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SUSTAINABILITY AND CORPORATE RESPONSIBILITY: II. BOARDS AND EXECUTIVES RESPOND TO STAKEHOLDERS

In Part I of this article, we asked the question: *How important is "corporate sustainability" to investors and stakeholders?* When the question is posed in the context of the *perceived* long-term viability or sustainability of firms in portfolio or for potential investments, the answer is "very important," as numerous recent surveys of investors show. On the topic of *sustainability* there is definite convergence of investors' thinking with the views of today's forward-looking corporate leaders and boards. The responses from a recent survey of leading global chief executive officers revealed that when the question about sustainability is asked, corporate leaders responded with an overwhelming majority view: *sustainability is very important to them and their enterprises, and is on its way to being fully embedded into their core business.*

How extensive are the changes being made by C-Suite and boards to achieve greater sustainability—and exhibit robust corporate responsibility—in Corporate America? How many leaders are *walking the talk*, to put it in blunt terms? And what kinds of changes in strategy and operations are necessary to achieve sustainability . . . and exhibit more corporate responsibility? We have been benchmarking large-cap companies, concentrating on "brand names" more familiar to both investors and stakeholders because of the companies' extensive public profiles (including branded product marketing).

The starting points for our examination of leading-edge "sustainability" companies focused on what exactly is it about "sustainability" that corporations are defining and then addressing, and what definable characteristics may be common to large-cap companies that are helpful guideposts for other public companies (of any size). What are the leaders of these companies doing to set their enterprises apart from their competitors and peers to attract capital, customers, future employees, and business partners? Here are just a few of the top-line characteristics we've identified:

- Executives, and more recently a number of boards of directors, are developing and framing the business case for corporate sustainability and greater demonstration of corporate responsibility and effectively communicating the rationale enterprise-wide, and to important external stakeholders, including current and potential investors.
- The process begins with "envisioning," and strategy-setting; then, the methodology for driving sustainability into every part of company operations and products is usually developed and constantly improved.
- Leaders leverage these sustainability and corporate responsibility (CR) strategies and enterprise-wide efforts to strengthen their brands for competitive advantage (these brands include both corporate names and product and service brands).

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- Leaders adopt powerful thematic approaches to enhance reputation management efforts; these are designed to inspire and motivate employees and internal stakeholders as well as to impress external stakeholders such as business partners, suppliers, and investors.
- These themes help enable and create widespread internal buy-in for the company's sustainability and corporate responsibility efforts and help communicate how the corporate programs are organized, managed, and implemented—and the impact on customers, clients, business partners and other stakeholders.
- The most powerful themes also serve to commit the company to the long-term effort to be more sustainable in all aspects of strategy development and implementation, operations, financial management, and environmental management.
- Sustainability leaders engage with credible third parties and external stakeholders for dialogue and to work toward resolution of outstanding issues (many of which have resulted in past proxy resolutions filed by activist shareholders).
- There is a discernible trend of greater transparency and disclosure of ESG and sustainability performance metrics (environmental, social issue and corporate governance), and participation in such efforts as the Global Reporting Initiative (GRI). Companies are filing reports with GRI, grading themselves or having third parties grade annual reports, and at a minimum are following GRI reporting guidelines.

First step: Making the business case

As the business case is made clear at the top—the recognition that corporate sustainability and responsibility initiatives and programs pay off in the marketplace and should not be a cost-only consideration—managers look for opportunities to drive positive change, drive sustainability into the enterprise at every level, and seek out opportunities for continuing to reduce expenses, increase margins, build a wider moat for competitive advantage, increase revenues, increase profit margins, and in the process build a more durable and sustainable enterprise.

A prime example of this is General Electric, which had for many years been challenged by activist investors on environmental issues (including PCB contamination of New York's Hudson River). Today, GE's booming "Eco-magination" initiatives are helping to reverse the negative images and are measurably building a more sustainable enterprise. The company's long-term focus on quality assurance helped evolve environmental management focus to develop better ways to operate and reduce costs—which led to expanded external opportunities—with Eco-magination-themed products and services now accounting for more than 15% of GE sales. By itself, all Eco-magination businesses would be a *Fortune 200* company! GE "green" products are in demand around the globe, as business customers seek out more efficient (and sustainable) products for their own operations (such as GE's improved performance locomotives).

In addition to top-line growth, recent academic studies have identified a correlation between sustainability leadership and market outperformance. Numerous stock indices—such as the Dow Jones Sustainability Indices and the FTSE4 Good—have been created to meet shareholder demand (particularly from institutional investors) seeking companies with strong governance and management teams who are proactively addressing core ESG issues (through the lens of both risk and opportunity).

The potential for bottom-line growth through increased efficiency and cost savings is also becoming significant for asset owners. Leading private equity firms, such as KKR, have begun to reduce costs and recognize investment opportunities in sustainability: KKR recently reported $160 million in portfolio company savings over two years from its Green Portfolio Program, in partnership with the Environmental Defense Fund (EDF).

