% of respondents who say their companies are very effective at given capabilities<sup>1</sup>



<sup>1</sup> In the 2012 survey, respondents were also offered an "extremely effective" option for each capability. This was not offered as an option in 2015.

<sup>2</sup> In 2012, the option was "rigorously quantifying the potential economic impact of external issues."

<sup>3</sup> In 2012, the option was "assigning resources to external issues according to the value at stake."

<sup>4</sup> In 2012, the option was "dedicating sufficient talent and resources to external-affairs activities."

Other results may explain why, exactly, so many companies are struggling to break through. While external engagement has risen on the board agenda in recent years, few respondents say their board members oversee these activities well. Only one in five say their boards are very effective at setting a framework for how their companies manage stakeholder relationships, at balancing stakeholder interests in their decision making, or at interacting regularly with the most relevant stakeholders.

What's more, few executives report that their companies are actively engaging with stakeholders. Just one-quarter say that in the past year, their companies have taken a very active approach to engaging with governments and regulators; 30 percent, by contrast, say their approach is either very or somewhat passive. Both in energy and in healthcare and pharma, where respondents are much likelier than average to expect increasing involvement from these groups, executives are also likelier to report more active strategies. Yet even those executives report room to improve and be more active: respondents in these industries are no likelier than their peers to say they're successful at managing their reputations.

The nature of a company's engagement matters because, according to respondents, organizations that take a more active approach are much likelier than others to connect directly with stakeholders, instead of hiring lobbyists or relying on industry associations to engage on their behalf. The most active companies

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According to respondents, the companies that take the most active approach to engaging with governments and regulators are more likely than all others to see success from their overall external-affairs efforts.

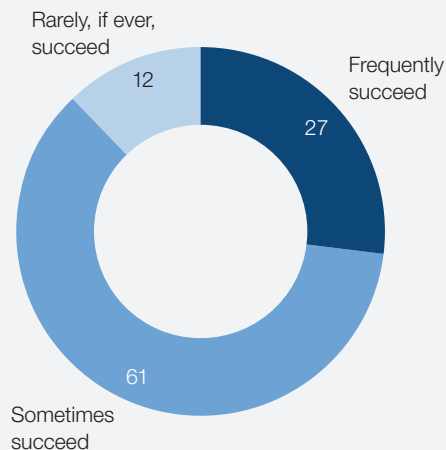
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**Exhibit 5 Companies that take an active approach to stakeholder engagement report higher rates of overall success at external affairs.**

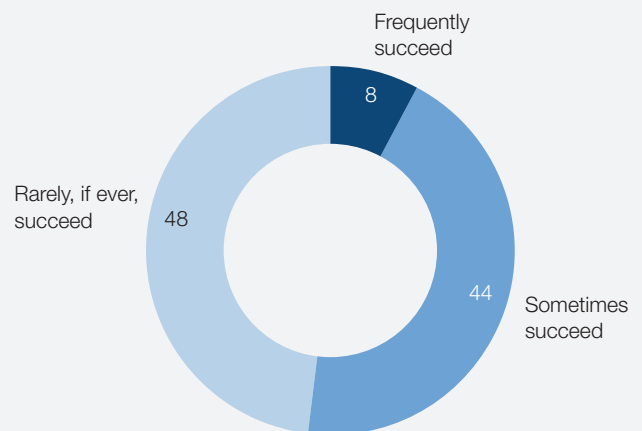
% of respondents

**Companies' success at shaping government policy and/or regulatory decisions that could affect their business environments<sup>1</sup>**

**Respondents at companies with a *very active* approach to stakeholder engagement,<sup>2</sup>**  
n = 337



**Respondents at all other companies,**  
n = 752



<sup>1</sup> Respondents who answered "don't know/not applicable" about their companies' success are not shown.

<sup>2</sup> Specifically, engagement of governments and regulators in the past 12 months.

are also much likelier than others to succeed at external-affairs management overall (Exhibit 5). Of those reporting an active approach, 27 percent of executives say their companies frequently succeed at shaping policy and regulatory decisions. Among all other respondents, 8 percent say the same.

