

Leadership in Corporate Sustainability – European Report 2018

Research Report by *Board Agenda* & Mazars in association with INSEAD Corporate Governance Centre



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Executive summary

MANY ORGANISATIONS ARE rising to the challenge of creating a sustainable business as pressure grows from multiple stakeholders, who are demanding that companies ensure they are taking a long-term view over their corporate sustainability strategies. But while organisations grasp these challenges, there appears to be a wide diversity in approaches to sustainability, and in particular how and whether the issues are understood at board level. Are boards receiving the right information and looking at the right measurements, are they asking the right questions, and how strong is the risk oversight of their sustainability efforts?

Business leaders understand that ignoring sustainability will affect their company's ability to create long-term value, and a clear majority believe their board has a clear understanding of the risks and opportunities of sustainability. But there is evidence of a wide diversity in the approach, knowledge, measurement and action taken by boards with clear disparities as to how sustainability is being managed and integrated with strategy.

The findings are in equal measure informative and encouraging but also show that there is some way to go before stakeholders will be able to see a clear picture. And perhaps, most worryingly, there is a small but significant proportion of businesses where sustainability is simply not on the boardroom agenda.

Key findings of the *Board Agenda* survey include:

- Three-quarters (73%) of European business leaders believe that ignoring sustainability will affect their company's ability to create long-term value.
- An identical 73% believe their current reporting approach delivers a comprehensive picture of their sustainability actions to investors and other stakeholders.
- 29% say they are aiming to be a market leader in sustainability, while 10% admit sustainability does not figure in how they position themselves.
- 59% claim their board has a clear understanding of the risks and opportunities of sustainability.
- More than half (53%) say their board sees a solid business case for sustainability, while a similar number (57%) say they aim to meet their obligations. Only a quarter (24%) cite growing pressure from customers.
- 30% say that everyone on the board has a good understanding of sustainability, with 40% claiming there are enough board members with the right knowledge levels, but 12% say board members struggle.
- One-third (32%) do not manage sustainability separately, while a quarter (24%) say it rests with the CEO. One-fifth (21%) have a head of sustainability who reports to the CEO.
- One in five (17%) have a dedicated board-level sustainability committee, while two out of five (41%) do not have a separate function within the board with oversight of sustainability, with a similar number saying it rests with another board-level committee.
- While 70% say their company makes a positive contribution to society, 17% state that this does not happen or isn't clear.
- One-third of respondents claim that sustainability expertise or a sustainability mindset are explicit selection criteria in the appointment of executive and non-executive board members, but 15% disagree.
- One-third agree that sustainability measures are an integral part of the performance measures and compensation of executive members of the board, but half disagree.

Forewords



Anthony Carey, head of board practice in the UK, Mazars

THE RESULTS OF the survey are positive and insightful. They demonstrate that boards have sustainability front and centre in their minds as a key strategic consideration and they recognise that it has a very significant impact on their companies' ability to create long-term value. It seems equally clear, however, that more work is needed by boards to make sure that they have the infrastructure in place within their businesses and in the boardroom to drive reliable and useful non-financial reporting, and to manage their long-term sustainable performance effectively.

It is very encouraging that almost 30% of boards are aiming to be market leaders in sustainability,

with a further 30% seeking to be seen as strong performers. Similarly, while recognising it is a self-assessment, about 60% of respondents consider their boards to have a clear understanding of the risks and opportunities related to sustainability in their company's strategy. Yet only 50% of respondents have a firm conviction that they have the right information and measures in place to help them understand their companies' position, ambition and progress on sustainability.

Moreover, in terms of how boards maintain sustainability oversight, only 17% said their boards had a dedicated sustainability committee with just 5% having a dedicated NED fulfilling this function. Likewise, only 35% fully agreed that sustainability expertise or a sustainability mindset are explicit selection criteria in the appointment of either executive or non-executive board members. A similarly low proportion, 33%, agreed that sustainability measures are an integral part of the performance measures and compensation of executive board members.

It is also surprising that boards do not see pressure from investors and employees as key drivers for their sustainability activity. This does not accord with millennials' focus on the issue when choosing favoured employers and may suggest a worrying generational divide is emerging between boards and their key stakeholders in many instances.

A gap seems to exist between the extent to which boards recognise that sustainability is a critical business issue, and their effectiveness in measuring and managing it. To close this gap, many boards need to address how they can enhance boardroom expertise in—and focus on—sustainability issues as a matter of priority. By doing so, they will greatly strengthen the likely long-term value of their businesses and reduce the risks of unexpected shocks.



