Getting beyond the structures

Survey and conclusions on corporate responsibility governance
Corporate responsibility (CR) focuses on the broad challenges that businesses face today:

**Ethical**
The primary ethical challenge for companies interested in CR is to create an honest and transparent business environment between and among employees, competitors, suppliers, partners, customers, governments and society.

**Social**
Social challenges include a range of issues from establishing honest relationships, providing fair wages and healthy, safe working conditions, through to respect for human rights and a commitment to community development.

**Environmental**
The environmental agenda is very broad. CR issues tend to centre around environmental protection including air, land and water quality; eco-efficiency, biodiversity and sustainability.

**Economical**
Corporate responsibility also encompasses long-term value creation for its stakeholders, for shareholders as well as the broader economic benefit to society which can be achieved through improved employment, procurement and investment practices.
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There is little doubt that ethical, social and environmental issues are now key components of the corporate agenda. They arouse as much interest and passion in stakeholders as the traditional flashpoints of financial performance or remuneration schemes and have the same ability to influence corporate reputation and corporate value.

But are these ‘new’ issues and related risks managed with the same rigor as traditional risks? Are the according governance structures which have grown so rapidly the right ones? And are companies using these structures not just to manage risks, but to optimize opportunities to develop improved business value?

To shed more light on this dynamic area, we conducted a survey among major Swiss companies in 2008 and 2009. Companies which already responded in 2008, were contacted again at the end of 2009 to see if any major changes took place. While most of these companies have not changed their governance structures, some of them have further strengthened the linkage to corporate strategy, set-up dedicated teams or improved their reporting. This reflects the growing management attention for the topic.

Of the 65 companies contacted, 30 completed the provided questionnaire, representing 14 different sectors. Throughout the questionnaire, we wanted to understand what companies are currently doing and to establish what best practice might look like. Thereby we aim to develop insights for leaders and managers on how to derive value from improved Corporate Responsibility (CR) governance.

What did we find?
The results of our survey of major Swiss companies’ responses to the CR challenge were at first sight very impressive. Companies described a plethora of measures and initiatives which indicate a significant degree of engagement with CR. Most companies had set-up a structured process to identify and update the board on the most relevant CR issues. 53% had defined key performance indicators and 43% had a board member or manager with responsibility for championing CR and environmental performance.

We see that commitment like this is an essential first step towards improved governance. Board awareness alone does not ensure that CR infrastructure supports the organization in mitigating the material CR risks and capitalizing on the presented opportunities. To a large extent this depends on the competence of the individuals involved. In fact, we observed a considerable number of organizations establishing clear criteria for the selection of CR committee members and commissioning formal reviews of the effectiveness of their committee. One of the companies even had external experts as members of their CR committee provide advice on critical environmental, ethical or social issues.

What do we believe?
The CR function should have an operational role that enables CR managers to embrace the full range of issues which fall under their remit, for example health and safety, HR and environment. Accordingly, CR function does not belong within Corporate Affairs or Corporate Communications, as is the case in some companies.

To manage CR successfully we believe it is essential that companies apply the same rigor to governance and performance management as they do to any other important business issue – ensuring that there is appropriate challenge, clear accountability, stretching objectives, measurement frameworks and assurance. With this survey we assess current practice and indicate where we believe companies could improve performance and harness CR governance structures to drive improved shareholder value.

Contact us
If you would like more information on any of the issues highlighted in this report, or would like to discuss CR in general with our specialist team, please contact us.

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Germany / Switzerland / Austria
Corporate responsibility: context and concerns

Public interest in CR is widespread and successful management of the challenging range of issues it encompasses is a vital element of business success. Organizations need to commit not just to putting the right kind of governance infrastructure in place, but to ensuring that it delivers both insight and value by mitigating risks and highlighting opportunities for business improvement.

Many factors driving change
A number of forces have combined to drive up interest in CR, including:

- Growing environmental and social challenges around the globe;
- Shifting consumer expectations and behavior;
- More stringent reporting frameworks;
- Greater engagement by the investment community;
- Publication and popularity of CR indices, for example the Dow Jones Sustainability Indexes;
- Competitor activities – market conditions require that at the very minimum companies keep up the pace in this area;
- Changing employee expectations – for an increasing number of workers it is important that their employer is ‘responsible’ to society and the environment;
- Better public access to information and greater expectations of corporate transparency;
- Expanded regulatory frameworks.

Corporate responses are measurable
Companies across the board are responding to these changes. The survey tells us that all companies formally address environmental topics and most of them also address social issues as part of their corporate responsibility related activities. 53% are measuring the success of their efforts through some form of key performance indicator.

