THE CONVERGENCE OF CORPORATE GOVERNANCE AND CORPORATE SOCIAL RESPONSIBILITY

THOUGHT-LEADERS STUDY

Strandberg
CONSULTING

by
Coro Strandberg

Study sponsored by:
Canadian Co-operative Association

March 2005

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SOLUTIONS FOR A SUSTAINABLE WORLD

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EXECUTIVE SUMMARY

Corporate governance reform efforts of the past decade have bumped into decade-old efforts to mainstream social and environment responsibility of corporations and a growing awareness that firms' off balance sheet environmental and social impacts can have tangible financial consequences. This encounter has fueled a debate regarding the degree and nature of convergence between corporate governance and corporate social responsibility. To that end the Canadian Co-operative Association, interested in promoting good governance and social responsibility practices to its member co-operatives, sponsored Coro Strandberg of Strandberg Consulting to conduct an international thought-leaders study on this convergence issue. Thirteen international thought-leaders representing a range of perspectives from business networks, sustainability think tanks, rating agencies, investment research and consulting firms, environmental groups, and academic and director training programs, were interviewed for their views on the nature of this "encounter."

Two divergent perspectives emerged from the interviews: one group believed CSR connects to governance at the values level, determining the boundaries and accountabilities of the company in relation to a broad universe of stakeholders and its social and environmental responsibilities and opportunities, while the other group perceived CSR governance to be an operational risk issue. This said, interviewees universally held the view that CSR risk management is a critical governance issue, as are board diversity, accountability and transparency and, for some, compensation systems — all CSR cross-over issues.

Interviewees differed again in the degree to which they see convergence — regardless of whether at the values or the operational risk levels — as having any meaningful influence on a company's performance. Most believe convergence will grow at a modest but constant pace for the foreseeable future. A key driver will be the development of a business case for CSR concerns and for some it will be the growing awareness of aging pension fund shareholders who come to understand the trade-offs between short term returns and long term social, environmental and economic prosperity.

Some opined that the degree to which CSR governance practices influence or drive a company's CSR performance depends on the nature of CSR embedment. Firms whose CSR values are highly aligned and embedded throughout their operations will be including CSR considerations in their business strategy which will in turn drive positive CSR performance.

There are a number of "take aways" from this study; key among them being that CSR factors are increasingly moving into the board room — whether at the level of risk or values — and this trend is expected to continue. Driven largely by the CSR business case, good governance will come to include aspects of CSR oversight. Vanguard companies anticipating these trends will be engaging stakeholders in the identification of their new accountability boundaries and establishing governance systems, structures, processes and policies to provide oversight on these 21st century business issues.

INTRODUCTION

"In a more globalized, interconnected and competitive world, the way that environmental, social and corporate governance issues are managed is part of companies' overall management quality needed to compete successfully. Companies that perform better with regard to these issues can increase shareholder value by, for example, properly managing risks, anticipating regulatory action or accessing new markets while at the same time contributing to the sustainable development of the societies in which they operate. Moreover these issues can have a strong impact on reputation and brands, an increasingly important part of company value."
Who Cares Wins: Connecting Financial Markets to a Changing World, p. i, UN Global Compact, 2004.

Corporate governance reform has emerged as a critical business issue, thrust on the world stage by a number of high profile corporate failures. While many regulatory efforts are underway to identify and codify good governance practices to rebuild public and market trust, there are a parallel number of efforts to map out the social and environmental — non-financial — boundaries of corporate governance. The UN Global Compact's 2004 report, "Who Cares Wins," which looks at the social, environmental and governance issues that can have a material impact on corporate financial performance, is one of many recent reports investigating the links between social, environmental and governance practices.

The purpose of this study is to probe these issues further. What is the degree and nature of convergence of social, environmental and governance practices of corporations? What are the governance practices that exemplify best practice social and environmental performance and how fundamental are these governance practices to a company's effective financial and non-financial performance? What are the factors driving these trends and will the social and environmental aspects of corporate governance grow in importance in the future?

