How Boards Can Deliver On Sustainability

Doing good is good business… The long-term economic viability of the organization is closely linked to its social licence to operate. Investor pressure to incorporate long-term ESG issues into company valuation is on the rise. Customers are more informed than ever, and are demanding transparency on environmental and social value. The call for sustainability can no longer be ignored. Board of directors are called to take leadership to articulate their company's mission beyond profits and put sustainability on the board agenda. How can boards deliver on sustainability by translating this awareness to action?

On August 2019, we witnessed a tectonic shift in the understanding of key business leaders about the purpose of the corporation from 'Business of business is business' towards '**Doing good is good business'**. The CEOs from 181 of the world's largest companies — as part of The Business Roundtable — declared that the purpose of a corporation is not just to serve shareholders, but "to create value for all our stakeholders."

The Intention – Action Gap

While the public declaration of these 181 CEOs is very important, the route from making a statement to fully embracing and implementing this principle is a long one. To close the intention-action gap, boards must be actively engaged in integrating sustainability into their long-term strategy and make sustinability part of the board agenda. As stewards of organizations, boards must develop a deeper holistic understanding of their responsibilities and recognize sustainability both as a fiduciary duty and a moral imperative.

Incorporating sustainability into the organizations' core activities requires the company to articulate its corporate mission beyond profit, to include environmental and social goals, as well as adopt a more holistic view of value creation to encompass all stakeholders including their customers, supply chains, and the communities in which they operate. Once sustainability aspirations are set, the company must deliver by turning good intentions to good results.

There are several reasons why progress has been slow to close the intention-action gap:

The "HOW" is not yet established and varies by company

The complexity and diversity of stakeholder expectations and industry dynamics make it difficult to craft a 'one size fits all' approach to sustainability management, requiring each company to craft their own approach to sustainability. Material issues differ even between companies in the same industry. As a result, companies must articulate what sustainability means to them by identifying and prioritizing the sustainability issues core to their mission.

ESG Data is not Comparable to Measure Sustainability Performance

Investors are increasingly looking for incorporating environmental, social, and governance factors to calculate enterprise value. However, standards and regulations are not yet in place to define how to value and report performance on material sustinability topics. Emerging global standards for sustainability reporting, including the GRI standards and SASB are gaining broader acceptance, but the field of sustainability reporting is still open for public and private organizations to experiment with new approaches.

Establishing consistent and comparable KPIs for measuring social, environmental, and governance impact is essential for the boards to respond to investor demand for integrating sustainability into investment criteria and establishing trust with stakeholders through transparency. What matters is to select criteria based on what is material to the company's value in the long run and not what is convenient or easy to delivery. In the long run, there will be a value placed on natural capital through government regulations and costs of externalities will be internalized.

Sustainability is a Board Responsibility

The responsibilities of the board members are not limited to short term interests of the shareholders, but also include long term impacts on anyone affected by their decisions and future generations. As 'trusted' agents, board members need to ensure that the stakeholders 'trust' the corporation to ensure their long-term commitment to work with the corporation towards achieving its mission. Corporate board members have a fiduciary responsibility to act in good faith and with a reasonable degree of care, and they must not put themselves under any conflict of interest..

The term fiduciary refers to a relationship in which one person has a stewardship responsibility of care for the assets or rights of another person. The word "fiduciary" is derived from the Latin term for "faith" or "trust." The term "stewardship" implies an inherent willingness to serve others (a moral duty), and a willingness to subordinate one's interests to that of others by acceptance of the duty to serve. As early as 1790 B.C. the Babylonian Code of Hammurabi established rules of law governing business conduct for the behavior of agents entrusted with property[1]. Aristotle (384 B.C.- 322 B.C.), influenced the development of fiduciary principles, recognizing that in economics and business, people must be bound by high obligations of loyalty,

[1] Joseph F. Johnston, Jr., "Natural Law and the Fiduciary Duties of Managers," Journal of Markets & Morality (2005)

honesty and fairness, and that when such obligations are not required or followed, society suffers[2].

The fiduciary responsibilities of board members fall into three categories: **Duty of loyalty** imposes an affirmative duty on the board to protect the interests of the corporation, and an obligation to refrain from conduct which would injure the corporation and its shareholders. **Duty of care** requires directors to make a business decision based on all available and material information and to act in a deliberate and informed manner. This requires board members to act in good faith for the company's best interest in both the short and the long-term based on a reasonable investigation of available options. **Duty of full disclosure** requires boards provide reasonably complete disclosure especially when shareholders are asked to vote and when the company completes a conflict of interest transaction.

According to the Conference Board[3], recently the notion of fiduciary duty is expanding to include sustainability issues. Increasingly the pursuit of sustainable business initiatives is perceived as consistent with corporate governance standards. In particular, judicial action[4], recent stakeholder constituency statutes[5], and statutory exculpatory provisions under corporate law[6] have laid the groundwork for boards to consider non-shareholder interests and concerns in making investment decisions[7]. Extending the duty of full and fair disclosure **further to include environmental, social, and governance matters** is critical for gaining and retaining the trust of present and future stakeholders.

Sustainability through a Governance Lens

The next leap in sustainability management will come from boards taking on the responsibility to proactively manage the companys' sustainability efforts. To aid them with this effort, we designed the **Sustainability Governance Scorecard** – an impact-research conducted to help improve the state of the world by speeding up learning from peers. We analyzed publicly available data through a 'governance lens', seeking to assess and provide good examples on whether Global

[2] John H. Walton, "Deuteronomy: An Exposition of the Spirit of the Law," Grace Theological Journal (1987)
[3] The Conference Board, "Sustainability in the Boardroom," DN-008, June 2010
[4] See, for examples of cases where the legal courts underscored the importance of assessing the impact on key stakeholder relations of a Business decision made in the context of hostile takeovers a shareholder instituted derivative actions: Unocal Corp. Mesa Petroleum Co., 493 A. 2d 946, 955 (Del. 1985), discussing how boards should consider the impact on constituencies other than shareholder when analyzing the reasonableness of defensive measures; and Paramount Communications, Inc. v. Time Inc., 571 A. 2d 1140, 1153 (Del. 1989)
[5] For example, 15 Pa. Cons. Stat. §1715. In general, see Kathleen Hale, "Corporate Law and Stakeholders: Moving beyond Stakeholder Statutes," Arizona Law Review, Vol. 45, 2003, p. 829
[6] Delaware Code Annotated, Title 8, Section 102(b) (7), permitting the use of clauses in the certificate of incorporation (therefore approved by shareholders) to insulate corporate directors from monetary liability for any action arising from a breach of their duty of care. Exculpatory clauses provide more freedom and leniency to directors in their decision-making capacity and encourage them to take strategic risk.
[7] . Pursuit of Social Investments," The Conference Board, Director Notes No. DN-002, January 2010.

