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Governance driving sustainability: Reaching a renewed compact

As sustainability increasingly becomes a corporate imperative, companies would do well to continue strengthening their governance processes and practices. BY LAWRENCE LOH, THI THUY NGUYEN AND ANNETTE SINGH

THE last year has seen a challenging corporate environment, as companies experienced first-hand the vital importance of adaptability and resilience.

As the Covid-19 situation in Singapore went through its various phases, companies had to adapt to the accompanying regulatory changes in safe management measures.

Amid this, Singapore-listed companies have generally continued to improve their corporate governance practices and processes. The mean overall score of the Singapore Governance and Transparency Index (SGTI) 2022 rose slightly to 70.6.

This represents an increase of almost 2 points, and has allowed the Index to breach 70 points for the first time.

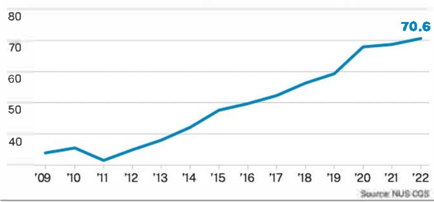
The SGTI assessment framework is based on 5 dimensions. On average, scores in each of the 5 sections rose in 2022. This is another improvement over last year, when there were improvements in 3 of the 5 sections.

The mean scores in Engagement of Stakeholders and Disclosure and Transparency saw the highest increase this year, which is notable because these 2 sections are among those with the lowest average scores.

Although this is partly to be expected because these areas would have greater room for improvement, it is also heartening because it shows companies are putting more effort into areas of governance to which they have typically given less attention.

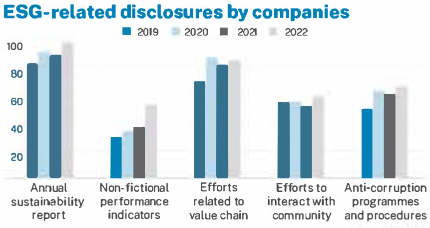
The board and senior management provide strategic leadership to achieve sustainable long-term value. PHOTO: PIXABAY

Mean score trend for general category



Source: NUS CGS

ESG-related disclosures by companies



Source: NUS CGS

B.R.E.A.D sectional score

Source: NUS CGS

Sustainability: Emerging and embedding

Sustainability practices and processes are emerging from being a niche concern among Singapore companies and becoming embedded into the mainstream.

This is reflected in disclosures related to ESG (environmental, social and governance): 98 per cent of companies released sustainability reports, up from 89 per cent previously.

The share of companies disclosing non-financial performance indicators rose from 37 per cent to more than 50 per cent.

Increases were also seen in disclosures of companies' efforts to ensure their value chain is environmentally friendly, or consistent with promoting sustainable development.

From the social and governance perspectives, more companies disclosed their efforts to interact with the community, and released details on their anti-corruption programmes and procedures.

On a related note, the share of companies that reported conducting an external search for new directors fell from 20 per cent to 13 per cent.

This may increase again next year, however, following the latest update to the Practice Guidance for the Code of Corporate Governance.

The Practice Guidance recommends that Nominating Committees use a variety of sources when appointing new directors.

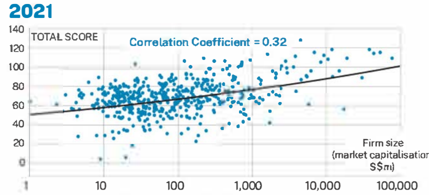
The broadening of recruitment sources may not immediately appear to be related to ESG, but can in fact have a significant impact through enhanced board diversity.

When considering sustainability, there may be a need to cast a wider net to include a greater range of governance issues.

Sustainability: Relating and levelling

SGTI 2022 also shows a fall in the overall variation of performance among companies. This can be seen in a number of ways. The correlation coefficient between market capitalisation and overall score, which measures the strength of the linear relationship between these 2 factors, remains at 0.3 (0.37 in 2022, 0.32 in 2021). This is lower than the 0.6 in 2020,

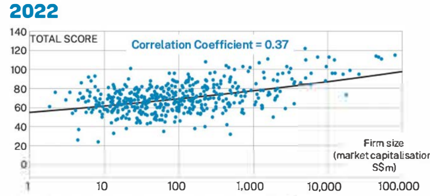
2021



Note: The data for the charts are presented scaled in logarithm with base 10

Source: NUS CGS

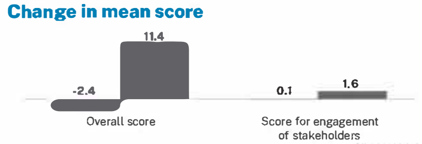
2022



Note: The data for the charts are presented scaled in logarithm with base 10

Source: NUS CGS

Change in mean score



Source: NUS CGS

and shows that in recent years there has been a weaker relationship between firm size and performance in corporate governance practices.

This levelling effect becomes clearer in looking at the changes in scores between 2021 and 2022. The lowest-ranking companies in 2021 (approximately 100 companies), increased their overall score by an average of 11.4 points in the 2022 assessment. By comparison, the highest-ranking companies in 2021 (approximately 100 companies) saw their average overall score fall by 2.4 points. Similarly, small-cap companies had a larger increase in their overall score than did big-cap companies.

Sustainability seems to be contributing to this effect. Small companies, and those that are lower-ranked, are becoming more engaged with sustainability-related efforts, and this is helping to boost their performance in corporate governance.

Thus, the lowest-ranking companies in SGTI 2021 show a larger increase in scores for the Engagement of Stakeholders section of the assessment framework (1.6 points) than the top-ranked companies (0.1 points). Small-cap companies also showed a slightly larger increase in their Engagement of Stakeholders scores than large-cap companies.

Governance as impetus for sustainability

Sustainability and governance are inextricably linked as the board and senior management provide strategic leadership to achieve sustainable longterm value. More than this, over and above merely forming the "G" in ESG, governance can be said to drive sustainability.

Aspects of governance, such as board and board committee issues, risk management and safeguarding shareholder rights, directly or indirectly influence what sustainability looks like in companies.

As sustainability increasingly becomes a corporate imperative, companies would do well to continue strengthening their governance processes and practices. Using a horse and cart analogy, sustainability is the "cart" and governance is the "horse".

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