In order to address these questions, 13 "thought-leaders" working and advising in the corporate governance field were interviewed. Representing a range of perspectives from business networks, sustainability think tanks, rating agencies, investment research and consulting firms, environmental groups, and academic and director training programs, these thought-leaders were selected for their diversity and reputation as leading thinkers in corporate governance and social responsibility. While 13 interviews is a small sampling of the field, it is hoped that the following overview of their thoughts on these topics can help identify the direction corporate governance and corporate social responsibility (CSR) are headed together and provide insights to corporate boards and management, regulators, and investment and governance professionals as they chart their path in this new territory.

It is interesting to note that many of the individuals interviewed stated that they do not use the term corporate social responsibility, preferring the language of corporate citizenship — balancing a set of rights and responsibilities of corporations — or corporate responsibility. This report will continue to use the term CSR for ease of understanding.

The following is a summary of the themes and trends identified by these thought-leaders as they commented upon the convergence between corporate governance and corporate social responsibility.

OPINIONS ON CONVERGENCE

The most significant difference amongst the interviewees was their opinion on the nature of convergence between CSR and corporate governance. They divided into two groups: 1) those who saw convergence at the level of values and 2) those who saw convergence at the operational risk level. However, the groups were not mutually exclusive, insofar as there was a unanimous view that CSR is increasingly becoming a factor in risk and opportunity management, and therefore, business strategy.

CONVERGENCE AT VALUES LEVEL

Those who saw convergence at the level of values perceive that good governance is becoming more broadly defined to include ethical considerations, a result of a number of significant governance oversight failures. The two comments below are representative of this view:

- Good governance is primarily about values rather than rules. If good governance flows from values, it is important to state them and live them. CSR is an external expression of those values.
- Corporate governance is going beyond the traditional core governance functions to incorporate the values dimension. Part of the governance process is determining what kind of corporate citizen the company seeks to be; CSR is part of this exercise.

According to this group, governance has largely been a "box-ticking" exercise to date. However, there is an emerging paradigm of governance that perceives CSR and corporate governance to be one and the same at the level of values: an ethical strand joins governance with CSR thinking. Governance must have an ethical backbone because good governance practiced as a technical exercise results in Enron, considered by many to be a shining star in terms of technical governance. Ethical or values-based governance considers such issues as the kind of product and service the company produces, how it is produced and the social and environmental impacts of production — considerations of a CSR nature. A values-based governance program would include a corporate philosophy governing medium and long term actions, articulating an approach that reconciles short term profits with long term profitability.

One interviewee described convergence in this way: corporate responsibility is coming to be understood as the space where business accountability boundaries are being renegotiated. Up until recently power companies wouldn't have been concerned about social issues in the supply chain. Food companies didn't see health of food as an issue beyond legal compliance. The connection is that CSR drives a changing basis of accountability within a business, which drives the basis on which corporate governance is framed and implemented. To address these emerging accountabilities companies come to understand that they need to embed CSR in the governance structure.

CONVERGENCE AT RISK LEVEL

An alternative view was expressed by a number of interviewees who believed CSR only connected to corporate governance at the operational risk level:

- It depends on what you mean by convergence — CSR is an operational risk issue. We are learning from corporate governance meltdowns and the rise of social and environmental reporting standards (through the Global Reporting Initiative[1]) to systemize non-financial issues. While corporate governance is now defined in a way that includes risk management, it is a question of what risk one is looking at — in the case of CSR, social and environmental risks.
- We are not seeing a convergence, but a realization that CSR risks can have a financial impact on a company and companies should be managing this area. Companies are recognizing the financial risks evident in CSR.
- We are not talking about CSR but about risks which will be ingrained in corporate behaviour.
- Not a convergence but a risk to be managed. Companies don't make value judgments, but some things become so reprehensible in society that they become a risk to the business.
- CSR is evolving from an NGO-driven movement for greater good to a business led risk management strategy, and because of this CSR is central to governance. Long range risk management business planning is central to a global company's strategy in a globalized world.

For this group, convergence is being driven by the view that boards have a fiduciary responsibility to address risks and CSR is fundamentally about risk management. They did not share the view that CSR converges with governance at the values level. However, across the board interviewees agreed that because the nature of CSR management can differentiate company performance it is relevant to corporate governance. They agreed that effective management of CSR risks and opportunities can improve financial results thereby warranting governance

[1] The Global Reporting Initiative (GRI) is a voluntary international standard for social, environmental and economic reporting. http://www.globalreporting.org/

oversight, though they did not all agree that this necessarily implied a fundamental convergence between CSR and governance.

