

Winds of Change:

Environmental Sustainability Rises
to the Board Level



iligent
Institute



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WE ARE DILIGENT INSTITUTE

The Institute provides publicly available, industry-leading research on global board governance. Today's increasingly dynamic world presents a dizzying array of economic opportunities and challenges. As companies navigate that environment, high-quality governance is more important than ever to ensure effective oversight, protect and create jobs, and positively impact the economy. The Institute equips board directors and corporate leadership teams at organizations around the globe with the information to make forward-looking decisions that leave a meaningful mark on the world.

Diligent Institute was founded in 2018 to offer a global perspective on the complex and disruptive board governance topics that directors and leadership teams are tackling today. The Institute serves as the global governance research arm of Diligent Corporation®, the leading Enterprise Governance Management provider of secure corporate governance and collaboration solutions for boards and senior executives.

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Executive Summary

With high-impact weather events on the rise, natural resource scarcity increasing, and the other looming impacts of climate change, boards of directors are facing intense pressure from stakeholders to get more involved in environmental sustainability governance. Diligent Institute set out to understand how directors and boards globally are engaging with this complex set of issues.

This report found that environmental sustainability conversations are already happening in boardrooms around the world:



Had board-level conversations over the past 3 years



Discuss environmental sustainability issues at least annually



Cover the topic at least quarterly



89%
Expect an increase / the same level of discussion over the next 3 years



2%
Expect a decrease in discussion over the next 3 years

Furthermore, despite the level of board discussion on the subject, organizations have not yet embraced formal governance processes. Almost half of the respondents (48%) reported that their board had no established governance policies or practices related to environmental sustainability issues.

Directors have a myriad of interrelated reasons to elevate environmental sustainability to the board level, but the most common drivers are:



Societal Impact



Long-term viability



Reputational risk

Surprisingly, “investor pressure” was selected as a motivator by only 9% of the directors who took the survey. Meanwhile, this report uncovered that boards have not yet coalesced around a specific ownership structure for the sustainability function. A full 25% said that environmental and sustainability issues were not overseen at all, and 10% of respondents did not know if or how they were governed. However, several respondents indicated that environmental sustainability governance was assigned to a specific group:



Entrust it to the full board



Place it with a board committee



Use some form of below-the-board oversight

The divergences in practice found by this report exist in part because of the dynamic nature of the environmental sustainability governance landscape. But this dynamism, this progress, is a good thing, and it’s here to stay. Each organization will have to determine which approach makes sense for their geography, industry, and company. Environmental and sustainability oversight, reporting, and operating are going on globally. Now, as one respondent put it, it’s “time to add good governance” to those practices.

Introduction

Boards of directors across the globe are tasked with answering some of the toughest questions that an organization can face.

Board members oversee strategy at the highest level and represent the last line of defense for monitoring. Commentators routinely alternate between praising corporate directors for their prudent decisions and pointing fingers at boards for being either unaware or unconcerned about damaging activities occurring at their corporations. With such importance placed on the director's role, it is no wonder that debates about the relationship between international business and critical global issues have reached the boardroom. Environmental sustainability is one such issue.

With high-impact weather events on the rise, resource scarcity increasing, and the looming potential devastation of climate change, all societal institutions are being asked to evaluate their role in contributing to both the problems and the solutions.¹ Boardrooms have not escaped this scrutiny. More broadly, directors are facing increasingly intense pressure to get involved in areas seemingly outside their traditional core functions.

In such dynamic and uncertain times, and with directorship already being more demanding than ever, it's reasonable to wonder where the line should be – if boards engage in governance on environmental issues, or social issues, or questions of company culture, at what point do they infringe on management's domain? To what extent do these societal issues impact the bottom line? Is the fervor of investors and shareholders, the media, the public, and others on environmental issues just a “fad,” or will the pressure mount? To what extent should boards expend time or energy on long-term environmental sustainability planning, versus taking more cursory measures or just waiting it out?

To better understand the ways boards are tackling these questions and what conclusions they are reaching, Diligent Institute developed this report on the governance of environmental sustainability issues. For the purposes of this report, in the survey “environmental sustainability issues” were defined as “anything related to environmental impact or stewardship of the environment, including but not limited to climate change, resource scarcity, air or water pollution, waste disposal, and deforestation.”

By delineating environmental sustainability and studying related governance issues specifically, this report examines the trajectory and significance of one issue at play in the larger sustainability/ESG debate. Beyond that, this report provides specific information and insight into how businesses treat this escalating global crisis. Diligent Institute sought to answer three overarching questions:

1. To what extent do environmental and sustainability issues rise to the level of board consideration?
2. What compels directors to consider environmental and sustainability issues within their oversight?
3. On a practical, structural level, how are boards overseeing environmental sustainability? (Who owns that function? What official or unofficial policies and practices apply? What are the biggest challenges around governing in this area?)

1. Intergovernmental Panel on Climate Change, “Global Warming of 1.5°C,” October 2018, <https://www.ipcc.ch/sr15/>
US Global Change Research Program, “Fourth National Climate Assessment,” November 2018, <https://nca2018.globalchange.gov/>

Diligent Institute concludes that environmental sustainability issues do rise to the board level, and they will likely do so at higher rates over the coming years, even for boards that have rarely governed on the topic before. There are many reasons for directors to prioritize these issues, but the most common ones are “societal impact,” “reputational risk,” and “long-term viability.” The number of boards that formally hold environmental and sustainability issues under their purview is nearly the same as the number of boards that do not. No particular structures or policies emerge as highly popular.

Ultimately, scientists don’t think environmental problems are going away anytime soon, and apparently, neither do directors. If boards are going to devote valuable time to this topic, then it is recommended that boards be proactive and adopt an approach to environmental sustainability governance that actively helps the organization meet its established goals.

DEFINING COMMON TERMINOLOGY

There is a myriad of related terminology commonly used in the literature in this area. The acronym ESG refers to how businesses approach “Environmental, Social, and Governance” issues. This term can be unclear because evaluating board activity around environmental and social issues ultimately becomes a question of how that company governs. Another common acronym in this area is CSR, which refers to “Corporate Social Responsibility.”

The terms do cover similar topics; however, CSR speaks more to companies having a broader “moral” responsibility — a kind of ethical corporate consciousness — where ESG refers to a subset of issues with moral implications that companies might care about for a variety of reasons, some of which might be ethically motivated.

Additionally, “sustainability” has multiple nuanced meanings. In an environmental context, sustainability is concerned with the human behaviors that contribute to the degradation of the planet, the overconsumption of natural resources, and climate change. An alternate definition of “sustainability” refers to a business’s focus on thriving in the long term. In the past few years, investors and directors have begun to shift their focus more toward seeking out long-term profit and value creation.

Some writers and organizations might denote sustainable business practices as anything with a long-term approach or perspective. Others use the term more broadly and include some ESG/CSR topics.

For example, the Sustainable Accounting Standards Board explains in the Introduction to its 77 standards:

“The SASB’s use of the term ‘sustainability’ refers to corporate activities that maintain or enhance the ability of the company to create value over the long term. Sustainability accounting reflects the governance and management of a company’s environmental and social impacts arising from production of goods and services, as well as its governance and management of the environmental and social capitals necessary to create long-term value.”

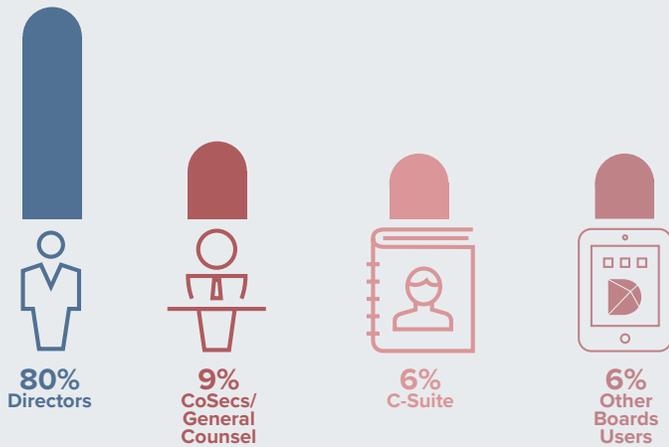
This approach treats environmental, social, and governance issues as valuable because they are integral to the long-term success of the company.

