


Oversight of Corporate Sustainability Activities


DIRECTOR'S HANDBOOK SERIES

2014

Executive Summary

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EY Center for Board Matters

NACD®
NATIONAL ASSOCIATION OF CORPORATE DIRECTORS




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Executive Summary

Value creation, long-term business resiliency, strategic risk management, and stewardship represent the essence of the board's role in overseeing corporate sustainability activities. Sustainability oversight is increasingly becoming a board-level issue for several reasons. First and most fundamentally, boards are meant to safeguard the assets of the companies they serve, and one of the trickiest "assets" to understand, let alone protect, is the company's social license to operate. Second, the ways in which a company affects, and is affected by, global mega-trends such as population growth, an expanding urban middle class in emerging markets, demographic change, resource scarcity, climate change, and transformative technologies—all of which fall under the rubric of sustainability issues—are often at the core of board-management discussions about strategy, risk, and performance. Thus, understanding how a company executes its business model within a changing operating context, and with an eye toward long-term profitability, is squarely a board issue and a director's responsibility.

The Current State of Sustainability Governance

Many companies still see sustainability as a set of "softer" issues that can be relegated to marketing or public relations departments. The links between environmental and social issues, core business operations, and corporate reputation are becoming increasingly material, however.

- In one recent survey, the number of companies reporting that their sustainability activities contributed to profits rose by 23 percent year over year, and nearly half of the respondents reported changing their business models in response to sustainability-related opportunities.[1]
- Companies are highlighting their place on global sustainability indices including the Dow Jones Sustainability Index, FTSE4Good, and Corporate Knights' Global 100, which saw 31 new honorees in 2014.[2]
- Ninety-five percent of the world's 250 largest companies, and 86 percent of the largest U.S. companies, produce sustainability reports. [3]
- Shareholder interest is growing: nearly half of shareholder proposal submissions in 2014 related to environmental and social matters. [4]

According to one report, companies that fail to connect their sustainability activities to financial and operational performance are missing out on potential opportunities to better understand how sustainability can identify and reduce risk and boost returns.[5] As David Kiron, executive editor of *MIT Sloan Management Review*, put it, leading-edge companies "don't dwell on [sustainability] as a cost issue. They focus on how their efforts can increase market share, boost energy efficiency, and build competitive advantage."[6]

Despite these trends, the extent of board-level oversight of sustainability issues varies considerably. Studies from organizations such as the Investor Responsibility Research Center Institute (IRRCi) and Ceres show that a notable and growing proportion[7] of large, publicly traded companies have explicit, board-level oversight of sustainability and corporate responsibility activities: indeed, they are three times more likely than smaller companies to have board oversight of environmental and/or social issues.[8]

But the overarching message of the IRRCi and Ceres reports, as well as similar studies,[9,10] is that there is considerable room for improvement. At many companies, the level of board-level oversight of environmental and social sustainability activities is not consistent with the link between these activities and the firm's strategic imperatives, or with the attention that key stakeholders are placing on the underlying issues. While many companies have a group devoted to sustainability issues and may produce a sustainability or corporate responsibility report, far fewer have board-level oversight that helps set the "tone at the top." In addition, board committees that do have some level of oversight for sustainability-related issues often lack dedicated knowledge in the areas they are responsible for, despite being permitted to hire outside advisors and experts.[11]

About the Handbook

The Director's Handbook on Oversight of Corporate Sustainability Activities attempts to distill a wide range of environmental, social, and governance concepts into a handful of board-level focus areas. It is organized around four recommendations for boards and directors as they consider how best to engage with management on sustainability-related issues:

- Recommendation No. 1: Directors should understand the company's definition of sustainability in the context of the company's strategy and specific circumstances.

- Recommendation No. 2: The board and management should align on the sustainability message and information the company chooses to report publicly.

- Recommendation No. 3: Boards should clarify roles for oversight responsibility of sustainability activities, including external reporting.

- Recommendation No. 4: Directors need to establish parameters for sustainability reporting to the board regarding the information required to support robust discussions with management.

The handbook's appendices include the following information:

- Tips for raising sustainability awareness in the organization (included in this Executive Summary).
- Self-assessment: Is your board sustainability-ready?
- Director perspectives on sustainability oversight: Excerpts from NACD interviews.
- Model charter for sustainability committee of the board.

