G Padmanabhan: Corporate sustainability a panacea for growth – values, convictions and actions

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Introduction

1. Good morning to Dignitaries on the dais, members of faculty and my young friends in the audience. At the outset, my apologies for not being able to be physically present on this occasion on account of some personal exigencies. I am thankful to the organisers for having agreed to my thoughts being shared in absentia. Thanks to my colleague, Mr. C V George, General Manager and head of our Kochi office for readily agreeing to read out my address.

2. In the year 1938, Dr K. M. Munshi established Bharatiya Vidya Bhawan with the motto "Let noble thoughts come to us from every side". Bhawan's Royal Institute of Management with its aim of providing management education of international quality has seamlessly woven this motto of Bharatiya Vidya Bhawan into its very fabric. Congratulations and Best wishes to the Institute in its march towards greater heights and glory. It feels wonderful to be addressing a group of young management students and the faculty members. It takes me back down the memory lane when many years ago, I was a student like you though there is a world of difference the way we looked at the outside world then and now. There were no mobile phones, no Face book or Twitter, SMS was not in the dictionary and a mouse meant a rodent.

3. In a few months' time you all would be charting your own career paths some would join the main stream corporate sector; some may have their own start-ups, some of you could aspire to join the financial sector and even regulation. Going forward, your education here would equip and enrich you with enough knowledge and wisdom in the art of decision making.

Appropriateness and relevance of the topic

4. "Corporate sustainability a panacea for growth: values, convictions and actions"

You have chosen a very interesting topic, but it led me to think whether there is any panacea for growth? Some of you must be aware that in Greek mythology, Panacea was the goddess of Universal remedy. She was said to have a poultice or potion with which she healed the sick. Hence, the term is also used figuratively as something intended to completely solve a large, multi-faceted problem. Can corporate sustainability aid growth, create value and actions on environmental protection? The unequivocal answer is YES. But at the same time, level of development of the country, poverty etc. also needs to be factored in while calibrating the corporate sustainability action commands. Please remember that a company is an artificial person with perpetual existence. The society trusts it to exist for ever to serve posterity ad infinitum. The sustainability has therefore to balance the needs of the present with the needs of the future. Further, the shareholders constituting the company enjoy limited liability just because the society has undertaken unlimited liability. The sustainability also requires arrangements to balance the concerns of limited liability of the shareholders with the unlimited liability of the society, state and the public.

5. The World Commission on Environment and Development (WCED), known as the Brundtland Commission report defined the corporate sustainability as "Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs". The sustainable development is critically dependent on economic growth, environmental protection, and social equality. Poverty resolution, of course, proceeds in priority over all other actions.

6. It is, in fact, an alternative to the traditional growth and profit-maximisation model. While corporate sustainability recognizes that corporate growth and profitability are important, it also requires the corporation to pursue societal goals, specifically those relating to sustainable development – environmental protection, social justice and equity, and economic development.

7. The kind of changes that earlier took a century to happen are now seen within the span of a decade. Hence the concept of corporate sustainability is becoming increasingly vital.

The what and why of corporate sustainability

8. Sustainability is a basic commitment towards economic, environmental, social and governance performance – a strong message demonstrated to both internal and external stake holders. Taking Tobin's "Q" Theory as the proxy for firm value, a significantly positive relation between corporate sustainability and its market value is found. Moreover there is evidence to support that being sustainable causes a firm to increase its value. This is also proved by companies with remarkable sustainable development strategies and reporting which are more often viewed by investors as being safe and stable for higher growth with a higher valuation in market pricing mechanism by financial markets.

9. Corporate Sustainability adds the dimension of directionality to speed, converting it to the velocity required for long term success. It could be described as a business approach that creates long term shareholder value by embracing opportunities and managing risks deriving from economic, environmental and social scenarios.

