

# Corporate Governance

Integrated Governance for Sustainability

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# Agenda

**New Developments**

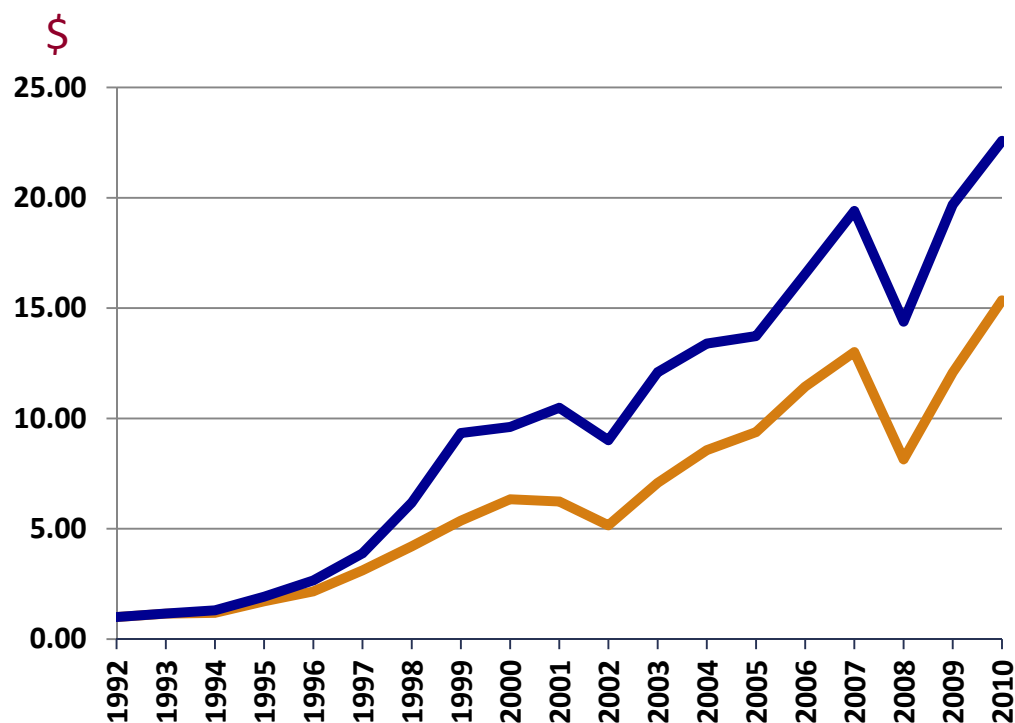
**Integrated Governance**

# Sustainable strategy

Sustainable strategy: Does it pay off?

Two initially virtually identical sets of firms in terms of industry membership, size, financial performance, capital structure, and growth prospects. One group included firms that in early 90s had adopted corporate policies regarding commitments to enhance environmental and social performance

- ✓ **Board responsibility**
- ✓ **Executive compensation**
- ✓ **Measurement and Reporting**

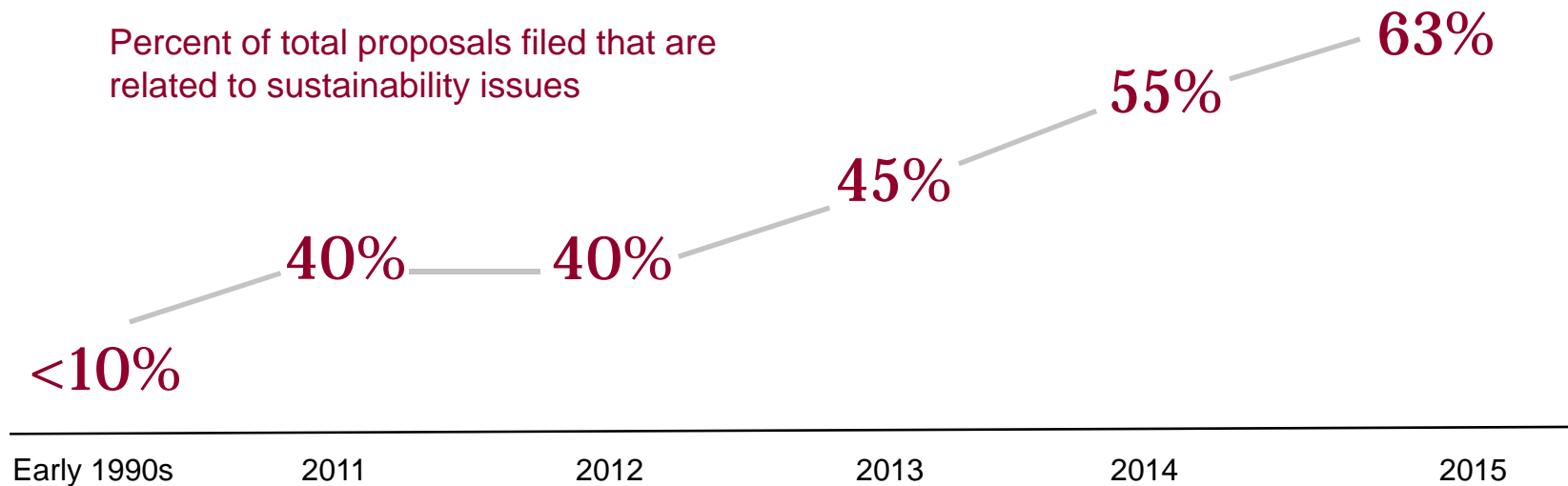


\* Robert G. Eccles, Ioannis Ioannou and George Serafeim, 2014.  
“The impact of Corporate Sustainability on Organizational Processes and Performance” *Management Science*