METHODOLOGY

The Diligent Institute Environmental and Sustainability Governance survey was sent through the Diligent Boards™ mobile application to users around the world from September-November of 2018. The previously stated definition of “environmental and sustainability issues” was explicitly stated at the outset of that survey. Interviews were also conducted with a global set of directors, executives, and subject matter experts. Numerous research participants informed this project with their insight, anonymously or on the record, and comments from some of those conversations are included in this report. Any opinions expressed by interviewees are their own, and do not necessarily reflect the position of any of the organizations with which they work.

SURVEY RESPONDENT DEMOGRAPHICS – OUT OF 447 RESPONDENTS

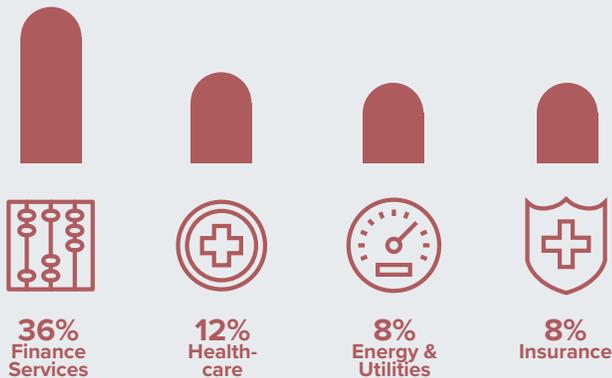
● ROLE:



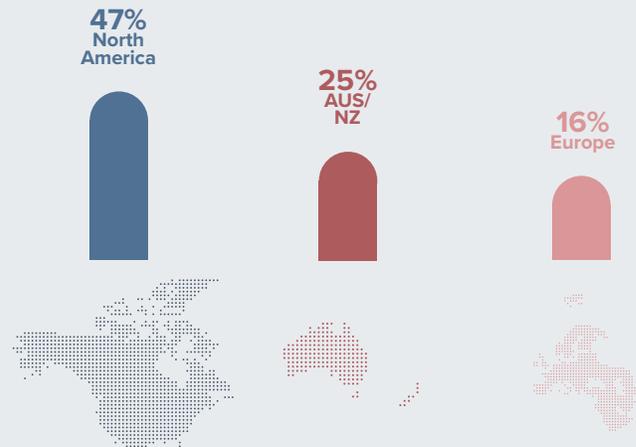
● ORGANIZATION SIZE:



● INDUSTRY:



● LOCATION:





Results

BOARDS ARE NOW DISCUSSING ENVIRONMENTAL SUSTAINABILITY ISSUES

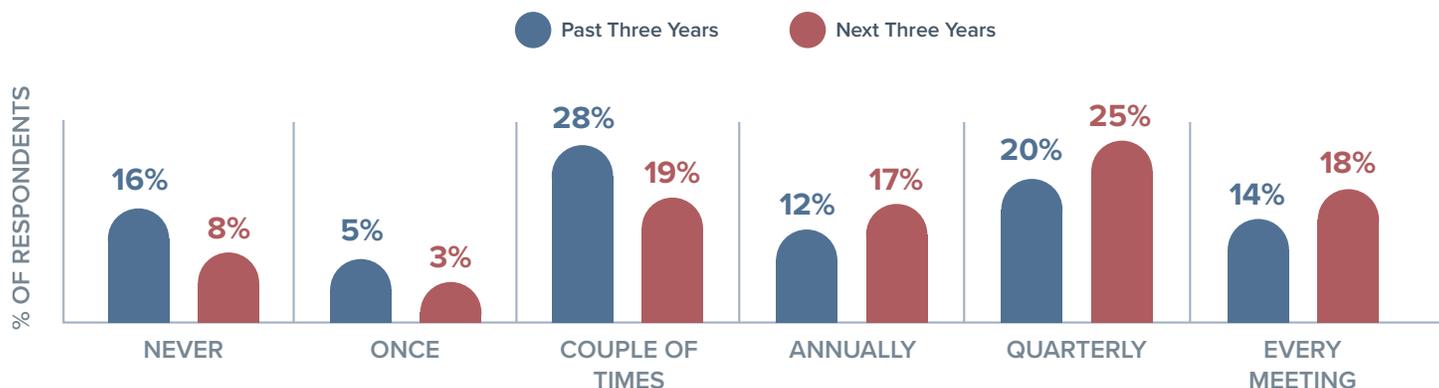
Environmental and sustainability issues are already a topic of discussion in the boardroom. Eighty percent of respondents have had a board-level discussion about environmental sustainability over the past three years. Almost half of the respondents (46%) reported covering the topic at least annually in that time frame, and around a third (34%) discussed it quarterly or at every meeting. Furthermore, 46% of respondents indicated that environmental and sustainability issues are formally overseen at the board level.

Tensie Whelan, Clinical Professor of Business at New York University, the Director of the Center for Sustainable Business, and the former President of the Rainforest Alliance, articulated the historical trend: “I would say that the big shift happened about ten years ago on the corporate side. We started to see corporations ramp up investments in sustainability programs. Consumer products led the way, then commodity companies, mining companies, and pharma companies started looking more to the long term. We started to see significant engagement on sustainability at that time.” Leslie Hosking spent fifteen years as a director and seven years as the chair of Australia’s largest cement manufacturing company, Adelaide Brighton, and ten years as an independent director at AGL Energy Limited, a public electric and gas company in Australia.

“Consumer products led the way, then commodity companies, mining companies, and pharma companies started looking more to the long term. We started to see significant engagement on sustainability at that time.”

She noticed a marked uptick in board focus on environmental issues even more recently. He explained that “about three or four years ago, the emphasis on environmental issues started to increase,” and while climate change played a large role, “it was also driven by the heightened awareness of the media, communities, the public itself, and even some investment companies that were looking at ethical investments and considering if they wished to be invested in energy intensive industries that emitted carbon. Those factors have driven boards to be more conscious of how we report these matters to our shareholders and to the community.”

Frequency of Board Environmental Sustainability Discussions



BOARDS EXPECT THEIR ROLE IN ENVIRONMENTAL SUSTAINABILITY GOVERNANCE TO INCREASE

When asked to make predictions about the next three years, board members demonstrated a belief that governance of environmental and sustainability issues will increase. Fully 89% of respondents expect the amount of board discussion on the subject to increase or stay at the same level over the next three years; only 2% expect a decrease. More specifically, 45% expect an increase or are already talking about it at every meeting. That trend holds across variations in geography, industry, size, region, and listing status.

Even boards who have not yet tackled the topic area before are expecting to start. While 16% of respondents had not discussed environmental sustainability over the past three years, only 8% do not expect that environmental sustainability issues will be covered over the next three years. Across all demographic groups, the percentage of respondents saying that they will “never” discuss environmental sustainability dropped by about half as compared to the past three years. This suggests a consistent trend towards starting board deliberations on the subject.

The pressures on companies to improve on environmental sustainability metrics are only increasing, as Whelan explains, “Sustainability in business has also been clearly ramping up as issues like climate change and water scarcity have taken on far more immediacy people thought that the problem was 30 or 40 years in the future, but really, it’s happening now.”

Craig Winkler, a non-executive director of Xero Ltd. said, “Interest in this area is not changing because company environmental performance is getting worse, but simply because the environment is. There is enough outside interest that it’s going up the list of items that the board spends time on. Personally, I think it’s a bit overdue.”

Both businesses, in general, and public companies, in particular, expect more sustainability discussion than the average respondent. Most public company directors expect environmental sustainability to be a topic of regular discussion at the board level over the next three years.

