Harvard Law School Forum on Corporate Governance

The Board's Role in Sustainable Leadership

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Tags: **Board oversight**, **Boards of Directors**, **Climate change**, **Corporate purpose**, **Environmental disclosure**, **ESG**, **Long-Term value**, **Stakeholders**, **Sustainability**
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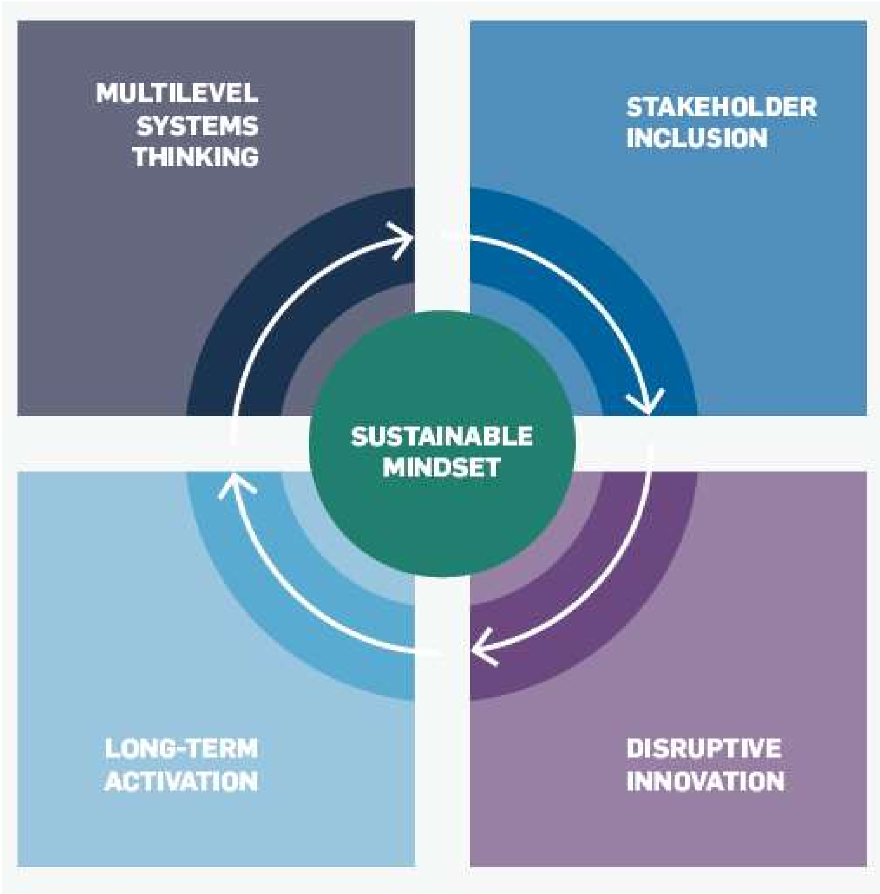
Editor's Note: **Laura Sanderson** co-leads the Board and CEO Advisory Partners in Europe; PJ Neal leads the Center for Leadership Insight; and Emily Meneer leads the Social Impact and Education sector Knowledge Management team at Russell Reynolds Associates LLP. This post is based on a Russell Reynolds memorandum by Ms. Sanderson, Mr. Neal, Ms. Meneer, and Jemi Crookes. Related research from the Program on Corporate Governance includes **The Illusory Promise of Stakeholder Governance** and **Will Corporations Deliver to All Stakeholders?**, both by Lucian A. Bebchuk and Roberto Tallarita (discussed on the Forum **here**); **For Whom Corporate Leaders Bargain** by Lucian A. Bebchuk, Kobi Kastiel, and Roberto Tallarita (discussed on the Forum **here**); and **Restoration: The Role Stakeholder Governance Must Play in Recreating a Fair and Sustainable American Economy—A Reply to Professor Rock** by Leo E. Strine, Jr. (discussed on the Forum **here**).