Sustainability Leaders (GSLs) have the right processes, people, incentives, and culture to provide good governance[8].

We analyzed the public disclosures of 183 companies across 7 countries and 10 sectors through a governance lens to understand the state of their sustainability governance and identify good examples to speed up learning from peers. The companies were selected from the sustainability indexes of stock exchanges, all of whih are signatories of the Sustainable Stock Exchanges Initiative, across US, UK, Germany, South Africa, China, India and Türkiye. Over 300 questions were answered based on public disclosures of GSLs, using their annual reports, sustainability reports, and websites. Our evaluations for the questions were shared with the investor relations departments of the companies for their review prior to the publication.

The SG Scorecard has two key conclusions: (1) **There is significant room for improvement** in the effectiveness of execution and accountability of the sustainability programs of even the leading companies, let alone the large number of enterprises all around the world. (2) **There are extensive peer-to-peer learning opportunities** based on good practices shared by the GSLs on how they approach their sustainability efforts.

5 key lessons emerge for boards based on the state of the world with respect to governance of sustainability and best practices that emerged from our research. Boards can deliver on sustainability by: Choosing the right board with skills for sustainability across multiple dimensions; identifying sustainability areas core to the company's mission and setting materiality thresholds across ESG categories based on broad stakeholder participation including communities and the environment; ensuring comprehensive scope (ESG, Safety and occupational hazards, Human rights, Lifecycle impacts, and Stakeholders) of policy, setting targets, measuring performance, and implementation. This can be accomplished by linking targets to executive compensation; putting an appropriate governance structure over sustainability in place to effectively provide guidance and oversight; and adopting a global perspective and increasing transparency to spark collective action and accelerate impact towards global goals. For each section; we share a list of questions boards can use to regularly discuss and steer their companies towards sustainable value creation.

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[8] How guidance and oversight is provided over the company's sustainability efforts?
How comprehensive the sustainability efforts are in terms of stakeholders, value chain, and geographies? and
Whether continuous improvement is embedded in their efforts through a learning loop?

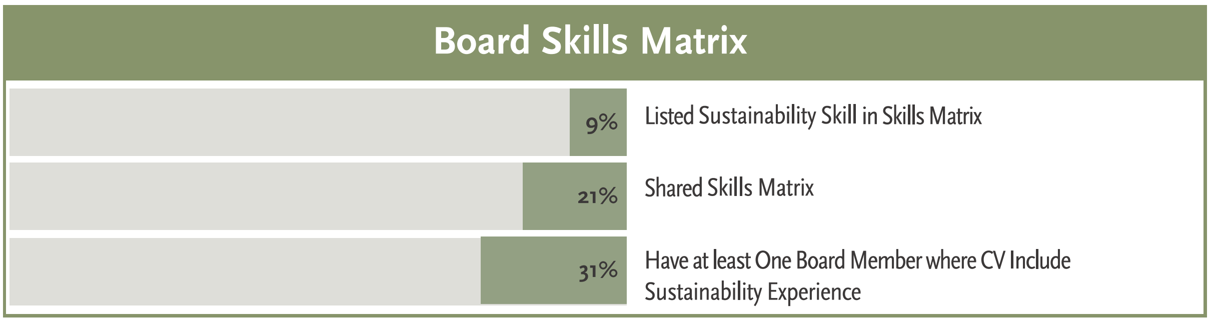
1. Board Structure and Skills: Choosing the Right Board

Responsible boards make sustainability a leadership priority and ensure they have the right people (skills and diversity) to provide leadership and direction on sustainability. Board members need to have the right skills to provide guidance and oversight to the sustainability plans of the corporation. The board needs to have sufficient expertise to understand the decision-making processes of key stakeholders, have members who are familiar with evolving sustainability standards and practices, and sufficient diversity to adequately evaluate different dimensions, perspectives and risks related to sustainability issues.

Sustainability as Skill

Sustainability is a long-term issue for companies. Boards are responsible for long-term decision, guidance, and strategy setting for organizations. Therefore, sustainability is a key board responsibility. Decisions like redesigning the value chain, introduction of new technologies, investing on green innovations are some of the critical issues where boards' need to take responsibility. Board's time perspectives should be longer than those of the management teams. Hence, boards need to make sure that the top management does not fail to address key sustainability issues whose effects will be realized in the long term, exceeding management teams' term.

Although sustainability is gaining importance, members with such experience are lagging in board composition. Our research findings show that **the percentage of companies with at least one board member with any reference to sustainability expertise in their CVs is only 31%. Only 26% of the GSLs publish a Board Skills Matrix and only 9% list sustainability as a skill they seek for their boards; indicating significant potential for improvement in this area.**