As sustainability issues and priorities are unique to individual companies, each board will need to develop its own approach to oversight. This handbook attempts to lay a foundation of common language so that corporate directors might more effectively discharge their responsibilities when it comes to safeguarding their company's less tangible assets. One director described his board's view of its sustainability oversight responsibilities in this way:

> Much of our value-added comes from our sponsorship of, and visible support for, the various programs being pursued by the company. Knowing that the board is focused on sustainability helps mobilize [management's] efforts and maintain momentum in the face of competing priorities. We provide encouragement and recognition for the company's accomplishments—both large and small—and help ensure that the programs are well-coordinated among the business units and geographies.
>
> We also complement the company's enterprise risk management program by monitoring the risks and opportunities related to sustainability and climate change, and identifying steps to protect and enhance the company's reputation and brand image.

The complete report is available exclusively to NACD members. To become an NACD member, please contact Kelly Dodd, Membership Development Officer, at 1-202-380-1891 or kkdodd@nacdonline.org. To learn more about NACD, visit www.NACDonline.org.

APPENDIX

Tips for Raising Sustainability Awareness in the Organization[12]

The following are considerations for organizations seeking to make sustainability a higher priority at the executive level. Directors can ask management for an assessment of how well the organization is performing against each of these critical areas.

1. Involve leadership, i.e., tone from the top
Embedding sustainability in a corporate culture requires leadership support from the outset. The sustainability perspective must be consistently communicated throughout the organization by an engaged leadership team that understands the importance of sustainability to the long-term success of the company, is involved in setting goals, and is held accountable for company performance.

2. Include sustainability in the corporate strategy
Consider integrating sustainability into the core of the company's strategy and processes throughout its value chain. Sustainability issues have the potential to affect various aspects of an organization and should not be looked upon in isolation. Determine the business case to include sustainability in other corporate agendas such as innovation, quality, safety, public policy, and human resource initiatives.

3. Employee engagement
A skilled and motivated workforce is a sustainable workforce. Involving employees in the development and implementation of the corporate sustainability program can be motivating, educational, and instill a sense of pride in the company. Consider ways to make it easy for employees to make sustainable decisions at work and in their personal lives.

4. Engage external stakeholders
Stakeholders across the value chain—from suppliers to customers as well as shareholders and members of the community in which you live—are important sources of sustainability engagement and can each provide context and ideas that help enhance the company's sustainability journey.

5. Identify and assess the materiality of risks and opportunities
Employ a systematic approach to determine which environmental, social, and governance issues have the greatest impact on the business and the greatest influence on stakeholder decisions about the company. This allows company leadership to prioritize issues and allocate resources effectively.

6. Look for quick wins
Demonstrating early results helps to accelerate an organization's sustainability journey. It encourages support from stakeholders, illustrating to investors that sustainability is a strategic priority for the company.

7. Set goals and monitor performance
An organization must think strategically about setting sustainability goals. In addition, an appropriate set of criteria and metrics should be developed so as to continuously monitor and report on company performance. Consider whether using nontraditional performance metrics—including those related to environmental and social issues—could help align compensation with risk. In addition to financial metrics, performance goals could align with overall sustainability strategy, including clearly defined metrics relating to such topics as energy efficiency, water usage, health and safety, and the reduction of carbon emissions.

8. Communicate progress internally and externally
An open and transparent approach toward reporting progress on sustainability-related goals can help a company reinforce the importance of environmental and social issues and enhance the company's brand.

Endnotes

[1] David Kiron et al., "The Innovation Bottom Line," The Boston Consulting Group *BCG Perspectives*, Feb. 5, 2013, www.bcgperspectives.com/content/articles/sustainability_energy_environment_innovation_bottom_line.

[2] Jacquelyn Smith, "The World's Most Sustainable Companies of 2014," *Forbes.com*, Jan. 22, 2014, www.forbes.com/sites/jacquelynsmith/2014/01/22/the-worlds-most-sustainable-companies-of-2014.

[3] "Corporate Sustainability Reports Reach 86% of U.S. Largest Companies," *SustainableBusiness.com*, Dec. 9, 2013, www.sustainablebusiness.com/index.cfm/go/news.display/id/25389.

