



## The Bulletin

*Protiviti's Review of Corporate Governance*

### Sustainability: The What, Why and How

The oft-discussed topic of sustainability conjures up different images for different people in different sectors. As discussions of sustainability move beyond financial performance, they tend to spawn divergent views. Many frame the term as what constitutes responsible behaviour in driving continued development and growth without deteriorating the environment, depleting natural resources, or creating conditions that destabilise the economy and vital social institutions.

When it comes to sustainability, there are several important realities:

- The topic is no longer a “tree hugger” fringe concept, as many directors and senior executives believe it is inevitable and, of necessity, strategic. However, some constituencies prefer to embrace the traditional view of the corporation and remove external stakeholders, the environment and social considerations altogether to focus solely on the sustainability of the business and its profits.
- Reasonable people can differ in their views as to the appropriate sustainability objectives for the enterprise, based on its industry, stakeholder interest and long-term outlook, as well as the time frame in which the entity should pursue those objectives.
- A meaningful impact is only possible through the collective efforts of multiple constituencies in the private sector, sound policies in the public sector, cross-border global cooperation and investors committed to the sustainability agenda.

In this issue of *The Bulletin*, we discuss sustainability — what it is and why it's important, and the obstacles to achieving it. We also present some options organisations have for integrating sustainable development into the business.

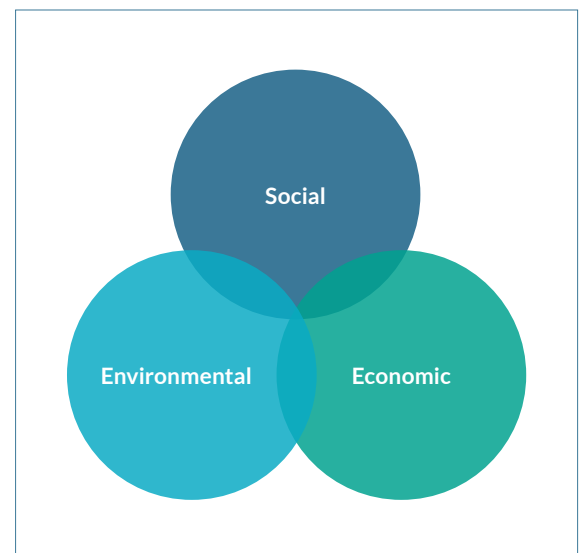
## Evolution of Sustainability

The focus on sustainability has evolved over several decades. It began in the United States in the early 1970s, for example, when an environmental regulatory framework was legislated to combat formidable health and environmental problems arising from post-World War II industrial activity. That framework mandated certain standards and banned certain chemicals to position pollution prevention as a significant opportunity for intertwining environmental and business agendas.

On a global basis, incidents such as the industrial waste contamination of Love Canal in New York (1978); the partial meltdown of a nuclear reactor on Three Mile Island in Pennsylvania (1979); the Bhopal, India, methyl isocyanate (MIC) gas leak (1984); the Chernobyl, Ukraine, nuclear disaster (1986); and the Exxon Valdez oil spill in Alaska's Prince William Sound (1989) each served as notice of the value of effective preventive measures in addressing ecological concerns. Continued population growth, the accelerating pace and scale of industrialization, and scientific discoveries fueling debate regarding pollutants, waste disposal challenges and greenhouse gases have increased pressure for regulatory action and corporate social responsibility.

In 1992, the United Nations (U.N.) facilitated ratification of an international environmental treaty at the Earth Summit in Rio de Janeiro. Subsequent multilateral agreements followed, including the Kyoto Protocol in 1997 and the more recent Paris climate accord in 2016. When the CEOs of many companies, including oil companies, expressed disappointment in President Donald Trump's decision in 2017 to withdraw from the Paris accord, it sent a clear signal that the business community views sustainability as an important imperative.

According to one source, sustainable development is the discipline of meeting the needs of the present without compromising the ability of future generations to meet their respective needs.<sup>1</sup> Sustainability extends beyond the environment to include economic and social dimensions. For example, the U.N.'s 2005 World Summit concluded that it is necessary to integrate "three components of sustainable development — economic development, social development and environmental protection — as interdependent and mutually reinforcing pillars."<sup>2</sup> Sometimes referred to as EES, these pillars are often depicted in a Venn diagram of overlapping circles (shown below) to accentuate that they are inextricably tied to each other over the long term, representing the so-called "triple bottom line."



