

Sustainable corporate governance

Corporate governance that respects the environment, serves the common good and maintains productivity





Foreword

Dear readers,

Sustainability and responsible corporate governance – what do these mean in practice and how do they fit together? Are your structures and processes already resilient in terms of resource scarcity and preserving value? Do the ways in which you structure your company and allocate functions reflect principles of social responsibility? How are objectives monitored and managed to maintain productivity and efficiency?

Companies, experts, government bodies or research institutions rarely come up with any tried-and-tested policies or ground-breaking responses to these questions when we talk to them about the sustainable transformation of our economy. There is still a great deal of reluctance to engage with the “G” (governance) in ESG. Movements such as Fridays for Future, or the progress being made on quantifying climate change, have brought greater transparency to the “E” (environment) with issues such as reducing emissions, increasing energy efficiency and the circular economy, and have intensified the debate around solutions within companies. The “S” (social) is also attracting increasing attention, not least due to the introduction of Germany’s Supply Chain Due Diligence Act (Lieferkettensorgfaltspflichtengesetz, or LkSG), and with initiatives on raising awareness of equal rights such as Diversity Month or the BeyondGenderAgenda network. On the “G”, many companies’ responses have so far been limited to anti-corruption measures or staffing quotas for women, but the issue is bigger than this and more attention is required.

Decades of economic growth have brought prosperity and progress, but we have also increasingly seen unwanted and sometimes unexpected adverse effects of growth. Crises of all kinds are being triggered by a number of factors, including environmental crises and societal crises such as the Ukraine war, which both impact and are impacted by companies’ day-to-day business. The current lack of transparency, uncertainty, and transformation in social awareness demand new approaches and solutions for corporate governance.

But what can you do from a business perspective to address this situation?

Our response: align your company towards long-term, effective sustainable corporate governance

An integrated approach to management, strategic leadership and monitoring are crucial for any company looking for an effective, long-term way to serve the common good and respect the environment while maintaining productivity. It’s not a question of either-or: you need to pursue economic, environmental and social goals all at the same time.

We hope this position paper will contribute to the sustainable transformation in corporate governance and provide you with inspiration and practical help on your journey. It provides a summary of what we think are illuminating trends in the economic, social and regulatory spheres, as well as thought-provoking sections that highlight requirements and dysfunctional ways of thinking that fail to include all of the stakeholders in the system. It also provides a basic understanding of the sustainable corporate governance narrative with a definition of terms, a maturity assessment and a grading tool you can use to determine your level of ambition, as well as a selection of tried-and-tested approaches to introducing sustainable corporate governance in your company.

We want to thank the Sustainable Corporate Governance Competence Team – comprising of Paul Czech, Anna-Sophia Christ, Gertraud Bettermann, Dr Sebastian Everding and many others – for providing a “big picture” perspective and passages that we think will prompt readers to contemplate or rethink this issue.

We hope you find the paper inspiring and look forward to entering into discussion with you, listening to your ideas and working with you to think one step ahead all the time: working together for sustainable corporate governance that maintains productivity without acting today at the cost of tomorrow, and without making decisions at the cost of other stakeholders’ legitimate interests.

Do get in touch.

Daniela Hanauer, Robert Kammerer and PwC’s Sustainable Corporate Governance Competence Team



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Economic growth and prosperity

Over the past 250 years, the global economy has experienced continuous and steadily accelerating growth. This began with the use of steam power to mechanise production in the second half of the 18th century, replacing heavy physical work for many people. This initially provided a boost to the textile industry in particular, followed a few years later by the railways and the steel industry. The second industrial revolution was characterised by mass production and the production line. Power stations and mains electricity supplies developed in parallel with this to supply industry with energy; oil and other fuels joined the mix from the second half of the 19th century onwards.¹

The third industrial revolution took place in the 20th century, with the automation of production using computer technology: the era of information and communication technology had arrived. Now, in the 21st century, the economy is undergoing a fourth industrial revolution. Further developments in digital solutions using technologies such as AI, big data, robotics and machine learning are providing unprecedented opportunities for companies to create value in a more efficient and productive way.² The transformation at the process and system level has also been accompanied by a transformation of the role of the workforce, requiring constant change in management and leadership models.

Physical labour has increasingly given way to skilled and knowledge-based tasks; work will increasingly require broader intelligence-based and social skills in future. As the last point suggests, knowledge-based work is increasingly being superseded by automation and digitalisation: the advent of smartphones means that knowledge can be accessed (almost) all the time and everywhere, and AI applications such as ChatGPT can search through huge numbers of sources in a very short period of time.

This makes it all the more important for us to prioritise intelligence-based and social skills such as reflection, empathy, innovation and sensitivity and (continue to) train people in these skills.³ Corporate leaders need to adjust their compass to this “new north”, along with companies as a whole.

The interaction between economic growth, humanity and nature

Economic growth over the last 250 years has led to significant improvements in the quality of life in many areas, although not all stakeholders have benefited equally.⁴ However, we also see an increasing number of macroeconomic externalities – i.e. unwanted and sometimes unexpected adverse side-effects of growth.⁵

Some of these challenges relate to environmental, social and governance (ESG) issues. The first component, environment, refers to companies’ impact on natural ecosystems – for example, through resource consumption or pollution. The second component, social, represents the human impact of the entire value chain in terms of issues such as working conditions, equality of opportunity and consumer affairs. The third component, governance, relates to the way a company is run. For example, it covers the internal guidelines that serve as the foundation for management decision-making and defines how responsibility is allocated and monitored. Non-financial reporting in accordance with the relevant regulations is also used to ensure transparency and stakeholder dialogue. The “G” is thus closely linked to the “E” and the “S.” To demonstrate how the three aspects interact, we have included two examples below: one on the economic use of natural resources, and the other on the increasing inequality of opportunity in and as a result of organisational structures.

¹ Schwab, K. (2016). Die vierte industrielle Revolution.

² Ibid.

³ Bockhorni, M. and Beauchamp, C. (2019). Der Unterschied zur Maschine: soziale Kompetenzen des Menschen. In: Erfolgreich als Online-Marketing-Manager: Auf diese Soft Skills kommt es an – heute und in Zukunft. pp. 21–28.

⁴ For example, the number of people living in absolute poverty has roughly halved in the last 20 years and life expectancy and literacy have risen significantly, while infant mortality has fallen sharply. See Rosling, H. et al. (2018). Factfulness.

⁵ Müller-Christ, G. (2014). Sustainable management: Einführung in Ressourcenorientierung und widersprüchliche Managementrationalitäten. UTB. p. 112 et sqq.

Economic use of natural resources

During the first three industrial revolutions, the global population was far smaller relative to the planet's carrying capacity than it is now. We are now repeatedly overshooting the planetary boundaries with our actions – and in some cases, we have already exceeded the planet's capacity for natural regeneration. Visible manifestations of this include the death of coral reefs⁶ and the melting of permafrost.⁷ “Earth Overshoot Day” comes earlier every year, shifting from 3 August in 2013 to as early as 4 May in 2023. This is the day in the year when our consumption “overshoots” the world's capacity to preserve its finite resources.⁸

A transformation is required towards a form of corporate governance that maintains productivity, but without sacrificing tomorrow at the cost of today.

Economic growth and rising consumption are driving an increase in environmental damage. Conversely, economic recessions and reduced consumption allow the environment to recover, thus allowing nature to survive for longer. For example, the reduction in flights and car journeys during the COVID-19 pandemic had a positive effect within a very short time.⁹ Germany's ability to meet its climate goals in 2022 (in terms of reducing greenhouse gas emissions) was due, in part, to the fall in industrial production caused by increased oil and gas prices.¹⁰ The task of corporate governance will be to reframe discussions on the costs of protecting the environment and conserving resources, and focus instead on the costs of delaying action now only to be forced to make productivity savings later on. Companies that are heavily dependent on public resources, such as the food industry, have a particular responsibility for preserving the value of their assets since their economic impact on the natural world directly impacts the opportunities for productivity.¹¹

What is needed here are management decisions and actions that do not conflict with other stakeholders' (legitimate) interests.

We define sustainable corporate governance as a form of governance that operates with a commitment to not sacrifice tomorrow for today, and to avoid decisions that may favour one location but clash with the rightful interests of stakeholders elsewhere. All the while, sustainable corporate governance also maintains company productivity. It forms part of the title of a recent **European Commission initiative**. This initiative aims to improve the EU's corporate law and corporate governance framework to incentivise companies to focus on long-term benefits in a way that integrates stakeholder interests and moves away from short-term gains (see Chapter B 2 for more details).



⁶ www.ardalpha.de/wissen/natur/tiere/artenschutz/korallen-gefahr-klimawandel-korallenbleiche-100.html.

⁷ www.ardalpha.de/wissen/umwelt/klima/klimawandel/permafrostboden-klimawandel-kohlendioxid-methan-100.html#:~:text=Permafrost%20ist%20eigentlich%20wasserundurchl%C3%A4ssig%20%2D%20wenn,Br%C3%BCcken%20und%20Leitungen%20brechen%20zusammen.

⁸ www.overshootday.org.

⁹ www.zeit.de/wissen/gesundheit/2020-03/corona-auswirkungen-klima-umwelt-emissionen-muell.

¹⁰ www.zeit.de/wissen/umwelt/2023-03/klimaziel-2022-emissionen-verkehr-klimaschutz.

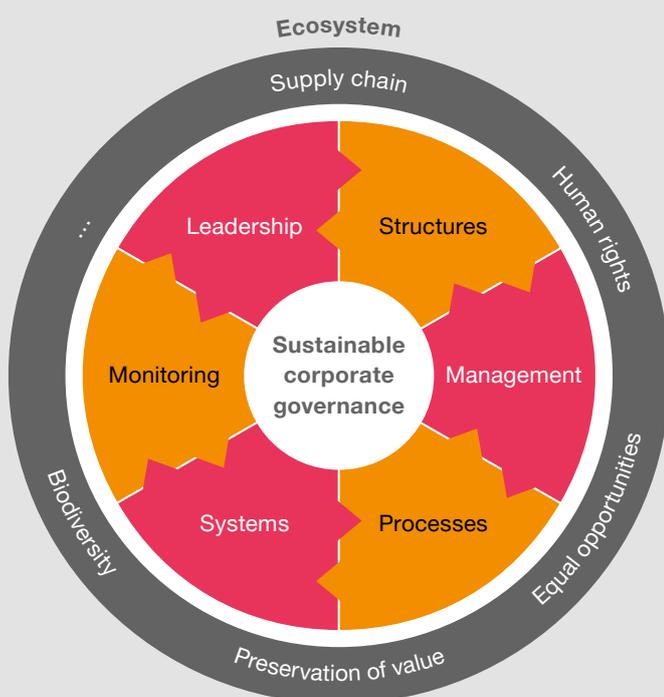
¹¹ Göpel, M. (2020). Unsere Welt neu denken.



