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SUSTAINABILITY IN THE BOARDROOM:  
AN EMPIRICAL EXAMINATION OF DOW JONES  
SUSTAINABILITY WORLD INDEX LEADERS

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**Abstract**

In recent years, there has been a virtual explosion of interest in corporate governance. Corporate scandals and the need to protect minority shareholders' interests are two of the reasons behind the development of corporate governance codes in numerous countries and corporations. At the same time, the concepts of "sustainable development", "corporate responsibility", and "corporate citizenship" have taken root in the business world. Although corporate governance and sustainable development have been extensively researched as separate fields of inquiry, less attention has been paid to the interaction between the two. This paper attempts to bridge this gap by examining how corporate governance systems are evolving so as to take account of sustainable development thinking. We analyze the governance systems of the leading companies in the 18 market sectors included in the Dow Jones Sustainability World Index (DJSWI). We present the results of our in-depth analysis of the 18 cases and propose the Sustainable Corporate Governance Model that emerges from that analysis.

**Keywords:** Corporate governance, sustainable corporate governance, sustainable enterprise, sustainable development, business in society.

# **SUSTAINABILITY IN THE BOARDROOM: AN EMPIRICAL EXAMINATION OF DOW JONES SUSTAINABILITY WORLD INDEX LEADERS**

## **Introduction<sup>1</sup>**

In recent years, there has been a virtual explosion of interest in corporate governance. Corporate scandals and the need to protect minority shareholders' interests are two of the reasons behind the development of corporate governance codes in numerous countries and corporations. Most corporate governance codes contain recommendations intended to foster good corporate governance and increase transparency and disclosure (Mallin, 2002). At the same time, the concepts of "sustainable development", "corporate responsibility", and "corporate citizenship" have taken root in the business world. Although corporate governance and sustainable development have been extensively researched as separate fields of inquiry, less attention has been paid to the interaction between the two. This paper attempts to bridge that gap by examining how corporate governance systems are evolving so as to take account of sustainable development thinking. We analyze the governance systems of the leading corporations in the market sectors included in the Dow Jones Sustainability World Index (DJSWI). The objectives of this paper are twofold: to analyze in depth how and to what extent DJSWI leaders have integrated sustainability into their corporate governance systems; and to develop a model for sustainable corporate governance based on corporate governance and sustainable development theories, and built on empirical research into the corporate governance systems of leading DJSWI companies.

We start the paper by reviewing the literature on corporate governance systems – agency theory (Jensen and Meckling, 1976; Fama and Jensen, 1983), legalistic perspective (Williamson, 1964; Berle and Means, 1968; Mace, 1971), resource dependence (Pfeffer, 1972; 1973), class hegemony (Mills, 1956; Domhoff, 1969), the integrative work of Zahra and Pearce (1989), and the more recent studies by Johnson, Daily and Ellstrand (1996), Daily (1996), and Daily et al. (2003). Our goal was to identify the elements of governance systems that are key determinants of firm performance. In order to integrate the sustainability dimension into our research framework, we also consider the most important insights on corporate governance systems from stakeholder and sustainable development theories (Freeman, 1984; Gladwin, Kennelly and Krause, 1995; Bansal and Roth, 2000). Drawing from the aforementioned literature streams, we identify the issues that we should consider in our in-depth research into the governance systems of DJSWI leaders. Next, we describe the research design and methods used for the study. This is followed by a discussion of the results of our analysis of the corporate governance systems of DJSWI

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leading companies. In this discussion, we explain the most noteworthy practices (from a sustainability point of view) that we have observed in the governance systems of the companies in our sample and we present the Model of Sustainable Corporate Governance that emerges from our benchmark study. We conclude by pointing out the limitations of our research and discussing the implications for researchers and practitioners.

## Theory

### *Corporate governance systems*

The literature on corporate governance systems follows four main approaches – agency theory (Jensen and Meckling, 1976; Fama and Jensen, 1983), the legalistic perspective (Williamson, 1964; Berle and Means, 1968; Mace, 1971; Budnitz, 1990; Bainbridge, 1993; Miller, 1993; Cieri, Sullivan and Lennox, 1994), resource dependence (Pfeffer, 1972; 1973), and class hegemony (Mills, 1956; Domhoff, 1969). The theoretical origins of these four approaches are, respectively, economics and finance, corporate law, organizational theory and sociology, and Marxist sociology. Agency theory views the modern corporation as a nexus of contracts between principals and agents (Aguilera and Jackson, 2003) and has contributed valuable insights into many aspects of the manager-shareholder relationship (Daily et al., 2003), and thus into the role of Boards of Directors (c.f., Jensen and Meckling, 1976). The legalistic perspective considers that Boards contribute to their firms' performance by fulfilling their legally mandated responsibilities, that is to say, corporate leadership without actual interference in day-to-day operations (c.f., Williamson, 1964). The resource dependence perspective views Boards as important boundary spanners that provide information to executives and are able to obtain resources for company operations (c.f., Pfeffer, 1973). Finally, the class hegemony perspective views Boards as a means of perpetuating the power of the ruling capitalist elite and its control of social and economic institutions (c.f., Mills, 1956).

Two issues that the aforementioned perspectives have addressed are the roles that Boards of Directors have to fulfill, and the attributes Boards must have in order to contribute to firm performance. In Table 1 we summarize the attributes and roles considered by the four perspectives (Zahra and Pearce, 1989; Johnson et al., 1996; Daily et al., 2003).

**Table 1. Attributes and roles of Boards of directors**

	Perspectives
<b>Attributes</b> – Composition – Characteristics – Structure – Process	Legalistic, resource dependence, class hegemony, agency theory Legalistic, resource dependence, class hegemony, agency theory Legalistic, agency theory Legalistic, class hegemony, agency theory
<b>Roles</b> – Control – Service – Resource – Strategy	Legalistic, resource dependence, class hegemony, agency theory Legalistic, resource dependence, class hegemony, agency theory Resource dependence Resource dependence, agency theory

*Board composition* refers to size (number of directors), director types (executive and non-executive directors), and minority representation (ethnic minorities and females) (Hillman, Cannella and Paetzol, 2000). *Board characteristics* has two basic components – directors’ background (age, educational background, values, and experience) and Board personality (Zahra and Pearce, 1989). *Board structure* refers to the dimensions of the Board’s organization, covering the number and types of committees, committee membership, and the flow of information among those committees, and Board leadership (Zahra and Pearce, 1989). *Board process* refers to the approach the Board takes in making its decisions, including the frequency and length of meetings, the CEO-Board interface, the formality of Board proceedings, and the extent to which the Board is involved in evaluating itself (Mueller, 1979; Vance, 1983). *Strategy role* refers to the Board’s essential contribution in formulating strategy and monitoring its effective implementation (Baysinger and Butler, 1985; Kosnik, 1987). *Service role* involves enhancing company reputation, establishing contacts with the external environment, and giving counsel and advice to executives (Carpenter, 1988; Loudon, 1982; Pfeffer, 1972). *Control role* refers to the Board’s task of assessing firm performance, evaluating the CEO, and defining executive compensation policies (Brindisi, 1989; Brossy, 1986). *Resource role* implies a view of the Board as a means of facilitating the acquisition of resources that are critical to the firm’s success (Pfeffer, 1972; Pfeffer and Salancik, 1978).

### ***Sustainable development and stakeholder theories***

Although, as we have just seen, corporate governance has been studied in the literature from different perspectives, agency theory plays a pivotal role. While producing valuable insights into many aspects of the manager-shareholder conflict, agency theory has overlooked important interdependencies among other stakeholders of the firm (Aguilera and Jackson, 2003). Thus, this dominant approach has impeded a deeper analysis of new idiosyncratic relationships of today’s firms.

Stakeholder theory posits that the capacity of a firm to generate sustainable wealth over time, and hence its long-term value, is determined by its relationships with critical stakeholders (e.g., Carroll, 1989; Donaldson and Preston, 1995; Freeman, 1984; Jones, 1995; Jones and Wicks, 1999; Mitchell, Agle and Wood, 1997; Post, Preston and Sachs, 2002). In this theory, the corporation is defined as a socio-economic organization built *to create wealth for its multiple constituencies*. The stakeholders<sup>2</sup> of any firm are usually quite diverse, but relationships between the firm and each of its stakeholders have many common features; in addition, the stakeholders have common interests (as well as potentially conflicting interests) (Mitchell et al., 1997).

According to this view, the critical challenge for contemporary management is to recognize the mutual interests among the firm and its stakeholders. Following this argument, Jones and Hill (1992) developed a ‘stakeholder agency’ model and argued that managers should act as ‘agents’ for stakeholders (the relevant ‘principals’). However, the multiple-valued objective implicit in stakeholder theory has led to much controversy and criticism (Jensen, 2000). Jensen considers that, if widely adopted, stakeholder theory will reduce social welfare because it increases agency costs in economic systems. Surprisingly, in the same article, Jensen asserts that “we cannot maximize the long-term market value of an organization if we ignore or mistreat any important constituency” (*ibid*: 50).

<sup>2</sup> Post, Preston and Sachs (2002: 8) propose the following definition of stakeholders: “The stakeholders in a firm are individuals and constituencies that contribute, either voluntarily or involuntarily, to its wealth-creating capacity and activities, and who are therefore its potential beneficiaries and/or risk bearers.”

Building upon these previously discussed research streams, our approach to stakeholder theory is both normative and instrumental. The first argument is rooted in the idea that through business activities –and responsible business leaders– individual welfare and society in general can be improved. Thus, assuming that corporations have a critical role and responsibility in social development, stakeholders have a legitimate interest in procedural and/or substantive aspects of corporate activity (Donaldson and Preston, 1995). Second, engaging with stakeholders through dialogue can be a way of obtaining legitimacy or a “license to operate”, as well as a way of gaining strategic sources of sustainable competitive advantage, such as trust, reputation and innovation (Jones, 1995; Rodríguez, Ricart and Sánchez, 2002), or of generating disruptive business models and innovations (Hart and Sharma, 2004).

