Translating Sustainability into a Language Your Board Understands

By Denise Kuprionis and Pamela Styles

Sustainability and ESG (Environment, Social Responsibility, Corporate Governance) are words that executives and directors use, but few can translate the words into a meaningful dialogue or a process that underpins how their company works. Yet, sustainability is essential to business and directors. As part of their fiduciary responsibility to enhance the company's long-term value, directors must pay attention to these issues. There is also a rising tide of investor support. For these reasons, increasing share value and listening to investors, proactive boards are adding a focused discussion around ESG/Sustainability to their 2017 board agendas.

Articles and studies on ESG abound. Subject advocates, researchers, sustainability officers, and consulting groups write about their work, but who's doing the reading? Do your eyes glaze over when you come across another story on sustainability? In the boardroom, do you discuss what ESG factors the company will disclose?

The following questions and answers are intended to help directors and those who support the board better understand ESG and lead the alignment between companies and stakeholders on ESG matters. The practical bias of this article reflects our decades of experience working with corporate boards, and our understanding of corporate secretary and investor relations priorities.

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What Are We Really Talking About?

Sustainability seems to mean something different to everyone. Understanding the alphabet soup of terminology and reporting frameworks is confusing and makes it easy to put a serious discussion on "tomorrow's" board agenda. Are we talking about social responsibility, climate change, carbon footprints, water, energy, customers, supply chain, risk, disclosure, GRI (Global Reporting Initiative), SASB (Sustainability Accounting Standards Board), IIRC (International Integrated Reporting Council), or CDP (Carbon Disclosure Project)? Although we could talk about any of these things individually, what's important is to talk about the

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big picture and for executives at your company to come together to have a unified conversation about what sustainability means for your businesses and the future of your company.

For a long time, directors seemed to think that "sustainability talk" meant diverting profit away from shareholders. In reality, "sustainability talk" looks at the long-term risks the company may face and at bottom-line results. Investors want to understand the risks that climate change could pose, the company's stance on social responsibility, and the energy and environmental opportunities for economic ROI.[1]

Talking about sustainability may generate a different perspective around your company's strategic planning, outperforming competition, retaining talent, and understanding how certain social and environmental concerns relate to the company's products and markets.

Do Investors Really Look at a Company's Sustainability Performance?

Do investors care? An article in PwC's October 2016 newsletter, *Governance Insight Center*, summed it up this way: "In today's economy, financial metrics tell only part of a company's value story; intangibles such as brand, talent, and customer reach are increasingly important factors in investment decisions. More and more, stakeholders are considering environmental, social and governance (ESG) factors when they evaluate a company's strategy, risk profile, and ultimately, its plan for creating long-term value."[2]

Financial metrics are, more or less, black and white, and understood equally among company officers and investors. ESG factors do not yet have common meanings or one universally accepted way to define or measure progress. There is a need for sustainability fundamentals, similar to financial fundamentals, and these measurements are developing.

The Global Reporting Initiative (GRI) is the sustainability field leader in voluntary ESG reporting.[3] Formed in 1997, it is an independent international organization that helps businesses, governments, and other organizations communicate on critical sustainability issues. GRI reporting guidelines address environmental practices and disclosure, social, and governance practices, and help businesses align sustainability disclosure with global standards; they are compatible with ISO 26000.[4]

The Sustainability Accounting Standards Board (SASB), formed in 2011, is working within the current financial regulation system used by the Financial Accounting Standards Board (FASB) to develop sustainability accounting standards that integrate into a company's Form 10-K. SASB is developing distinct provisional accounting standards for 79 industries in 11 sectors.[5]

Investors are increasingly asking about companies' sustainability policies and reporting. As GRI, SASB, and other metrics usage become more widespread, investors will more easily be able to compare one company's response to another's. However, regardless of what measurement stick a company uses, it is imperative that executives focus on issues and risks that may materially affect their businesses' economic, environmental and social future.

The early decades of the sustainability field were largely associated with investor activism. This still exists to a degree, but a much broader base of mainstream investors pays attention today. Although the Conference Board's Sustainability Practices 2016 report indicates that average shareholder support for resolutions asking US companies to disclose climate change risks rose by 10 percentage points to 26 percent in 2016 from 16 percent in 2015[6] *(see ICCR's list of 2016 climate change proposals*[7]), it is equally important to understand that such activism is being dwarfed by a rapid increase in mainstream investor attention to sustainability. As of the latest US SIF report, out of the total $40 trillion assets under management (AUM) in the U.S., $8.72 trillion AUM or 22 percent—$1 out of every $5 AUM—includes sustainability in investment decision-making. Out of that there is a 70:30 percent split. The report shows $2.56 trillion (30 percent) tend toward shareholder resolutions, which suggests the vast majority of ESG-focused AUM are effectively "mainstream" investors using sustainability to strengthen their investment analysis.[8]

How Can ESG/Sustainability Disclosure Be Used to Competitive Advantage?

Companies are increasingly highlighting sustainability efforts. As of 2015, 81 percent of the S&P500 companies published sustainability reports, compared with less than 20 percent reporting as of 2011.[9]

Today's heightened interest in resource scarcity, climate change, and population growth requires businesses to think differently about their products. "ESG performance is increasingly a consideration for people when they are deciding on whether to buy a company's products or go to work for a particular company. Price and functionality, or pay and benefits, usually trump other considerations."[10]

"We continue to see very clear demonstrations of the U.S. corporate community's embracement of Sustainability reporting. Measuring, managing, and reporting on ESG—Environmental, Social, and Corporate Governance issues has been established as a mainstream practice in both the corporate and investment communities."

