Doughty Centre   **Corporate Responsibility**
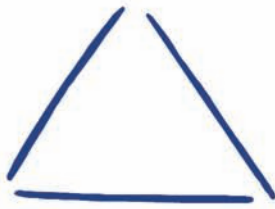
Cranfield
UNIVERSITY
School of Management

The Governance of Corporate Responsibility
A Doughty Centre 'How to' Guide

#4 in the Doughty Centre 'How to do Corporate Responsibility' Series

Doughty Centre, Cranfield School of Management
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THE DOUGHTY CENTRE FOR CORPORATE RESPONSIBILITY

The Doughty Centre aims to combine rigorous research and leading-edge practice. We focus on three things:

1. knowledge creation: rigorous and relevant research in to how companies can embed responsible business into the way they do business;

2. knowledge dissemination: introducing Corporate Responsibility more systemically into existing graduate and executive education (both in relevant open programmes and customised, in-company programmes); and

3. knowledge application: working with alumni, corporate partners and others to implement our knowledge and learning.

VISION

Sustainability and Responsibility at the heart of successful management.

MISSION

To inspire future and current managers with the passion for, and to equip them with the skills and outlook to, put sustainability and responsibility at the heart of successful organisations.

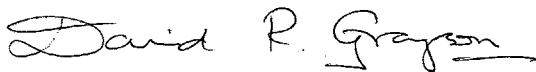We welcome enquiries for collaborations including around:

❖ speaking and/or chairing conferences and in-company events

❖ facilitating organisations in the public, private or voluntary sectors who wish to produce their own think-pieces/ "white papers" on Corporate Responsibility, sustainability or public-private-community partnerships

❖ practical projects to embed CR in an organisation

❖ scenario-development and presentations to help organisations envision a more responsible and sustainable future

❖ co-creation and joint publication of research, think-pieces and practical "how-to" guides

❖ design and delivery of organisation-customised and open learning programmes around CR, sustainability or public-private-community partnerships

Foreword

At the Doughty Centre for Corporate Responsibility we seek to work with companies to understand the challenges they face in embedding a commitment to Corporate Responsibility and Sustainability. Over the next few years, we will be producing accessible and rigorous action-research on corporate responsibility (CR) to assist companies in improving their environmental, social and financial performance.

As a new centre within an established school of management, we realise that CR has much to learn from existing disciplines such as Strategy and Organisational Behaviour. Academic research in the field of governance has indeed first focused on a regulatory approach that gave boards more of a compliance role. But in the wake of globalisation trends, boards started to focus on strategic and organisational questions that were previously the preserve of CEOs. The financial crisis in 2008 showed that boards must now be more proactive. The traditional compliance approach needs to make room now also for an integrity and CR leadership approach. This needs to be reflected in governance structures and practices.

How organisations achieve sustained change in other respects should have much to teach us about how to embed CR. Hence this guide and our future publications also seek to make the link between CR and existing management theory, in a way which we hope blends established theory and latest practice, in a relevant and timely fashion. Our thanks go to the businesses and their representatives who were interviewed for this guide; to friends and colleagues from other organisations who commented on the draft; and particularly to Dr. Heiko Spitzeck, who has researched and written it. We welcome comments and further examples.

David Grayson, March 2010

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Marcia Balisciano	Director of Corporate Responsibility, Reed Elsevier
Ruth Bender	Senior Lecturer in Finance and Accounting at Cranfield School of Management
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Victoire de Margerie	Victoire has held several board positions. Currently board director and member of audit committee at Outokumpu (steel producer, Finland), and Ciments Francais/Italcementi (cement producer, France and Italy), and chairperson of the board at Rondol (nano technology start-up, UK)
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Baroness Denise Kingsmill	Non-executive of various Plc, private, charitable, arts and Government boards, and a member of the Doughty Centre Advisory Council
Ashok Krishnan	Finance Change Manager, Prudential Plc
Noel Purcell	Global Chair, Caux Round Table
Toby Shillito	CR Index and Business Support Director, Business in the Community
Murray Steele	Emeritus Professor for Strategic Management at Cranfield School of Management and holds several non-executive Directorships.

Contents

"The proper governance of companies will become as crucial to the world economy as the proper governing of countries."

Executive Summary

Imagine a Financial Times reporter asking you critical questions on corporate responsibility (CR) issues of your organisation's strategy and your governance arrangements for this strategy. How comfortable would you feel being a board member of a CR leader or a laggard? Corporate governance for CR can make a significant difference! This is especially true as CR has become part and parcel of good business and risk management and therefore, should be managed as such. This guide aims to explain how to integrate CR and sustainability issues within the governance framework of an organisation, providing some answers from CR leaders as well as outlining some potential pitfalls. Our recommendations have been compiled from a wide array of reports and academic research (listed in the reference section).

James D. Wolfensohn, former President of the World Bank, stated in 1999 that:

"The proper governance of companies will become as crucial to the world economy as the proper governing of countries".[i]

The latest corporate governance crisis began in the early 2000s, with cases such as Enron, Arthur Andersen and Parmalat, and has carried through to today's global financial crisis – proving Wolfensohn prediction. In all cases wealth has been destroyed, millions of people have lost their jobs, pensions have been lost or devalued and tax-payers' money has been used to bail-out failing companies and industries. The world has been answering these challenges through increasing legislation (e.g. the Sarbanes-Oxley Act of 2002) and several corporate governance recommendations (e.g. from the OECD) in order to restore a critical resource for business: trust.

Earning trust, however, is not a box-ticking exercise or a simple question of compliance with the new rules. The endless cycle of boom-bust-regulation is a short term measure and conversely is actually likely to destroy even more trust in the long run.[ii] Corporate governance needs to be done with integrity as good behaviour cannot be legislated. Companies which have understood this lesson are not only better at risk management, have lower stock price volatility and protect their reputation – they are also able to capitalise through better financial performance, their attractiveness to prospective employees and innovation (see section 2). Their governance processes have integrated ethics and responsibility and thus allows them to respond to critical questions from internal and external stakeholders effectively. After all, CR is the ability of a corporation to respond effectively to a wider set of stakeholders. Board members especially need to be prepared for a very new set of questions in order to maintain their social licence to operate in the current low-trust environment. When asked why CR had made it on the board agenda, a significant number of directors quoted 'stakeholder pressure'.

The governance arrangements of CR corporate leaders typically include a champion at board level, a culture of critical loyalty, an awareness of the drivers and materiality of CR issues, proactive stakeholder engagement and a clear link between CR and day-to-day operational activities (see section 3).

To govern effectively and manage a company with integrity many boards have established new support structures, such as CR sub-committees (see section 4). A CR committee helps to formulate a strategic approach to CR, keeps track of necessary Key Performance Indicators (KPIs), engages with stakeholders and makes sure the organisation's performance is reported transparently.

However, it would be too easy to think that CR can simply be outsourced to a sub-committee. The board has clear roles for assuring a sound CR governance and management process (see section 5) – strategic planning and risk management being just two of them.

Middle management especially often maintains that there are significant barriers to CR governance (see section 6) such as an unarticulated CR strategy, groupthink, a lack of training and education, lack of critical feedback and – sometimes – complications arising from national characteristics.

Whatever the obstacles, we perceive CR spreading into, and across, the boardroom. Although such companies are still a minority, more and more approach CR as an opportunity rather than simply risk management. These companies are more proactive and strategic in formulating their CR goals and aspirations, with reporting processes in place that give an account on performance as well as on weaknesses (see section 7). Companies will learn that it is better to foster critical discussions inside the boardroom, rather than being confronted with criticism from outside. However, for many this realisation may only dawn after a crisis has occurred and when trust has been lost. Boards cannot choose whether they want critical feedback, they can only choose how: proactive (inside and controlled) versus reactive (outside and uncontrolled). This guide is intended to assist any organisation which opts for the first option.

"Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals."

Introduction

2.1 What is CR Governance?

In the realm of business, the term 'governance' describes consistent management in which policies, processes and decision-making work in unison. Similarly, 'integrity' is a term describing perceived consistency of actions, values, principles, expectations and performance.

