Boards and Sustainability: From Aspirations to Action

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Boards of directors can play a critical role in determining how much attention their firms pay to sustainability. Craig Smith and Ron Soonieus explain how boards can turn their aspirations for sustainability into meaningful action, particularly in light of the fundamental questions boards should be asking in the wake of the COVID-19 pandemic.

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Champions of sustainability have long recognized the importance of 'getting the board on board' with sustainable business practices. Boston Consulting Group conducted a large-scale study which identified board action as one of eight key factors in increasing the attention businesses pay to sustainability.[1] Conversely, Paul Polman, former CEO of Unilever and principal architect of the Unilever Sustainable Living Plan, described the failure to make sustainability a board priority as one of the six major obstacles to corporate action.[2] The utility of board engagement in producing tangible results, socially or environmentally, has long been acknowledged by both sustainability groups, like the UN Global Compact,[3] and corporate governance groups, like the National Association of Corporate Directors.[4] Both reason that action is part of the fiduciary duty of board members to increase their firm's long-term value and mitigate its risks. They also argue that it is the responsibility of business to help address the urgent sustainability issues confronting humankind.

Simply put, an issue which is not on the board's agenda is unlikely to be at the heart of the organization's strategy. Yet surveys suggest that only a few boards give sustainability sufficient attention. A 2018 Ceres report on the progress of 600 large, publicly-traded U.S. companies found that only 31 percent had formally integrated sustainability into the board committee charters.[5] So why *aren't* boards more engaged with sustainability? The obstacles include misunderstandings of the fiduciary duty of directors; short term thinking, sometimes coupled with a focus on maximizing shareholder value; a belief that investors do not care; uncertainty about sustainability's financial implications; and a dearth of expertise.[6]

Yet a recent Board Agenda and Mazars survey, titled *Board Leadership in Corporate Sustainability* and developed in association with the INSEAD Corporate Governance Centre, is more encouraging. It suggests that, while board members are increasingly conscious of the need to incorporate sustainability into their broader business practice, they struggle to acquire the information, expertise, and processes that will allow them to deliver on their commitments.[7]

Nonetheless, as companies struggle with the COVID-19 pandemic, some analysts predict that they are more likely to put aside sustainability in order to focus on pressing financial concerns. While contradicting the common emphasis on taking a long term view, this change would exacerbate lack of board engagement on sustainability.

> What are boards really saying about sustainability? What are the obstacles to more effective action? What changes should be made by boards to respond more effectively to sustainability challenges?

Using the Board Agenda findings, our own interviews with twenty-five non-executive board members, and related research, we have explored how sustainability is being addressed in the boardroom. Our study examines three key questions: What are boards really saying about sustainability? What are the obstacles to their taking more effective action? What changes should be made by boards so that their companies respond more effectively to sustainability challenges?

Board Engagement Requires More Than Good Intentions

According to the Board Agenda survey, many board members believe their companies cannot succeed in the long term without supporting the communities they work in and the natural environment they depend on.

Of 234 surveyed business leaders—chief executive officers, chief finance officers, board chairs, executive and non-executive directors, company secretaries and sustainability officers—at companies of various sizes:

- 73 percent felt that ignoring sustainability will affect their company's ability to create long-term value;
- 53 percent said their board sees a solid business case for sustainability;
- 29 percent indicated that their organisations aim to be positioned as market leaders in sustainability and to use it for competitive advantage, while a further 30 percent aim to keep up with developments and be seen as strong performers.

> Only half strongly agreed or agreed that their companies had in place information and measures which allowed them to accurately quantify their company's position, ambitions, and progress with regard to sustainability.

However, these beliefs and aspirations did not necessarily extend to their firms identifying the policies which need to be in place and the information required to meet environmental and societal challenges.

