Activating Sustainability in the Boardroom

The business case for sustainability has never been stronger

Organizations are under increasing pressure to create holistic approaches to sustainability and broader Environmental, Social and Governance (ESG) strategies to meet regulatory requirements and societal and investor expectations. At the same time, sustainability also presents an enormous opportunity for value creation to those that develop more sustainable products or solutions.

Russell Reynolds Associates examined the role boards can play in activating sustainability across their organization, setting out:

- The importance of forging a collaborative relationship with the management team
- The four key areas of board responsibility when it comes to sustainability
- Actionable recommendations and examples of implementing effective sustainability oversight

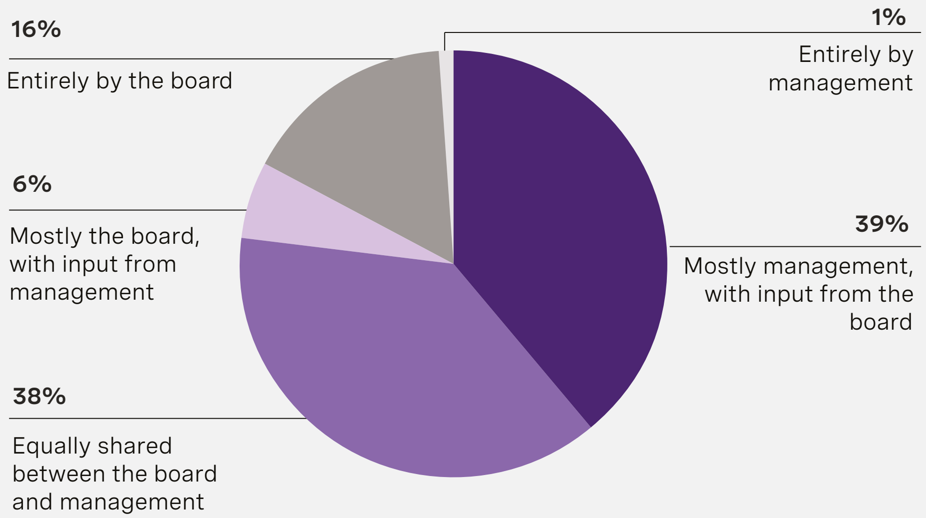
An increasing number of companies are in the process of transforming their business and operating models to deliver sustainable value to their customers, employees, investors, and the wider societal context in which they operate. However, most boards and management teams are struggling with this transition.

Activating sustainable leadership requires a high degree of coordination, starting with the board and senior leadership becoming aligned on the sustainability vision and roadmap, and allowing next-generation leaders and front-line employees to become conduits for embedding the sustainability agenda into the fabric of the organization. This results in more unified messaging when interfacing with customers, suppliers, and other external stakeholders.

Why boards and management teams need to work together on sustainability

RRA's 2021 research on the board's role in sustainable leadership found that a collaborative relationship between the board and management team is essential to achieving sustainability targets. This was confirmed in RRA's 2022 Global Leadership Monitor, a survey of 1,590 global executives, as the majority of leaders reported that responsibility for the sustainability strategy is shared across their organization's leadership either 1) equally between the board and the management team, or 2) mostly within the management team with input from the board.

How is sustainability oversight shared between management and the board?



Source: RRA Global Leadership Monitor Survey 2022, 1,590 global executives

This highlights the need for board of directors and management collaboration when it comes to sustainability strategy and governance. When this partnership works well, sustainability initiatives are thoughtful and productive, eventually becoming fully integrated into the business over the long term. When the board and management struggle to reach alignment, sustainability efforts risk being disjointed or unsuccessful. While both parties are responsible for successful sustainability outcomes, the board's responsibilities are distinct from management's.

