# The „G“ in ESGRC: Sustainable and safe leadership

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The acronym ESGRC stands for Environmental, Social, Governance, Risk and Compliance. The „G“ for governance is the link between ESG and GRC and is therefore of particular importance.

Alongside regulation, governance, risk and compliance (GRC), digital transformation and artificial intelligence (AI), economic, social and environmental sustainability (ESG) is an important megatrend of the coming decades that will have a significant impact on the private lives of all people, but also on governments, public and private organisations and the fundamentally new world of work.

However, what „sustainable (ESG) leadership“ (governance) actually means and how this can be implemented effectively and efficiently is clearly regulated (compliance), but is still largely unknown. An integrated ESGRC management system helps to identify the requirements and derive risk-based measures to fulfil the requirements.

**So what does governance mean?**
There is no legal definition (yet). This paves the way for creative, good, bad, vague, useful and meaningless definitions from academia, various industries, consultants, standards and much more. Or, without defining „governance“, there is a lot of regulation on how governance should be practised. To a certain extent, this is problematic, especially as „governance“ is often seen as the most important issue for an organisation and its bodies.

From a compliance perspective („what is mandatory and what is voluntary?“), governance could be translated as the „principles of proper corporate leadership and supervision, including the interaction of the governing bodies“. Based on the principle of legality, the executive bodies must fulfil the obligations set out in comprehensive regulation and, where there is still room for discretion, ensure that their most important objectives are achieved by applying the Business Judgment Rule (BJR). In the case of management, this should generally be „sustainably securing the existence and increasing the value of the organisation“ (contrary to the message of various business administration classics, which still postulate „profit maximisation“ as the primary objective) [see Scherer/Fruth 2014, p. 207, with reference to the questionable „black zero“ for failure to make necessary investments].

The distinction between „governance“ and „management“ also appears difficult, especially as „management“ should not only be operational, but also strategic. Firstly, it must be clarified whether the monoistic („board“) or dualistic („management and supervisory body“) model is being analysed. In the latter case, the distinction could be seen in the roles, tasks, rights and duties of the various „bodies“ to be described: „governance“ focuses on shareholders, management, supervisory body and stakeholders, while „management“ focuses only on management.

Important topics that „governance“ must conscientiously address are presented below, albeit not exhaustively.

**Mission & vision[1]**
Companies are confronted with increasing crises, rising inflation, the risk of recession, deindustrialisation and geopolitical and economic upheaval, among other things. We should and must look for solutions and opportunities: Shaping the future sustainably instead of constantly managing crises!

**Risk-based management[2]**
At present, we only know one thing for sure: that nothing is certain. This makes it difficult for decision-makers to set appropriate goals, develop targeted strategies and make good business decisions [see Scherer 2012, pp. 201-211 and Scherer/Fruth 2014].

Misjudged situations before almost all of the crises of the last 15 years, with blaming others and banal excuses that they were all „black swans“, i.e. unforeseeable events, lead to disenchantment with politics and dwindling trust in our corporate leaders [see Scherer/Romeike/Gursky 2021, p. 159-165].

In practice, it is unanimously criticised that managers no longer dare to make confident decisions, which means that when tasks are delegated to managers, twice as many problems are often returned instead of a solution [see Scherer 2022, Chapter 2].

**Stakeholder orientation**
The first step is to determine the current situation using appropriate (!) analyses of the company, environment, materiality and stakeholders. Appropriate risk management methods, including (worst case) scenario analyses, should then be used to identify strengths and weaknesses, threats and opportunities (e.g. with the help of a SWOT analysis) [see Scherer/Romeike/Gursky 2021, p. 159-165].

The „prudent businessman“, board of directors, supervisory board, managing director, manager would still have to strengthen their „Achilles' heels“ in the areas of digitalisation and AI, regulatory and sustainability requirements, as well as dependence on too few real top performers.

**Responsibility and risks of liability[3]**
Many statutory provisions, which establish mandatory rules in all areas of entrepreneurial activity via individual case law with countless examples, require prudent businessman, board members, managing directors and supervisory boards to act „conscientiously“ (Sections 93, 116 AktG, 43 GmbHG, 347 HGB).

