

**A compilation of INSEAD Research**

***From our Faculty: CSR and Sustainability at Board Level***



**INSEAD Corporate Governance Initiative**

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## Editorial

Humanity has never been as powerful and careless as in the wasteful use of limited natural resources and in the lack of serious action on climate change, an issue that has finally gained scientific validation.

The narrative has become clear: the world faces an uncertain future with a burgeoning global population fuelling the growth of ever larger cities, demanding more goods and services, while most natural resources are dwindling and climate change effects are contributing to planetary risk.

The United Nations has pushed the green economy and sustainable development as new models for businesses and governments to adopt. Even though the term 'green economy' suggests an environmental focus, it is as much about creating a socially inclusive and equitable society as it is to have a low-carbon and resource-efficient one. It is about seeking to improve every aspect of life on earth and moving away from bad trade-offs. Sustainability is a paradigm changer for our global world, for our companies and for their boards.

Changing paradigms, however, is never easy. The recently held United Nations climate conference in Warsaw evidenced a lack of political will and the issue of distributive fairness continued to plague the talks – repeating the scenario of earlier conferences on the subject. How severe do disasters need to be for public and political opinion and in particular behaviours to change fundamentally?

*“Positive deviance means doing the right thing, despite being surrounded by the wrong institutional structures, the wrong processes and stubbornly uncooperative people. That is what sustainability-conscious leadership means today. Surrounded by evidence of rampant unsustainability it is no longer possible to say ‘I did not know’”,* asserts Sara Parkin, Founding Director, Forum for the Future<sup>1</sup>.

And increasingly, people are letting companies know when they are viewed as seriously off-course. The headquarters of a major US cereal company was the subject of continued protests by people demanding that the company stop using palm oil in its products;<sup>2</sup> viral social media campaigns were directed at the two major US soda producers for their unethical procurement of water from developing nations; while a two-year survey<sup>3</sup> of 24 million customers of a major UK retailer, clearly revealed that they expect the company to do the ethical and environmental thinking for them, before the product even reaches the shelf.<sup>4</sup>

A trend of embedding ethics, CSR and sustainability into organisations is being seen across sectors. Unilever is harking back to its founding purpose in an attempt to prove that sustainability is in its DNA, rather than purely a box ticking exercise. Procter & Gamble agrees with its rival: *“The holy grail is connecting sustainability with brand equity. If we don't then it won't appeal to our customers,”* says Virgine Helias, P&G's director of global sustainability<sup>5</sup>. The Eric Wright Group<sup>6</sup> is the only construction and civil engineering

<sup>1</sup> <http://sd.defra.gov.uk/2010/09/sustainability-leadership-in-a-perverse-world/>

<sup>2</sup> [Marketing Week \(Online Edition\)](#), 11/25/2013

<sup>3</sup> Sainsbury's 20x20 sustainability commitments programme

<sup>4</sup> The Guardian 4<sup>th</sup> December 2013; [www.theguardian.com](http://www.theguardian.com)

<sup>5</sup> Eric Wright Group has undertaken high-profile contracts, including building Allianz Park, Saracens Rugby Club's new stadium in Barnet, north London, a £12.25m engineering block for Lancaster University and the Energy Coast

group that is half-owned by a charitable trust, “because sustainability is incredibly important to us, and corporate social responsibility is not something we pay lip service to. I think it sets us apart,” says group managing director Jeremy Hartley<sup>7</sup>. In the banking sector, HSBC takes a long-term view in community involvement and believes in building programmes that last a minimum of three years. The great news is that many of its flagship programmes such as ‘Care for Nature’ and ‘Corporate Responsibility Challenge’ launched in 1989 and 2006 respectively, are still on-going today<sup>8</sup>. Finally, US Secretary of State Kerry has singled out action on climate change as the legacy issue for the second term of the Obama presidency.

These initiatives are proof that it is possible to move the global economy away from its inefficient ways of the past. Such a shift also brings new opportunities, as shown in the finance area, where impact investing – which demands that financiers take into account not just economic outcomes, but also the impact on society and the environment (precisely because not doing so will lead to lower returns) – is increasingly regarded as a valuable innovation in investment practice. Impact investing is incidentally revealing what Warren Buffet has said for so long, namely that ‘markets are not perfect’.

When prices are no longer a perfect guide, governance becomes more important. The emergence of impact investing may actually close the old governance debate between the shareholder vs. the stakeholder with a surprising ‘middle’ consensus: shareholders are better off when they take into account the impacts on communities and the environment.

Steering through this new landscape requires board members, as custodians of their companies, to play new roles, address new issues, and recognise more complex interdependencies and connections between the resources used by a company and its implications on the relationships with its stakeholders. ‘To do the right thing’ is not as obvious as before, and may in fact be radically at odds with past practices.

Leaders who do not speak the new language may soon find themselves ‘old’ or ‘left behind.’ In the words of Peter Bakker, Head of the World Business Council for Sustainable Development, “businesses cannot succeed in societies that fail”<sup>9</sup>. And we quickly add that societies cannot succeed if business fails. Squaring all that, making sense of it, and coming to the right conclusion is more than ever the complex task of today’s board members.

*Professor Ludo Van der Heyden  
The Mubadala Chair in Corporate Governance and Strategy  
Director of the Corporate Governance Initiative  
January 2014*

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University Technical College in Workington, the UK’s first vocational college for energy sector specialisation. The group is also active in the health sector, building primary care facilities in Great Harwood, Clitheroe and Colne, east Lancashire. It constructs distribution warehouses and commercial offices and is developing a low-volume residential housebuilder.

<sup>6</sup>Eric Wright Group has undertaken high-profile contracts, including building Allianz Park, Saracens Rugby Club’s new stadium in Barnet, north London, a £12.25m engineering block for Lancaster University and the Energy Coast University Technical College in Workington, the UK’s first vocational college for energy sector specialisation. The group is also active in the health sector, building primary care facilities in Great Harwood, Clitheroe and Colne, east Lancashire. It constructs distribution warehouses and commercial offices and is developing a low-volume residential housebuilder.

<sup>7</sup>The Daily Telegraph, 4 December 2013

<sup>8</sup>Business Times Singapore, 4 December 2013

<sup>9</sup><http://www.wbcds.org/newsroom/key-messages.aspx>

### From our Faculty: CSR and Sustainability at Board Level

*In his editorial 'Dare we believe in a better world', Professor Ludo Van der Heyden talks about how the financial crisis was only a symptom. The real problem was deeper and concerned less the poor quality of financial execution, but rather the poor quality of governance of financial institutions and those who purport to oversee them. The oxygen of good business practice is the value added, bringing invention, innovation; things that reassure us; make us happier, healthier and more alive than otherwise. And if we all uncompromisingly commit to this – then the value destruction that we have seen over the last few years would not have been for nothing.*

### Building and Nurturing a High Performance – High Integrity Corporate Culture



The hope for a 'better world' relies on people having a high degree of integrity, and Professor **Jean-Francois Manzoni** finds that though it begins with a basic compliance dimension, high integrity requires more than laws and regulations. Doing the 'right thing' may not be clear cut, but over the last few years, society has become increasingly demanding of organisations' social impact, appropriateness of certain business practices or distribution of wealth between shareholders, managers and employees.

### Making Sustainability Profitable



**Professor Subramanian Rangan, Knut Haanaes, David Michael and Jeremy Jurgens** found some interesting companies that go beyond compliance and look at what drives them. In search for the most effective sustainability practices in emerging economies, a recent study reviews more than 1,000 companies ranging in size from US\$ 25million to US\$ 5billion. What is most striking about the new sustainability champions is their motivation. Government regulations and competitors, the main drivers for many companies, matter less to them; they work largely from internal motivations.

### Business Model Innovation for Sustainability



Sustainability and profitability do go hand-in-hand; agree **Professors Karan Girotra and Serguei Netessine**, who bring an interesting and seemingly simple perspective: it simply involves looking for better business models with fewer inefficiencies. Business model innovation requires active engagement from the top management and the board. The bigger picture can only be seen from those with oversight responsibilities and those that best understand the complexity of the entire organisation and the business model of the company. Unless the board is involved and engaged along with senior management, in discussions that initiate business model audits on an annual basis, this will not succeed. Audit your business model and see if there are new inefficiencies that are creeping up that needs an appropriate response.

## Shareholder Primacy, Corporate Social Responsibility, and the Role of Business Schools



However, in order to formulate the right business model for a company, the board needs to revisit what is meant by an organization and the interconnectedness of all stakeholders. **Professors N. Craig Smith and David Ronnegard** remind us that it has long been argued that a corporation is not 'owned', but exists in and for itself. The board works for the corporation alone (though they are accountable to shareholders). The sole purpose of a corporation is not to make money for its shareholders or to serve the interests of self-described stakeholders. In fact, the challenging proposition of a corporation is to get shareholders and everyone else to part and keep parting with what the corporation needs to become stronger, more resilient and enduring...which in turn is of more value to all stakeholders.

