

What Can We Learn From The Global Sustainability Leaders?

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This paper is based on the Academy's publication: Sustainability Governance Scorecard (2019),
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WHAT CAN WE LEARN FROM THE GLOBAL SUSTAINABILITY LEADERS?

Fifty years ago, American economist Milton Friedman wrote in an article to New York Times stating that "Business of business is business."

Long gone are the days of single-minded pursuit of short-term profits by business leaders. A growing number of stakeholders, particularly investors, are increasingly focused on the role corporate boards play in providing guidance and oversight over a company's sustainability strategy and performance.

The funds managed by signatories of Principles for Responsible Investment (PRI) reached 90 trillion USD in 2018 and by being a signatory, they commit to incorporate environmental, social, and governance (ESG) factors into their investment decisions; to better manage risk and generate sustainable long-term returns. Therefore, boards are now increasingly embracing "**Doing good is good business**".

Awareness on what is necessary for a sustainable future as well as commitment to action is on the rise. Sustainable Development Goals (SDGs) were approved by almost 200 countries as a common framework to focus on actions for a sustainable future, in 2015. Since then, a growing number of companies commit to SDGs and prioritize sustainability issues at the CEO and board level. However, **progress has been slow**.

Therefore, Argüden Governance Academy has developed a **Sustainability Governance Scorecard®** for the **Global Sustainability Leaders** (GSLs) to identify how the best companies govern and conduct their sustainability efforts.

Purpose of an Organization and the Right Leadership

There are different ways an organization can attract and engage its various stakeholders. Having an inspiring purpose articulated in form of a mission statement may be one of the most effective ways and it may provide a genuine answer to ensure long-term sustainable relationships with stakeholders.

Simon Sinek, the British-American author, motivational speaker and organizational consultant, presents "why" as an influential notion in his impactful book "Start with WHY". By understanding "why," the author says

leaders can enhance their leadership skills to better fulfill organizational goals and vision. Sometimes, organizations may use marketing subterfuge in order to draw customers and other stakeholders to purchase their goods and services. Yet manipulating customer/stakeholder needs through marketing strategies like pricing, promotion often ends up in short term gains only. On the other hand, long-term sustainable growth is often enabled when an organization is truly capable of inspiring its customers and stakeholders.

Therefore, Simon Sinek adds to his argument: “Organizational leaders need to understand why, how and what the entity does in the business environment. They need to establish the needs, wants and expectations of their stakeholders.”

Sustainability Governance Scorecard project has a number of goals, which are aligned with establishing a purpose for an organization and articulating a focused mission statement. One of the objectives is to contribute to the process of long-term value creation by providing sustainability leaders with appropriate measurement tools. SG Scorecard furthermore aspires to raise much needed awareness for the Sustainable Development Goals.

This impact research also aims to bring insight and information to the attention of decision makers to motivate action and improve effectiveness of implementation. Sustainability Governance Scorecard© (SG Scorecard) does not only identify and provide information about the state of the GSLs, but also highlights good examples from which the world could learn. The SG Scorecard is designed to motivate the business world to act for a more sustainable future by highlighting good practices in sustainability governance.

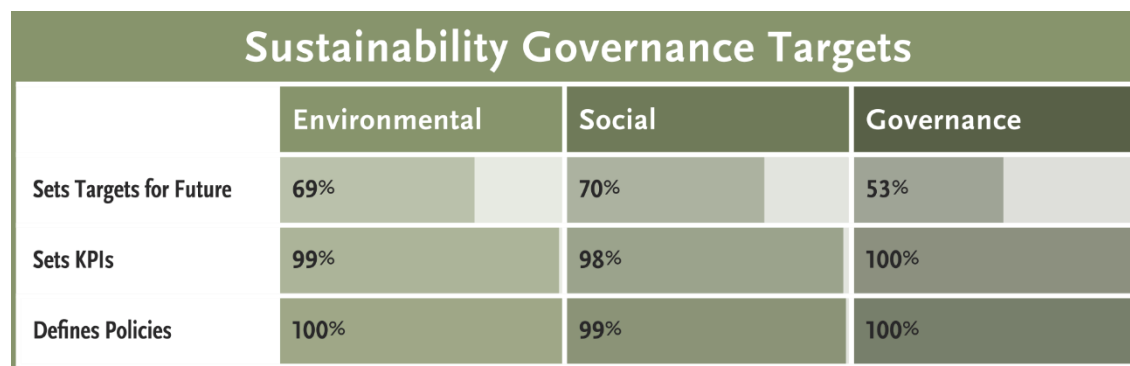
The SG Scorecard has Two Key Conclusions

