

Catalysing ‘Sustainability’ dimension of Corporate Governance

In the last few years, the emphasis of governance has started extending from “shareholder” to “stakeholder” and consequently from mere “Profitability” now to “Sustainability”. Growing companies have realised that it is necessary to govern themselves focussing on sustainability with long term sustainability which calls for strengthening and re-orienting the business strategies and the governance framework in harmony with sustainable development goals.



Dr. S. K. Gupta, FCS

Managing Director & Chief Executive Officer
IPA of Institute of Cost Accountants of India, New Delhi
cbst.sk Gupta@gmail.com



Dr. Nandita Mishra

Associate Professor, Dept. of Commerce & Finance
Amity University, Noida
nmishra2@amity.edu



It is an undisputable fact that the concern for sustainable development has entered our life and caused quite a lot of things to change. Maybe one of the most important changes that should be mentioned is the way the business world begins to think, work and act. The companies, especially the big transnational corporations have started taking the sustainable development issues seriously. What has changed is that the management boards and the executives have begun bearing in mind the sustainability issues in all their activities and actions. The mindset of the business leaders, of the “people with money” has begun to change and getting profits and more money is no longer the only leading principle in the corporate governance world. The sustainable development ideas have entered there as well and have the potential to improve this world for the better.

CORPORATE GOVERNANCE

Despite economic growth in the era of neoliberal globalization, the first round of the neoliberal reforms failed to reduce global poverty and inequality, which led to economic and political instability. This approach did not recognize the challenges which such development policy creates in terms of results. Growing concern about environmental degradation, disappointment with development efforts to reduce poverty and inequality on a global scale together with economic and socio-political instability has shifted focus from the model of economic growth to the new model of sustainable development. There are changes in society, the thinking and behaviour of people is changing, business environment is changing, new trends and concepts being developed - to which enterprises should respond appropriately if they have to ensure their success in the long run on a sustainable basis.

At a fundamental level, the word governance comes from the Latin root “gubernare” - meaning to steer or to pilot. Corporate governance, as first defined by the UK Cadbury Committee in 1992, is “the system by which companies are directed and controlled.” However, corporate governance is more than the system of specific checks and balances that contribute to the responsible oversight of a company. Corporate governance is concerned with achieving a balance between social and economic objectives, and between the objectives of individuals and the company. The corporate governance matrix exists to encourage the efficient use of resources and also to ensure that someone is held to account for the way in which these resources are used. The goal is to align as closely as possible the interests of individuals, corporations and society”. (Sir Adrian Cadbury, ‘Global Corporate Governance Forum’, World Bank, 2000). It’s the all-encompassing mechanism that, when

implemented effectively, imparts integrity, ethics, transparency, accountability and culture across the company. Corporate governance is a combination of structures and processes. While the structures refer to all the bodies responsible for the firm's direction and control, the processes consist in the activities developed to satisfy the stakeholders' expectations. Good governance is not only important for corporations, it's important for society. Corporations that recognize that their business impacts the environment around them create an innate sense of accountability to their societies. Sustainability governance is a part of the overall governance structure in which an organization defines its management responsibility and oversight for sustainability activities and performance.

SUSTAINABILITY AND SUSTAINABLE DEVELOPMENT

The term sustainability has many definitions, starting from the broadest one included in the Brundtland Report (1987). Corporate sustainability means that companies should consider the future as well as the present in their decision-making and actions, with the aim of using their resources for creating value in the long run. Sustainability is a long-term vision that characterizes socially responsible companies and that refers to a concept of global corporate responsibility including legal, economic, social and environmental aspects. This approach implies the balance of interests of all those who contribute to the current and future company's success, by means of sustainable value creation that satisfies both shareholders and other stakeholders in the long term. Corporate sustainability is understood as the ability of a company, through its governance practices and market presence, to positively influence ecosystems (improving natural resources, reducing pollution levels, etc.), society (supporting local populations, creating employment etc.) and economic development (distributing wealth through dividends, paying fair salaries, respecting supplier payment obligations etc.)

