

Strategy & Corporate Finance Practice

# The pivotal factors for effective external engagement

Survey results show that senior leaders have increasingly prioritized stakeholder engagement, which remains a challenge for many companies. Certain capabilities distinguish companies that have met the challenge.



**Fostering strong relationships** with communities, customers, owners, and other groups of external stakeholders can help companies understand and meet their needs.<sup>1</sup> In crises like the COVID-19 pandemic, when stakeholders look to companies for support and governments step in to aid the business community, managing external relationships becomes even more important. Our latest McKinsey Global Survey on external engagement,<sup>2</sup> which was conducted before the pandemic, found that senior executives recognized the need to engage stakeholders and were increasingly focused on their companies' efforts in this area.<sup>3</sup> Nearly 60 percent of respondents said the topic ranks among their CEOs' top three priorities.

Leaders' increasing focus has come amid growing evidence that addressing societal issues and stakeholders' priorities creates long-term value.<sup>4</sup> Some respondents—particularly those at organizations that excel at external engagement—said

they view external issues as an opportunity. Yet the findings also showed that external engagement has remained a challenge for many organizations.

The results point to three factors that set apart the best performers on external engagement.<sup>5</sup> Specifically, these organizations effectively define and embed an engaging corporate purpose,<sup>6</sup> enable their external-engagement functions with technology and metrics, and make organizational-design choices that improve the function's agility.

### **C-suites increasingly focus on stakeholder engagement and the value at stake**

The findings show that external engagement has continued to grow as a priority for CEOs and other senior leaders. Fifty-eight percent of respondents said their organizations' CEOs treat the management of external engagement as

## **Nearly 60 percent of respondents said the topic of external engagement ranks among their CEOs' top three priorities.**

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<sup>1</sup> Bill Schaninger, Bruce Simpson, Han Zhang, and Chris Zhu, "Demonstrating corporate purpose in the time of coronavirus," March 2020, McKinsey.com.

<sup>2</sup> The online survey was in the field from October 8 to October 18, 2019, and garnered responses from 1,418 participants representing the full range of regions, industries, company sizes, functional specialties, and tenures. To adjust for differences in response rates, the data were weighted by the contribution of each respondent's nation to global GDP.

<sup>3</sup> We define external engagement as activities performed by departments such as external affairs, public affairs, corporate affairs, government and regulatory affairs, communications and public relations, corporate social responsibility (CSR), and environmental, social, and governance (ESG).

<sup>4</sup> Witold Henisz, Tim Koller, and Robin Nuttall, "Five ways that ESG creates value," *McKinsey Quarterly*, November 2019, McKinsey.com; "The ESG premium: New perspectives on value and performance," February 2020, McKinsey.com.

<sup>5</sup> We define a high-performing organization as one that, according to respondents, is frequently successful both at shaping the debate around government policy and/or regulatory decisions and at managing its corporate reputation among civil-society groups. High-performing organizations exist in a variety of sectors.

<sup>6</sup> An organization's purpose reflects its responsibility to maximize profits on behalf of shareholders and its desire to find a purpose across environment, social, and governance (ESG) themes on behalf of a broad range of stakeholders, including customers, employees, and communities.

a top three or top priority on their agendas. That share has increased significantly since 2013, when 40 percent of respondents said it was a top or top three priority (Exhibit 1). What's more, leaders have been devoting a substantial portion of their time to external issues: 38 percent of respondents reported that their CEOs spend at least one-quarter of their time managing external engagement.<sup>7</sup>

External engagement has also been on other leaders' minds. Just over half of respondents said the topic has been a top or top three item on their boards' agendas, up from 31 percent in 2013. CFOs also have been investing time in stakeholder management: one-third of respondents said external engagement is among the top three priorities on their CFOs' agendas. The emphasis that CFOs have put on external engagement is consistent with other research indicating the potential for strong external engagement to create business value.<sup>8</sup>

By industry, respondents in consumer packaged goods and retail and in automotive and assembly reported the biggest increases in leaders prioritizing external engagement since 2013. A majority of respondents in each industry said external engagement is a top three priority for their organizations' CEOs and boards.