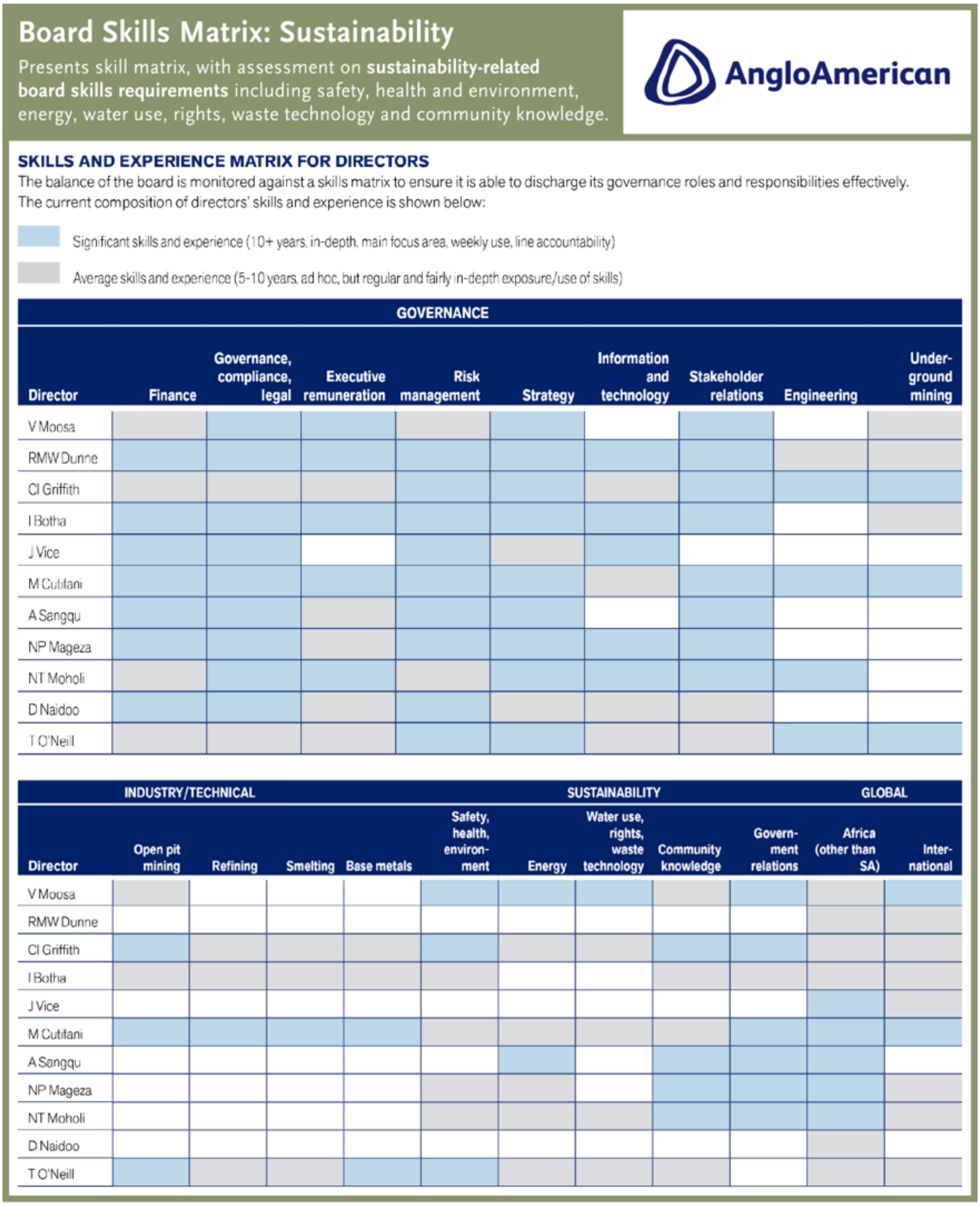


Based on Argüden Governance Academy research for Sustainability Governance Scorecard ©

Board Skills Matrix

A skills matrix identifies the skills, knowledge, experience and capabilities desired of a board to enable it meet both its current and future challenges and realize its opportunities. Disclosing a skills matrix is good practice and offers an opportunity for considered reflection on whether the board has the right skills and diversity for providing guidance and oversight on sustainability.

For example, in its board skills matrix, **Anglo American Platinum** explicitly shows sustainability as a required skill and provides in-depth information on sustainability related board skill requirements including health & safety, environment, energy, water use, human rights, waste technology, and community knowledge.



Board Skills Matrix: Sustainability

Presents skill matrix, with assessment on **sustainability-related board skills requirements** including safety, health and environment, energy, water use, rights, waste technology and community knowledge.

AngloAmerican

SKILLS AND EXPERIENCE MATRIX FOR DIRECTORS

The balance of the board is monitored against a skills matrix to ensure it is able to discharge its governance roles and responsibilities effectively. The current composition of directors' skills and experience is shown below:

Significant skills and experience (10+ years, in-depth, main focus area, weekly use, line accountability)

Average skills and experience (5-10 years, ad hoc, but regular and fairly in-depth exposure/use of skills)

	GOVERNANCE								
Director	Finance	Governance, compliance, legal	Executive remuneration	Risk management	Strategy	Information and technology	Stakeholder relations	Engineering	Underground mining
V Moosa									
RMW Dunne									
CI Griffith									
I Botha									
J Vice									
M Cutifani									
A Sangqu									
NP Mageza									
NT Moholi									
D Naidoo									
T O'Neill									

	INDUSTRY/TECHNICAL				SUSTAINABILITY					GLOBAL	
Director	Open pit mining	Refining	Smelting	Base metals	Safety, health, environment	Energy	Water use, rights, waste technology	Community knowledge	Government relations	Africa (other than SA)	International
V Moosa											
RMW Dunne											
CI Griffith											
I Botha											
J Vice											
M Cutifani											
A Sangqu											
NP Mageza											
NT Moholi											
D Naidoo											
T O'Neill											

Source: Anglo American Platinum Limited 2017 Integrated Report, p. 90-91

Managing sustainability is complex and requires multiple perspectives to be represented for the board to effectively engage in strategic discussions and make long-term business decisions. Sustainability-related skill requirements can cover a wide range of ESG issues, which are necessary for board members to unnderstand the sustainability risks and impacts across the corporations value chain and how this might impact the business model and competitive positioning of the corporation. Boards also need to have the skills and experience to provide guidance on sustainability driven innovation and value creation opportunities.

Diversity of Mind

Having the right skills, experience and diversity is the first step, but there must be productive dialogue within members of the board to reap the benefits of diversity. This requires experienced, collaborative and responsible board members, and a strong board culture based on trust.

