ISSUE 130

BOARD PERSPECTIVES:

Risk Oversight

ONE YEAR LATER: DOES THE BUSINESS ROUNDTABLE STATEMENT MATTER?

A year ago, the Business Roundtable (BRT) released its "Purpose of a Corporation"[1] statement expressing a "fundamental commitment" to deliver value to all company stakeholders. Today, as the economy emerges from a terrible pandemic, does this statement matter to directors?

The BRT's statement in which 181 chief executives of prominent American companies committed to deliver value to their respective stakeholders (consisting of customers, employees, suppliers, communities and shareholders) has drawn varying reactions in the marketplace. In our view, the statement is an acknowledgment from these business leaders that:

- **Delivering superior financial results isn't good enough.** This is a message institutional investors and asset managers overseeing trillions of dollars in sustainable, responsible and impact-investing assets have conveyed to CEOs and their boards in recent years. It emphasizes the importance of environmental, social and governance (ESG) matters and turning the volume down on myopic short-termism behavior.
- **Government activism is on the rise.** With rising demands for social justice and changing expectations from multiple stakeholders as markets rebound from the COVID-19 experience, more Americans, particularly those who are younger or fall into various minority groups, view capitalism as failing to address present-day environmental and social challenges. Accordingly, proponents of governmental intervention are proposing significant taxpayer-funded alternatives to address these challenges.

[1] "Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans,'" Business Roundtable, August 19, 2019: www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans.

- **Formidable political gridlock does not offer solutions.** Current and foreseeable political realities raise reasonable doubts about whether the public sector can lead effectively in addressing inequality, climate change, water and resource scarcity, and other 21st-century issues.
- **The status of international affairs adds to the uncertainty.** Geopolitical tensions are forcing their way into the strategic calculus being debated in the C-suite and boardroom as companies revisit old assumptions about the merits of doing business in certain markets, countries and regions.

The above matters are not just American issues, but global concerns that require systemic thinking and expansive cooperation across both the private and public sectors.

The bottom line: More and more people perceive that the traditional corporate focus on shareholder interests and maximizing profits is not fit for purpose if it functions in a vacuum that places environmental and social concerns in a category of issues belonging to other institutions. The implied intent of the BRT statement is that the private sector should contribute to addressing these concerns in the context of sustainable development.

One of the challenges in evaluating whether the BRT statement really matters is that more than a few companies believe it merely codifies what they are already doing. This belief is understandable given the lack of uniform, global standards for identifying appropriate stakeholder interests and measuring progress toward addressing them. Therefore, there is ample opportunity for discretion in interpreting whether these interests are being addressed adequately. The reality is that the statement is one of intention — and progressing from intention to buy-in, ownership, action and accountability takes time.

A careful read of the BRT statement makes a few points clear. First, each company "serves its own corporate purpose," so there is an explicit acknowledgment that not all companies are alike. Second, each company "share[s] a fundamental commitment to all … stakeholders," specifically to deliver value to customers, invest in employees, deal fairly and ethically with suppliers, support communities in which the company operates, and generate long-term value for shareholders.

In the United States, under Delaware law (where many companies are incorporated), directors have a fiduciary duty to act in the best interests of shareholders. This question of balancing accountability with diverse interests can thus be tricky. The BRT's statement does not alter the reality that shareholders own the company, and that the board and CEO act on their behalf. From a practical standpoint, the statement must be applied in that context. The good news is that this isn't hard to do. Treating customers, employees and suppliers right and sustaining the communities in which the company operates are solid, long-term plays that benefit shareholders, provided that acceptable financial performance is delivered concurrently.

Stakeholder commitments should not be viewed as mutually exclusive, but rather as integrated — meaning, they are integral to generating sustainable long-term shareholder value. Thus, boards and their CEOs must rationalize the balancing of these interests in this manner because, by law, the board cannot ignore the primacy of shareholders' interests.

The lack of global reporting standards offering sufficient comparability and transparency to investors and the market for assessing the adequacy of what companies are doing is the proverbial ball and chain that hampers progress. Without such standards, skepticism regarding the corporate community's commitment to action is likely to remain high in an environment where reasonable people differ as to what the appropriate level of commitment entails.

