CSR Governance

Literature Review

Working Paper #1

Prepared by:
Coro Strandberg
Strandberg Consulting

March 2007

Corporate Social Responsibility (CSR) Governance
Literature Review

Executive Summary

Strandberg Consulting conducted a literature review of the professional and academic literature on CSR governance, reviewing 36 publications dated from 2000 – 2006. The focus of the review was to identify trends and drivers, analyze current perspectives and document best practices and systems for a board-level approach to CSR. The Literature Review informed the Conference Board Report: "The Role of the Board of Directors in CSR", published in 2008. The report can be found at www.e-library.ca and www.corostrandberg.com

Trend to CSR integration

Overall, the literature review documents a modest trend towards board consideration of CSR issues, with specific trends including an increasing orientation to stakeholder considerations; the incorporation of CSR issues within systematic risk and opportunity management; and a growing awareness that CSR oriented companies will generate long-term shareholder value. Research has documented a modest trend to delegating CSR oversight to board committees and greater disclosure of CSR governance systems.

Diverse drivers of CSR governance

Key drivers of CSR governance include the emergent CSR business case, corporate governance scandals, investors increasingly focusing on operational and reputation risks, changing social expectations of the role of corporations, globalization, development of corporate governance standards that reference CSR, increasing social and environmental disclosure, legal/director liabilities, independent directors, and stakeholders including non-governmental organizations (NGOs), employees and regulators.

CSR material to corporate bottom line

The literature review points to the materiality of CSR to the corporate bottom line, including the following elements:

- Reputation and brand equity
- Productivity
- Efficiency
- Improved risk profile
- Innovation
- Improved access to capital
- Broadened license to operate
- Attraction and retention of employees
- Avoidance of future regulation

- Mitigates climate change impact on business

Generally authors believe that CSR can help a company maximize its competitive advantage, thus material direct and indirect CSR values are an unavoidable boardroom issue.

Boards determine corporate values

The literature review also pointed to the role that boards of directors play in determining core values, principles and corporate purpose. Thus, it was argued that boards have a responsibility to define the CSR values-framework and to create the attendant reward and other incentives for motivating strong CSR performance.

Stakeholders affect performance

The literature provided considerable coverage of the role stakeholders play in affecting corporate performance. Many references held the view that it is in the enlightened self-interest of companies to understand and respond to stakeholder interests as a wider view will better inform corporate strategy, generating enhanced long-term performance. While there are strong views that company boards should be considering stakeholder interests, it was recognized that practice is currently limited in this area.

Common stakeholders referenced as being within board purview include employees, customers, suppliers and local communities, primarily. Additional stakeholders include creditors, governments, environment, media and the general long and short term interests of corporations.

Principles and practices

The literature points to some principles that could frame a CSR governance program, and proposes a number of practices that boards could and should adopt for effective CSR governance. A view was expressed that boards should deal with CSR in their routine business agenda, rather than as an add-on. Key practices found within the documents, that could form the basis of a CSR governance road-map include:

CSR Governance Framework • ***Boards to integrate CSR considerations into the following:***

• Purpose, values and policies
    o Consider external guidelines and international codes
• Develop strategy, targets and key performance indicators (KPIs); monitor performance and implementation
• Set up accountabilities to monitor performance
    o E.g. board committees, designated board portfolio to independent director
• Identify and manage material SEE (social, environmental and ethical) risks and opportunities
    o Have processes and controls in place to manage and/or leverage them

- Integrate CSR considerations into major acquisitions or investments
- Identify and address stakeholder issues
    - Consider stakeholder engagement
- Include CSR consideration in CEO recruitment/succession planning
- Link remuneration to both financial and non-financial metrics
- Board recruitment, evaluation and training
- Disclosure and reporting

Across the literature, oversight of CSR risk and opportunity management and disclosure of material CSR issues were most frequently mentioned roles for corporate boards.

Key conclusions

A scan of the CSR governance literature from 2000 – 2006 results in the following key conclusions:

- CSR is an extension of corporate governance
- Directors have a vital role to play in ensuring CSR is reflected in corporate values, strategy, risk management structures, incentive programs, and disclosure practices
- Canadian law supports the consideration of CSR issues and stakeholders as being in the best interests of the corporation. CSR is thus supportive of fiduciary duty
- Trends in forces affecting business suggest that greater board attention to CSR issues will be warranted in the future
- Board consideration of CSR issues is nascent, with some leadership examples overseas

Thus, one can expect greater attention paid to CSR within governance circles in the years ahead, and growing evidence of CSR practices within leading company boards.

Corporate Social Responsibility (CSR) Governance
Literature Review

Introduction

Strandberg Consulting conducted a literature review of the professional and academic literature on CSR governance, reviewing 36 publications dated from 2000 – 2006 in order to identify the main themes in the literature. The following provides the results and an analysis of the review.

Background and Methodology

We undertook a comprehensive review of the professional and academic literature on corporate governance and CSR. We scanned the literature published on this topic to seek the most advanced thinking and research in this field. From the list of resources identified in the global scan, we selected 36 of the most relevant publications for detailed examination. The focus of the review was to identify trends and drivers, analyze current perspectives, and document best practices and systems for integrating CSR at board level. We selected papers published since 2000 to ensure the perspectives were current and meaningful and only reviewed papers that came to our attention prior to December 31, 2006.

This document synthesizes our review of the literature and is divided into the following sections:

- current context, trends and drivers of CSR governance
- business case
- materiality and business risk and opportunity
- values, stakeholders, principles and practices

The literature review focused on CSR governance in general and did not attempt to draw specific conclusions about the state of CSR governance practice and debate within Canada. However, a few key documents were sourced for having specific Canadian applicability.

Current Context, Trends and Drivers

Most writings on CSR governance situate its evolution within the backdrop of the corporate governance scandals at companies such as Enron and WorldCom earlier this decade, which drove a concern for accountability and transparency amongst corporate leaders and regulators. This, coupled with growing shareholder activism, changing societal expectations about the role of corporations, and the globalization of capital markets, has resulted in a proliferation of governance principles and codes of conduct over the past 10 – 15 years.[1]

[1] SustainAbility and International Business Leaders Forum, *The Power to Change: Mobilizing Board Leadership to Deliver Sustainable Value to Markets and Society*, p. 17.

As pointed out by SustainAbility, a UK-based consultancy and think tank, in a 2004 CSR bulletin[2], corporate governance worldwide is characterized by a lack of universal rules or standards. The OECD's updated 2004 corporate governance guidelines – designed to apply across jurisdictions – attempt to fill this void. The Principles explicitly state that boards are expected to take stakeholder interests into consideration, including employees, creditors, customers, suppliers and local communities, and point out that the observation of environmental and social standards is relevant in this context.[3]

Another milestone in the CSR governance literature is the South African King Report, which predated the updated OECD guidelines by 10 years, and went beyond the then traditional financial and regulatory aspects of corporate governance to advocate an "integrated approach to good governance in the interests of a wide range of stakeholders having regard to the fundamental principles of good financial, social, ethical and environmental practice."[4]

Other developments over the past 10 years which have propelled CSR onto the governance agenda include publication of the Association of British Insurers' (ABI) "Disclosure Guidelines on Socially Responsible Investment" (2001) (see page 24 for details) and the UK Turnbull report: "Internal Control, Guidance for Directors on the Combined Code" (2001), the latter which asks companies to consider the following:

"Are the significant internal and external operational, financial, compliance and other risks identified and assessed on an ongoing basis? (Significant risks may, for example, include those related to market, credit, liquidity, technological, legal, health, safety and environmental, reputation, and business probity issues)."[5]

These UK standards and guidelines focused on risk management, encouraging boards to establish arrangements for "significant" CSR risks. Companies were advised to determine which CSR risks were significant to their business and to develop appropriate structures to manage them.[6] This consideration of CSR aspects within corporate governance frameworks were mirrored in other national initiatives occurring in Europe, North America, Africa and Australia then and since.

In Canada, for example, the Canadian Council of Chief Executives (CCCE), seeking to instill public confidence in capital markets and the enterprise system on the heels of the corporate scandals, published a statement, "Governance, Values and Competitiveness: A Commitment to Leadership" in 2002. They laid out their views on corporate governance,

---

[2] SustainAbility, *Missing Links: Corporate Governance, Responsibility and Sustainability*, p. 2.

[3] Organization for Economic Co-operation and Development, *OECD Principles of Corporate Governance,* p. 58.

[4] Institute of Directors, *King Committee on Corporate Governance, Executive Summary,* King Committee on Corporate Governance*, Executive Summary of the King Report 2002*, p. 6.