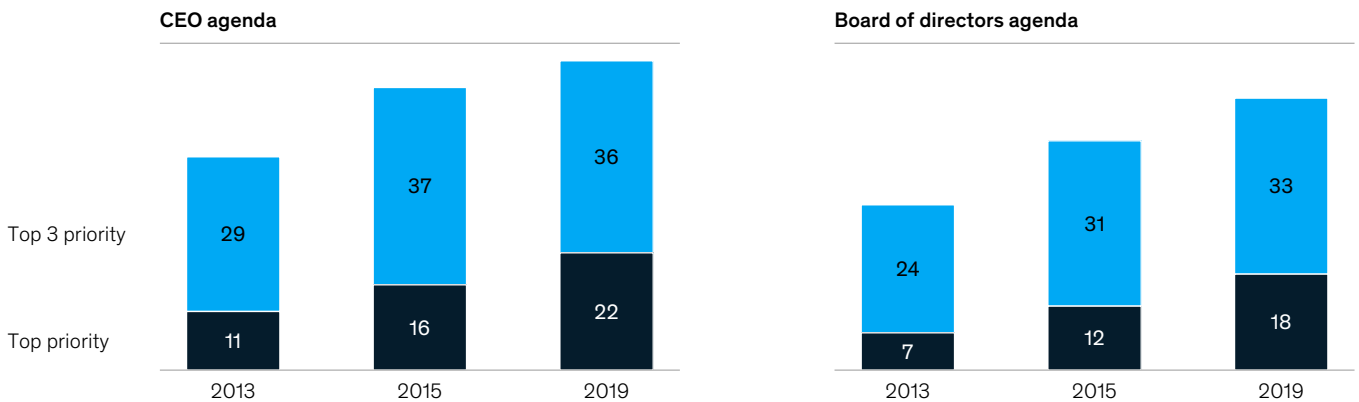
**External engagement presents opportunities to create value but has remained a challenge for many companies**

About three in ten respondents said their organizations see external-engagement issues as an opportunity to create long-term value, as was true in the previous survey from 2015.<sup>9</sup> Respondents at organizations that excel at external engagement—the category we call high-performing organizations—were more likely than others to describe these issues as an opportunity to create significant value.

Exhibit 1

**External engagement has been a growing priority for CEOs and board directors.**

Priority of external engagement on leaders' agendas, % of respondents<sup>1</sup>



<sup>1</sup> Respondents who said "top 10 priority," "not a top priority," "not on the agenda," or "don't know" are not shown. In 2013, n = 2,186; in 2015, n = 1,334; and in 2019, n = 1,418.

<sup>7</sup> This question was asked only of C-level respondents who said their organizations' CEOs include external engagement on their agendas; n = 54.

<sup>8</sup> Witold Henisz, Tim Koller, and Robin Nuttall, "Five ways that ESG creates value," *McKinsey Quarterly*, November 2019, McKinsey.com.

<sup>9</sup> "How to reinvent the external-affairs function," July 2016, McKinsey.com.

Twenty-four percent of respondents at high-performing organizations—twice the share of other respondents—predicted that external issues would increase their organizations' operating income by 10 percent or more.

Since the 2015 survey, perceptions about external-engagement issues' effects have shifted in various regions. Respondents in Asia–Pacific and in

