Private Sector Opinion

Responsible Boards—Action Plan for a Sustainable Future

Dr. Yılmaz Argüden

A sustainable global economy is one that combines long-term profitability with ethical behavior, social justice, and environmental care. Companies can play a fundamental role in creating a sustainable future by embracing this challenge as an opportunity for innovation and long-term value creation. This paper discusses steps that companies can take to craft the sustainability vision, build sustainable boards, and integrate sustainability into the organization.

Foreword

In this paper, Yılmaz Argüden traces the development of a corporation's attitude toward sustainability from its being an add-on that is nice to have and may enhance corporate reputation, through an approach that sees it more as a tool of risk management, to considering it a builder of value not just for the corporation but for all its stakeholders as well. This last stage in the progression is not just a matter of sharing a fixed quantum of value generated by the corporation, but rather it involves all parties working to enhance the total value created and thereby increasing value for all concerned. Clearly to do that, trust has to be built among all the players. Yılmaz Argüden has a great deal of experience with such relationships through his position of elected chair of the United Nations Global Compact Local Networks Advisory Group, bringing together companies, civil society, and labor unions from diverse countries and situations around the world.

The paper then focuses on the essential role of the corporate board in this process, bringing very practical guidelines to stimulate and assist any

board of a corporation embarking on the journey toward greater sustainability and value creation. From my own experience chairing boards, I know just how important a role the board must play in this process. It is not just in working with the executive to build a vision of what the company is trying to achieve, but also in setting targets against which progress can be measured.

The trust that has to be built externally with stakeholders must first be created internally, if trust is to be robust. Openness between the non-executive members of the board and the executives is essential, with confidence that information is openly shared and that differences of opinion are openly discussed and resolved, while also making sure that the vision and values are truly penetrated throughout the company. This not only involves the board and executives setting the right tone, but it also includes questioning and discussion at all levels in the company, checking that the penetration is indeed deep and robust.

As internal trust and coherence are built, the same process needs to take place externally. Transparency and open reporting are essential, but so is the ability of a board through its own diversity to understand and relate to the great diversity of those with whom the company engages externally, whether these are the parts of society affected by its operations, its customers, those in its supply chain, governments, or labor organizations. Building and leading a board with members who can truly contribute to this process is an essential step.

The paper concludes with a detailed and invaluable checklist of questions for any board to ask itself. This list helps a board build assurance that it is on the right track. It is as useful to a company just starting on the journey as it will be to those companies already well advanced in creating sustainable shared value and that want to make sure they are not missing any opportunities. I encourage all boards to review this checklist for responsible boards and challenge their executives in all of these areas.

Sir Mark Moody-Stuart
Chairman
Foundation for the Global Compact

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As external pressures—including resource scarcity, globalization, and access to information—continue to increase, the way corporations respond to sustainability challenges will determine their long-term viability and competitiveness. According to a recent survey,[1] executives at all levels see an important business role for sustainability. Yet there is significant room for improvement in the effectiveness of execution and accountability of their sustainability programs.

Trust is the essence of good governance and the foundation of sustainable development. In today's world, institutions increasingly rely on the use of not only their own resources but also the resources of others. And to gain access to those resources of others, institutions need to create trustworthy relationships. These stakeholders include not only shareholders, employees, labor organizations, and customers but also those who provide credit to the company, those in its supply chain, and the governments in the countries where the business operates—in short, individuals and organizations in all parts of society. License to operate increasingly requires fulfillment of a firm's responsibilities to society.

Good governance and sustainability are *CRAFTED*

Earning the trust of stakeholders is the key to mobilizing their resources toward a common vision. The communication and behavior of each institution influences the use of its own resources as well as those of its stakeholders. Therefore, the key to good corporate governance and sustainable success is in ensuring that the principles of *Consistency, Responsibility, Accountability, Fairness, Transparency, and Effectiveness* are *Deployed* (CRAFTED)[2] throughout the organization.

Consistency of the policies of a corporation is necessary to ensure that right expectations are formed throughout the value chain, thereby making the whole value chain stronger. Value creation requires measured risk taking, and risk is the kin of profit; therefore, taking initiative and *responsibility*, which naturally involves risk taking, is a critical element of value creation. An organization must be *accountable* and *fair* to all the stakeholders whose resources are entrusted to it, if access to those resources is to be sustainable. *Transparency* in relationships is the key to earning trust. Success requires *effective* use of the resources

1   Sheila Bonini and Anne-Titia Bové, "Sustainability's strategic worth: McKinsey Global Survey results," McKinsey & Company, July 2014, http://www.mckinsey.com/Insights/Sustainability/Sustainabilitys_strategic_worth_McKinsey_Global_Survey_results?cid=other-eml-alt-mip-mck-oth-1407.
2   Yilmaz Argüden, *Boardroom Secrets: Corporate Governance for Quality of Life* (Melbourne, Australia: Palgrave MacMillan, 2009).

entrusted to a corporation. Sustainability of success requires continuous improvement and innovation, which in turn requires continual learning and the participation and involvement of everyone in the organization. Hence, the key to sustainability is the creation of a climate that emphasizes good governance principles and *deployment* of a good corporate governance culture throughout the organization.