There is a **significant room for improvement** in the effectiveness of execution and accountability of the sustainability programs of even the leading companies, let alone the large number of enterprises all around the world.

There are **extensive peer-to-peer learning opportunities** based on good practices shared by the GSLs on how they approach their sustainability efforts.

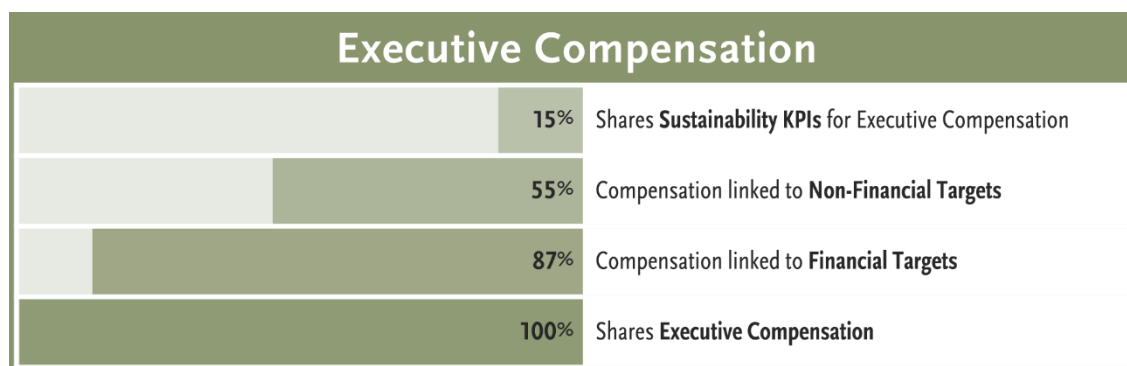
A Closer Look at the Results of the SG Scorecard

- 1 License to operate in today's world requires responsible leadership – companies who actively manage sustainability benefit both the company and the society. Our research shows that leaders in this arena have successfully integrated policy, KPIs, and results coverage to include environmental, social, and governance issues. To move forward, companies will have to **adopt a data-based management approach to sustainability through**:
 - **Showing commitment by setting and publicly sharing targets for environmental, social, and governance (ESG) related outcomes:** Among the Global Sustainability Leaders only 69%, 70%, 53% set targets for ESG, respectively.



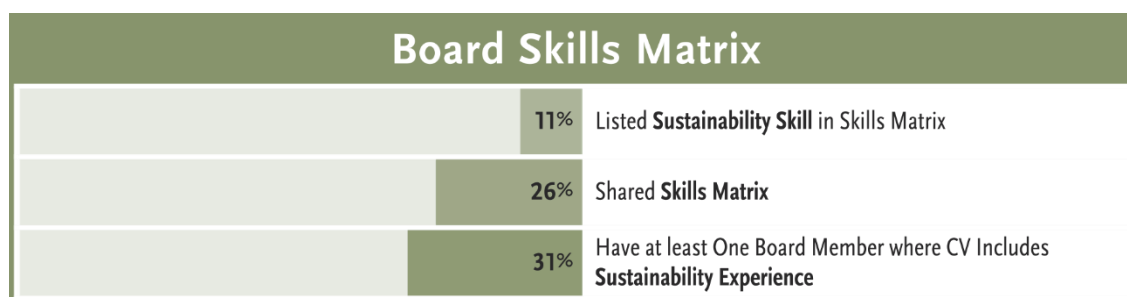
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- **Aligning management incentives with sustainability targets:** We find that **only 15%** GSLs link executive compensation to sustainability targets.



