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THE SUSTAINABILITY IMPERATIVE AND GOVERNANCE: UNDERSTANDING A NEW FRONTIER IN CORPORATE BOARD OVERSIGHT

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From its birth in the mid-nineteenth century, the modern corporation has undergone many changes and adjustments to reflect shifts in economic and social ethics and values. Now, another reorienting moment for companies is upon us. The change, this time, is coming from the gradual and forceful buildup of the importance of enterprise sustainability.

The force of sustainability, added to the worldwide growth in civil society activism that has preceded it, is contributing to a re-centering of the corporation as a stakeholder in society. Tough global social issues are increasingly seen as responsibilities for businesses as well as governments, and innovative business leaders are viewing these problems as growth opportunities. This provides an occasion to rebuild trust that is good for business and good for society.¹ As the top stewards of the corporation, the boards of directors should be involved in these efforts to restore the standing of business as a social as well as an economic contributor.

In this Essay I argue that (1) sustainability is a business and social phenomenon that matters; (2) sustainability lacks adequate corporate governance attention, often prompted by misconceptions about its significance to governance and reflecting a generally poor understanding of their relationship, and that (3) companies that lack experience in this arena can take simple steps to strengthen their governance of sustainability—with the added benefit that doing so will help business regain public trust,

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1. According to a recent GlobeScan poll, American public support for the free market economy has dropped sharply in the past year, and is now lower than in China. Large business in the U.S. enjoys less public confidence than almost any other institution save the U.S. Congress. *See Sharp Drop in American Enthusiasm for Free Market, Poll Shows*, GLOBESCAN (Apr. 6, 2011, 12:00 AM), http://www.globescan.com/news_archives/radar10w2_free_market/; Lydia Saad, *Congress Ranks Last in Confidence in Institutions*, GALLUP (July 22, 2010), <http://www.gallup.com/poll/141512/congress-ranks-last-confidence-institutions.aspx>.

a trust that has substantially depreciated during the recent financial crisis and recession.

I. SUSTAINABILITY MATTERS

To understand why sustainability represents a new frontier for business in general and for board oversight in particular, we need to review the late history of its rise. In recent years, months, and now almost weekly, a steady stream of academic, government, business and general interest studies, articles, and reports have documented a seismic shift in public and business awareness of sustainability in the United States.² This shift has coincided with increased global sensitivity to climate instability as a motivating influence to innovate economic and business growth models with sustainability at their core.³

The scope and breadth of sustainability's significance is reflected in the definitions companies use to express it. Though a precise common definition has yet to emerge, we can look to the definitions used by four diverse companies to capture its magnitude and common elements:

Baxter: "We define sustainability as a long-term approach to including our social, economic and environmental responsibilities among our business priorities."⁴

Ford: "We define sustainability as a business model that creates value consistent with the long-term preservation and enhancement of environmental, social and financial capital."⁵

Stora Enso: "Sustainability is the term we use to describe economically, socially and environmentally responsible

2. See UN GLOBAL COMPACT & GOLDMAN SACHS, CHANGE IS COMING: A FRAMEWORK FOR CLIMATE CHANGE - A DEFINING ISSUE OF THE 21ST CENTURY 7 (2009); Ram Nidumolu, C.K. Prahalad & M.R. Rangaswami, *Why Sustainability is Now the Key Driver of Innovation*, HARV. BUS. REV., Sept. 2009, at 56; Maurice Berns et al., *The Business of Sustainability: What It Means to Managers Now*, MIT SLOAN MGMT. REV., Fall 2009, at 20; KPMG INT'L, CORPORATE SUSTAINABILITY: A PROGRESS REPORT 3 (Apr. 2011) (produced in cooperation with The Economist Intelligence Unit) [hereinafter KPMG PROGRESS REPORT]; PROGRAMME FOR SUSTAINABILITY LEADERSHIP, UNIV. OF CAMBRIDGE, A JOURNEY OF A THOUSAND MILES: THE STATE OF SUSTAINABILITY LEADERSHIP 2011 (Apr. 2011).

3. See ORG. FOR ECONOMIC CO-OPERATION AND DEV. (OECD), TOWARDS GREEN GROWTH 3 (May 2011).

4. *Sustainability*, BAXTER (2011) http://www.baxter.com/about_baxter/sustainability/.

