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# PASSPORT TO RESPONSIBILITY

The State Department's Kris Balderston forges a bold new program of public-private partnerships.

United States of America

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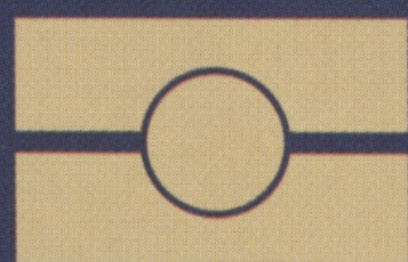

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# A Commercial Intervention

## American business needs to enter rehab. Here's the 10-step program.

By Jeffrey Hollender

American business is suffering a crisis of public confidence, failing to fulfill its social and environmental responsibility while making ever greater profits by employing fewer and fewer people. While much public discourse circles the edges of the problem and offers incremental changes, we need radical solutions to harness the potential of business to avoid the multiple crises and planetary disaster toward which the global economy is moving.

New solutions must start with new principles that drive the design of corporate purpose and governance. I urge shareholders, employees, management, and other key stakeholders to consider this 10-step roadmap to better business through sustainable and responsible corporate governance.

1. *Mission and Values.* Build sustainability into your corporate strategy and structure. The John Lewis Partnership PLC, the largest department store chain in the United Kingdom, has a stated purpose of serving the happiness of its employee-partners (the company is 100 percent owned by its 69,000 staff members), among whom all profits are shared each year. Through its "Sustainable Living Plan," Unilever is committed to cutting the environmental footprint of its products in half by 2020, helping more than one billion people take action to improve their health and well-being, and sustainably sourcing 100 percent of agricultural raw materials. Novo Nordisk has also adopted an ambitious charter that spells out the company's values and commitments, including a commitment to ensuring that all products and services "make a significant difference in improving the way people live and work." Nothing short of bold and courageous commitments will make a meaningful difference.

2. *Radical Transparency.* Disclosure must be a key pillar in your business practice, one that requires reporting regularly on sustainability strategy and nonfinancial business performance. The Global Reporting Initiative (with which *CR Magazine* partners) maintains a sustainability reporting framework, which sets out the principles and performance indicators that organizations can use to measure and report their economic, environmental, and social performance; it should be required for companies generating more than $25 million in revenue. Seventh Generation has used this process for close to a decade. Firms with less than $25 million in revenue should complete the B Impact Rating System, a free evaluation procedure to assess a company's impact on each of its stakeholders and help guide a process to improve social and environmental performance.

3. *Sustainability Standards.* When it comes to sustainability, business must heed the so-called precautionary principle: "When an activity raises threats of harm to human health or the environment, precautionary measures should be taken even if some cause-and-effect relationships are not fully established scientifically. In this context, the proponent of an activity, rather than the public, should bear the burden of proof. The process of applying the precautionary principle must be open, informed, and democratic, and it must include potentially affected parties. It must also involve an examination of the full range of alternatives, including no action." Setting measurable sustainability objectives will demand accountability and inspire progress toward reaching goals.

4. *Equity in Compensation and Performance Standards.* Shared—not skewed—prosperity should be our goal as a nation and as business leaders. The amount of money paid to senior management in the United States is unreasonable. It's time for change. Base compensation at firms generating more than $1 billion in revenue should not be greater than 50 times the lowest paid person in their firm; total compensation should not be greater than 100 times the lowest paid person in their firm. Firms under $1 billion should target half that amount. My base compensation at Seventh Generation was limited to 17-to-1. Further, sustainability and corporate responsibility performance results must be a core component of the evaluation of senior executive performance and compensation packages. The weighting given to sustainability performance should be disclosed in annual reports, so that it is clear to shareholders and other stakeholders how executives are being rewarded.

5. *Equity Ownership for all Employees.* Business creates wealth; typically, that wealth is not equitably shared with employees. Consider that just 1 percent of Americans own nearly 50 percent of the nation's total wealth. A minimum of 10 percent of annual corporate profits should be invested in an employee stock purchase program for all employees and be distributed using a modified formula that compresses base salaries into a spectrum that ensures no employee receives a distribution of less that 10 percent what the highest paid employee receives.