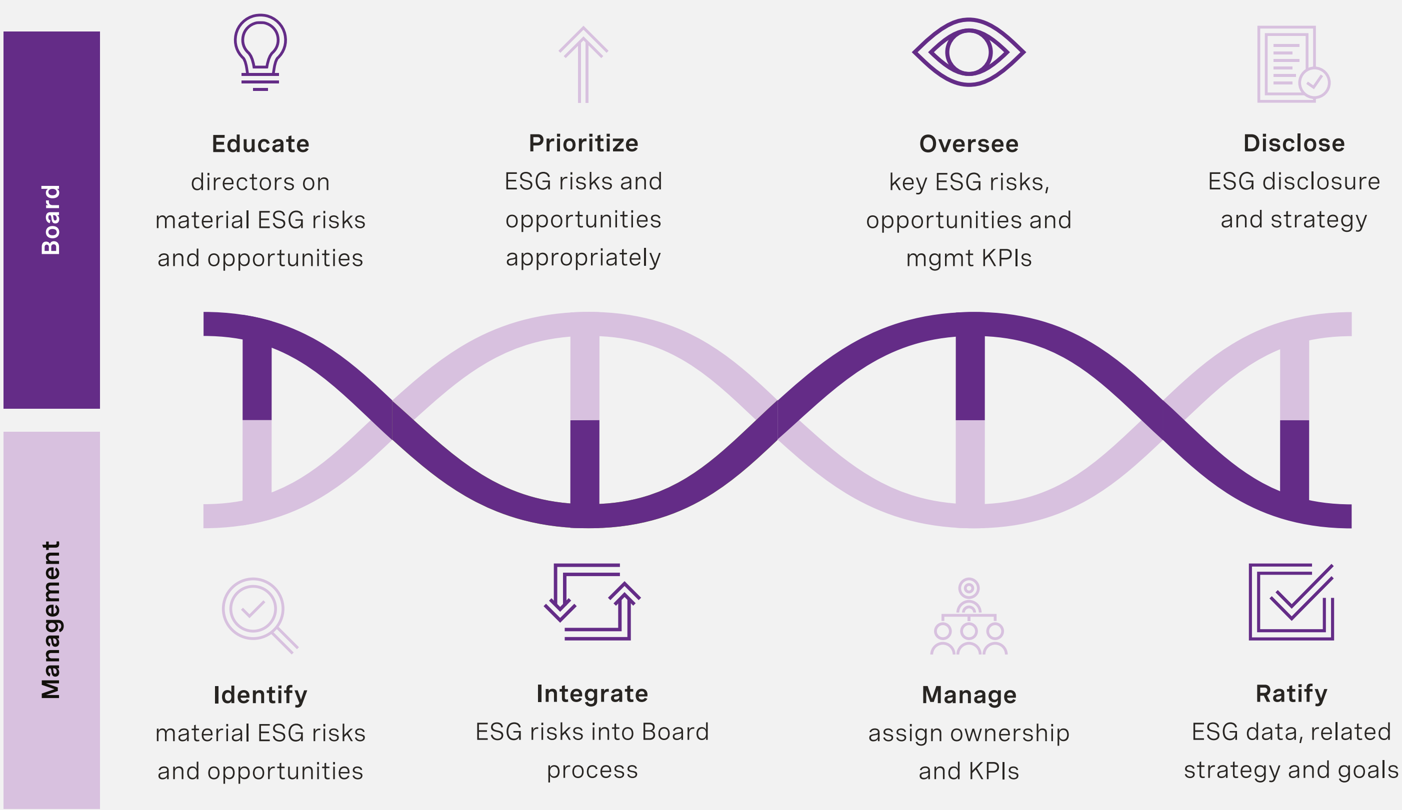
The four key board responsibilities for driving and governing sustainability

Board directors should focus their sustainability oversight broadly on four key responsibilities:

1. Educating
2. Integrating
3. Overseeing
4. Ratifying

Regional, and local laws, as well as directives and corporate governance guidelines, must be considered as boards review and create new sustainable governance practices.

A collaborative approach to board and management sustainability responsibilities



Educate

Educate directors on material sustainability risks and opportunities to equip the board to productively contribute to their company's sustainability strategy discussions.

With the increasing pressure on companies to deliver visible sustainability results, the board must be able to appropriately challenge the CEO and management on key strategic decisions regarding sustainability matters. The goal is not for the board to become sustainability experts, but rather to possess the baseline understanding of stakeholder expectations and how sustainability can create value and reduce risk.

The board should also be able to address questions across stakeholder groups, particularly shareholders, who are increasingly conscious of risks to their investments in companies that are not performing in terms of sustainability indicators. This is not just about appointing a standalone sustainability director. Ultimately everyone on the board must be able to engage in productive discussions around sustainability. This will require enabling directors to educate themselves.

Actions boards can take to educate directors:

1. **Create dedicated sustainability training sessions:** Organize dedicated training sessions on sustainability with external or internal specialists to provide deeper technical perspectives (e.g., independent external sustainability counsel).