Over the past 30 years, hundreds of voluntary standards pertaining to specific environmental, social, ethical or safety issues have been developed, with support from a broad range of stakeholders and experts in various sectors and domains. Many of these standards were developed due to consumer demand and pressure from nongovernmental organisations (NGOs) funded to deal with specific areas of concern or abuse. Companies have often

<sup>1</sup> This definition is sourced from the International Institute for Sustainable Development's website: [www.iisd.org/topic/sustainable-development](http://www.iisd.org/topic/sustainable-development).

<sup>2</sup> 2005 World Summit Outcome, General Resolution 60/1 of the U.N. General Assembly, October 24, 2005, paragraph 49: [http://data.unaids.org/topics/universalaccess/worldsummitoutcome\\_resolution\\_24oct2005\\_en.pdf](http://data.unaids.org/topics/universalaccess/worldsummitoutcome_resolution_24oct2005_en.pdf).

adopted standards to evidence the performance of their organisations or products in addressing specific issues. In some cases, the evidence is manifested through certifications from third parties to provide assurances to current and prospective customers and advocacy groups.

Meanwhile, the concept of selective investing — environmental, social and governance (ESG) — evolved, influencing how asset managers and long-term investors analyze investment alternatives and manage investment portfolios. For example, the global rejection of apartheid initiated mass disinvestment in the 1980s from many South African companies to pressure the regime in the interests of social justice. Over time, environmental groups and institutional investors managing huge portfolios have collaborated to address issues such as climate change, water scarcity, pollution and human rights abuses by advocating change and redirecting capital flows to drive focus on solutions and accountability for results.

Ultimately, with the turn of the new century, the so-called “responsible investor” concept emerged. ESG offers a set of standards for a company’s operations that socially conscious investors use to evaluate investment alternatives. The criteria related to environmental issues examine how a company performs as a steward of the natural environment in which it operates. Social criteria examine how a company manages relationships with its employees, suppliers, customers and the communities where it operates. Governance deals with a company’s leadership, executive pay, audits, control environment and shareholder rights.<sup>3</sup>

As professionally managed funds deploying ESG factors to screen investments have increased assets under management into the trillions of dollars,<sup>4</sup> directors and executives have taken notice. For example, Vanguard issued last year an open letter addressed to directors of all public companies calling on U.S. companies to improve their governance practices and outlining factors that were increasingly important in its evaluation of such practices, including those related to diversity and climate issues.<sup>5</sup> This year, BlackRock issued a letter to chief executives calling for a “positive contribution to society” beyond financial performance in realising their organisation’s full potential, with emphasis on “understand[ing] the societal impact of [their] business as well as the ways that broad, structural trends — from slow wage growth to rising automation to climate change — affect [its] potential for growth.”<sup>6</sup> As these demands increase, so will the requests for increased transparency through better reporting.

With examples of bad corporate behaviour during the Enron era at the beginning of the 21st century, reckless risk-taking precipitating the 2007–2008 financial crisis, catastrophic cyber breaches, egregious violations of laws and regulations, and disregard of safety considerations in addressing cost and schedule pressures, governance — the “G” in “ESG” — has emerged as a significant differentiator and, in some cases, a make-or-break factor for investors. As important as these matters are, they’re mere table stakes. The focus on sustainability raises the bar further, with the BlackRock letter calling for a “new model for corporate governance.”

<sup>3</sup> “Environmental, Social and Governance (ESG) Criteria,” Investopedia: [www.investopedia.com/terms/e/environmental-social-and-governance-esg-criteria.asp](http://www.investopedia.com/terms/e/environmental-social-and-governance-esg-criteria.asp).

<sup>4</sup> “The Results Are In: Sustainable, Responsible, Impact Investing by U.S. Asset Managers at All-Time High — \$8 Trillion!” by Hank Boerner, Governance & Accountability’s Sustainability Update blog, November 16, 2016: <http://ga-institute.com/Sustainability-Update/2016/11/16/the-results-are-in-sustainable-responsible-impact-investing-by-u-s-asset-managers-at-all-time-high-8-trillion/>.

