

Steward of the Corporate Conscience-

The Evolving Role of the Governance Professional in 21st Century Organisations:

Could organisations more proactively address environmental, social and governance issues before being required to do so by regulation? How might this be achieved and what do you see as the role of the governance professional?

I. Introduction:

Organisations can more proactively address environmental, social and governance ('ESG') issues before being required to by regulation; in fact, organisations must do so, to ensure long-term value and sustainable performance. In this essay, I will illustrate how simultaneously aligning discrete, employee-level initiatives and broader, executive-level priorities can help address ESG risks. Firstly, I will provide a high-level overview to contextualise the interconnectedness of corporate governance and corporate-social responsibility ('CSR'). Then, I will examine how improved information analytics, a "top-down" purpose-led strategy, and integrated reprioritisation across the corporate structure can contribute to a change in organisation values. Finally, I will assess the role of the governance professional in driving this evolving commercial landscape.

I.i. Contextualization of the Question:

Successful, sustainable corporate governance requires accountability and transparency;¹ this can be achieved within organisations through the implementation of a legislative framework and the distillation of aligned values. A regulatory framework provides rules defining the legal standards (national and international) with which an organisation must comply. Creating and cultivating a corporate conscience will ensure shared values manifest in the daily interactions and behaviours of members of an organisation.²

Organisations comply with regulations, because non-compliance may result in fines, sanctions or the loss of goodwill. These consequences would directly impact an organisation's profitability, reputation and ability to operate in their particular industry. Customers and clients who directly engage with an organisation must trust the quality of goods and/or services provided—an organisation must create value for its consumers. More broadly, an organisation must also add value to the society it exists in; "to prosper over time, every company must not only deliver financial performance but also show how it makes a positive contribution to society".³ As such, organisations have slowly begun to rely on a "triple bottom line" model—considering people, the planet and profits. Successful ESG practices, directly and indirectly, impact how an organisation is viewed by consumers, within the industry, and more broadly, in society.⁴

¹ Jane Taylor, 'Creating Sustainable Value from Good Governance' (KPMG; Sustainable Business Council 2018) <<https://assets.kpmg/content/dam/kpmg/nz/pdf/October/guidance-creating-sustainable-value-from-good-governance.pdf>> accessed 20 November 2019.

² Alfred Farha, 'The Corporate Conscience and Environmental Issues: Responsibility of The Multinational Corporation' (1990) 10 *Northwestern Journal of International Law & Business*.

³ PwC Governance Insights Center, 'ESG In the Boardroom: What Directors Need to Know' (PricewaterhouseCoopers LLP 2019) <<https://www.pwc.com/us/en/services/assets/pwc-esg-directors-boardroom.pdf>> accessed 10 December 2019.

⁴ In this essay, "organisations" refer to for-profit corporations. Nonetheless, it is possible to extrapolate the framework offered in this essay to not-for-profits and charities as these organisations also acquire and maintain financing from investors. These organisations must also responsibly manage profitability and productivity.

II. How Can Organisations Proactively Address ESG issues?

The proactive management of ESG issues (before being required to do so by regulation) is possible. Gathering, processing and reporting ESG information, helps organisations predict and manage risks, and thereby develop solutions to enable value creation. The specific implementation of such an approach depends on the unique commercial and industrial context of each organisation.

II.i. ESG Data and Reporting:

It is critical to gather data for analysis and develop a robust system for disclosing ESG issues.

To manage ESG-issues, corporations must consider global guidelines (i.e.; OECD Guidelines for Multinational Enterprises and The Ten Principles of The United Nations Global Compact), sectoral frameworks and the organisation-specific context (i.e.; geography, history, ownership structure).⁵ Data can be collected using key performance indicators ('KPIs') and standardized industry metrics (such as those provided by the Sustainability Accounting Standards Board ('SASB')). KPIs (including, though not limited to: human rights indicators; labour relations indicators; environmental management indicators; anti-bribery and corruption practice indicators) will help an organisation gauge standards and measure progress over time. Moreover, organisations must leverage and adapt existing information-technology infrastructure to measure ESG performance. As digitalisation and automation evolve, software and programmes used to assess financial information should also assess ESG metrics. Developing internal systems that allow for integrated ESG information-reporting in a format that is comparable to financial information, will allow for a consistent comparison of both metrics. Furthermore, organisations must actively engage with auditors to have assurance on ESG performance and financial performance.