In line with the increasing regulatory requirements, the liability risks for managers are increasing enormously: the average settlement amounts of the 50 largest US liability court judgements in the period from 2014 to 2018 almost doubled from USD 28 million to USD 54 million [see Scherer 2022]. According to the UN Environment Programme, the number of climate lawsuits has also

more than doubled from 2017 (900) to 2022 (2,200). Litigation has been recognised as a „key mechanism in the fight against climate change“ [see beck aktuell 2023].

In addition to the management board, managing directors and supervisory board, employees are also partly responsible, especially in the case of delegated entrepreneurial duties to so-called „special representatives“. Recently, the Federal Fiscal Court ruled that a managing director who does not have the necessary competences for his office may not accept the office at all or must resign in order to avoid personal liability and condemned him [BFH, decision of 15 November 2022, case no. VII R 23 / 19].

Not only the Whistleblower Protection Act, but also numerous other regulations oblige organisations to set up complaint channels for various stakeholders (primarily employees, but also third parties) [see Scherer/Grötsch 2023].

Confidentiality must be guaranteed for whistleblowers. With increasing awareness and the realisation that there is no threat of sanctions for whistleblowing, concerned or dissatisfied people will provide more information in the future. The subsequent internal investigations or investigations into suspected cases will make compliance violations more transparent and may lead to sanctions, but - even more importantly - process improvements. For example, in summer 2023, the Federal Ministry for Economic Affairs and Climate Protection introduced a complaints office for cases of violations of the OECD Guidelines: The „National Contact Point for the OECD Guidelines for Multinational Enterprises (NCP)“.

**New regulation in the area of governance (corporate management) and sustainability (ESG)**

**Oversight**[4]

In the area of governance (corporate management), there have recently been a mass of new regulations. For example, the „OECD Guidelines for Sustainable Corporate Governance“ of June 2023 for multinational companies. The new „G 20 OECD Principles for Corporate Governance“ have been in place since September 2023.

The „German Corporate Governance Code (2022)“ requires large companies to ensure the „appropriateness and effectiveness“ of compliance, risk, internal control and auditing systems, particularly with regard to sustainability.

The large companies in turn pass this on to their business partners, including SMEs, by requiring various certificates or other evidence.

The new Section 1 of the Act on the Stabilisation and Restructuring of Companies (StaRUG, Gesetz über den Stabilisierungs- und Restrukturierungsrahmen für Unternehmen) stipulates that managing directors and board members of corporations are obliged to carry out continuous risk checks, business continuity management (BCM) and crisis management. It requires – as the Federal Court of Justice has done several times in the past – that decision-makers are aware of the economic and financial situation of their organisation at all times (!) and initiate appropriate measures if there are signs of a crisis. This provision applies not only to companies in crisis, but also to stable and healthy organisations [see Scherer/Grötsch/Fruth 2023].

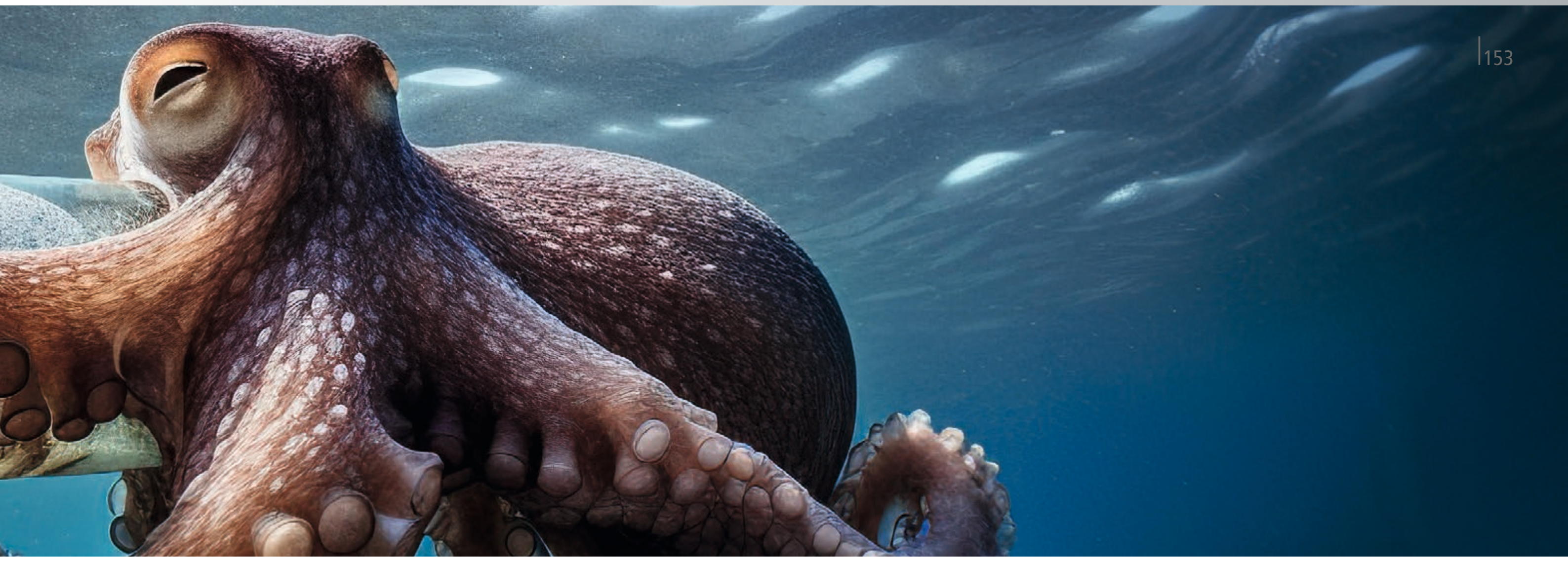
The Nuremberg Higher Regional Court (OLG Nuremberg, judgement of 30 March 2022, Ref. 124 1520 / 19) recently imposed the same requirements on a small company with fewer than 20 employees and sentenced its managing director personally to pay almost one million euros in damages for breaching this duty and failing to set up a compliance and internal control system.

