

CSR & Corporate Governance

By Wayne Visser

Part 1 (23 January 2010)

Last week, I spoke on the links between CSR, corporate governance and competitiveness at the 3rd International Conference on Corporate Governance in Istanbul. It is a topic close to my heart, as I have for a long time believed that corporate governance may be the best route to mainstreaming CSR.

When I was Director of KPMG's Sustainability Services in South Africa, we were fortunate that Judge Mervyn King – under the auspices of the Institute of Directors and through the Code that bears his name – took a global lead on integrating CSR ideas into corporate governance.

The King Report, issued in 1994, was the first corporate governance code in the world to include explicit reference to stakeholders and the 2002 revised code (King II) included major sections on business ethics and integrated sustainability reporting.

King III, launched in 2009, goes even further. According to Mervyn King – who chaired also the conference panel I spoke on in Istanbul and who I interviewed while I was there – says that “the philosophy of King III revolves around leadership, sustainability and corporate citizenship.”

The reason for emphasising the King Code is because – through a research project I am doing on sustainability and corporate boards for Cambridge University – it is abundantly clear that this approach is the exception, rather than the rule.

For instance, in all the UK codes, from Cadbury through the Combined Code to the Walker Review, there is no direct reference to CSR, sustainability or even to stakeholders. So these have to be inferred through risk and reputation, or occasional references to environment, health and safety.

The US tackles the issue differently, through the Sarbanes Oxley Act, which is heavy on accounting prescriptions, including compliance with ethics codes. But I am sceptical about its effectiveness. The onerous requirements either result in companies skipping across the Atlantic to list in London, or instil a tick-box mentality.

It is worth remembering that Enron had an ethics code, ethics officers and many lauded CSR programmes, none of which diminished the culture of greed that caused its ultimate

demise. As Mervyn King says: “Moses tried it and failed; Sarbanes and Oxley tried it and they will fail. We cannot legislate against dishonesty.”

So how do you embed CSR into corporate governance, and is there a link to competitiveness?

Part 2 to follow ...

Part 2 (27 January 2010)

Given the narrow, financial focus of many international corporate governance codes, how can corporate governance be used as a strategy for embedding CSR?

In fact, the basic principles of corporate governance all have CSR/sustainability implications. In a report I worked on when I was running KPMG’s Sustainability Services in South Africa, we identified 6 ‘Director’s Sustainability Imperatives’ and 12 areas for action. These covered the areas of: board accountability, values/strategy, risk management, management systems, performance monitoring/reporting and stakeholder interaction.

Of these, one of most effective levers for change in CSR is the explicit or implicit requirement for reporting in most corporate governance codes.

The UK’s abandoned 2005 Operating and Financial Review (OFR) legislation would have provided a basis for sustainability reporting. Instead, companies are now only required to conduct a Business Review, in terms of the much more limited disclosure requirements of the 2003 EU Accounts Modernisation Directive, which (much like the Turnbull Review) focuses on the major risks facing the company. The Association for Certified Chartered Accountants, among others, remain critical of this approach, saying that the Business Review “will not bring about any material improvements to corporate reporting.”

In the case of the King Code, direct reference is made to the GRI’s Sustainability Reporting Guidelines, and all listed companies need to comply. In chapter 9, the Code states: “Reporting should be integrated across all areas of performance, reflecting the choices made in the strategic decisions adopted by the board, and should include reporting in the triple context of economic, social and environmental issues. The board should be able to report forward-looking information that will enable stakeholders to make a more informed assessment of the economic value of the company as opposed to its book value.”

Even in the absence of such compelling reporting requirements, most corporate governance codes embrace the principles of ‘material disclosure’ and ‘comply or explain’. These requirements can be used to challenge companies. Have they reported on the most material social, environmental and ethical issues for the company? How do these translate into risks, liabilities and impacts? If they are not reporting these, can they explain why?

... the role of non-executive directors in Part 3

Part 3 (29 January 2010)

The second lever of change for integrating CSR through corporate governance is the role of non-executive directors (NEDs).

There is no explicit CSR-related role for NEDs in the corporate governance codes – only an emphasis on their role in questioning the strategy, performance and controls for risk management. So once again, CSR would have to be inferred. There are a few hooks, however:

The Tyson Report on Board Diversity suggests that non commercial NEDs (i.e. from NGOs, academia or civil society) have important contributions to make, including their understanding of social, political and environmental issues.

There is a recommendation in the 2009 Walker Review of Corporate Governance of the UK Banking Industry that boards should provide expertise to NEDs to receive increased support, training and access to external experts in areas of risk. The implication is that NEDs would have an enhanced ability to challenge boards.

The Walker Review also recommended that an increased amount of time and attention should be paid to risk governance and independence of risk management functions, implying a more critical role for NEDs.

Mervyn King believes NEDs most important role is to ask “intellectually naive questions”, which tease out corporate responses to strategic issues such as sustainability. However, they should not become siloed, i.e. the only place on the board where sustainability is considered or where accountability lies.

NEDs have a tricky balancing act, as they have to be a team play, yet also retain some distance/independence from the executive board members. King believes the current trend in the US to stack the board almost exclusively with NEDs is a mistake and will backfire; it is the combination of executive directors and NEDs that gives the board strength.

At the end of the day, integrating CSR and corporate governance requires strong and socially aware leadership. However, it also requires an enabling environment. In a report I worked on for Cambridge University on what makes a ‘sustainable economy’, many of the gaps identified were governance gaps – issues like short-termism, divided purpose, inappropriate incentives and misleading measures.

I am also struck how many measures in the Accountability’s Responsible Competitiveness Index relate directly to corporate governance – indicators like efficacy of boards, ethical behaviour, wage equality, strength of audit and accounting standards and transparency of transactions.

So it is clear to me that, not only is corporate governance a key vehicle for communicating and embedding CSR, but it is also part of building a responsible, sustainable and competitive economy. CSR, as part of corporate governance, needs to become – to borrow a phrase from Mervyn King – the plugged in ‘rhythm’ of organisations and economies in the dawning age of responsibility.

Downloads

Sustainable Economy Dialogue report

Source:

First published on the CSR International Blog in three parts, 23–29 January 2010. Part 1 (23 January 2010): <https://csrinternational.blogspot.com/2010/01/last-week-i-spoke-on-links-between-csr.html>; Part 2 (27 January 2010): <https://csrinternational.blogspot.com/2010/01/csr-corporate-governance-part-2.html>; Part 3 (29 January 2010): <https://csrinternational.blogspot.com/2010/01/csr-corporate-governance-part-3.html>