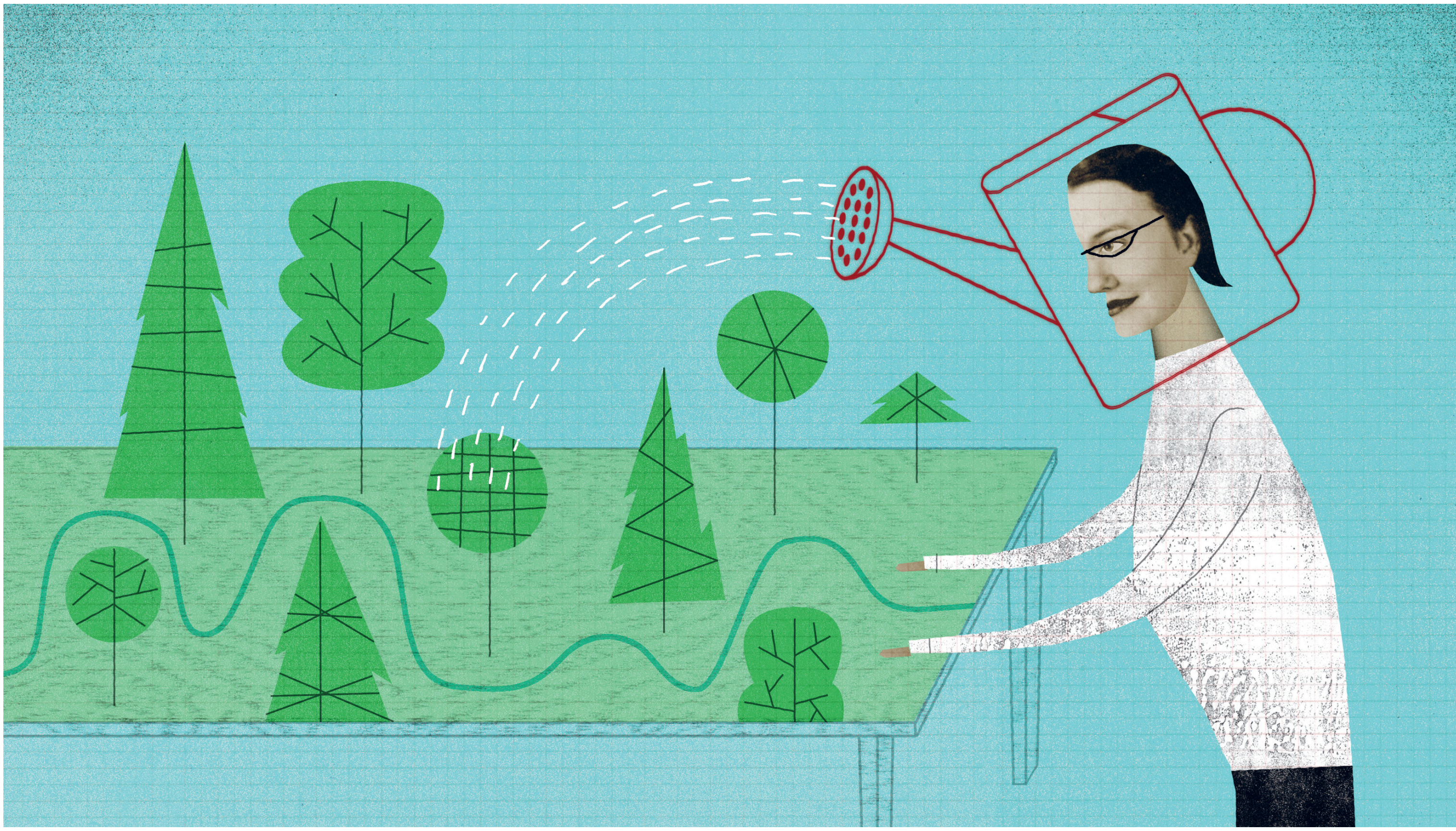

DIRECTORS Learn Their ESGs

Brunswick's **MARIA FIGUEROA KÜPÇÜ** talks to Professor **TENSIE WHELAN,** Director of the Center for Sustainable Business at NYU's Stern School of Business, about the need to reshape corporate leadership for the future.