The concept of sustainable development has received a wide range of definitions. Gladwin, Kennelly, and Krause (1995) propose a definition that includes the principal components of the ideas shared by a majority of the definitions. In their view, “sustainable development is a process of achieving human development [...] in an *inclusive, connected, equitable, prudent, and secure manner*. *Inclusiveness* implies human development over time and space. *Connectivity* entails an embrace of ecological, social, and economic interdependence. *Equity* suggests intergenerational, intra-generational, and interspecies fairness. *Prudence* connotes duties of care and prevention: technologically, scientifically, and politically. *Security* demands safety from chronic threats and protection from harmful disruption” (p. 878).

In the management field, sustainable development theory has attempted to broadly redefine the global societal role of the business corporation (Gladwin, Kennelly, and Krause, 1995; Hart, 1997; Sharma, Vredenburg, and Westley, 1994; Shrivastava, 1995; Starik and Rands, 1995; Westley and Vredenburg, 1996). Researchers have proposed that our future lies in building sustainable enterprises and an economic reality that connects industry, society, and the environment (Hart, 1997; Senge and Carstedt, 2001). According to Elkington (1997), the firm’s ultimate objective is not singular (create value for its shareholders) but rather threefold (create economic, ecological, and social value). Therefore, the central value of the sustainable firm is not economic growth but sustainable development. In other words, to succeed in this endeavor it is essential to develop business models and products that work financially, in addition to being socially, ecologically, and ethically correct. Another stream of literature has sought to demonstrate how firms may gain competitive advantage from sustainability strategies through efficiency cost savings, and product stewardship (Hart and Ahuja, 1996; Porter and van der Linde, 1995; Shrivastava, 1995), acquisition of strategic resources and capabilities (Hart, 1995; Rodríguez, Ricart and Sánchez, 2002), and development of learning and dynamic capabilities (Hart and Sharma, 2004).

Following these theories and thoughts, we base our research into the corporate governance practices of DJSWI leading companies on two basic assumptions regarding the path towards sustainable development. First, firms must change their values, strategies and businesses models in order to embed sustainable development dimensions. Second, firms must open their boundaries by establishing a fluid, honest, and transparent dialogue with their stakeholders.



## Methodology

Given the relatively new and unexplored nature of the phenomenon –how and to what extent leading companies are embedding sustainability in their governance systems– in this study we adopted an inductive research strategy (Eisenhardt, 1989, Yin, 1984) based on qualitative research techniques (Miles and Huberman, 1984). Qualitative research, as opposed to traditional quantitative empirical tools, is particularly useful for exploring implicit assumptions and examining new relationships, abstract concepts, and operational definitions (Weick, 1996; Bettis, 1991). The aim was to conduct an analysis of firms that are leading the sustainability process in order to see how, in practice, sustainable development is affecting and changing corporate governance systems. Rather than conduct a statistical study to find out the ‘average’, we wanted to see if there is a *trend* towards sustainable corporate governance, and also develop constructs that will facilitate future hypothesis testing (Eisenhardt, 1989). Thus, companies were not selected randomly. Rather, they were chosen because they were recognized as sustainability leaders by the most renowned sustainability index, the Dow Jones Sustainability World Indexes (DJSI World). DJSI World includes more than 300 companies, representing the top 10% –the sustainability leaders– among the 2,500 largest companies in the Dow Jones Global Indexes, covering 59 industry groups in 34 countries. This sample covers different geographical areas (Australia, Europe, Japan, and North America) and a wide array of industries, offering a rich diversity of corporate cultures.

The identification of sustainability leaders for the Dow Jones Sustainability Indexes is based on the corporate sustainability assessment conducted by Sustainability Asset Management (SAM) Research, which evaluates opportunities and risks for the eligible companies based on economic, environmental, and social developments. After this process, SAM Research identifies the companies with the highest sustainability performance score for each market sector in the Dow Jones classification. Finally, a group of 18 companies constitutes the market sector leaders<sup>3</sup>. This process is reviewed annually. Those eighteen companies are the sample for our exploratory study.

The literature review on corporate governance systems and sustainable development and stakeholder theories allowed us to obtain the initial research questions through which to explore the corporate governance practices of the DJSWI leading companies. These research questions provided guidance for this study and allowed us to concentrate on identifying “meaningful events” or activities (Yin, 1981). Specifically, we focused our research on the embedding of sustainability and stakeholder openness values in the attributes (composition, characteristics, structure and process) and roles (control, service, resource and strategy) of the sample companies’ corporate governance systems. The research was conducted over a period of one year and involved triangulation among a variety of data sources (Yin, 1984), including corporate web pages and public reports, answers to customized questionnaires sent to companies, and additional information gathered with the collaboration of Sustainability Asset Management (SAM) Research Division. Qualitative studies such as this have provided critical insights into a variety of phenomena, such as innovation (Galunic and Eisenhardt, 2001), entrepreneurship (Miner et al., 2001), alliances (Larson, 1992), social issues (Dutton and Dukerich, 1991), organizational change (Smith and Zeithaml, 1996; Brown and Eisenhardt, 1997), and proactive responsiveness to environmental uncertainty (Sharma and Vredenburg, 1998).

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<sup>3</sup> The sample is composed of the following companies: 3M, British Telecom, CRH, Dofasco, DuPont, Lend Lease, Intel, Marks & Spencer, Novozymes, Pearson, Procter & Gamble, Severn Trent, Shell, Swiss Re, Teijin, Unilever, Volkswagen, and Westpac Banking.

Data collection involved several overlapping steps (Yin, 1984). Beginning in 2002, two MBA students and two research assistants conducted an exhaustive search for information on corporate governance, using publicly available sources, namely Internet web sites and company reports. Next, a questionnaire was prepared and sent to all the corporations in the sample. The response rate was 62.5%. We also relied on the valuable collaboration of SAM for completing this process and obtaining the remaining information. SAM's information also allowed us to compare some results with a wider sample of almost 800 companies. This comparative analysis was especially useful for identifying emerging practices. The information gathered from public sources was then compared and contrasted with the results from the questionnaires and the SAM information in an exploratory fashion to enhance 'generalizability' (Miles and Huberman, 1984).

## Results

Analysis of the corporate governance systems of DJSI leading companies pointed to important results that we discuss below and led to the proposal of the Sustainable Corporate Governance Model.

## Values

Individuals in firms have bounded rationality, cognitive biases, and personal values that direct their actions (Cyert & March, 1963; Hambrick & Mason, 1984; March & Simon, 1958). When fully experienced, shared values lie at the core of a firm's culture and make it possible to successfully and safely decentralize the decision-making process. Values reflect beliefs about what is truly important. For this reason, the acceptance of values tightly coupled with the principles of sustainable development is essential for achieving real progress towards a sustainable organization.

According to the conceptual foundations of sustainable development and stakeholder theories, the underlying value of a sustainable enterprise is to endure and understand that its ability to endure depends on its contribution to the endurance of its physical and social environment. Therefore, we analyzed to what extent the values included in the sample companies' value statements were coherent with that underlying value. Although the companies in our sample tend to give different names to these values, we have used what we consider to be the most standard terms as a way to obtain meaningful results in our research. In Table 2, we present the results.

**Table 2. Corporate Values (18 DJSI Sector Leaders)**

Values	DJSI Leading Companies
Sustainability	12
Responsibility	12
Integrity	11
Dialogue with stakeholders	8
Diversity	8
Innovation	10



As we can see, ‘responsibility’ and ‘sustainability’ are the most accepted core values, with 12 companies embracing them, followed by ‘integrity’, with 11. The values ‘dialogue with stakeholders’ and ‘diversity’ also have a wide acceptance, with 8 companies adopting them. Interestingly, we see that 10 of the DJSWI leading companies consider innovation to be a core value. This may be interpreted as a sign of the importance of innovation for remaining competitive, but we can also infer that innovation can be considered as a driver of sustainability.

### ***Board composition and characteristics***

Composition and characteristics are closely related attributes. The resource dependence perspective has emphasized the relevance of these attributes because it considers Boards as important boundary spanners that provide essential resources, or secure those resources through linkages to the external environment. Furthermore, because of their prestige in their communities and professions, directors help to enhance the firm’s legitimacy in society (Boyd, 1990; Pfeffer, 1972, 1973; Pfeffer & Salancik, 1978; Price, 1963; Provan, 1980). Some authors have seen a positive relationship between Board composition (e.g., ratio of insiders to outsiders, or proportion of female and minority Board members) and acts of social responsibility (Zahra & Stanton, 1988) or corporate philanthropy (Wang & Coffey, 1992), while others have observed that firms strategically alter Board composition in order to respond to significant changes in their external environment (Hillman et al., 2000).

Board members should have the skills, experience and capabilities required for exercising their specific responsibilities as effectively as possible. We might therefore expect leading sustainability companies to have in their boardrooms members and executives who are capable of providing essential new viewpoints and expertise on sustainable development topics. At the same time, given the novelty of the CR/SD<sup>4</sup> field, we wanted to find out if Board directors receive some kind of induction training to improve their understanding of the implications of sustainable development for the firm.

Our results show that 13 Boards are adequately conversant with and aware of sustainable development issues. However, only 4 companies have formal CR training programs for their directors. Table 3 shows the results for Board composition and characteristics.

**Table 3. Composition and characteristics of the Board**

	Yes	No	Not Known
One or more directors knowledgeable about SD	13	1	4
Induction training in SD	4	6	8

<sup>4</sup> Throughout the article we use the terms “corporate responsibility” and “sustainable development” and their abbreviations CR and SD interchangeably.

The cases of DuPont and Dofasco help to show the strong commitment and experience of Board members in the field of sustainable development.

The DuPont Board has thirteen members, five of whom have a relevant track record in the field of corporate responsibility or sustainable development. To mention just one, Chad Holliday, CEO and Chairman, is a promoter of sustainable development within his company. He has written the article “*Sustainable Growth, the DuPont Way*”, published in *Harvard Business Review*, and co-authored the book ‘*Walking the Talk: The Business Case for Sustainable Development*’.