From this perspective, diversity could be defined as respect and ability to listen and hear "the other". Diversity of mind is trusting that different frames of reference are valuable: including culture, religion, race, ethnicity, socio-economic status, age, gender, tenure, experience, and geography. Diversity is a dialogue between different people and different paths of thought. It is a resource for triggering energy and creative solutions in companies and communities, including boards[9].

Boards of directors need **diversity of mind** within the board to better fulfill their key responsibilities of providing guidance and oversight for sustainability. Boards can realize such a balance in making strategic choices that involve risk taking with an effective process for challenging management decisions, only if they have the right experience set. A well-functioning board should have members with a **diversity of perspectives** since no single individual would be capable of striking the right balance between risk & reward, short-term vs. long-term impacts, and interests of various stakeholders for all relevant decisions.

As for the responsibility of the board in providing oversight, **diversity of experience** plays an important role in early detection of signs to protect the company from ‘agency risks.’ In particular, clear separation of management rights (taking initiative and implementation) and governance rights (guidance, approval, and oversight), is critical in minimizing potential ‘agency’ risks of the management such as fraud; cronyism (building a personal fiefdom with company resources); lethargy (focusing

[9] Friman, M.J., Aaltonen, T., Ahtola, E., Öhman, L. (2012). Diversity in board work and steering organizations, Boardman Oy.

on excuses as opposed to results); being too risk averse (that may lead to over-investment) or being too risk prone.

Diversity for its own sake is not an improvement in governance; what matters is the combination of complementary skills and experiences that members bring to the table to better address the challenges the company is likely to face. Boards are beginning to realize that it is the breadth of perspectives, not just inclusion of various groups, is the key that fosters an appropriate climate creating benefits for the organization.

Some boards approach to the issue of diversity by utilizing a checklist, covering different diversity factors. However, too much focus on checklists may create isolated groups with limited interaction, therefore expected benefits may not be reached. Real life cases are very complex. It would be very difficult to develop creative solutions for the challenges without a board who not only has diversity of mind but also effectively utilizes it to mutually reach conclusions. Effective board diversity can be achieved when opposing ideas would be presented and discussion would be held in a respectful manner before making decisions on challenging issues.

Does the board have **the right skills** to provide **guidance and oversight** to the sustainability plans of the corporation?

- Does the board have **sufficient expertise** to understand the decision making processes of key stakeholders?
- Does the board have members who are familiar with the **evolving sustainability standards and benchmarks**?
- Does the board have enough **diversity to adequately evaluate the different dimensions** (industry experience diversity, age diversity, tenure diversity, ethnic diversity, gender diversity, geographical diversity, stakeholder experience diversity) perspectives, and risks of the sustainability issues?
- Is there a **board skills matrix** detailing the skills and experiences of board members across multiple dimensions, including **sustainability as skill** across ESG areas relevant for the company?

2. Materiality based on Broad Stakeholder Participation

ESG Materiality

According to a recent study only 20% of an S&P 500 company's market value can be explained by its physical and financial assets (down from 83% in 1975) and the remainder comprises intangible factors, such as intellectual capital, human capital, brand and reputation, and relationships with regulatory bodies, non-governmental organizations, customers, suppliers and other external stakeholders. Therefore, sustainability issues that may have an impact on these intangible areas pose a significant risk as well as an opportunity to create value for the company.

Material matters are broadly defined, as per GRI guidelines, as issues that have impact on an organization’s ability to create, preserve, or erode economic, environmental, and social value for itself, its stakeholders and society at large. Investors are increasingly looking for evidence that their portfolio companies are focused on the material ESG issues that matter to financial performance and a well-defined commitment to sustainability.

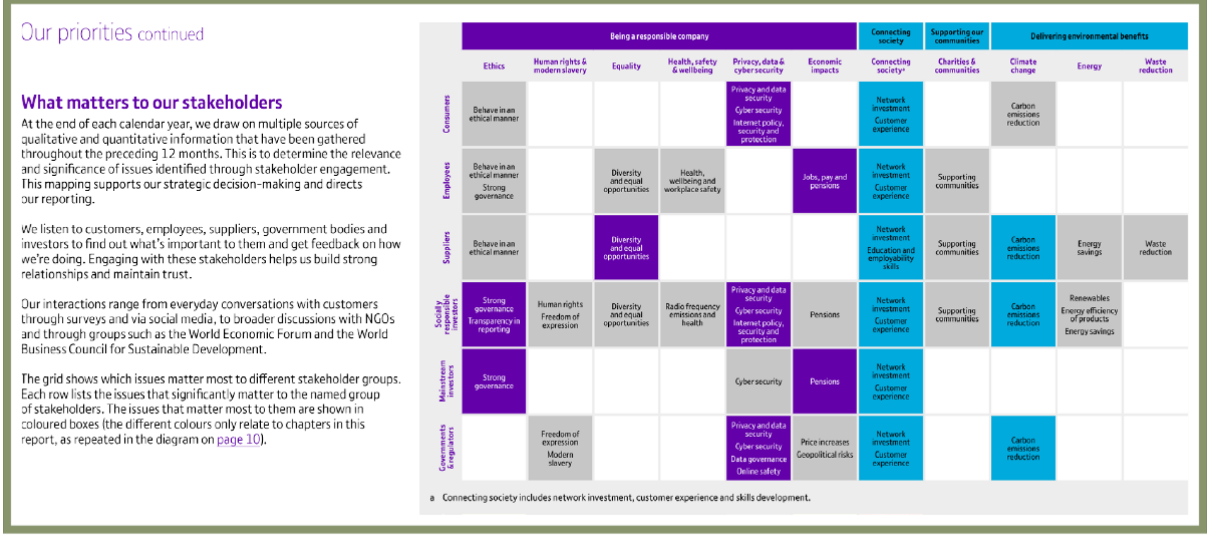
Boards must be actively involved in setting materiality thresholds across ESG issues and focus on what matters most by prioritizing sustainability efforts around where they can have greates impacts. The board must discuss the materiality of issues including the imact on the company and the impact of the company on other stakeholders including local communities and the environment, evaluate risks as well as value creation opportunities across sustainability issues, and assess materiality both for the short-term and the long-term viability of their organizations.

