Introduction to Board Oversight of Sustainability

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The role of corporations and other business organizations in society has become a hotly debated issue that has attracted the attention of numerous participants in the political arena; however, until recently board members generally showed little interest in the debate and remained focused on their traditional role of maximizing shareholder value. It is now becoming clear that questions regarding the role of business are tied to essential strategic and operational sustainability-related issues that are critical to the discharge of directors’ responsibilities with respect to setting the long-term strategy of their companies and which have attracted the attention of investors, consumers and other stakeholders upon which companies depend for their survival.

According to studies conducted by the Conference Board and the Boston Consulting Group board oversight is one of the top drivers of a company’s attention to sustainability, a result that is not surprising given that the board is uniquely situated within the organizational hierarchy to ensure that sustainability is integrated into the long-term business strategy and that due consideration is given to social and environmental trends that will impact the company’s operations and the markets in which it operates. The board is the only organizational body that can seamlessly integrate sustainability into decisions and actions that fall within the board’s core functions including oversight of risk management, compliance and the recruitment and remuneration of the CEO. Moreover, board commitment and leadership on sustainability is highly visible and sends a strong signal about prioritization of sustainability to employees and external stakeholders such as investors. Finally, while CEOs may come and go, and short-term pressures will inevitably batter all companies at some point, the board can offer long-term leadership continuity on sustainability through its strategic planning decisions and succession planning for the CEO and other senior executives.

For KPMG, the critical sustainability-related issues fell under the broad rubric of environmental, social and governance, popularly referred to as “ESG”, and included topics such as:

- Climate change impacts
- Water and waste management
- Natural resource scarcity
- Product and worker safety
- Supply chain management
- Workplace diversity and inclusion

1 A New Agenda for the Board of Directors: Adoption and Oversight of Corporate Sustainability (Global Compact LEAD, 2012), 6.
2 ESG, Strategy and the Long View: A Framework for Board Oversight (KPMG LLP, 2017), 1. The terms “sustainability”, “corporate social responsibility”, “CSR” and “ESG” are sometimes used interchangeably in this publication depending on the terms selected and used by different researchers and commentators.
● Talent management
● Employee relations
● Human rights
● Health
● Labor practices
● Executive compensation
● Political contributions
● Board independence, composition and renewal

While board members and senior executives generally understand the issues involved with ESG, corporate social responsibility ("CSR") and the strategic value of implementing ESG and CSR strategies, studies have shown that board oversight of environmental and social issues is often deficient. Researchers on corporate sustainability from the MIT Sloan Management Review and The Boston Consulting Group ("BCG") reported that while 86% of companies agreed that boards should play a strong role in their company’s sustainability efforts, only 48% said their CEOs are engaged, and even fewer (30%) agreed that their sustainability efforts had strong board-level oversight. The report also mentioned a 2014 United Nations Environment Programme Finance Initiative study of 60,000 businesses that found that only 2% of companies that reported on ESG information had a director with responsibility for sustainability and that only 374 companies had a sustainability committee that reported directly to the board (and none of those committees included board members). The results of a research study published in the Harvard Business Review in 2014 showed that no more than 10% of US public company boards had a committee dedicated solely to corporate responsibility.

The researchers cautioned that a company’s top executives and board members needed to be mindful of the interests and expectations of investors and noted that corporate leaders must recognize that an increasing number of shareholders are (literally) invested in whether a company’s ESG activities connect with its financial success. Noting that improving board engagement on sustainability issues faced several hurdles (e.g., the unclear financial impact of developing sustainable business practices, competing priorities, a lack of sustainability expertise among board members and short-termism), the researchers recommended that steps to be taken to improve directors’ expertise with respect to sustainability through training, new appointments to the board and accessing external expertise through external/independent advisory boards.

The researchers also noted that it was essential to integrate ESG considerations into directors’ responsibilities and activities, something that might be accomplished by forming new committees dedicated to sustainability or by instilling ESG duties within existing committees, and to include sustainability on the agenda of top management. Many larger companies with publicly-traded securities have indeed established committees of the board to exercise some level of oversight of ESG and CSR programs; however, the activities of these committees often do not extend to assessing the environmental and social impact of strategic business decisions and/or monitoring and providing recommendations on ESG and CSR trends and developments. Many ESG and CSR board committees spend most of their time on compliance activities in relation to existing laws and industry standards and fail to move beyond that level of involvement to brainstorming about stakeholder engagement.

