JONES DAY

GOVERNANCE PERSPECTIVES

OCTOBER 2018

What Should Boards *Really* Be Doing About ESG?

IN SHORT

The Background: In recent years, issues relating to environmental, social, and governance ("ESG") topics have become higher corporate priorities, tracking with the developing expectations of investors and the public.

The Issue: Many companies have already addressed ESG issues, but others may need to fine-tune their plans to turn aspiration into action.

The Outcome: Corporate boards should recognize their companies' ESG achievements and coordinate future efforts and disclosures in this area, emphasizing issues relevant to their own corporate culture and linked to long-term shareholder value.

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For Corporate America, the focus on ESG issues has never been sharper. Investors—ranging from retail shareholders to the very largest fund families—are challenging companies to tackle social issues, including more traditional social topics like diversity and employee safety to special-interest matters like gun safety and the opioid crisis. Earlier this year, BlackRock, for example, called on U.S. CEOs to adopt "A Sense of Purpose" and to address broader societal goals, asserting that companies that understand and exercise leadership on these social issues are better positioned to deliver long-term value for investors. Not surprisingly against this background, ESG-focused shareholder proposals received substantially increased support in the last proxy season and will no doubt continue to proliferate.

Some have questioned the correlation between ESG and value creation, particularly as extreme ESG-focused exchange-traded funds have struggled. They have even suggested that a commitment to these social topics may be inconsistent with the fundamental corporate governance principle that U.S. companies are to be operated for shareholder benefit. However, especially in an increasingly connected, borderless world, there can be little doubt that commitments to employees, communities, and sustainability are neither new, nor in any real way anything other than just plain common sense.

For corporate directors, while the message seems clear, the manner to address it to the satisfaction of a company's diverse shareholder base is very likely not at all clear. The following are a few thoughts about how boards might engage effectively in the era of ESG.

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Directors Should Approach ESG as an Opportunity, Not a Problem

As boards turn specific attention to ESG matters, they might start with how their companies are addressing many issues of need. In fact, most companies have, when they think about it, deeply engrained corporate-wide commitments to ESG objectives—whether worker safety, freedom from discrimination or harassment, community involvement, environmental compliance, or a broad range of other social and environmental causes.

Boards should recognize, however, that if the company does not act, outsiders will advocate for their own choices. Before outside voices shape the discourse, boards should set aside time to assess what issues are most relevant and fit best with the company's long-term goals. Companies have long prioritized good corporate citizenship generally, and issues like sustainability are by no means new to the boardroom. But ESG topics are varied and often complex, and many issues elicit passionate and divergent responses from investors, the media, and others. Boards should consider requiring that their companies organize, coordinate, and succinctly describe things they are already doing, consider things they might do, perhaps by peer benchmarking, and, as discussed next, ensure that their company's public messaging is consistent and clear.

Companies Should Have Clear and Comprehensive Messages on ESG

This is not an area for modesty—investors, the media, and the public generally know about a company's efforts on environmental and social matters only through the company's own statements. ESG messages need to be comprehensible and consistent in all fora—from corporate website, to proxy statement, to press releases, and to analyst call scripts.

In this regard, a company's proxy statement is a critical channel for this messaging, and because there are few disclosure requirements on these topics, companies can craft messages to resonate with their audience. Disclosure on ESG matters should be easy to find and should state clearly the information sought by investors and other stakeholders. Moreover, this is an area where successes should be celebrated.

Those Perplexing ESG Rankings

ESG rankings gained prominence this year and, as has been widely reported, can produce very disparate results company-by-company. Boards should, of course, review where their companies rank, what that means (and doesn't mean), and what, if any, actions should be taken as a result. In most instances, more focused public disclosures of the type suggested above will rapidly improve rankings.

Directors Should Continue Integrating Broader Social Considerations into Risk Assessment Practices

Many social issues present real risks to a company, such as resource scarcity, carbon emissions, and sexual harassment. Effective, high-functioning boards—and executives—discuss and address those risks regularly. Boards that are not yet evaluating this broader set of risks should start; boards that already perform this key function should be transparent with their conclusions.

Deliberate, thoughtful engagement will, over time, ultimately enhance shareholder value and strengthen the company. Accordingly, we urge boards to discuss how an increased emphasis on societal issues could affect their companies and work with their managements to set a strategy to position their companies to thrive as society evolves around them.

THREE KEY TAKEAWAYS

1. Directors should assess the company's areas of risk and opportunity and determine how to focus the company's efforts in the areas with the best cultural fit and highest potential impact.

2. Effective messaging is critical; companies should organize and synchronize their communications on ESG issues in all fora and proactively assess their shareholder outreach efforts on these matters.

3. BlackRock's 2018 letter to U.S. CEOs sent a strong message that resonated in many settings. Corporate America has the muscle to turn the message into action. Expectations placed on corporations will only continue to grow; the time is now for public companies and their boards to respond.

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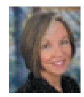
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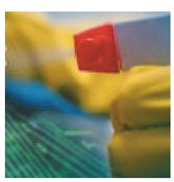
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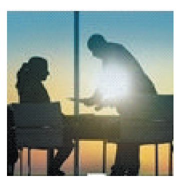
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