ecoDa
The European Voice of Directors

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PEOPLE GOVERNANCE AS A STRATEGIC CHALLENGE FOR BOARDROOMS

INTRODUCTION

Although directors owe their duties to shareholders, ecoDa is convinced that there is a need for a broad perspective and to cover the stakeholders' dimension in the boards' decision process.

Building sustainable companies should integrate the human dimension of corporate' actions. People in a business are indeed an important element of intangible asset of a company. Board members share responsibility for all aspects of the company's performance. Addressing people governance in boardrooms is a transversal way of looking at things; it involves elements of strategy (management, innovation, communication of financial and non financial elements).

The evolution of the corporate governance terrain itself is calling for a complementary approach. There are some opinions that because of the crisis, the shareholders' model should be completed by a more collective approach. Boards and companies at large are facing new pressures from different actors whether institutional investors, regulators, societal rating agencies, executive search firms, law firms, executive compensation firms, consumers, press or the civil society. Ethical investments funds and companies' reports on their environmental and social performance alongside their financial performance are contributing to non-financial goals in addition to profit. The most recent national codes of CG refer increasingly frequently to stakeholders' interests. The financial crisis as well as certain excessive remunerations have also conducted to a disengagement of the workers forces and to a confidence crisis.

There are ever more incentives to induce companies to behave in an ethical way that takes due account of corporate social responsibility (CSR) in general and of human rights in particular. As to public and private procurement, more and more use is made of social, ecological, ethical criteria in order to select suppliers. Likewise, investors are taking a closer look at extra-financial factors as part of the investment process, including corporate governance, environmental, and social and ethical issues. Investors are making decisions according to whether or not companies are putting a value statement for the board level into the way business is managed. These factors can highlight potential risk for companies and investors. Financial analysts and CG monitors are also looking at the approach of people governance to monitor the culture and behaviour of companies. Many of these extra- financial factors can also have a significant impact on a company's reputation and valuation (example: BP). Including stakeholder approach seems then to produce value for shareholders.

Corporate Social Responsibility and Social Reporting have been perceived as "corporate governance in action". It is of paramount importance that European businesses demonstrate the utmost responsibility not only towards employees and shareholders, but also towards society at large.

PRACTICAL EXAMPLE: THE FRR (FONDS DE RÉSERVE POUR LES RETRAITES)

For instance, the FRR (Fonds de reserve pour les retraites), a public agency that was set up in the service of the long-term survival of the French retirement pension system, adopted a five-year responsible investor strategy in the spring of 2008. The Strategy adopted by FRR is consistent with the United Nations principles (Global Compact) and take extra-financial factors into account in the analysis and the management of a portfolio of invested assets. The obligations are formulated with flexibility and it is the responsibility of each manager to integrate them and to report on their implementation. These extra-financial factors enable long-term investment.

This policy and the related system in place help the fund to optimally and preventively manage the risks of image or reputation to which the deployment of its investment policy ineluctably exposes the fund. In addition, for its evaluation of the FRR's portfolio, its Responsible Investment Committee has recourse to the analyses done by a specialized rating agency. This agency assesses all companies whose securities are included in the FRR's portfolio in terms of their compliance with the principles of the Global Compact and international conventions.

The pressures are also coming from a legal perspective. The Directive 2003/51/EC of the European Parliament and of the Council of 18 June 2003 amending Directives 78/660/EEC, 83/349/EEC, 86/635/EEC and 91/674/EEC on the annual and consolidated accounts states that "*to the extent necessary for an understanding of the company's development, performance or position, the analysis shall include both financial and, where appropriate, non-financial key performance indicators relevant to the particular business, including information relating to environmental and employee matters*".

Beside the EU Convention on Human rights and the UN Global Compact, different European initiatives are pumping up. For instance, in its 2009 April Recommendation on the regime for the remuneration of directors of listed companies, the European Commission states that "*performance criteria should promote the long-term sustainability of the company and include non-financial criteria that are relevant to the company's long term value creation, such as compliance with applicable rules and procedures*".
The resolution adopted by the Parliament on 18 May 2010 and related to "Deontological questions related to companies' management" emphasises the general social responsibility of company boards for the sustainable, longer-term development of firms based in an EU Member State. The Commission has also issued a public consultation on non-financial disclosure by companies and has planed to put forward in 2011 a new framework initiative to tackle issues related to the societal challenges that enterprises are facing.