<sup>5</sup> “Vanguard Calls for More Diverse Corporate Boards, Better Climate-Change Disclosures,” by Ryan Vlastelica, *MarketWatch*, September 1, 2017: [www.marketwatch.com/story/vanguard-calls-for-more-diverse-corporate-boards-better-climate-change-disclosures-2017-08-31](http://www.marketwatch.com/story/vanguard-calls-for-more-diverse-corporate-boards-better-climate-change-disclosures-2017-08-31).

<sup>6</sup> “A Sense of Purpose,” Larry Fink’s Annual Letter to CEOs, BlackRock, Inc., January 16, 2018: [www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter](http://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter).

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*“Responsible investment ... explicitly acknowledges the relevance to the investor of environmental, social and governance factors, and of the long-term health and stability of the market as a whole. It recognises that the generation of long-term sustainable returns is dependent on stable, well-functioning and well-governed social, environmental and economic systems.”<sup>7</sup>*

## Why ESG Is Important

ESG criteria have evolved into an investment methodology that embraces sustainability factors as a means of identifying companies with superior business models — offering added insight into the quality of a company’s management, culture, strategic outlook, risk profile and other characteristics.<sup>8</sup> But there are other reasons why ESG is important. For example:

- Younger generations place high importance on sustainability issues. Millennials, for example, are an optimistic generation that is ready to solve problems to make the world a better place. Tapping into that entrepreneurial spirit is smart business — and essential to talent acquisition and retention. In fact, a recent survey noted that 56 percent of public company directors believe that a corporate social responsibility policy increases a company’s ability to attract and retain employees.<sup>9</sup>
- Deploying cost-effective technologies to increase process efficiencies and develop environmentally friendly products and services has become attractive in most sectors.
- While the road ahead is long and littered by brutal politics and more questions than answers, world opinion has been coalescing around achieving the goal of sustainable development.

Since the start of this century, closer attention is being paid to the correlation between ESG performance and financial performance. There are several reasons why:

1. Environmental issues have had a more direct impact on the perception that customers, shareholders and other stakeholders have of the value businesses create; they now associate a company’s environmental performance with reputation, brand image and long-term viability. That perception extends beyond an organisation’s boundaries to encompass its supply chain and distribution channels.
2. Globalisation, increased competition for natural resources and growing concern over carbon emissions have increased calls for transparency into company sustainability performance related to energy use, waste use, pollution, natural resource conservation, and management of environmental risks that might generate significant liabilities. For example, beverage manufacturer Coca-Cola has established a goal of improving water efficiency in manufacturing operations by 25 percent by 2020 compared with a 2010 baseline.<sup>10</sup>
3. The impact of catastrophic incidents involving oil spills, hazardous waste, toxic emissions, environmental compliance, plant explosions, and public and employee health and safety is immediate. The headline effect is persistent in the communities affected by

<sup>7</sup> “The Value of Responsible Investment: The Moral, Financial and Economic Case for Action,” University of Cambridge Institute for Sustainability Leadership, 2014, page 7: [www.cisl.cam.ac.uk/publications/publication-pdfs/ilg-the-value-of-responsible-investment.pdf](http://www.cisl.cam.ac.uk/publications/publication-pdfs/ilg-the-value-of-responsible-investment.pdf).

<sup>8</sup> “What Is ESG?” Pax World: <https://paxworld.com/sustainable-investing/what-is-esg/>.

<sup>9</sup> “The ROI of Corporate Social Responsibility,” by Melanie C. Nolen, Corporate Board Member, 2018: <https://boardmember.com/the-roi-of-corporate-social-responsibility/>.

<sup>10</sup> “Improving Our Water Efficiency,” Water Stewardship & Replenish Report, August 16, 2017, The Coca-Cola Company: [www.coca-colacompany.com/stories/setting-a-new-goal-for-water-efficiency](http://www.coca-colacompany.com/stories/setting-a-new-goal-for-water-efficiency).

