The Sustainability Board Report

Family Business Special Report 2020

Executive Summary

Which trends and characteristics come to the fore when it comes to sustainability and corporate governance?

This question underpinned our analysis in developing the 2020 Sustainability Board Report (TSBR). It found that, although the prevalence of sustainability committees at the board level is increasing, the proportion of directors on sustainability committees with sustainability credentials remains staggeringly low: only 17%. One would expect more than one out five of the directors in a finance and audit committee to have expertise in finance. Why is that not the case for sustainability? Do certain types of company fare better?

New evidence suggests that family businesses do. Indeed, this Special Report finds that family-owned businesses, irrespective of their industry, are better equipping themselves for present and future challenges by staffing their boards with expertise and experience in sustainability – creating the foundation for robust long-term business strategies. As compared to the *Forbes Global 2000*[1] companies previously examined, the proportion of directors with sustainability credentials on sustainability committees in family-run businesses rises from 17% to 34%[2].

Discussions with seasoned board advisors and an analysis of the existing literature have yielded two potential reasons to explain this finding. First, family-owned businesses naturally care about the long-term. Sustainability is transformed from a buzzword to be sprinkled into annual reports to a principal fundamental to the ethos of the organisation. Second, because of their typically concentrated ownership structures, family businesses are better able to monitor and avoid opportunism by executives, which leaves space for longer-term strategic objectives like sustainability.

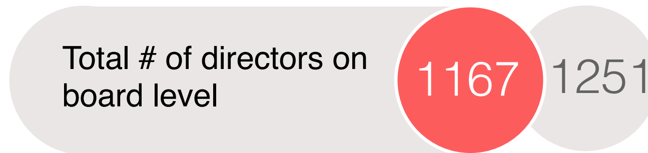
That said, there is no one recipe to be followed when it comes to sustainability. Having competent and experienced directors on sustainability committees does not, in itself, even begin to resolve the immense environmental, social and governance (ESG) challenges that businesses will face in the 21st century. These findings remain, however, significant and warrant further exploration and dissemination across the corporate governance world.

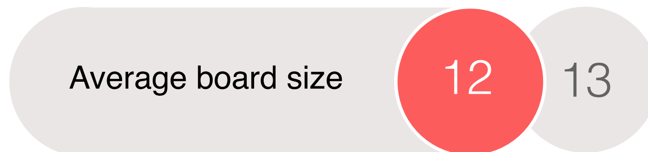
[1] The first 100 i.e. largest companies in the 2020 edition of the Forbes Global 2000 list, https://www.forbes.com/global2000/#2759ca99335d

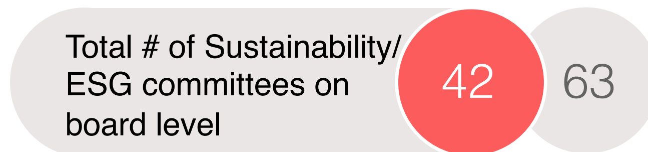
[2] See methodology on page 4

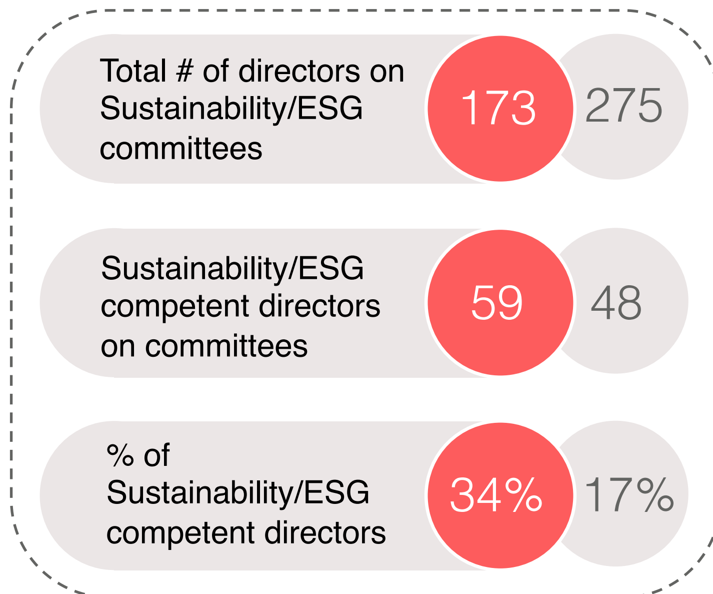
Research Overview

Family Business (Top 100)
Forbes Global 2000 (Top 100)









Methodology

Similar to the study conducted in the 2020 Sustainability Board Report, which examined the first 100 companies in the 2020 *Forbes Global 2000* list, this analysis looks at the board composition of family-owned businesses. It uses the *EY and University of St Gallen Global Family Business Index 2019*[1], which is the latest index of its type. All data relating to board of directors' composition, board committees and charters were collected in October 2020 from the companies' own websites.