2. **Conduct materiality assessments:** Consider conducting a materiality assessment to determine the specific sustainability factors that are of the most importance to the company and its key stakeholders. Holistic understanding of materiality is key. In some jurisdictions, companies should be conversant in the concept of "double materiality," which looks at both the climate-related impacts on the company and at the company's impacts on the climate and other dimensions of sustainability. [1]

3. **Prioritize stakeholder engagement:** Engage with critical stakeholders (investors, employees, customers, suppliers, and broader communities within which the company operates) on sustainability opportunities and risks to understand their priorities, challenges, and perceived opportunities.

4. **Educate committee chairs and members on sustainability:** The audit chair and members of the committee should be educated on sustainability reporting and the audit thereof. Equally, nomination committee members need to be educated in a way that enables them to appoint future board directors that bring relevant sustainability experience and skills. When codices require dedicated sustainability expertise on boards, leverage that expert to help educate and inform other board members.

5. **Develop a shared sustainability framework:** Discussions will be most effective if the board and management have a common sustainability framework and vocabulary.

[1] 'Double materiality': what is it and why does it matter? - Grantham Research Institute on climate change and the environment (lse.ac.uk)

Case Study

A German MDAX constituent with revenues of approximately 10 billion euros organized multiple workshops with external advisors to further educate their board on sustainability. The workshops included presentations from a leading management consulting firm and from RRA on the role of the board in driving sustainable leadership.

These workshops were part of the board's ongoing journey to become more familiar with the strategic, governance and leadership challenges of sustainability and enable them to make informed decisions about how to oversee and ratify sustainability reporting more effectively. Moreover, it also helped them reflect on how they can work with management on driving forward the sustainability agenda and its associated value creation opportunities.

Questions the board should ask itself:

- What level of sustainability expertise do our board and management teams currently have?
- Are we prioritizing the right sustainability factors that are most material to our business?
- What are the key gaps, both at a high level and, more specifically, related to our organization's footprint?
- How do we best acquire this expertise, and equip each board and management leader to challenge and contribute in a meaningful way?

Integrate

Integrate sustainability risks and objectives into board processes and internal control and risk management system.

Integrating sustainability into the board's day-to-day responsibilities is critical to the governance of sustainability risks and opportunities, ensuring that sustainability matters are front and center for the company. The board must also comply with local corporate governance.

Actions boards can take to integrate sustainability into the board's responsibilities:

1. **Include sustainability in planning conversations:** Make sustainability an integral and consistent part of the board's and CEO's agenda.

2. **Fully integrate sustainability into the board's process:** Depending on the maturity of the company's sustainability approach and other mechanisms to get sustainability issues front and center for the board, different models can be applied (e.g., creating a sustainability committee). Regardless of model, sustainability should ultimately be integrated fully into the board's oversight of strategy and risk in all relevant settings.

3. **Create accountability:** Each committee should be held accountable for designated sustainability oversight responsibilities, in addition to integrating sustainability into the overall board's agenda.

One framework for committee sustainability responsibilities

Nomination Committee

- Proven expertise on enterprise-relevant sustainability issues should be included in the boards of directors' competency profile
- Make sustainable leadership a key component for the CEO and senior management's succession, as well as appointment

Audit Committee

- Educate the committee around non-financial disclosure requirements
- Ensure that at least one member of the audit committee has sustainability-related reporting experience in the context of special accounting/auditing
- Ensure the audit committee chair is well-versed in sustainability reporting and auditing
- Consider data continuity between publications including financial disclosures, proxy statements, standalone sustainability reports and dedicated company websites

Remuneration Committee

- Compensation structure must be geared to the sustainable and long-term development of the company
- Link CEO and management compensation to ambitious sustainability targets

Sustainability Committee

- Create clear character and agenda around sustainability topics, including how to distribute responsibly across the entire board over time

Sustainability committees

Requirements around dedicated sustainability/ESG committees vary by jurisdiction. Beyond regulatory requirements, the choice will depend upon the company's specific context, board culture, industry, and regional norms. For example, 13% of S&P 500 companies[2] have a dedicated committee or a committee tackling ESG matters, versus 33% of the DAX 40[3] and 54% of FTSE 100.[4]

However, a sustainability committee should not be considered a proxy for the company's level of commitment to sustainability. Many companies that are considered leading in terms of sustainability have found it more effective to integrate the topic across the entirety of the board's work, either in other committees or at the full board level, as opposed to having a standalone committee.

Case Study

The board of a Canadian TSX constituent that operates as an apparel manufacturer with a market cap of approximately CA$7.5 billion has been integrating sustainability factors throughout its responsibilities.