Sustainable corporate governance refers to a holistic and integrated approach to leadership, monitoring and management that serves the common good and respects the environment while ensuring that the company remains productive, effective and relevant over the long term. This comprises a business model tailored to the company’s stakeholders that internalises externalities, aligns value creation with values, and reflects these values in how profits are distributed while taking financial interests into account.

In practical terms, this requires internal company structures, processes and systems to be designed so that leadership, management and oversight respect the planetary boundaries and increase equality, both on the strategic and the operational levels. This includes companies rethinking and redesigning their decision-making cultures, remuneration structures and incentive schemes – for example, to support managers in dilemmas where a trade-off between profit and sustainability might appear inevitable. This requires sustainable leadership, an ethical and responsible form of leadership, based on transparency and standardised procedures that allow management to see the bigger picture and base decisions on a range of different stakeholders’ perspectives.

Fig. 1 Sustainable corporate governance



Source: PwC “Sustainable corporate governance”.

Providing a basic understanding

Our years of experience in advising clients on the interface between regulations and sustainability has shown us time and time again that many companies are reluctant to embark on the journey towards sustainable corporate governance, as also shown by market analyses and collaborations on research and development. This is often due to a lack of understanding of what sustainable corporate governance is. Sustainability is still seen as a complex topic, and increasingly as a worn-out buzzword – even as narratives of sustainability in our economy are becoming more vital than ever, as described above.

This position paper starts with a summary of what we think are illuminating trends transforming the economy, and how we can use sustainable corporate governance to make the most of the opportunities they offer (see Chapter B). For an initial assessment of where your corporate governance model is on the path to sustainability, each section includes targeted questions that can be combined to provide a quick checkup on your current maturity level.

This is followed in Chapter C 1 by a grading tool you can use to determine your level of ambition and make an initial performance assessment. This self-assessment is followed in Chapter C 2 by three approaches towards implementing a sustainable corporate governance policy within your company that can be used to close any gaps between your aspiration and your current position. Different indicators are provided for each specific approach to help determine whether it is suitable for incorporation into your management systems and processes. We conclude the paper by presenting a well-established framework for sustainable business transformation (see Chapter D).

The section below takes a look at the various terms associated with sustainability in the corporate context. In conjunction with other information provided, this will allow you to assess your basic understanding of the sustainable corporate governance narrative.

This position paper is best thought of as providing food for thought on how to make your corporate governance more sustainable based on your company’s values and business model. A proactive, comprehensive stance is needed (not an “either-or” attitude) that allows you to pursue economic, environmental and social goals all at the same time.

Many different sustainability-related terms have been in use for a number of years in business and academic circles. This section explains a few of them based on our understanding of sustainable corporate governance.

Corporate sustainability

The Brundtland Commission defined sustainability in general as a way of meeting the needs of both present and future generations: “Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs.”¹² The general definition of sustainability has been extended since the mid-1990s to include three dimensions, the “triple bottom line”: the economy (first line, which requires liquidity), the environment (second line, always ensuring that resources used are regenerated naturally) and social issues (third line, maintaining and building up social capital with a focus on workers and their social environment). According to this principle, sustainable corporate governance is achieved if the requirements of all three dimensions are met at the same time. In 2015, the United Nations (UN) published Agenda 2030, comprising 17 Sustainable Development Goals (SDGs) that set out sustainability requirements at a global level in detail. Many companies and countries – including Germany, with the 2016 Sustainability Strategy and its successors – have aligned themselves with these goals and have committed to working together to achieve them.

Corporate responsibility

Numerous terms include the ethical and moral aspects of responsibility. They emphasise that individuals are accountable for their actions. The German Corporate Governance Code (Deutscher Corporate Governance Kodex, or DCGK) refers to the widely known mediaeval concept of the “honourable merchant,” an individual trading on a sustainable basis,¹³ while the European Commission’s strategy for corporate social responsibility talks about “the responsibility of enterprises for their impacts on society.”¹⁴

Corporate social responsibility (CSR)

The acronym CSR is widely used and is generally understood as corporate accountability for core business activities. CSR is ultimately a business strategy that is oriented towards sustainable, long-term development and which pursues social and environmental goals as well as purely economic ones. The European Commission’s Green Book defines CSR as “a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis.”¹⁵

A. B. Carroll’s CSR pyramid¹⁶ from 1991 is often cited as a way of visualising corporate responsibility and refers to the need for sustainability based on four incremental steps:

1. **Financial, long-term assurance:** economic responsibility is a basic prerequisite
2. **Legal responsibility:** compliance with applicable legislation
3. **Ethical responsibility:** alignment with current societal values and norms
4. **Philanthropic responsibility:** voluntary commitment (i.e. neither required or expected by society)

The Green Book definition was expanded in 2011 to include the impact of business operations on the whole of society since social and environmental concerns had previously not been sufficiently incorporated into companies’ core strategies.¹⁷ The Green Book also differentiates between internal CSR, which relates to business-related issues (e.g. human resources, occupational health and safety) and external CSR, which focuses on the interaction between companies, society and the environment (e.g. local communities, business partners, human rights).

Corporate citizenship

Corporate citizenship refers to a moral and societal approach that goes beyond a company’s own business activities and can address societal problems in the social setting. It thus describes a sub-aspect of sustainable corporate governance: namely corporate commitment within the local community. It includes actions such as corporate donations or sponsoring (corporate giving), setting up corporate foundations, or supporting charities through employee engagement (corporate volunteering).

¹² United Nations (1987). Report of the World Commission on Environment and Development: Our Common Future (Brundtland Report). p. 41.

¹³ Deutscher Corporate Governance Kodex (2022). p. 2.

¹⁴ European Commission (2011). Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: A renewed EU strategy (2011–14) for Corporate Social Responsibility. p. 6.

¹⁵ European Commission (2001). Green Paper: Promoting a European framework for Corporate Social Responsibility. p. 6.

¹⁶ Carroll, A. B. (1991). The Pyramid of Corporate Social Responsibility: Towards the Moral Management of Organizational Stakeholders.

¹⁷ European Commission (2011). Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: A renewed EU strategy (2011–14) for Corporate Social Responsibility.

B

A new operating environment for corporate governance

“Almost 40% of CEOs do not think their companies will still be economically viable in ten years if they maintain their current course.”

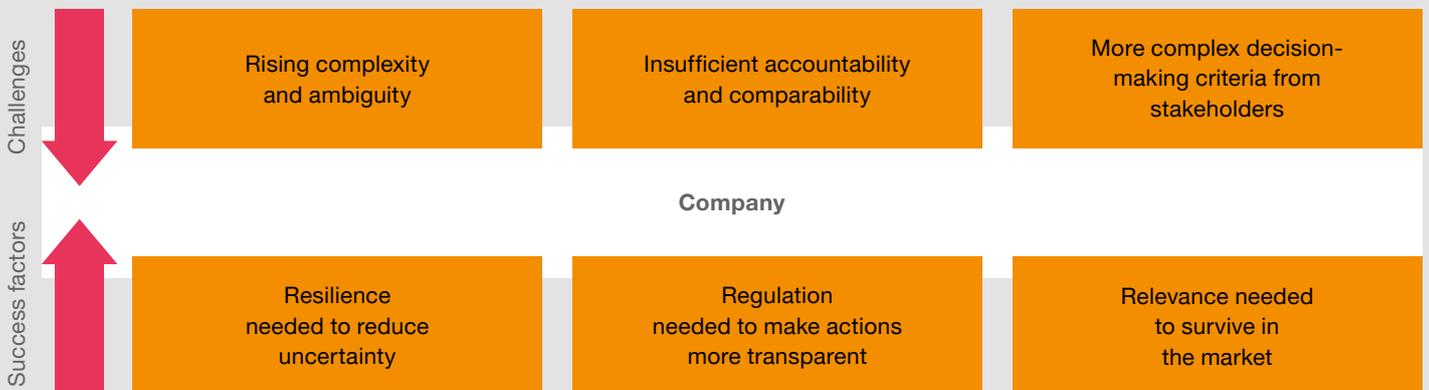
PwC’s 26th Annual Global CEO Survey, 2022

“Business as usual” is over

Responses from business representatives to the challenges of modern corporate governance (see PwC’s 26th Annual Global CEO Survey) have been evident for some time. The variables of our economic system are constantly changing and their significance is being reframed. We need to start thinking about new developments, regulations and preferences before they become a reality. On top of this, the rate of progress and change seems to be rising exponentially.

To keep up with the hectic pace of change, companies need to rethink their leadership, management and culture. Stakeholders have seen “business as usual” as the wrong approach for some time now. Tried-and-tested approaches to doing business that have evolved over the last 250 years and have been hugely successful have now become obsolete since, as set out above, they are unsustainable and no longer offer much chance of success for the future. The challenges this creates for corporate governance can be summarised under three headings: rising complexity and ambiguity (see Chapter B 1), insufficient accountability and comparability (see Chapter B 2) and complex decision-making criteria from stakeholders (see Chapter B 3). In order to address these challenges effectively, we have identified **resilience**, **regulation** and **relevance** as crucial elements in any successful sustainable corporate governance policy. Chapter C outlines how you can implement these in your corporate governance model.

Fig. 2 The three pillars of the new operating environment



Source: PwC “Sustainable corporate governance”.