- these incidents. Public awareness of these issues has matured and expectations of prevention and reductions have increased substantially.
4. Human rights abuses, child labour, dangerous working conditions and harassment cultures are not tolerated in substantially all boardrooms and, once disclosed, impair reputation in the investor community. Customer awareness of environmental and social issues is increasing. Yes, consumers may want high-quality products at the lowest possible price. But do they want to buy jewelry made with conflict diamonds? Do they want clothing, shoes and technology made by people working long hours for meager pay in inhumane sweatshops with physically and psychologically unhealthy conditions — a supply chain “strategy” to significantly reduce production costs by exploiting millions of people in developing countries? Do they want products manufactured with slave labour? For most consumers, the more aware they are of these issues, the more likely they will answer “no” to such questions.
  5. Often considered as one-off incidents 20 years ago, corruption and bribery, financial reporting irregularities, violations of laws and regulations, and unethical and irresponsible business behaviour are now viewed as evidence of a flawed culture and governance failure. Plausible deniability is no longer effective as the cover it used to be. Violations of the rules of fair play and responsible stewardship and failure to treat people right are noticed — first by employees, next by customers and suppliers, and ultimately, by investors, regulators and the public.
  6. The focus on diversity and inclusion has emerged as a legitimate issue. If the talent pool and the customers served are diverse, wouldn't a diverse workforce be more qualified, creative, innovative and loyal? As the research continues to demonstrate the link of diversity and inclusion to superior performance, this question has evolved from the theoretical to the highly practical/relevant to a mission-critical imperative.
  7. During a roundtable session Protiviti conducted at a National Association of Corporate Directors (NACD) event with active directors in 2017,<sup>11</sup> attendees raised concerns about environmental issues, income inequality, student debt levels, pay-for-performance and public policy decisions that may create potential talent and labour shortages. With the digital revolution that is enabled by cloud technology, big data analytics, robotics, machine learning and artificial intelligence changing the future of work, the debate rages as to what will happen to jobs as the physical economy transitions to the virtual economy.<sup>12</sup> The culmination of these issues forces a broader question as to whether there needs to be new thinking about the role of business in economic and social development.
- In summary, sustainability is not just another trend or buzzword, nor is ESG another forgettable acronym. The world is changing and with change comes more demanding expectations from investors seeking socially responsible behaviour and increased oversight by executives and boards. As its nexus with financial performance increases, ESG performance sets a high bar for companies accountable for delivering acceptable returns to shareholders.

<sup>11</sup> “Geopolitical and Regulatory Shifts,” *Board Perspectives: Risk Oversight, Issue 96*, Protiviti, October 2017: [www.protiviti.com/US-en/taxonomy/term/3566](http://www.protiviti.com/US-en/taxonomy/term/3566).

<sup>12</sup> “Where Is Technology Taking the Economy?” by W. Brian Arthur, *McKinsey Quarterly*, October 2017: [www.mckinsey.com/business-functions/mckinsey-analytics/our-insights/where-is-technology-taking-the-economy](http://www.mckinsey.com/business-functions/mckinsey-analytics/our-insights/where-is-technology-taking-the-economy).

As companies become more innovative, agile and strategic in their approach to integrating the two, breakthroughs emerge in process design and new products and services that open new markets.

## Obstacles to ESG Initiatives

For companies committed to integrating ESG with financial performance, there are obstacles to overcome. First and perhaps foremost is that, notwithstanding the growing body of evidence that responsible investment strategies translate into outperformance, there is a view on the part of more than a few constituencies that such investments are incompatible with positive returns. Therefore, they may constitute neglect of fiduciary duty.<sup>13</sup>

A second challenge is related to the first: deciding the nature of the ESG performance objectives relevant to the organisation, given its unique circumstances. A related point is the feasibility of what can be accomplished, considering the available technology and extent of collaboration, or lack thereof, between the public and private sectors.

At the NACD roundtable referred to earlier, several directors expressed concern over the short-termism “inside the beltway” of Washington, D.C. The type of short-term thinking applied when formulating policy and the kinds of long-term thinking driving sustainability discussions are like mixing oil and water. In business, short-termism on the part of senior management is also a sustainability killer. Simply stated, sustainability requires a long-term outlook in both the private and public sectors. Without that, the sustainability discussion is over before it begins.

Another key point: Sustainability performance without acceptable financial performance is unsustainable. While sustainability leads to corporate performance being inclusive of ESG performance, poor financial performance is a nonstarter. Therefore, ESG performance must be integrated with — and is not a substitute for — financial performance.

Then there is the so-called “time horizon disconnect” that drives a powerful wedge in the dialogue. Sustainability proponents want immediate action and an aggressive pursuit in implementing that action. Business leaders must deal with financial and resource constraints. Strategists and policymakers must balance the two.