Depending on the company there is a varying terminology for 'sustainability committee'. Some committees are named 'ESG' or Corporate Social Responsibility (CSR) committee. Alternatively, the sustainability efforts are explicitly integrated into the Risk, Audit or Corporate Governance committee. For the purposes of this study, sustainability, ESG or CSR must be clearly stipulated. Moreover, if a company did not have a dedicated sustainability board committee, the credentials of the board directors were not further evaluated.

TSBR's proprietary assessment methodology screens all relevant director profiles for sustainability credentials and competence. A straightforward approach using a three-point checklist is used.

A director is considered 'with sustainability credentials' or 'ESG competent' if he or she meets one of the three core criteria:

1. Executive or board experience actively involved in ESG/sustainability strategy or governance
2. Board member of a material non-profit organisation, foundation or charity, or fellowship of an international campaign body (e.g. World Economic Forum, United Nations Global Compact, WBCSD, CECP, etc.)
3. Formal ESG/sustainability certification/accreditation or published academic paper/research or report in the area

This approach has several limitations, including an absence of a 'quality' metric and significant variability in the data. Our conclusions are therefore conservative and draw heavily from further interviews and discussions with experts in the field, in addition to the latest academic literature.

[1] The 2019 EY and University of St Gallen Global Family Business Index is the basis sample of our research. They are considering several factors to what constitutes a family business, such as the business must be run by the second generation or more. One or more family members must be involved in the running of the business, i.e. be a part of either the board of directors or executive leadership. Please find the detailed methodology of the list here: http://familybusinessindex.com/

Findings

Of the 100 family-owned companies in our sample, 42 had what TSBR defines as a sustainability committee. Of these, 33 (79%) had at-least one sitting director with ESG credentials. Of the 173 directors serving on these sustainability committees, 59 (34%) had ESG credentials.

There was, however, significant geographic variation.

Europe seems to be leading the pack. Family businesses there had just below average (33%) relative number of sustainability committees but had the highest proportion of ESG competent directors and percentage of committees with at least one competent director, with 45% and 100% respectively.

Family businesses in North America, on the other hand, had the highest relative number of sustainability committees (61%) and a below-average number of ESG competent directors (33%). Because of the smaller sample size, data from Asia and Latin America is less robust.

However Latin America does seem to be lagging behind, with very few (11%) ESG competent directors serving on sustainability committees.

What are the best explanations for this data?

The first is the long-term strategy lens often adopted by family-owned firms. Scholars of family business have pointed to family firms as potential bastions of stewardship and to their practices that encourage a long term, socially responsible orientation with all stakeholders[1]. By sheltering managers from the short-term pressures, the family ownership model encourages the pursuit of long-term value with full consideration of all environmental, social and governance risks at play. This explains how a family's multi-generational perspective, especially one that aligns with ESG goals, are often translated into material changes at the governance level.

[1] Isabelle Le Breton-Miller, Danny Miller, "Family firms and practices of sustainability: A contingency view", Journal of Family Business Strategy, Volume 7, Issue 1, 2016, Pages 26-33,http://www.sciencedirect.com/science/article/pii/S1877858515300504

Findings

The second potential explanation is that family-run businesses may be better able to address the principal-agent challenges that good governance seeks to address. Indeed, when (non-family) executives and directors have shorter time horizons, they may be inclined to use their positions for private gain, thereby reducing resources that would otherwise contribute to sustainability. There is considerable literature that argues that public family businesses, because of their typically concentrated family ownership, are better able to curb such short-term opportunism through better monitoring capacities – including but not limited to specialised board committees[2].