Prof. N. Craig Smith, chaired professor of ethics and social responsibility, INSEAD, and **Ron Soonieus**, managing partner, Camunico, and executive-in-residence, INSEAD

THIS RESEARCH INTO leadership in corporate sustainability clearly shows that the subject is rising up the business agenda. For many boards and business leaders, sustainability has become a key factor to contend with, measure and address.

The increase in awareness reflected in the survey is in line with a shift we see elsewhere. Driven by a developing societal awareness, companies face growing demands, if not pressures, to conduct their business sustainably. These come from stakeholders such as consumers, investors, national governments and NGOs, and have been articulated in international documents and agreements, of which the UN Sustainable Development Goals have gained particular prominence.

To keep up with the ever-increasing demands, however, it is not enough for boards to just be aware of and express a commitment to sustainability. What was good enough yesterday is no longer sufficient today. For example, a company being eco-efficient and socially responsible in its own operations is no longer doing enough in many sectors today. Often companies must address the sustainability of their supply chains as well.

Sustainability is increasingly becoming associated with basic questions of company purpose, core product offerings, business models and innovation, and what value creation means to the organisation. These considerations demand the attention, drive, and decision-making of the board. Simply put, if an issue is not on the board's agenda, it is unlikely to be at the heart of an organisation's strategy, culture or governance. A lack of board attention to sustainability is short-sighted, if only as a matter of good governance, not least with institutional investors also looking at company sustainability policies in a more holistic way.

The findings of this research must inevitably be judged with regard to the representativeness of the participants and the potential for social desirability bias in their responses. That said, it is



surely encouraging to find strong evidence within this sample of substantial board awareness of the importance of sustainability. However, the research also shows that boards still struggle to get the right information, expertise and processes in place to address sustainability issues effectively. For instance, only around a third of participants agreed that a sustainability mindset was an explicit selection criteria in appointing board members and senior executives, and only a third reported that sustainability was an integral part of the performance measures and compensation of executive board members.

The urgency and means of addressing these issues will vary. There are, however, some actions that any board could take right away, if it isn't doing them already, including: scheduling time for fundamental discussion about corporate purpose and what value means to your organisation; acquiring in-depth information on sustainability performance for your board; looking for sustainability expertise and mindset when appointing new board members; and explicitly integrating sustainability into board committees and board member duties.

Introduction

Confidence or complacency? Consistency gaps raise questions over sustainability strategies

IT WILL NOT have escaped board members' attention that there is an ever-increasing focus on sustainability in modern business life. This takes on many forms, but all are key components of how companies carry out their business. Whether it is a commitment to the United Nation's Sustainable Development Goals, adherence to national government legislation or a response to investor, employee and consumer pressure, boards now need to demonstrate that they are not only aware of the importance of sustainability to their organisations, but also that they are willing to act positively to ensure their words are matched with actions.

It is against this environment that *Board Agenda*, together with Mazars and INSEAD Corporate Governance Centre, set out to understand exactly what is motivating board members to keep sustainability on their agenda, and how they are demonstrating their knowledge of sustainability issues while translating them into corporate strategy and action.

The results of our investigation are revealing—they answer some questions, but also show that board members need to be asking more questions, both of themselves and of their organisations. There is a degree of confidence expressed that companies are addressing sustainability issues. But equally, there is a lack of consistency over how and what sustainability data is gathered and analysed, and how that is translated into action and responsibility. There is a risk of a growing gap between what the board believes it understands about sustainability, and the reality that they are not measuring it. And this risk can lead to complacency.

That sustainability is a key focus of the boardroom agenda is of no surprise, but cracks are appearing in what board members understand and how they interpret sustainability, how it is being measured and managed, and where real responsibility lies: is it with board members or with a company executive who reports to the CEO? Indeed, just how seriously is sustainability being taken? Is it just a focus on the environment, or are other aspects such as social issues being taken into account?

And are there still organisations that are failing to address sustainability? There is a small, but alarming, core for which the topic is not figuring in boardroom conversations at all.

