Michael Hilb
(Editor)

Governance of Sustainability

The Role of the Board of Directors and Management in Sustainable Value Creation

Haupt

Michael Hilb
(Editor)

Governance of Sustainability

Haupt

Michael Hilb
(Editor)

Governance of Sustainability

The Role of the Board of Directors and Management in Sustainable Value Creation

Haupt Verlag

ISBN Print: 978-3-258-08332-2
ISBN E-Book: 978-3-258-48332-0

Cover design and typesetting: Die Werkstatt Medien-Produktion GmbH, D-Göttingen
Cover illustration: iStock.com/537453406_quickshooting

1st edition: 2023

www.haupt.ch

Introduction

Governance practitioners, regulators, and academics, as well as investors, seem to be focused on one debate in the 2020s: The role of business in society and toward the environment. Although these types of debate are not new, but recur periodically as they are inherent to capitalism, the scope of this debate can be seen as broader, both in terms of the number of debaters across all stakeholder groups and the range of issues raised. In addition to many technical, organizational, and legal issues, the debate touches on the foundation of business and the corporation: its purpose.

This raises important questions for corporate governance. In particular, the question of whether the concept of corporate governance needs fundamental reform or just expedient renewal. This meta-question is addressed in my introductory article and runs through the other 12 articles written by 16 practitioners and scholars.

In Section A, the authors present different **conceptualizations** of sustainable value creation. Boris Galonski proposes to combine the perspectives of sustainability and value creation, while Tomas Casas-Klett and Martin Nerlinger suggest the business model perspective to assess sustainability. I outline the concept of the multipurpose corporation as a way to overcome the perennial debate.

The authors in Section B offer complementary **interpretations** to enrich the debate. Elena Szederjei and Roderik J. P. Strobl introduce trust and Stefan R. Meier postulates cooperation as key aspects to better comprehend the concepts. Monique J. Morrow adds another key dimension to a comprehensive understanding of sustainable corporate governance by introducing corporate digital responsibility.

What are concrete **applications** of corporate governance of sustainability and sustainable corporate governance? Three articles in Section C highlight five cases. Reto Schnarwiler outlines how a leading reinsurance company integrates sustainability into its corporate governance approach, Mirjam Staub-Bisang explains the stance of a leading asset manager in Barbara Dubach's and Laura Brechlin's article on the relevance of stakeholder engagement, and Peter Brändle presents three cases from the cosmetics, food, and agricultural industries.

Finally, Section D includes three articles from which **implications** for board members are derived. Helle Bank Jorgensen suggests ten steps to climate governance, Katrin Muff outlines the concept of the positive impact board, and Antonio Hautle urges board members to take a comprehensive approach to sustainable governance.

These contributions highlight different perspectives on this fascinating and wide-ranging field, sometimes taking opposing viewpoints. Hopefully, they will provoke more questions than lay claim to the truth that did not, does not, and never will exist in answering the most fundamental question of capitalism: What is the role of capital and the corporations in society and vis-à-vis nature? In this spirit, I wish you pleasant reading, many startling insights, and new questions that will help you find the appropriate answers for your company and yourself.

Prof. Dr. Michael Hilb Burgdorf, March 31, 2023

Table of Contents

From Corporate Governance of Sustainability to Sustainable Corporate Governance

Michael Hilb

Abstract
What is the best way to integrate sustainability into the corporate governance framework? Boards of directors have chosen two distinct paths: the functional way, which focuses on corporate governance of sustainability, and the foundational approach, which leads to sustainable corporate governance. This article assesses the merits and limitations of both approaches and calls for a transition to sustainable corporate governance. This requires board members to engage regularly with stakeholders and to continuously debate the underlying assumptions to further develop the governance framework as required.

Author
Prof. Dr. Michael Hilb is founder of DBP Group, chairs the Board Foundation, and serves on several boards of directors and trustees. He is a titular professor at the University of Fribourg and teaches strategy, entrepreneurship, and corporate governance at universities in Asia and Europe. Michael Hilb graduated from the University of St. Gallen with an MSc and a PhD and was a Visiting Fellow at Harvard University and INSEAD.