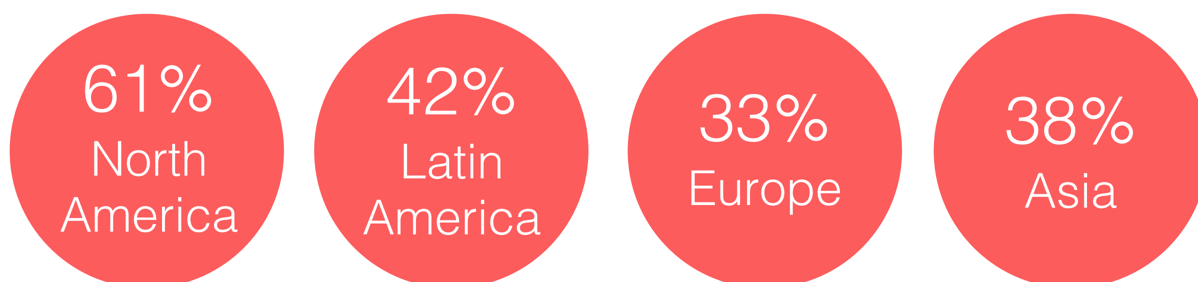
Finally, the geographic variation in the data is likely to be explained by different priorities assigned to sustainability issues, in addition to the relative maturity of family firms in their home markets. In China, the average private firm is approximately 20 years old. By comparison, many family enterprises in Europe have been working for over 100 years to keep the business on a sustainable route. This point highlights how the corporate governance debate needs to better understand the context of differing models in different countries, as well as their implications for sustainability.

[2] Anderson, R. C., & Reeb, D. M. (2004). Board composition: Balancing family influence in S&P 500 firms. Administrative Science Quarterly, 49(2), 209–237

Geographic Overview

Depicted below are the percentages of companies that **have a dedicated sustainability committee** at board level.

On this page we are only showcasing 4 regions. All individual countries are consolidated as per below geographical split.



Detail Data

Country	Sample size	# ESG Board Committees & %	Total # of directors on committees	Total ESG competent directors & %	# of committees with ESG competent directors
North America	23	14 / 61%	63	21 / 33%	12 / 86%
Latin America	12	5 / 42%	18	2 / 11%	2 / 40%
Europe	33	11 / 33%	42	19 / 45%	11 / 100%
Asia	32	12 / 38%	50	17 / 34%	8 / 67%

Conclusion

Family firms account for a significant portion of global business activities and are considered by some as a pillar of economic development worldwide. But their link to sustainability is less obvious. The data from this report indicates that, from a corporate governance perspective, family businesses may be ahead of the curve in adapting to environmental, social and governance challenges. More research is now needed to better understand the implications this might have for sustainability leadership in the 21st century.

One final insight from the analysis of the world of family business is worth highlighting. A common mistake family firms and the consultancy firms that advise them make is to impose a 'best practice' governance structure that can be used as a blueprint across contexts and geographies. Similarly, in sustainability, like in family businesses, no one size fits all. Having ESG competent directors on ESG committees is not enough. Sustainability is not a 'desirable', nor is it an agenda item to be briefly considered by executives with no relevant experience. It must be at the core of a company and all boards must actively be playing a supervisory role.

Expert Interview
on Family Business & Sustainability

Expert Interview

With **German Herrera,** Global Co-Lead Family Business Advisory, Egon Zehnder

We sat down virtually with German Herrera, to better understand the dynamics of family business and their approach to sustainability. German works closely with family members and owners to create an environment conducive to driving the best people decisions, including leadership succession and governance across generations. He also works closely with boards and CEOs on succession strategies, recruiting, assessing, developing and retaining leadership talent.

TSBR: What do you consider are the fundamental differences between family businesses (FB) and non-family businesses (NFB)?

German: There are a lot of small differences that individually probably don't mean much, but if you add them up it makes a big, big difference. Starting with the fact that family owned companies are usually trying to, what I call, 'optimise a different equation' to a public NFB or a private equity (PE) backed company. These latter firms are focused on maximising shareholder value, and PE backed companies are focused on 'exit value'.

What you see in FB is that they are trying to maximise their equation. Every family has a different one. But they also have many things in common: First, they have more of a long term view – they are not thinking in quarters or three years – they are thinking in generations: "What am I going to leave for my kids?", "What am I going to leave for my grandkids?" Second, FB think about stakeholders in a broad way. It's not only shareholders. It's also the communities in which they operate. Finally, people who are making the decisions and who are 'running the show', are not thinking about their pay check, their bonus, or their stock appreciation – they are thinking a little more about 'legacy'. When you put all these points together it makes a huge difference in terms of perspective, impact and the equation they are trying to optimise.

TSBR: Considering current global challenges, but also your mentioned 'long term view' that FB are taking, what are their strategic priorities?

German: Every FB has a different priority. It's based on their individual needs, legacy and exposure, but if I had to generalise or summarise – the best strategic framework in application that I know is 3Ps: Profit, People, Planet[1]. We all recognise that a company needs to make profit in order to stay alive. But in FB 'People' and 'Planet' follow closely.