Applicable worldwide, the International Organisation for Standardisation (ISO) has adopted standards for corporate governance, anti-corruption, whistle-blowing, compliance and risk management systems and is currently also developing standards for internal investigations, the UN’s 17 Sustainable Development Goals and ESG disclosure.

In the area of sustainability, the UN’s 17 Sustainable Development Goals are highly prominent at a global level and are also cited in most sustainability reports.

However, numerous new regulations at European level are also pushing organisations towards greater sustainability, in some cases with the threat of very high fines: for example, the EU Taxonomy Regulation, the Corporate Sustainability Reporting Directive (CSRD) with its European Sustainability Reporting Standards (ESRS), the Corporate Sustainability Due Diligence Directive (CSDDD), which will lead to the revision of the Supply Chain Due Diligence Act (LKSG, Lieferkettensorgfaltspflichtengesetz) and the draft directive to prevent greenwashing (Green Claims Directive).

However, this context also includes numerous highly relevant regulations in connection with the responsible handling of information, digitalisation and artificial intelligence, such as the Artificial Intelligence Act (AI Regulation) or the Digital Services Act and many more. In the area of IT and information security in particular, the regulation and liability responsibility of organisations is increas-



ing enormously. See ISO 38507: 2022 (Governance of IT), NIS-2 Directive and Implementation Act with liability responsibility of the bodies (Art. 20 NIS-2) and sanctions (Art. 34 NIS-2), DORA (Digital Operational Resilience Act) as well as TISAX (VDA-ISA) for suppliers in the automotive industry and much more.

As compliance (compliant behaviour) is the basis of entrepreneurial activity, it is essential to find your way through this jungle of standards and ensure that these requirements are observed. If organisations manage to become better and more resilient by fulfilling all these requirements, they do not represent bureaucracy, but „healing pressure".

**Data and Decisions**[5]

If the legal framework for corporate decisions and measures is defined by binding rules (compliance) – as shown above as an example for the area of governance and sustainability – there is no room for manoeuvre for management decisions [see Scherer 2019 with detailed commentary on the BGH ruling on HSH Nordbank, in which the BGH presented the principles of the business judgment rule (Section 93 (1) AktG) in textbook form].

The so-called „business judgement rule"[6] should always be considered when making business decisions with discretionary powers – including in the area of governance. If this method is observed, there is a liability privilege for entrepreneurial decisions: the decision-maker is not liable even in the event of failure.

The thoroughly rational rule is: obtain all relevant information for the question to be decided, evaluate it appropriately with risk management expertise and methodology and then decide in the interests of the organisation and the justified expectations of the stakeholders, free of selfish objectives, as unfortunately so often happens in practice.

Finally, the whole process must also be documented, as the burden of proof for adherence to this method lies with the decision-maker. Information and media skills, as well as basic knowledge of behavioural economics, are the basis for being able to think, decide and act in a legally compliant and target-oriented manner.

