Evolutionary Governance – Segway to ESG

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The world has seen a momentous change in the 21st century from consumerism and entrepreneurialism to a pandemic led focus on ESG: Environmental Stewardship, Social Responsibility and Purposeful Governance.

For far too long have we ignored the cries of our planet-our only home! There is no Plan B. We have a unique opportunity to quickly take action, or nature will take its own course. In just 240 years we have released more carbon than we did in all history before that. The planet has limited capacity to warm more than 1.5 °C. We will breach that danger mark in 5-6 years if dramatic action is not initiated. Biodiversity loss is frightening and we must rectify the damage we have done to our planet.

Evolving Nuances of Governance

History showcases that governance has always been complex and nonlinear. It requires constant adaptation to the times but are we really where we need to be? Understanding change has become one of the most prominent challenges for contemporary governance. Governance policies must be set on the basis of understanding current comprehensive global ESG issues.

Evolutionary Governance Theory (EGT) is a framework for analysing and explaining governance and its evolution. Let's take a look into the past to see how governance has evolved over time, from living in clans to an age of cloud governance, here we are today on verge of another transition. Today, governance policies around the world have a lot of focus on sustainability but is that enough or have organisations around the world found a way to exploit the system again? Let's take an

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example of large organisation such as H&M and Decathlon that used this as an opportunity to greenwash society into purchasing their products.

Hijmans van den Bergh, member of the board Netherlands Authority for Consumers and Markets (ACM), said, “Consumers that wish to make sustainable choices must be able to have confidence in the veracity of the claims that businesses make on their products or websites”. The active participation of all the stakeholders in the process of development in a society is an indispensable condition for good governance.

Moving Schedule IV closer to ESG:

The Indian Companies Act 2013, Schedule IV serves as a code of conduct for Independent Directors. The evolutionary nature of governance requires society to incorporate a sustainability lens in the process. ESG can be integrated into the code in the following ways:

- **ESG Audits and Due Diligence** – Independent Directors shall implement processes to enable ESG audits and due diligence which will help improve processes such as production which have environmental and social implications.
- **Balancing all stakeholders' expectations** – Shareholders make investment decisions based quarterly profits of companies. While this is critical, it must be effectively balanced with long-term expectations of communities, environment, and regulators.
- **Making ESG a Board-Level responsibility** – The board must strive to be responsible stewards of shareholders, environment and society at large. Each board member must in their own capacity contribute to the ESG agenda.
- **Appointment of Board-Level ESG Champion** – Each board must have an ESG champion that understands the science behind ESG. This person should be leading the company on its ESG journey towards net zero.
- **ESG-based Board Evaluation** – Directors of the board need to be assessed based on their ability to initiate and contribute to ESG initiatives, while causing significant improvements in CSR measures.
- **ESG KPI's in Executive Compensation** – Most large organisations are shifting a portion of executive pay based on sustainability activities to help adopt ESG initiatives in the organisation.

A shift from shareholder primacy to stakeholder capitalism

The Business Roundtable announced a declaration where 181 companies signed a new statement on the purpose of a corporation, which is to ensure that the companies are run sustainably for the benefit of all stakeholders involved. “CEOs work is to generate profits and return value to shareholders; but the best-run companies do more. They put the customer first and invest in their employees and communities. In the end, it's the most promising way to build long-term value,” said Tricia Griffith, President and CEO of Progressive Corporation.

Companies must realise that the success of our system depends on long-term inclusive growth. Working ethically with suppliers to protecting shareholders who invest money that help companies innovate and grow, each stakeholder involved is essential in the long-term success of a company.

As a society, we need to move past red tapism and actually focus on acting rather than reacting to the destruction caused by human society. A great example of evolutionary governance is the Patagonia success story in which the organisation's vision was recognised for upholding a dynamic mix of policies that have put sustainability at the very core of its successful business model.Designing durable yarns from recycled fabrics shows its commitment to protecting the environment. Not only are they ethically sourcing raw materials from relevant sources but also helping small businesses such as small farms by sourcing from them. The Body Shop founder and former CEO Anita Roddick beautifully captured the power of little acts of impact when she said, "If you think you're too small to have an impact, try going to bed with a mosquito."

Breaking the resistance to change

Governance needs to be flexible as per the requirements of the situation; it needs to be able to account for the change in technology, which is one of the driving factors for the evolution of governance. The resistance to change must be broken by incorporating governance policies that take into account present-day global crises. The ability to adapt to various situations will lead to superior strategic decisions and increased profitability.

The evolution of governance is critical in bringing out the best from all stakeholders. On the social front, employees can only be expected to perform at optimum levels when they are in a hospitable workspace environment. They need to have a sense of security and be fairly remunerated to give their best. For these reasons, we have seen a shift in governance on the social front. With consumers becoming prosumers and being more actively involved in the production process we see companies shifting their approach towards a sustainable one on all levels. Governance must be more than just a fiduciary responsibility toward shareholders it needs to be able to ensure the sustainability of the firm.

The path of any corporate is dependent on its governance policies set by the board, brands such as Uniqlo or Nike focus on high-quality products that have good longevity. Other brands such as H&M or Zara are considered fast fashion brands while other brands such as Patagonia are considered sustainable clothing brands. All of these companies are profitable and based on completely different governance policies set by the board. Governance needs to evolve based on all stakeholders involved and this evolution and innovation in governance will be able to achieve sustainable profitability.

Boards should recognise that we no longer need to source cheap raw materials that destroy the environment, have labour laws in place that make the lives of employees a living hell or be ambiguous in our decision-making process and conceal information from the public to be profitable. As Albert Einstein once said, "Problems cannot be solved at the same level of awareness that created them ". Just as humans evolve we need our governance policies to evolve. Ms. Rohini Nilekani said, "We cannot be mere consumers of good governance, we must be participants; we must be co-creators." ■

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