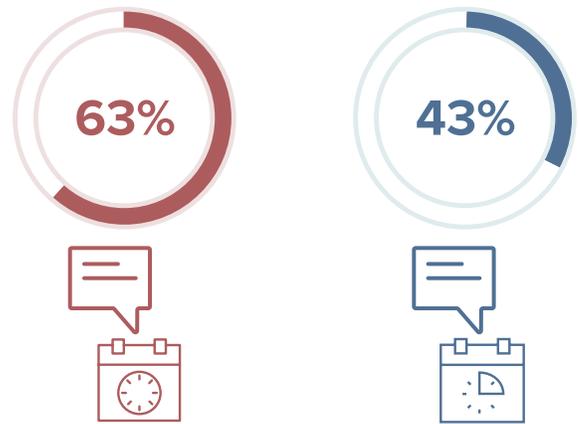
The vast majority of respondents – 72% – expect at least annual coverage, and a striking 53% expect environmental sustainability discussions to occur quarterly or at every meeting. Additionally, businesses expect even more coverage than their not-for-profit and government counterparts. Two-thirds expect discussion of environmental sustainability to occur at least annually, which is 16 percentage points more than those who reported discussing the topics annually over the past three years (For not-for-profit and government organizations, there is a 14 percentage point increase, but only 57% expect annual discussion).

NORTH AMERICAN BOARDS LAG BEHIND BOARDS IN OTHER REGIONS

Boards in North America lag behind those in Australia and New Zealand, Europe, and a grouping of the remaining global respondents in both past and expected governance on this topic, driven mostly by US as opposed to Canadian responses. Australia and New Zealand, on the other hand, have the most extensive experience governing on environmental issues and expect to do the most oversight in the coming years. European respondents were almost as likely as their non-North American counterparts to cover and expect to cover sustainability annually, but they are less likely to believe that they'll reach quarterly or every meeting coverage.

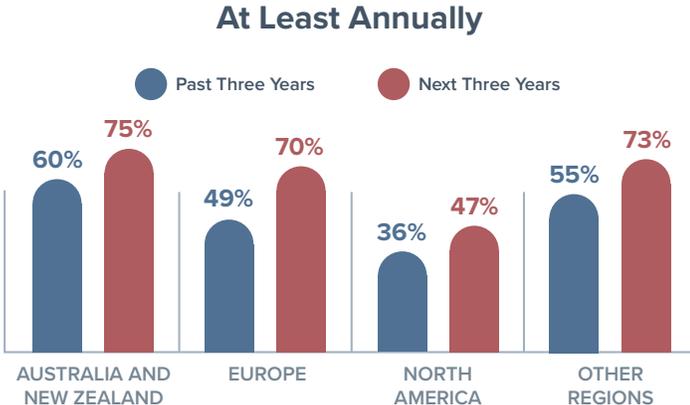
Piere Clarke, the Chief Risk Officer at Barclays - Mozambique articulated one reason why certain regions might be more invested in environmental governance than others, "Living in Africa, you're so clearly able to see the impact of global warming, to see the impact on weather patterns. Generally, we know that we've got to adapt." But US companies weren't feeling the same pressure, as Whelan explains, "some developing countries were more aware that climate change is relevant now (for example Bangladesh is highly effected by sea level rise) but the US had been lagging."

However, the fact that this is changing, albeit more slowly, is reflected in the data. Whelan also noted that "financial risk and consumer pressure are forcing US business to take action. The US government has abdicated a lot of responsibility, so now there is demand from citizens that companies take on responsibility that were never part of their mandate ten years ago."

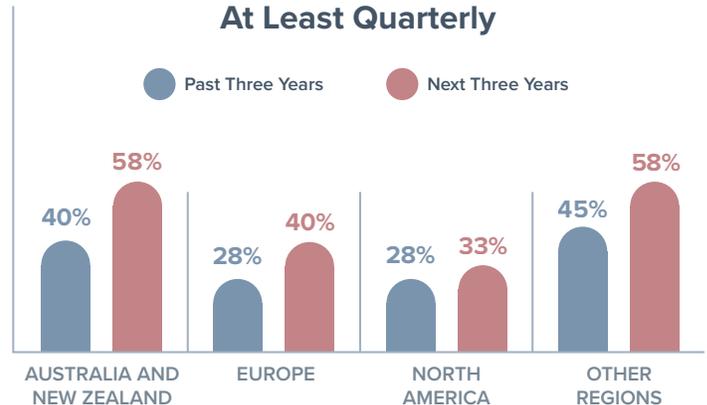


60% of respondents expect discussion at least annually, while 43% expect it quarterly or every meeting.

Percentage Discussing Sustainability At Least Annually



Percentage Discussing Sustainability At Least Quarterly



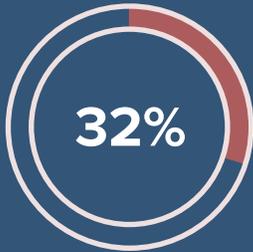


United States v. The Rest of the World



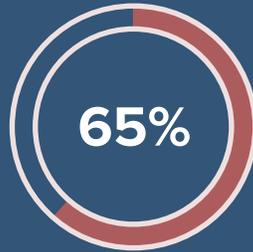
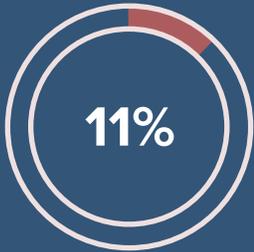
Environmental and sustainability issues are formally overseen at the board level

Reporting on environmental and sustainability issues in some form

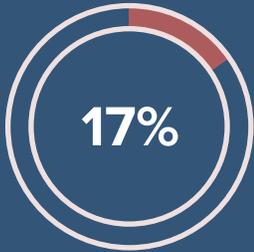


Full board has a formal mandate for environmental and sustainability issues

The board has no established policies or practices around environmental and sustainability issues.



Any committee has formal mandate for environmental and sustainability issues



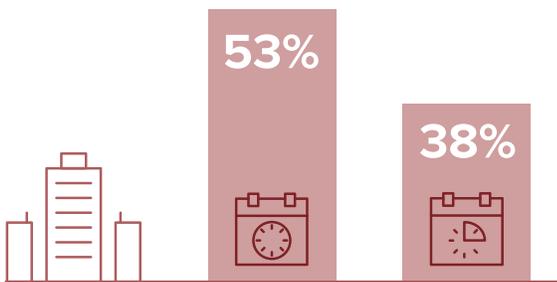


Discussion Frequency: Small & Financial Organizations

Smaller organizations (under 1,000 employees)

also expect increased board coverage, but they are starting from a different place. Compared to the average respondent, 1.5 times as many small organization boards have never broached the topic.

This is likely to change – while 24% had never discussed it in the past three years, only 13% expect to never discuss it in the next three. Environmental issues are often considered beyond the scope or ability of smaller companies, especially when boards are focused on rapid growth or overwhelmed with their monitoring requirements. However, this data suggests that boards at smaller organizations expect to do more environmental sustainability oversight in the future.

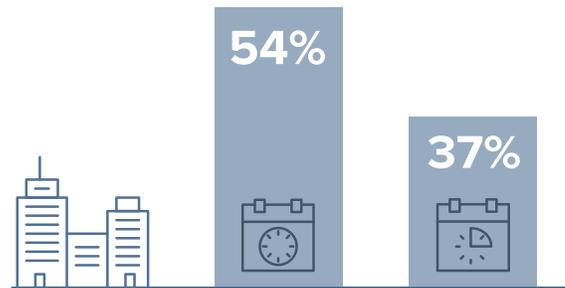


53% of smaller companies expect at least annual discussion, and 38% expect it quarterly or every meeting.

Mark Love, the Corporate Governance Manager and former Chief Risk Officer at Barclays - Switzerland said, “The board agenda is full. There is so much competition for time in meetings. Changes in the regulatory environment have driven that over the past 7-10 years, and we can’t take our eye off the overall strategy of the business as well. Given that, nothing gets muscled in without someone really championing it.”