# Investor Interest

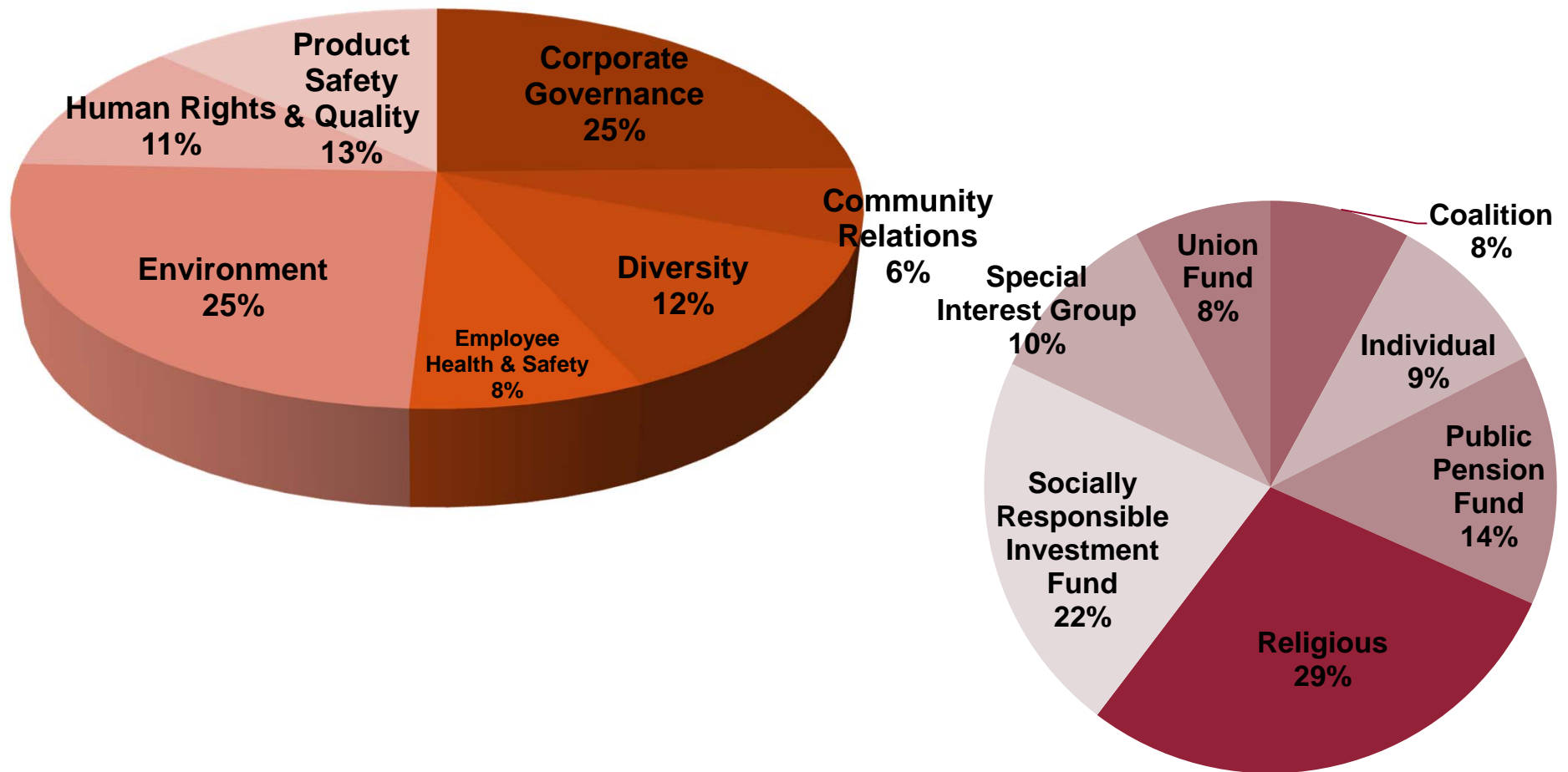
## SHAREHOLDER PROPOSALS

Percent of total proposals filed that are related to sustainability issues



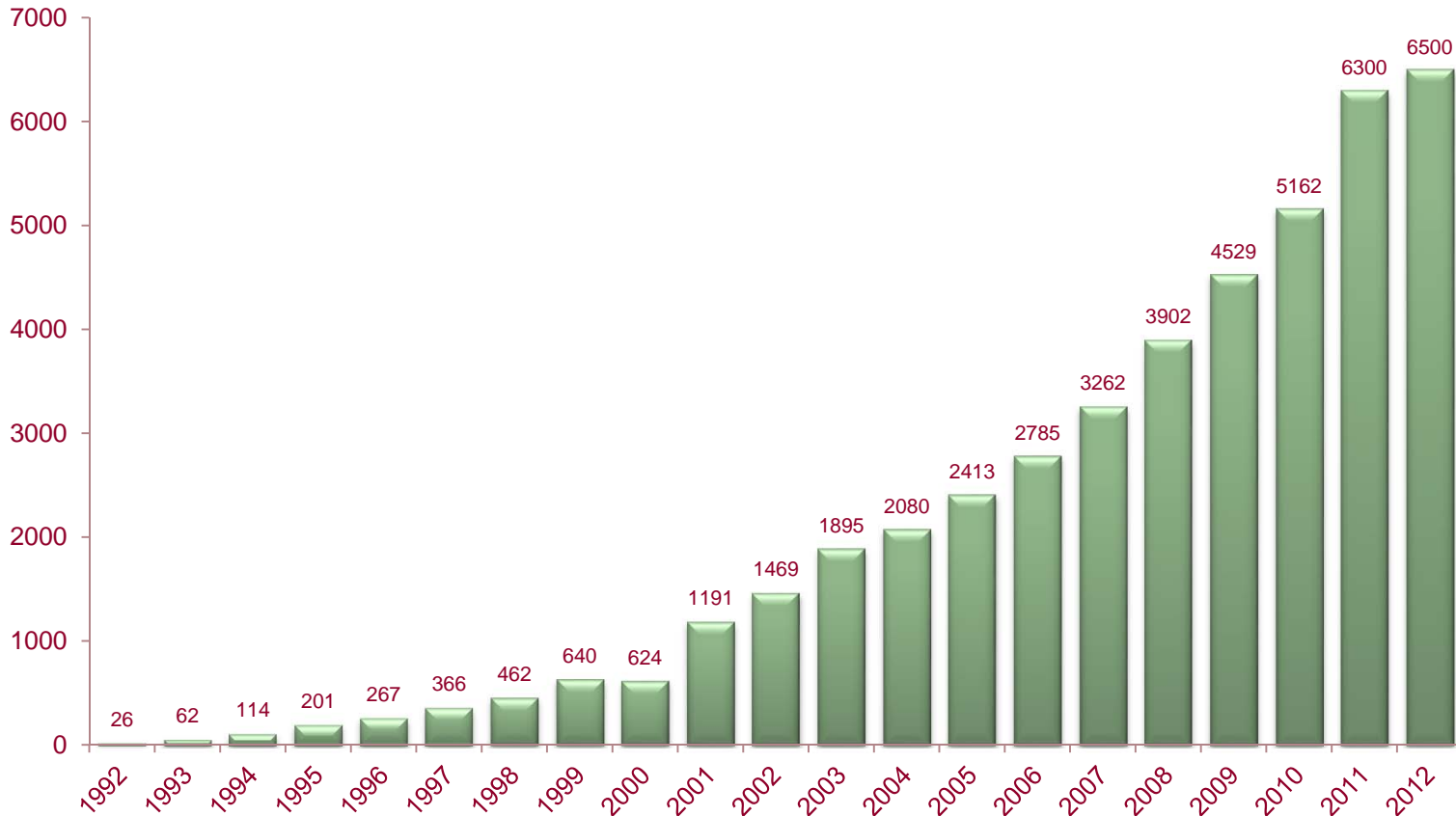
Sources: EY, 2011-2014, As You Sow, 2015