Only 53 percent of respondents said that their companies' sustainability principles and intentions had been translated into effective business policies. Similarly, only half strongly agreed or agreed that their companies had in place information and measures which allowed them to accurately quantify their company's position, ambitions, and progress with regard to sustainability. While respondents exhibited some understanding of the risks and opportunities of sustainability, their responses overall suggest that boards are just beginning to recognise its complexities and the difficulties companies face in gauging and integrating sustainability measures.

Survey responses also revealed that board members had limited sustainability knowledge or expertise:

- Only a third of respondents strongly agreed or agreed that their company required sustainability expertise or mindset in appointing non-executive board members or recruiting executives who are members of the board;
- Less than 30 percent of companies have a head of sustainability who reports directly to either the board or the CEO (and more than half represented firms that did not have a head of sustainability);
- Only 17 percent reported that their boards have a dedicated sustainability committee.

To better understand the attitudes of directors toward sustainability and how often and deeply they discussed the topic during board meetings, we conducted in-depth semi-structured interviews with twenty-five experienced European non-executive directors representing fifty well-known companies.[8] In return for anonymity, our participants responded frankly, granting us rich insights into the engagement of boards with sustainability.

Five Archetypes of Board Sustainability Behaviour[9]

We distilled our analysis of the interviews to reveal five distinct behavioral archetypes of board members. Although these profiles are stereotyped simplifications of individual behaviour, they help to explain why the attitudes of board members may diverge and why sustainability issues may be buried.

While the interviews did reveal that directors tend to gravitate towards companies with like-minded board members—birds of a feather flocking together—many nonetheless found that they had very different ideas from their colleagues on how sustainability should fit with business principles and strategy. One participant had been elected to the board by employees, rather than directors, specifically to speak on environmental issues. She found herself facing an uphill struggle with the other board members. "Having the board take sustainability seriously has been a long and lonely battle," she reported.

We offer suggestions on how sustainability might be tackled where boards are predominantly characterised by a particular archetype as well as some broader recommendations for turning sustainability aspirations into effective action.

1. The Denier

We define deniers as those who see sustainability as nothing more than a buzzword or a fad that will fade away in time. In companies whose boards are dominated by deniers, sustainability is typically (at most) a page in the annual report. As one respondent put it, "If it does get onto the board's agenda, it's item number thirty-eight." Because open hostility to sustainability is largely unacceptable today, these members aren't always obvious. On their boards, environmental and social issues are conspicuous only by their absence. "In the five boards I'm on, it's almost never discussed," one director said, adding, "although most have a section in the annual report."

"In my experience, sustainability in the short run is about value destruction," another denier told us. A third described his company's attitude toward sustainability as 'the technocratic approach,' admitting, "We are listed much higher on the Dow Jones Sustainability Index (DJSI) than we think we should be. Apparently, we have become very skilled in filling-out their 300-page questionnaire."

As well as causing firms to overlook long-term risks, this approach is dangerous because it can so easily lead to greenwashing – the use of PR, marketing, or corporate communications to exaggerate the environmental benefits, or understate the environmental damage, of a company's products and services. Volkswagen's "clean diesel" advertising campaign, which ran while its vehicles were emitting up to 40 times the permitted levels of pollutants, is a salutary example.

Eroding Denial

Whether on a board largely composed of deniers or merely reporting to them, our (non-denier) interviewees argued the necessity of meeting them on their own terms. Approach sustainability, indirectly if necessary, through specific, concrete concepts like cost-reduction, business opportunities, consumer demand, or risk exposure, rather than arguing abstract notions about the wellbeing of the planet or future generations.

Choose your moment with care, being careful not to raise the issue in times of crisis. "That's when companies resort to alpha-male behavior to fix things," said one interviewee. Another advised, "Never address these things at the end of the meeting, out of the blue."

> "What drives your resistance to sustainability?"