They have prioritized codifying sustainability oversight in their Corporate Governance and Social Responsibility Committee charter and disclosing data for multiple external frameworks. This supports establishing clear goals and a communication strategy around those objectives. The board considers sustainability to be a key strategic growth pillar.

Questions the board should ask itself:

- How often are sustainability topics on our full board's meeting agenda?
- Is sustainability a key component of broader discussions about strategic opportunities and risks?
- Is our culture such that directors feel empowered to raise sustainability issues in context of other strategic business decisions?
- When recruiting new board member(s), what competencies around sustainable leadership does the regional corporate governance code specify?
- What does the local law specify on sustainability related reporting knowledge for members of the audit and/or risk committee?
- Is the organization's board process and risk management system adequately accounting for sustainability?
- Is the compensation committee linking management compensation to sustainability targets?

[2] Navigating The ESG Journey In 2022 And Beyond | Deloitte US;
[3] DAX Supervisory Boards Include More Women Than Ever | Russell Reynolds Associates
[4] Mattison Public Relations | More than half of FTSE 100 companies now have a board-level ESG committee - the next metric in ESG corporate comms

Oversee

Oversee key sustainability risks, opportunities, and management's KPIs on an ongoing basis and in close partnership with the management team.

Incorporating sustainability strategy oversight into the board's responsibilities is essential for staying aware of the company's progress towards sustainability objectives and to provide appropriate feedback to management. Without intentional and regular board review of activity, progress, and outcomes, sustainability cannot be meaningfully integrated into strategic decisions.

Actions boards can take to oversee sustainability progress:

1. **Set clear metrics:** Agree on clear metrics with the management team to track progress towards established goals. Be transparent about progress and highlight potential or new hurdles on the journey. Establish board norms of reviewing sustainability and other non-financial metrics as regularly as the board reviews financials.

2. **Discuss progress frequently**: Discuss progress on sustainability measures at every board meeting, as well as with the CEO and management team. Encourage regular sustainability updates from management, establishing direct lines of communication from executives leading ESG initiatives, where appropriate and agreed upon by the CEO.

3. **Stay informed about risks and opportunities:** Stay informed about the evolution of sustainability risks and opportunities and encourage sharing on related topics. Pay attention to the internal control and risk management systems, which should incorporate sustainability-related risks. This should include the processes and systems for recording and processing sustainability-related data.

4. **Integrate sustainability into culture oversight:** Consider the board's oversight of company culture and develop an understanding of the extent of employee alignment on sustainability issues throughout all levels of the organization to identify any potential gaps.

Case Study

An American NYSE constituent in the organic food distribution industry with a market cap of over $1 billion reviews, at least annually, the company's policies and strategies addressing environmental, social and governance concerns, including sustainability and corporate responsibility, from a corporate governance standpoint and recommends any modifications to address evolving requirements of various stakeholders.

Questions the board should ask itself:

- Is our reporting system aligned with current local/regional requirements?
- Is our sustainability strategy clear and actionable, and is the company tracking the right metrics?
- What external audit and assurance framework is in place to monitor progress against the sustainability strategy, targets, and the integrity of non-financial reporting?

Ratify

Ratify management's sustainability metrics and related disclosures.

The board is accountable for sustainability disclosures, which enables the company to showcase its commitments and progress to investors, customers, employees, and policymakers.

Actions boards can take to ratify sustainability progress:

1. **Communicate the sustainability journey:** Validate and visibly champion decisions made by the management team regarding the sustainability journey.
2. **Report on sustainability metrics:** Include reporting on sustainability progress and in appropriate disclosures, either as stand-alone reports or incorporated into other disclosures, such as the annual report. Sign-off on major sustainability commitments and be accountable for them in front of all stakeholders.
3. **Prioritize compliance and audit of sustainability goals:** Confirm the accuracy of non-financial reporting and public market disclosures, potentially including a third-party audit of such information. Evaluate oversight processes for compliance with relevant local corporate governance codes and laws.
4. **Proactively monitor for sustainability-related risks:** Proactively monitor and prepare for any new reporting requirements on the horizon.

Case Study

Novo Nordisk is a leading healthcare business headquartered in Denmark, with revenues of $22 billion. For decades, sustainability has been a priority for Novo Nordisk and the topic is owned by the entire board.