Many corporations have been vocal in recent years about their commitment to environmental, social and governance concerns, taking them as seriously as they do financial returns. But attempts to measure and account for that commitment have been scattershot. The boardroom in particular has remained something of a black box on these issues. Even there, however, growing pressure on ESG has spilled into headlines, notably with recent actions against oil and gas companies.

Research by NYU's Stern School of Business in January 2021 attempted to shine a light into that boardroom black box. It found that expertise on ESG matters critical to businesses remains sorely lacking among their board directors. Looking at the résumés of over 1,100 board members of Fortune 100 companies, it found less than a third had any relevant experience in ESG. When isolating aspects of ESG most impactful for particular companies, the percentage of board members with relevant experience dwindled to single digits.

Tensie Whelan was the author of that report. She is the Director of the Center for Sustainable Business at New York University's Stern School of Business and the author of a steady drumbeat of research and professional insights into ESG concerns, particularly climate change. Whelan is the former President of the Rainforest Alliance and has served on numerous advisory boards both for

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nonprofits and corporations. She previously served on advisory boards with Unilever and Nespresso and currently serves on the advisory boards of ALO Advisors, Buzz on Earth, Giant Ventures, Arabesque and Inherent Group.

Tensie spoke about her view of the current ESG landscape with Brunswick Partner Maria Figueroa Küpçü, who leads the firm's US Business and Society practice and is Head of its New York office. While the discussion focused on the critical role of boards, it included insights into corporate leadership on ESG in general and how ongoing pressure from investors to meet short-term financial predictions continues to weigh on the progress toward more sustainable business practices.

What's different about this moment and ESG?
One of the things about transformational change is that when you're in it, you can't really tell that it's happening. That's true throughout history. So we see these different drivers, but we don't know if this moment is different or not. This time, it feels different.

While many have been talking for many years about climate change and diversity and racism issues and the need for companies to work with their stakeholders in a value creation way, it hasn't been seen as existential or mandatory. Today, it's becoming very hard to say this is a nice-to-have, not a must-have, when climate change is very clearly affecting business and people in all different ways, when governments are saying they're going to go net zero by 2050 and that's going to mean massive regulatory changes. It's very difficult to do that when, in this country at least, the kind of preponderance of evidence around racism and unconscious or implicit bias in business is becoming clearer and clearer.

I would say another major driver is the lack of government leadership. In the past, business could say, "Well, that's government's responsibility to tackle some of these issues." But today many big businesses have more money than small countries and more influence than medium-sized countries in certain ways. Increasingly too, the transparency of what businesses are doing is something that customers can see very easily and hold them account to.

These different trends are coming together to create not a moment but actually a massive shift, a paradigm shift.

What are some of the pressure points that you think companies should be watching more carefully?
There are several levers. Increasingly, investors are saying, "We need to understand how you're performing on these issues to include in our assessment of you," whether it's to establish your creditworthiness, or for private or public equity investments. CFOs, who need to talk to those investors, are noticing that the ESG reports developed by their sustainability folks are not necessarily as robust as they should be. We also saw the SEC put forward an ESG risk alert—they're going to start paying much more attention to what investors are saying about their own ESG practices. That's happening in Europe as well.

Another lever is consumers. We've done research in retail and what we've found is, in the last five years, 55% of the growth in consumer-packaged goods came from sustainability-marketed products against virtually all of the CPG categories. That's personal care and food products. When we first started tracking this in 2019, we saw conventional dairy, for example, at -10% growth and alternative, plant-based or organics at +10%. Six months later, the two biggest dairy producers in this country declared bankruptcy. And it's not only products, but consumers are also looking for where the companies stand on important issues of the day such as immigration or, in this country, voting laws.

Then, on the regulatory side, the Biden administration is getting much more involved proactively in this area. In the EU, the IFRS, the body that oversees international financial accounting regulations, is now creating ESG standards. And I heard the acting commissioner of the SEC talk about it—creating their own standard and harmonizing with others. So, we're starting to see harmonization amid the chaos that we have out there around different standards. That will drive more and better reporting hopefully.

I would say the millennials and Generation Z see this as existential to their future. They care about these issues and they want to work for companies who care and share their values. As companies are trying to compete for the best and the brightest, they need to be authentic in terms of their sustainability investments.

