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SUSTAINABILITY IN THE BOARD ROOM – FROM 'WHETHER' TO 'HOW'

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In a landmark report by the UK Commission on Corporate Governance published in 1992, Sir Adrian Cadbury made the now famous remark that "Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The 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". Sir Adrian's words marked a paradigm shift from Professor Milton Friedman's 'the business of business is business' free market manifesto asserted in the 1970s.

Now, corporate responsibility and sustainability are recognized the world over as pressing obligations for all businesses whether large or small, public or private. Since the time of the Cadbury report, we have seen a veritable maelstrom of various related standards, guidelines and regulations emerge in all parts of the globe. The GCC region is no exception to this development.
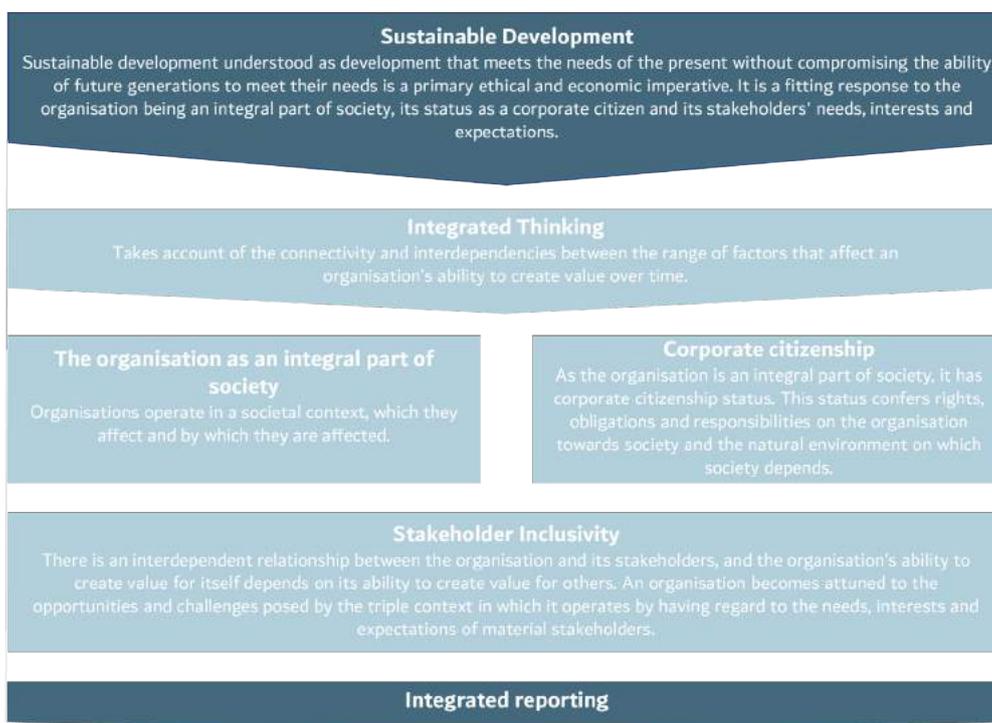
Although many of these standards are voluntary, the intensifying stakeholder expectations are often making them de facto compliance. Publishing a sustainability report based on the Global Reporting Initiative's reporting standard may well be voluntary, however, your business partner may

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not wish to do business with you without you having one. Many of us may not even have heard of the Equator Principles, yet non-compliance with them may seriously limit your access to major project financing. The list of standards is getting longer and demands tougher by the day.

Specifically in the governance space, sustainability is now hardwired into numerous governance frameworks around the globe. The most celebrated of these perhaps being the series of King's reports issued since 1994 in South-Africa. The first report built on the spirit of the Cadbury report, however, making sustainability related recommendations much more explicit. The latest King's report, issued in 2016, now leads the way in how sustainability is built into board room responsibilities, and as such continues to influence the development of other governance guidelines and related listing and regulatory requirements internationally.

The below offers a brief overview of the three most salient points relating to sustainability requirements as addressed in King IV, namely corporate strategy, disclosure requirements and board structures.

