Maximizing Opportunity, Minimizing Risk: The Board's Role in AI and Sustainability

Artificial intelligence has emerged as a pressing issue for boards that demands new approaches to governance to ensure that companies are seizing opportunities for value creation, while minimizing enterprise risk. AI technologies possess the potential to revolutionize industries, disrupt traditional business models, and profoundly alter long-term strategies for growth.

As boards navigate the complexities of AI adoption, they are confronted with myriad challenges, including ethical considerations, legal implications, data privacy concerns and the need for transparent decision-making processes. However, Russell Reynolds Associates' latest Global Leadership Monitor shows that boards are not prepared to address these challenges - only 30% of board directors believe their organization has the right expertise on the board to advise on generative AI implementation. And management teams feel even less confident, with only 20% of leaders agreeing that their board has the right expertise in place.

To address this gap, boards will benefit from looking at the experience of governing a similarly transformative issue: **sustainability**. While the two may not seem immediately connected, both require paradigm shifts in how businesses operate, how leaders manage, and how boards govern. Moreover, both can create significant enterprise value when implemented effectively - but can also destroy significant value if mishandled.

Corporate boards therefore have a responsibility to ensure they are effectively monitoring the risks and opportunities posed by AI and sustainability, and helping management to prioritize and triage as necessary. Importantly, providing such effective oversight does not require deep technical knowledge of either subject, nor does it benefit from the appointment of so-called "single issue directors" whose primary role on the board is to serve as subject-matter expert on sustainability or AI. Rather, the board will benefit from adding directors with lived experience managing these topics in a business environment, and must adhere to a consistent and coordinated process that clearly delineates the board and management's responsibilities in transforming their business and operating models in response to these disruptive forces.

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Why boards and management teams must work together to drive sustainability and AI progress

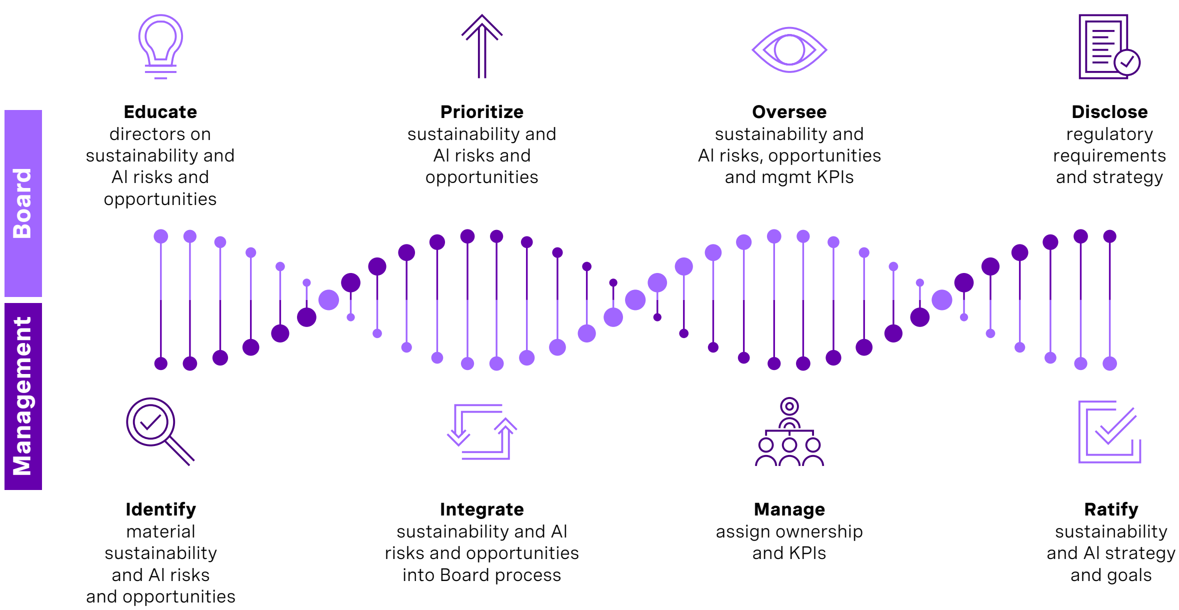
Recent RRA research shows that a coordinated relationship between the board and management team is essential for creating sustainability strategies that create both social and financial value for stakeholders. As AI grows more accessible and makes its way into the boardroom, it's clear that the same collaborative oversight will be required to capture AI opportunities while minimizing the significant risks.

