



# How Boards Can Focus on What Matters in Sustainability

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By David Young and Ron Sooni

Boards are not carving out time for high-value strategic work when it comes to ESG governance. And that's a problem for companies pushing for sustainability.

It's just about unanimous: some 91% of directors think their boards should devote more time to strategic aspects of environmental, social, and governance (ESG) issues according to a recent survey by BCG and the INSEAD Corporate Governance

Centre. The survey finding reflects a recognition that boards can add the most value in their mission of stewarding the company over the long term by ensuring that **sustainability** is integrated into the corporate strategy. Yet more than half (53%) of those same directors say their boards are not doing this effectively.

Why the disconnect between director intention and reality? For two reasons: full boards are working on sustainability-related details that do not require significant attention from all members, and management is not framing a sufficiently developed discussion on strategic implications of sustainability. In combination, this prevents directors from devoting board time to high-value strategic reflection on sustainability.

To better understand this problem—and how to solve it—we look at board governance of sustainability as three distinct areas of focus:

- **Sustainability Hygiene.** This is about attention to ESG-related matters such as materiality, data, reporting, stakeholder engagement, and sustainability initiatives. This is the most basic level of board governance and should be handled primarily by board committees.
- **Sustainability Controls and Practices.** This area covers oversight of how the company is adopting controls and best practices to assure the integrity of its ESG journey. While committees can also effectively handle this area, the full board often spends significant time on it.
- **Strategic Reflection and Implications.** This involves discussion and insight on how the **societal and business** context is changing and how sustainability can become a source of lasting competitive advantage and value creation. Ultimately, boards should be spending most of their collective time in this area.

Today, boards tend to be most comfortable in overseeing the first two categories. After all, this work draws on the traditional skills and expertise of most directors. But boards can provide the most value by focusing on the last category—drawing

upon critical thinking and insights to question the status quo, press leadership to reimagine the business, and stress-test strategies for sustainable growth and new value creation.

To do this, boards must rethink their approach to covering sustainability in the board agenda by adopting a governance model that frees up time for strategic thinking—and then diving deeply and unflinchingly into the strategic challenge of sustainability, focusing on the right issues and asking the right questions.

## The Internal Barriers to Strategic Thinking

As companies push for sustainability, establishing the appropriate hygiene and controls and practices is certainly vital. (See “A Closer Look at Hygiene and Controls and Practices.”) However, the long-term strategic thinking required for a true sustainability transformation is often blocked by traditional mindsets and failing to understand sustainability as source of advantage.

### A Closer Look at Hygiene and Controls and Practices —

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Excellence in the first two areas of sustainability focus for boards is table stakes today.

Among the key elements of sustainability hygiene: whether the company is publishing a quality sustainability report, has set minimum targets expected by its stakeholders, and has made its commitment to sustainability clear to investors and stakeholders. Directors do have an important role in these areas, particularly at the beginning of a company's

sustainability journey. The board, for example, should ensure there are checks and balances and processes that guarantee the integrity and accuracy of what is being reported.

Over time, though, the full board should spend less time on this—with the bulk of it handled in committees. Too often these hygiene issues continue to consume board attention, reflecting that many directors see sustainability as a compliance exercise and not a true value creation opportunity.

Sustainability controls and practices involve the ways in which the company is integrating sustainability into core management processes including accounting, target-setting, risk management, capital allocation, and rewards and incentives. The board's role is to ensure that there is continuous improvement in both areas, including the way in which sustainability is integrated into the core business.

**The Strategic Imperative.** The drive for sustainability is a fundamental shift in the competitive and market dynamics of virtually all industries—changing the boundaries of businesses, adjusting the priorities of investors, spurring new regulatory considerations, and motivating new business ecosystems. And the pace of change is exceedingly fast. Consider that forecasts for many markets, such as renewable energy and electric vehicles, have vastly underestimated the speed of adoption. Consequently, boards must bring a new lens to strategy, one that is based on a forward-looking view of how the changes in context pose new risks for business-as-usual and how sustainability could create new business advantage as the world changes.

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To navigate the current period of broad and disruptive change, boards need more cognitive diversity, including directors who are comfortable with uncertainty.

This will be an ongoing discussion for the board, because the issues that are **material** for the company are dynamic by nature. For example, many board members now are heavily focused on supporting the drive by companies to achieve net zero. But more and more, stakeholders also expect a broader “nature-positive” strategy—one that not only addresses climate issues but also biodiversity. At the same time, new sustainability-related issues—the disruption of the pandemic or the fallout from the war in Ukraine, for example—will emerge with little notice.

**The Vicious Cycle.** Boards will want to hone their ability to explore sustainability issues and identify opportunities that these matters can present. Yet they frequently find it challenging to conduct this sort of deep, continuous assessment of a company’s sustainability effort for two key reasons.