Our data shows that 72% of the companies with a CR strategy approved it within the last five years. This behavior is also reflected by the market development in many sectors.

For example, Swiss consumer products and retail companies are acutely aware of the potential for brand value optimization and brand damage that CR represents. 71% consider biological cultivation to be very relevant or even decisive for their strategic development. Furthermore, also sustainability (64%) and fair trade (57%) are considered to be of similar relevance. 1

Financial services is another sector where changes are having a significant influence on corporate behavior. According to statistics produced by the European Social Investment Forum, €2.665 trillion of assets were managed on a socially responsible basis in Europe by the end of 2007 which corresponds to a growth of 102% compared to 2005. The Swiss market accounts for €21.1 billion of those assets with a growth of 183% since 2005. 2

Differentiator or hygiene factor?
The acceptance of corporate responsibility as a relevant topic, at both company and market level, has been swift and decisive. We therefore question how long CR will be an area in which companies can differentiate until it becomes more of a hygiene factor, an essential part of an organization’s license to operate. The according answer is expected to differ across industries and markets.

Companies that have achieved competitive advantage in this area are typically those that have gone beyond the first step of establishing the kind of governance structure that consumers, employees, trading partners and investors expect. They are now using CR to reduce risks and to identify opportunities that add value to business.

“72% of companies with a CR strategy approved it within the last five years.”

1 LOHAS – Lifestyle of Health and Sustainability, Ernst & Young, 2007.
Corporate responsibility governance structures and their contribution

More than half of the companies which took part in the survey (53%) had a dedicated CR committee in place which in most cases meets at least twice a year. 23% had a board member with responsibility for championing CR and environmental performance and 37% assigned such responsibilities to a manager on a lower hierarchical level. Furthermore, 81% had a network across various locations of officially designated people with responsibility for CR in general, or a single component of CR.

Typical agenda
Our research shows that typically, companies believe that the responsibilities of the CR committee and/or individual board directors and managers responsible for CR are to:

- Develop and review the CR related strategies;
- Coordinate implementation measures, monitor progress and oversee CR reporting and communication;
- Review emerging risks and trends;
- Keep the board updated on key CR issues.

Variety of structures
We saw three different types of CR committees:

- More than half of the companies with a dedicated CR committee had members drawn across the board and executive team, complemented by heads of support functions or operational business units, in one instance even supported by external experts;
- One fifth of the companies had a committee made up exclusively of board members and the executive team;
- In one fourth of the companies, the committee solely comprised heads of support functions or operational business units.

Although committee structures and reporting lines vary, our results suggest that the CR committee is consistently seen as the voice of leadership and the source of strategic oversight and challenge.

We believe that the selection of non-executive directors for the CR committee is crucial to bringing the appropriate level of challenge to the executive management team on matters as diverse as investment in renewables, through to human rights issues in emerging markets. In leading practice, expert non-executive directors help their organizations chart a course through the many complex issues that they face daily. Typically, it’s not just the challenge which brings benefit, but the fact that non-executive directors also bring new ways of thinking about corporate responsibility which helps their organizations build better policies and practices around important issues that underpin their future success.

“53% of companies had a dedicated CR committee in place.”
Use of experts
Less than half of the companies with a CR committee applied selection criteria to help ensure that the members were competent to provide appropriate scrutiny and challenge. One company also invited several external experts to join their CR committee for this purpose.

Given the broad spread and fast moving nature of CR issues, lack of specific knowledge would seem to be a significant obstacle to effective CR risk management, let alone business improvement. We believe that companies may not have all the skills required for effective CR governance in house and that good practice suggests that they should look outside the organization for effective challenge on CR topics. This is due to the fact that in large part, the CR agenda is decided by a broad stakeholder group representing communities that are external to the organization.

Main information sources
Almost all of the CR committees received and reviewed information on environmental aspects. Across all companies other main information sources were related to compliance & ethics, human resources, communication and health & safety. Nearly half of the companies with a CR committee also looked at strategy and community related matters. Few committees also used additional feeds, e.g. focused on business units or procurement.

To monitor the company’s progress in managing CR related issues, companies mainly rely on internal sources. Among the companies that assigned the responsibility for CR to an individual manager and/or committee, most of them receive qualitative reports from the business units (63%) and obtain performance data and indicators (60%). Still almost half of the companies receive feedback on the progress made from CR focused internal audits. External sources are less considered. While 33% monitor the notations of rating agencies only 27% also commissions external audits (with differing scopes).

How is the company’s progress in managing CR issues monitored?