1 Introduction

In the business world, there is a tendency to respond to each new challenge by developing seemingly new strategies and, as a result, new governance approaches. While the ability to anticipate and respond quickly to new trends is usually seen as a strength, it is not always the most effective approach. There is always a risk of living in the illusion of being able to influence a phenomenon rather than focusing on managing its impact.

The same is true for sustainability. Very often the focus is on proposing new ways to manage issues that are considered sustainable, be it diversity, climate change, or human rights, rather than challenging the underlying assumptions of governance. Even the terminology used, such as ESG ('environmental, social and governance'), often implies ambiguity. While companies are busy setting up their governance systems to define, enact, and measure environmental and social activities, investors ask for indices to assess them.

How to bring clarity to this debate? There are two distinct perspectives for how companies approach sustainability: The functional perspective, i.e. corporate governance of sustainability, and the foundational perspective, i.e. sustainable corporate governance.

2 Corporate Governance of Sustainability – The Functional Perspective

As companies recognize the increasing relevance of the role of business in society and the environment, they are beginning to functionalize sustainability by establishing sustainability functions, appointing Chief Sustainability Officers, or more generally, adopting corporate governance of sustainability. This approach appears to offer a quick fix: Senior management signals to stakeholders that an issue has been addressed.

Boards that choose this perspective typically begin by discussing measurements, measures, and metrics, driven by external expectations and a desire to present what has been achieved to the outside world. While the mission statement may be slightly adjusted to signal commitment, these changes are often semantic in nature and rarely based on a fundamental change in motivation.

As a result, sustainability-related activities are limited in focus and tend to remain stand-alone. Dedicated teams ensure that they are carried out as planned. At the same time, decision makers consider them done. Given the responsive nature of the action, the organization places great emphasis on communication, risking a cosmetic veneer.

3 Sustainable Corporate Governance – The Foundational Perspective

Developing sustainable corporate governance is quite different from establishing a sustainability function. This implies an integrated view to ensure that everyone in the company is committed and aligned to sustainable value creation, defined as economic value appropriation that generates net positive value for current and future generations of stakeholders, i.e., employees, consumers, suppliers, investors, regulators, and society at large. This requires a sustainable approach to corporate governance, which can be defined as overall systems and structures that enable sustainable value creation.

The path to achieving this begins with addressing the motivation or, in other words, the purpose of the organization. Once the motivation is clarified, the company can adapt the mission statement. Only then does the organization begin to define a roadmap and agree on metrics and measures, and finally measure the impact achieved.

As a result, the activities are likely to be comprehensive and fully integrated into organizational behavior. The measures are usually substantive and consistent with the image presented. Therefore, they are more likely to be viewed as credible by the stakeholders.

4 The Perspectives in Perspective

While both perspectives have merit, it is important to understand the different goals, development paths, and implications as outlined above (see Table 1).

Table 1: Corporate governance of sustainability and sustainable corporate governance in comparison

	Corporate Governance of Sustainability	Sustainable Corporate Governance
Nature	Functional	Foundational
Approach	Reactive	Proactive
Development Path	Measurements, measures, metrics, mission, and motivation	Motivation, mission, metrics, measures, and measurements
Outcome	Focused and standalone	Comprehensive and integrated
Impact	Cosmetic	Substantive

Both perspectives can be, and are, adopted by companies. However, there are risks associated with both approaches that should not be underestimated.

The biggest challenge to overcome is the perception gap: The functional approach can easily lead to greenwashing accusations that are counterproductive to the purpose of responding to changing expectations. In this case, it is advisable not to oversell, but to say what you do, i.e., to comply with regulations and societal expectations, and not to go any further. Second, the company must decide to what extent it wants to actively participate in influencing societal norms and narratives, e.g., through lobbying or communications.

Companies that choose a foundational approach face a different set of communication challenges, as they need to convince the various stakeholders that they pursue a different approach than their peers who choose a functional approach. This cannot be done through communication alone but requires the active involvement and engagement of all relevant stakeholders, i.e., owners, employees, regulators, business partners, and society in general. This engagement must not only be comprehensive, but also related to the process. Stakeholders must be involved from the beginning, i.e., from aligning to a common motivation, to the end, i.e., measuring performance.