HOLISTIC RISK MANAGEMENT

Many interviewees acknowledged that corporations face a broader portfolio of risks today than in the past — today's risks are more diverse with significant financial impacts. Traditional governance tools fail to capture these new and emergent risks such as labour issues in the supply chain, environmental stewardship, human rights, and other issues society cares about and which can be extremely material. Corporations lacking processes for identifying and managing these risks fly blindly.

A burgeoning new area of enterprise risk management looks at risk issues more holistically. For example, the positive management of stakeholder relations should result in lower operational risk — less disruption, fewer law suits, and reduced brand risks. To assess companies' overarching risks, financial analysts are starting to develop a better understanding of social, environmental and ethical corporate performance issues.

Interviewees largely agreed that risk management is also about leveraging market opportunities — companies addressing social and environmental issues have an opportunity to grow their business in new and competitive ways. From a strategic perspective, for example, maintaining a positive and constructive relationship with non-financial stakeholders can play an important role in promoting the sustainable competitive advantage of an individual firm. Companies which do this well will develop strategic strength.

Some went even further to comment that there is a huge market share to be gained in going beyond the law in responsibility and care for nature and people. Companies whose products and services are penetrated with CSR values will find market benefit.

As CSR requires a company to consider the long range view of its sustainability — i.e. three-to-five years and beyond — issues like climate change, global poverty and security, and other environmental and social trends take on more importance from a risk management perspective: How is a company preparing to take on new regulatory demands, for example? What is its climate change policy and how is it preparing for the impact of climate change on its markets?

PACE OF CONVERGENCE

Some of the through-leaders commented that convergence is growing in importance and is not going away; others that it will grow incrementally. Some felt if CSR remains compliance-oriented it will be kept at a superficial level — it may grow, but it won't be deep. Other comments included:

- Capital providers, primarily institutional investors and those who assess credit ratings, discount risk, set debt rates, etc., will determine whether and how quickly CSR becomes a mainstream governance issue.
- The degree to which convergence accelerates depends on material evidence that CSR affects a company's performance and valuation. For these issues to take off they will

need a business case — there needs to be more evidence that CSR can be a differentiator in terms of outperforming from an equity perspective or reduced risk from a credit perspective.

- Regional diversity is also predicted with North America expected to demonstrate steady incremental growth while convergence in Europe will evolve at a faster pace, a function of the legalistic governance models in the US versus the principle-based governance systems in Europe.
- While there may be a theoretical trend towards convergence, currently most CSR programs are dislocated from formal governance processes. For example, stakeholder engagement results may be summarized in a CSR report, but typically are not brought to management's or the board's attention, nor are products and services or risk management systems affected by stakeholder input. This disconnection results in organizational dysfunction because the information is not flowing into governance practices. Nonetheless, in some cases, CSR issues are leaching into governance processes. Formal frameworks are becoming more permeable to some of these CSR issues.
- As experience of leading CSR companies has shown, after some time spent embedding CSR across their organizations, boards revise their codes of conduct (traditionally interpreted as integrity or narrowly defined ethics) to include broader issues of citizenship and sustainability.

And finally:

- Convergence will proceed at a slow to medium pace driven by events, scandals and the globalization debate.

There was a view that convergence will grow in importance but will be spurred more by particular issues such as climate change and other disaster-driven concerns:

- A few CSR issues will make their way into the boardroom. At the headline level there will be convergence; boards will be asking if management has considered social and environmental factors. However, it is unlikely this effort will result in a deep thoughtful process that looks at all dimensions of social and environmental performance. Rather, CSR considerations will form a large weave with small issues slipping through.
- In the short and medium term this issue-based approach to CSR is expected by some to drive convergence and behaviour in a directional way. Boards will want assurance the bases have been covered while certain social and environmental issues will have a big impact on governance. How these issues such as climate change are managed will have a ripple affect on the management of other social and environmental issues.
- On these matters the key issue will be where the responsibility boundaries are drawn, going forward and back through the supply chain: how far out can companies be held responsible for issues like corruption? Such questions will be moved up to the board because they are very complex and strategic.

