10 Ideas to Make Corporate Governance a Driver of a Sustainable Economy

by Olivier Boutellis-Taft

This article looks at the changes boards and policy makers need to consider in order to address climate change and make sustainability a consideration in all decisions they make.

Since the industrial revolution, the market economy has propelled prosperity, well-being, life expectancy, cultural creativity and personal fulfilment. However, our economy is also aggravating natural resource depletion, deadly pollution, overconsumption and growing social concerns ranging from income inequality to climate migration. Different global studies support one of the largest scientific consensuses ever, the planet is in crisis. Warnings about a climate crisis are not new, we have seen increasingly urgent calls to address climate change (see Figure 1).

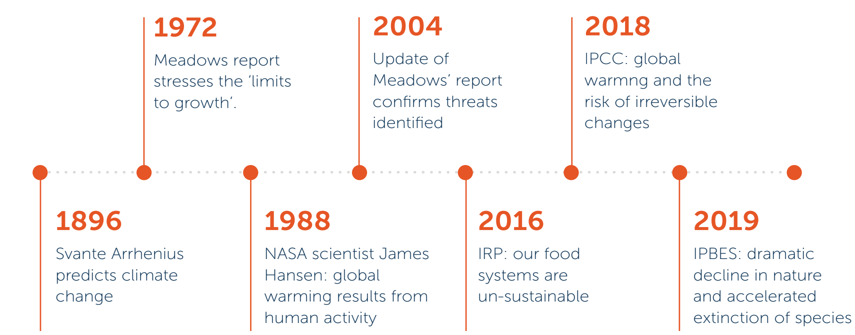

Figure 1: Warnings for the climate crisis

The only way forward is to change how the economy operates. This starts with changing how businesses are run. Corporate governance is an instrumental tool to shift towards a sustainable economy. It is no longer about doing good and making the world a better place: it is about staying in business.

This article proposes ten ideas to help boards and policymakers/regulators undertake the necessary changes to make sustainability the cornerstone of the decisions they make. Boards have the power to transform their business and can help leverage one of the greatest drivers of change: markets. But policymakers and regulators must change too, to support and accelerate systemic transformation.

This article is a preview of our publication 10 ideas to make corporate governance a driver of a sustainable economy, where we:

- suggest changes in boards' roles and practices, and
- propose legislative and non-legislative actions by EU and national policymakers and regulators.

Boards have a prime responsibility to make the economy sustainable

Markets have proved to be a great transformative force: we need to leverage their power to move towards a sustainable economy. Boards can take the following actions to start business' sustainability transformation:

1. Recognise their public interest responsibility to make business sustainable

All boards must take their responsibility to put their businesses on an accelerated path toward sustainability to ensure the survival of the business. From a practical business standpoint, sustainability encompasses many matters that fall directly under the board's strategic responsibility, such as access to raw materials, energy efficiency, supply chain resilience, social license, reputational risk and contingency planning.

2. Transform the business model

Businesses will not be able to absorb the waste and pollution that our current economic system creates. At the macro level, this means moving to a circular economy. At the micro level, it means transforming the business model. The board's agenda must reflect its priority to transform the business and monitor its progress.

The board will need to broaden its approach to risk management including, e.g. the impact of stranded assets, environmental litigation and reputational risk. Boards also need to anticipate regulatory reforms that address environmental challenges.

3. Make board composition fit for (renewed) purpose

The people and processes in business decision-making will have to change to shift the agenda and drive it forward. The board will need to define the collective profile for its work as well as the profile of individual board members, reflecting on what makes a 'good board member'. The board is also responsible for creating new roles, such as the accountant as key change maker, moving from

Chief Financial Officer to Chief Value Officer, who can evaluate the company's value creation beyond financial success.

Boards should seek to diversify professional competences and ways of thinking. Knowledge of sustainability issues relevant to the business has become critical. Most importantly, boards need members with the capacity to think laterally, challenge and speak-up. To this end, it is useful that different cultures, social backgrounds and generations find their way into the boardroom.

4. Regularly (re)assess functioning and processes

Board efficiency starts with putting effective processes in place to constantly assess the board's functioning. Experience shows that shortcomings in such processes have often played a role in corporate failures. Boards need to develop:

- objective director selection and recruitment procedures,
- ad hoc on-boarding and development programmes,
- balanced reward and retention policies,
- regular individual performance assessments, and
- full board assessments.