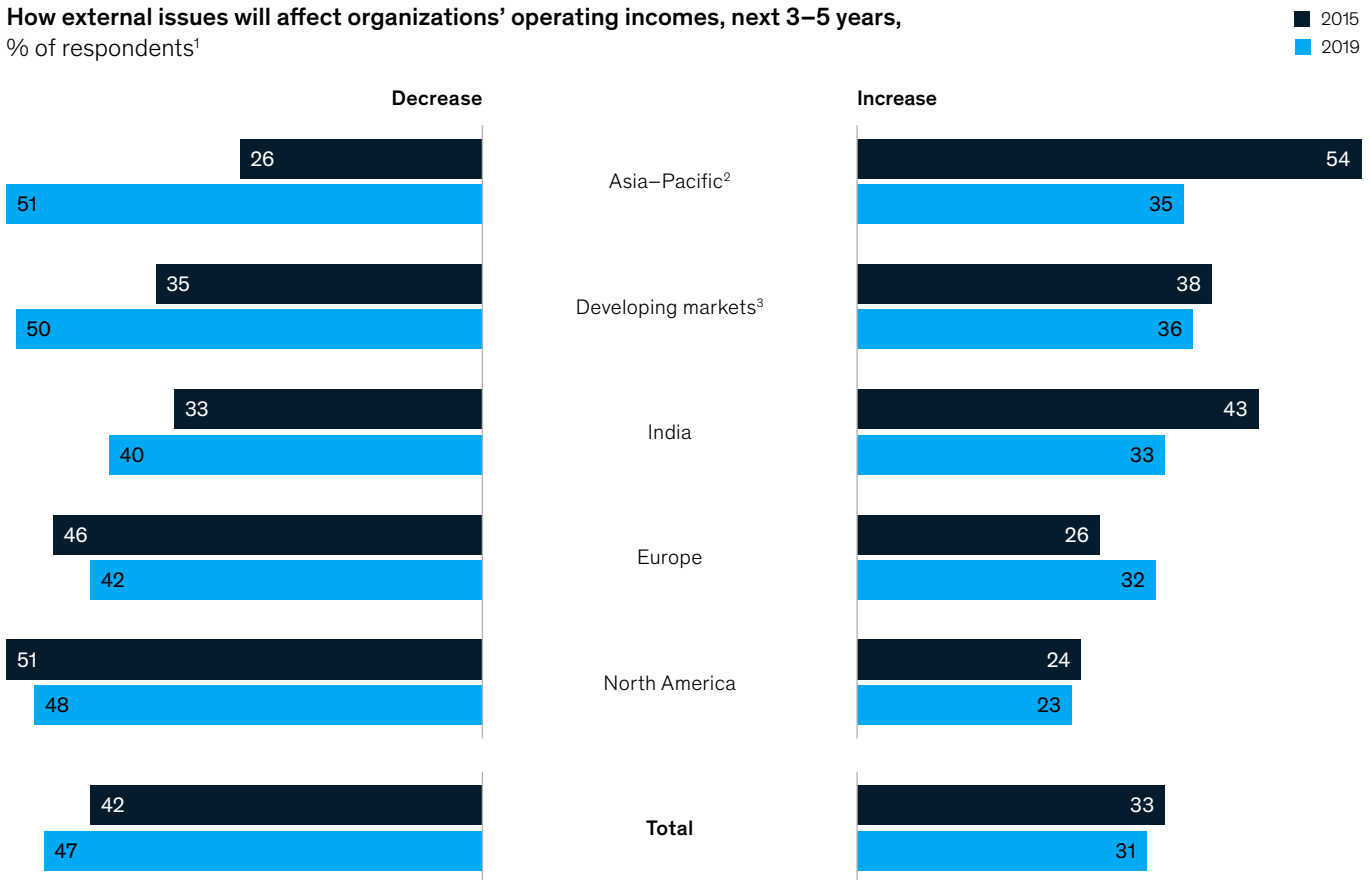
developing markets were more likely than in the previous survey to say these issues are a risk to their companies' operating income (Exhibit 2).<sup>10</sup> Overall, nearly half said external issues will decrease their organizations' operating incomes,<sup>11</sup> up from 42 percent previously.

Even as leaders have increasingly focused on external engagement, the findings suggest that

Exhibit 2

### Respondents in Asia–Pacific and developing markets have become more likely to see external-engagement issues as a risk.

How external issues will affect organizations' operating incomes, next 3–5 years, % of respondents<sup>1</sup>



<sup>1</sup> Respondents who said “no effect” or “don’t know/not applicable” are not shown. In Asia–Pacific, n = 167 in 2015, and n = 158 in 2019; in developing markets, n = 234 in 2015, and n = 288 in 2019; in India, n = 107 in 2015, and n = 129 in 2019; in Europe, n = 474 in 2015, and n = 524 in 2019; and in North America, n = 352 in 2015, and n = 319 in 2019.