10. It is based on two guiding principles:

- Sustainable business practices are critical to the creation of long-term shareholder value in an increasingly resource-constrained world
- Sustainability factors represent opportunities and risks that competitive companies must address

Amul, for instance, is one of the foremost examples of corporate sustainability in modern India. By working towards the welfare of the dairy farmers, bringing about the white revolution and turning India from a milk deficit to a milk surplus country, taking care of the nutrition needs of the country, it has managed to address the needs of several stakeholders and has also addressed the overarching goals of social justice and equity, and economic development.

Recent trends in corporate sustainability

- ***Transparency***

11. Just like technological change, transparency is an irreversible force. Reporting and disclosure will undoubtedly continue to grow, driven by ever-lower barriers to information access, higher public interest and regulatory changes. Already over 5,000 corporations disclose their Environmental, Social and Governance factors (ESG) performance on an annual basis, and this number is bound to grow.

- ***Trust***

12. The ever-growing impact of business on society indicates that citizens and consumers expect corporate power to be exerted responsibly. As people grow more skeptical, self-organised and prone to challenging authority, the corporate community will have to enhance efforts on building trust. This means being proactive and thorough in how a company views its responsibilities and impacts on society, and then showing how it manages operations accordingly.

13. I am sure all of you have heard of Dr. Ela Bhatt and SEWA. She took the element of trust and transparency in corporate accountability to another dimension when SEWA withdrew the entire supply of a snack from the market, even to the extent of trying to track each sold packet, because they had discovered that one of the ingredients had health hazards.

- ***Community participation***

14. Industry is expected to do more in areas that used to be the exclusive domain of the public sector – ranging from health and education, to community investment and environmental stewardship. Environmental issues are a good example of this blurred line. Natural resources are now recognised to be finite and under stress. What was once unthinkable is becoming reality: water and even air now come with price tags.

Companies that collaborate with scientists, civil society and public regulators and show early on that they "really care" and will thus stand out ahead of others.

- ***Accessing new markets responsibly***

15. With concepts like the Blue Ocean Strategy gaining ground and mere competition becoming out-moded businesses are moving from being "resource takers" to "market builders". With economic growth going global, foreign direct investment is becoming more about building and gaining access to new markets and less about simply exploiting low-cost inputs. Overcoming barriers to growth, such as civil violence, uneducated workforce and unsustainable sources of energy, water, minerals and soil is now an imperative in a manner that was never so before.

- ***Initiatives to engage companies***

16. Initiatives, standards and consultancies for engaging in corporate sustainability are booming at national and global levels. The UN Global Compact, a strategic policy initiative for businesses by the United Nations, is engaging "with over 12,000 companies in more than 145 countries on human rights, labour standards, environment and anti-corruption. In India too there is a growing awareness of the overarching responsibility of business which goes beyond mere profitability.

17. Corporations around the world are increasingly recognizing that sustained growth of their organisation requires cooperation of all stakeholders, which requires adherence to the best corporate governance practices. In this regard, the management needs to act as trustees and prevent asymmetry of benefits between various sections of stakeholders.

The four pillars of corporate sustainability

18. ***Sustainable development*** **–** Sustainable development is a broad, concept that balances the need for economic growth with environmental protection and social equity. It should not be left to government regulators and policy makers alone. While corporations have always been the engines for economic development, they need to be more proactive in balancing this drive with social equity and environmental protection, partly because they have been the cause of some of the unsustainable conditions, but also because they have access to the resources necessary to address the problems.

19. ***Corporate Social Responsibility (CSR)*** – CSR deals with the role of business in society. Its basic premise is that corporate managers have an ethical obligation to consider

and address the needs of society, not just to act solely in the interests of the shareholders or their own self-interest. In fact in the debate on CSR, what is usually in question is not whether corporate managers have an obligation to consider the needs of society, but *the extent to which* they should consider this need. CSR contributes to corporate sustainability by providing ethical arguments as to why corporate managers should work towards sustainable development. Voluntarism and empathy on the part of lead to the success of any CSR initiative. While the first pillar defines the vision of the organisation, CSR defines the ethics of the organisation. But, CSR is not synonymous with sustainability. It is giving back to society a part of what it has taken from the society. Depending on the context, it can on rare occasions contribute negatively to sustainability. India is the only country which has explicit legal provision prescribing CSR for companies above a threshold. The concept CSR has been evolving and changing very fast if one has to look at amendment in the schedule as well as rules relating to CSR over the last six months.