### Corporate Social Responsibility: The Key to Attracting & Retaining Top Talent



Once you shift the mindset of the people in your organisation from a short-term focus on the value that we get from the activities and focus on the value that we can create for all stakeholders, the possibilities become much greater, notes **Professor Filipe Santos**. People will think differently by being more in tune with societal needs and will find innovative ways of doing business, creating new revenue streams, expanding core capabilities and achieving competitive advantage in new markets.

### Meeting Report, INSEAD Directors Forum: Sustainability at Board Level



We are herewith sharing the report of our last INSEAD Directors Forum (IDF) held in September 2013. IDFs are a place for the holders of the INSEAD Certificate in Corporate Governance to discuss new ideas in governance with the objective of a greater contribution to an organisation's long-term success. One such paradigm shifting concept is sustainability. This IDF was devoted to discuss the board's leading role in its effective deployment and integration into the business. With input from INSEAD professors and guest speakers, our directors had the opportunity to benefit from the expertise presented on:

- Sustainability by **André Hoffmann**, Vice Chairman of Roche Holdings Ltd and Givaudan AG, Vice President of WWF International and INSEAD Board Member
- Becoming Sustainable: the what, why, how according to **Professor Subramanian Rangan**
- Deepening the discussion on CSR & Sustainability for Corporate Governance with **Professor Craig Smith**
- Impact Investing according to **Charles-Antoine Janssen**, Sustainability Investor

*For more publications on corporate governance visit [www.insead.edu/governance](http://www.insead.edu/governance) and on CSR and Sustainability visit <http://centres.insead.edu/social-innovation/what-we-do/research-resources.cfm>*

## Executive Summary

**Building and Nurturing a High Performance  
– High Integrity Corporate Culture**

Jean-Francois Manzoni

Chapter in the book „Performance Measurement and Management Control: Advancing Global Practice“, by Marc J. Esptein, Jean-Francois Manzoni and Antonio Davila, Editors (Emerald, 2012)

**The Author**

Jean Francois Manzoni, former Shell Chaired Professor of Human Resources & Organisational Development; Professor of Management Practice, INSEAD

**“Human beings tend to act their way into new attitudes much more than they think their way into new behaviours.”**

*It is now generally accepted that organisations that enjoy lasting success do so in part because they have developed a strong and positive organisational culture. My favourite definition of culture is that of Goffee & Jones (1998, p15): “Culture comes down to a common way of thinking, which drives a common way of acting”. This definition captures the fact that culture is about the way people think, translates into the way people behave, and that culture refers to a pattern of behaviour that is reasonably pervasive throughout the organisation.*

**Re-shaping Culture**

Changing an organisation’s culture requires modifying the „common way of thinking“ of its members. As a result, many organisations have over the years launched „culture change programmes“, where the goal was to modify employee attitudes. Such efforts tend to fail because they miss a counter-intuitive but long-known aspect of human functioning: *Human beings tend to act their way into new attitudes much more than they think their way into new behaviours.*

Re-shaping the culture of an organisation hence requires reshaping the behaviour of enough people, for long enough for them to internalise the new behaviour, i.e. for the new behaviour to become „a habit“. Re-shaping employee behaviour requires the alignment of the signals sent by all the managerial levers to which employees are exposed. These levers must send consistent enough signals, and must do so for a long enough period for employees to internalise the new behaviour.

A good example: For about two decades, Tesco – the British-based international retailer - created and nurtured a remarkable corporate culture characterised by high employee engagement, customer focussed innovation and excellence in execution. It did so through a series of managerial levers such as:

- Incredibly aligned, with the organisation’s strategy and with one another.
- Applied with great intensity (i.e. no box-ticking exercise, but rather real time and energy invested into the activity).
- Consistent over time, driven by a management team that worked together for over a decade.

**Integrity and high performance**

Though it begins with a basic compliance dimension, high integrity requires more than laws and regulations. Doing the „right thing“ may not be clear cut, but over the last few years, society has become increasingly demanding of organisations’ social impact, appropriateness of certain business practices or distribution of wealth between shareholders, managers and employees.

**“In the short term, there can be clear conflicts between requirements of performance and integrity ”**



*As Cynthia Cooper, the whistle-blower in the WorldCom accounting misreporting explained, “People don’t wake up one day and say, I think I’ll become a criminal today. Instead, it’s often a slippery slope and we lose our footing one step at a time.”*

The link between high performance and high integrity is not straight-forward, though there is a certain amount of anecdotal evidence suggesting that over the long run this relationship is generally positive. In the short term, there can be clear conflicts between requirements of performance and integrity, e.g. a price increase can destroy customer goodwill but lead to immediate profits. These trade-offs are at the heart of managers’ jobs and are hard to assess.

However, it is increasingly clear that breakdowns in integrity can be extremely costly. For example, UBS and *Societe Generale* have suffered considerable losses because of employee misconduct; disappearance of companies like Enron, Parmalat or WorldCom also involved inappropriate behaviour and cover-ups; and regulators have recently leveraged fines in excess of US\$1 billion on companies such as Pfizer, J&J, Siemens, etc.

## **Integrity breakdowns**

In some cases, individuals who commit ethical transgressions know that they are doing so but choose to go ahead anyway. The two major conscious drivers for such misbehaviours are fear and greed, both of which can be enhanced or reduced by management actions.

Managers must remember just how little encouragement is needed for many reasonable human beings to perform acts that they know to be problematic... which they then tend to rationalise.

Studies of individual and corporate wrong-doing also suggest that misbehaviour tends to increase over time. As Cynthia Cooper, the whistle-blower in the WorldCom accounting misreporting explained, *“People don’t wake up one day and say, „I think I’ll become a criminal today.“ Instead, it’s often a slippery slope and we lose our footing one step at a time.”* As described by Cooper, who knew the people behind the criminal actions, were basically *„good people who made bad decisions“*. They took a first action that breached their principles and rationalised it away. This first ethical breach made it easier to commit a second one, at which point they became almost condemned to continue lying in order to conceal their initial transgressions.

Effective control systems can help detect and prevent such transgressions. But over-reliance on control systems can actually backfire, as explained below.

In many cases, people do *not* realise that they are about to commit an ethical transgression! They fail to realise that they’re about to *„cross the line“*. In part, this unawareness is caused by the fact that it’s not always easy to identify what is the *„right thing to do“*, as stakeholders’ expectations are often difficult to identify and/or reconcile.

Beyond this fundamental difficulty, managers also need to be mindful of four other factors that can lead them to be blind to their – and their colleagues’ – ethical transgressions:

1. Ethical fading: In some cases, human beings can fail to notice the ethical implications of their actions. Research shows that the following conditions can trigger an increase rather than a decrease in this behaviour:

- Small financial penalties associated with transgression: The individuals believe that paying the penalty discharges them from any other responsibility. The decision is no longer perceived as an ethical one, it becomes a business decision.
- Existence of a large number of rules and regulations: This tends to lead individuals to feel that they no longer have to self-monitor. The question



**“How can top management encourage employees to do the right thing for a complex set of stakeholders often representing divergent needs?”**



Image courtesy Naypong www.freedigitalphotos.net

*The desire to maintain a positive image of ourselves can lead us (unconsciously) to regard as acceptable actions that we otherwise known to be problematic.*

ceases to be, „*is this the right thing to do?*“ and rather becomes, „*is this allowed? Can I get this through the system?*“

- Disclosure of conflict of interest can also lead to a decrease in self-monitoring, as individuals come to feel that the disclosure discharges them of their responsibility to behave ethically.

2. Motivated blindness: Most of us believe that we can be objective even when we have a stake in the outcome of the decision. Research shows instead that a) it is exceedingly difficult for human beings not to be influenced by their stake in the decision; b) most of us over-estimate our ability to do so.

3. Confirmatory biases: We are prone to selecting, interpreting and even remembering events in ways that are consistent with our beliefs. Very often this filtering process will be totally unconscious, which makes it harder to observe and correct. Furthermore, these biases are a lot more pervasive than we tend to think. For example, many individuals turn out to be far more prejudiced than they thought, when tested in ways that do not rely on introspection but instead tap on the individuals' unconscious processes.

4. Self-serving bias/ Identity protection: The desire to maintain a positive image of ourselves can lead us (unconsciously) to regard as acceptable actions that we otherwise know to be problematic. Research shows that we extend this favour to members of our „*in-group*“. That is, we accept from ourselves and from our „*friends*“ behaviour that we find inappropriate in other individuals. Research also shows that individuals who think of themselves as virtuous often transgress *more*, as their „*virtuous identity*“ leads them to over-estimate the ethicality of their actions.

To create high performance – high integrity organisations and corporate culture, top management must strive to create a common way of thinking which drives a common way of acting, such that (tens of) thousands of managers and employees – coming to the matter with different personal norms and often different cultural norms – will become willing and able to respect the law and, more generally, to „*do the right thing*“ for a complex set of stakeholders often representing divergent needs. This is a challenging task, for reasons explained above. The chapter proposes a number of possible solutions to these challenges.