Companies can therefore no longer ignore internal and external impacts of their decisions. However, if companies are trying to build their environmental bona fides, companies are doing too little in people governance. In the UK, people refer now to Corporate Responsibility and to sustainability rather than social responsibility.

In this context, the working group set up by ecoDa and chaired by Pierre Klees tried to analyse how corporate governance can accommodate and effectively deal with the challenge of integrating the people dimension in the corporate decision making process. This document helps to eliminate a number of blind spots, i.e. issues that very often don't appear on the official board agenda but that are implicitly present in every strategic discussion.

I. THE ROLE OF BOARDROOMS IN SETTING A VISION AND A SENSE OF SHARED PURPOSE

As expressed by Michael E. Porter, "*at a very basic level, the competitiveness of a company and the health of the communities around it are closely intertwined. A business needs a successful community, not only to create demand for its products but also to provide critical public assets and a supportive environment. A community needs successful businesses to provide jobs and wealth creation opportunities for its citizens*". If shareholders remain of critical importance, it is obvious that companies can not remain sustainable competitive in a deteriorated societal and environmental environment.

Different concepts such as "Corporate Citizen", "People, Planet, Profit", and now "shared value" have been developed to invite companies recombining shareholder value with societal values.

WHAT IS "SHARED VALUE"?

The concept of shared value can be defined as policies and operating practices that enhance the competitiveness of a company while simultaneously advancing the economic and social conditions in the communities in which it operates. Shared value creation focuses on identifying and expanding the connections between societal and economic progress.
The concept rests on the premise that both economic and social progress must be addressed using value principles. Value is defined as benefits relative to costs, not just benefits alone. Value creation is an idea that has long been recognized in business, where profit is revenues earned from customers minus the costs incurred. However, businesses have rarely approached societal issues from a value perspective but have treated them as peripheral matters. This has obscured the connections between economic and social concerns.

All of these concepts highlight the need for companies to grasp the importance of the broader business environment surrounding their major operations; this requires a huge change in companies' practices in integrating these elements into their risks and their strategies. Addressing stakeholders' matters does not imply philanthropy but a win-win solution for companies. The scale in the world risks is also changing (climate change, etc.) and companies are forced to target their activities as well as products or services to the growing demand for ecologically and socially behaviors. Institutional investment communities are increasingly demanding extra-financial information. As a key issue for the reputation of the company, corporate social responsibility is important for shareholders. Rating agencies also invite companies to make corporate social responsibility part of their strategy.

More than a legal or voluntary approach (to improve corporate image), serving society in some higher way is at first strategic for companies; it is closely linked to competitiveness and a form of corporate strategic management. Nestlé has already developed a Shared Value Forum. "*Through good practices' development, companies can generate a dynamic of sustainable value by integrating intangible elements in their strategy, values and culture but also in practical terms in the performance, management systems and risk control*".

As a forum for constant questioning, the board is undoubtedly the right place to deal with stakeholders' matters. Directors can pay due regard to other concerns without necessarily having to go against the financial priorities. Trying to combine the shareholders' interests and the social and environmental requests can at the end generate innovative thinking and new processes for a better competitiveness. It might differentiate the company from its competitors by the implementation of business sustainability programs, innovative logistics models, etc. Moreover, to get market leadership, European companies have to be sustainable and to respond more and more to environmental and social constraints.

In addition, taking intangible assets into account enables the company to reduce risks and helps directors to comply with their duty of care. Directors must pay close attention to the issues faced by the company and apply reasonable diligence and prudence in all the decision-making on behalf of the company. If boardrooms have to work in the interests of shareholders, they have to follow a reasonable approach for company's prosperity and sustainability; "*they should not work under shareholders' command but define a balance between listening shareholders and defining a proper strategy on a longer period*".

Board members should become conscious that they have a role to play in setting and disseminating the corporate identity and culture. Corporate Governance is not only about 'formalism' and public compliance at the detriment of the governance 'culture and behaviours', it is also about fixing "*the boundaries that specifically suit the company in view of an efficient value creation process"*. It is obvious that board members are the keepers of the corporate culture and its values. They have got a role and responsibilities in setting the tone at the top, morale and culture of the organization and in developing a specific mindset. With product-market globalization, companies' culture is becoming at way to distinguish oneself. Two of the main outward impacts of the company's culture are good image and reputation. They generate a competitive advantage and they help the company in differentiating with the others in a "flat world". This process helps to move towards an enterprise rather than a firm and to define a specific corporate soul. Moreover, innovation is not only about products but also about new processes and new mindsets.