20. ***Stakeholder theory*** – The basic premise of stakeholder theory is that the stronger your relationships are with other external parties, the easier it will be to meet your corporate business objectives.

21. The crucial part for any organisation would be to identify all stakeholders, their needs and prioritise these needs. One of the methods that could be used for this purpose and has been found to be quite successful is the Balanced Scorecard Method, which integrates organisational goals and work flows with those of different groups of stakeholders. While the objectives and priorities of different stakeholders may vary, there is a general agreement on areas such as environmental protection, economic stability, across many stakeholder groups. Few groups would argue against these goals, although they may debate the level of priority or urgency.

22. The third pillar, therefore, defines the business objects of the organisation. As a strategic management concept it enables contact with all stakeholders and defines the nature of relationship between the corporate and the stakeholders.

23. The TATA group of companies has been working towards corporate sustainability and publishing reports for several years, with TATA steel taking the lead, since the year 2000–01. In the words of Cyrus Mistry, Chairman TATA Group, “Ultimately our very purpose is long-term stakeholder value creation”. Another company which merits attention is ITC Ltd. Their commercial model of moving over from being a cigarette company to a multi business conglomerate including agri business was a necessity on account not only because of high incidence of taxes on tobacco being levied by the Government but also due to the growing awareness among the general public towards the ill effects of smoking and the consequent move away from cigarettes. The company had to ensure that it survives – thus sustainability was the key – and to this end, they migrated towards edible oil production and marketing, with the thrust on sunflower oil. The farmers in Andhra were migrated from cultivating tobacco to growing sunflower. ITC established e-choupals (a success story of IT usage of the rural masses) which guided the farmers on production and marketing of sunflower seeds to their benefit. This resulted in overall growth for the farming community as well, in addition to the significant growth of ITC which has now been sustained for more than a decade, and at the same time, conforming broadly to the pillars outlined earlier.

24. ***Corporate accountability*** – The fourth and final concept underlying corporate sustainability is corporate accountability. Accountability is the legal or ethical responsibility to provide an account or reckoning of the actions for which one is held responsible. Accountability differs from responsibility in that the latter refers to one’s duty to act in a certain way, whereas accountability refers to one’s duty to explain, justify, or report on his or her actions.

25. I shall focus a little more on the fourth pillar- corporate accountability. Not just because as a banker accountability looms large in my mind but also because as ex-CAG, Vinod Rai stated, “Accountability cannot be regulated or relegated to the background in

pursuit of power. Every institution must be held accountable." The ever-growing impact of business on society means that citizens and consumers expect corporate power to be exerted responsibly and the corporate needs to show that this is so, which is where the concept of accountability comes in.

Explanation of corporate accountability

26. In the corporate world, there are many different accountability relationships, but the relevant one in the context of corporate sustainability is the relationship between corporate management and stakeholders. This relationship is an extension of the traditional fiduciary model, which in turn is based on agency theory and agency law, wherein corporate management is the "agent" and the stakeholders are the "principal". This relationship can be viewed as a contract in which the principal entrusts the agent with resources and the agent is responsible for using those resources in the principal's best interest. The agent is also held accountable by the principal for how those resources are used and the return on investment.

27. All of you must be following the latest news. It is full of stories of corporate "dis-accountability" (if I may coin a new word). So much so that judicial activism has taken on a new meaning in our country. In this environment some sterling corporates have set new benchmarks of corporate accountability. While the act of withdrawing cars from the market after discovering manufacturing defects by large corporates is laudable, such an act by a cash strapped organisation with a diverse and very poor and illiterate membership, like that of SEWA, with far lesser staying power, shows tremendous commitment towards accountability to stakeholders.