DRIVERS OF CONVERGENCE

Interviewees pointed to a number of drivers of the trend towards values and/or risk-based convergence, key among them being a desire to close the trust gap and development of a CSR business case:

Drivers of convergence at the values level include:

- **Stakeholders:** Information technology and globalization is resulting in greater interconnection between stakeholders and companies. In the absence of a satisfactory global governance system, stakeholders are pressing for a better definition of CSR governance. Many of these stakeholders are part of a growing body of investors, employees, and consumers who don't want to exploit the interests of some stakeholders in the interest of serving others. The evidence is showing that firms acting with a multi-stakeholder perspective are out-performing those taking a unitary approach.
- **Employees:** As a stakeholder group, employees were identified as a key driver of CSR. There is a growing recognition that to produce long term quality and sustained market leadership, and thereby generate shareholder returns, companies must unlock employee motivation. Companies that live a values-based approach can generate employee pride, motivation, and dedication with positive benefits on employee productivity and ultimately financial performance.
- **Reputation and Trust:** The huge loss in value suffered as a result of recent corporate scandals drew attention to what can happen to companies that fail to address CSR issues. Companies that realize their efforts to build ethical value through mechanical and legalistic remedies do not get them where they need to go — do not help them build brand loyalty and reputational capital — turn to some of the bigger questions: the principles that underpin a company's operations beyond simple box-ticking. In defining these principles companies extend their corporate vision to consider others affected by what they do and the decisions they make. The desire to build trust results in improved transparency, a robust system of checks and balances, and programs that build internal integrity, in effect, improved governance.
- **Globalization:** The lack of formal global governance structures to guide corporate behaviour has made trade liberalization a politically charged issue, forcing businesses and economists promoting trade liberalization to ensure the benefits of globalization are shared more broadly. Values-driven CSR governance is promoted as a means for engendering public support for globalization.
- **Leadership:** In some instances, corporate leaders are the CSR drivers, advancing CSR competencies throughout their organizations and linking CSR issues with mainstream business issues.

Drivers at the risk level include:

- Increasingly shareholders seeking financial rewards are recognizing CSR issues can act on share price and want to know what companies are doing about their CSR risks.

Mainstream financial analysts and companies are also becoming aware that CSR issues are not marginal but have materiality for a company, necessitating more strategic thinking about CSR.
- The materiality of some CSR issues is becoming so significant that individual managers and departments are unable to resolve them on their own and seek board guidance.
- Governments are regulating in some CSR areas such as environment and labour issues, making it ill-advised not to stay abreast if not ahead of these issues.
- New regulations requiring more robust risk reporting compel companies to be more mindful of non-financial issues, thereby driving CSR into corporate governance and accounting processes.
- Legal liabilities and class action law suits create challenges with financial implications resulting in a jolt effect on the architecture of what gets counted.
- A number of CR risks are sector-dependent — in some sectors certain CSR issues can affect business survival and as such become central to the way business is managed.

For the most part, interviewees predict modest but increasing convergence between governance and CSR at either or both the values and risk levels, a trend driven by external events such as corporate scandals, climate change and globalization, a growing awareness of the business case for CSR performance and best practices of leading companies. There is some skepticism that these drivers will not affect a company's approach to corporate responsibility in any material way for the foreseeable future.

GOVERNANCE PRACTICES DEMONSTRATING CSR PRINCIPLES

When asked asked to identify governance practices which best demonstrate corporate social responsibility principles, all interviewees mentioned disclosure, accountability and transparency, board diversity, and risk management as the most critical areas of connection. Compensation was included as a key cross-over issue by some.

One thought-leader commented that very few governance and CSR practices *don't* overlap. Other comments included:
- The **Global Reporting Initiative** identifies a number of cross-over indicators, including independence and expertise of directors; board-level processes for overseeing the identification and management of economic, environmental and social risks and opportunities, and the linkage between executive compensation and achievement of financial and non-financial goals.
- **Risk management oversight** is a fundamental connection point. A key board duty is the consideration of long term corporate risks. Directors' competencies, their proactive efforts to take a broad view of things that affect intangible assets and their ability to assess strategy in this area are critical for effective governance and corporate performance.
- Many interviewees mentioned **disclosure, transparency and accountability** as key cross-over practices, with the caveat that such matters shouldn't be left to CSR departments or they risk becoming hollow exercises. Companies need meaningful disclosure of social, environmental, and ethical issues so they and others can see beyond

candy-coated window dressing — disclosure needs to speak to issues of risk management and strategic advantage, which link to economic issues for the company. Governance-oriented disclosure should review the progress of CSR integration: do the internal control systems cover CSR; does incentive compensation address CSR objectives, etc. There should be transparency in terms of the board's CSR operations and the status of the company's stakeholder relationships. A view was also expressed that there is too much emphasis on reporting and disclosure — while disclosure is important, "it is end of pipe stuff." Companies first need to go upstream and develop policies on the spectrum of CSR issues and then report on policy *implementation*.