What Should Directors Be Asking?

Most days, news headlines will include a story on sustainability, climate change, water scarcity, or social instability. Perhaps that's why "Sustainability issues are now top of mind for many CEOs. In fact, chief executives now rank 'Sustainability' among their top five challenges, according to the 2016 Conference Board CEO Challenge, an annual survey of business leaders' most pressing concerns."[11]

For those still avoiding the subject, there is growing discussion that it may be time to reframe sustainability as a possible antidote to decades-long frustration with investor "short-termism."[12] Directors are already tasked with long-term value creation for shareholders; sustainability is a natural extension.

Boards must ensure that their management teams are embracing meaningful discussion around determining sustainability risks that are significant to the company's long-term financial future. If sustainability is not already on the board agenda, the first question to ask is, why not?

Questions Directors Should Be Asking:

- Where does our company stand in its sustainability program efforts compared to peers?
- Has our company carefully considered GRI, SASB, or IIRC's measurement work?
- How do outsiders view our company's sustainability discussion and disclosure?
- Do we effectively communicate the rational for our choices to stakeholders?
- How should we prepare for investor inquiry or proactively present to investors?
- How can we reach higher competitively by encouraging robust collaboration between sustainability and IR program strategies for ESG/sustainability positioning?

What Does a Board Oversight Structure for Sustainability Look Like?

The first step is for directors to formalize sustainability as a board priority. It could be highlighted in the board's governance guidelines, be included as a board goal, or be itemized on its annualized governance calendar. This is important because investors are increasingly focused on board oversight of ESG/Sustainability,[13] and proxy advisory firms are increasing their focus, as evidenced by the January 2017 acquisition of leading ESG research and data provider IW Financial by ISS.[14]

Directors should determine whether oversight of sustainability matters is better brought to a board committee before reaching the full board and, if so, reflect this responsibility in the committee charter.

Public frustration with a company's sustainability efforts and disclosure often originate from a lack of clear board oversight or a lack of a designated company spokesperson. Internal silos contribute to the frustration. Many of the company's operating and administrative departments must be at the table for sustainability discussions to take place; including, investor relations, legal, operating heads, risk management, and the corporate secretary, and someone must be the designated leader and the board's primary information source. This leader must have a clear understanding of the company's sustainability plans, progress, and reporting disclosures.

Directors must set the tone and disclose the board's role in prioritizing Sustainability—if the board wants to capture opportunities. Adding a C-suite level position or Chief Sustainability Officer would convey an even higher level commitment.[15] Such a position can facilitate coordinated board and management's focus on company-specific material issues, agreement on the risk factors that impact the business, and incorporate sustainability measures into long-term planning, and coordinated public communications.[16]

What Areas of ESG/Sustainability Will See Most Attention in the Near Term?

Recent political election results in the United States have spawned myriad publicized myths and beliefs related to ESG/Sustainability. We need to talk about this to help you cut through the noise.

Many (but not all) believe that the rapidly maturing sustainability field is past the tipping-point,[17] where democratic change of political administration in any country can significantly deter its continuing growth and mainstreaming. It has been 20 years since the beginning of voluntary ESG/Sustainability disclosure and establishment of leading organizations. The field has subsequently grown in acceptance and adapted through many changes in public policy.

When we put aside two contentious macro-level debates—the big elephants in the room, "climate change" and "global warming"—there is a lot of room for agreement and constructive participation for everyone.

Although debates may come to an impasse over such questions as: if, when, why, who, how soon, how much, or how fast, boards must strive to move past these queries. The reality is that there are real near-term ESG/Sustainability-related concerns and opportunities for companies and stakeholders to constructively direct their attention. The debates on timing and degree of climate change or global warming will continue, but boards must start taking action now.

With change comes opportunity. Potential policy sea changes and regulatory reductions emanating from Washington, may provide US companies sufficient regulatory relief[18] so their boards and leadership teams can have the luxury of constructively addressing ESG/Sustainability to their fiduciary benefit. The changes may allow companies to shift from defense to offense. Opportunities may include:

- Pro-actively using elements of ESG to compete for capital and commercial enterprise,
- Bridging existing sustainability program successes into an impactful IR program strategy,
- Leading with related board policy, practice and public positions, and
- Fostering stakeholders' trust and support of the board by association to risk mitigation.

What Are My Next Steps as a Director?

Ask, "How prepared is my company to respond to increased sustainability expectations from investors, customers and employees?" Be prepared to do seven things:

(1) Add sustainability discussions to the board agenda.

(2) Focus on what sustainability means for the company.

(3) Ask for briefs on industry developments, both in substance and in governance.

(4) Engage with the company's chief sustainability officer and investor relations officer.

(5) Establish an effective board oversight approach.

(6) Look for balanced perspectives among differing constituencies and stakeholders.

(7) Consider the appropriate sustainability disclosures for the company.

Final Word

We hope you have gained valuable perspective in reading this article. Sustainability is becoming "mainstream" and we encourage directors to look at it with anticipation, not trepidation. It is providing a new lens to myriad strategic and competitive positioning opportunities.

Notes

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