Traditionally, corporate governance is described as the system by which companies are directed and controlled. [iii] Since the environmental awakening of the 1980s and 1990s first environmental and later wider social issues have become increasingly relevant for corporations and need to be addressed alongside the purely financial aspects of corporate decision-making. Sir Adrian Cadbury noted in this regard:

> *"Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The corporate governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society."*[iv]

There are two clear ways to approach CR and Corporate Governance:

1. First, a focus on the responsibility of the board to the general public – *the responsibility of governance.*

2. The second element, and the focus of this guide, concerns the governance of the CR agenda within the firm, or – *the governance of responsibility.*

Responsibility of Governance

At the beginning of this millennium 51 out of the 100 richest economies of the world were not nation states, but corporations.[v] At that time the sales of Wal-Mart exceeded the Gross Domestic Product of Norway.[vi] However, while Norway is a democratically-governed country, the corporate decisions and activities of Wal-Mart do not require a similar set of democratic checks and balances. The strategies and operations of Wal-Mart and the other 50 multinational corporations affect the lives of many people around the world, people who do not have representation or any real influence on the decision-making processes of these corporations. The boards of multinational corporations therefore need to be aware that their fate is intrinsically linked to the success of the societies in which they operate – or as Björn Stigson, President of the World Business Council for Sustainable Development, quoted:

> *"Business cannot succeed in societies that fail."*[vii]

Governance of Responsibility

Corporate Governance is the system by which companies are directed and controlled.[viii] The Governance of Responsibility is the integration of CR issues into governance mechanisms and corporate decision-making. While not all decisions are made by the board directly, the example that executives and the leaders set in their own behaviour and internal policies shape organisational decision-making across all levels of the business. This is especially true for high profile CR issues, such as human rights, climate change or discrimination – issue that have a strong impact on the profitability and reputation of any organisation. Boards and corporations increasingly need to provide a credible account of their CR activities in order to gain legitimacy and acceptance in the public sphere. Directors need the *ability* to *respond* to any stakeholder challenging the board on their financial, social and environmental impacts.

This guide focuses on best practice of the governance of responsibility from a select group of companies and their directors, highlighting lessons that can be learned and put into practice by any organisation.

2.2 Drivers and Benefits of CR Governance

Drivers

The *corporate crises* around Enron, WorldCom, Parmalat and others triggered widespread criticism of the corporate governance arrangements of the early 2000s. A general response was an array of initiatives, mostly by governments, ranging from the Cadbury Report to the Sarbanes-Oxley Act in the US to corporate governance recommendations by the OECD, all containing implicit and explicit CR governance recommendations. Other relevant initiatives include the EU Green Book, a multitude of different international as well as regional corporate governance recommendations, and the multi-stakeholder Global Reporting Initiative.

These initiatives all share a common aim: to make corporate governance more trustworthy and responsive to stakeholder demands (including those of shareholders). This aim marked a shift away from being answerable only to owners or shareholders towards becoming accountable to a wider group of stakeholders – a 'stewardship' approach. This change in approach was overdue: even before the big governance crisis of 2002 the King Report in South Africa had shown the way by taking a stakeholder approach back in 1994.[ix] Similarly, the Cadbury Report of 1992 developed a set of principles of good corporate governance that was incorporated into the London Stock Exchange Listing Rules (now part of the Combined Code).

Figure 1: Drivers and Benefits of CR Governance

Drivers	Benefits
❖ Governance or issues crises creating the need to establish internal controls and risk management	❖ Enhanced financial performance and attractiveness to investors
❖ Legislative compliance	❖ Reputation and brand equity
❖ Institutional investors' expectations for greater governance or to become more attractive to socially-responsible institutional investors	❖ Minimised risk
❖ Client reassurance	❖ Attract and retain talent
❖ Competitors demonstrating CR leadership	❖ Innovation
❖ Employee expectations	❖ Access to capital
❖ Stakeholder pressure	❖ Timely and more non-invasive legislative compliance
❖ Desire to set high standards/take a leadership role	

In 2007 the UK Department of Trade and Industry summarised the 'big picture' role beyond the shareholder that good corporate governance has:

"...investors and key stakeholders should be made aware of the potential risks facing the organisation and the policies in place to mitigate them. When these conditions are met capital markets may operate more effectively, scarce human and financial capital may be allocated more efficiently, and company stakeholders are likely to be treated more fairly and equitably, as well as more effectively exercise their responsibilities." [x]

The codes and standards that arose at the start of the new millennium, in the aftermath of the corporate crises, presented a *compliance* challenge for organisations. 'Compliance' re-establishes and fosters the confidence of *investors* as well as other stakeholders after governance crises. However, it was recognised that a focus on financial compliance above other considerations would not prevent the occurrence of future financial surprises – directors needed to extend their role to include, for example, reputational issues. New regulations, such as the 2006 Companies Act in the UK, extended the duties of directors to include considerations regarding:

❖ the long-term consequences of their decisions as well as the interests of the employees;

❖ relationships with suppliers and customers;

❖ the impact of decisions on communities and the environment;

❖ maintaining a reputation for high standards of business conduct.

These requirements go beyond compliance and are not a simple box-ticking exercise. Directors now have to govern with integrity and be willing to engage in critical discussions on an organisation's performance not only on financial terms but also on social and environmental terms. They have to assure that the company's ethical principles are set up and clearly stated, are upheld and get translated into performance, as if they are not then they find themselves on the defensive on both CR and economic terms.

At the end of 2003 institutional shareholders (investors, insurers and pension funds) controlled roughly 80% of the UK equity market and close to 60% of the US market. [xi] Pension funds realised that their *clients* were not only interested in profitable investments but also in there being a safe and healthy environment at the time their pension is due. Some embarked on quiet diplomacy, asking corporations about their CR performance. An example of this is Hermes Pension Management Ltd., which took an active role as an institutional investor. In its 2003 'The value of corporate governance' report, where 10 principles for governance are detailed, they give significant regard to the importance of '*...ethical behaviour and regard for the environment and society as a whole'.* [xii] Institutions like Goldman Sachs and the International Finance Corporation developed CR principles for their investment strategies, increasingly scrutinising corporate extra-financial performance indicators for an indication of how companies managed CR-related risks and detected opportunities. One interviewee in a Conference Board of Canada report noted:

"Increasingly, public pension funds and big institutional investors, because they represent stakeholder groups, will tell boards they haven't done their jobs effectively unless they define CSR metrics and CSR accountability of the CEO." [xiii]

Some organisations have progressed significantly on a voluntary level in their efforts towards good corporate governance. McKinsey in 2002 reported that more than 70% of investors were willing to pay a premium for a well-governed company. [xiv] Research in 2006 on the Dow Jones Sustainability Index and again in 2009 on the UK Business in the Community (BITC)'s Corporate Responsibility Index (CRI) found that leading companies had developed special governance arrangements for CR and sustainability.[xv] The research concluded that these arrangements gave them a competitive edge and improved their trustworthiness to investors.

While some regulatory changes will affect an organisation depending on where it is listed (e.g. Sarbanes-Oxley in the US and the London Stock Exchange regulations in the UK), directors might be confused about which of the many voluntary codes to follow. For effective CR governance it matters less which voluntary guidelines are adopted – it is more important that CR governance is thought through at the top of the organisation and the chosen codes are incorporated within a strategy aligned with stakeholder interests. For a summary of some of the relevant pan-corporate governance legislation and voluntary codes please see Table 1.

Table 1: Pan-Region Governance Legislation and Codes

Name/date	Use in practice	Scope
Legislation		
Sarbanes-Oxley	Sarbanes-Oxley (SOX) was enacted by the US government in 2002 following the Enron governance scandal. SOX is mandatory for all public listed companies and has far-reaching provisions such as the personal liability of the CEO and CFO for reporting.	Public listed companies within the U.S. It has an international spread
UK Companies Act 2006	The 2006 version of the Companies Act legislates for companies registered in the UK and contains a new set of provisions regarding directors' duties to stakeholders.	Listed companies in the UK
Voluntary		
OECD Principles of Corporate Governance [xvi]	The OECD Principles are among the most influential guidelines internationally. Set up in 1999 and revised in 2004 they are intended to keep the dialogue about good corporate governance alive and to influence national legislation.	International – as they inspire many new national legislations (e.g. Eastern Europe)
EU Action Plan 2003 and 2006 [xvii]	The European Union issued an Action Plan on Modernising Company Law and Enhancing Corporate Governance in the EU (2003) and further reviewed this in 2006. The aim is to harmonise national legislation as well as encourage dialogue on good corporate governance through the establishment of the European Corporate Governance Forum.	Europe
Hermes	Hermes Pensions Management Ltd. is a leading institutional investor in the UK. In 2001 Hermes revised its corporate governance principles and encouraged companies to manage their affairs more effectively towards stakeholders and the environment.	Primarily Hermes Investments but also inspiring other investors (e.g. CalPERS).