The aforementioned SASB is an ESG-related reporting system, in which: "public corporations [can] disclose financially material information to investors in a cost-effective and decision-useful format".⁶ To undertake such reporting processes, organisations must begin to consider ESG-issues "financially material" risks and therefore develop rigorous assessments of these risks. A high-quality and robust internal ESG risk-identification and reporting system, will enable organisations to convert identified risks into business opportunities and communicate its strategy for growth with investors. Developing the aforementioned interconnected system of risk analysis will require organisations to dedicate resources to encourage collaboration across business functions (compliance, human resources, risk, finance & accounting, legal, operations) to understand how these risks can be best transformed as well as to the research and

⁵ Threadneedle Asset Management Ltd, 'Environmental, Social and Governance Indicators and Key Issues Reference Document' (Columbia Threadneedle Investments 2016) <https://www.columbiathreadneedle.com/media/4956293/en_esg_indicators_and_key_issues.pdf> accessed 20 November 2019.

⁶ PwC Governance Insights Center (n 3); (*Sustainability Accounting Standards Board*, 2019) <<https://www.sasb.org/>> accessed 20 November 2019.

development of solutions (i.e.; sustainable products and services to generate revenue; capital allocation towards ESG-relevant factors). Ultimately, conducting consistent data analysis will enable organisations to both, benchmark and improve reporting in the future, and, practice transparency through proactive disclosure.

II.ii. Redefining Organisational Strategy:

When an organisation views sustainable practices as a method for cultivating a comparative advantage, it may develop a business strategy that aligns with this aim.

An organisation that is associated with harmful environmental practices, human rights violations, poor working standards or unsustainable commercial processes is likely to face challenges in business operations.⁷ In the late 1980s, Toyota began to manufacture hybrid engines, thereby reducing the company's dependence on rare-earth metals, as well as the related financial and operational risks.⁸ In the 1990s, Nike was widely criticised for allegedly abusive labour practices, especially in South Asian factories.⁹ In response, the organisation decisively improved transparency (a key corporate governance principle) by publishing a report detailing factory contracts, salaries and conditions. At present, Unilever's "Sustainable Living" programme¹⁰ decouples "growth and output as well as reduces its resource footprint by focusing on waste reduction, resource efficiency, sustainability innovation and ecological sourcing".¹¹ These deliberate changes by multi-national corporations illustrate an intention to refine and preserve their "social licence to operate".¹²

Almost all jurisdictions rely on a "comply or explain" approach to corporate governance, whereby non-compliance must be accounted for via an organisation's reporting. By incentivizing a values-based shift within the organisation, individuals are likely to comply with existing legislative standards and also champion innovative approaches to proactively identifying and managing ESG issues—thereby, fostering

⁷ Knut Haanaes, 'Why All Businesses Should Embrace Sustainability' (*IMD Business School*, 2016) <<https://www.imd.org/research-knowledge/articles/why-all-businesses-should-embrace-sustainability/>> accessed 24 November 2019.

⁸ 'The Story Behind the Birth of The Prius, Part 1' (*Toyota Motor Corporation Official Global Website*, 2017) <<https://global.toyota/en/prius20th/challenge/birth/01/>> accessed 24 November 2019.

⁹ World Business Council for Sustainable Development, 'The State of Corporate Governance in The Era of Sustainability Risks and Opportunities' (Gordon and Betty Moore Foundation 2019) <https://docs.wbcsd.org/2019/03/WBCSD-The_state_of_corporate_governance_in_the_era_of_sustainability_risks_and_opportunities.pdf> accessed 25 November 2019, p.18.

