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IOD Institute of Directors — Building Tomorrow's Boards®

DIRECTORS' DIALOGUE SERIES

ESG STRATEGY for the BOARD:

Turning Rhetoric into Reality in a VUCA World

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Reading Material

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FROM THE
PRESIDENT'S DESK

Evolving Corporate **ESG Strategies**

The Environment, Social & Governance (ESG) agenda has been steadily navigating its way through the 21st century, and gaining significant traction from organisations and their stakeholders. The recent wave of global regulations, enforcement, increased awareness and expectations, and emphasis on maintaining stakeholders trust and reputation is driving organisations to adopt a more integrated approach towards their ESG goals.

ESG issues continue to evolve as strategic business imperatives. The pandemic has highlighted the importance of sustainable and resilient business models to support the economic recovery strategies of companies, along with insightful reporting to provide stakeholders with a clear understanding of those models when making informed investments and taking other related decisions. Investor expectations on such disclosures are rapidly evolving, and companies are carefully navigating these expectations, including the related need for robust internal controls around data collection, as well as the content and presentation of sustainable information that they publish.

ESG metrics hold the following concerns in high esteem:

- **Environmental concerns:** Waste management, usage of renewable energy and other precautionary measures in order to minimize their impact on the environment.
- **Social concerns:** Corporate Social Responsibility, healthy employer-employee relationships, how the company repays its employees as well as the community outside of its primary group of activities.
- **Governance-related concerns:** Accountability and transparency in the activities carried out by the company.

The ESG Funds invest in 'Mutual Funds' or 'Companies', following the Environmental, Social and Governance (ESG) criteria. Investment approaches to ESG also include activist hedge funds, focus funds, and relational funds. In India, ESG Investments offer tax benefits to the investors, under Section 80G of the Income Tax Act. These companies have a lower risk of facing regulatory related issues and punishments, related to environmental damage, governance or management integrity.

ESG funds have attracted record inflows during the pandemic. A greater focus on ESG typically yields higher resource use efficiency, lower cost of operations, reduced risk, stronger employee engagement, lower cost of borrowing, and increased analyst coverage and investor

interest. Investors too are placing their bets on companies with high environ-mental, social and governance scores. India already has about 23 ESG funds, and assets add up to Rs.12,000 crore by end of June 2021. Globally, there would be almost 50 trillion dollars focused on ESG investing by 2025.

The role of ESG in tackling environmental, social and business issues can be noted in the landmark judgment of May 26, 2021. A Dutch court ordered Royal Dutch Shell and the group companies to significantly deepen their planned greenhouse gas emission cuts. The company was ordered to cut the carbon-dioxide emissions by a net 45% by the end of 2030, compared to level of emissions in the year 2019. The verdict was an aftermath of a petition, filed by a group of environmental NGOs.

In March 2019, the Ministry of Corporate Affairs revised the NVGs on the Social, Environmental and Economic Responsibilities of Business, and released the 'National Guidelines on Responsible Business Conduct' (NGRBC). These principles urge businesses to actualize the principles in letter and spirit. The Listing Regulations of SEBI have added new reporting requirements on ESG parameters called the 'Business Responsibility and Sustainability Report' (BRSR). It has mandated the 1000 largest listed companies by market capitalization vide its directive issued on 10 May 2021, to report annual sustainability progress through BRSR. The BRSR seeks disclosures from listed entities on their performance against each of the nine principles of the 'National Guidelines.

The BRSR is intended to have having quantitative and standardized disclosures on ESG parameters to enable comparability across companies, sectors and time. Such disclosures will be helpful for investors to make better investment decisions. The BRSR shall enable companies to engage more meaningfully with their stakeholders, by encouraging them to look beyond financials and towards social and environmental impacts. ESG strategic reviews are persuading companies to embrace circular economy practices and throwing up new business opportunities across segments like energy optimization, waste management, electric mobility and the sharing economy.

ESG is not just a business buzzword but a gateway for new frontiers of change. ESG has become the foundation of future business strategies. Today, most customers are looking at the ESG value proposition of the companies they buy products and services from. In a post pandemic world, business resilience can be better achieved with a robust ESG framework.

Stewardship in the 21st century is centered around a value driven purpose that promotes health and well-being by dissolving systemic inequalities to build companies that are more equitable, diverse and prepared. Corporate stewardship is inextricably linked to responsible capitalism, collaboratively building resilient corporate cultures that ultimately impact a broader stakeholder base, and managing the accelerating changes faced by companies from an ESG perspective.

Boards need to pay more attention addressing various environmental social and economic challenges. New initiatives will continue to alter the regulatory landscape and define the role of the company in society. Boards need professional development and competency focused on bringing ESG, climate and sustainability insights to boards, investors, and executives globally. Having an ESG oversight is important to providing effective oversight. ESG integration requires leadership and an ESG transformation mindset. Today, we are not only transgressing the planetary boundaries, but also social and cultural ones. Technology has provided an opportunity for people to be more connected than ever. Future-ready board members are highly focused on cooperative decision-making and inclusiveness. Ethics & compliance are intrinsic factors shaping a holistic ESG strategy.

The world is becoming hyper-connected, automated and uber-smart, and everyone benefits. Six billion people are always 'on' around the planet, each of us seeing different information and content all the time. By 2022, our digital egos have moved to the cloud, and are developing a life of their own.

The focus on ESG is a consequence of the need to build better business ecosystems and provide greater resilience for the future. Thus, sustainability reporting with a focus on ESG issues is the need of the hour, as it can help organisations to measure, understand and communicate their economic, environment, social and governance performance. The common means of presenting non-financial reporting among companies is through publication of annual sustainability reports and integrated annual reports based on the GRI standards and the Integrated Reporting Framework.

In the evolving ESG landscape in India, corporates need to prepare their own road maps for best-in-class approaches and practices for ESG governance, and integration, and evolution and convergence of reporting standards. However, there must be connectivity between the financial and the so-called non-financial reports. There is an urgent need to improve the comparability in ESG reporting, which can be achieved through a consistent global framework. Internationally accepted reporting frameworks such as GRI, SASB, TCFD, <IR>, and IFRS are presently in the process of standardizing and integrating these into a one 'Financial & Sustainability Report'.

The lasting impact of the pandemic has taught us that the future of work is 'hybrid'. This calls for operational resilience. Given the advantages of a hybrid environment of improved productivity and increased happiness index, a growing number of organisations are moving to hybrid workforces. We need clear ground rules that foster a culture where everybody feels included, regardless of where they are located. Companies

need to train on topics such as building resilience, effective communication, time management and diversity to drive behavioural change across broad segments of the workforce, making even remote employees feel seen and valued. In the face of rapid changes in the social and business climate, having regular dialogue with employees creates a sense of belonging.

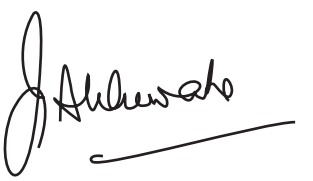
Boards continue to reshape and develop path- breaking multiple stakeholder customer centric dynamic strategy to embrace robust data technology platforms with digital cloud - based cutting edge market solutions. IOD which never stands still, has continued its efforts to support the directors by developing timely and relevant knowledge through new and updated training programmes in both 'live' and 'virtual' formats.

The foundation on which our global economic systems and governance practices have been built is nearing expiry. Technology in the next 20 years will bring more change than the previous 200 years. Technology is well on its way to becoming a creative force – and a thinking machine, as well. Technology is now gearing up to go inside us, thereby changing who we are and rapidly redefining what it means to be human, to allow us to transcend the limitations of humanity.

As global conditions begin to normalise in 2022, we enter a period of great reset – for which the board of directors need to be prepared. A future ready board will need a culture of continual learning and strategy adaptation in order to meet growing expectations for extraordinary board- level stewardship in the 21st century.

I congratulate the editor of 'Director Today' for coming out with this very topical issue of Evolving 'ESG Strategies in the Boardroom', for this 'New Year issue' of January 2022. We have been very fortunate to have the **Hon'ble Prof. (Judge) Mervyn E. King SC** (Chairman, King Committee on Corporate Governance; Patron, Good Governance Academy, Chair Emeritus, IIRC & GRI and former Judge, Supreme Court of South Africa) as the **'Guest Editor'** for this issue. His message as the 'Guest Editor' focuses on the important aspect of ESG reporting, which is getting integrated with other sustainability reports. An 'International Sustainability Standards Board' (ISSB) has recently been set up by the IFRS for the purpose of tackling environmental and social challenges.

Let us welcome with open hearts the bright **'New Year 2022'**, a year of return to hope, good health and togetherness. IOD wishes you all - a challenging, but a prosperous 'New Year'. ■



J. S. Ahluwalia
President
Institute of Directors

January 01, 2022

FROM THE
GUEST EDITOR'S DESK

Corporate Reporting is not what it used to be

Hon'ble
Prof. (Judge) Mervyn E. King SC
Chairman, King Committee on Corporate Governance;
Patron, Good Governance Academy;
Chair Emeritus, IIRC & GRI, and;
former Judge,
Supreme Court of South Africa

The days of doing an annual report made up of the financial statements plus comments from the Chair are gone forever. Financial reports today are connected to the Environmental, Social and Governance (ESG) reports or the so-called intangible assets.