So on every front I think we're seeing a real coalescence around sustainability. And then as a final point, I would say that our research is demonstrating that sustainability is basically the next wave of good management. Sustainability can drive innovation, operational efficiency, risk mitigation, employee engagement. If you approach it as a total quality management opportunity, as opposed to a compliance mentality, you can unlock a lot of value not only for your own company but for all your stakeholders, which then ultimately unlocks more value for you.

What prompted you to do the research on board expertise and what did you learn from it?
I have sat on a couple boards and I've worked with boards and I was intrigued about what I perceived as a lack of understanding about the issues.

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We looked at Fortune 100 board members (1,188 of them), and we looked at their ESG credentials, described either on the financial disclosures to the SEC or on the corporate website. We figured if they think it's important, they'll put it in those two places. What we found is that only 6% of Fortune 100 board members have relevant environmental experience and only 6% have governance experience. When you look at cybersecurity—huge issue—only eight board members of 1,188 have credentials in cybersecurity. Look at the environmental side, climate—huge issue—only three board members in 1,188 have climate credentials. Two have water credentials—also a super important area.

Even on the social side, 21% had experience, but there's nobody with experience in worker voice. You had people with experience in diversity, healthcare (although most of the healthcare people were mainly on healthcare company boards). But nobody with a worker perspective.

So there are huge gaps. When you look at the industries—huge climate impacts for property and casualty insurance and no climate expertise on the board, for example. Really fascinating and concerning to see the lack of expertise on material ESG issues.

We looked at a pharmaceutical company that had been sued regarding opioids. Pharmaceutical companies have major environmental challenges, major social challenges and major governance challenges. There was not one person with ESG credentials on that board prior or even after that crisis.

In terms of what boards can do, there are a growing number of ESG credentials courses for board members, including at my own institution. Secondly, the boards need to work with the C-suite to understand their material ESG issues and determine where they might need some expertise. If you don't know the right questions to ask, it doesn't really help to try to just hire that expertise.

And when you hire board members with expertise, they shouldn't be tokens. Just like putting one woman and one Black person on the board doesn't mean that they can suddenly change everything for all women or all Black people. It's the same for ESG. You put one little environmental person on the board, they can't change everything. You need to actually carry that through. For example, one way you can do that is to create a standalone ESG committee that works closely with company leadership on embedding ESG into the business strategy, on tying compensation to ESG KPIs, on doing risk scenarios.

What's your best argument for a board member who says, "What we've always done is still working for us. I'm not really seeing a lot of material risk in this," or, "We don't have space for any of this new kind of expertise"?

I would say that sustainability is driving both huge innovation and growth for those companies who are getting out in front of it, and it is also causing huge risk for those who are falling behind. Your role as a board member is to ensure that the company is pursuing a good overall strategy. That is what you're supposed to do. If you're not paying attention to those material issues that can create a competitive advantage or create a major risk, you could potentially be held liable for not holding up your contract as a board member to do the best for the company.

What we're seeing from the research is that companies that have embedded sustainability are outperforming those that don't. We did a meta-analysis of 1,000-plus academic studies over the last five years and found that there was a positive correlation between corporate financial performance and ESG. Increasingly it's becoming clear that this really drives good business.

"IN THE LAST FIVE YEARS, 55% OF THE GROWTH IN CONSUMER-PACKAGED GOODS CAME FROM SUSTAINABILITY-MARKETED PRODUCTS."

Is inequality coming more sharply into view in the same way that sustainability has? Is it following the same trajectory?

I see inequality as part of sustainability, part of that social piece. When I talk to companies, the two issues that they talk most about are climate change and inequity—inequity in gender and race, but also wealth, including CEO pay versus worker pay. All of those different elements of inequity or inequality.

They're at the very beginning of that journey. And there's no data out there on how companies are performing on metrics around inequality within the company. That is changing as the SEC is now requiring some reporting around human capital, and as states and investors are asking for EEOC reporting to be made public.

Externally, the license-to-operate question will continue to grow. The massive inequality that we're seeing—a tiny percentage of people controlling 85% of the wealth—that is not a long-term recipe for success, and business is already being caught up in the populist backlash to that. They don't quite know what to do about it yet, but I think they're beginning to focus on it.

The slowness to adopt these changes, is it just a question of inertia, people just doing things as they've always done? Or is it more that boards are dedicated to the old notions of shareholder primacy?

I think bureaucratic inertia cannot be underestimated [laughter]. People don't like to change. People have their relationships, their ways of doing things. It's very hard to move ocean liners quickly to avoid icebergs.