Sustainable Development
Sustainable development understood as development that meets the needs of the present without compromising the ability of future generations to meet their needs is a primary ethical and economic imperative. It is a fitting response to the organisation being an integral part of society, its status as a corporate citizen and its stakeholders' needs, interests and expectations.

Integrated Thinking
Takes account of the connectivity and interdependencies between the range of factors that affect an organisation's ability to create value over time.

The organisation as an integral part of society
Organisations operate in a societal context, which they affect and by which they are affected.

Corporate citizenship
As the organisation is an integral part of society, it has corporate citizenship status. This status confers rights, obligations and responsibilities on the organisation towards society and the natural environment on which society depends.

Stakeholder Inclusivity
There is an interdependent relationship between the organisation and its stakeholders, and the organisation's ability to create value for itself depends on its ability to create value for others. An organisation becomes attuned to the opportunities and challenges posed by the triple context in which it operates by having regard to the needs, interests and expectations of material stakeholders.

Integrated reporting

Sustainability and stakeholders are central to corporate strategy

Each revision of the King Code has strengthened its emphasis on sustainability and its inseparable interplay with corporate strategy. King has adopted the widely accepted definition of sustainability as a company's responsibility to conduct operations in a manner that meets existing needs without compromising the ability of future generations to meet their needs.

The emphasis on understanding the needs and expectations of current and future generations has led to the adoption of so called stakeholder inclusive approach to strategy development, whereby the legitimate interests of stakeholders are considered and recognized over and above

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solely the shareholders' interests, in a manner which befits the long-term sustainability of the entity. This is a significant departure from how the role of the board has traditionally been understood as having a fiduciary duty towards shareholders alone.

An important practical implication of inclusivity is that the board should identify important stakeholders and the executives should engage with them to ascertain legitimate expectations and needs. Furthermore, this engagement and its outcomes should be reflected in the company's public disclosures.

King IV - Stakeholder relationships

Principle: In the execution of its governance role and responsibilities, the governing body should adopt a stakeholder-inclusive approach that balances the needs, interests and expectations of material stakeholders in the best interests of the organisation over time.

Recommended practices

1. The governing body should assume responsibility for the governance of stakeholder relationships by setting the direction for how stakeholder relationships should be approached and conducted in the organisation.

2. The governing body should approve policy that articulates and gives effect to its direction on stakeholder relationships.

3. The governing body should delegate to management the responsibility for implementation and execution of effective stakeholder relationship management.

4. The governing body should exercise ongoing oversight of stakeholder relationship management and, in particular, oversee that it results in the following:
   a. Methodologies for identifying individual stakeholders and stakeholder groupings.
   b. Determination of material stakeholders based on the extent to which they affect, or are affected by, the activities, outputs and outcomes of the organisation.
   c. Management of stakeholder risk as an integral part of organisation-wide risk management.
   d. Formal mechanisms for engagement and communication with stakeholders, including the use of dispute resolution mechanisms and associated processes.
   e. Measurement of the quality of material stakeholder relationships, and appropriate re sponses to the outcomes.

5. The following should be disclosed in relation to stakeholder relationships:
   a. An overview of the arrangements for governing and managing stakeholder relationships.
   b. Key areas of focus during the reporting period.
   c. Actions taken to monitor the effectiveness of stakeholder management and how the out comes were addressed.
   d. Future areas of focus.

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One of the most concrete examples of how the requirement for inclusive strategy development has manifested itself in practice is the emergence of materiality analysis. Traditionally, one of the board's key duties has been to assist the executives in anticipating material changes to the operating environment to ensure resilient business strategies. However, now that the meaning of materiality has expanded from 'material to shareholder' to 'material to stakeholders', the scope of the associated analyses of potentially significant issues has widened considerably. Hence, both sustainability and integrated reports now typically include an explicit narrative on how these analyses have been carried out, which stakeholders have been consulted, and how the board and the executives have been involved in identifying and prioritizing material issues. And, importantly, how the analysis has informed strategy.