- **Board composition and diversity** is another area of intersection even under a narrow, traditional interpretation of corporate governance. As many interviewees remarked, there is a push to move away from cronyism and towards recruitment of independent directors with diverse skills, knowledge, backgrounds and expertise. In order to improve the quality of decision-making at the board level — where the link to CSR can be found — it is important to include directors who not only understand the business but have non-traditional backgrounds. If it is accepted there are new forms of risks and opportunities in today's markets, then appointing directors with more diversity can yield a freshness of perspective that might otherwise not exist in a homogeneous situation. Gender and ethnicity are perceived to be second order dimensions of diversity; some boards are beginning to address these goals in their recruitment efforts.
- Some include **compensation** (i.e. board, executive and staff compensation) as a cross-over governance practice that can affect corporate social performance. These interviewees held the view that management incentives and success indicators need to be broadly defined from a long term perspective, not simply for the short term, in order to provide the incentives to encourage CSR performance and a holistic approach to risk and opportunity management. It was acknowledged that presently few boards perceive CSR compensation and reward systems as central to their corporate governance practices, but it was thought likely that this practice would grow in future.

Many thought-leaders commented that the key issues of risk management, diversity and disclosure are relevant to the operations of a good board, if not the lowest common denominator. Most interviewees agreed these practices are governance functions under the CSR rubric and that a properly governed organization ought to be concerned about these issues.

WHEN GOVERNANCE PRACTICES DRIVE CSR PERFORMANCE

Some interviewees also commented on the degree to which these governance practices influence or drive a company's CSR performance. They held common views insofar as they thought the influence of these practices on CSR performance depends on the degree of CSR alignment and embedment. If CSR is highly aligned and embedded throughout a firm, this will affect business strategy, which in turn is likely to drive positive CSR performance. If the board's CSR commitments are not aligned to the firm's business strategy its CSR-oriented governance practices will have a limited impact on business — CSR — performance. This can be observed in the difference between the investment practices of an oil and gas company moving to a position of leadership in a post-carbon economy versus an oil and gas company that invests in photovoltaics merely as a niche business opportunity. The former example demonstrates significantly greater alignment of CSR values with corporate strategy. Many CSR embedment indicators are found in a company's governance practices: reporting and assurance, CSR included in business strategy, board composition, CSR management seniority, CSR incentive structure, and stakeholder engagement.

One view was expressed that governance practices such as risk management, diversity, disclosure, and compensation are *enablers* of CSR performance. As preconditions for CSR performance, the more these fundamentals are clarified, consistent, and integrated into the business, the greater the CSR performance. If only lip service is paid to these governance practices, CSR performance will languish. Once these fundamentals are established, external pressure (society, stakeholders, global issues, and scandals) and internal forces (employees, accounting, etc.) will drive meaningful CSR performance.

RELATIONSHIP WITH STAKEHOLDERS

Interviewees were largely circumspect about the degree to which stakeholder relations are and will be addressed at the governance level. The further one gets from shareholders and employees, the less widely accepted this is as a pillar of governance, except as a derivative of the risks and strategic opportunities faced by a company. Not a box-ticking exercise, the identification and management of key stakeholder relations and overall corporate positioning is deemed a function of business strategy and risk management. However, some interviewees went further than this in considering the role of stakeholders in a values-based governance model where stakeholder relations feature more prominently.

Within a values-based governance framework, stakeholder relations are a consideration under the principled question that addresses the impact of a company's operations on society and the environment. Boards governing from a values-based perspective would consider stakeholder relations as a derivative of this question. There are, however, few examples of this approach in practice. Few boards are known to have a robust stakeholder relations policy.

