MEMO

BSR

Governance and Oversight of Just and Sustainable Business

BSR FAQ | APRIL 2023

1. INTRODUCTION

This FAQ sets out BSR's perspective on the governance and oversight of just and sustainable business at companies. We believe that engaged boards, empowered executive leadership, and clear roles and responsibilities throughout companies are essential for the creation of long-term value for investors and society.

2. DEFINING GOVERANCE AND OVERSIGHT

Why is governance and oversight important?
A clear system of governance and oversight ensures that strategies relating to just and sustainable business will be created, implemented, and actioned.

What is the difference between governance and management?
Governance is the system by which business operations are directed and controlled. The governance structure of a company specifies the distribution responsibilities among different participants, such as the board, managers, and shareholders, and spells out the rules and procedures for making corporate decisions.

Management is the deployment of resources to achieve business goals. The management of a company includes running the day-to-day operations of a company, coordinating the efforts of staff to achieve strategic objectives, and ensuring that the company's resources are used effectively and efficiently.

Governance is about direction, accountability, and oversight, whereas management is about execution, implementation, and operations. It is important to distinguish between these two different concepts when defining how to advance sustainability and social justice goals with companies by not (for example) assigning "management" expectations to boards.

Who leads governance and management, and who are they accountable to?
The company board is accountable to the company's shareholders. The company's board chair leads the board in keeping with the organization's vision, mission, and strategic planning goals. Duties of boards include choosing the CEO, reviewing / approving company strategy, approving major policies, making major decisions, and overseeing performance.

The company management is accountable to the company's board. The CEO leads the company in keeping with the board's direction. The duties of management include making operational decisions, making operational policies, keeping the board educated and informed, creating the company strategy for Board review / approval, implementing the strategy, and bringing well-documented recommendations and information to the board.

What are the key elements of governance and oversight for just and sustainable business?
Governance and oversight for just and sustainable business is the formal integration of social and environmental goals into a company's corporate governance and operating mode and ensures that material social and environmental issues are effectively managed at all levels of the company. Governance and oversight can be complex because social and environmental issues cut across many different components of a business.

BSR believes that a governance and oversight system should include the following five elements: (1) board level oversight, accountability, and sign-off; (2) executive leadership; (3) a core sustainability team (or similar); (4) clear roles and responsibilities for employees integral to the success of just and sustainable business; and (5) a system for understanding external perspectives via meaningful stakeholder engagement.

3. STRUCTURES FOR GOVERNANCE

How should a company board engage on the topic of just and sustainable business?
Best practices include incorporating just and sustainable business into the board mandate, designating a board committee (or committees) for relevant social and environmental issues, training board members on material social and environmental topics, and hiring experts to the Board.

BSR believes there are four critical areas for boards to address:

- **Stucture:** Formalizing the board's mandate for just and sustainable business via inclusion in relevant board committee charters and / or creating a new board committee to oversee just and sustainable business.
- **Competencies:** Recruiting board members with the right knowledge, competencies, and expertise in relevant topics, and with diverse backgrounds.
- **Strategy:** Developing a strategy with clear consideration for how material topics, emerging issues, and stakeholder impacts shape business success over the short, medium, and long-term.
- **Oversight:** Establishing goals, incentives, and accountability for management. Meaningful disclosure (e.g., formal approval of annual disclosures on social and environmental topics) is a key aspect of achieving oversight.

How are regulations changing board oversight of just and sustainable business?
Regulations and other emerging global standards are substantially increasing expectations and requirements for board oversight of just and sustainable business. The main implications include: (1) board oversight (e.g., of specific topics); (2) responsibilities outlined in board mandates; (3) board expertise and knowledge; (4) how risks and opportunities are considered in strategy; (5) incentive and remuneration considerations; (6) the board's role setting up and overseeing due diligence processes; and (7) signing off sustainability reports and disclosures.

For example, the proposed EU Corporate Sustainability Due Diligence Directive (CSDDD) is expected to establish a "duty to act" on the consequence of their board decisions relating to sustainability, climate change, and human rights impacts, while the EU Corporate Sustainability Reporting Directive (CSRD) will require boards to be a part of the company's due diligence process and sign off sustainability information within a company's management report. Further, the International Sustainability Standards Board (ISSB) will require climate disclosure and an explanation of board governance and oversight.

These regulations and standards redefine the role of the board implicitly (by creating new corporate standards) and explicitly (by specifically obliging boards to oversee sustainability and human rights at their companies).

What are the best practices for establishing and maintaining board competency on just and sustainable business?
There is increasing awareness of the need to fill the gap in expertise and skills at board and management levels on social and environmental topics, such as climate change, human rights due diligence, and social justice. Best practices include training board members on material topics and emerging trends through formal means (such as executive education) or informal means (such as regular briefings and inviting the participation of external speakers).

It is important to ensure diversity of skills and experience at board level, including consideration of diversity or race / ethnicity, gender, and age. Ideally at least one board member has expertise on material social and environmental topics.

Should there be a separate board committee dedicated to just and sustainable business, or should matters of just and sustainable business be integrated into other board committees?
Assigning social and environmental issues to a board committee (or committees) allows for key issues to be considered systematically and in greater depth. However, there is no "one size fits all" approach to how this is achieved—every company board is uniquely structured, and different issues may be suited to different committees.

For example: an audit committee may oversee human rights due diligence overall or specific topics (such as privacy); a compensation committee may oversee diversity, equity, and inclusion; a nominating and governance committee may ensure that appropriate sustainability skills and experience are present on the board; a public policy committee may consider matters relating to government relations or social impact; a dedicated sustainability or corporate responsibility committee may oversee a company's materiality assessment process and ensure that social and environmental risks are being appropriately identified, tracked, and addressed.