Table 1: Pan-Region Governance Legislation and Codes (continued)

| Name/date	Use in practice	Scope
Voluntary		
UK Combined Code	The Combined Code on Corporate Governance was established by the Financial Reporting Council in 2003 and was revised in 2006. It is a 'comply or explain' listing requirement for firms traded on the London Stock Exchange. Due to the financial crisis the Walker Report laid out requirements for the corporate governance arrangements in the banking sector in 2009.	Listed companies in the UK
King III Report [xviii]	The King Report intended to increase South Africa's attractiveness to investors. Designed by Mervyn King in 1994 and revised in first in 2002 and again in 2009 the report was intended as a voluntary guideline but became a listing requirement for the Johannesburg Securities Exchange in 1996. The King Report pioneered a stakeholder-oriented governance approach.	South Africa
Global Reporting Initiative (GRI)	The GRI seeks to make sustainability reporting by all organisations as routine as and comparable to financial reporting. Thousands of organisations across different industries are using the GRI as their reporting standard.	Global outreach

It is not only investors and government who are interested in CR and sustainability. A 2006 Ipsos MORI study[xix] revealed that 86% of UK employees thought it important that their employer acts responsibly with regard to society and the environment. Other stakeholders are also highly critical of corporate activities – the Edelman Trust Barometer 2009[xx] showed that trust in business to do what is right is in decline, fuelled especially by events in the global financial markets.

Benefits

One of the key benefits of good CR governance is a better *financial performance.* An analysis of the MSCI World Index between 2000 and 2005 revealed that leaders in corporate governance arrangements outperformed laggards by 32%. [xxi] Research conducted by IPSOS MORI (2008) found that firms continuously participating in the BITC CRI financially outperformed the FTSE350 on total shareholder return between 2002 and 2007 – by between 3.3% and 7.7% per year. [xxii] These companies also showed lower stock price volatility. The data suggests that good CR governance and management serves as a proxy for 'good management' in general.

Good governance arrangements also protect the organisation's *reputation* and foster *brand equity.* Critical stakeholders pay increasing attention to a company's position on human rights, climate change and general environmental responsibility. That said, in the current low-trust environment having policies alone is not enough to convince stakeholders. The company needs to credibly account for their management approach and performance on KPIs. In the BITC CRI, as a measure for reputation, leading companies with dedicated CR committees perform better than those companies without (see Figure 2).[xxiii]

Figure 2: BITC CRI: Performance with a CR Committee
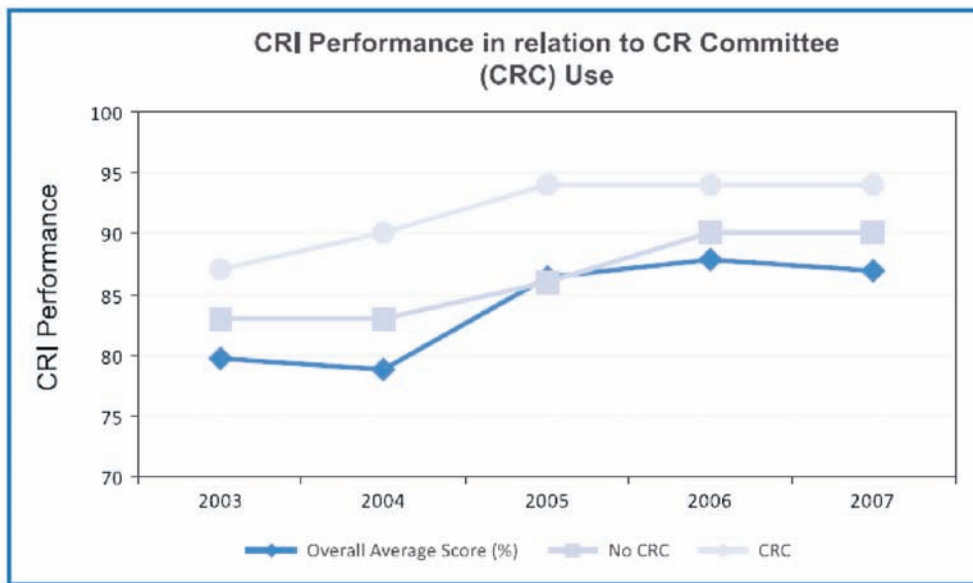
An effective CR and sustainability management system helps to *reduce risks* and ensures a company is aware of the issues within its environment. Engagement with stakeholders especially helps the company to address issues proactively instead of, for example, having to react to a negative media campaign that can damage a firm's reputation.

There is also evidence to suggest that an effective approach to CR has a positive effect on prospective employees. The Ipsos MORI study conducted in November 2006 found that 86% agreed with the statement that:

> *"…it is important that their employer is responsible to society and the environment."* [xxiv]

Concomitantly, the next generation of managers is much more aware of the CR agenda and more likely to challenge potential employers on their CR management – as Cindy Cahill from Deloitte in the UK said:

> *"We hire about a thousand graduates a year. Increasingly we are being asked during the interview process about our corporate responsibility and sustainability commitments by this group of stakeholders."* [xxv]

Having the right governance structures in place puts directors in contact with critical stakeholders. If a director understands that stakeholder criticism can actually provide valuable intelligence on new product or service requirements, then such input can be used by a company to spur *innovation*. For example, communication between a broadcasting company and a pan-disability group in the UK enabled the company not only to comply with upcoming regulation but also to grow its business with disabled customers. The pan-disability organisation facilitated access to local groups supporting people with various physical and mental disabilities. A new call centre dedicated to serving such customers was set up by the broadcasting company, which dealt with approximately 43,000 subscribers in 2008. The pan-

disability group also provided external verification of the suitability of a remodelled remote control handset for physically disabled customers. [xxvi] Without clear support from the board and clear CR priorities such innovations are harder to achieve.

We are increasingly seeing investors and the general public interpreting a corporation's CR strategy as a proxy for management quality. [xxvii] If a company does not listen to its critics, has no position on human rights and is unclear about its social and environmental performance – then the risk of doing business with that company might be perceived as too great and it could find that *access to capital* (from potential customers, suppliers and investors) gets more difficult.

The reasons given above summarise consultants' and researchers' views on why corporations should engage with governance of CR. However, what do directors themselves say? When you ask directors why they have brought CR to the boardroom, their answers fall into the following categories: [xxviii]

❖ **Business Case:** The board was increasingly aware of the business case for CR

❖ **Corporate Identity:** CR was a founding principle of the firm

❖ **Merger & Acquisition:** CR entered the boardroom through mergers

❖ **Stakeholder Pressure:** Stakeholders lobbied successfully for the integration of CR at board level

❖ **Shareholder Pressure:** Major shareholders requested the inclusion of CR in strategic planning

❖ **Leadership:** Individual board members showed a strong desire for the company to exhibit CR leadership

❖ **Just the Right Thing to Do:** Directors became increasingly committed to doing the right thing to do as they saw other companies failing to uphold integrity

"Corporate Responsibility needs to be linked to business strategy in order to have an impact at board level."

Critical Success Factors for Achieving CR Governance

As discussed earlier, we define the Governance of Responsibility as the integration of CR issues into governance mechanisms. From our interviews and the literature, we have identified six critical success factors for the Governance of Responsibility to work at the board level. Each factor is essential in itself and as part of the six, as the success and impact felt of any is inter-dependent on the success of the others.

1. Awareness of the materiality, drivers and benefits of CR governance

2. Board Leadership

3. Culture of openness and critical loyalty

4. Proactive stakeholder engagement

5. CR built-in instead of bolt-on – a clear link to day-to-day business practice

6. Clear statement of the company's principles for doing business

3.1 Awareness of the Materiality, Drivers and Benefits of CR Governance

"Corporate Responsibility needs to be linked to business strategy in order to have an impact at board level." (Marcia Balisciano, Director CR Reed Elsevier)

The spread of CR within the board means that directors increasingly understand the socio-political issues affecting the long-term success of their organisation and integrate them systematically into organisational decision-making. CR is becoming a differentiation strategy for companies which want to separate from the mainstream market and foster an image of a business both profitable *and* responsible.

Questions which all board members and executives will need to be able to answer in the future include:

❖ Which societal trends will have an impact on our business in the future and how can we benefit from them?

❖ Can I explain our CR approach to the media in a short but precise way?

❖ How does our risk management mitigate against the environmental and social risks of our business?

❖ How confident am I that our current management systems give me a good overview of the social, environmental and economic performance of the organisation?

❖ Are we improving our CR performance? How are we positioned vis-à-vis our competitors?

❖ Can I quote the key business benefits of a sound CR approach?

❖ What and where are the potential disconnects between our CR strategy and implementation on an operational level?