This arose from it being established by the beginning of the 21st Century that limited liability companies were using natural assets faster than nature was regenerating them. At the same time, populations across countries were increasing.

Further, the makeup of the market capitalisation of companies showed that only about 20% of its value was expressed as additives in a balance sheet, according to financial reporting standards. The result was that many standard setters and framework providers sprung up in the ESG space.

This caused clutter and confusion for preparers and users, and diluted comparability.

The pandemic showed how scientists collaborated under Sustainable Development Goal 17 to perfect a vaccine in nine months rather than nine years. This caused the executives of the framework providers and standard setters in the ESG space to start collaborating. Five of the main ones issued a statement of intent to collaborate and the International Financial Reporting Standards (IFRS) Foundation issued a statement that it was increasing its mandate to include sustainability reporting. On November 03, 2021, they announced the establishment of the International Sustainability Standards Board (ISSB).

Sustainability, like a coin has two sides. There are the impacts of the company's activities in producing its product and other outputs such as waste which have an impact on the three critical pillars for sustainable development, namely people, planet and profit. Likewise, those three critical pillars have an impact on the company. Thus, when Lehman Brothers collapsed it impacted adversely on the company's financial condition (its balance sheet), its operating performance (its income statement and cash flow), as well as its risk profile (its cost of capital).

The ISSBs will be global baseline standards but with a focus on enterprise value creation while the European Union (EU) has developed it's Corporate Sustainability Reporting Directives (CSRDs) which are focused on both sides of the coin. Work is afoot by the various task teams to try and align these two standards.

At the same time the International Accounting and Auditing Standards Board (IAASB)

> *"Financial reports today are connected to the Environmental, Social & Governance (ESG) reports or the so-called intangible assets."*

is talking to these task teams to try and ensure that the language is assurance friendly and that there can be a reasonable assurance of sustainability and integrated reports.

One thing is common cause, both for the IFRS, the EU and the Securities Exchange Commission (SEC) in the United States, and that is that there must be connectivity between the financial and so-called non-financial reports.

Consequently, the integrated report has become more important because it is the one commonality between the IFRS standards, the EU standards and the standards still to be announced on sustainability issues in the US.

Preparers and users must be alert as to the evolution of corporate reporting which is now moving with great expedition. ■

Prof. (Judge) Mervyn E. King SC, Chairman, King Committee on Corporate Governance; Patron, Good Governance Academy, Chair Emeritus, IIRC & GRI and former Judge, Supreme Court of South Africa.

A committed South African, dedicated campaigner for justice and fairness, an accessible and selfless man, Prof. (Judge) King has changed the corporate governance landscape not only in South Africa but also internationally.

He was conferred with Golden Peacock Global Award for Lifetime Achievement in Corporate Governance few years back in London. Earlier Late Sir Adrian Cadbury was also conferred with Golden Peacock Global Award for Corporate Governance.

Board Accountability on ESG issues is here to stay

MS. SANDA OJIAMBO
CEO & Executive Director
United Nations Global Compact

United Nations Global Compact

> "Board directors face increasing scrutiny on how they oversee environmental, social and governance matters. Strengthening ESG oversight and accountability should be a priority for all boardrooms in 2022 and beyond."

The sharpening climate crisis and the Covid-19 pandemic, with all its unforeseen and unparalleled consequences, are helping to make ESG a top concern for today's investors. Large institutional investors are not only backing environmental and social shareholder proposals like never before; they are also voting against the re-election of directors where ESG management is perceived as ineffective. Boards need to understand these concerns and act – fast.

Shareholder pressure is hitting home. For example, BlackRock voted against 255 directors for climate-related concerns during the 2020-21 proxy season, according to their voting spotlight report. Activist hedge fund Engine No. 1 elected three directors to the board of Exxon Mobil, against the board's recommendation, with the goal of forcing the energy giant to reduce its carbon footprint. Other investors are taking a similar approach, holding directors accountable for resource management, human rights, and racial, ethnic and gender diversity issues in addition to climate concerns. As a result, companies are under pressure to develop sound ESG programs that meet shareholders' rising expectations.

Adding to the pressure is a growing number of studies that show that high ESG standards are positively correlated to stronger financial performance.

Starting at the top

To build credibility with investors and the broader stakeholder community, boardrooms first need to train the spotlight on themselves: do they have the right mix of skills and gender, age and ethnic diversity to effectively guide their company and its

ESG strategies? Are they walking the talk by aligning executive pay to ESG targets? In a recent survey undertaken by Russell Reynolds Associates and the UN Global Compact, it was found that sustainability experience or mindset is a requirement in only 4 percent of non-executive and senior executive appointments today.

ESG oversight should ideally be performed by directors from diverse backgrounds, with the right skills and relevant environmental or social experience. Thus far, most institutional investors are not prescriptive in this regard; they recognize that appropriate skills may change with industry and size. However, some expect boards to at least provide clear disclosure on the ESG knowledge and awareness among their ranks.

Secondly, boardrooms need to determine the right oversight structure. Some boards may consider creating a specific ESG committee responsible for centralizing and integrating recommendations. Others may prefer to deal with such matters at board level. Either way, board directors must be able to demonstrate that ESG oversight is strong and capable of delivering the sustainable value creation and total shareholder return that investors now demand.

Adopting sound principles

Ultimately, however, companies are judged by their actions. Those that can demonstrate their commitment to the Ten Principles of the UN Global Compact (UNGC) and the UN's Sustainable Development Goals (SDGs) are likely to be more credible and more valued by stakeholders.

Embracing the Ten Principles means that companies agree to operate in ways that respect human rights, labor rights, the environment and the fight against corruption. These principles are critical to corporate integrity, helping companies set the stage for long-term success.

The UN Global Compact is the world's largest corporate sustainability initiative and in 2022 we will enhance our requirement for communicating progress. All participants in the UN Global Compact are required to report annually using a framework called the Communication on Progress (CoP). The enhanced CoP will include more granular questions on the SDGs and Ten Principles.

The enhanced CoP has been designed to give solidity to corporate ESG credentials at a time when regulators are clamping down on greenwashing and stakeholders are more skeptical about ESG claims. Among other benefits, the new CoP will allow companies to measure and demonstrate progress on the Ten Principles in a consistent and harmonized way which will help build credibility and brand value. They will also be able to compare their progress against peers by accessing a UN Global Compact database that will be one of the largest sources of free, public and comparable corporate sustainability data in the world. This database will provide technical help, resources and guidance while also helping to identify gaps and set goals to improve sustainability performance year on year. As such it is set to become a valuable asset for corporate transparency.

Ensuring performance

Sound sustainability governance and management are more important than ever. Joining in the CoP process will not only allow companies to gauge how well they are doing, but will also help prepare them for a raft of mandatory new ESG regulatory and reporting requirements that will begin to take effect in the new year.

After years of work, regulators are getting closer to issuing a single set of globally accepted accounting and sustainability disclosure standards. The International Sustainability Standards Board, set up by the International Financial Reporting Standards Foundation (IFRS), will report on its recommendations in 2022. The EU and UK will also issue new ESG-focused reporting requirements next year.

But rather than see these as an additional reporting burden, companies should seize the new disclosure regulations as an opportunity to prove, transparently and conclusively, that they can do well by doing good. Companies that hold themselves to high environmental, social and governance standards outperform their peers. This fact should be front of mind in every boardroom as 2022 begins. ■

THEME ARTICLE

Board's ESG Strategy for Creating a Sustainable Corporate Future

*Prof. Colin Coulson-Thomas

The negative impacts of human activities upon the environment and their social consequences have reached such levels that there is a scientific consensus that certain consequences need to be addressed by collective action at national and global level. Many of the undesirable impacts derive from the operations of private sector companies to meet the demands of customers, who like the Governments that encourage and incentivise economic growth want the benefits of development and consumerism, but without their negative consequences.

Boards of companies have discretion to investigate and address the negative consequences of corporate activities. However, doing so requires expenditure and the use of resources that can raise prices, involve opportunity costs and put an enterprise at a disadvantage in comparison with less meticulous competitors. Since the 1950s a succession of articles, books and various speeches of business leaders, including at IOD conferences, have put the case for corporate social responsibility (CSR) and more responsible business behaviour.

As awareness has grown of the extent to which growth, development, lifestyles and business activities are damaging the environment, reducing biodiversity, depleting natural capital and contributing to global warming and climate change, calls for environmental action have joined those for social responsibility. A focus on governance arrangements is also needed to better achieve them. These are all areas that IOD events and publications have addressed since the institute's formation. 'CSR' has evolved into 'ESG' as more stakeholders, laws, regulations, codes and standards have also sought to encourage sustainable business conduct.