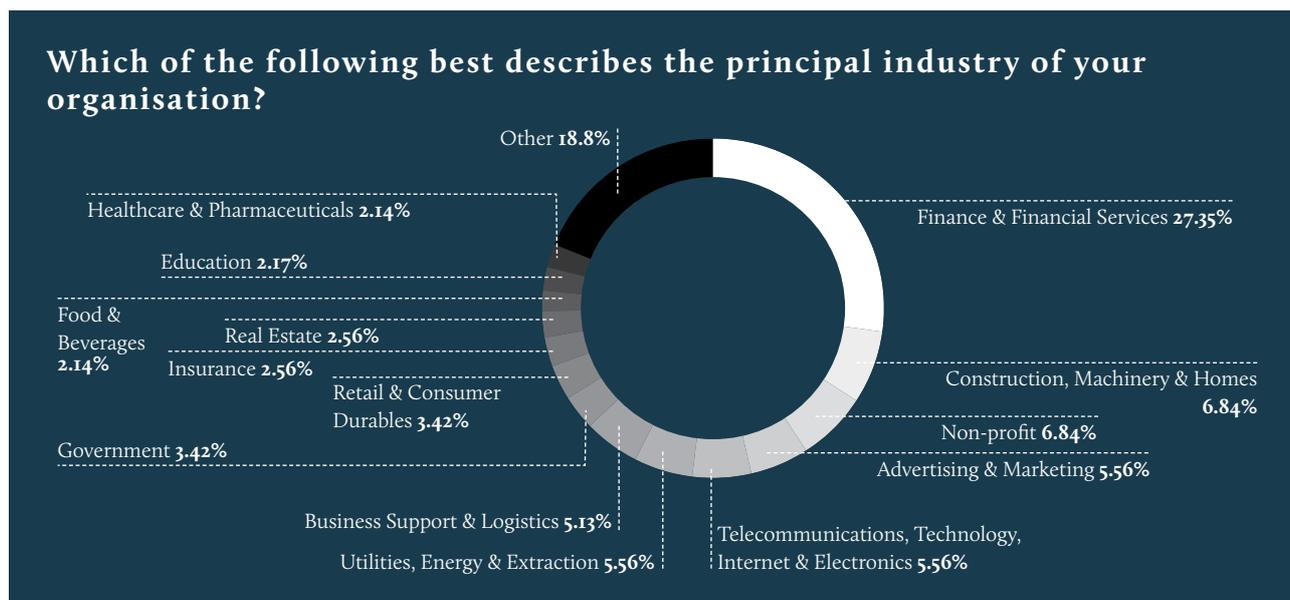


Some will see sustainability as an end in itself; others will see it as part of creating a competitive advantage; while a further set of business leaders will look beyond the present and see sustainability as part of a wider 'purpose' of the business.

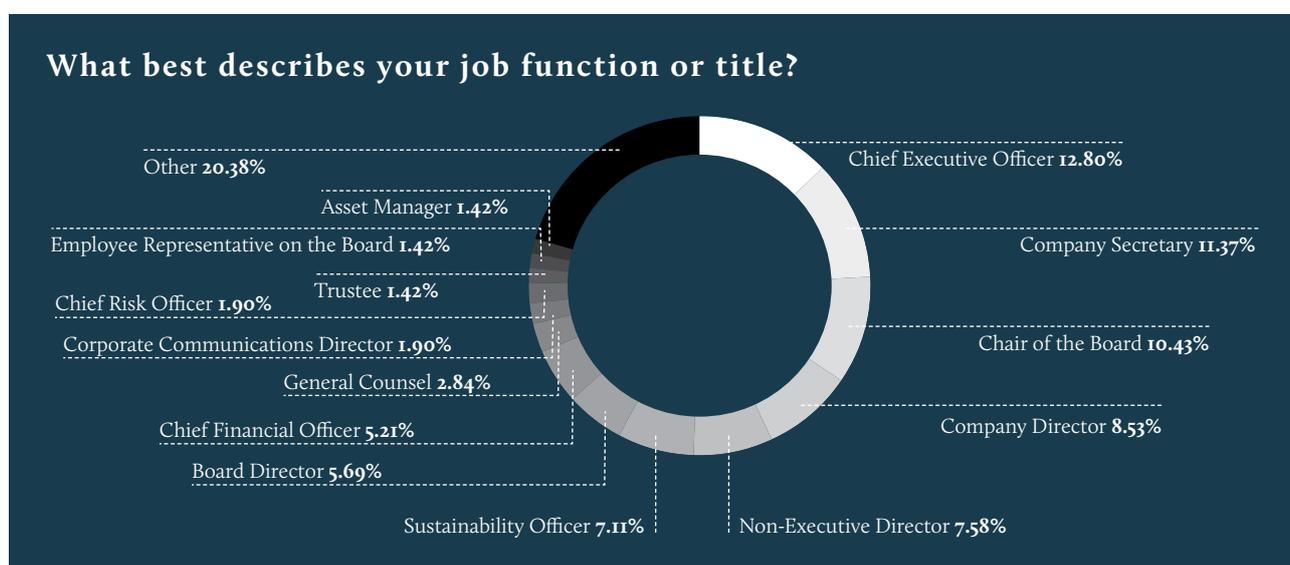
One thing is for sure, though: the results show that boards are becoming more aware of the complexity of sustainability and are focusing more on how to integrate and measure it while being increasingly aware of the difficulties in doing so. And as with so many other complex situations, there are no simple solutions.