[5] Association of British Insurers, *Disclosure Guidelines on Socially Responsible Investment*

[6] As reported in Association of British Insurers and British Bankers Association, *Guidance on Corporate Social Responsibility Management and Reporting for the Financial Services Sector,* p. 21.

calling for companies to have a written code of ethics or conduct that, along with other matters, deals with the following:

- The purpose and values of the business
- Relationships with stakeholders including customers, suppliers and the media
- Environmental protection
- Product quality and safety
- Workplace health and safety
- Employment practices, human rights and non-discrimination
- Political contributions
- Corporate and employee involvement in the community.[7]

The statement asserts that companies which demonstrate strong moral values and good corporate citizenship will engender reputation and shareholder value benefits, and advises that to serve the interest of their shareholders, companies must take into account the interests of a wide variety of stakeholders[8]. The statement, written from the perspective of the CEOs of Canada's largest public corporations, comments that among the core functions of company boards is the need to oversee management of the firm's ethical operation and to tie compensation to both short and long-term performance[9]. In their discussion on board recruitment and development they recommend that the board should take into account the benefits of diversity.[10] They commit themselves to leadership on three fronts, including corporate citizenship: "Good corporate citizenship at home and abroad, including respect for human rights, environmental stewardship and community investment, plays an essential role in enhancing public trust, attracting and retaining talented people and reducing investor perceptions of risk. We therefore commit ourselves to continuing to review our strategies and practices with respect to corporate citizenship."[11]

In his paper "What Directors Need to Know about CSR", Mark Schacter, a Canadian governance advisor, chronicles the pressures on company directors as a result of the spate of corporate scandals in the early 2000s. He observes that there has been a recent trend towards pushing directors into stakeholder territory and comments on the growing view that "there will be increased pressure for directors to demonstrate that they have adequate understanding of stakeholder interests and CSR issues".[12] He predicts four trends that will have a significant impact on director responsibilities in the future:

1. Growing pressure on corporations to give stakeholders a role in corporate governance
2. Growing pressure to disclose social, environmental and economic performance

[7] Canadian Council of Chief Executives, *Governance, Values and Competitiveness: A Commitment to Leadership,* pp 14-15.
[8] CCCE, p. 15.
[9] CCCE, p. 16.
[10] CCCE, p. 18.
[11] CCCE, p. 30.
[12] Mark Schacter, *What Directors Need to Know about Corporate Social Responsibility",* p. 2.

3. Increasing regulation in previously voluntary areas (e.g. product stewardship, transfats, etc.)
4. Increasing interest by the financial community in non-financial performance.[13]

US-based Business for Social Responsibility produced an analysis of corporate board trends vis-à-vis CSR. They, too, document a number of new demands on boards of directors, a result of legislative mandates that are changing the board's composition, role and authority, and increased attention to non-financial risks and opportunities. Building upon Schacter's list they summarize the new demands as follows:

- Increasing financial community interest in the link between shareholder value and non-financial performance
- Growing consideration of stakeholder involvement in corporate governance
- Increasing disclosure of company policies and performance on social, environmental and economic issues
- Increased attention to company positions on key public policy questions, such as the environment and human rights
- Ongoing scrutiny of board composition and diversity[14]

Their article points to a recent trend to delegating responsibility for social and environmental oversight to board committees. According to their research, 20% of Standard & Poor's 500 have board committees that oversee CSR issues such as environment, health and safety and eight of the top ten Fortune "Most Admired Companies for Social Responsibility" had board CSR committees in 2004.[15]

In Canada, research conducted by board and executive search consultants SpencerStuart on board practices of the 100 largest publicly-traded Canadian companies by revenue, revealed that five (5%) Canadian boards had social responsibility or public policy committees, compared to 11% of a comparable group of US companies in 2005.[16]

A US Conference Board survey of over 150 companies in 2000, supplemented by data of board practices in 750 companies, revealed the following:

- "Approximately 15% have a citizenship-related committee, compared to about 10% in a 1980 study.
- 37% of respondents conduct annual or twice yearly board reviews of their company's citizenships objectives.
- Over 70% claimed to have reached a board decision during the past year driven by their company's corporate citizenship positions."[17]

[13] Schacter, pp. 10 – 14.
[14] Adapted from Mark Schacter's *Boards Face New Responsibilities* in CA Magazine and referenced in Aron Cramer and Matthew Hirschland, *The Socially Responsible Board,* p. 20.
[15] Cramer and Hirschland, p. 21.
[16] SpencerStuart, *Board Trends and Practices at Leading Canadian Companies,* p. 14.
[17] As reported in SustainAbility, *The Power to Change*, p. 15.

It is illuminating to track the regulatory framework for consideration of stakeholder issues in board decision-making by analyzing US developments in this area. In the 1980s a wave of corporate constituency statues were enacted to empower states to fend off hostile takeovers, with 30 such laws in place by the mid-1990s.[18] According to research conducted by Blake, Cassels and Graydon for Industry Canada in 2003 on "Stakeholder Interest Provisions in Corporate Law", these constituency statues allowed directors to consider the effects of proposed actions upon specific constituency groups, typically shareholders, employees, suppliers, customers, creditors, communities in which the corporation is situated, and the long-term and short-term interests of the corporation.[19] Their research was inconclusive as to whether or not non-shareholder stakeholder interests could override the interests of shareholders as they found the statutes to be silent on this question. They also were unable to identify any demonstrable impacts from explicitly including stakeholder interests as permissible considerations.

In its analysis of the Canadian context, the law firm concluded that Canadian corporate law already addresses stakeholder interests in three specific ways, chief among them that directors can take stakeholder interests into account in determining what is in the best interests of the corporation. Section 122(1a) of the Canada Business Corporations Act (CBCA) states that in exercising their powers and discharging their duties, directors shall *act honestly and in good faith with a view to the best interests of the corporation.*[20] According to Blake et al, courts have been flexible in their interpretation of what constitutes corporate best interests: "The jurisprudence reflects the court's adherence to the so called business judgment rule in most situations and indicates a willingness to allow directors the flexibility in their decision-making to consider stakeholder interests where appropriate."[21] While their research concludes it is therefore unnecessary to include an explicit stakeholder interest provision in the CBCA, they nonetheless drafted a model provision which articulates that directors and officers may, in determining the best interests of the corporation, take into account the interests of such groups as shareholders, employees, suppliers, customers and creditors of the corporation, and the communities in which the corporation is located.[22]

This legal interpretation is reinforced by the court ruling in the Peoples Department Stores Inc. (Trustee of) v. Wise, [2004] 3 S.C.R. 461, 2004 case. In this judgment of whether the actions of Peoples' board of directors were consistent with the "Duty of Loyalty" in the CBCA, it was noted that directors can be seen to be acting in the best interests of the corporation if they consider, inter alia, "the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment".[23]

---

[18] Allen White, *The Stakeholder Fiduciary: CSR, Governance and the Future of Boards,* p. 12.
[19] Blake, Cassels & Graydon, *A Study of Stakeholder Interest Provisions in Corporate Law",* p. 31.
[20] CBCA at s.122(1)(a) as referenced in Blake, p. 38.
[21] Blake, p. 45. This is further supported by Teck Corp. V. Millar (1972) where the judgment held that considering employee and community interests could be consistent with the bona fide interests of the shareholders. "If [directors] observe a decent respect for other interests lying beyond those of the company's shareholders in the strict sense, that will not […] leave directors open to the charge that they have failed in their fiduciary duty to the company" as quoted in Peoples Department Stores Inc. p. 25.
[22] Blake, p. 51.
[23] Peoples Department Stores Inc. (Trustee of) v. Wise, p. 26.

A joint Canadian research project was conducted by Innovest Strategic Value Advisors and the Risk Management Institute of the University of Toronto to investigate the integration of environmental issues into financial analysis. The report concluded that environmental factors are not well integrated into investment decisions in spite of the impact on sector and stock valuations that environmental concerns and opportunities can have.[24] To address this gap, they call for corporate directors to be informed of the environmental risks and opportunities facing the company and its sector, ensure they are being addressed by management, and disclose them to investors. They further recommend that directors receive sufficient education to help them fulfill these obligations. "Under recent changes to regulations, corporate directors in Canada have to approve all corporate disclosures by signing off on the financial statements and the MD&A (Management Discussion and Analysis). It would befit them, therefore, to learn as much as possible about all environmental risks and opportunities that may have a material impact on the company."[25]

Risk management is a key CSR governance consideration and trends are suggesting it will become more so in future. In 2001 SustainAbility and Friends Ivory and Sime (FIS) conducted research into board approaches to CSR and risk, looking at the risk management practices of 14 large UK companies. They started from the position that effective management of social, environmental and ethical (SEE) risks begins with the board, with senior leadership affecting employee decisions and behaviours. Their research found that "a substantial number of companies had not assigned explicit board responsibility for SEE issues. Of those that had assigned board responsibility, few were clear about how this responsibility relates to board responsibility for risk management. Only one company was able to present a very detailed picture of their overall system of internal control in which the board, internal audit, line management and SEE functional management were formally integrated."[26] Their research found that the survey companies lacked board-approved policy statements regarding the full range of SEE issues, and were primarily focused on environmental considerations if at all. While there were examples of boards acknowledging the significance of non-financial risks, they had not developed approaches for their systematic management.