5. *Ford Motor Company Issues its 8th Annual Sustainability Report*, Ford Motor Company (Jun. 28, 2007), http://media.ford.com/article_display.cfm?article_id=26255.

business operations. These three aspects need to be in balance for our business to be successful.”⁶

Walmart: “At Walmart, we know that being an efficient and profitable business and being a good steward of the environment are goals that can work together. Our broad environmental goals at Walmart are simple and straightforward: To be supplied 100 percent by renewable energy; [t]o create zero waste; [t]o sell products that sustain people and the environment.”⁷

An increasing body of findings attests to how these understandings of sustainability have made a powerful burst onto the business and global policy scene. Research on the views of Chief Executives conducted in October 2009 by the Business Council in collaboration with The Conference Board found that almost two-thirds indicated that sustainability has reached a tipping point and has become a mainstream concern for business.⁸ An even larger 81% agreed that “business leadership will increasingly be judged by the ability to create enterprises that are economically, socially, and environmentally sustainable.”⁹

In 2011, the IBM Institute for Business Value interviewed 320 global companies and concluded that today enterprise sustainability is a strategic imperative and “[n]o longer just a matter of legal compliance or philanthropic generosity.”¹⁰ IBM found that a leadership group of 15% of companies had a sustainability program as a core part of their business strategy designed to generate competitive advantage.¹¹ Another 43% of companies surveyed have sustainability programs in progress but are not addressing all aspects and opportunities.¹² One quarter said

6. *Our Approach*, STORA ENSO, <http://www.storaenso.com/responsibility/our-approach/Pages/test.aspx> (last updated Apr. 21, 2011).

7. *Sustainability*, WALMART STORES, <http://walmartstores.com/Sustainability/> (last visited Nov. 1, 2011).

8. BUSINESS COUNCIL SURVEY OF CHIEF EXECUTIVES & THE CONFERENCE BOARD, CEO SURVEY RESULTS: MEMBERS EDITION 9 (Oct. 2009).

9. *Id.*

10. *Driving Performance Through Sustainability*, IBM, <http://www-935.ibm.com/services/us/gbs/thoughtleadership/ibv-performance-through-sustainability.html> (last visited Nov. 1, 2011). IBM surveyed and interviewed executives at 320 global companies representing 26 industries in 31 countries. See IBM INST. FOR BUS. VALUE, DRIVING PERFORMANCE THROUGH SUSTAINABILITY: STRATEGY, SYNERGY AND SIGNIFICANCE 2 (2011), *available at id.* (follow the “Download the complete IBM Institute for Business Value study” link) [hereinafter IBM DRIVING PERFORMANCE REPORT]. The companies surveyed are at varying levels of progress in their sustainability programs. *Id.* at 7.

11. IBM DRIVING PERFORMANCE REPORT, *supra* note 10, at 7.

12. *Id.*

their initiatives are at advanced stages of implementation.¹³ KPMG International and The Economist further reported in 2011 that sustainability was “a powerful undercurrent running through the pages of the business media, an almost compulsory topic of discussion at meetings of business leaders, and among the most thoroughly researched business issues of the past decade.”¹⁴

II. A GOVERNANCE “DEFICIT”

Despite these developments, there is evidence of a governance deficit on sustainability. One of the causes might be that the sustainability aim of creating long-term value, while balancing the business need for profit with the ethics of social and environmental responsibility, is uncharted territory for traditional compliance-oriented corporate governance practice. This practice is based more on meeting short-term shareholder rights and expectations and less on corporate sustainability and responsibility for the long haul. Perhaps because of this, many companies still lack the structural framework to enable proper director oversight of enterprise sustainability, and it lags in receiving adequate boardroom attention.

For example, a 2011 survey of public companies conducted by The Conference Board in collaboration with NASDAQ and NYSE Euronext found that less than 13% of manufacturing companies have established a standing board committee dedicated to environmental and social issues, and the percentage is even lower for companies providing financial services and non-financial services (5.4% and 5.5%, respectively).¹⁵ Another study published by The Conference Board in 2011 found that many U.S. public companies do not employ any of the existing standards to quantify and report on social and environmental initiatives; often, these organizations use their own definition of sustainability, which limits the ability of investors to compare performance across companies and industries.¹⁶ In the traditional governance models, the corporation’s primary focus is on shareholder value rights and the operating decision rule is based on

13. *Id.*

14. KPMG PROGRESS REPORT, *supra* note 2, at 3.

15. MATTEO TONELLO & JUDIT TOROK, THE CONFERENCE BOARD, THE 2011 U.S. DIRECTOR COMPENSATION AND BOARD PRACTICES REPORT, Research Report R-1486-11-RR, at 107 (2011) (produced in cooperation with NASDAQ and NYSE Euronext).