Materiality Matrix

Materiality analysis not only allows the company to prioritize their sustainability efforts by considering the ESG issues most related to its business, but also to inform sustainability reporting and communication with stakeholders. In its materiality matrix, for example, **British Telecom** shares the results of its stakeholder engagement process and frames a comprehensive set of material topics around positive value-generation opportunities (being a responsible company, connecting society, supporting communities and delivering environmental benefits). Engagement covers a wide range of stakeholder groups and uses multiple sources of qualitative and quantitative for assessment of materiality.

Materiality Matrix

Shares the results of its stakeholder engagement process and frames a comprehensive set of material topics around positive value-generation opportunities, across a wider angle of stakeholder groups.



Our priorities continued

What matters to our stakeholders

At the end of each calendar year, we draw on multiple sources of qualitative and quantitative information that have been gathered throughout the preceding 12 months. This is to determine the relevance and significance of issues identified through stakeholder engagement. This mapping supports our strategic decision-making and directs our reporting.

We listen to customers, employees, suppliers, government bodies and investors to find out what's important to them and get feedback on how we're doing. Engaging with these stakeholders helps us build strong relationships and maintain trust.

Our interactions range from everyday conversations with customers through surveys and via social media, to broader discussions with NGOs and through groups such as the World Economic Forum and the World Business Council for Sustainable Development.

The grid shows which issues matter most to different stakeholder groups. Each row lists the issues that significantly matter to the named group of stakeholders. The issues that matter most to them are shown in coloured boxes (the different colours only relate to chapters in this report, as repeated in the diagram on page 10).

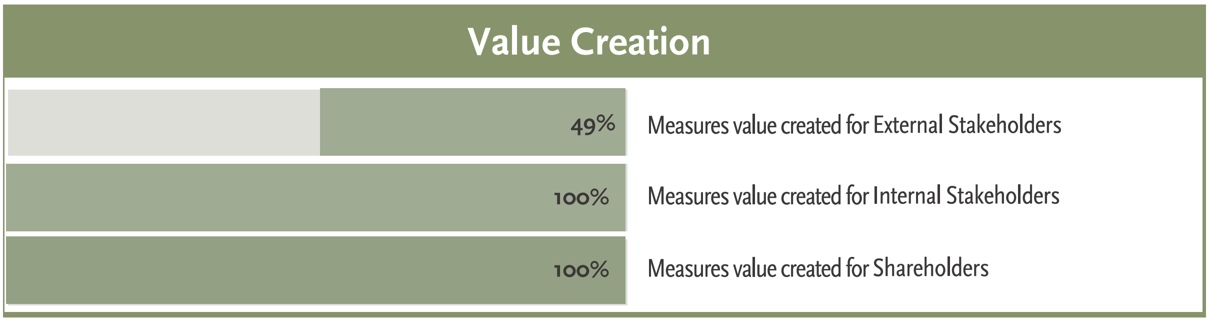
	Being a responsible company						Connecting society	Supporting our communities	Delivering environmental benefits		
	Ethics	Human rights & modern slavery	Equality	Health, safety & wellbeing	Privacy, data & cyber security	Economic impacts	Connecting society[a]	Charities & communities	Climate change	Energy	Waste reduction
Consumers	Behave in an ethical manner				Privacy and data security Cyber security Internet policy, security and protection		Network investment Customer experience		Carbon emissions reduction		
Employees	Behave in an ethical manner Strong governance		Diversity and equal opportunities	Health, wellbeing and workplace safety		Jobs, pay and pensions	Network investment Customer experience	Supporting communities			
Suppliers	Behave in an ethical manner		Diversity and equal opportunities				Network investment Education and employability skills	Supporting communities	Carbon emissions reduction	Energy savings	Waste reduction
Socially responsible investors	Strong governance Transparency in reporting	Human rights Freedom of expression	Diversity and equal opportunities	Radio frequency emissions and health	Privacy and data security Cyber security Internet policy, security and protection	Pensions	Network investment Customer experience	Supporting communities	Carbon emissions reduction	Renewables Energy efficiency of products Energy savings	
Mainstream investors	Strong governance				Cyber security	Pensions	Network investment Customer experience				
Governments & regulators		Freedom of expression Modern slavery			Privacy and data security Cyber security Data governance Online safety	Price increases Geopolitical risks	Network investment Customer experience		Carbon emissions reduction		

a Connecting society includes network investment, customer experience and skills development.

Source: British Telecom Delivering our Purpose Report - Update on our progress in 2016/17, p. 8

Stakeholder Engagement

The success of a company depends on its **relationships with the external world**, not just customers and investors, but also employees, regulators, politicians, activities, NGOs, the environment and technology. Good governance needs to achieve balance between risk/reward, short/long-term, concerns of different stakeholders, and motivation/control of management. Our research reveals that even among GSLs, companies take too narrow a view of the relevant stakeholders and are too focused on limiting the downside: **We find that 100% of the companies analyzed measure value for internal stakeholders, but only 49% for external stakeholders.**



Based on Argüden Governance Academy research for Sustainability Governance Scorecard ©

Stakeholder engagement is a critical process that helps companies understand their key environmental and social impacts and identify sustainability risks and opportunities. For this process to be effective, there should be open communication, with an intent on understanding concerns and creating dialogue for establishing trust-based relationships. Best-in-class companies adopt a **long-term, comprehensive view of their stakeholders** to encompass external stakeholders and **clearly articulate how the fulfillment of their purpose benefits society to foster dialogue.**

The boards need to understand the key issues raised by the stakeholder engagement process and how the management plans to address them. Furthermore, the board needs to have a process to evaluate the management's sustainability plans to address the key issues.

Competitive strategy requires an understanding of not only the players of the industry in which a company operates, but also its suppliers, customers, potential substitutes, and new entrants, as well as the shifting trends in technology and in the regulatory environment. Therefore, an understanding of the concerns and inner workings of these key stakeholders is useful in guiding the corporation during the process of developing strategies, as well as in implementing those strategies.

Having members with diverse stakeholder experiences can help improve board decision making.