The Dofasco company is a Founding Sponsor of the Sustainable Enterprise Academy (SEA) at the Schulich School of Business at York University (Canada). The SEA’s mission is to provide senior executives with the vision, education, tools and support to champion sustainable development in their organizations. Dofasco President and CEO John Mayberry, as well as other Dofasco senior executives, completed the program in 2001. The Dean of the Schulich School of Business has been a member of Dofasco’s Board of Directors since 1985. He has supported the creation of the Sustainability Enterprise Academy.

### ***Board Structure***

Board structure refers to the dimensions of the Board’s organization. It covers the number and types of committees, committee membership, the flow of information among those committees, and Board leadership. In order to protect shareholders’ rights, agency theory researchers have recommended creating compensation and appointment committees, audit committees, and shareholder relations committees (Demsetz & Lehn, 1985; Jensen & Meckling, 1976). These committees should be chaired by outside directors to ensure real and effective supervision (Davis, Schoorman & Donaldson, 1997). The setting-up of Board committees –remuneration committee, audit committee, appointments committee, and so on– has permitted Boards of Directors to deal more specifically with relevant issues affecting the corporation. In view of the implications of sustainable development for the firm, it might seem reasonable that the firm’s top corporate governance body should have a committee, led by one of its members, to promote, supervise and assess the incorporation of sustainability criteria into the firm’s strategy and operation, and into the activities of the Board itself.

We reviewed the Board structures of the DJSI market sector leaders, looking for Board committees with formal responsibilities in CR or similar (henceforth CR committees). We distinguished between CR committees with only non-executive members, and committees with both executive and non-executive members. Our results show that 10 companies have already appointed a CR committee to integrate sustainable development topics into their strategy and operations. There are more Board committees with only non-executive members than with executive and non-executive members, although the difference is not significant. We also observed that the firm’s CEO is always present in CR committees made up of executive and non-executive members.

Whereas we can find as many names for CR committees as there are companies in the sample, in practice most of the committees have similar responsibilities. Summarizing, those responsibilities are the following:

- Consider, review, evaluate and monitor environmental, social and ethical policies.
- In collaboration with top management, ensure that strategy takes sustainable development dimensions into account.
- Advise the Board on SD/CR policies.

Among companies without a CR committee, we identified two systems that allow the Board of Directors to track the company's progress towards sustainability:

- Five companies integrate sustainability issues and CR policies in *existing* Board or top management committees. In this case, some of these committees assume new responsibilities in relation to sustainable development.
- Two companies have appointed one director of the Board with specific responsibilities for reviewing and monitoring environmental, social and ethical policies.

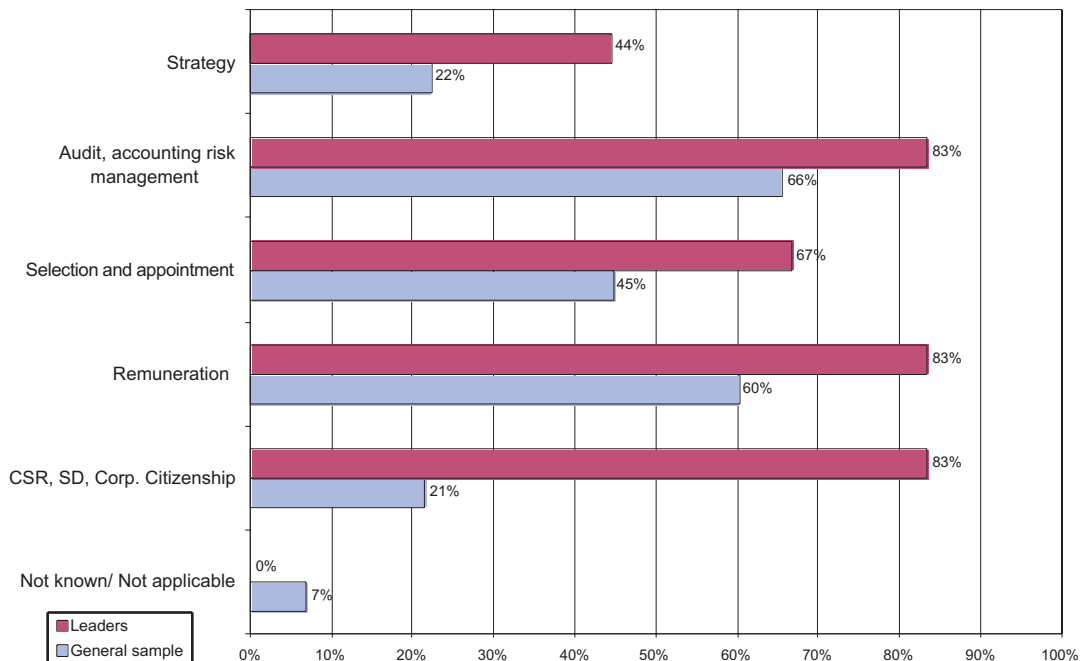
Considering all the different types of corporate governance structures and systems mentioned above, we can say that all companies except one have some type of governance structure that allows the Board of Directors to review, supervise and assess the firm's 'triple bottom line'. Table 4 shows these results.

**Table 4. Structure of the Board for integrating sustainability into strategy**

Governance Structures			Number of Companies
Formal CR Board Committee	Made up of only non-executive members	6	10
	Made up of executive and non-executive members	4	
Other governance structures	Integration of CR, SD in existing Board/top mgmt committees	5	7
	Appointment of a Board director with specific responsibilities in CR, SD	2	
Without any kind of structure			1

As we will see later, the structure of the Board is a key factor for ensuring the integration of sustainable development into the firm's strategy. The creation of CR committees or the assumption of sustainable development responsibilities by existing committees provides a strong mechanism to strengthen sustainability strategy. As a matter of fact, comparing the DJSI leaders with all the companies analyzed by SAM (approximately 800 companies), we find that the biggest difference lies precisely in the appointment of CR committees (see Graph 1). While 83% of DJSI leaders have appointed a CR committee<sup>5</sup>, only 21% of the universe of firms analyzed by SAM has formalized sustainable development responsibilities within a Board committee. Thus, adapting Board structure to sustainability requirements turns out to be a fundamental factor for ensuring a better quality and depth of overall formulation and implementation of sustainability strategy.

**Graph 1. Appointment of Board committees**



Source: SAM Research.

Furthermore, Graph 1 shows that DJSI leading companies invariably have better governance structures for dealing with typical Board responsibilities than ordinary companies. Corporate governance reports and codes –e.g., Winter report (EU), Higgs report (UK), Aldama report (Spain), Cromme code (Germany)– always recommend the appointment of specific committees to undertake some of the Board's key responsibilities, such as selection, appointment and compensation of key executives, audit, and information disclosure. In Graph 1, we can observe how DJSI leading companies follow these recommendations on corporate governance more closely than ordinary companies. We would like to insist, however, that, although these differences in the degree of fulfillment of good corporate governance codes can be considerable, the most important and noteworthy

<sup>5</sup> This percentage comes from the sum of those DJSI leading companies that have a specific CR Board committee and those that have integrated CR policies and responsibility within an existing Board committee. The former make up 55% of the sample, and the latter, 28%.

difference resides in the appointment of CR committees. From these results we can conclude that *sustainability is a key component of good corporate governance*.

A good example is Westpac Banking of Australia, which has established a complete governance structure to fully integrate corporate responsibility into the way it does business. In 2001, the Board set up a Board Social Responsibility Committee to reinforce the firm's commitment to sustainable and socially responsible practices. Westpac's corporate social responsibility governance system is a hierarchical structure segmented into four layers (from top to bottom): the Board and the Board Social Responsibility Committee, which overlaps with Executive Office CSR business review (comprising the Chief Executive Officer and CSR management), which overlaps with the Customer Committee, the Environmental Advisory Group and Stakeholder Engagement. This then leads into a two-way relationship with the final layer, business units (see Figure 1).

**Figure 1. Westpac Banking CR Governance Structure**



The Board is responsible, among other things, for ensuring that business is conducted ethically and transparently, setting standards for social and ethical practices, and monitoring compliance with Westpac's social responsibilities and practices. The principle purpose of the Board Social Responsibility Committee is to foster Westpac's commitment to operate its business in a manner consistent with the rapidly changing demands of society. The Social Responsibility Committee reviews the social and ethical impacts of Westpac's policies and practices and oversees initiatives to enhance Westpac's reputation as a socially responsible corporate citizen. It also participates with management in setting the strategic direction for Westpac's image, including social and environmental policy, community involvement, and ethical policy relating to lending and investment activities. The Social Responsibility Committee is made up of three non-executive Board members plus one executive Board member, who is the CEO. According to Westpac's Senior Advisor on Corporate Responsibility and Sustainability, typical agenda items of the Board of Social

Responsibility include: sustainable supply chain management; feedback from external assessments and ratings; performance measured against social and environmental indicators; external sustainability reporting; new customer satisfaction measures; and review of initiatives for Indigenous Australians.

### ***Board Process***

Board operations –such as the selection of agenda items for Board meetings, Board materials distributed in advance, Board access to independent advisors, establishment of directors’ responsibilities, and so on– are working procedures that determine how the processes of information generation and sharing, decision-making and accountability, and distribution of resources and wealth are carried out. Because most of the aspects of sustainable development are quite new for most companies, it seems advisable for their top corporate governance bodies to regularly consider and prioritize these issues and foster good practices in their boardrooms. Thus, discussion of sustainable development and its implications for the firm should become routine for the Boards of Directors of companies that have adopted sustainability as a core value and business driver.

We observed the communication and working processes most commonly used for dealing with sustainability in the sample firms’ governance structure. We focused our analysis on the frequency of Board meetings at which sustainable development topics were discussed, the communication mechanisms between the Board and CR committees, and the practice of inviting external experts on CR or sustainable development to Board meetings.

