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From Financial Performance to ESG Results: How to Assess the Firm's Overall Impact

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Abstract

The growing importance of Environmental, Social and Governance (ESG) factors in the corporate world raises some important issues for boards of directors: how to govern ESG, how to define ESG main goals and policies, how to integrate them into the firm's strategy, how to assess ESG performance and how to connect ESG with financial performance.

In this paper, I present and discuss some of the challenges that boards of directors face in assessing the company's ESG goals and policies, and how ESG performance is connected with the firm's global impact. I present a framework that discusses how ESG policies can be integrated into the firm's strategy, and its goals assessed within the wider firm's impact.

Keywords: Corporate Governance, Boards of Directors, ESG Goals and Policies, Corporate Strategy.

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1. The Challenge of Assessing the Firm's Performance

In January 2021, Ingka CEO Jesper Brodin and Deputy CEO Juvencio Maeztu were discussing the firm's strategic challenges. Although the pandemic had taken a heavy toll on the retail company, its financial performance was very resilient. The CEOs reflected on Ingka's commitment during the pandemic and its central priorities over the previous two years. The firm's purpose, aimed at making comfortable homes more affordable and accessible, was very relevant in assessing its impact. Ingka's progress on major initiatives such as its digital transformation, the opening of new Ikea city centers, and investments in more sustainable products and the circular economy were core elements of this assessment (Masclans and Canals, 2021).

Ingka's experience suggests that companies across a range of industries are facing complex challenges such as the pressure to mitigate their environmental impact or growing bottlenecks in global supply chains. In addition, they are trying to design new business models that allow them to operate successfully from a financial standpoint while helping them tackle these wider social challenges. In some industries, companies may need longer timelines to attain some sustainability goals. In oil and gas, for instance, the transition to more sustainable energy sources and net-zero emissions will take years. Against this backdrop, the relevant point for companies and their boards of directors is not only to report and disclose data on these initiatives in a transparent and comprehensive way. It is also how to assess the firm's overall impact and progress, integrate financial and non-financial dimensions of performance, and take into account all of the company's impacts on customers, people, shareholders, the planet and other stakeholders.

Ingka's recent challenges also highlight the conundrum of firms with successful performance and a commitment to protect the environment and local communities. The economic slowdown following the Covid-19 crisis, mounting trade barriers, changing consumer preferences, and the sustainability movement are having a negative impact on many companies' performance. Moreover, not only investors but consumers, employees and other stakeholders are putting the pressure on companies to disclose their effects on the environment and society at large, beyond financial indicators.

Nevertheless, the biggest challenge for companies is not the diversity of themes and indicators that boards of directors need to monitor and disclose, but rather the lack of consistency among them and weak connection with the firm's purpose and strategy. Comparisons of non-financial indicators of companies in the same industry are difficult to carry out. Some performance indicators are required by national regulators. These include, among others, disclosure of financial performance, executive pay and carbon emissions. Other indicators, such as ESG factors, are strongly supported by institutional investors and proxy advisors. ESG rating firms also provide some special scores and rankings on these issues, but the diversity of criteria and methodologies are not functional, not even for investors.

Some firms also use some indicators related to the unique nature of each company. Specific corporate performance dimensions such as innovation rates, productivity and customer satisfaction fall into this category. Boards may consider them useful, but investors do not seem to pay too much attention to them, and, in most cases, they do not ask about them. Unfortunately, the lack of connection of these factors with the firm's overall strategy is one reason why they are not considered relevant by some investors. The gap between what investors want to hear and what regulators expect, on one hand, and what the board considers relevant, on the other, is still very large.

In this paper, I address the main challenges that boards of directors face when assessing the firm's overall impact and highlight three themes to help firms more coherently integrate financial and non-financial performance with strategy. The first theme relates to the firm's performance, which should focus not only on its financial results in isolation, but on its connection with purpose, vision, strategy and business model, as well as the capabilities and resources it has developed over the years. This connection and consistency highlight dimensions that make companies unique.

The second theme is that companies should have a clearly defined strategy that can create sustainable value with mid- and long-term horizons. Sustainability in value creation requires firms to adopt a unique approach in serving customers by investing in some resources and developing some special capabilities (Ioannou and Serafeim, 2019; Porter and Serafeim, 2019). The board should ensure the firm's strategy is clear and sustainable and report on it. Financial performance looks at the past; strategy considers how the firm will create value in the future.

The third theme is how to consistently integrate financial and non-financial indicators. In this pursuit, the challenge is not the creation of standards, although these are necessary and helpful; compliance is very important, but not enough. The genuine challenge is how uniquely a firm–under the leadership of its board–establishes its long-term strategy and assesses its overall performance and impact over time, in the context of its purpose and strategy.

Before presenting a holistic framework to understand the firm's performance, it is also relevant to consider some central questions: What is the firm's overall impact? Impact for whom?

2. Corporate Performance and Overall Impact: What Should the Firm's Goals Be?

Boards of directors should monitor the senior management team and oversee the firm's performance. This is an established principle in good corporate governance practices. Over the past decades, this board duty focused on monitoring the CEO and making sure that the company tried to maximize shareholder value. Investors, investment bankers and consultants developed different tools that highlighted how companies could create shareholder value and how they should report on value creation (Fama and Jensen, 1983; Rappaport, 1986). The increasing importance of non-financial factors, such as those behind ESG dimensions, and the emergence of the notion of multi-stakeholder governance, have caught boards and investors unprepared to deal with the complexities of working with indicators other than financial ones.

The reflection on the firm's disclosure of performance brings the discussion of shareholder primacy versus broader stakeholder interests back to the table. Companies are institutions that have a clear *raison d'être* in society: serving customer needs while simultaneously creating economic value. National law grants companies the license to operate under this tenet and protect its shareholders with limited responsibility. Companies should generate profits to allocate them toward R&D, learning opportunities and capital investments, and pay shareholders a good return on their investment. Competitive capital markets put pressure on companies to pay shareholders well.

Effective customer service, people development and environmental-protection initiatives should not be viewed by boards of directors as constraints that companies have in their value creation process. Rather, they are the true drivers of customer loyalty and brand power, employee engagement, and innovation, as illustrated with the experience of Ingka and other companies. In the same way as companies consider their legal duties to perform, they should consider what it

takes to continuously meet and serve customer needs, and develop and engage their employees. Customer loyalty and employee engagement lead to more creative environments, enable the development of new capabilities and products, and help firms remain competitive in the long term.

As Flammer (2015), Eccles, Ioannou and Serafeim (2014) and Gartenberg, Pratt and Serafeim (2019), among others, showed, there might be some trade-offs between companies' profitability and their caring about customers, people and the environment in the short term, but firms should adapt their strategy and business models to take those relevant realities into account. Companies should hire good people, pay them well, invest in their development and prepare them to serve customers in alignment with the firm's mission. Only companies that truly care about their customers, employees and the environment can successfully compete for the long term.