# Shareholder Proposals On ESG Issues



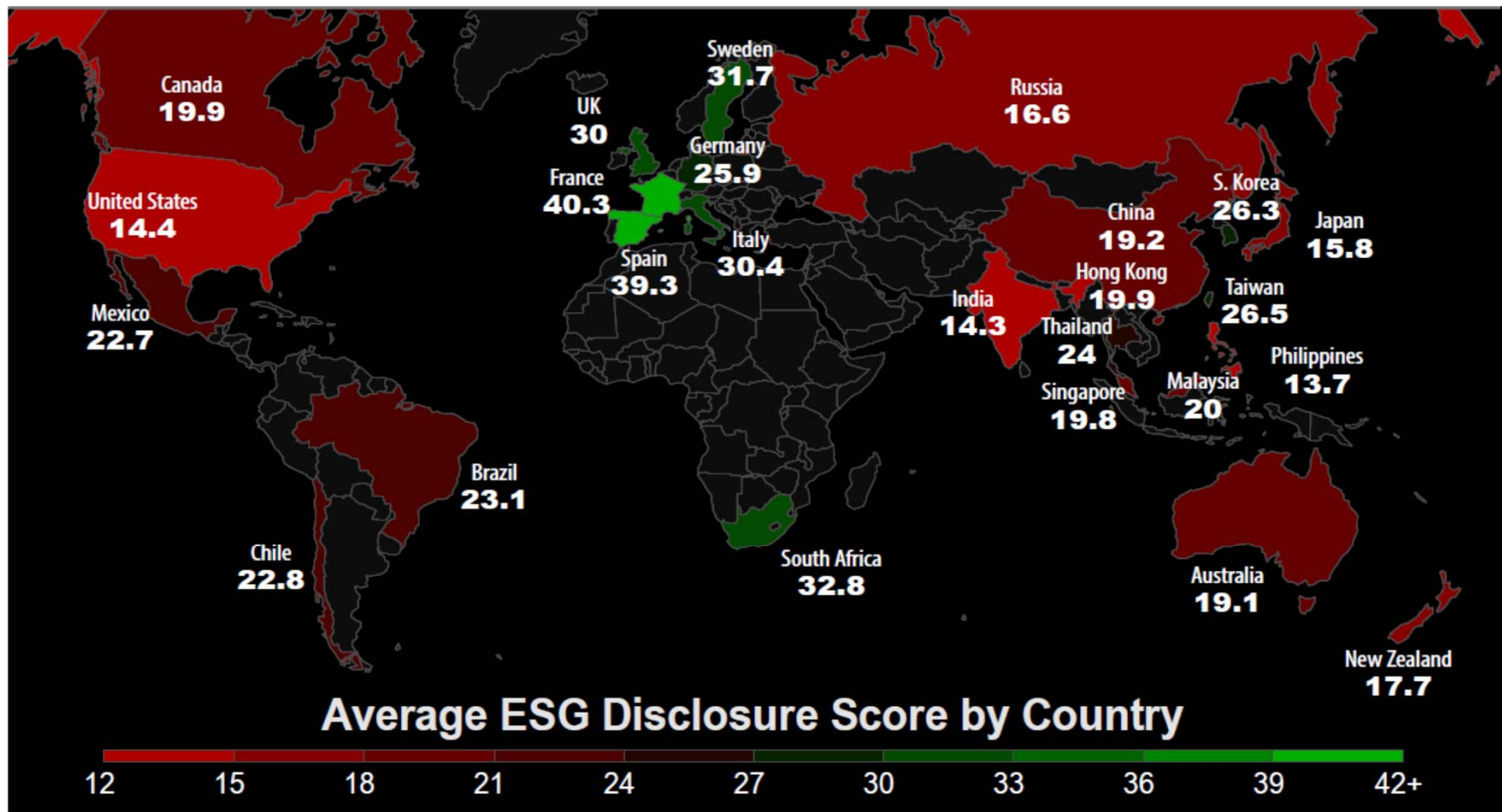
Source: Grewal, Jody, George Serafeim and Aaron Yoon. *Investor Activism on Sustainability Issues*. 2016. HBS Working Paper

# Number of Companies Issuing ESG Reports



*2015: ~ 8,500 companies representing > 65% of all market capitalization*

# ESG Disclosure across Countries



Source: Bloomberg ESG Transparency Map. Bloomberg Terminal. Based on a sample of 12,022 actively traded companies. Data as of 10/02/2015.

# ESG Reporting Mandates across Stock Exchanges

**Table 2.1: Sustainability measures becoming more widespread among world's stock exchanges**  
A snapshot of sustainability measures in 55 stock exchanges