Emirates National Oil Company's Materiality Matrix in 2016 Sustainability Performance Report

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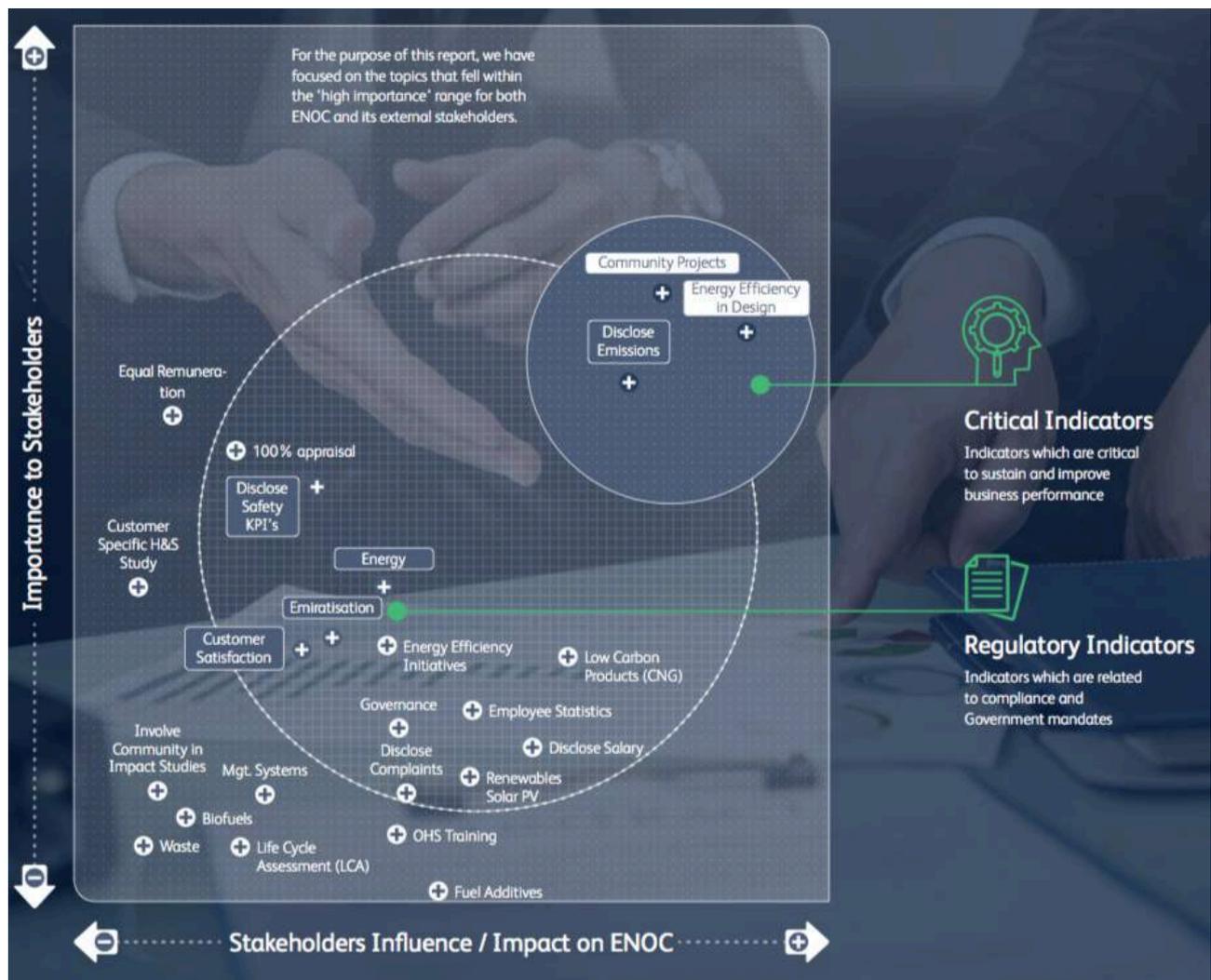
Beyond changes in corporate strategies themselves, we are also witnessing additions to and changes in existing executive roles – for instance, the common role of the Investor Relations Manager is changing towards that of a Stakeholder Relations Manager, and a new role of Chief Sustainability Officer is being added to an increasing number of c-suites.