The experiences of Ingka and other firms also show that good financial performance does not intrinsically contradict ambitious goals around employee engagement or positive environmental policies. These experiences are also consistent with the hypotheses offered by Porter and Kramer (2011) and Henderson (2020), among others. Companies that take employees' expectations seriously and aspire to offer customers sustainable products are also better poised to create a positive culture of innovation, product design and development that contributes to generate new competitive advantages. The challenges that companies voluntarily choose to address are transformed into drivers of innovation and change, helping them develop new capabilities and, eventually, new competitive advantages.

The trade-off between shareholder objectives and the interests of other stakeholders arises when companies do not have a clear purpose or strategy, or when they execute strategy with mediocre business models. The March 2021 Danone governance crisis that led to the dismissal of its Chairman and CEO, reveals that companies with purpose are not a problem in terms of financial performance. The real problem emerges when purpose is not fully integrated into strategy and the business model, leading the firm to underperform. Here, the role of the board of directors is critical. The board should discuss the purpose-versus-profit debate with the CEO, deeply analyze its arguments, and adopt and own a position that it can communicate to investors.

The debate between shareholders versus other stakeholders is relevant in this context. The criticisms against stakeholder management are incomplete and incoherent with actual business experience. As Hart and Zingales (2017) rightly argue, it is shareholders who should decide on the philanthropy initiatives of the companies they invest in. Nevertheless, relevant stakeholder management is not about philanthropy. By developing people, channeling resources to innovation to better serve customers, working with suppliers to improve their effectiveness or offsetting the firm's negative environmental impact, firms take these social issues seriously and invest and innovate to create sustainable value.

Boards of directors are fiduciaries who should look after the firm's overall impact and assess the sustainability of its performance. In this role, boards and senior management teams need to consider several dimensions. Sometimes, these factors are clearly regulated by law, such as minimum wages or carbon emissions. In other cases, board members should use their business judgment to consider these factors, discuss them with the CEO and weigh their potential impact on the firm's performance and reputation. If shareholders disagree with the directors' business decisions, they can express their views and opt not to reelect them in the next shareholders meeting.

Friedman (1970) and Jensen and Meckling (1976) simplified the argument by underscoring the primacy of shareholder value, but they also introduced uncertainty in some areas. In particular, by highlighting the focus on profits, they did not explicitly consider the negative externalities

generated by the firm's activities. Moreover, some policies related with stakeholders may help the firm create value for the long term, but require investment and expenses in the short term. The timeframe of value creation is also very relevant. Time horizons are different for different types of shareholders. Shareholders are heterogeneous, so centering the focus only on shareholder value may not be a good guide for the debate. Unfortunately, the contemporary versions of shareholder primacy do not contemplate these critical features.

Bebchuk and Tallerita (2021) are also right in some of their criticisms of companies whose CEOs explicitly supported the 2019 Business Roundtable statement on corporate purpose and multi-stakeholder management. They are right in highlighting the contradiction of these CEOs in supporting purpose while not changing any major corporate policy or submitting it to a shareholder vote. However, their argument is incomplete. As the experiences of many innovative companies reveal, it is possible to integrate purpose into strategy and business model, develop a multi-stakeholder management and create long-term value.

A word of caution in this debate is needed. Shareholders in abstract are a simplification. In the real world, shareholders are diverse, heterogeneous and driven by different motivations and expectations that evolve over time. Listed companies in capital markets are not the majority of firms. Family-business and private-equity backed firms are dominant in the corporate world outside of the US and the UK. In these companies, the alignment between shareholders, boards of directors and CEOs is quite high.

Agency problems are real in most listed companies, but are not the biggest governance concern in other firms with relevant shareholders of reference. Privately-owned companies have governance problems as well, but shareholders are more involved with the company and able to remove CEOs and change the board more flexibly than in public companies. Some problems that arise in the debate between shareholder primacy and stakeholder perspective only make sense within the context of highly dispersed ownership in listed companies. When shareholders, boards and senior managers share the same long-term vision and are fully aligned, the debate between shareholders and other stakeholders is less relevant. Shareholders and stakeholders alike have an important share in the firm's destiny.

The growth of distributed ownership in listed companies in the West led to the lack of proper monitoring of boards of directors by shareholders and the dominance of powerful CEOs. The rise of managerial capitalism did not have the checks and balances necessary for good corporate governance. This explains the call for independent, external board members that regulators in Western countries began making in the 1990s.

Unfortunately, these problems have yet to be resolved. Institutional investors are dedicating more time and effort in considering companies' long-term prospects, as reflected in their stewardship reports. Despite this rising interest, it is important to note that these reports disclose a mere handful of engagements–direct contacts with boards of directors or senior managers–out of the myriad of companies they have invested in. Most institutional investors are not spending the time needed to serve as good shareholders of their investees. A significant problem in assessing the firm's performance is shareholders' genuine interest in acting as responsible investors who care how companies are governed and managed. This requires time and commitment. The relevant role that shareholders should play in corporate governance is threatened when they fail to spend sufficient time monitoring the board and engaging in positive conversations with directors.

In this context, boards and CEOs with disconnected shareholders are open to attacks from activist shareholders, who will emerge when the firm's performance falters. Supporters of shareholders' primacy should remember that companies are not machines. They are human groups, most of whom aspire to serve their customers' needs and create economic value in this process. Shareholders should dedicate efforts to better understand the companies they invest in and positively engage with management teams and boards to discuss the firms' long-term horizons.

Although the notion of shareholder primacy seems to have the advantage of simplicity, it does not give the complete picture on the firm's performance. Academia should also acknowledge that, in many companies, the nature of this debate is different. In the real world, the debate is between companies that are well governed, effectively managed, driven by a clear purpose or mission, guided by a coherent strategy and with a good financial performance; and companies whose shareholders and boards are more focused on short-term value creation and their short-term horizon leads them to under-invest in people, R&D or new products and services. Carefully framing the terms of the debate is very relevant for corporate governance.

3. A Holistic Perspective of the Firm's Performance and Impact

The board of directors' duty to monitor top management and corporate performance calls for more holistic models to assess the company's overall performance and impact. This is not only a question of whether shareholders should have primacy over other stakeholders; it is about establishing a credible framework that explains how a company promotes and sustain value creation for the long term. Firms create long-term value with a clear strategy and unique business model to help them better serve their customers.

Andrews (1971), Porter (1980, 1996) and Rumelt (2011), among others, described the notion and relevance of business strategy for the firm's long-term performance. They identified the need to serve customers in a unique way, the role of strategy to help develop competitive advantages, the importance of the core idea of the business, and the decisive contribution of people to strategy and, in particular, people with managerial responsibilities. Nevertheless, these contributions were disregarded by most financial analysts and capital markets.

Since the 1980s, investment banks, scholars and consulting firms have created new indicators of financial performance, all aimed at assessing a company's financial returns. Part of this effort was useful; for instance, it helped identify firms with good accounting profitability that were not generating enough cash flow to invest in new projects, sustainably manage debt levels and pay decent shareholder returns. This became the dominant culture in corporate reporting over the past four decades.

In the 1990s, the new strength of stakeholder management (Freeman, 1984) and the consideration of the triple bottom line–people, planet and profit–began to emerge in discussions on performance assessment and corporate reporting. In parallel, the increased focus on corporate social responsibility emerged and created additional challenges to the shareholder primacy perspective. Unfortunately, the early stages of this new perspective were timid and non-holistic, and the dominance of financial indicators continued.

