Not ESG, but G(EES)

RESPONSIBLE BOARDS FOR A SUSTAINABLE FUTURE

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"Trust is the essence of good governance and the foundation of sustainable development."

2015 has been a milestone for a sustainable future: The world leaders adopted the Sustainable Development Goals at the UN Sustainable Development Summit September 25–27, 2015. The title of the agenda was *Transforming our world: the 2030 Agenda for Sustainable Development*. In November, under the Turkish presidency, the G20's focus was on ensuring inclusive and robust growth through collective action in accordance with the "three I's" – Implementation, Inclusiveness, and Investment for growth. In December, an enduring, legally binding treaty on climate action which contains emission reduction commitments from nearly 200 countries starting in 2020 was signed to keep the global warming below the 2°C level, and even target actions to achieve the below the 1.5°C level[1]. This represents a turning point for action to limit climate change below dangerous levels. It signals the end of business as usual. Future investment will need to be compatible with a zero-carbon world.

In 2022, COP27 discussions made it abundantly clear that the transition to net-zero requires more than commitment and institutions need to start taking action.

Widening our perspective for a more comprehensive view of sustainability

A sustainable global economy is one that combines long term profitability with ethical behavior, social justice, and environmental care. When we look at the state of the world today – climate change, deteriorating water resources, plastic waste, income inequality, gender inequality, corruption – it is evident that institutions need to assume responsibility for sustainable development and take action.

For corporations to truly contribute to a sustainable future, there is a need to widen the lens through which we view sustainability. Sustainability requires decision-making processes that incorporate all potential impacts of a company, incorporating the

1 On August 4th, 2017 the United States under the Trump administration has pulled out of its commitment to the Paris Agreement that was made by the Obama administration.

positive and negative externalities into its decision-making processes, and avoiding short-sightedness and selfishness. This means:

- Adopting a comprehensive view of how a company creates value beyond financial measures to include economic, environmental, social, and governance outcomes throughout the value chain,
- Adopting a long-term perspective and incorporating different time-horizons into the strategy and target-setting processes,
- Considering direct and indirect impacts of the company's decisions and actions,
- Becoming more inclusive by considering the impact of all their decisions and actions on all stakeholders, current and future,
- Taking responsibility for managing and positively influencing their value-chain and ecosystem and opening to new ways of collaboration to solve sustainability challenges.

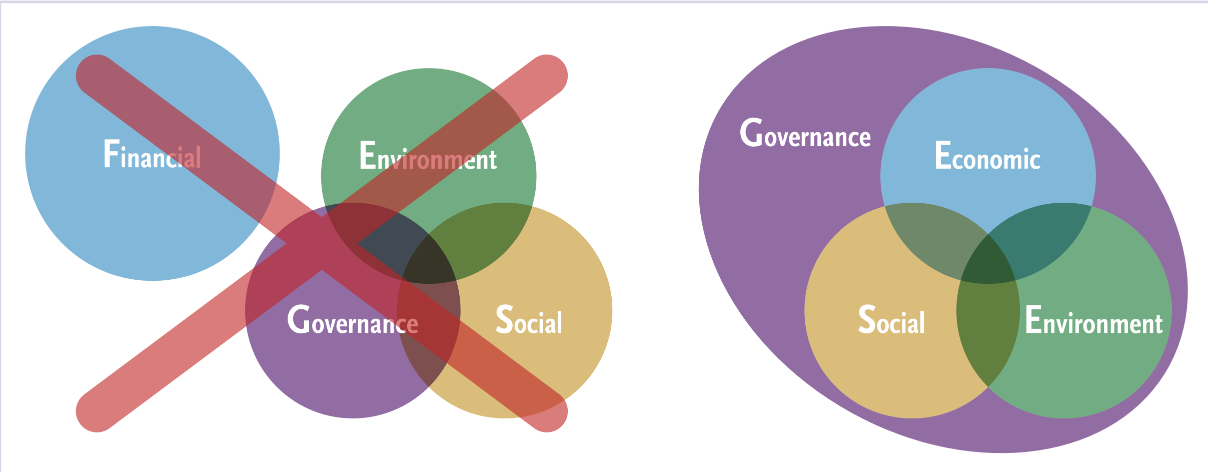
Gaining the trust of stakeholders requires transparent disclosure on all these dimensions in an integrated manner. If we expand our perspective to include all the impacts that a company creates now and in the future; we need to upgrade our measurement, evaluation, and reporting practices accordingly.

