EgonZehnder

Boards: Stepping Up as Stewards of Sustainability

In partnership with

The Sustainability Board Report ™


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Foreword

Michael Ensser, Chair-elect, Egon Zehnder

In my recent conversations with chairs and board directors, I've observed a greater sense of urgency than ever before about sustainability. Boards recognize that they have a critical role to play in how their companies navigate challenges that will fundamentally impact the planet and our lives—not least the climate crisis, whose effects are starkly visible all around us—along with greater demands to contribute to strengthening the societies in which they live and operate.

It's no exaggeration to say that the boards' stewardship of companies' environmental, social, and governance (ESG) journey is now just as important as their oversight of financial performance—in fact, they are inextricably linked.

This publication, which Egon Zehnder is proud to publish in collaboration with The Sustainability Board Report (TSBR), shows just how widespread boards' concern with sustainability has become. As one indicator, TSBR's global research finds that the percentage of boards with a sustainability committee has risen from 54 percent in 2019 to 80 percent in 2022.

I see this growing emphasis in the work of the Board Academy, which I have had the privilege to chair: It brings together board members of Germany's largest companies, and sustainability has dominated many of our recent conversations. So much so that the Academy has recently become the German chapter of the World Economic Forum's global Climate Governance Initiative. Yet many chairs and board directors tell us they are still grappling with the question of how to exercise their role as stewards of sustainability—in other words, how to nurture the capabilities, knowledge, and mindsets needed to move from words to action.

The purpose of this report is to help answer that question. For example, it emphasizes the importance of every board member committing to stay on top of relevant sustainability issues, through their own reflection and structured learning programs. It also points to the need for greater diversity on boards—in terms of gender, age, and experience—as a critical enabler of greater engagement on ESG.

Above all, this report calls on chairs and board directors to summon the courage and imagination to look beyond compliance and risk mitigation when it comes to ESG—and instead to integrate environmental and social imperatives fully into the board agenda. That requires board members to bring more than their heads to the game: They need their hearts and souls too. As I step into my new role as Chair of Egon Zehnder, I will seek to live up to this commitment myself. Our Firm stands for Leadership for a Better World, and my colleagues on the board and I will need to step up as stewards of sustainability ourselves if we are to realize that promise.

Frederik Otto, Founder, The Sustainability Board Report

Many leading organizations have recognized the need to act on the climate emergency and to provide equal opportunity for their people and the communities they operate in. They are trying to make their businesses work toward more societal benefit—at least in theory. One might remember the widely published redefinition of the purpose of a corporation to promote an economy that serves all, by the influential Business Roundtable in America in 2019. A sustainable future is desirable for obvious reasons, but it is also good for business and long-term investment.

Over the last decade, I have talked to many large global organizations about their strategic priorities and how to align them from an organizational and people perspective. When I became personally more concerned about environmental degradation and galloping social inequality, I wanted to increasingly understand to what extent sustainability was a factor in decision-making. Unfortunately, most leaders did not know how to navigate or respond to these issues, or simply didn't care. It showed very clearly that sustainability reports, presentations, and various other collateral have limited usefulness for stakeholders to really understand the organizational accountability for these existential risks and opportunities.

After discussing this trend with some of the world leaders in corporate governance and sustainability, we concluded that it is the board of directors that must be accountable to oversee ESG and its incorporation into core strategy. As fiduciaries to all stakeholders of the organization, boards have a special responsibility to ensure their business is sustainable and has longevity.

We agreed that it would be very important to understand how thoroughly boards structure sustainability oversight, and how knowledgeable directors are on ESG. The result was The Sustainability Board Report (TSBR)—a completely independent, non-profit project, providing thought leadership and a regular exercise to assess the ESG preparedness of boards.

This year we are going into our report's fifth edition, tracking a global snapshot of boards and directors' ESG engagement. We are delighted to be collaborating with Egon Zehnder on this publication, which showcases our 2022 report's key findings and combines them with Egon Zehnder's own research and insights.

Since TSBR's first piece in 2019, I have spoken to many chairs, directors, and advisors about sustainability engagement. Some of them are the most committed individuals to positive change I have ever met. These leaders wield enormous influence and have the power to change organizations for the better. We need more of them.