<sup>2</sup> Includes respondents in Australia, Hong Kong, Japan, New Zealand, Philippines, Singapore, South Korea, and Taiwan.

<sup>3</sup> Includes respondents in China, Latin America, Middle East, and North Africa.

<sup>10</sup> Asia–Pacific includes respondents in Australia, Hong Kong, Japan, New Zealand, the Philippines, Singapore, South Korea, and Taiwan.

Developing markets include respondents in China, Latin America, the Middle East, and North Africa.

<sup>11</sup> Customers, government, and regulators are the top three perceived influencers of companies' operating income, as was true in the 2015 survey.

# Just 7 percent of respondents reported that their organizations frequently align the interests of stakeholders and of their businesses.

organizations are no better at external engagement now than in 2015.<sup>12</sup> Just 7 percent of respondents reported that their organizations frequently align the interests of stakeholders and of their businesses. In 2015, 6 percent said their organizations frequently succeeded at doing so.

## The capabilities that matter for engaging with stakeholders

To seize the potential opportunity from stakeholder engagement, other organizations can look to high-performing organizations and the three sets of capabilities that distinguish them from the rest. High performers define and embed a corporate purpose, enable the external-engagement function with technology and tracking, and design the function to be more agile (Exhibit 3).

### Define and embed a corporate purpose

According to the results, several external-engagement capabilities that typically fall to a company's leadership team rank among the attributes that most distinguish high-performing organizations. Respondents at these organizations were much more likely than others to say their companies effectively clarify their societal contributions to external and internal stakeholders in three different ways.

First, these leaders articulated a strong fact-based narrative about the company. Respondents at

high-performing organizations were nearly three times more likely than others to say their organizations express their narratives very well. A fact-based narrative can take the form of a defined purpose—that is, a commitment from the company to its stakeholders—especially in a time of crisis, when stakeholders' needs are particularly acute.<sup>13</sup>

Second, respondents at high-performing organizations were nearly three times more likely than others to say their companies demonstrate effective thought leadership on topics of public interest (for example, by serving as a trusted source for how to address environmental, social, and governance issues). Finally, respondents at high performers were twice as likely as others to say their organizations are very effective at defining a corporate purpose that engages employees.

### Enable external engagement with technology and metrics

Respondents from high-performing organizations were five times more likely than others to report very effective use of digital tools in external-engagement activities, a capability that just 7 percent of others report at their organizations. Furthermore, the findings show that many companies aren't even using digital tools in these activities. Overall, 31 percent said their organizations use no digital tools, and nearly three in ten said they use these tools for basic activities, such as news and reputation tracking.<sup>14</sup>

<sup>12</sup> "How to reinvent the external-affairs function," July 2016, McKinsey.com.

<sup>13</sup> Bill Schaninger, Bruce Simpson, Han Zhang, and Chris Zhu, "Demonstrating corporate purpose in the time of coronavirus," March 2020, McKinsey.com.