Ethical Investment Research Services (EIRIS) in the UK commented in a 2005 research briefing on a few of the drivers influencing the take-up of SEE risk management at the board level. For example, in Europe the EU Accounts Modernisation Directive requires companies to provide an analysis of relevant risks and uncertainties, including the social and environmental aspects, in their annual reports. In the US the adoption of processes like Enterprise Risk Management suggest "some sense of addressing, controlling and managing social, environmental and ethical (SEE) risks". EIRIS asserts that these

---

[24] Innovest Strategic Value Advisors and University of Toronto Risk Management Institute, *Finance and the Environment in North America: The State of Play on the Integration of Environmental Issues into Financial Research".*
[25] Ibid, p.17.
[26] SustainAbility and Friends Ivory and Sime, *Governance, Risk and Corporate Social Responsibility,* p. 6.

developments imply that SEE risk management approaches have broad applicability.[27] Their study, conducted 4 years after the SustainAbility and FIS collaboration referred to above, analyzes how well boards and senior management address SEE risks and opportunities. They assess the board's role and its review of SEE matters, SEE director training, and SEE pay incentives. In contrast to the earlier research, their investigation reveals that larger UK-based companies are leaders in embracing the concept of SEE risk management and providing evidence of SEE risk management systems, showing that UK firms had moved to bridge the gaps in the recent period. On a global basis, according to their research, companies from the UK, Norway, Switzerland and France have made the greatest progress in developing SEE risk management systems and larger companies excel in this area over smaller companies.[28]

Also during this period, over 250 investors, academics, NGOs, and governments from 21 countries were consulted on investor priorities for future development for a study sponsored by Business in the Community, FTSE Group and Insight Investment. Corporate responsibility governance was one of the major priorities across all respondent groups. The feedback pointed out that "although 'traditional' corporate governance has risen to the fore in recent years, many people believe that the same principles of board controls and accountability should be applied to managing corporate responsibility risks and opportunities as well."[29] This investor view lines up with the recommendations from the research project conducted by Innovest and the University of Toronto profiled earlier.

Henderson Global Investors, a UK-based investment management firm with over £63 billion in assets, similarly commented that investors are recognizing the importance of corporate responsibility for long term shareholder value. "Engaging with companies to understand these areas and where necessary encourage improvements in practice can help to protect and enhance the value of investments and enable investors to exercise stewardship over their assets. These concepts are being woven into the fabric of institutional investment."[30] Developments in the UK and elsewhere that require pension funds to disclose their approach to social, environmental and ethical issues will further drive this trend.

While progress on the development of board-governed SEE risk management systems is in evidence, at least in Europe, it is also revealing to see the degree to which company sustainability reports have evolved on the CSR governance front. SustainAbility documented in its 2004 survey of corporate sustainability reports that "very few boards yet understand the connections between corporate governance and the triple bottom line agenda".[31] Their study classified governance as the hottest topic and posed a number of questions to a panel of experts on the linkages between corporate governance, market risk and sustainable development. Panel member George Dallas, Managing Director of

---

[27] Ethical Investment Research Services, *SEE Risk Management: A Global Analysis of its Adoption by Companies",* p. 3.
[28] Ibid, p. 13.
[29] Craig McKenzie et al, *Rewarding Virtue: Effective Board Action on Corporate Responsibility,* p. 3.
[30] Henderson Global Investors, *Governance for Corporate Responsibility,* p. 3.
[31] SustainAbility, *Risk & Opportunity: Best Practice in Non-financial Reporting",* p. 1.

Standard & Poor's (S&P) Corporate Governance Practice, commented that S&P's corporate governance analysis incorporates an assessment of the quality of a company's stakeholder relations including key non-financial stakeholders such as employees, customers, suppliers and local communities. They probe the company's transparency and disclosures on social and environmental issues, and look for evidence of where such issues have been poorly managed. This analysis stems from their belief that a company's relations with its key stakeholders can be critical to its long-term financial and operational sustainability.[32]

In their 2004 analysis of the top 50 global sustainability reporters the think tank observed that corporate governance had emerged as one of the defining issues.[33] In their 2006 sustainability reporting survey they note an increase in the *coverage* of corporate governance approaches but no comparable increase in reported sustainability integration at the board level. They point specifically to the fact that while many reports document the board's role, membership and structure, discussion around boardroom accountability for sustainability issues is limited. They list seven companies that do well in "Governance and Strategy", one of the four reporting areas studied, including Anglo Platinum, BT, Ford, GSK, Nedbank, Nike and Rabobank.[34] Their initial somewhat negative view is countered by subsequent observations that their research suggests that "sustainability thinking is not only incorporated into reporting at leading companies, but is also filtering into boards, brands and business models."[35] In future sustainability reports, they predict, as CSR issues become more critical to corporate success, the reporting spotlight will centre on the role of boards, CEOs, and financial markets.[36]

Larry Elliot, a finance columnist for the Guardian Weekly, brings up director liability as another driver of a board sustainability role, regarding climate change in this instance. Writing in February, 2006, he speculates that boards of directors contributing to global warming through their business decisions may be subject to lawsuits arising from their companies' actions, and that insurers will become wary about writing policies for such companies. He documents the case of Exxon Mobil which is vulnerable in this respect for its lobbying against efforts to combat greenhouse gas emissions, in the face of its 1% contribution towards global carbon emissions. An insurance executive is quoted as saying his company may be forced to approach Exxon Mobil with: "Since you don't think climate change is a problem, and you're betting your stockholders' assets on that, we're sure you won't mind if we exclude climate-related lawsuits from your D&O (directors and officers) insurance". As Elliot says, those kinds of moves will be sure to concentrate minds in the boardroom.[37]

---

[32] SustainAbility, p. 11.
[33] Ibid., p. 25.
[34] SustainAbility, *Tomorrow's Value: The Global Reporters 2006 Survey of Corporate Sustainability Reporting,* p. 15.
[35] Ibid., p. 6.
[36] Ibid., p. 30.
[37] Larry Elliott, *Boardrooms feeling the heat; climate change concerns challenge belief that business growth is always good", Guardian Weekly,* p. 28.

Elliot is backed up in his views by a report of a leading insurance trade journal, "Business Insurance"[38] which reported on the liability of corporate directors and officers for climate change impacts of their actions (or inactions) on shareholders. According to their research, an insurance company was contemplating excluding climate risks from their Directors and Officers liability coverage where customers were not prudently taking steps to prevent such losses.

But SustainAbility and International Leaders Business Forum (IBLF) in their call for boards to take a leadership role in delivering sustainable value to markets and society bring up a more compelling, visionary reason for company directors to step up to governance on critical social and environmental matters. Writing in 2001, they document how the role of business in society is being redefined with the massive transfer of assets to the private sector, bringing company roles and responsibilities under the public and government spotlight. They postulate that if company boards fail to take leadership on this question, other actors will define their boundaries for them.[39]

Another study pointing to the trend towards increased director attention on social and environmental matters is a 2005 global thought-leaders study on the convergence of CSR and corporate governance commissioned by the Canadian Co-operative Association and authored by Coro Strandberg. Her research revealed that 13 subject matter experts from sustainability think tanks, rating agencies, investment research and consulting firms, global business networks, etc., perceived a definite trend towards greater integration of CSR considerations into business strategy and boardrooms, some driven by board's risk management priorities and others guided by a values-based governance approach.[40] Asked for their views on the pace of this convergence, none saw a strong drive in this direction, but most expected there to be an inexorable move towards board table CSR, primarily issue-driven, with some boards leading the pack in their more strategic approach to tackling social and environmental developments and opportunities.[41] Drivers of this convergence, whether risk-based or values-based, were believed to include stakeholders, employees, reputational and trust issues, growing realization of the business case, scandals, globalization, independent directors, values-based corporate leaders, investors, regulators, and legal liabilities.[42]

Strandberg's thought leaders believed that CSR issues will increasingly penetrate the boardroom. Indeed, it is predicted that financial market analysts will be probing the frequency and nature of CSR discussions at the board table over the medium term, further driving this trend.

Business Case

---

[38] As reported in Evan Mills and Eugene Lecomte, *"From Risk to Opportunity: How Insurers Can Proactively and Profitably Manage Climate Change"*, Ceres Report, p. 25.
[39] SustainAbility and International Business Leaders Forum, *The Power To Change,* p. 8.
[40] Coro Strandberg, *The Convergence of Corporate Governance and Corporate Social Responsibility Thought Leaders Study.*
[41] Ibid., pp. 6 – 7.
[42] Ibid., pp. 38 – 39.