This requires the five impact levels to be considered as follows:

Motivation: Sustainable governance can only work if those responsible and commissioned adopt the mindset of sustainable value creation. At the same time, they must recognize that there are different mindsets and motivations and that it is ultimately up to stakeholders to evaluate a company's behavior. However, the company must align its governance to be consistent with its interpretation of expectations and mindsets.

Mission: Sustainability is not just a matter of motivation; it must also be reflected in a clear mission that sets a distinct direction within the company and among its business partners. Even more important, however, is that the owners define a corporate purpose that ensures sustainable value creation.

This mission statement not only has legal significance, but also sends a strong signal to stakeholders.

Metrics: The commitment to sustainable value creation must be treated like any other endeavor: It should be translated into tangible goals that can be measured to monitor progress, but also to communicate them to all stakeholders. Defining metrics is of particular relevance, as sustainable value creation is the most important metric.

Measures: Like any clear mission, it must be translated into clear measures, both in terms of business direction and governance. This means, for example, designing the structures to accommodate the voices of different stakeholders, and setting up the system to support collaboration and measure these changes. At the same time, the composition of the board should represent the defined purpose, as should the way the owners, board, and management work together. Most importantly, sustainable governance requires a culture that provides space for debates and dialogue about sustainable value creation.

Measurements: Finally, metrics must be applied to ensure transparency and provide feedback to all stakeholders on the extent to which the organization has met or exceeded expectations. Both should be measured: sustainable value creation, but also progress toward sustainable governance.

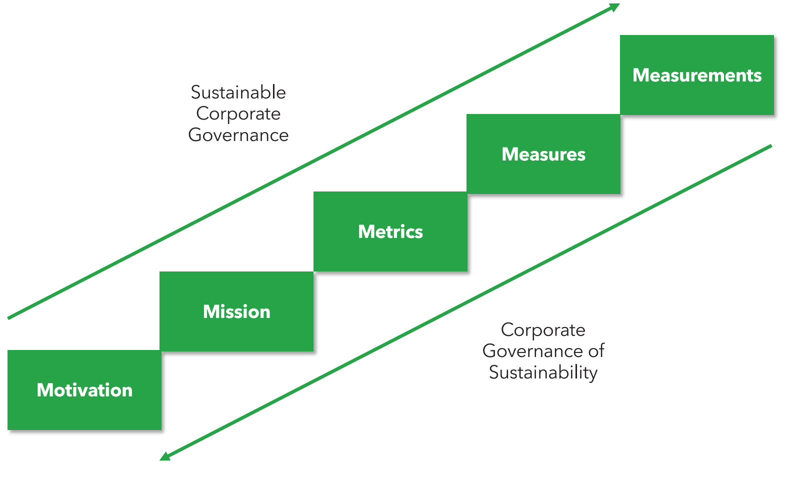

Exhibit 1: The five impact levels (impactlevels.com)

5 Making Sustainable Governance Sustainable

Overcoming these challenges is key to turning an organization focused on corporate governance of sustainability into an organization committed to sustainable corporate governance. However, this is only the first step. Sustainable corporate governance is not a destination, but a journey; it is a dynamic process, not a static concept. It requires the board to constantly realign both its goals and its governance. This means that the board must maintain an ongoing dialogue with its key stakeholders and align itself internally to deliver on the promise of sustainable value creation.

In this regard, fully integrating the issues into its leadership culture is imminent. A commitment to constantly questioning the goal and being open to stakeholder input are prerequisites. This requires that the debates and resulting decisions along the five M's thrive in a governance culture that is effective from an institutional perspective and considers the impact. This calls for considering three governance lenses in board discussions and decisions:

- **The cognitive governance lens:** The cognitive lens illuminates how decisions are made and what conditions and contexts may influence outcomes. In particular, it addresses cognitive biases and their effects. Thus, it considers the cognitive limitations of board members as decision makers.
- **The political governance lens:** The political lens acknowledges that individual decision makers have vested interests that may influence discussions and decisions. These interests may also lead to the formation of alliances among individual members to achieve certain outcomes.
- **The ethical governance lens:** Finally, the ethical lens illuminates the fact that different decision makers have their own values and ethical viewpoints, which can be influenced by various factors. These values affect how decision makers evaluate a situation and ultimately reach a conclusion.