The principles of sustainable development include: Stable and long-term economic growth; proportionate and balanced economic and social development, Active employment policies Reduction of regional differences; Growth of personal income and consumption, Preservation of the environment for future generations and efficient usage and allocation. Sustainability is a long-term vision that characterizes socially responsible companies and that refers to a concept of global corporate responsibility including legal, economic, social and environmental aspects. Over the last decade, concerns about sustainability among companies have increased, which has also led to an increase in their investment on issues related to sustainability. The Dow Jones Sustainability Index is an opportunity for companies to differentiate themselves. In fact, the DJSI considers sustainability as a business model that allows companies, which take economic, social, and environmental risks and opportunities into consideration in their management decisions, to be identified.

CATALYSING SUSTAINABILITY THROUGH CORPORATE GOVERNANCE

In today's economy, companies are facing intense pressure and scrutiny around their corporate behaviour apart from their own jurisdictions, also from communities, investors and customers across the globe. Now more than ever, companies are being

held accountable for their actions, as their size, power and influence expands across borders and has profound impacts on societies and stakeholders. Corporate governance is a structure that boards and senior managers rely on to help them manage the company responsibly and according to sound ethics and accountability. The principles of corporate governance are based on transparency, accountability, responsibility and fairness. Those four principles are also inherently related to the company's corporate social responsibility. Good corporate governance and social responsibility help corporations keep things in good balance. It also supports the company's efforts to develop control mechanisms, which will also increase shareholder value and promote satisfaction with shareholders and stakeholders.



Corporate Governance and Sustainability (Saltaji, 2013)

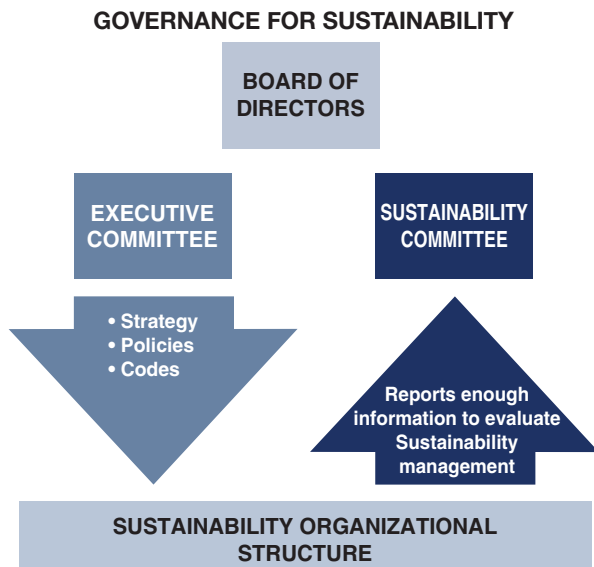
In 'sustainable development' and 'governance' we possibly have two of the most essentially contested terms in the entire social science. There is an ongoing debate about the meaning and application of sustainable development in a business context. It is determined in different ways. In a broad sense, the sustainability of a company means examining its development over time, taking into account its commitment to a healthy environment, economic and social systems. The literature survey provides evidence that the paradigm of corporate governance has shifted progressively towards contemporary social and environmental issues. Sustainability is complex and multidimensional, in the sense that firms have three obligations in society. Companies not only are expected to produce economic results, but they are also expected to simultaneously demonstrate environmental and social performance. Nowadays the issues of sustainable development are everywhere around us. Everybody talks about sustainability in all aspects of our life. It is becoming also part of the agenda of the business world for the small and medium size companies also. Gradually environmental and social issues begin to pose new topics in the agenda for board meetings of the big corporations. The corporate governance begins to pay more and more attention not only to the return rate of the investments but also to the footprint that the company has on the society.

Corporations are also taking a look at how they can incorporate sustainability into their strategic planning. In taking this approach, companies need to take four key aspects into account. These key aspects hold equal importance.