Many corporations' interest in sustainability issues started out as *nice to have* as part of their social responsibility programs and as a way to build their corporate reputation. However, those that have taken it seriously as a board and CEO responsibility soon understood that paying attention to sustainability issues was in fact a great *risk management* tool, particularly since avoidance is much more economical than repairing a corporate reputation after a significant failure.

More recently, some forward-looking business leaders began to see the challenge of sustainability as an opportunity for *value creation*. They came to realize that, if sustainability issues are becoming relevant for large numbers of people throughout the world, addressing them properly would be a good business case for satisfying a global need. (See Exhibit 1.)

Exhibit 1: Evolution of the Sustainability Frontier

	Corporate Social Responsibility	Risk Management Tool	Value-Creation Opportunity
How companies manage sustainability	Sustainability efforts are de-coupled from strategy and financial metrics and used as a marketing tool	Sustainability efforts are focused on compliance and opportunity for managing reputational and operational risk in volatile markets	Sustainability is a core driver of strategy and innovation in products, ways of doing business and managing stakeholders
Board's role in sustainability	Increasing marketing and brand equity	Managing reputational risk due to globalization Reducing costs across the value-chain as well as long-term resource Ensuring regulatory compliance	Resilience in volatility Competitive advantage and long-term viability Impact on solving global problems

We live in a world of varied stakeholder expectations, complex global challenges and resource constraints. Gaining competitive advantage and resilience in today's volatile markets will require re-defining the role of the corporation in today's society. Companies that embrace the sustainability challenge as an opportunity for innovation and long-term value creation focus on the following:

- Making sustainability a leadership priority and part of the core strategy;

- Adopting a long-term view for value creation and innovation;

- Forming partnerships to move beyond the capabilities of individual companies to solve complex global challenges;

- Capturing value across the value chain and product lifecycle to reach their sustainability targets;

- Engaging stakeholders and increasing transparency on company performance;

- Assessing risks and performance against nonfinancial targets in addition to financial targets before compliance requirements increase; and

- Ensuring that sustainability initiatives are adopted throughout the organization.

Box 1 offers an example of how one company incorporated sustainability into its culture.

Next, we will discuss some of the steps that boards can take to help their companies embrace and benefit from the sustainability agenda.

Box 1: Unilever's Sustainable Living Plan

Unilever's approach to sustainability is one that goes beyond a philanthropic act and places the goal of sustainability at the core of the business value proposition. The Sustainable Living Plan that Unilever CEO Paul Polman launched in 2010 defined business targets in financial, economic, and social metrics. Since the sustainability plan was announced in 2010, the company's share price has increased by 40 percent.

As Unilever's CEO, Polman decided not to report earnings quarterly so he could focus on building long-term value rather than giving in to the pressures of short-term financial metrics. He also focused on building a shareholder base that believed in his vision and wanted returns in the long run. At the core, his choices reflect his mission to change the way people see businesses as value creators and community builders, and to get them to rethink business fundamentals that lead to financial returns.

Challenges are varied, but Unilever has seen them as an opportunity to devise new ways of doing business. To achieve targets, Unilever had to look across its supply chain, rally industry leaders behind the commitment to source from sustainable resources, focus on raising awareness to change customer behavior and on designing products to minimize the environmental impact.

RESPONSIBLE BOARDS

A sustainable global economy is one that combines long-term profitability with ethical behavior, social justice, and environmental care. Sustainability improves the quality of human life while protecting the potential of future generation to do the same. Good governance also has a role in this responsibility to contribute toward a sense of universal commitment and universal participation in sustainable development.

According to the Conference Board,[3] the notion of fiduciary duty has recently started expanding to include sustainability issues. Increasingly the pursuit of sustainable business initiatives is viewed 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] Similarly, in 2009 the Committee for Economic Development issued recommendations on the potential contributions that boards of directors can offer to improve overall business performance while responding to social concerns.[8]

Therefore, the responsibilities of board members are not limited to the short-term interests of the shareholders but also include long-term impacts on anyone effected by their decisions, including future generations. To ensure the long-term commitment of stakeholders to work with the corporation toward achieving its mission, board members, as trusted agents, need to ensure that the stakeholders trust the corporation.