The Strandberg thought leader research reinforced the prevailing view that the degree to which a business case for CSR can be documented will have a strong affect on CSR governance. As with the thought leaders, the literature was united on this front. SustainAbility and the International Business Leaders Forum (IBLF) teamed up in 2001 to write a primer on board leadership on the triple bottom line[43]. They situate their board leadership framework in the context of growing pressures on boards of directors to provide leadership in a challenging business environment, with:

- increased societal expectations of business and growing demands on companies to minimize harm from their activities and to deliver not only economic but real social and environmental value; and
- a need for clear corporate values and purpose statements to guide companies through this turbulence and to develop radar systems to pick up and respond to these marketplace and societal signals.[44]

They quantify the business case benefits of a triple bottom-line approach found within reputation, brand equity, improved risk profile, innovation, productivity, efficiency, improved access to capital, broadened license to operate, and ability to attract and retain talent which result in material benefits on the company's long-term shareholder value and success[45]. This is the foundation of their argument for why the triple bottom-line is an unavoidable boardroom issue.

The King Report also comments on the business case rationale for CSR governance, expressing its view that "a company is likely to experience indirect economic benefits such as improved productivity and corporate reputation by taking (social responsibility) factors into consideration."[46]

Ceres, a US-based environmental think tank and research organization, commissioned a study by Innovest Strategic Value Advisors in 2002 as part of their Sustainable Governance Project. They sought to understand the business case for companies to adopt strong environmental positions, in this case greenhouse gas emission reduction targets. Their report documents the following reasons for boards taking this environmental stance:

- Risks associated with future regulations
- Eco-efficiency gains (e.g. reduced energy costs)
- Concern over future climatic changes and the implications for business
- Concern over reputation
- A desire to improve competitive positioning.[47]

---

[43] SustainAbility and International Business Leaders Forum, *The Power to Change.*
[44] Ibid., p. 4.
[45] Ibid., p. 10.
[46] Institute of Directors, *King Committee on Corporate Governance, Executive Summary,* p. 11.
[47] Innovest Strategic Value Advisors, *Value at Risk: Climate Change and Future of Governance,* p. 31.

These business case motivations could apply equally well in any industry with embedded environmental liabilities.

George Dallas in his paper which links non-financial stakeholder relationships to corporate governance, points to two real, albeit intangible elements of corporate performance: minimizing operational and reputational risks and maximizing sustainable competitive advantage[48]. The former, he postulates, has a goal to predict how a company's relationships with non-financial stakeholders and its social/environmental performance "might expose it to risks such as operational disruptions, loss of market share, lawsuits, or regulatory penalties that could damage its competitive position, reputation, brand value, growth or financial profile".[49] He also comments that stakeholder relationships can be a source of opportunity and competitive differentiation: "responsible social and environmental behaviour can improve relations with employees, customers, regulators and suppliers, which in turn can strengthen a company's competitive position, cost profile, and overall sustainability. Good stakeholder relationships imply good corporate responsibility, and can also be viewed as a proxy for good management".[50]

These authors point to a growing view that CSR issues are material to a company's bottom-line, and thus justification for board level oversight.

The Materiality of Business Risk and Opportunity

This matter of materiality, particularly as it relates to CSR business risks and opportunities, is a growing CSR governance issue as well. Clearly, boards of directors should only concern themselves with material matters, raising the question of how to identify and quantify social, environmental and ethical issues of significance. This was another trend in the CSR governance literature, tied very clearly to risk and opportunity management considerations. The Materiality Report, produced by the UK think tank AccountAbility in association with others, proposes a rationale, framework and process for identifying the key social and environmental considerations that could be material to a company's long term success, and argues for including material social and environmental issues into the governance process. Specifically, their process recommends board level commitment to, and engagement in, the materiality determination process and board review and sign-off of the conclusions.[51]

George Dallas, then a governance expert with S&P, comments that "well-managed companies and boards monitor public opinion and interest groups in key areas of strategic importance and risk to ensure they are not near a "tipping point", past which an event relating to a company's social or environmental performance could trigger a *materially*

[48] George Dallas, *Relationship with Non-Financial Stakeholders Key to Linking Corporate Responsibility with Corporate Governance.*
[49] Ibid., p. 2.
[50] Ibid., p. 2.
[51] Maya Forstater, Simon Zadek et al, *The Materiality Report*, p. 34.

adverse shift in public opinion and stakeholder relations."[52] (emphasis added.) Interviewed by SustainAbility for their 2004 Global Reporters Survey, Dallas further comments that S&P looks for evidence that a company has identified material social and environmental risks and has introduced processes and controls to manage and govern the company with regard to these risks. As he says, "these matters should have explicit board oversight".[53] According to this rating agency, alarm bells ring when companies fail to identify their material social and environmental risks and when they lack processes and controls to manage and govern themselves with regard to these risks. It brings on additional scrutiny when board oversight of social and environmental issues is non-existent or minimal.

In 2002 the British Banking Association (BBA) and the Association of British Insurers (ABI) released a comprehensive toolkit for CSR management and reporting in the financial services sector. The guidance document outlines a step-by-step approach to understanding the business drivers for CSR and provides guidance on how financial companies can integrate CSR into the core of their business. The document outlines the governance imperative up front, demonstrating how organizational values and corporate governance should be put in a CSR context. The guidelines acknowledge that companies starting out in CSR typically treat CSR as a response to individual issues, without including it in their values or governance processes such that companies fail to profit from a strategic approach. According to the BBA and ABI, companies on this path come to realize CSR as a source of significant business risk and opportunity and start to integrate CSR into their values and corporate governance, thus providing "a strong framework within which the management of CSR issues can be prioritized, planned and conducted in the wider business context, enabling CSR to be better integrated into corporate behaviours to achieve sustainable performance and results."[54]

The Strandberg report also documented a strong view amongst some global CSR governance thought leaders that CSR is directly connected to corporate governance through risk, whereby CSR is perceived as an operational risk issue and thus a matter for board review. Some interviewees cautioned that they didn't see this as evidence of a convergence between CSR and corporate governance per se, but simply recognition amongst company boards that there are financial risks inherent in CSR issues that need management – to those boards, CSR is not about making value judgments. While some thought leaders differed on the values dimension of CSR governance, all agreed, however, that the nature of CSR management can differentiate company performance, making it relevant to corporate governance. They rallied around the view that "effective management of CSR risks and opportunities can improve financial results, warranting governance oversight".[55]

Values

---

[52] Dallas, p. 3.
[53] SustainAbility, *Risk and Opportunity: Best Practice in Non-Financial Reporting,* p. 13.
[54] Association of British Insurers and British Bankers Association, p. 12.
[55] Strandberg, p. 5.

Strandberg's interviews with CSR governance thought leaders pointed to a divergence of opinion between whether CSR governance is (simply) a risk management issue, or whether it is more fundamental to the nature, purpose and culture of a company. She documented a stream of thought amongst the subject matter experts that good governance was becoming more broadly defined to include ethical considerations and that good governance is about values, not rules. In this context, CSR is an expression of those values and ethics. Some interviewees held that the governance process, in part, is about determining what kind of corporate citizen a company seeks to be and that CSR is a fundamental component of such an exercise. Changing boundaries of corporate responsibility are starting to define a new range of accountabilities that affect business performance to include social and environmental issues. Thus, embedding CSR in the governance structure helps clarify board roles and responsibilities internally and externally to the corporation.[56]

Allen White, writing from an American perspective in his role as advisor to Business for Social Responsibility (BSR), sees the board of directors as chief architects of a company's values whether or not they are conscious of this. He comments:

"In fulfilling its duties, the board – knowingly or unknowingly – helps shape the CSR agenda of the organization. As the highest governance body, directors are instrumental in setting the values and standards within the organization through their decisions regarding strategy, incentives and internal control systems. (…) Through its remuneration, nominations, audit and finance committees, the board signals to management, employees and external stakeholders how it views the tough trade-offs between short-term shareholder value and long-term wealth creation. The board can make choices to enhance various aspects of corporate responsibility, such as defining CEO salaries versus the employee average; improving diversity in board recruitment to reflect the spectrum of stakeholder interests; demonstrating commitment to social audits along with financial audits; and guiding capital investment and portfolio investment with an eye toward contributing to sustainable development. Even absent a CSR committee of the board or a strong awareness of CSR issues among individual directors, the board inevitably, by choice or chance, exerts powerful influence on the organization's CSR performance".[57]

In its corporate governance guide to directors (more of which will be profiled later), the London Stock Exchange (LSE) sets out a role for the board of directors in values-setting. According to their guidance document, once the company has decided on its CSR commitments, these should be reflected in its statement of values or purpose and its core principles of doing business.[58]

The 2004 report "Rewarding Virtue: Effective Board Action on Corporate Responsibility"[59] focuses on the means by which a board of directors can foster trust in their company and guard against unethical action. They document a number of

---

[56] Strandberg, pp. 4 – 5.
[57] Allen L. White, *The Stakeholder Fiduciary: CSR, Governance and the Future of Boards*, p. 4.
[58] London Stock Exchange, *Corporate Governance: A Practical Guide,* p. 56.
[59] Craig McKenzie et al, *Rewarding Virtue: Effective Action on Corporate Responsibility.*

suggestions on how a board can ensure it fosters a culture of integrity, fairness, and accountability by aligning its internal and external incentive programs towards corporate responsibility. Underpinning their framework for board engagement on CSR is a lengthy commentary on the critical leverage a board of directors has over an organization's cultural integrity. According to the report, boards of directors which develop a strong values orientation with the attendant reward and other incentives to foster ethical behaviour will preside over enduring values-based cultures able to nurture stronger trust relationships in society, stronger brands and stronger business performance as a result.