Companies in the finance and financial services sector provide an illuminating demonstration of how organizations in industries that haven’t historically engaged in extensive environmental sustainability governance might expand board involvement soon.

Finance is not traditionally considered to have a high environmental impact, nor a high level of environmental responsibility; yet, the sector has an even higher increase (17 percentage points) in the number of boards expecting annual discussion than the overall sample does.

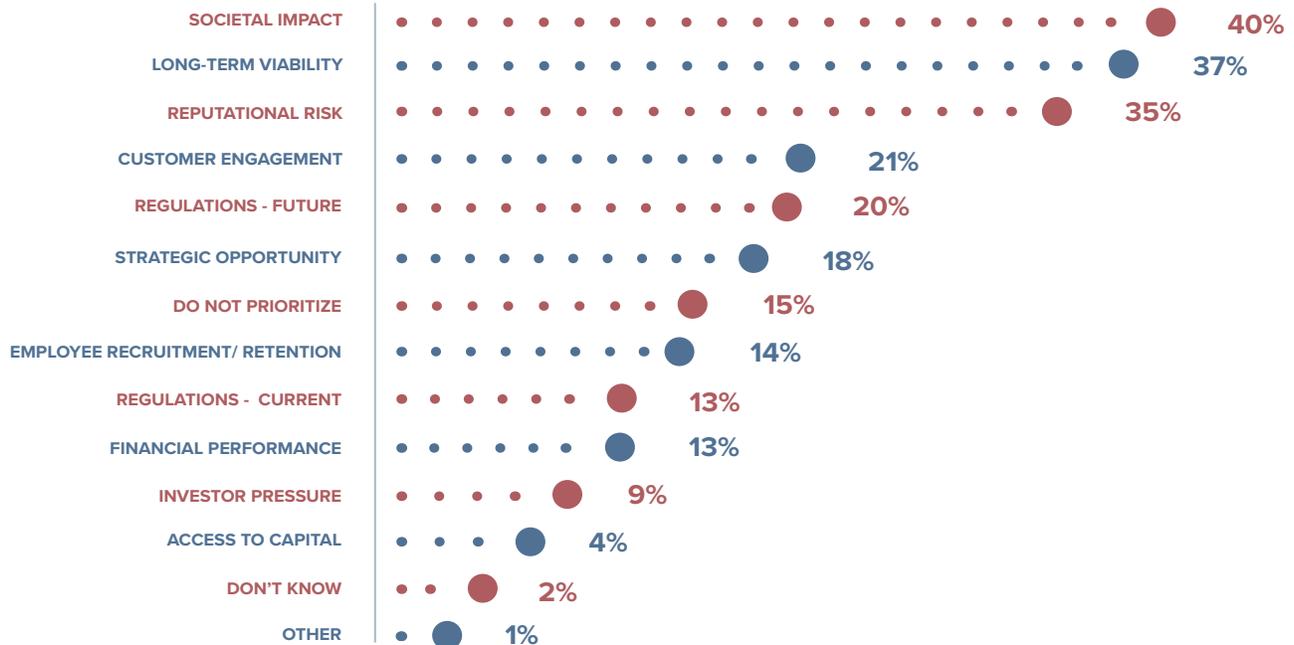


54% of finance companies expect at least annual discussion, and 37% expect it quarterly or every meeting.

Gareth Ackerman, Chairman of the Pick n Pay grocery chain in South Africa, explains, “Every industry needs to think about it now. For example, even the technology industry should be examining where they get their energy from, and what the greenhouse effect is for the energy from their servers.”

Societal Impact, Long-Term Viability and Reputational Risk Are Prime Motivators

Director Motivations for Board Environmental Sustainability Governance



Company directors (excluding not-for-profit and government respondents) were asked to select their primary motivations for prioritizing environmental and sustainability issues at the board level and offered the option to indicate that they do not prioritize them at all. Board meeting time is valuable and scarce. The set of reasons to devote some of it to environmental and sustainability concerns is large, and it varies by industry, locality, and organization type. Many of the reasons are also inextricably related.

Given that, it is especially telling that three motivations emerged so clearly as the most common among directors: societal impact, long-term viability, and reputational risk.

Forty percent of directors indicated that societal impact was one of their top reasons for prioritizing environmental sustainability. This suggests that many directors would like to drive organizational outcomes that benefit the general public.

Given that respondents were able to select multiple motivations, one can also interpret this as more of an aspiration for directors than a driving force for change.

Understandably, fewer directors are willing to or interested in devoting board resources to an initiative without compelling corporate returns – only 6% of directors selected “societal impact” alone.

Two respondent groups are less likely to heavily weigh the societal impact of environmental governance. Directors who have discussed environmental sustainability quarterly or every meeting over the past three years chose “long-term viability” as a motivation 58% of the time, as compared to the 42% who selected “societal impact.” Additionally, organizations with under 1,000 employees selected societal impact less frequently (34%). It makes sense that smaller companies with fewer resources available to devote to these issues would need stronger justification to raise environmental concerns to the board level.

Finally, directors in the United Kingdom were more likely to consider societal impact a strong motivator, with 49% ranking it in their top three. For comparison, 39% of Australian directors selected it, as did 36% of US directors.

The second most commonly cited motivation for directors to elevate environmental issues to the boardroom is long-term viability. The popularity of this option demonstrates that directors see environmental and sustainability issues as key to the future of their businesses. Directors said this was a primary motivation 37% of the time. Environmental pressures are increasingly posing existential threats to companies in a variety of industries.

An oil and gas company or a mining and materials company board must consider resource depletion and, as a respondent explained, an insurance board has to consider variations in the “profitability of business due to climate change losses.” Centering the long-term viability of an organization in boardroom environmental and sustainability discussions enables organizations to proactively plan for an uncertain future and develop a business that can survive in the face of drastic environmental changes. Rather than treating environmental issues like a side project, this way of thinking wraps them into a broader conversation about how to become the kind of organization that can thrive through the long haul. Directors with more experience in governing on environmental and sustainability issues prioritize long-term viability the most highly – as already stated, those directors who have discussed the topic quarterly or every meeting over the past three years selected “long-term viability” 58% of the time, 16 percentage points more often than any other reason.

However, among directors expecting to discuss the topic only annually, it was the third most common motivation at only 33%, and it dropped to fourth at only 22% amongst those expecting to discuss it once or never. In that final subset, it was supplanted by those who said that they don’t prioritize it. This lends credence to the view that more robust environmental sustainability governance programs take a more holistic, long-term approach to the subject. One respondent explained that the biggest obstacle to effective governance in this area was that the “importance for business viability and the business case is underappreciated.”

Reputational risk is the third of the top-tier director motivations for board involvement in environmental sustainability – 35% of directors selected it. Guarding against reputational damage is a traditional motivation to oversee environmental issues within a company.

This motivation is also a conventional component of board responsibility – risk oversight. For some companies, this is already part of the enterprise risk assessment. Historically, the damage to reputational capital from poor environmental oversight would likely come from a single devastating event in that an organization in one of several industries with high-environmental impact could have prevented or resolved more effectively (e.g., oil spill or chemical contamination).

“Investors progressively want to know that boards are paying attention. We should be studying future risks more closely, but that doesn’t always happen when risks aren’t immediate.”

Systemically engaging in environmentally damaging practices could also devastate an organization’s image if revealed. As popular interest in environmental preservation and sustainable business increases, the potential is far higher for news of a company’s environmentally degrading actions to be devastating to its reputation as well, even in cases where the damage itself is smaller. As such, more industries have the potential to face consequences for operating unsustainably. Carina de Klerk, Communications and Investor Relations Manager at Reunert, a South African electronics company, articulated her view: “It should be a part of the risk discussion. The ranking would depend on which industry you’re in. Investors progressively want to know that boards are paying attention. We should be studying future risks more closely, but that doesn’t always happen when risks aren’t immediate.”