**The capabilities that drive success**

While success in external affairs is rare, it's not impossible—and it depends on more than just active engagement. We looked at 27 specific external-affairs capabilities in an effort to understand exactly how and where the most successful organizations are excelling. Executives at these organizations are more likely than other respondents to report effectiveness at each capability, and the gaps between their responses are especially pronounced in ten of them.

Half of these ten standout capabilities relate to the ways companies organize their external-affairs functions (Exhibit 6). For example, 57 percent of respondents at successful companies say they are very

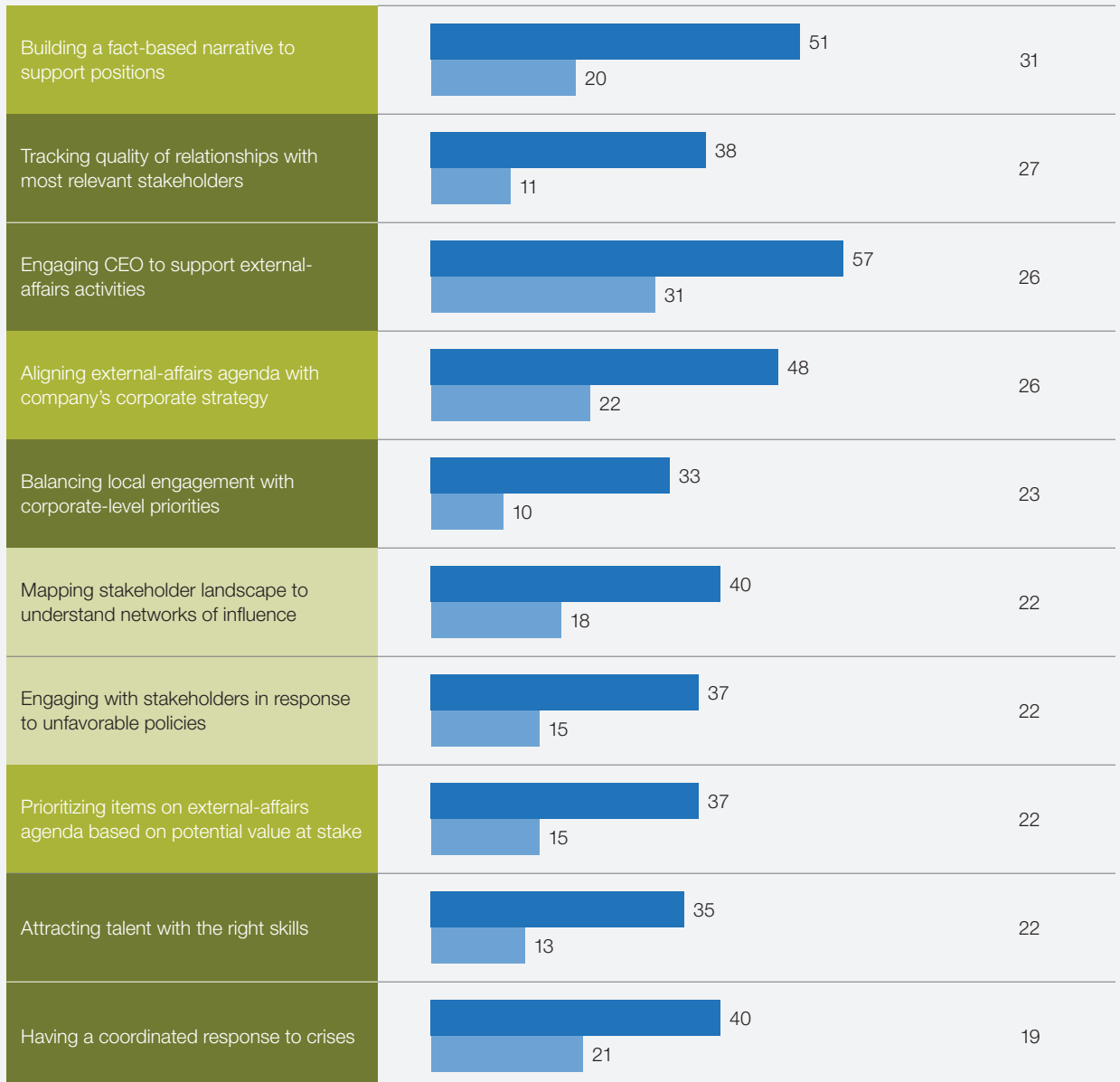
**Exhibit 6**
**Of the ten capabilities where successful companies most outperform their peers, five are organization related.**