Resilience is needed to reduce uncertainty

Systems increase in complexity as they grow

As the number of stakeholders in a system grows, so does the range of potential relationships (which may influence one another), and this generates more complexity. Over the last 250 years, globalisation has significantly increased the number of stakeholders in the global economic system. Digitalisation is also increasing the speed of production, communication and transactions – almost exponentially.¹⁸

The acronym VUCA (volatility, uncertainty, complexity, ambiguity) has been used to describe this phenomenon of a rapidly changing world since the end of the 20th century. It refers to the properties of a system which pose new challenges for corporate governance as the system expands. Global challenges have intensified in recent years and the terms used to describe them have also developed: “volatile” has become “brittle”, “uncertain” has been intensified to “anxious”, “complex” has been extended to “non-linear” and “ambivalent” to “incomprehensible”, or BANI for short.

Resilient business models for a secure future

Companies need to become more resilient to deal with today’s BANI world and remain viable in the world of tomorrow. This involves more than simply analysing potential opportunities and risks, their impacts, and how to deal with them. It also requires a fundamental rethink to create a second line of resilience to respond to currently unimaginable situations. An extreme example from our recent history is Russia’s attack on Ukraine. This war has had a significant and huge impact on the economy. While discussions about diversifying energy sources in Germany

and other countries had occurred in the past, preventive action had not been considered essential. It was only when the consequences of the war became clear that some countries and companies were forced to change course – at a higher cost than would otherwise have been the case.¹⁹

Corporate leaders, middle managers and all rank-and-file employees need to have a high tolerance for ambiguity to deal with this highly uncertain world in the long term and set up resilient business models. Tolerance for ambiguity is key for today’s and tomorrow’s decision-makers since it provides them with the resources needed to identify and manage the uncertain and sometimes conflicting circumstances and events that arise in a BANI world. Ideally, these skills will have been acquired before entering the world of work, but if not, corporate leaders need to invest in employees to ensure they are fit for the future. Our implementation approaches (see Chapter C) show how you can refine your management systems to achieve this.

Part 1: Sustainable corporate governance maturity assessment

- Can you identify the long-term areas for development (> 5 years) that will impact/may impact your company’s fitness for the future?
- Is your management model resilient enough to respond flexibly and effectively to unforeseen events or crises?
- Does your company have a good tolerance for ambiguity in decision-making?

Click here to go to the complete quick checkup.

¹⁸ Roser, M., Ritchie, H. Mathieu, E. (2023). What is Moore’s Law? <https://ourworldindata.org/moores-law>.

¹⁹ www.leopoldina.org/fileadmin/redaktion/Publikationen/Nationale_Empfehlungen/2022_ESYS_Sonderimpuls_Versorgungssicherheit_web.pdf.

Regulation is needed to create transparency

In a world of constant change and the uncertainties this involves, there is a huge need for certainty, comparability and standards. Corporate scandals fuel doubt and – when coupled with heightened social awareness – increase the demand for greater transparency.

In Germany, older sustainability-related commitments, frameworks and auditing standards such as ISO 26000 and 14001 are still widely used, but are now often insufficient to fully meet demands for transparency and social responsibility. This soon becomes clear if we compare the 17 ambitious SDGs that arose from the 2015 Paris Agreement on Climate Change and the UN's Sustainability Agenda with the current sustainability goals and efforts of many German companies. In our experience, companies increasingly use the SDGs and the UN Sustainability Agenda as the basis of a roadmap and as a benchmark for socio-economic and environmental transformation to meet ever-rising expectations.

However, this is not just confined to companies – the regulators have also adjusted their focus in the past few years. There appears to be a general trend of regulators abandoning the principle of voluntary commitments in favour of statutory requirements. They now expect reporting (and the communications associated with it) to provide a framework based on robust criteria that fully meets the need for transparency as part of sustainability. A brief outline of the major changes is provided below.

A new era of sustainability reporting

Sustainability reports have been published in Germany for some time now in accordance with national and international guidelines and frameworks as best practice, such as the [German Sustainability Code \(Deutscher Nachhaltigkeitskodex, or DNK\)](#) or the [Global Reporting Initiatives \(GRI\)](#). Ever since 2004, when the [EU Modernisation Directive 2003/51/EC](#) was transposed into German law in the shape of the Accounting Reform Act (Bilanzrechtsreformgesetz), large corporations have been required to include special non-financial performance indicators that are significant for the company in (group) management reports.

During the euro crisis, [Accounting Directive 2013/34/EU](#) expanded reporting to include environmental and social aspects, and revoked the principle of voluntary commitments. Since 2014, [Directive 2014/95/EU \(the Non-Financial Reporting Directive, or NFRD\)](#) has required public interest entities with more than 500 employees to include non-financial information in their management reports by publishing a [non-financial statement \(NFS\)](#). The EU has also issued clear regulations for these statements to serve as a guide for companies. These regulations were extended in 2017 by [Directive 2017/C 215/01](#) to include guidelines on non-financial statements.

In 2021, the draft of the [Corporate Social Responsibility Directive \(CSRD\)](#) was finally published. The directive was adopted in November 2021 and entered into force at the start of 2023. The CSRD once again considerably expanded the existing rules on non-financial reporting, in terms of both scope and content. This makes sustainability reporting by EU companies among the most comprehensive and highly comparable globally. A notable innovation in the new directive is the concept of double materiality. This requires companies to disclose the impact of their operations on a range of sustainability issues while also assessing how sustainability issues affect the company's economic situation. Among other things, the CSRD also requires sustainability goals to be published in financial reports.

Requirements for sustainability in governance

In addition to reporting obligations, the EU Commission has been discussing various [sustainable corporate governance](#) approaches since 2020. This included an initiative to reform currently inadequate EU corporate law to promote a more sustainable economy. In practical terms, the initiative aimed to “better align the interests of companies, their shareholders, managers, stakeholders and society. It would help companies to better manage sustainability-related matters in their own operations and value chains with respect to social and human rights, climate change, environment, etc.”²⁰

²⁰ European Commission, Summary of the sustainable corporate governance initiative, https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12548-Sustainable-corporate-governance_en.

The initiative gained worldwide attention as it engaged with the debate on the actual purpose of a company. Alongside a range of obligations for companies, it also called for a clear regulatory framework that would tighten up the obligations of company boards on sustainable action and create incentives for companies to develop in a way that is more sustainable overall.

The result of this initiative was the Corporate Sustainability Due Diligence Directive (CSDDD). The draft of this directive was published on 23 February 2022 by the European Commission and contains numerous calls for action directed at companies. In practical terms, it aims to combat adverse impacts on people and the environment by requiring companies to take a more robust stance on integrating due diligence processes into their management structures.

The EU Council and Parliament have now published their own views on this. The items to be discussed in the next “trilogue” (European Commission, Council of the European Union, European Parliament) will include issues such as the scope of application (number of employees, turnover, sector) and sanctions. Based on these issues, a final decision will be made, allowing the new directive to be adopted.

This focus means that the CSDDD will expand the regulations under the German **Supply Chain Due Diligence Act (Lieferkettensorgfaltspflichtengesetz, or LkSG)**, which have been applied nationally since 2021, to include requirements on human rights and the environment in particular – among others, obligations to achieve climate goals. The LkSG focuses on specific human rights-related and environment-related risks – both in internal company operations and in the supply chain (Tier 1 and Tier n) – and specifies due diligence obligations based on these risks.

Another key regulation on sustainable corporate governance is the **German Act Implementing the Second Shareholder Rights Directive (Gesetz zur Umsetzung der zweiten Aktionärsrechterichtlinie, or ARUG II)**, which requires remuneration structures for board members of listed companies to be oriented not only towards sustainable corporate development, but also “towards the promotion of a sustainable and long-term development of the company” (Section 87(1) sentence 2 of the German Stock Corporation Act, or AktG). The new 2022 version of the **German Corporate Governance Code (DCGK)** also requires the remuneration structure of listed companies to be oriented towards the company’s sustainable and long-term development. The new version of the DCGK expands the duties of members of the management and supervisory boards and recommends that the supervisory board and the chair of the audit committee should have appropriate competencies in sustainability. An extension of

operational monitoring, risk management and compliance systems to include environmental and social factors is also recommended to support a move towards a sustainability-oriented, comprehensive risk management system. The new version states that sustainability goals need to be appropriate to the needs of stakeholders, not just shareholders – the DCGK has moved from the commonly used shareholder value approach to a stakeholder value approach.

However, the rules cover more than just remuneration structures.. Under the first and second **Leadership Positions Acts (Erstes Führungspositionen-Gesetz, or FÜPoG I, and Zweites Führungspositionen-Gesetz, or FÜPoG II)**, from 2015 and 2021, respectively, both private companies and public sector organisations are required to ensure gender diversity in leadership positions, among other things. A key component of these acts applies to listed companies that are subject to parity co-determination: the management board will be required to include at least one woman and one man if the board has more than three members in total.

Other legislation – such as the **Financial Market Integrity Strengthening Act (Finanzmarktintegritätsstärkungsgesetz, or FISG)** of 2021, which tightens the rules on corporate governance on the basis that strong internal oversight committees are fundamentally important for good governance – is intended to restore confidence in German financial markets.

Green finance as a way to increase sustainability

Regulation of financial markets is seen as a key factor in the transformation to sustainable economic activity. Today’s investors prioritise sustainability and expect high-quality information, a strategic plan for long-term value creation, and improved risk management – all of which assume that ESG is fully integrated into the company. Companies that create transparency on their business activities and the associated social and environmental impacts and achieve high ESG ratings can benefit from the increase in confidence and the reduction in the cost of capital that this brings.

A report published by the **UN Global Compact** in collaboration with several financial institutions in various countries as far back as 2004 included guidelines and recommendations on how to better integrate ESG issues into asset management, securities brokerage and associated analysis. This report was entitled **Who Cares Wins: Connecting Financial Markets to a Changing World**, and its overarching aims were to create more resilient financial markets, contribute to sustainable development, raise awareness and mutual understanding among stakeholders, and improve trust in financial institutions.

Another step in green finance was the **MSCI Socially Responsible Investing (SRI)** Index launched in 2011, which also produces sustainability ratings for funds – i.e. sustainable investments. Companies with an excellent ESG rating are highlighted, while those with products that have adverse social or environmental impacts are excluded from the index.

The **Task Force on Climate-Related Financial Disclosures (TCFD)**, founded in 2016, has developed a standardised, comparable specification for disclosing materially climate-related financial opportunities and risks, which serves as a basis for investors, lenders and insurance underwriters. Since the TCFD's recommendations offer guidance on truly sustainable operations, their use is now advised by various regulations (e.g. the CSRD).

