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Insights

RESPONSIBLE AND SUSTAINABLE BUSINESS CONDUCT: EVERYONE'S BUSINESS

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SUMMARY

"Business sustainability is essential to the long-term prosperity of global companies. But what does this mean in practice and how is sustainability defined? Today's smart business leaders know that they are operating in a fishbowl, where everything they do is on display and social media enables news and information to travel around the world in seconds. They are also operating in a world where many governments are failing to provide a stable, secure environment for businesses to operate. To address these challenges, CEOs are recognizing that they need to incorporate broader principles of sustainability in their everyday business decisions. This is not simply a matter of doing the right thing, it's smart business." (Professor Michael Posner, NYU Stern School of Business (2014), see *World Economic Forum: Why it pays for businesses to boost sustainability*).

As we enter the decade to deliver the UN's Agenda 2030 and the Sustainable Development Goals and make critical progress towards the Paris Climate Agreement, it is clear that the frameworks and environment within which business operates, together with its operating models and practices, are collectively at a pivotal juncture. This reflects not only convergence across stakeholder expectations and action concerning responsible and sustainable business conduct, but also business' own voluntary commitments and practice concerning these issues. This includes a realisation that innovative collaborative approaches (including a mix of mandatory and voluntary measures at international and national levels) are necessary to grapple with "governance gaps" at the heart of real progress. At the same time, this process of transition also provides opportunities to create new businesses, goods and services and enhance business leadership, value and trust, including across systems that are critical to support structural change (see *World Economic Forum: Systems leadership can change the world - but what exactly is it?*).

This week the World Economic Forum will gather in Davos and aim to give concrete meaning to the newest buzzword – "stakeholder capitalism"– through a focus on **Stakeholders for a Cohesive and Sustainable World** and assist business, governments and international institutions in tracking progress towards the above twin imperatives for our time. This continues the trajectory of action over the summer with the G7's Business for Inclusive Growth commitment and the Business Roundtable's revised Statement on the Purpose of a Corporation (signed by 181 CEOs of global corporations) to place a more sustainable and inclusive approach at the centre of corporate purpose, value and stakeholder interests – and the importance of a business' social licence to operate rather than purely the primacy of shareholder interests (see *Business Roundtable: Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans'*).

Whilst these collective commitments present a pivotal opportunity, the delivery of their potential is clearly dependent upon transferring intent into concrete plans and actions to align business' operating and legal and governance approaches to support and create long-term value through responsible and sustainable business conduct. This includes pro-actively addressing environmental, social/human rights and governance risks.

Many leading businesses have recognised an integrated view of sustainability and responsible business conduct as a key strategic priority. This encompasses issues such as climate change and transition to a low / zero carbon economy, tackling corruption, strengthening the rule of law, the empowerment of women, diversity and inclusion, respecting human rights, efficient consumption, responsible sourcing and supply chain practices. The World Economic Forum's Global Risks Report, released last week, highlights the critical need for an holistic and integrated strategic approach to these issues because for the first time the top risks are not directly related to economic risks but environmental from extreme weather, biodiversity loss, natural and human-made disasters to the prospect that businesses' and governments' efforts to mitigate climate change will fail, with the associated adverse societal, governance, geopolitical and economic impacts. (see *World Economic Forum: The Global Risks Report 2020*).

While nuances exist, **"sustainability"** and **"ESG"** encompass the broad set of environmental, social and governance considerations that impact a company's ability to execute its business strategy and create value. These concepts remain strongly influenced by the Brundtland Commission's tri-partite **people, planet and profits framework** and that sustainable development is "development that meets the needs of the present without compromising the ability of future generations to meet their own needs" (see Brundtland Commission Report, Our Common Future (1987)). So whilst business sustainability clearly seeks to maximise performance opportunities, it also recognises business' social responsibility (and, increasingly over time, legal liability risks) associated with its own conduct and business relationships that may de-stabilise this inter-generational balance through adversely impacting their stakeholders' interests in respect of the environment, climate and social / human rights that underpin a business' social licence to operate. The interaction of business with sustainability requires integrating this responsibility into business models, decisions, products and services, and value chain relationships to enable a sustainable means of value creation – sustainability through responsible and ethical practices (and vice versa).

However, for many businesses (even in leading / engaged sectors) significant progress is still required and action across these issues remains undeveloped, fragmented, under resourced or not a priority. As a result, they may not adequately manage legal security, address sources of social accountability risk to support resilient risk governance and decisions, nor ensure alignment between stakeholder trust, and corporate purpose, value and reputation. Many of these issues manifest and drive ultimate risk to business in an interdependent manner across these three areas (and only escalate in scope and severity if the interdependency is not identified and addressed).

Therefore, it is important for CEOs (and their business teams) to take a strategic view and appreciate that a singular and / or even primary focus only on legal compliance (or just focusing on the "legal entry point") may not fully account for:

- An expanding legal and regulatory environment over time.

Situations where legal compliance does not provide sufficient holistic legal and social risk governance and resilience – the law is a lagging indicator and many business examples over the last year alone demonstrate that social accountability will be determined against the standards upon exit rather than those existing upon entry – or accepted international standards or norms. These standards or norms, such as the OECD's Guidelines for Multi-National Enterprises on Responsible Business Conduct and the UN Guiding Principles on Business and Human Rights can provide a "risk resiliency" buffer for business decisions over time, in complex operating environments, where local laws are contrary to or lower than international standards, absent or not enforced – and enable a business to "mind the gap" between legal compliance and social accountability risk and stakeholder trust.