Yet, it is critical that board members not be viewed—either by themselves or by their peers—as representing a particular stakeholder, but rather as key members of the team that make up the board. This understanding is critical to ensuring that their ties to the stakeholders do not create conflicts of interest with the company. Duty of loyalty requires that the sole responsibility of a board member is to be the interest of the company.

Successful and sustainable organizations need not only to demonstrate a willingness to involve the stakeholders in decision making and to embrace a culture of transparency and accountability, but also to ensure that processes and organizational infrastructures are in place to build trust among stakeholders.

For example, **Coca Cola** has set a global target to collect and recycle 100% of its packaging by 2030. This target would be difficult to achieve without the support of a wide range of stakeholders including customers, its supply chain and the city government. Transparency creates accountability, not just for the company but also for its stakeholders. Better transparency in reporting ESG outcomes can restore trust in business by showing that it is taking action on sustainability. It can also mobilize stakeholders to contribute towards progress towards sustainability goals. Addressing sustainability challenges such as climate change requires collaboration between multiple stakeholder groups in a long time horizon and trust is essential for that collaboration to be impactful and long lasting.

Earning the trust of the stakeholders is the key to mobilize their resources towards a common vision. Transparency in relationships is the key to earning that trust. In order to gain and retain the trust of stakeholders the most important issue is to have the right attitude. The yardstick should be the ethic of reciprocity or the golden rule that is prevalent in most religions and philosophers' writings summarized as "Do unto others as you would have them do unto you."

Have the **material issues** that would substantially affect the company's strategy, business model, capital or performance been properly identified?

- Has the board been involved in **setting the materiality thresholds** in each sustainability area? (economic, environmental, social, governance)?
- Have the **trends, current and future impacts** been considered?
- Has the management **prioritized** the key sustainability issues?
- Has the management considered **resource requirements** to deal with the prioritized issues in its mitigation plans?

Has an adequate **stakeholder engagement process** been conducted?

- Has the management comprehensively identified its relevant stakeholders and prepared a **stakeholder map**?
- Has the management identified **material ESG issues for each stakeholder group** through **two-way communication** (including how the company can impact the issue and how the stakeholders can add value)?
- Has the management **identified sustainability initiatives** targeting each stakeholder group and communicated results to the company's stakeholders?
- Does the board have access to the **key issues raised** by this process?
- Does the board have a **process to evaluate** the management's sustainability **plans** to address the key issues?

Has the board reviewed the **materiality matrix** to include:

- Material ESG issues **for the company** in the **short-term and the long-term**?
- Material effects of ESG issues **on all stakeholders including the planet, employees and communities** in which the company operates in for the short-term and the long-term?

3. Set Targets and Assess Performance for an Expanded Scope

Comprehensive Policy and Implementation

Managing sustainability requires a company to assume responsibility to manage the impact of all its activities, including its supply chain and the full product portfolio throughout the lifecycle of its products. Hence boards need to focus not only on the sustainability issues arising from the company’s own operations but also on managing the impacts throughout its value chain and throughout the lifecycle of its full product portfolio.

To expand the scope of their sustainability efforts, boards must ensure the comprehensiveness of policy and implementation throughout the value chain including the supply chain, the product lifecycle, all geographies, all stakeholder groups, and all levels of the organization. **What gets measured gets improved**. It is also important that the company measures performance across key sustainable performance indicators, reports past performance as well as future targets; assess performance and remedial actions, and is transparent and accountable with their sustainability efforts and disclosure policy.

Supply Chain Responsibility

Supply chains are critical links that connect an organization's inputs to its outputs. Many companies’ greatest sustainability risks and opportunities are in the supply chain. However, sustainability efforts of many companies are limited to measuring the sustainability of their own business operations and do not extend these efforts to their suppliers and customers. Encouraging companies to measure and report more details about suppliers can lead to improved performance.

Source: General Mills 2017 Global Responsibility Report, p. 36

In this chart, **General Mills** presents results on **emissions reduction efforts** across its **value chain**. General Mills takes environmental stewardship into consideration all the way from agriculture, packaging supply chain, producing, shipping, selling and consuming. The chart shows results for the current year and targets and puts the numbers in perspective by sharing previous years' results. For each part of the value chain, General Mills shares **the percentage of GHG emissions** from that section (e.g. Agriculture and transportation account for 50% of total GHG emissions, supply chain for 8%), **level of influence** the company has (e.g. Low, Medium, High), **key drivers** and relative importance for that phase, **assessment of performance** compared to previous years, and approach for reaching targets (e.g. External collaboration, sustainable sourcing commitments).

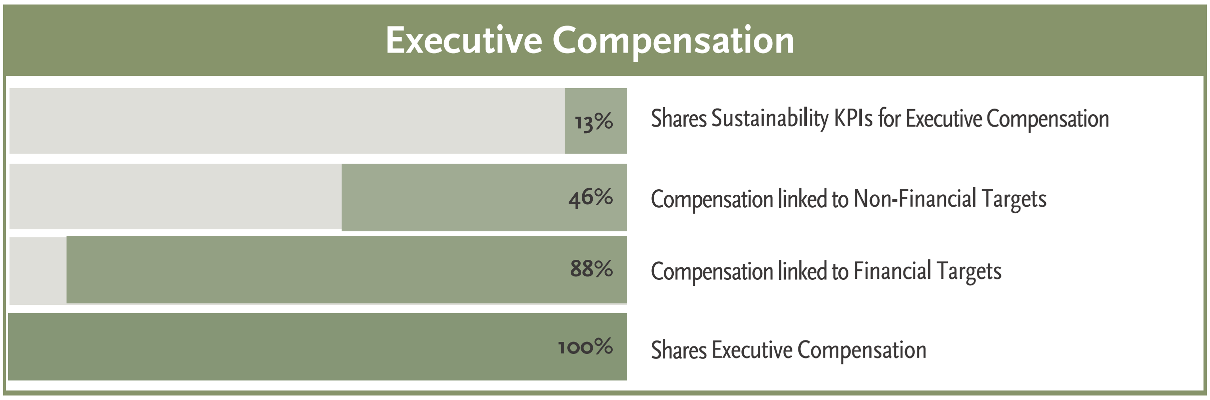
Accepting responsility for the supply chain might involve utilizing their purchasing power to encourage, audit, collaborate, and provide benchmarking and learning opportunities with its suppliers on key sustainability issues. Our research reveals that there is still potential for improvement in ensuring implementation effectiveness and reducing risk across supply chain through more effective due diligence and establishing incentive mechanisms: **We find that only 46% of GSLs report audit coverage of supply chain, and only 4% report incentives that extend to the supply chain.**