Porter and Kramer (2011) went one step further with the notion of shared value, by which companies pursue social goals in a way that also drives additional shareholder value creation. Porter and Kramer were right in underlining that companies' pursuits of environmental and social initiatives that are detached from corporate strategy are doomed to fail. Unfortunately, this notion was probably fell short in assessing the firm's overall impact.

Only with the very recent sea change in the way large institutional investors consider ESG dimensions and the upsurge of impact investment funds has a new perspective emerged in the corporate performance and reporting debate. The early innovators in integrating financial and non-financial reporting such as the GRI (Global Reporting Initiative) and SASB (Sustainable Accounting Standards Board) have been joined by new initiatives, including The Carbon Disclosure Initiative or the World Economic Forum's Stakeholder Management framework, promoted in cooperation with the Big Four auditing firms (World Economic Forum, 2020).

Despite recent progress, the quality of ESG performance indicators is still a work in progress. There is the challenge of comparing corporate performance across industries, as well as between same-industry firms that apply different indicators. Also, there is a lack of clear standards of materiality,[1] measurement and reporting. In financial accounting, materiality designates all material issues that should be properly reported in financial statements. As a result, financial performance is tangible, clear, well defined and highly monitored by audit firms. On the contrary, non-financial performance is still non-standardized, with different institutions setting references and standards and offering scores and rankings, without an overall view on the information that they bring or how they can promote a more holistic perspective of the company's performance.

Fortunately, there are some initiatives underway to create international sustainability standard frameworks to report on ESG factors, including recent efforts by the five leading voluntary framework and standard architects: CDP, the Climate Disclosure Standards Board, the Global Reporting Initiative (GRI), the International Integrated Reporting Council (IIRC) and the Sustainability Accounting Standards Board (SASB). The Enacting Purpose Initiative, promoted by the British Academy, also offers a powerful framework to think about purpose in an integrated way and measure the achievement of purpose.

This lack of standards in non-financial factors is not the chief obstacle in measuring firms' performance. The presence of different standards and the evolution of sustainability reporting have led to both greater awareness and confusion regarding this issue. According to Pucker (2021), increased integrated reporting has not significantly contributed to offsetting negative environmental impacts.

Far before the emergence of non-financial performance indicators, companies such as Ingka, Schneider, Nestlé, Pepsico and Unilever, among others, reported on their activities from a holistic vantage point, combining financial and non-financial information, and clearly integrating them. In this way, investors, customers, employees and other stakeholders have been able to better evaluate the performance and overall impact of these firms, beyond the specific benefits they derive from them.

These companies and their governance frameworks have a common thread: they all have connected purpose, values and ESG with strategy, business model and shareholder engagement. These dimensions are relevant factors in the firm's performance. But they also share another similarity: their boards and top management teams have been able to successfully articulate these building blocks and create a governance and management model coherent integrates these critical dimensions. This process requires time and a firm determination to extend its scope to include investors and key stakeholders. Once the model is holistic and reasonably consistent, it becomes a powerful lever in helping firms bolster the quality of their governance frameworks and management teams.

[1] Materiality is a quality related to the impact of non-economic factors–including ESG factors–on financial performance.

In the following sections, I present an overview of how some of these companies are governing their long-term evolution and measuring their performance by expanding the board and senior management's focus to consider both business performance and the firm's impact on people, customers, environmental and stakeholder dimensions.

3.1. Unilever

When Unilever CEO Paul Polman and his team began working on the Unilever Sustainable Living Plan in 2009, they reflected on the best way to address changing consumer needs, enhance employee engagement and consider Unilever's environmental impact across the value chain. The board gave Polman and his team the explicit goal of returning Unilever to financial prosperity. What might have looked like a huge conundrum for the CEO offered an opportunity to rethink the company's strategy.

Unilever's management team embraced the challenge, sparked a well-structured and creative organizational change process, and consistently defined the firm's purpose, which became integrated into Unilever's strategy, business model and strategic decisions. A few years later, the governance and management model they developed was clear and distinguishable. More importantly, it was recognized by investors as unique.

Although it was ultimately successful, the transformation that Polman unleashed at Unilever was not simple. On the contrary, it was a complex process for a large company with eight business units, wholly owned subsidiaries in more than 100 countries, and a dual shareholding structure and headquarters in The Netherlands and the United Kingdom. Moreover, Unilever needed to regain the respect of investors following years of mediocre financial performance.

In 2010, Unilever unveiled a new corporate purpose, "Making sustainable living commonplace." It was complemented by a well-structured vision, coherent goals, strategy and business model, and disciplined execution. As Polman and other board directors shared (Canals, 2019), the hardest part of this transformation process was not defining a clear purpose; what was truly complex was achieving a viable integration of Unilever's purpose into its strategy and business model to ensure it could create sustainable economic value. Once this framework was well-defined and operational, accountability and performance assessment also became more functional.

Unilever's governance model put purpose at the center of its activities. At the heart of purpose, the commitment to customers, employees and key stakeholders, including shareholders, were made explicit. The company's disclosures on its impact on each of these realms was not an artificial experiment or a ratings game. Unilever started to report on the main themes and dimensions which the management team and board of directors felt best reflected the company's performance.

Polman and his team strived to improve Unilever's effectiveness and financial performance, while simultaneously focusing their attention on three ESG-related areas where the company felt responsible for, but that could help Unilever boost sales growth and make a positive difference (see **Figure 1**). The first area was–and still is–health and well-being. Its aim was to help more than a billion people to take action with two main themes: health and hygiene, and nutrition. Each theme had a few well-defined KPIs, which were directly linked with product development, operations and sales.

The second area was "Enhancing Livelihoods" and comprised three major initiatives: (1) fairness in the workplace, (2) opportunities for women and (3) inclusive business. The third area was environmental impact, with four major themes: (1) greenhouse gas emissions, (2) water usage, (3) waste, and (4) sustainable sourcing. It took some effort, but employees and shareholders gradually appreciated and understood what Unilever was trying to accomplish and how it was planning to assess its performance along these new dimensions.

These areas firmly connected Unilever's impact with its purpose and offered a comprehensive view of its progress on its financial and commercial goals, while advancing its efforts to enhance people's health and nutrition, promote fairness and inclusiveness, and reduce its environmental impact, all articulated in well-designed policies, careful investments and a disciplined innovation process. While some of these initiatives have worked better than others, their overall impact has been very positive for Unilever. It has undoubtedly blazed new trails both in its adoption of purpose and stakeholder management, and the coherent integration of financial and non-financial themes in its reporting.

3.2. Ingka

In 2018 Ingka's board and senior management team decided to accelerate the company's transformation process in the face of evolving digitalization and a stronger commitment to sustainability. At the heart of this transformation was Ingka and Ikea's sense of purpose: to make customers' lives more affordable and comfortable (Masclans and Canals, 2021). Ingka's board approved the 2019-2021 strategic plan, which included ambitious revenue growth, margins and cash-flow objectives. Achieving these goals would require new strategic initiatives, most of which related to ESG dimensions: the affordability of Ikea products for consumers, accessibility via an omni channel approach, and sustainability throughout the value chain. Ingka's board fostered the firm's growth along these three dimensions, which were closely connected with Ikea's purpose.