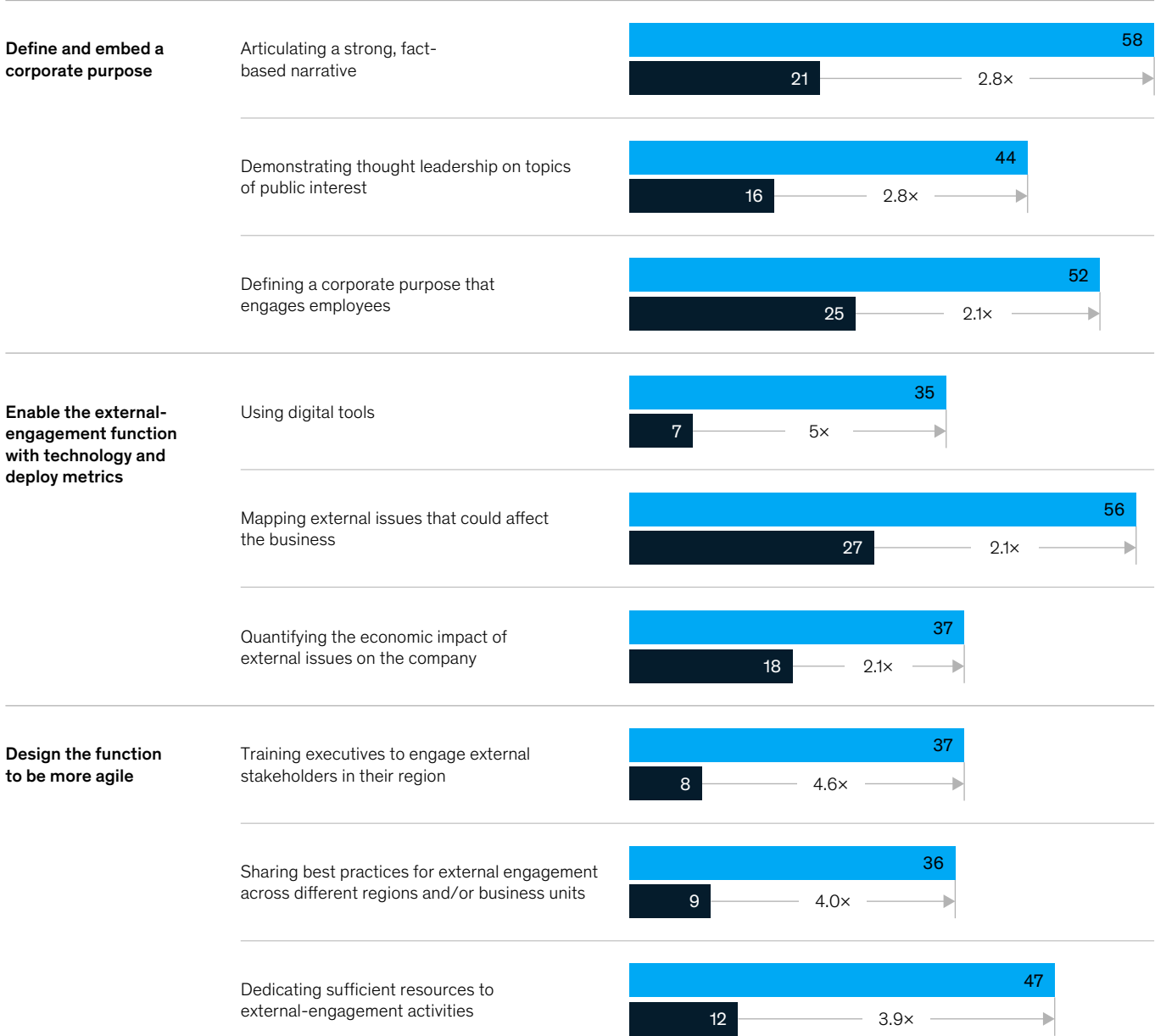
<sup>14</sup> Figures were recalculated after removing respondents who said "don't know" (9 percent of total responses).

Exhibit 3

**Organizations that excel at external engagement have strong capabilities in three distinct areas.**

% of respondents saying their companies are very effective at given practice<sup>1</sup>

■ At high-performing organizations<sup>2</sup> (n = 109)  
 ■ At all other organizations (n = 1,309)



<sup>1</sup> Out of 16 capabilities tested in the survey.

<sup>2</sup> Respondents who said their companies were frequently successful at shaping the debate around government policy and/or regulatory decisions that could affect their business environments and at protecting and/or enhancing their corporate reputation among civil-society groups (eg, nongovernmental organizations, consumer groups).

Even in the industries that have most commonly adopted digital tools—in financial services, and in healthcare systems and pharma and medical products—about one in five respondents said their companies haven’t embraced digital tools (Exhibit 4).

