



Corporate Governance

**THE FOUNDATION FOR CORPORATE CITIZENSHIP
AND SUSTAINABLE BUSINESSES**



Global
Corporate
Governance
Forum



Corporate Citizenship and Sustainable Businesses



Corporate citizenship — a commitment to ethical behavior in business strategy, operations and culture — has been on the periphery of corporate governance and board leadership, linked mainly to corporate reputation. However, in today's globalized and interconnected world, investors, creditors and other stakeholders have come to recognize that environmental, social, and governance responsibilities of a company are integral to its performance and long-term sustainability.

Today, these concerns help determine profits. For companies to operate successfully and sustain growth, boards must incorporate these new dimensions into their core decision-making processes.

The global financial crisis has heightened the need for corporate boards of directors to provide well-informed strategic direction and engaged oversight that stretches beyond short-term financial performance. Doing so prepares companies to more comprehensively address risks, by anticipating potentially adverse impacts on people and the environment and managing tangible and reputational risks. It can also generate wealth by creating shareholder value through an increase in business opportunities and broader access to markets.

A new vision of business is emerging — one where a set of core values, encompassing human rights, environmental protection and anti-corruption measures, guide the board's oversight, relationship with management, and accountability to shareowners.

“Good corporate governance practices instill in companies the essential vision, processes, and structures to make decisions that ensure longer-term sustainability. More than ever, we need companies that can be profitable as well as achieving environmental, social, and economic value for society.”

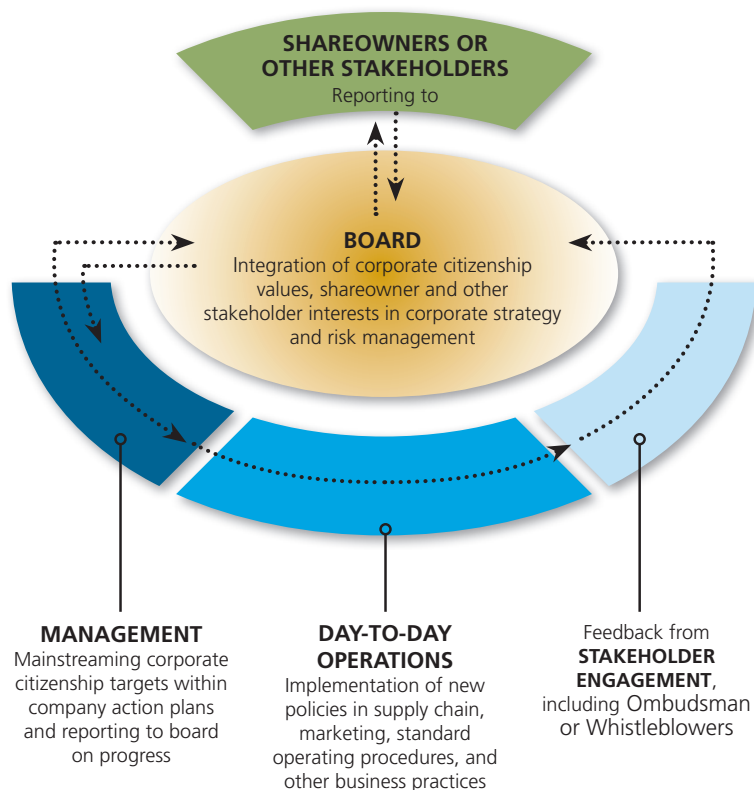
RACHEL KYTE | VICE PRESIDENT, BUSINESS ADVISORY SERVICES, IFC

Boards, collectively and directors individually, are central in accomplishing these objectives, for, as Sir Adrian Cadbury said, “corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals.”

The impetus for this new understanding of board responsibilities can be found in a growing number of global and industry-specific initiatives. Chief among these are the OECD Principles of Corporate Governance and the United Nations Global Compact.

These benchmarks inform the work of the Global Corporate Governance Forum in its efforts to promote good corporate governance practices in emerging markets and low income countries.

The figure below shows how responsible business and sustainable profits are embedded into the function of the board:



“A well-governed company takes a longer-term view that integrates environmental and social responsibilities in analyzing risks, discovering opportunities and allocating capital in the best interests of shareowners. There can be no better way to restore public confidence in both businesses and markets and build a prosperous future.”

GEORG KELL | EXECUTIVE DIRECTOR, UN GLOBAL COMPACT

“Good corporate governance is the glue that holds together responsible business practices, which ensures positive workplace management, marketplace responsibility, environmental stewardship, community engagement, and sustained financial performance. This is even more true now as we work worldwide to restore confidence and promote economic growth.”