Boards: Stepping Up as Stewards of Sustainability

By Rachael De Renzy Channer and Ashley Summerfield

Egon Zehnder's work with boards across the globe reveals a paradox.

On the one hand, board members are keenly aware of the environmental and social requirements their companies must address—given emerging legislation and global reporting standards, sustainability-conscious investors and customers, and the increasingly clear link between long-term company performance and sustainability. Boards know that environmental, social, and governance (ESG) goals can no longer be an afterthought, way down the agenda after financial governance and performance.

On the other hand, many board members tell us they feel ill-equipped to act on the ESG imperative in a structured and systematic way. Our research shows that many boards have not yet embedded the skills, mindset, and courage to pioneer a new way of doing business and change the ways in which long-term risks and opportunities are identified and assessed. This not only places their companies at risk—both reputationally and performance-wise among investors and customers—but also misses an opportunity to take the lead in finding ways to leave the planet in better shape for future generations.

Sustainability is no longer a nice-to-have item on a board's agenda, appearing after financial governance and performance. Most farsighted boards know it is not a tick-box exercise either, included to merely meet legislative, procedural, or reporting requirements. Rather, sustainability—a term often used interchangeably with ESG—has moved to the core of a company's business. This awareness has been driven by the links between long-term company performance and ESG performance; investors with sustainability at the core of their decisions; and emerging legislation and global reporting standards.

This dichotomy suggests that board leaders and members need to challenge themselves on multiple fronts if they are to embed sustainability in the board's DNA. Questions to ask include:

- Do we have the deep commitment and courage required to act as stewards of sustainability?
- Do we have the right mindset and mix of people on the board? Do we have enough knowledge about sustainability, and if not, how do we change this?
- Do we have a clear understanding of the full scope of ESG as it relates to our company?
- Do we put sustainability at the heart of our decision-making?

To help answer these questions, this report presents the data and insights of the 2022 TSBR, a survey of the world's largest 100 publicly listed companies to determine board ESG preparedness and director ESG engagement; and Egon Zehnder's research on the role of boards in defining and driving sustainability agendas in companies.

WHAT THE RESEARCH TELLS US

While boards are striving to meet the challenges and opportunities of ESG via committees and sub-committees, and are increasingly becoming more diverse, there needs to be more focus on all the moving parts of sustainability, increased education on relevant sustainability issues, and an enhanced mix of individuals who together challenge the status quo.

DEFINING SUSTAINABILITY AND ESG

The terms "sustainability" and "ESG" span environment, human capital, social capital, business models and innovation, and governance. Tackling these issues requires both short- and long-term vision, with the needs of both current and future generations given consideration. This means boards and their companies must factor in a wide range of possible outcomes and make bold decisions while remaining flexible to respond to shifting situations.

Committed to Committees

TSBR's data (Figure 1) indicates that just over one-quarter of the directors in the surveyed companies were members of a relevant committee, with 45 percent on committees assessed to be ESG-engaged.[1] In 2019, this figure was only 16 percent, signaling significant improvement in representation of ESG-engaged directors on committees.

There was also a rise in the percentage of boards with a relevant committee, from 54 percent in 2019 to 80 percent in 2022.[2,3] TSBR also identified an increase in dedicated committee activities around ESG, from 52 percent in 2020 to 69 percent in 2021.