Stakeholders

Alongside risk- and values-based governance, stakeholder relations are common features in the CSR governance literature. SustainAbility and IBLF point to the ongoing debate over the question as to whether boards should be accountable to shareholders only or to other stakeholders as well. They argue that an 'either/or' dichotomy is a simplistic view of the complex environment within which companies operate and fails to capture the realities of corporate business planning and decision-making. Companies, especially those with a global orientation, operate in a web of relationships that necessitates boards pay attention to international conventions, voluntary codes of conduct, changing societal expectations of business and the growing power of public opinion.[60]

The King Report weighs in with its view that companies must be discerning about who to include in its stakeholder family insofar as it is unrealistic for a company to be accountable to all stakeholders. "The modern approach is for a board to identify the company's [key] stakeholders, including its shareowners, and to agree on policies as to how the relationship with those stakeholders should be advanced and managed in the interests of the company."[61] The Report enumerates the complexity of today's social license to operate: "Boards have to consider not only the regulatory aspect, but also industry and market standards, industry reputation, the investigative media, and the attitudes of customers, suppliers, consumers, employees, investors, and communities (local, national and international), ethical pressure groups, public opinion, public confidence, political opinion, etc."[62] According to King, when developing company strategy, stakeholders such as customers, employees, suppliers and the community in which the company operates need to be considered, whether the relationship is contractual or non-contractual.[63]

The OECD Principles of Corporate Governance, updated in 2004, 10 years after the King Report, is regarded by many as the standard-bearer in corporate governance. Its principles stipulate that corporate governance frameworks should "recognize the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs and the

[60] SustainAbility and International Business Leaders Forum, *The Power to Change*, p. 16.
[61] Institute of Directors, p. 6.
[62] Ibid., p. 7.
[63] Ibid., p. 7.

sustainability of financially sound enterprises".[64] The Principles acknowledge that the corporate interest is served by recognizing stakeholder interests and their contribution to long-term performance; concern over corporate reputation and corporate performance often requires recognizing broader interests. Regarding disclosure and transparency, the Principles state that disclosure should include material information on issues regarding employees and other stakeholders.[65] Specifically, the Principles recognize that disclosure helps to improve public understanding of corporate policies and performance with respect to "environmental and ethical standards, and companies' relationships with the communities in which they operate."[66] And in listing the responsibilities of the board, the guidelines stipulate that the board should take into account the interests of stakeholders.[67]

According to SustainAbility's analysis, "in contrast to the stockholder-versus-stakeholder debate, the OECD sees it to be in the enlightened self-interest of shareholders to understand and respond to wider stakeholder interests."[68] SustainAbility's view is that while company law or stock markets may focus on shareholder accountability, "it is in the enlightened self-interest of the latter to understand and respond to other stakeholder interests, too."[69] They point to the considerable research that demonstrates the business case for inclusion of sustainable development and stakeholder interests and the relevance of this performance on equity valuation.[70]

Business in the Community, FTSE Group and Insight Investment weighed in with their stakeholder views in their 2005 sponsored study on the role of the board in corporate responsibility, by advising that boards ensure the company understands stakeholder CR expectations and their perceptions of the company's CR performance.[71] They, as the others, believe that this wider view will inform corporate strategy, generating enhanced long-term financial performance.

George Dallas, in his publication on the relationship of non-financial stakeholders to corporate governance, agrees, and comments that with companies moving to adapt to the Sarbanes-Oxley Act of 2002 and other corporate governance reforms, boards of directors are likely to pay more attention to strategic oversight and enterprise risk management.[72] Investors, too, "are increasingly focusing on operational and reputational risks, and their effect on corporate financial performance and market valuations."[73] He posits that the thread that binds these trends together is the need for directors, managers, and investors to better understand a company's relationships with key non-financial stakeholders – employees, customers, communities, and regulators. To Dallas, a broader understanding of stakeholder relationships is essential to foster long-term shareholder value. As he

[64] OECD, *OECD Principles of Corporate Governance*, p. 21.
[65] Ibid., p. 22
[66] Ibid., p. 49.
[67] Ibid., p. 24.
[68] SustainAbility, *Risk and Opportunity: Best Practice in Non-Financial Reporting*, p. 14.
[69] SustainAbility, *Missing Links: Corporate Governance, Responsibility and Sustainability* Issue Brief, p. 4.
[70] Ibid.
[71] Craig McKenzie et al, p. 27.
[72] George Dallas.
[73] George Dallas, p. 1.

says, "Good corporate governance and good relations with non-financial stakeholders are becoming interrelated, and in turn form a good proxy for overall management quality."[74]

Allen White's comments from across the Atlantic are similar, though with more of an activist bent: "Corporations are responsible to multiple stakeholders, all of whom are integral to the success of the business. All contribute to wealth creation, and all merit the attention of boards (and management) to ensure long-term success of the company. Doing otherwise, directly or indirectly, introduces risks and ignores opportunities to undermine the single most important asset of any firm – trust in its leadership, products and services."[75]

He bases his views on what has been referred to as the team production model (TPM), the central idea of which is that the corporation comprises a multitude of parties that "jointly and inseparably contribute to its capacity to produce wealth. Shareholders are one such contributor, but there are many others: employees who contribute their human capital; suppliers who contribute their technology know-how; consumers who place their trust in the products and services of the organization; communities that contribute their infrastructure and environmental assets (water, air and land); and governments that provide a stable legal framework that enables the corporation to function within reasonably certain rules and procedures. (…) The implication is that if all of the aforementioned stakeholders contribute their assets – and take risks in doing so – to the corporation, it follows that each should be given voice in the corporation's governance structure at a level commensurate with its contribution. Shareholders are not the only asset providers, nor the only risk takers. Boards in their selection, composition and decision-making should be accountable to these multiple parties. This is the essence of what might be called stakeholder governance."[76]

In his paper, White moves the reader through an analysis that concludes in a view that stakeholder governance should predominate board room structures. He hypothesizes that if company boards were designed to genuinely meet the 21st century needs and expectations of business-society relations, other structures would evolve which establish new procedures for board selection (e.g. stakeholders voting for some directors) or which create a bi-cameral structure with stakeholders taking board seats. He challenges boards of directors to think how they might be more representative, responsive and responsible to all of the corporation's stakeholders. As BSR, which commissioned White's paper, comments in their paper on CSR governance, White's "alternative futures are responses to the need to revisit existing structures in light of new imperatives."[77]

Strandberg's thought leader report also tackled the stakeholder question[78]. According to the 13 thought leaders interviewed in the study, values-based boards were thought to take stakeholder considerations more centrally into account, though there were few examples

---

[74] George Dallas, p. 5.
[75] Allen White, p. 5.
[76] Allen White, pp 5 – 7.
[77] Cramer and Hirschland, p. 24
[78] Strandberg, pp. 11 – 12.

of robust stakeholder relations policies in evidence at the time of the research (2005). However, some felt that amongst companies that include stakeholder engagement in their business strategy there are signs that boards are experimenting with stakeholder input. Primarily boards were thought to be providing oversight to ensure effective stakeholder engagement programs were in place and well-managed. The report sums up the views on stakeholder engagement in this way: "Except as a by-product of corporate risk management, stakeholder relations have not caught on as a key governance practice. This is apparently no less the case for values-governed companies at present".[79]

The principles for board stakeholder relations are clearer than the roadmap, at present, according to this limited review. While there is rallying consensus on the need for company boards to take stakeholder considerations into account, and few limits on their mandate for doing so, current practice in this area is limited. With the emergence of principles and guidelines for corporate sustainability governance, as outlined below, this may well change in future.

CSR Governance Principles

The literature review revealed two sets of principles for framing best practice in CSR governance. First, the King Report set the stage with its views. It laid out seven characteristics of good corporate governance, including *responsibility* ("while the board is accountable to the company, it must act responsively to and with responsibility towards all stakeholders of the company"); and *social responsibility* ("a well-managed company will be aware of, and respond to, social issues (…). A good corporate citizen is increasingly seen as one that is non-discriminatory, non-exploitative and responsible with regard to environmental and human rights issues."[80])

The Association of British Insurers (ABI) and the British Banking Association (BBA) set out seven principles of good CSR governance[81] ostensibly designed for bankers, insurers and asset managers, but with applicability for any sector.