**Working Paper available on**

**<http://www.insead.edu/facultyresearch/research/doc.cfm?did=49327>**

**Full Publication available on**

**<http://www.emeraldinsight.com/books.htm?issn=1479-3512&volume=25>**



### Making Sustainability Profitable

**Knut Haanaes, David Michael, Jeremy Jurgens and Subramanian Rangan**

*Harvard Business Review/ Boston Consulting Group Report*

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*Rapidly developing economies are often portrayed as sustainability laggards – perceived to be more focussed on addressing poverty than on protecting the environment. However, in 2010, the Boston Consulting Group and the World Economic Forum found that in markets where the pressures of resource depletion are felt most keenly, corporate sustainability efforts have become a wellspring of innovation, and a source of competitive advantage.*

As old ways of production and distribution become more costly, companies will increasingly compete on the basis of a new paradigm: the efficient use of resources. They will monitor the payback from resources by optimising consumption through the more efficient use of those resources. They will also manage the put-back – that is, the effect of their actions on the future supply of natural resources and on the climate – in order to limit the damage. To succeed in this new world, companies will need to put resource management at the core of their business – as a central part of management rather than relegate it to a vaguely defined office of social responsibility.

#### The Search

In search for the most effective sustainability practices in emerging economies, the study involved reviews more than 1,000 companies ranging in size from US\$ 25million to US\$ 5billion. What is most striking about the new sustainability champions is their motivation. Government regulations and competitors, the main drivers for many companies, matter less to them; they work largely from internal motivations. As befits leaders, they manage their context and are pushed from the inside to move more aggressively. To understand these outliers better, we selected five companies for a deeper analysis into how they brought about their success. Far from holding back, their focus on sustainability has spurred new opportunities and growth. China's Broad Group, Kenya's Equity Bank, India's Jain Irrigation Systems, India's Shree Cement, and Costa Rica's Florida Ice & Farm exemplify different aspects of resource management.

#### The Approach

Some pursue sustainability out of pragmatism, some out of idealism. But all have consistently generated above-average growth rates and profit margins. To make their environmental efforts pay off financially, these companies have followed one or more of three general approaches: (1) taking a long view and investing in initially more expensive sustainability operating methods that eventually led to dramatically lower costs and higher yields; (2) using a bootstrap approach by making small changes that generated substantial savings, which they then used to fund advanced technologies that

**“The innovators adopt a different mind-set about costs, they focus on increasing the efficiency of the system as a whole.”**



Image courtesy 'digitalart' www.freedigitalphotos.net

*“Probe a bit deeper, and you find that the top-performing companies are significantly stronger ‘embracers’ of sustainability than low-performing companies are. This isn’t causation, but it’s an indication.” (Knut Haanaes)*

made production even more efficient; and (3) spreading their sustainability efforts to the operations of their customers and suppliers (and in the process devising new business models that competitors find hard to emulate).

It is remarkable how many companies in emerging markets chose to embark on sustainability efforts long before any imperative arose. In the process they often gained important first-mover advantage as markets for environmental friendly goods grew. In a world of scarcity, companies will need to consider their total return not just on assets but on resources. Companies that fail to calculate this equation will find themselves at the mercy of price increases and volatility, regulation and social pressures, while those that master it will enjoy competitive advantage and gain market share.

## **Sustainability and Growth**

What are the key elements of an internally driven focus on sustainability and growth? (1) Monetize resource management: adopting resource management as a strategic differentiator that will drive growth and profitability; being explicit about optimising cost as part of its commitment to sustainability; (2) Embed resource management: go beyond strategy and into corporate structure, governance and company’s mission; (3) Measure, measure, measure: what gets measured gets managed – everything else falls off the radar when people get busy; (4) Look widely at resource management: take a holistic perspective on their resource use, looking at all inputs and outputs; (5) Be innovative with the business model: just like products, business models have a limited lifespan and must evolve over time, not just make changes within it; (6) Shape the business ecosystem: look beyond own operations and include the entire value chain; (7) Constantly explore and improve: pioneers will have to keep moving and business intelligence is vital to drive constant improvements in its operations.

Collectively, these companies vividly demonstrate that trade-offs between economic development and sustainability aren’t necessary. Rather, the pursuit of sustainability can be a powerful path to reinvention for all businesses facing limits on their resources and their customers’ buying power.

**Full Publication available at**

*Harvard Business Review* 91, 3 (2013) 132-135: <http://hbr.org/2013/03/making-sustainability-profitable/ar/1>

# Executive Summary

## Business Model Innovation for Sustainability

**Karan Girotra and Serguei Netessine**

*Manufacturing and Service Operations Management 15(4)*

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*The first thing that comes to mind to a manager in any industry, when he thinks about innovation, is about a new product or new technology - often linked to billions of dollars in R&D and specifically skilled personnel. And this is also true for innovation in sustainability - develop new technology, new fuel, new energy, new car, solar panels, etc. We suggest, in fact, that this is not the way to think about innovation. Often, we already have plenty of technologies that are perfectly adequate, but the stumbling block is our ability to adopt those technologies and a lack of innovative business propositions that would make it profitable for companies to do so.*

When you innovate a business model, you are not changing the product, the customers, the market or the technology. Instead, it is about changing the way you deliver the product or service in the same market. Some call it the operating model of the business or others call it the product or service delivery system. Our approach in business model innovation goes along the lines of finding inefficiencies which most often decrease profit. Sustainability and profitability go hand-in-hand and it simply involves looking for better business models with fewer inefficiencies.

### Oversight from the top

Business model innovation requires active engagement from the top management and the board. The bigger picture can only be seen from those with oversight responsibilities and those that best understand the complexity of the entire organisation and the business model of the company. Unless the board is involved and engaged along with senior management, in discussions that initiate business model audits on an annual basis, this will not succeed. Just as companies have auditors – internal and external – for annual financial inspections, so should they have regular business model check-ups. Audit your business model and see if there are new inefficiencies that are creeping up that needs an appropriate response.

Business model innovation involves diverse abilities - from finance, marketing, R&D, etc., and so the key is to promote more inter-departmental collaboration, and a governance culture that encourages this as well as sponsors workshops for the different trades to get together for business model innovation.

Though companies spend billions on R&D, the returns are not very well known or at best are ephemeral, and recent studies show that it is impossible to capture this information. So what is the alternative? Business model innovation does not

**“Audit your business model and see if there are new inefficiencies that are creeping up that need an appropriate response.”**



Image courtesy kromkrathlog www.freedigitalphotos.net

*All we are talking about is changing the rules by which a company operates, and it is not centred around a single person or visionary. In fact, business model innovation is based on the laws of economics - simple rules that anyone can understand and apply with a relatively simple framework shown in our paper.*

require inventing new things, does not require huge investments, does not require huge risk-taking. All we are talking about is changing the rules by which a company operates, which can be often be done with just a paper and pencil, and is not centred around a single person or visionary. In fact, business model innovation is based on the laws of economics - simple rules that anyone can understand and apply with a relatively simple framework shown in our paper.

### **Illustration of the problem**

Carbon emissions and electricity consumption are mostly consumed in houses to heat up, cool down or light up, etc. Think about one of the cheapest and most effective ways to reduce global warming. - reduce electricity consumption by replacing the regular bulbs with energy efficient bulbs. It is well known that those bulbs pay for themselves quickly, even though they are more expensive, they last much longer and are more efficient. The technology is proven and reports show that this is the cheapest way to reduce carbon emissions and save money. So you would assume that everyone would be doing it. However, if you go to average homes or organisations in the US, they haven't made the change. Why aren't people making the shift? And how can you change this situation? It does not involve new products, technology or markets. Instead it is about business model innovation. We found that some people just don't think enough about long term decisions. For example, the company manager who manages a particular building counts the cost of replacing hundreds of bulbs and is not sure of the returns, and can't be bothered to figure this out...with the end result being that many companies don't do anything. And ironically, the way the industry has responded to this challenge is by trying to come up with yet more efficient bulbs, cheaper and better, but still nobody buys them!

The status quo is being tackled in some countries by the emergence of new types of companies called 'energy efficiency service companies'. They measure the energy consumption of a company, change light bulbs, replace air-conditioning, isolate windows, etc. The company doesn't have to do anything, nor spend any money up front. At the end of the year, the innovative service company looks at the savings due to a more efficient energy consumption and shares the profit 50-50 with the client. These companies are growing in number and size, illustrating that this kind of business works. And now, even utility companies are offering this service, since they already have a lot of the energy usage data.

What are the blocks and challenges that stop business model innovation? Why didn't the light bulb company come up with this idea? One big reason is that most companies simply do not systematically think about business model innovation. The company that produce light bulbs, probably has a big energy department that comes up with new technology but they don't have a department who thinks about new business models to sell those bulbs. This is silo thinking.