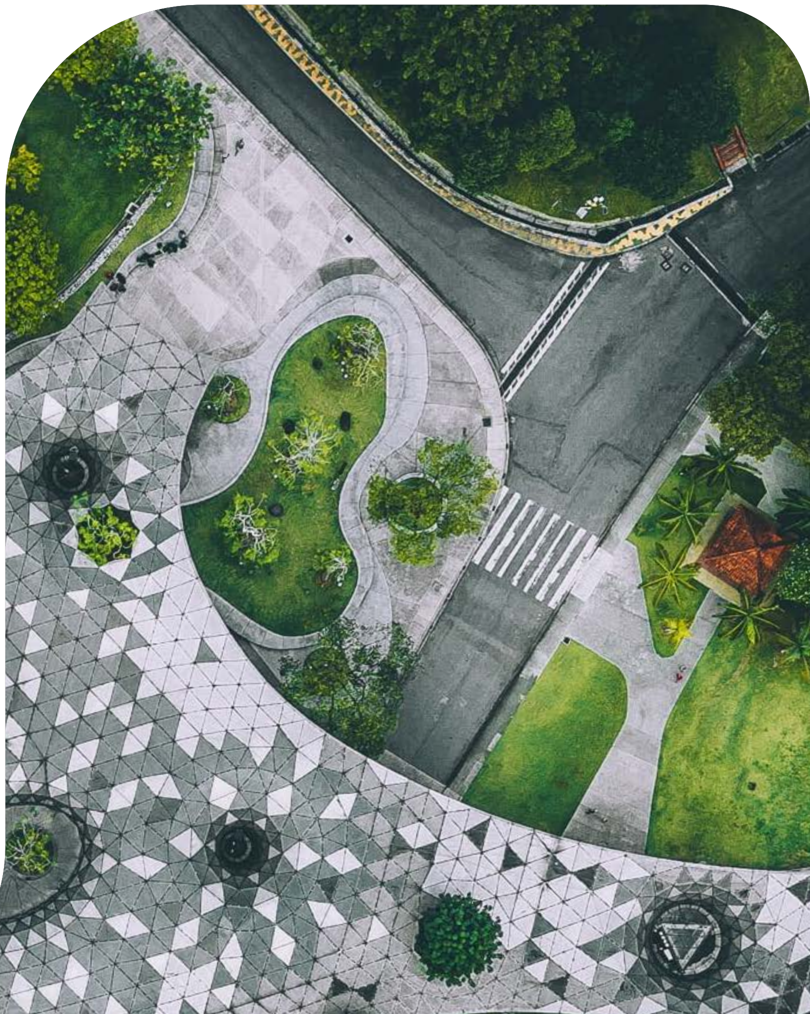
Figure 1: Key data from The Sustainability Board Report 2022

1,260
directors included in the survey

80%
of companies had relevant committees

27%
were members of a relevant committee

45%
of directors sitting on relevant committees were ESG-engaged



HOW TSBR CONDUCTED ITS STUDY

TSBR collated and analyzed a wide range of data on board activities and composition for the top 100 listed companies globally. It identified the presence of a relevant board committee that stipulates sustainability issues in its committee charter, and then analyzed the demographics of board members serving on these committees. To be included in the study, directors had to be assigned to a relevant committee. Businesses that did not disclose any sustainability policy as part of their board committee charters were not included in the study. TSBR's full methodology can be found here.

[1] TBSR includes two measures of ESG engagement: those who are considered ESG-conscious or have an awareness and knowledge of issues, and those who are ESG-competent or have the capacity to act on issues

[2] Refers to committees in which a sustainability narrative is clearly stipulated in their charters. Some committees are named 'ESG' or 'CSR' committees, while in other cases sustainability responsibilities are part of shared committees such as Corporate Governance and/or Nomination committees, Risk, or Public Policy/Affairs committees

[3] The Sustainability Board Report 2022

The Diversity Difference

TSBR highlighted a positive link between gender diversity and ESG engagement in the top 100 companies (Figure 2). Diversity is considered by many to play a critical role in boards' progress on their stewardship journeys, as demonstrated by TSBR's findings presented above. Egon Zehnder's research has shown that more women and environmental experts, a younger average age, and shorter tenure on the board often have a positive effect on corporate sustainability.[4] Diversity is not limited to gender and age, but should also embrace factors such as race, ethnicity, sexual orientation, lived experience, and geographical location—although links between these factors and sustainability performance have not yet been measured. Above all, a differing outlook or mindset is a necessary addition to enable boards to step up as stewards of sustainability.

Globally, there has been a significant improvement in gender diversity on boards, with Egon Zehnder's data showing that the percentage of women on boards grew from 14.6 percent in 2012 to 27 percent in 2022. In the Netherlands, legislation requires boards to include a minimum of one-third men and one-third women, and in India, 2013 legislation made it compulsory to have at least one woman on the boards of publicly listed companies. These drivers have increased gender diversity in those countries.

There has also been significant progress on board diversity in individual companies. As just one example, a multinational plastics company headquartered in the United States has not only established geographical diversity on the board through ensuring representation from all regions in which the company operates but is also seeking to transition the board to being at least 50 percent female.