28. Companies enter into contracts (both explicit and implicit) with various stakeholder groups as a matter of everyday business and these contractual arrangements can serve as the basis for accountability relationships. For example, companies that receive environmental permits and approvals from regulators to operate facilities are often held accountable by the regulators for whether the terms of the approval are being met. Proponents of social contract theory suggest that corporations are given a "license to operate" by society in exchange for good behaviour, (read judicious utilisation of resources) and as such the corporations should be accountable to society for their performance.

29. The contribution of corporate accountability theory to corporate sustainability is that it helps define the nature of the relationship between corporate managers and the rest of society. It also sets out the arguments as to why companies should report on their environmental, social, and economic performance, not just financial performance. In 1997, John Elkington of the UK consultancy, Sustain Ability, called this type of accounting on environmental, social, and economic performance as "triple bottom line" reporting.

30. An example of this kind of "triple bottom line" reporting would be Infosys which voluntarily made all disclosures in the public domain leading to greater corporate accountability after the Satyam scam.

31. Let me talk about my own organisation for a while. While there is no prescription by any authority as regards balance sheet disclosures by the Reserve Bank of India, as a commitment towards transparency and building trust, our Annual Report (2013–14) has an entire chapter on the Central Bank's vision for the coming year.

32. The RBI is one of the few Central Banks across the globe which has taken upon itself the mandate for developmental banking- be it financial inclusion, training of bankers to render better customer service and not only providing reporting software to banks but also training on how to use these packages for best output. Apart from these, several initiatives have been taken by the RBI in improving transparency, be it administration of interest rates in commercial deals or reporting in balance sheets.

33. In addition to this the Bank has taken upon itself the corporate social responsibility of financial literacy and apart from its core functions, each major department of the Bank

undertakes different kinds of outreach activities towards building financial literacy in the country's populace – from Town Hall meetings to exhibitions and quiz competitions. The Banking Codes and Standards Board of India (BCSBI), is also an initiative of RBI towards accountability by the entire banking system, by preparing, developing, promoting and publishing comprehensive Codes and Standards for banks and for providing for fair treatment to their customers as also to function as an independent and autonomous body to monitor and ensure that the Codes and Standards adopted by banks are adhered to, in letter and spirit, while delivering services to their customers.

34. So far I have talked about the corporate sector in the general sense. Being a representative of the financial sector, that too, being a central banker, let me dwell a bit more about this sector. The financial sector is in a way different from the general corporate sector as the operation of balance sheet is different. An efficient financial sector is essential to a well-functioning economy. Therefore, it should serve in improving the efficiency of the economy as well as increasing its productivity. In other words, it should be a means to the real economy. According to Stiglitz, the financial sector has, in general, a very straightforward set of tasks: Firstly, it has to *allocate capital*, i.e. making sure that capital goes to areas where its return is highest. Secondly, it should *manage risks* in a way that, using the ability to absorb risk, it allows capital to go where higher return on investments can be made. Thirdly, it is also supposed to *perform these tasks efficiently* – therefore, at a relatively low cost.

35. It is now imperative to ask the question as to whether the laws of the financial markets work towards sustainable development. Or is there any conflict? Let me now try to address that:

36. Firstly, while sustainable development aims to increase the opportunities on a longer time horizon i.e., both present and future, the financial sector mainly strives for the short-term maximisation of financial profits and the return on investment. The pursuit of such a short-term objective goes against the basic tenets of sustainable development which aims at assessing the impact of today's decision making on the future generations. Where are the global banks of 80s and 90s today? Some of the large ones which survived are now facing reputational risk with questions being raised by investors and regulators on money laundering and absence of governance culture. One of the main reasons for this kind of behaviour is that investors can maximise financial return on their investment and may not directly be exposed to the consequences of their actions on the society or environment as a whole. Insider trading and colluding with corporate customers for short term profits on treasuries have down-sized many large financial conglomerates when the regulators catch up with their pace. For example, Investors in petroleum companies can gain attractive short-term returns from high oil prices. However, carbon emissions will have an impact on the long-term health of the economy as well as the environment. But what about the role of the large merchant bankers and financial institutions who invested in these companies?