Our results show that the frequency of meetings at which sustainability policies are formally discussed varies *from once to four times a year* (see Table 5). We should also mention that most companies state that sustainability is informally discussed at many, if not all, Board meetings because sustainable development is integrated into the way they do business and is at the core of the firm’s strategy. The agenda for each meeting is normally finalized one month before the meeting, and information, whether related to sustainability or not, is distributed one or two weeks in advance, with one week being the standard. Nevertheless, sensitive matters or urgent issues may be discussed at the meeting without written materials being distributed either in advance or at the meeting.

**Table 5. Sustainable development in Board meetings**

Number of Board meetings in which sustainability strategy and policies are formally discussed	Number of Companies
Once a year	4
Twice a year	4
Three times a year	3
Four times a year	5
Not Known	2



Regarding Board CR committees, we observed that the frequency of meetings varies from two to four times a year. After each meeting, the committee reports to the Board on its activities and decisions. Furthermore, as some or all of the CR Committee's members are also Board members, communication is secured through membership of both bodies. Other common communication mechanisms to inform the Board of sustainability issues are: periodic updates to directors on all matters, including sustainability, and regular reports to directors on CR from internal executive committees.

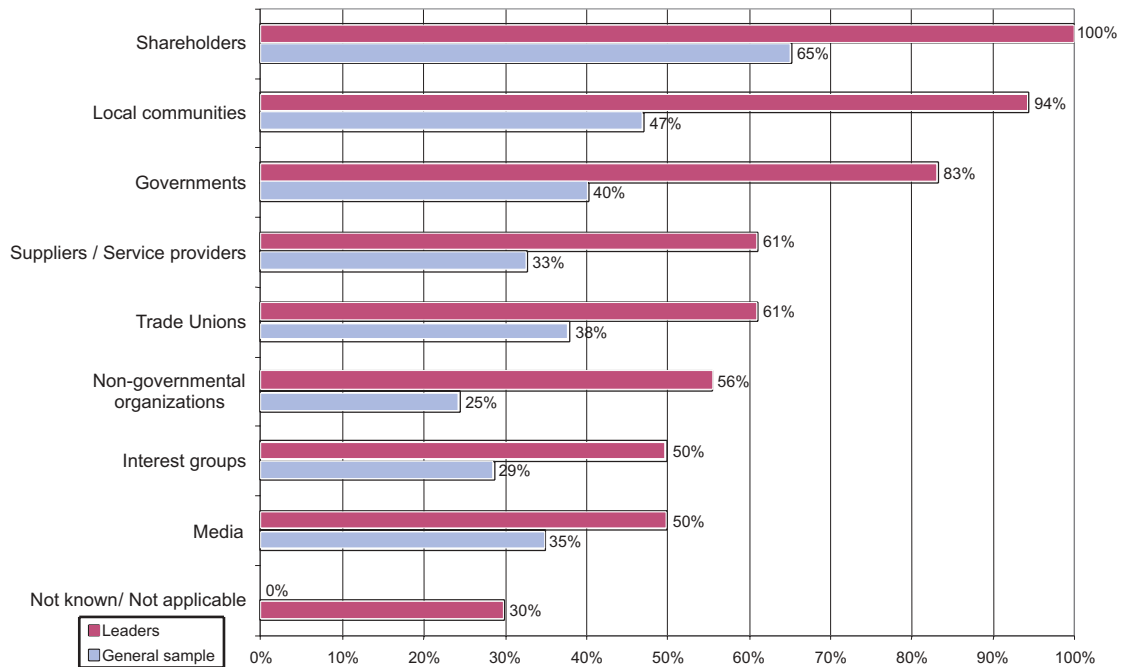
For instance, Marks & Spencer's CR Committee meets at least three times annually. In addition, there are bi-monthly updates to all Board members on CR and the environment. The CR Committee receives relevant papers at least a week prior to the meeting, which is the norm for all M&S Board level meetings. The main Board has special responsibility for environmental and external stakeholder policies. One Board member has specific responsibility for environmental issues, and internal sustainable development experts (assisted by external expertise as required) feed in to the CR Committee at every meeting.

Finally, in none of the companies analyzed is there a formal policy of inviting external sustainable development experts to Board meetings. However, based on the responses from the companies we contacted, we found that most of them do actually invite external experts when they consider it appropriate. That means, for instance, that external guests are invited from time to time to talk to the Board about topics affecting the corporation (e.g., global warming, biotechnology, etc.) or to advise the Board on sustainable management policies and tools.

### ***Board's resource role***

As we explained above, the resource dependence perspective on corporate governance underlines the importance of the Board and its members in ensuring that the firm obtains the necessary resources, through their linkages to the external environment. As we indicated in the literature review, in stakeholder theory the corporation is defined as a socio-economic organization built to create wealth for its multiple constituencies. In Graph 2 we can see the answers provided by DJSI leaders and ordinary companies to the question "To what extent do these stakeholders influence the firm's decisions?"

The first conclusion that we can draw from Graph 2 is that DJSI sector leaders are clearly more 'stakeholder-oriented' than ordinary companies. In all cases, at least 50% of DJSI sector leaders consider the different stakeholder groups important for their businesses. For ordinary companies, on the other hand, only shareholders go beyond this percentage. These results confirm that traditional companies still see shareholders as the main stakeholders and other groups as less relevant. Shareholders are considered to be the most important stakeholder for both groups, with 100% for DJSI sector leaders and 65% for ordinary companies. However, DJSI sector leaders consider other stakeholders as being almost equally important, such as local communities, with 94%, and governments, with 83%. In the case of ordinary companies the percentages are reduced by half. Suppliers and trade unions also have a remarkable result in the case of DJSI sector leaders, with 61% of the companies recognizing them as a relevant group. Finally, NGOs, interest groups, and the media are the groups least involved in any form of stakeholder dialogue. Nevertheless, half of the DJSI sector leaders already regularly involve these groups in stakeholder dialogue activities.

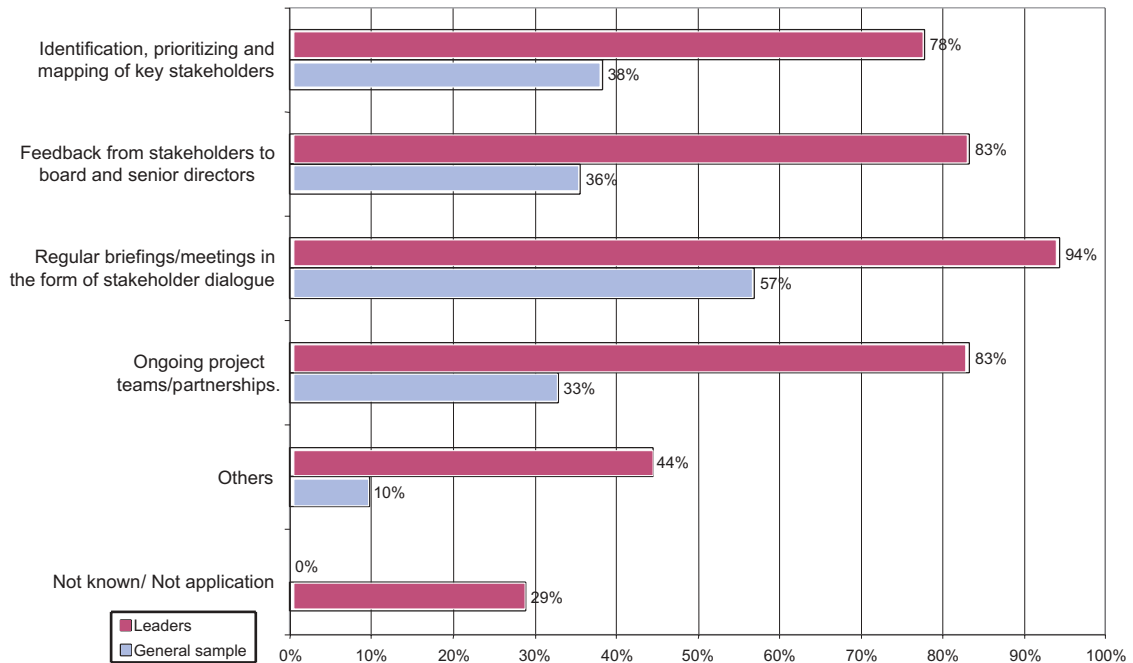
**Graph 2. Importance of stakeholder groups<sup>1</sup>**

<sup>1</sup> The *customer* group is missing from these results. However, our analysis of DJSI sector leaders shows that 100% of these companies recognize customers as a relevant group. We can assume that this percentage would also be close to 100% for ordinary companies.

Source: SAM Research.

Dialogue mechanisms are activities that allow the firm to interact with its stakeholders. Our research found that stakeholder dialogue is a common practice among DJSI sector leaders. Mechanisms such as stakeholder panels, meetings with local communities, forums with employees or suppliers, and internet and intranet communication tools are just a small sample of the different systems used to establish relationships with stakeholders. After having reviewed all of the different types of stakeholder dialogue activities, we can group them into the following categories:

- Identifying, prioritizing and mapping key stakeholders for input into strategy
- Establishing feedback mechanisms from stakeholders to the Board and senior directors
- Regular briefings and meetings in the form of stakeholder dialogue
- Ongoing project teams and partnerships

**Graph 3. Engagement processes with stakeholders**

Source: SAM Research.

Graph 3 shows that all four of these mechanisms are quite widespread among DJSI sector leaders, but not among ordinary companies. The holding of regular meetings (e.g., stakeholder panels) is an almost universal practice, with 94% of companies (all but one) indicating it as a regular procedure for engaging with stakeholders. Likewise, approximately 80% of DJSI sector leaders use the other three mechanisms mentioned above to interact with stakeholders.

As we can see in Table 6, direct involvement of Board members in this dialogue with stakeholders is common practice among DJSI leading companies. Nevertheless, only informal processes can be considered a widespread procedure. Since we can assume that the outcomes of formal processes of Board interaction with stakeholders have a greater impact on Board decisions and firm strategy, it seems that this is an area that even leading companies are only just starting to cultivate.