Leadership should involve not only managing your own organization but also positively influencing the stakeholders in the ecosystem as well as assuming responsibility to improve the business climate. In turn, this will enable companies to not only improve the resilience of their companies to environmental and social risks, but also to identify opportunities for innovation and value creation.

Companies that take sustainability seriously, also improve the sustainability of their success. Sustainability of the success of a corporation can only be achieved by adopting a long-term perspective, considering the interests of all stakeholders in decision making, and continuous ability to invest and innovate. **Sustainable success** can be achieved through integrated thinking (for innovation and sustainability), effective implementation (for value creation and value capture), and proper communication of value creation and value capture models (value reporting for gaining the trust of the stakeholders to gain preferential access to various forms of capital).

Governance of sustainability should be prioritized if we are to drive real change. Governance is providing guidance and oversight to management to ensure sustainability of the organization by gaining the trust of all stakeholders. Therefore, good governance is about creating a climate in which a culture for building value and trust nourishes. Good governance needs to ensure that the organization has the right people, processes, information, and values to create value and build trust.

Reframing the sustainability debate: Not ESG, but G(EES)



Sustainability is closely linked to the ESG acronym, directing companies to focus on reporting on environmental, social, and governance issues with regards to their sustainability impact. However, this view of sustainability reporting requirements has several impediments, and we believe does not reflect a comprehensive and integrated approach to how companies should approach sustainability. There are two main reasons why ESG reporting is falling short:

1. **F (Financial reporting) & ESG (sustainability reporting) division suggests that sustainability is not viewed holistically and fully integrated into the decision-making processes of the company:**
    - Separating financial reporting from sustainability reporting positions ESG reporting as an adjunct activity. Analysis and management of environmental and social impact should not be considered as adjunct to financial impact but rather as an integral consideration in all decision-making. Sustainability reporting should not be limited to ESG but should focus on reporting on the company's impact across business, the environment, and society. Integrated Reporting is a tool that can enable this holistic view.

- Financial reporting typically does not encompass the full economic impact of a company's operations: A more comprehensive and integrated view of economic impact would include the value chain as well as a wider range of stakeholders, including operating geographies and communities in which the company operates. Internalizing this perspective of managing the impact of our actions would allow companies to look from a wider lens that would enable more innovative and effective solutions to sustainability issues by mobilizing stakeholders and assuming responsibility for transforming their value chain.

2. **The G in ESG refers to a governance definition that is limited; adopting a more comprehensive view of governance can enable more effective management of sustainability:**
   - The ESG acronym shows a limited view of governance as an additional dimension of impact. Rather than a separate impact domain, **governance is a framework** on how **guidance** and **oversight** is provided over all decisions and actions that have economic, environmental, and social impacts. Current reporting practices on governance encompass issues such as anti-corruption, but the more important focus should be on how sustainability is governed (the governance of sustainability).
   - Labeling G for governance as one of the concepts along with Environment and Social (ESG), does not encompass how we should provide governance to all our decision-making and their implications for Economic (financial outcomes for the company as well as economic development for the whole value chain), Environmental, as well as Social domains. Therefore, the definition of G should be a central, overarching category and requires looking at the whole with integrated thinking.

We suggest a more appropriate acronym would be **G(EES)** – in other words prioritizing the governance of sustainability impact (economic, environmental, and social impact). This change in language would serve to instill a proper understanding of good governance that needs to encompass evaluation of the impacts of management decisions on the Economic, Environmental, and Social domains. We need to understand that good governance is the key to the sustainability of sustainability efforts.

What do all these developments mean for the corporate boards around the world?

As external pressures, including resource scarcity, globalization and access to information, continue to increase, how corporations respond to sustainability challenges will determine their long-term viability and competitiveness. According to the latest McKinsey Global Survey[2] on the topic, executives at all levels see an important business role for sustainability. The same survey results also show that aligning sustainability with core business strategy and stakeholders (like consumers, employees, investors) is the top reason for implementing sustainable business practices. Yet, there is significant room for improvement in the effectiveness of the execution and accountability of their sustainability programs.