Despite some progress in gender diversity, however, Egon Zehnder's Global Board Diversity Tracker reveals that older people still outnumber younger people on boards. In fact, there seems to be a move toward even more experience, with the average age of board members increasing slightly from 59.8 years in 2014 to 61 years in 2022. Research has shown that the capital market will start to show a preference for younger and more diverse boards due to their performance in terms of corporate sustainability.[5]

Figure 2: Gender diversity and ESG engagement

32% of the directors included were female

37% of directors on relevant committees were female

Overall, female directors were **60%** more likely to be ESG-engaged than their male peers

Female directors were **24%** more likely to be a member of a relevant committee

On committee level, female directors were **22%** more ESG-engaged than their male peers

[4] Fresh impetus for greater sustainability in boards: The significance of board composition in European companies, Egon Zehnder
[5] It starts with the CEO, Egon Zehnder

Gaps in Skills and Knowledge

Egon Zehnder's research has shown that many boards still focus on financial metrics above all others, resulting in financial performance and shareholder value remaining the predominant decision drivers for CEOs (Figure 3). ESG concerns are placed lower on CEOs' priority lists, even though the CEOs are recognizing the increasing urgency of addressing environmental and social challenges.[5]

Many companies have well-established processes for measuring ESG performance, driven by legislation and stakeholder demands. Egon Zehnder's global survey of hundreds of executives, Creating a Sustainable World, found that most respondents believe their boards are well equipped to monitor sustainability threats and opportunities. However, the study found that many boards lack the skills and knowledge to translate such monitoring into improved governance—and that progress on setting and meeting ESG goals varies widely between companies and sectors.

Skewed Focus

In many parts of the world, engagement, measurement, and progress is greatest for environmental topics, as these may be easier to understand and quantify. Climate-related considerations, including the setting of 1.5°C-aligned or net-zero emissions targets, are becoming high priorities for companies—sometimes overshadowing other relevant and critical issues.

When no legislation exists, social and governance have typically been given lower priority, although companies in sectors such as textiles and natural resources have had to respond to pressures to address their social impacts in order to retain their operating licenses. Regional variations also occur, with India and the United States, for example, having extensive experience on addressing governance issues in response to legislation.

There is no single template for success to deal with these complex topics, and we note differing approaches across sectors and regions. One company in the pharmaceuticals sector has been successful in separating out the E, S, and G portfolios, appointing one senior leader to be responsible for each, reporting back to the board. This approach resulted in previously fragmented ESG efforts becoming consolidated. Another company appointed a "shadow board" whose mandate was to challenge the board and come up with new and fresh ideas. Members of the "shadow board" could then go on to be appointed to the board.

Figure 3: CEOs' ranking of decision-making metrics

1st — **Financial**
(e.g., profitability, TSR, share price, sales)

2nd — **Growth**
(e.g., market share, M&A, geographic expansion)

3rd — **Talent Management**
(e.g., considerations linked to diversity, leadership capability)

4th — **Innovation**
(e.g., new technologies, % profit from new products, R&D budget)

5th — **Health and Safety**
(e.g., incident rates, % improvement, stress-related absence)

6th — **Environmental, Social, and Governance**
(e.g., carbon footprint, diversity & inclusion, human rights concerns, social activism)

[5] It starts with the CEO, Egon Zehnder

The Merits of the Right Mix

Egon Zehnder's research shows that the right "blend" of individuals, combined with an optimal board culture and effective personal dynamics, can move the organization from words to action, with the board playing its overall role as steward. Board members do not all need to be experts in sustainability. Rather, it is important that generalists are willing and able to improve their literacy on the various dimensions of sustainability—and develop a keen appreciation of the sustainability-related challenges and opportunities specific to their companies. Open-mindedness and a willingness to keep their understanding current in an ever-changing environment are essential characteristics of board members.