1. **Societal influence:** This refers to how society impacts the corporation, including the influence on stakeholders.
2. **Environmental impact:** This refers to the impact of the corporation on the geophysical environment, such as water waste, paper waste and energy waste.
3. **Organizational culture:** This refers to the relationship between the corporation, including its managers, and its internal stakeholders, particularly employees, and all that those relationships entail.
4. **Finance:** This refers to the impact of the corporation's financial return in relation to the potential for risk and the level of risk.

THE GOVERNANCE OF SUSTAINABILITY

Good governance is widely acknowledged as a foundation for sustainable development, including sustained and inclusive economic growth, social development, environmental protection and the eradication of poverty and hunger. There are now widely accepted arguments that governance should play a stronger role in SDGs agenda. Indeed, in order to achieve the economic, social and environmental objectives, it is necessary to establish good governance by first identifying the mechanisms, process and outcomes.



Source: Sustentare

The relevance of sustainability for the business activities of organisations has led to the need to include sustainability management as a direct formal responsibility of Boards of Directors.

In order to carry out its role of supervising sustainability, the Board of Directors must:

- Implement a Governance Model that can evaluate and advise executive management of the company about the principles, policies, commitments and actions that need to be taken to meet the expectations of shareholders and of society in relation to Sustainable Development and Corporate Responsibility;

- Have a sufficient number of Non-Executive Directors with the knowledge and experience to evaluate and challenge executive management regarding the implementation of all actions in the area of sustainability;
- Set up mechanisms and communication channels which make sufficient and necessary information available to Non-Executive Directors to evaluate sustainability management in the organisation;
- Separate the powers of supervision and execution at all hierarchical levels of the organisation in order to provide relevant and independent information about the company's results (e.g. Internal audits, Inspections, Information systems, whistle blowing, etc)

For the Board of Directors to carry out its role of creating and executing a coherent sustainability strategy, it must:

- Formally make a clear commitment in relation to social, environmental and ethical issues, and identify a set of specific goals, which also reflect society's expectations;
- Create or adopt company standards which communicate succinctly the organisation's commitment to sustainable development
- Build a strategic and differentiating strategy for Sustainable Development, which reduces social, environmental and economic risks with the potential to impact the present and future performance of the company, and /or takes advantage of the economic, social and environmental opportunities that have the potential to maximise the present and future performance of the company;
- Develop a structured and intensive internal and external stakeholder dialogue, leading towards the set-up of external stakeholder panels, which interact directly with the Board of Directors.
- Adopt a sustainability organisational structure that involves the main leaders of the company and those responsible for both the positive and negative impacts of the company, which will maximise the effectiveness of the implementation of sustainability programs;
- Build management controls and procedures that allow the results of sustainability management in the organisation to be evaluated and communicated.

SUSTAINABILITY GOVERNANCE BEST PRACTICES

1. **Strategy and Culture:** The board ensures material Environmental, Social and Governance (ESG) risks and opportunities are addressed by the company's strategy and that sustainability is integrated in the culture.
2. **Oversight and CEO Relations:** The board establishes a governance structure to enable oversight of the company's management of ESG issues, risks and opportunities and includes ESG in CEO relations.
3. **Risk Management and Major Decisions:** The board ensures ESG-related risks and opportunities are integrated into the company's management of enterprise risk and major corporate decisions.
4. **Board Composition and Competency:** The board builds ESG into board renewal, education and evaluation systems.
5. **Disclosure and Shareholder Relations:** The board provides oversight of the company's disclosure of its ESG performance and position and ensures shareholders have appropriate ESG information.