For each company, the business case for sustainability will be different. Whether the focus is on customers, employees, regulators, investors, or other stakeholders, opportunities and competitive advantages are becoming more clear and first have been movers benefitting.

Strong leadership at the top

Increasingly, we are finding that the chief executive officer initiates and is deeply involved in the corporate sustainability efforts. Strategy-seeing begins at the top with the leader acting as champion and visionary. In at least one notable case, the CEO experienced a transformational moment and serious sustainability and corporate responsibility efforts began at that point. Perhaps the most dramatic example of both a reputational turnaround and serious drive toward the sustainable (and responsible) enterprise is that of Wal-Mart Stores, Inc.

The chief executive officer had a profound personal response to *Hurricane Katrina* events of September 2005, which inflicted serious damage on the Gulf of Mexico coastline states. The CEO was moved by the stories of how Wal-Mart employees helped those affected by the storm, some working through difficult periods as their own homes were destroyed and families affected. This epiphany in time resulted in perhaps the most important supply chain *change* story in corporate history.

Five years on, the successor to CEO David Glass—current CEO Michael Duke—commented in the company's 2010 Sustainability Report: "*When I became CEO last year, I said that we would 'broaden and accelerate' our commitment to sustainability at Wal-Mart. By that, I meant we would make sustainability a priority throughout our entire company and we would act with a sense of urgency.*"

In the years prior to 2005, Wal-Mart was criticized by a growing number of external stakeholders including the leading Socially Responsible Investor (SRI) on a number of issues, especially including supply chain operations. Then CEO David Glass executed a far-reaching course change and today the company is striving to have the most sustainable and responsible supply chain of any retailer—and perhaps any large-cap company with a dispersed network of 60,000 or more individual suppliers.

Primary focus: Supply chain sustainability

As globalization of business operations continues, investors are focusing on the polices, practices and behaviors (and outcomes) for companies—worldwide. Wal-Mart's sweeping and comprehensive sustainable sourcing initiative is changing many elements of its global supply chain, in terms of sourcing policies, behaviors of supplier companies, and behavior and outcomes in entire sectors and industries. Soon consumer behaviors will be affected as more information about corporate sustainability and responsibility is directed at customers. In the future when shoppers are in the local Wal-Mart store, they will be offered products with pricing and shelf positioning influenced by the sustainability practices of the suppliers. Other companies are following the lead of Wal-Mart—America's largest private sector employer and the largest force in retailing.

Board of director involvement

Corporate boards are becoming more aware of the importance of sustainability and corporate responsibility to investors and stakeholders and some boards now maintain oversight of sustainability—often as part of their increasing oversight of risk oversight. Organizations such as the National Association of Corporate Directors (NACD) stress the importance of risk oversight, including such concerns as reputational risk, cost reduction, outsourcing and supply chain, climate change risks and opportunities, and global standards and protocols.

The PepsiCo board has six committees—one is the Corporate Responsibility Committee, which oversees the enterprise-wide efforts of the global beverage and snack food company. The company states: "*At PepsiCo, Performance with Purpose* *means delivering sustainable growth by investing in a healthier future for people and our planet. We bring that purpose to every aspect of our business . . .* " (from the company's statement of "Purpose," which focuses on Human Sustainability, Environmental Sustainability, Talent Sustainability and Responsible Sourcing).

McDonald's, Inc. adopted formal Corporate Governance Principles for board operations. The board has six (6) committees including a Corporate Responsibility Committee which acts in an advisory capacity to senior management regarding strategies and policies that affect the company as a "socially responsible organization." Board oversight includes: product safety; workplace safety; employee opportunities and training; diversity; the environment; and sustainable supply chain initiatives.

At the corporate level, cross-functional and issue-specific governing bodies manage and monitor issues; these include:

- A Worldwide Corporate Relations Council to guide and align operations on social and environmental issues across the McDonald's system.
- The Corporate Responsibility Department, with corporate staff coordinating and supporting global corporate responsibility policies, programs, and financial and qualitative reporting.
- The Quality Systems Board, which includes the quality assurance directors in each major geographic sector and senior level supply chain and food safety specialists, who develop and execute global strategies.
- The Global Environmental Council, which identifies global strategic environmental priorities and acts as a forum for best practices to share *local* environmental initiatives and programs.
- The Sustainable Supply Steering Committee (McDonald's maintains a Worldwide Supply Chain Department to oversee its suppliers).

This committee was formed in 2007 with representatives from the supply chain department, other corporate functions, corporate responsibility, corporate communications, and business units in each area of the world. The supply chain guiding vision is: *"We envision a supply chain that profitably yields high-quality, safe products without supply interruption while leveraging our leadership position to create a net benefit by improving ethical, environmental and economic outcomes."* There are three important elements of operations—*walking the talk:*

- Ethical Responsibility, with McDonald's purchasing from suppliers following guidelines that ensure the health and safety of employees and the humane treatment of animals.
- Environmental Responsibility to influence the sourcing of materials; ensuring the design of products; manufacturing; distribution; minimizing lifecycle impacts on the environment.
- Economic Responsibility to deliver affordable food and engage in equitable trade practices.