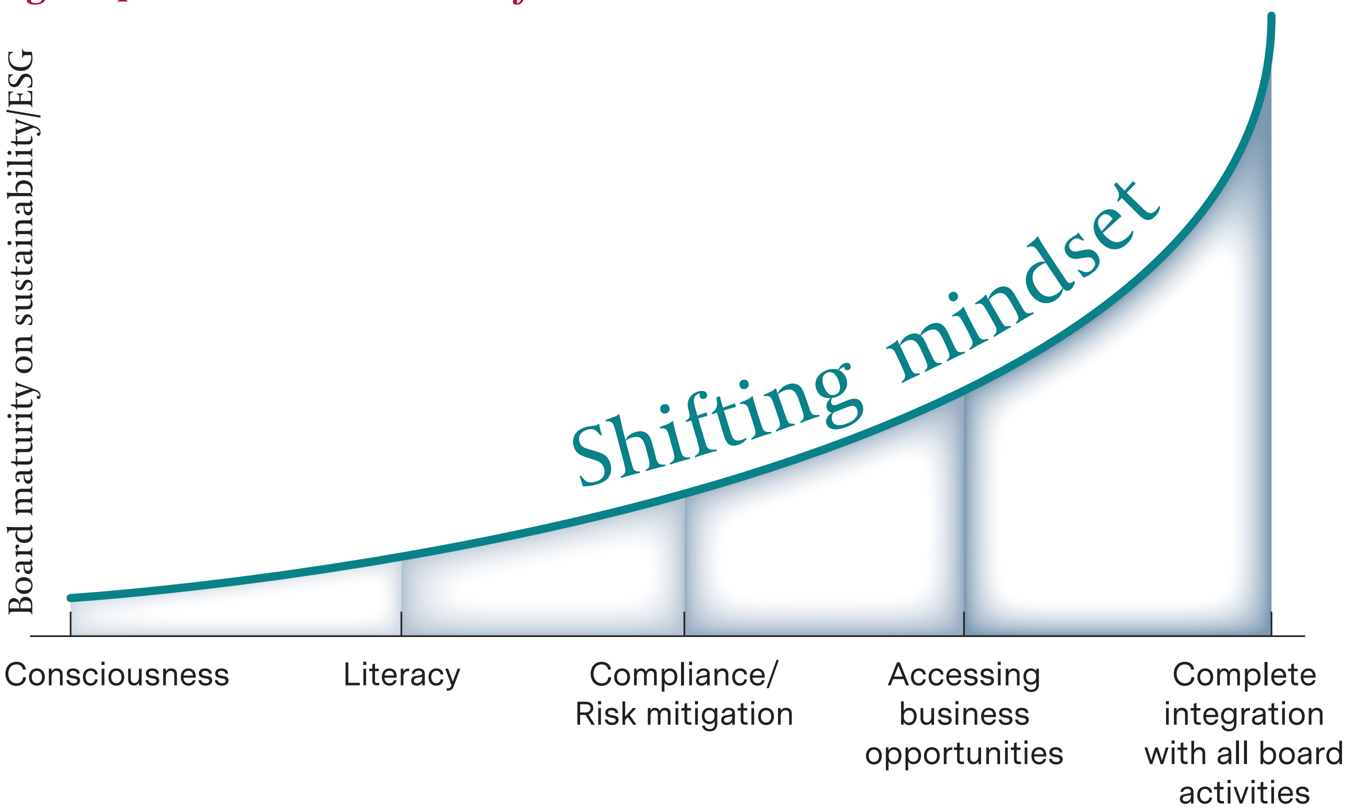
A positive board culture and healthy board dynamics are vital for boards to become better stewards of sustainability. While chairs need to continue to facilitate the efficient performance of the board functions, developing a culture of curiosity and transparency among board members plays a significant role in embedding sustainability into board agendas. As Egon Zehnder's Chair Jill Ader puts it, "Not everyone can be passionate, but blockers are not going to allow for progress."

STRENGTHENING BOARDS' SUSTAINABILITY FOCUS

Egon Zehnder's work with global firms across sectors suggests that the incremental changes being adopted by many boards are not achieving the transformations required to meaningfully progress the sustainability agenda.

Moving the board along the ESG maturity curve (Figure 4) takes courage from both the chair and the board members. We propose four actions to help boards progress along this curve.

Figure 4: The board ESG maturity curve



1. Move ESG to the core of board activities

Boards should not wait to have all the challenges facing them and the solutions to these challenges resolved before they act. Rather, it is important to act early and commit to a way forward, knowing that actions will change as the journey evolves. Chairs play a significant role in creating this momentum.

Initially boards may engage with ESG through sustainability or ESG committees which are mandated to drive this agenda. We have observed different methods of increasing board knowledge and confidence on this topic; for example, one large multinational chemicals and technology company invites an expert on an emerging topic to chair the meetings of the ESG committee to help ensure the committee members are kept informed of current challenges and opportunities.