Sustainability—both social and environmental—has quickly risen to the top of corporate agendas in recent years. This is in part because of the growing evidence that sustainable practices result in improved financial performance, and in part due to pressure from investors, employees, and the public for companies to articulate the role they play in addressing societal challenges. As one director recently told us, sustainability "has never been a higher priority for the board than it is today."

In 2020, Russell Reynolds Associates published a study in partnership with the United Nations Global Compact examining the attributes that make executive leaders effective at driving sustainability outcomes. In this post, we study the issue from the board's perspective, looking at how corporate directors engage with the challenges and opportunities related to sustainability, how they structure and operate the board to oversee related activities, and ultimately, how they enable sustainable in the enterprise.



To better understand the board's role in sustainable leadership, we interviewed more than 130 corporate directors and C-suite executives from around the world, surveyed more than 1500 additional corporate leaders, conducted an extensive analysis of executive- and board- level talent and recruiting practices, and leveraged our deep expertise in sustainable leadership and corporate governance practices.

What emerged from this research is an awareness of just how much board directors struggle to take the first step toward engaging on sustainability. From those boards who are already leading on sustainability, it illuminated a 10- step roadmap toward progress, touching on items as wide ranging as board culture, risk management, and corporate purpose.

Driving the Discussion

One recent survey of board leaders found ESG oversight was seen as the most important business issue for boards—but also one where board leaders were concerned about making near term progress. Why is it so important? There are many reasons why boards are interested in the topic, but they largely boil down to two related issues:

- **Sustainable business practices result in improved financial performance for corporations.** Long gone is the belief that business must choose between doing good and doing well. As one director told us, "we realized very early on that in order to create long-term shareholder value, building a sustainable company is key." This work can be done in many ways including via new products and services that address specific societal needs, by reimagining the supply chain, and by establishing partnerships and joint ventures with emerging partners. These efforts are not only good for the planet, but increasingly essential for business. One leader told us "you could be the least cost bid, but it doesn't matter, the ability to say that we measure sustainability and that we have a program helps win business."
- **Corporate leaders must be able to explain to their stakeholders what role the corporation is playing in addressing societal challenges.** "There are a lot of things we don't agree on," said one leader, "but sustainability is a unifying force for employees, customers, even shareholders." Companies that effectively engage on sustainability issues start by identifying their unique differentiators or areas of comparative advantage, and then

leverage them to maximize social and financial value (for example, a global logistics company using its proprietary expertise to help governments coordinate disaster relief). This is partially driven by increased awareness and education people are now informed about sustainability in ways they weren't previously—and partially by risk "Reputation is everything," a director said. "A board is very motivated by a company working to keep its reputation in place."