But comparable ESG reporting offers a glimpse beyond current profitability to longer-term factors that may be more critical to sustainable success. It also depicts how management is considering — as well as balancing — the diverse interests of relevant stakeholders. Armed with such reporting across the market, investors can decide whether to remain invested in the corporation or redirect their capital elsewhere.

Many are rethinking the corporation's purpose amid the recognition that to succeed, organizations must attract three things: customers, talent and investors. In recent years, all three have expressed a preference for companies that contribute to a positive environmental and social impact over those that do not:

- Clearly, customers want quality, convenience and value for money, but they have become more conscious of choosing environmental and social impact when that option is available to them.
- Talent seeks opportunity, compensation and flexibility, but environmental and social impact — along with a trust-based culture — can be a difference-maker in choosing and remaining loyal to an employer.
- Sources of capital demand an attractive risk/reward trade-off. But they are also recognizing the long-term benefit of investing in effectively governed companies delivering a positive environmental and social impact.

This is why we believe that companies balancing the needs of shareholder interests with the interests of other stakeholders are more likely to possess the resilience to adapt to changing market realities than organizations focused solely on maximizing profits. ESG metrics, as well as traditional performance targets around financial results, the customer experience, innovation and human capital management, offer a balanced family of measures that set the organization's path in the right direction.

Future-ready boards are best equipped to set this tone of balance. Such boards are likely to do the following:[2]

- Engage in big-picture, out-of-the-box, bold and disruptive strategic thinking
- Constructively challenge the CEO and management team, when warranted and with recognition that a lot is on their plate, and maintain a long-term focus
- Foster diversity in skills, experiences and perspectives in the boardroom, C-suite and management ranks
- Think and act digitally
- Focus on innovation performance
- Nurture a flexible, adaptive, resilient, ethical and trust-based culture
- Ensure that appropriate sustainability objectives are defined and tied to financial results
- Communicate to shareholders a cogent story that addresses multiple stakeholder interests

While not intended to be exhaustive, the above suggestions position directors to think more broadly about stakeholder interests as they work with and through the CEO to oversee the company's affairs and also serve the long-term interests of shareholders.

Questions for Boards

Given the risks inherent in the entity's operations, has the board assessed its future-readiness so that it thinks more broadly about stakeholder interests as it serves the shareholders and advises the CEO?

[2] "Is Your Board Future-Ready?," Protiviti, *Board Perspectives: Risk Oversight*, Issue 116, June 2019: www.protiviti.com/US-en/insights/bpro116.

How Protiviti Can Help

Protiviti assists executive management and the board with the enterprise's assessment of its risks and the effectiveness of its capabilities for managing those risks, including risks related to ESG performance. Protiviti supports organizations throughout their sustainability journey by offering a holistic and integrated approach, encompassing all the following elements in order to help you Face the Future with Confidence®. For example, Protiviti can assist management with:

- **Discovery and Strategy-Setting —** Defining sustainability objectives and related strategic guidelines, assessing the maturity of the sustainability program, and understanding material topics for the business and stakeholders.
- **Data Management and Development —** Identifying data supporting the analysis of sustainability material topics and building the data collection, aggregation and validation process.
- **Performance and Reporting —** Monitoring the sustainability program objectives and reporting comprehensively and transparently the organization's ESG performances to stakeholders.
- **Governance and Risk Management —** Designing or enhancing the governance framework to better address ESG risks and compliance requirements, as well as to strengthen the internal control environment.

Audit Committee Self-Assessment Questions

In these dynamic times, it is best practice for boards and their standing committees and individual directors to self-assess their performance periodically and formulate actionable plans to improve board performance based on the results of that process. To that end, audit committees should consider the illustrative questions we have made available at ***www.protiviti.com/US-en/insights/bulletin-assessment-questions-audit-committees****. These comprehensive questions consider the committee's composition, charter, agenda and focus and may be customized to fit the committee's assessment objectives in light of current challenges the company is facing.*

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