Regulation (EU) 2020/852 of the European Parliament and Council, better known as the **EU Taxonomy Regulation**, adopted a key regulatory framework for expanding sustainable investment and a classification system for sustainable approaches for corporate decision-making. This regulation is classed as a delegated act with direct effect on companies in Europe. It requires companies to include new content in their non-financial reporting from 2022 onwards. The companies affected must state the proportions of revenue, investment and operational expenditure associated with economic activities that are considered environmentally sustainable under the EU Taxonomy. The Taxonomy arose from the EU's "**Sustainable Finance**" Action Plan and forms part of the European Green Deal, with the aim of diverting capital flows into more environmentally sustainable activities, protecting investors from greenwashing, mitigating market fragmentation and directing investment to where it is most urgently required. The EU Taxonomy sets six environmental objectives; companies must contribute to at least one of these objectives and do "no significant harm" to any objective for their actions to be deemed environmentally sustainable. This is intended to avoid a monocausal approach to sustainable activities and promote an integrated approach to the environmental objectives.

Securing social acceptance with proactive positioning

Standardising sustainability through regulation, making it comparable and increasing transparency and manageability will be important issues in the future. Regulations on digitalisation, such as the **General Data Protection Regulation (GDPR)** and the **EU AI Act**, also include requirements for sustainability and responsibility. Regulation will create many major positive incentives and require transformation.

However, the framework created by these regulations often needs to be revised. Issuing new frameworks and laws or updating existing ones can be a slow process: political debates can drag on for a long time, and in many cases, it takes even longer to implement the regulations once they have been agreed. Regulations need to be continuously updated, as they lag behind current public opinion and discourse.. By the time measures have been taken and systems adjusted, the slow pace of this process means that the business activities they cover are no longer at the centre of attention. The process is further complicated by overlaps between various (new) areas, with connections between these areas remaining undetected until the drafting period, preventing them from being incorporated into the process. This means they are generally slipped in retrospectively and only adopted when the relevant laws are updated. In the EU Taxonomy, for example, e-mobility is rated positively, but the effects of the increasingly popular carsharing model are not factored into the rating.

It is therefore up to companies to incorporate sustainability into their structures at an early stage and ensure they maintain social acceptance for their operations. They need to bear in mind that existing guidelines, regulations and the associated objectives can be useful signposts, but are often an insufficient basis for acting sustainably in line with the latest standards and principles. Companies need to be proactive and keep one step ahead of regulations by thinking ahead about their objectives rather than simply relying on the regulations as a guide. The general principle is that taking responsibility and ambitious action are key to this transformation.

Part 2: Sustainable corporate governance maturity assessment

- Do you take a proactive approach, going beyond regulatory requirements to include sustainability in your governance model?
- Do you keep up to date on relevant developments in sustainability regulations?
- Are your sustainability activities transparent for third parties and standardised to allow comparability?

Click here to go to the complete quick checkup

Relevance is needed to survive in the market

From shareholder capitalism to stakeholder capitalism

The 20th century saw an economic boom in industrialised countries after companies started focusing on the principle of shareholder value. This states that company activities should always focus on increasing company value, with priority accorded to increasing profits. However, today's social transformation now requires companies to take a holistic view of value creation – also referred to as “stakeholder capitalism”, a term coined at Davos 2020 by Klaus Schwab, co-founder of the World Economic Forum.

Stakeholder capitalism goes beyond internalising externalities, requiring companies to be in a position to serve all stakeholders.²¹ Examples of this include fair distribution of wages, transparency when dealing with customers or accepting responsibility for local impacts on the environment and society. This attitude is increasingly reflected in regulations as well, such as the latest version of the DCGK as explained above (see Chapter B 2).

A rethink of the economy is thus underway, promoted by a range of different stakeholders with a variety of motives who are foregrounding issues such as sustainability, equal rights or democratic values. Questions are increasingly being asked about whether company actions are ethical. Four representative trends for various stakeholder groups are described below.

The employee perspective: competition for increasingly demanding workers

The hustle-culture narrative is over. Nowadays, more flexible working hours are in demand, and organisations such as the ver.di trade union are successfully making this demand a reality – leisure time and meaningful activities are an increasingly important consideration in the world of work. These may be outliers now, but they are on the increase. Although salaries remain at the top of the list of criteria when deciding which job to go for, they are nowhere

near as important as they used to be.²² Employees are increasingly paying attention to ensuring that company values align with their own values and that the company takes its responsibilities seriously in practice.²³

The skills shortage is also steadily getting worse. This is not only because jobs increasingly require academic qualifications and new types of jobs are emerging that make old ones appear unattractive; it also reflects a generational change as baby boomers leave the workforce. While some jobs are disappearing, new jobs are being created at the same time to drive digitalisation and technical advancement in the economy.²⁴

This increasingly puts corporate leaders in a position where they have to make more efforts to attract workers, who themselves have greater and sometimes entirely new demands from their employers. For example, a company car is not the incentive it used to be: discussions now revolve around mitigating the impact of CO² emissions on climate change with shared mobility. The challenges today's companies face are not just about recruiting talent, but also about retaining good employees. Reports are increasingly coming from the USA on the “Great Resignation”, referring to the increasing numbers of employees who are resigning or about to do so. In Europe too, there is a rising number of “quiet quitters”.²⁵ Without dismissing the suffering faced by people stuck in unsatisfactory jobs, many activities nowadays require a high level of self-motivation that “quiet quitting” chips away at.

The customer perspective: changing criteria when choosing a product

The idea that the consumer is king is hardly new. Even Adam Smith spoke of the “invisible hand” of the market. This is the idea that the market is driven by consumers' purchasing decisions. In a digital age where consumers are gradually becoming “prosumers”, their power is on the increase.²⁶

²¹ Schwab, K. (2021). Stakeholder Capitalism: A Global Economy that Works for Progress, People and Planet. New Jersey.

²² <https://de.statista.com/infografik/28090/was-arbeitgeber-attraktiv-macht>.

²³ <https://de.statista.com/infografik/28090/was-arbeitgeber-attraktiv-macht>.

²⁴ Dettmers, S. (2022). Die große Arbeiterlosigkeit: Warum eine schrumpfende Bevölkerung unseren Wohlstand bedroht und was wir dagegen tun können.

²⁵ Von der Oelsnitz, D., Behring, M., Schmidt, J. (2023). Fachkräftemangel und „Big Quit“. In: Krisengerechtes Employer Branding: Empfehlungen für Unternehmen am Beispiel der Corona-Krise. Wiesbaden. pp. 1–5.

²⁶ Toffler, A. (1980). The third wave: The classic study of tomorrow. New York.

There is an increasingly moral aspect to the idea of consumer sovereignty. Consumers want to know precisely where raw materials are sourced and the conditions under which products are produced. This means that price very often figures less strongly in their decisions than the question of whether it is ethically and systemically responsible to use a certain type of product and to support the company behind the product by purchasing it. In Germany, Sustainable Shopping Basket (Nachhaltiger Warenkorb)²⁷ is a source of information launched by the Council for Sustainable Development to promote and simplify consumer decisions based on ESG criteria. There are also many other initiatives, associations, certification schemes and standards that create transparency on the sustainability of products and services, such as Certified B Corporations, PET Recycled, REACH, the Cradle to Cradle Certified Products Programme, the Ethical Trading Initiative (ETI) and Blue Angel (Blauer Engel). This puts pressure on corporate leaders to take a stand on sustainability, but also provides an opportunity to highlight their company's sustainability activities and make their efforts more visible.

The supplier perspective: tracing back to raw materials

Most companies have a network of upstream or downstream suppliers, or form part of a network of partner companies. Demands for increased transparency resonate throughout these networks, and the new laws referred to above such as the LkSG or CSDDD also promote this trend. For corporate leaders, this means keeping an eye on the demands that business partners might pass on to them in the short, medium and long term, and the requirements that their own supply chain needs to meet. Tracking scope 2 greenhouse gas emissions (e.g. from energy consumed by the company's own data centres) and scope 3 emissions (e.g. from employee commuting) is one example of a challenging management issue that leaders need to engage with in sustainability reporting.

The investor perspective: more than just drivers of ROI

More and more investors and lenders are pivoting towards sustainability and now expect ESG criteria to be included in management decisions. This may result from the regulations referred to above, such as the EU Taxonomy, thus making their desire to ensure compliance the main driver of the change. But investors are also increasingly making values-driven decisions since they want to invest in projects with a future or are being influenced by sectoral trends. BlackRock CEO Larry Fink caused quite a stir in his annual letter in 2020, writing about the future relevance of

sustainability and the fact that this will also be expected of BlackRock.²⁸ The critical discussions around the Norwegian sovereign wealth fund's ESG exclusion criteria made companies and shareholders take a closer look at ESG. Investor awareness is on the increase.

In green finance, too, rating agencies such as MSCI, Sustainalytics and ISS have included transparency and comparability as performance indicators for several years now. This challenges corporate leaders to also take a proactive stance at the financial level and to make good use of the ratings; otherwise, there is a risk of reputational damage if they underperform.

Securing the right to play by meeting stakeholder expectations

The trends listed vary within stakeholder groups and depend on differences such as demographic or geographical factors. But the great thing about pioneers and opinion formers is that they often have the power to take others with them. They disseminate their opinions via online platforms and news channels. It's worth bearing in mind that bad news travels faster than good news most of the time, regardless of whether it's true. Bad publicity directly impacts the company's image and can trigger boycotts by customers, investors or suppliers. This increasingly puts decision-makers under pressure to meet stakeholder expectations. They need to keep an eye on all perspectives if they want to avoid losing their "right to play" on the market, retain social acceptance for their operations, and comply with demands that cannot always be met directly.

Part 3: Sustainable corporate governance maturity assessment

- Do your employees identify with your corporate purpose?
- Do you meet your customers' ESG requirements for your products/services?
- Do you know what the ESG impact of your entire supply chain is?
- Do you meet the ESG investment criteria for your sector?

Click here to go to the complete quick checkup.

²⁷ Vgl. www.nachhaltiger-warenkorb.de/.