Patience is essential. Our small sample of largely sympathetic directors agreed that one-to-one conversations about sustainability were preferable to broaching the subject with the whole board. Once you have established an amicable relationship, you may be able to bring denial out into the open. After a series of patient, rational discussions with colleagues, one participant recalled reaching the point where he could directly ask fellow directors: "What drives your resistance to sustainability?"

2. The Hardhead

Unlike deniers, hardheaded board members are ready to talk about sustainability—and in positive terms. They regard it as a factor affecting their business. But because it is only one factor among many, they tend to reduce it to strategic reasoning. How can the costs be minimized? Are there any market opportunities? If so, how can they be maximized? As one participant put it, "We do what we can, but our business is still gas."

Indeed, hardheaded board members are particularly prevalent on what might be called the dark side of sustainability. Oil and gas companies, transport operators, and agrochemical giants all take a surprisingly keen interest in the environmental and human impact of their operations, as do businesses for which health and safety are a major concern.

Our interviewees voiced several common hardhead objections to sustainability proposals:

- Society is demanding solutions, but it's not giving up our products and services;
- The end-user is not as demanding as people like to think;
- "Recyclable plastic technology is available but is very costly;
- "Who are we to say that rainforests are rainforests, when the prosperity of the local people comes from palm oil?"

It can be difficult to counter such arguments and to see their logical flaws.

Redirecting Hardheadedness

Again, it is best to confront hardheaded board members on their own terms, urging them to make their company "best in class" or to "choose a more ethically acceptable route that's not too far from existing practice," as two of our interviewees suggested. "We will never be green," said one hardhead we interviewed, "We focus on the issues we can really influence."

If your company faces a diversity of issues, you might suggest appointing a dedicated sustainability director or non-executive directors from other industries, citing the need for diversity of thought to strengthen your argument. One board member reminded us, "Sector knowledge is important for two-thirds of your board. But one-third should think differently."

> "Consider making sustainability part of the risk or strategy committee to give it more 'skin in the game'"

Hardheaded board members are nothing if not reasonable, so start with suggestions that will yield tangible results. From there, you can move on to matters which are not less important, but may be harder to grasp, such as longer-term risk. "The board started to get an interest in the environment, when it started to raise these issues from a strategic risk perspective," one director noted. "Consider making sustainability part of the risk or strategy committee to give it more 'skin in the game,'" another advised.

Sustainability is relevant to a range of existing board committees: Corporate Governance, Audit, Compensation, and Nominating Committees. Nonetheless, it must also receive some attention from the entire board.

And be ready to concede when you are beaten. As one interviewee said: "If the CEO is not interested, it's tantamount to flogging a dead horse." Giving ground temporarily isn't the same as giving up entirely. Keep track of the situation and the characters in it. You will soon learn to distinguish alpha-male deniers looking for a quick fix from ever-reasonable hardheads. Develop antennae to sense future disruption, risk, and alternative technologies that will strengthen your sustainability arguments in the board meetings yet to come.

3. The Superficial

The superficial archetype are decent folk who truly want to do their bit for society and the environment. But it's important to remember where the old saying places good intentions. Directors of this type may be well-meaning, but they are often afraid to take the lead. They may be more concerned with being *seen* to do the right thing than with actually doing it. As a result, their positive influence is often less than that of hardheaded directors. As one interviewee said, "The boards I'm on don't have a lot of interest in sustainability. They don't see it as a differentiator. But most want to be decent, nothing more, nothing less."

Superficial directors often have a shallow understanding of the need for sustainability. "The outside world is demanding CSR (corporate social responsibility) and sustainability reports or officers," said one director. "That's why we create them, not

because we see a business benefit in doing so." Their conversations about sustainability go around in circles, rather than moving forward. Superficial boards tend to pass the buck, rather than taking action.

The worst among this type of boards implicitly promote greenwashing. By talking the talk, they encourage executives to do the same but fail to build the strategic framework executives and managers need to take real action.