[1] John Elkington, Triple Bottom Line or 3P framework

TSBR: Do you feel there is a different approach to corporate governance between FB and NFB?

German: I think there is. NFB that are publicly traded focus more on regulation, oversight and fiduciary responsibility, whilst trying to minimise their overall risk. Public FB admittedly will follow a similar approach. The board's role in a private FB is more to help the owners with their equation of the 3Ps (Profit, People and Planet). Of course, between FB and NFB there are overlaps with respect to risk management and diversification. In the end, boards tend to converge in what they do, regardless whether a company is private or public. What is remarkable for FB though is that they would usually start off with more of an advisory board that transforms over time into a fiduciary oversight body.

TSBR: Trying to bridge to sustainability and ESG now – it is becoming best practice to incorporate sustainability matters into the core strategy of a company. Do your clients talk to you about sustainability? Do they embrace it? How do FB approach this?

German: Yes, on both. We're getting asked about it a lot. My sense is, when you're talking to FB, especially those that have a high concentration around family ownership, sustainability is in their DNA. Since the day they were founded this is what they believe in and they use their companies to help. A good example is 'Patagonia' – since their inception their value proposition was always around sustainability. Today, they are an example in many cases.
You have everybody interested in sustainability today. There are multiple reasons and it's hard to pinpoint who is doing it for what. But there are people who really believe in sustainability and think it is important when you have the means and the power and the scale. There are others who are worried about not caring for sustainability enough and it's becoming more of a problem for them. Then, there are companies that are getting pressure from their consumers and investors, and some are embracing sustainability simply because they need to attract the best people. If you're a company that does well and good, more people are going to want to work for you. In my eyes, as long as we're proactive about sustainability and add value – it's a win-win.

TSBR: Considering that FBs have a higher percentage of Sustainability/ESG competent directors – what might motivate a candidate to join a FB board and what makes those companies attractive for candidates?

German: That is a very loaded question (smiles). I do a lot of board searches. Different people have different reasons for joining a board. You get people who just want to join a board because it is prestigious, or they simply have time on their hands. On the other side, you get individuals who want to give back. They have already made their money; they had a successful career – those people are a bit more selective. They select a board based on impact and purpose.

So, if someone is more purposeful and has a better track record and general interest – they will be drawn to boards that have more meaning, more impact and are more interested in the long-term. Boards with more conviction about sustainably attract the people that are aligned with them.

TSBR: Do you think it is important to have a stand-alone sustainability committee on board level?

German: I believe boards who have a committee are more serious about it (sustainability) than those who don't. I'm not in favour of having a committee just to say you have one, meaning you must put resources behind it too. It is important to establish a structure that enables you to do what you want to do, otherwise it becomes an unfunctional or incompetent committee.

TSBR: How would you summarise why FB are doing better in appointing ESG competent directors than NFB?

German: Care. Because they are doing it for the right reasons. Because they are thinking long, long, long term. They are thinking hundreds of years – generations. That's what moves them. When you have the flexibility, liberty and luxury to think with that kind of timeframe – you're also making better decisions.

As Egon Zehnder's Family Business Advisory Practice Global Co-leader, German assists families, owners, and managers in navigating the challenges of leadership, succession, and governance across generations.
He established and led the firm's Miami office for nine years, working closely with multinational companies, family-owned businesses, and private equity firms. He also played a foundational role in opening the firm's office in Bogotá, Colombia.

German has a master's of business administration from Harvard Business School and bachelor's degree in industrial engineering from Columbia University. He loves spending time outdoors with family and friends. Currently, German is on the Board of Trustees of the Pan American Development Foundation, which works to promote economic opportunity in Latin America and the Caribbean.

About Us & Contact

The Sustainability Board Report is a privately funded not-for-profit project developed by a group of individuals passionate about sustainability leadership. We believe that business has the ability to drive meaningful change.

The report's purpose is to showcase the importance of sustainable corporate leadership. We focus on showcasing inspirational and impactful leadership on a systemic level. We are interested in future oriented policy and governance, and how leaders are executing ambitious plans for better business.

Our findings and research are based on proprietary methodologies. Before drawing conclusions we take academic papers and thought leadership into account. We aim to combine theoretic concepts with actionable recommendations on a business level.

For all enquiries regarding this report, or if you would like to get in touch with one of the contributors, please contact us directly via email.

The spirit of this project is to create an open dialogue with business leaders and their communities.

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