Principles	Explanatory Notes
Owned	A CSR governance structure needs to have defined, visible and appropriate points of ownership and corresponding accountability. This should include ownership at Board and Executive level, in addition to senior management accountability in Group central functions and within business units. The role of the Audit Committee and other Executive Committees should be considered.
Externally Informed	The governance arrangements should incorporate mechanisms for receiving external input from relevant stakeholders and demonstrably respond to external opinion.
Inclusive	All levels of management and staff, including the Board and Executive (…) have a role in achieving CSR governance. (…) The

[79] Strandberg, p. 12.
[80] Institute of Directors, p. 11.
[81] Association of British Insurers and British Bankers Association, p. 23.

	governance arrangements should also be comprehensive in consideration of all relevant CSR impacts/risks.
Networked	The governance arrangements for the individual CSR issues should be sufficiently links across the company (…) and integration should be driven from the top of the company, through the corporate strategy and policy.
Balanced	(…) CSR should be balanced in the context of other business priorities and programs. (…)
Evolutionary	(…) Governance arrangements need to be able to predict and appropriately respond to changing priorities and expectations.
Accountable	Accountabilities need to be defined and actively implemented through established performance review processes. (…)

CSR Governance Practices/Framework

The ABI and BBA guidelines proposed a framework of structural and system components of a comprehensive CSR governance program, some of which include:[82]

Structure	
Structural Elements	**Key role/responsibilities**
Board sponsor/accountable executive	Overall accountability for CSR performance, delivery of Group strategy and policy commitments
Group CSR Manager/Director	Oversight and coordination of the CSR management and reporting programme
CSR Committee	Think-tank for CSR strategy and policy development, and consultative forum for the CSR Manager/Director. Committee would ideally be chaired by responsible Board/Executive sponsor
System	
Process Elements	**Key Details**
Statement of corporate values/principles	Comprising clear definition of core values of the company, under-pinning all policies, processes and behaviours
Policies containing management and performance objectives	Containing CSR aspirations and objectives to provide demonstration of intention for continued improvement
Responsibilities and accountabilities	Defining roles and specific responsibilities and accountabilities for each functional element of the governance structure

The King Report also overviewed the board's key CSR responsibilities as follows[83]:

[82] Association of British Insurers and British Bankers Association, p. 24.
[83] Institute of Directors, pp. 17, 22, 30, 31, 34, 39

- Define the purpose [and values] of the company and (…) identify the stakeholders relevant to the business of the company
- Develop a strategy combining purpose, values and stakeholders and ensure management implements the strategy
- Monitor implementation
- Identify and monitor the non-financial aspects relevant to the business of the company
- Identify key risk areas and develop key performance indicators, including behaving responsibly towards all stakeholders. Develop a system of risk management and internal control, incorporating mechanisms to deliver a register of key risks that could affect shareowner and relevant stakeholder interests
- Communicate its strategic plans and ethical code internally and externally; it is the board's duty to present a balanced and understandable assessment of the company's position in reporting to stakeholders. Reporting should address material matters of significant interest and concern to all stakeholders
- The board must determine the social and environmental issues, policies and practices relevant for disclosure

George Dallas identifies attributes of strong and weak analytical profiles with respect to the board's stakeholder relations and social/environmental performance[84], among them is that the board oversees efforts to:

- identify material social and environmental risks and has processes and controls in place to manage these; and
- link external social and environmental reporting to internal management and governance processes.

Nonexistent or minimal board oversight of these efforts would be characterized as a company with a weak analytical profile.

The European-based Global Reporting Initiative 2006 Sustainability Reporting Guidelines identifies "Governance" as a key reporting indicator. Specifically company sustainability reports are to describe the governance structure of the organization, including committees with responsibility for specific tasks such as setting strategy or organizational oversight. They ask sustainability reporters to indicate responsibility for economic, social and environmental performance within the committee's mandate.[85] Other governance reporting indicators include the linkage between compensation for members of the board and the organization's performance, including social and environmental performance; board procedures for overseeing the organization's management of economic, environmental, and social performance, including relevant risks and opportunities, and compliance with international standards, codes of conduct, and principles, and the frequency with which the board assesses the company's

[84] George Dallas, p. 5.
[85] Global Reporting Initiative, *Sustainability Reporting Guidelines,* p. 22.

sustainability performance; and process for evaluating the board's own performance, particularly on economic, environmental and social matters.[86] The significance of these guidelines needs to be considered in light of the fact that worldwide there are 950 declared GRI reporters at the close of 2006. Much as SustainAbility is documenting a modest increase in the number of sustainability reporters disclosing their CSR governance practices, we can expect this trend to grow in the years ahead.

In the UK, at least, the impetus will also come from the London Stock Exchange (LSE) who, in partnership with Robson Rhodes, a UK management consultancy firm, put together a guide to corporate governance which includes significant provision for CSR considerations. This relatively new guidance document, "Corporate Governance: A Practical Guide" takes into account the requirements of the Combined Code on Corporate Governance applicable in 2004 to all UK incorporated companies listed on the LSE.[87] In it they state that "the board needs information from inside and outside the company to enable it to monitor and review effectively the company's performance against its strategic objectives. This information should embrace financial and non-financial measures of performance."[88] They provide the following list of non-financial performance measures all of which can relate to CSR in some fashion and some of which do so directly:

- Market positioning of key brands
- Customer satisfaction/retention
- Employee satisfaction and turnover
- Proportion of business attributable to new customers/products
- R&D and innovation measures
- Social and environmental performance
- Shareholder and other key stakeholder assessments of the business.[89]

The LSE guidelines advises nomination committees to determine if there is a particular type of expertise that the board would find helpful, such as perspectives on how to improve corporate social responsibility performance.[90]

They turn to RSMiInternational's "Building World-Class Boards" (2003), for a list of risks that a company board should assess, including among them:

- Reputational risk
- Poor employee motivation
- Not responding to market trends/failure to innovate
- Pool level of customer satisfaction
- Failure to enact high standards of ethics across business
- Stakeholder concerns on products/business probity
- Supply chain problems such as human rights, child labour

[86] Ibid., p. 23.
[87] London Stock Exchange, *Corporate Governance: A Practical Guide.*
[88] Ibid., p. 8.
[89] Ibid., p. 8.
[90] Ibid., p. 20.

- Health, safety and environmental issues.[91]

The LSE guide devotes an entire section of its 9-section document to Taking Corporate Social Responsibility on Board, posing such questions as:

- "Does the board's approach to CSR flow directly from the corporate strategy?
- Is there a board member with a special remit for CSR issues?
- Have key stakeholders been involved in determining the group's CSR focus; what are their views on the group's approach and performance in this area?
- Are relevant external guidelines being followed?
- Have demanding targets and deadlines for action been set in key areas?
- Have the principal risks and opportunities related to CSR been identified?
- Is there transparency in reporting progress made and in discussing the scope for further development?"[92]

They call upon directors to ensure sufficient time is devoted to CSR issues and that CSR is taken into account as a matter of course when making acquisitions or other major investments. The Guide also quotes from the Investor Relations Society best practice website on how to manage effective investor relations. Best practice suggests that companies should provide investors information on "the company's CSR policies including the policy objectives for each CSR area with quantified progress towards their achievement and information on any pending litigation on health and safety or other socially responsible investment matters."[93]

The Association of British Insurers (ABI), whose member companies account for almost 20% of investments in the London stock market, has produced a set of reporting guidelines on corporate governance within their 2001 Disclosure Guidelines on Socially Responsible Investment. Because investors need information on what boards believe to be their main exposures and how these are being managed, companies should state in their annual report whether the board:

- "takes account of the significance of the social, environmental and ethical (SEE) matters to the company;
- has assessed the significant risks to the company's short and long-term value arising from SEE matters, as well as the opportunities to enhance value that may arise from an appropriate response and is managing them; and
- has received adequate information to make such assessments and that directors are trained on SEE issues."[94]

As the board's key responsibilities are to help set policy and strategy, develop a risk management and accountability framework, approve major investments, mergers and acquisitions and select and remunerate senior management, SustainAbility and IBLF argue that it is the board's role to integrate a triple bottom-line perspective into each of

[91] Ibid., p. 42.
[92] Ibid., p. 54.
[93] Investor Relations Society website as quoted by LSE, p. 69
[94] Association of British Insurers, 2001, p. 2.

these roles[95]. In 2004, SustainAbility called on companies to explain why they perceive environmental or social aspects to be important and how they weigh and prioritize CSR issues in light of their long term strategy, on the basis of their view that this is the essence of good corporate governance.[96]

One of SustainAbility's key recommendations from their 2006 Global Sustainability Reporting Survey is for boards to "review the ways in which the sustainability agenda is likely to change the competitive landscape, as through the growing involvement of companies like Wal-Mart. As the spotlight shifts to scalable solutions, how is the company's strategy and portfolio of initiatives aligned?"[97] Specifically they recommend that boards assess whether their business strategy is aligned to the sustainability agenda and to ensure that they have not overlooked the value creation opportunities stemming from these sustainability trends.

