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Integrating sustainability into corporate governance

Top executive remuneration should be linked to sustainability performance. BY LAWRENCE LOH

THE board of directors is the main influencer of corporate governance within a company. Poor corporate governance can cast doubt on a company's operations and its profitability. While the key elements of sustainability embrace environmental, social and governance (ESG) issues, sustainability can only be advanced in businesses if it is embedded deep in the board's governance mandate.

How can sustainability be effectively mainstreamed into the boardroom agenda? In Singapore, listed companies are required to adhere to the Code of Corporate Governance on a comply-or-explain basis.

The current Code was issued in August 2018. While a quantum improvement from the earlier versions of 2012, 2005 and 2001, the world has changed since. Recent events, including the global pandemic, natural disasters and the effects of climate change, have brought the issue of sustainability to the fore. Interestingly, the term "sustainability" is mentioned only once in the current Code ("sustainable", "sustainably" and "sustained" are each similarly mentioned once).

Sustainability has to be one of the core parts of the Code in form and, more critically, in substance. Perhaps it is now time to review the Code to correct this lack of balance.

All Singapore-listed companies have been required to prepare a sustainability report yearly, beginning with the financial year ended Dec 31, 2017. REUTERS FILE PHOTO

Governance assessment

The recently-released Singapore Governance and Transparency Index (SGTI) by CPA Australia, NUS Business School's Centre for Governance and Sustainability (CGS) and Singapore Institute of Directors is a stark indicator of the need to sharpen the focus on sustainability.

Amongst the five domains of the SGTI assessment, the specific one related to sustainability – engagement of stakeholders – has the lowest relative scores. In fact, it has plateaued in SGTI 2021. Some areas for improvement, such as in addressing the health and safety of customers and employees, ensuring the sustainability of value chain processes, and the training and development of employees, are obvious.

At a broader level of disclosure, about one-third of companies provided non-financial performance indicators, which is well below the almost nine-tenth offering financial performance indicators. This is indicative of the relative tilt of corporate leadership in listed companies.

Sustainability assessment

Drilling down, some detailed insights can be discerned from the *Sustainability Reporting Review 2021* by Singapore Exchange and CGS. This review assesses all companies listed on the Exchange, particularly in the alignment with the five required components of sustainability reporting in the listing rules.

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Nonetheless, only 72 per cent of companies consider sustainability as part of strategic formulation. Even less (48 per cent) involve their boards of directors in determining material ESG factors, while a mere 54 per cent oversee management on such factors.

Interestingly, only 26 per cent of companies link top executive remuneration to sustainability performance. This is despite the finding that 70 per cent link sustainability targets with business strategy and 46 per cent link these targets to financial performance which, even in itself, is relatively low.

On a broader level, the review uncovers that 61 per cent of companies include subsidiaries within the scope of sustainability reporting, and only 21 per cent make disclosures on the full business operations including supply chains.

Board synthesis

The combined findings of the two reports highlight causes for concern. It appears that sustainability is still not entrenched at the board level. It may well be that there is low acceptance by directors on the criticality or relevance of sustainability. Or the fact that sustainability is still viewed as more esoteric and less urgent to address immediately than financial, operational or business concerns.

If anything, given the escalating importance attached to sustainability by stakeholders, particularly investors and even consumers, it behoves boards to heed sustainability-related matters. And this includes making the necessary disclosures.

Larger companies generally perform better in sustainability reporting than smaller firms – big-caps perform better than mid-caps, which in turn do better than small-caps. Yet, companies listed on the mainboard perform poorly compared to companies listed on the Catalist board, on average. This suggests that the sponsor guidance for Catalist companies may contribute to the good showing for Catalist-listed firms. Thus, some hand-holding could bring the smaller mainboard-listed firms up to par in sustainability.

Take, for instance, a critical aspect of sustainability – climate change. While 45 per cent of companies include climate change factors in their economic and ESG considerations, only 2 per cent use globally accepted frameworks such as those recommended by the Task Force on Climate-Related Financial Disclosures (TCFD) for their reporting; these are notably the large-cap companies.

More can and should be done to nudge firms to prioritise sustainability reporting and factoring ESG into their long-term business strategy.

This is where the Code of Corporate Governance can be improved, to provide more guidance on the specific provision of non-financial performance indicators, linking top executive remuneration to sustainability performance, and disclosures on the full business operations (including subsidiaries) and supply chains. A good start would be to mandate the use of globally accepted frameworks such as the TCFD framework. That would help usher in a better climate of sustainability-focused governance.

The author is a former member of the Corporate Governance Benchmarks Committee of the Singapore Institute of Directors