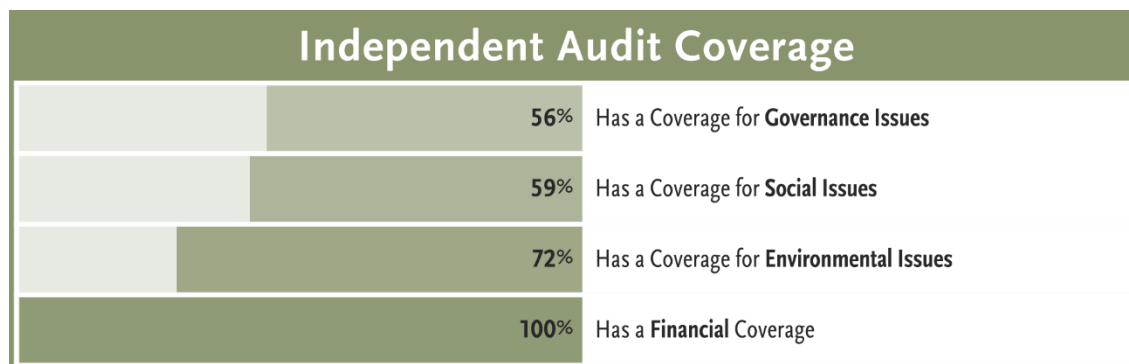
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- 2 Board Leadership** in leading change in sustainability is the key and there is room for improvement in ensuring **the right people and processes** are in place for managing sustainability:
- **Board skills in sustainability need to be developed and assessment of skill combination, as well as diversity, is required to address today's complex challenges:** We find that only 26% of the companies in our sample reported a board skills matrix, and **only 11%** of companies identified sustainability as a required board member skill.



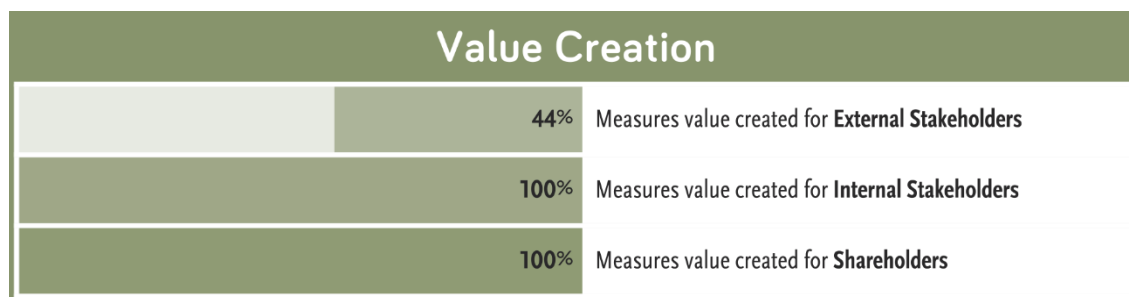
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- **Oversight over material issues should include environmental, social, and governance areas as well as supply chain:** We find that all of the companies analyzed have an independent audit for financial results, but independent audit coverage for environmental, social, and governance issues are 72%, 59%, 56% respectively, and only 48% for supply chain.



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- 3 Stakeholder Engagement needs to take a central position and companies should proactively integrate external stakeholders – especially communities and the environment – into their value creation model:** We find that all the companies analyzed measure value for internal stakeholders, but only 44% for external stakeholders.

