How Leadership Shapes Sustainability Governance

By Ron Soonieus , INSEAD

Amid regulatory and societal pressures to meet sustainability standards, strong personal leadership in the boardroom is needed to ensure competitive advantage and corporate longevity.

Driven by geopolitical uncertainty, trade risks and new technologies such as generative AI, the most profound business transformation in 50 years is underway. Alongside these factors, pressures from regulators and stakeholders are mounting around the reporting, transparency and accountability of companies’ social and environmental impacts.

The effects of regulatory requirements such as the **European Sustainability Reporting Standards**, which cover a full range of sustainability issues, including climate change, biodiversity and human rights, have a profound impact on organisations and their boards, according to recent global research I’ve done under the remit of the **INSEAD Corporate Governance Centre**, together with colleagues from BCG and Heidrick & Struggles.

In this year's survey, regulations stood out as a big driver for sustainability efforts at the board level. Specifically, 51 percent of global board directors surveyed said they are acting on sustainability because of legislative requirements. Also, 69 percent of respondents indicated that sustainability-related concerns will take up more of board directors' time.

Good news? Yes, to a certain extent. It means that boards are starting to pay serious attention to sustainability – a positive change from earlier research. However, while the rules and regulations serve a clear purpose, compliance alone does not guarantee the long-term success of a company.

That's where the shoe pinches. Boards continue to wrestle with integrating sustainability fully into company strategy. In our report titled "**The Role of the Board in the Sustainability Era**", 66 percent of global directors said that sustainability considerations should be fully integrated into business strategy. However, only 38 percent said that this is currently the case in the organisations they oversee.

Governance for sustainability

Board governance of sustainability involves **three distinct areas**. The most basic area is sustainability hygiene, which involves attention to sustainability-related matters including reporting, sustainability initiatives, data and stakeholder engagement. The next area of governance is controls and practices, which covers oversight of how the company is adopting controls and best practices to ensure the integrity of its sustainability journey. Finally, strategic reflection and implications is where boards should be focusing most of their time.

The strategic reflection area involves understanding how the world is changing, deciding what role the organisation should play in this changing world, and what that means to things such as the business and product portfolio. In this exercise, it's not sufficient to look at sustainably issues in isolation; they should be viewed in relation to trends such as generative AI, inflation and geopolitical shifts. The views and strategy arising from these reflections should then drive sustainability hygiene, controls and practices – not the other way around.

It is important to focus on all three areas because focusing only on compliance might lead companies to believe that by complying with sustainability regulations, sustainability is "done". As such, they may only work on incremental or operational improvements, or worse, become risk-averse and defensive.

Taking a strategic long-term perspective

In the evolving societal and business realities, sustainability can become a source of lasting competitive advantage and value creation. Boards have a key role to play in looking beyond the immediate horizon and ensuring sufficient weight is placed on making sustainability an integral part of strategy. In fact, the board provides the most value when it reflects and questions the status quo, presses management to reimagine the business, and stress-tests strategies for sustainable growth and new value creation.

Moving from the first two areas to strategic reflection demands critical thinking as well as taking tough and sometimes risky decisions – something that might not be straightforward for everyone. Venturing into an uncomfortable space requires a long-term view and personal leadership.

In addition to changing societal expectations, businesses ranging from producers to financial institutions are confronted with unconventional risks – such as water scarcity, flood and drought risks and crop failures – that are material to their business. Directors need new mechanisms in this increasingly complex world to pick up weak signals and identify emerging challenges. That is how they can tackle them effectively and turn them into competitive advantage.

When asked what is preventing board members from spending meaningful time on strategic thinking about sustainability, more than 72 percent of directors cited the need to devote time to other unrelated high-priority topics. Thirty-two percent said short-term sustainability matters take priority, while 35 percent don’t know enough about the long-term strategic implications of sustainability to have a meaningful discussion.

Fortunately, there are directors and organisations that have become very good at long-term planning. For instance, at the director roundtables we organised, we saw that companies that are asset-heavy and with long business cycles are naturally more accustomed to long-term thinking.