DuPont provides a good example of the strategic nature of Board level stakeholder engagement. After a long process of stakeholder engagement, the company is changing to new businesses. According to DuPont: “As we organize and grow our efforts to work with external stakeholders with diverse viewpoints, areas of expertise and regional perspectives, we find at least three areas for growth: climate/energy, food and nutrition, and safety and security. All three address important global issues and all three require unprecedented partnerships between the private and public sectors.” Because one of DuPont’s growth areas (food and nutrition) requires the development of biotechnology-based products, DuPont has created an independent Biotechnology Advisory Panel to guide the company’s actions in the development, testing and commercialization of this type of product.

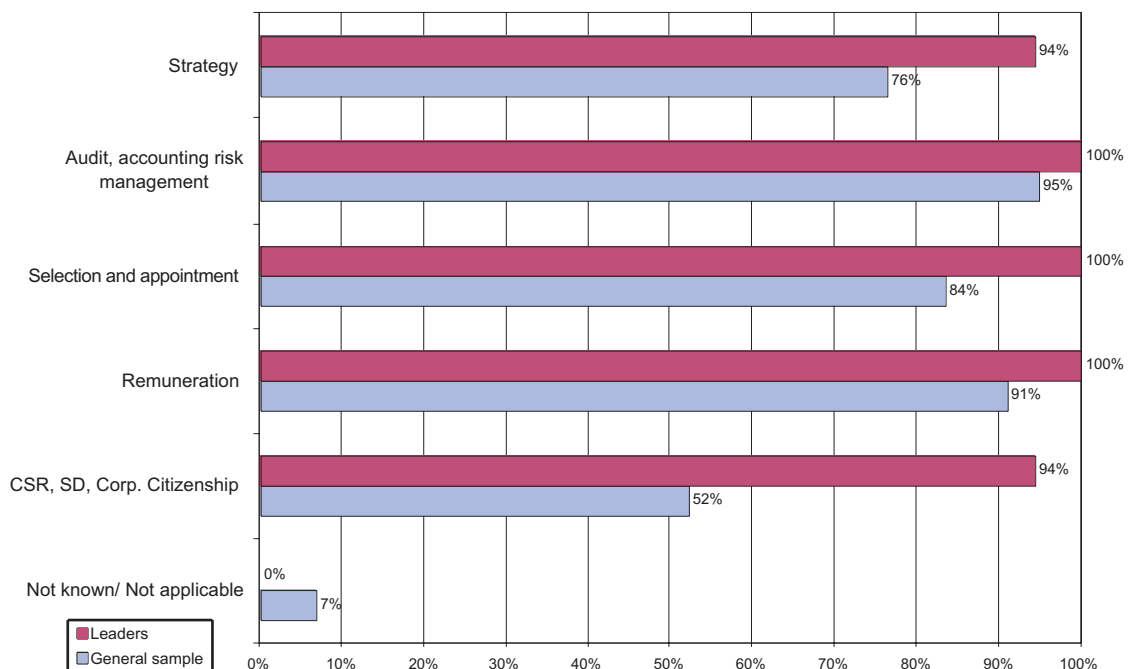
**Table 6. Board interactions with stakeholders**

	Yes	No	Not Known
External advisory councils on sustainable development	7	11	0
External experts invited to Board meetings	7	3	8
Formal responsibility of CR Comm. / Chairman and/or CEO	8	10	0
Informal processes	15	1	2

***Board’s strategy role***

As we stated in the literature review, firms must change their strategies in order to embed sustainable development dimensions; likewise, formulating strategy is one of the key roles of Boards. As a result, one crucial role of top corporate governance bodies is to make sure that SD/CR is a key variable embedded in the strategy formulation process. Graph 4 depicts different roles which are formally taken on by the Board of Directors. Once again we can see how the biggest difference between DJSI leading companies and ordinary companies lies in the field of CR.

**Graph 4. Formal responsibilities of Board of Directors**



Source: SAM Research.

Only 52% of the ordinary companies consider sustainable development a responsibility of the Board of Directors, compared to a remarkable 94% (all but one) of the DJSI leading companies. We can obtain an interesting insight by comparing the results from this graph with the Board structure table. In Table 4 we found that only one sample company did not have any kind of structure to integrate sustainability into strategy. This is the same result that was found regarding the issue of ‘formal responsibilities of the Board of Directors’. Therefore, we can infer that Board structure is a decisive factor for embedding sustainability into the firm’s strategy.

The way the Board of Directors ensures that sustainable development is integrated as a key variable in the strategy formulation processes *is totally dependent on the firm’s governance structure*. Therefore, in order to analyze this issue, we will distinguish among the different structures of DJSI leading companies considered previously:

- *Companies with Board CR committees.* These committees play an active role in providing input and assessing companies’ CR policies, objectives and practices. They also inform Boards about company results on the sustainability front. The CR committee is always supported and informed by top level corporate units. In some cases, an executive team with corporate sustainable development responsibilities interacts with the CR committee to formulate and review the strategy and policies.
- *Companies with existing committees taking on CR policies.* This case is quite similar to the previous one. However, because of the broader responsibilities of this kind of committee, we cannot expect as much attention to be given to sustainability issues as in a committee devoted exclusively to sustainability.
- *Companies with one Board member responsible for social and environmental policies.* In this case, corporate officers for environmental and social affairs report to this director and keep him/her informed about the company’s results in those areas.

Finally, we will mention some of the communication systems used by DJSI leading companies to allow better interaction between the Board of Directors and management in relation to sustainable development:

- Formal communication –through regular reports and/or shared membership– from the top executive body to the Board of Directors on sustainable development policies and performance. Some companies have gone a step further and have created a specific executive committee –made up of members of the executive management and top executives from each division– tasked with formulating and supervising the implementation of sustainable strategies in business units. In this case, corporate units and divisions support, provide input to, and advise the top executive committee, which, in turn, informs the Board on the company’s progress towards sustainability. Sustainability policies and strategy are discussed in the interaction process between the Board of Directors and management.
- Formal communication –through regular reports– from an internal sustainability committee to the Board of Directors. This internal committee, which is the main group responsible for implementing environmental, social and ethical initiatives, is normally made up of CR directors and managers from support functions such as Human Resources, Communications, Procurement, or Corporate Governance.

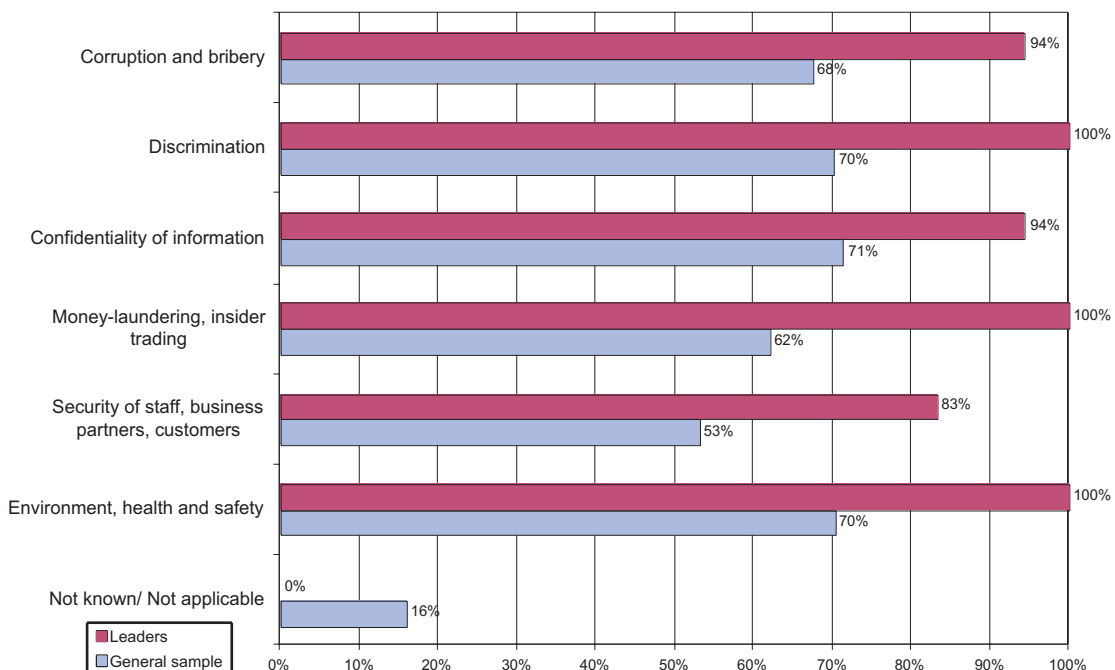
**Board’s service role**

Most perspectives on corporate governance underline the importance of the *service role* of the Board. Within the context of sustainable corporate governance, we expect that a key Board activity in this role will be that of promoting core values. Values reflect beliefs about what is truly important. For this reason, the acceptance of values tightly coupled with the principles of sustainable development is essential for achieving real progress towards a sustainable organization. In this section we discuss how the Boards, or any other department on behalf of the Board, of DJSI leading companies play three roles related to the promotion of core values. First, we will see different tools and policies used for internalizing the values assumed by the company. Second, we will analyze different ways of checking the level of awareness of values throughout the organization. Third, we will show how sustainability leaders are extending their commitment to support sustainable development externally and to other players in the value chain.

**Internalizing values**

Several mechanisms are in place to achieve the acknowledgment of corporate values inherent in sustainable corporate governance, but a formal declaration of values and principles in the form of a *code of conduct* is the most common mechanism used for this purpose. All leading companies have a written statement of business practice to guide all employees and managers in their day-to-day work. Generally, this document contains the company’s values, vision statement –sometimes a sustainability mission statement– and a code of business principles and conduct. It covers issues from obeying the law to displaying integrity, as well as responsible and sustainable business practices (Graph 5 depicts the most common issues covered by codes of conduct). The code of conduct always receives the complete approval of the Board before its formal release and is handed out to all employees. In Graph 5 we can observe how DJSI leading companies’ codes clearly address ethical, social and environmental values and principles. The percentages are considerably smaller for the general sample.