To move toward a more sustainable future, we need to have organizations that assume their sustainability responsibilities and act on them. Corporations—with their resources, efficiency, innovation capabilities, and access to talent—have the opportunity to be at the forefront of this change. Therefore, the top decision-making bodies for the organizations— their boards of directors—have a critical role to play in building a better future for humanity.[9]

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[3] Matteo Tonello, "Sustainability in the boardroom," No. DN-008 (New York: The Conference Board, June 2010).

[4] 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 and shareholder-instituted derivative actions, see Unocal Corp. versus Mesa Petroleum Co., 493 A. 2d 946, 955 (Del. 1985), discussing how boards should consider the impact on constituencies other than shareholders when analyzing the reasonableness of defensive measures; and Paramount Communications, Inc. versus 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*, 2003, 45: 829.

[6] See 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] Janet E. Kerr, "Pursuit of social investments," Director Notes No. DN-002 (New York: The Conference Board, January 2010).

[8] Committee for Economic Development, *Rebuilding Corporate Leadership: How Directors Can Link Long-Term Performance with Public Goals* (Washington, D.C.: Committee for Economic Development, 2009), available at www.ced.org.

[9] See Mark Moody-Stuart, *Responsible Leadership: Lessons from the Front Line of Sustainability and Ethics* (Sheffield, United Kingdom: Greenleaf Publishing, 2014), for excellent examples of how boards really deal with key sustainability issues.

According to a 2010 research by the UN Global Compact (the world's largest corporate citizenship and sustainability initiative), only 39 percent of 1,300 surveyed companies have boards that routinely address corporate sustainability issues.[10] The mechanisms used by companies vary widely, with three models appearing most frequently: full-board oversight, dedicated sustainability committees, and existing committees taking responsibility for sustainability.

Regardless of the mechanism a board uses to fulfill its sustainability responsibilities properly, it needs to 1) craft a sustainability vision, 2) build a sustainable board, and 3) integrate sustainability into the organization. (See Figure 1.) In the following pages, we will examine each of those actions in some detail.

Figure 1: The Board's Sustainability Responsibilities

Key Success Factors	Focus Areas for the Board	Key Requirements
1 Crafting the sustainability vision	Comprehensive Scope	The scope of the board's oversight on sustainability issues is well-defined, comprehensive, encompasses the entire value chain, product life-cycle and company's jurisdictions
	Stakeholder Engagement	An adequate stakeholder engagement process is conducted that includes identification of key stakeholders, understanding of stakeholder expectations through 2-way dialogue and prioritization of initiatives
	Materiality and Risk Management	Sustainability risk analysis encompassing strategic, operational, compliance and disclosure is conducted and key risk areas are prioritized
2 Building a Sustainable Board	Board Skills	Board members have appropriate expertise, understanding of sustainability issues and diversity to provide guidance and oversight
	Board Processes	Board processes are in place to identify sustainability risks and opportunities, internal control, monitoring and self-evaluation mechanisms are established
	Timely and adequate information	Information flow to the board is relevant, context based, timely, balanced, and comprehensive
3 Integrating sustainability into the organization	Leadership and Culture	Sustainability priorities are integrated into the company's culture, strategies, and policies including resource allocation
	Deployment and Accountability	Sustainability initiatives are adopted by managers across the corporation and sustainability performance metrics are linked with remuneration policy
	Transparency and Reporting	The company's disclosure policy includes financial, social, environmental, governance performance metrics, is evaluated by an independent party and performance against targets is clearly communicated to all stakeholders

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10   Adam Aston, "Profiting from sustainability: 5 tips for corporate boards," *The Guardian Sustainable Business*, August 2013.

1. CRAFTING THE SUSTAINABILITY VISION

A sustainability vision should be carefully crafted to accurately represent the board's concept of its responsibilities and the potential impacts of tangible and intangible factors on the company and its stakeholders. It needs to involve all levels of the organization as well as stakeholders who are not part of the organization.

Developing a comprehensive scope

A board should define its sustainability responsibilities unambiguously through a *sustainability charter.*[11] The charter should do the following: 1) clearly specify the scope of the board's[12] oversight of sustainability issues; 2) specifically reference the company's priority sustainability issues; 3) create links with the business strategies and priorities; and 4) provide a framework for integration with the company's risk management systems.

The **scope** of sustainability issues to be covered should include a **comprehensive** set of subjects, such as safety, health, environmental, and community impact, as well as human rights, labor rights, anti-corruption, and business ethics. Another important issue to consider is the company's standards of conduct and level of implementation in all the jurisdictions that the company operates in. OECD[13] Guidelines for Multinational Enterprises particularly focus on this issue.