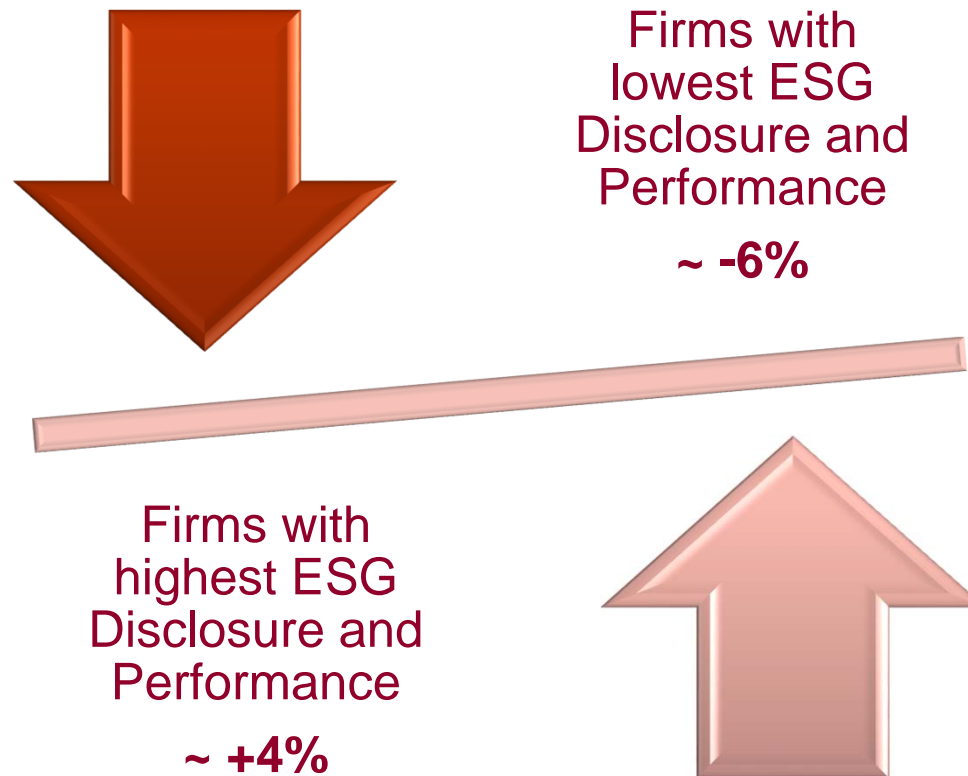
Country of Primary Business or Headquarters Location	Stock Exchanges	Number of listed companies	Market Cap in USD millions	SSE Partner Exchange	Requires environmental and social reporting?	Offers sustainability guidance or training for companies?	Offers sustainability guidance or training for investors?	Provides sustainability related indices?
Argentina	<a href="#">Bolsa de Comercio de Buenos Aires</a>	104	53,105	No	No	No	No	No
Australia	<a href="#">Australian Securities Exchange</a>	2048	1,365,958	No	Yes	No <sup>2</sup>	No	No
Austria	<a href="#">Wiener Börse AG</a>	104	117,671	No	No	No	No	Yes
Bermuda	<a href="#">Bermuda Stock Exchange</a>	58	1,566	No	No	No	No	No
Brazil	<a href="#">BM&amp;FBOVESPA S.A.</a>	366	1,206,426	Yes	Yes	Guidance, Training	Guidance	Yes
Canada	<a href="#">TMX Group Inc.</a>	3,873	2,113,822	No	Yes	Guidance, Training	Training	Yes
Chile	<a href="#">Bolsa de Comercio de Santiago</a>	307	265,150	Yes	No <sup>1</sup>	No	No	No
China	<a href="#">Shanghai Stock Exchange</a>	964	2,615,035	No	Yes	Guidance	No	Yes
China	<a href="#">Shenzhen Stock Exchange</a>	1,575	1,452,154	No	No	Guidance	No	Yes
Colombia	<a href="#">Bolsa de Valores de Colombia</a>	78	202,693	Yes	No	Training	Guidance	No
Cyprus	<a href="#">Cyprus Stock Exchange</a>	95	2,105	No	No	No	No	No
Egypt	<a href="#">Egyptian Exchange</a>	213	73,372	Yes	No	No	No	Yes
Germany	<a href="#">Deutsche Börse AG</a>	720	1,936,106	Yes	No <sup>1</sup>	Guidance, Training	No	Yes
Greece	<a href="#">Athens Exchange Group</a>	251	82,594	No	No	No	No	No
Hong Kong, China	<a href="#">Hong Kong Exchanges</a>	1,657	3,100,777	No	No <sup>1</sup>	Guidance, Training	No	No
India	<a href="#">BSE India Ltd.</a>	5305	1,138,834	Yes	Yes <sup>3</sup>	Guidance	No	Yes
India	<a href="#">National Stock Exchange of India</a>	1,683	1,112,952	No	Yes	Guidance	No	Yes
Indonesia	<a href="#">Indonesia Stock Exchange</a>	483	346,674	No	No	No	No	Yes
Ireland	<a href="#">Irish Stock Exchange</a>	50	177,514	No	No	No	No	No
Israel	<a href="#">Tel-Aviv Stock Exchange</a>	495	203,301	No	No	No	No	No
Jamaica	<a href="#">Jamaica Stock Exchange</a>	57	4,648	Yes	No	No	No	No
Japan	<a href="#">Japan Exchange Group, Inc.</a>	3,416	4,668,219	No	No <sup>1</sup>	No	No	Yes
Jordan	<a href="#">Amman Stock Exchange</a>	237	26,538	No	No	No	No	No
Kazakhstan	<a href="#">Kazakhstan Stock Exchange</a>	80	26,359	No	No	No	No	No
Korea, Republic of	<a href="#">Korea Exchange</a>	1,815	1,234,549	No	No <sup>1</sup>	No	No	Yes
Luxembourg	<a href="#">Bourse de Luxembourg</a>	274	78,641	No	No	No	No	Yes
Malaysia	<a href="#">Bursa Malaysia</a>	909	500,387	No	Yes	Guidance, Training	No	Yes
Malta	<a href="#">Malta Stock Exchange</a>	37	13,180	No	No	No	No	No
Mauritius	<a href="#">Stock Exchange of Mauritius</a>	94	9,300	No	No	No	No	No
Mexico	<a href="#">Bolsa Mexicana de Valores</a>	143	526,016	Yes	No	Training	No	Yes
Morocco	<a href="#">Bourse de Casablanca</a>	75	53,831	No	No	No	No	No
Netherlands (HQ) & others	<a href="#">Euronext</a>	1,067	3,623,096	No	No	No	No	Yes
New Zealand	<a href="#">NZX Limited</a>	147	83,919	No	No	No	No	No
Nigeria	<a href="#">Nigerian Stock Exchange</a>	196	117,126	Yes	No	No	No	No

Source: George Serafeim and Grewal, Jody. 2016. *ESG Metrics: Reshaping Capitalism?*. HBS Technical Note. 2016



# Competition Effect

Stock Price Reactions around EU Nonfinancial Disclosure Mandate



Source: Jody Grewal, Eddie Riedl and George Serafeim. 2015. Market Reaction to Mandatory Nonfinancial Information. HBS Working Paper.

# SASB's Sector Level Materiality Map

Issues	Health Care	Financials	Technology & Communication
<b>Environment</b>			
GHG emissions			
Air quality			
Energy management			
Fuel management			
Water and wastewater management			
Waste and hazardous materials management			
Biodiversity impacts			
<b>Social Capital</b>			
Human rights and community relations			
Access and affordability			
Customer welfare			
Data security and customer privacy			
Fair disclosure and labeling			
Fair marketing and advertising			
<b>Human Capital</b>			
Labor relations			
Fair labor practices			
Employee health, safety and wellbeing			
Diversity and inclusion			
Compensation and benefits			
Recruitment, development and retention			