²⁸ <https://www.faz.net/aktuell/finanzen/larry-fink-blackrock-chef-mahnt-mehr-nachhaltigkeit-an-17738174.html>



Sustainable corporate governance – from strategy to execution

Suppose you had yet to learn of the level of maturity of your sustainable corporate governance policy at the outset. In that case, you should now have a basic understanding after answering the quick checkup questions in Chapter B. Now that you know where your governance system stands in relation to sustainability, the next step is to find out whether your current position matches your objectives and the level of ambition appropriate for your governance, or whether there is a gap between aspiration and reality (see Chapter C 1). If there is a gap between your level of ambition and your maturity level, you will find three structural approaches that we have found to be effective in our work with corporate leaders (see Chapter C 2).

[Click here for a full maturity assessment](#) 



Level of ambition on sustainable corporate governance

The central question for your company's leaders when determining your level of ambition is the role you will play in the sustainable transformation of our economy: How does your governance model factor in resource shortages and preserve value into structures and processes? How do the ways you structure your company and allocate functions reflect management's acceptance of its social responsibility? How do your leaders manage and monitor activities to ensure that efficiency, productivity and profitability are achieved in parallel with this? We classify sustainable corporate governance programmes into four levels of ambition: conformist, pragmatist, strategist and visionary.

Conventional governance aims at maximising profits through efficiency. Sustainable governance reframes this narrative with a new attitude where the company can achieve both resilience and relevance, take account of regulations, serve the common good and protect the environment whilst at the same time achieving productivity (efficiency). Figure 3 shows the levels of ambition in this new model.²⁹



²⁹ Based on Müller-Christ, G. (2014). Nachhaltiges Management: Einführung in Ressourcenorientierung und widersprüchliche Managementrationalitäten. Stuttgart; and Raworth, K. (2018). Die Donut-Ökonomie: Endlich ein Wirtschaftsmodell, das den Planeten nicht zerstört.

Fig. 3 Levels of ambition on sustainable corporate governance

Level of ambition	Conformist	Pragmatist	Strategist	Visionary
Guiding principle	Focusing on financial returns, conformists consider sustainability simply as a legal requirement to be complied with.	Pragmatists are also focused on financial returns, and they recognise that efficient processes which conserve resources can be an effective means to this end – but only use these processes where they are financially viable.	Companies need human and material resources, but they are in increasingly short supply. Strategists understand that they can only succeed in the long term if these resources are maintained.	Visionary consider themselves to be part of a global environmental, social and economic ecosystem, and reflect this understanding in their processes, systems and management approach.
Levers selected	Compliance with regulations	Increasing internal eco-efficiency by optimising workflows	Increasing internal eco-efficiency and using it to preserve value through external collaboration	Establishing eco-efficient internal workflows on a holistic basis
Limitations	Regulations are limited to single issues, which may ignore potential interfaces with other issues and lead to inconsistent actions.	Resources are used more efficiently, but the resources thus saved are used to increase productivity instead of being conserved within the natural environment.	Large amount of work involved, as sustainability ambitions and goals must be checked and updated regularly.	May create a competitive disadvantage, as revenue may be sacrificed in favour of sustainability.



Source: PwC “Sustainable corporate governance”.

Conformist – focus on compliance



The conformist role can also be thought of as a minimalist position. The guiding principle for conformists is “we’re focusing on financial returns and consider sustainability simply as a legal requirement to be complied with.” This statement shows clearly that the company has aligned its general ambitions and goals with maximising shareholder value.

Companies are usually conformists at the start of their sustainability journeys, considering sustainability from the perspective of reporting and disclosure. They tend to measure their sustainability performance for compliance purposes and concentrate their efforts on environmental issues such as net zero or conserving resources. Since resource scarcity is now a huge issue in many value chains, many companies are becoming more ambitious than simply complying with legal requirements – for example, to meet the expectations of investors, customers and other stakeholders.

Pragmatist – focus on objectives



The guiding principle for a pragmatist is “we’re focusing on optimising financial returns, and we’ve identified efficient processes which conserve resources as an effective means to this end – as long as they’re financially viable.” This statement makes it clear that the company tends to see sustainability as a means of influencing company performance but has relatively weak sustainability ambitions and goals.

Pragmatists can usually be identified by the fact that they focus primarily on quick gains and risks in the immediate future and seldom consider sustainability as an opportunity for the company. Efforts are often made in departments or

divisions where increased environmental efficiency offers a quick win or where a major risk needs to be minimised. This means that pragmatic companies tend to concentrate on reporting or risk management and do not drive further development or ways of embedding sustainability more strongly within the company. There is thus a risk of overlooking opportunities, such as reducing long-term operating costs or improving cash flow by effectively preserving value or diversifying the supply chain.

Strategist – focus on success



Company leaders who take on the role of strategists are guided by the principle of “we have recognised that we can only ensure our company’s long-term success if the increasingly scarce human and material resources this requires are maintained.” This makes it clear that the leadership team has placed sustainability at the centre of the corporate purpose and has set relatively high sustainability ambitions and goals. This means that the company will meet the expectations of the majority of its stakeholders. In contrast to pragmatists, strategists primarily see sustainability as an opportunity to secure the future of the company by ensuring it develops and provides more differentiated products or services. It is not just the company’s internal governance (processes, systems and management) that is oriented towards sustainability; the company also collaborates with external partners and invests to maintain the substance of its value chain.

However, strategists still tend to try to use sustainability to achieve a competitive advantage. Reporting and disclosure are carried out on a scientific basis, and senior management remuneration is integrated with this. In most cases, leadership teams that have taken on the role of a strategist will adjust their sustainability ambitions and goals at regular intervals to fully achieve the high expectations of their stakeholders, both now and in the future.

Visionary – intrinsically motivated



Leaders that have taken on the role of visionaries are guided by the principle of “we consider ourselves to be part of a global environmental, social and economic ecosystem, and reflect this understanding in our processes, systems and management approach.” This statement makes it clear that a visionary company tends to take meaningful action and has declared sustainability to be the ultimate goal of the company. Consequently, the company’s sustainability ambitions and goals are set relatively high, and its products and services are sustainable, too. Visionary leaders also more frequently advocate for improving and tightening up standards and regulatory frameworks through public lobbying and participation in debates. Visionaries are prepared to forego revenue and profits in favour of greater sustainability, consciously running the risk of incurring competitive disadvantages when their high sustainability standards exceed current regulatory requirements.

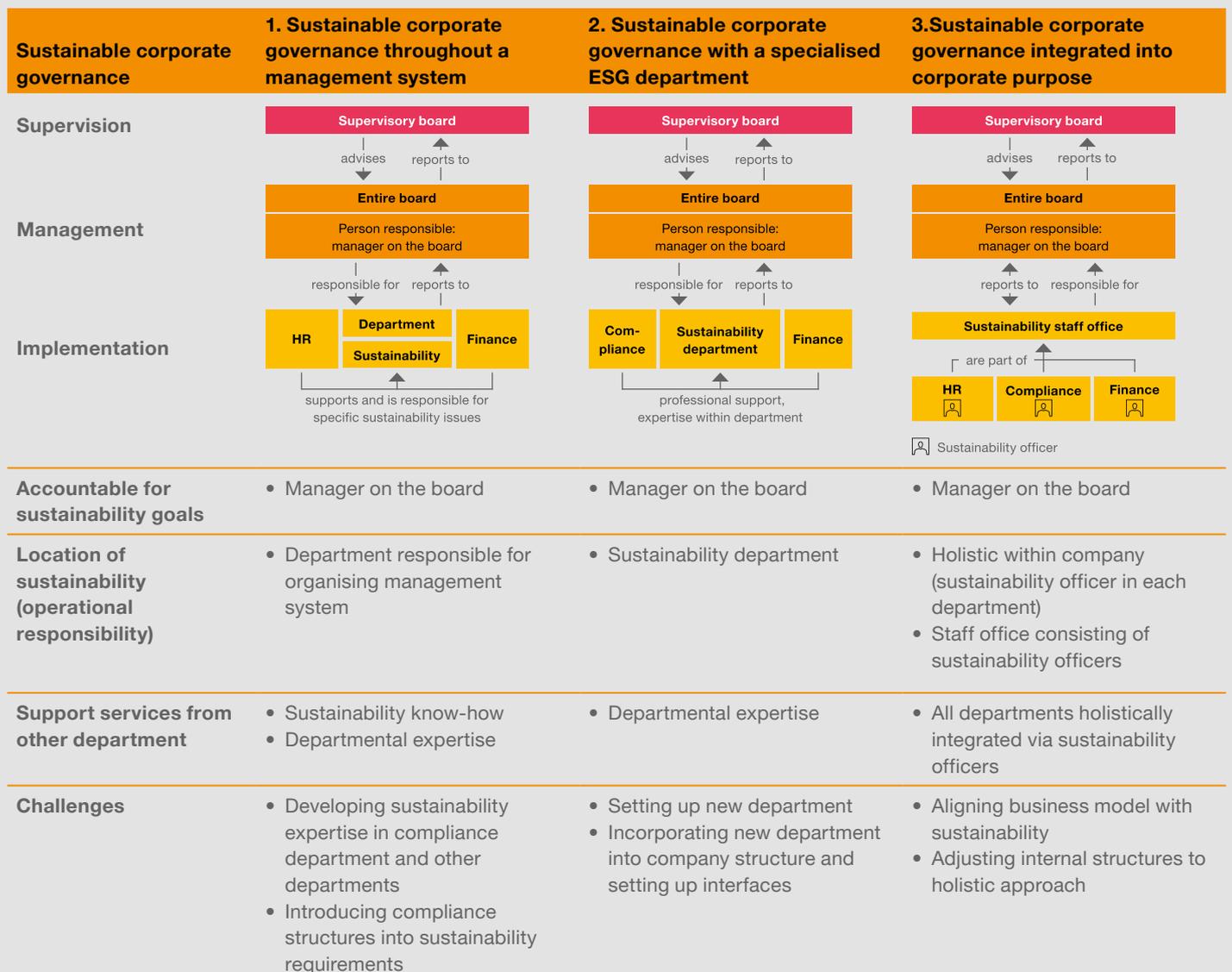
Like strategists, visionaries are likely to have implemented sustainability by adopting a harmonised approach to all sustainability matters throughout the company and defining responsibilities for the various tasks involved. When implementing this approach, the company also continuously considers new developments in the market to ensure it will be able to maintain its visionary position in the future.