That's because the emergence of generative AI poses many of the same governance risks and opportunities that companies have already begun to face with sustainability.

Each require that a company's management and board build a collaborative process to:

- Develop a clear understanding of its primary stakeholders (for example, employees, customers, investors, suppliers, society-at-large), and what matters most to them;
- Continuously scan the market to identify previously unrecognized risks and opportunities related to sustainability and AI;
- Ultimately, identify how to turn risk into opportunity, driving value creation.

In such a collaborative process, the board and management each play distinct roles that build upon each other to drive effective governance. At every step, each group leverages their distinct perspective, skillset, and mandate to lay another plank in the governance scaffolding that protects the company and its stakeholders' interests.



Importantly, this coordinated approach does not imply that the board should not constructively challenge management's position or provide alternative views. Rather, by adhering to a well-defined and coordinated approach, both "sides of the house" can ensure they are delivering on their mandate and serving their intended governance roles.

When the board and management partnership works well, sustainability and AI can be fully integrated into the business as levers for value creation. When the board and management struggle to reach alignment, sustainability and AI efforts risk becoming disjointed or unsuccessful bolt-ons to existing workflows, rather than tools for rethinking business and operating models.

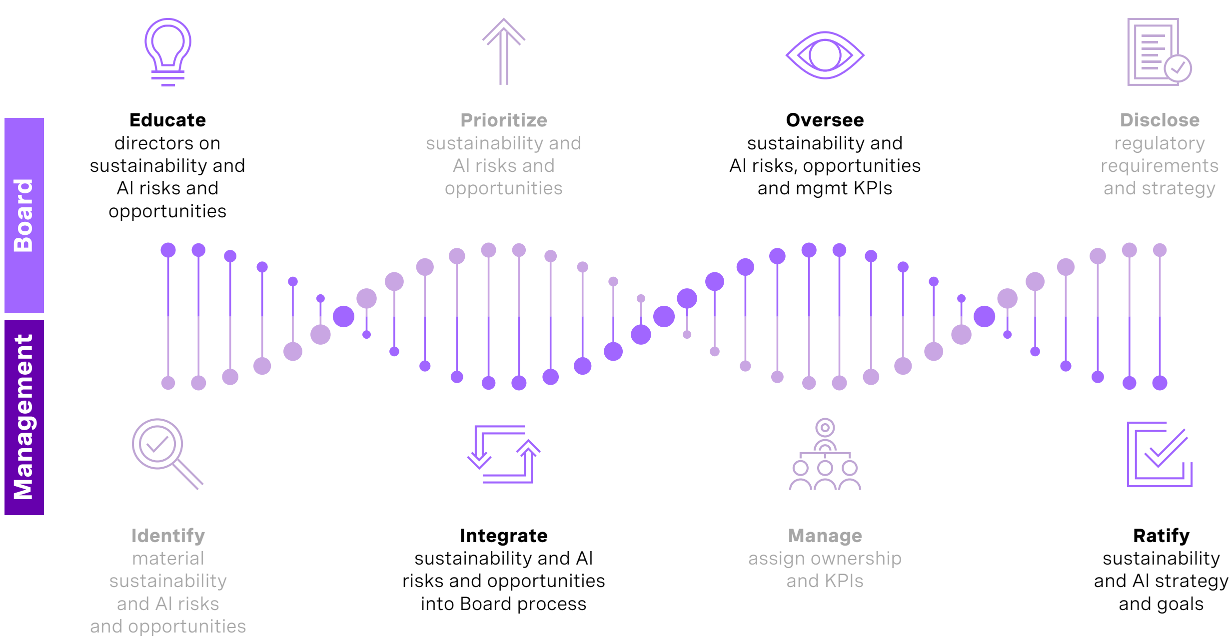
The board's responsibilities for governing sustainability and AI

Board directors should focus their sustainability and AI oversight broadly on four key responsibilities, each of which complement the corresponding responsibilities of management:

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 define their fiduciary responsibilities.