Independent audit of ESG performance and processes are also important for transparency purposes. One reason external assurance for sustainability issues is not widespread is because sustainability reporting covers diverse topics and quantitative as well as qualitative metrics that are difficult to measure. Furthermore, the material sustainability issues vary by sector and even by company. Consistent external assurance and disclosure for sustainability issues can enable the development of standards in sustainability reporting and provide investors with increased confidence in the quality of sustainability performance data, thereby making it useful for decision-making.

For example, **Bayer** discloses the results of its **supplier assessment** across several sustainability areas including **environment**, **labor practices, human rights**, **fair business practices**, and **sustainable procurement**. The online assessments and on-site audits are analyzed and documented in order to define specific improvement measures in the case of unsatisfactory results. The report also mentions that in case of critical results, the suppliers are asked to rectify identified weaknesses within an appropriate period time based on specific action plans.

Keep Leadership Accountable

In order to focus management behavior on capturing opportunities from sustainability and ensure that sustainability practices are adopted as every day practice in decision making, boards need to make management explicitly accountable for the company’s environmental and social impact. By aligning executive compensation with strategic sustainability targets and tying performance payouts to non-financial sustainability metrics, boards can sharpen management’s focus on sustainability issues. By limiting the number of sustainability goals in its incentives, companies can wield huge power to change leaders’ behavior.



Based on Argüden Governance Academy research for Sustainability Governance Scorecard ©

Our research reveals that existing remuneration plans for executives are not aligned with sustainability goals. We find that 88% of GSLs link executive compensation with financial targets **and only 13% linked to sustainability targets.** Without this link, it is unlikely that sustainability will receive the attention and priority that it deserves.

Comprehesive Scope: Does the board have a **Sustainability Charter** with appropriate scope?

- Does it include **all areas of sustainability**, such as safety, health, environmental and community impact; human rights, labor rights, anti-corruption and business ethics?
- Does it include the responsibilities throughout the **value chain**?
- Does it include product responsibilities throughout the **life-cycle** of the corporation's full product portfolio?
- Does it include **highest standards of conduct in all the jurisdictions** that the corporation operates in?

Leadership: Has the board reviewed and approved the **company's sustainability mission**?

- Are the **key sustainability issues identified** and approved by the Board incorporated into the corporation's strategies, policies, objectives, and associated management systems (value creation opportunities)?
- Has the corporation **allocated sufficient resources** to address the key sustainability issues? (sustainability of the efforts)

Deployment: Are all the executives and key employees of the corporation in different geographies familiar with the sustainability priorities of the corporation?

- **Incentives:** Does the board link sustainability performance metrics with the remuneration policy for top management?
- **Remedies:** Does the board have an explicit policy for those who fail to follow the sustainability standards of the corporation?

4. Right Structure and Process

Board’s Oversight of Sustainability

The board’s oversight role requires setting up an effective internal control mechanism, ensuring independence of audit and strict compliance, monitoring ethics and business conduct within the company and its value chain, and transparency in external reporting and disclosure. Effective tracking of sustainability performance and communication to the board is essential for improving oversight of sustainability.

To provide oversight over material sustainability issues, boards should clearly define their sustainability responsibilities through a ‘**Sustainability Charter**.’ The Charter should clearly specify the scope of the board’s oversight of sustainability issues; specifically reference the company’s priority sustainability issues; make the linkages with the business strategies and priorities; and provide a framework for the integration with the company’s risk management systems.

The scope of sustainability issues that need to be covered should include a comprehensive set of subjects such as safety, health, environmental, and community impact; human rights, labor rights, anti-corruption and business ethics. Another key issue to consider is the standards of conduct and level of implementation in all the jurisdictions that the company operates in. OECD’s MNEs Guidelines particularly focus on this issue.

The boards also need to provide sufficient oversight to the management's identification of risks and opportunities of sustainability issues, including those related to strategy, regulatory and legal liability, product development and pricing, disclosure and reputation, as well as the management's action plans. In doing so, the boards' unfettered access to outside experts should be assured.

Generally financial information is more readily available and presented in great detail. However, other key information such as information about the deveopment of the intellectual capital and reputation of the corporation and supplier, customer, employee, and community satisfaction surveys are also required for quality decision making. Generally, these types of information may have a greater relevance for the future value of the corporation and for the board members to fulfill their stewardship roles.

Information quality drives decision quality

Information flow to the board needs to be relevant, context based, timely, balanced, and comprehensive. **Balance** refers not only to the amount different dimensions of information, but also to its detail. Putting information into **context** requires an ability to show the bigger picture as well as including comparative benchmarking data. **Relevance** of information, in turn, is related to the decision-making process. The board has to understand the issue, and the options, costs, risks, and impacts of each option for different stakeholders. **Comprehensiveness** refers to the different dimensions of sustainability, including social, environmental, and governance aspects. Environmental impacts may include a broad range of issues, anywhere from carbon emissions to biodiversity, from energy efficiency to water and air pollution etc.

For information to be **useful**, it needs to be presented within a context which should include comparisons with past performance and budget targets, lead indicators, current trends, emerging issues, emerging benchmarks, compliance with applicable laws and regulations, and the key upcoming regulations and standards.

Does the board have the **right processes** to provide guidance and oversight to the sustainability plans of the corporation?