In our discussions with clients and R&D departments, we are often asked how companies can best integrate sustainability into their governance processes. There is no one-size-fits-all answer to this question, since sustainability is a complex, diverse issue and conditions will vary greatly from one company to another. Our many years of experience and practical insights show that there are three promising approaches to answering the questions about governance (see Fig. 4).

The first approach is to locate sustainable corporate governance within a management system – for example, by integrating it into the compliance management system (see Chapter C 2.1). The second approach brings

sustainable corporate governance into the company via a specialised ESG department (see Chapter C 2.2), and the third approach aims to create a holistic process to establish a top-down, pro-sustainability stance throughout the entire company (see Chapter C 2.3). Since each approach has its own advantages and disadvantages and needs to be considered independently of the level of maturity you have identified and the ambitions you have previously defined, we recommend that leaders should analyse which approach best fits their company’s existing governance policy. Before we go on to comment on the three approaches in detail, it should be noted that there are many different options available within the approaches, and they should be understood as a guide only.

Fig. 4 Three selected approaches for sustainable corporate governance



Source: PwC “Sustainable corporate governance”.

2.1 Sustainable corporate governance throughout a management system

Making use of existing structures and processes

One way of developing sustainable corporate governance within your company is to scale up established structures, processes and systems through an existing management system. For example, this could be done by using the tried-and-tested IDW PS 180 or ISO 26000 frameworks to manage non-financial issues throughout the company. However, this approach is wider than just ensuring compliance with the law.

Use case: environmental compliance management system

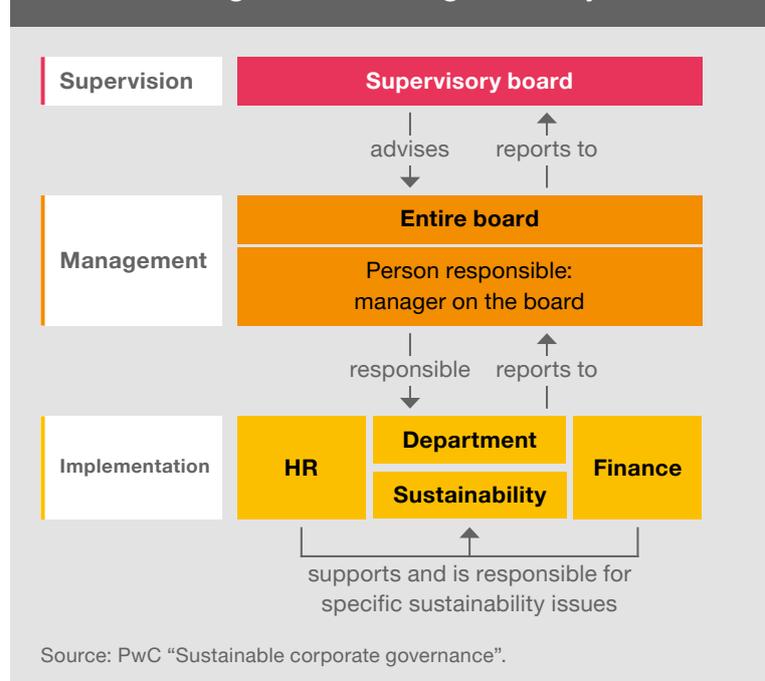
Environmental compliance management systems are a tried-and-tested approach to help leadership teams increase levels of environmental protection, particularly in the manufacturing industries. It involves merging the requirements for an environmental management system (e.g. ISO 14001, EU EMAS) with the requirements for a compliance management system (e.g. ISO 26000, IDW PS 980) to form a unified governance system. This results in a holistic, compliance-driven corporate governance approach for sustainable management that also considers environmental issues. The process can also be extended to cover other ESG topics. For example, the widely used ISO 45000 standard for occupational health and safety can be structured in the same way and integrated into the management system as an additional topic.

Bundled management and monitoring, decentralising expertise

Since the method in this approach has a similar structure to a management system, it makes sense to organise several of your company's sustainability topics around the function responsible for the management system (see Fig. 5). This lead department will generally already have the system knowledge required, along with established structures and processes: when combined with sustainability expertise, these can be used for your sustainability transformation.

In this approach, the lead department that oversees the management system is given principal responsibility for leading the transformation. The other departments use their expertise to support implementation in operations. This makes sense because the approach does not require the lead department to develop full sustainability expertise (e.g. on decarbonisation and the circular economy). As with all of these approaches, the entire management board is responsible for disseminating sustainability goals. In this approach, the entire management board is supported by the lead department based on the "tone from the top".

Fig. 5 Organisational structure for sustainable corporate governance throughout a management system



The biggest challenge with a management-driven approach is the need to determine the lead department's capacity to fulfil its intended role of ESG management, considering the current structures and existing knowledge. Our practical experience shows that companies should start by identifying and analysing the individual sustainability tasks, and should then check whether ESG requirements can be established in the same way as existing tasks within the company. You also need to determine whether your lead department needs to be strengthened to perform its new task, and if so, to what extent. Alongside existing employee expertise, this will largely depend on your company's ambitions. For example, a company that aims to become a strategist will have to expand the relevant department and assign it a more important role in the company. On the other hand, our experience suggests that a conformist company – because of the minimalist approach to sustainability that this role entails – will require less additional capacity in the lead department to meet its ambitions.

Criteria for deciding whether a management system-based sustainable corporate governance policy is suitable for your company:

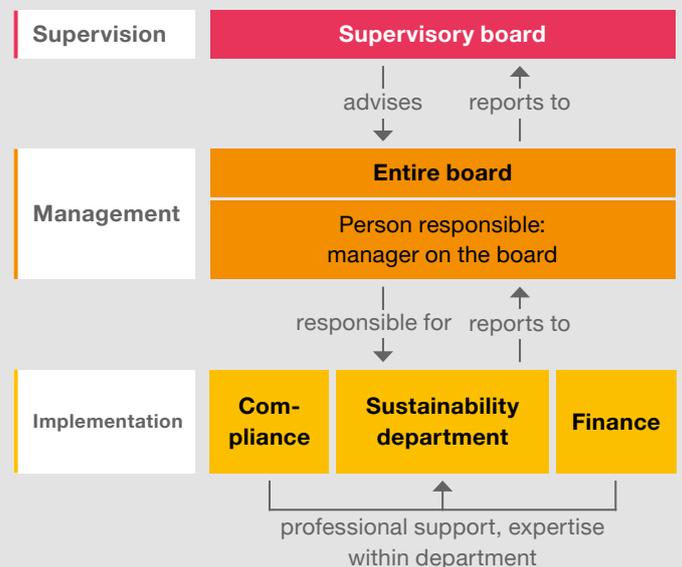
1. Your company has well-developed management systems.
2. Your leadership team uses management systems to guide the entire company.
3. Existing management systems are seen as effective management tools.
4. Existing management systems can be flexibly combined.
5. Sustainability expertise is present at operational business level.

2.2 Sustainable corporate governance with a specialised ESG department

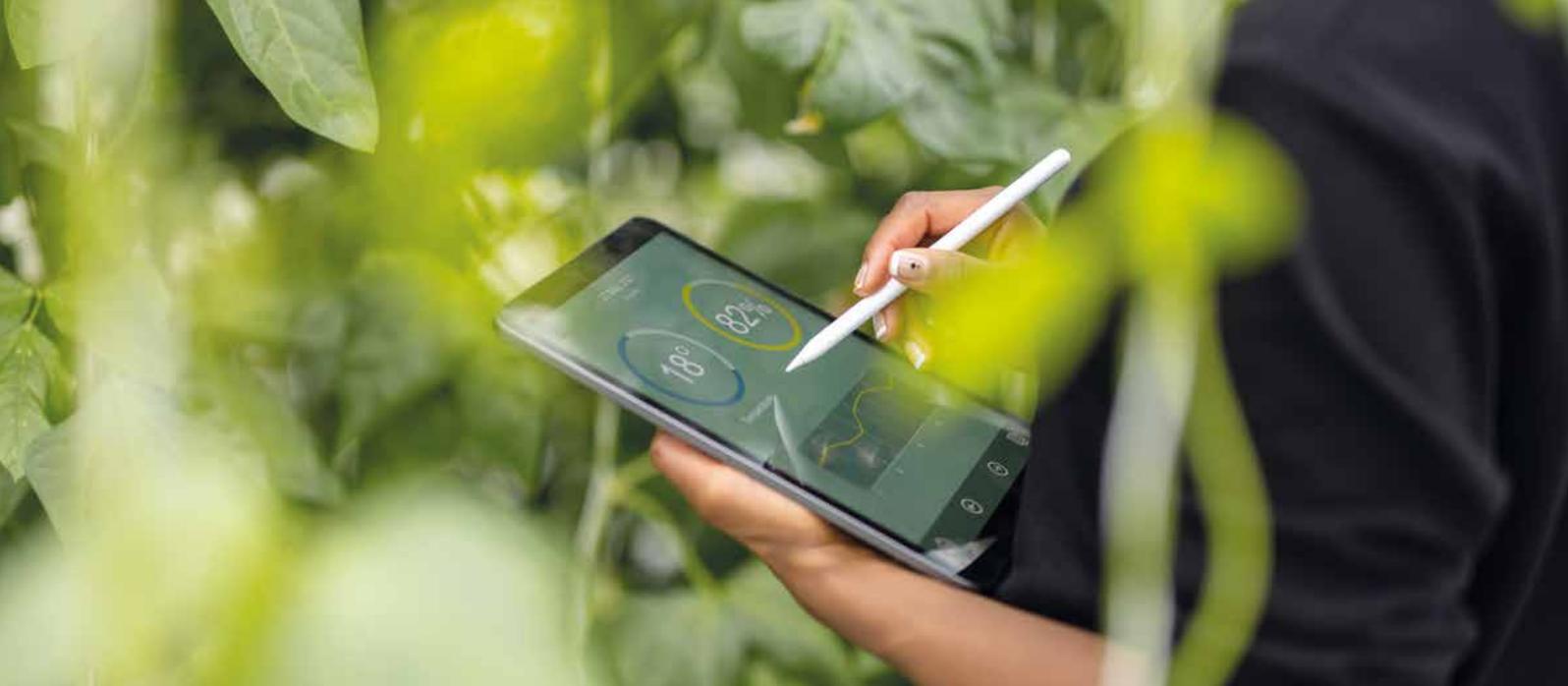
Structuring a specialised sustainability department

The second approach involves the company establishing a specialised sustainability department where all processes can be brought together instead of being spread across different functions. This department can then be in charge of developing and refining the sustainability strategy, sustainability project planning and sustainability management, sustainability communication and compliance, and sustainability reporting. It also supports other departments on sustainability issues. For example, it can design training on sustainability and human rights for the HR department or support the communications department with communication around sustainability.