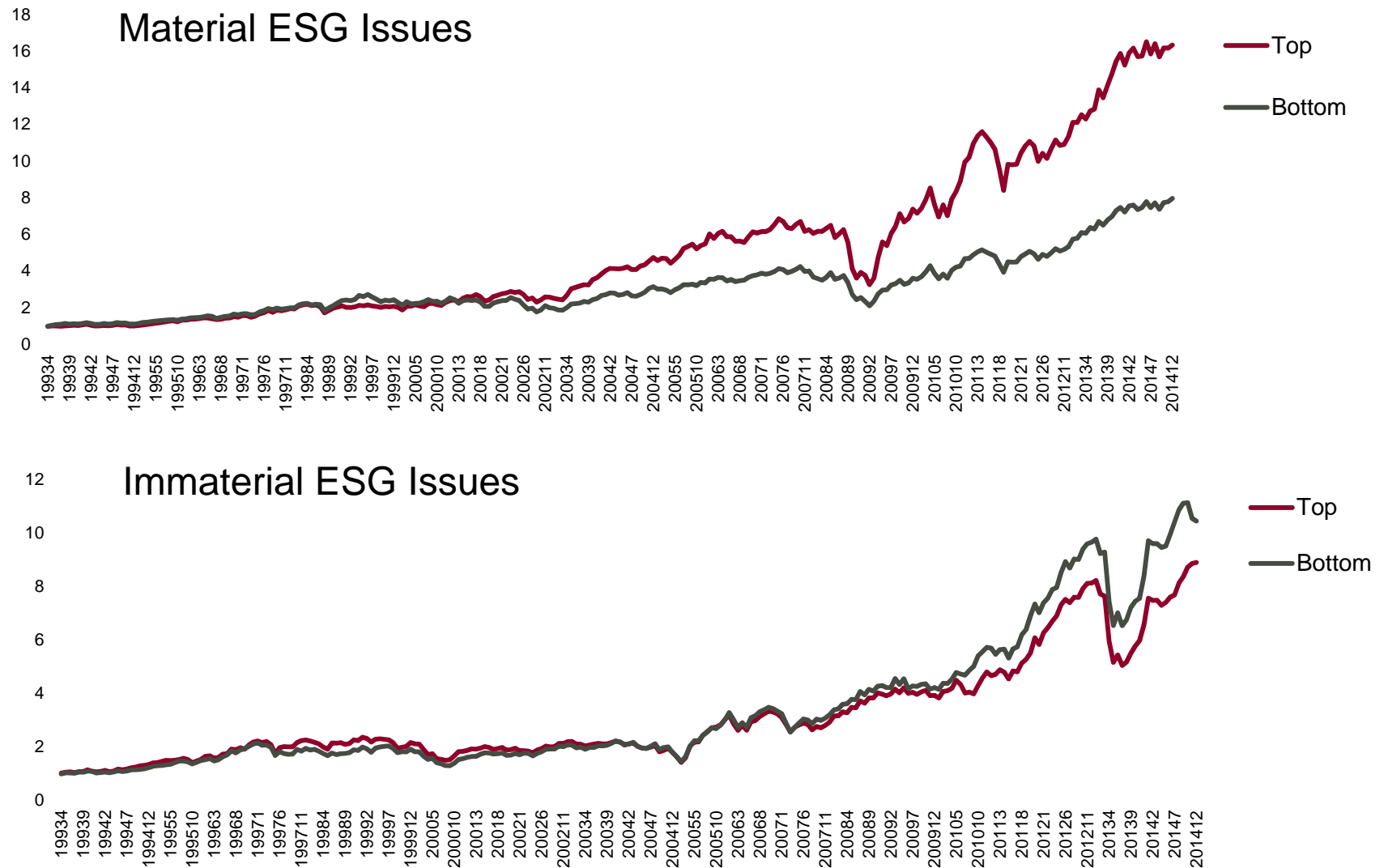
Source: Sustainability Accounting Standards Board. [www.sasb.org](http://www.sasb.org).

## Financially Material Metrics

**~20 percent**

# Stock Price Performance of Portfolios

Khan, Mozaffar, George Serafeim, and Aaron Yoon. "Corporate Sustainability: First Evidence on Materiality." *Accounting Review* (forthcoming).



# Future Stock Price Performance

Materiality Index	Low	High			Low	High		
	Value-weighted				Equal-weighted			
	Annualized Alpha		Difference		Annualized Alpha		Difference	
Alternative Factor Models								
Raw return	7.18%	10.64%	3.47%	**	12.05%	15.72%	3.67%	**
5-factor alpha	-1.27%	2.91%	4.18%	***	1.96%	4.65%	2.69%	*

Immateriality Index	Low	High			Low	High		
	Value-weighted				Equal-weighted			
	Annualized Alpha		Difference		Annualized Alpha		Difference	
Alternative Factor Models								
Raw Return	7.11%	8.65%	1.54%		13.11%	11.77%	-1.34%	
5-factor alpha	-0.15%	1.22%	1.37%		3.49%	3.01%	-0.49%	

Khan, Mozaffar, George Serafeim, and Aaron Yoon. ["Corporate Sustainability: First Evidence on Materiality."](#) *The Accounting Review* (forthcoming).

# Future Growth in Return-on-Sales

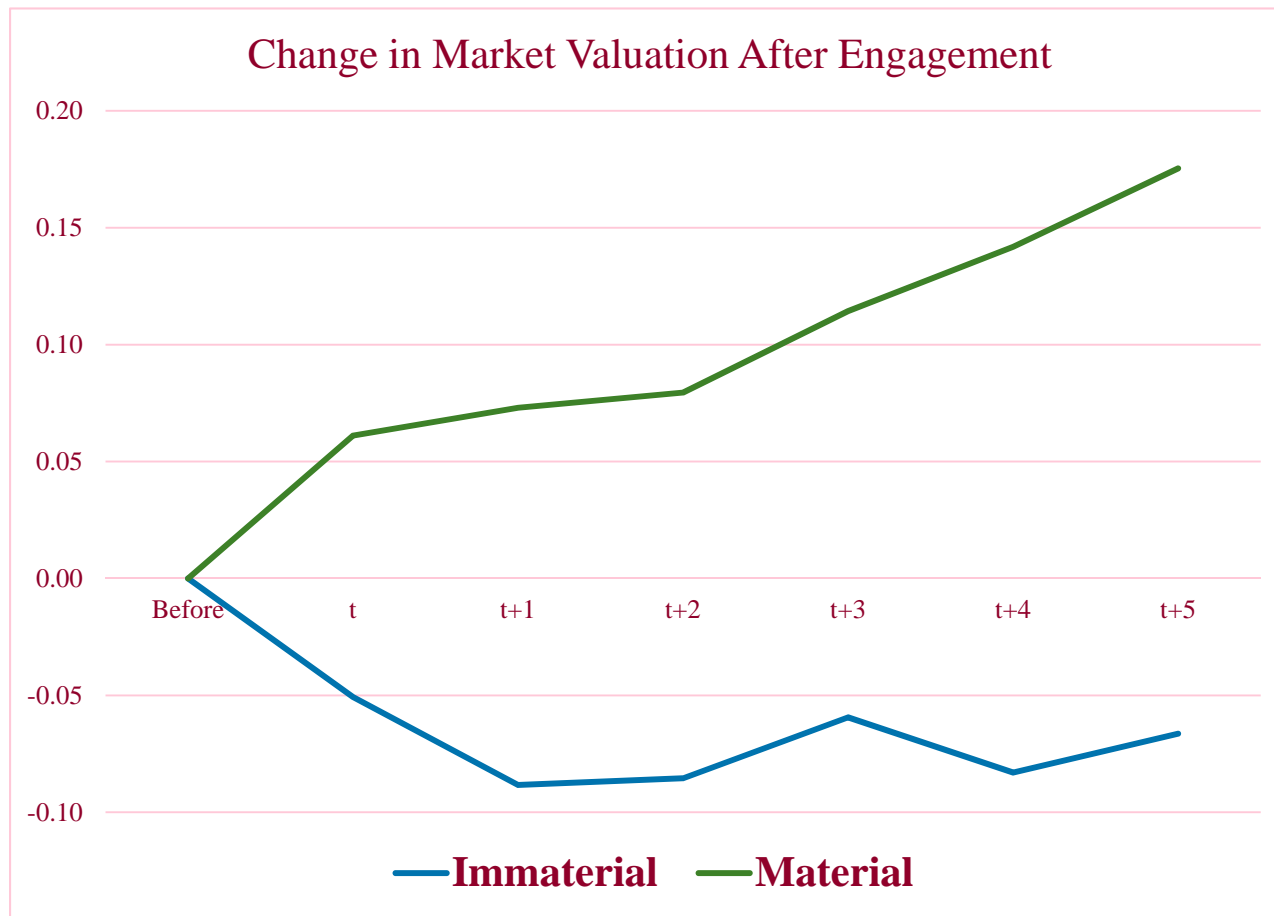
Material Issues	t=0 to t=3
Low	-2.51%
High	4.74%
Difference	7.26%
t-stat	2.73
Immaterial Issues	t=0 to t=3
Low	-0.27%
High	-3.68%
Difference	-3.41%
t-stat	-1.34