**Graph 5. Focus of codes of conduct**



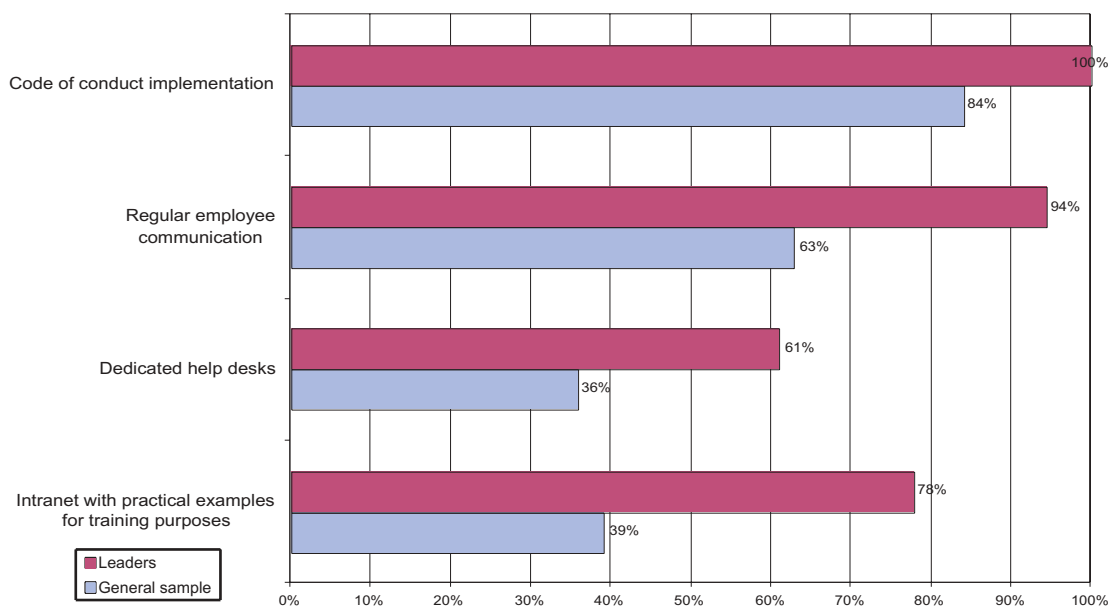
Source: SAM Research.



There are other tools to reinforce the understanding of the code of conduct or corporate values related to sustainability. They include communication programs, training programs for managers and employees, and dedicated help desks and procedures for solving code of conduct concerns and doubts. The latter usually include open door policies, telephone hotlines, confidential e-mail systems, ‘whistle blowing’ processes, or on-line tools. Less frequent is the invitation to employees to offer their opinions on code of conduct reviews and awards for outstanding ethical or environmental behaviors or practices. A summary of the results follows:

- All companies have a code of conduct for guiding employees’ and managers’ behavior in their day-to-day work.
- Seventeen companies have communication policies to reinforce the understanding of values and principles stated in the company’s code of conduct.
- Fourteen companies have intranet programs to enhance understanding of the code of conduct through practical examples and training sessions.
- Thirteen companies link compliance with the code of conduct to employee remuneration.
- Eleven companies have help desks for solving code of conduct doubts.
- Four companies invite employees to give their opinion in code of conduct or ethical policy reviews.
- Three companies offer awards for teams or individuals that demonstrate excellent business practice in social, ethical or environmental behavior.

**Graph 6. Procedures for internalizing values and codes of conduct**



Source: SAM Research.

Graph 6 gathers these data and compares the implementation of some practices among DJSI leading companies and the universe of firms analyzed by SAM. As we can see, there are considerable differences between DJSI leading companies and ordinary companies. The code of conduct is the most important tool for internalizing values. However, the use of systems to internalize the code of conduct across the organization is much more developed in DJSI leading companies than in ordinary companies. The difference in the degree of implementation of these systems is over 30% on average. These are important results because unless there are clear systems to implement the code of conduct, it has no impact on management or employees' behavior.

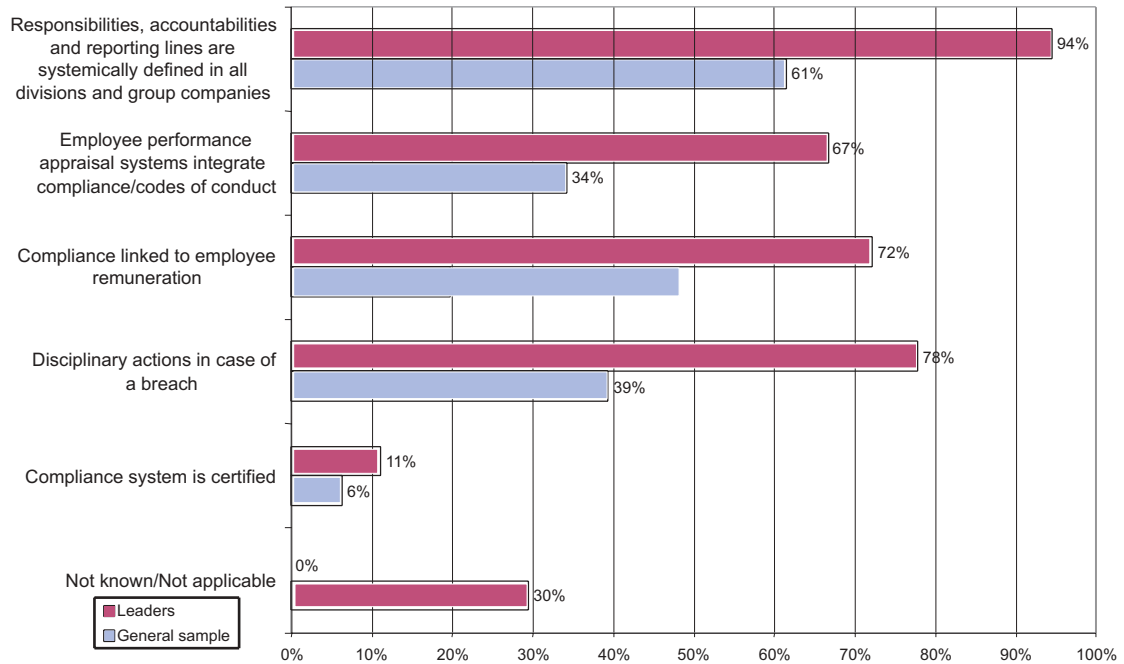
### *Checking the level of awareness of values*

Whereas the code of conduct is a reserved power of, and is endorsed by, the Board of Directors in DJSI leading companies, the implementation programs are the responsibility of the business units or divisions. A senior manager in each business unit is usually appointed to act as owner of the implementation programs. In addition, all executives and managers must sign their knowledge of the code of conduct and their commitment to promote it among employees. We also observed that some companies have created a corporate compliance committee or have appointed a compliance officer to oversee the policies and systems in place to ensure compliance with the code of conduct in all divisions and business units. Senior managers or compliance committees report regularly to the Board of Directors or Board audit committee and keep them informed of adherence to business principles across the organization. Moreover, most companies apply disciplinary procedures in the event of a breach of the code of conduct. It is also worth mentioning that 72% of the companies link employee and managerial pay to compliance with the code of conduct as a way to ensure full awareness of business principles and values across the organization. Also, 67% of the companies have made compliance with the code of conduct an integral part of their employee performance appraisal system. The annual or bi-annual employee surveys given to all employees are commonly used for measuring the level of awareness of business principles and values. In addition, some of these companies have a performance indicator for measuring the level of awareness of business principles among employees. A smaller number of companies have gone a step further and are conducting a Business Conduct and Ethics audit in all business units and subsidiaries. The results are reported to the Board audit committee, which, in turn, informs the Board of Directors. A summary of our findings follows:

- Seventeen companies have internal management systems and reporting structures to ensure adherence to the principles and values endorsed in the code of conduct.
- Fourteen companies take disciplinary action in the event of a breach of the code of conduct.
- Thirteen companies link the code of conduct to employee and manager remuneration.
- Twelve companies have employee performance appraisal systems that take account of compliance with the code of conduct.
- Seven companies conduct internal Business Conduct and Ethics audits.
- Three companies track the progress of the level of awareness of business principles and values among employees.

Graph 7 compares some of the code of conduct implementation procedures in the DJSI leading companies and the universe of companies analyzed by SAM.

**Graph 7. Implementation procedures of codes of conduct**



Source: SAM Research.

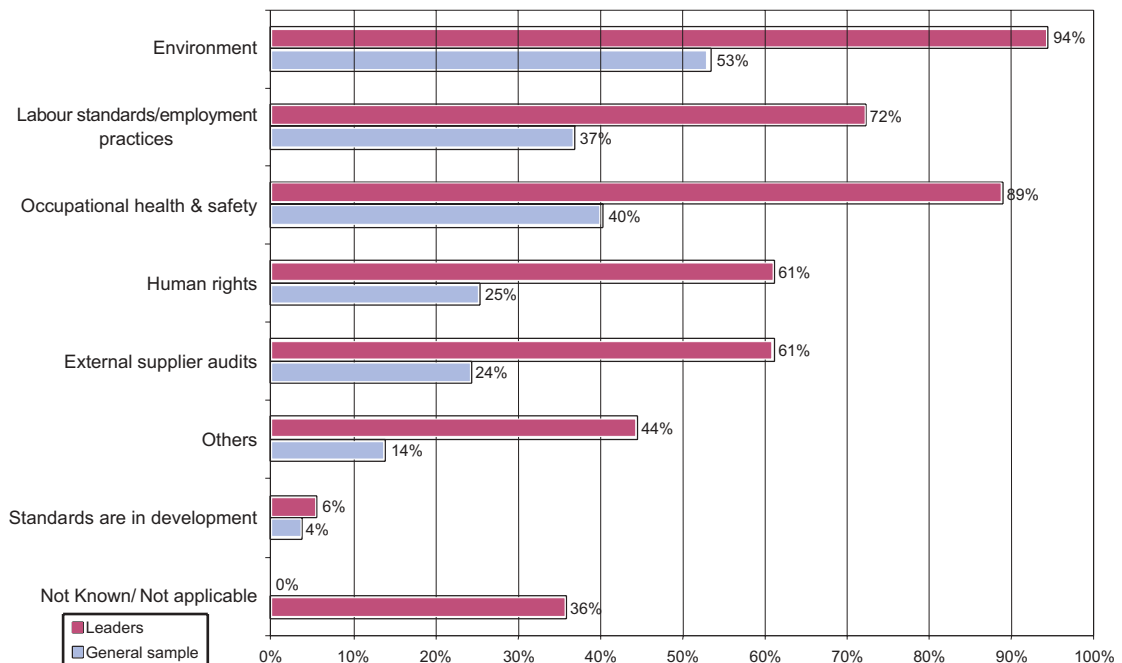
As we can see in Graph 7, defining responsibilities and reporting lines is the most common system for implementing the code of conduct, with 94% for DJSI leading companies and 61% for ordinary companies. Comparing the results for these two groups of companies, we see that DJSI leading companies are far more advanced than ordinary companies. In some areas, such as linking compliance to employee remuneration, the difference increases to more than 50%. The field of compliance system certification is the only one where the results and the differences are not so significant. These findings reaffirm the main idea that DJSI leading companies not only have declarations or statements about the importance of embracing new values in accordance with sustainability, but also have systems and procedures to ensure that all company members live up to those values.