Turning Good Intentions into Good Results

The trick with superficial board members, according to our participants, is to play on their good intentions rather than dwelling on past failures or decisions. They often don't know where to start, so they're likely to accept carefully chosen positive suggestions. Focus on issues that relate directly to the organization's mission. A state-owned bank, for example, has a duty to serve the wider population, not just its own customers and executives. One respondent succeeded by regularly reminding fellow directors: "We can't put ourselves on the wrong side of the fence."

When their desire to do good is genuine, superficial directors are prime candidates for a dedicated sustainability committee. There, they find a safe, transitional space, where the company's most active advocates of sustainability can comfortably talk through the issues and devise concrete actions for the whole board to ratify.

4. The Complacent

Early adopters of CSR reports, green products, and responsible supply chains often have not kept up with the latest thinking on sustainability. Not wanting to disrupt the deeply ingrained habits of their business, directors in this group are often reluctant to talk about sustainability. They may use past sustainability triumphs to shut the conversation down. Complacent board members invariably let good practice obstruct *best* practice, often causing the board to do even less than a superficial board.

Rousing the Complacent

Most importantly, one director told us, "Don't embarrass people, policy, and decisions of the past 20 years." When speaking with complacent directors, focus on small actions, rather than proposing a wholesale strategic review. In recruiting a new CEO, for example, try to include sustainability credentials among the recruitment criteria. Rather than rehashing the past, focus on calling attention to current consequences and errors, like greenwashing, as they arise.

Form coalitions with like-minded directors. Try to move the debate away from past work and into the present, urging the board to regain some of its old spirit and its members to become true believers once more.

5. The True Believers

These directors are not defined by the *strength* of their belief, but by their understanding of sustainability. True believers, like former Unilever CEO Paul Polman, link the long-term economic viability of their organizations inextricably to social and environmental responsibility.

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True believers may initially resemble the hardheaded in their adherence to careful analyses of the benefits and disadvantages of sustainability. Unlike hardheads, though, they take a truly long-term approach to governance. They recognize the enormity of the challenges facing the planet and society and of the fundamental changes businesses must make if environmental and human concerns are to be among their innate drivers, deeply integrated in company strategy.

As one participant from a board of true believers put it:

> "Sustainability is no longer only about the environment, no longer a tick-box exercise. It has developed into a more holistic and broader view that you could call long-term value creation. The question is always: Are our products and business models future-proof?"

Another said, "Sustainability is not a goal on its own but rather a framework that guides strategy execution and the creation of long-term value."

Challenges with True Believers

Yet true believers are also not without their challenges; they all too readily become their own worst enemies. Our interviewees pointed out that true believers need to be encouraged to carefully consider how best to engage with those who have not prioritized sustainability to the same extent. They may also risk becoming overinvolved in sustainability and neglecting economic constraints, albeit from a long-term perspective.

Reviewing and Communicating Your Sustainability Strategy

Our interviews highlighted the many different attitudes to sustainability between boards, and between board members. While some directors have only limited interest in sustainability, others understand more deeply their responsibilities and the sustainability changes their companies need to make. Of the latter, some believe they have done enough while others strive for a greater impact. In both cases, accepting the critical need for sustainability is not an end unto itself; boards still grapple with how to move forward.

These conflicts, as well as the frustrations of board members who struggle to translate broad commitments into action, are apparent in the Board Agenda report. "In too many cases, company boards are struggling to articulate a strategic narrative … Many suffer from a real dissonance in their strategy, where they can see the need for significant—even transformative—change at some future point, but simply tinker around the edges of business-as-usual in response to the commercial pressures of today," reports Tom Dellay, CEO of Carbon Trust.[10]

Of course transformative change is easier to achieve in some environments than others. Research suggests that directors of privately held companies can more easily take a long-term perspective than those of publicly traded organizations whose earnings are closely scrutinized and whose stocks sell in milliseconds. Family-controlled businesses enjoy both the luxury and the challenge of looking generations ahead. And, of course, transformation may be easier for more profitable businesses.