If companies need to make decisions before regulations have been finalized, they should adopt a principles-based approach to mitigate the need for future backtracking.



Educate

Educate directors on material risks and opportunities related to sustainability and AI, equipping them to productively contribute to their company's strategy discussions.

Leaders at the very top of the organization will not be expected to have deep technical knowledge of AI or sustainability concepts. However, they are responsible for understanding 1) how both can add value and mitigate risk across the value chain, 2) what AI is capable of and where it should—or should not—be deployed, 3) the risks associated with AI and sustainability, and most importantly 4) the risks of doing nothing.

Effective governance of sustainability and AI requires that boards have clear understanding of who the company's core stakeholders are, and how its choices can both create value for those stakeholders - or deliver unintended consequences. Those unintended consequences include AI's potential for perpetuating bias in the data sets on which it has been trained, or the environmental impacts of a company's operations and supply chain.

It's vital that this process involves a range of stakeholder perspectives, reflecting myriad points of view on the subjects of both sustainability and AI. These viewpoints are likely to shift on a regional and temporal basis, particularly as companies move through various points of the business cycle. As directors engage with these various stakeholder perspectives, retaining a long-term lens will be crucial for avoiding the "quarterly results" trap that diminishes many companies' ability to make progress.

As the primary advocate for and conduit to a company's stakeholders, the chief sustainability officer or equivalent senior leader can help the board identify, prioritize, and better understand the needs of various stakeholder groups, ensuring that the board is accurately assessing the potential risks and rewards of any strategic decision.

Integrate

To manage risk and make strategic decisions, integrate sustainability and AI strategy into board discussions, processes, and systems.

To truly capture the potential value of sustainability and AI, while mitigating corresponding risks, both topics must be integrated into all risk management and strategic decision-making processes. Treating them as siloed topics to be considered at static points throughout the board's calendar will result in a fractured and ineffective governance approach. Instead, they must become cross-cutting themes that are considered by the entire board, in every discussion (as opposed to being subjugated to committee oversight alone). That said, each committee will apply their own lens to each topic (see the "How sustainability and AI can be integrated into board committee responsibilities" box below).

While the specific approaches will vary from board to board, all directors should be on the lookout for opportunities to bring a sustainability or AI innovation lens to strategic conversations. This may include making both topics an integral part of the CEO's updates to the board; holding regular discussions between the board, CEO, and senior executives like the chief sustainability or chief digital officers; and identifying how each board committee will hold itself accountable for integrating a sustainability and AI innovation lens into their work.

How sustainability and AI can be integrated into board committee responsibilities:

Nomination Committee

- Include expertise on enterprise-relevant sustainability and AI issues in the board of directors' competency profile
- Make sustainable leadership and a commitment to Responsible AI a key component for CEO and senior management succession and appointments

Audit Committee

- Educate the committee around non-financial disclosure requirements
- Ensure that governance and audit mechanisms include assessment of adherence to company's Responsible AI principles

Compensation Committee

- Orient compensation structure to the sustainable and long-term development of the company
- Link CEO and management compensation to ambitious sustainability targets
- Ensure senior technical leaders are incentivized to prioritize Responsible AI practices

Oversee

In partnership with the management team, oversee key sustainability and AI risks, opportunities, and KPIs on an ongoing basis.

While it's important that the board and management collaborate around sustainability and AI, it's equally critical that the board recognize its ultimate responsibility in holding management to account for its responsibilities and commitments.

Therefore, the board and management team must agree on clear metrics to track progress towards sustainability and Responsible AI goals, as well as a regular metrics review schedule that aligns with the board's broader financial reviews. The board should also consider its oversight of company culture, and the extent to which externally stated values and commitments around sustainability and Responsible AI align with the lived experience of employees at all levels of the organization.

Ratify

Ratify management's sustainability and Responsible AI metrics and related disclosures.

As the company's ultimate fiduciary, the board is responsible for authorizing and endorsing public commitments and disclosures related to sustainability and AI. Doing so visibly and enthusiastically showcases company commitments and progress to investors, customers, employees, and policymakers, while simultaneously communicating the seriousness and authenticity of their strategies.

Boards should validate and publicly champion decisions made by the management team regarding their company's sustainability and AI journey. This includes reporting on progress, ideally via within major disclosures like the annual report. Demonstrating this accountability to all stakeholders will be crucial.