The board makes all key decisions on sustainability and is involved in strategy discussions and solving hard business issues. Executives proactively reach out to and engage with board members on their specific areas of expertise. The company has a set of 10 guiding principles, The Novo Nordisk Way, which underpin every key decision. The company uses a facilitation approach to ensure that the entire company lives up to the Novo Nordisk Way. Issues are addressed locally, and a consolidated report is shared with the board and management.

Since 2004, Novo Nordisk has published one integrated annual report covering their financial, environment and social statement, as well as management review. The ESG reporting is in accordance with relevant disclosure standards, including those of the IFRS Foundation, the Taskforce on Climate-related Financial Disclosures (TCFD) and the Carbon Disclosure Project (CDP).

Questions the board should ask itself:

- What are our sustainability reporting compliance controls? Are they as rigorous as those used for more traditional financial reporting?
- Are we reporting against the right internationally recognized frameworks?
- Are our board directors sufficiently well-versed in sustainability-related reporting?
- Does our board have the right experience and skills to constructively challenge the management team on this topic?

Recommendations to fully integrate sustainability into board governance processes

Implement temporary multi-committee responsibility

Governing and overseeing sustainability is the responsibility of the entire board. However, to achieve this, companies might need a temporary structure while integrating sustainability practices into the board.[5] The model that requires the least structural change, while also distributing responsibility across several groups of non-executive directors, is the **multi-committee responsibility model**.

Under this model, each committee on the board integrates sustainability into their responsibilities. When this model is employed, take care to ensure that sustainability items that don't clearly fit into an existing committee remit do not fall through the cracks, and that the overall approach to sustainability oversight is consistent and harmonious.

BCG-INSEAD's six different ESG governance models

The ideal model - and the board of the future	All of these can be used as a stepping stone to the ideal model				The undesirable model - and many boards today
Fully integrated	Dedicated committee	Added to an existing committee	Multiple-committee responsibility	Board champion	Not formally embedded
31% of companies	20% of companies	10% of companies	10% of companies	15% of companies	12% of companies
			Probably the preferable stepping stone to the ideal model for most companies.		Probably a major underestimate, the surveys are skewed in favour of sustainability-friendly directors.

Source: BCG-INSEAD Board ESG Pulse Check (March 2022). Some 2% of companies surveyed say they use a "different" model.

[5] Ron Soonieus, "Designing Sustainability Governance: Board structures and practices for better ESG performance," INSEAD Corporate Governance Centre, March 2022.

Case Study

Linde PLC is a global multinational industrial gas and engineering company with sales of $31 billion in 2021. The board's oversight of ESG risks and opportunities is integral to their business strategy. As stated in their 2022 Proxy Statement, the board and its committees actively oversee Linde's ESG strategy, programs, and policies, which are managed on a day-to-day basis by senior executives. The board revised certain committee charters to specify ESG programs and practices.

In 2021, Linde undertook a comprehensive review of its ESG program and practice oversight, resulting in several actions to increase board oversight:

- **Sustainability Committee:** Created a new sustainability committee to focus on environmental matters.
- **Human Capital Committee:** Expanded the scope of the "Compensation Committee" and renamed it to the "Human Capital Committee" to reflect the committee's enhanced oversight of policies, practices, and goals.
- **Nominating and Governance Committee:** Implemented active monitoring of the changing ESG landscape and reporting recommendations for changes to Linde's governance programs and practices.

Cultivate a sustainable mindset in current and future board directors

Cultivate a sustainable mindset among existing board directors by investing in education on sustainability as it pertains to the industry and company. This education also includes understanding the respective stakeholder groups' concerns and wishes, which are key to the business's sustainability transformation. When appointing new directors, rather than selecting a dedicated sustainability specialist, appoint directors with a sustainable mindset and with skills relevant to the company's sustainability challenges and opportunities to infuse sustainable leadership across the board.

Integrate sustainability into organizational culture

Fully integrating sustainability into a business requires a major cultural transformation. Like other transformation efforts, board oversight is critical. Today, sustainability represents a significant value creation opportunity in its broadest sense for people, planet, and profits. To fully capture this value creation opportunity, there must be organizational alignment around ambition, strategy, culture, and internal and external communications. Sustainability impacts the entire organization and the ecosystem in which it functions—boards need to be exposed to all material aspects.