Methodology

The *Board Agenda* survey was conducted during the summer of 2018 with 234 responses from chief executive officers, chief finance officers, board chairs, executive and non-executive directors, company secretaries and sustainability officers. Participants were recruited via an online survey which was powered by SurveyMonkey.



The respondents represented publicly listed companies, family-owned companies, not-for-profit organisations, private equity and venture capital investors, and were drawn from the UK & mainland Europe. One-fifth came from quoted companies with an annual turnover greater than €500m, while 14% were from quoted companies with an annual turnover of less than €500m. Some 17% represented family-owned businesses while 13% came from private equity/venture capital houses, with a similar number representing the not-for-profit sector.



The findings

I. Do boards understand where and why their companies are trying to position themselves on sustainability?

Nearly 60% of business leaders believe their boards are either keeping up with developments in sustainability to position themselves among the best performers, or are going one step further and claiming that they aim to be a market leader, using sustainability to gain a competitive advantage. This indicates that they do not see sustainability as an end in itself, but rather they believe it can be used to their advantage. This can be interpreted as either good business sense or a cynical strategy, especially when one considers that a further 27% of business leaders say they aim to meet their sustainability obligations as a responsible corporate citizen regardless of competitive advantage.

Your company has a clear idea of where it is trying to position itself on sustainability

We aim to be a market leader using it for competitive advantage **28.72%**

We keep up with developments to position ourselves among the best performers **30.26%**

We do what we can, but it doesn't figure in how we position ourselves in the market **9.74%**

We aim to meet our sustainability obligations as a responsible corporate citizen regardless of competitive advantage **26.67%**

Other **4.62%**

A small number (10%) would appear to have a more casual attitude, saying that they do what they can in regards to sustainability, but that it doesn't have a bearing on how they position themselves in their markets. That is not to say that board directors are ignoring sustainability: more than half (59%) agree that their boards have a clear understanding of the risks and opportunities of sustainability, with only 5% disagreeing.

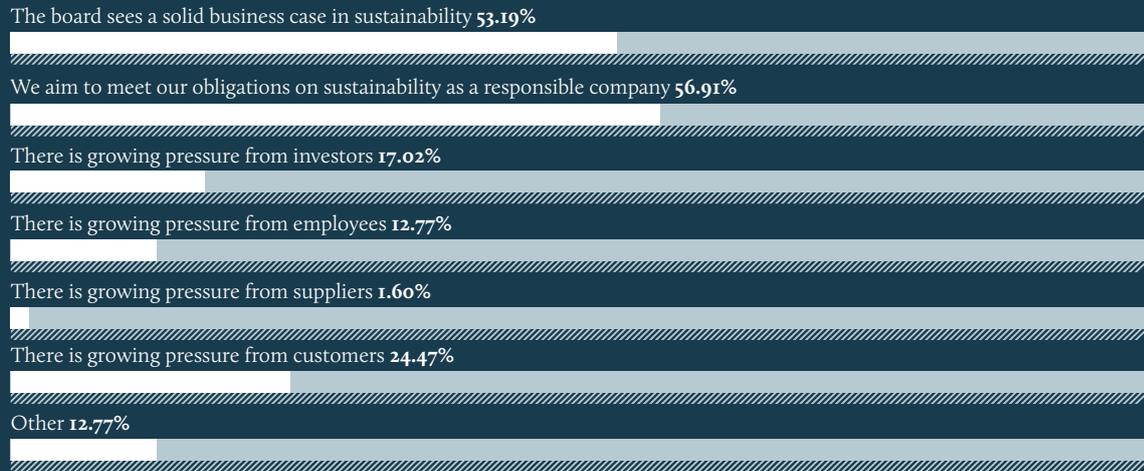
This is confirmed by the 53% who say the board sees a solid business case for pursuing a sustainability strategy. A similar number (57%) claim they aim to meet their obligations over sustainability. But an equal number also see pressure coming from outside the boardroom, with business leaders saying that investors, employees, suppliers and customers are driving sustainability activity and policies.

Either way, there is a strong belief that sustainability is increasing in importance as a boardroom topic. Indeed, our business leaders rank it second only to financial results in terms of the top issues considered by today's boards, just ahead of culture and risk management.

And there is an equally strong belief that the sustainability principles and intentions of their organisations are delivered by effective business policies and objectives—more than half (53%) agree with this sentiment, though 40% are less sure, and there remains a hard core of 8% that disagree.

But there is perhaps a sense of realism here as well. One respondent told us: “[Sustainability] is high on the agenda and we are travelling in the right direction. However, we have a long way to go particularly to engage our supply chain in our mission.”