¹⁰ 'The Unilever Sustainable Living Plan' (*Unilever UK & Ireland*, 2019) <<https://www.unilever.co.uk/sustainable-living/the-unilever-sustainable-living-plan/>> accessed 10 December 2019.

¹¹ Knut Haanaes (n 7).

¹² Olivier Jan, 'The Board And ESG' (*CorpGov.law.harvard.edu*, 2019) <<https://corpgov.law.harvard.edu/2019/02/25/the-board-and-esg/>> accessed 10 December 2019.

the corporate conscience. Encouraging regard for the legal and social licence to operate, is likely to “avoid mechanical ‘box-ticking’ and encourage companies to become more accountable and transparent in the marketplace”.¹³ To create organisation-wide change, sustainability must be prioritised by the senior management (C-Suite) and the Board of Directors. When executives formally embed sustainability within business practice, the organisation’s cultural narrative is likely to also shift to create a robust linkage between immediate financial returns and long-term reputation-building. Ultimately, cultivating such a deeply-rooted internal organisational focus on responsible corporate governance can catalyse a cycle of proactive investment in sustainable practices.

II.iii. Integrated Change across Organisational Structure:

Cultivating a corporate conscience that influences an organisation, requires all members of the organisational hierarchy to become active stakeholders in the organisation’s success and remain accountable to one another.

Firstly, the Board of Directors must compose a “Statement of Purpose” to address ESG-issues; this will provide intergenerational organisational obligations and create a framework for evaluating and rewarding future decision-making. At present, a new generation entering the workforce will often consider the extent to which their potential employer’s culture and mission are consistent with their personal values.¹⁴ Therefore, it is likely that employees will be motivated to contribute to an organisational purpose that focuses on ESG matters. When performance is measured against ESG-metrics, an organisation communicates that process and outcome are equally important—for instance, through acknowledging and rewarding socially and environmentally conscious innovation (regardless of immediately apparent commercial value). Secondly, organisations must actively engage stakeholders and investors. An integrated report will analyze the material effect of ESG-issues on financial performance, assessing how the organisation’s strategy and governance align with performance and value creation. The International Integrated Reporting Council and CECP’s Strategic Investor Initiative advocate for such an approach.¹⁵ Notably, investors employ shared strategies when considering sustainable investment options, including: exclusionary screening (of companies in objectionable industries); norms-based screening (of companies that violate international guidelines, such as the UN Global Compact); best-in-class screening (of companies with strong ESG performance history); and, impact investing (engaging with companies that make a positive impact on ESG issues while also earning a high market return).¹⁶ To attract and retain

¹³ World Business Council for Sustainable Development (n 9), p. 32.

¹⁴ Olivier Jan (n 12).

¹⁵ Robert G. Eccles and Svetlana Klimenko, 'The Investor Revolution' [2019] *Harvard Business Review* <<https://hbr.org/2019/05/the-investor-revolution>> accessed 10 December 2019.

¹⁶ Robert G. Eccles and Svetlana Klimenko (n 15).

investment, it is imperative that organisations transparently communicate their purpose-led strategy and the (measurable) growth being achieved in this regard. Thirdly, it is critical to leverage middle management to identify ESG-concerns and strategise on the administration of ESG-solutions. These individuals provide a connection in the organisational hierarchy between the executive-level (who plan how to address ESG-issues), and the front-end employees (who must alter their actions in the delivery of product and service innovations). Mobilising middle management encourages a multi-dimensional, shared responsibility within the organisation; fostering understanding amongst these employees about the importance of ESG-focused solutions creates a trickle-down effect. These individuals will encourage their teams to take initiative for meeting ESG-related goals for shareholders, and serving society. Governance professionals occupy a critical role in openly communicating with the middle management to outline the material ESG-issues that impact the business, in rewarding middle management on financial and ESG-based performance, and making upward mobility within the organisation partly contingent on success in meeting ESG targets.