### *Promoting values externally*

The most extended and proactive way in which DJSI leading companies foster corporate values externally is by assessing suppliers in accordance with social and environmental criteria. The development of a 'sustainable chain policy' or 'sustainable supplier guidelines' is discussed and endorsed by the Board of Directors or the Board CR committee. Graph 8 shows the social and environmental areas taken into account in the evaluation and selection of key suppliers. Environmental aspects and occupational health & safety risks are the areas that receive the most attention. They are followed by labor standards and, at a large distance, by human rights. If we restrict the analysis to DJSI

leading companies, we find high percentages: 94% take environmental aspects into account when selecting and evaluating key suppliers, and 89% consider occupational and health & safety issues. These high percentages are consistent with the adoption of standardized environmental management systems, as many organizations that have adopted these systems display a preference for suppliers that are similarly certified. Compliance with labor standards is also considered by 72% of the companies. A smaller percentage, 61%, includes human rights in the evaluation. These results are especially important for companies operating in developing countries, where institutional weakness, lack of regulations and poverty leave employees in an extremely vulnerable position. To some extent, the sustainable enterprise may face up to these deficiencies and promote good environmental, social and ethical practices among its suppliers.

**Graph 8. Areas considered in the evaluation and selection of key suppliers**



Source: SAM Research.

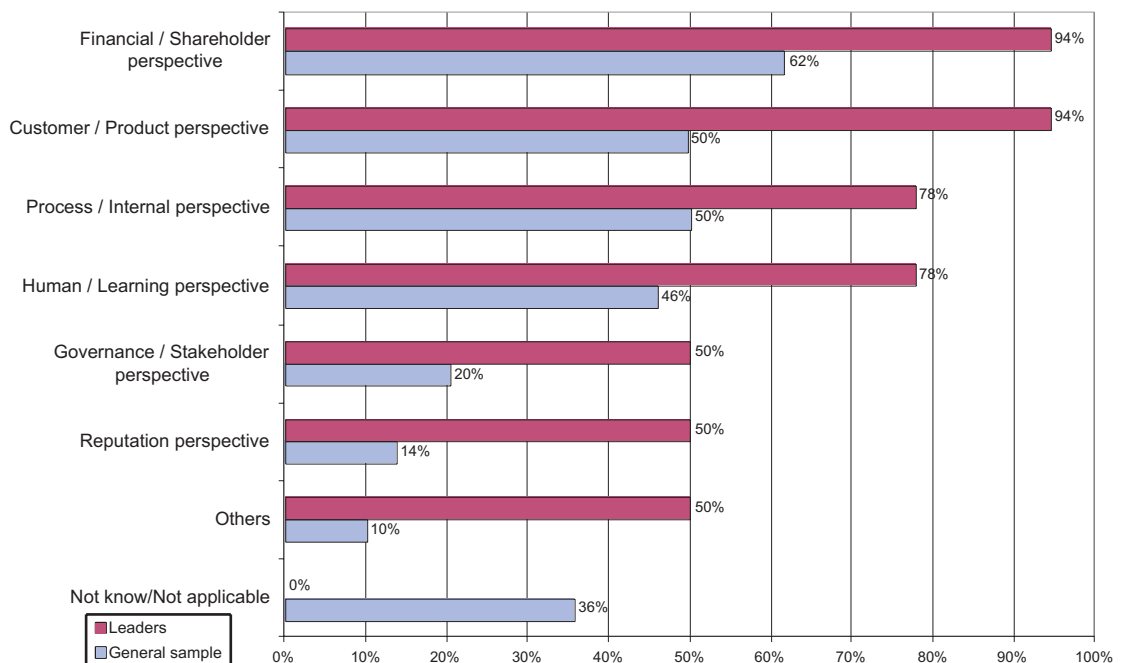
We see impressive differences between DJSI leading companies and the rest. For example, more than 50% of ordinary companies take only environmental aspects into account. The percentages for labor concerns are even lower: only 40% of ordinary companies take health & safety and labor standards into consideration when selecting and evaluating suppliers, and only 25% care about human rights. Finally, 36% of the universe of firms analyzed by SAM has no sustainability-related requirements when selecting and evaluating suppliers. As several DJSI leading companies stated, developing a sustainable chain policy is crucial for enhancing sustainability practices across the value chain. At the same time, it allows the firm's procurement department to assess and select suppliers systematically and in accordance with sustainable development principles. We observe that this policy can be complemented with other activities or policies aimed at achieving a higher commitment from suppliers, for example: the application of some parts of the code of conduct –especially those relating to labor and human rights– to suppliers; the establishment

of dialogue channels and training programs to improve suppliers' sustainable performance; and the offering of rewards to suppliers that excel in social, ethical and environmental business practices. Finally, the endorsement and support of international standards, such as the United Nations Universal Declaration of Human Rights<sup>6</sup>, is also used to exhibit to the community the firm's commitment to social, environmental and ethical values. This decision is formally approved by the Board of Directors. Twelve of the DJSI leading companies have endorsed an international standard.

### *Board's monitoring role*

In all the different perspectives on corporate governance, assessing firm performance is a key role of the Board. In our analysis of DJSI leading companies we focused on how these companies' Boards evaluated their firms' performance from a triple bottom line perspective. Since the Balanced Scorecard (BSC) has become a standard tool –in fact, all DJSI leading companies use the BSC as a strategic planning and management tool– we analyzed to what extent leading companies have incorporated sustainability objectives into their corporate BSC; that is to say, whether their BSC are Sustainable BSC. As proposed in the sustainability literature, the *Sustainable Balanced Scorecard* (SBSC) provides a broader vision by integrating all three dimensions of sustainability and so is particularly suitable for value-based sustainability management (Figge *et al.*, 2002).

**Graph 9. Perspectives of BSC**



Source: SAM Research.

<sup>6</sup> The most common standards supported by DJSI leaders are: United Nations Universal Declaration of Human Rights, United Nations Global Compact, ILO Declaration of Fundamental Principles and Rights at Work, the ILO Tripartite Declaration concerning Multinational Corporations and Social Policy, and other more specific standards depending on the firm's main business activity and location.

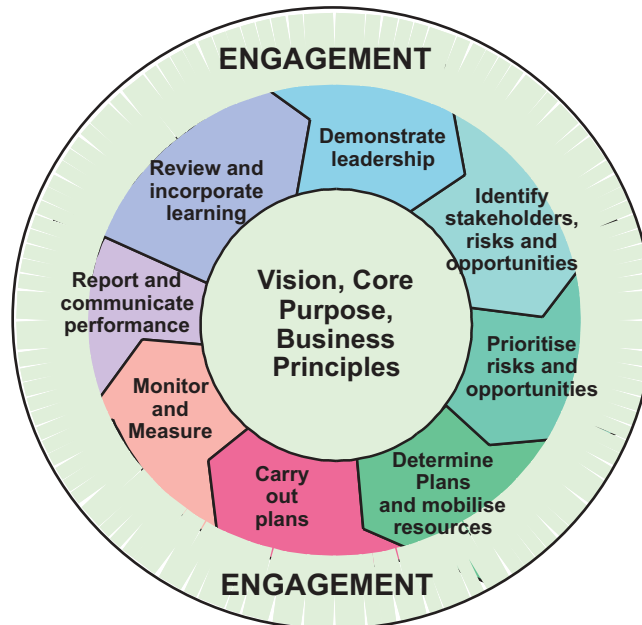
Graph 9 offers the results regarding the different perspectives of the BSC considered by companies. As we can see, the ‘traditional’ perspectives (customer, financial, process and learning) have the biggest percentages, both in DJSI sector leaders and ordinary companies. The inclusion of new perspectives is not yet a common practice. Only 50% of DJSI sector leaders have included new perspectives, such as governance/stakeholder and reputation. Nevertheless, some companies, instead of or in addition to adding a new perspective, are considering sustainability in the traditional perspectives of the BSC. Anyway, from the questionnaires we sent to DJSI leading companies, we conclude that the adaptation of the BSC to sustainable development dimensions is still at an embryonic stage. Most of the leading companies with a SBSC are just taking the first steps to transform their BSC into a SBSC. It is interesting to gain some insight into how these companies are developing, or want to develop, a SBSC. We observed three different ways of integrating sustainability dimensions:

- By integrating new social and environmental strategic objectives into the current BSC perspectives. For instance, Dofasco has included environmental strategic objectives in the ‘internal management’ perspective, whereas stakeholder satisfaction (e.g., customers and workers) is included in the ‘customer’ and ‘people’ perspectives and monitored through satisfaction surveys. Similarly, Novo Nordisk, has included new strategic objectives and has adapted some of its BSC perspectives to reflect its commitment to addressing sustainability issues: the ‘customer’ perspective has been transformed into the ‘customer & society’ perspective to include social, environmental and bioethical objectives.
- By adding *new perspectives* to the BSC to include sustainability objectives. For example, Westpac Banking has included a fifth perspective, named the ‘corporate responsibility’ perspective, which considers financial, customer, employee, community, social and other general (reputation, sustainability and governance ratings) sustainability measures. Some companies (e.g., DuPont or Marks & Spencer) have added other perspectives related to sustainability dimensions, such as ‘good governance’, ‘reputation’ or ‘community consent’.
- By developing a specific scorecard for the social or environmental dimension. This could be considered as a ‘second level’ scorecard that improves the implementation of the sustainability objectives and helps a specific corporate division to monitor its performance. For instance, 3M has set up an EHS Scorecard that details critical eco-efficiency performance at 3M operations. The EHS Scorecard reflects 3M’s ‘Environmental Targets 2005’ program, which sets new five-year corporate environmental goals (e.g., improve energy efficiency, reduce waste, etc.). These goals address environmental issues through eco-efficiency and pollution prevention metrics. They are complemented by individual business unit goals that incorporate product life cycle management within the unit’s strategic plan.