There's also a hangover of belief that this is a drag on the bottom line. Looking at the '70s and '80s when we had "sustainable products" that actually didn't work well and didn't get good response in the marketplace, and socially responsible investing that was mainly negative screens that didn't perform that well. People now point to that and say, "Well, this stuff doesn't work."

I would say though, that every time we have a generational shift, things get better. When I first got into this business, the CEOs, to a man—because they were all men, you know—thought this was all ridiculous. And now, this next generation says, "Well, this is important, but I'm struggling to actually move it forward because I have this shareholder pressure to focus on short-term quarterly results." At least they get it, whereas before they didn't even know what you were talking about.

I think the next generation will say, "Actually, this is core to what I'm going to be delivering here as a CEO." There obviously are CEOs of that older generation who are doing that now—there are always exceptions.

We saw during COVID that despite the Business Roundtable statement, despite statements that say, "We care about our workers," boards and CEOs went ahead with massive executive compensation packages, with share buybacks, with dividends, and at the same time laid off or substantially reduced their labor force. So there is an ongoing emphasis that is very strongly entrenched.

Regardless of what they say, investors continue to reward that and to discourage more constructive behavior. Over and over again I see investors having a fit when a company announces, "I'm going to increase pay to my front-line workers." So you see that ongoing challenge.

I think the other area, too, that's really challenging is more and more companies are owned by private equity. A large contingent of private equity—not all—make their money through short-term engineering, and loading companies up with debt, and reducing their labor force. You can't get off that roller coaster because the pension funds, for instance, invest in it—they have a fiduciary duty to make a certain return and they can make those returns through this short-term approach. If they want to go to a more long-term approach, they're not making the returns that they've committed to at a time when it seemed like it made sense that you could commit to whatever it was, 10% return on your portfolio.

So we do have some very entrenched shareholder primacy/short-term capitalism approaches that are going to really take time and real effort to remove. It's not going to happen overnight.

Speaking of the change in generations: You wrote recently that the changes in MBA programs are happening rather slowly. Is there growing momentum to build this into the next generation?

I'm seeing much more momentum in the last year or two than I saw earlier. If you look around the world, virtually every few months a university is creating a new center for sustainability on the corporate side, and more courses are being offered. You're seeing more students.

I am getting notes from students saying, "I'm coming to Stern because of the sustainability programs." And also, and this is the most rewarding thing as a professor, I got a note from a young woman from India who as the basis of the course she took with me went back and started a sustainable business in India.

So you see those kinds of things happening, which are very exciting. At the same time, due to the university system of tenure and the way things are set up, you can't easily change the core courses. These are taught by people who have been teaching them the same way for 30 or 40 years. So that is challenging. It's changing, but it takes a much longer time. Again, an ocean liner kind of challenge.

We owe it to students to prepare them and not teach them outmoded ways of thinking about things. There's a lot of work to be done still. But I feel very, very supported at Stern in what we're doing, and there's complete commitment by the dean of Stern and the president of NYU.

> "OUR RESEARCH IN EVERY SINGLE AREA IS FINDING THAT SUSTAINABILITY DRIVES BETTER PERFORMANCE. WE NEED TO BUILD THAT INTO OUR CORE BUSINESS STRATEGIES."

Are you a fan of quarterly reporting, going back to these issues of short-termism?

I'm not. I understand the rationale that you want to keep people accountable, make sure that they're managing things well. But I think that it really drives perverse incentives the way it's currently structured. The way Unilever has set this up where they provide guidance but have basically told their investors they're not going to provide quarterly calls and quarterly reports because they want to focus on what's best for the business in the longer term, to me that makes much more sense.

I think the key thing we need to remember is that managing for the price of the stock is not the same as managing for the well-being of the company. When we have quarterly reporting, that generally causes an extreme focus on managing for the stock.

Our research in every single area is finding that sustainability drives better performance. We need to build that into our core business strategies.

These coming decades are going to be very traumatic in terms of environmental and social issues but also will create an enormous opportunity for business to design new services, processes and products that are going to help solve for those issues. Business has the opportunity to shape our lives in a positive way.

I think that will be very motivating to people working at the company, to suppliers with the company, to investors in the company, to consumers of their products. It's a great opportunity, and I hope people will take advantage of it. ◆

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