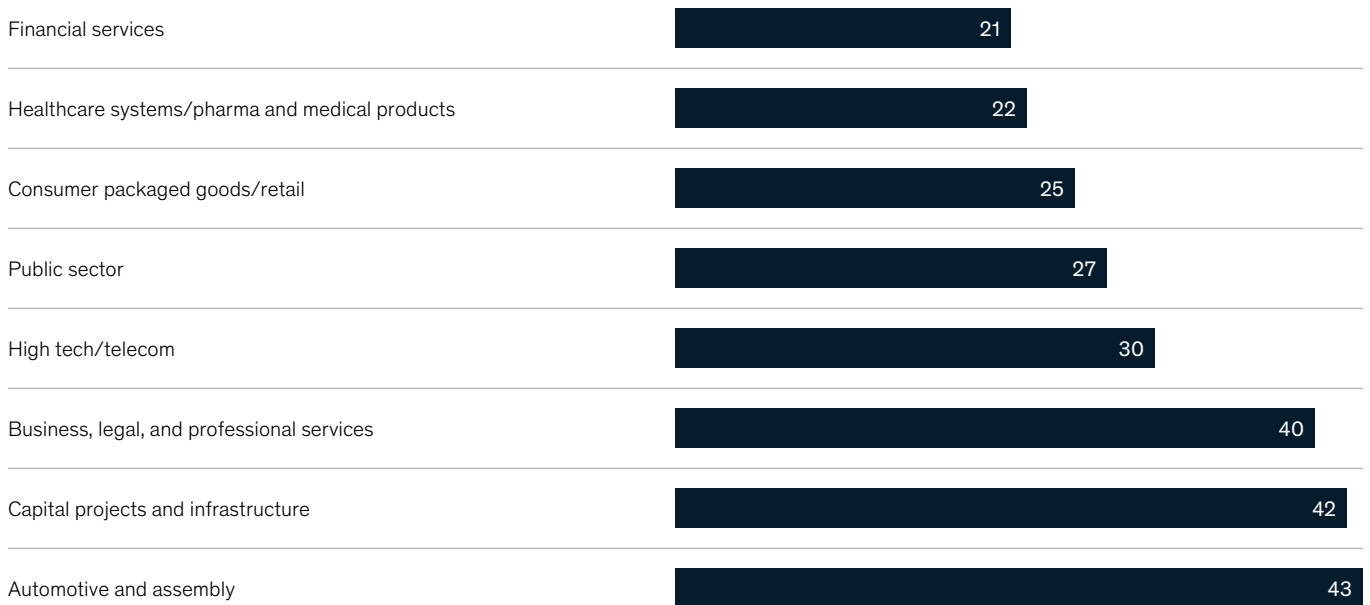
The findings also shed light on how high-performing organizations use digital tools to predict and measure external-engagement performance. Respondents at these companies were more likely than others to say their companies use digital tools for basic engagement activities and for more advanced purposes such as stakeholder-sentiment analysis and predictive legislative analysis.<sup>15</sup>

Respondents also indicated that high-performing organizations were more likely than others to effectively map the external issues that could affect their business. Taking this comprehensive look at potential issues helps companies better understand the short-term and long-term value at stake and therefore prioritize the external-engagement activities to track.<sup>16</sup> These high-performing organizations also excelled at tracking impact, which strong digital capabilities can enable. Respondents from these organizations were twice as likely as peers elsewhere to say their companies effectively quantify the economic impact of external issues on the business. Responses also showed that these

Exhibit 4

**Even in the industries that have most embraced digital tools in engagement activities, many organizations aren’t using them.**

% of respondents who say their organizations do not use digital tools in external-engagement activities, by industry<sup>1</sup>



<sup>1</sup> Figures were calculated after removing respondents who said “don’t know.” In financial services, n = 189; in healthcare systems/pharma and medical products, n = 102; in consumer packaged goods/retail, n = 89; in public sector, n = 66; in high tech/telecom, n = 141; in business, legal, and professional services, n = 190; in capital projects and infrastructure, n = 63; and in automotive and assembly, n = 67.

<sup>15</sup> Respondents from high-performing organizations were about twice as likely as others to say their companies use digital tools for stakeholder-sentiment analysis and predictive legislative analysis.

<sup>16</sup> Witold Henisz, Dhruv Malhotra, and Robin Nuttall, “A new measure to assess companies’ external engagement,” January 2019, blogs.lse.ac.uk.

organizations use more metrics than other companies do to track both external-engagement activities and the outcomes that result from them (Exhibit 5). In fact, many companies aren't tracking such measures at all. Nearly 40 percent of respondents said their organizations aren't using any outcome-based metrics, and one-fifth said their organizations use no activity-based metrics.