ESG Concerns, Motivations and Drivers

The ESG motivations and concerns of some boards may be externally driven, reflecting legal and regulatory requirements, pressures from stakeholders or wider public expectations. Some directors may have felt obliged or compelled to respond, in order to attract funds from ESG investors, or because of fears of the negative consequences for themselves or a company's reputation of not being seen to do so. They might desire to do just enough to satisfy those concerned, by setting up particular and self-contained initiatives and reporting on them.

In comparison, members of other boards could be inwardly motivated. Directors are supposed to exercise independent thought. Rather than just react to external influences, they might also positively want to be more responsible in a number of areas and proactively take steps to ensure corporate activities have more beneficial and less damaging impacts. Some directors are driven to reduce negative externalities, address certain challenges and operate more sustainably. They take the initiative in pushing for changes of direction and emphasis.

Directors should be aware of the consequences of corporate activities, alert to developments in the business environment affecting them, and sensitive to changing stakeholder views about them. They may need to be both responsive and proactive. Some directors who were sceptical in the past might have been persuaded to address ESG issues by the increased attention being devoted to them, their engagement with stakeholders and emerging evidence of the reputational, financial and relationship benefits of embracing them. They may also have their own individual concerns and, consequently, now view ESG as a higher priority for action. There may be other board members who 'follow fashion' and 'go with the flow'.

Widening the Scope of ESG

While the responsibilities of many managers relate to particular activities, projects, functions or business units, the responsibilities of directors extend to the whole of a company

and its various networks of relationships. Increasingly, issues confronting boards, whether environmental, social or corporate governance, are inter-related. Because they affect many activities, people and organisations, often they cannot be easily delegated to particular executives or single functional departments for them to address.

In recent years, environmental, social and governance concerns have featured on the agendas of multiple IOD events, in addition to the aspects particular occasions have largely focused upon. Speakers at institute conferences, congresses and conventions have regularly called for boards to acknowledge and address ESG responsibilities to a wider range of stakeholders. ESG criteria and thinking should apply to all aspects of corporate activities and not just carefully selected examples featured in an annual report to show some action has occurred.

The need for greater environmental and social responsibility and more responsible governance has now reached such a level that most, if not all, matters before a board and corporate activities and their impacts should now be viewed through an ESG lens. The continuation of vital relationships and avoidance of reputational damage may depend upon it. The implications of not doing this are such that directors should challenge and probe for areas to which ESG considerations are not applied, in order to identify possible ESG related risks.

Providing Responsible Strategic Direction

Directors should ensure that corporate purpose, vision, values, goals and objectives are aligned with the strategies, policies and behaviour to achieve them and consistent. Some boards are so focused upon ensuring that ends sought are responsible, that they overlook the question of whether this is also the case with the means being used to achieve them. Activities and operations in pursuit of a laudable objective might have undesirable consequences and themselves cause negative externalities.

Environmental and social goals and objectives should be ambitious and even stretching, but also affordable and achievable. Interested stakeholders may have views on what ESG objectives should be, how they should be pursued, and what they would like to see reported. In the absence of targets, suspicions of a lack of focus upon ESG considerations may arise. However, previously agreed ambitions should not be allowed to become a straitjacket. Aspirations may change and new concerns and possibilities can arise.

Directors should achieve a balance between measuring, monitoring and reporting on what they set out to do, and being open, receptive and flexible in relation to new opportunities and pressures for more responsible conduct. A managerial focus upon just delivering 'the numbers' can get in the way of 'raising the bar', 'pushing the boundaries' and being alert to changing requirements and emerging options. Board members, and particularly independent directors, should be on the alert for greenwashing. Its prevalence suggests some directors are not as vigilant as they ought to be. In some sectors, higher profit and growth could be a cause for concern. They might indicate ignored negative externalities.

Responsible Collective Action

Capabilities required to implement strategic priorities that are not owned and available internally should be accessible as and when required, either from existing business partners or other collaborative arrangements with likeminded and complementary partners. The latter could include public bodies, voluntary organisations and local community associations with shared interests and required competences.

Coalitions and/or consortia of organisations may need to be brought together to address common requirements, such as those of cities for climate change adaptation and more resilient infrastructures. Acting together may make it easier to obtain local endorsement and support. Both customers and suppliers may need to acquire or develop the skills to programme manage a portfolio of such projects. Synchronizing changes of demand and supply may reduce disruption and facilitate implementation.

Addressing many of the challenges facing humankind is likely to require collective effort. More might be achieved by working with external organisations. What a company does in collaboration with other entities may be more important than its own solo activities. Rather than identify modest projects that a company might achieve on its own, a board could opt for it to play a role within collaborations that aspire to have a greater and collective impact.

Responsible Public-Private Collaboration

Effective boards recognise the potential for corporate and stakeholder engagement and alignment around shared interests. They understand the inter-connectedness of different existential challenges and the opportunities they create. Addressing them can require holistic perspectives, systemic thinking and awareness of the greater impact of collective endeavour. Transition and transformation journeys may need to be accelerated while they are still possible. Boards could initiate conversations to assemble those needed to undertake them.

Whereas the remits of many public bodies are limited by enabling legislations and may be subject to Ministerial influence, the objects clauses of corporate constitutions in many jurisdictions often give directors wider discretion in terms of the activities a company can undertake. While many public bodies are also expected and/or required to offer 'standard' services to all citizens, companies can often offer alternatives, choice and bespoke responses.

Collaboration with other parties can also be easier for many companies. Boards may be free from an annual funding round in which they have to compete with other Government departments. Companies may be able to try different approaches to suit local requirements. While Governments can and do sometimes act quickly and decisively in crisis situations, on other occasions the greater freedom of action of corporate boards can be more conducive of diversity, flexibility and creativity. Directors can play a vital role as instigators, enablers and supporters of exploration, innovation and entrepreneurship.

Engagement with Stakeholders

Engagement with stakeholders and greater awareness of their aspirations and priorities might enable conversations to be switched from price to value created and consequences. Whereas competition to reduce price can result in a bare minimum being delivered, engagement may allow opportunities to be identified to add more value without a corresponding increase in resources used and/or time required. It might also enable co-creation possibilities to be explored and business partners to add additional benefits.

Within some stakeholder groups there may be differing perspectives on areas of concern and contending views on what ESG priorities ought to be. Pragmatic boards recognise that some stakeholders can have more power than others to influence a company's prospects and there may be expectations, requirements and standards relating to ESG activities, priorities and reporting that, in addition to their intrinsic merits, it would be prudent to observe.

When engaging those with whom it would like an enterprise to build relationships, a board should not be so concerned with satisfying the diverse requirements of others that it loses sight of its own purpose and priorities, and neglects to reflect and articulate its own views on what it would like to achieve. Building a coalition of the committed, likeminded and willing may be more important for making progress and having an impact than trying to juggle disparate and possibly incompatible interests.

Relevant Corporate Governance

Corporate governance should be appropriate for a company's purpose, its stage of development, the particular challenges it faces and the opportunities a board is seeking to create and/or seize. Governance arrangements may also need to embrace supply chain and other stakeholder relationships and collaborative agreements. Just as they might be inadequate, governance structures and processes can also be over-elaborate and inflexible and, as a consequence, impose unwelcome costs and delays.

There needs to be sufficient diversity within a board itself to address the different areas of activity and concern that might fall within an ESG umbrella. Boards that delegate ESG matters to particular executives or a committee of the board should make sure that they do not abdicate their own responsibility for ensuring a company's ambitions, strategy and activities are responsible and sustainable and likely to be viewed as such by stakeholders.

Some boards may find that certain parts of a business, particular collaborations and other ventures, and/or major projects, might need to be governed and/or managed differently on account of the nature of their activities, the timescales required and other parties concerned. Scrutiny should reflect the ESG and other risks involved. Overall governance frameworks should recognise and accommodate such diversity. They should enable rather than constrict.

Responsible Corporate Reporting

Corporate reporting on value creation and the longer-term suggests boards vary in their perspective. Some do the bare minimum to address particular applicable requirements, or just enough to satisfy certain expectations. It may be left to someone in a finance team to apply a checklist, standard or 'tick box' approach. Other boards are more diligent in providing guidance and reviewing drafts. They may recognise that saying more about corporate ESG priorities and intent might attract potential partners and build relationships with supporters.

When board colleagues 'look the other way' or are reluctant to 'rock the boat', it may take courage to question whether a company's financial results and integrated reports take full account of negative externalities resulting from corporate activities. Often they do not and environmental harm may be hidden and/or social net benefit and value created exaggerated. Responsible directors probe the rationales for valuing some items, while excluding others.

Rather than hope that an annual report or other corporate communications might be read by relevant parties, a board could encourage proactive approaches to those who could support or assist the implementation of a company's ESG strategy. Steps may have to be taken to move potential allies and partners through successive awareness, understanding, support and commitment to action stages of a relationship. Listening to their responses may enable changes that could encourage their involvement and improve impacts.