Further Reading from RRA

- The Board's Role in Sustainable Leadership
- 2022 Global Leadership Monitor
- Where was the Canary in the Boardroom? Why ExxonMobil's Proxy Contest Loss is a Wakeup Call for all Boards
- Divides and Dividends: Leadership Actions for a More Sustainable Future

External References

- Stephen Angel, "Sustainable Growth: Notice of 2022 Annual General Meeting of Shareholders & Proxy Statement," Linde.com, 2022.
- Ron Soonieus, "Designing Sustainability Governance: Board structures and practices for better ESG performance," INSEAD Corporate Governance Centre, March 2022.

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Methodology

The Global Leadership Monitor (first launched in 2021) is an annual online survey of executives and non-executives. The Global Leadership Monitor tracks key threats to organizational health and leadership preparedness to face them, as well as indicators of confidence in leadership, and leaders' engagement and career aspirations. Russell Reynolds Associates surveyed its global network of executives using an online/mobile survey in March of 2022.

Read more about the Monitor's methodology here.

About Russell Reynolds Associates

Russell Reynolds Associates is a global leadership advisory firm. Our 520+ consultants in 47 offices work with public, private and nonprofit organisations across all industries and regions. We help our clients build teams of transformational leaders who can meet today's challenges and anticipate the digital, economic and political trends that are reshaping the global business environment. From helping boards with their structure, culture and effectiveness to identifying, assessing and defining the best leadership for organisations, our teams bring their decades of expertise to help clients address their most complex leadership issues. We exist to improve the way the world is led.

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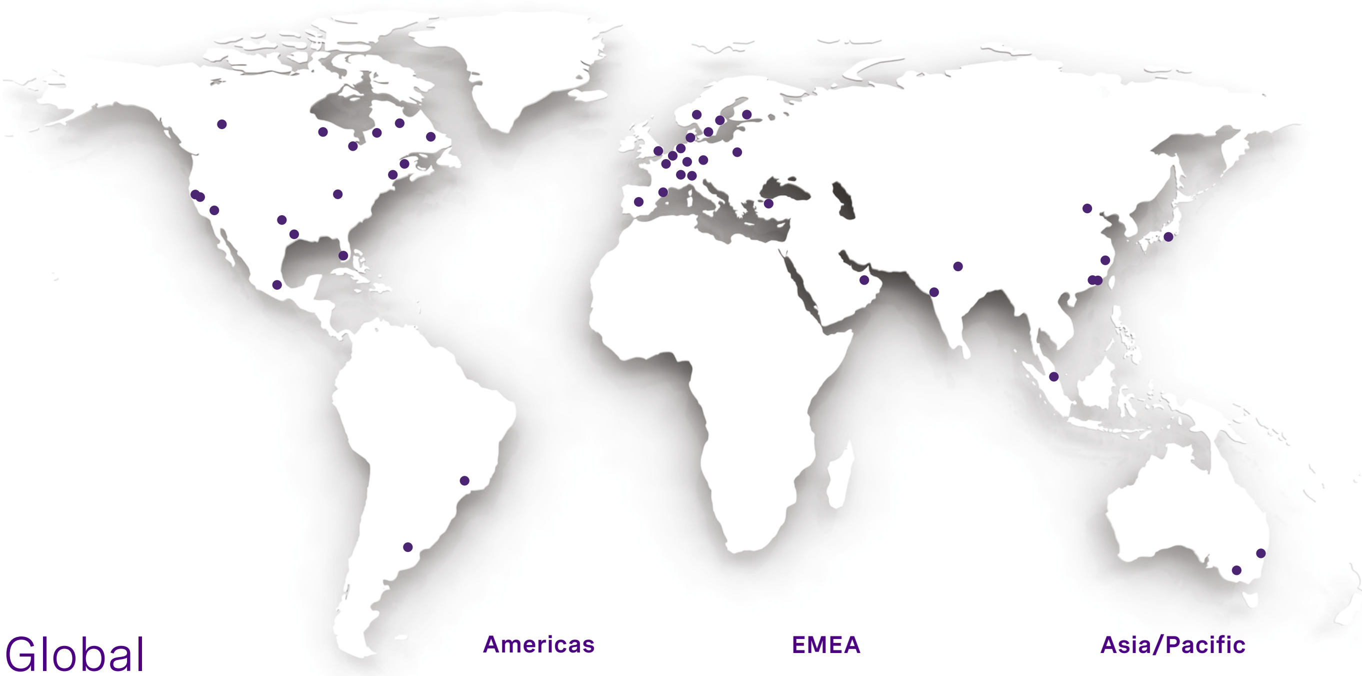

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