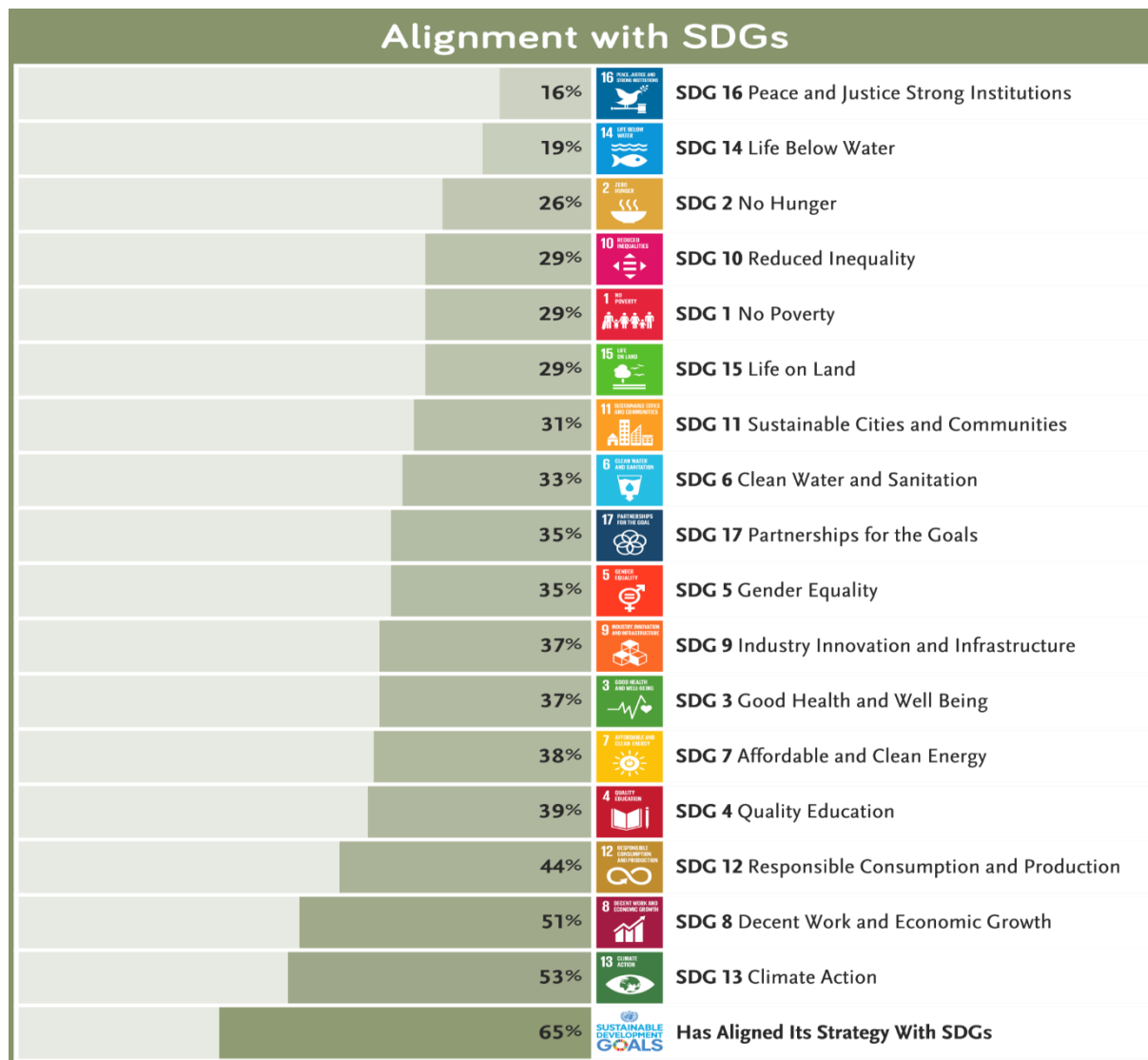


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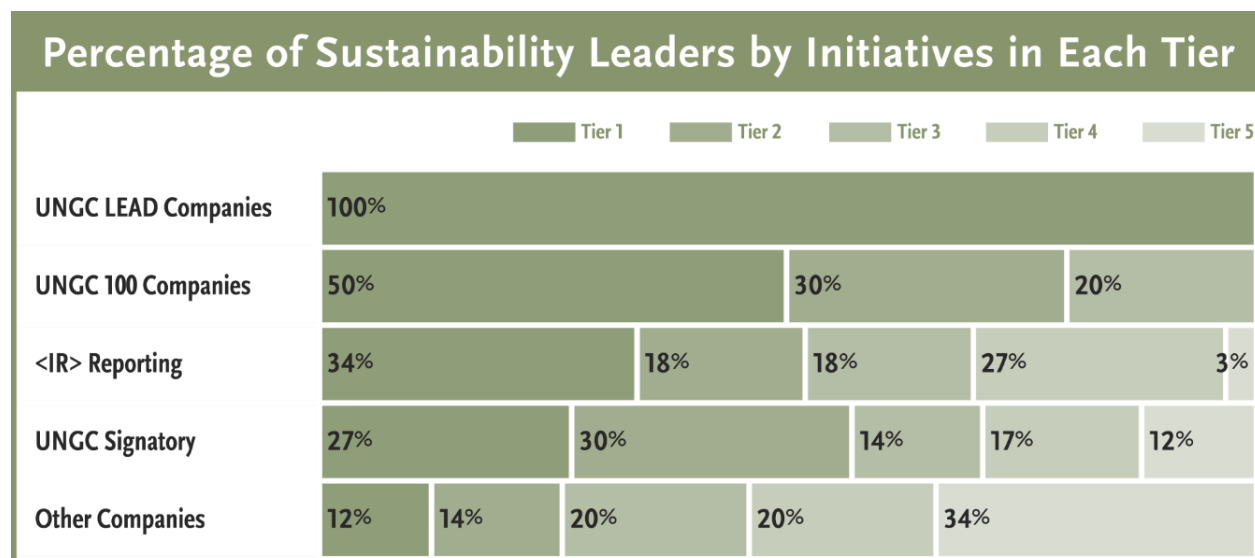
- 4 Aligning incentives with the world we want in the future requires changes in the overall taxation, incentives, and regulatory system. For this system change, Global Sustainability Leaders (GSLs) need to take leadership:** We find that companies tend to prioritize SDGs that align with their core business model, rather than taking an all-encompassing approach to creating the right climate and environment for sustainable development. Going forward, the companies should:

- **Link their strategies to the SDGs to mobilize resources, manage risk and effectively communicate the company's contribution to sustainable development:** Currently, **only 65%** of Global Sustainability Leaders link their strategy to SDGs. We find that GSLs have embraced the global climate change agenda (52% of GSLs linked SDG 13: Climate Change) to their strategy and that SDG engagement is higher for SDGs that are actionable within their business models – SDG 8: Decent Work and Economic Growth (51%) and SDG 12: Responsible Consumption and Production (44%).
- **Increase action and partnership around creating the right climate for sustainability through institution building:** We find that engagement of GSLs with SDG 16: Peace and Justice Strong Institutions is **only 16%**. Promoting the rule of law; fighting corruption, bribery, and organized crime; protecting fundamental freedoms and non-discriminatory laws and policies; and in short ensuring

responsive, inclusive, participatory, and representative decision-making at all levels (good governance) should be a priority of not only all citizens, but particularly the business leaders as well.



- 5 Integrated reporting** is a holistic tool to help companies tell the story of how they create value now and in the future. Companies should **adopt transparency in reporting practices and can use Integrated Reporting as a transformative tool for continuously getting better at managing sustainability**. We find that companies embracing the UN Global Compact and the Integrated Reporting (<IR>) Framework seem to have better chances of incorporating sustainability into their culture by providing better governance of their sustainability efforts. Among the GSLs, all UNGC LEAD Companies are Tier 1, and 80% of UNGC 100 Companies and 52% of <IR> Reporting are in Tier 1 or Tier 2, whereas only 12% of UNGC Signatories 12% and 3% of <IR> Reporting companies are in Tier 5.