What are the key drivers for your sustainability activity and policies? (Choose up to three)

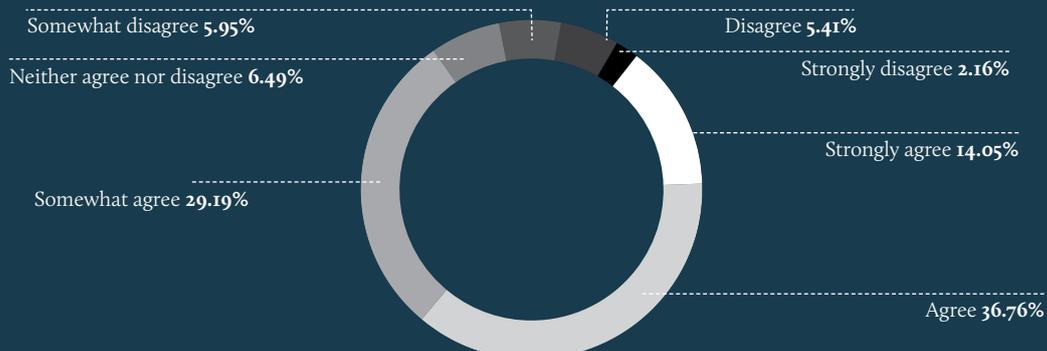


2. Does the board have the right information to understand where it is on its sustainability journey?

The short answer is that yes, the board believes it receives the right information and has the right measures in place to understand the company's position, ambition and progress on sustainability. A very small majority (51%) agree that the correct measures and information are in place. Only 8% disagree. But a substantial minority (42%) are not so sure, with 30% giving a very tepid 'somewhat agree' answer to the question. This large element of doubt must be a cause for concern—if the board is not entirely sure it is getting the right information and measurable results, then how can it truly be confident it is heading in the right direction?

This lack of confidence is reflected in the apparent knowledge base of the board, as perceived by business leaders. While 30% are confident that everyone on the board has a good understanding of sustainability and its place in the enterprise's strategy, a larger percentage (40%) are prepared to accept that enough board members have the right kind of knowledge and understanding. Add to this the worrying finding that 20% believe that board members either struggle to see how sustainability fits into the strategy, or that there is actually no one on the board with the necessary specialised knowledge or interest, and a picture begins to emerge of boardrooms that perhaps shouldn't be as confident as first indicated.

The board has the right measures in place to understand the company's position, ambition and progress on sustainability



How would you best describe the sustainability knowledge base of your board?



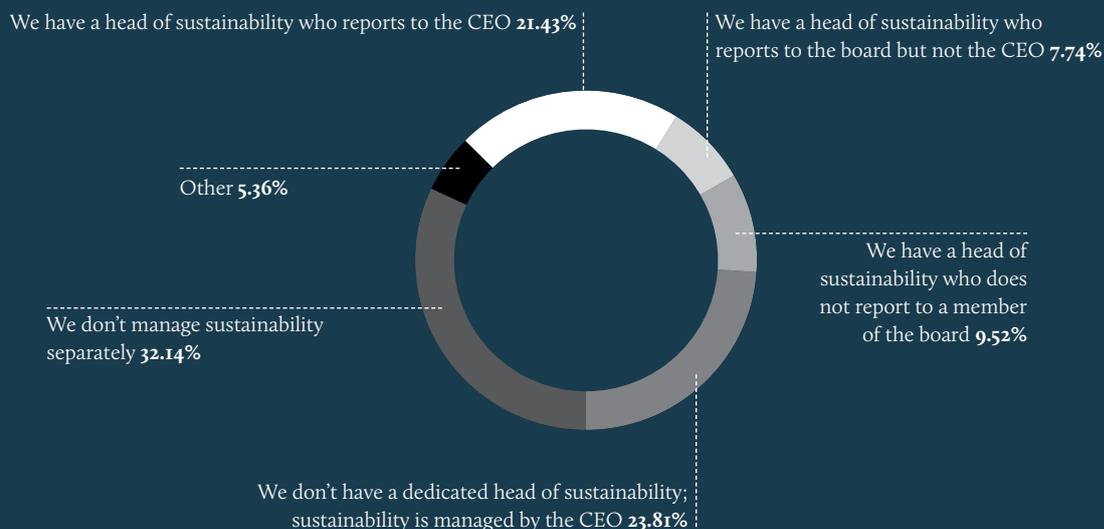
As one respondent commented: “Sustainability is a leadership issue (state of mind/being)—it relates to how you manage and oversee the business day-to-day as well as strategically. Every decision should be made with sustainability in mind but until people can measure the impact of their ‘sustainability’-driven decisions, it will not mean much.”

Is there a disconnect emerging between what boards say and what they do? Or is there a lack of concrete commitment?