Directors have a unique role as either trustees or even creators of sustainable and responsible corporations and need the capability to apply due diligence regarding social and environmental issues. [xxix] However, switching to responsible business requires a new kind of director with a broader skill set:

"People with hybrid backgrounds – such as those with both NGO and business experience – will be viewed as more valuable than those directors with a single-minded focus." [xxx]

Research from the Dow Jones Sustainability Index found, however, that only a minority of companies offer CR induction training for directors. [xxxi] Not training directors can lead to mixed messages being sent to those in positions of authority. Take, for example, the sign-off on spending: a traditional authority process may dictate traditional financial returns for approval on proposals, excluding CR indicators for risk avoidance, reputation management, staff engagement and brand equity. This can result in a state where sustainability considerations might be neglected, but is likely to cause significant difficulties, as Nike found when, after prolonged negative publicity, they then had to integrate child labour tracking systems in the way they selected suppliers. [xxxii] The necessary policy changes at Nike definitely needed board approval. Furthermore, employees will get cynical if board members talk about sustainability but do not 'walk' it in practice. Therefore, for proper risk and opportunity assessments we strongly recommend training directors on CR and sustainability-related issues through, for example, scenario-planning exercises or other CR seminars.

3.2 Board Leadership

"If the CEO has not bought into Corporate Responsibility you are fighting an uphill battle." (Cindy Cahill, Deloitte)

It is important to have the CEO as a CR champion at board level – in other words, to have the absolute commitment of top-level management. Board-level representation "sets the tone at the top" [xxxiii] and sends a strong message to the organisation and stakeholders of the support they give to CR efforts and that the power and authority (governance) for CR starts at the top. Just think of how Jeffrey R. Immelt's announcement of 'Ecomagination' in 2005 triggered innovation at General Electric (GE). GE has

brought 70 new cleantech products to market and envisions annual revenues of $25bn in 2010 from this product range. [xxxiv] A CR Champion at board level does not degrade other board members to mere passengers – as in the case of GE the whole board needs to work together for Ecomagination to succeed.

CEO's are increasingly taking a leadership role in CR matters. Researching 51 companies in the BITC CRI that had completed the CRI every year since its inception in 2002, we found that most CR initiatives are lead at board level by the CEO or managing director. [xxxv] Similarly, a 2008 study by Ernst & Young reported that, out of the 31 FTSE 100 companies interviewed, 71% had a board member championing CR issues[xxxvi].

Table 2: Anchoring Points of CR

Anchoring within the organisation	2002	2003	2004	2005	2006	2007
No. of firms with CEO or managing director heading CR initiatives	25	30	34	35	36	36
No. of firms with chair heading CR initiatives	6	11	11	8	9	7

Reference: see Spitzeck (2009).

Our research into the BITC CRI further indicates that CR is spreading within the boardroom. In 2002, a single board member was responsible for CR in 65% of the cases; this number dropped over the years to 47%. At the same time, the sharing of responsibilities among various board members increased from 27% in 2002 to 51% in 2007. [xxxvii] By 2007 having multiple board members responsible for CR (including the CEO) was the preferred governing mechanism, clearly demonstrating a spread of CR in the boardroom (see Table 3).

Table 3: Structural Patterns of CR Governance

Governance structures for CR	2002	2003	2004	2005	2006	2007
No structure at board level	4	1	1	1	1	1
Single board member responsible	33	26	25	24	23	24
Multiple board members responsible	14	24	25	26	27	26

Reference: see Spitzeck (2009).

3.3 Culture of Openness and Critical Loyalty

Demonstrating CR leadership and being a representative of how power and authority operates requires self-reflection and a critical stance towards one's own performance. Not everything will always run smoothly and organisations need to learn how to deal with the new responsibility and sustainability requirements. Once that is done, continuous learning from the lessons learned during implementation and operation will help to improve future performance.

You can assess whether or not your traditional power structures enables a culture of openness and feedback. For example, if you need to embed CR further into the business, it is important to tap into employees' interests and motivations. However, in order to do so, you need to give them the space to learn, reflect, question and then feed-back. This can be done through forums, meetings, question sessions or feedback forms and will allow them to interpret the new facts and decide what they need to do and how it affects them and their relationship with the company. Some guiding questions might be:

1. Does your current power structure allow this process to happen? The success of such a learning process relies on whether or not the organisation tolerates such openness and learning. The HR and Internal Communications teams should be well positioned to help answer this.

2. Are board members and managers open to critical loyalty? If not, you will need to either address this issue or work within the existing culture by, for example, engaging and informing a specific board member and enlisting their support in favour of a learning culture.

A board's openness to feedback helps them to identify areas for improvement and we would advise organisations to strive for and nurture a culture of critical loyalty. This is in contrast to the frequently encountered culture of blind loyalty or fear, where employees and stakeholders are not offered any channels to communicate critical issues and loyalty is defined as not challenging superiors in any way. In a culture that encourages critical loyalty, members of the organisation and stakeholders are encouraged to challenge the organisation's goals constructively and continuously. Any shortcomings will be seen as an opportunity to learn. Encouraging board openness should be easier in this current climate of accountability and desire that board members be closer to and more familiar with the businesses whose boards they sit on. It also pre-empts the risk of whistle-blowing forcing the company to have critical conversations first with the media, rather than first raised and discussed inside the company.
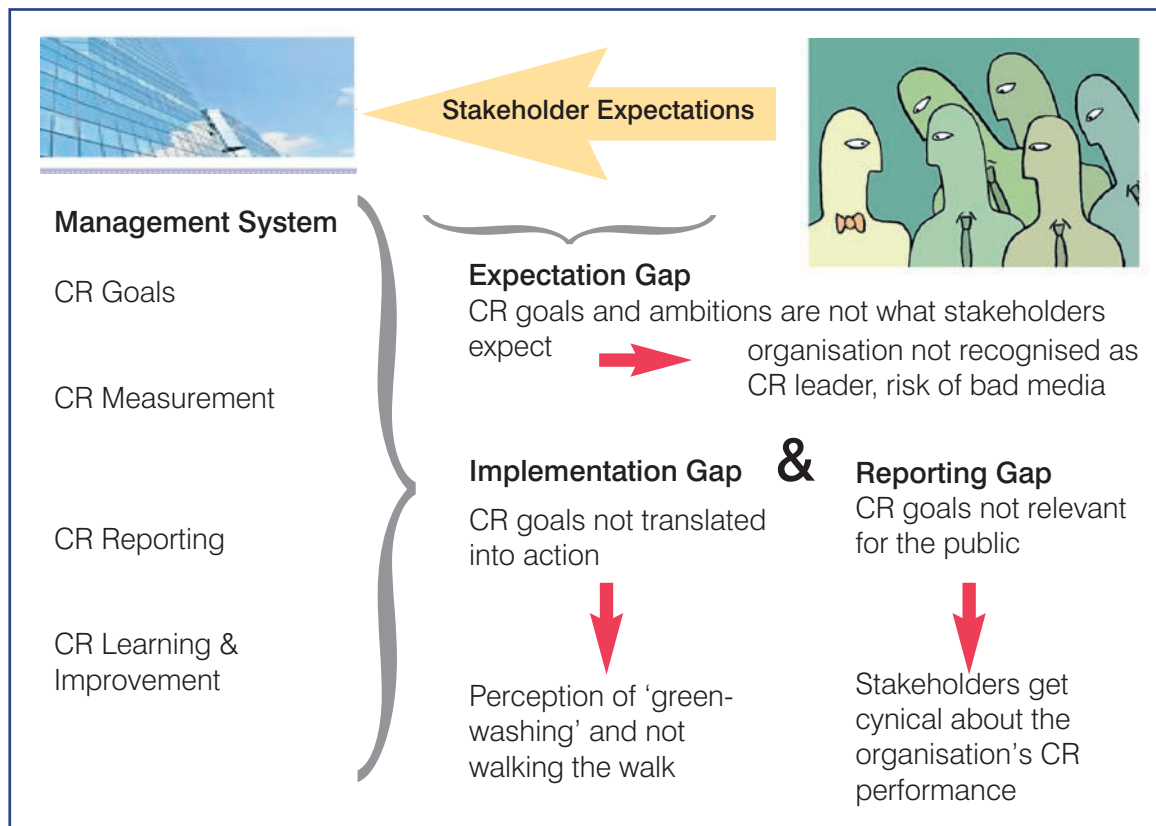
3.4 Proactive Stakeholder Engagement

Organisations that have realised the learning and innovation potential in engaging with critical stakeholders, approach stakeholder discussions proactively (see the Doughty Centre publication 'Stakeholder engagement: A roadmap to meaningful engagement' for a guide to how to engage with NGO and community stakeholders). Different stakeholders were affected in diverse ways by the governance crisis of 2002 and the financial crisis of 2007-2009. Employees have lost their jobs, pensioners' and employees close to retirement have lost part of their retirement funds and many SME owners are struggling for business survival. The social consequences of governance failures have led to demands for new regulation and to stakeholders in general being more critical. There is a significant risk of managing an organization out of synchronicity with stakeholder concerns (see the expectation gap in Figure 3 below). Not surprisingly, research found that leaders in the Dow Jones Sustainability Index have a strong stakeholder orientation. [xxxviii] Among the important groups corporate leaders are engaging with, and that you should consider engagement with depending on business and local circumstances, are customers, local communities, government, suppliers, trade unions and NGOs.