THIERRY BUCHS
HEAD, PRIVATE SECTOR DEVELOPMENT DIVISION OF SWITZERLAND’S
STATE SECRETARIAT FOR ECONOMIC AFFAIRS (SECO)

Board Responsibilities

Today’s corporate citizenship — defined by a clear call to environmental, social and governance responsibility — links directly to three fundamental functions of boards and their directors’ duties to the companies and shareowners they serve:

- ▶ *Protecting stakeholder rights and interests*
- ▶ *Managing risk*
- ▶ *Creating long-term business value*

The following sections explain how these aspects link through the OECD Principles and UN Global Compact. The examples of strategies illustrate the business benefits of proactive leadership.

PROTECTING STAKEHOLDER RIGHTS AND INTERESTS

The OECD Principles call on businesses to recognize and safeguard stakeholders’ rights, including legitimate interests and information needs. These Principles call on boards to be truly accountable to shareowners and to take ultimate responsibility for their firm’s adherence to a high standard of corporate behavior and ethics.

Effective corporate governance requires due diligence in rallying the support and commitment of the broad network of business stakeholders, including shareowners, employees, customers and communities. If stakeholders are adversely affected by a company’s actions, shareowner value will suffer. With the growth in pension and insurance funds and other institutional investors, shareowners are increasingly also company stakeholders, such as employees or customers. Therefore, these groups’ needs are increasingly interconnected.

The UN Global Compact’s ten principles similarly call on boards to address critical dimensions of concern to stakeholders. Boards that recognize the value of a holistic approach to stakeholder engagement, particularly in the environmental, social and governance realms, find that shareowners are similarly committed to such issues. This includes ongoing communication with



stakeholders about material concerns, as well as regular disclosure about company performance, ideally linked to periodic financial reporting. Responding to stakeholder concerns can have other direct business benefits:

- ▶ Widespread consensus is that the long-term costs of corruption are high for both society and business. Anti-corruption measures can strengthen relationships with stakeholders by building a culture of trust and collaboration.
- ▶ When companies enact anti-corruption initiatives that include empowering employees, this in turn can cultivate good reflexes on the part of individuals to address workplace dilemmas.
- ▶ Employees who work where their rights and needs are respected tend to be more productive, delivering higher quality work than those who are routinely mistreated.

High standards of integrity, transparency and disclosure can be influential in restoring public and investor trust in the private sector. They are also a starting point for ongoing, constructive dialogue with stakeholders, such as communities, who are affected by and can, in turn, help determine a business's performance.

Why is corporate governance important?

Corporate governance refers to the way that Boards oversee the running of a company by its managers, and how Board members are held accountable to shareowners and the company. This has implications for company behavior not only to shareowners but also to employees, customers, those financing the company, and other stakeholders, including the communities in which the business operates.

Research shows that responsible management of environmental, social and governance issues creates a business ethos and environment that builds both a company's integrity within society and the trust of its shareowners.

The OECD Principles of Corporate Governance

First published in 1999, the OECD Principles assist governments in improving the legal, institutional and regulatory framework that underpins corporate governance and ultimately helps preserve financial and economic stability. The Principles provide practical guidance for corporate governance best practices, including protection of shareowner rights and board responsibilities, to stock exchanges, investors, corporations, and others. Updated in 2004, following a spate of corporate scandals, the Principles now contain even stronger recognition of the importance of stakeholders in corporate governance as well as emphasizing the need for timely, accurate, and transparent disclosure mechanisms and communication.

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www.oecd.org/corporate

MANAGING RISK

New understandings of business risk show that boards have a legal and fiduciary responsibility to manage environmental, social and governance risks. Directors need to be informed and prepared to manage these long-term concerns alongside typical corporate directives. By addressing and managing these risks effectively, boards can position their businesses to perform well financially and secure a long-term license to operate. By failing to do so, boards can undermine their company's reputation.

More and more companies are extending their internal controls to encompass a range of ethics and integrity issues. Many investment managers examine the rigor and quality of these controls as evidence that companies are undertaking good business practices and are well managed:

- ▶ Proactively identifying possible human rights concerns allows a business to more effectively address potential risks.
- ▶ Initiatives such as the IFC-led Equator Principles — a financial industry benchmark used by more than 60 financial institutions worldwide to determine, assess and manage social and environmental risk in project financing — and the Dow Jones and FTSE4Good Sustainability Indexes have made it increasingly apparent that socially responsible practices can improve access to financial markets and reduce capital costs.
- ▶ The competitive advantage of risk management gained through anti-corruption includes ensuring alignment with customer expectations, safeguarding reputation, and meeting demands of ethical investment funds, pensions, and other investors.



