The status of social and ethics committees: A TRIALOGUE/ EY SURVEY

The Companies Act, 2008 (Act 71 of 2008) introduced the requirement that all listed companies, State-owned or of high public interest, must maintain a board-level committee mandated to oversee key environmental, social and governance (ESG) issues, inform the board on developments and report to stakeholders. Today, three years into their implementation, most companies have established social and ethics committees (SEC). But are they having an impact?

SELECTIVE SURVEY SAMPLE

The research drew on a small sample of 12 listed companies. Participants spanned a range of sectors including mining, financial services, manufacturing, building and construction, retail and wholesale, and IT and telecommunications. They represent a mix of business-to-business (more than half), business-to-consumer and combined business models. Three-quarters were headquartered in Gauteng with the remainder based in the Western Cape. They employ an average of 13 900 people.

In early 2015, Trialogue and EY embarked on a joint research project to assess the status of South Africa's SECs. Through in-depth interviews with chairpersons or company secretaries, we set out to gain an understanding of the successes and challenges these committees are experiencing in fulfilling their mandate and the direction they are likely to take in the future. This article represents the culmination of this research.

Role and mandate

What the research showed

All participants reported having formal mandates or terms of reference. However, these varied significantly in the breadth of issues covered. The specific issues covered tended towards the social domain, with topics related to labour, transformation and ethics – as mandated by the Companies Act Regulations – featuring prominently in more than three-quarters of research participants (see Table 1 below).

Table 1: SEC mandates and terms of reference

MORE THAN 75% OF RESPONDENTS	NO RESPONDENTS
• Enterprise and supplier development (100%) • Ethics – conflict of interest (excluding board) (100%) • Corruption (100%) • Skills development (92%) • Employment equity (83%) • Community relations (83%) • Employee relations (83%) • Human rights of directly employed (83%) • Social stewardship of suppliers and contractors (75%)	• Efficacy of board committees • Business model and strategic response • Accountability – rewards and penalties • Governance of IT (and manufactured capital) • Governance of financial capital and investments

Issues of governance, risk, business model and strategy were less common. This is not necessarily a result of neglect, but rather because such topics have traditionally been overseen by other committees and management structures. It does, however, signal that opportunity exists to further integrate sustainability issues into the core management of South African companies.

More than half the participants described their committees' role as holistic and oriented to proactive, long-term management of non-financial issues. However, this was not necessarily evident in their actions and responsibilities (see Strategy and reporting and Linkages sections below). A quarter of participants consider their SECs to be taking a compliance-driven approach, reinforcing the significance of regulation and legislation in driving corporate behaviour in South Africa.

Observation: Position SEC as custodian of future business health

The Companies Act mandates the SEC, while the Companies Act Regulations mandate its functions. However, they give little input on whether the committee should be adopting a forward-thinking, strategic role, or a compliance role that monitors the business's response to pre-determined issues. The various issues that need to be addressed are longterm by nature, requiring a considered response now to sustain the business in the years ahead. So, at the very least, these issues enable business strategy – assuming they are not in themselves integral to the strategy.

The importance of compliance oversight should not be discounted. But there is an opportunity for the SEC to go further by taking on a visionary role and exploring how changes in the external environment translate into risks and opportunities for the business. A mandate that positions the SEC as a custodian of future business health is vastly different to one that checks, for example, the progress of a Broad-based Black Economic Empowerment (BBBEE) score or comments on the annual reduction in a carbon footprint.

Of the more than half claiming to adopt a holistic, forward-thinking role, many were found to be responding to the issues being presented to them by the company, rather than anticipating them. Further, linkage to strategy was not always evident. If there is a body of wisdom flowing from the SEC members' years of experience, surely that wisdom would be put to better effect where a holistic and visionary mandate is in place as opposed to a compliance-based mandate?

Framework alignment

What the research showed

We asked participants which frameworks, legislation and regulations are included in, or formally guide their SEC mandates. Local frameworks feature prominently, with all respondents reporting alignment with the Companies Act, the King Report on Governance for South Africa, 2009 (King III) and the dti BBBEE Codes of Good Practice. The Johannesburg Stock Exchange (JSE) Socially Responsible Investment (SRI) Index and the UN Global Compact were also popular among research participants, with nearly all citing these as major influences. Interestingly, the Global Reporting Initiative, a significant global sustainability reporting framework, was mentioned by only half of interviewees.

Understandably, the issue- or sector-specific frameworks were least common. For example, the responsible investment-related frameworks such as the UN Principles of Responsible Investment (UNPRI) and the Code for Responsible Investing in South Africa (CRISA) were the least common frameworks, with only one company citing each.

Observation: Use frameworks not for compliance, but to frame long-term thinking

The various frameworks and legislation provide a useful checklist against which procedures, structures and issues covered can be assessed. The SEC is perfectly placed to oversee mandatory compliance. However, a sequential process of working through the requirements of one framework at a time lends itself to a tick-box outcome, where procedures are followed but the vision is lost.