Stakeholder engagement has become a popular barometer for checking if corporate strategy is in line with external expectations. [xxxix] 97% of the 31 FTSE100 companies surveyed by Ernst & Young in 2008 had set up structures of dialogue with external stakeholders to identify their expectations. [xl] It is a useful tactic for conducting 'reality-checks' and benchmarking how your organisation performs against society's current expectations. The Co-operative Bank, for example, lets their customers vote on their general policy for doing business. Unilever's Brand Imprint programme invited stakeholders to share their social and environmental concerns and evaluated how this presents risks and opportunities for business. Allianz creates a materiality matrix evaluating CR issues from the company's as well as from stakeholders' point of view.

While stakeholder engagement has been used in the past to identify risks, the input of stakeholders is also increasingly shaping corporate innovations. Ongoing research at the Doughty Centre has found that businesses with non government organisation (NGO) engagements can foster innovation such as new product lines for disabled customers or pre-school children, new marketing channels towards a customer segment or significant process innovations. [xli] This is a useful approach to take when

Figure 3: Matching Stakeholder Expectations with Management Systems

building a case internally for proactive meaningful stakeholder engagement. The board's role in this will vary from endorsement to actual engagement with key stakeholder figures – and the degree will obviously vary depending on how engaged and involved your board members are. At the very least, however, they should provide endorsement of a proactive stakeholder approach and underline the benefits of it to the business.

However, stakeholders are not a homogenous body and have different needs. It is therefore important to identify stakeholders according to specific issues and circumstances and have structured discussions on the issues that are of importance to them, rather than discussing everything with everybody. Bearing this in mind, companies therefore use different mechanisms to engage with stakeholders. These mechanisms are a useful tactic for identifying and then prioritising the issues relevant to an organisation. A board-advising stakeholder panel usually consists of CR opinion leaders with a broad view giving feedback on the firm's CR strategy, reporting and performance. To address high priority issues (e.g. climate change) relevant partners from government and NGOs are invited to help design policies and assist implementation. If the issues are relevant to local communities (e.g. in an oil pipeline project), most companies directly engage with that community's leaders. Some examples of stakeholder engagement mechanisms are given in Table 4.

3.5 CR Built-in Instead of Bolt-on

"It is basically the executive's responsibility to determine and manage Corporate Responsibility issues that are relevant to the business, and for the whole board to advise and monitor." (Baroness Denise Kingsmill)

The board has ultimate responsibility for making sure that the valuable input of stakeholders, revised policies on sustainability issues and their own deliberations have an impact 'on the ground'. A company promising CR targets without employees delivering on them gets quickly labelled a 'greenwasher' or 'spin-maker' [xlii].

Business integration assures that CR goals are translated into action and addresses the implementation and reporting gap visualised in Figure 3 earlier. The 2008 research by Ernst & Young found that 58% of the corporations they interviewed (out of 31 FTSE100 companies) drew members for the CR committee from members of staff across the business and thus facilitated business integration. [xliii] As only 6% of the sample had an independent stakeholder panel, businesses need to catch up and align their CR strategies with stakeholder concerns. We would advise companies to make sure their CR priorities are in line with stakeholder expectations and to therefore seek more dialogue.

A case in point for sound business integration is the British retail icon Marks & Spencer, which has implemented a 'How we do business' committee on which executives from every major

Table 4: Stakeholder Engagement Mechanisms

Company	Mechanism and aim	Explanation
EDF Energy	Stakeholder Advisory Panel – General issues	The stakeholder advisory panel provides independent opinion and insights to EDF Energy on social and environmental policy matters.
HSBC	Stakeholder Engagement Workshops – General issues	In 2008 HSBC held a series of stakeholder engagement workshops to learn about the issues that were of importance to stakeholders and how they expect the company to report on them.
Camelot	Formal advisory panel – General issues	Prominent CR experts and specialists representing different stakeholder interests.
Novartis	Ethics Council on Stem Cell Research – Specific issues	To deal with the ethical issues in stem cell research, Novartis set up an Ethics Council composed of well-known scientists and ethicists.
Vodafone	Stakeholder Focus Groups – Discuss specific issues	A group of stakeholders was invited to share their views regarding a specific issue in Vodafone's business.

Reference: collated from interviews and desk research.

business department take responsibility for the company's CR strategy. [xliv] The composition of this committee fosters business integration, an aim clearly expressed in these words from CEO Sir Stuart Rose:

> *"The internal Plan A structure we've put in place has also enabled our staff to get involved. At M&S we deliberately talk about 'How we do business' rather than CSR. Our CSR committee has become our 'How We Do Business Committee', with overall responsibility for delivering Plan A policy. I chair this committee, so these actions are taken at the heart of the business. Second, we've also spread responsibility for the delivery of Plan A as wide as possible by appointing Plan A specialists in every part of our business – such as food, clothing, HR, marketing, communications and logistics. And we've appointed 570 Plan A champions in our stores to support the adoption of Plan A among their customers and colleagues. This way Plan A is hooked into all parts of the business – much more so than if it was just the responsibility of our CSR team."* [liv]

Establishing a CR committee also has some material benefits. Our research into the BITC index shows that companies with a CR committee scored on average 9% better in the index than the general population. [xlvi] This suggests that the use of CR committees is beneficial to CR performance at least as evaluated by BITC's CRI.

The Role of other Business Committees

However, CR issues are neither bound to specific functional areas such as marketing or supply chain nor to critical business processes such as recruiting or quality management. Therefore, it would be unreasonable to think that CR does not have an impact on other committees. All board committees have a critical role to play in making sure the business is run responsibly (see Table 5 below). We advise working with these committees to identify business practice synergies and opportunities for collaboration.

Table 5: Business Committees and the CR Role

Committee	CR role
Internal Control	CR risks must be formally included in the company's risk register and assessment procedures.
Audit	The implementation and performance of the CR strategy needs to be evaluated to the same standards as the commercial strategy.
Selection and Remuneration	The selection, training, succession planning and remuneration of board members and managers all need to take CR aspects into account.
Risk	Integration of social and environmental issues in the company's risk register and risk management processes.

3.6 Clear Statement of the Company's Principles for Doing Business

A key role for the board is to lay out the ethical standards for how the company conducts its business. Governance will struggle without clear standards and without guidance on accessing if behaviour is acceptable or not. Without this, the ethical boundaries of a business are open to interpretation. Principles for doing business set out how an organisation aims to conduct itself in areas such as governance and ethics, human relations, stakeholder relations and environmental management. One tactics used by many is to align the company's principles with significant global initiatives, for example issues of human relations can be aligned with the declaration on fundamental principles and rights at work developed by the International Labour Organization.

The company's stated principles for doing business should show clearly the ethical compass the board uses to steer the business. This statement helps internal as well as external stakeholders to understand the intentions of the board and allows accountability.

Westpac Group is Australia's oldest bank and clearly lays out its business principles.[xlvii] They determine the standards against which the company judges its own CR performance and invites stakeholders to hold the company to account. These principles are used to report the performance of Westpac in their annual reports.

*"The basic role of CR committees is to discuss issues
or risks that are usually driven by opportunities,
stakeholder concerns, or emerging issues in the
media and society in general."*

The CR Committee

Many boards have developed new support structures to deal with the range of issues they now face. As our research shows, the preferred option is the establishment of a CR committee. Committees are usually set up if issues are too numerous or complex to be handled by the entire board. Investigations by Cramer and Hirschland found that eight of the Fortune 'Top 10 Most Admired Companies for Social Responsibility' had a CR committee in place. [xlviii]

As discussed earlier, ongoing Doughty Centre research is seeing a rise of CR committee use in the BITC CRI – from 16% in 2002 to 61% in 2007[xlix]. Table 6 outlines some of the more prominent examples.

Table 6: Examples of CR Committees

Company	CR committee
Anglo American	Safety and Sustainable Development Committee
GlaxoSmithKline	Corporate Responsibility Committee
Marks & Spencer	How We Do Business Committee
Merck	Board Committee on Public Policy and Social Responsibility
McDonalds	Corporate Responsibility Committee
Unilever	Corporate Responsibility and Reputation Committee

4.1 Positioning of the CR Committee

Companies have several different options regarding where to integrate CR committees into their governance structure (outlined in Table 7).[l] In most cases best practice suggests a combination of options below, for example a board CR committee as well as an executive CR committee.