Supply chains are critical links that connect an organization's inputs to its outputs. For many companies, sustainability efforts are limited to measuring the sustainability of their own business operations and do not extend to their suppliers and customers. However, brand owners need to accept responsibility throughout their value chains. This may involve wielding their purchasing power to encourage, audit, collaborate with, and provide benchmarking and learning opportunities for its suppliers on key sustainability issues.

Apart from engagement with suppliers within the value chain, a company can use such approaches as supplier management, product design, manufacturing rationalization, and distribution optimization to minimize negative externalities throughout its value chain. Furthermore, the sustainability impacts of the company's activities further downstream, including its final customers, can also be mitigated by product design and customer education.

In short, the company should manage the impact of all its activities, including its supply chain as well as its full product portfolio[14] throughout the lifecycle of its products. Hence

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[11] Sometimes this may also be called a "corporate responsibility charter."
[12] If there is a specific committee assigned for this responsibility, the charter may cover the relevant committee's responsibilities.
[13] Organisation for Economic Co-operation and Development.
[14] William McDonough and Michael Braungart, *Cradle to Cradle: Remaking the Way We Make Things* (New York: North Point Press, 2002).

boards need to focus not only on the sustainability issues arising from the company's own operations but also on minimizing the impacts throughout its *value chain* and *throughout the lifecycle of its full product portfolio*.

Materiality and risk management

Despite the current tendency to measure market performance by short-term financial returns, sustainability issues are becoming more relevant for investors, customers, and communities. According to the Intangible Asset Market Value[15] report, only 20 percent of the market value of a Standard & Poor's 500 company can be explained by its physical and financial assets (down from 83 percent in 1975), and the remainder comprises intangible factors, such as intellectual capital,[16] human capital, brand and reputation, and relationships with regulatory bodies, nongovernmental organizations, customers, suppliers, and other external stakeholders.

Therefore, sustainability issues that may have an impact on these intangible areas pose a significant risk for the value of a company. Boards need to seriously consider sustainability risks in four dimensions: strategic, operational, compliance, and disclosure. The *sustainability risk analysis* for the company would typically include seven questions:

1. Which aspects of **sustainability issues** are relevant for the company?

2. What procedures and tools are used for the assessment?

3. What are the short-term and long-term **economic**, **environmental**, and **social** impacts?

4. What are the major **synergies**, **conflicts**, and **tradeoffs**?

5. What **measures** can be put in place to **mitigate** harmful impacts?

6. How does management handle variability, uncertainty, complexity, and ambiguity (VUCA) regarding the key issues?

7. What is the **least-cost** (economic, environmental, and social) mitigation option?

Responses to these questions should assess stocks and flows of economic, environmental, human, and social impacts; identify positive, negative, or constant trends; determine the degree to which effects can be reversed; determine the degree to which negative impacts are shifted to future generations; and estimate long-term costs of failure to act at present.

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[15] See "Ocean Tomo's annual study of intangible asset market value—2010," (Chicago: Ocean Tomo, LLC, 2011), www.oceantomo.com/media/newsreleases/intangible_asset_market_value_2010.

[16] Yilmaz Argüden, et al., *Entelektüel Sermaye*, No. 7 (Istanbul: ARGE Consulting Publications, 2005).

A board needs to ensure that the ***material issues*** that would substantially affect the company's strategy, business model, capital, or performance are properly identified. In doing so, the board needs to be actively involved in setting the materiality thresholds, and it needs to ensure that the trends as well as current and future impacts have been considered. Boards also need to ensure that management has prioritized the key sustainability issues and considered the resource requirements to deal with the prioritized issues in its mitigation plans.

Increasing stakeholder engagement

Stakeholder engagement is a critical process that helps companies understand the environmental and social impact of their operations and identify sustainability risks and opportunities. First, the company needs to prepare a **map** of its relevant **stakeholders** for the issue at hand. Then comes the choice of the engagement model, communication, consultation, participation, and partnership, with each level requiring more resources.

Tools of engagement may include interviews, workshops, focus groups, town-hall meetings, stakeholder-perception surveys, stakeholder panels, and joint decision making.[17] The board should understand the critical issues raised by the stakeholder engagement process and how the management plans to address them.

2. BUILDING SUSTAINABLE BOARDS

Boards need members who understand the impact that organizations have on the environment, their employees, and society in general. Corporate boards have to make difficult tradeoffs when considering actions that are not positive contributors to all areas of sustainable effectiveness.[18]

Ensuring that the board has appropriate skills

Board members not only need to be experienced in providing guidance and oversight, but they also should have a sound understanding of the concerns and decision-making processes of the company's stakeholders. And they need to be familiar with the company's sustainability issues and the evolving sustainability standards and benchmarks. These matters should be taken into account both at the recruitment stage for board members and at the design and implementation of the orientation and board education programs.