Some boards convene additional full board meetings focused specifically on sustainability topics, while others appoint sustainability experts to the board with the mandate to drive this agenda. Ultimately, however, effective stewardship requires boards to place sustainability on an equal footing with financial performance and risk assessment in all decisions and to integrate the ESG agenda into regular board meetings.

2. Develop board members through education and exposure

As highlighted previously, although not all board members need to be sustainability experts, there is a responsibility for keeping up to date on emerging sustainability issues and opportunities. We have heard examples of boards offering training sessions on emerging issues and inviting experts to brief the full board on emerging and critical sustainability matters or to help drive transitions on key sustainability issues. For example, boards appoint experts on addressing climate-related impacts or to advise on local ESG issues when establishing operations in new regions or countries.

However, our research suggests that while committees and expert briefings may be valuable in the early stages of sustainability journeys and while tackling individual topics, one-off interventions are not always effective in achieving the necessary mindset shifts. Every board member needs to begin with themselves and demonstrate the commitment to remaining on top of relevant sustainability issues, through their own regular education and learning.

3. Challenge mindsets through diversity of age and gender

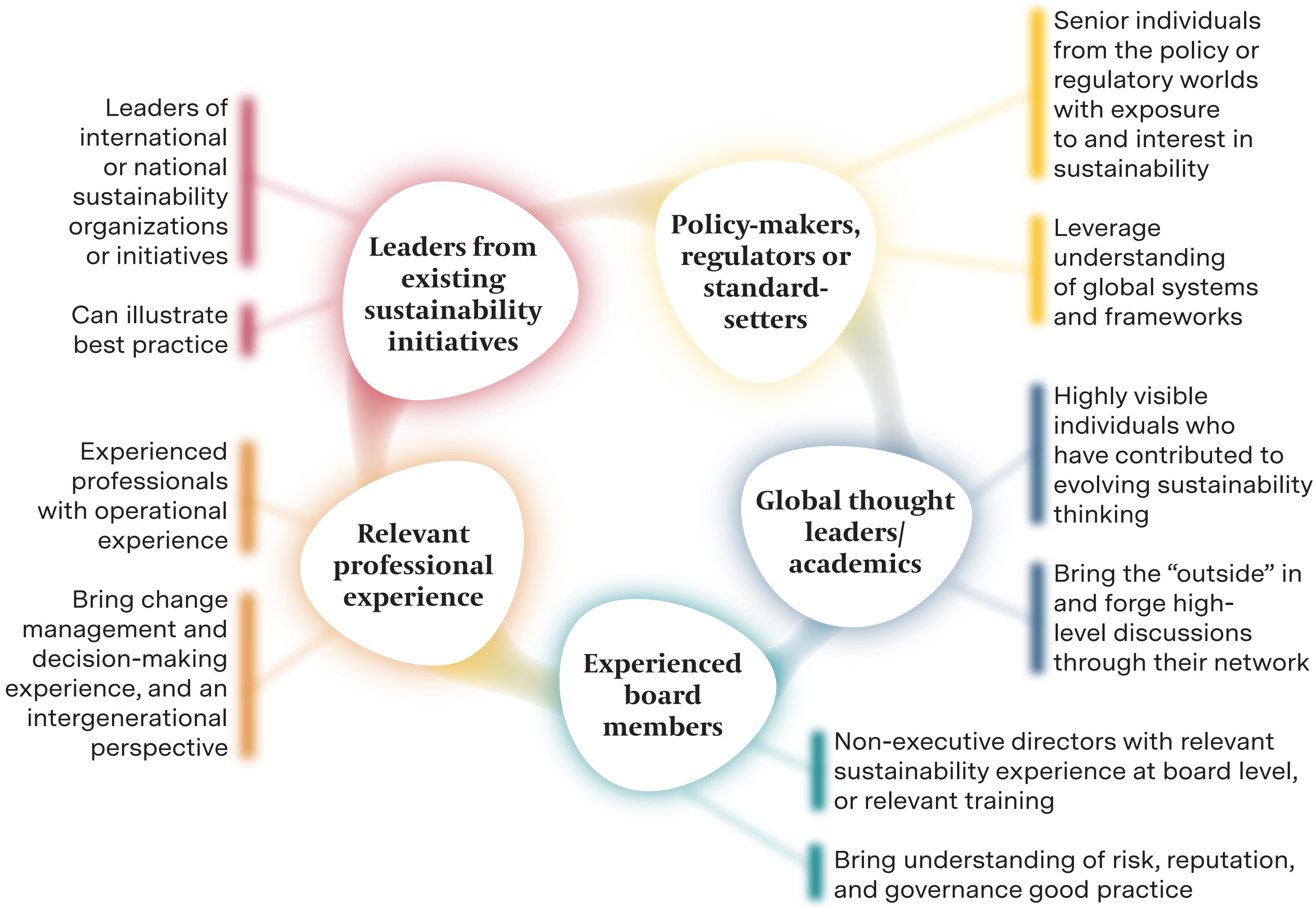
A clear link has been demonstrated between diversity and board stewardship. Although the data shows improvements in gender diversity, in part in response to legislation, the relatively static age demographics of boards is robbing organizations of the important perspective of the younger generation. Boards need to give attention to increasing gender diversity during recruitment of new board members, as well as to considering younger applicants, even if they may require training and mentorship to fulfill their duties.