FACTORING CORPORATE GOVERNANCE IN SUSTAINABILITY EFFORTS

Sustainable governance considers not only the board's role in ensuring the long-term and enduring success of the company but also includes the steps the board takes to ensure it performs an effective oversight function of the organization's social and environmental performance. Board governance should include the interests of all company stakeholders and should consider the impacts of ESG-related risks and opportunities. More companies are now acknowledging that relationships within corporate governance are not only between shareholders, management and the board, but also with the company's key stakeholders and the community in which the company operates. Boards must question the effectiveness of their internal controls and evaluate their governance processes by asking in depth and challenging questions such as:

- How well does the board understand the pressing new risks that are affecting their company?
- To what extent is the board considering and actively discussing ESG-related risks and opportunities?
- What does the communication and oversight look like between sustainability and other relevant business functions?
- Are there specific key performance metrics and indicators around ESG related issues that are being supervised by top-level management?
- Is the board composed of directors with relevant skills, education and expertise?
- Are the remuneration incentives in line with the company's strategy that promotes long-term growth?

CORPORATE GOVERNANCE AND SUSTAINABILITY - ACTION AGENDA

A critical question is 'how will sustainable development be implemented?'. It must be understood that sustainable development does not just 'happen' in an automatic or preordained way. It needs to be carefully discussed, openly debated, and possibly even centrally planned. Crucially, these governing processes are unlikely to take place in an institutional and political vacuum. On the contrary, they will need to be embedded in systems of governance, and targeted at particular steps in the policymaking process such as options appraisal, decision making, and/or implementation. When integrating the concept of sustainability, the company should develop management models and strategies that will lead to

the creation of social, environmental and economic values. It is necessary to set up corporate governance structure and mechanisms which incorporates a positive response to the country's social, economic and environmental risks and opportunities. Desired actions include : Integrate sustainability into the business process management (sustainability must become an integral part of strategic management and business planning), Integrate sustainability into the measurement and performance management (quantify the effects of sustainable activities in the financial performance and its impact on the growth of shareholder value), Identify appropriate business performance metrics (identification of social, environmental and economic indicators that impact internal and external stakeholders).

The Organisation for Economic Cooperation and Development checklist for improving governance for sustainable development.

THEME QUESTIONS

- **A clear understanding of sustainable development (SD):** Is the concept of SD sufficiently clear and understood by the all employees and other related parties?
- **Clear commitment and leadership:** Is there a clear commitment at the highest level to the formulation and implementation of SD objectives and strategies? Is this commitment effectively communicated across all hierarchical levels in the organization?
- **Specific organizational mechanisms for management of sustainability considerations:** Is there an organizational 'catalyst' in charge of enforcing SD strategies? Are there specific reviews of laws and regulations to check whether they conflict with sustainable development? Is SD integrated into budgeting, appraisal, and evaluation processes?
- **Effective stakeholder involvement:** Do mechanisms exist with government or independent organisations to ensure that consumers are informed about the consequences of their consumption decisions? Are there guidelines on when, with whom, and how consultations should be carried out? Are transparency mechanisms being reinforced at different levels of stakeholder engagement?
- **Efficient knowledge management:** Are there transparent mechanisms in place for managing knowledge? Is the flow of information between the experts and decision makers efficient and effective?

“ Sustainable governance considers not only the board's role in ensuring the long-term and enduring success of the company but also includes the steps the board takes to ensure it performs an effective oversight function of the organization's social and environmental performance. Board governance should include the interests of all company stakeholders and should consider the impacts of ESG-related risks and opportunities.

TOP DOWN INTEGRATION

Since the Board of Directors sits at the apex of a corporation, governance plays a central role in the implementation of a sustainable strategy. By altering board composition and board structure, a company can foster effective corporate governance that integrates ESG-related risks and manages stakeholder interests. However, to successfully achieve sound corporate governance, a company should look beyond the structural and compositional aspects. In order to fully comprehend effective corporate governance in its entirety, a company should understand that corporate governance is only as good as the sum of its parts and processes, that impart culture, integrity, respect and reliability. The first impulse for sustainable corporate strategies stems from the board of directors. The presence of a leader who raises followers' commitment to achieve the organizational mission and objectives is a prerequisite to transfer the principles of sustainability into the goals and behaviours of the whole organization. Boards can better integrate sustainability throughout the systems and process:

- By establishing clear lines of responsibility, between executives, committees, managers and regional business functions. In doing so, a company can encourage accountability towards certain targets and goals.
- By establishing oversight and monitoring mechanisms such as frequent assessments, evaluations or reports to the board or committee responsible.