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[17] For pros and cons of each, see Neil Jeffery, *Stakeholder Engagement: A Road Map to Meaningful Engagement*, No. 2 in the Doughty Centre "How to do Corporate Responsibility" Series (Bedford, England: Cranfield School of Management, July 2009).

[18] Edward E. Lawler III and Christopher G. Worley, *Management Reset: Organizing for Sustainable Effectiveness* (San Francisco: Jossey-Bass, 2011).

Recent studies show a positive correlation between board diversity and both strategic innovation and corporate reputation.[19] Board ***diversity*** in every sense of the word, including but not limited to gender diversity, is really important in ensuring that the board is fit to drive change toward a sustainable business. Diversity of age, tenure, gender, ethnicity, cultural background, and geography, as well as of functional and industry experience, ensures that multiple perspectives are represented on the board. This inclusion of varied points of view can be particularly valuable as the board engages in strategic discussions and makes long-term business decisions.[20]

Diversity of industry experience, for example, can enhance the board's ability to adequately evaluate the different dimensions, perspectives, and risks of sustainability issues and bring a better understanding of benchmarking opportunities. Likewise, tenure diversity can keep a board from falling into "groupthink," and age diversity can broaden the board's understanding of the sensitivities of different cohorts of customers and stakeholders. Ethnic, gender, and geographic diversity also can improve understanding of the sensitivities of different social segments and markets. And diversity of stakeholder experience exposes the board to the decision-making processes of different stakeholders.

Developing board processes

Many boards establish a separate sustainability committee[21] to review sustainability risks and remedial plans, and then to highlight the key issues for the full board to consider. At a minimum, the sustainability committee should take the following steps:

- Identify and manage important social and environmental issues and ensure that the information on social and environmental performance management is reliable;

- Identify and engage with key stakeholders;

- Monitor the efficiency and effectiveness of sustainability management systems and controls.

The board needs to understand the sustainability risks and impacts across the corporation's value chain and the effect such risks might have on the business model and competitive positioning of the corporation. The board needs to focus on sustainability-driven innovation and value-creation opportunities and to provide guidance on the relationship between sustainability issues and the corporate strategy.

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[19] Toyah Miller and Maria Del Carmen Triana, "Demographic diversity in the boardroom: Mediators of the board diversity-firm performance relationship," *Journal of Management Studies*, 2009, 46: (5) 755–86.

[20] See the following articles by Yilmaz Argüden: "Diversity at the head table," *Private Sector Opinion 19* (Washington, D.C.: International Finance Corporation, 2010); "Global boards help make companies global," Harvard Business Review Blog, November 2011; and "Why boards need more women," *Harvard Business Review* Blog Network, June 2012.

[21] The committee may also be named "responsibility committee" or "safety, health, environmental protection, and stakeholder engagement committee," or the responsibility may be assigned to the audit or risk committee.

The board also needs to provide adequate oversight of the management's identification of risks and opportunities associated with sustainability issues, including those related to strategy, regulatory and legal liability, product development and pricing, and disclosure and reputation, as well as oversight of the management's action plans. In doing so, the board should have unfettered access to outside experts and should be able to have private sessions with these experts to receive independent advice.

To form independent views on significant stakeholder concerns, the sustainability committee and/or the board needs access to stakeholder engagement processes. Yet it is critical that board members never put themselves in a position to commit the company to any course of action, as that is a management responsibility; the board is a decision-making body and works as a team.

The board has a responsibility to ensure that the internal control and monitoring systems provide sufficient attention to sustainability issues, compliance, and timeliness and adequacy of external reporting. Obviously, all these activities take time, and therefore the board should allocate sufficient time and resources to deal with sustainability risks and the management's plans to address them. The time allocation should consider the breadth and immediacy of sustainability issues that need to be addressed.

Board deliberations should also include evaluation of the adequacy of the directors and officers (D&O) insurance package to sufficiently protect the directors against liabilities arising from sustainability issues. The board should institute a learning and continuous improvement process for its own operations by incorporating the recommendations of the insurers into its sustainability plans and by conducting a regular self-evaluation exercise that assesses the board's approach and effectiveness in providing guidance and oversight on sustainability issues. Many companies call on independent third-party experts to help conduct a comprehensive and objective self-evaluation process.