To prevent complacency and groupthink, these processes need to have the necessary degree of independence and objectivity.

5. Think in an integrated way

Boards need to integrate the environment as a consideration at all levels of the business and to take a fully integrated approach to strategy, management and reporting by:

- a comprehensive approach to strategic planning including scenario analysis,
- managing change inclusively and efficiently through experimentation, decentralisation and empowerment, and
- adopting the international integrated reporting <IR> framework to measure transformative progress and share experience on issues that are of public interest.

6. Transcend the business' boundaries

The board needs to comprehend the entire supply chain, stakeholders and ecosystems of the business, at least to manage reputational risk from a narrow self-interested perspective. Appropriate due diligence needs to be conducted throughout the entire supply chain. Impacts on markets need to be analysed and measured, including lifecycle assessments of products.

Policymakers and regulators need to become strategic enablers of change. Policymakers and regulators can strategically enable change when they:

7. Rethink the role of regulators

Systemic transformation calls for rapidly rolling out best practices and changing collective values and behaviours. It appears that solutions are often better developed close to practice, rather than mandated by untested laws produced in offices. It is critical that regulators closely monitor and understand market developments and the emergence of best practices – or lack thereof.

Once these best practices emerge, regulators need more focus on outcomes and effective enforcement of better and simpler rules to produce results, not more regulation. Regulators' efforts and results on simplification should be regularly assessed and policymakers and regulators at all levels should be responsible for their results.

8. Move from shareholder protection to stakeholder protection

In terms of financial markets, there should now be a shift in focus to protecting broader stakeholder interests and not only of the financial interests of investors.

9. Create a European regulatory framework for corporate governance in the single market

The EU corporate reporting framework suffers from a piecemeal approach with several legal texts dealing with different reporting obligations. The time has come for consolidation. An EU corporate governance code would better match the reality of a single market and bring consistency, coherence, legal certainty and, if done well, effective outcomes. An EU code would need a strong supervision framework, possible with a single European capital market supervisor.

10. Ensure consistent and effective enforcement

Change rarely occurs by decree. The effectiveness of any law depends on effective enforcement mechanisms. Inconsistent and uneven enforcement disrupts the market and slows down progress.

Enhance the 'comply or explain' principle - In a 'comply or explain' context, the quality, specificity and acceptability of the explanations need to be properly evaluated; this principle can only work as long as compliance is properly monitored and enforced.

Clarify director liability - Director liability needs to evolve with business' growing impact. Directors should bear the full consequences of their actions, omissions, negligence or wrongdoing. They should be responsible for preventing and mitigating negative environmental and societal impacts.

Rethink sanctions - Rules that are not applied or unevenly enforced are not only inefficient, they are counterproductive. Sanctions are not (only) aimed at dissuading or punishing: they are primarily aimed at protecting legitimate businesses and ensuring that there is a level playing field. Sanctions must be proportionate to the extent of the offense, its consequences, notably on the environment, and to the perpetrator's size and means.

The European Commission should step up its oversight of Member State' enforcement policies to prevent local political interference and safeguard independence, objectivity and a level playing field amongst European business.

Accountants are crucial in this joint effort

Making our economic system sustainable is a collective responsibility. In their different capacities, professional accountants play a key role at all stages of corporate governance. Good business decisions start with reliable information. As businesses change their benchmarks for success, accountants contribute by: measuring impacts, disclosing information, and certifying what is reported.

The accountancy profession has leveraged its expertise in the field of non-financial reporting and now has a long-standing experience on how to help companies make the right changes to reduce their environmental footprint – and costs.

Act now act swiftly

Corporate governance needs to take a holistic approach and consider all aspects of doing business and prioritise the transition to a circular economy as this growingly appears as the only option in a finite world. The private and public sector need to work together more, at local, national and European levels. Policymakers must play a leading role in internalising negative externalities into business costs.

We encourage the EU to continue showing leadership, including in multilateral forums, and taking decisive action even if others hesitate. Competitiveness is very important, but without a viable planet it doesn't matter anymore. We urge boards as well to begin now on the path to a more sustainable future.

Change starts today!

This article is a preview of the publication 10 ideas to make corporate governance a driver of a sustainable economy, which aims to inspire debate, so we welcome your feedback.

Send your thoughts and opinions on how corporate governance needs to evolve to iryna@accountancyeurope.eu by 1 October 2019.

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