Who should be thinking about business model innovation? It can be done in various ways. In some companies it might be part of their R&D activities, because they go hand in hand, i.e. when you come up with new products, then

***“Often, we already have plenty of technologies that are perfectly adequate, but the stumbling block is our ability to adopt those technologies and a lack of innovative business propositions that would make it profitable for companies to do so.”***

you have to think of what is the right business model for this product. In order to do business model innovation you don't need any special skills, but you do need a high level of understanding of the company, such as what is the present company business model, how does the industry operate, what are the inefficiencies, how does the company make money, etc. So, the top management must be involved, including carrying out the regular business model audit.

### **Example of a solution**

Amazon is a favourite example of a company that is remarkable in how it completely revamped its business model many times over. It originally started as a book retailer with outsourced wholesalers and distributors. But then as they grew, they realised that these distributors and wholesalers were not always good in logistics and sending a single book to customers. So they learned how to do this and then instead of being a book retailer, they became a company that became an expert in logistics. Next, they decided to sell this service to other companies, and invited everyone on the Amazon platform, offering to carry others' product, handle deliveries, warehouse, order from suppliers, etc. – to leverage their expertise. And at each step, people said, they were crazy to invite competition by sharing their knowledge, but the company has grown and expanded in products and markets, and each time they examined their business model. At some point they were handling so much data from suppliers and customers that they started getting more into data service and doing cloud computing for others and selling their servers for computations...it is a continuously evolving business.

So what makes them innovative? It is an extremely analytical and data driven organisation. Very little is based on visionary ideas by one person. It is all about getting real data and analyzing that and making decisions - evidence based management. They try and get the best possible information and then they experiment. In business model innovation, it is good to experiment, make small minimal viable business changes, see how it operates and then move forward.

**Full publication available at: <http://ssrn.com/abstract=2289291>**

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## Executive Summary

### Shareholder Primacy, Corporate Social Responsibility, and the Role of Business Schools

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*A recent Financial Times article highlighted views of many academics who talked about how deeply entrenched the idea of shareholder primacy is in management education. “The prevailing view in business schools has been that a primary function of corporations is to further the interests of their shareholders,” says Colin Mayer, professor of management studies at Oxford’s Saïd Business School and the author of Firm Commitment. Craig Smith, professor of ethics and social responsibility at INSEAD, agrees. “Students come in with a more rounded view of what managers are supposed to do but when they go out, they think it’s all about maximising shareholder value,” he says.*

The dominance of shareholder primacy in business schools is a relatively recent phenomenon. “For most of the 20th century, schools emphasised the theory of managerialism,” says Lynn Stout, a Cornell Law School professor and author of *The Shareholder Value Myth*, adding, “This treated company executives as stewards entrusted with running organisations that had economic and social purposes in the interests of a wide range of beneficiaries.”

Among the most frequently cited economics papers of the past three decades - most agree that a turning point was the 1976 paper, *Theory of the firm: Managerial Behaviour, Agency Costs and Ownership*, co-authored by Michael Jensen and William Meckling. The authors argued that the problem in companies was that executives were serving their own interests rather than those of owners, or shareholders. Proponents of this „agency theory“ argued for incentives for managers to increase the value of the company. However, the idea that managers are agents of shareholders (who are principals of a corporation) is a flawed concept that has taken hold in business.

By the 1990s, the idea that corporations should serve only shareholder wealth as reflected in stock price came to dominate other theories of corporate purpose. Executives, journalists, and business school professors alike embraced the need to maximise shareholder value with near-religious fervor.

Accordingly, the legitimacy of the „Shareholder Primacy Norm“ (SPN) considered to be part of a manager’s legal fiduciary duty to make decisions that further the interests of shareholders - is at the core of what has been called the „basic debate“ in business ethics: whether corporations should be managed for the primary benefit of shareholders or for a wider constituency of stakeholders?

This paper shows that managers believe they are following a legal norm, but it would seem that they are actually following a social norm which they think is a legal norm because of its pervasiveness in business. Managers are not required by law to maximise shareholder value. Nevertheless, as highlighted in the paper, the social norm of shareholder primacy is reinforced by the structure of corporate law which is geared towards shareholder primacy: shareholders exert control over the corporation primarily through their legal right to elect and dismiss directors.

***“As long as shareholders have sole voting rights for the board of directors their interests are likely to remain primary as they alone wield elective power.”***



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***Should corporations be managed for the primary benefit of shareholders or for a wider constituency of stakeholders?***

The fiduciary duties imposed on managers in common law are due to early judicial depictions of their relationship with shareholders as one of trust. Managers were considered trustees for the shareholders who were the owners of the corporation. However, the corporation was legally separated from its shareholders in the mid-19th century and considered to own itself, whereas shareholders were considered to own shares as a separate form of property. Despite the legal separation of the corporation from its shareholders in terms of ownership, important features of the structure of corporate law that came with the earlier depiction remained, both in terms of fiduciary duties and more importantly in terms of voting rights of shareholders.

In practice, managers work in the primary pursuit of shareholder interests because: a) they believe it is their legal duty, if not a moral duty; b) they fear being dismissed by the board if they do not; and, c) they are often incentivized by remuneration that is tied to shareholder interests. With this social norm and the associated set of beliefs and incentives in place, it is not surprising that managers also believe that they should not engage in CSR that might be inconsistent with shareholder interests.

## **Winds of Change**

There are signs of change. Four out of five executives surveyed by the consulting firm McKinsey (2006) thought that *“generating high returns for investors should be accompanied by broader contributions to the public good.”* However, almost 90% of respondents said they were motivated to champion social or environmental causes by profitability or improving public relations. Although many executives think that they should consider the interests of non-shareholder stakeholders, this appears to mostly hold true when they don’t conflict with shareholder interests and in particular when both go hand in hand.

Many advocate making management a true profession, which would include the teaching of a formal body of knowledge and a commitment to a code of conduct. The latter, a *“Hippocratic Oath for managers,”* has inspired an MBA Oath movement, to which over 300 institutions have committed as of 2013.

Various companies from Nestlé and Unilever to Costco, PepsiCo and Starbucks – are developing strategies that focus less on short-term share value and embrace long-term environmental sustainability and inclusive business models. *“It’s almost as if the world knows something business schools don’t,”* says Thomas Donaldson, professor of legal studies and business ethics at University of Pennsylvania’s Wharton school. *“They’re holed up in a fort surrounded by people who see it differently – but they get to stand in front of the class with the chalk.”*

Unilever, under CEO Paul Polman, has taken a different approach in adopting its „Sustainable Living Plan“, by doing away with earnings guidance and quarterly reporting and telling hedge funds they are not welcome as investors. It suggests that investors be put on notice that the firm is taking a long-term view on value creation.

In the paper, two avenues for change are examined, concerning the dominance of the SPN as a social norm. One recommendation comprises changing board composition to extend voting rights to non-shareholder stakeholders, and though this may be difficult, some increase in stakeholder representation is possible. And the other is to correct the influence of business schools.

## Business Schools' Influence

The standard principal-agent view of the manager's role, widely prevalent in business schools, is ill-founded. First, it assumes shareholders own corporations; whereas, in fact, corporations are independent legal entities that own themselves and shareholders own shares of stock, which amount to a contract between the shareholder and the corporation providing the former with rights under certain limited circumstances.

Nonetheless, ill-founded or not, the financial economics *Theory of the Firm* still today informs much teaching at business schools across the curriculum and business purpose is widely held to be maximizing shareholder value. Many suggest that MBA and executive education should change such that the legal duties of directors are better understood. A broader rethink is the need of the hour.

An honest teaching of the theories of the firm must portray the plurality of views available regarding its purpose - *Shareholder Theory*, *Stakeholder Theory*, and *Social Contract Theory* are key contenders. The stakeholder approach is about creating as much value as possible for stakeholders, without resorting to trade-offs. Thus business is viewed as a *stakeholder value creation enterprise*. In „social contract theory“, a corporation operates in a society at the discretion of the community and on the understanding that the corporation implicitly makes some commitments to that community - one of its main moral duties is to abstain from violating minimum standards of human rights and justice in society.

## Role of Boards

This paper raises many provocative questions related to the role of boards. A basic question from a board's perspective is: To what extent does the board feel it is representative of stakeholders vs. shareholders? It is very clear that the law does not require the company to focus solely on shareholders and in certain respects, different classes of stakeholders are required to be given attention, and there is nothing preventing boards and companies from giving attention to issues such as corporate social responsibility and sustainability, without regard to whether this is profit maximising...at least legally.

Boards need to define and acknowledge that corporate purpose is more than maximizing shareholder value, and how does this translate in terms of board decision making? If one accepts the idea that the company exists to serve multiple stakeholders, how does it go about doing that? How does a board protect the long term interest of a corporation, which may or may not be aligned with shareholders' various different interests.