BSR's Hirschland and Cramer tackle governance structures in their review of the board's social responsibility role, suggesting that boards can either establish a CSR-focused committee, give one or more directors a CSR portfolio, expand an existing committee's charter to include CSR matters, or treat the board as a CSR Committee of the Whole.[98] They comment that a CSR-specialized board committee is often the preferred approach, providing for stronger board leadership in CSR strategy and oversight. Regarding committee mandates, BSR suggests CSR committees could provide advice and recommendations to the board on the following:

- Stakeholder issues and trends and strategies to address them
- Metrics, adherence to codes of ethics and conduct
- Stakeholder engagement, reputation and brand issues
- Selection of external environmental and social auditors
- Public policies and litigation
- Internal policies and practices affecting environmental and social objectives.[99]

As non-financial matters are an evolving area of board focus, they suggest a "knowledge deficit" might exist that could be addressed by committees seeking information and views from non-traditional sources.[100]

Henderson Global Investors' study on the CSR role of non-executive directors similarly advises boards to review the way they address these issues and "consider whether establishing a specialist committee would enable them to do so more effectively."[101] Their 2003 report documents a number of UK companies that have done so. They analyzed the mandates of these committees and identified the following prospective roles:

---

[95] SustainAbility and International Business Leaders Forum, *The Power to Change,* p. 10.
[96] SustainAbility, *Risk and Opportunity,* p. 3.
[97] SustainAbility, *Tomorrow's Value*, p. 3.
[98] Cramer and Hirschland, p. 21.
[99] Ibid.
[100] Ibid.
[101] Henderson Global Investors, *Governance for Corporate Responsibility,* p. 4.

- Setting and informing corporate responsibility strategy
- Monitoring strategy implementation
- Challenging management
- CSR reporting
- Shareholder communication[102]

For their study, they interviewed a number of non-executive directors for their views on these trends, and further concluded that it would be valuable for boards to appoint directors with corporate responsibility expertise. Boards tend to be too homogeneous, coming from a narrow range of backgrounds and lacking diversity. They suggest recruiting directors with business experience in corporate social responsibility (e.g. environment, health and safety, consumer relations, human resources) or from the voluntary or public sector that have experience managing large organizations can broaden the range of perspectives brought to the board table.[103] They also encourage companies to factor CSR matters into the various stages of board management, including its structure, succession planning, director appointment and board evaluation. Companies should disclose these practices in their annual reports, they counsel, to assure investors and other stakeholders that they are properly addressing non-financial issues.[104] Henderson, for its part, seeks high performance in these areas from companies in which they invest.

SustainAbility and Friends Ivory and Sime (FIS) in their Governance, Risk and CSR snapshot report provide an overview of best practice for SEE risk management. Top of their list is "Board Leadership and Accountability". They believe that there should be board leadership and accountability on SEE issues, with a named board member and/or committee responsible for identifying and managing SEE risks and opportunities. So, too, should the board:

- Ensure that management systems to implement SEE policies are in place and fully integrated into the internal control systems;
- Publicly disclose its SEE policies, in which the board clearly outlines its expectations of employee behaviour; and
- Make a description of the board's system of control on SEE factors available to shareholders.[105]

A Ceres report on the role of insurers to promote responsible climate change behaviour further reports on a study conducted by the world's largest insurance broker, Marsh, which has articulated the following questions with respect to assessing climate change and D&O risk:

[102] Ibid., p. 7.
[103] Ibid., p. 5.
[104] Ibid., p. 1.
[105] SustainAbility and Friends Ivory and Sime, *Governance, Risk and Corporate Social Responsibility*, p. 8.

- “Management accountability/responsibility: Does a company allocate responsibility for the management of climate-related risks? If so, how does it do so?
- Corporate governance: Is there a committee of independent board members addressing the issues?
- Emissions management and reporting: What progress, if any, has a company made in quantifying, disclosing and/or reporting its emissions profile?
- Regulatory anticipation: How well has a company planned for future regulatory scenarios?”[106]

According to the Ceres report, oversight of these issues is the responsibility of the board of directors. Ceres commissioned another report on corporate governance and climate change[107] in which they quantify how 100 leading global companies in the 10 most carbon-intensive sector industries in the US are positioning themselves to address climate change. They developed a “Climate Change Governance Checklist”[108] with fourteen governance steps that companies can take to proactively address climate change. Amongst this list are two explicitly referring to the board: 1) board committee has oversight responsibility for environmental affairs and 2) board conducts period review of climate change and monitors progress in implementing strategies. They base their analysis on their view that climate change will have a material impact on long-term shareholder value in carbon-intensive industries, and is thus a responsibility of the board.

On the matter of board-governed executive compensation, two large UK investment managers, Henderson Global Investors and Universities Superannuation Scheme, conducted research into remuneration practices linking corporate executive remuneration to responsible long-term corporate success. They call for boards to link remuneration to a more balanced range of measures than those focused on financial targets alone. “Incorporating strategically significant aspects of the ‘responsibility’ agenda into performance measurement and remuneration frameworks should provide incentives for actions that are both responsible and deliver long-term business benefits.”[109] These extra-financial factors could include customer and employee satisfaction, corporate reputation, health and safety or the environment.

The Ceres sustainable governance project previously referred to, which explored best practice in sustainability and corporate governance, based its analysis on the view that responsible behaviour on climate change issues can build shareholder value while ignoring embedded climate change risk could undermine a board’s fiduciary duties.[110] Their study documented examples of fiduciary leadership among company boards to justify Ceres’ claim that good governance means boards adopt a strategic position around

[106] Evan Mills and Eugene Lecomte, p. 26.
[107] Douglas Cogan, *Corporate Governance and Climate Change: Making the Connection.*
[108] Ibid., p. 3.
[109] Henderson Global Investors and Universities Superannuation Scheme, *Getting what you pay for: Linking executive remuneration to responsible long-term corporate success,* p. 3.
[110] Innovest Strategic Value Advisors, *Value at Risk; Climate Change and the Future of Governance.*

sustainability imperatives affecting their businesses.[111] Their framework for corporate sustainability governance would require that board directors "be satisfied that the company's environmental stance makes good business sense, and that the cost of inaction is not an impaired valuation of a firm's assets"[112].

Citigroup Smith Barney published a paper in 2005 that outlines their approach to sustainable investing and how they interpret sustainable development for financial markets. They outline their methodology for valuing the sustainability performance of companies and in so doing use a 7-point Sustainability Governance Review model to distinguish leaders from average performers and laggards. Fundamentally they are seeking companies that:

"1) display senior management commitment to 2) a strategic vision of sustainable development that is 3) integrated into business processes via functioning management systems that can 4) identify and manage environmental and social risks and 5) promote potential sustainable opportunities in line with 6) good financial disciplines and that is 7) reported transparently to investors."[113]

Their investment analysts use this Sustainability Governance Review model[114] to assess if a company's sustainable development approach aligns with its overall strategy and key stakeholder priorities. For example, existence of a board-level sustainability committee is taken as evidence that companies are taking these issues seriously. Companies whose boards have radar systems for identifying sustainability risks are favoured as are those that look at the opportunity side of sustainability. These behaviours are expected to be an important differentiator for investors seeking companies that are sustainable product innovators. Analysts using this model will evaluate how companies integrate sustainability considerations into their decisions, particularly for major or long-lasting capital expenditures. Finally, a company's willingness to disclose its environmental and social impacts will be seen as a further indicator of strong sustainability governance.

A joint report sponsored by Business in the Community (BITC), Insight Investment and the FTSE Group in 2005 made a number of recommendations for board action on corporate responsibility. Specifically, they recommended that "the board should:

- Set values and standards
- Think strategically about corporate responsibility
- Be constructive about regulation
- Align performance management
- Create a culture of integrity
- Use internal control to secure responsibility."[115]

[111] Ibid. p. 30.
[112] Ibid.
[113] Citigroup Smith Barney, *Crossing the River and Interpreting Sustainable Development for Financial Markets",* p. 36.
[114] These indicators are derived from Smith Barney, pp 36 – 41.
[115] Craig McKenzie et al, p. 6.

With regard to reporting, they recommended the board "include in its report on corporate governance, an explanation of the board's governance of the company's corporate responsibilities and include in its remuneration report, information about how, if at all, long-term, intangible and corporate responsibility factors are incorporated in the remuneration framework."[116]

Their advice to boards further stipulates that audit committees review the company's internal control systems to ensure that they adequately identify and manage CSR risks and that they assess whether the internal audit procedures effectively monitor adherence to the company's standards and values.[117]

Their collective views are influenced by their beliefs that boards have a responsibility to be accountable to stakeholders – thus, they feel that boards should issue regular corporate responsibility reports, an important means by which the company fulfills its accountability. However, they also recommend dialogue and consultation with stakeholders and their representatives as another form of accountability.[118]

Sir Derek Higgs, BITC Deputy Chair, is quoted in the report as saying "If companies are to enjoy the long-term rewards associated with a reputation for trustworthy and responsible behaviour, boards must deal with corporate responsibility in *their routine agenda items*: approving strategy, reviewing risks, managing executive incentives, overseeing internal control and setting the tone of the business. Boards that treat corporate responsibility as a bolt-on, risk failing to fulfill their obligations to both shareholders and others."[119] (emphasis added). The report's recommendations for integrating CSR into board room matters involve "minor" changes to existing practices, whereby CSR perspectives are introduced into the basic board routine and not added on, reflecting their view that CSR should be embedded into corporate strategy and operations.