Improving information quality to increase decision quality

Information flow to the board should be relevant, context based, timely, balanced, and comprehensive. For instance, the board needs information that is *relevant* to the decision-making process. Board members have to understand each issue and all the options—their costs, risks, and impacts—and how they may affect different stakeholders. And they need to have this information in the *context* of the bigger picture, 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 important upcoming regulations and standards.

This information must reach the board in a *timely* manner to allow for informed and considered decision making. The information the board receives should be *balanced* in amount, dimensions, and detail. And it should be *comprehensive* in its coverage of the different dimensions of sustainability, including social, environmental, and governance aspects. Environmental impacts may also include a broad range of issues—from carbon emissions to biodiversity, from energy efficiency to water and air pollution, and so on.

Generally, financial information is readily available and presented in great detail. Far less available are facts and figures necessary for quality decision making in other areas, such as the level of intellectual capital and reputation of the corporation as well as results of surveys measuring the satisfaction of suppliers, customers, employees, and the community. Yet for the future value of the corporation and for the board members in fulfilling their stewardship roles, these types of information may be more relevant than financial data. For the board to exercise its oversight responsibilities, it should receive on a timely basis the findings and *recommendations* from any investigation or audit by the internal audit department, external auditors, regulatory agencies, the corporation's insurance companies, or third-party consultants concerning the corporation's sustainability matters.

Finally, the board should determine the sustainability *key performance indicators* (KPIs) it would like to follow on a regular basis and to incorporate into the executive remuneration policies. The board should also receive regular information on these KPIs to enable it to monitor progress toward sustainability goals. All the decisions made through this decision-making process—using the provided information—have a financial impact on the company's balance sheet and will be a key determinant in calculating the enterprise value of the business itself.

3. INTEGRATING SUSTAINABILITY INTO THE ORGANIZATION

Awareness of and responsibility for sustainability cannot be delegated to one segment of the organization. It must be firmly established at the top and inculcated throughout all levels and aspects of the company. And then it needs to be *practiced* as an integral part of doing business.

Building a sustainability vision

The board sets the tone at the top and establishes the corporate culture. Therefore, all the members of the board should support, improve, and guide the corporate culture with their actions. They must be models in their conduct, their decisions, and how they communicate those decisions. Corporate culture is the cornerstone of trust inside and outside the company.

Furthermore, the board needs to consider incorporating "sustainability consciousness" into its criteria for *choosing a CEO* and filling the other top executive positions. Candidates for leadership positions, if they are to convince others to follow, need to demonstrate strong conviction and an understanding that identifying sustainability risks requires stakeholder engagement. The board also needs to hold the CEO to account on the sustainability performance of the corporation by incorporating sustainability-performance data into its deliberations on executive remuneration policies.[22]

A good governance culture includes open-minded, early, and honest *communication*. Transparency requires that analyses, decisions, and actions be documented, put into context, and considered for materiality. Information relevant for governance needs to focus on costs, risks, options, and impacts. Its context, timeliness, and comparison with relevant benchmarks are more important than its ultimate precision. Therefore, it is the management's responsibility to explain the bigger picture, issues, options, and recommendations in a way that is up to date and comprehensible and in an executive format.

Creating an appropriate *climate for learning* is a critical leadership challenge. Actions speak louder than words: to create an environment that promotes learning, leaders should start with themselves. To develop trust within the corporation, they should share their own mistakes and the lessons they have learned—and turn this into a common learning process and a transparent environment that will set the stage for continual learning. Leaders should ensure that the corporate culture encourages the attitude that "to win, we have to take calculated risks," rather than "we should do nothing for fear of making a mistake."

Professional diligence also requires management to *disclose mistakes* and problems in a timely fashion. This may be unpleasant, but it builds trust and helps create a culture of continual learning. If the management has valid concerns, the board has to know them. Mutual trust between the board and the management also requires acceptance and internalization of the separation of management and governance rights.

Sustainability issues are generally long term and need long-term attention.[23] Therefore, the board should ensure that the company can maintain the efforts to have a sustainable impact. Hence sufficient *resources*—financial, organizational/human resources, and intellectual—should be allocated to address the fundamental sustainability issues.

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22 Yilmaz Argüden, "Right reward for right performance: Aligning executive compensation with good governance," *The International Journal of Disclosure and Governance*, 2013, Vol. 10.
23 Therefore, the sustainability of effort is critical, as the Turkish saying, "What breaks a rock is not the strength but the continuity of water flow."

Building organizational capacity

Corporations are feeling the demand—from competitive pressures as well as from the increasing expectations of stakeholders—to implement ***continuous learning*** and development. Therefore, board action is needed to ensure that the corporation's sustainability agenda is an integral part of the culture, and that its systems promote learning and continuous improvement at all levels of the organization. For this purpose, key sustainability issues need to be identified and incorporated into strategies, policies, objectives, and associated management systems, with a particular view toward value-creation opportunities.