In addition to the SBSC, we also analyzed other management systems that could be used for deploying, assessing, and reviewing objectives in accordance with sustainability policy. An interesting example is provided by Shell. In 1999, Shell developed the Sustainable Development Management Framework (SDMF) to help raise awareness of sustainable development across Shell companies and to embed its requirements into decision-making (see Figure 2).



Figure 2. Shell's Sustainable Development Management Framework

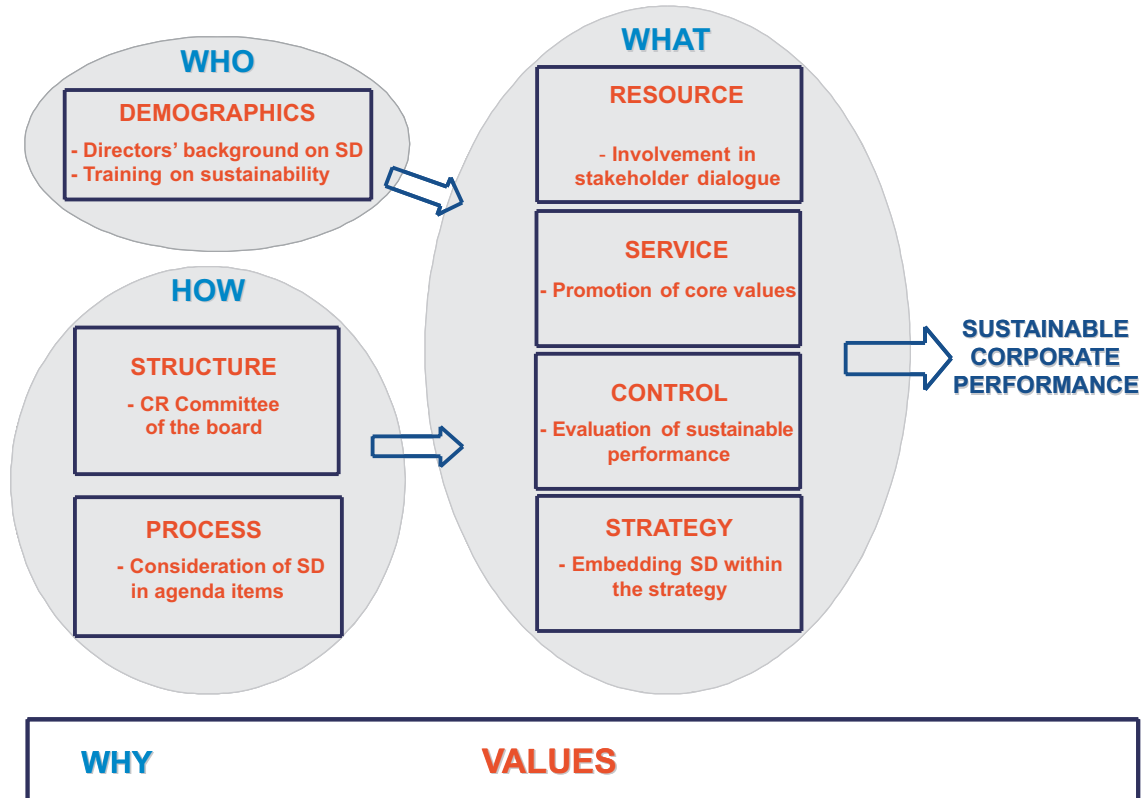


Within this framework, Shell has developed a self-assessment tool to be used at group, business or operating unit level. Its main purpose is to align business processes and sustainable development: by integrating economic, social and environmental considerations into decision making; by balancing short-term priorities and long-term needs; and by engaging stakeholders. At the same time, it is intended to raise awareness and understanding, stimulate dialogue, and lead to an action plan for systematic improvement of sustainable development alignment. The self-assessment tool is comprised of six steps and a series of short statements describing the degree of alignment at four levels –from minimal to full alignment– for a number of business processes based on SDMF.

### *Sustainable Corporate Governance Model*

From our analysis of the corporate governance systems of DJSI leading companies there emerges the Sustainable Corporate Governance Model. As we can see in Figure 3, in order to contribute to a firm's sustainable corporate performance, its governance system should give appropriate answers to four key questions: **who** the Board's members should be, **what** their most important roles should be, **how** the Board should function so as to play those roles in an effective and efficient way, and **why** the Board should do it.

Figure 3. The Sustainable Corporate Governance Model



*Why? Values.* In accordance with the sustainability requirements, the proposals of the sustainability literature and the insights obtained from our analysis of DJSI leading companies, the single ultimate goal of business should not be to create shareholder value but to endure, while at the same time enhancing the ability of the larger system to endure. This will only be possible if the firm's value foundations are coherent with this view of the firm. Therefore, sustainability must be part of the nitty-gritty of corporate governance and must permeate governance systems.

*Who? Demographics.* Since composition and characteristics are such closely related attributes, we have merged them under the label "demographics". One of the basic points on which corporate governance scholars agree is that Board members must have the necessary knowledge, experience, skills, network, etc. to carry out their duties. As we have seen in our study of the governance systems of DJSI leading companies, their Board members have a fine understanding of SD/CR requirements and challenges. The companies achieve this by including experts on these topics in their Boards and, to a lesser extent, by providing training to their directors.

*How? Structure and Process.* Most corporate governance codes propose the establishment of Board committees –audit, appointment, etc.– and underline the importance of Board working procedures. As we have seen in our research, DJSI leading companies have adapted their Boards' structure to tackle SD/CR issues and discuss them in their meetings just as they do the more traditional issues.

*What? Resource, Service, Control and Strategy Roles.* Resource dependence, legalistic, agency theory and class hegemony perspectives on corporate governance propose, to a greater or lesser extent, control, service, strategy and resource as the key roles of governance systems. From our research on DJSI leading companies we have seen how these roles acquire substance when SD/CR is embraced by their top corporate governance bodies. As we can see in the Sustainable Corporate Governance Model, involvement in stakeholder dialogue (resource role), promotion of core values (service role), embedding SD/CR within strategy (strategy role), and evaluation of sustainable performance (control role) are the specific tasks that governance systems should undertake to promote sustainable corporate performance in firms.

### **Limitations and Implications**

In this paper, drawing from the corporate governance, sustainable development, and stakeholder theory literatures, and based on our own research on the corporate governance systems of the 18 market sector leaders of the Dow Jones Sustainability World Index, we have presented the Sustainable Corporate Governance Model. Aside from this contribution, certain limitations of this study should be pointed out.

First of all, this is a benchmark study that focuses on leading companies' practices to explore the future of corporate governance systems in relation to sustainability issues. We would therefore like to emphasize that neither our study nor the emerging Model is intended to represent the way in which the average firm is embracing sustainability in its governance systems. Rather, the objective has been to shed some light on how sustainable governance systems could take shape in the near future.

Also, although it is legitimate to state that our sample of companies represents leading companies in the field of sustainability, this should not mask its limitations. The 18 companies we have analyzed in depth are the DJSWI *market sector* leaders. It is obvious that circumstances differ between market sectors, and so companies in different sectors have different experiences and sensitivities towards SD/CR. That is why we have found diverse approaches and degrees of commitment to SD/CR, which adds to the richness of the study.

Finally, the proposal for a Model of Sustainable Corporate Governance is not an attempt to question or replace previous recommendation and frameworks suggested in the literature on corporate governance and codes of governance. As we have explained throughout the paper, we have focused our analysis on governance practices related to SD/CR, not on good governance in its broadest interpretation. Thus, the proposals for a committee on SD/CR or for directors' training on these issues do not imply that companies should not set up compensation and appointment committees, nor train their directors in accounting. On the contrary, the Model should be viewed as a way of integrating SD/CR into the fabric of existing governance models.

As we stated in the introduction, this piece of research aims to bridge the existing gap between the governance and SD/CR literatures. In pursuing this goal we have uncovered a number of new and interesting questions. A few of the key questions are: What is the most appropriate form of director involvement in stakeholder dialogue? Under what circumstances should formal or informal relationships with stakeholders be favored? Is it better to integrate SD/CR issues in existing BSC or to set up an SD/CR scorecard as a way to highlight the issues' importance? Based on what circumstances should a Board make its choice between these two possibilities?

Reputation seems to be the main reason for most companies to consider SD/CR issues (World Economic Forum, 2004). Of course, reputation is a strategic asset and, as such, should be carefully managed. Nevertheless, to advance towards sustainability, society needs firms to adopt an approach towards SD/CR issues based more on innovation. Innovation is a way to build more sustainable (in the double sense) competitive advantages. Our analysis of DJSI leading companies, the best practices included in this paper, and the Sustainable Corporate Governance Framework might be useful for companies that are aware of the importance of sustainability and of their role in achieving it, and are trying to incorporate SD/CR issues in their governance systems.

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