III. The Evolving Role of the Governance Professional:

It is imperative that governance professionals view themselves, and are viewed by their colleagues as stewards of the organisation's long-term values. As proposed by Eckstein and Parchomovsky, there must be a transition towards the recognition of a fiduciary duty “among directors and corporate officers vis-à-vis one another”.¹⁷ Notably, recent legal opinions and regulatory guidelines across various jurisdictions indicate that ignoring how ESG factors impact financial returns, is a violation of fiduciary duty.¹⁸ A broader view of fiduciary duty would be: that the corporate governance professional exercises influence to reconcile the interests of various stakeholders (including shareholders), and collaborates with other executives to align these interests with the strategy, aims and corporate governance framework of the organisation.

This redefined conceptualisation of fiduciary duty can be extrapolated to understand how a governance professional may adapt and include ESG principles into the organisation policy before being required to do so by regulation. Accordingly, the role of the governance professional is to be a steward, and to enable stewardship amongst others to ensure the appropriate management of resources and, promote the manifestation of organisation values. In doing so, the organisation could proactively address ESG-issues before being required to do so by regulation. Functioning under a fiduciary duty to other directors and stakeholders would develop a system of trust within the organisation, and thereby encourage and enable governance professionals to implement a structure-wide, “values-based” corporate conscience.

¹⁷ Asaf Eckstein and Gideon Parchomovsky, 'Toward A Horizontal Fiduciary Duty in Corporate Law' (*Corpgov.law.harvard.edu*, 2018) <<https://corpgov.law.harvard.edu/2018/03/24/toward-a-horizontal-fiduciary-duty-in-corporate-law/>> accessed 25 November 2019.

¹⁸ Robert G. Eccles and Svetlana Klimenko (n 15).

Governance professionals can ensure that oversight and individual action occurs simultaneously. On a micro-level, governance professionals must conduct training and plan meeting agendas with stakeholders across the organisation in a manner that guides behaviour, and decision-making. On a meso-level, governance professionals can leverage their role in the senior management tier to draft policies that reflect the social purpose and corporate conscience, while supporting and advising executives and the Board to embrace CSR within organisational operations. Furthermore, on a macro-level, governance professionals must remain attentive to the changing demographics and socio-political landscape influencing the organisation. As public priorities and concern towards issues vary, it will be necessary for governance professionals to proactively identify these areas and champion solutions in advance of increased future regulation.

The role of the governance professional will be multi-dimensional and evolving. It will be critical to collaborate with a diverse team of stakeholders across the organisation, to predict potential ESG issues and risks, innovate sustainable solutions to be integrated within the organisation and take an active role in the organisation decision-making to influence future corporate strategy.

IV. Conclusion:

To proactively manage ESG-related issues and achieve change across the organisation, there must be engagement with all levels of employees to consistently identify risks, innovate solutions and measure progress. Integrating data analysis and reporting within the long-term organisation purpose, and communicating goals with stakeholders and the community, are useful strategies in delivering ESG-related solutions.¹⁹ Instead of limiting sustainability teams to particular projects, and isolating action to manage specific threats, organisations should integrate solutions to ESG-related risks as part of the long-term business strategy. Currently, investors increasingly expect organisations to develop sustainable practices that complement regulatory requirements. To meet this market-demand and bolster an organisation's reputation, executives must construct a purpose-led corporate narrative; doing so, integrates the value created by sustainable practices within the corporate culture, and furthermore, parallels this value with financial returns. Chair of The Sustainable Business Council, Jane Taylor, aptly stated, “an organisation needs to stand for something it believes in, going beyond profit and impacting society”;²⁰ governance professionals can and must, proactively champion the development of an organisation's corporate conscience.

¹⁹ PwC Governance Insights Center, 'Mind the Gap: The Continued Divide Between Investors and Corporates On ESG' (PricewaterhouseCoopers LLP 2019) <<https://www.pwc.com/us/en/services/assets/pwc-esg-divide-investors-corporates.pdf>> accessed 10 December 2019.

²⁰ Jane Taylor (n 1).

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