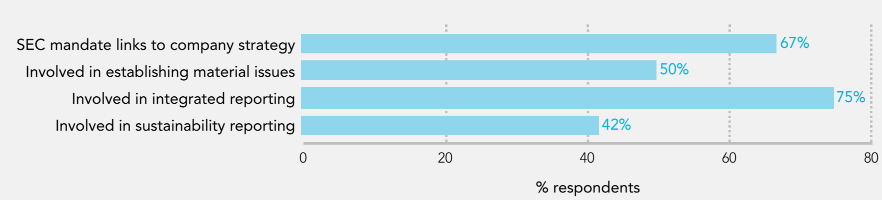
Adhering to voluntary standards – such as the UN Global Compact, the JSE SRI Index or the UNPRI – portrays the company in a good reputational light. Inevitably, adherence takes effort and can be disruptive to regular operating methods in the short term. Fundamentally, however, there are long-term advantages that extend beyond reputational gain and the SEC would do well to consider which standards to follow and how these collectively add value to the sustainability of the business.

Strategy and reporting

What the research showed

Two-thirds (67%) of respondents reported that the aspects covered by the SEC mandate are incorporated into company strategy (see Figure 1 below). In practice, this is not usually done through formal processes or mechanisms. More often, SECs and their members serve as advocates for sustainability issues during board strategy sessions, ensuring that these topics receive due consideration. Their periodic reports to the board serve to educate the broader group of decision makers on non-financial topics that have the greatest potential to impact on

1 SEC INVOLVEMENT IN STRATEGY AND REPORTING



company performance and outlook.

Fewer (50%) SECs are involved in establishing their company's material issues. However, their degree of involvement in this area varies. For many, these issues are determined at a management level, with SEC involvement limited to the approval stage. This signifies a lower level of involvement than would be expected of a committee taking an holistic/integrated approach to sustainability.

Three-quarters (75%) of SECs play a role in integrated reporting processes, primarily in the review and sign-off stages. Least common (42%) is SEC involvement in sustainability reporting. However, it is important to note that this is likely due to a decline in stand-alone sustainability reporting among South African corporates as more of them switch to integrated reporting.

Observation: Use SEC to align strategy to material issues

The SEC has a number of touch-points with the reporting function as well as business strategy. For reporting, the SEC may fulfil a vetting role to ensure information put into the public domain is credible and does not compromise business competitiveness. With integrated reporting now driven by the International Integrated Reporting Council (IIRC)'s guidelines, the traditional approaches to company reporting are being challenged. SECs should consider alternative reporting approaches and how the company conveys its value creation story via its integrated report and other financial, governance and sustainability reports, while taking into account what detail is posted on the internet.

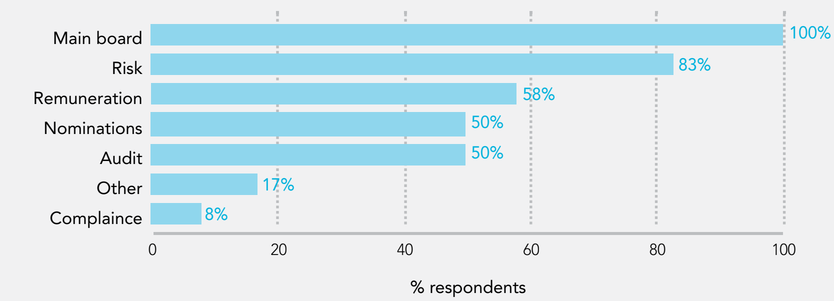
An informal relationship between the work of the SEC and business strategy offers some point of connection. However, with direct access to the main board (see Linkages section below), the SEC is well placed to ensure alignment between these important business functions. In doing so, the SEC should be in a position to offer insights into which issues are considered material to the sustainability of the business.

Linkages

What the research showed

All SECs report a link with the main board via formal reports at board meetings. Most SECs also have relationships with other board committees through shared committee

2 LINKAGES BETWEEN THE SEC AND OTHER BOARD COMMITTEES



members and areas where subject matter overlaps (see Figure 2 above). Risk committees, in particular, were most often cited as an area of blurred lines or similar mandates, and it was not uncommon for companies to split oversight of sustainability issues between the SEC and risk committee.

Two companies reported direct reporting relationships between the two committees: Altron's SEC reports to its risk committee twice a year while Barloworld's risk committee reports into its social, ethics and transformation (SET) committee as required.

At a management level, linkages are typically in the form of standing invitees representing relevant functions. Only 25% of respondents reported a relationship between their SEC and the strategy function, further supporting the notion that companies are still struggling to align SEC issues with core business strategy .

Observation: Use linkages to improve integrated thinking

SECs have an instrumental role to play in rationalising frequent overlaps in the way related issues are managed by different business functions inside a company.

For instance, it is possible for a company to deal with energy consumption at an SEC level and renewables at an operational or strategic level, without any cross-pollination of ideas or knowledge.

SECs are in an ideal position to look in on the business to see where effort is duplicated or issue management is poorly co-ordinated. They should also be in a position to comment on where and how linkages between different business functions could contribute towards more integrated thinking.