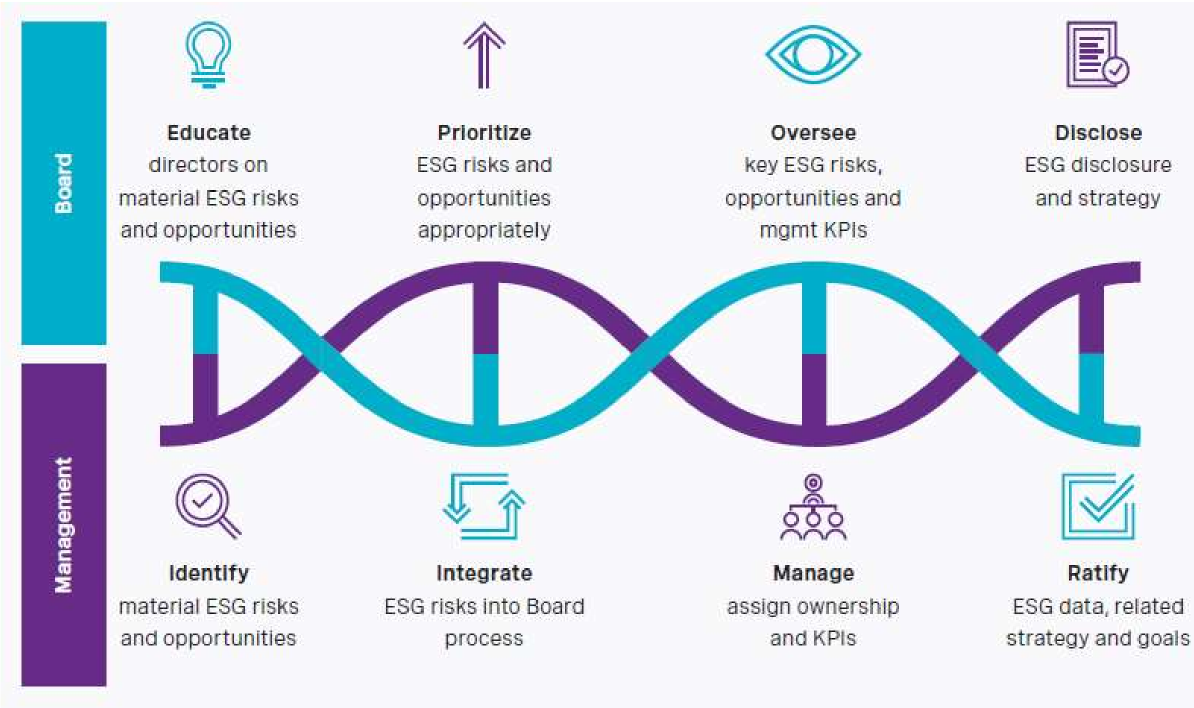
- When NomCo chairs were asked to identify their top three responsibilities, 74 percent included ESG oversight
- Asked to rank the relevance of a dozen different internal efforts, NomCo chairs in the Americas listed ESG oversight as number 5, but it dropped down significantly in other regions – number 9 Europe and number 10 in Asia

Many boards feel they are already behind on this issue, given the relatively rapid advancement of the topic. "Yesterday, sustainability was on the board agenda as a token to balance the social and environmental price of profit," said Steve Langton, who leads RRA's Board and CEO Advisory Partners in the Asia Pacific region. "Today, it is a top board agenda because profit won't be possible again without it. The opinion of community, employees, customers, suppliers and, of course, shareholders now have collective power. Tomorrow, corporations won't have access to capital, talent and brand trust without advanced and effective sustainability agendas and priorities."

Once a board decides it needs to act, directors often struggle to decide how to do so, and how ambitious to be. As one board leader admitted to us, "As is typical of a company at our level of maturation, we've done a lot on the sustainability front, but maybe not in the most sophisticated fashion."

Management and the board need to work together to push forward their ESG efforts

"When it comes to ESG, a collaborative relationship between management and the board is essential for long-term success," said Molly Smith, an ESG expert and a member of the Board and CEO Advisory Partners practice at RRA. "Management identifies and prioritizes risks and opportunities in order to manage and disclose those issues as appropriate. At the same time, the board educates directors on the same risks and opportunities, integrates them into the board process, oversees the work of the company, and ratifies associated data, strategy, and goals." When this partnership works well, ESG initiatives are thoughtful and productive meaning they become fully integrated into the business over the long term. When board and management struggle to reach alignment, ESG efforts risk being disjointed or unsuccessful.