Figure 1
Unilever Sustainable Living Plan

IMPROVING HEALTH AND WELL-BEING		ENHANCING LIVELIHOODS		
HEALTH AND HYGIENE **TARGET** By 2020 we will help more than a billion people to improve their health and hygiene.	**NUTRITION** **TARGET** By 2020 we will double the proportion of our portfolio that meets the highest nutritional standards, based on globally recognized dietary guidelines.	**FAIRNESS IN THE WORKPLACE** **TARGET** By 2020 we will advance human rights across our operations and extended supply chain.	**OPPORTUNITIES FOR WOMEN** **TARGET** By 2020 we will empower 5 million women.	**INCLUSIVE BUSINESS** **TARGET** By 2020 we will have a positive impact on the lives of 5.5 million people.

REDUCING ENVIRONMENTAL IMPACT			
GREENHOUSE GASES **TARGET** Halve the greenhouse gas impact of our products across the lifecycle by 2030.	**WATER** **TARGET** Halve the water associated with the consumer use of our products by 2020.	**WASTE** **TARGET** Halve the waste associated with the disposal of our products by 2020.	**SUSTAINABLE SOURCING** **TARGET** By 2020 we will source 100% of our agricultural raw materials sustainably.

Source: Unilever's Annual Report 2018

Ingka's approach shows how purpose and ESG dimensions can dovetail with strategy and business model. Moreover, it illustrates how some themes of purpose, such as the affordability of products and services, sustainability and promotion of the circular economy, can turn into the driving forces of innovation and change in companies. It is true that a firm might face trade-offs in the short term: costs might go up for a while, required investments will require financial resources, traditional products–less affordable or less sustainable–might still have strong demand and result more profitable than newer offerings. Transformation toward more sustainable products or services and more environmentally friendly processes may entail higher costs and lower profitability in the short term. The same can be said of people policies aimed at improving employee education and training.

Any corporate transformation process sparks disruption, as evidenced in the 1990s with the advent of e-commerce or in current times with the emergence of artificial intelligence applications in different business functions. Companies need to adapt and discover new opportunities for growth if they want to survive. Those that adapt and enhance their agility will be better poised to develop new products and services, serve customers in a unique way, and

attract top talent. In addressing purpose and sustainability, boards and senior managers need to embrace the same approach: understand the implications of different options and the risk of inaction; discover opportunities and explore alternatives; establish criteria to assess the various options; define areas where the company can experiment; and finally, adopt a broad map for change and transformation.

The takeaway from Ingka's experience shows that these goals add some complexity, but they can be successfully interwoven into the business model. When the board of directors approves the transformation process with a broader set of goals, the scope of the company's business and its performance become far more holistic. In turn, investors gain a better understanding of the company and different stakeholders can observe how the company balances diverse goals and trade-offs.

Ingka's reporting extended beyond financial performance and ESG dimensions. Its approach was integrated and holistic, with the board of directors focused on strategic, sustainable growth around affordability, accessibility and sustainability Ingka's challenges and opportunities emerging from these three themes were translated into ten initiatives, 10 jobs (see Figure 2), each one with specific goals in a three-year timeline (2019-2021).

Figure 2
Ingka: 10 Jobs to Be Done

01	02	03	04	05
Create strong position leading from our Purpose.	*Create* a home furnishing movement.	*Create* a simple and unique digital Customer.	*Create* affordable services to make IKEA convenient.	*Create* a new world of IKEA in every city.
06	**07**	**08**	**09**	**10**
Create the IKEA stores of tomorrow.	*Create* a people and planet positive IKEA.	*Create* a relevant and affordable offer.	*Create* a simpler and better IKEA, designed for the future.	*Create* a people movement and make our culture and values a living reality.

Source: https://www.ingka.com/newsroom/media-resources/ (April 29, 2021)

Each of these jobs had specific targets, policies and action plans. An interesting point is how Ingka's top management defined job number 7: "Create a people- and planet-positive Ingka." This job was defined by three areas. The first was "healthy and sustainable living," with three specific commitments and five targets. The second was "circular and climate-positive," with three specific commitments and five targets. The third was "fair and inclusive," with three commitments and three targets. It is important to note that some of these initiatives and targets were not simply discretional choices selected by the board to promote sustainability. Rather, they were fully integrated in product development and sought to positively influence consumer behavior, not simply to sell more units of specific products. Ingka's efforts to promote recyclable products, phase out plastics in its products and promote the use of renewable energies, both internally and by customers, reflect the interplay between its environmental focus and product innovation.

3.3. Schneider Electric

Two overriding forces were behind Schneider Electric's profound transformation over the past 15 years: the need to fight climate change through the use of clean energy, and the application of digital solutions to improve its energy-usage effectiveness. Under the leadership of Jean-Pascal Tricoire, Schneider's board of directors and senior management team transformed these challenges into important opportunities to reinvent the company and better serve customers. In this way, two major sources of potential disruption–digitalization and electrification–became the catalysts of change for Schneider. The firm's purpose to create a world where innovation, effectiveness and sustainability in energy use could intersect became the driver of the firm's transformation (Masclans and Canals, 2019).

This was a long journey, with many obstacles along the way. But the board and the senior management team were convinced about the need to transform the company through a coherent model of change that encompassed the aforementioned dimensions and effectively transmitted its related goals and commitments to employees, shareholders and other stakeholders. The new sustainability goals might have been viewed as additional obstacles to the firm's performance. On the contrary, Schneider Electric viewed them as opportunities to develop new products and services and strengthen their business.

In 2021, the company released the report, "Schneider Sustainability Impact," which disclosed information on financial performance and six other areas of impact: Climate, Circular Economy, Trust, Equity, Generations and Local. Each area had specific performance goals and indicators and clear targets to be achieved by 2025 (see **Figure 3**). This model was the outcome of Schneider's longstanding efforts to disclose non-financial information. The company also strived to connect their company-specific targets with the 17 United Nations Sustainable Development Goals.

What is truly relevant is that Schneider's objectives were all adopted voluntarily: all significantly exceeded the minimum legal requirements in their countries of operation. Moreover, the firm integrated these targets into its business model and main activities. Some of them, such as Climate and Circular Economy, were fully incorporated into Schneider products, solutions and customer services. They were tightly interwoven into the offer that Schneider was making to its customers. Others were connected with people policies to enhance employee well-being, especially in emerging countries with limited access to education, training, health services and social assistance benefits.

Even more remarkable, Schneider's integrated pursuit of these goals and transparent disclosure became the focal point in its regularly published reports and presentations for analysts and investors. By jointly presenting financial, social and environmental performance, Schneider not only highlighted its commitment to sustainability and social dimensions; it also showcased its efforts to wholly integrate these factors in its business operations.