Table 7: Examples of CR Committees

Company	Description
Within the board	CR issues are discussed as part of normal board meetings.
Formal committee on CR	A formal committee designs CR strategies and gives recommendations for board approval.
Executive committee on CR	An executive committee has well-defined executive powers in terms of CR strategy and is authorised to make decisions on behalf of the entire board.
Ad-hoc committees on CR	Ad-hoc committees are set up to accomplish a particular task, for example to design or revise the organisation's CR strategy.

The placement of the CR committee depends on the company's general CR maturity. Beginners are more likely to govern CR issues needing urgent attention in an ad-hoc fashion and usually lack a sound management system and framework. However, as soon as CR moves from being 'bolt-on' to being 'built-in' to a firm's purpose and strategy, CR issues are more naturally discussed at every board meeting and the board comes to be supported by a new board or executive committee.[li]

4.2 The Role of CR Committees

The basic role of CR committees is to discuss issues or risks that are usually driven by opportunities, stakeholder concerns, or emerging issues in the media and society in general. The committee then considers proposals for management to address the issues through, for example, an annual report to the full board. In most cases this means adapting the policies already in place and improving performance on the issues concerned. As a follow-up the committee continuously reviews the organisation's performance against policies, a strategic framework and KPIs. Among the specific remits stated in terms of reference which companies use are:[lii]

❖ Designing, implementing and monitoring principles and policies

❖ Setting of metrics and performance reviews

❖ CR compliance and risk management

❖ Critically reviewing strategy with internal and external stakeholders

❖ Raising issues of concern with the board

❖ Reviewing the organisation's CR reporting

In the majority of cases the board CR committee is headed by an independent director.[liii] An independent director can give unique insight into the company from an 'outside' view, can be seen as unbiased and not allied with internal parties or politics, and can bring specialist knowledge to the board that may not be readily available or needed on a permanent basis. However, the disadvantage is that they will not be as familiar with the company and its internal workings as an executive board member would be. We recommend that each organisation makes a decision on this based on their current complement of board members, their accepted roles and the availability of directors to lead the CR committee. The critical factor is that the lead director carries credibility and authority within the board and across the company.

4.3 Measuring the Board and CR Committees Effectiveness

How do you know if your board and the CR committee perform well and are effectively safeguarding your reputation? An effective board knows which issues and stakeholders are relevant and how they impact on the organisations performance. Organisational processes give the board the information to make informed decisions and to react quickly to changing societal developments. Effective CR governance also enhances stakeholders' trust. We have created the following lists of questions, for board members and executives, that might help you test the current state of your board and CR committee effectiveness and identify areas for improvement:

CR and Sustainability Awareness

1. Is your board/CR committee able to explain the organisation's CR approach in a few convincing sentences that you would like to see on the front page of the *Financial Times?*

2. Can board/CR committee members name the most material responsibility and sustainability issues and do they know how these will develop over the next 1, 5, or 10 years?

3. Do board/CR committee members know the most important stakeholders and their views on corporate conduct?

4. Are policies in place regarding these most important issues?

5. Would a media review of critical reports on the organisation reveal that an issue has not yet been addressed properly by the CR committee?

If your answers are mostly negative then you have identified several areas where your CR committee need improvement. Simple solutions such as providing seminar training or away days/workshops or materials such as the CR report can help – but lack of knowledge among the directors could be a symptom of underlying disinterest or lack of pro-active concern. It is important to assess if the committee members need to be engaged at a deeper level or if they need to be empowered to act. It could be they are unclear of their role, who to talk to, where to get information from or may simply think it is someone else's responsibility.

Governance Process Checks

1. Can the board/CR committee demonstrate that critical incidents which have been raised internally did not get used to punish the messenger but rather to improve organisational practices?

2. Does a survey among board/CR committee members show that they feel free to raise critical issues and that they are well informed about the organisations CR and sustainability performance?

The answers to these two questions highlight whether or not internal processes of critical feedback work properly. It is always better to deal with criticism inside instead rather than facing it in the newspapers. If the answers to the questions above are not satisfactory companies usually face one of the following two problems: (1) Lack of Communication or (2) Ineffective Knowledge Management.

The Caux Round Table has developed a structured interview to be conducted with each board member to enable a board to assess its understanding of the risks associated with environmental, social and governance factors. This 'Arcturus' framework[liv] is a diagnostic tool that has been used with a number of companies around the world.

Communication issues might exist if employees do not feel comfortable raising issues or using hotlines because they are unsure what changes are triggered by their complaints or they do not understand that the system is set up as a learning – in contrast to a denouncing – tool. Whether they are on the board or the shop floor, members of any organisation need the confidence to speak up and to see that their feedback is used and valued by the organisation.

Spreadshirt is a small company specialising in printing T-shirts on demand with motifs sent in by customers. Every now and then the company receives racist or sexual images to be printed. In order to deal with this situation an Ethics Council has been set up comprising of several employees. This council takes decisions on whether the questionable image can be printed or if the request should be declined. Critically, all decisions are made public within the internal newsletter and fed back to the employees so they become aware of what is considered inappropriate material. The company thus has established a self-governing system regarding the issue of unethical print motifs.

Knowledge management issues might prevent effective board briefing on CR. An efficient internal knowledge management system should provide directors with a sound framework and set of indicators to judge the organisation's CR performance, and the views of stakeholders as well as areas for improvement. It is critical that indicators are not only used for reporting purposes but also to foster organisational learning.

CR and Sustainability Performance

1. Has the organisation improved its performance on responsibility and sustainability KPIs under the board's leadership?

2. Is stakeholder trust or satisfaction growing?

3. Are critical issues transparently reported and addressed?

These questions relate to the CR committee's overall performance and accountability. The answers will provide various insights into the leadership's strengths and weaknesses, from which improvement should be made in order to have a CR committee with an effective and strategic approach to CR. We recommend that companies set up a sound management process which tracks important CR performance indicators and reports them to stakeholders. An ongoing dialogue with stakeholders also avoids any expectation gap (refer back to Figure 3) and, in some cases, stakeholders might even make concrete recommendations on how to improve performance. Measuring and reporting CR issues should be undertaken in as serious as fashion as measuring and reporting financial performance is. Only then are directors really informed about the CR strategy and the performance of the organisation they steer, and therefore able to defend this publicly if need be. Companies new to this topic can learn a lot by joining business networks such as BITC to exchange experiences and best practices.

Lloyds Banking Group started tracking and correlating staff overtime, staff turnover and workplace satisfaction and found that the more satisfied staff are, the less turnover there is. This raises customers' trust in the people they come into contact with over a long period of time, which is in turn translated into increased customer satisfaction and finally sales performance. Companies that are not tracing these 'soft' CR indicators are not able to find these critical correlations.

*"The endless cycle of boom-bust-regulation
accomplishes little in the long run."*

Board Roles and Responsibilities

While boards have a wide array of responsibilities, the areas covered in this section are either affected by or enter the board's remit because of CR trends. Boards usually review these CR activities and performance on a quarterly basis. A clear role for the board needs to be agreed and boards need to set their expectations and clarify accountabilities. From this, a framework can be developed that gives guidance to senior managers and board members so that an effective and thorough working relationship can be developed. The categories we have outlined below can be used to develop these 'terms of reference' for the board's role for oversight of CR in the organisation.

5.1 Strategic Planning

The board needs to set up and follow a clear CR strategy integrated in the organizations general business strategy, arguably part of normal corporate strategy development. To do this, directors have to evaluate the risks and opportunities that the firm faces in relation to societal and environmental developments. Societal trends regarding climate change, population growth, water scarcity, consumer behaviour and the impact of rising economies like China and India will have an impact, especially on transnational corporations. Scenario planning techniques are increasingly used to raise awareness of possible events and prepare the organisation for future decisions. It is in helping with strategic planning that those directors (or non-executive directors) with experience from different industries or companies that have worked on improving their sustainability performance can prove themselves to be a strong additional resource.

Additionally, a key role for the board is to strategically plan and then communicate appropriate moral/ethical standards for how the company conducts its business. Without this, governance struggles – especially if the conduct communicated does not match, or works against, the prevailing culture of the organisation. These standards should be integrated into the strategic planning of the business, as part of how the business operates, not as a separate check-list of actions.

5.2 Risk Management

During the last three decades the cost of the US tort system has risen from 0.5% to 2.3% of gross domestic product.[lv] A new set of lawyers – called legal activists – use the legal process as a powerful tool for stimulating social change, holding corporations to account for their social and environmental impacts. As well as these legal liability issues corporations also come under scrutiny in the court of public opinion. Controversies around child labour (Nike), human right abuses (Shell in Nigeria) and animal rights (Huntingdon Life Science) demonstrate that CR issues can pose a real risk to the strength of a company's brand and their wider reputation. Boards who handle these issues badly have reported long-term irreparable damage to the market and brand value of the company.