6. *Board Membership.* Good governance starts with a diverse board of directors. Studies show a strong correlation between a good record of electing women to the board and high profitability. Yet, at the average Fortune 500 company, women hold less than 16 percent of all board seats. International models should inspire us: In Norway, public companies are required to elect women to 40 percent of the board. We need to set a goal for all U.S. companies that targets 30 percent by the end of 2013 and 50 percent by 2015. Racial diversity on boards should reflect our national identity with a target of 25 percent minority representation by the end of 2013 and 50 percent by 2015.

Moreover, employees should elect at least one board member. Employees are critical stakeholders in every business, but they rarely have a voice when it comes to policy or strategy.

7. *Board Fiduciary Responsibility.* The Board of Directors must determine what is in the best interest of the company and its shareholders, including factors such as the long-term prospects and interests of the company, its shareholders, as well as the social, environmental, and economic effects of any action on current and retired employees. Additionally, they must consider the impact of their decisions on suppliers and customers, local communities and society as a whole.

   Ceres, the pioneering nonprofit sustainability advocate, advises the establishment of a host of procedures. They suggest that boards receive regular training and education on key sustainability issues and create specific committees for such issues. That, in turn, would lead to outlines and definitions of specific, sustainability-related responsibilities and accountability structures, and the development of policies addressing sustainability issues that materially impact the company's performance and plans. Finally, the sequence envisions a presentation of the company's vision and strategy for implementing these policies.

8. *Open Dialogue With Key Stakeholders.* Philip Rosedale, the creator of Second Life (a virtual world) and Linden Lab's founder and former CEO, asked all his employees three confidential questions every quarter: 1.) "Do you want to keep me or find a new CEO—yes or no?"; 2.) "Over the last three months, did I get better at this job or worse—yes or no?"; and 3.) "Why?"

   Dialogue at most companies tends to run in one direction, from management to everyone else, preventing an open, honest, and constructive conversation. CEOs should be available, in-person, no less frequently than quarterly to answer questions that staff seeks to pose. Annually, the CEO should seek open-ended input from all stakeholders on a variety of issues and disclose the results of their concerns. Stakeholder engagement is a critical process that helps companies understand their environmental and social impacts, identify risks, and develop innovative solutions to sustainability challenges.

9. *Capitalization and Corporate Assets.* Short-term focus, the quest for ever higher returns, externalized impacts, and the absence of moral imperatives all contribute to a system that requires an entirely new paradigm to address the way in which capital relates to and affects business. The following suggestions will require a radical departure from current norms:

   - No single entity or a group of affiliated entities (other than employees as a group, founders, and founding families) should own or control more that 15 percent of the equity of the company.
   - The majority of the equity invested in a private company will ideally come from direct investors, such as individuals and families, rather than financial intermediaries.
   - Investments will not be accepted from any investor whose capital comes from a fund that expires in fewer than 10 years from the date of investment or has an investment time horizon that is shorter than 10 years.
   - Due diligence should be required on all new investors, including a conversation with at least three CEOs who have received an investment from the investor. New investors must also demonstrate at least one investment that they have made and held for over 10 years.
   - Every employee of the company should own some form of equity in the company from their date of hire.

10. *Investment of Corporate Assets.* While it is common for companies to give less than 1 percent of their profits back to society for charitable purposes, no company would survive without the value that nonprofit organizations provide to the well-being of society. These organizations fill in the gaps left by our government as it continually reduces the social safety net and support of low-income neighborhoods, arts and education, as well as environmental protection. A groundbreaking coalition called 1% for the Planet involves hundreds of companies that have pledged to donate one percent of their gross revenues for charitable purposes. A minimum of five percent of operating profits should be distributed for charitable purposes.

In assessing all of these ideas, remember that studies have demonstrated that investors will pay a higher premium for good corporate governance; that good corporate governance reduces the cost of debt; and that good corporate governance improves the stability, operational efficiencies, and sustainability of businesses.

But remember that regulations in and of themselves cannot deliver good corporate governance. Regulations can only define a minimum operating standard and cannot of themselves engender moral behavior. Thus, the most effective forms of corporate governance will be driven not by rules or regulations, but rather by an internal ethical compass that clearly delineates between right and wrong.

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