It has long been argued that a corporation is not „owned“, but exists in and for itself. The board works for the corporation alone (though they are accountable to shareholders). The sole purpose of a corporation is not to make money for its shareholders or to serve the interests of self-described stakeholders. In fact, the challenging proposition of a corporation is to get shareholders and everyone else to part and keep parting with what the corporation needs to become stronger, more resilient and enduring...which in turn is of more value to all stakeholders.

***“Managers may believe they are following a legal norm, but it would seem that they are following a social norm which they believe is a legal norm because of its pervasiveness in business.”***



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*Four out of five executives believe that generating high returns for investors should be accompanied by broader contributions to the public good.*

**Full Working Paper available at:**

**<http://www.insead.edu/facultyresearch/research/doc.cfm?did=52943>**



## Corporate Social Responsibility : The Key to Attracting & Retaining Top Talent

By Filipe Santos

### The Author



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As corporations recognise the link between CSR and sustainability, opportunities arise for socially conscious leaders to change the world from the inside out.

Up-and-coming leaders today are looking for more than a good salary – they’re searching for meaning in their day-to-day work and they tie their personal values more closely to their career than previous generations

“There is a longing for a sense of meaning with many executives,” Filipe Santos, INSEAD Associate Professor of Entrepreneurship and Academic Director of the INSEAD Social Entrepreneurship Initiative, noted outside the school’s 2013 INSEAD Global Business Leaders Conference in Abu Dhabi recently.

“They are told to run a company for profit but now they’re thinking. ‘I want to go beyond that, I want to have impact in society which is sustainable and makes a difference.’”

This leaves companies with the choice. Either they increase the opportunities for very highly skilled employees to engage with societal issues or they don’t, and are likely to find many of their best people leave the organisation to find one that meets their expectations.

### Shifting corporate mindset

By giving a platform to these ‘social intrapreneurs’ and creating an environment that incubates and promotes their initiatives, smart companies are finding that not only are they able to keep their most talented and highly skilled people, they are fulfilling society’s growing expectations of the company’s role and opening the way for new ideas, broader markets and innovative ways of doing things.

“Once you shift the mindset of the people in your organisation from a short-term focus on the value that we get from the activities and focus on the value that we can create for all stakeholders, the possibilities become much greater,” notes Santos.

People will think differently by being more in tune with societal needs and will find innovative ways of doing business, creating new revenue streams, expanding core capabilities and achieving competitive advantage in new markets.

### From CEO to junior employee

Firms don’t have motivations to engage in social issues, he argues. It’s the people inside the corporation, the social intrapreneurs from all ranks of the corporate hierarchy, from CEO to junior employee, who spark change. Able to leverage off a corporation’s network of resources, market share and distribution channels, they address some of the toughest social and environmental challenges while delivering long-term value for their company.

Whether this is by finding more inclusive ways of doing business with previously excluded sections of the population; pushing forward ideas on energy conservation; or introducing methods of reusing or recycling within the company itself, social intrapreneurs push boundaries beyond their regular role and introduce

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changes to internal operations or business initiatives which enable their company to become more engaged with societal issues. They disrupt the way business is conducted, with the backing of corporate heads.

Getting that support from the organisation, says Santos, is the tricky part.

## **Pushing through change**

While social intrapreneurs may avoid the continual search for funding, faced by social entrepreneurs looking to run their own mission-based enterprise, they have to navigate complex corporate structures, meet the often diverse needs of multiple stakeholders and risk being seen as the lone wolf.

Social intrapreneurs seek to create social impact through the firm's resources but without primary concern for profit as the main outcome, Santos and co-author Christiane S.Bode, PhD Candidate in Strategy note in their recent paper *The Organizational Foundations of Corporate Social Entrepreneurship*.

They challenge the perceptions of other organisational members who think that corporate initiatives which do not focus on value capture are unjustified.

So they need in some way to articulate why the ideas and initiatives they want to create are good for the company. And they need to find the way it resonates with each of the internal stakeholders.

“[Successful intrapreneurs] engage in creative and selective framing of the initiative, generating multiple rationalisations for its existence, to gain the support of various stakeholders.”

The reason why people within a corporation support an idea may be very different, Santos explains. “Some may do so to benefit their reputation, some because it improves the loyalty of employees and some may genuinely want to have a direct impact on society.

“A clever social intrapreneur has to understand what motivates different people, and frame ideas slightly differently when seeking individual support.”

## **Social intrapreneur vs entrepreneur**

While social intrapreneurs, don't get the recognition which comes with founding a successful company branded with their name, they do have the satisfaction of getting their disruptive ideas to market — and to more customers sooner than the more widely-recognised social entrepreneur. Greater environmental or social impact is achieved as a result.

For companies, the benefits may not be obvious straight away, says Santos. But as they engage more generally with those issues across the entire value chain, they will actually find opportunities for value creation and then it will become “not just a public relations exercise with a nice report but actual and genuine change... creating meaningful activities and changing areas of the business to incorporate issues that society cares about.”

## Sustainability at Board Level INSEAD Directors Forum Fontainebleau, September 13<sup>th</sup>-14<sup>th</sup> 2013

In a world in flux, traditional thinking about the roles of directors is being challenged. The INSEAD Directors Forum (IDF) is a place for the holders of the INSEAD Certificate in Corporate Governance to discuss new ideas in governance with the objective of a greater contribution to an organisation's long-term success. One such paradigm shifting concept is sustainability. This IDF is devoted to discuss the board's leading role in its effective deployment and integration into the business. With input from INSEAD professors and guest speakers, our directors had the opportunity to benefit from the expertise presented and from the experiences shared, and left the meeting more informed about the topic and their responsibility as directors.

Professor Tim Rowley, co-director of the INSEAD International Directors Programme opened the day by stating: *"One way boards add value to management and the organisation is to check for blind spots. Since managers are pressing hard to drive financial value and sometimes feel pressure from short-term oriented markets, they might miss some of the risks further along the time horizon. Effective boards ensure a healthy balance between the short and long term. Sustainability is one of those areas that has been on the horizon for a long time. Today, it has become a topic that board members, at the very least, must understand in sufficient detail to know if it is a blind spot."*

### Sustainability by André Hoffmann, Vice Chairman of Roche Holdings Ltd and Givaudan AG, Vice President of WWF International and INSEAD Board Member



The participants of this International Directors Forum (IDF) devoted to the topic of sustainability are welcomed by **Professor Ludo Van der Heyden, Mubadala Chaired Professor in Corporate Governance and Strategy and Academic Director, INSEAD**

**Corporate Governance Initiative.** Professor Van der Heyden warmly welcomes our honorary guest speaker **André Hoffmann, Vice Chairman of Roche Holdings Ltd and Givaudan AG, Vice President of WWF International and INSEAD Board Member** (as well as former participant of an IDP Module).

Hoffmann begins by sharing what he feels is one of his life's principal missions, which is to bridge the gap between philanthropy, business and the environment. He does this by bringing different platforms together to create value through sustainable growth, a fundamental for *"taking people out of poverty"*. He defines sustainability as an ability of an ecosystem to function and maintain productivity for a prolonged period of time. This requires deeper engagement at all levels – in field work, new initiatives, awareness, measurement & regulation, and – perhaps most importantly – education.

*"Sustainability is important,"* says Hoffmann, *"because the human population is growing and levels of consumption are increasing, while natural resources are limited and their regeneration is quite sensitive to – and often destroyed by – human activity. The human footprint has passed critical thresholds. Indeed, we have reached a level where all choices and actions today will affect our future, are interconnected and no action can be considered as unimportant or irrelevant. The call for action is NOW."*

With increasing awareness comes the need to measure. Hoffmann recommends The Global Footprint Network (GFN) – a metric that allows us to calculate human usage of the planet and its natural resources. This brings up startling facts, for example, if everyone lived the lifestyle of the average American, we would need 1.9 planets to be sustainable. GFN reports that since the 1970s, humanity has been in ecological overshoot with annual demand on resources exceeding what the Earth can regenerate each year. It now takes the Earth one year and six months to regenerate what we use in a year. We are falling behind every day. Hoffmann reports, *"August 20 was Earth Overshoot Day 2013, marking the date when humanity exhausted nature's budget for the year. We are now operating in serious overdraft. For the rest of the year, we will maintain our ecological deficit by drawing down local resource stocks and accumulating carbon dioxide in the atmosphere above sustainable levels."*

Hoffmann explains that according to the Chatham House think-tank, this changing global resource landscape immediately points to major risks that businesses need to consider: supply disruptions, volatile prices, accelerated environmental degradation, and rising political tensions over natural resource access. A recent study by the Boston Consulting Group and INSEAD encourages businesses to take heed of resource management as a competitive opportunity and necessity; given that natural resource scarcity is a fact, future market leaders will increasingly focus on resource management as a pathway to growth and this concern will increasingly be at the core of business strategy.