3.4. Assessing Overall Impact: Beyond Integrated Reporting

The Unilever, Ingka and Schneider experiences reflect pioneering examples of how companies can integrate ESG factors into their purpose, strategy and business model, and also deliver very strong economic performance. While pathbreaking, they are extremely useful for all boards of directors in deciding which ESG and other non-financial factors to closely monitor, which performance indicators to follow, and how these factors can connect with financial performance. As these companies show, the firm's impact goes beyond financial reporting and its integration with non-

financial reporting. This is an important step but, in the end, companies should be able to communicate internally and externally who they are, why they are in business, how they create value, and their overall impact. It is not merely a question of people preferring to engage with socially conscious companies, whether as customers or employees: a growing number of investors want to know the overall impact of the firms they invest in.

Figure 3
Schneider Sustainability Impact: Long-Term Commitments

CLIMATE	BASELINE	Q1 2021	2025 TARGET
1. Grow green revenues	70%	72%	80%
2. Help customers save CO_2 emissions	265M	276M	800M
3. Reduce CO_2 emissions from top 1,000 suppliers	0%	in progress	50%
RESOURCES			
4. Increase green material content in our products	--	in progress	50%
5. Plastic-free and recycling	--	in progress	100%
TRUST			
6. Suppliers who provide decent work to their employees	--	in progress	100%
7. Confidence of our employees to report unethical conduct	81%	in progress	+10 PTS
EQUAL			
8. Increase gender diversity (Hiring/Management/Leadership)	41/25/24	44/25/25	50/40/30
9. Provide access to green electricity to 50 M. people	30M	30.7M	50M
GENERATIONS			
10. Double hiring opportunities for interns, apprentices and fresh graduates	4,939	x1.11	x2.00
11. Train underprivileged people in energy	281,737	287,601	1M
LOCAL			
12. Country presidents with local commitments	0%	100%	100%

Source: Schneider Sustainability Impact 2021-2025 Report (Q1 2021).

4. A Framework to Assess Corporate Performance and Impact: The Role of the Board of Directors

The tidal wave of non-financial factors that companies must now consider, coupled with institutional investors and regulators' mounting pressure for additional ESG-related disclosures, have created an enormous challenge for boards of directors. For many firms, reporting on financial performance and non-financial issues is significant, but integrating them in a meaningful way is difficult. The expectation from the board is to produce longer reports on non-financial dimensions, which unfortunately often result in information overload, regardless of whether these factors are material to the company's expected performance and results. I begin this section by first exploring some principles that may help gain a deeper understanding of the firm's global performance based on the experiences outlined in this paper, followed by a holistic framework for considering the firm's impact.

4.1. Some Insights on the Firm's Impact

Although the companies' experiences presented in this paper are unique, they offer useful insights for the boards of directors and senior managers in a broad range of companies, both listed and privately held. The first is that companies keen on improving their environmental and social impact should clearly delineate their areas of focus based on their material importance for the firm's performance, P&L and balance sheet. At Unilever, Polman and his team did not casually decide on environmentally focused areas as a public relations exercise. Unilever chose areas in which the company had a negative effect and made concerted efforts to track its performance and reduce its adverse impact within a reasonable timeframe. In this sense, firms should choose their ESG themes wisely and closely monitor their impacts, including those which are material for the company's operations. By indirectly reminding people of its purpose, a company can reinforce its commitment to sustainability, social goals and consideration of all costs–including those not explicitly reflected in financial reports.

The second insight is that the impact of environmental and social factors on the firm's performance transcend explicit costs or additional investments. Companies with good governance and effective management are able to coherently integrate these challenges into the firm's strategy and business model. Moreover, tackling these issues may spark additional innovation to help design novel products or services at premium prices, boost demand with new offerings or reduce costs. Empirical evidence also shows that purpose and ESG factors help intensify employee engagement, which also yields a positive impact on the firm (Gartenberg, Pratt and Serafeim, 2019).

The third insight is to consider the overall material impact of environmental and social factors on the firm. This material impact goes beyond costs and can be divided into six specific areas (see **Figure 4**). The first area is the potential for new revenues that come from product innovation and a different customer value proposition and better margins. The second area is the impact on expenses–both positive and negative–also with a mid-term horizon. This should consider the firm's negative impacts as costs to take into account, even if regulations in a country do not force companies to do so. The third area is the impact on the firm's balance sheet and, particularly, its capacity to raise new equity or issue debt with a lower cost of capital in light of its environmental and social profile, and the management of stranded assets that are losing value due to energy transition. The fourth area is the impact on the firm's reputation, in particular, among customers and employees–including future hiring–and other stakeholders as well. The fifth is the company's

risk profile, including financial, reputational, regulatory, environmental and social risk. The sixth area of impact is the ability to engage long-term shareholders, who may be better aligned with the firm's purpose and strategy.

Figure 4
Environmental and Social Factors: A Holistic View of Materiality

<table>
<tr><td rowspan="6">ENVIRONMENTAL AND SOCIAL FACTORS' IMPACT</td><td>REVENUES</td><td>• Reputation
• Brand awareness
• New customers
• Growth
• Premium price products</td></tr>
<tr><td>EXPENSES</td><td>• Explicit environmental and social costs
• Costs of inaction</td></tr>
<tr><td>BALANCE SHEET</td><td>• New investment
• Equity
• Debt
• Stranded assets</td></tr>
<tr><td>REPUTATION</td><td>• Customers
• People hiring and development
• Stakeholders</td></tr>
<tr><td>RISK PROFILE</td><td>• Financial
• Reputational
• Regulatory
• Environmental
• Social</td></tr>
<tr><td>SHAREHOLDERS</td><td>• Shareholders' engagement
• New equity
• Dividend policy</td></tr>
</table>

The fourth insight is that improvements in this complex process do not happen overnight. It is important for the management team to define aspirational but reasonable goals that are well integrated with the firm's strategy and provide it with a sense of direction, while the firm continues to perform well. The experience of these firms also shows that mistakes can be made in this process. Establishing overly ambitious goals can negatively impact the firm's reputation and demotivate employees if the firm fails to attain them.

The fifth insight is that goals should have a clear link to the firm's purpose, strategy and business model. Sustainability targets in and of themselves are not a source of competitive advantage (Porter and Serafeim, 2019). Companies need to discover a way to integrate environmental factors into strategy and offer a unique customer value proposition. Unilever's chosen areas were fully consistent with its purpose. As a matter of fact, they were established almost in parallel with the development of the firm's purpose in 2009 and 2010. Goals should also be coherently integrated in the firm's strategy and business model since this enables the company to create value for all.

The company's performance between 2009 and 2020 was clearly above average among its peers in the food, beverages and home products sector. It is a prime example of how a company can grow while considering environmental and social dimensions in product development, and create long-term economic value for all, including shareholders, by considering different stakeholders in its decisions and embracing a holistic and fair approach.

The sixth insight is that the board's level of aspiration is important in order to mobilize employees and suppliers to achieve the defined goals and boost their commitment to serving customers. The companies discussed in this chapter were both ambitious and aspirational in the selection and simplicity of their chosen goals and the KPIs selected to monitor them.

