Building momentum for sustainability in the boardroom

This new decade for businesses will be defined by leaders who can balance financial gains with sustainable actions. How can companies make the shift?

CEOs and boards face unique responsibilities, challenges, and opportunities when managing a company's affairs while simultaneously meeting the appropriate interests of its shareholders and stakeholders. In an era of rising climate change risk and increasing demand from consumers and investors for better environmental, social, and governance (ESG) practices, CEOs and boards are also responsible for understanding the potential impact and related risks of ESG issues on the organization's operating model. More than 80% of global consumers today feel strongly that companies should help improve the environment as part of their business model.[1] And more than 70% of employees say they are more likely to work for a company with a strong environmental agenda.[2] Environmental issues are crucial to many employees and consumers but, of course, are only part of the larger group of ESG considerations. Shareholders are also demonstrating a preference for sustainably focused businesses, with one recent survey of global investing firms showing ESG issues are "almost universally top of mind" among executives.[3]

If we look at the COVID-19 pandemic as an example of a high-impact event, it is clear how quickly economies and businesses can shift from business as usual to imminent chaos. Companies will be put in the spotlight, and their stakeholders will analyze what their response is, how fast they react, and what the impact of their actions are long term on employees, customers, and society as well as on their financial performance. In response to the COVID-19 pandemic, companies in many countries took the lead to ensure the well-being of their employees in different ways, from expanding their flexible work policies (including work from home), covering sick-pay costs for non-permanent employees, running internal communication campaigns, modifying and restricting travel, and canceling events.[4] Companies that have embedded sustainable policies will typically be able to navigate severe disruptions such as this better and faster than others are able to, and will do so in a coordinated way that supports their overall purpose.

Twenty-first-century CEOs and boards are being pushed to demonstrate a positive impact on the environment, their employees, and the communities they serve as part of their business strategy—or risk being seen as wildly out of touch. This is forcing boards and executives to take a more strategic and substantive approach to ESG.

1 Nielsen, "Global consumers seek companies that care about environmental issues," November 9, 2018, nielsen.com.
2 Adele Peters, "Most millennials would take a pay cut to work at an environmentally responsible company," *Fast Company*, February 14, 2019.
3 Robert G. Eccles and Svetlana Klimenko, "The investor revolution," *Harvard Business Review*, May–June 2019, hbr.org.
4 Willis Towers Watson, "North American companies take steps to protect employees from coronavirus epidemic," press release, March 5, 2020, willistowerswatson.com.

Setting a standard

Consider Paul Polman, the legendary former CEO of Unilever, who made sustainable business practices the foundation of his leadership strategy. When the company was faced with a hostile takeover—with good commercial logic—Polman believed that the dynamics would destroy Unilever's unique culture and way of doing business, so the potential merger tested Polman's commitment to responsible capitalism. Polman fought off the takeover and established a legacy as a CEO who puts long-term principles before short-term profits. He also showed that it is a strategy that can pay off: two years after the takeover attempt, Unilever's stock price had climbed from roughly $40 per share to more than $60 (as of September 2019). The company's commitment to ESG issues has permeated different areas of sustainability, including diversity and inclusion. As part of Unilever's iconic Sustainable Living Plan, launched in 2009, the company committed to building a gender-balanced company and set a target of 50% women in management positions by 2020.[5] As of March 2020, it had reached its target, with half of its 14,000 manager positions globally filled by women.[6]

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Why progress is slow

Polman's success offers leaders a road map for how to make sustainability a value proposition that defines their strategy and drives business results. However, the fact that his story is still the exception suggests that most executives and board members are still not doing enough to transform their business models or to invest in the ESG practices that stakeholders are clamoring for. Indeed, this is clearly proved by the extent of attention that new environmental pledges from companies such as Microsoft and BlackRock have received, both on social media and in the traditional press, and indicates that companies having clear, bold sustainable goals is not yet the new normal.

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5 Unilever, "Advancing diversity & inclusion," unilever.com.
6 Thomas Buckley, "Unilever reaches gender balance across management team of 14,000," Bloomberg, March 2, 2020, bloomberg.com.

It's not surprising that CEOs and board members are struggling with the transition. Evolving from a model that measures success based on profits alone to one that tracks environmental, social, and human impact as measures of business value is no small feat. Executives and boards need to reinvent their business strategies and find ways to balance environmental and social impact measures with financial outcomes.

For board members, whose role is generally oversight and guidance, this can require a cultural shift. In the early days of such a transformation, they may need to take a more active role in defining strategy, identifying project opportunities, and having potentially difficult conversations with senior executives who are failing to evolve. This may require a new set of skills and greater collaboration between boards and the executives they serve.

Another central challenge is a lack of consistent metrics to demonstrate sustainable progress. Several nonprofits have been developing tools to measure ESG impact. Sustainable investment funds monitor ESG criteria as a measure of success, while credit agencies are threatening a ratings downgrade if companies don't address green risks.[7] Beyond that, new regulations are requiring companies to track and report on nonfinancial metrics, including the EU nonfinancial reporting directive (NFRD) and a plethora of regulations that require companies to diversify their boards. But, in spite of all these sticks and carrots, few standard metrics have been globally embraced. This has made many board leaders hesitant to set bold environmental goals or to make declarations of accomplishment, for fear of being called out for "greenwashing."[8]

In some cases, these accusations have been justified; there are several examples of global companies making shamelessly fraudulent claims to boost their sustainable profile. And even when organizations take genuine steps to have a positive impact, they can face accusations from competitors questioning their authenticity—even when those accusations turn out to be unfounded. Such battles for the attention of the public highlight the importance of environmental issues to corporate reputation today and the difficulty of instilling progress deeply into the way companies function.