Finally, the strategy taken by investors in this age of sustainable development is challenging perceptions of the role of the corporation in society. What is the role of business in tackling governance and sustainability challenges? Where is the line drawn to balance ESG and financial performance, and how do organisations orchestrate the culture and discipline toward achieving that balance? What is the role of strategy in melding the two and, in doing so, what fundamental changes are needed in strategy-setting and traditional mindsets for managing the business to make it happen? These and related questions around sustainability require serious reflection for executive management and the board to formulate a clear vision for the path forward. As noted earlier, reasonable people can reach different answers in charting the road map forward.<sup>14</sup>

<sup>13</sup> “Mainstream Slow to Accept Benefits of Responsible Investment,” by Fiona Reynolds, *Financial Times*, November 15, 2014: <https://www.ft.com/content/a8e2d2c6-69b8-11e4-8f4f-00144feabdc0>.

<sup>14</sup> “Corporate Strategy in the Age of Sustainability,” by Ioannis Ioannou, *The Guardian*, April 29, 2013: [www.theguardian.com/sustainable-business/blog/corporate-strategy-sustainability-trend](http://www.theguardian.com/sustainable-business/blog/corporate-strategy-sustainability-trend).

## The ESG Continuum

A company's commitment to sustainability and ESG issues might seem self-serving if it is pursued in the interests of the enterprise's long-term survival. That said, the real objective of sustainable development is to extend the life expectancy of ecosystems, societies and economies through collaboration with other organisations — for profit and not-for-profit, in the private and public sectors, and across borders on a global scale. That means sustaining the natural resources, cultures and communities that enable commercial activity, and the governance structures and financial and other markets essential for corporate competition and viability. The question is: What does the organisation do about sustainability?<sup>15</sup>

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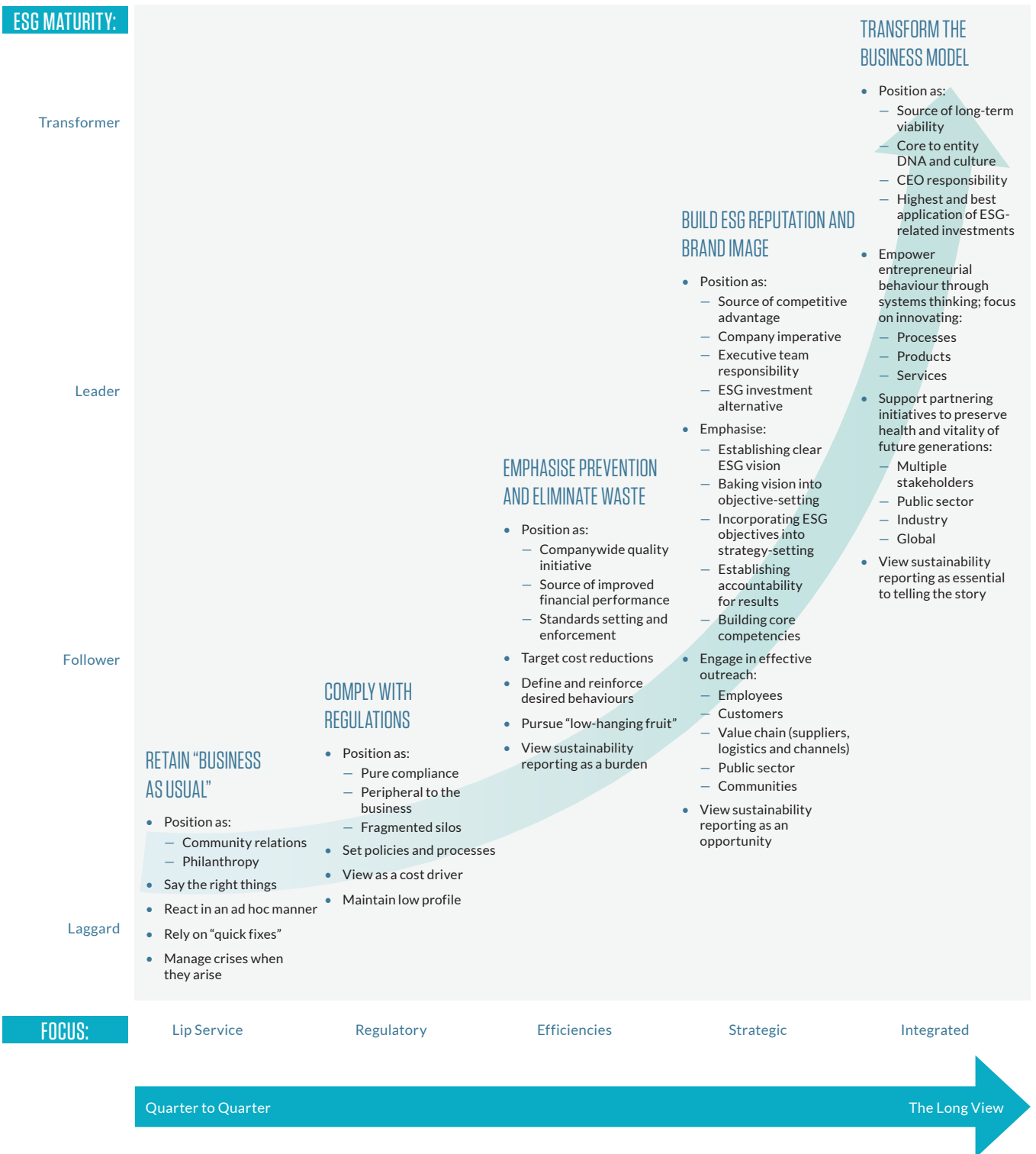
Every organisation needs to answer this question based on the nature of its industry, culture, markets, stakeholder priorities, regulatory environment, appetite to lead and invest, intrinsic challenges from an execution standpoint, and long-term outlook. With that in mind, below is an approach for management to consider:

- **Articulate sustainability guiding principles and core values** — Clarify directionally what the company wants to accomplish from a sustainability standpoint to drive strategy-setting and internal and external communications.
- **Assess current ESG performance** — Identify areas where management sees the most opportunity for impact.
- **Conduct an assessment of opportunities and risks** — Considering the current ESG performance, assess the upside of taking steps to improve performance against the risks associated with inaction.
- **Assess the organisation's sustainability infrastructure** — Understand and evaluate the effectiveness of the current policies, processes, organisational structure, reporting, methodologies and systems supporting the pursuit of sustainability objectives.
- **Formulate a sustainability strategy** — Based on the guiding principles and core values and the assessment of opportunities, risks and current sustainability infrastructure, define a road map of key initiatives for accomplishing sustainability objectives. Formulate the strategy to execute the initiatives outlined in the road map.
- **Establish accountability for results** — Set targets, assign executive sponsorship, define initiative ownership and specify the appropriate performance metrics. Integrate ESG performance monitoring with financial and operational performance monitoring and the reward system.
- **Establish disclosure controls and procedures** — Establish the appropriate controls and procedures to ensure reliable internal and external ESG reporting.

Every organisation is different. Accordingly, management and the board must decide the level of ESG maturity at which the organisation will operate. The continuum on the following page illustrates alternative stages of maturity depending on management's focus.

<sup>15</sup> *The A to Z of Corporate Social Responsibility*, by Wayne Visser, Dirk Matten, Manfred Pohl and Nick Tolhurst, John Wiley & Sons, 2010, page 115.

• • • Environmental, Social and Governance (ESG) Continuum



*The real objective of sustainable development is to extend the life expectancy of ecosystems, societies and economies through collaboration with other organisations – for profit and not-for-profit, in the private and public sectors, and across borders on a global scale.*



Today, engaging in *lip service* to say the right things and focus primarily on philanthropy and community relations seems way behind the realities of the times. Laggards who don't "walk the talk" eventually get exposed and pay the price of reputation loss and brand erosion.

*Regulatory* compliance is a positive development. But it's driven more from the risk perspective and leads to follower positioning from a sustainability standpoint. That may be the baseline or foundation on which many organisations start building their strategy for success.

*Efficiencies* are a higher level of focus that advances the organisation toward a leadership position. If the focus is on improving the cost-effectiveness of internal processes, it's a logical step because that tactic improves profitability. For example, computer manufacturers integrate alternative, recycled and recyclable materials into their product and packaging design, which reduces waste and operating costs. That is a solid efficiency play. However, an exclusive focus on operational efficiency objectives is not equivalent to a strategic approach to the market.