Fig. 6 Organisational structure for sustainable corporate governance with a dedicated department



Source: PwC "Sustainable corporate governance".



Integrating the sustainability department into the corporate structure

As is clear from Figure 6, this approach involves concentrating sustainability in a single specialised department in the company. This department can either be completely new or created based on an existing one. The sustainability department should be placed on the same footing as other established departments such as HR and accounting. This ensures that the new department is integrated into established structures and has sufficient voice to ensure that sustainability is not treated as a low-priority issue. The sustainability department reports directly to a board member responsible for the sustainability transformation. Like with the management system-based approach, sustainability issues and goals are disseminated effectively throughout the whole company by the board member responsible, who establishes a credible “tone from the top”; the sustainability department assists this board member with communication. With this approach, the entire board has stronger professional support than is the case with the management system-based approach: for example, the sustainability department develops guidelines and training that help employees with implementing sustainability projects.

Depending on what structures already exist within the company, it may make sense for other departments to support the sustainability department on specific issues (see arrows in Figure 6). Ideally, this support should be on activities around sustainability that are structurally similar to that department’s usual activities rather than specific sustainability expertise. For example, our experience shows that the accounts department can support the sustainability department in analysing quantitative data for non-financial statements because it is already skilled

in analysing financial KPIs. It is then up to the experts in the sustainability department to analyse and interpret the results and compile a sustainability report. Compared with the management system-based approach, the sustainability department approach concentrates sustainability expertise even more strongly within one department, and sustainability expertise is less needed when supporting other departments.

Sustainability department: scope and expertise

The size and expertise of the new sustainability department depend on the size of the company, but also – above all – on its ambitions. A company that considers itself a conformist primarily needs expertise in sustainability compliance and sustainability reporting. If, on the other hand, the company is a strategist and has committed to an ambitious decarbonisation strategy, it will also need employees with sufficient knowledge in this area.

Criteria for deciding whether a sustainability department-based sustainable corporate governance policy is suitable for your company:

1. Your company is structured in specialised ESG departments that are responsible for individual issues.
2. A board member can lead on sustainability.
3. The size of the sustainability department required to realise your company’s ambitions fits with your overall corporate structure.
4. Existing departments do not have sufficient sustainability expertise for the desired transformation.
5. Existing departments could support a sustainability department with their specialist expertise.

2.3 Sustainable corporate governance integrated into corporate purpose

Sustainability internalised in the company management's stance

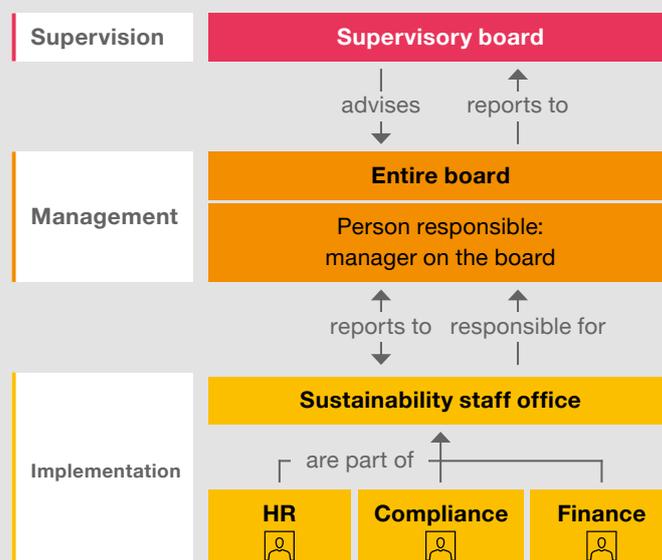
The third approach holistically embeds sustainability in the entire management structure, which means integrating sustainability into the corporate purpose. For example, a car manufacturer might set a sustainability goal that involves not just slowing the pace of climate change by switching its product range to electric cars, but also makes it a company aim to help design the mobility of the future: mobility using assets (e.g. cars) that are manufactured in an environmentally-friendly way while also upholding human rights and avoiding pollution, are accessible to everyone, and are organised in an economically feasible way. Implementing this type of holistic transformation requires a system of sustainable governance that combines professional competence with sustainable leadership.

Sustainability expertise embedded in every department

In this approach, internal structures also need to be adjusted to align with sustainability goals. Unlike the two approaches presented above, this integrated approach does not have one central department in charge of the individual issues. Instead, it uses sustainability officers – experts in each department responsible for a specific sustainability issue, such as the Head of Sustainable Innovation, Head of Green Finance or Director Responsible for HR. For example, the sustainability officer in the HR department monitors and manages the integration of the company's strategic sustainability goals, develops anti-discrimination guidelines, and designs and organises sustainability and human rights training.

The tasks that each of these sustainability officers take on in each department will depend on the current role and responsibilities of the department, legal requirements, and company ambitions. These factors will also determine whether any additional employees are needed to provide support. For example, if the production department in the company is also in charge of development, the sustainability officer in that department will need expertise in both areas, i.e. sustainable innovation.

Fig. 7 Organisational structure for sustainable corporate governance integrated into corporate purpose



 Sustainability officer

Source: PwC "Sustainable corporate governance".



Sustainable leadership refers to a style of leadership embodying the attitude that economic, social and environmental aspects need to be balanced. It fosters a culture of systematic decision-making, which takes a long-term approach to managing any conflicts that might arise.

Sustainable innovation aims to consider the environmental and social impacts of a product or service at the development stage. This is about more than just avoiding externalities: sustainable innovation also actively promotes research and development with aims such as achieving the SDGs.

Sustainable finance structures financing in a way that considers or even explicitly promotes environmental and social considerations, alongside the traditional financial factors. It also fosters a healthy financial culture that can largely sustain itself, even in crises.

The financial department will also play a central role in a holistic transformation of this kind with its reporting and investor relations work, as allocating financial resources to uses that are not solely in the company's financial interests will require a paradigm shift in decision-making. For example, procurement criteria will have to be adjusted to go beyond simple financial profitability. The procurement criteria for new packaging made from recycled materials would need to be weighted so that a slightly higher purchase price could be accepted despite cheaper alternative bids being available.

Financial resources may also need to be invested in areas that only indirectly relate to company products but are essential to preserve company value in the long term, such as investment in renewable energy sources for green electricity at production sites and generally funding the roll-out of this technology. Green bonds are another example of sustainable finance: the company's leaders might decide to invest in areas such as climate and environmental protection projects that are frequently higher-risk and only generate small returns in the short term.

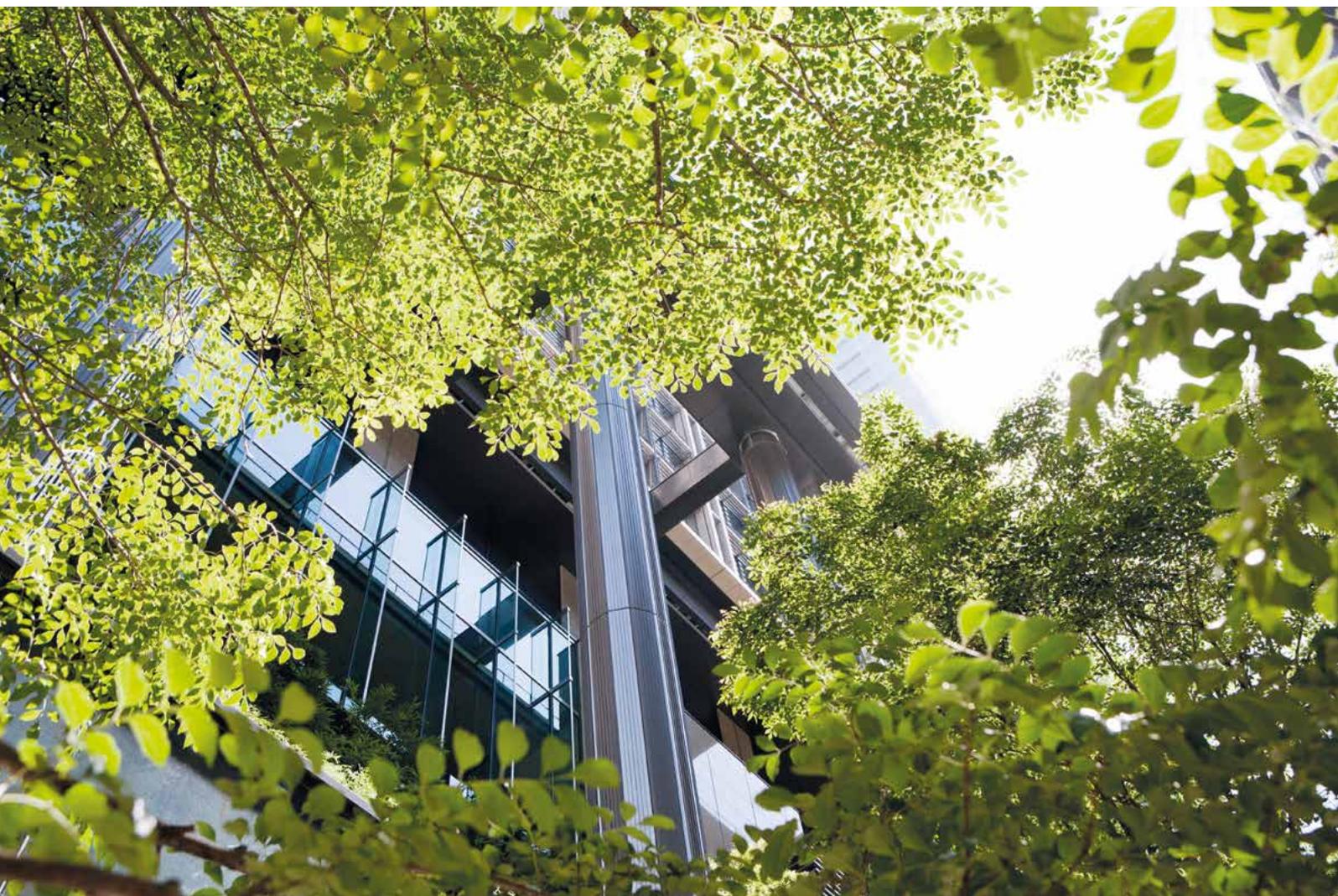
Constant communication within the network

As emphasised in Figure 7, we recommend that the designated sustainability officers are networked with one another across the individual departmental functions and work together to drive forward the company's cross-cutting sustainability agenda. Sharing a staff office with a head of department ensures that individual projects and tasks remain in step and helps prevent "sustainability silos" from developing.