Reporting needs to evolve dramatically

Underscoring the strategic importance of sustainability, King II first recommended that organisations ought to publish sustainability reports and consider the Global Reporting Initiative's then guidelines in preparation of such reports. King III took a significant step further in recommending that companies publish integrated reports. This was the first ever formal governance requirement internationally for fully integrated reporting – i.e. reporting on both financial information and sustainability (social, economic and environmental) impacts.

King IV – Reporting

Principle: The governing body should ensure that reports issued by the organisation enable stakeholders to make informed assessments of the organisation's performance, and its short, medium and long-term prospects.

Recommended practices (salient points to sustainability)
11. The governing body should oversee that reports such as the annual financial statements, sustainability reports, social and ethics committee reports, or other online or printed information or reports are issued, as is necessary, to comply with legal requirements, and/or to meet the legitimate and reasonable information needs of material stakeholders.

12. The governing body should oversee that the organisation issues an integrated report at least annually, which is either:
      a. a standalone report which connects the more detailed information in other reports and addresses, at a high level and in a complete, concise way, the matters that could significantly affect the organisation's ability to create value; or
      b. a distinguishable, prominent and accessible part of another report which also includes the annual financial statements and other reports that must be issued in compliance with legal provisions.

13. The governing body should approve management's bases for determining materiality for the purpose of deciding which information should be included in external reports.

The implications of the above are far reaching, especially considering that the practice of integrated reporting is still in its infancy with many companies and industries still struggling to adopt fully-fledged sustainability reporting practices. Nonetheless, the number of companies now publishing integrated reports is growing rapidly across different regions, with South Africa leading the way mostly due to its formal listing requirements to do so.

An interesting fact to note is that integrated reporting practices are now also being adopted by private companies as well as not-for-profits.

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It appears that many organizations wishing to voluntarily and proactively disclose financial and sustainability related information are seeing the value in integrated reporting over separate financial and sustainability disclosures. This is a pertinent trend to note in the GCC region where many large organizations are non-listed entities.

Board committees are changing and need new skills

Beyond governance processes, King's call for integrated strategic thinking, where financial and sustainability concerns are considered in a balanced manner, has wide-ranging impacts on governance structures as well as required skills at board level. King's sustainability requirements impact the role of all conventional board committees (audit, risk, compliance, nominations, etc.), making appreciation of material sustainability issues an essential director competency. This is a potential skills gap and development need in many board rooms.

In addition to changes to existing board committees, King recommends that a specific social and ethics committee is set up. This committee should oversee ethics, corporate citizenship, sustainable development and stakeholder relationships. Such committees are now prevalent in South Africa, and their number is increasing internationally (operating under various titles).

Context matters – or does it?

While it is now widely acknowledged that sustainability is a strategic issue requiring board room attention, it is equally true that the ways in which governance and sustainability intersect must be considered within the context of the distinct legal charters and traditions in different jurisdictions. Furthermore, different ownership structures, business forms and corporate aspirations undoubtedly have an impact on the degree to which governance requirements are perceived as compliance issues or desirable performance enables or both. This article, in all its brevity, has aimed to focus on those aspects of King's requirements that are core to nearly all board rooms regardless of company form, structure or region. It is also worth noting that King IV has been specifically written in such a way as to make it universally applicable to all organisations: public and private, large and small, for profit and not-for-profit.

In conclusion

In a world where sustainability has become more central to business performance, shareholder returns and stakeholders' expectations, the question for boards now is about how to address sustainability, rather than whether to do so. The trend is clear regardless of region, sector or organizational form – the nuances of implementation will, of course, vary.

Before addressing the 'how', there is the need to reflect on the 'why'. What does sustainability mean for our specific business, what is the business case, and do we have the requisite skills, knowledge and resources to address the issues effectively.

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