As a matter of principle, the entire board should have the opportunity to engage with matters of just and sustainable business that impact company strategy and have the right level of understanding required for informed decision making. The audit committee can play an important role in assigning issues to board committees and clarifying when the responsibility extends to the full board.

3. STRUCTURES FOR MANAGEMENT

What are best practices for executive oversight and leadership?
The "tone from the top" and good executive leadership helps build a culture of just and sustainable business throughout a company; if just and sustainable business is on the leadership agenda, it will be prioritized.

Clear roles and responsibilities provide clarity, alignment, and expectations to those executing the work on just and sustainable business, and enable effective communication between different functions, business units, and teams.

Rewarding performance and creating consequences for non-performance on a set of clearly defined goals helps ensure that just and sustainable business is placed on the same level as other aspects of business. For example, social and environmental performance can be linked to executive compensation and employee bonuses more broadly via key performance indicators linked to issues such as health and safety, CO_2 emissions, or diversity.

How should just and sustainable business be organized inside companies?
The most effective organizational structure for just and sustainable business will be different across companies and industries, though most can be categorized as "centralized", "embedded", or "distributed" structures:

- **Centralized:** A larger team (e.g., 15+ staff) acts as the center of expertise and implementation at the company. This team will implement key aspects of just and sustainable business, such as strategy, reporting, and stakeholder engagement, while relying on other functions to implement the strategy and improve performance. Centralized structures are often associated with joined up approaches to just and sustainable business, such as leadership for climate change, human rights, and labor issues being jointly assigned to a single chief sustainability officer.

- **Embedded:** A smaller team (e.g., 5 or fewer staff) implements core elements of just and sustainable business (such as reporting and disclosure) but relies more on other functions to lead strategy development and implementation.

- **Disitributed:** A variety of different teams (e.g., sustainability, human rights, civil rights, DEI, product responsibility) lead different elements of just and sustainable business, often in different functions of the company. In this model there are often multiple rather than single executive leads—for example, there may be a chief sustainability officer for climate change, a VP for human rights, and a VP for supplier responsibility all leading different programs.

BSR believes that a dedicated "head" of just and sustainable business can be a best practice for some companies but not others; more important is the existence of a joined-up and cohesive approach that is accountable to the company board. We note that terms such as "sustainability", "ESG", and "social impact" have taken on different meanings in different industries and can be associated with very different team and individual mandates.

Which department or function should just and sustainable business be part of?
The most effective function for just and sustainable business will vary across companies and industries. BSR has seen both successful and unsuccessful teams located in departments as diverse as strategy, commununications, risk, government affairs, legal, product, and procurement; for this reason, we have concluded that department or function on its own this is not an important variable determining success. Far more important is that the team (or teams) reside in a part of the company where they can make, shape, and influence the decisions, actions, and implementation priorities most relevant for the company's material social and environmental issues and have a direct line to CEO / executive leadership decision making.

Should there be a chief sustainability officer, and what should their brief be?
For many companies a chief sustainability officer can be a very effective role, provided the chief sustainability officer is resourced, empowered, and supported effectively. The precise role will vary depending on the company's material issues—for example, it may focus on value creation where the company is in the business of providing sustainability solitions, or it may focus on risk mitigation where the company is faced with material risks; in both cases, being a change agent and coalition builder are common themes. For some companies a chief sustainability officer may be focussed on a constrained set of issues (e.g., climate change and nature), while in other companies a chief sustainability officer may have a broader brief that also encompasses human rights, labor

issues, and ethics. There may be other leaders inside companies (e.g., a VP human rights) with chief sustainability officer-like roles. In all cases, direct access to the CEO and Board is essential.

How should other functions and teams be engaged?
A core sustainability team (even a large one) cannot fulfill a company's just and sustainable business strategy alone, and a broader group of employees should take on roles and responsibilities to help implement the strategy, achieve goals, and improve performance. This is particularly true for companies with "embedded" and "distributed" approaches.

Many companies create cross functional working groups (or similar, such as councils and networks) to provide a platform for validating programs and initiatives, implement and support strategic initiatives, and engage a broader base of employees. These cross functional working groups can be composed of multiple functions, operations, and geographies, and it is important to establish clear meeting frequencies, agendas, and communications channels.

These cross functional working groups can be formal (e.g., defined membership, formal charter, regular meeting cadence) or informal (e.g., shifting membersip, flexible charter, and meeting "as needed"), with different approaches suiting different company cultures. In all cases an effective support staff or "secretariat" is needed for success.

How should external stakeholders be engaged?
Effective approaches to just and sustainable business require a deliberate, strategic, and structured approach to securing the insights, perspectives, and involvement of affected stakeholders (such as customers, civil society organizations, and local communities) and other experts (such as academics) and to embedding them into company decision making. This is the subject of a different BSR FAQ on meaningful stakeholder engagement.

Should companies establish external stakeholder advisory councils?
An external advisory council can help bring diverse thinking, improved rigor, and greater determination into programming and strategy. When doing so it is important to develop clear terms of reference, including:

- **Objective:** Determine the objective of the group (e.g., review policies; input into strategy; provide emerging issue knowledge; guide industry best practice etc.).
- **Composition:** Determine the makeup of the group, roles and responsibilities, and term limits.
- **Meeting frequency and agenda:** Set clear meeting frequency, agendas for each meeting, and communication channels.
- **Transparency:** Establish clarity on whether / where the external advisory council is publicly known and / or whether the external advisory council can issue its own communications.

ABOUT BSR

BSR™ is an organization of sustainable business experts that works with its global network of the world's leading companies to build a just and sustainable world. With offices in Asia, Europe, and North America, BSR™ provides insight, advice, and collaborative initiatives to help you see a changing world more clearly, create long-term business value, and scale impact.

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