Some predict that shareholders — many of whom are pension fund beneficiaries — will drive an increasing focus on broad stakeholder concerns. Pension beneficiaries will increasingly demand greater accountability and responsibility of their pension investments. In this future environment it is expected that companies will come to understand that good governance lies in choosing decisions and strategies in the interest of the ultimate shareholders of the company. It will want to know: Who does it understand its owners really to be? How does it understand those interests? It is thought that the search for answers will drive a stakeholder orientation at the governance level.

There was a minority view among interviewees that stakeholder interests are becoming more prevalent in governance as companies realize that maintaining a positive and constructive relationship with non-financial stakeholders can play an important role in promoting a sustainable competitive advantage of an individual firm. Developing strong relationships with key constituencies can be a source of competitive advantage, creating strategic strength for a firm. Conversely, companies that fail to effectively risk-manage their stakeholder relationships can reduce corporate value. Analysts, too, are coming to understand an assessment of a company's stakeholder relations can offer insights into a company's overall management capacity: Are there documented problems that appear? Is there a system that speaks to the management of stakeholder relationships that can have a material impact on how a company operates?

It was also recognized that some companies and sectors are more sensitive to stakeholders than others, much as there are different degrees of stakeholder sensitivity in different jurisdictions. It was suggested that in many parts of the developing world, emerging economies and frontier societies, stakeholder relations are more evolved at the governance level. Businesses in these jurisdictions can have deep community roots and as such, many are in the vanguard of addressing social and environmental conditions and engaging stakeholders.

While few boards are known to address stakeholder relations as a governance issue, leading boards have been identified as experimenting in this area. Companies with a high degree of CSR alignment believe themselves to be responsible to a range of stakeholders on both financial and non-financial issues, and govern themselves accordingly. Some interviewees commented that amongst companies that place stakeholder relations in their business strategy there are signs that boards are beginning to experiment with stakeholder input.

While mechanisms for stakeholder engagement at the board level are at the experimental stage, leading boards are at a minimum providing oversight to ensure there is an effective stakeholder engagement program in place and that management is talking to critics as well as friends. In line with emerging CSR disclosure standards, these boards are providing a check and balance to ensure stakeholder input is considered in strategic planning and that there is disclosure on how stakeholder input has been factored into company decision-making.

While these are, admittedly, some leading CSR governance practices, by far the most common interviewee opinion is that company boards do not see stakeholder practices as a key governance matter. The following opinion expressed this view very definitively: "Companies are driven by one thing: share price. If doing something nice to stakeholders improves share price, they are all for it. If those stakeholders can damage share price the company will manage the stakeholders and if this means paying lip service or doing something more fundamental they will do it." Except as a by-product of corporate risk management, stakeholder relations have not caught on as a key governance practice. This is apparently no less the case for values-governed companies at present.

FUTURE TRENDS

Most interviewees commented that CSR issues will increasingly permeate the board room. In the future corporate governance is expected to include more than just structures and procedures. It will include policies and assessments of policies related to long range issues. It is largely predicted that increasingly boards will be asked by financial market analysts to disclose the frequency and nature of their CSR discussions.

There is an overall trend towards greater accountability of corporations, not just in financial matters, but regarding impacts on society. Institutional investors are pushing non-financial issues more and more. As companies come to understand looking for loopholes will not serve them in the longer term they will drift to a principles-based approach to governance — the bridge between CSR and governance. Up until recently a lot of resources and effort have been spent on spin — marketing CSR — getting the message out that companies are doing the right thing without necessarily doing so. It is becoming more important that a company's decisions stand up to scrutiny than in the past and this will drive CSR convergence at both the risk management and the values level of a corporation.

CSR aspects of governance are expected to grow in future because non-financial issues are increasingly relevant for a number of industries especially in those countries with governance gaps. Most large companies are owned by the public (through pension funds) who have an interest in long term corporate performance. With increasing awareness, these shareholders will be seeking long term superior returns that are sustainable and that don't exhaust the resource base, burn bridges with key service providers, abuse employees or others, or generate good one-year returns at the expense of future returns.

We are in a transitional period of governance in which the independence of boards and their role is being redefined. The search by companies and regulators for best universal practices is resulting in considerable experimentation. With non-executive directors recruited outside the business world, the effect on governance is unclear but promises to be significant. This diversity will bring added perspectives and make decisions more well-grounded in both financial and non-financial matters with unknown but potentially profound affects.