Under this approach, responsibility for disseminating sustainability ambitions and goals within the company lies primarily with the designated sustainability officers, not the board. They act as the first point of contact for their departmental colleagues, raise awareness of the issues and are responsible for operational implementation of the strategy in their departments. The company's leadership team remains responsible for the sustainability strategy, just like under the other two approaches. To enable the leadership team to fulfil this responsibility, the staff office provides regular updates on progress and activities.

Criteria for deciding whether a holistic sustainable governance policy is suitable for your company:

1. You want to orient your corporate purpose entirely towards sustainability.
2. Your corporate structures can be entirely oriented towards your sustainability goals.
3. Sustainability can be embedded and decentralised to every department within your company.
4. Your company's finance department allows a holistic sustainability transformation.
5. Sustainability expertise is already present in some departments.





Implementing your sustainable corporate governance policy

The PwC approach: a sustainable business transformation framework

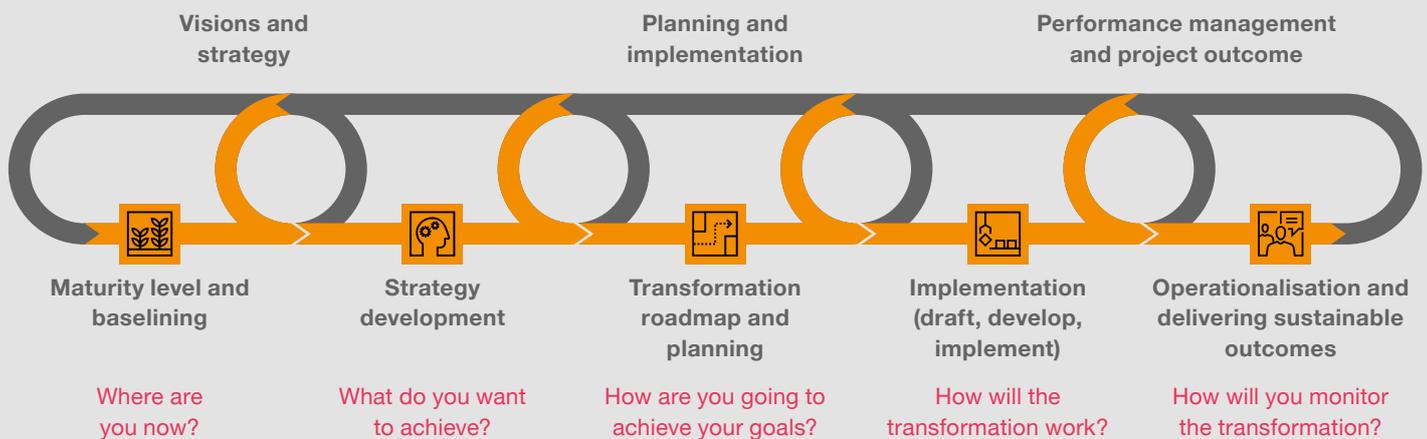
Sustainability generates more complexity in governance. It requires a rethink of the connections within your company, as well as how your company has an impact on and is impacted by the environment. Tracking how the company's impact changes as it develops requires a systemic understanding of impact mechanisms. There is unlikely to be a one-size-fits-all solution to implementing a sustainable governance policy within a company.

Different processes may be needed to implement your sustainable corporate governance policy and its individual elements, depending on your level of ambition (see Chapter C 1) and goals (see Chapter C 2), the type of company you run and its legal structure. To effectively

support our clients in introducing sustainability in practice, we in the global PwC network have developed a sustainable business transformation framework. This is best viewed as a framework for the implementation process that supports iterative workflows and agile methods. Our sustainable business transformation framework helps us understand where you are heading towards transformation. It allows us to select the best approaches for achieving your goals and identify relevant activities and services that will deliver the desired outcomes based on where you are now.

The framework's agile and modular approach can also be used in SMEs and family-run organisations. It can be applied as an add-on to existing structures and processes, allowing you to pursue strategic goals without disrupting the existing corporate culture or management elements.

Fig. 8 Sustainable business transformation framework



Source: PwC "Sustainable corporate governance".

Iterative process to your sustainable corporate governance outcome

Maturity assessment – where are you now?

Our maturity assessment tool looks at where you currently are and helps determine how your current governance system is designed. We have developed maturity assessments for all three approaches described above. These provide materiality and risk ratings that can be used to determine the best starting point for achieving your goal. We also use benchmarking and ecosystem analyses to investigate your current market positioning to provide an overall picture of your company's resilience.

Strategy development – what do you want to achieve?

Based on your company's resilience and level of ambition on sustainable corporate governance, the next step is to work with you to identify strategic options and development scenarios for a coherent sustainable corporate governance strategy. Depending on your level of ambition, we link this strategy with departmental or corporate capital and investment budgets or design an entirely new budget plan. Depending on the complexity and dynamics of the variables under analysis, we then dive back deeper into the iterative positioning process until the visioning and strategy-setting phases are complete.



Transformation – how are you going to achieve your goals?

Once we have assessed your current situation, we work with you to look at how to get from here to where you want to be. We break down your vision into milestones that you want to reach on your journey and also ask about skills. Sustainable corporate governance requires companies to identify new narratives in several areas which requires specific skills that may not have been needed before. Potential business cases can then be identified at this point in the transformation based on the connections between capital and sustainability defined in the previous step.

Implementation – how will the transformation work?

With the transformation plan in hand, we then go through your company with you on four different levels. It's important to note that these levels are not arranged hierarchically; they instead run in parallel and complement one another. The first level is the governance level, where we develop the management and monitoring systems for your sustainable corporate governance policy based on a number of different standards and frameworks. At this point, we make sector-specific proposals and/or adjust the process to reflect where you sit between regulations and voluntary commitments. At the second level, we analyse your services and products. We develop the value chain for each product and/or service in line with the sustainable corporate governance approach you have selected. This may also be closely connected with the third level (transformation of the operating model), depending on

how your company differentiates between operational and organisational structures. The fourth level covers corporate culture and dealing with change. The skills required (as discussed above) then need to be imparted: this doesn't mean that all employees have to become sustainability experts. Still, everyone will need to acquire basic "know-why" and an understanding of the sustainability narrative in line with your company's level of ambition. We achieve this using a range of culture change mapping tools to develop a comprehensive communication action plan together with you, including a "tone from the top" campaign and employee training. At the same time, we check whether the roadmap we made earlier will achieve your goal within the allotted period or whether the plan needs to be tweaked.

Operationalising – how will you make your transformation transparent?

You also need to get to grips with operationalisation during or after the implementation phase. This involves setting up an appropriate reporting system that tracks developments and makes them transparent for external audiences. Our approach here is closely based on the broader regulatory environment – both current regulations and expected ones. Operationalisation needs to track potential for further developments, and not just because of the constant changes in legislation. As described before, sustainable corporate governance increases stakeholder presence within companies. This means that communication formats need to be more attuned to stakeholders.

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Conclusion: the debate on sustainability is continuously evolving

A lot has changed since the first debates around sustainability. Changes and upheavals in society have triggered political debates, which in turn have led to new regulations. These developments are still continuing: younger generations, in particular, are driving the transformation of society and are shaping a green movement on an unprecedented scale. New ideas that are unimaginable today will shape the discourse in the future and be passed on to corporate leaders.

Events will continue to generate new ideas and drivers of change. Perhaps, a new pandemic like the one we have just gone through may act as another game changer, or researchers may discover new, unforeseen causal relationships in the environmental realm. Further attacks on democracy and armed conflict could modify trade agreements and make the question of human rights in supply chains even more prominent. And laws such as the LkSG or the EU's CSRD will continue to place demands on companies in the future and require transparent responses.

Even current regulations are causing considerable upheaval. For example, we won't know until 2025 what impact the CSRD will actually have on sustainability reporting and the extent to which assumptions on company size and sector will be needed. Gaps will also open up that will have to be filled with new regulations and new approaches. Increasingly, companies themselves will be seen to be responsible for identifying gaps and potential dysfunctionality in the regulations, not just the regulators. This has given rise to the concept of corporate political responsibility, referring to the idea that companies have a responsibility to advocate for political changes and play their part in actively shaping society.

Ultimately, companies that want to survive in the market need to adapt to constant change: moving forward, adopting innovations and never standing still for long. Clearly, then, the only constant is change – and so even the approaches set out in this paper are only a snapshot. They represent the current situation and best practice based on current regulations and foreseeable future ones.

It is already clear that new approaches will develop in the future. Another example looming on the horizon is that our clients are increasingly interested in using KPIs to manage sustainability, and so we have already developed best practice approaches here. We'll also provide advice and assistance on sustainability and sustainable corporate governance, in particular, as other novel approaches pop up – reporting on them, playing our part in actively shaping the changes, and identifying optimal solutions for our clients.





Contacts

Get in touch with us!!

Now is the time to start your transformation to sustainable corporate governance.

Our skilled experts are here to guide you on your journey towards a responsible corporate future that keeps your company efficient for the long term.



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About us

Our clients face diverse challenges, strive to put new ideas into practice and seek expert advice. They turn to us for comprehensive support and practical solutions that deliver maximum value. Whether for a global player, a family business or a public institution, we leverage all of our assets: experience, industry knowledge, high standards of quality, commitment to innovation and the resources of our expert network in 152 countries. Building a trusting and cooperative relationship with our clients is particularly important to us – the better we know and understand our clients' needs, the more effectively we can support them.

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