**Design a more agile external-engagement function**

The organizational-design choices that companies make for their external-engagement functions also set apart high-performing organizations, as was true in the previous survey. Excelling at external

engagement and at predicting the issues that will have the greatest impact on the organization requires that companies train their leaders, share best practices internally, and allocate resources to the issues with the most value at stake. Companies that do so can become more agile in their external-engagement efforts; if leaders are better prepared to engage with external stakeholders on the company's behalf, then a company's capabilities in this area are stronger for it.

Respondents at high-performing organizations were 4.6 times more likely than others to say their organizations are very effective at training top executives such as general managers and country-

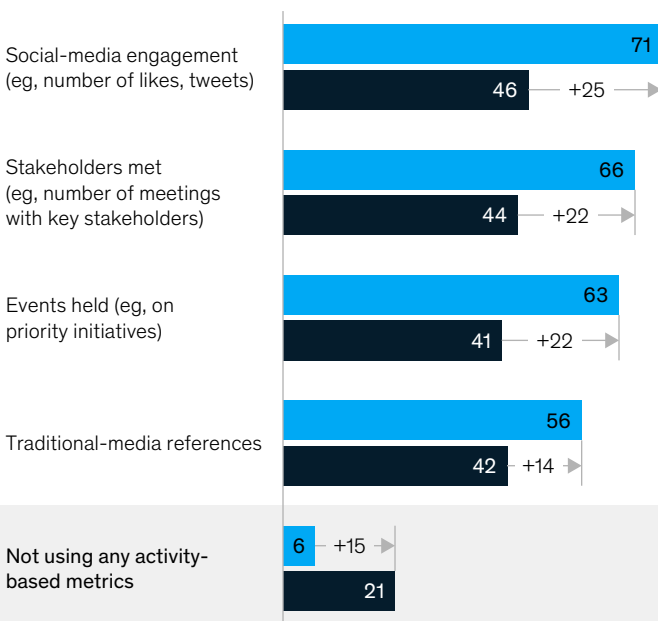
Exhibit 5

**Respondents at high performers are likelier than others to say their organizations track engagement activities and outcomes.**

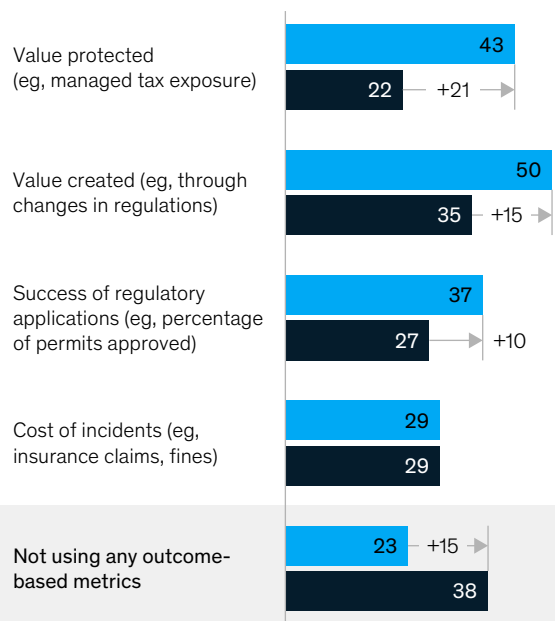
% of respondents saying their companies use given metric to track the success of external-engagement activities<sup>1</sup>

■ At high-performing organizations<sup>2</sup> (n = 109)  
 ■ At all other organizations (n = 1,309)

**Activity-based metrics**



**Outcome-based metrics**



<sup>1</sup> Figures were recalculated after removing respondents who said "don't know." Respondents who said "other" are not shown.

<sup>2</sup> Respondents who said their companies were frequently successful at shaping the debate around government policy and/or regulatory decisions that could affect their business environments and at protecting and/or enhancing their corporate reputation among civil-society groups (eg, nongovernmental organizations, consumer groups).



level managing directors to engage external stakeholders in their regions. They also were four times more likely to report effectiveness at sharing best practices for external engagement across regions and business units. Furthermore, they were nearly four times more likely than others to say their organizations are very effective at dedicating sufficient resources to external-engagement activities.<sup>17</sup> The findings also show that some organizations have an agile operating model for their external-engagement functions. About three in ten respondents said their companies have external-engagement talent that “flows to the work”—that is, talent dynamically reorganizes around issues—and a similar share indicated that the functions include cross-functional project teams.