<table>
<thead>
<tr>
<th>Source</th>
<th>Percentage</th>
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<tr>
<td>Qualitative reports from the different business units</td>
<td>63%</td>
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<tr>
<td>Performance data and indicators</td>
<td>60%</td>
</tr>
<tr>
<td>Internal audits</td>
<td>43%</td>
</tr>
<tr>
<td>External audits</td>
<td>27%</td>
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<tr>
<td>Notation of rating agencies</td>
<td>33%</td>
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Corporate strategy and corporate responsibility practice

In determining the success of CR governance, we believe that it is important not only to measure the CR performance itself, but also to track how well the business performs as a result of CR input to corporate strategy.

Accordingly, the governance committee should drive more than the external reporting as CR is now such an all-pervasive issue. It should also be expected to make a significant contribution to the development and success of the business. It is the strength of this contribution which is the most important test of the value the CR function provides.

“About two-thirds of the companies had set up a structured process to identify and update the board on the most relevant CR issues.”

How do companies decide what matters to the business?
About two-thirds of the companies had set up a structured process to identify and provide updates on the most relevant CR issues and commitments for their company. Among these we saw a range of processes used, whereby the following were most widely applied: benchmarking with competitors (84%), dialogues with the company’s stakeholders to identify their expectations (79%) and risk mappings which include CR aspects (63%). While the solutions adopted varied between companies, we observe that leading companies are clearly placing reliance on stakeholder engagement and the external challenge which stakeholder panels or similar structures can provide.

How did you identify the areas that mattered to your business?
What issues are typically addressed?
In the context of corporate responsibility, almost all the companies formally address the issues of environment, human resources and health & safety. Furthermore, a vast majority also formally addresses ethics and governance (90%), relationship with communities (73%), and philanthropy (73%). Overall, about two-thirds of the companies have at least all six of these issues on their CR agenda.

Which of these issues are formally addressed by the CR Managers?

What are CR success factors?
There was a reasonably strong consensus on the factors which companies considered critical to the successful implementation of a CR program. They identified the following points as the top 3 success factors:
- Visible and credible leadership from the top, including the involvement of the right people;
- Integration of CR into the business model, existing management methods, and corporate culture;
- Transparent and fact-based regular communication and reporting to internal and external stakeholders.
Getting beyond the structures – Survey and conclusions on corporate responsibility governance

Our survey shows that companies use a range of internal and external measures to monitor the company’s progress in managing CR issues. The majority relied most heavily on qualitative reports but over half also had internal KPIs (key performance indicators) in place.

KPIs
Of those companies having specific KPIs to measure their corporate responsibility performance, more than half defined more than ten KPIs and another 14% had five or more indicators. Interestingly, one-fourth of companies either gave no or only limited formal group guidance on measuring and reporting KPIs, or chose not to respond to this question. Furthermore, about one-third of the companies with KPIs in place fully collate their performance data through electronic management tools. Another third indicated that they have reporting tools in place for parts of their defined indicators.

All too frequently, we see indicators being reported without any clear understanding which KPIs can really help an organization to monitor the business impact of the CR issues and mitigate the related risks. While there is no ‘correct’ number of KPIs, if businesses adopt too many they face the risk of gathering data rather than making use of information. A more constructive approach is to ensure KPIs are in place which focus not so much on the volume of outputs, but more on their quality and the level of their contribution to the business overall.

Those companies having corporate responsibility KPIs in place, how many KPIs did they define?

- Less than 5: 29%
- Between 5 and 10: 57%
- More than 10: 14%
Internal audit
About half of our sample of companies used their internal audit (IA) function as an information feed to the CR managers and committees. We believe that IA’s involvement can be a powerful driver for effective CR as it can demonstrate to line management the importance placed by the organization on these issues and on managing potential risks. It can give the board confidence that key controls are in place and operating. Most importantly, it can identify improvements that can reduce organizational risk and improve corporate reputation.

Other scrutiny
While one third of the companies in our sample used external auditors to monitor CR performance, some used both internal and external auditors to monitor its CR progress.

Nearly all of the CR committees from the companies participating in the survey performed a review of CR performance at least once a year. About half of them did so more than twice a year. In addition, two thirds of the CR committees underwent some form of evaluation of their performance. We believe that regular assessment of the contribution of the CR governance function is essential if it is to deliver sustained business value and that leading practice companies are likely to rely on a variety of tools and techniques to assess performance.

Individual performance evaluation
With view to individual, rather than corporate accountability, 35% of the companies at least partially assigned the achievement of the company’s CR objectives to individual persons. 20% of companies incentivized higher management levels for meeting selected CR targets.

“20% of companies incentivized higher management levels for meeting selected CR targets.”
Hallmarks of successful corporate responsibility governance

Based on the insight gained through the survey and from our view of market leading practice, we believe there are a number of hallmarks for a well-structured CR governance function that not only knows the right questions to ask, but can make constructive use of the answers to help drive business performance and thereby grow corporate value.