Not all companies have the same values: board members have got a say to adjust and make them changing. Board members have also got the duty to make the practices coherent with these values and culture and to adjust the practices to what can be made in reality.

Implementing appropriate long-term strategies requires a collective and permanent process at board level. Diversity and complementarities in terms of personal attributes and backgrounds (beyond gender diversity) can foster the collective dynamics through various individual mindsets.

The pursuit of shared value and its integration into the management and the decision-making process requires a mature corporate culture and a constant adjustment to the corporate values. Therefore, CSR implementation for instance can not resume to a stick-boxing process and can not be imposed by a one fits all regulation.

RECOMMENDATIONS

- The board has to grant long term value and sustainability. Boardrooms should fix yearly calendars of deep lives not only on strategy and risk management but also on the corporate culture and its results.
- To integrate stakeholders' views in their decision, board members must be aware of the collective choice-making and of the corporate culture. The proper corporate understanding must include the corporate culture and values. A values charter must be addressed to each new board member as soon as they join the board.
- Board members should adjust the corporate values charter periodically on consultation with the stakeholders. They should challenge the company's management and act as a forum for constant questioning. The values charter should be used to create a value charter. The drafting of a charter should be linked to the strategy and risk management. This is part of the strategy process.
- The board should get a broad sense of outside perspectives of the company. Economic intelligence is key for companies.
- It is important to identify and to evaluate the importance of the different stakeholders in the implementation of the strategic objectives. Board members should find the right balance between the different interests, discuss and explain the hierarchy they impose with reference to the corporate values, ethics and culture. Independent board members and ethics committee have a crucial role to play in that respect.
- As responsible of the corporate strategy, directors must guide the management towards "a unique positioning and a distinctive value chain to deliver on it". Key suppliers could contribute substantially to the performance of a company.

- Companies should define incentives for managers to take into account stakeholders' interests. Directors will also have to increase the communication on the intentions or activities of the company towards operating in an ethical and socially acceptable manner.
- The role of boards' education and coaching is important
- The board' evaluation should integrate its role in setting and questioning the company values.
- It is important to introduce a culture of diversity of thinking on boards. Recruitment should take into account the corporate values and the way the candidate is aligned with them.
- An annual report on people governance should be established by the board.

II. BEYOND CSR, THE IMPORTANCE OF PEOPLE STRATEGY/GOVERNANCE

1. THE ESSENTIAL LINK BETWEEN CSR AND CORPORATE GOVERNANCE TOWARDS SUSTAINABILITY

The European institutions' willingness to link CSR and Corporate Governance is not new. In 2001, the European Commission mentioned that "*by stating their social responsibility and voluntarily taking on commitments which go beyond common regulatory and conventional requirements, which they would have respect in any case, companies endeavour to raise the standards of social development, environmental protection and respect of fundamental rights and embrace an open governance, reconciling interests of various stakeholders in an overall approach of quality and sustainability* ".

In 2007, a Report on CSR of the European Parliament (adopted by an overwhelming majority of MEPS) states "*that the CSR debate must not be separated from questions of corporate accountability, and that issues of the social and environmental impact of business, relations with stakeholders, the protection of minority shareholders' rights and the duties of company directors in this regard should be fully integrated in the Commission's Corporate Governance Action Plan*".

In addition, there are also current discussions on whether the Doing Business Index from the World Bank should include governance quality's evaluation, and corporates' social and environmental responsibilities in the countries included in the report.

The European Commission has just included CSR in the name of the unit in charge of Corporate Governance.

Both CG and CSR are key elements to building (and regaining) people's trust (in the single market) and contribute to the competitiveness of European business, because well run, sustainable companies are best placed to contribute to the ambitious growth targets (set by Agenda 2020). The actions of the enterprise should be more oriented to the progress of our society and of the mankind, instead of reducing said action to the sole financial discussion.

2. THE MISSING PART: PEOPLE GOVERNANCE

CSR is becoming a communication tool and the CSR discourse emphasizes a certain responsibility, as a consequence of doing a certain business. People governance draws the attention to the inherent human aspects of business. Hence, people governance refers to an action itself, CSR refers to a consequence of that action. People Governance is not only about outward impacts, it is about inward impacts too.