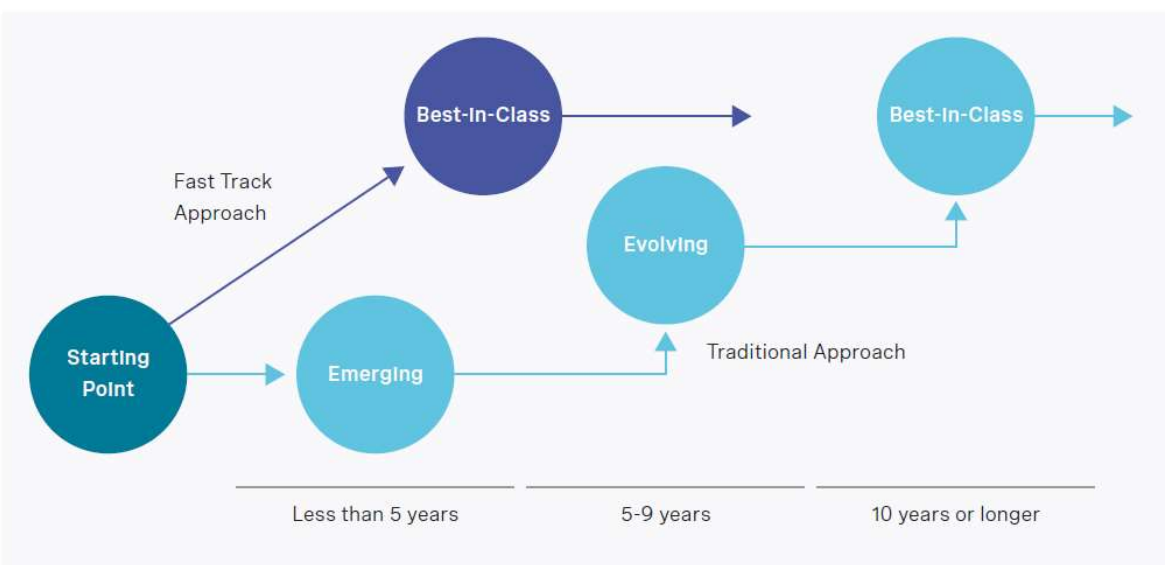


The Path Forward

When boards decide to increase their focus on sustainability, they often struggle to determine what steps to take, and how much effort to put behind those initial actions.

Insights gathered during this research illuminated a 10-step roadmap for boards, built around the issues of board leadership; board culture; purpose, strategy, and risk alignment; structure and process; and people and composition.

Prior research by Russell Reynolds has shown that quickly going all-in on efforts like these may ultimately results in stronger long-term performance for companies. When assessing how corporations developed their diversity, equity, and inclusion (DE&I) efforts—a similar undertaking in many ways to sustainability—we learned that most companies take a linear and lengthy approach to building up their operations, adding elements slowly over five to 10 years. However, a small group of companies took a fast track approach, investing heavily upfront to establish a mature set of operations and practices. These fast track companies quickly outpace traditional ones, reaching maturity in about half the time. [1]



The lesson for boards? Be bold in your actions on matters as important as these, and commit the organization to high levels of performance right from the start.

(Where does your board stand on each of these issues? See the appendix for a self-assessment tool.)

Board Leadership

1. **Embed sustainability into all discussions with the CEO and executive team:** Investors, regulators, and others must know that the board is not just supportive of corporate sustainability efforts, but is an active partner in orienting the company around sustainability. Moreover, as investors increasingly prioritize ESG metrics in their capital allocation decisions, having a board that can speak authentically to the objectives and results of their sustainability activities goes a long way in establishing the credibility and maturity of a firm's sustainability efforts. "You cannot change the business model unless shareholders buy in," one director said. That talk must be backed up with results, though.

2. **Proactively engage with external stakeholders about sustainability**: While those stakeholder conversations are essential, they are also meaningless unless board leaders have a collaborative partnership with their CEO and other senior executives, and are engaging with those leaders regularly on the issue. "These are complex issues, so it doesn't lend itself to the management team coming to the board with a recommendation," one another said. "It is more of a collaborative and iterative process." For it to be an iterative process, directors must embed sustainability into all their discussions with the CEO and executive team. The topic must be constantly top-of-mind, and executives must come to expect that the board will ask about it every time they speak. There is also signaling value to these conversations, as they prompt executives to constantly think of sustainability as part of their remit, even when not being explicitly tasked with it.

Board Culture

3. **Establish a purpose-driven culture that looks at issues through a sustainability lens:** Just as board leaders must be aligned with the CEO and external stakeholders, so too must the culture of the boardroom. Directors need to approach their work through a sense of purpose, and be committed to integrating sustainability into all they do. "The sustainability agenda starts with the board," one director told us. If a sustainable mindset isn't embedded in the organization, no amount of structure or processes will make up for its absence. Every single member of the board should be encouraged to view

the company and its operations through the lens of sustainability, and have no hesitation bringing up sustainability-related matters in any conversation with executives or fellow-directors.