Therefore, a key role of the board is to instigate and oversee a risk management process. Following the UK Turnbull Committee's guidance on internal control, board reviews of the organisation's risk register need to include risks stemming from sustainability and responsibility issues. Those we interviewed during the research for this guide agreed that CR risks are specific to the business concerned, for example an airline cannot avoid the issue of carbon emissions, while a bank needs to make sure its customers possess sufficient financial literacy to understand the nature of the products offered and taken up.

5.3 Compliance

As a result of the governance crises of Enron and other similar incidences (discussed earlier), a natural focus for CR governance is compliance with regulation, governance standards and other external and internal regulation. The board has to ensure that governance systems run smoothly and that they can demonstrate that they do. Despite the fact that governments issue new regulation and corporations comply, basic governance failures have remained:

> *"The endless cycle of boom-bust-regulation accomplishes little in the long run."* [lvi]

If this cycle is to be broken, board members need to play their part and have to ensure that their company complies with the spirit, and not just the letter, of the law. They need to govern with integrity. Instead of seeing regulation as a limitation faced by their business, CR leaders increasingly consider sensible regulation a basic requirement for doing business with integrity. Higher CR standards applied by one company can, in some cases, generate a first-mover disadvantage as other industry players do not have to live up to new commitments and therefore do not incur the same costs. However, by cooperating with regulatory bodies and industry associations, visionary companies can make sure the bar is raised for the whole industry – either by establishing new industry standards (e.g. the Fair Labour Association, Equator Principles, Extractive Industries Transparency Initiative, Marine Stewardship Council certification etc.) or by better regulation.
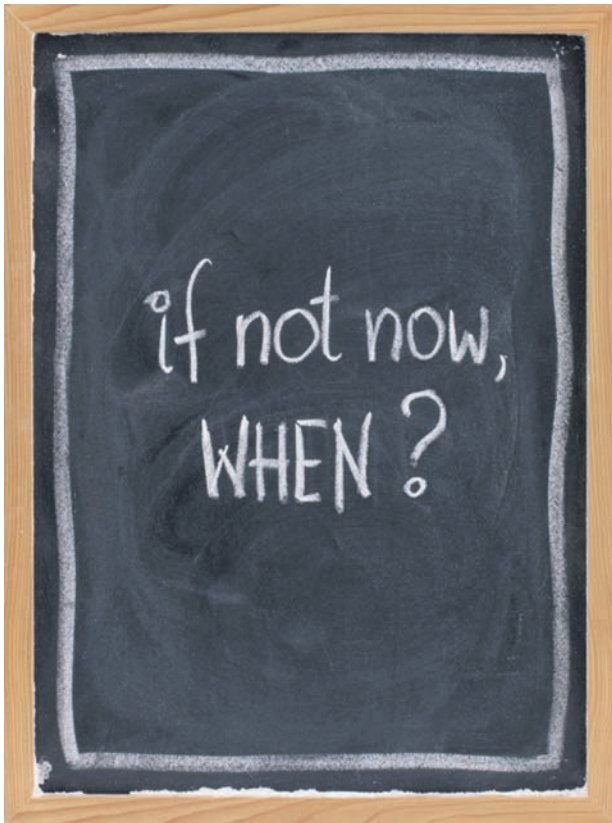
5.4 Implementation

Companies who succeeded in having CR work at an operational level had internal standards such as statements of business principles or codes of conduct. [lvii] Companies implement these in the following ways:

- ❖ inclusion in job description (94% of companies analysed in the research)

- ❖ disciplinary actions in case of a breach (78%)

- ❖ compliance linked to employee remuneration (72%)

- ❖ integration into individual annual review (67%)

The researcher Ricart and colleagues also showed that organisations make use of regular employee communication (94%) and their intranet (78%), with practical examples and training questions to encourage responsible behaviour. Further research has shown that some companies report that executive compensation has been negatively affected as a result of poor implementation of health and safety standards. [lviii]

Board members have a role to play in implementation. How authority is devolved to implementation level, and how corresponding power is distributed, starts from the board and cascades into the company. Therefore the board have a responsibility to ensure that implementation is enabled by their good governance.

5.5 Board Remuneration, Selection and Succession Planning

"What gets measured gets done" is an old management saying. CR performance and implementation benefits from associated metrics being included in remuneration systems. For example, many oil and mining companies integrate occupational health and safety targets into executive incentives. However, most systems still rely mainly on financial metrics, which explains why social and environmental issues do not get systematic attention. As long as board members are not held responsible for CR targets, there will be little progress on an organisation's CR strategy.

However, existing appraisals on the board and individual directors can easily be enhanced to incorporate a view on how well they are doing on CR-related issues.

Management guru Henry Mintzberg predicts that for succession planning in the future, directors will be chosen based on their values and attitudes rather than just credentials.[lix] In his judgment, companies will apply three basic criteria: Select – Socialise – Judge.

- ❖ First directors are selected to become members of a social system.

- ❖ Then, they need to be socialised to learning about the organisation's value system and 'how things are done responsibly'.

- ❖ Lastly, they will be evaluated not only on their performance but also on how this performance was achieved.

It is important, therefore, that understanding of CR and sustainability is included in the required skills and experience of at least some board members – although arguably it should now be considered part of the generic skills expected of all board members. Similarly, effectiveness in discussing and dealing with CR should be one of the issues examined in the regular appraisals that effective boards do of their own performance.

5.6 Driving Change of Policy

As mentioned earlier, first-movers can sometimes find themselves at a disadvantage by having to experiment (and pay for the cost of experimentation) regarding how they manage ethical issues. Nike, for example, experienced this. Upholding human rights and avoiding child labour in supplier firms came at a significant upfront cost to the company – and this would have been translated into a competitive disadvantage if competitors had not done the same. In this instance, Nike set up the Fair Labour Association and lobbied for new industry standards regarding labour issues.

Dealing successfully with similar challenges requires the ability of the board to enter into partnered governance with legislators and NGOs. It also requires 'leaps of faith' and the bravery to experiment; the board needs to give 'permission' for the company to take these steps.

5.7 Oversight Techniques/Models

Companies will often need to adapt their existing management systems to enable the new CR and sustainability commitments. This involves establishing baseline standard and expectations, and defining and measuring the performance of extra-financial indicators and their relation to the organisation's financial performance.

Without a managing system for CR issues the board cannot evaluate progress over time and document successes and identify failures. Equipped with a sound management framework (e.g. a sustainability-enhanced version of the Balanced Scorecard), the board can provide internal leadership in direction, focus and ambition – and in turn the company can give a credible account of how negative impacts are minimised and positive impacts maximised. Amanco, Latin America's leading manufacturer of plastic pipes, uses a sustainability-enhanced Balanced Scorecard to steer its business. [ix] This has helped the company to be recognised as a leader in responsible business and also benefitted the financial bottom line. However, is important to keep in mind that CR issues are constantly evolving and that the managing system should be changing according to new challenges. As indicated above stakeholder engagement is a useful tool to update and challenge the company's performance indicators.

"There is a risk of Groupthink on boards. Board members should not be afraid to challenge in a constructive way the accepted view. Although consensus is desirable, dissent can also be valuable."

Barriers to CR Governance

Threats are the downside of unrealised opportunities. The following barriers are frequently reported by frustrated CR managers as well as directors.

6.1 Organisational Culture and Values

A main obstacle for sound CR governance is often the implicit culture of an organisation. Enron is a case in point. The company had ethical guidelines and policies, had won CR awards and was a respected organisation. However, Enron's underlying culture was often described as 'winning at any cost' driven by 'the smartest guys in the room'. This culture enabled the board to suspend the ethics code twice in order to set up the infamous Special Purpose Entities which finally led to the demise of the company. The Enron case highlights the fact that culture can overrule structures and that a 'winning at any cost' culture seriously inhibits good CR governance.

6.2 Unarticulated CR Strategy

Many boards have yet to formulate a consistent CR strategy that is compelling for both internal and external stakeholders. The CR strategy needs to identify the most material issues and have a set of SMART metrics (Specific; Measurable; Actionable; Relevant; Timely) that operational managers can use to improve their CR performance. An unarticulated strategy creates confusion over priorities, uncertainty about the link to the business, and what/how the strategy is followed through and measured. A series of CR workshops is often used by boards to discuss and define KPIs for CR, as well as to find a suitable management framework.