What’s more, the leaders overseeing external engagement at high-performing organizations are different from those at other organizations. At high performers, 85 percent of respondents said their companies’ CEOs are the senior-most executives responsible for external engagement, whereas 69 percent of those at other organizations said the same. The background of external-engagement leaders also looks different at high performers. Responses show leaders of high-performing external-engagement functions were much more likely than leaders at other companies to have worked in government or diplomacy.

## Looking ahead

It’s no surprise that more senior leaders have been investing time in external engagement, when operating income could be at risk. Amid the COVID-19 crisis, the stakes for ineffective engagement—and the potential value of engaging with stakeholders proactively—are even higher than

usual, with many governments around the world providing assistance (financial and otherwise) to companies in hard-hit sectors. To better manage relationships with external stakeholders during this time of crisis and in the future, leaders should focus on building the three strengths that most differentiate companies with effective external engagement:

- **Define and embed a corporate purpose.** Defining a purpose helps a business rethink its role in society amid stakeholders’ mounting demands that companies contribute across various dimensions, such as those that fall under the ESG umbrella. Embedding a purpose that reflects a company’s unique capacity to contribute to the world can increase topline growth and reduce costs.<sup>18</sup> To do so may require that leaders seek input from a wide range of external stakeholders while building a purpose-focused culture and balancing trade-offs between purpose and profit.<sup>19</sup>
- **Enable the function with technology and deploy metrics.** Many new, reliable technologies can boost the impact of companies’ external-engagement activities. As more data become available in digital formats, companies can deploy digital tools and closely track metrics to provide CFOs with insights they can trust. Companies that adopt and tailor digital technologies to their needs stand to gain a strong competitive advantage, and the findings show that organizations using digital tools for more advanced activities are likelier than those with just basic uses to be very effective at each of the 16 capabilities we asked about, both in areas that benefit from the use of digital tools and with other aspects of external engagement.

<sup>17</sup> Respondents reporting external-engagement success were more likely to work for organizations with annual revenues of \$1 billion or more, suggesting that larger organizations tend to perform better at external-engagement management. They also were about twice as likely as others to say their organizations have external-engagement teams of 20 or more people.

<sup>18</sup> Pablo Illanes, Nina Probst, Bill Schaninger, and Bruce Simpson, “Purpose: Shifting from why to how,” *McKinsey Quarterly*, April 2020, McKinsey.com; Witold Henisz, Tim Koller, and Robin Nuttall, “Five ways that ESG creates value,” *McKinsey Quarterly*, November 2019, McKinsey.com.

<sup>19</sup> Naina Dhingra, Robin Nuttall, and Matt Stone, “Embedding purpose: Fewer slogans, more action,” August 2019, McKinsey.com.

— *Design a more agile function.* As across other parts of the organization, agile ways of working can help external-engagement functions create more flexible allocation of resources and make employees' expertise more widely available within the organization.<sup>20</sup> While these are early days for agility within external engagement, the function will likely see benefits from undergoing this structural change. The first step for companies is to consider external-engagement experts a resource to tap early

in the development of major projects, rather than as a team to approach only when something has gone wrong. By embedding external-engagement experts in project-based teams throughout the organization from the outset of projects, companies can promote the use of external-engagement best practices. Additionally, providing leaders with a clear set of facts and context on priority topics can help equip them to engage externally on the companies' behalf.

The survey content and analysis were developed by **Leo Geddes** and **Robin Nuttall**, an associate partner and a partner, respectively, in McKinsey's London office, and **Ellora-Julie Parekh**, a director of practice management in the Brussels office.

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<sup>20</sup>For more on organizational agility, see Wouter Aghina, Aaron De Smet, and Kirsten Weerda, "Agility: It rhymes with stability," *McKinsey Quarterly*, December 2015, McKinsey.com.