Khan, Mozaffar, George Serafeim, and Aaron Yoon. ["Corporate Sustainability: First Evidence on Materiality."](#) *The Accounting Review* (forthcoming).

## Shareholder ESG Proposals: Material?

**~40 percent**

# Effect on Shareholder Value



Source: Grewal, Jody, George Serafeim and Aaron Yoon. *Investor Activism on Sustainability Issues*. 2016



# The Role of Governance

Are current governance practices adequate?

## Expertise

Do board directors have the expertise to govern an organization?

**NVIDIA:** generated 78%, 83% and 84% of total revenue for years 2012, 2011, 2010 from sales to customers outside US. NVIDIA has a nine-person board yet only one member has international work experience

## Time

Are directors spending enough time governing?

**Sirius XM Radio:** 13 board members, 7 meetings a year. Members sit on an average 2.9 boards with 3 directors sitting on more than 4 boards

## Compensation Incentives

Are compensation incentives, especially for the CEO aligned to serve long-term competitiveness?

Examining a list of 20 CEOs who have profited the most from stock options in the period 1992-2005 12 out of 20 companies underperformed their competitors in the future

# Integrated Governance

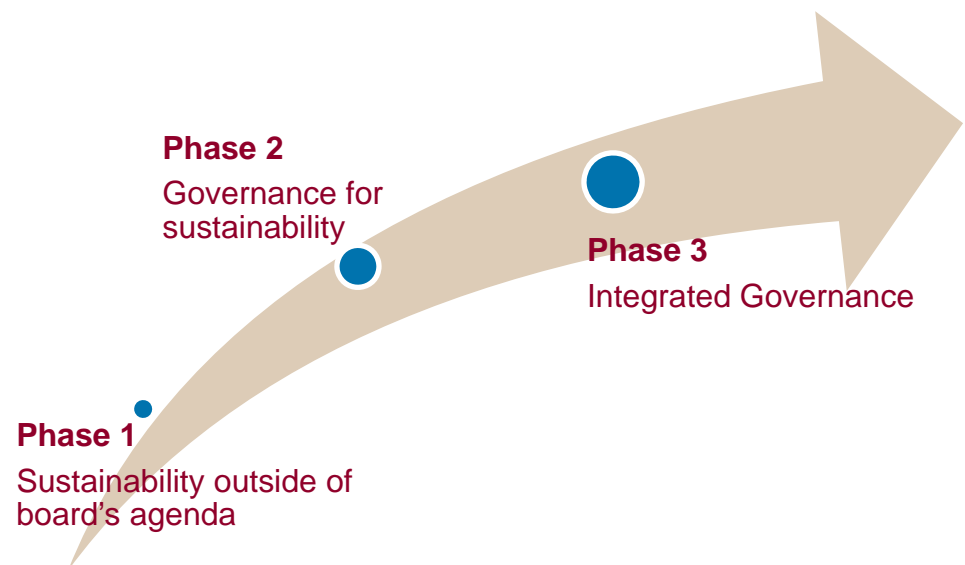
## The challenge

- How corporate governance interacts with sustainability?
- How can corporate governance promote the formation of sustainable strategies?
- How can some of the current weaknesses in governance practices be addressed?

## Integrated Governance definition

Integrated governance is “the system by which companies are directed and controlled, in which sustainability issues are integrated in a way that ensures value creation for the company and beneficial results for all stakeholders in the long term.”

There are three major stages, each with its unique characteristics that describe the journey each company has to go through to achieve a model of integrated governance.



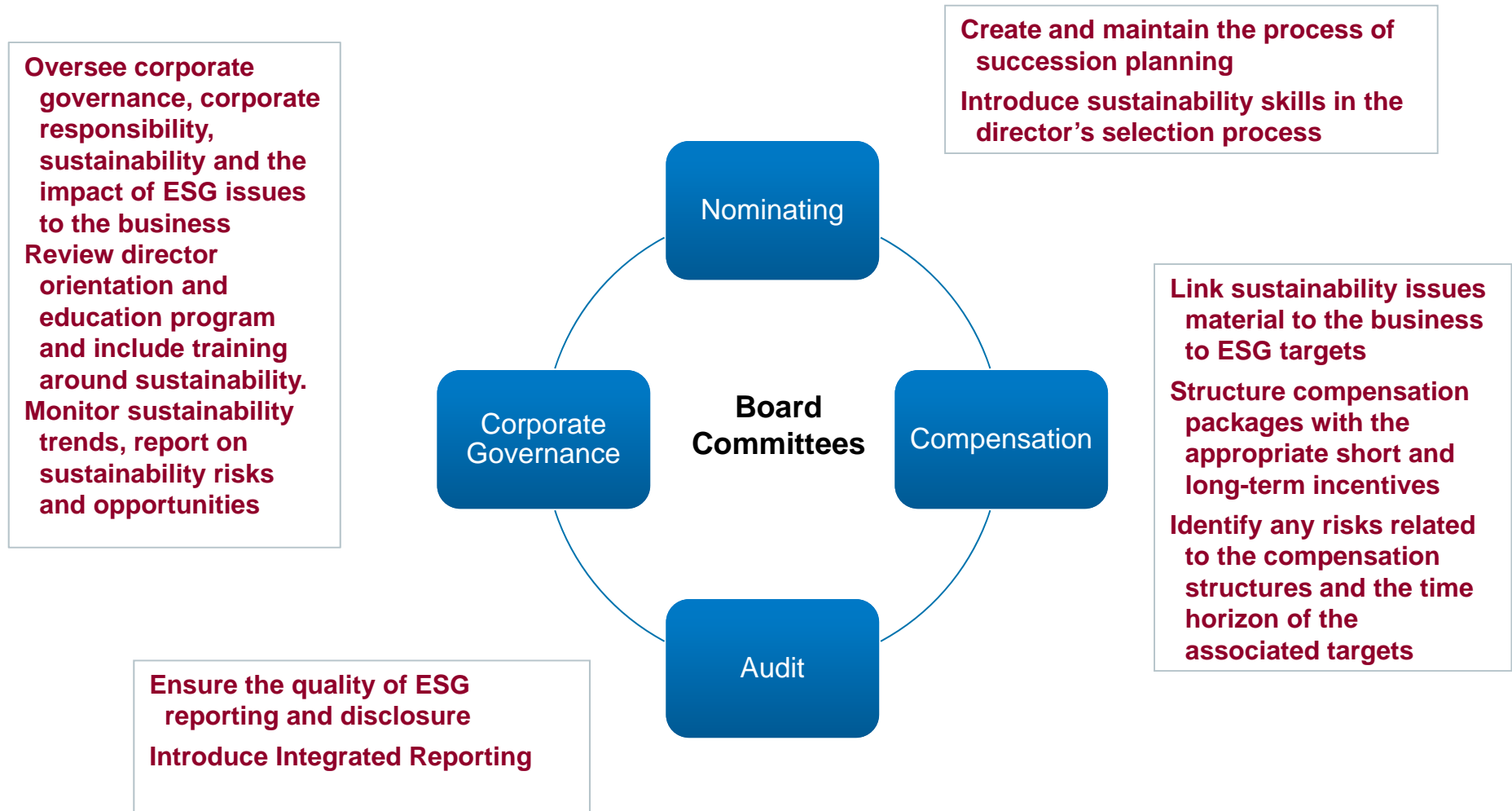
Source: KKS and UNEPFI. Integrated Governance: A new model of governance for sustainability. 2014.