4. **Educate directors on sustainability:** To enable that culture and mindset, boards must continuously educate directors. The nature of this education will vary by company and sustainability priorities, but should be centered around understanding the perspectives and experiences of stakeholders—ranging from investors, to employees, to consumers and the broader communities in which the company operates. Such stakeholder empathy is critical to understanding the ecosystem in which the company operates, and therefore being able to identify the sustainability risks and opportunities the company faces. One CEO took the entire board to Brazil for such purposes. “I could not explain the issues and corruption we were facing, I had to take them there and show them what it means,” she said. As chair at another company, she brought outside stakeholders into the boardroom to offer firsthand exposure to critical issues in other countries. While these activities were done with large groups, it can also be helpful to engage with directors one-on-one or in smaller settings. Directors—especially those who might not be fully conversant on the topic—may appreciate the opportunity to ask more basic questions in a more private setting than around a full board table.

Purpose, Strategy, and Risk Alignment

5. **Apply a sustainability lens to corporate strategy decision-making:** Sustainability must be fully integrated into all aspects of corporate strategy—companies cannot have a separate “sustainability strategy” and be truly impactful. While the corporate strategy is developed by the executive team, the board needs to be engaged and aligned throughout the entire process, and ensure that sustainability is always front and center. The work should be holistic. It should capture both the potential benefits of being more sustainable, as well as the risks. “From a risk management perspective, the cost of non- conformance with sustainability standards is just going to get higher and higher,” one board leader told us. “It’s a very real risk, no different than the risk of hurricanes or cybersecurity systems going down,” and boards need to account for it in their planning.

6. **Set goals and establish clear metrics for tracking progress towards them:** To be seen as credible, it is important that boards have a clear plan and related metrics for whatever sustainability efforts they undertake. “Companies often set goals,” one director said, “but few say how they will achieve them. What humans do you have to allocate to that? Financial resources? How will you do that?” Companies that are specific in both goal and plan are significantly more believable than those that simply disclose a goal and nothing else. Additionally, the act of setting a plan with associated performance targets or metrics enables easier performance measurement, and the ability of the board or senior management to disclose performance to investors and stakeholders.

Structure and Process

7. Structure the board to engage meaningfully on sustainability matters: While many boards consider creating a stand-alone sustainability committee—focusing attention on the issue in the same way they do audit, compensation, and nominations and governance matters –the specific structure is ultimately less important than ensuring that the strategic and nuanced discussions around sustainability take place. Achieving this will help connect sustainability into all other board agenda items and discussions. It will also have a follow-on effect in the business: “As soon as we started looking at it as a board,” one director told us, “the business started saying they should also pay attention because the board is paying attention.”

8. **Change compensation models to account for sustainability targets:** Another process to make sure people are focusing on sustainability: Tie compensation to it, and make that link public. When compensation becomes intertwined with something like sustainability, other parts of the organization quickly fall in line: recruitment, training and development, strategic planning, performance management. It can be done broadly or tied to very specific initiatives, as one director told us about: “All management board members will be incentivized for CO_2 reduction,” they said. These efforts are traditionally acknowledged and reported in annual reports or other disclosures, which also help bring public awareness to the efforts.

People and Composition

9. **Make sustainability mindset a factor when hiring directors:** A recent survey we conducted of NomCo chairs indicated that sustainability is now seen as a critical leadership competency for directors (63 percent of respondents) and senior executives (77 percent). The majority also said that the competency is more important now than ever before.