Advice to boards for a sustainable, AI-enabled future

Regardless of where boards fall in the maturity curve of sustainability and AI governance, we recommend the following key actions to elevate the board's oversight and ability to leverage the transformational impact of these forces:

1. Ensure that senior management and the board are clear on their respective roles in driving change and mitigating risk when it comes to sustainability and AI.
2. Don't rely on single-issue directors to fill the board's expertise gap - instead, look for opportunities to educate the entire board on the company's stakeholders, their priorities, and how the company creates value for them.
3. Integrate sustainability and AI into all risk management and strategic decision-making processes, such that they become a lens for identifying opportunity and risk.
4. Establish clear metrics for holding management to account against the company's sustainability and AI ambitions, and review progress regularly.
5. Publicly champion decisions made by the management team regarding their company's sustainability and AI journey, demonstrating board support for the company's ambitions.

When aligned, sustainability and AI become powerful levers for value creation. It's time to embrace the transformational power of these two forces, and reshape how companies approach their governance.

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About Russell Reynolds Associates

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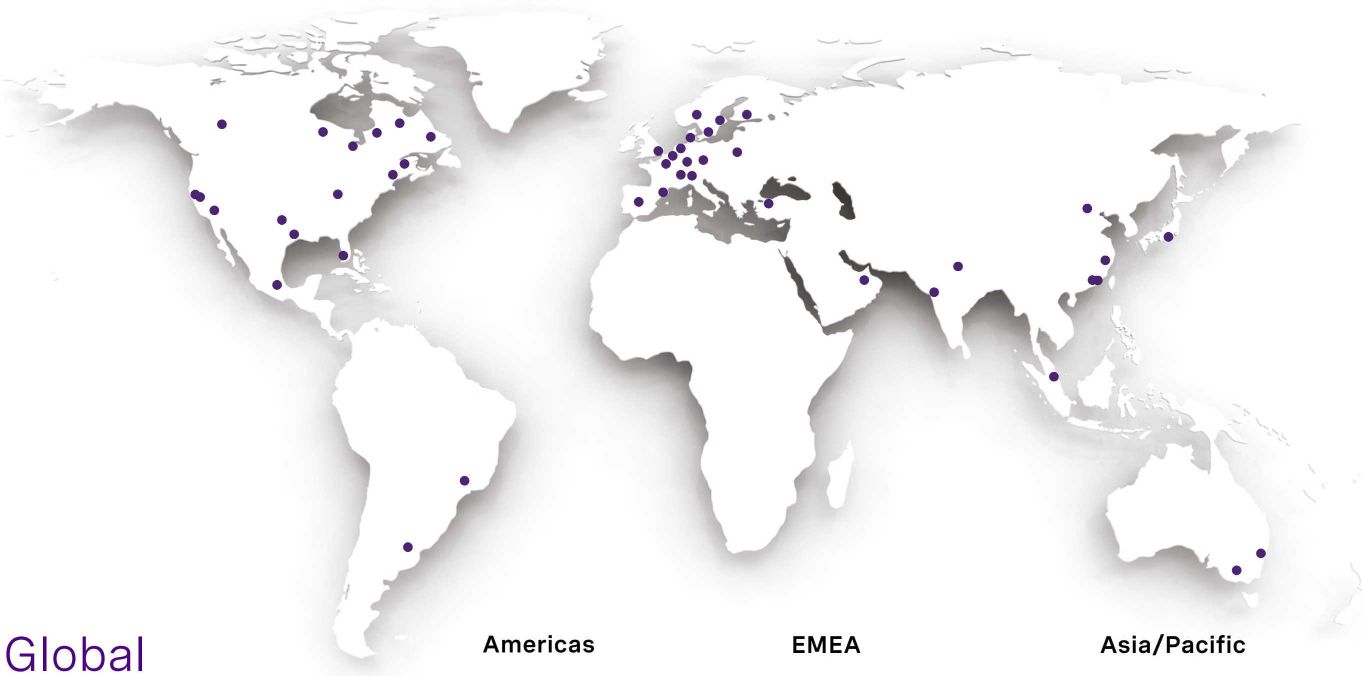

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