In concluding the session, Hoffmann takes questions from the participants:

• **Q:** *It takes a long time to change people's behaviour, so how do you motivate for sustainability?* **A:** *There are two basic realities that can be highlighted to motivate people – that the cost of resources has dramatically increased (it no longer is a matter of a few percentages); and that you can change the choices you give to your consumers and constituents.*

• **Q:** According to the GFN, different countries are at different levels of resource consumption, so how do you respond to this disparity and how do you get consensus between countries

**A:** We are already in overdraft mode, and we are more interconnected than we realize. If we want to look at the future, it is in the best interest of each country to manage its resources properly, regardless of the present disparity. That is the reality. It is no longer about equality, but about survival.

• **Q:** As somebody who really understands the importance of sustainability, are you optimistic about the future? How do you sustain your passion? **A:** I look at myself more as a philanthropist than a conservationist. I try to understand what the challenges are. If you want to make the world a better place, you need to address the challenge of the excessive consumption of natural resources – this is most important. It is about facts, but also about having the faith that we will choose to do something about it; if we don't we are in for very big trouble. And those who create or capture value need to keep in mind that there are those who can't – and we have to become more inclusive in our value creation exercise: this is where sustainability is about changing mind-sets and practices, so that we leave a world that is viable for the next generations.

• **Q:** Should sustainability be part of a core curriculum for MBA? **A:** I have been trying to make this happen for the past six years at INSEAD. I believe the awareness is increasing and it will happen.

## Becoming Sustainable: the what, why, how according to Professor Rangan

Taking the topic of sustainability into the second day of the IDF, **Tim Rowley, Professor of Strategic Management and Organisations & Director of the Clarkson Centre for Board Effectiveness at Rotman School of Management and Visiting Professor at INSEAD**, speaks a few words to the participants.

"Boards create and protect value, but they find the former more difficult," says Professor Rowley, "their biggest challenges being their struggle with information gaps and the social dynamics of the board team." He reviews what falls 1. within the board's domain of decision-making, identifying strategy, configuration of organization (including acquisitions, divesting, human talent, etc.), and decisions 2. around risk by setting the tolerance bar and then monitoring it. "Today, we look at the context of sustainability in the board room and how you handle decisions around this. This is a conversation that must take place in the boardroom," Professor Rowley concludes, before introducing **Subramanian Rangan, Professor of Strategy and Management, The Abu Dhabi Crown Prince Court Endowed Chair in Societal Progress.**



"I have a dream," begins Professor Rangan, details of which he doesn't reveal immediately. Instead he questions the accepted general logic of the traditional allocation of resources that drives the short-term performance of a firm. The tool of the executive board is net present value (NPV), and this implies that the future is less important than the present.

"My dream," reveals Professor Rangan, "is that board of directors would understand their role better - which is one of

creating and protecting the net future value (NFV), which by the way," he adds, "is also the net fair value."

The board's role is that of custodian and steward, according to Professor Rangan, and this is how it will rebuild enterprise in a trust deficit world. "Today nobody trusts the corporation or business leaders and part of the reason is that corporate governance is broken, with boards judged too often as ceremonial decorations. How many boards truly shape the course of how things can be?"

## Value Capture vs. Value Creation

Professor Rangan encourages his audience to embrace a paradigm shift in how they think about sustainability and its implications. Though efficiency and growth are important for a firm, adaptation is vital for future value creation, and that involves three things:

- The trust issue (fairness)
- Changes in tastes (ideas) such as mission for gender parity, going green, etc.
- The ability to adapt to trends

He believes directors need to think more about the difference between value capture and value creation, and their contribution to both.

A recent research study by INSEAD and the Boston Consulting Group searched for best practices on sustainability.

(Harvard Business Review 91, 3 (2013)132-135: <http://hbr.org/2013/03/making-sustainability-profitable/ar/1>).

It was found that almost all companies uniformly focused on growth. "And we can't have quality growth if we don't address sustainability," Professor Rangan stresses. He believes that firms focus excessively on efficiency, a little on growth but very little on adaptation. "This is the big ticking bomb. The survival of enterprises depends on their ability to adapt."

BCG-INSEAD's (<http://centres.insead.edu/social-innovation/what-we-do/academic-corporate-reports.cfm>) study of companies showed the path followed by adaptive companies:

**Motivating:** Growth constraints such as lack of water, talent, customers, etc., are a great source of intellectual challenge and motivation for the management.

**Mobilizing:** This concerns the emotional trigger, with adequate authenticity and symbolism, to "move" stakeholders, and especially employees, and open up to the challenge and the destination.

**Mainstreaming:** Better practice companies then integrate sustainability into every function of the value chain, as part of the core business, and not under a delegated CSR department. This is a change of mind set, fostered by the two previous steps, and can be very powerful. Every single department of the company is involved, from sales to production, supply chain to R&D. "It is not only about what we will do and for whom we will do this, but how we will operate; it projects the company forward in a different way," says Professor Rangan.

**Metrics:** Beyond motivating, execution demands targets and timelines. Sustainability now moves beyond a simple PR exercise, and becomes an integral part of business operations, where measuring and monitoring is essential. A new criterion of metrics is devised. There are different options available, like the Global Reporting Index (GRI), which is a high benchmark tool freely available and quite implementable.



**Monetization:** The board and shareholders invest in sustainability for value creation, because without that it only remains one of the company's goals and not a strategic value of the firm. Monetization needs to be discussed to turn sustainability into a strategic priority.

**Methodology:** To sustain sustainability (no pun intended); it needs a method to operate and to be systemically implemented, with a concept of **ROR (i.e. return on resources)**. Professor Rangan concludes, *"I see three things - a cognitive part; a systemic distribution (not delegation) throughout organization, and then, by really making sustainability endogenous to the company, it becomes scalable."*

An interesting debate evoked by this research is that some people study sustainable enterprises with an aim to find out if it leads to higher performance, and usually they find positive correlation. *"However, we should admit the possibility that the correlation could also go the other way,"* Professor Rangan challenges: *"High performance leads to sustainability, with the theory of 'common cause'. Companies that do things well do many things well, and excellent companies do many things excellently. So excellence over time de facto leads to sustainability. This has powerful implications in how you develop leaders, how they think and how creative they are and must remain."*

### Architecture of the Board: What does this mean to the Role of Directors?

In reference to making sustainability profitable, Professor Rangan says that this is only one side of the coin; the other side is making profitability sustainable. *"Though they go hand in hand, I think much more of the latter, because future value lies there."*

Expanding on his dream that directors would see their role as stewards of net future value, Professor Rangan suggests the following board committees:

1. **Constraints Committee:** What will the future growth constraints be? Is it going to be legitimacy, i.e. trust, license to operate; or is it going to be talent (our education system is broken); will we worry that we don't have water; or energy? *"This is only exogenous if you say it is. What are you doing about it? How are you future-proofing this business?"* Professor Rangan poses a few questions that would be the domain of this committee.

2. **Contribution Committee:** Every board should have a contribution committee, which oversees how the organization is shaping the future, because it isn't just about protecting but rather creating the future. *"We need to create new models for apprenticeship, mentoring, diversity and inclusiveness issues, water management, etc... and examine thoroughly what your firm's contribution is? You cannot buy trust, but you can build trust, by being fair, by contributing, by not just having a rubber stamp strategy. Too much of this work is put on the shoulders of the management team, when it is the board that must be driving the creation of future value."*

3. **Coaching Committee:** It is important to recognise that most directors don't know the issues, and need to learn. IKEA is a great example of learning and adapting. Being the largest consumer of wood products (and consistently opposed by WWF), they went to WWF and asked for coaching. And together they created the FSC (or Forest Stewardship Certificate) that changed the whole industry while also providing a stable supply chain for wood. Similarly with cotton, which is a very water-thirsty crop (10,000 litres of water are required to produce one sheet of cotton!); IKEA went back to WWF for water strategy

coaching leading to a new initiative labelled 'Better Cotton.' By 2015, it will be a benchmarked standard (like ISO 50,000 for mining companies). There is a knowing-doing gap, but there is also a knowing-knowing gap, and more board members need to be educated in many subjects. There is a need to construct a community of directors and executives where it is not just a world of compliance, but also of contribution and coaching. Bring the outside in; be a boundary expander.

4. **Compensation Committee:** It is vital that this committee be alert to these new behaviours, and is not just rewarding results as in the past. Culture is ultimately determined by what you pay people for; thus, incentives need to be aligned to properly induce adaptive changes.

*"I want to suggest to you that to create and protect net future value, you need to think about the constraints of the future, about the contributions that the enterprise makes and will make to industry and society, while engaging in coaching and getting the information and tools that you and that executives need to get us there. It's not just wishful thinking; it's enlightened thinking. Create the methodology, and then align the compensation so that it's fair internally,"* Professor Rangan summarises.

### Discussion

A lively discussion follows Professor Rangan's session with participants sharing ideas and thoughts. Thoughts such as shifting the goal post beyond GDP, to being more expansive to include equality issues, political stability, shifts of power to the masses due to technology, etc. Questions are raised such as how do you build a successful enterprise in a failed society? Do you talk about regret or risk? Do you want to protect or create?