Long-term environmental reputational risks are only becoming more likely, and directors are taking note. Industries less heavily intertwined with the environment might not see much impact now, but they could become more heavily scrutinized in coming years.

These three motivations mirror the three most common ways that directors and boards tend to think about environmental sustainability: a great thing to do for the planet and society at large; the key to a long-term value-creating, money-making business strategy; and a necessary step in protecting the company's brand and fulfilling the board's risk-management role. All of these motivations were within 10 percentage points of one another in terms of selection frequency, further reflecting the complicated motivational structure behind sustainability governance. Public company directors actually only had three percentage points of differentiation among these three motivations.

Regulations are an obvious motivation for board involvement in environmental sustainability oversight – 25% of for-profit directors said that regulations drive their prioritization of environmental sustainability issues. Among public company directors, that percentage goes up to 33%. Interestingly, more directors reported being motivated by future regulations than current regulations (20% future and 13% current in the general for-profit sample, 26% future and 16% current among only public company directors). Directors clearly expect increased political and popular pressure on environmental issues to generate increased regulatory requirements. By governing proactively in this area, companies can set themselves up for an easier transformation into regulatory compliance.

Investor pressure was selected as a primary motivation by only 9% of the directors surveyed. Since much of the debate around ESG has centered on investor interest and investor demands, it is noteworthy that so few directors indicated that the pressure caused them to elevate environmental issues to the board level. The number rises slightly (12%) for public company directors, but even then, it pales in comparison to all of the other priorities that drive board action on this topic. It is possible that investors are not applying as much real pressure in this area as much as the commentary would suggest. Each company is likely to have a different experience, but Hosking has noticed investors “using a big stick to force environmental change” in Australia. He says that “proxy advisory focus on environmental issues has been heightened in Australia, and our superannuation fund managers are very much focusing on ESG to the extent that they're contemplating voting against reappointment or remuneration at the AGM if the company doesn't perform well in ESG.”

BOARD PERSPECTIVE

Guy de Selliers, a board member at Ageas S.A., AMG Advanced Metallurgical Group, Ivanhoe Mines Limited, and other privately held companies, explains how this can be particularly significant for a company without a large direct environmental impact:

“At an insurance company that mostly insures families and small businesses, we aren't as directly concerned by the sustainability of our operations because we don't give direct rise to those issues. We are attuned to the topic because it matters to people. We just did a whole exercise on how to position the company for the next 10 years, and there is no doubt that these issues are more important now. People are asking more from corporations than to just make profits. We have to put sustainability at the top of our agenda because employees care about it. For example, we can make decisions about where to invest our money based on sustainability goals. An insurance company only needs periodic board level conversation, rather than frequent ones, because once we make a decision like, ‘we aren't going to invest in coal companies,’ we don't need to revisit it at every meeting.”

Furthermore, De Klerk has seen mounting insistence as well, saying “Investors are asking these questions more regularly now, but it is more the European investors asking. The US investors do so less often. European investors want to understand if you’re a signatory to the UN Global Compact, and we should see a growing interest in how corporates are supporting the Global Goals for Sustainable Development. This is a new focus area that businesses will need to start making strategic decisions about.”

The regional variance in investor pressure likely contributes to how rarely it was selected and to how far the US lags behind other countries on this topic. Another stronger interpretation of this result is that management and investor relations departments are fielding investor requests, so boards aren’t directly engaged.

Finally, it also makes a lot of sense that while investors initially trigger board interest in environmental matters, once discussion has been initiated, most directors develop more nuanced and substantive justifications to move forward with environmental and sustainability governance.

Customer engagement was selected by 21% of for-profit directors. Consumers want assurances that the products and services they engage with are environmentally friendly. In some cases, extraordinary performance by a company in this area can excite a customer base and increase loyalty. This opportunity is driven by the same forces behind another motivation – employee recruitment and retention, which captured 14% of for-profit director responses.

Winkler puts it simply:

“Good corporate citizenship is going up the register of what potential employees are looking for – they want to know that they work for a company doing ‘good things.’ It’s partly generational and partly just the rise in social consciousness around looking for good employers.”

Environmental sustainability initiatives that have board-level oversight and support demonstrate an organization’s commitment to the future of the planet. Another 18% of directors ranked “strategic opportunity” as a top motivation. Even if the specific opportunities vary a great deal between industries, organizations, and geographies, the frequent selection of this catchall strategy option shows that environmental sustainability is increasingly a field where the potential for great financial gain is anticipated.

As De Klerk elaborates: “It isn’t only about the risk. Renewable energy, artificial intelligence, and infrastructure development are just some examples of the business opportunities in this area. The major issue is establishing how you are creating shared value. We’re low on environmental risks because we don’t play in a specific sector and the majority of our businesses are not high energy users. There are really more opportunities for us than risks.”

“As the carer for the next generation of Australians, it is our social obligation to increase awareness of environmental responsibilities. Parents are now expecting that we educate the children about sustainability. My Directors are acutely aware of our ESG responsibilities and actively monitor progress towards our environmental initiatives on a quarterly basis. For example, many of our centres have compost systems and work farms, 80% have a herb or vegetable garden, and our play areas, toys and equipment are environmentally friendly.”

- Mark Johnson, Chairman of G8 Education, which is the largest listed child care provider on the ASX with more than 500 centres across Australia and Singapore

Boards Split on Ownership of Environmental Governance Function

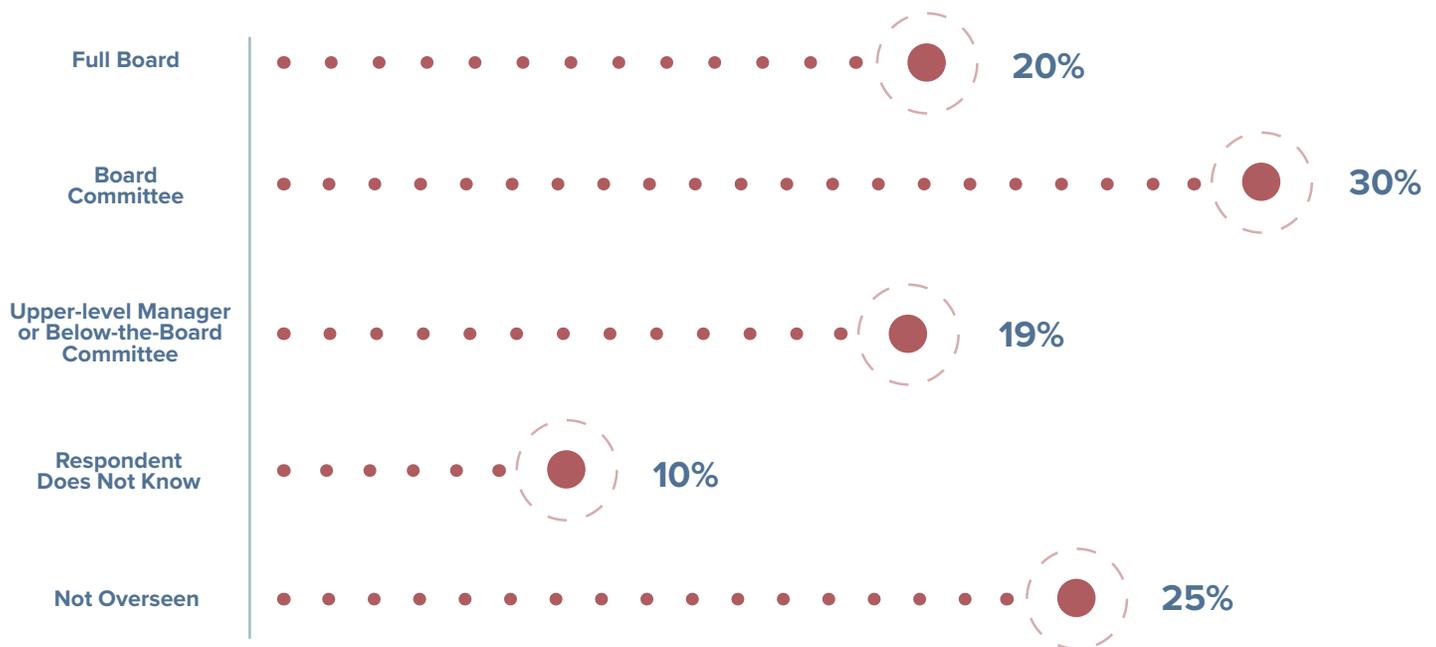
Given the complexity and variety of directors' motivations to cover the issue, it is unsurprising that there is little unanimity on structural best practices. For 46% of respondents' organizations, environmental and sustainability issues are formally overseen at the board level. More specifically, 20% of respondents reported that their full board has a formal mandate covering environmental and sustainability issues, and 30% reported that a board committee is responsible for it.