As addressing short-termism, the MIT and BCG researchers noted that directors needed to reconsider and set aside their traditional assumptions that their primary fiduciary duties are to maximize shareholder value and that shareholders care most about short-term profits. In fact, scholars and judges have been steadily chipping away at the notion of shareholder primacy and recognizing a duty of directors to take into account stakeholders beyond the owners of the corporation including employees, customers, communities, the “environment” and “society as a whole”. At the same time, the concept of “value creation” has been revisited and refocused to include long-term value for all stakeholders, a target that is best achieved by integrating sustainability into the business. A related trend is the public acknowledgement by many companies that their compliance obligations extend beyond laws and regulations to include voluntary standards relating to ethics and environmental and social responsibility such as the UN Global Compact and the OECD’s Guidelines for Multinational Enterprises.

KPMG noted that the evidence is mounting as to a strong positive connection between a company’s ability to identify and incorporate these issues into their long-term strategies to achieve a competitive advantage and the company’s return on investment. Companies that continue to ignore ESG and CSR issues are vulnerable to environmental, legal and reputational risks while companies with strong ESG and CSR performance tend to have a more stable and loyal investor base, lower cost of capital and realize benefits in terms of employee engagement and customer purchaser behavior. In spite of all this, however, directors continue to struggle with how to make ESG and CSR a priority in the boardroom. According to KPMG, directors must overcome a number of challenges:

- Short-term pressures caused by the need to meet quarterly earnings expectations and maintain the strength of investment vehicles that are valued daily or monthly cause companies to ignore addressing ESG and CSR issues, which by their very nature, are more long-term oriented.

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6 Id. at 16.
7 Id.
8 Id. at 1 and 5.
• Directors are often confused by the language and nomenclature that surrounds ESG and CSR issues and which includes definitions and concepts such as CSR, “corporate responsibility”, “shared value”, “conscious capitalism”, “impact investing”, “triple bottom line”, “responsible business”, “corporate citizenship” and “sustainability”.

• Some of the issues associated with ESG and CSR have traditionally been viewed as “soft” brand/marketing topics rather than strategic issues. While many companies did make their initial forays into environmental and social responsibility as a marketing tool and relied heavily on philanthropic acts, this approach will no longer do and may even expose the company to negative feedback as being mere “greenwashing”. Directors need to change their own mindsets and those of many within their organizations: attentiveness to ESG, CSR and sustainability can be good for branding, but it needs to be more fully integrated into strategy.

• There is no “cookie cutter” approach to ESG and CSR: every company faces different issues and circumstances will change as their operating environment evolves, all of which means that directors must continuously access all of the relevant issues and adjust the company’s strategy and operational activities.

• Standards and tools for addressing many of the ESG and CSR issues are still evolving, many in just their earliest stage, and directors often have to act with clear guidelines of the type that have developed in areas where laws, regulations and related interpretations have been in place for extended periods of time. Sustainability reporting and stakeholder engagement are just two areas, each extremely important, where directors are being tasked to develop sufficient expertise to make critical decisions about communications with investors and other stakeholders on ESG and CSR issues including what is “material” and thus mandates disclosure and in what form should those disclosures be made.

• ESG and CSR issues are not something that can be treated and addressed as an afterthought, instead directors and members of the executive team need to accept a radical redefinition of their focus and activities in order to connect and embed ESG and CSR into the company’s core business activities and processes (i.e., strategy, operations, risk management and corporate culture) and demonstrate strong leadership and commitment in interactions with internal and external stakeholders in order to secure “buy in” to long-term strategic initiatives.

Support for ESG and CSR programs by the board of directors is an important element of the requisite “tone at the top” for increasing the chances of success for CSR. Board members must understand that ESG and CSR programs are consistent with their traditional role and duty to effectively manage the legal, financial and reputational risks to the company that arise from the environmental and social impacts of the company’s activities. Board members must insist that ESG and CSR be integrated into the company’s strategic decision making and performance management and assessment systems, a priority which includes allocating sufficient resources to ensure that personnel are able to efficiently engage with the company’s stakeholders. In addition, board members must push for creating and maintaining systems that provide them with the information that they need in order to understand and evaluate the company’s ESG and CSR programs.
Ceres, a non-profit organization advocating for sustainability leadership (www.ceres.org), has developed and disseminated its Ceres Roadmap as a resource to help companies re-engineer themselves to confront and overcome environmental and social challenges and as a guide toward corporate sustainability leadership. In the area of governance for sustainability, Ceres stated the overall vision for companies is having sustainability embedded from the boardroom to the copy room and managing their entire value chain for sustainability. Specific expectations regarding governance were as follows:

- **G1 – Board Oversight:** Corporate boards will provide formal oversight for corporate sustainability strategy and long-term performance. Sustainability considerations will be integrated into board discussions on strategy, risk and revenue.
- **G2 – Management Accountability:** The CEO and company management—from C-Suite executives to business unit and functional heads—will be explicitly accountable for achieving sustainability goals.
- **G3 – Executive and Employee Compensation:** Sustainability performance results will be a core component of compensation packages and incentive plans for all executives and employees across the business. Companies will include sustainability criteria in all employee performance assessments.
- **G4 – Corporate Policies and Management Systems:** Companies will embed sustainability considerations into corporate policies and risk management systems to guide day-to-day decision-making.
- **G5 – Public Policy:** Companies will clearly state their position on relevant sustainability public policy issues. Any lobbying will be done transparently and in a manner consistent with the company’s sustainability commitments and strategies.

One of the most significant drivers of enhanced board oversight of sustainability has been the changing expectations of institutional investors, a trend which is discussed in detail below. In addition, directors have become keenly aware of the expectations of other stakeholders regarding the role and purpose of corporations in society and the need for corporations, through their boards and senior executives, to forge a strategy that takes into account the environmental and social impact of operations as well as traditional financial performance objectives. Consumers are demanding that companies integrate sustainability into their products and services and employees are seeking to work for companies that aim to “make a difference” as well as profits. Lawmakers are imposing additional sustainability-related legal and regulatory compliance requirements on corporations, thus causing directors to make appropriate changes to their enterprise risk management processes. Finally, traditional notions of directors’ fiduciary duties, which assumed primacy of shareholders’ interests and maximizing shareholder value, are giving way to a model of directors’ duties that gives due weight to the interests of stakeholders.
About the Author

This chapter was written by Alan S. Gutterman, whose prolific output of practical guidance and tools for legal and financial professionals, managers, entrepreneurs and investors has made him one of the best-selling individual authors in the global legal publishing marketplace. His cornerstone work, Business Transactions Solution, is an online-only product available and featured on Thomson Reuters’ Westlaw, the world’s largest legal content platform, which includes almost 200 book-length modules covering the entire lifecycle of a business. Alan has also authored or edited over 90 books on sustainable entrepreneurship, leadership and management, business law and transactions, international law and business and technology management for a number of publishers including Thomson Reuters, Practical Law, Kluwer, Aspatore, Oxford, Quorum, ABA Press, Aspen, Sweet & Maxwell, Euromoney, Business Expert Press, Harvard Business Publishing, CCH and BNA. Alan is currently a partner of GCA Law Partners LLP in Mountain View CA (www.gcalaw.com) and has extensive experience as a partner and senior counsel with internationally recognized law firms counseling small and large business enterprises in the areas of general corporate and securities matters, venture capital, mergers and acquisitions, international law and transactions, strategic business alliances, technology transfers and intellectual property, and has also held senior management positions with several technology-based businesses including service as the chief legal officer of a leading international distributor of IT products headquartered in Silicon Valley and as the chief operating officer of an emerging broadband media company. He has been an adjunct faculty member at several colleges and universities, including Berkeley Law, Golden Gate University, Hastings College of Law, Santa Clara University and the University of San Francisco, teaching classes on corporate finance, venture capital, corporate governance, Japanese business law and law and economic development. He has also launched and oversees projects relating to sustainable entrepreneurship and ageism. He received his A.B., M.B.A., and J.D. from the University of California at Berkeley, a D.B.A. from Golden Gate University, and a Ph. D. from the University of Cambridge. For more information about Alan and his activities, and the services he provides through GCA Law Partners LLP, please contact him directly at alangutterman@gmail.com, follow him on LinkedIn (https://www.linkedin.com/in/alangutterman/) and visit his website at alangutterman.com.

About the Project

The Sustainable Entrepreneurship Project (www.seproject.org) was launched by Alan Gutterman to teach and support individuals and companies, both startups and mature firms, seeking to create and build sustainable businesses based on purpose, innovation, shared value and respect for people and planet. The Project is a California nonprofit public benefit corporation with tax exempt status under section 501(c)(3) of the Internal Revenue Code dedicated to furthering and promoting sustainable entrepreneurship through education and awareness and supporting entrepreneurs in their efforts to launch and scale innovative sustainable enterprises that will have a material positive environmental or social impact on society as a whole.

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