These same companies progress to a more *strategic* approach when they, in addition to improving the energy efficiency of their processes, offer services to help customers compute more while consuming less and design for end-of-life and recyclability. By making investments that enable customers to meet environmental, operational and financial goals, they advance their sustainability positioning to a leadership role by raising the table stakes for playing in the industry. That position is achieved by incorporating environmental and social objectives into strategy-setting in addition to financial objectives.

Finally, there is the rarefied air of the *integrated* stage that leads to transforming the business model. Embedding sustainability into strategy *and* product development to establish a sustainable business model increases both opportunity and risk. An integrated approach inevitably requires new talent, deploys new technologies, and coalesces sustainability and strategy to create the breakthrough innovations that sustain the business and maximise ESG *and* financial performance. A transformative approach to sustainability is a source of long-term viability, particularly if it offers technologies and services that address some of the world's challenges. Thus, the way the entity conducts business today carries with it a long view toward sustaining its future success, reputation and brand equity.

This discussion is strictly illustrative of the different stages along the ESG continuum. There are other ways to express sustainability maturity; this is just one. In practice, the continuum must be customised by sector.

## Sustainability Leaders

There are many examples of companies taking the lead in embracing sustainable development. Take the automotive industry. With demanding emissions standards set in China, Europe and the United States, and regulators considering timelines that could eliminate gasoline-powered vehicles within a generation, General Motors (GM), Ford, Volkswagen, Daimler and Volvo are among the automakers committed to converting their lineup to all-electric and hybrid vehicles. For example, GM announced plans in the fourth quarter of 2017 to offer 20 new all-electric models by 2023, including two within the ensuing 18 months.<sup>16</sup> The following day, Ford announced

<sup>16</sup> "GM and Ford Lay Out Plans to Expand Electric Models," by Bill Vlasic and Neal E. Boudette, *The New York Times*, October 2, 2017: [www.nytimes.com/2017/10/02/business/general-motors-electric-cars.html](http://www.nytimes.com/2017/10/02/business/general-motors-electric-cars.html).

a plan to invest US\$4.5 billion over five years with the objective of adding 13 electric models to their offerings.<sup>17</sup> These companies have signaled their commitment to drive increased usage and acceptance of electric vehicles, even though current sales of such vehicles, along with plug-in hybrids, amount to only 1 percent of the market.

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This accelerated pace of development is integrated with plans for building fleets of autonomous vehicles for ride-hailing services to achieve a world described by the GM chief executive as “zero crashes, zero emissions and zero congestion.”<sup>18</sup> To refer to this vision as a major departure from the status quo is an understatement. The current lack of a definitive time frame reflects the reality that no one really knows how the future will evolve, including how the regulatory environment and consumer tastes and demand might change. But auto-makers are making some big bets.

According to reports from both Glass Lewis and Ceres, more companies — particularly, utilities and industrials — have started linking ESG performance to executive

compensation. While this linkage is most often focused on goals driven by compliance with laws and regulations, some leaders focus on other sustainability targets. For example, aluminum manufacturer Alcoa ties a portion of executive cash compensation to ESG stewardship, including voluntary greenhouse gas (GHG) emissions reductions, energy efficiency and diversity goals. Energy company Exelon offers its executives a “long-term performance share award” for achieving nonfinancial performance goals, including safety targets, GHG emissions reduction targets and stakeholder engagement goals in shaping public policy. Metrics and monitoring tied to the reward system lift the focus on sustainability goals from a silo mentality to a cross-organisational priority.<sup>19</sup>

Another example of a leader is General Mills. The food company recently released a set of sustainable sourcing commitments that began with a robust risk assessment process to prioritise 10 commodities representing 50 percent of its total raw material purchases, including oats, wheat and corn, that it plans to source sustainably by 2020.<sup>20</sup> With respect to social issues, Johnson & Johnson, which manufactures medical devices, pharmaceuticals and consumer packaged goods, applies a detailed policy that incorporates various human rights declarations to all of its workplaces, including its overseas operations and supply chain.<sup>21</sup>

<sup>17</sup> “Ford Reveals Its Electrification Plans,” by Patrick Olsen, *Consumer Reports*, October 3, 2017, [www.consumerreports.org/ford/ford-announces-electric-car-plans/](http://www.consumerreports.org/ford/ford-announces-electric-car-plans/).