[4] EY, "Let's Talk: Governance: 2014 Proxy Season Review," July 2014, www.ey.com/US/en/Issues/Governance-and-reporting/EY-2014-proxy-season-review.

[5] Matteo Tonello, "Sustainability in the Boardroom," The Conference Board *Director Notes*, No. DN-008, June 2010 [hereinafter "Sustainability in the Boardroom"].

[6] Boston Consulting Group, "Study Shows Increased Profits for Companies That Embrace Sustainability" (press release), Feb. 5, 2013, www.bcg.com/media/PressReleaseDetails.aspx?id=tcm:12-126773.

[7] Ceres and Sustainalytics, *Gaining Ground: Corporate Progress on the Ceres Roadmap for Sustainability* (Ceres: Boston MA, 2014) [heeinafter *Gaining Ground: Corporate Progress on the Ceres Roadmap for Sustainability*]. The report states: "32% of companies' (198) board of directors formally oversee sustainability performance, up from 28% in 2012" *id*. at 13. This refers to 32% of companies in tiers 1 and 2 (the report evaluated 613 of the largest publicly traded U.S. companies on integrating sustainability and divided them into one of four performance tiers.). *See infra* note 8 for a March 2014 study by the Sustainable Investments Institute found that 277 S&P 500 companies, or 55.4 percent, have board-level oversight of sustainability issues.

[8] Sustainable Investments Institute and Investor Responsibility Research Center Institute (IRRCi)*, Board Oversight of Sustainability Issues: A Study of the S&P 500* (New York NY: IRRCi, Mar. 31, 2014), http://irrcinstitute.org/pdf/final_2014_si2_irrci_report_on_board_oversight_of_sustainability_issues_public.pdf [hereinafter *Board Oversight of Sustainability Issues*].

[9] "Sustainability in the Boardroom," *supra* note *5.*

[10] Business for Social Responsibility (BSR) and Global Compact LEAD, "Board Adoption and Oversight of Corporate Responsibility" (discussion paper), Apr. 4, 2011, www.bsr.org/reports/BSR-LEAD_Discussion_Paper_Board_Adoption_and_Oversight.pdf.

[11] *Board Oversight of Sustainability Issues, supra* note *8.*

[12] Ernst & Young LLP and Miami University, COSO (Committee of Sponsoring Organizations of the Treadway Commission), *Demystifying Sustainability Risk* (New York NY: EY, May 2013).

About the Contributors

Center for Board Matters

EY's Center for Board Matters

Effective corporate governance is an important element in building a better working world. EY's Center for Board Matters is committed to bringing together and engaging with boards, audit committee members and investors to exchange ideas and insights. Using our professional competencies, relationships and proprietary corporate governance database we are able to identify trends and emerging governance issues. This allows us to deliver timely and balanced insights, data rich content and practical tools and analysis to boards, audit committees, institutional investors and others interested in governance topics. Additional information about the EY Center for Board Matters can be found at www.ey.com/boardmatters.

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Climate change and sustainability continue to rise on the agendas of governments and organizations around the world with rapidly evolving drivers and expectations. Your business faces regulatory requirements and the need to meet stakeholder expectations as well as respond to the opportunities presented for revenue generation and cost reduction. This means a fundamental and complex transformation for many organizations and the embedding of climate change and sustainability into core business activities to achieve short term objectives and create long-term shareholder value. The industry and countries in which you operate as well as your extended business relationships introduce additional complexity, challenges, responsibilities and opportunities. Our global, multidisciplinary team combines our core experience in assurance, tax, transactions and advisory with climate change and sustainability skills and deep industry knowledge. You'll receive a tailored service supported by global methodologies to address issues relating to your specific needs. Wherever you are in the world, EY can provide the right professionals to support you in achieving your potential. It's how we make a difference. Additional information about EY Climate Change and Sustainability Services can be found at www.ey.com/us/sustainability.

NACD's mission is to advance exemplary board leadership—for directors, by directors. We deliver the knowledge and insights that board members need to confidently navigate complex business challenges and enhance shareowner value. We amplify the collective voice of directors in setting a substantive policy agenda.

NACD was founded in 1977 as the only national membership organization created for and by directors. Today, more than 15,000 directors and key executives from public, private, and nonprofit companies rely on us for board development, resources, education, and connections.

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