3. How is sustainability and its oversight managed within the business?

Boards can manage sustainability in a number of different ways, and there is arguably no hard and fast rule over the right or wrong ways to do so—as long as it is managed. But it is important that responsibility for sustainability management resides in a clearly defined position—if everyone thinks that someone is responsible, then there is a risk that no one is.

How does your company manage sustainability?



How does your board maintain sustainability oversight? (Select all relevant)



So, this is the picture from the boardroom. A fifth have a head of sustainability who reports to the CEO. Nearly a quarter (24%) do not have a dedicated head of sustainability, but in a move that could be interpreted as demonstrating the importance placed on the issue, it is instead managed directly by the CEO. Some 17% have a head of sustainability, though under half report to the board (not directly to the CEO) while more than half of these do not report to the board at all.

However, the largest share (32%) do not manage sustainability separately. An optimist might believe that this is because sustainability is built into executive and director job descriptions. A pessimist might take a different view.

Optimists will point to the finding that nearly two-thirds of our business leaders say that oversight of sustainability resides within a combination of a non-executive director and/or one of the board committees. Some 17% have a dedicated sustainability committee, while a further 5% say there is a dedicated non-executive director for sustainability, but no committee. Instead, 32% say it is an explicit concern of either the audit or risk committee, with a much smaller proportion indicating it is an explicit concern of the nomination and/or compensation committee.

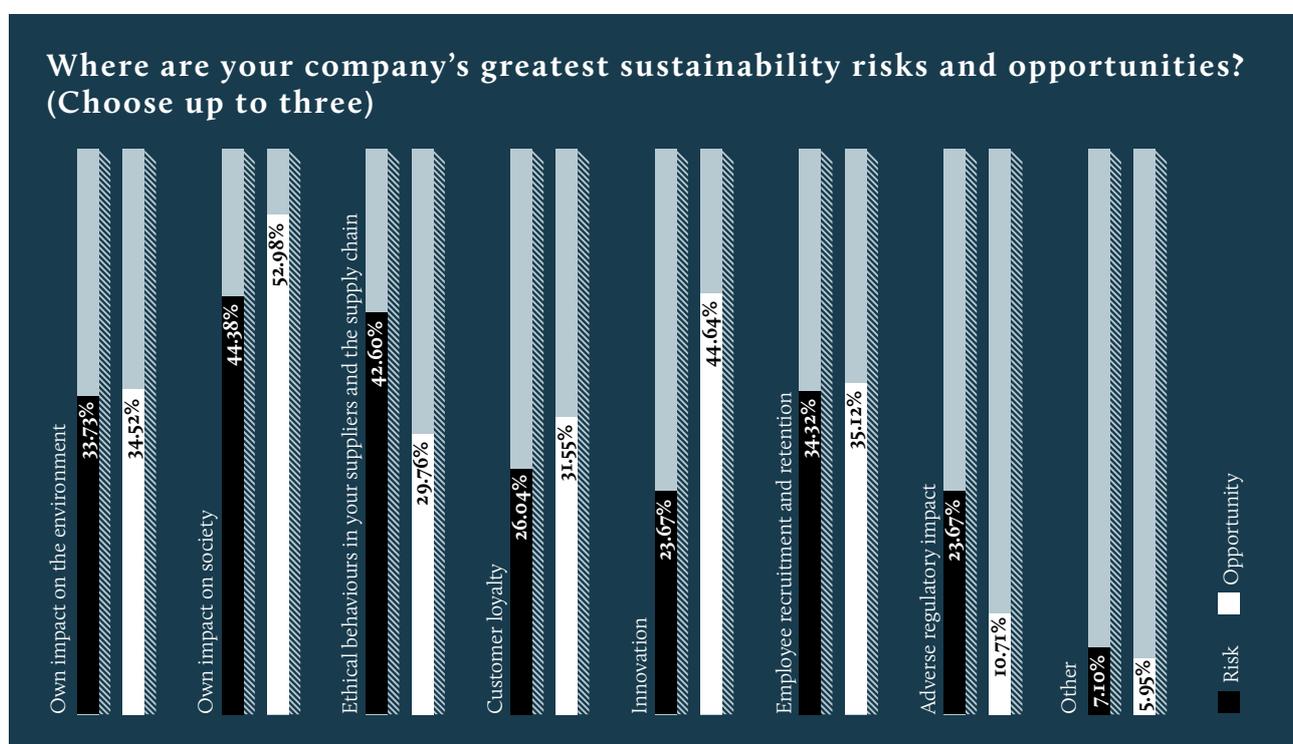
This is encouraging, but what should we make of the fifth of respondents who say that none of these options apply? Or, for that matter, the 42% who indicated that there was no separate function within the board for sustainability? One respondent commented: “We believe that sustainability must be handled as a core competence by everyone and not by an individual person or committee.” Perhaps this attitude goes some way to explaining this finding.