<sup>18</sup> “Zero Crashes, Zero Emissions, Zero Congestion,” by Mary Barra, chairman and CEO of General Motors, LinkedIn, October 3, 2017: [www.linkedin.com/pulse/zero-crashes-emissions-congestion-mary-barra/](http://www.linkedin.com/pulse/zero-crashes-emissions-congestion-mary-barra/).

<sup>19</sup> “Why Most Companies Don’t Link ESG Performance to Executive Pay,” by Jessica Lyons Hardcastle, *Environmental Leader*, January 29, 2016: [www.environmentalleader.com/2016/01/why-most-companies-dont-link-esg-performance-to-executive-pay/](http://www.environmentalleader.com/2016/01/why-most-companies-dont-link-esg-performance-to-executive-pay/).

<sup>20</sup> “General Mills Commits to Sustainably Source 10 Priority Ingredients by 2020,” media release, General Mills, September 25, 2013: [www.generalmills.com/en/News/NewsReleases/Library/2013/September/sourcing\\_10](http://www.generalmills.com/en/News/NewsReleases/Library/2013/September/sourcing_10).

<sup>21</sup> “Statement on Human Rights,” Johnson & Johnson: [www.jnj.com/about-jnj/company-statements/statement-on-human-rights](http://www.jnj.com/about-jnj/company-statements/statement-on-human-rights).

These are but a few examples. They illustrate how companies are taking a lead role in making commitments to sustainable development on environmental, social and governance fronts.

## Sustainability Reporting and Disclosure

Organisations publish sustainability reports to disclose the economic, environmental and social impacts caused by the everyday activities of their businesses. A sustainability report also describes an organisation's values and governance model and evidences the extent of the link between the company's strategy and commitment to a sustainable global economy. There are a variety of sustainability reporting guidance materials supporting this reporting. This guidance is expected to drive more consistent and robust reporting by sector.<sup>22</sup>

Sustainability reports provide transparency and accountability to investors and stakeholders and help drive improvement of internal processes and market offerings. The discipline of sustainability reporting can help organisations measure and monitor performance against established economic, environmental,

social and governance goals. The increased transparency leads to better decision-making and a sharper focus on communicating with external stakeholders and advancing the organisation's maturity along the ESG continuum.

## Integration With Enterprise Risk Management (ERM)

The updated ERM Framework from the Committee of Sponsoring Organisations of the Treadway Commission (COSO)<sup>23</sup> offers a framework for incorporating environmental, social and governance objectives germane to an organisation's sustainability programme with other relevant business objectives.

The process of identifying, evaluating and managing risk (ERM) will likely surface sustainability opportunities and risks relevant to the organisation's prospects for success in the future. This process necessitates an assessment to ascertain which sustainability risks are material, thus driving more formal reporting and disclosure of them. That is why effective sustainability reporting and disclosure often begin with the broader ERM process.

<sup>22</sup> Major providers of sustainability reporting guidance include Global Reporting Initiative (GRI) Sustainability Reporting Standards, Organisation for Economic Co-operation and Development (OECD) Guidelines for Multinational Enterprises, ISO 26000, International Standard for Social Responsibility, and Sustainability Accounting Standards Board (SASB).

<sup>23</sup> "So, You've Implemented ERM? Take Another Look," *The Bulletin*, Volume 6, Issue 8, Protiviti, September 2017: [www.protiviti.com/US-en/insights/bulletin-vol6-issue8](http://www.protiviti.com/US-en/insights/bulletin-vol6-issue8).

## Summary

The premise underlying a corporate focus on sustainability is this: There is compelling evidence that humanity is living beyond its means potentially at the expense of compromising the welfare of future generations. That is an impossible nut to crack without corporate leadership. Ultimately, sustainability is about enhancing civilization's ability to address critical environmental, economic and social challenges and enabling the general welfare of present and future generations. Over the long run, it can ensure the future viability of the organisation.

Everything else being equal, ESG criteria offer powerful differentiators for screening

investments. Depending on the sector, they provide insight regarding opportunities for enhancing returns over the long term and the potential for increased future risk. A strong commitment to sustainability places an emphasis on actions, not words; on disruptive innovation, not "business as usual"; and, most importantly, on leadership, collaboration and transparency. Indifference to sustainability issues in business carries with it the risk of reputation damage, brand erosion, loss of talent, increased shareholder activism, business decline and, ultimately, business failure. Accordingly, sustainability issues are worthy of attention in both the C-suite and boardroom.

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