Balanced ESG Approaches

Directors should pay particular attention to activities within their supply chains, which for many companies may be where the bulk of particular negative externalities might arise and be largely hidden. Responsible boards endeavour to minimize carbon footprints and greenhouse gas emissions as quickly as possible. For example, where possible, energy could be sought

from renewable sources and that produced by coal fired power stations avoided.

Just as higher financial returns may result from both increasing revenues and reducing costs, so improving ESG performance might call for reduced negative consequences and enhanced positive ones. Some directors largely focus on the reduction of damaging activities, and view this as a challenge, involving problems to be addressed. For others, ESG and responsible business conduct is more than scaling back, ending unsustainable operations and dealing with negative consequences. It also involves opportunities and positive and collective initiatives to create, enable and support operations and lifestyles that are desirable as well as sustainable.

Following COP26, the future of humankind and that of many other forms of life on our planet remain in the balance. Responsible directors should look out for proposed activities that are not sustainable, or would consume scarce natural capital that will be required by future generations to cope with the higher adaptation costs, losses and damages they are likely to face. Rather than discounting future revenue streams, perhaps a premium weighting or other incentives could be used to postpone developments and growth that might trigger tipping points that could result in unstoppable and escalating increases in temperatures.

Creating Responsible Futures

For an increasing number of boards, ESG is about opportunity and responsible innovation, enterprise and capitalism to create new options and choices for stakeholders to live and operate more sustainably and in harmony with the natural world. It could involve regeneration and rewilding, social and economic inclusion, climate justice and the support of transition and transformation. It can engage and may excite, but it might also require passion and courage to achieve. Boards of some quoted companies may face the challenge of getting enough investors to recognise the importance and value of such longer-term programmes.

More directors may need to become educators, advocates and ambassadors and act more explicitly as a corporate conscience. Rather than hide past excesses, irresponsible activities, and mistakes, they should encourage executives and customers whose demands contributed to them to move on and learn from them. They should probe and seek to understand the drivers and root causes of operations and proposals that appear irresponsible or prove to be harmful so that they can be addressed. They should encourage accountability and imaginative thought.

Creating more responsible, inclusive and sustainable corporate futures and lifestyles may require significant, if not radical, changes of priorities and a switch of focus from activities to outcomes that concerned stakeholders increasingly seek and require. As catalysts, directors can encourage exploration of why corporate offerings are purchased and consumed. Maybe the feelings and fulfilment that customers hope manufactured offerings might offer could be more reliably delivered by less environmentally damaging and resource intensive alternatives such as a garden centre, recycling team or life coach. If we are to survive and co-exist with nature, ESG laggards will have to be replaced by more acceptable and enlightened providers.

***Prof. Colin Coulson-Thomas** holds a portfolio of leadership roles and is IOD India's Director-General, UK and Europe. He has advised directors and boards in over 40 countries.* ■

THEME ARTICLE

Measuring and Managing Nature-related Risk - As important as Acting on Climate

*Mr. David Craig

For any business to succeed -- no matter the sector -- measuring risk and performance is critical. Yet there is one thing very few businesses know how to measure, let alone act on to improve -- their risk and exposure to nature. As the business world is embarking on setting targets for reducing carbon emissions and meeting its climate targets, unless our dependencies and impacts on all the natural systems is measured and managed, we will nether meet our climate goals or mitigate the exposure to biodiversity and natural ecosystems. This means measuring and managing nature-related risk.

In June 2021, we launched the Taskforce on Nature-related Financial Disclosures (TNFD) to tackle this exact problem. With the backing and endorsement of the G7 and G20, the TNFD aims to help global businesses, regulators, advisory firms, and financial institutions understand the scale of the issue, develop a way of measuring and declaring this risk, and a framework for acting on it.

As you might imagine, it is not a simple task. But we are fortunate to be following in the footsteps of the Task Force on Climate-related Financial Disclosures (TCFD), which since 2017 2015? has beaten a path in helping businesses and financial institutions understand how to measure and disclose climate risk. The extra challenge for us is to be able to harness and measure the sheer scale of our natural world – all the marine and terrestrial ecosystems on the planet.

In essence, the global economy is underpinned by the natural world. According to the World Economic Forum's analysis (WEF) more than half of global economic output – some $44 trillion a year – is moderately or highly dependent on the forests, oceans, soils, water systems and wider biodiversity that surround us. The WEFs 2021 global risks report held up biodiversity loss as one of the top risks to the global economy.

Whether it's a semiconductor manufacturer reliant on water for cooling, a furniture maker that depends on a sustainable supply of wood, or an agriculture company that needs pollination for crop production, nature impacts are all around, affecting operations, supply chains, jobs, and markets.

In thinking about biodiversity, two important and interlinked points need keeping in mind. First, marine, and terrestrial ecosystems have absorbed 60% of the world's carbon emissions since the industrial revolution began, which underscores that protecting nature is essential to reducing emissions and combating climate change – they go hand-in-hand.

But secondly, nature is rapidly deteriorating – a football field of tropical rainforest disappears every six seconds – and vast amounts of the global economy are exposed to that impact: Moody's has warned that companies with $2.1tn in debt have a "high or very high" exposure to nature-risk.

In India, over 12% of wild mammals, 19% of amphibians and 3% of bird species face the threat of extinction, while one-third of India's wetlands have been lost in the past 40 years. When it comes to soil degradation, nearly 150 million hectares of Indian territory is affected – an area the size of Mongolia. The impact is clear, and the repercussions for farming communities, food supplies and market prices are devastating, the social impact of nature degradation cannot be ignored particularly for a country like India where it is estimate that 25% of the total workforce is involved in farming.

At COP26, we saw good progress on addressing some of these issues, with nature mentioned in conjunction with climate at a greater scale than ever before. The final agreement acknowledges the importance of "protecting, conserving and restoring nature and ecosystems". Nature was also a hot topic

at side events and panel discussions alongside the formal negotiations. Finance ministers, central banks, supervisors, and development banks all committed to scale up work on nature issues.

Now, we must go further and faster in aligning the climate and nature agendas if we are to cap global warming AND tackle the spiralling risks associated with nature degradation.

Our first goal is to agree on how businesses can best measure their exposure. Building on the work of the TCFD and existing standards and research, the TNFD is working with 34 Taskforce Members – including senior executives from Tata Steel, BlackRock, Bank of America, AB InBev, S&P, Singapore Exchange, and Nestlé – to build a risk-management and disclosure framework that will allow companies and financial institutions to assess their exposure to nature-related risk, declare it and act on it.

In the first quarter of this year, we will release a beta version of that framework, built around metrics that already exist. It will provide companies, regulators, and others with a meaningful measure – something they can look at and see whether they are performing well or need to improve. For example, if a business has operations that are reliant on water for cooling but there is a sustained risk of drought where it operates, the company would be able to capture that situation and let others know about it, including what it is doing to mitigate the threat. Banks that lend to the business and auditors that evaluate its liabilities would be able to see the declaration and act accordingly.

Over the course of 2022, we will work with our members, as well as leverage the input of the TNFD Forum, a wider group of more than 250 companies, financial institutions, and multilateral bodies, to launch this fully functioning management and disclosure framework. Declarations would initially be voluntary, but the aim, ultimately, would be for them to be mandatory. The overall goal is to bring about a shift in capital allocation away from nature-negative operations and towards nature-positive ones.

This isn't just a U.S. or UK initiative being imposed on the rest of the world. Our Taskforce has purposefully sought input from members from across the globe – Europe, Africa, Latin America, Australasia and Asia, with India a prominent contributor. We have global banks, major regulators, auditors, and globe-spanning corporations, like Tata Steel, or XXX that are actively involved in the design

As co-chair of the India UK Financial Partnership, involving over 60 CEOs, the financial regulators, HMT, and India Ministry of Finance I have seen the opportunity from government and business focusing together to create better economic outcomes. I have also witnessed first-hand the impressive steps the Indian businesses and government are taking to reduce their impact on environment. India now has more large solar generation projects than any other major economy in the world, which means that it's recent commitment at COP26 that over half of all energy generation will be from renewable sources by 2030 looks not just achievable but transformational, the benefits are not just from energy dependency and CO2 emissions reduction but also massive pollution and air quality improvement. But of course, with such reliance on nature we must all go further. Boardrooms must include nature and environment in their risk-management oversight. Governance must take into account how nature-related risk is being mitigated, both at the operational level and when it comes to longer-term corporate strategy. Senior ESG officers should already be incorporating nature and biodiversity in their management models and hiring the skills and expertise required to manage this going forward.

There is no doubt that this issue will be the next major concern in risk management. Taking steps to understand where the regulatory guidelines will fall is the best way to position any business for the future. It is something that every business can act on right away, with TNFD keen to work with partners – whether via Taskforce Members or its wider Forum – to explain how nature and biodiversity related risk can be assessed and accounted for. In the next few months, once the TNFD has released a first draft of its disclosure framework, boardrooms can start to gauge their exposure and think through what steps will be required to mitigate risks and embed new practices into the business. We welcome the active participation and input form India business in this phase.