First, directors are dealing with fast-changing regulatory and compliance issues, increased (often ambiguous) reporting and transparency demands, and demands from investors and NGOs—all of which fall under the hygiene and controls and practices categories. In addition, members increasingly risk being held liable for inaction. The European Commission’s draft directive on Corporate Sustainability Due Diligence, for example, introduces a “directors’ duty of care” provision requiring directors to consider the human rights and environmental (including but not limited to climate change) consequences of their decisions in the short, medium, and long term. It demands that directors put into place and oversee due diligence actions and policies and adapt the company’s strategy where necessary.

In conversations with directors, we frequently hear that just keeping up with such developments requires considerable effort—leaving little time for strategic reflection.

Second, companies have historically recruited directors who are experienced in yesterday's business context; they are more comfortable with matters of sustainability hygiene and controls than in challenging the fundamentals of the business model. Given the current period of broad and disruptive change, boards need more **cognitive diversity**, including directors who are comfortable with uncertainty and complexity, represent a wider range of stakeholder perspectives, are able to challenge today's business models and market norms, and can drive innovation and change to capture advantage from sustainability.

This gap between traditional board skills and the “sustainable world” perspective that's now required can leave directors feeling less equipped to address questions related to long-term sustainability strategy. As a result, they often default to focusing on areas where they have the most expertise—hygiene and processes and controls. The increasing regulatory and reporting demands only reinforce this tendency.

With limited time spent on thinking about sustainability and strategy, the company may fail to anticipate market shifts until new rules and regulations demand change. Yet again, the board is consumed with addressing those new requirements rather than engaging in strategic discussions that could put them ahead of such trends—a vicious cycle that prevents boards from devoting their time to the most consequential issues.

## Driving Strategic Thinking on Sustainability

Boards that want to increase the value they bring to a company's sustainability efforts should focus on two areas: effective sustainability governance and critical assessment of the implications of sustainability on the corporate strategy.

First, they must select a sustainability governance model through which hygiene and controls and practices are handled appropriately—without requiring significant time from the full board. On the basis of our work with scores of boards and with the INSEAD Corporate Governance Centre, we have identified four models of governance, each suited to a different company type and stage in the sustainability journey:

- **Dedicated sustainability committee.** This committee makes decisions and then offers recommendations for full board approval. This model works particularly well for companies that are behind on sustainability and want to make fast progress.
- **Sustainability added to an existing committee.** Under this model, sustainability governance is handled by a committee, such as audit or governance, which makes recommendations to the full board. Such an arrangement can make sense for companies for which sustainability issues are likely to have limited impact or where integrating sustainability is straightforward.
- **Multiple committees addressing sustainability.** This model distributes responsibility for sustainability across some or all existing board committees. This can work well for companies that have sufficient committee structure to cover all elements of sustainability.
- **Sustainability board champion.** This approach involves assigning one director with significant expertise in sustainability as the lead on the topic. This model can be a good fit in a number of situations, including for small companies where sustainability impacts just one line of product or services.

Boards should adopt a model best suited to the company's context—including its overall culture, the dynamics within its industry, and the maturity of its sustainability efforts. They should also recognize that they may need to change the model over time as the company's maturity in terms of sustainability evolves.

Once an appropriate governance model is implemented, boards need to ensure that the time they have freed up for strategic work is used effectively. They can do this by asking critical questions that shed light on the company's sustainability progress:

1. Is the company driving a transition in its corporate portfolio, business boundary, and asset base that enables sustainability transformations in company operations, customers, and industry infrastructure?
2. Is the company's product portfolio evolving, with a growing share of revenues and higher margins from the sustainability segments in the company's markets?
3. Is the company restructuring its value chains to capture unique sustainability content and capabilities?
4. Is the company creating an innovation portfolio and supporting ecosystems that accelerate investment in sustainability technologies, infrastructure, products, and services?
5. Is the company developing new customer value propositions that are differentiated and priced on their sustainability advantages?
6. Does the company have a portfolio of commercial arrangements, investments, and ventures that mitigate or solve scarcity in critical sustainability resources?
7. Is the company building the necessary human capital?
8. Is the company supporting the creation of new business ecosystems that enable sustainability solutions and markets?
9. Does the company have a clear view on the degree to which sustainability demands in the market will create stranded assets, and do they have a plan to manage that risk?

In short, the board should be testing whether the company is transforming the business deeply and quickly enough to capture competitive advantage from



sustainability, and is guiding management to make the investments necessary to do so.

## A Guiding Light on the Road to Sustainability

Boards can play a powerful role in helping guide companies on their sustainability journey—but only if they are able to focus on the strategic challenges and opportunities along the way. In our work, we find that directors are struggling to play that part today, with reporting, regulatory, and compliance matters consuming significant amounts of time and crowding out substantive discussion on sustainability strategy.

Directors need to impose discipline on their process for governing sustainability issues. This requires matching the company’s model for sustainability governance to its context to create the space for true strategic reflection—and then making the best use of that time by focusing on relevant and impactful issues. Boards that take these steps will enable—not hinder—a successful and ongoing sustainability transformation.

## Authors

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**David Young**

Managing Director & Senior Partner, BCG Henderson Institute Fellow  
Boston

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**Ron Soonieus**

Senior Advisor  
Amsterdam

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