BOARD LEVEL COMMITTEE DEDICATED TO ESG ISSUES

Creating a board-level committee that is responsible for ESG or sustainability oversight is a well-known approach for improving corporate governance and internal controls over sustainability issues. By restructuring boards and adding a specialized committee, a company can establish accountability for the oversight and consideration of ESG issues, as well as a line of responsibility throughout the various business activities and day-to-day operations. A regular report from the committee to the full board, comparable to reports from other standing committees, can help raise the board's level of understanding and ensure that critical issues receive the scrutiny they require

SUSTAINABILITY EDUCATION, SKILLS AND EXPERTISE AT BOARD LEVEL

Boards often seek directors who have expertise and relationships that could facilitate challenging and innovative

decision-making. However, research reveals that sustainability or ESG related skills and experience are rarely taken into consideration. Not every director or member of senior management can be an 'ESG expert' but directors and appropriate company personnel should educate themselves on the key ESG issues facing the company and be able to converse comfortably on those issues that matter or present significant risks.

ESG RELATED ISSUES IN ENTERPRISE RISK MANAGEMENT AND INTERNAL CONTROL PROCESSES

Another vital element of any corporate governance structure is how it identifies and reacts to operational risks and opportunities. There has been an evolving discourse that has petitioned for the inclusion of ESG-related risks within governance processes such as Enterprise Risk Management (ERM) and internal control mechanisms. In order to act in the best interests of the company, directors should be expected to consider and identify the long-term risks to a company's interests and to take steps to mitigate them. Specifically, directors should have an explicit duty to identify and mitigate all the economic, social and environmental factors

EXECUTIVE REMUNERATION: PAY FOR SUSTAINABILITY PERFORMANCE

In the absence of well-defined metrics and targets tied to tangible plans, ESG integration becomes vague and less likely to be achieved. One way in which a board can facilitate ESG integration is to establish executive remuneration incentives that take into account social and environmental factors. Linking ESG performance measures to remuneration metrics is an emerging trend the world over.

CULTURE, ETHICS AND VALUES

In the wake of multiple high-profile scandals of corruption, bribery, and ethical conduct, boards are drawing more attention to the culture that is embedded throughout the organization. A common approach to standardizing and controlling the culture throughout a company is to establish a "code of ethics," "code of conduct. Culture in business is a key ingredient in delivering long term sustainable performance. When there is a healthy culture, the systems, the procedures and the overall functioning and mutual support of an organization exist in harmony. This brings enhanced integrity, confidence, long-term success and, trust of all stakeholders.

ASSOCIATION WITH RESPONSIBLE SUPPLIERS

Sustainable and responsible sourcing is becoming decidedly important for companies competing in international markets. Sustainable and responsible sourcing bases supplier selection on social and environmental criteria, in addition to an economic assessment. The company evaluates potential suppliers using specific frameworks and models; then, it signs manufacturing and commercial agreements with those who have received a high score. Such agreements usually contain contractual obligations for responsible conduct in addition to an economic assessment.

SUSTAINABILITY PRACTICES

Businesses are big users of natural resources, so it makes sense that they'd also be interested in operating as "green" as possible without compromising the vitality of their operations. Many businesses are finding that a good way to do this is by incorporating conservation principles into their mission, culture and strategic planning. Companies are trying to develop a culture that encourages all employees and other stakeholders to reserve energy, cut costs, reduce waste and enhance other environmental factors

SUSTAINABILITY REPORTING

Companies are no longer seen merely as instruments of the shareholders, but they exist within society, so they have responsibilities to that society: a wide variety of other stakeholders are interested in the company, are affected by and influence its activities. Sustainability reporting is a tool to increase transparency and accountability in the issues that traditional financial reporting is not dealing with. These include the linkages between environmental, social and economic issues as well as long-term perspective. Reporting on sustainability matters has increased in the private sector since the 1990s (WGEA, 2013). Social and environmental information disclosures reduce the information asymmetry between stakeholders and organization that leads to harmonization of corporate and societal objectives.