The lack of standard metrics can make any claims risky—and unfamiliar to boards used to clearly defined accounting standards—but in today's business context, this is not justification not to try. As long as CEOs and boards define their measurement strategies from the outset, are transparent with stakeholders about what they are doing and how they will measure results, and have those results audited by a trustworthy third party, these claims can be validated. Even if a company fails to meet its goals, honest admissions of trying can still win approval from skeptical stakeholders because it demonstrates authenticity and the ability to discuss the progress they've made and what they are going to try next.

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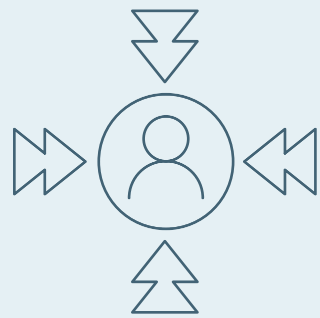
7 Billy Nauman and Anna Gross, "Credit rating agencies focus on rising green risks," *Financial Times*, November 26, 2019, ft.com.

8 Bruce Watson, "The troubling evolution of corporate greenwashing," *The Guardian*, August 20, 2016, theguardian.com.

Five steps toward strategic sustainability

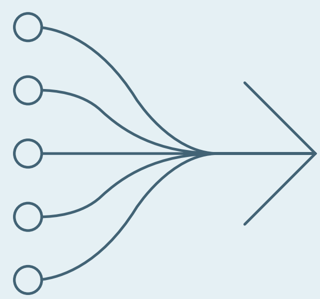
None of this will be easy, and all of it will require executives and board members who are committed to change and willing to defend their goals to wary stakeholders. With the right talent and commitment in place, the following five steps can put an organization on the path to a more sustainable future:

01 Bring in new leaders with experience in sustainability



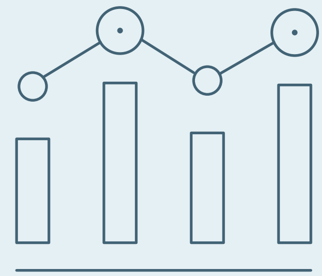
If organizations don't have sufficient experience or commitment on their current teams (and most don't), they should consider adding board members and executives from other fields who have experience in sustainable business practices and can educate other board members and executives on the best path forward.

02 Align sustainability goals with purpose, strategy, and the business model



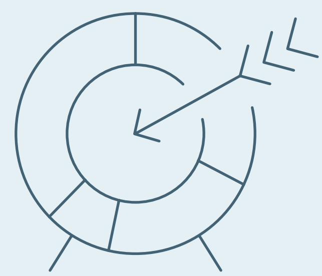
Good governance is anchored in an "organizational sense of self." Why do we exist? What unique purpose do we serve? Does this purpose fuel our strategy? Our business model? Then, what sustainability factors are most important to creating long-term financial and nonfinancial value in the business and the communities we serve? One global beer maker is focused on reducing water use and investing in local watersheds, which makes sense, as its primary products are 95% water. A global electronics manufacturer focuses its sustainability goals on landfill diversion and creating more energy-efficient products. ESG materiality should be constantly reviewed. Finally, urgent problems that stem from atmospheric greenhouse gases and global income inequality must be addressed. Reduction of atmospheric carbon and increasing boardroom and workforce diversity are two critical "E" and "S" goals material to all organizations.

03 Find the link between sustainability efforts and fiscal results



As with any business investment, ESG projects have to deliver measurable value—otherwise, it's just philanthropy. Common value propositions can include increased revenue streams from new sustainable products, cost savings from waste reduction, increased employee engagement, continued access to natural resources, or increased customer loyalty. Once a company links sustainable actions to its business model, identifies key performance indicators, sets deadlines, and reports goals and results to shareholders, it will be able to see the connection between sustainable investments and business outcomes.

04 Set realistic, attainable goals



It is tempting to set big attention-getting goals, such as cutting emissions by 20%. But unless that number is based on careful calculation—and a business plan with milestones, resources, and key performance indicators—businesses can set themselves up for a greenwashing backlash.

05 Report and communicate your ESG assessment results

Several global organizations, including the Global Reporting Initiative (GRI), Sustainability Accounting Standards Board (SASB), and Task Force on Climate-Related Financial Disclosures (TCFD), have developed reporting standards for environmental and social impact efforts. By disclosing their ESG results, executives and boards can demonstrate their commitment to the cause, help shape the future of reporting, and ensure their sustainability efforts will meet or exceed future reporting baselines.

Creating a sustainable business model is not a passing trend. Our evolving response to the COVID-19 pandemic confirms that our responsibility to the larger community in which an organization operates has never been more important. Companies and leaders who embed sustainability principles and factors into their strategies and business can create a legacy that could last for generations. Those who refuse to change, or who adopt these principles only as a passing trend, risk losing market share and damaging their own tenure. The time has come to decide which kind of leader you want to be.

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