16. MATTEO TONELLO, THE CONFERENCE BOARD, SUSTAINABILITY MATTERS: WHY AND HOW CORPORATE BOARDS SHOULD BECOME INVOLVED, Research Report R-1481-11-RR, at 41–42 (2011).

risk to the firm. Directors have a duty to ensure that companies meet their legal obligations, protect shareholder interests, and provide accurate and timely information to investors, regulators, and markets. But when it comes to cross-industry, cross-functional, and cross-generational issues of the type “sustainability thinking” often requires, firm-only approaches clash with the reality of interconnected thinking of sustainability. Yet, this is just the oversight that is sorely needed in the emerging era of sustainability.

To achieve it, boards of directors need to overcome an over-reliance on law and regulation to inform their decisions. Because law and regulation require social and political consensus to build before they take effect, they tend to reflect the power of incumbent industries. They will generally lag behind cutting-edge business practice and changing social preferences. Boards can suffer the same fate. But today more than ever, directors are expected to understand the rationale for change and adapt corporate strategies to evolving trends such as sustainability.

Some corporate boards may still decide to satisfy their governance duties through an emphasis on legal compliance alone. This approach in the era of sustainability may be absolutely necessary but is absolutely insufficient. Several national corporate governance reform efforts such as those in Germany¹⁷ and South Africa¹⁸ are, for the first time, using the language of “sustainability” and “stakeholder governance.”

III. MISCONCEPTIONS AND SIMPLE FIRST STEPS

There is a better corporate governance approach than the traditional “compliance-only” method. It is to meet legal requirements as a baseline but to govern toward the future as a need. This approach combines accountability for shareholder value creation with an ethic of stewardship and corporate responsibility that enables and empowers a sustainability focus from the highest level of the company.

A simple approach companies can take as first steps to strengthen their governance is to consider three common misconceptions about sustainability:¹⁹

17. See, e.g., Michael Nietsch, *Corporate Governance and Company Law Reform: A German Perspective*, 13 CORP. GOVERNANCE: AN INT’L REV. 368, 371 (2005).

18. See, e.g., Philip C. Aka, *Corporate Governance in South Africa: Analyzing the Dynamics of Corporate Governance Reforms in the “Rainbow Nation,”* 33 N.C. J. INT’L L. & COM. REG. 219, 222 (2007).

19. See TONELLO, *supra* note 16, at 90 for further discussion of these misconceptions.

Misconception #1: To many corporate leaders, sustainability is an increasingly popular but essentially unknown business concept. Skepticism often results from lack of knowledge.

Corrective Action: An essential first step for business leaders is to understand the notion of sustainability, recognize the body of knowledge that accompanies it, and begin discussing its application in the specific circumstances facing the company.

Misconception #2: Many executives believe that the allocation of shareholder resources to sustainability initiatives is a financially unsound decision.

Corrective Action: No single rationalization shows how sustainability improves the bottom line, but the case for the financial and competitive benefits of pursuing an aggressive sustainability strategy can and is being made at leading companies. Conducting a thorough assessment of the opportunities for improving sustainability and advancing business goals is an important first step for a company to consider.

Misconception #3: Corporate board leaders believe that the allocation of shareholder resources to sustainability initiatives violates their duty to maximize shareholder value.

Corrective Action: The business judgment rule protects board consideration of stakeholder interests as a means to durable shareholder value maximization. Posing shareholder and stakeholder interest as an either/or choice is a false dichotomy.

Boards of directors need to take note that shareholder interest in sustainability is rising, as evidenced by a rise in proxy resolutions addressing climate, the environment and sustainability.²⁰ This is the moment for companies and their boards to take a step ahead and avoid having to play catch-up later.²¹

20. For example, the 2011 Proxy Season Update from Ernest & Young reported that social and environmental resolutions comprised 40% of all shareholder resolutions. See *2011 Proxy Season Update*, ERNST & YOUNG (2011), [http://www.ey.com/Publication/vwLUAssets/2011_proxy_season_update_CCASS/\\$FILE/SharehldrPropsl_slpsht.pdf](http://www.ey.com/Publication/vwLUAssets/2011_proxy_season_update_CCASS/$FILE/SharehldrPropsl_slpsht.pdf).

21. Through research, meetings, and dialogue involving companies, NGOs, governmental bodies, and a wide range of staff and external experts, The Conference Board has been actively engaged in the corporate discourse on sustainability and has a Center for Sustainability created to precisely promote better understanding and inform executives on the issue. *The Conference Board Center for Sustainability*, THE CONFERENCE BOARD, <http://www.conferenceboard.org/sustainability> (last visited Nov. 1, 2011).