**Social Responsibility**[7]

In its paper „Future of Education and Skills 2030", the OECD listed critical and creative thinking, for example, among the cognitive skills required, a topic that is rarely found in teaching or further education plans and therefore also rarely in practice. According to the OECD, social skills will also remain indispensable in the future, as will the ability to use new technologies in a legally compliant and target-orientated manner. technologies in a legally compliant and targeted manner (keyword „AI compliance").

The UN sees Sustainable Development Goal No. 4, „Education for Sustainable Development", as an indispensable prerequisite for achieving zero poverty (1), zero hunger (2), etc. [Scherer/Grötsch 2022a].

**Strategy**[8]

In current sustainability reports, you can read which strategic goals are currently being derived by „prudent businessman" in the various sectors on the basis of a materiality analysis. At the top of the list of objectives is „sustainable livelihood", usually followed by „customer and stakeholder satisfaction" and „legally compliant organisation and compliance". Risk management and business continuity management (BCM) and „strategic personnel development / combating the shortage of skilled labour" with „new work" topics, as well as „ecological sustainability" are also included.

In line with the goal of „appropriate digitalisation using AI technologies", the topic of „IT and information security" is highly prominent almost everywhere.

Due to the almost impenetrable jungle of mandatory regulatory requirements at global, European and German level, the great art is to first get into the information flow of the requirements relevant to the respective organisation, to interpret or translate these requirements correctly, to separate the „wheat from the chaff" and to answer the question: „What is mandatory and what is optional?"

Finally, steps must also be taken to fulfil the numerous requirements in the minds and processes of the organisations in order to establish the „effectiveness" that is repeatedly tested by courts and auditors.

A key point in mastering this is the ability to recognise that there is often up to 70 percent overlap, redundancies or analogies in these countless requirements.

**Value creation**

It is clear that investments in digitalisation, sustainability, value creation processes, governance, risk and compliance initially cost money. How much, depends on the existing level of maturity of the governance structures.

**Sustainable livelihoods and resilience**[9]

No matter what it costs: These investments are indispensable, they strengthen the viability and resilience of the organisation and its employees, mean a sustainable increase in corporate value and future viability.

At the same time, these governance structures also fulfil the requirements of shareholders, investors, financiers, customers and other important stakeholders. The resulting structure and transparency of the organisation also provides financial relief.

And not to be underestimated for executive bodies and other managers is the new supreme court judgement of the Federal Court of Justice that corresponding compliance and control systems with whistleblower systems have a discharging effect if employees below management level commit breaches of duty.

Due to the shortage of skilled workers, many organisations are increasingly concentrating on their promising core business, pooling their human resources and trying to productively fill the gaps with the help of digitalisation and the use of artificial intelligence and continue to operate successfully by taking advantage of new opportunities.

***Note:*** *The article almost summarises the main theses from Scherer, J. [2023]: The formula for happiness and success [Die Formel für Glück und Erfolg]: ESGRC, 2023, summarised. Internet: https://www.risknet.de/elibrary/paper/die-formel-fuer-glueck-und-erfolg-esgrc/*

[1] *The headings in this text are taken from ISO 37000:2021, Governance of Organisations, chapter 6.1: Purpose*
[2] *ISO 37000: 2021, chapter 6.9: Risk Governance*
[3] *ISO 37000: 2021, chapter 6.5: Accountability*
[4] *ISO 37000: 2021, chapter 6.4: Oversight*
[5] *ISO 37000: 2021, chapter 6.8: Data and Decisions*
[6] *Current case law on the responsibility and liability of executive bodies for decisions with discretionary powers: BGH, judgement of 10.01.2023, ref. 6 StR 133 / 22 („Remuneration of VW works councils") and BGH, judgement of 10.02.2022, ref. 3 StR 329 / 21 („Liability of board members for breach of trust in the case of decisions with an inadequate information basis").*
[7] *ISO 37000: 2021, chapter 6.10: Social Responsibility*
[8] *ISO 37000: 2021, chapter 6.3: Strategy*
[9] *ISO 37000: 2021, chapter 6.11: Viability and Performance over time*

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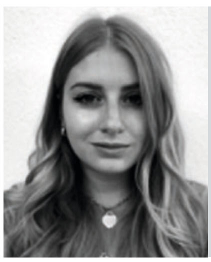


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