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How Directors Can Use Sustainability to Drive Value

As investors focus on environmental, social and governance issues, boards that lead in these areas may reap significant benefits.

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Boards frequently encounter sustainability and other environmental, social and governance (ESG) issues in the oversight of a company's operations, management, financial reporting and public disclosure. Investors increasingly highlight the importance of ESG issues through investment strategies, shareholder proposals and public statements. Industry groups also monitor companies' ESG efforts, and the Securities and Exchange Commission (SEC) has focused public attention on the issue in recent years.

Boards considering ESG issues, particularly sustainability initiatives, will confront several questions: What are the relevant measures and how should the company define them? What are the potential benefits and costs? The particular needs of the company and perspectives of key constituencies will drive these considerations and may differ from company to company.

Your Key Stakeholders Care

Even if sustainability topics do not arise on earnings calls or occupy analysts' attention, the following key constituencies may focus on the topic and expect overt action from the company:

- *Shareholders.* Shareholders may expect particular disclosures and measurement analytics from a company and may publicize their expectations for certain practices. Large institutional shareholders are increasingly adding ESG metrics to their portfolios.

- *Asset Managers and Mutual Funds.* In addition to traditional investors' funds, asset managers are increasingly offering ESG or sustainability-screened investment vehicles. Often these funds seek particular sustainability disclosures or business practices. Companies that lag in this area could risk being screened out of significant investment vehicles.

- *Employees and Other Business Relationships.* Employees, customers and suppliers often care about ESG issues, and that can affect the company's bottom line. Many companies use ESG and sustainability efforts to help attract and retain talent, recognizing that employees care about these issues. Companies also reap value in communicating their efforts to customers and suppliers — recognizing the brand-building effects of caring about ESG concerns and sustainability.

- *Media.* Media outlets increasingly focus on sustainability topics and companies' practices in this area. Boards may want to consider the reputational benefits of leading in sustainability.

ESG Initiatives Can Build Long-Term Value

Directors may also consider whether sustainability policies or practices can build long-term value for their company.

- Implementing ESG measures can help foster innovation, identify efficiencies and manage risk, with recent data indicating that the boards of approximately one-third of the largest publicly traded US companies engage in sustainability oversight functions.

- Recent studies show a positive correlation between a company's adoption of sustainability policies and its outperformance of counterparts over the long-term in stock market and financial performance.

- Many ESG initiatives not only have potential to build long-term value but are cost-effective even on a short-term basis.

- Disclosure can be tailored appropriately to focus on those areas that are most important to the company and its key stakeholders.

Consider Data Quality and Reliability

Sustainability data and related reporting must be accurate and reliable to function as intended. Many sustainability factors can be difficult to measure and are measured differently across companies and industries. Industry groups have highlighted this issue, and companies may retain third parties to certify or audit ESG data and related disclosures. The Sustainability Accounting Standards Board (SASB), for example, seeks to ensure consistent and reliable quantitative measures of sustainability to facilitate comparability across companies and industries.

When considering data sources and measures of reliability, companies may ask:

- What are the precise data points and how are they measured?

- Is the information qualitative or quantitative? What is the degree of subjectivity or objectivity in the measurements and can they be compared across periods, companies or industries?

- How do sustainability measures compare to other metrics used for evaluating the company and its performance?

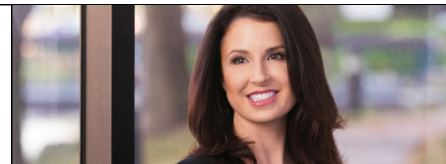
- Should the company retain a third party to audit or certify sustainability measures?

Initiatives Look Beyond Legal Requirements

Sustainability and other ESG initiatives represent an area where companies may seek to go well beyond minimum legal requirements. In doing so, many boards have taken steps yielding significant value to the company and its shareholders. While regulators have considered requiring sustainability disclosures, such disclosures remain voluntary. For example, in April 2016, the SEC considered the need for additional disclosure requirements for US public companies specifically relating to sustainability, but stopped short of prescriptive action in this area. Nonetheless, more than 80% of S&P 500 companies voluntarily issue ESG reports today, compared to only 20% in 2011. This trend is likely to continue as US public companies focus on their efforts in this area.

Conclusion

Directors may consider the costs and benefits of integrating sustainability or other ESG factors into their evaluations of business performance and public disclosures. Specific approaches will differ from company to company, but many companies find that leadership in this area can yield significant benefits.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