No one is pretending this is going to be easy. But the rewards – for nature, climate, for local communities and the global economy – will be vast if we get this right. The focus on climate in recent decades has created significant commercial opportunities, not least in renewable industries. Likewise, a clearer assessment of nature-related risk can spur innovation and opportunity. The World Economic Forum estimates up to $10tn in new economic activity will be generated by 2030 with a shift in capital towards nature-positive outcomes, this benefit is not just to big business but the rural communities, especially in India, whose very existence depends on the health of our natural ecosystems and how to maintain both their natural and economic productivity.

We will only reap those benefits by managing the risks. We know that without changing the way businesses look at and account for nature and biodiversity, we will never see the changes we need. So, when it comes to tackling nature-risk, we need to get to work right away.

***Mr. David Craig** *is Co-chair of the Taskforce on Nature-related Financial Disclosures (TNFD), and Senior Adviser to London Stock Exchange Group plc (LSEG). He co-chairs the India-UK Financial Services Partnership (IUKFP) between UK and Indian Banks, the UK HMT and the Indian Ministry of Finance.*

THEME ARTICLE

Sustainable Business is becoming Business as usual - a **Sustainable Strategy is Key**

*Ms. Jessica Fries

> "My Accounting for Sustainability Project is providing you with the guidance, tools and training required. My only hope is that you can learn from these examples and take heart from the success of the members of the various A4S networks."

Sustainability has never been more important for companies and their long term success. Amid climate change, the global pandemic, and a growing number of other pressing social and environmental issues, there is a strong business case for shifting toward resilient and sustainable business models. A sustainable business is one that delivers financial returns in the short and long term in a way that generates positive value for society and the environment, operates within environmental constraints and contributes to the ongoing resilience of social and environmental systems. In the past, organizations took action as part of corporate responsibility. They are now seeing sustainability as core to strategy and decision making, reinforced by action from investors, regulators, customers and communities. In summary, sustainability issues are business issues. While the specific factors that are most relevant to your company will vary depending on the nature of your business and the geographies in which you operate, there are certain universal environmental and social factors that are likely to impact all companies in some way. There is a growing recognition of the need to address systemic environmental crises such as biodiversity loss and climate change. Social issues, such as equity, diversity and inclusion, are also becoming business critical. A new generation of consumers, employees and shareholders is expecting more from businesses at a time of growing ability to identify and unite around issues of concern. These factors have a profound impact on the operating environment for business, presenting both risks and opportunities. Examples of some of the key trends impacting business over the coming decades, many of which are interconnected, are summarized below.

The focus on sustainability risks and opportunities has increased dramatically, including the following drivers:	
• Transitioning to net zero GHG emissions • Building resilience to climate impacts • Restoring nature and biodiversity	• Addressing poverty and inequality • Tackling diversity, equity and inclusion • Building sustainable supply chains

HRH The Prince of Wales established Accounting for Sustainability in 2004 to make sustainable business, business as usual. Since then, A4S has worked with senior global leaders from across the business and finance world to inspire leadership, transform decision making and scale up action.

Over the past two years, the pace of change has accelerated dramatically. There is an expectation that directors will consider

social and environmental factors when making decisions. This trend has been reinforced by the pandemic. A4S has undertaken research into lessons learned for business, captured in the report, "Building a Better Future", which identified the following key takeaways:

- Values-based, purpose-driven approaches have enriched decision making and laid the basis for resilience.
- There is increasing appreciation that a multi-stakeholder, multi-capital approach offers a holistic view and a strong framework for better business performance.
- Organizations that make meaningful contributions to their communities now are building trust and a positive reputation.
- Capital markets are focusing more heavily on sustainable businesses, which are benefiting from more access to capital.
- Insight into the vulnerabilities that have been exposed in global supply chains is showing organizations how to create more sustainable structures for the future.

Further, the growing appreciation among capital market participants as well as society as a whole into the significant risks associated with the climate crisis has provoked a step change in approaches. Investors are increasingly demanding that companies set clear net zero goals and report on their plans and progress. This acceleration in pace was evident at the recent UN Climate Conference, COP26, hosted in Glasgow, UK. Over US$130 trillion of private capital is now aligned to net zero emissions by 2050 as part of the Glasgow Financial Alliance for Net Zero (GFANZ), a consortium of more than 450 banks, asset managers and insurers. Speaking at the announcement Mark Carney, UN Special Envoy for Climate Action and Finance and former Chair of the Financial Stability Board, said, "We now have the essential plumbing in place to move climate change from the fringes to the forefront of finance so that every financial decision takes climate change into account."

> "We now have the essential plumbing in place to move climate change from the fringes to the forefront of finance so that every financial decision takes climate change into account."
>
> ***~ Mark Carney***
> ***UN Special Envoy for Climate Action & Finance; & former Chair of the Financial Stability Board***

The changing regulatory and reporting landscape

To tackle the climate crisis and deliver on their net zero commitments, businesses and investors need the right information to set strategy and make informed decisions. Without this information they are walking blindly, making the reductions in greenhouse gas emissions needed to avoid the worst impacts of climate change significantly more difficult to achieve. A growing number of regulators are stepping in to place requirements on companies and their directors to take action and provide investors with disclosures on climate-related risks as well as wider environmental, social and governance (ESG) factors.

96% of the world's largest 250 companies already prepare sustainability reports, alongside thousands of other organizations around the world. However, without global mandatory reporting standards on par with and connected to those for financial reporting the quality and comparability of the information in these reports can be limited. This makes informed decision making difficult for investors and other stakeholders, and increases the risk of greenwashing. Further, setting credible net zero greenhouse gas emission goals and assessing whether we are on track to meet them is dependent on robust measurement, accounting and reporting along the full value chain.

An essential piece of plumbing announced at COP26 has been the establishment of the IFRS Foundation's International Sustainability Standards Board (ISSB). For A4S, and many in our network, this is something we have been working towards for a long time. This is a significant milestone towards the establishment of an accounting and financial system that can provide the foundation for a vibrant and sustainable economy – a 21st century system fit to deliver the information critically needed for the challenges now faced.

Speaking at the 'Finance for the Future Awards' the day before the announcement HRH The Prince of Wales said, "When I first established Accounting for Sustainability back in 2004, my aim was to help ensure that we were not battling to meet 21st century challenges with, at best, 20th century decision-making and reporting systems. I am relieved to hear that, seventeen years later – so not before time! – real progress is being made. Tomorrow, a key focus of discussions at COP26 will be on finance, including, I hear, the establishment of the IFRS Foundation's International Sustainability Standards Board. Accounting for Sustainability – A4S – has contributed to this

progress by bringing together many of the key global organizations involved in the reporting arena, firstly through the establishment of the International Integrated Reporting Council at a roundtable that I hosted in 2009, and then the Task Force for Climate-related Financial Disclosures in 2015. Additionally, A4S works with CFOs and investors to support the practical adoption of reporting frameworks to drive better decisions."

The ISSB standards will be focused firstly on climate-related risks, with an expectation to expand into other environmental, social and governance (ESG) issues in the future. Developing global standards for sustainability reporting in this way will provide investors, and other capital market actors, with the information they need to assess and evaluate an organization's business performance, inclusive of social and environmental factors. It could also open the door for investors to see the impact of their investments and channel finance towards sustainable outcomes at the scale so desperately needed, although it is important to highlight that the ISSB will focus on enterprise value-relevant ESG issues only, so companies and investors will need to continue to draw on standards such as those developed by the GRI which use an impact lens to determine materiality.

A number of governments have already signalled their intention to adopt the ISSB's standards, in some cases alongside standards which also enable the assessment of a company's impact on society, the environment and the economy. This 'dual materiality' approach is the focus of the EU's current work to develop its own standards, which are leveraging the existing GRI standards as a key reference point. One of the big complaints from companies and investors is the 'alphabet soup' of standards, creating confusion and complexity and acting as a barrier to action. The ISSB's creation is a big step towards simplification, although there is further to go.

Why it is essential for Boards and Executive Management to be involved

Understanding the impact of sustainability trends may signal a need for strategic shifts to refocus the entity's business strategy to counter risks and embrace new opportunities. It may also require changes to the business model. Such changes require active engagement and support at the highest level of entity governance, and a clear tone from the top which catalyses change throughout the organization. The importance of board oversight is clear in the emerging regulations, including the Taskforce on Climate-related Financial Disclosures, a key pillar of which is governance, with these reporting guidelines emerging as the baseline for global reporting requirements, including those being developed by the ISSB.

Redefining an organization to incorporate sustainability at its core will often require significant organizational change, including setting a clear strategy that is defined, implemented, and continually improved. It may also require changes to targeted performance and operational plans, and proactive stakeholder engagement, to retain stakeholder support and ensure access to key resources. The board and executive management is key for spearheading and driving these changes at strategic and operational levels. The board is ultimately accountable for the organization, for appropriate allocation of budgets to achieve strategic objectives and for monitoring performance against those objectives.