The seventh insight is that, in a world dominated by technology and software, companies can become true innovators, architects of successful business models, and magnets for talent and development. And as these firms prove, this is possible even in mature industries like the food and beverages, or retail. At the time of writing, Unilever was rated among the world's best employers, along with distinguished large technology firms. The incredible impact of integrating financial and non-financial performance cannot be overstated. In this process, the firm's purpose can play a very relevant and positive role.

The final insight is on ESG regulation (Coffee, 2020). Companies should comply. But Ingka, Schneider and Unilever began their process of defining purpose and ESG areas and goals years ago, when regulation in this area was practically non-existent. What is truly remarkable about these firms is not only their pioneering role in integrating ESG with their strategy and business model. It is the fact that they chose areas which were material to their business and others where they could make a unique impact. Moreover, they included ESG factors most relevant to the company and its different stakeholders. The lesson here is that companies should define their own purpose and appropriate ESG factors. Firms should take regulatory duties into account, but regulators will not tell them which areas they should emphasize and monitor. This responsibility falls to the board and the top management team (Canals, 2019; Polman and Winston, 2021).

This leads to important reflection for companies, regulators and scholars. In corporate governance, there is a school of thought that believes companies should simply follow the law and comply with formal regulation, with no need to move beyond this scope of duties. The experiences of Unilever, Schneider Electric and Ingka show the opposite is true. Well ahead of regulation, they chose which ESG areas and goals to pursue, explained their materiality to shareholders and the investment community, and effectively integrated them into their strategy and business model.

No company, no matter how large, can singlehandedly resolve the challenge of climate change or other complex social issues (Yan, Almandoz and Ferraro, 2021). But it is also true that regulation alone will fall short. Regulation is imperfect, subject to political bargaining and lobbying, typically overdue and dependent on enforcement. The voluntary adoption of ESG dimensions is rational, embeddable into the firm's business and capable of making the company more competitive in the long term. Moreover, good governance practices will trigger a positive ripple effect. Regulation is indispensable in ESG areas. But the experiences of these firms offer a powerful lesson, showcasing the effectiveness of good boards of directors and CEOs and serving a reference to many companies around the world.

As the companies discussed suggest, the lively academic debate on the firm's goals as defined by shareholder primacy versus stakeholder management perspectives is incomplete. More and more companies–along with some investors–view this debate as obsolete. Well-governed

companies should develop their strategy and business model to efficiently serve customers, engage their people and make a positive impact on other stakeholders while creating economic value. While considering this wider perspective may seem more complex, it is dynamic: it opens up new business models and fosters innovation. The board and the CEO need to make prudent decisions to ensure this process is sustainable.

4.2. A Holistic Framework for Impact Assessment

Within the boundaries of legal and regulatory duties, boards of directors and senior managers have the discretion of defining and prioritizing the ESG factors they deem most closely related to the firm's purpose, culture or business. In the end, the business judgement of the board is essential. In the cases of Unilever, Ingka and Schneider, their boards of directors defined and approved a way to report on ESG factors when standards on this type of reporting were non-existent. They chose specific areas of interest and key indicators because they were closely connected with basic customer needs, as emphasized so clearly in their firms' purpose. This was essential in determining where the company would place its ESG-factor focus, beyond the requirements of national laws and regulations.

The board of directors and senior management team should assess the firm's impact, not only for reporting purposes. As the stewards of the firm's long-term development, they should develop a framework to assess performance.

Adopting a generic framework of performance is not enough. It should take into account the firm's characteristics, its industry, its whole value chain and how it sustainably creates value. This approach should allow investors and other interested parties to monitor the firm's performance reasonably well and draw comparisons with other industry peers. The way of assessing performance and impact has a direct outcome: it helps the board of directors and the senior management team track the company's progress in core areas. Disclosure and reporting come later. The first party interested in assessing impact should be the board of directors itself.

The firm's performance and impact should consider the holistic perspective explored in the previous section with the experiences of Unilever, Ingka and Schneider Electric. The board and the CEO should work together to understand the firm's primary areas of impact, the consideration of the relevant stakeholders (see **Figure 5**), and design and select the performance indicators that are truly relevant for the company.[2] The firm's impact on shareholders is very relevant to continue to attract capital, but it should also focus its efforts to sustainably creating value for customers and attracting and developing people with the best professional and personal competencies. To this end, the board and the senior management team should firmly understand the firm's purpose, vision, strategy, business model, corporate policies, and how they are interconnected. The framework to understand the firm's performance should take these dimensions into account.

The design of the holistic framework should integrate the main drivers of the firm's value creation. **Figure 6** presents a summary of the firm's overall impact assessment framework presented in this paper. It has three major building blocks: governance; people and management; and impact on specific stakeholders. The first block is related to the firm's governance and includes some main

[2] The balanced scorecard is a widely used framework among senior managers which integrates key indicators of performance, beyond financial factors (Kaplan and Norton, 1996). They tried to expand traditional financial views on the firm's performance by including four major themes: financial performance, customer perspective and satisfaction, internal business processes, and learning and growth. It did not include any of the current non-financial factors considered relevant in corporate governance today.

governance pillars: the firm's investors, board of directors, management team and its purpose (why the company exists and what it tries to achieve).

The second block is related with people, strategy and main corporate policies. This block suggests that management hires and develops people, defines a strategy and a business model to serve customers, establishes an organizational structure and approves corporate policies. The third block expresses the company's impact on key stakeholders stemming from the firm's governance and management. The governance and management decisions have some effects on customers, employees, economic value creation, the organization's economic health, the environment, stakeholders and shareholders. They also impact the entire organization and its people. The firm's impact is not static, but dynamic. Impact assessment may lead companies to rethink their governance and management models, as well as some specific policies.

This framework can be beneficial for different companies. But each company is unique. In designing a model for impact assessment, the board and senior managers should consider the firm's unique features, its specific industry and value chain, and other factors, as well as their internal logic that makes sense in each case.

First and foremost, this framework considers that organizations come into being because there are some entrepreneurs, founders or investors who set it up. In many cases, founders appoint a board of directors and select a CEO and senior management team. At times, the board, senior management team or investors want to highlight a special purpose for the company. These four ingredients are the initial pillars of the company: shareholders, boards of directors, managers and a purpose.