The strategy needs to:

❖ Represent the aspirations of the organisation now and in the future, both in terms of its objectives/targets and regarding how it articulates its overall approach to CR and corporate governance

❖ Be clear about the role the board and management will take in the strategy, especially how authority and power will be used (i.e. who has accountability and how this has been developed)

❖ Be realistic, practical, and relevant to the company culture/ethics, region and industry

❖ Be framed so that operational managers can develop achievable tactics for target achievement

❖ Be representative of stakeholder input, from a comprehensive stakeholder consultation and analysis process

6.3 Groupthink

"There is a risk of Groupthink on boards. Board members should not be afraid to challenge in a constructive way the accepted view. Although consensus is desirable, dissent can also be valuable." (Baroness Denise Kingsmill)

If the drivers and benefits of CR governance are not recognised by the majority of the board, then group think and the mindset of the chairperson and CEO can become obstacles to effective CR governance. The message for directors dealing with CR is clear: don't sit on boards if you want to be popular and if your income depends on the directorship. We see in many organisations that the next generation of managers are very aware of CR and sustainability issues but find it difficult to convey this message to senior management. This is especially true in companies where there is no open discussion and where messengers bearing bad news gets punished.

Engagement up the management line is possible, and a push from the 'middle' can be very effective. There are two key things to bear in mind of you find yourself in this position:

❖ Bring the voice of the stakeholder in to the company, to demonstrate the external climate, and link what they are saying to business operations such as supply chain or marketing.

❖ Start a catalytic action, so that other senior managers from different departments/regions become engaged through joint projects, sharing of budgets or encouraging joint approaches to stakeholder engagement where skills can be transferred. This will create a network of senior supporters and confirm that CR is business operations-related, thus attracting the interest of the board.

6.4 Lack of Training and Education

As long as directors do not clearly understand the CR risks and opportunities of their business, it will be difficult to reap the rewards of effective CR governance. To tackle this, organisations can:

❖ Run sessions on scenario planning which can be a productive way of introducing CR topics to the board.

❖ Manage the knowledge around CR and sustainability, alerting directors to relevant legislation, best practice examples and opportunities through networks and industry projects.

❖ Encourage membership of industry-wide or CR-specific networks, such as BITC in the UK, where access to knowledge and discussion is readily available, including off-the-record conversations at senior level where appropriate.

6.5 Lack of Stakeholder Engagement and Critical Feedback

In the absence of a culture of open communication the board 'knows best' and may not listen to critical stakeholders. This translates more often than not into a mismatch between stakeholder expectations and corporate performance and can often be the root cause of a crisis. Section 3.4 contains advice on developing meaningful stakeholder engagement. However, be aware that you may face a barrier of 'disinterest' or 'time poor' directors and struggle to enlist their support for stakeholder engagement. In this instance, the issue is one of attitude, which needs to be managed as a leadership issue, ideally with the chairman of the board.

6.6 Overuse of Consultants

In facing the challenges of the stakeholder society it is necessary to include expert advice and consultancy. However, as the governance of CR is not a tick-box exercise, ready-made solutions should not be expected of consultants. We advise boards to use external advisors and consultants to assist their reflection process, helping to ask the right questions but leave it to the board to formulate the right answers. After all, a critical journalist or stakeholder will demand well-thought-out answers from the board, not from the consultants.

6.7 National Characteristics

Governance models are significantly influenced by national characteristics that can become obstacles as well as drivers. The German model of governance mandates employee representatives at the board level, favouring these stakeholders over others. In the Anglo-American tradition there is a strong focus on shareholder financial value that, if narrowly interpreted, might inhibit CR.

Be aware of how your region and its culture impacts on your governance model – and identify its strengths and weaknesses. Often you may need to adapt your approach, especially if you are part of a global corporation, to take into account regional differences. A good starting point is to identify these influences and discuss the implications of them openly with the directors and CEO.

"CR governance in this context is not a 'one size fits all' approach"

Trends and Recommendations

CR governance is now a definite presence in boardroom – and companies increasingly make use of a board CR committee.

In fact, the definition of 'good governance' in the future is expected to contain a strong element of CR embedded into the DNA of an organisation, from sourcing its materials to waste management to catering for stakeholders' concerns as you would for shareholder concerns. We predict CR governance will evolve from a box-ticking exercise to comply with standards towards an integrated integrity approach of how and why business is done in certain contexts. In the long term we expect that the language of CR will disappear as issues of social and environmental relevance will become mainstream.

You will see your competitors switch from a reactive CR approach (compliance with guidelines, defensive on shortcomings, not reporting on areas for improvement) to a more proactive approach including stakeholder engagement, transparent reporting which includes areas of weak performance, and using critical stakeholders input for organisational learning and innovation. Through this, this they will differentiate from their peers.

Issues of increasing importance are climate change, water scarcity, energy and food security, and relations with local communities where the company has a significant business presence.

CR governance in this context is not a 'one size fits all' approach and therefore, a checkbox approach is not necessarily the best approach. As a consequence of this, we cannot simply give you with a template of how your final governance settings should look, nor provide tick-box exercises to check the health of your governance arrangements. However, we can give some process recommendations that do help organisations determine the best governance arrangement for them.[lxii] These also serve as a continuous learning tool if the process is periodically repeated.

1. Raise board and management awareness

❖ Present an assessment of current CR governance to the board.

❖ Ensure you have a process in place to review emerging trends and that the board regularly assesses environmental and societal concerns.

❖ Engage in scenario planning – how do societal trends affect your business through to 2020 and how can you best prepare and benefit?

❖ Do a media analysis of critical reports on your organisation and demonstrate how you can learn and innovate from it.

❖ Commission a benchmarking study positioning your organisation in the responsibility field of the industry.

❖ Arrange a meeting with (critical) stakeholders such as responsible investors or NGOs.

2. Clarify and document the organisation's principles for doing business

❖ Integrate CR into mission and value statements.

❖ Develop business principles considering each stakeholder group (customers, communities, etc.).

❖ Include your principles in the reporting process.

3. Identify material CR issues, risks and opportunities

❖ Design a management framework containing high-level commitments, stretching goals as well as short-term KPIs to demonstrate performance. Get board and stakeholder sign-off. This helps the board to think strategically about CR and to align strategy effectively with stakeholder concerns.

❖ Update all of your policies regarding risk management (risk register) and innovation.

❖ Communicate your values and articulate why new policies make sense.

❖ Assure compliance with new policies through employee training, whistleblower guidelines and organisational learning mechanisms. Report incidents transparently to the board and internal stakeholders and use them to leverage organisational learning (rather than punish).

4. Embed CR into the organisation's DNA

❖ Provide targets on CR and make it clear who has direct accountability for each target.

❖ Spread responsibilities for CR throughout the organisation by, for example, implementing a CR champions network[lxiii] and integrating CR targets into individuals' performance targets. After all, CR is everybody's business.

❖ Tap the enthusiasm of social intrapreneurs – people working inside organisations driving business value by implementing sustainability innovations.[lxiv]

❖ Embed into staff thinking through how you recruit, induct, train, appraise, reward, promote and take difficult decisions using your corporate values.

5. Establish a CR committee

❖ Institutionalise board and executive action via a formal CR committee.

❖ Set up (a) CR committee(s) to assist the board in managing CR issues, identifying risks and opportunities.

❖ The committee(s) should regularly review performance and help the board as well as the executives to suggest strategies for improvements.

6. Include CR in board member selection, training and evaluation

❖ Integrate CR concerns into board recruitment and training to avoid the loss of knowledge.

❖ Ensure the board is provided with the necessary expertise so it can make informed decisions.

7. Reporting and continuous improvement

❖ Make your CR aspirations and results public so external stakeholders can help to remind you of areas of improvement and laud you for performance.

❖ Ensure transparent reporting of CR governance matters.

❖ Include your stakeholders' comments (both good and critical) into the reporting. Use their feedback to trigger organizational learning.

❖ Get your reports assured by external auditors, especially if you have a problematic CR history.

❖ Join benchmarking groups like the BITC CRI to compare your performance to peers.

"The proper governance of companies will become as crucial to the world economy as the proper governing of countries."

Conclusions

Effective governance of CR and sustainability goes beyond a compliance approach. It fosters financial performance, builds a strong reputation for integrity, capitalises on innovation and fosters trust with key stakeholders. Leading organisations are aware that their success depends on the trends in their environments. Therefore, they integrate CR and sustainability issues into the decision-making at the top of the organisation, synchronise their goals and ambitions with the concerns of their stakeholders and make sure the organisation performs accordingly.

How organisations approach the governance of CR will differ depending on the industry, geographical location and the issues they are confronted with. There is no 'one size fits all' approach. However, there are some key questions leaders, directors and managers should ask themselves, and find convincing answers for them, before they have to give an interview regarding some crisis to the media. There is no choice regarding the question if organisations want to consider CR issues – the only choice is on how the issues get addressed. Effective CR governance approaches this challenge proactively and the Doughty Centre hopes that this guide will help you to deal with this challenge.

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