Another significant concern is the ***deployment*** of the board's sustainability priorities throughout the organization. A successful deployment program requires 1) establishing a framework for effective communication and learning for the employees and the members of the supply chain; 2) incorporating sustainability issues into hiring and remuneration policies as well as supplier-identification processes (having appropriate incentive systems); 3) establishing clear guidelines and remedies for those who fail to follow the corporation's sustainability standards; and 4) making sure the management information systems provide for adequate, appropriate, and verifiable data on sustainability priorities.

Internal control systems, external reviews, stakeholder engagement processes, and compliance requirements all should actively support opportunities for continual learning, rather than being seen as box-ticking compliance requirements.

Transparency and reporting

Emerging global standards for sustainability reporting, including the G4 and IIRC,[24] are gaining broader acceptance, but the field of sustainability reporting is still open for public and private organizations to experiment with new approaches. For example, the government of New Zealand is publishing a balance sheet for the assets and liabilities of the government. Despite being a leading example for governments elsewhere, this public balance sheet approach has significant room for improvement, particularly in incorporating environmental assets and liabilities. On the corporate side, Puma has come up with another groundbreaking example by including the environmental costs of its entire supply chain in its sustainability reporting. (See Box 2.)

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[24]   G4 and IIRC refer to the GRI (Global Reporting Initiative) G4 guidelines and the IIRC (International Integrated Reporting Council) framework.

Box 2: Puma—Quantifying the "Real" Cost of Operations

PUMA is one of the companies leading the field of sustainability reporting. Its innovative approach to costing all its environmental, social, and economic impacts is a best-in-class example of a holistic approach to reporting that goes beyond compliance. It provides a model for companies that will follow suit. In calculating its 2010 environmental profit and loss (EP&L), Puma quantified the costs of its environmental impact and added it to its balance sheet and reported its actual costs.

Executive Chair Jochen Zeitz wrote, "I sincerely hope that the Puma EP&L and its results will open eyes in the corporate world and make the point that the current economic model, which originated in the industrial revolution some 100 years ago, must be radically changed. A new business paradigm is necessary and a transformation of corporate reporting will be central to this—one that works with nature and not against it."

PUMA's approach brings to light some of the challenges inherent in managing for sustainability, namely the complexity of defining metrics to set targets and a company's limited ability to control the impact of actual circumstances on these targets. Quantifying environmental costs required Puma to develop methodologies for assigning costs to metrics ranging from greenhouse emissions and land use to working with its supply chain to identify the points where most costs were incurred.

Tackling this issue has not only allowed Puma to have a positive influence on managing the entire environmental footprint of its operations by looking at the entire value chain, but it also has enabled the board to better evaluate risk, achieve cost savings, and fuel innovation.

Such examples are particularly important, because, as management consultant Peter Drucker famously said, "What gets measured gets improved." These examples also provide benchmarking opportunities for others to follow, thereby increasing the speed of learning.

CONCLUSION

Sustainability is the balanced pursuit of three goals mutually: ecological health, social equity, and economic welfare. Sustainable behavior preserves nature's functions and diversity, not allowing them to be systematically impoverished by human intervention. And it encourages the fair and efficient use of resources to meet basic human needs globally, including the safeguarding of opportunities for future generations to continue to improve quality of life.

The main purpose of ethical and moral behavior is to constrain the individual's short-term interests for the long-term survivability of humanity (the community/future generations).[25] Therefore, sustainability is firmly engrained in ethical and moral behavior. Hence all organizations—and as their stewards, boards of directors—are responsible for a sustainable

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[25] This definition is based on Ege Cansen's speech on "Ethics and Morality" for the Argüden Governance Academy, January 2014.

future. Responsible boards are critical not only for the survival of the corporation that is entrusted to them, but also for the survival of humankind and our planet for a sustainable future.

This article has presented a summary of the responsibilities and activities that are crucial for boards of directors in fulfilling their fiduciary, ethical, and moral responsibilities for a sustainable future. We close with a practice guide—35 questions that boards need to address and reflect on, at a minimum, to properly fulfill their sustainability responsibilities.

Practice Guide: 35 Sustainability Questions for Responsible Board Members

1. CRAFTING THE SUSTAINABILITY VISION

Comprehensive Scope: Does the board have a *sustainability charter* with appropriate scope?

1. Does it include *all areas* of sustainability, such as safety, health, environmental and community impact, human rights, labor rights, anti-corruption, and business ethics?