Actions you can take to drive change

For organizations that have not firmly embedded sustainability into their overall strategy, it can be difficult to know where to start. However, there are six key questions which may prompt thinking around what your business can do to be more sustainable.

Key questions to consider

1. How sustainable is your business model?
2. Is sustainability integrated into your strategy?
3. Is sustainability integrated into your risk management?
4. Do your governance arrangements reflect your sustainability commitments?
5. Is directors' remuneration linked to achieving sustainability outcomes?
6. Do you measure and report progress against your sustainability targets on a regular basis?

Tabling and considering these key questions may help to identify the core areas where the board and executive management can focus attention to elicit change. More guidance on these questions, and investor expectations associated with them, is provided in the 'A4S Essential Guide to Enhancing Investor Engagement'.

The wider A4S Essential Guide series provides further guidance on each dimension of integrated thinking and decision making. For the board, a key starting point is integration of ESG into each of the key governance functions. The diagram below sets out examples of integration across key board committee.

BOARD LEVEL
Approves strategic plans and budgets and reviews forecasts. Monitors corporate performance.

Board of Directors	• Review and approve organization's sustainable business strategy • Assess organization's performance against sustainable business strategy
CEO	• Develop, execute and monitor organization's sustainable business strategy and policies

BOARD COMMITTEES

Audit Committee	Nominations and Governance Committee	Strategy and Investment Committee
• Understand risk and provide challenge on control environment pertaining to sustainability performance reporting • Review and approve integrated reports • Oversee compliance with regulations relating to sustainability	• Ensure Board has the right mix of skills and capabilities, including demonstrated competence in sustainability • Ensure the director orientation and education programme includes training on sustainability matters	• Oversee and monitor progress against the integrated strategy • Ensure that sustainability factors are considered in the review and approval of major investment decisions
Remuneration Committee	**Sustainability Committee**	**Risk Management Committee**
• Align remuneration policies and incentive compensation plans with sustainability goals that are challenging and lead to the creation of long term social, environmental and financial value	• Contribute to organization's strategic plan ensuring it reflects long term factors and constitutes a sustainable business model • Assess organization's performance against sustainability aspects of integrated strategy • Oversee the organization's compliance with safety, health and environment policies and regulations	• Monitor the organization's aggregate exposure to sustainability risks • Oversee the organization's risk management and business resilience policies

The "A4S Essential Guide to Engaging the Board and Executive Management" gives further examples to help to steer a clear path toward improved resilience and success. With detailed guidance, step-by-step checklists and case studies, the guide illustrates how finance teams can use regular board activities to demonstrate that social and environmental risks and opportunities are key drivers of value.

Importance of finance function involvement

A4S has long sought to inspire action by engaging with CFOs and their finance teams, who play a pivotal role in the financial, strategic and risk management decisions that help create more resilient organisations.

The finance function are the traditional custodians of value measurement and reporting, and their strong existing competencies in data compilation, processing and reporting can add significant value in steering organisations toward improved sustainability processes. Finance teams are also habituated to working with uncertainty, and are increasingly involved with developing scenarios or modelling to assess potential future states of a business in an uncertain future.

That is why one of our key aims is to scale up action across the global finance and accounting community. A4S have recently launched the Asia Pacific Chapter of the Accounting for Sustainability (A4S) Chief Financial Officers Leadership Network with a view to encouraging collaboration and insight sharing across the Asia Pacific Region. Participating in the network may help you to solve challenges when it comes to sustainability, develop finance teams, adopt a leadership stance, and influence others to take action. For more information, see the 'Asia Pacific Chapter of the CFO Leadership Network' on our website.

The key is to start

It is important to note that you do not need to have extensive sustainability plans and processes in place from the start. Ensuring continual progress with honest and transparent communications around the entity's transformation journey and disclosing the status against objectives is key. Having honest conversations with investors, lenders and advisors can also help you to understand where you are and what you need to do to improve.

While achieving progress at the pace and scale needed to tackle the pressing problems faced can be challenging, wherever you

are in the process, the most important thing to do is to start. A4S and other organizations provide a wide array of resources that can assist you on your sustainability journey, and ensure that you are resilient in a changing landscape.

**Ms. Jessica Fries* *is the Executive Chair of the Accounting for Sustainability (A4S), which is a part of The Prince of Wales's Charitable Foundation (PWCF) Group of Charities. She is also a member of the International Integrated Reporting Council Governance and Nominations Committee; the Smith School Global Sustainable Finance Advisory Council; the UN Global Assessment Report Advisory Council and the Global Reporting Initiative.* ■

THEME ARTICLE

Use ESG Strategies in the Boardroom to help shape

India's – and the World's – Future

*Ms. Helle Bank Jorgensen

For 30 years, I have worked with world-renowned leaders to help businesses in many countries turn sustainability, including ESG and climate, risks into innovative and profitable business opportunities.

Although I have been called a pioneer, the reality is that my experience and knowledge was shaped by leaders in India and elsewhere who wrote about and practised sustainable business practices long before I was born. One of these leaders, a larger than life one, is Jamsetji Tata, founder of the Tata Group. He noted more than a century ago: "In a free enterprise, the community is not just another stakeholder in business, but is, in fact, the very purpose of its existence."

Unfortunately, his wisdom did not stay front and centre of business conversations. Instead, many business leaders started to believe that the singular purpose of their existence was to make profit for their shareholders. This belief was aided and abetted by Milton Friedman, who posited that the main purpose of the corporation is to make a profit—without exception.

That thesis has brought the world to its knees. A fast-growing number of people now realize that there are limits to how much we can use nature's free resources without putting in place any regenerative measures. A warmer planet will change how we live, work and do business. Mother earth is starting to send us invoices in the form of severe changes to weather patterns.

We are already cashing cheques, but the price just keeps getting higher. We are having to spend more money making businesses and supply chains more resilient to this climate onslaught. Lives and livelihoods are being lost due to these climate-change events. Biodiversity is shrinking like a puddle in a heatwave, while more and more people are experiencing a sharp drop in quality of life and their health.

In short, the world needs a miracle, probably several. However, there is one that a board of directors can deliver when they start to learn about and understand the risks and opportunities that they face. And that must start with them learning the ABCs of ESG (environmental, social and governance) and climate issues. These issues, which have traditionally been excluded from financial analyses, now need to be addressed by companies in India and all over the world.

There is a lot of work to do and not much time to get it done. 'The Sustainability Board Report™ 2021' of The Sustainability Board Report Ltd.- an independent not-for-profit project, which aims to showcase different dimensions of sustainable business leadership and corporate governance, examines the world's largest 100 publicly listed companies. The data showed that only 40% of directors serving on a board committee that oversees ESG and sustainability were ESG Conscious (The Sustainability Board definition of ESG Consciousness is "elucidates sustainability, knowingness, attitudes, and behaviour"). Of greater concern, fewer than 1 in 10 directors (8%) had any kind of formal ESG training.

Why can board members deliver this miracle the world needs? In short, they are the most influential players in a company. They not only hire and fire the CEO, but they are the guardians of the company's long-term success. They agree on the purpose of the business, set the strategic direction and make informed decisions about what is best for the company and its stakeholders.

A new report by Heidrick & Struggles and INSEAD- "Changing the Climate in the Boardroom" released in December 2021 gave some cause for optimism that the rupee is starting to drop in some boardrooms. Three-quarters (75%) of the surveyed 301 boards in indicated that climate change is very or entirely

important to their company's strategic success. On the flip side, 69% said climate change knowledge is not a formal requirement for joining their board, and climate change knowledge is not included in their board's competency matrix.

Boards simply need to take more responsibility. A company's success in 2022 and beyond will be contingent on how well it embeds ESG considerations into all its deliberations and decisions. ESG cannot be an afterthought; ESG must be the proactively embedded compass that every employee and business partner uses.

This compass must guide all employees, shareholders, stakeholders and customers to the company's true North Star: its purpose, value and impact on everyone and everything that they impact.