FINAL THOUGHTS ON CORPORATE GOVERNANCE AND SUSTAINABILITY

Companies who do not respond to sustainability will "almost certainly face extinction." In line with this bold assertion, sustainability is perhaps the most recent of firm imperatives argued to better align an organization's economic mandate with broader social objectives. A sustainability-oriented board can really be a change agent. it can maintain a constant dialogue with all the stakeholders and ensure that sustainability is dynamically integrated into corporate objectives and business operations to create a shared sustainability culture. Corporate Governance is a crucial catalytic for the achievement of Sustainable Development Goals (SDGs) for which three aspects of governance need to be considered: good governance (the processes of decision making and their institutional foundations), effective governance (the capacity of countries to pursue sustainable development), and equitable governance (distributive outcomes).

Good governance ultimately fosters sustainability, creates sustainable values and helps companies achieve their values. Companies also realize long-term benefits, including reducing risks, attracting new investors and shareholders, and increasing the company's equity. As the quest for corporate sustainability continues to improve and enhance the principles of good corporate governance, companies will feel pressured to support their efforts with transparency and public disclosure. Transparency efforts will provide information to the general public on the relationship between corporate governance and improved sustainability. Harmonizing corporate governance with sustainable development will give the companies the ability to offer products and services that attach environmental, social and financial value to their levels of quality, perceived as such by customers and providing a clear license to operate (from all relevant stakeholders). Furthermore, the sustainable

“Companies are no longer seen merely as instruments of the shareholders, but they exist within society, so they have responsibilities to that society: a wide variety of other stakeholders are interested in the company, are affected by and influence its activities. Sustainability reporting is a tool to increase transparency and accountability in the issues that traditional financial reporting is not dealing with. These include the linkages between environmental, social and economic issues as well as long-term perspective.

development policy has led to the emergence of the "socially responsible investors". They are investors that follow closely the work of the companies they invest in and are very much interested on their sustainable development performance. In today's world, a sustainable approach to corporate governance can be a source of competitive advantage and a long-term success factor for any firm. 

REFERENCES:

1. Argyriades, Demetrios (2006). Good governance, professionalism, ethics and responsibility. SAGE Publications: International Review of Administrative Sciences, Vol. 72(2), p. 155-170;
2. Brugmann, J. and Prahalad, C.K. (2007) Cocreating Business's New Social Compact, Harvard Business Review, 85, 80-90.
3. Campbell, J.L. (2007) Why Would Corporations Behave in Socially Responsible Ways? An Institutional Theory of Corporate Social Responsibility, Academy of Management Review, 32, 946-967.
4. Adrian Cadbury ; The Cadbury Report 1992
5. Gimenez C. , Sierra V. , Rodon J. , 2012, Sustainable operations: Their impact on the triple bottom line, Production Economics 140 (2012), 149–159
6. Hewson M, Sinclair T (Eds), 1999 Approaches to Global Governance Theory (University of New York Press, New York)
7. Jukneviene V. and Krateivaite R. (2012). Good governance as the instrument for the implementation of sustainable development's conception. Social Research. Nr. 3 (28), 28
8. Kocmanová & Alena (2011). Corporate governance and sustainability. Economics & Management, 16, 543-550.
9. Marlow, D.R.; Moglia, M.; Beale, D.J.; Stenstromer, A. Embedding sustainability into a utility's business culture. J. AWWA 2012, 104, E121–E126
10. Organisation for Economic Cooperation and Development (OECD, Paris) – A checklist for improving policy coherence and integration for sustainable development
11. Salvioni, D.M.; Gennari, F. Corporate governance, sustainability and capital markets orientation. Int. J. Manag. Sustain. 2014, 3, 469–483
12. UNDESA; UNDP; UNESCO (2012). Governance and development: Thematic Think Piece. New York: UN System Task Team on the post-2015 UN Development agenda