SustainAbility and IBLF propose a board leadership framework they refer to as L.E.A.D.E.R., which outlines 6 core principles that reflect general good corporate governance and are related to the three core functions of a board of directors:

- determining values, policy and strategic direction
- developing an accountability, control and risk management framework
- selecting and remunerating the CEO and directors based on their ability to advance the company's sustainability performance.[120]

They then outline 15 areas of action that are germane to improving CSR practices, including amongst them:

---

[116] Ibid., p. 7.
[117] Ibid.
[118] Ibid., p. 30.
[119] Ibid., p. 3.
[120] SustainAbility and International Leaders Business Forum, *The Power to Change,* p. 4.

- develop a board charter or policy to guide its activities and define its boundaries of responsibility
- approve stakeholder engagement strategies on CSR issues
- establish formal structures (e.g. board committees, advisory panels or board sponsor) for monitoring CSR performance
- identify key CSR risks
- approve a set of key performance indicators (KPIs) to assess CSR performance and compliance
- approve a policy for CSR reporting
- assess capacity and diversity of the board regarding CSR expertise
- incorporate CSR aspects into CEO succession planning and leadership development
- align remuneration processes to incorporate CSR considerations.[121]

Strandberg's 13 CSR governance subject matter experts also identified a number of key governance practices which best demonstrate CSR principles. They included: risk management, board diversity, disclosure and compensation, the latter considerably less well developed in practice.[122]

Across these various frameworks and guidelines for CSR governance practice some common components appear:

CSR Governance Framework • ***Boards to integrate CSR considerations into the following:***

• Purpose, values and policies
    o Consider external guidelines and international codes
• Develop strategy, targets and key performance indicators (KPIs); monitor performance and implementation
• Set up accountabilities to monitor performance
    o E.g. board committees, designated board portfolio to independent director
• Identify and manage material SEE risks and opportunities
    o Have processes and controls in place to manage and/or leverage them
• Integrate CSR considerations into major acquisitions or investments
• Identify and address stakeholder issues
    o Consider stakeholder engagement
• Include CSR consideration in CEO recruitment/succession planning
• Link remuneration to extra-financial factors
• Board recruitment, evaluation and training
• Disclosure and reporting

[121] Ibid., pp 37 – 39.
[122] Strandberg, pp. 10 – 11.

It is interesting to note that the two most referenced roles for corporate boards regarding CSR are risk and opportunity identification and management and CSR disclosure. Additionally, it bears repeating the view expressed strongly by BITC's Deputy Chair that boards must deal with CSR in their routine agenda items, not as a bolt-on activity.

As boards of directors chart their path towards integrated CSR governance, as trends noted in this report predict, they will seek best practice guidance. The foregoing assessment of recommended CSR governance practices could well form the basis of a common framework for CSR governance, possibly even redefining global standards for good corporate governance. While much of the standard-setting appears to be taking place in the UK and South Africa, nonetheless, corporate governance thought leaders and even the Canadian Council of Chief Executive Officers recognize the significance of CSR or corporate citizenship considerations as a means of advancing corporate performance and building trust in society. The recent revision to the Global Reporting Initiative, which presents a standard for reporting on CSR governance practices, promises to be another significant prod to advancements in this area.

Conclusions

A scan of the CSR governance literature from 2000 – 2006 results in the following key conclusions:

- CSR is an extension of corporate governance
- Directors have a vital role to play in ensuring CSR is reflected in corporate values, strategy, risk management structures, incentive programs and disclosure
- Canadian law supports the consideration of CSR issues and stakeholders as being in the best interests of the corporation. CSR is thus supportive of fiduciary duty
- Trends in forces affecting business suggest that greater board attention to CSR issues will be warranted in the future
- Board consideration of CSR issues is nascent, with some leadership examples overseas

While there is only modest evidence of CSR governance practices at present, the trends and drivers documented through this literature review, and the existence of best practice frameworks to guide CSR governance, are expected to drive further leadership and performance in this area in the years ahead.

APPENDIX A

BIBLIOGRAPHY

Association of British Insurers. *Risk, Returns and Responsibility.* 2004.

———. *Disclosure Guidelines on Socially Responsible Investment.* 2001.

Association of British Insurers and British Bankers Association. *Guidance on CSR Management and Reporting for the Financial Services Sector*. 2002.

Blake, Cassels and Graydon LLP. *A Study of Stakeholder Interest Provisions in Corporate Law*. 2003.

Canadian Council of Chief Executives. *Governance, Values and Competitiveness: A Commitment to Leadership.* 2002.

Citigroup Smith Barney. *Crossing the River and Interpreting Sustainable Development for the Capital Markets.* 2005.

Cogan, Douglas C. *Corporate Governance and Climate Change: Making the Connection.* Ceres Publication, March 2006.

Cramer, Aron and Matthew Hirschland. *The Socially Responsible Board.* 2006.

Dallas, George. *Relationship with Non-Financial Stakeholders Key to Linking Corporate Responsibility with Corporate Governance.* Standard & Poor's, 2005.

Elliott, Larry. "*Boardrooms Feeling the Heat.*" *Guardian Weekly,* Feb. 17 – 23, 2006, p. 28.

Ethical Investment Research Services. *SEE Risk Management: A Global Analysis of its Adoption by Companies.* 2005.

Forstater, Maya, Simon Zadek, Deborah Evans, Alan Knight, Maria Sillanpää, Chris Tuppen and Anne-Marie Warris. *The Materiality Report: Aligning Strategy, Performance and Reporting.* AccountAbility publication, 2006.

GRI Secretariat. *Global Reporting Initiative Sustainability Reporting Guidelines (G3).* 2006.

Henderson Global Investors and University Superannuation Scheme. *Getting What You Pay For: Linking Executive Remuneration to Responsible Long-Term Corporate Success.* 2005.

Henderson Global Investors. *Governance for Corporate Responsibility: The Role of Non-Executive Directors in Environmental, Social and Ethical Issues.* 2003.

Innovest Strategic Value Advisors. *Value at Risk: Climate Change and Future of Governance: CERES Sustainable Governance Project Report.* Ceres Report. 2002.

–––. *Corporate Environmental Governance.* 2002.

Innovest Strategic Value Advisors and University of Toronto Risk Management Institute. *Finance and the Environment in North America*. 2006.

Institute of Directors. *King Committee on Corporate Governance, Executive Summary.* South Africa, 2002.

International Federation of Accountants. *Enterprise Governance: Getting the Balance Right*. 2004.

London Stock Exchange. *Corporate Governance: A Practical Guide.* 2004.

McKenzie, Craig, et al. *Rewarding Virtue: Effective Board Action on Corporate Responsibility.* Report of Insight Investment, Business and the Community and FTSE Group, 2005.

Mills, Evan and Eugene Lecomte. *From Risk to Opportunity: How Insurers Can Proactively and Profitably Manage Climate Change.* Ceres Report, August 2006.

Organization for Economic Co-Operation and Development. *OECD Principles of Corporate Governance*. 2004.

Peoples Department Stores Inc. (Trustee of) v. Wise, [2004] 3 S.C.R. 461, 2004 SCC.

Schacter, Mark. *What Directors Need to Know about Corporate Social Responsibility.* 2005.

SpencerStuart. *Canadian Board Index; The Evolving Role of Boards in Leadership and Human Capital Development, Board Trends, and Practices at Leading Canadian Companies.* 2005.

Strandberg, Coro. *The Convergence of Corporate Governance and Corporate Social Responsibility.* 2005.

SustainAbility. *Tomorrow's Value: The Global Reporters 2006 Survey of Corporate Sustainability Reporting.* 2006.

———. SustainAbility and International Business Leaders Forum. *The Power to Change: Mobilizing Board Leadership to Deliver Sustainable Value to Markets and Society.* 2004.

———. *Missing Links: Corporate Governance, Responsibility and Sustainability*, Issue Brief #X, September 2004.

———. *Risk and Opportunity: Best Practice in Non-Financial Reporting.* 2004.

SustainAbility and Friends Ivory and Sime. *Governance, Risk and Corporate Social Responsibility.* 2001.

White, Allen. *The Stakeholder Fiduciary: CSR, Governance and the Future of Boards.* 2005.

Zollinger, Peter. *Missing Links: Corporate Governance, Responsibility and Sustainability.* SustainAbility Issue Brief #X, 2004.