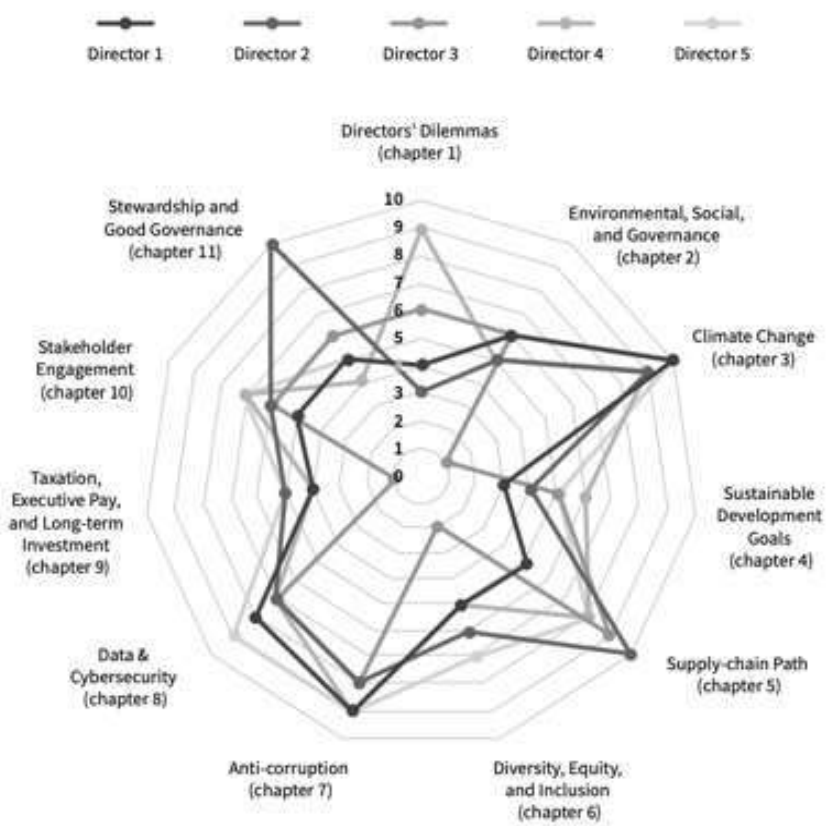
Professor Mervyn King, Professor Extraordinaire at the University of South Africa on Corporate Citizenship and another world-renowned leader, describes the situation so eloquently: "The Company itself is an incapacitated person that has no heart, mind, soul, or conscience of its own." Therefore, the leader, the employees and the partners need to be the heart, mind, soul and consciousness of the company. They must become 'Stewards of the Future' ('Stewards of the Future: A Guide for Competent Boards' is a book authored by Ms. Helle Bank Jorgensen, releasing in January 2022)

The book is filled with insight, experience and wisdom from over 100 world renowned board chairs, board directors and executives. It focuses on identifying ESG risks and turning them into opportunities. In each of the 11 chapters there are 10 key questions that boards and executives can use to determine how well aligned they are on ESG strategies, actions and outcomes. Then they can plot out the answers on the chart below to gauge how well these critical issues are dealt with in the boardroom.

However, it is not just climate, biodiversity and other environmental matters that are or should be on the top of board agendas in the year to come. Add social issues to the list. Although our world has been ravaged by the COVID-19 pandemic, we can all see the mental health damage this has caused, too. This has hit our kids — our future — the hardest.

Being a board member today – and tomorrow is and will be very different than being a board member of yesterday. And there is no looking back – unless you want to put your head in the sand and hope for a miracle. I hope that you want to be a steward of the future and will use your wisdom to help shape India's — and the world's — future.

Example: Recording of individual director's 1-to-10 rating of performance on 11 critical issues facing boards and the corporations they serve (for ease of illustration, only 5 board directors are indicated). Correlation to respective chapters in the book is included.



Source: Competent Boards.

> "When we leave this Earth, as we all inevitably must, what matters will be what we leave behind and for whose benefit. Ten conscience questions per chapter and eleven chapters later, you will know what your company should leave behind and for whom."
>
> ***~ R. Gopalakrishnan, Author and Corporate Advisor***

**Ms. Helle Bank Jorgensen is an internationally recognized expert on sustainable business practices. She has a 30-year track record in turning Environment, Social, Governance (ESG), Climate and Sustainability risks into innovative and profitable business opportunities. She works with many global Fortune 500 board members and executives, as well as smaller companies and investors. She is the founder and chief executive of Competent Boards.* ■

THEME ARTICLE

Driving Environmental Stewardship through Executive Compensation

*Mr. Shai Ganu

The Intergovernmental Panel on Climate Change's (IPCC) 6th Assessment Report released in August this year callout climate change as a code red for humanity. Unless the world sees a drastic reduction in greenhouse gas (GHG) emissions well beyond the targets already adopted worldwide, average global temperature is expected to surpass the 1.5°C threshold within the next 20 years, causing extreme and irreversible damage to people and the planet. South Asia, including India, will experience an increase in extreme weather events.

Given the criticality of climate crisis, more and more companies and investors are realising the importance of including climate change metrics both in management systems, corporate disclosures, and compensation plans alike. Additionally, other stakeholders including customers and employees have joined the discussion and are voting on their feet and favouring companies that take climate change seriously. Customers are also more willing to buy products and services that set meaningful targets for climate change.

India's recent announcement of a net-zero target at the COP26 Summit is a signal of its climate action and steps the country is taking to curb carbon emissions. However, to translate this target into reality, laying out a pathway to reduce emissions and transition to a low carbon economy is going to be the next step.

Executive compensation as a change accelerant

Executive compensation – both as a carrot and a stick – is a critical lever for companies' management to be held accountable for climate transition. Incentive plans have proven to be an effective tool to focus management's efforts on key priorities and drive desired outcomes. As the saying goes, 'what gets rewarded gets measured, and in turn, gets done'.

In 2019, the World Economic Forum unveiled the Principles for Effective Climate Governance for non-executive board directors. These principles set out how well-governed boards should incorporate a climate lens into all relevant aspects of their oversight functions. In particular Principle 6 — Incentivisation, identifies executive compensation as one of the key mechanisms that drive the right behaviours and enable the company to deliver on its climate transition strategy.

Board Remuneration Committees view Climate and other Environmental, Social and Governance (ESG) issues as top business priorities. They are incorporating these goals in performance management and executive incentive plans.

According to Willis Towers Watson's 2020 board of directors' global survey on Aligning ESG and Executive Incentives, nearly four in five respondents (78%) are planning to change how they use ESG with their executive incentive plans over the next three years. Directors listed Environmental and Climate issues as their number one priority, and 41% plan to introduce ESG measures into their long-term incentive plans over the next three years, while 37% plan to introduce ESG measures into their annual incentive plans.

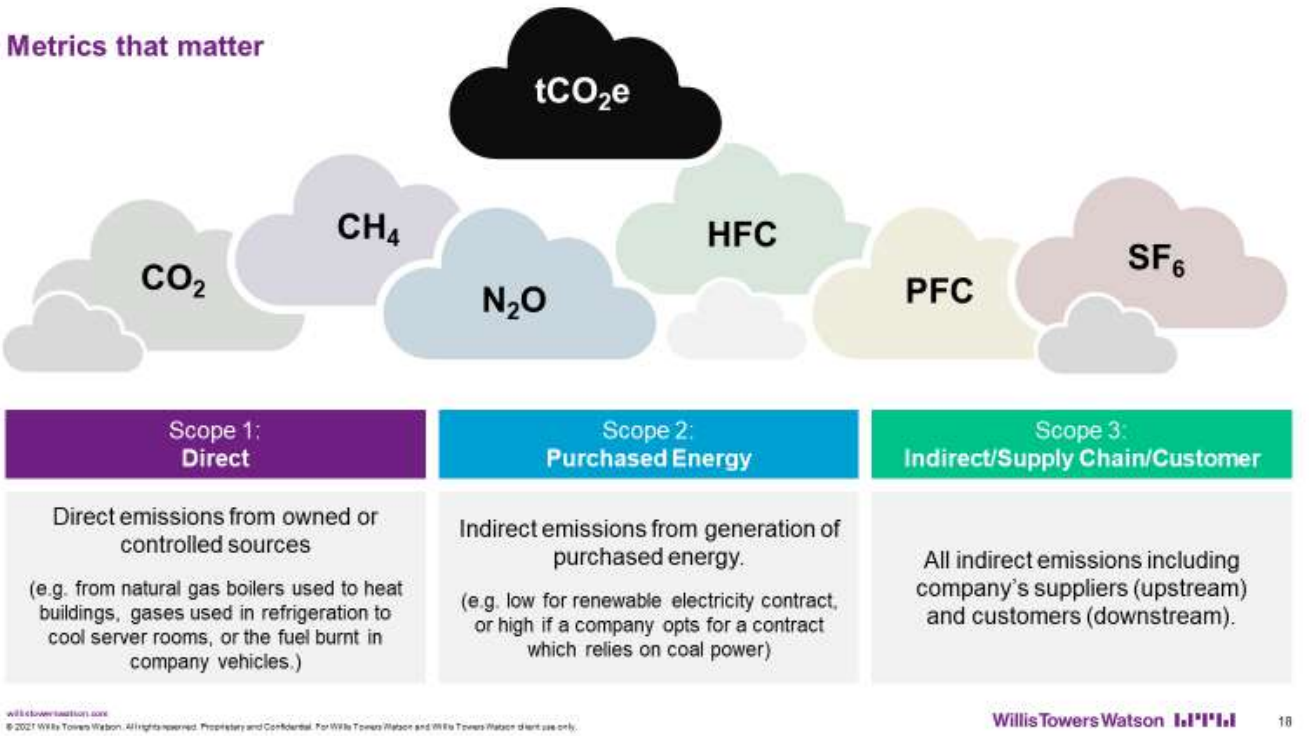
Metrics that matter: measuring carbon emissions

Depending on the industry, there could be several Climate related goals - such as GHG emissions, Carbon intensity, water security, waste management, circular economy, bio-diversity, renewable energy consumption etc. However, the most pressing goal is related to GHG emission reductions.