Committee composition

What the research showed

Committee size ranged from three to six members with an average of four directors. All reported independent chairpersons, and the proportion of independent and non-executive members ranged from 33% to100% (average: 66% and 78%, respectively)

Black representation varied more significantly, from 0% to 100% (average: 60%), and female representation ranged from 0% to 67% (average: 37%). In the case of both race and gender, the SECs in our sample showed greater variation, but on average were more diverse than the main boards.

Committee members are often selected by the nominations committee according to the skills and competencies required. This means that the main responsibility for understanding the range of ESG issues impacting on the company also falls on this committee.

Observation: Cultivate diverse skills to probe important non-financial issues not receiving adequate attention

Members of SECs are required to deal with a diverse set of issues. Therefore, they should possess the wisdom and experience to guide the business's response to these issues. Diversity and specialised skills are essential when establishing the committee's composition. The research showed that diversity in terms of race and gender was usually in place. However, it was not within this survey's scope to determine whether the skills exist to deal with some of the specialist topics that companies are confronted with. It may be useful, for example, to have someone who understands community dynamics represented on a mining SEC committee, or someone with expertise in low-income financing serving on the SEC of a bank.

One could argue that seasoned board committee members do not need specialist knowledge, but rather the ability to gather and interpret information that is presented to them. That said, interpreting information correctly depends on having the correct information to interpret in the first place – and this is never a certainty.

Accordingly, SEC members should use their collective experience to probe issues that are not necessarily presented to them and are not necessarily being addressed by the company. This demands proactive thinking and highlights the need for a diverse skill set that covers the material issues a company is managing.

Skills and tools

What the research showed

Respondents stressed the importance of appointing SEC members who have a strong moral compass and feel comfortable navigating a diverse set of issues. While it is not reasonable to expect a committee member to be an expert in all areas, they should be able to seek information in appropriate places. Sector-specific knowledge is also important.

Providing specific training for SECs is not common; providing training on sustainability issues to the main board is more prevalent. Few tools are currently employed to support the SEC function. However, some companies are beginning to evaluate how they can better gather and disseminate useful information to the committee. Executives in one participating company have developed a stakeholder management tool and a company gender-mapping tool which they are using to inform periodic reports to their SEC.

Observation: SECs should push for accurate internal reporting

Ideally, the SEC should be presented with a dashboard indicating how the business is managing its material issues, with a means of interrogating the detail as and when the need arises. Companies are starting to develop common data platforms and relevant indicator-based reporting processes. But progress on this front is slow. All too often, the information comes from different sources, with inconsistent levels of detail and without any aggregation of data to give the big picture view. SECs should be pushing for integrated data systems so that they can make informed judgements without having to wade through detailed statistics.

It is unrealistic to expect SEC members to be knowledgeable on all ESG-related topics, particularly when the range of topics included in the SEC mandate is so varied. Yet little training of SEC members appears to be taking place. SECs would be more enlightened and empowered to make informed decisions if they were armed with knowledge about lead practice. Here, executive briefing sessions on trends and latest advances in a particular field could certainly make a positive contribution.

SEC CHALLENGES AND SUCCESSES

CHALLENGES

- Clarifying the committee mandate
- Securing top-level buy-in
- Ensuring strategic alignment
- Navigating a challenging and diverse set of issues.

SUCCESSES

- Raising the profile of sustainability issues and ensuring decision makers appreciate their strategic value
- Identifying critical non-financial issues and formalising a response
- Influencing key decisions.

Communications

What the research showed

Companies are conveying the activities and outcomes of their SECs through channels such as AGM presentations made by the committee chairperson. Periodic reporting channels, such as sustainability reports and integrated reports, are the most common communication tools. Respondents also cited websites as a useful tool for ongoing updates and communication. However, their use was less common.

When relevant, some companies release issue-specific briefs, though this is infrequent. However, levels of investor engagement remain low. Stakeholders are given the opportunity to provide input through AGMs and general hotlines that are not SEC-specific. In practice, though, almost no feedback is received.

Observation: SECs should promote stakeholder engagement – both reporting and feedback

Management of ESG issues and how this translates into sustainable business practices is fast becoming critical to stakeholder expectations and, more specifically, a company's public image. The SEC should play its part in ensuring that the information over which it presides is appropriately communicated directly to its critical stakeholders and through external communication platforms such as the company's integrated report and website.

Changes on the horizon

Most companies in the survey admit their SECs are in the early stages of development. Looking ahead, participants expect their mandates to be refined; to develop a deeper understanding of the issues and their strategic importance; and to have the composition of the SEC adjusted, with a greater focus on independence. Respondents also expressed interest in strengthening their management systems with improved performance dashboards and data quality.

The SEC is uniquely placed, with direct access to the main board and a mandate to reach into the depths of the business. As a result, it is capable of having a strong influence on the way a company heads down the path of sustained value creation.

To realise its potential, however, the SEC will need to view its mandate holistically. This means the SEC needs to be proactive in engaging the business on what is managed, how it is managed and how the business is performing.

For more information on this survey or to run workshops on the issues covered in this article, contact Cathy Duff, director, Trialogue, on 011 026 1308.