- Social accountability risks drive an increasing scope of "hard consequences" for business (and those impacted by their actions).
- Whilst culture eats strategy for breakfast – it also trumps formal corporate governance systems for lunch and "cultural / formal governance dissonance" is often the foundation of systemic corporate scandals.

Articulating the optimal "smart mix" across mandatory and voluntary measures to address and drive responsible and sustainable business conduct remains a work in progress (at global and national levels), namely: clear and effective definition and metrics; use of disclosure and transparency; due diligence; re-articulating the scope of fiduciary duties and consideration of stakeholder interests; social accountability vs legal liability (including parent company liability); the role and design of corporate grievance mechanisms and the nature and purpose of the corporate form itself (including the role of "B corps"); and aligning culture more centrally within corporate governance and with values and purpose.

However, this evolving environment continues to underscore the importance of a range of trends that are and will continue to drive the need for an integrated and interdependent legal and social accountability risk governance approach and framework:

- **Convergence and harmonisation** across global expectations, standards and systems – reflected in public policy, international and sectoral standards, law and regulation (including corporate governance, disclosure and reporting, due diligence), commercial contracts, company's own commitments, policies, processes and practice (including sustainability linked products and services) and public benchmarking.

- **Even greater transparency**, not only through real time information feeds but more extensive regulatory, investor and company **reporting**, co-ordinated **stakeholder action** (through an increasing focus by **investors and pension funds**about how to leverage their stewardship role, act as 'universal asset owners' and disinvestment), and stakeholder accountability mechanisms – multi-stakeholder or company.

- **More complex risk and value profile.** As companies publicly provide more information (which is assessed and enhanced with the benefit of third party and stakeholder reporting and information), their risk and value profile becomes more complex and requires pro-active, aligned management and monitoring.

- Corporate scandals create **accountability for a broad range of situations and behaviour beyond 'traditional' dishonesty or corruption** including diversity / inclusion, immigration / asylum, privacy and misinformation, nature of products/services, 'fair decisions' – with personal senior executive accountability for ethical issues (rather than just management of financial resources).

- **Personal executive impact and consequences.** In 2018 the reported number of CEOs dismissed due to ethical lapses surpassed those for reasons associated with company financial performance or conflict with the company's board.

- **Need to de-risk political processes**, arising because, according to Paul Polman (ex-CEO of Unilever), over the next 10 years, "more responsibility will be put on business to move faster to implement the [UN's] sustainability goals simply because of the financial flow that needs to happen that cannot come right now from government" (see *theguardian.com: Ex-Unilever boss seeks 'heroic CEOs' to tackle climate change and inequality*). This is also in response to risks that public support for the system that sustains companies is eroding, as evidenced by the G7's response through the Business for Inclusive Growth commitment and EU Commission's Action Plan on Financing Sustainable Growth to address continuing challenges with global social and wealth inequalities.

- A **"finite window of trust"** for business to convert collective voluntary commitments into action (for example by the Business Roundtable members and others), failing which a "smart mix" of measures will necessarily evolve that includes greater mandatory measures, as has been foreshadowed by the EU Presidency in respect of the business and human rights agenda and its commitment to the European Green Deal (see *Finnish Government: Agenda for Action on Business and Human Rights*).

Whilst these factors contribute to a more complex and challenging strategic and operating environment for business, they also provide opportunities to create and enhance business leadership, value and reputation resiliency through:

- **Navigating market disruption**, identifying potential **competitive differentiation and advantage**, and **accelerating performance**.
- **Aligning strategic innovation in new markets, services, products (and/or re-design) and ways of operating**, such as renewable or energy saving technologies, green or social / SDG-linked bonds, sustainable finance, and socially responsible investing.
- **Harnessing effective and integrated use of data and technology**, for example blockchain in supply chains to support an aligned risk profile, transparency, cost management and SME accessibility.
- Attracting and retaining the **best talent**, in particular millennials (and others!) who consider corporate purpose and values on par with remuneration.
- Recognising that **responsible business conduct and culture** is not only within an organisation's direct control to manage and, accordingly, to create positive and sustainable impact, but **underpins achieving all of the SDGs** for business (and its stakeholders), Governments and societies.
- Reframing business' role in **collaborative and collective multi-stakeholder action** – within and across business sectors, with States / governments and civil society – and specifically to address challenges where business requires State action and / or support – such as the fight against corruption that may simultaneously fund achievement of the SDGs within the next ten years.

Notwithstanding the challenge, it is clear that key stakeholder groups will continue to press business to maintain the momentum to move beyond the business case debate to action – "scale up and speed up". For business, the competitive and resilience benefits and opportunity are also increasingly compelling – and in circumstances where inaction is no longer a viable strategic option – action on responsible and sustainable business conduct is rising to the top of the "to-do list" for CEOs and Boards.

Key ESG Considerations

- **Environment**. Greenhouse gas emissions, biodiversity, plastics, water and non-renewable materials sourcing, usage, waste disposal.

- **Social**. Human rights, labour relations, diversity, product safety, employee health and safety, community development, responsible sourcing, corruption.
- **Governance**. Ethics and culture including dissonance with formal systems; board diversity, composition and functioning; shareholder rights and stakeholder engagement; accountability, transparency and reporting practices.

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