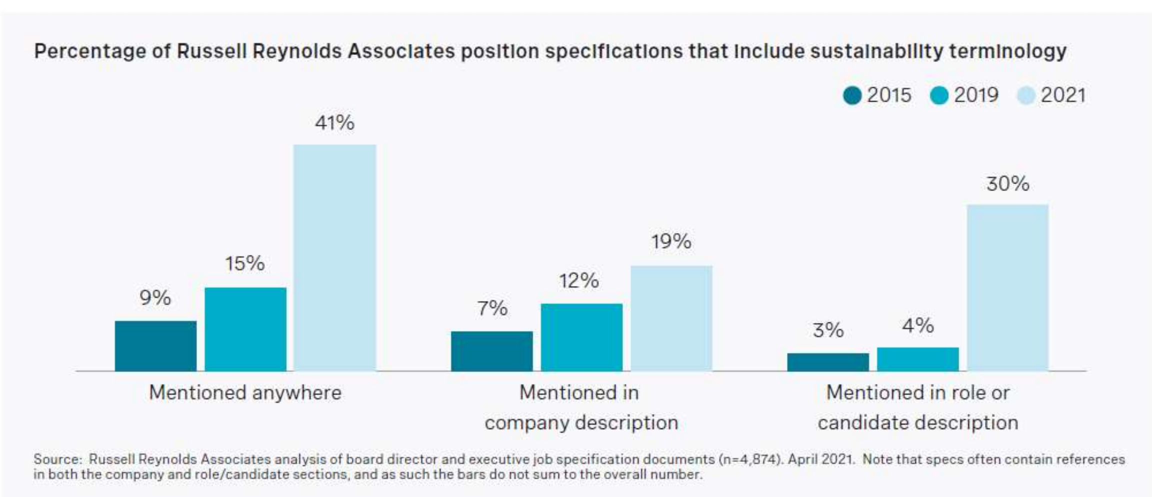
“A CEO cannot do their sustainability work without support from the board,” one executive said, which requires that boards must be filled with sustainability- minded directors. While some people may be concerned that recruiting based on sustainability mindset limits the pool of potential directors, it can also be a recruiting tool, attracting high performing directors who want to be associated with sustainable efforts.

When recruiting directors, it is important to avoid confusing sustainability expertise with a sustainability mindset. Simply recruiting “a sustainability director,” someone who perhaps served as a chief sustainability officer, will likely result in them being marginalized in the boardroom. “You don’t need an expert, you need great directors,” one board leader said. Those great directors might lack hands-on sustainability experience, but should have a sustainable mindset: a belief that business is not a commercial activity divorced from wider society, and the ability to align all aspects of running their organization with related core values and beliefs.

10. **Make sustainability mindset a factor when hiring CEOs:** Likewise, it is also critical to make sustainable leadership a requirement for executive hiring. Without it, the business is unlikely to embrace sustainability, or fully realize ambitious efforts. “Picking the right CEO is the biggest impact we can have as a board on this issue,” one director told us. This view reflects the reality that a company’s commitments start at the top with the CEO, and flow down through the executive ranks and throughout the organization. Without their commitment, it is unlikely to be factored into the strategy, key metrics, or other essential corporate activities.

- Sustainability is increasingly seen as a critical leadership competency, with NomCo chairs saying it was important or extremely important in the selection of board directors (63 percent) and senior executives (77 percent).
- Both these numbers are on the rise: Fifty-two percent of respondents said this was more important now than in past years for board directors, and 58 percent said the same about senior

Corporations are already starting to make this transition, as an April 2021 analysis of job specifications showed: In 2021, 41 percent of searches conducted by Russell Reynolds Associates referenced sustainability, up from 15 percent in 2019, and 9 percent in 2015.



What should boards look for when recruiting a CEO? Our recent research in partnership with the United Nations Global Compact identified a Sustainable Leadership model, combining a sustainable mindset with a differentiated set of capabilities that have enabled them to drive transformation within and beyond their own four walls: multilevel systems thinking, stakeholder inclusion, disruptive innovation, and long-term activation. (For more information on the Sustainable Leader model, see the appendix.)

Conclusion

As sustainability efforts gain momentum in society, and as expectations grow that corporations will play a central role in making the world a better place, it is essential that board leaders know how to enable and drive sustainability within the enterprise. The 10- step roadmap identified by leading directors and captured in this study provides a clear set of best practices for board leaders to follow. By engaging thoughtfully around board leadership; board culture; purpose, strategy, and risk alignment; structure and process; and people and composition, board leaders can ensure that their company "does well by doing good."