2. Does it include the responsibilities throughout the *value chain*?

3. Does it include product responsibilities throughout the *lifecycle* of the *corporation's full product portfolio*?

4. Does it include highest standards of conduct in all the jurisdictions that the corporation operates in?

Stakeholder Engagement: Has an adequate stakeholder engagement process been conducted?

1. Has the management comprehensively identified its relevant stakeholders and prepared a *stakeholder map*?

2. Has the management identified *sustainability initiatives* targeting each stakeholder group through two-way communication?

3. Does the board have access to the *key issues raised* by this process?

4. Does the board have a process to evaluate management's *sustainability plans* to address the key issues?

Materiality and Risk Management: Have the material issues been properly identified that would substantively affect the company's strategy, business model, capital, or performance?

1. Has the board been involved in setting the *materiality thresholds* in each sustainability area (economic, environmental, and social)?

2. Have the trends as well as current and *future impacts* been considered?

3. Has management *prioritized* the key sustainability issues?

4. Has management considered *resource requirements* to deal with the prioritized issues in its mitigation plans?

2. BUILDING SUSTAINABLE BOARDS

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

1. Does the board have sufficient *expertise* to understand the decision-making processes of key stakeholders?

2. Does the board have members who are familiar with the *evolving sustainability standards* and *benchmarks*?

3. Does the board have enough *diversity* to adequately evaluate the different dimensions, perspectives, and risks of the sustainability issues? For example, does it have diversity in the following areas:

   - Industry experience—to better understand benchmarking opportunities
   - Tenure—to avoid groupthink
   - Age—to better understand the sensitivities of different cohorts of customers and stakeholders
   - Ethnic, gender, and geographic—to better understand the sensitivities of different social segments and markets
   - Stakeholder experience—to better understand the decision-making processes of different stakeholders

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

1. 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?

2. Does the board understand the *sustainability risks and impacts* across the corporation's value chain and how this might affect the competitive positioning of the corporation?

3. Does the board provide *guidance* on incorporation of sustainability issues into corporate strategy and the company's focus on sustainability-driven innovation and value-creation opportunities?

4. Does the board provide sufficient *oversight* to the management's identification of risks and opportunities concerning sustainability issues, including those related to strategy, regulatory and legal liability, product development and pricing, and disclosure and reputation, as well as the management's action plans?

5. Does the board have *access to outside experts* on various dimensions of sustainability, who can provide second opinions on management reports on sustainability issues?

6. Has the board allocated *specific and sufficient* time during its annual time budget to adequately review the sustainability issues for the corporation?

7. 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?

8. Does the board *D&O insurance package* sufficiently protect the directors against liabilities arising from sustainability issues, and does the corporation incorporate the recommendations of the insurers into its sustainability plans?

Timely and Adequate Information: Does the board receive timely and adequate information to evaluate the performance of the corporation's sustainability plans?

1. Does the board regularly receive sufficient information about sustainability performance of the corporation, including comparisons with past performance and budget targets *(oversight of the quality of implementation)*?

2. How about lead indicators, current trends, emerging issues, emerging benchmarks, compliance with applicable laws and regulations, and the critical upcoming regulations and standards *(continuous learning)*?

3. Is information about the level of intellectual capital and *reputation* of the corporation measured and made available to the board?

4. Does the board receive on a timely basis *findings* and *recommendations* concerning the corporation's sustainability matters from any investigation or audit by the internal audit department, external auditors, regulatory agencies, the corporation's insurance companies, or third-party consultants?

3. INTEGRATING SUSTAINABILITY INTO THE ORGANIZATION

Leadership and Culture

1. Are the sustainability issues that are identified and approved by the board incorporated into the corporation's strategies, policies, objectives, and associated management systems *(value-creation opportunities)*?

2. Has the corporation allocated sufficient resources to address these sustainability issues *(sustainability of the efforts)*?

    *   Financial resources
    *   Organizational/human resources
    *   Intellectual resources
    *   Any significant changes to the plans and resource requirements (which should be reported to the board)

Deployment and Accountability

1. Are all the executives and key employees of the corporation in different geographies familiar with the sustainability priorities of the corporation *(deployment)*?

2. Does the board link sustainability performance metrics with the remuneration policy for top management *(incentives)*?

3. Does the board have an explicit policy for those who fail to follow the sustainability standards of the corporation *(remedies)*?

4. How does the board ensure *continuous learning* regarding developing sustainability issues—within the organization as well as throughout the supply chain?

Transparency and Reporting

1. Has the board adopted a *disclosure policy* for the corporation's sustainability program, and does it review the *disclosure on management approach* to sustainability?

2. How does the board assure itself that the *sustainability reporting* by the company is adequate, appropriate, and *verifiable*?

ABOUT THE AUTHOR

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