37. Secondly, the indifference towards environment by the financial sector arises for two main reasons. First, as we have seen, it is only interested in the maximisation of financial profits through high turnover and does not have a real concern in the quality of its investments but so long as they are profitable investments. This means that there is no ethical consideration of investments, or no consideration of "bad" externalities in the calculation of financial profits. Further, accounting and reporting systems do not adequately convey potential environmental risks and therefore, financial markets are compelled to make decisions on exposures based on biased information.

38. Thirdly, though financial markets are supposed to help to manage risks and deal with uncertainty, it is also true that higher turnover and enlarging risks leads to higher profits. As a result, one may get attracted to short-term financial profits irrespective of the risks associated with it and its effects on the real economy and society can be completely ignored; for instance, in terms of job loss, company closures or systemic problems to the whole

economy like what happened after global financial crisis. Therefore unlike corporates, the financial sector is more prone to take higher risks.

39. Fourthly, this sector is characterised by a great deal of sophistication and specialisation and tests the players' abilities for making investment decisions in a very short time in a highly competitive environment. Furthermore, the highly complex financial instruments also add to the information asymmetry and participative and informed decision making.

How the international banking community is addressing the issue?

40. The international banking industry has increased focus on sustainable development and has concerns over potential environmental liability and damage to reputation. A bank could be held for the environmental degradation that occurred as a result of its lending practices. Banks are held responsible for the environmental impacts associated with projects for which they provided funding. American banks were reportedly the first to consider the implementation of environmental policies in relation to lender liability, including implementing some form of assessment of environmental factors before approving commercial loans. In fact, the Multilateral funding agencies such as the International Bank for Reconstruction and Development and the International Finance Corporation have also played a significant role in the development of social lending and investment guidelines by focussing on:

a) ***Development and integration of credit risk assessment tools:*** due to the potential liability issues associated with environmental risks, many large international banks have adopted lending practices which involve *screening credit applications based on environmental* criteria.

b) ***environmental reporting and management guidelines:*** many initiatives regarding environmental information and reporting requirements have been widely supported by this sector including the UNEP Financial Initiative, the Global Reporting Initiative (GRI) and more recently, the environmental management and reporting guidelines by the "Forge Group" in the UK.

c) ***Issue of climate change:*** Another driver that has influenced how the credit and lending sector responded to the issue of sustainable development has been that of climate change. Banks initial interest in climate change was prompted by a need to better understand the implications for credit risk in their own lending activities, that is, the extent to which companies' profitability and asset valuations would be negatively impacted and therefore impair their credit risks. However, there is limited evidence to show that lending terms have been tightened for companies exposed to carbon liabilities.

41. So, what is described in the "good governance" framework of a corporate as "effective and efficient" also covers the sustainable use of natural resources and the protection of the environment. However, for the financial sector, being ***effective and efficient*** means that it should serve the economy by increasing its efficiency and its productivity (hence its effectiveness). Therefore to include the sustainable development perspective into finance, the different aspects which would have to be considered are: (i) internalisation of externalities in the calculation of an investment (ii) assigning a long-term horizon to investments so as to safeguard the financial capital for the future; (iii) greater use of sustainability ratios, and (iv) a changing perspective on the connotation of financial profits.

Concluding remarks

42. For business, environmental, social and governance responsibilities are no longer add-ons. They are integral to success. While the great majority of companies have yet to commit to this trajectory, there is a strong upward growth curve in actively engaged companies, with a vanguard taking serious action in all key markets. Companies that have

been able to convert sustainability challenges into opportunities are the ones that are most likely to thrive.

43. The growing feeling is that corporate sustainability has drawn a line in the sand, and it's best for business to get on the right side.

44. I would like to conclude with a quote "What we possess is temporary, but what we become is permanent." (Devdutta Pattnaik)

45. The time has come for us to strive towards permanence!

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