Appendix: Board Self-Assessment Tool

"Board effectiveness is front of mind for institutional investors, activists, political and regulatory bodies, and the media," said Richard Fields, who leads RRA's board effectiveness practice. "Self-assessment tools help boards pressure test their own performance, positioning them to meet the demands of external and internal stakeholders."

The tool below is designed to assist board leaders in evaluating where their board stands in its ability to drive sustainability throughout the enterprise. Directors can rate their board as Emerging, Evolving, or Best-in-Class for each of the 10 recommended actions. Examples for each rating are provided.

Fields adds: "Given the tremendous attention on oversight of sustainability issues—a topic that most directors would not list as a core competency—self-assessment tools like these are especially valuable."

Board Leadership

	Emerging	**Evolving**	**Best-in-Class**
Embedding sustainability into all discussions with the CEO and executive team	We have executives present sustainability initiatives and performance to the board	The board proactively engages with executives about sustainability issues	Our executives proactively bring up sustainability in discussions with directors knowing it is a critical issue
Proactively engaging with external stakeholders about sustainability	We engage with investors and other stakeholders about sustainability issues when they bring it up	We have a growing understanding of who our stakeholders are, what they want to engage with us about, and we will speak with them when they initiate it	We proactively meet with stakeholders for the sole purpose of discussing sustainability and seeking their input

Board Culture

	Emerging	Evolving	Best-in-Class
Establishing a purpose-driven culture that looks at issues through a sustainability lens	We have articulated the purpose of the company	Our purpose has become the north star for board decision making	Purpose and culture drive value creation in our organization, which then reinforces our culture
Educating directors on sustainability	We provide pre-reads on sustainability and related topics to our directors, which they can choose to read	We bring in stakeholders for discussions with the full board	We take the full board to meet stakeholders in their environment

Purpose, Strategy, and Risk Alignment

	Emerging	Evolving	Best-in-Class
Applying a sustainability lens to corporate strategy decision-making	We discuss sustainability during strategic planning process	We have a stand-alone sustainability strategy	We integrate sustainability issues into every element of corporate strategy
Setting goals and establishing clear metrics for tracking progress towards them	We measure sustainability goals and outcomes primarily through the lens of risk management	We increasingly measure sustainability goals and outcomes through the lens of value creation, rather than risk management	We measure sustainability goals and outcomes primarily through the lens of value creation

Structure and Process

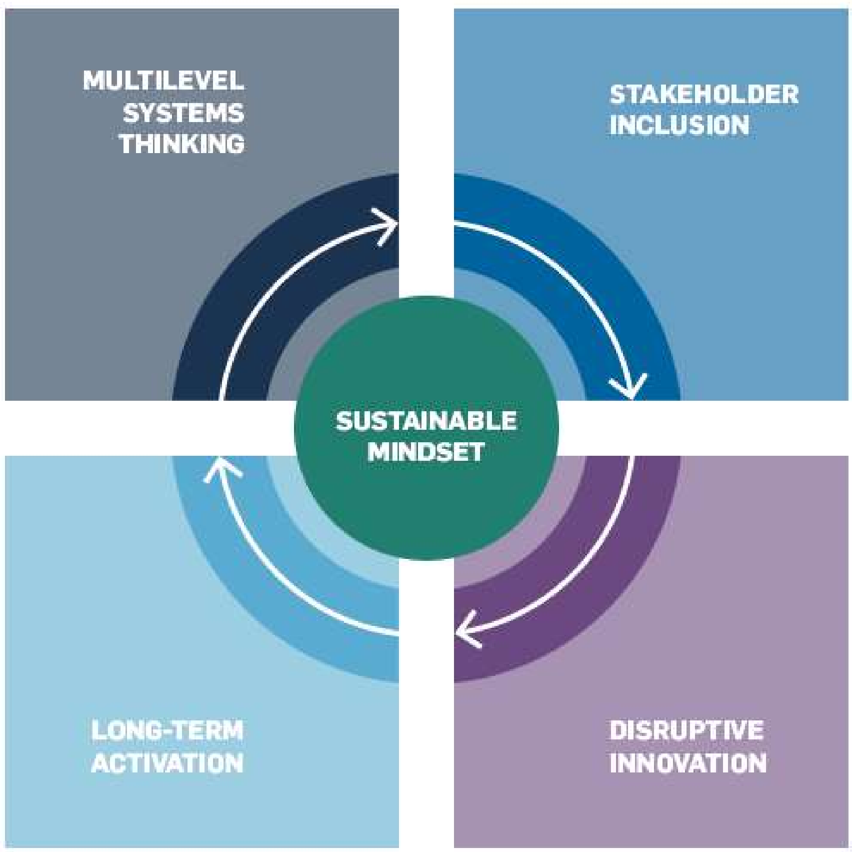
	Emerging	Evolving	Best-in-Class
Structuring the board to engage meaningfully on sustainability matters	We have standing items related to sustainability on every meeting agenda	We have established a stand-alone sustainability committee	We have sustainability committee expertise flowing into all other parts of boardroom discussions
Changing compensation models to account for sustainability targets	We measure sustainability targets and discussing performance, but it is not tied to compensation	A small component of variable compensation is linked to near- term sustainability performance	Our variable compensation is overwhelmingly linked to medium- and long-term sustainability performance