CONCLUSION

This thought leader study on the convergence between corporate governance and corporate social responsibility has been conducted during a period of great debate regarding the definition of good governance. The boundaries and definition of corporate governance are in a period of significant flux such that emergent CSR issues have made it on the radar of many companies and regulators around the world as never before.

By and large the thought-leaders interviewed for their views on the convergence between corporate governance and corporate social responsibility were not a homogenous group. Their views differed fundamentally in a few areas and converged in others. To start, many of them do not use the term CSR, preferring corporate responsibility or other variations. While there was some dispute as to what was meant by convergence, they were unanimous in their view that CSR is an emergent area of risk in the broadening portfolio of risk management. No one really argued that the reclassification of risk to include the management of non-financial risks implied a convergence — though a number of interviewees advanced the view that CSR and governance are converging at the values level of governance, a result of the reclassification of the boundaries of corporate accountability to include non-financial stakeholder issues. Ethical or values-based governance considers such issues as the kind of product and service a company produces, how it is produced and the social and environmental impacts of production. As these boundaries are renegotiated, CSR is driven into the boardroom.

For the most part, interviewees predict a modest but increasing convergence between governance and CSR at either or both the values and risk levels. This trend is deemed largely driven by external events such as corporate scandals, climate change and globalization, a growing awareness of the business case for CSR performance and best practices of leading companies. Some interviewees expressed skepticism of the degree to which these drivers have and will affect a company's approach to corporate responsibility in any material way for the foreseeable future.

Disclosure, accountability and transparency, board diversity and risk management were commonly named by interviewees as key governance practices that best demonstrate corporate social responsibility principles. Compensation was included as an important cross-over issue by some and all agreed that a properly governed organization ought to be concerned about the corporate social responsibility nature of these practices.

Some interviewees also commented on the degree to which these governance practices influence or drive a company's CSR performance. They held common views insofar as they thought the influence of these practices on CSR performance depends on the degree of CSR alignment and embedment. Highly aligned CSR firms achieve positive CSR performance. The converse is also true. Governance practices such as risk management, diversity, disclosure, and compensation can be seen as *enablers* of corporate responsibility performance: as preconditions for CSR performance, the more these fundamentals are clarified, consistent, and integrated into the business, the greater the CSR outcomes.

Interviewees for the most part were not convinced that stakeholder relations will be addressed in any significant way at the governance level, except as a derivative of the risks and strategic opportunities faced by a company. While some thought the role of stakeholders featured more prominently under values-based governance models there are thought to be few examples of this approach in practice.

Most believe that CSR issues will increasingly permeate the board room whether as a risk management issue or as a more fundamental issue pertaining to the nature and purpose of the company. The overall trend towards greater accountability of corporations, not just in financial matters, but regarding impacts on society will have a big impact on how this drama is played out. The renegotiation of the accountability boundaries of business will be further advanced by the appointment of independent directors from more diverse backgrounds resulting in increased consideration of CSR factors in governance, at both the risk and value levels.

APPENDIX

METHODOLOGY

During February and March 2005, 13 half-hour interviews were conducted with the following corporate governance thought-leaders. Their views were summarized into the trends and themes identified in this report.

INTERVIEWEES

Dan Bakal,
Director of Electric Power Program,
CERES

Chris Bartch,
Principal and Lead Professor,
The Directors College
McMaster University,
Professor of Strategy and Governance of DeGroote School

Len Brooks,
Professor of Business Ethics and Accounting,
Executive Director of Clarkson Centre for Business Ethics and Board Effectiveness

Linda Crompton,
President and CEO,
Investor Responsibility Research Centre

George Dallas,
Managing Director and Global Practice Leader, Governance Services,
Standard and Poor's

John Elkington,
Co-Founder and Chair,
SustsainAbility

Tim Gardener,
Global Head,
Mercer Investment Consulting

Sean Gilbert,
Associate Director, Technical Development
Global Reporting Initiative

Gavin Power,
Senior Advisor,
United Nations Global Compact

Rick Samans,
Managing Director,
Global Institute for Partnership and Governance,
World Economic Forum

David Stewart-Patterson,
Executive Vice-President,
Canadian Council of Chief Executives

Simon Zadek
Chief Executive
AccountAbility

Peter Zollinger,
Executive Director
SustainAbility

RESOURCES

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