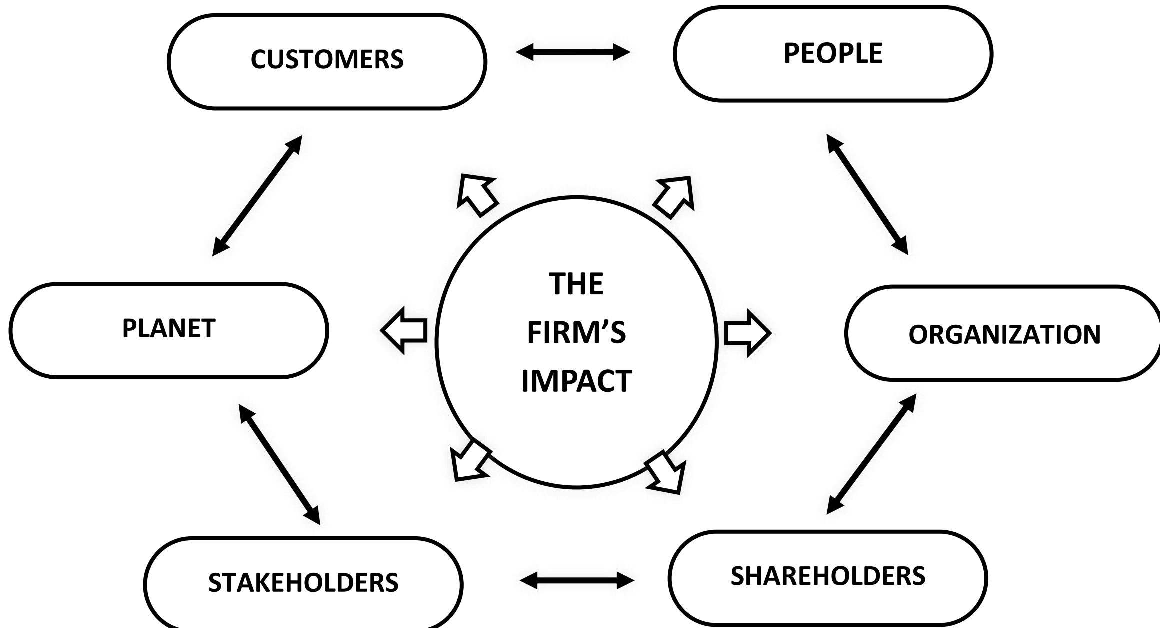
The second block of this model highlights that managers hire and develop people, acquire physical assets and define a strategy, a business model and an organization to create value for customers. These decisions involve some specific choices on corporate policies that will determine the firm's evolution.

The third block of this model assesses the firm's impact. Performance assessment should aim to gather information on the firm's activity in a holistic way. Its operations will affect customers (satisfaction, retention or reputation), employees, as well as economic value creation shareholders, other stakeholders (suppliers, partners and local communities), the planet (environmental effects) and the organization itself, starting with its own people and their ability to learn and create value in the future.

This description of the firm's effects and outcomes is more complex than purely financial information and involves some logical linkages and trade-offs. It is certainly difficult to reduce it to an index or a rating. It is understandable that some investors would prefer to simplify the complexity of a firm's operations and performance by using indexes, like the ESG State Street R-Factor or Morningstar Sustainability Rating, among many others.

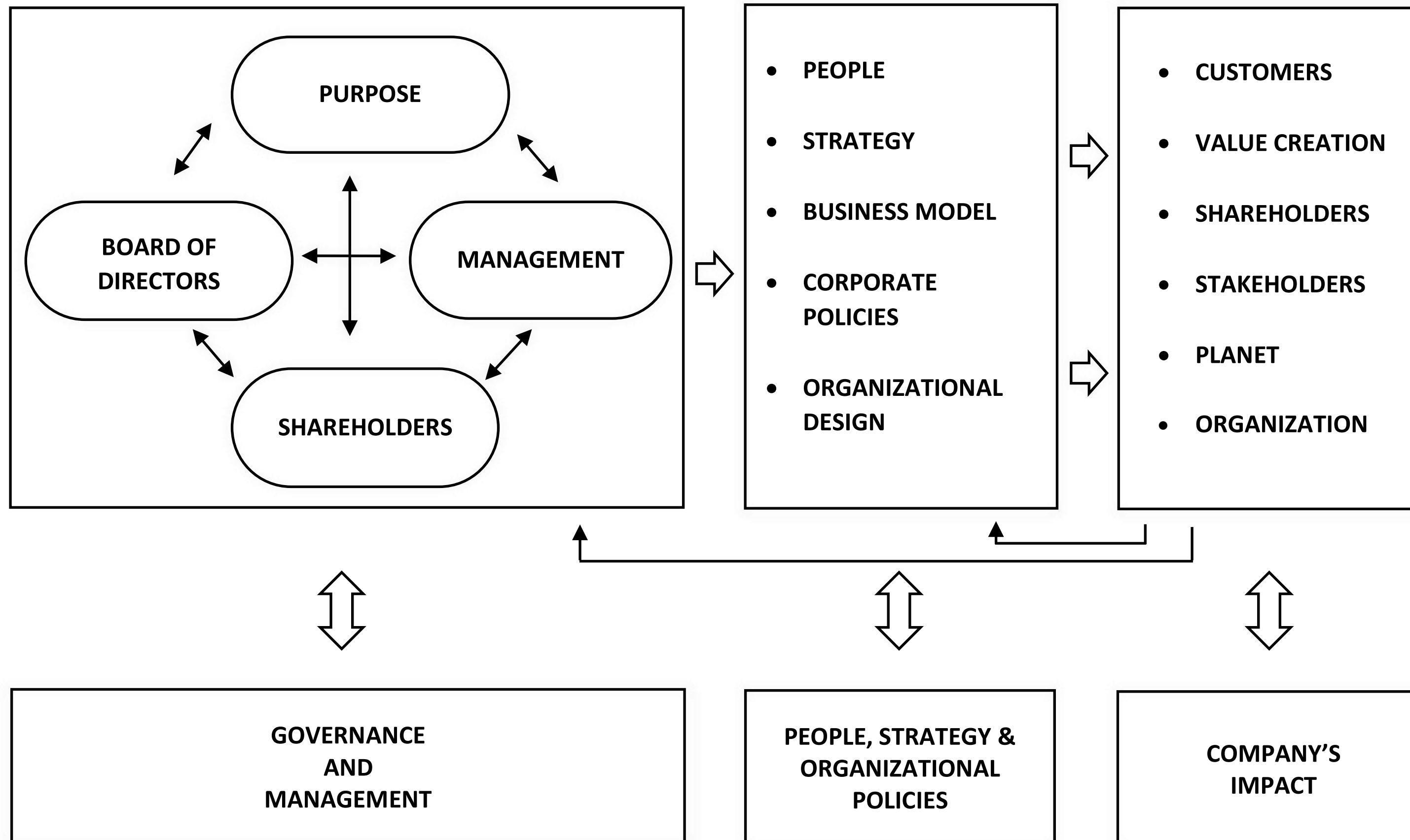
Indexes and rankings are useful but sometimes overlook relevant factors. Moreover, they do not consider the consistency of ESG policies with the firm's strategy and business model. They do not discuss whether the index is rich enough to capture all the factors relevant in the firm's performance, as well as their underlying causality relations. Some investors may narrow their focus to financial performance or simple indexes that offer a synthesis of other factors. But there are other investors who aspire to serve as good stewards of a firm. To this end, they should first gain a deep understanding of the firm, its strategy, its business model and how different dimensions of performance are connected with them.

Figure 5
The Firm's Impact on Stakeholders



With these relationships in mind and the understanding that performance entails a range of factors, the evidence from the companies discussed in this paper suggests several areas where firms should focus their performance assessments, all of them related with the key stakeholders (see Figure 5). The first is impact on customers: customer satisfaction, engagement, brand power and loyalty to the firm's products and services. The second is the firm's impact on people and employee development. The third area is the impact of the firm's policies on the organization itself: its learning, innovation and adaptability to change, among other dimensions. The fourth is the impact on shareholders, including both total financial returns as well as the quality of governance, stewardship and engagement. The fifth area is the impact on key stakeholders, including suppliers and the local communities where the company operates. The sixth area includes the company's environmental impact. This set of factors will connect with some of the E and S–environmental and social–dimensions in ESG.