Professor Rangan cautions that adaptation, though vital, will require perseverance because it takes a certain dreaded path - **the J-curve** - where things get worse before they get better. Furthermore, business often tries to keep emotions out of its sphere, but both **logos and pathos** play a very important role in mobilizing people and making the 'J-curve' less steep. *"People will not take the pain because you promise them some future gain. You need pathos. You need to capture the heart of the people, and that is through emotions. And you need to be fair. Then they will be ready to even sacrifice for the greater good. However, we fundamentally have a fairness deficit - and we no longer know what fair means,"* warns Professor Rangan in conclusion.

### Deepening the discussion on CSR & Sustainability for Corporate Governance with Professor Craig Smith



With increasing tension of business in society and sustainability, there is a need to understand this issue in the context of corporate governance and why and how directors need to give it attention. **Professor Craig Smith, the INSEAD Chaired Professor of Ethics and Social Responsibility, and Member of the Scientific Committee of Vigeo**,<sup>1</sup> guides participants through some initial ideas, invites

them to examine some concrete cases in group work, and then brings the main points of their group discussion into a plenary discussion.

<sup>1</sup> Founded in 2002 by Nicole Notat Vigeo has established itself as the leading European expert in analysis, the notation and the audit consulting organizations, with regard to their procedures, practices and outcomes related to environmental issues, social and governance "ESG".

## What is CSR & Sustainability?

The most widely accepted definition, from the Brundtland Report (1987), still stands today: *'Sustainable development meets the needs of the present without compromising the ability of future generations to meet their own needs.'*

Professor Smith encourages some provocative discussions around the room regarding profitability and sustainability – what does it mean, how can it be measured, is it affordable, what is long-term, what is non-financial reporting? An interesting example comes from Africa where the biomass industry, which is important but highly subsidized, is still not profitable. Everyone agrees that we live in a resource-constrained world.

Various responses are given to Professor Smith's question, so why this increased attention to sustainability in business? Some of the reasons are due to the many pressure groups – government, NGOs and protests, including 'Occupy Wall Street' – all instrumental in more businesses taking on sustainability issues. There is an agreement that we live in a circular economy – i.e. there is a scarcity of resources and we need to put it back into the ecosystem to survive. We can no longer operate as if there are infinite resources, as was done in the past with a linearly expanding economy mind set. We are **consuming without "resourcing"** – and that is by definition not sustainable.

The insurance industry is especially attentive now to these issues, especially around climate change. The trust of stakeholders; the influence of regulators; pressures from investors; war for talent resources are some of the other reasons for sustainability. However, everyone feels that there needs to be a methodology and not just a reaction to a trend.

## Change in mind-set

Professor Smith talks about the concept of integrating the triple bottom line: economic, social and environmental. He reminds the audience that the doctrine of corporate social responsibility was considered *"a fundamentally subversive doctrine in a free society,"* by Milton Friedman, Nobel Prize winning economist, in his most cited 1970s article. Even The Economist in 2005 dared to label CSR a *"completely stupid rhetoric"* that is not a business responsibility.

Yet, a **December 2005 McKinsey survey** (<http://www.leadway.org/pdf/Global%20Survey%20of%20Business%20Executives.pdf> - Source December 2005 McKinsey Quarterly Survey of 4,238 global business executives;) of over 4000 C-level executives from 116 countries revealed that business executives across the world overwhelmingly believe that corporations should balance their obligation to shareholders with explicit contributions to the broader public good. That opened the gates of the executive boards to the notion of sustainability. Today we are discussing fully opening the gates of the board room to the topic.

A more recent survey in 2010, of 700 CEOs from around the world, carried out by **UN Global Compact-Accenture** ([http://www.accenture.com/Microsites/ungc-ceo-study/Documents/pdf/13-1739\\_UNGC%20report\\_Final\\_FSC3.pdf](http://www.accenture.com/Microsites/ungc-ceo-study/Documents/pdf/13-1739_UNGC%20report_Final_FSC3.pdf)) confirmed that businesses must give attention to sustainability, immediately adding that not enough is being done.

*"The CEOs in this survey said that this needs to be fully integrated in the strategy and operations of the company, and the burning issue is how to do it. They need the board's help," says Professor Smith.*

## A fundamental question: Why do it?

There is the 'fundamentally right thing to do' argument; and then there is the 'business case for it' reason. Participants agree that at the time of making decisions, you don't always know the outcome, so you make the best judgement to do what is deemed right at the time. The reputational risk factor however is a strong motivator too, as there is a danger that if you don't give adequate attention to this on the board, value can be destroyed very quickly. But how far do you need to go? How do you balance your cost structure that you need to stay competitive with sustainability issues?

Professor Smith answers some of these concerns, *"There is ample evidence now that CSR and sustainability can provide an enduring economic advantage."*

He cites a **KPMG report (2005)** ([http://www.kpmg.eu/docs/Corp\\_responsibility\\_Survey\\_2008.pdf](http://www.kpmg.eu/docs/Corp_responsibility_Survey_2008.pdf)) that 74% of corporate CSR reports identified 'economic considerations' as drivers for corporate responsibility, especially reputation and brand, and improvement of market position. He also cites a 2006 article by **Porter & Kramer** that says that *'CSR has emerged as an inescapable priority for business leaders in every country.'*

## Sustainability matters at board level

Professor Smith asks the participants to consider how quickly value can be destroyed if today's board hasn't looked seriously at CSR. The notion of sustainability has changed, and you cannot carry on business as normal. It is no longer about 'whether' but about the 'how'. The social and environmental problems are progressively becoming business problems, especially when it is increasingly understood that they are caused by business, or probably more likely that business is a key willing actor in the issue. It is important for the board to understand the supply chain pressures and decide what the board's responsibility is and that of the management. But that is the fundamental question for any issue, and it is essential that there is a close relationship between the two, to establish performance and risk and be able to control both.

According to the **2012 KPMG report "Expect the Unexpected: Building Business Value in a Changing World"**,

([http://www.kpmg.com/dutchcaribbean/en/Documents/KPMG%20Expect\\_the\\_Unexpected\\_ExecvteSmmry\\_FINAL\\_WebAccessible.pdf](http://www.kpmg.com/dutchcaribbean/en/Documents/KPMG%20Expect_the_Unexpected_ExecvteSmmry_FINAL_WebAccessible.pdf)) there are 10 mega forces that are likely to impact businesses over the next 20 years: climate change, population growth, water scarcity, material resource scarcity, volatility of fossil fuels, food security, ecosystem decline, deforestation, urbanization, growth of the middle class. These issues relate to identifying potential risks, interventions and opportunities – which are all board responsibilities. The board can design effective strategies to address risks and simultaneously take advantage of the opportunities created.

Though easier said than done, Professor Smith agrees, *"There isn't a one-size-fits-all solution to sustainability issues."* The group work carried out by participants highlight exactly this point: each company has different footprints that gives rise to different risks and opportunities.

## Role-play as external directors in real cases

Professor Smith moderates an afternoon of group discussions of case studies based on real companies facing real sustainability issues. In nine small groups, the participants take on the role of the external directors on the board of Gold Miners Inc. (GMI); Pharma Inc., and ABC Supermarkets. The companies are fictitious or disguised but the sustainability issues faced are real and pose varying challenges for the participants role-playing board members.

In the GMI case, on the agenda is the troubled investment of USD 5bn in its Suarez gold mine in Latin America, and after four years of developing the mine and getting all the legal and regulatory approvals, production has yet to start. What should the board do? All the three groups of external directors agree that this is a decision for the board, since it involves a major investment and potential reputational risks – both environmental and social. Concerning the latter, the issue seems to be the lack of understanding of the local context, since even after a thousand meetings, there continues to be a conflict between the company and the local population. The directors ask if the issue is about fair-share or some more fundamental difference in mind set, such as the native view of their land as sacred. Is there adequate representation of the indigenous people in decision-making? Is there a discord between locals and the government? They suggest that arbitrators be brought in. In regard to the cyanide mercury pollution, the directors suggest looking at different technologies to mitigate environmental risks. However, they wonder if selling is a real option, and believe that it is their responsibility to either find a way to maintain the mine or close it. They acknowledge that though they have regulatory approval, the social license to operate is lacking.

The case around Pharma Inc. (a global research based pharmaceutical company with products in over 100 countries) is about a company under threat, with a fewer blockbuster drugs emerging from its R&D and an increasing loss of revenue to generic drugs competition. With the current business model at threat, the board is asked to consider a couple of radical initiatives ‘to create shared value’ – described as an effort to both achieve business economic objectives and expand positive impact on society. The directors agree that these are strategic decisions and hence on their agenda. However, the directors in all the groups feel that a lot more information is needed before any decision can be made, such as financial analytics, evaluation of reputational risks, whether these initiatives fit with the existing business, whether the right skills and competencies are in place, what is the cost-benefit analysis, a more detailed analysis of the company’s drug portfolio, the impact on profit margins if the company moved to generic drugs, etc. A few suggestions are given, including the integration of a broader sustainability strategy in emerging markets as well as carrying out some pilot test in high-net markets.