4. Where are the risks, where are the opportunities?

When asked where the company’s greatest sustainability risks lie, business leaders consider the company’s impact on society to be the biggest risk facing them currently. This is closely followed by the ethical behaviour of the supply chain (see earlier comments), employee recruitment and retention, and the company’s impact on the environment.

But conversely, the impact that a company can have on society is seen as the biggest opportunity, followed by innovation. Employee recruitment and retention is also seen as a good opportunity, alongside environmental impact and customer loyalty.

Sustainability opportunities and risks are explicitly considered in a number of investment areas, playing an integral part in innovation and product development, with slightly less emphasis when considering acquisitions and investments in major fixed assets, divestments even less again.



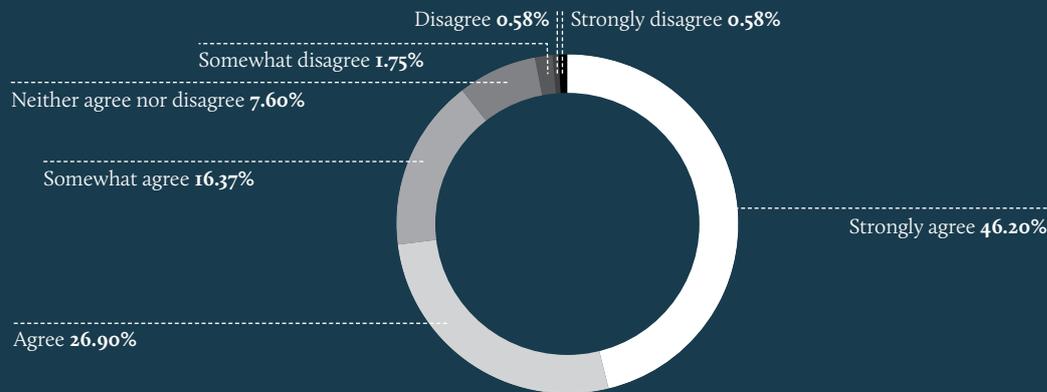
5. Out of sight, out of mind: what are the risks of ignoring sustainability?

Irrespective of where responsibility—or not—for sustainability lies within an organisation and its board, it would appear that on the face of it, business leaders believe their boards are not ignoring the issue. Indeed, nearly three-quarters agree that ignoring sustainability will affect their company’s ability to create value in the long term. As one respondent commented: “Sustainability value creation is key. Investors should walk the talk, too, and support companies in their sustainability agendas.”

A similar proportion are following the call of BlackRock’s Larry Fink to show how companies make a positive contribution to society. When asked, nearly seven out of ten respondents said their company is explicitly reporting how it makes such a contribution.

But again, there is a small but worrying number who don’t agree with these sentiments. Some 12% do not see sustainability playing a role in long-term value creation, while 17% do not believe their company is showing how it makes a positive contribution to society.

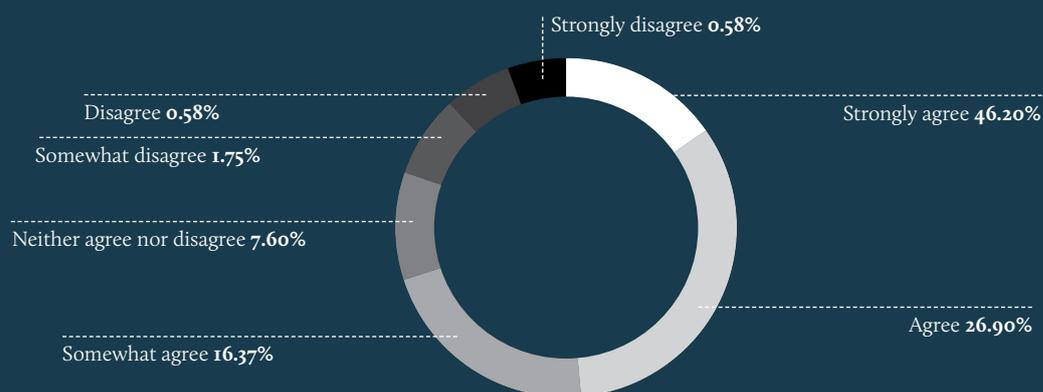
Ignoring sustainability will affect your company's ability to create value in the long term



As one respondent said: "Sustainability is spoken about often today. However, what happens on the ground... is very different from what companies actually do. This situation will change only when there is a paradigm shift among the people as a whole, when they become conscious of the importance of sustainability and act in a responsible way in relation to sustainability."

