The importance of corporate purpose at board level

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Directors' duties in a world of evolving risk

The role of corporate boards has never been as important as today. In a world where the environmental, social and economic risk landscape is evolving rapidly, boards have the key role and fiduciary duty to identify and address the material part of these risks to protect the long-term value of their companies. While attentive boards have always considered immediate environmental and operational risks, the last five years have unearthed new challenges to be considered at an unprecedented rate. Geopolitical and market risks threaten supply chain security, environmental degradation leads increasingly to material physical and transition risks, and growing calls to address social inequality and equity can no longer be ignored by any company. Rapidly evolving changes to regulations and financing conditions show how the rules are being rewritten as we enter this new era of risk.

Not addressing these challenges is not an option. Whether firms are in the business of extracting resources or delivering services, the operational, liability, litigation and reputation risks of ignoring these topics grow by the day. The immediate challenge before corporate boards is therefore the mitigation of unfamiliar and rapidly evolving risks in a changing governance context. While no single intervention is a silver bullet for this, having a well thought-out environmental, social and governance (ESG) strategy embedded in a credible corporate purpose can provide a useful starting point.

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Corporate purpose at board level

The concept of "corporate purpose" is simple: to deliver value for different stakeholders, a company must have clarity on why it exists (purpose), what it wants to achieve (vision) and how it plans on delivering on these goals (mission and values). While the whole company can be involved in defining purpose (successful examples exist of both top-down, as well as bottom-up purpose definitions), the board is the natural organizational home for its stewardship. As the ultimate guardian of the long-term success of a company and its survival, board directors can and should use corporate purpose as their guiding principle and their impetus to better manage ESG concerns.

In a joint research project led by Oxford University called the Enacting Purpose Initiative (EPI), we talked to more than 40 board directors to understand current practice and to find meaningful examples of how corporate purpose can give a company meaningful direction in tackling today's risk landscape. We found that when embedded at the most senior levels of decision-making, purpose can act as an organization principle for boards of directors. Purpose then becomes important not just for the cultural alignment of an organization, but for the definition and implementation of its long-term strategy.

To enable directors to make this link, we derived the so-called SCORE framework through the EPI. It outlines five actions– simplify, connect, own, reward and exemplify – that can help boards to define and execute a meaningful corporate purpose. In short, the "simplify" item outlines that purpose needs to be defined in a way that it is clear, meaningful and understandable for everyone inside and outside the organization. A board-signed purpose statement can help give clarity to stakeholders about how a given purpose relates to value creation at the company. The "connect" item highlights that purpose should link to the strategy and operational reality of an organization. The "own" item underlines that purpose should be structurally owned by the board, yet culturally owned by the whole organization. The "reward" item argues that purpose should be considered in reward and incentive schemes. And finally, the "exemplify" item highlights the importance of communicating internally and externally how purpose influences real practice. Here, it is important to highlight not only which steps have been taken on account of a corporate purpose, but also which steps have not been taken (e.g., which investments were not made).

Credibility of corporate purpose

With the rise of the idea of corporate purpose, its credibility has rightfully been challenged. Many corporate purpose statements that we see in the market are toothless and have nothing to do with a company's operational reality. For a corporate purpose to be credible, it must be more than a marketing slogan or a vague set of values. It must become an organizing principle and truly reflect the reason why an organization exists. Getting there is not a "feel-good" exercise. Boards of directors across all sectors today face growing pressure from all types of stakeholders including investors, customers, employees and suppliers for a clearer explanation of their organizational purpose.

Measuring corporate purpose

To make purpose more meaningful, it needs to be linked to measurement. This is not as difficult as it may seem. If purpose is indeed treated as the impetus for a credible long-term strategy, then its measurement can and should derive from the normal process of setting environmental, social and economic key-performance indicators, associated short-, medium- and long-term targets, as well as clear responsibilities and accountabilities for achieving those. Using corporate purpose as anchor for measurement can also help companies navigate materiality – in other words, what really matters – within an ever-growing sea of sustainability-related reporting standards (e.g., the ISSB) and regulations (e.g., the European CSRD).

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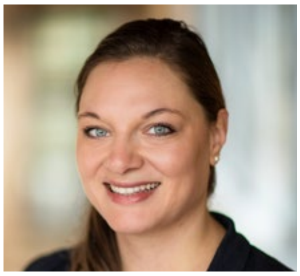
Particularly investors can play an important role in enabling companies on their purpose journey. Recent calls for better articulation of purpose from global investment management firms, together with specific commitments on purpose by asset owners, are accelerating this momentum and elevating it to a critical board issue. Boards of directors, senior management and investors have a shared responsibility to work together to ensure effective internal governance and external reporting when it comes to purpose.

Yet, our research has also shown that investors remain skeptical of current corporate purpose proclamations. While there is a widespread appreciation of the potential significance of purpose to a more long-term and holistic approach to strategy and risk-management, most institutional investors we talked to do not see purpose being taken sufficiently seriously in the companies they invest in. The main concerns are about a lack of clear communication, shallow statements without substance or clear associated goals, and the absence of mechanisms for accountability.

Yet, perhaps the biggest remaining challenge of implementing performance measures in relation to corporate purpose is not even the additional measurement but the fostering of integrated thinking. Taking purpose seriously requires management to fully buy into the importance of environmental and social factors, both from a fundamental and from a risk perspective. They require the adoption of new lenses of materiality that go beyond financial materiality and challenge traditional notions of firm boundaries. A board-championed corporate purpose agenda can help achieve this within organizations. At the very least, it will enable a meaningful conversation about the long-term goals of a company and its self-perceived role within society.



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