4. Shake up board dynamics and culture

Many boards are stuck in the status quo, continuing to do business in a way that is no longer relevant. To fully embrace their stewardship roles, they need to have the courage to challenge current practices and thinking, the flexibility to dive into unchartered waters knowing that plans and targets will likely change, and the vision to see both the short and long term.

Focusing on board dynamics and culture to harness diversity and fresh thinking will go a long way in tackling the various dimensions of sustainability. Bringing people from different, sometimes seemingly incongruent, worlds onto a board can help challenge the status quo and ensure the right blend of individuals to make the necessary shifts (Figure 5). We have seen places where this is happening, for example with the appointment of a CEO of a sustainability consultancy to the board of a chemicals company, and the recruitment of a CEO of a global charity to the board of a building materials company.

Figure 5: Achieving the right mix of individuals on the board to shake up the culture



GETTING THE RIGHT INDIVIDUALS ON BOARD

While we have suggested opportunities for the board as a whole, the attributes of individual members are also key to advancing sustainability progress. Including individuals on a board with a systems mindset, who are driven toward action and have strong transformation and innovation skills, can help drive a smooth and effective transition.

Our "span of influence" describes individuals in terms of their understanding of and engagement with sustainability (Figure 6). We define "tea lights" as those with an individual interest or passion in sustainability but are unlikely to drive action; "beacons" as having some interest in individual sustainability topics or solutions; "firestarters" as those who will drive change in the organization; and "luminaries" as those engaging with sustainability as a systemic challenge.

Although a board will likely include tea lights, beacons, and firestarters, the presence of at least one luminary will be critical to igniting board stewardship and lighting the way to a more sustainable future. Current board members need to reflect on their outlook with reference to the span of influence, and what actions they can take to evolve their mindset and thinking. This in addition to looking for desirable qualities in new board appointees.

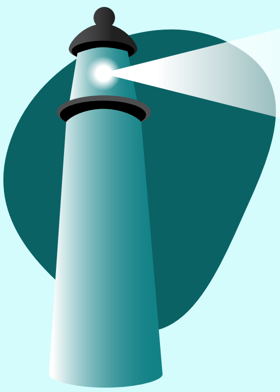
Figure 6: Individuals' span of influence on boards

Tea light: Head in the game

Individual interest or passion

- Demonstrates intellectual acceptance of the issues surrounding sustainability
- Holds personal views but is unlikely to share with others at board level
- May be seen by management as neutral on the topic of sustainability
- Perhaps feels a personal responsibility but does not see it as a board responsibility
- May underestimate the role of the board as stewards in driving systems change

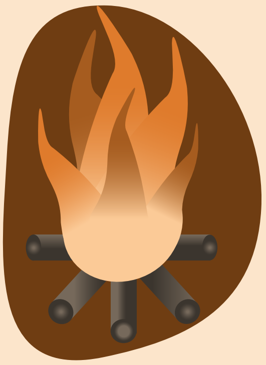
Beacon: Skin in the game



Local/topic change agent

- Recognizes the stakes and urgency of sustainability issues
- May act as a focal point for the topic on a board where there is no official "home" for sustainability
- Encourages the board to consider the topic on an ad-hoc basis and request education from external experts
- May see technology as the solution, as opposed to seeing the need for behavioral and corporate change
- Seeks to optimize the status quo rather than rethinking the business model
- May encourage individual executive team members and be seen as open-minded on selected sustainability topics