Another 19% of respondents say that an upper-level manager or a committee below the board level has responsibility for environmental sustainability oversight. On the other hand, 25% of respondents say that environmental and sustainability issues are not overseen at all within their organization. Finally, 10% of respondents admitted that they do not know who in their organization oversees it. There are two main conclusions to draw from these findings.

First, a sizeable percentage of boards see environmental sustainability as formally within their purview. These organizations run the gamut in terms of how often they discuss environmental sustainability issues at the board level, from a couple of times to every meeting.

Second, placing responsibility with a board committee is more popular than the full board. This is not entirely surprising. Among respondents who do have formal board oversight, 36% have an existent committee with a separate primary function (e.g., audit) that also has a charter covering environmental and sustainability issues.

Where does formal environmental sustainability oversight live?



For organizations with limited activity impacted by or impacting environmental issues, this structure seems especially sensible. The risk or audit committee might be a good fit for the kind of oversight work needed, and it doesn't require constantly making space on the full board agenda or restructuring the board entirely. Another 35% of respondents with formal board oversight in this area have either an ESG or CSR committee with a charter covering environmental and sustainability issues or a separate, specific committee dedicated to the task.

This practice might be a better fit for an organization with a significant environmental impact, robust sustainability programs, or board commitment to societal impact and improvement. Alternatively, adding a specific committee for this issue might overtax a board, and many directors are already expressing concerns that there are too many committees for the board to function properly. Ackerman emphasizes that whatever committee does have jurisdiction, "it is critical that it reports back to the board on a regular basis the way that audit and income committees do." Boards can each assess their level of impact and the level of oversight needed and then consider which structure best matches their needs.

A substantial number of boards are taking no oversight steps at all. Given that only 8% of respondents expect to never discuss the issue in the coming years, and that 60% expect annual discussion, it is striking that 25% of respondents report no sustainability oversight and 10% of respondents don't know if or where sustainability is overseen.

Finally, among the companies that don't have board involvement but do engage in high-level oversight, the most common structure was to have an upper-level manager with environmental and sustainability issues included in their responsibilities without it being their full-time job (23% of the respondents without board oversight).

A very small number of respondents had engaged a full-time upper-level manager, like a Chief Sustainability Officer, or had a committee below the board level in charge of environmental sustainability oversight (4% and 6% of respondents without board oversight, respectively). The lack of below-the-board committee oversight is slightly surprising, however.

COMMITTEE OVERSIGHT

Hosking advocates for adding environmental oversight functions to relevant existing committees that have non-financial focus:

"What is becoming common practice now in Australia is that board subcommittees, generally two or more, of say two to four board members each, cover Human Resources, Remuneration, Safety, and now Sustainability and Corporate Governance. The committees generally meet in the weeks prior to the full board meeting and consider in detail reports from operational departments on health and safety areas, plus on people and performance issues, and increasingly sustainability and governance matters. The committees then report lead and lag measures to the full board on the number of safety incidents, the movement of staff, staff confidence, any breaches of environmental legislation, any near misses on leakage from properties, etc. A lot of this has developed in the past two to three years because of increasing attention on the environment and general public awareness. I would say that the top ASX 100 companies all have that type of function these days because we're required by law to produce a sustainability report."

SUSTAINABILITY COMMITTEE

De Selliers, a board member at Ageas S.A., AMG Advanced Metallurgical Group, Ivanhoe Mines Limited, and other privately held companies, believes that for companies with significant environmental impact, a distinct sustainability committee is the best way to get the most value out of governance efforts in the area from his experience in the mining and metals industry:

“It has to be overseen by a committee on the board to make sure that we’re spending the time and effort and money required for our degree of care to be reflected not just in what we say but what we do. At the mining company, sustainability is one of the main concerns of the board, at the top of the agenda, and the committee meets four times a year, and reports to the board every time we meet. I’m happy to be the chair of a sustainability committee because I can really judge what’s being done. I go on-site and I can very quickly see if I’m on a site where sustainability is cared about or if it is not. I recommend going on site visits, touching and seeing and feeling to really evaluate if sustainability has been made a priority.”

For companies in the early stages of environmental governance but aware of environmental issues, an employee committee involving all relevant stakeholders could provide a good way to aggregate and leverage existing environmental initiatives. Boards that are reluctant to take on a formal, involved role might consider this option.

THE ROLE OF EMPLOYEE CHAMPIONS

- **Gareth Ackerman, Chairman of the Pick n Play grocery chain in South Africa**, emphasizes that sustainability is necessary for businesses to consider, but he is doubtful about board engagement without a sizeable management push. He says, “My company is a family firm and my father put it on the agenda, so we’ve been dealing with environmental issues for better or worse for about thirty years. Businesses have to pay attention. Customers are demanding it. Also, you’re getting increasing sustainability funds that won’t invest unless you have a good sustainability track record. But I don’t think that boards generally care too much unless the executives have a passion for it.”

More specifically, he thinks that boards “have to have a champion for the issues, who understands them and can make sure you’re getting proper value for your work. Then there should be a champion underneath that person who works with experts in the business and reports to the CEO.” Empowering a high-level employee with direct access to the C-Suite to take on the sustainability banner is one strategy businesses can employ to achieve better visibility into environmental operations and help ensure that sustainable priorities are taken seriously. Each board should consider how much access they want and need to have to that point person to ensure effective oversight.

- **Mark Love, the Corporate Governance Manager and former Chief Risk Officer at Barclays - Switzerland**, describes a potential synergy for employee enthusiasm and board involvement at a subsidiary organization, noting that at his company, “For a few employees, sustainability is a subject they feel strongly about. Often that’s someone on the facilities management team, given our limited environmental impact. It really comes down to people taking it upon themselves to say, ‘this is really important to me’ and to keep their colleagues informed.”
- **Dale ter Haar serves as a non-executive director for several boards in Botswana**. At BSE-listed Chobe Holdings PLC, which owns a number of safari lodges, he says “The decisions we make at the board level are to approve the budgets for environmental projects. It is management driven. We have some discussion but not in too much detail because the government and management have taken such an active role in pushing it. As an environmentally conscious board member, I’m comfortable that between the legal environment and the management’s environmental credentials there are enough drivers without the board having to do anything. Should either of these drivers change for the worse, then clearly the board would take a more active role in pushing this important agenda.” This emphasizes Whelan’s earlier point that in countries where the government has abdicated responsibility, the board might be called upon to step up in a more intensive way, even if they aren’t legally required to do so.

Boards Have Not Yet Embraced Environmental Governance Policies

It seems that board awareness of and interest in sustainability concerns does not consistently transform into specific board policies. This supports the narrative that boards are generally in the early stages of governance in this area. While discussions are increasing, and directors are being pressured to consider environmental concerns, in most cases, that hasn't yet translated to a robust or intentional program.

Almost half of the respondents (48%) reported that their board had no established governance policies or practices related to environmental and sustainability issues. It seems that board interest in or awareness of sustainability concerns has not translated consistently to specific actions. Currently, only 10% of respondents said that executive compensation is tied to environmental and sustainability performance metrics, and only 10% of respondents said that environmental and sustainability expertise is considered in executive recruitment. However, these policies and practices studied here might not be the perfect fit for most organizations surveyed. For instance, the necessity of expertise is highly industry dependent for certain industries sustainability expertise might not ever enter the picture, but in others it's always been part of the recruiting framework.

