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Translating Sustainability Into a Language Your Board Understands

Proactive directors are adding a focused discussion on ESG and sustainability goals to their board agendas. By Denise Kuprionis and Pamela Styles

Sustainability and environmental, social, and governance (ESG) are terms that many directors and executives use, but few can incorporate them into a meaningful dialogue or explain the relevant process that underpins how their company works. Yet sustainability is essential to the business and to 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, proactive directors are adding a focused discussion of ESG and sustainability to their 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 more wisely lead the alignment between the company and its stakeholders on ESG matters. The practical bias of this article reflects the authors' decades of experience working with boards and understanding of corporate secretary and investor relations priorities.

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, which makes it easy to delay putting a serious discussion on the board's agenda. Are we talking about social responsibility, climate change, carbon footprints, water, energy, customers, supply chain, risk, or disclosure? About Global Reporting Initiative (GRI), Sustainability Accounting Standards Board (SASB), International Integrated Reporting Council (IIRC), or Carbon Disclosure Project (CDP)? While we could talk about any of these things individually, what's important for boards is to see the big picture, and for executives at your company to come together to have a conversation about what sustainability means for your business and the future of your company.

For a long time, directors seemed to think that discussing sustainability 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 return on investment.

Talking about sustainability may lead to a different perspective of your company's strategic planning, an opportunity to outperform the competition, the retention of talent, and an understanding of 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 they care? PwC's report, *ESG Pulse 2016*, 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 ESG factors when they evaluate a company's strategy, risk profile, and ultimately, its plan for creating long-term value."

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.

GRI is the sustainability field leader in voluntary ESG reporting. Formed in 1997, it is an independent international organization that helps businesses, governments, and other entities communicate critical sustainability issues. GRI reporting guidelines address environmental practices and disclosures, and social and governance practices, and help businesses align sustainability disclosure with global standards. These guidelines are compatible with the International Standardization Organization's standard 26000.

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

Investors are increasingly asking about companies' sustainability policies and reporting. As GRI, SASB, and the use of other metrics become more widespread, investors will be able to compare one company's response to another's more easily. However, regardless of what measurement standards a company uses, it is imperative that directors and executives focus on the issues and risks that may materially affect their company's 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. The Conference Board's 2016 Sustainability Practices report indicates that average shareholder support for resolutions asking U.S. companies to disclose climate change risks increased by 10 percentage points to 26 percent in 2016. However, it is important to understand that such activism is being dwarfed by a rapid increase in mainstream investor attention to sustainability.

According to the latest report from US SIF, out of the total $40 trillion of assets under management in the United States, $8.72 trillion, or 22 percent, includes sustainability in investment decision making. That represents $1 out of every $5 in assets under management. The report also shows that $2.56 tril-

Questions directors should ask

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

What are my next steps as a member of the board?

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.

lion (30%) tends toward shareholder resolutions, which suggests that the vast majority of ESG-focused assets under management are by effectively "mainstream" investors simply using sustainability to strengthen their investment analysis.

A Competitive Advantage

Companies are increasingly highlighting sustainability as a competitive advantage. As of 2015, 81 percent of S&P 500 companies published sustainability reports, compared with less than 20 percent doing so in 2011. 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," according to "Sustainability Disclosure: Getting Ahead of the Curve," a report published by Deloitte & Touche.

"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," noted Louis D. Coppola, executive vice president of the Governance & Accountability Institute.

What Should Directors Be Asking?

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

For those still avoiding the subject, there is growing sentiment that it may be time to reframe sustainability as an antidote to decades-long frustration with investor short-termism. Directors are already tasked with long-term value creation for shareholders. Sustainability is a natural extension of those efforts.

Boards must ensure that management embraces meaningful discussion about sustainability risks that are significant to the company's long-term financial future. If sustainability is not already on the board agenda, it is up to boards to demand to know why.

An Oversight Structure

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

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Public frustration with a company's sustainability efforts and disclosures 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 individual must have a clear understanding of the company's sustainability plans, progress, and reporting disclosures.

If the board is serious about capturing opportunities presented by sustainability efforts, directors must set the tone and disclose the board's role in prioritizing sustainability. Adding a C-suite level position or chief sustainability officer would convey an even higher-level commitment. This individual could facilitate coordinated focus between the board and management on company-specific material issues and agreement on the risks that impact the business, and incorporate sustainability measures into long-term planning and coordinated public communications.

Making Sense of the Noise

The recent presidential election results in the United States have spawned myriad publicized myths and beliefs related to ESG and 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, where democratic change of the political administration in any country can significantly deter its growth and mainstreaming. It has been 20 years since the inception of voluntary ESG and sustainability disclosure and the 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.

While debates may come to an impasse over if, when, why, who, how soon, how much, how fast, and other logistical challenges, boards must strive to move past these queries. The reality is there are real near-term ESG and sustainability-related concerns and opportunities for companies and stakeholders to constructively direct to their attention. The debates over the timing and degree of climate change and global warming will continue, but boards must either start or continue to take action now.

With change comes opportunity. Potential policy changes and regulatory reductions emanating from Washington may provide U.S. companies sufficient regulatory relief so that their boards and leadership teams have the luxury of constructively addressing the fiduciary benefits of ESG and sustainability. The changes may allow companies to shift from defense to offense. Opportunities may include:

- Proactive use of elements of ESG to compete for capital and enterprise;
- Bridging existing sustainability program successes into a meaningful investor relations program strategy;
- Leading with related board policy, practice, and public positions; and
- Fostering stakeholders' trust and support of your board's decisions by association to risk mitigation.

The Final Word

Sustainability is becoming mainstream, and we encourage directors to look at it with anticipation instead of trepidation. It provides a new lens to myriad strategic and competitive positioning opportunities.

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