As the world continues to get smaller, the mutual interdependence of the corporations and their stakeholders grows larger. To achieve success, institutions increasingly rely upon the utilization of not only their own resources, but also the resources of others. To be able to gain access to the resources of others, institutions need to create trustworthy relationships.

Therefore, the key to success and development is gaining the trust of present and potential stakeholders. These stakeholders include not only shareholders, employees, labor organizations and customers, but also those who provide credit to the company, those in its supply chain and the governments in whose countries the business operates; in short, individuals and organizations in all parts of society.

For example, to be able to grow fast and compete globally, firms need to gain access to global credit or equity capital markets. Similarly, as the role of corporations in the development of the world's economy increases and the scope of their influence widens, so does the breadth of their responsibilities. The license to operate increasingly requires fulfilment of the firms' responsibilities to the community. The trustworthiness of corporate architectures, processes, and behaviors become an indispensable characteristic of the corporation not only for their shareholders, but also for their stakeholders.

Today, successful and sustainable organizations need to demonstrate not only a willingness to involve their stakeholders in decision making; to embrace a culture of transparency and accountability; to be fair and consistent in relations with stakeholders;

2 Sustainability's deepening imprint: McKinsey Global Survey, July 2017

but also, to have an organizational infrastructure that ensures “corporate trust.” Hence, good governance is the key to creating sustainable companies.

Many corporations’ interest in sustainability issues started out as ‘**nice to have**’, as part of their social responsibility programs and to build their corporate reputation. However, those who have taken it seriously as a board & CEO responsibility soon understood that paying attention to sustainability issues was in fact a great ‘**risk management**’ technique, particularly since avoidance is much more economic than repairing corporate reputation after a significant failure. Nowadays, some forward-looking business leaders began to view the challenge of sustainability as an opportunity for ‘**value creation**’. They came to realize that if sustainability issues are becoming relevant for large numbers of people throughout the globe, addressing them properly would be a good business case for satisfying a global need.

Corporations that flourish through the utilization of others’ resources are becoming increasingly aware of the need to be accountable to those who have a say in those resources. As our dependence on global resources increases, we need to be aware of the need for our governance systems and attitudes to gain a global dimension as well.

Companies that have embraced these challenges and transformed it into an opportunity for innovation and long-term value creation gain several advantages:

- Innovation in products and ways of doing business;
- Lower cost of capital and easier access to capital markets;
- Lower cost of operation through less dependency on limited resources;
- Long-term resilience against volatility in commodity prices and resource constraints;
- Increase loyalty from customers and employees;
- Flexibility to experiment with new approaches.

	Corporate Social Responsibility	Risk Management Tool	Value-Creation Opportunity
Role of Sustainability	• Sustainability efforts are de-coupled from strategy and financial metrics and used as a marketing tool	• Sustainability efforts are focused on compliance and opportunity for managing reputational and operational risk in volatile markets	• Sustainability is a core driver of strategy and innovation in products, ways of doing business and managing stakeholders
Role of the Board of the Directors	• Increasing marketing and brand equity	• Managing reputational risk due to globalization • Reducing costs across the value-chain as well as long-term resource dependence • Ensuring regulatory compliance	• Resilience in volatility • Competitive advantage and long-term viability • Impact on solving problems

There are a number of reasons why progress has been slow for companies in viewing sustainability as a strategic imperative:

- Capital markets and investor expectations evaluate company performance through short-term financial metrics rather than long-term value-creation;
- The complexity and diversity of stakeholder expectations and industry dynamics make it difficult to craft a one-fits-all approach to sustainability management, requiring each company to craft their approach to sustainability;
- As there is no value placed on natural capital and costs of externalities are not internalized, companies do not incur the costs of not integrating sustainability into their performance metrics;
- There is limited data and tools for measuring returns through non-financial metrics (incl. social, environmental and governance);
- The global nature of problems requires non-traditional partnership across corporate, non-governmental and public spheres as well as among competitors within the same industry to share the costs of initial investments and increase effectiveness of execution;

- Change requires successful execution within the company, including adoption of vision throughout the organization, its value chain and product-cycle; which is increasingly difficult in today's multi-stakeholder world;
- The global nature of challenges and the lack of sovereign bodies make it difficult to impose penalties on responsible parties, slowing down progress.