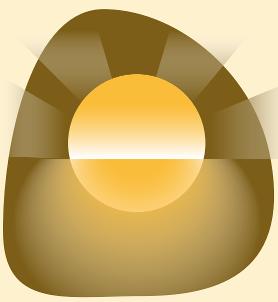
Firestarter: Heart in the game



Organizational change advocate and agent

- Acts as a source of motivation
- May initiate conversations relating to sustainability
- Sees sustainability as a collective responsibility and seeks to raise the level of sustainability literacy across the board
- Challenges the status quo to drive systemic and cultural change
- Encourages management to integrate sustainability across operations and functions
- May demonstrate a strong personal passion that is infectious to others

Luminary: Soul in the game



System change agent

- Connects sustainability with their own purpose and identity
- Is recognized as someone who seeks to connect across geographies and industries
- Has professional visibility but does not need to be a "celebrity"
- Seeks to address systemic injustices and regulations that protect the status quo
- Is likely to be energized by making connections and forging partnerships, with an element of creativity
- Navigates the ecosystem and builds bridges across civil society, corporates, and governments
- Encourages the shift toward inclusive leadership approaches

Egon Zehnder has developed a framework to assess where existing board members and new board candidates sit on the span of influence, and their potential role in contributing to board stewardship. We consider this framework to have value in highlighting ways in which individuals can bring value to the board (Figure 7). The framework examines individuals' cultural fit, leadership competency, and ESG experience and exposure. The ESG experience/exposure metrics shown in Figure 6 are aligned with the dimensions of the Sustainability Accounting Standards Board (SASB) Framework, which provides sector-level guidance to help identify ESG issues that are materially relevant to industries and companies.

Figure 7: Framework for assessment of individuals' potential contribution to board stewardship

Integrating sustainability into a board's activities is a journey that requires working with the complexity of the challenge and committing to making meaningful change to prosper over the long term, with social justice and the health of the planet top of mind. An extensive and integrated focus on sustainability calls for a caring, committed, diverse, inclusive, educated, and equitable board. It also requires the boardroom to be a safe space in which entrenched culture and behaviors can be challenged without repercussions.

Chairs and board members alike need to embrace their stewardship roles, steering companies from regarding society and environment as something "out there," to a position of being at the service of society and the environment. This radical mindset shift, which is the moral obligation of leaders at all levels, is critical to ensuring not only the longevity of the company, but of the planet for current generations and those to come. The courage to step out of the comfort of the past into an unsteady present that demands bold action for the future is what will truly define a committed board.

As Jill Ader, Chair of Egon Zehnder, puts it: "There is a bravery in not accepting incrementalism. Give boards the option to go far, and then the option to go further, and they'll likely take the further option!"

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About Egon Zehnder

Egon Zehnder is the world's preeminent leadership advisory firm, inspiring leaders to navigate complex questions with human answers. We help organizations get to the heart of their leadership challenges and offer honest feedback and insights to help leaders realize their true being and purpose. Our 560 consultants across 63 offices and 36 countries are former industry and functional leaders who collaborate seamlessly across geographies, industries and functions to deliver the full power of the Firm to every client, every time.

We believe that together we can transform people, organizations and the world through leadership.

For more information, visit www.egonzehnder.com and follow us on LinkedIn and Twitter.

About TSBR

The Sustainability Board Report (TSBR) is an independent not-for-profit project.

We aim to showcase different dimensions of sustainable leadership and corporate governance. By developing best practice and thought leadership, our reports help individual leaders, organisations and investors to understand the changing landscape of environmental, social and governance (ESG) preparedness, consciousness and competence.

We collaborate with business leaders, non-executive directors, board advisors and academia to create meaningful, actionable and potent narratives.

TSBR also releases an annual report on ESG preparedness of boards of directors of the world's largest publicly listed companies. Our work has featured in leading business and academic publications and is considered a trusted resource for sustainable leadership and governance insights.

To learn more please visit www.boardreport.org.