% of respondents who say their companies are very effective at given capabilities<sup>1</sup>

**Type of capability**

- Strategy formulation
- Organization
- Stakeholder engagement

- Respondents at most successful companies,<sup>2</sup> n = 79
- Respondents at all other companies, n = 1,255

**Percentage-point difference**


<sup>1</sup> Out of 27 capabilities the survey asked about. The 10 capabilities shown represent the biggest percentage-point differences between respondents at the most successful companies and those at all other companies.

<sup>2</sup> Respondents who say their companies are frequently successful both at shaping government policy and/or regulatory decisions and at managing their corporate reputations among civil-society groups.



effective at engaging their CEOs on the external-affairs agenda, compared with 31 percent of all others. And while only 35 percent of high performers say their companies are very effective at attracting the right talent, they're almost three times likelier than their peers to say so. When asked how their external-affairs functions are organized, those at the most successful companies also report a different approach than others do. The best companies are likelier than others to have a mix of central and local management and, relatedly, to effectively balance local needs with corporate-level priorities.

Of course, not every standout capability is organizational in nature. When setting the external-affairs agenda, respondents at the most successful companies are 2.5 times likelier than their peers to say they're very effective at building fact-based narratives to support their positions. They are also much likelier to report effectiveness at tracking the quality of their relationships with stakeholders. Other data suggest that digital tools have a role to play here. Although a whopping 82 percent of all respondents say their organizations use digital tools (such as social media) for business reasons, those at successful companies use these tools differently. When asked about their main goals for using digital tools, for instance, they most often cite promoting their companies' priorities and engaging with specific stakeholders, rather than driving website traffic or increasing their companies' media visibility—which respondents at other companies cite more often.



### Looking ahead

- *Take an analytical approach.* Most survey respondents expect that governments and regulators will grow more involved in their industries over time—and that there are real implications for company value. Consequently, organizations can no longer afford to take a qualitative approach to engaging with these stakeholders and hope for the best. Regardless of their industry or location, organizations should think of external relations as an extension of their business and apply the analysis-based management practices they use in other areas of their companies. This means, for example, tracking the economic impact of their companies' external-affairs activities (and the quality of their stakeholder relationships) and using that information in specific tactics for engagement, such as the development of fact-based narratives that will resonate with external stakeholders.
- *Reimagine the organization.* To succeed in external affairs, organizations need the right structure and people to support it. For many companies, this requires a rethinking of the function's setup, so its work is more visible in the organization and more strategic, too. To start, companies should focus on developing the standout capabilities (especially those in the organization category) that have helped the most effective organizations succeed. The leaders of external-affairs functions should also seek to play a more active role in shaping strategic decisions that could be affected by external forces. They will also need strong talent in their functions—people who can act as thought partners to other functions and build long-term relationships with external stakeholders. ■

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<sup>1</sup> The online survey was in the field from November 5 to November 15, 2015, and garnered responses from 1,334 executives representing the full range of regions, industries, company sizes, functional specialties, and tenures. To adjust for differences in response rates, the data are weighted by the contribution of each respondent's nation to global GDP.

<sup>2</sup> When asked about the expected impact that external-affairs issues will have on their companies' income in the next three to five years, 42 percent of respondents believe their income will decrease, 15 percent believe it will stay the same, 33 percent believe it will increase, and 11 percent say they don't know or it's not applicable. Figures do not sum to 100 percent, because of rounding.

<sup>3</sup> We define a most successful company as one that, according to respondents, is frequently successful both at shaping government policy and/or regulatory decisions and at managing their corporate reputations among civil-society groups.

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