Figure 6
Corporate Performance Assessment: A Holistic Framework



When the firm deploys its strategy and operations, its performance is not limited to its impact on external parties: customers, shareholders or the environment. The firm also has an internal impact through its decisions, policies and operations (see **Figure 7**). The board of directors should assess this impact as well. It is possible to distinguish several areas of internal impact on the firm itself. The first is on its own employees and their motivation, engagement, compensation and development, and the basic policies the firm has in place: compensation, development and learning, diversity, inclusiveness, and dimensions of the firm's culture such as collaboration, cross-functional learning or new opportunities. This set of indicators assesses how the learning occurs inside an organization, and how people also learn tacit knowledge about the way to do things.

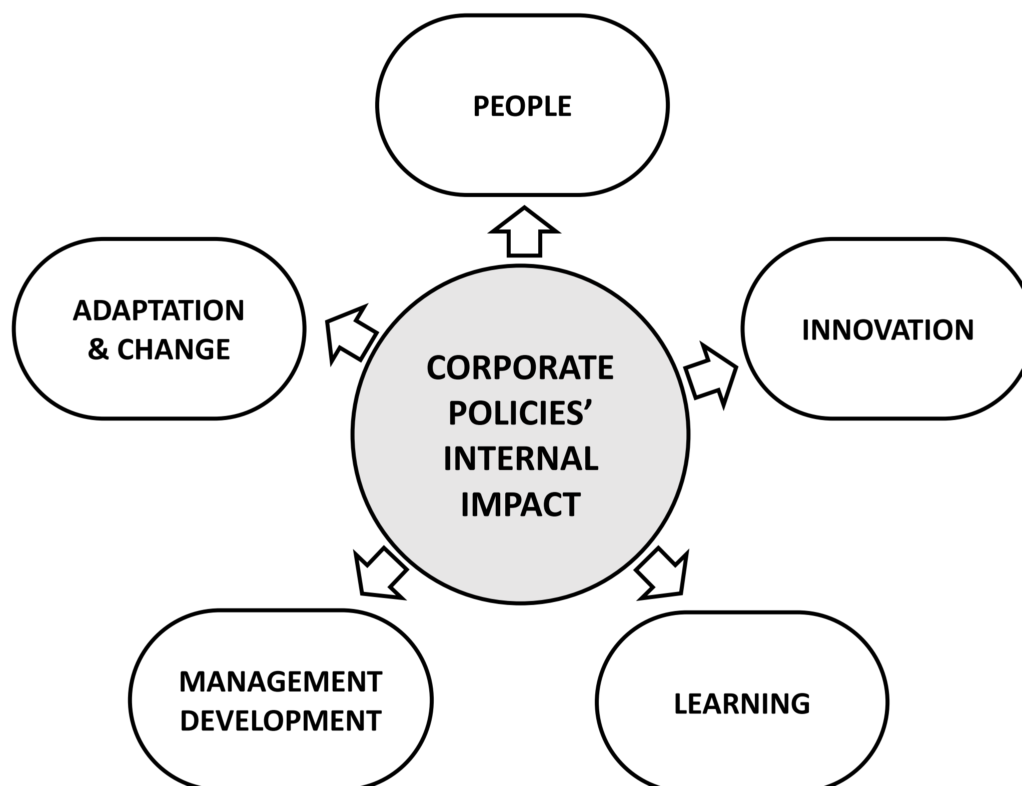
The second is the impact on the organization and its capability to innovate and develop new initiatives to expand the firm's scope and better serve customers. Innovation, new investments and new business ventures fall under this umbrella. The third is the organization's ability to learn from external and internal changes, and its own decisions, in particular, from wrong decisions and organizational mistakes.

The fourth is an assessment of leadership and management development. This is a complex dimension, but organizations that aspire to have a positive external impact also need to help their people grow. An indicator of success is the evolution of a richer and more diverse leadership pipeline. The fifth is the capacity to adapt and change in facing new challenges. This is particularly important in times of disruption. These challenges pose a risk for many companies, but also offer opportunities. When senior managers consider them as such, they can be a source of innovation and help their employees grow and develop.

Boards of directors should understand these interlocking relationships within the unique context of their companies and work with the CEO and senior managers on a specific performance assessment model. As illustrated by the experiences of Unilever, Schneider and Ingka, the board does not need to come up with a long list of indicators. Rather, they should focus on those that are truly relevant for both the nature of the company itself–including regulatory requirements– and the firm's explicit purpose.

In some cases, firms may want to highlight particular attributes or features in their notion of purpose, such as customer, people or environmental issues. Boards are free to expand the scope of these dimensions but need to connect them to the company's wider purpose and ensure they are tightly integrated into its strategy and business model.

Figure 7
The Firm's Impact on the Organization



5. Final Reflections

Assessing the firm's overall performance is a complex challenge. It should consider the diverse stakeholders to whom the firms and its board of directors are accountable. It also should entail an array of financial and non-financial dimensions, which are properly integrated to avoid long lists of disconnected factors.

The experience of companies like Unilever, Ingka, Nestlé and Schneider Electric in reporting their overall performance offers interesting insights and reflections for all companies. The first is that companies that care about their environmental and social impact should clearly define which fundamental areas they should emphasize beyond meeting regulatory standards and in accordance with their material importance for the firm's performance, P&L and balance sheet.

The second reflection is that boards of directors may want to be more ambitious in their objectives, by setting their sights over and above legal compliance. This was Unilever's tack when it defined targets aimed at enhancing the health and hygiene of millions of global consumers. In a similar vein, Schneider minimized its negative environmental impact on an accelerated timeline, as well as promoted solutions for customers' efforts to reduce their carbon footprint.

These experiences highlight the need for firms to wisely choose and closely monitor specific impacts that are material to their activity and highlight an essential element of their purpose. Boards should explain the criteria behind these themes and their connection with the firm's

overall strategy and business model. They should also make an effort to make sure that shareholders understand the framework and get them on board.

The third reflection is that companies need to consider the broader implications of their environmental and social impacts. These impacts can include a growth in revenues through innovation and premium prices, as well as positive and negative impacts on expenses and the firm's balance sheet, especially its capacity to raise equity or issue debt at lower costs due to a better environmental risk profile.

The fourth reflection is the need for the ESG goals and areas chosen by the board to be firmly integrated into the firm's purpose, strategy and business model. As the companies profiled in this chapter attest, there is clear evidence supporting the connection between ESG factors and value creation, which is an overarching responsibility for the board. This approach also shows that when companies consider different stakeholders in their decision making, this process helps in building stronger and sustainable economic value for all, shareholders included.

The board's assessment of the firm's performance should be approached as more than a mere fulfilment of their duties. It is indispensable to shed light on how economic and non-economic value is created through the company's policies and decisions, and the firm's potential to continue creating value sustainably in the future. This is an essential function of boards of directors and a key competence that they should develop.

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