- Has the board established a special **Sustainability Committee** to review the sustainability risks and plans to highlight the key issues for the full board to consider?
- Does the board understand the **sustainability risks and impacts** across the corporation's value chain and how this might impact the competitive positioning of the Corporation?
- Does the board provide **guidance** on incorporation of sustainability issues to **corporate strategy** and focus on sustainability **driven innovation**, value creation opportunities?
- Does the board provide **sufficient oversight** to the management's identification of **risks and opportunities** of sustainability issues, including those related to strategy, regulatory and legal liability, product development and pricing, disclosure and reputation, as well as the management's action plans?
- Does the board have access to **outside experts** on various dimensions of sustainability to receive second opinion on management reports on sustainability issues?
- Has the board **allocated specific and sufficient time** to adequately review sustainability issues for the corporation?
- Does the board conduct a **regular self-evaluation** exercise that incorporates the board's approach and effectiveness in providing guidance and oversight on sustainability issues?

Does the board receive **timely and adequate information** to **evaluate the performance** of the corporation's sustainability plans?

- **Oversight of the quality of implementation**: Does the board regularly receive sufficient information about the sustainability performance of the corporation, including comparisons with past performance and budget targets?

- **Continuous learning:** How about lead indicators, current trends, emerging issues, emerging benchmarks, compliance with applicable laws and regulations, and the key upcoming regulations and standards?
- Is information about the level of **intellectual capital** and **reputation** of the Corporation measured and made available to the board?
- Does the board receive **findings** and **recommendations from any investigation or audit** by the internal audit department, external auditors, regulatory agencies, corporation’s insurance companies, or third party consultants concerning the corporation’s sustainability matters on a timely basis?

5. Partnership for Goals – Climate of Trust

Awareness about the importance of changing behaviors for a sustainable future as well as commitment to action is definitely increasing. Sustainable Development Goals (SDGs) were approved by almost 200 countries in 2015 as a common framework to focus on actions for a sustainable future.

It is clear that corporations should take leadership and mobilize stakeholders if we are to reach the SDG targets of 2030. The global nature of problems requires non-traditional partnership across corporate, non-governmental and public spheres as well as among competitors within the same industry to share the costs of initial investments and increase effectiveness of execution.

As part of our research, we also evaluated the link reported by GSLs between strategy and specific SDGs. Our findings reveal that companies tend to prioritize SDGs that align with their core business model, but fall short on creating the right climate and environment for sustainable development.

We find that GSLs have embraced the global climate change agenda (53% of GSLs linked SDG 13: Climate Change to their strategy) and that **SDG engagement is higher for SDGs that are actionable within their own business** - SDG 8: Decent Work and Economic Growth (50%) and SDG 12: Reponsible Consumption and Production (45%).

Based on Argüden Governance Academy research for Sustainability Governance Scorecard ©

Developing a Climate of Trust

Increased action and partnership is required around creating the **right climate for sustainability** through institution-building and preserving the basis of our life on this planet by protecting the oceans. **We find that engagement of GSL with SDG16: Peace and Justice Strong Institutions is 20%.** The SDG #16 will require multi-stakeholder and long-term systematic approach for a better future; and responsible boards have a role to play. Unless companies focus on building effective, accountable institutions and ensure inclusive decision-making at all levels, they will bare the costs of low-trust in business in the long-term.

Corporations that flourish through the utilization of others' resources are becoming increasingly aware of the need for our governance systems and attitudes to gain a global dimension as well. To build the world we want in the future, we need to **change the global incentive systems** (ie. carbon pricing, anti-corruption). For such a system change, **GSLs need to take collective leadership**.

Adopting a long-term horizon, these SDGs have significant impact on the environment and social structure in which business will operate in the future. Furthermore, the complexity of the nature of this SDG requires mobilizing resources for a common goal. GSLs can lead the way in establishing this link and serving as role-models for other businesses to follow and spark collective action.

Partnership for Goals

- Has the company incorporated **SDGs into their sustainability strategy** process and prioritized relevant SDGs?
- Does the board **set targets, measure impact and monitor progress** across relevant SDG categories?
- Does the board **evaluate potential partnership** options for progress against goals and **measure the combined impact** of cooperative initiatives?

Reporting and Communication

- Has the board adopted a **disclosure policy** for the corporation's sustainability program and does it review the disclosure on management approach to sustainability?
- How does the board ensure itself that the **sustainability reporting** by the company is adequate, appropriate and **verifiable**?

Continuous Learning

How does the board ensure continuous learning both within the organization, and throughout the supply chain regarding developing sustainability issues?

Sustainability is balanced pursuit of three goals mutually: **ecological health, social equity,** and **economic welfare**. Sustainable behavior calls for nature's functions and diversity not to be systematically impoverished by human intervention and resources to be utilized fairly and efficiently in order to meet basic human needs globally, including the preservation of the opportunities for the future generations to continue to improve quality of life.

Good governance of sustainability issues is key for boards of directors to fulfill their fiduciary, ethical, and moral responsibilities for a sustainable future. These are critical not only for the survival of the corporation that is entrusted upon them, but also for the survival of humankind and our planet for a sustainable future. We all have a long way to improve and we can definitely speed up learning by identifying and adopting good practices from our peers.

Dr. Yılmaz Argüden is a leading strategist, advisor, and board member of major public and private institutions, and NGOs. He is the Founder and Chairman of ARGE Consulting who has served as the B20 Knowledge Partner for Governance & Sustainability. He is also the Chairman of Turkish office of Rothschild & Co. He has served on over 60 boards in four different jurisdictions as well as a member of the Private Sector Advisors of the IFC's Corporate Governance Group, and as the Vice-Chairman of the Governance Committee of the Business at OECD. He is also the Chairman of the Trustees of the Argüden Governance Academy Foundation and served as the Global Chair of UN Global Compact Local Networks. He is a recipient of numerous leadership, distinguished citizenship, and career awards, as well as having been selected as a Global Leader for Tomorrow, by the World Economic Forum.

Gizem Argüden is a graduate of Wharton School (2010) as a Joseph Wharton Scholar and a Benjamin Franklin Scholar (2010). Her dissertation at Wharton was on "Cross-national differences in corporate governance, family business groups, and control pyramids in corporate governance." Upon graduation she has joined and worked for McKinsey for 8 years, before joining ARGE Consulting. She is also a board Member of the Argüden Governance Academy Foundation.