Modelling personal leadership

In practice, sustainability challenges such as balancing climate risks and energy needs, defining the role of business in regard to societal issues and responding to stakeholder capitalism are complex and often laden with contradictions. Moreover, in today's dynamic environment, directors increasingly must bridge the divide between a wide range of competing interests and demands and provide clear guidance on the tough choices faced by management.

In a case study on **Barry Callebaut** – currently the world's largest business-to-business (B2B) cocoa and chocolate company – my colleagues N. Craig Smith, Lisa Simone Duke and I detailed how its chairman, Andreas Jacobs, turned his dream for cocoa sustainability in West Africa into action. Driven by his desire to protect the livelihood of cocoa farmers, as well as safeguard the future of the company, he advocated a supply chain transformation towards more sustainable cocoa. Although his initial endeavour didn't seem to work, he did not give up. Eventually, he won the support of the board and the company introduced sustainability as its fourth strategic pillar.

Strong personal leadership not only by management, but also in the boardroom, is more important than ever. It firstly involves building confidence among stakeholders in the strategy of the board and its ability to make hard choices with the longer term in mind. Directors can enhance confidence through greater transparency, such as by explaining the rationale of their decisions to stakeholders. Second, it requires directors to bridge divisions that might emerge among stakeholders and society at large. To ensure a broad perspective in decision-making, the board needs to constantly listen to and engage with groups with a variety of viewpoints on critical issues.

Making a moral stand

Indeed, expectations of the role of business in society are shifting. Expectations to "do good" have been added to boards' traditional responsibilities of overseeing finances, managing risk and selecting leadership. But regulatory and societal pressures aside, there is a moral dimension to doing good.

Encouragingly, while 51 percent of global board directors said they are acting on sustainability because of legislative requirements and 41 percent said they are doing so due to expectations from investors, insurers and lenders, 52 percent said it was the "right thing to do".

But what is the right thing to do? In a recent case study on nutrition, health and bioscience company DSM, my colleagues N. Craig Smith, Lisa Simone Duke and I describe an example of doing the right thing and creating shareholder value at the same time.

In August 2017, Helen Mets joined DSM as president of their Resins and Functional Materials (DRF) business, a long-standing chemicals division of the group. Although DSM was transitioning to a 100 percent nutrition and bioscience-based company that focussed on nutritional products that are good for people, Mets found that DRF sold legacy products that contained potentially harmful chemicals.

When Mets proposed to phase out these chemicals, the board's first question was, "Is this a business we want to stay in?" Mets responded, "If not us, then who? There's nobody better positioned to address the issues. If we're a company that says we use our unique capabilities to address the big issues in the world, then this is one of our proof points. We are not moving the problem elsewhere, that's not why I joined DSM." The board signed off. It was a courageous plan, but the board agreed that to be a purpose-driven company, DSM needs to make difficult choices.

Path to sustainability

There is a clear path towards full integration of sustainability in the boardroom, as challenging as it may seem. First, governance can be sharpened by reevaluating board composition, using long-term perspectives to guide decision-making and increasing transparency on issues such as director selection and evaluation. Second, boards need to examine how sustainability will impact the business – from supply chain issues such as the scarcity of critical resources to exploring new business ecosystems for opportunities. Third, beyond governing, directors need to demonstrate strong leadership.

Transitioning a business to a fully sustainable model is complex and affects every aspect of the organisation. In an increasingly volatile business environment, there are tough, consequential decisions to be made and priorities to be set. To push through the transformation successfully, directors need to model personal leadership and courage as well as take a moral stand in providing clear guidance amid the complexity. As the DSM case clearly shows, it is possible to do good and do well at the same time.

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Corporate Governance

Established in 2010, the **INSEAD Corporate Governance Centre** (ICGC) has been actively engaged in making a distinctive contribution to the knowledge and practice of corporate governance. Its vision is to be the driving force in a vibrant intellectual community that contributes to academic and real-world impact in corporate governance globally.

The ICGC harnesses faculty expertise across multiple disciplines to teach and research on the challenges of boards of directors in an international context. The centre also fosters global dialogue on governance issues, with the ultimate goal of developing high-performing boards. Through its educational portfolio and advocacy, the ICGC seeks to build greater trust among the public and stakeholder communities, so that the businesses of today become a strong force for good for the economy, society and the environment.