# Integrated Governance



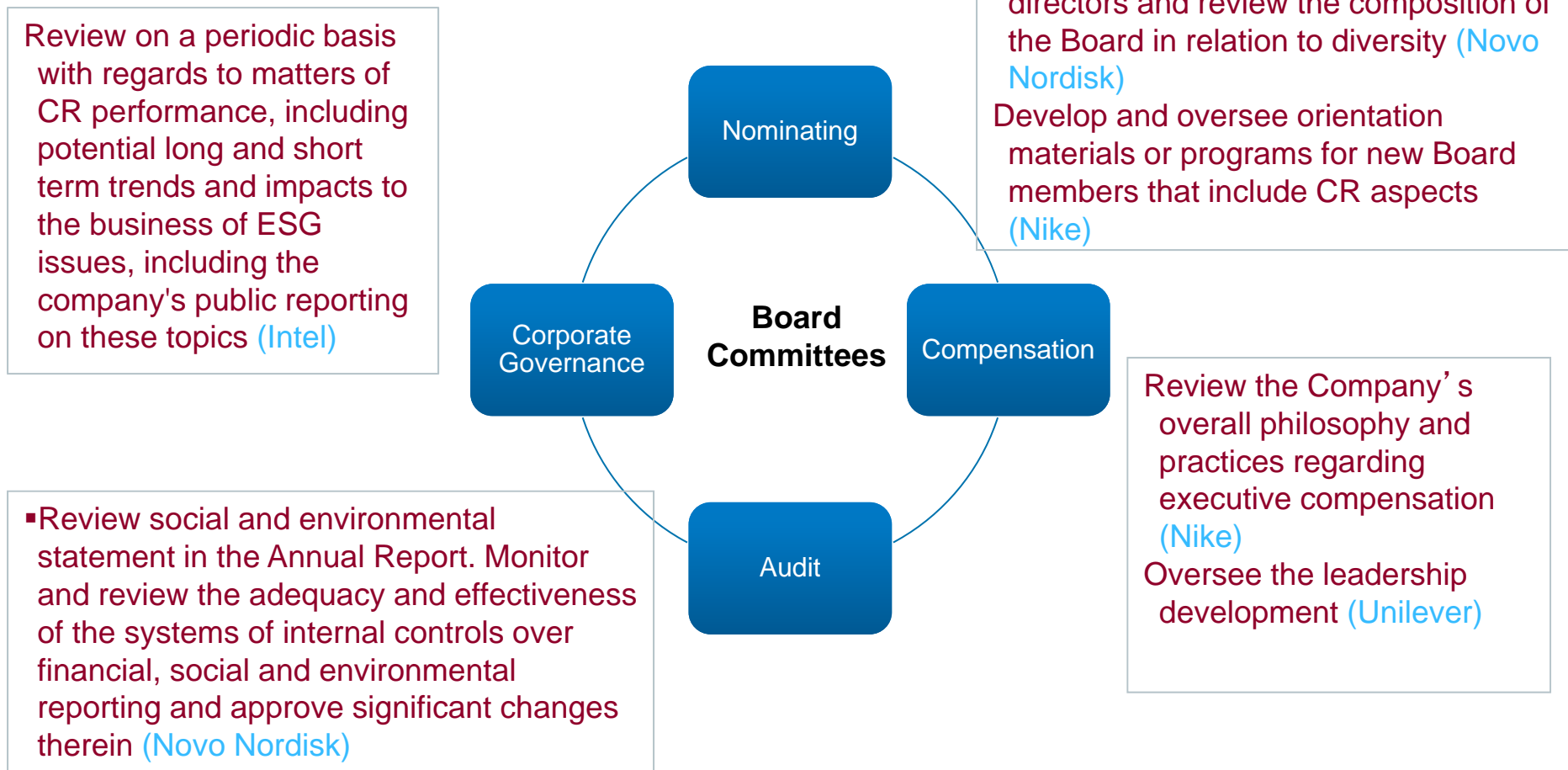
# Integrated Governance

Committee charters as the link of governance with sustainability



# Committee Charters

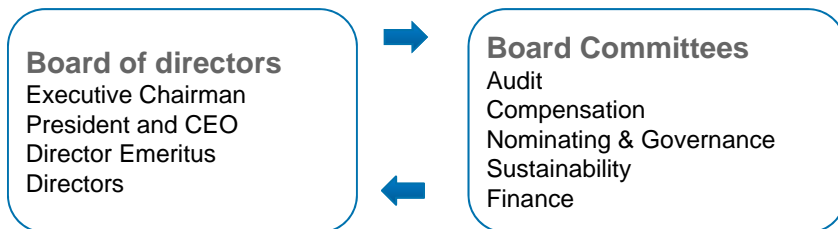
## Company examples



# Case study

## Ford Motor Company, a multinational automaker headquartered in Michigan, US

### Board-level Governance



### Sustainability Management



### Sustainable Mobility Governance

Senior-level team led by the VP Sustainability – responsible for defining the climate change strategy and delivering the sustainability strategy in the marketplace