In the ABC Supermarket case, the agenda before the board is whether or not to install refrigerator doors in the chilled food section of their stores, which could potentially upset customers who are used to a certain way of shopping. Refrigerators without doors were hugely wasteful of energy, but the doors would be costly to install and investment payback with reduced energy costs recoverable in ten years. Most of the groups agree that though this is not a board decision, since the company’s defined sustainability strategy is already aligned with installing the doors; it is now up to the management to implement this, but maybe the board should engage more with the management. However, they would like further information on the costs and the manner in which consumers will be informed and their responses measured. The directors recommend that management communicates benefits beyond power saving. At present the directors feel that there is insufficient consumer and shareholder engagement. Furthermore, they feel that the sustainability strategy may be a ‘piece-meal’ approach and not well integrated into the business. Also, one of the groups look at the financials, and feel that 10 years is too long a time for pay-back. They wonder if this initiative is viable for the company. The board needs to discuss short-term vs. long-term gains. And finally they feel that maybe this is actually a board decision but wonder at what level it shifts to a management decision.

Professor Smith’s key summarising thoughts:

- The question is no longer whether sustainability is something that business needs to give attention to but how?
- What are the potential sustainability impacts of the business - and on the business? What are the opportunities out there?
- Implementing sustainability is idiosyncratic, there is no one-size-fits-all.
- How much is enough? Sometimes, sustainability is seemingly at odds with consumer preference? Can an appropriate balance be found?
- How sustainability fits board concern with risk and strategy? Also, does the board need to get into addressing the right configuration of the organization and whether it has the right people?

Professor Smith concludes his session by citing **Chouinard, Ellison and Ridgeway (HBR, 2011: <http://hbr.org/2011/10/the-sustainable-economy/ar/1>)**: *“The global population is projected to grow from 6.9 billion people to perhaps 9 billion by 2050. Even if we only want things to stay the same, practices must change. It isn’t a question of whether business will radically transform, but only of when and how.”*

### Impact Investing according to Charles-Antoine Janssen, Sustainability Investor



Professor Rowley, before introducing **Charles Antoine Janssen, Managing Partner of Kois Invest, and IDP participant**, provokes the participants by asking them how they thought about sustainability. *“There are some people who think about sustainability because it is the right thing to do; others say you should do it because*

*strategically it is the way to make money; yet others say it is not part of strategy but part of risk set; and then there are those who live in the past and have no clue. Where are you in this range of thoughts? Is it never, is it a risk to be managed, is it a strategy or is it a fundamental value? And how does that translate in the businesses you supervise, and in the discussions you have at board level? It is absolutely critical to have this discussion, because the world is changing – and in terms of sustainability we are moving back, overall, even when changes can be noted.”*

Janssen, himself a board member, shares the values of impact investing that is increasingly attracting high interest globally, including from serious finance professionals some of whom now say that this is the standard today. Directors should understand these evolutions. He explains, *“Traditional investing sets a financial floor and looks at targeted financial returns; whereas philanthropy looks at targeting not just economic but societal returns. Impact investing is a combination of the two – it pursues socio-economic objectives and financial returns.”*

*“Of particular interest,”* Janssen says, *“is that there exist new – and possibly many – market possibilities that you may have neglected in your business.”* His experience has found that often a societal problem that a business might face can be reversed and turned into an opportunity: *“As you try and find a solution, you can end up creating a business.”*

Basically, impact investing is about financial returns with a social purpose; it intentionally seeks societal returns, adding that *“the notion of intention is important, but doesn’t have to be 100% of your business.”*

## Impact reporting

Reporting on both financial returns as well societal returns is important. One challenge in impact measurement is this: how do you compare the social impact of education with that accrued through housing? How do you compare the social element with the environmental element? There are two directions one can take here. One is to adopt a “balanced scorecard” approach and leave the balancing and trade-offs to the decision maker, that is to the boards. Another is to take the time perspective. Financiers have actually – and surprisingly – found that in many cases longer-term financial returns actually could be bigger by not investing in equities with negative community and environmental impacts. The economic justification seems to be that the latter impacts, will over time, be reflected by higher costs that are not well taken into account by current prices. Considering these other measures might thus also be regarded as partial proxy measures for environmental and social risk.

## The length and breadth of Impact Investing

It is often thought that impact investing looks at small companies, or only private equity and emerging countries – bottom of pyramid firms. Actually, it is found across all asset classes – in fair trade banks, bonds, private equity, green or social real estate, in commodities. An example of the latter is renewable bamboo - produced with the sole objective of reducing environmental impact - or some gold mines that go through stringent processes to validate their minimal pollution factor and their “social friendliness.”

*“Today there is roughly USD 500bn worth of assets under the control of a large number of players that incorporate impact factors in one way or another; some are closer to ‘green washing’ than others, but some are really applying the rules in a stringent manner,” explains Janssen.*

A year ago, in 2012, JP Morgan captured the status of this industry, reporting that it was at a point of uncoordinated innovation, with a phase of market building, leaders were emerging and infrastructure was being developed. They believe that in the next 5-7 years impact investing is going to accelerate, and most financial players of a certain size already have a small impact fund of USD 100mn. Impact investing is predicted to become a mature industry in roughly a decade.

## Success Factors

There is no hope of building a social enterprise if you don’t know how to build and run a proper business. “We see great guys who run NGOs, with beautiful souls but no clue about management and finance, and if they are alone in a team, it will be a catastrophe,” explains Janssen. You need hard business skills combined with an understanding of social and environmental skills. Additional profits can be made at no additional expense, provided all the required business skills are there, coupled with an understanding of societal needs and a heart and soul driving vision.

This is a very large un-served and uncorrelated market, in which your business could find a niche. “Furthermore, we have found it to be a great way to attract and retain talent. We have two people who are working for us for free at this time, just because they love it!” There are people willing to leave high paid careers in investment banking to join impact investing firms at half the market price because of the value set and vision. Other benefits are increased customer trust and better relations with regulators and governments.

Some Examples:

- A man and his wife sold their respective high tech and architectural firms for about USD 150mn in total, and asked

the bankers to help invest all of it into impact assets. The bankers thought it crazy and warned them that they risked losing all their money. They decided to do it themselves and started with 50% into impact in 2011, and published the track record i.e. returns of total portfolio, returns on impact and returns on non-impact. They found that the impact investment returns were higher than the total portfolio returns, even in the short run. Also, and what has been confirmed by the latest evolution of their portfolio, is that they are addressing a huge amount of societal needs and that there is money to be made if you can address those.

- A company that is involved in depolluting land and building sustainable and social housing: When they go to local authorities to rebuild and develop those areas, everyone is remarkably friendly to them, as are the citizens. Their first project realized an IRR of 30%, and they are confident of a minimum 20% IRR on future projects - because they are not seen as real estate sharks only interested in the money, but as a company serving the local community.

- (From a US model). A company in Belgium helps the homeless by building homes for them. The flats are small, about 20-25sq metres, with counselling and medical support available within the building premises. The homeless receive social security benefits of 750 euros a month, and they pay the company 350 euros a month, which is the market rate rent (@10 euros per sq. metre), which generates a 3% return. The State gives the company a credit guarantee, so if the person runs off or gets “drunk,” the State pays 12 months’ rent.

- An IT company provides employment to autistic people. Autistic people are known to be able to undertake software testing two times faster than normal individuals. However, due to their impaired emotional skills, they regularly get fired from the companies that employ them. This company is structured to answer those needs with one “advisor” supporting seven autistic people. The attrition rate among autistic people became extremely low. The company was setup by a CEO with an autistic son, and it is now growing rapidly. They have significant clients such as Vodaphone and others. What could have been perceived as non-existing market is a market today (fitting the “blue-ocean” or rather “blue pool” label).

## Concluding Thoughts

The forum concluded with a large consensus that the topic of sustainability requires board attention for the topic to be sufficiently anchored in and practised throughout the organization. The speakers made complementary points in this regard: Hoffmann and Rangan stressed the need for education, the former making a strong play to integrate the topic more solidly into the curriculum of business schools (including INSEAD’s); Rangan pleaded for boards to become the stewards of the creation of net future value and to pursue long-sighted visions when traveling on this sustainability path; Smith stated – with no dissent from the audience - that it is no longer a question of whether business should integrate sustainability into its strategy but how; and Janssen demonstrated the power and success of impact investing, showing how modern finance already embraced sustainability. Our directors walked away informed about the topic and ready to embrace these new responsibilities, realizing too that their responsibilities just became more complex. They left with an eagerness to hear more on the ‘how do this at board level’ – something that could be done at a future IDF. They also walked away feeling more connected with the world and their fellow directors, having been motivated to take on a challenge that is quite bigger than each of them could meet individually, but that they could indeed meaningfully advance if they laboured on this topic together