At organizations that discussed environmental sustainability quarterly or every meeting over the past three years, 29% tie compensation to environmental sustainability metrics, and 25% consider expertise in executive recruitment.

Thus, while more companies with more experience in this area have stepped up their ask of management, many still aren't taking those steps.

The limited number of directors who prioritize environmental expertise when recruiting new board members might not be the best indication of overall disinterest in environmental governance. Few respondents (7%) consider environmental and sustainability expertise in board member recruitment. Many boards that care deeply about sustainability do not feel they need a member with advanced expertise. Guy de Selliers, a board member at Ageas S.A., AMG Advanced Metallurgical Group, Ivanhoe Mines Limited, and other privately held companies, explains clearly:

“Board members need experience in the industry, and in an industry like mining, that means they’ve dealt with environmental issues. I don’t need to be an expert on chimpanzee location in order to make board-level decisions about whether or not to move forward with projects. Board members need to know just enough about the issues to make sure that management is doing what they need to be doing and that they have the right values. An experienced board member should be able to make sure that the company is taking it seriously without a lot of additional training. It could be counterproductive for board members to develop too much expertise on areas that are the responsibility of management.”

Hosking agrees, and suggests that, “Companies will have to gear up in terms of executive and staff skills in these areas in order to ensure compliance and good monitoring.”

Recruiting experienced directors for the board is only one option to gather the requisite expertise to govern effectively and efficiently on this issue. Yet, 62% of respondents said that their board has never brought in a speaker, internal or external, for education on environmental and sustainability issues. Another 9% have only done so once. Only 5% bring in speakers annually, including outside consultants and expertise from within their own organization, like sustainability champions, subject matter experts, or managers who oversee the topic. The numbers are slightly higher when it comes to personal education – 24% of directors report engaging in environmental sustainability education frequently and another 38% said they do so sometimes.

Yet, directors frequently cited lack of knowledge and relevant expertise as significant obstacles in conducting environmental sustainability governance. One respondent explained that “[the biggest challenge is the] lack of knowledge around the whole board table to make this issue an imperative.” With more expertise, it might be easier to assess whether sustainability ought to be considered a higher or lower priority. Another respondent explained that the board has difficulty “knowing what the important issues [are] on which to focus.”

Boards should consider surveying their own members and evaluating if they have enough knowledge and expertise for both current sustainability oversight and a potential expansion of oversight responsibilities.

REPORTING AT THE TOP LEVEL

Craig Winkler, a non-executive director at Xero Ltd., a global software company domiciled in New Zealand, explains:

“Reporting on ESG at the top level is tremendously helpful – it gives you the impetus to find, report on, and celebrate environmentally friendly things so that they don’t get lost and ignored. By doing so as part of a publicly available framework, you can demonstrate movement and a plan to shareholders and other stakeholders. Having something you report against is better than nothing – it tests you and gives you a sense of progress. While the available frameworks for doing so on environmental issues differ a little around the edges and might not be perfect yet, they’re getting there and they all incorporate a bunch of things that people actually care about. So, choose a framework, get some measurements, and make comparisons to figure out how to improve your own results.”

REPORTING

Reporting by Region	Australia and New Zealand	Europe	North America	Other Regions
Total (Selected at least one reporting option)	55%	60%	56%	76%
External framework (e.g., GRI or SASB)	21%	26%	17%	37%
Required by exchange	20%	29%	11%	29%
Internally developed standards	35%	34%	24%	37%

Almost two-thirds of public company respondents (64%) report out, in some fashion, on environmental sustainability metrics. There is no standard approach to reporting on this information, and companies have taken a variety of approaches to choosing what to measure, how much to share, and how frequently they disclose. Globally, certain stock exchanges require environmental and sustainability reporting, and 37% of public company respondents report to be consistent with those requirements. There are also independent organizations that offer frameworks or guidelines for environmental sustainability reporting (e.g. GRI or SASB), and 31% of public company respondents have voluntarily adopted one of those external standards.

Finally, 34% report based on internally developed performance metrics. Increasingly, shareholders and investors are asking for disclosures, and companies are asking the same from their suppliers. Even among private company respondents, 38% report on environmental and sustainability performance to some extent. The extent of reporting demonstrates the number of companies already measuring and considering data on this topic. Several respondents said that the biggest obstacle to environmental governance at their organization is difficulty accessing and tracking meaningful company information. Other respondents cited a dearth of enough available environmental consultants and external resources as their biggest challenge in aggregating environmental data or planning an oversight program.

Public companies that don't report environmental sustainability information offered a variety of additional rationales for this decision. Several respondents don't report because they aren't legally required to, or because shareholders and stakeholders haven't expressed any interest in more information. For many boards, environmental issues aren't enough of a priority to take time away from the other critical topics that directors must cover, either compliance related or to meet general strategy and growth goals. Lack of reporting doesn't mean environmental impact isn't being measured – one respondent stated that although “the business is very basic, the board reviews all environmental reports.” Another respondent articulated the common sentiment that as a small business, the focus is on growth right now.

ENVIRONMENTAL AUDITING

Hosking, who spent fifteen years as a director and seven years as the chair of Adelaide Brighton, and ten years as an independent director at AGL Energy Limited, thinks the information reported both to the board and ultimately to the public should be vetted more thoroughly than it is in the status quo.:

“I think that as with health and safety, there needs to be an independent audit of what the executives are telling the board so that the board has confidence that the process is robust and transparent and that the information is verified as being accurate. Let's say you have an engineer employed to go look for gas and drill for it, and they are remunerated with short-term incentives to get gas out of the ground, you wouldn't also give that person the job of reporting on when there has been a failure to protect the environment. Why not pay someone who is an expert and is not being paid to get gas out of the ground to tell us that information? The engineer has a conflict of interest. The same is true of environmental information reaching the board – it's the same as the process with financial information.”

With the onslaught of demands on directors, it makes sense for some boards to deliberately hold off on sustainability governance until they have more capacity or shift organizational focus. A couple respondents said they don't report because it isn't “traditional” for their industry or because it “hasn't been done historically” – it is a good time to reevaluate that approach.

The majority of explanations had to do with environmental sustainability's irrelevance to an organization's industry, or an organization's relatively small carbon footprint. Obviously, boards should be reporting on material information, and not take actions that detract from their ability to do that effectively. Yet, as this report has demonstrated, the landscape is shifting. One respondent put it succinctly: his “company has low environmental impact, and the issue has not been raised to the level of needing to take a position. That is now changing.”

Case Study: Clare Wardle – Coca-Cola European Partners, General Counsel and Company Secretary

MOTIVATIONS

First, we have a very strong focus on long term success – Coca-Cola as a brand has been around for a long time and those who invest in it wish it to be around for a very long time. We're committed to being successful in the long-term, so we need to be a good corporate citizen and maintain and enhance our reputation. We believe that this is our responsibility as a large business, and our Board, Chairman and our CEO are all very supportive of that. Finally, it's just good business. We want consumers to feel that our products are ethical and sustainable and that we are a positive presence in our communities.

In our industry, we're seeing a lot of very targeted taxation of our products in relation to sugar and plastic, and we expect future regulations on plastic and packaging. Plastic straws are a good example. Much of this is driven by changing consumer sentiment on sustainability issues, and it is important that we are in touch with this sentiment and responding to it appropriately.

BOARD INVOLVEMENT

Environmental sustainability initiatives are management's responsibility. The board is responsible for setting up the broader sustainability strategy. When we recruit board members with the skills and experience to supplement and expand our own skills and experiences with, sustainability experience is a key part of this. We need people who are motivated by and interested in the sustainability issues we deal with. This mindset is just part of being the right board member for our organization.