"*People governance is generally admitted as the implementation of ethical principles and attitudes that lead to the integration of people-related questions in all stages of the decision-making process by the governing bodies of the company in view to leverage sustainable growth*". It makes it possible to act coherently and to strengthen all the human dimensions connected to the internal and external activities of the company.

As stated by Edward Freeman, "it does not make any sense to talk about business or ethics without talking about human beings". In other words, "Decisions that directors take affect the destiny and quality of the lives of many human beings so that, although expertise, knowledge and skills are essential for efficient governance, something more is needed" (The Human face of CG). Employees are directly affected by the company's strategy and competitiveness.

Corporate added value increasingly consists of intangible items such as human capital. People capital / resources remain indeed the main company's asset as it can promote external and internal innovation. It is about collective intelligence and know-how pooling. Wealth creation does not depend only on costs reduction but also on work value creation.

Human strategy is part of the whole corporate strategy and therefore boards should get regular information and data on its main components. It is obvious that only the management is responsible for the daily management in terms of social dialogue, remuneration, training, etc. and that HR has to remain an issue for management. However HR is not neutral in terms on risk management and strategy, therefore the board should deal with it. The risks' mapping should include all significant human risks.

People governance is critical in establishing a sustainable competitive advantage, employee commitment and to secure experience and expertise within the company.

People strategy is furthermore relevant in case of business succession, takeovers and privatizations to assure continuity of the activities. The inability to appreciate fully the impact of social issues (corporate culture, management personalities, etc.) has led to the failure of most mergers.

To determine the company's strategy, the board requires not only financial and accounting data but also information related to more intangible assets (people, knowledge, relationships, reputation). It is important to get a view on the integrated performance (financial and extra financial) of the company and to adjust the internal resources to the external environment. Taking into account human strategy is the best guarantee for human sustainability in the company and hence, for sustainable value (in terms of performance, risk management and corporate sustainability). A business project is not only based on people related questions but on ideas about the objectives and the viability. However, the questions are essential and should be addressed each time they arise.

It is highly probable that boards that seriously take the human implications into account will increasingly be viewed positively by investors.

It is also important to make the corporate strategy understood by the employees to develop collective objectives. Companies are a place for employees' achievement and remain an operation of collective creation.

In terms of remuneration policy, the boards of directors are responsible for developing the remuneration structure, defining the main components and the criteria on which variable remuneration is to be based. A well-balanced remuneration package with performance-related pay should be linked to sustainable success factors and include extra-financial performance criteria. It is important for the board to keep up to date with what is going on in the outside world to avoid irrational decisions.

Decisions will result in behaviours and very often there's a gap between the two. In other words, the success of people governance will be measured by the behaviours it allows or generates. Therefore, whoever takes a decision according to people governance principles should control the process of implementation and should allocate all the necessary resources that allow creating consistency between the decision and the actual behaviours. The behaviour gap generates also a value gap.

In terms of people strategy, the board has the responsibility to listen to some feedbacks (to avoid "the say- do gap"). Employees for instance know if the people strategy is really implemented in the company. To measure the reality of people governance, companies like Belgacom are now integrating employee satisfaction as well as consumers' satisfaction into boards' and management evaluations.

RECOMMENDATIONS

- Board members should have a certain level of understanding in terms of CSR and people strategy to be able to support and encourage related managers' choices. Forward-looking managers require forward-looking board members.
- Specific boardroom's role in relation to Human Resources: the board should watch over HR aspects in case of growth operations either internal or external and should ensure a follow-up.
- *What form and title is stakeholder perspective and human capital tabled at board meetings?*
- *A prominent role to be played by the chairman? Has he got the most say on people governance?*
- *How far should the board be involved in considering human forces?*
- *The board can define the issues that should be represented on the "people aspects dashboard" of each manager in the company. How do we want our management to deal with people issues? How should this be measured and monitored?*
- *One board member can be designated to act as a "whistle blower": someone who emphasizes potential human risks. It should be a trustee (someone to oversee and direct the policy)? Should the board secretary (when existing) play a specific role*
- *Capital markets require criteria and information to measure up these elements*
- *Should ecoDa recommend spreading the benefit of share ownership, should ecoDa advocate for employee-owned firm?*
- Importance of the CEO role.
- Regarding employee representation, ecoDa should be opposed to one size fits all models. Employee directors can bring information on the internal know-how and on subcontractors