Voluntary Initiatives

Voluntary initiatives such as the **OECD Principles**, the **UN Global Compact**, the IFC-led **Equator Principles** (www.equator-principles.com), the **International Corporate Governance Network** (www.icgn.org) and numerous others seek to complement regulatory frameworks while encouraging innovation and proactive management among companies who are ready to be leaders in good practice. In cases of poor governance or weak governments, voluntary initiatives can also help set an ethical bar that would otherwise be absent.

IFC, the private sector arm of the World Bank Group, is helping board directors and company managers understand sustainability-related risks and opportunities alongside other aspects of core business decisions and processes. IFC also promotes this understanding through the international platforms of the Global Corporate Governance Forum and the Equator Principles, a finance industry benchmark for assessing sustainability in private sector investments.

CREATING BUSINESS VALUE

Core to the role of any board is guiding corporate strategy and creating wealth for shareholders. Many new business opportunities are emerging to address corporate citizenship priorities. Forward-thinking businesses are best placed to benefit. Immediate benefits cited by leading companies include improved reputation, higher employee retention rates, greater productivity, and cost benefits through operational improvements and innovation in products and services.

The most effective corporate citizenship and sustainability strategies are led from the top, incorporate a wide range of stakeholder views and are aligned with the company's business priorities. This ensures a more efficient and strategic allocation of resources to these initiatives, which may generate new business opportunities:

- ▶ Improved labor practices in supplier operations can translate into improved productivity and reduced reputational risks. Better working conditions improve the efficiency of the supply chain.
- ▶ Human rights strategies, such as preventing discrimination in the workplace and promoting gender and ethnic equality in business processes, have been shown to secure diversity and increase innovation in products and services. A diverse workforce and wider customer base guide development within new markets and previously untapped customer demographics.
- ▶ Environmental programs can provide financial benefits, such as reducing operating costs, leading to new markets and technologies, improving employee morale and increasing employee health.
- ▶ Good management of environmental, social and governance performance has been shown to strengthen reputation and brand value, important business assets.

The Ten Principles of the UN Global Compact

The UN Global Compact asks companies to embrace, support and enact, within their sphere of influence, a set of core values in the areas of human rights, labor standards, the environment, and anti-corruption:

HUMAN RIGHTS

PRINCIPLE 1: Businesses should support and respect the protection of internationally proclaimed human rights; and

PRINCIPLE 2: make sure that they are not complicit in human rights abuses.

LABOR STANDARDS

PRINCIPLE 3: Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;

PRINCIPLE 4: the elimination of all forms of forced and compulsory labor;

PRINCIPLE 5: the effective abolition of child labor; and

PRINCIPLE 6: the elimination of discrimination in respect of employment and occupation.

ENVIRONMENT

PRINCIPLE 7: Businesses should support a precautionary approach to environmental challenges;

PRINCIPLE 8: undertake initiatives to promote greater environmental responsibility; and

PRINCIPLE 9: encourage the development and diffusion of environmentally friendly technologies.

ANTI-CORRUPTION

PRINCIPLE 10: Businesses should work against corruption in all its forms, including extortion and bribery.

UN Global Compact

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The **UN GLOBAL COMPACT** is the largest corporate citizenship and sustainability initiative in the world. More than 5,000 corporations and 1,500 civil society organizations from 130-plus countries are working together to help align business practices with ten universally accepted principles in the areas of human rights, labor, environment and anti-corruption. Local networks in more than 70 countries, and three working groups at the global level in the areas of human rights, labor, and anti-corruption — all formed by representatives from business, government, civil society, and labor — are deepening policy recommendations and collective action to advance the Global Compact and its 10 principles.

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www.unglobalcompact.org

Established in 1999, the **GLOBAL CORPORATE GOVERNANCE FORUM** is a multi-donor trust facility located within IFC, the private sector arm of the World Bank Group. Through its activities, the Forum aims to promote the private sector as an engine of growth, reduce the vulnerability of developing and transition economies to financial crises, and provide incentives to corporations to invest and perform efficiently in a socially responsible manner. The Forum sponsors regional and local initiatives that address the corporate governance weaknesses of middle- and low-income countries in the context of broader national or regional economic reform.

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