POLICIES AND PRACTICES

We have hard measures and hard commitments – it's important to have those in addition to aspirations. For example, we have committed to collecting all of our packaging so that it can be reused and recycled. Similarly, we have metrics around what amount of water we use over and above what we return. All these commitments are available on our website. Then the CSR committee tracks them in detail and assesses our performance against those goals.

With these commitments in place, we can include them in how we measure the performance of the business as a whole and the people within it. So there is a clear link between sustainability and overall business performance and progress.

The biggest common obstacle to sustainability is always in business drivers that don't seem to line up. It's challenging you're telling people that they have to cut their budget and find savings and at the same time do this in a way that is more expensive today. You have to make sure that sustainability is built in the same way that safety is built in: "Yes, we want this to be efficient, but at a minimum, it has to be sustainable." Otherwise you will have people deciding to build a factory less sustainably today, and it ultimately costs far more money to make changes later. First, that thinking isn't an option. But second, leadership and directors need to really believe in sustainability and demonstrate that belief.

With that mindset in place, businesses will be better able to follow through on sustainability priorities irrespective of the short-term business context. The more you do that, the more it works, because people just take it for granted. That's not easy. Not everything will always work perfectly. And some companies earlier on in the journey have the policy, but not the underlying support to make it work. We're not perfect, and we're still working on it. You have to keep painting that bridge.

The Challenges Are Many — With Limited Consensus On The Right Approach

Environmental and sustainability governance is challenging. To reap the most benefit from its implementation, companies are asked to integrate it as a fundamental value throughout their organization. Respondents felt obstructed by “old-school” and “old-fashioned thinking,” by cultural lack of awareness, by lack of a champion, and by underappreciation of the business case by the board. Even for boards that are fully committed, there is no consensus on how to structure governance or what to report on.

Many respondents said the lack of consistent standards posed the biggest obstacle for their board to govern on sustainability. With so much media and investor attention, expectations can feel elusive, and the resources to understand them seem out of hand. Requirements are also in flux because of “changing governmental regulations” and the difficulty boards face trying to act while still unsure of “future regulatory issues with ESG.” There are other external pressures that make things more difficult – activists who want short-term results can take aim; foreign governments can change policy in this area rapidly; and public opinion, while clear at this moment, is frequently changing and hard to nail down.

For large, decentralized, and multinational organizations, “limited control of facilities” and a “lack of supply chain transparency” are common struggles. Even without such dispersion of operations, respondents noted that it was challenging to “have business units take ownership rather than second and third lines of defense” and that it wasn’t enough to rely on “support managers rather than line managers.” Another respondent wisely noticed that it is difficult to track and deal with “second-order environmental impact from company action.”

With environmental degradation occurring at such high levels, another respondent simply stated that their biggest challenge “is maintaining vigilant observation of uses impacting the environment.”

SUSTAINABILITY AND STRATEGY

Craig Winkler, a non-executive director at Xero Ltd., a global software company domiciled in New Zealand, said:

“I see sustainability as a part of strategy. It’s the CEO’s responsibility, ultimately, but the board is vitally interested. Thus, it has to be baked into the strategy of the organization in general. That means that every executive has responsibility for it and it’s part of what the board governs. Otherwise, it’s like saying that culture is solely the head of people’s responsibility – it sort of is, but really every manager and every team has responsibility for it. Ultimately, environmental sustainability needs to percolate down so that it is discussed and understood throughout the organization, because different components will have different impacts in different departments and functions. At various organizations I’ve been in, there is one lead environmental person constantly beating the drum about recycling, and he or she gets parked in the corner, sometimes celebrated but mostly ignored. For an organization to really get the benefits of operating environmentally sustainably, that goal needs to be absorbed into the DNA of the organization and the mindset of the people who work there.”

Conclusion

These difficulties all exist in part because of the dynamic nature of the environmental sustainability governance landscape. Thought leadership is constantly pushed forward on the subject. Investors are talking about it. The public is talking about it. Governments are talking about it. What actions each of these groups will take remains unclear. The trend, however, could not be clearer. Boards are talking about it already, and they will continue to talk about it at increasing levels. Directors' motivations are compelling and are emerging from serious business risks and opportunities. If anything, many will increase in significance in coming years. Businesses will likely begin to coalesce around certain practices and solutions, and the fact that they haven't yet is unsurprising.

There is no doubt that environmental governance is challenging, but it will behoove boards to recognize the way the winds are blowing and step up to proactively examine their current practices and deliberately structure environmental oversight to have the most impact for their shareholders and other stakeholders or risk falling behind competitors who did so more successfully.

Companies are obviously at different stages of their sustainability governance journey, and some companies simply bear more responsibility and have more capability to serve as environmental stewards. Some companies have more opportunity to gain by doing so. Some companies will have to work harder to change organizational behavior around environmental issues, and others have small, accessible steps that can move them much closer to operating sustainably.

Many businesses, researchers, and third-party consultants have made incredible great strides in this area. For those who are just becoming aware of the problem, the field can feel especially chaotic.

But this dynamism, this progress, is a good thing, and it's here to stay. Each organization will have to determine which approach makes sense for their geography, industry, and company. Environmental and sustainability oversight, reporting, and operating are going on globally. Now, as one respondent put it, it's "time to add good governance" to those practices.

FOR YOUR CONSIDERATION

The following are suggested questions for your board to consider in light of the findings in this report:

1. What is our current environmental impact – across business units and subsidiaries?
2. What feedback have we received from investors, shareholders, customers, employees, and other stakeholders about our approach to sustainability?
3. Have we developed specific goals and policies around sustainability, and to what extent are we measuring and reporting our performance?
4. What measurements are we using to evaluate environmental impact? Are they the right ones?
5. Do we have the right expertise in the boardroom for environmental sustainability conversations? Who should we bring in to inform the discussion? (e.g., sustainability officer, investor relations person, outside consultants, new board members, others)?
6. Do we have the right expertise at the management level for sustainability initiatives moving forward?
7. Do we disclose the right amount of information about environmental sustainability? If we are already reporting some information, can we do so more efficiently, with greater benefit to the organization? If we aren't disclosing, should we explore it moving forward?

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References and Further Reading

The following list of papers was helpful in providing context for this report. They are all highly recommended further reading about environmental sustainability and corporate governance.

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“This study examines the structure of CEO compensation, and it finds that the integration of corporate social responsibility criteria in executive compensation – a relatively recent phenomenon – leads to an increase in long term orientation; an increase in firm value; an increase in social and environmental performance; a reduction in emissions; and an increase in green innovations.”

Kristen Lang, Ceres, [“Change the Conversation: Redefining How Companies Engage Investors on Sustainability,”](#) February 6, 2019.

“Drawing from our interviews with Ceres investor partners, Change the Conversation highlights key trends in investors’ evolving expectations for corporate sustainability.”

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“In a climate of unpredictability, building sustainability competence into corporate boards—where directors are skilled at assessing business risks and growth opportunities in light of evolving environmental, social and governance factors —is the way forward.”

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“It is an issue that boards must deal with because many investors demand its consideration. Better yet, a board should consider climate change because it is the best interest of long-term shareholder value.”



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“This report finds that large public company sustainability reporting is maturing rapidly, with financial data presented alongside growing social and environmental metrics and quantified goals.”

Ioannis Ioannou and George Serafeim, [“Corporate Sustainability: A Strategy?”](#) February 12, 2019.

Sheila Bonini and Anne- Titia Bové, McKinsey & Company, [“Sustainability’s strategic worth.”](#) July 2014.

“Executives at all levels see an important business role for sustainability. But when it comes to mastering the reputation, execution, and accountability of their sustainability programs, many companies have far to go.”

Anne-Titia Bové, Dorothee D’Herde, and Steven Swartz, McKinsey & Company, [“Sustainability’s deepening imprint.”](#) December 2017.

“Companies are more active than ever in pursuing sustainability to align with values and engage stakeholders, a new survey shows. To see financial returns, though, integrating sustainability into core functions is key.”