People and Composition

	Emerging	Evolving	Best-in-Class
Making sustainability a factor when hiring directors	We use a screening process that assesses candidate beliefs on sustainability and alignment with corporate purpose	Our director candidates need to demonstrate fluency in sustainability topics	Our directors are sustainability champions and demonstrate past track records of sustainable corporate leadership
Making sustainability a factor when hiring CEOs	We use a screening process assesses candidate beliefs on sustainability and alignment with corporate purpose	Our CEO candidates need to demonstrate fluency in sustainability topics	Our CEO is a sustainability champion and demonstrates a past track record of sustainable corporate leadership

Appendix: The Sustainable Leadership Model

Executives who we would classify as "Sustainable Leaders" have a strong personal motivation and purpose. They combine a sustainable mindset with a differentiated set of capabilities that have enabled them to drive transformation within and beyond their own four walls.



Their sustainable mindset is based on the purpose driven belief that business is not a commercial activity divorced from the wider societal and environmental context in which it operates. They know that to be successful in the long term, leaders must innovate and manage across commercial, societal and environmental outcomes. Leaders with a sustainable mindset align all aspects of running their organization with these core values and beliefs.

The executives we studied are extremely successful leaders — the bar for entry to these CEO- and board-level positions is a very high one. The experience they have had to gain and the commercial and leadership acumen they have had to demonstrate to get to where they are today is substantial.

It is what they have succeeded in doing beyond that which provides valuable lessons. They have not simply advocated for the sustainability cause, rather they have innovated and pushed real change within their organizations by driving it to the core of organizational strategy and culture.

These sustainable leaders demonstrate four critical leadership attributes that are driven by their sustainable mindset:

- **Multilevel Systems Thinking:** Sustainable leaders go beyond a deep understanding of their own organizational system and incorporate the interplay with the larger business, societal and environmental systems around them. Critically they cut through that complexity to drive targeted decisions and actions that turn sustainability into a competitive advantage.
- **Stakeholder Inclusion:** Sustainable leaders do not manage stakeholders — they include them. They actively seek to understand a wide range of points of view in order to drive decision-making with all those stakeholders.
- **Disruptive Innovation:** Sustainable leaders possess the courage to challenge traditional approaches — they ask why it cannot be done differently. They cut through bureaucracy to drive the breakthrough innovation that is needed to find novel solutions that do away with a trade- off between profitability and sustainability.
- **Long-Term Activation:** Sustainable leaders do not simply have an orientation towards the long term, they set audacious goals and drive concerted action and investments in the pursuit of them. To do this requires a great deal of courage to stay the course in the face of setbacks and to make decisions that may be unpopular with some short-term oriented stakeholders.

Endnotes

[1] Crookes, Jemi, Ruben Hillar, Tina Shah Paikeday, and Alix Stuart. “Is There a Fast Track to DE&I Maturity?” Russell Reynolds Associates, 2019.
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