Gaining competitive advantage and resilience in times of varied stakeholder expectations, increasing global challenges and volatile markets require re-defining the role of the corporation in today's society. Companies that have undertaken this challenge are transforming it into an opportunity by:

- Making sustainability a key leadership priority and part of core strategy;
- Adopting long-term view for value-creation and innovation;
- Forming partnerships to move beyond the capabilities of individual companies to solve complex global challenges;
- Focusing on capturing value across the value-chain and product life-cycle to reach their sustainability targets;
- Engaging stakeholders and increasing transparency on company performance;
- Assessing risks and performance against non-financial targets in addition to financial targets before compliance requirements increase;
- Ensuring sustainability initiatives are adopted throughout the organization.

GUIDANCE • IMPLEMENTATION • LEARNING • OVERSIGHT

SUSTAINABILITY GOVERNANCE SCORECARD

ARGÜDEN GOVERNANCE ACADEMY

Good Governance for Quality of Life

https://sgscorecard.argudenacademy.org

https://argudenacademy.org/en

THE SUSTAINABILITY CHECKLIST FOR RESPONSIBLE BOARDS

Board Skills and Diversity

1. **Does the board have the right skills to provide guidance and oversight to the sustainability plans of the corporation?**
    - Does the Board have sufficient expertise to understand the decision-making processes of key stakeholders?
    - Does the Board have members who are familiar with the evolving sustainability standards and benchmarks?
    - Does the Board have enough diversity to adequately evaluate the different dimensions (industry experience diversity, age diversity, ethnic diversity, gender diversity, geographical diversity, stakeholder experience diversity) perspectives, and risks of the sustainability issues?
    - Is there a board skills matrix detailing the skills and experiences of board members across multiple dimensions, including sustainability as skill across ESG areas relevant for the company?

Materiality and Stakeholder Engagement

2. **Have the material issues that would substantially affect the company's strategy, business model, capital or performance been properly identified?**
    - Has the Board been involved in setting the materiality thresholds in each sustainability area? (economic, environmental, social, governance)?
    - Have the trends, current and future impacts been considered?
    - Has the management prioritized the key sustainability issues?
    - Has the management considered resource requirements to deal with the prioritized issues in its mitigation plans?

3. **Has an adequate stakeholder engagement process been conducted?**
    - Has the management comprehensively identified its relevant stakeholders and prepared a stakeholder map?
    - Has the management identified material ESG issues for each stakeholder group through 2-way communication (including how the company can impact the issue and how the stakeholders can add value)?

- Has the management identified sustainability initiatives targeting each stakeholder group and communicated results to the company's stakeholders?
- Does the Board have access to the key issues raised by this process?
- Does the Board have a process to evaluate the management's sustainability plans to address the key issues?

4. Has the board reviewed the materiality matrix to include:

- Material ESG issues for the company in the short-term and the long-term?
- Material effects of ESG issues on all stakeholders including the planet, employees, and communities in which the company operates in for the short-term and the long-term?

Comprehensive Scope and Deployment

5. Comprehensive Scope: Does the board have a Sustainability Charter with appropriate scope?

- Does it include all areas of sustainability, such as safety, health, environmental and community impact, human rights, labor rights, anti-corruption, and business ethics?
- Does it include the responsibilities throughout the value chain?
- Does it include product responsibilities throughout the life cycle of the corporation's full product portfolio?
- Does it include highest standards of conduct in all the jurisdictions that the corporation operates in?

6. Leadership: Has the Board reviewed and approved the company's sustainability mission?

- Are the key sustainability issues identified and approved by the Board incorporated into the Corporation's strategies, policies, objectives, and associated management systems (value creation opportunities)?
- Has the Corporation allocated sufficient resources to address the key sustainability issues? (sustainability of the efforts)

7. **Deployment: Are all the executives and key employees of the corporation in different geographies familiar with the sustainability priorities of the corporation?**
    - Incentives: Does the Board link sustainability performance metrics with the remuneration policy for top management?
    - Remedies: Does the Board have an explicit policy for those who fail to follow the sustainability standards of the corporation?