### Key Business Processes

Business Plan Review	Ford Production System
Global Product Development System	ISO 14001 Certification
Special Attention Review	Order-to-Delivery

### Structures for Managing Sustainability

#### Board and Executive-Level responsibility

- Sustainability Committee has primary responsibility for reviewing strategic sustainability issues
- Some issues are addressed in other committees and by the board as a whole
- Within management, VP of sustainability has primary responsibility for sustainability issues

#### Dedicated Sustainability Functions

- Ford's Sustainability & Vehicle Environmental Matters office coordinates corporate-wide sustainability strategy, including reporting, stakeholder engagement and integrating sustainability throughout the Company

#### Integration into Core Functions

- Numerous functions within the company have responsibility for some or multiple aspects of sustainability. For example Global Purchasing is managing sustainability issues in the supply chain

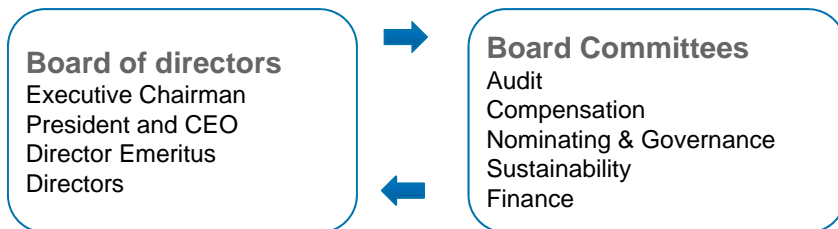
#### Issue-Specific Structures:

- Structures to address specific global sustainability issues. For example, Sustainable Mobility Governance Forum – senior-level team led by the VP of sustainability responsible for defining a climate change strategy and delivering sustainability strategy in the marketplace

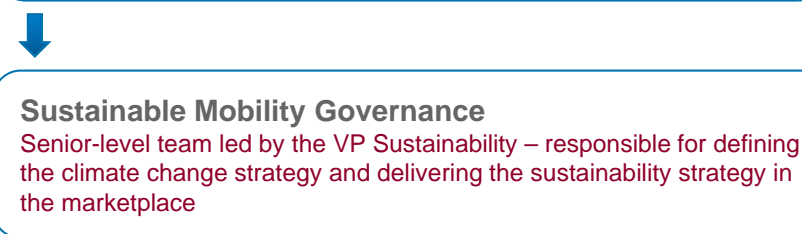
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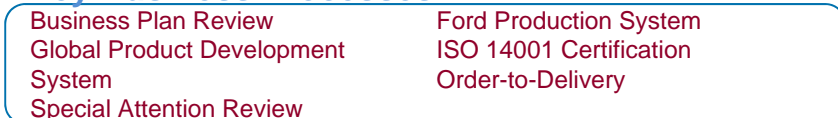
### Board-level Governance



### Sustainability Management



### Key Business Processes



### Key Processes for Integrating Sustainability

*Integrating sustainability considerations into existing systems and processes rather than creating new systems and processes is the most effective way to embed sustainability into the business*

#### Business Plan Development and Compensation

- Aligned elements of performance and compensation to support ONE Ford plan
- Executive compensation includes sustainability metrics
- Sustainability targets are integral to company-wide achievements and translate primarily into product and financial performance metrics

#### Business Plan Review

- Sustainability issues are a formal part of Ford's weekly Business Plan Review meetings, one of the key management processes. Sustainability scorecard is reviewed alongside other units' scorecards at the meetings

#### Corporate Policy Letters and Directives

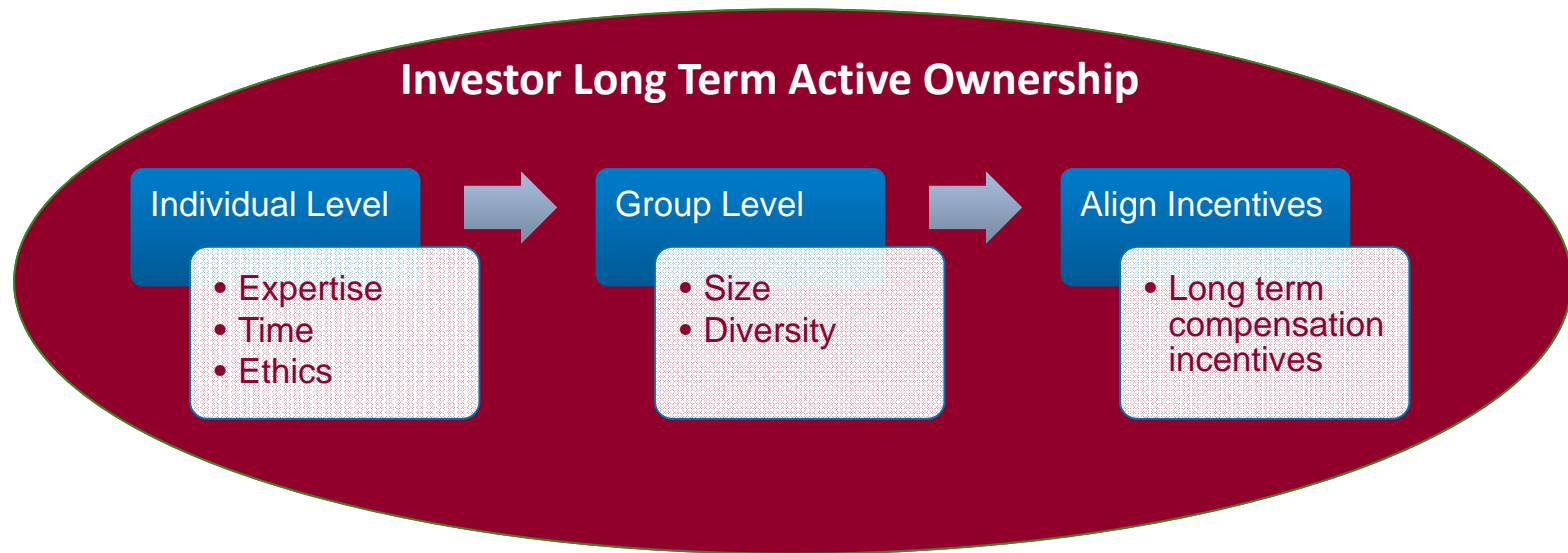
- Policy Letters, Directives and other corporate standards that govern all company activities relate to aspects of sustainability

#### Management Systems

- Systems and processes to manage different aspects of the business incorporate sustainability issues

# Integrated Governance

The four main components of Integrated Governance



Source: KKS and UNEPFI. Integrated Governance: A new model of governance for sustainability. 2014.



# Integrated Governance

Some of the recommendations around Integrated Governance