Still, businesses of any kind can keep sustainability on the board's agenda and ensure that directors not only initiate sustainable practices, as required, but also demonstrate, to employees, investors, customers, and other stakeholders, how today's actions can affect the profitability and future of the business and the planet.

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Historically business has often sat on the sidelines, adopting sustainable practices only to increase competitiveness and meet stakeholder pressure or regulatory requirements. This behavior is changing rapidly, as consumers and other stakeholders increasingly demand substantive change. Meanwhile escalating human development and environmental challenges overwhelm governments and international bodies. We are reaching the stage where the cost of inaction will impact not only an organisation but the very environment in which it operates.

It is one thing to have sustainability on the agenda, but it is something else to identify what sustainability really means to a company. Sustainability is a broad term and understandings of what it entails can differ widely between directors on the same board as well as between different firms. It is increasingly associated with questions of value creation and company purpose. Just how this is incorporated into the firm's core products, business model, and innovation strategy, are all considerations which demand the attention, drive, and decision-making of a well-informed board.

COVID-19 Changed Nothing (and Everything)

Many have been quick to conclude that, in the wake of the COVID-19 pandemic, the priority will be the economic recovery of individual companies and whole economies, and that sustainability will have to take a back seat. However, other voices suggest that the pandemic could, instead, increase our attention to sustainability, and especially climate change.

Our ongoing work has revealed a similarly polarized perspective on the crisis in corporate boards. Perhaps crisis really does reveal a person's true identity, or a board member's true archetype. One director told us "we are fighting to survive; sustainability is not on our priority list," while another said "COVID-19 shows us that ESG considerations are increasingly material to our ability to create value sustainably. It makes it very clear that in order to become more resilient we have to take a much more holistic view on our place in the world and the risks we are facing."

According to Klaus Schwab, founder and Executive Chairman of the World Economic Forum: "The COVID-19 pandemic and resulting humanitarian and economic crisis have reminded us that firms are themselves stakeholders in the sense that they have an intrinsic interest in and shared responsibility for the resilience and vitality of the economic, social, and environmental systems in which they operate."[11]

And businesses have leapt to help in many ways, adapting production lines to make desperately needed protective clothing and

ventilators. Struggling businesses have received assistance from governments, while public pressure to attach 'build-back-better' conditions to that money increases daily.

Indeed COVID-19 is throwing the interdependence between business, governments, and society into sharp relief, emphasizing the need to integrate corporate strategy, governance, and decision-making.

And many investors seem to agree. According to a study by Boston Consulting Group,[12] 48 percent of investors think it is important for healthy companies to continue their ESG agendas and priorities while navigating the crisis, even if it means lower earnings. These investors understand that sustainability may briefly take a backseat at firms in urgent need of liquidity, but they won't accept it for long. According to one investor, "We are keeping an eye. We will give them a few months to sort things out, but we will put ESG back on the agenda in the fall."

Their urgency makes sense. There is growing evidence that firms with high ESG integration will better withstand the crisis and subsequent economic downturn. And ESG funds are outperforming benchmarks.[13] According to Morningstar, these "are the quality companies of the 21st Century, and quality companies tend to hold up better than their lower-quality counterparts in difficult markets."[14]

"The fundamental nature of our role has not changed: we look after the company's long-term interest and survival. Covid-19 made us realise however that *how* we do that and *what* we should take into account has to change fundamentally."

So, has COVID-19 changed the role of the board? Yes and no. "The fundamental nature of our role has not changed," one participant told us, "we look after the company's long-term interest and survival. COVID-19 made us realise however that *how* we do that and *what* we should take into account has to change fundamentally."