Right Process and Information

8. **Does the Board have the right processes to provide guidance and oversight to the sustainability plans of the corporation?**
    - Has the Board established a special Sustainability Committee to review the sustainability risks and plans to highlight the key issues for the full Board to consider?
    - Does the Board understand the sustainability risks and impacts across the corporation's value chain and how this might impact the competitive positioning of the Corporation?
    - Does the Board provide guidance on incorporation of sustainability issues to corporate strategy and focus on sustainability driven innovation, value creation opportunities?
    - Does the Board provide sufficient oversight to the management's identification of risks and opportunities of sustainability issues, including those related to strategy, regulatory and legal liability, product development and pricing, disclosure, and reputation, as well as the management's action plans?
    - Does the Board have access to outside experts on various dimensions of sustainability to receive second opinion on management reports on sustainability issues?
    - Has the Board allocated specific and sufficient time during its annual time budget to adequately review sustainability issues for the corporation?
    - Does the Board conduct a regular self-evaluation exercise that incorporates the Board's approach and effectiveness in providing guidance and oversight on sustainability issues?

9. **Does the Board receive timely and adequate information to evaluate the performance of the Corporation's sustainability plans?**
   - Oversight of the quality of implementation: Does the Board regularly receive sufficient information about the sustainability performance of the corporation, including comparisons with past performance and budget targets?
   - Continuous learning: How about lead indicators, current trends, emerging issues, emerging benchmarks, compliance with applicable laws and regulations, and the key upcoming regulations and standards?
   - Is information about the level of intellectual capital and reputation of the Corporation measured and made available to the Board?
   - Does the board receive findings and recommendations from any investigation or audit by the internal audit department, external auditors, regulatory agencies, corporation's insurance companies, or third-party consultants concerning the corporation's sustainability matters on a timely basis?

Global Goals, Disclosure, and Learning

10. **Partnership for Goals**
    - Has the company incorporated SDGs into their sustainability strategy process and prioritized relevant SDGs?
    - Does the Board set targets, measure impact and monitor progress across relevant SDG categories?
    - Does the Board evaluate potential partnership opportunities for progress against goals and measure the combined impact of cooperative initiatives?

11. **Reporting and Communication**
    - Has the Board adopted a disclosure policy for the Corporation's sustainability program, and does it review the Disclosure on management approach to sustainability?
    - How does the board ensure itself that the sustainability reporting by the company is adequate, appropriate, and verifiable?

12. **Continuous Learning: How does the Board ensure continuous learning both within the organization, and throughout the supply chain regarding developing sustainability issues?**

Argüden Governance Academy is a non-profit foundation dedicated to improve the quality of "governance" by increasing trust for the institutions to help build a better quality of life and a sustainable future.

Academy's **Purpose** is: Improving quality of life and sustainability of the future.
Its **Mission** is: Improving quality of governance to improve trust for organizations.
Its **Vision** is: Being 'a center of excellence' for development and widespread adoption of good governance culture.
And the **Target Audience** is: Leaders of private sector companies, NGOs, public institutions, and international organizations; as well as individuals of all ages, from 7 to 77.

The Academy conducts education, research, and communication activities, and collaborates with local and international think-tanks, NGOs, and organizations to promote good governance.

Argüden Governance Academy is committed to play a pioneering role by adopting "Integrated Thinking" and "Good Governance Principles" in all its work and stakeholder relationships.

The Academy aims to:

- Ensure that good governance is adopted as a culture,
- Raise the understanding of "the key role of good governance in improving quality of life and sustainability of the planet",
- Guide the institutions by developing methods to ease the implementation of good governance principles,
- Inspire future leaders by promoting "Best Practices" of good governance,
- Increase the next generation leaders' experience of good governance,
- Disseminate global knowledge and experience at all levels of the society with a holistic approach,
- Become "the right cooperation partner" for the leading institutions in the world by creating common solutions for global issues.

The Academy advocated "Integrated Thinking" during Türkiye's presidency of the G20 and adopts this culture in all its activities.

Argüden Governance Academy became the first non-governmental institution in the world to report its work as an Integrated Report since its founding.

The Academy has been accredited by the Council of Europe to lead the awarding process of the European Label of Governance Excellence in Türkiye.