In multinational companies with far-flung supply chains and operations, the lesson that has been learned by sustainability leaders is that after strategies are determined, teaming works best for broad, effective implementation. In the most effective approaches, a multi-disciplinary, multi-functional team is assembled and trained and sustainability and corporate responsibility policies, practices and actions become serious considerations in business units, and in corporate functions (financial, legal, investor relations, marketing, public affairs, human resources, community affairs, communications, environment/health/safety, supply chain management, manufacturing, research and development, and other functions as needed).

Third-party engagement: Necessary

Effective third-party engagement and dialogue is another hallmark of sustainability leaders.

Relationships with third parties may begin as informal dialogues and frank exchanges of views and frequently lead to engagement and effective collaborations. Companies may partner with organizations in the private, public and social sectors to create and implement sustainability programs that enhance internal efforts. Some of these may be branded separate of the company name or brands, while some incorporate the brand into the project or initiative.

The engagement (and subsequent partnering) can be with critics, allies and potential allies, trade partners, suppliers, customers, and other external stakeholders. Common interests are addressed and issues resolved through dialogue and even partnerships. Corporate leaders have funded independent (third-party) organizations to address social and environmental issues. Feedback from these relationships is often very helpful to sponsoring companies.

Sometimes, company sustainability or responsibility programs will evolve into a life of its own. One prominent example: Ronald McDonald House, now a separate charity with thousands of volunteers carrying out the company's original vision—the mission of helping families of ailing children. (McDonald's Inc. is very much involved; a McDonald's executive is CEO of the charity and thousands of employees and franchise owners are involved in the cause to help the families of seriously ill children and their families.)

Another important example is the direct outgrowth of the comprehensive Wal-Mart sustainability focus, the now independent "Sustainability Consortium" (managed by staff at two universities) which involves literally hundreds of Wal-Mart suppliers in councils and sector-working groups.

Risk management is top-level consideration

Leaders in corporate sustainability and responsibility understand that in the end, this is all about *Risk Management.* The focus on risk focus may begin in the board room, and with CEO and C-Suite, and is then drilled down into core management functions and business units. This senior level addressing of risk can help mitigate potential risk situations, strengthen the organization, reduce costs (both in the short- and longer-term), and develop the strategies to create a more sustainable enterprise. As corporate boards deal with the recent SEC interpretation on their responsibility for disclosure of risks and opportunities related to climate change, the pathway to corporate responsibility and sustainability programs may become clearer for boards. *Why not disclose positive events, developments, initiatives, changes related to sustainability?*

Wal-Mart Stores, Inc. provides an excellent example that a company can dramatically rebound in terms of reputation management—and in a relatively short period of time. Plagued with a variety of "license to operate" issues just a few years ago, Wal-Mart is widely heralded as a sustainability leader, ranked #1 out of 500 U.S. companies based on sustainability reputation in last year's inaugural *Newsweek Greenest U.S Companies* ranking. This demonstrates the company's perceived commitment to sustainability and for some critics is a near-miraculous turnaround in public perception and reputation management.

As the number of third-party sustainability rankings grows and more companies disclose their ESG performance metrics, there will be increased competitiveness for inclusion on leading ESG rankings and indices—which ultimately shape both reputation and brand value.

Corporate risk management can be enhanced by the embracing of Sustainability initiatives. This concept was highlighted in an April 2010 *Harvard Business Review* cover story entitled: "Leadership in the Age of Transparency." The authors stated: *"[It is] no longer possible to ignore externalities. The true measure of corporate responsibility is the willing, constant internalization of externalities."*[1]

For finance executives, the top and bottom lines for sustainability can be the evolution of more sustainable companies better situated to respond to both risk and opportunity in the volatile and fast-changing global marketplace. The examples are offered in management journals and books—SAP (the software company) can respond quickly to need/demand for effective software tools to help client companies respond to SEC interpretations on climate change disclosure because (internally) SAP developed these measurement and management tools as part of their CR/Sustainability efforts—and subsequently offered these resources to client companies. As described, GE similarly developed its Eco-magination platform first for internal needs which led to the launch of enhanced and new products that the marketplace views with favor as many more companies embrace sustainability.

For financial executives, the business case for sustainability is becoming a narrative of top-bottom line growth, cost reduction and greater efficiencies, quality assurance, innovation, corporate resilience, and ultimately greater access to financial and human capital. ■

NOTES

1 Source: "Leadership in the Age of Transparency", Harvard Business Review, April 2010. (Retrieved at: *http://hbr.org/2010/04/the-big-idea-leadership-in-the-age-of-transparency/ar/1*)