It is increasingly clear that boards that disregard sustainability and their companies' responsibility to a broad range is stakeholders are neglecting good governance, at the very least. COVID-19 is not likely to be the only global crisis businesses will face. We have a responsibility to learn from it, better equipping ourselves to respond to the threat of climate change and other sustainability challenges.[15]

Allowing our view of what is financially material to remain static is no longer sufficient. Materiality is (and indeed has always been) dynamic and changes now with increasing speed.[16] Directors must learn to understand why ESG issues are financially material over time and adapt to those changes. Boards are increasingly crucial in overseeing how their company anticipates, deals with, and recovers from systemic externalities like financial crisis, climate change, and the next pandemic.

A good board must plan and act simultaneously to handle both current events and future ones. "We have been hit very hard by the COVID-19 crisis and we are fighting to survive," one director told us. "At the same time, we have put together a sub-committee of two directors, two senior executives, and a small support team to look at strategic options this crisis may open up for us."

Recommendations for Engaging Boards More Deeply with Sustainability

So, what can boards do to turn their sustainability aspirations into action? We suggest six approaches which we illustrate with some of the often-difficult questions board members should be asking. If anything, the COVID-19 pandemic has created a greater opportunity to ask these fundamental questions.

1. **Revisit** company statements of purpose.
   - What does value creation mean to your company?
   - Does your company have a comprehensive view of how the world is changing, not least given COVID-19, and of its role in that changing world?
   - How is your company supporting societal progress and does your corporate culture encourage participation?
   - Are your company's efforts consistent with current sustainability demands and principles?
   - Are they in line with the UN Sustainable Development Goals?
2. **Schedule** a meeting of the entire board with the sole purpose of discussing sustainability. Ask the CEO to provide all pertinent information and data on the company's sustainability progress. Compare leading edge sustainability practices with your own, ensuring ample time for in-depth discussion of:
   - The process by which your company identifies risks and opportunities into the medium- and long-term. Is it robust enough, taking the possibility of systemic risks and shocks (like pandemics) into account?;
   - Gaps between the organization's current sustainability practices and those it should have;
   - Existing strategies for reaching those goals, and strategies needed for future development;

- The board's sustainability priorities for short- medium- and long-term attention, and the intersections between these and the board's understanding of the company's purpose.

3. **Audit** the sustainability expertise and mindset of board members.
   - Which sustainability archetype predominates on your board?
   - Do the directors have sufficient expertise and interest to embed sustainability thinking in their processes, risk management, and investment decisions, including mergers, acquisitions, and innovation?
   - Does the board need to recruit new members, perhaps with specialist expertise?
   - How should the board's membership evolve to make sustainability a priority?
4. **Organize** the board in such a way that it can effectively oversee sustainability.
   - Which board committees should concern themselves with sustainability?
   - Should there be a dedicated sustainability committee and, if so, how will it report to the main board?
   - Does the board have a process by which to plan and act in accordance with a range of events on different timescales, including in times of crisis?
   - Would it help for an independent expert panel to scrutinize the board's actions and progress?
5. **Evaluate** the information provided to the board on sustainability.
   - Is there a suitable balance between attention to efficiency and resilience?
   - What information does the board currently have and what further information does it need?
   - Does the board have benchmark data by which to judge its performance and that of competitors?
   - Has the board established suitable key performance indicators (KPIs) for management?
   - Does the board need additional resources to better understand or investigate the firm's sustainability performance?
6. **Explore** how the firm engages with, and learns from, its critics—NGOs and others. Does the board need to hear from them directly?

Providing board oversight in the 21st century requires deep integration of sustainability and ESG factors in corporate strategy, governance, and decision making. Our six approaches, coupled with an appreciation of board director archetypes, should help boards to consider at minimum whether they are best equipped in developing a comprehensive view of where – and to what extent – the materiality of ESG factors is changing and how that may influence financial performance. Equally, it should help them better address the pressing sustainability challenges that affect the communities in which they operate. This is increasingly required to drive long-term growth and profitability. Many customers, investors, and other key stakeholders have come to expect it.

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