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The SG Scorecard Provides Peer-to-Peer Learning Opportunities

Our research shows that there are extensive **peer-to-peer learning opportunities** based on good practices shared by the GSLs on how they approach their sustainability efforts. These examples cover the following areas and are presented in our report.

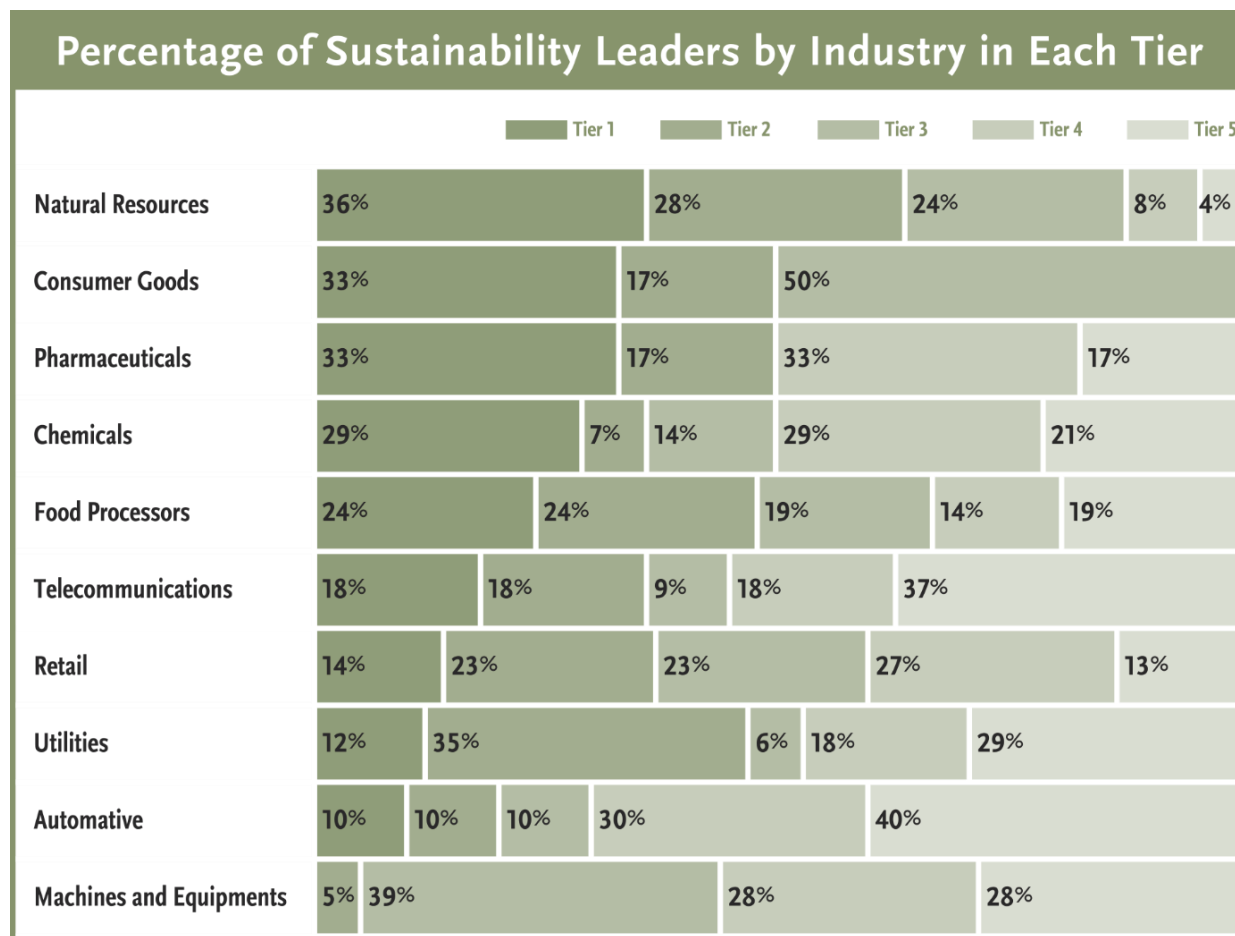
We find that best-in-class companies:

- Integrate sustainability into their core **value creation model** and lead the way in extending their strategy and management beyond pure financial outcomes, to encompass environmental, social, and governance-related factors that are critical for the future viability of their organizations;
- Understand that **engaging stakeholders** is key to obtaining the social license to operate in the 21st century and engage openly with stakeholders, including their communities;
- Conduct **materiality analysis** to gather insight on the relative importance of environmental, social, and governance issues to not only prioritize their sustainability effort, but also to inform sustainability reporting and communication with stakeholders;
- Ensure that their boards are fit to drive change towards a sustainable business by having **diverse boards** (age, tenure, gender, ethnicity, cultural background, geographic, functional, and industry experience);
- **Show commitment by setting targets** for sustainability performance and report their targets by geography;
- **Align incentives** by including **sustainability KPIs** in executive compensation;

- Ensure **comprehensiveness of policy and implementation** throughout the value chain including the supply chain, the product lifecycle, all stakeholder groups, all levels of the organization as well as geographic coverage and reporting of sustainability performance;
- Ensure **board oversight responsibilities** cover environmental, social, and governance issues which are core to sustainable value creation;
- Establish a **learning loop for continuous improvement** and create a climate of learning with measurable indicators (trends, benchmarking).

To move toward a more sustainable future, we need to have organizations that assume their sustainability responsibilities and act on them. Corporations – with their resources, efficiency, innovation capabilities, and access to talent – have the opportunity to be at the forefront of this change. To achieve this, boards of directors need to embark on a broad transformational change journey and lead the way in re-evaluating their traditional performance models and challenging the long-term viability of their prevailing definitions of how they contribute to a better future for the world.

Industries with longer term investment horizons (natural resources), those who are closer to the sensitivities of the general public (consumer goods) or more tightly regulated (pharmaceuticals and natural resources) tend to provide better governance over sustainability issues.



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The Sustainability Governance Scorecard® could be utilized by many stakeholders including boards and managements of companies, investors, regulators, civil society organizations, academia, and the representatives of the press for peer learning, identifying good examples, improving accountability and investment decisions.

In summary, we hope to improve the state of the world through the SG Scorecard by:

- Motivating the business world to act for a more **sustainable future** by highlighting good practices and providing benchmarking information, thereby assist **better deployment of good practices** throughout the business world;
- Contributing to more useful **reporting of material non-financial performance** information by highlighting processes and measurement tools for ESG issues across different time horizons, thereby contributing to the utilization of these metrics in assessing long-term enterprise value;
- Increasing **transparency, clarity**, and **consistency** of sustainability performance measurement and integration of a data-based approach to decision-making;
- Assisting NGOs, regulators, international organizations and other stakeholders to better **understand the state of the world** with respect to where we are in terms of **responsible leadership** for a better and more sustainable future;
- **Raising awareness and enable collective action on SDGs** by assessing which SDGs are prioritized by the business world, which ones are lagging, and sharing best examples on how to link SDG goals to strategy, how to set targets and how to mobilize relevant stakeholders for action.

For further information and good examples from Global Sustainability Leaders¹, please visit the Sustainability Governance Scorecard's website: sgscorecard.argudenacademy.org

¹ Global Sustainability Leaders are 150 leading public companies that are part of the Sustainability Indices (Dow Jones Sustainability Index, FTSE4GOOD, STOXX, BIST Sustainability Index, FTSE/JSE Responsible Index, Hang Seng Corporate Sustainability Index, and SSE Sustainable Industry Index) trading at key stock exchanges which are signatories of the Sustainable Stock Exchanges initiative (namely, China, Germany, South Africa, Türkiye, United Kingdom, and United States of America) and in 10 sectors: Automotive, Chemicals, Consumer Goods, Food Processors, Machinery & Equipment, Natural Resources, Pharmaceuticals, Retail, Telecommunications, Utilities. The list is provided on the next page.