So what are those ‘right questions’?
Typically, they are likely to include the following:

- Is the agenda of the CR committee clearly targeted at the topics which are most important to the organization?
- Are the competencies of the CR committee linked to the CR challenges and opportunities?
- Is the CR committee sufficiently independent from the direct management of the issues to provide robust challenge?
- Are better decisions being made as a result of engagement with the CR committee?

We believe that companies which have successfully achieved the transition from establishing the CR governance infrastructure, to ensuring it delivers business benefit, are likely to demonstrate a number of hallmarks as defined in the table.

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<th>Hallmarks of success</th>
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<td>Committed</td>
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<td>Focused</td>
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<tr>
<td>Embedded</td>
</tr>
<tr>
<td>Measured</td>
</tr>
<tr>
<td>Assured</td>
</tr>
<tr>
<td>Transparent</td>
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<tr>
<td>Complete</td>
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| Demonstrable commitment to CR from leadership in decision-making and resource allocation. |
| CR programs driven by business objectives and stakeholder concerns, with CR issues and risks identified by their potential impact on business success. |
| CR is seen as an integral part of the business and not as a ‘bolt on’ activity. An awareness of CR can be seen in decision-making and behaviours at all levels. |
| Clear targets are identified for CR, accountabilities for delivery are established and progress is measured against stakeholder-driven performance targets and best practice. |
| Robust governance, management and reporting processes are in place to provide assurance of progress in CR activities and adequate control of critical risks. |
| Open, honest and balanced communication takes place in relation to CR activities, representing successes and ongoing challenges. |
| CR strategies are in place to address key components: customers, employees, shareholders, the community and the environment. |
What does this mean for you?

There is little doubt that social, ethical and environmental issues have a considerable impact on corporate reputation and potentially, on corporate value. Our survey analysis shows that to manage CR successfully, it is essential to apply the same rigor as to any other key risk – ensuring there is clear accountability, objectives, measurement frameworks and assurance.

To help you ascertain how well CR is embedded in your own operations, how well it is managed and how successfully it contributes to the development of your business, we propose the following questions to help spark thought and debate.

**Questions for the board**
- What information do I need to understand the nature and impact of social, ethical and environmental risks to the business?
- How confident am I in the accuracy and balance of public disclosures on environmental and social performance?
- How well do I need to understand the subject matter to challenge whether we are doing the right things in the right area?
- How do I get comfort that we are sufficiently forward-looking to understand the potential impact of climate change or other CR issues on our future success?

**Questions for management**
- What are the key social, ethical and environmental issues that could affect our long term success?
- What opportunities does the CR agenda present? What is our ambition?
- How do we manage social, ethical and environmental risks?
- Who is accountable for our CR performance?
- How are we improving our CR performance?
- How comfortable are we in our ability to deliver on our improvement objectives?
- What have we done to ensure that our progress reports are balanced and accurate?
- How is the management of social, ethical and environmental matters integrated into core business processes, such as performance management, internal assurance and business planning?
Corporate responsibility leading practice

Based on a combination of our own experience and the insights gained as a result of this study, we believe that CR leading practice can be defined as follows:

Best practice in corporate responsibility governance

<table>
<thead>
<tr>
<th>Board</th>
<th>The board has a set agenda item to review emerging social, ethical and environmental issues and risks and progress in mitigation and management.</th>
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<tbody>
<tr>
<td>Board committee</td>
<td>To support the board in the above, a dedicated board sub-committee is in place to provide oversight of the management of social, ethical and environmental issues, risks and opportunities in the organisation.</td>
</tr>
<tr>
<td>Committee composition</td>
<td>The relevant committee is composed of executive and non-executive directors with appropriate expertise and knowledge to effectively challenge progress in the organization and to review and approve policy.</td>
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<tr>
<td>Materiality</td>
<td>A systematic process is applied for determining the social, ethical and environmental issues which are most relevant to the organisation, and focus in the committee is given to the review of progress in these areas.</td>
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<tr>
<td>Accountability</td>
<td>Individual members of the organisation’s leadership are held accountable for environment, social and ethical performance and regularly present to the committee to account for progress.</td>
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<tr>
<td>Reporting</td>
<td>Clear frameworks are established for reporting progress across the most material social, ethical and environmental issues considered. The committee signs off external reports on these subjects.</td>
</tr>
<tr>
<td>Assured</td>
<td>Internal and external assurance is sought by the committee to gain independent insights on emerging risks and progress as well as to gain comfort that disclosures are both balanced and accurate.</td>
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