Part of demonstrating this commitment revolves around communication. Nearly half (48%) agreed that their current reporting approach delivers a comprehensive picture of their sustainability actions to investors and other stakeholders. Others were less convinced.

Your current reporting approach delivers a comprehensive picture of your sustainability actions to investors and other stakeholders

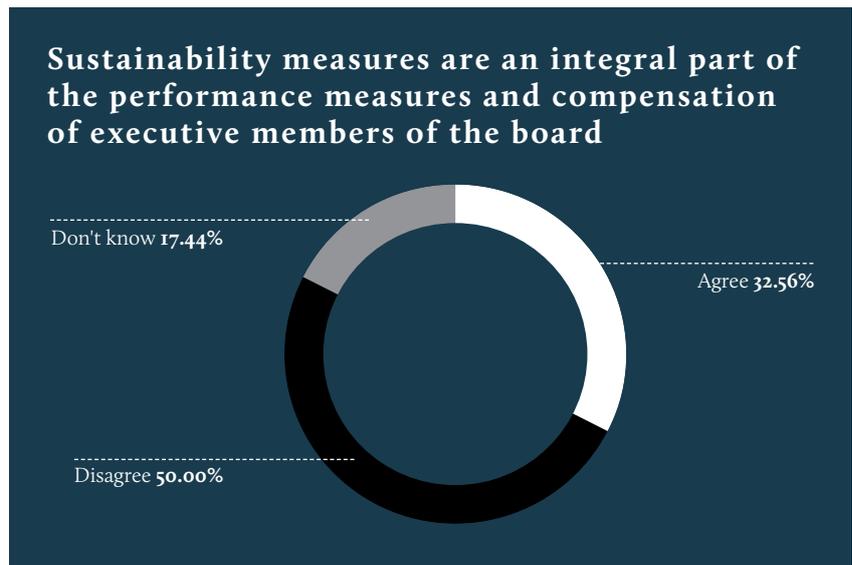


6. Does sustainability play a role in board-level recruitment?

One way to boost the knowledge and understanding of sustainability issues at board level is to ensure that the issue is built into the boardroom recruitment process. One-third of respondents claim that sustainability or a sustainability mindset are explicit selection criteria in the appointment of non-executive board members. An identical proportion agree that this is the case with executives who will also be board members.

But in each case nearly 15% disagree with this notion, both at a non-executive and executive level.

At the same time, there would also appear to be a disconnect between the desire, on the one hand, to promote a sustainability agenda, and performance measurement/ executive compensation on the other. Half of the respondents say sustainability measures do not form an integral part of executive performance measurement and compensation. Only a third say that it does, while 17% simply do not know.



One respondent commented: “Sadly I believe we need a turnover of a generation. Senior managers talk about it but create a culture of fear and rejection towards this. Compensation schemes are the best evidence of this. Ethical behaviour is not rewarded. We need fresh blood in private and listed companies.”



Conclusion

Our survey suggests that there are good grounds for optimism. Sustainability is very high on the boardroom agenda, second only to financial performance.

There are positive findings in our survey, but equally a note of caution needs to be sounded. While many board members appear to have sufficient knowledge and understanding of sustainability issues, not all do, which is why it is imperative that the issue is built into recruitment, education and reward processes.

Above all, board directors need to ensure there are no disconnects between what they believe is happening, and the reality. They need to have a clear understanding of why sustainability is a key boardroom issue—is it an end in itself or does it form part of a wider, integrated business strategy?

They need to be able to measure progress on their sustainability journey. They need the right information so that they can make informed decisions, changing course if necessary.

They need to listen to a wide range of stakeholders to understand their sustainability concerns, and get a clear picture of how their sustainability efforts impact on the wider environment.

And they need to understand where sustainability fits within the whole business strategy. Businesses and their leaders need to be on top of this if they want to be a modern, forward-looking business.

Without this, there will be a persistent gap between where the board thinks it is, and the reality. Such a position is unsustainable.

Key questions for boards

1. What is the board-level understanding of sustainability?
2. What is the board's attitude towards sustainability? Is it part of market positioning, a means in itself or part of the organisation's wider purpose?
3. What weight is given to sustainability compared with other corporate issues such as financial reporting, risk management, productivity and cultural change?
4. Where does responsibility for sustainability lie at board level?
5. How is oversight of sustainability managed?
6. How is sustainability integrated into wider risk-management processes?
7. How is the organisation's sustainability agenda communicated to stakeholders?
8. Is sustainability considered as part of any investment decision?
9. Where are the greatest sustainability risks and opportunities?
10. Does sustainability form part of a recruitment, retention and reward strategy?

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