Tonnes of carbon-dioxide equivalent (tCO2e) is the most commonly used and standardised unit in carbon accounting to quantify GHG emissions. tCO2e is the unit for GHG emissions, reductions, carbon pricing, and carbon credits. It is an important agreement in climate change policy as it provides a standard measure of emissions. The six main greenhouse gases: carbon

dioxide (CO2), methane (CH4), nitrous oxide (N2O), hydrofluorocarbons (HFCs), perfluorocarbons (PFCs) and sulphur hexafluoride (SF6) are converted according to their global warming impact and expressed as tCO2e.

A company's GHG emissions can be classified under three scopes. Scope 1 is direct emissions from owned and controlled resources, Scope 2 is indirect emissions from sources of purchased electricity and Scope 3 is all indirect emissions along the company's value chain, including suppliers, customers, and partners.



To effect meaningful change, companies should set sufficiently stretched and long-term tCO2e reduction targets. For example: a 50% reduction by 2030 and net-zero by 2050. In some industries environmental impacts are at the core of their business strategies and companies are transforming their portfolio or product mix accordingly. Not only do they need to focus on both climate impact measures such as CO2 emission reductions, but also on climate transition priorities, such as energy companies shifting towards renewable energy production.

Incorporating climate measures into incentive plans

There is a strong consensus among investors that companies must select climate metrics that are material to their businesses. Investors expect companies to demonstrate the appropriateness and extent of climate metrics through market-leading disclosure. They want the metrics to be material to the company and goals to be significant, measurable and transparent. If sustainability and environmental goals are front and center of the company's business strategy, then it should consider linking relevant ESG measures to executive incentive plans.

There are a few design alternatives to do so, ranging from underpins, to modifiers, to short-term incentive (STI) plans, to key performance indicators (KPIs) within long-term incentive (LTI) plans, and a standalone hyper-long-term incentive plan.

Whilst over the past few years, we have seen an increase in prevalence of ESG metrics in executive incentives, there is still room for improvement for adoption of climate metrics. Based on a recent Willis Towers Watson's research of US S&P 500 companies and top 350 European companies, more companies have environmental measures in their annual incentive plans compared to their long-term incentive plans. And we expect more companies to start incorporating ESG and Climate measures in both STI and particularly in LTI plans.

Indeed, most boards believe that climate goals should be measured over the medium- to long-term (three to five or more years), even if this means incentivising executives to make longer-term climate investments that often do not bear fruit during their tenure.

Effective governance of climate-related compensation plans

The continuum of effective compensation governance starts with the company's business imperatives. And the Board plays a critical role in setting the long-term vision and defining short- and medium-term milestones. Boards need to prioritise which climate topics are most important to address, where they should be addressed (i.e which committee or the full board), how often to address them and how to provide effective oversight.

Following which, the Remuneration Committee and the Board should pay attention to the selection of relevant performance measures. This should start with a broad funnel of metrics and then refined based on key principles of alignment with strategy, materiality of outcomes, measurability and target-setting, comparability over time and across companies, and clarity and transparency. Metrics that are consistently measured and tested by management, reviewed and vetted by the board, and shown to be material to the business and of value to investors and stakeholders, should then be linked to incentive plans as discussed in earlier section.

Next, companies should pay heed to disclosures to investors and the public. It is important for management and the board to be in sync on what gets disclosed and how it gets communicated. The board should review and discuss the programs and achievements summarised in public statements. Finally, the Remuneration Committee and the Board must monitor progress and direct management to expand, contract or reprioritise the range and depth of climate issues management is taking on.

Call to action for companies

The merits of linking executive compensation and climate objectives are well established. Emissions reduction and renewable energy adoption are increasingly prevalent metrics in executive incentive plans, especially in Europe and the U.K. and in high-emitting industries such as Oil and Gas.

There remains much for the business community to learn about the implications of transition to net-zero. Setting consistent and reliable goals and milestones will be challenging. But companies must resist the temptation to inaction, as climate risk is widely considered the single most significant risk to the planet, businesses and the stability of the global financial system.

The recently released 'Executive Compensation Guidebook for Climate Transition' by Willis Towers Watson in collaboration with the World Economic Forum's Climate Governance Initiative provides an important resource guide to companies. As companies navigate through some of these complexities, they will benefit from drawing on key executive compensation guiding principles of *Purpose, Alignment, Accountability, and Engagement*.

Importantly, this starts with the appreciation of why the organisation exists, ensuring management is aligned with interests of all stakeholders, having clarity regarding pay and performance linkages, and understanding human behaviours, retention and engagement. These will help companies design more meaningful pay programmes and effect positive outcomes.

***Mr. Shai Ganu** is the Managing Director and Global Leader for Executive Compensation at Willis Towers Watson.*

THEME ARTICLE

Implications of COP26 and ESG

*Mr. Pradeep Chaturvedi

The outcome document, known as the Glasgow Climate Pact, calls on 197 countries to report their progress towards more climate ambition next year, at COP27, set to take place in Egypt. A number of participants felt disappointed because of softening of the language of the declaration. The language of the earlier draft "the phase-out of unabated coal power and of inefficient subsidies for fossil fuels" was softened. The language in the final draft was toned down to "phase down" coal use. India was credited to have demonstrated diplomatic acumen in achieving this change.

The UN Secretary General summed up the outcome of COP26 at Glasgow in following words, "The approved texts are a compromise. They reflect the interests, the conditions, the contradictions and the state of political will in the world today. They took important steps, but unfortunately the collective political win was not enough to overcome some deep contradictions. We must accelerate actions to keep the 1.5 deg goal alive. We are still knocking on the door of climate catastrophe. It is time to go into emergency mode or our chance of reaching net zero will itself to zero. I reaffirm my conviction that we must end fossil fuels subsidies. Phase out coal. Put a price on carbon. Build resilience of vulnerable communities against the here and now impacts of climate change. And make good on the $ 100 Billion climate finance commitment to support developing countries. We did not achieve these goals at the conference. But we have some building blocks for program". His concern was clear.

Key COP26 Achievements

The COP26 outcome document, however, reflected commitments to end deforestation; to drastically reduce methane emissions; and to mobilize private finance around net zero. The text also reaffirmed resolve towards the 1.5 degree goal; boost climate finance for adaptation; recognized the need to strengthen support for vulnerable countries suffering from irreparable climate damage. At COP26, parties built a bridge between good intentions and measurable actions.

Private Sector Engagement

The private sector also showed strong engagement with nearly 500 global financial services firms agreeing to align $ 130 trillion – some 40 per cent of the world's financial assets – with the goals set out in the Paris Agreement, including limiting global warming to 1.5 degrees Celsius.

Cut Emissions from Methane and Coal

There was also a methane pledge, led by the United States and the European Union, by which more than 100 countries agreed to cut emissions of this greenhouse gas by 2030. Meanwhile, more than 40 countries – including major coal-users such as Poland, Vietnam and Chile – agreed to shift away from coal, one of the biggest generators of CO2 emissions.

US – China Pledge for Climate Cooperation

Also, in a surprise for many, the United States and China pledged to boost climate cooperation over the next decade. In a joint declaration they said they had agreed to take steps on a range of issues, including methane emissions, transition to clean energy and decarbonisation. They also reiterated their commitment to keep the 1.5C goal alive.

Green Transport

Regarding green transport, more than 100 national governments, cities, states and major car companies signed the Glasgow Declaration on Zero-Emission Cars and Vansto end the sale of internal combustion engines by 2035 in leading

markets, and by 2040 worldwide. At least 13 nations also committed to end the sale of fossil fuel powered heavy duty vehicles by 2040.

Beyond Oil and Gas Alliance

Many 'smaller' but equally inspiring commitments were including one by 11 countries which created the Beyond Oil and Gas Alliance (BOGA). Ireland, France, Denmark, and Costa Rica among others, as well as some subnational governments, launched this first-of-its kind alliance to set an end date for national oil and gas exploration and extraction.

On the thorny issue of financing from developed countries in support of climate action in developing countries, the text emphasizes the need to mobilize climate finance "from all sources to reach the level needed to achieve the goals of Paris Agreement. Private businesses have to play a more crucial role.

India's Stand

The Prime Minister of India presented five nectar elements, 'Panchamrit', to deal with the challenge of climate change, as follows:

First: India will take its non-fossil energy capacity to 500 GW by 2030.

Second: India will meet 50 percent of its energy requirements from renewable energy by 2030.

Third: India will reduce the total projected carbon emissions by one billion tonnes from now till 2030.

Fourth: By 2030, India will reduce the carbon intensity of its economy by less than 45 percent.

And fifth: By the year 2070, India will achieve the target of Net Zero.

These 'Panchamrits' will be an unprecedented contribution of India to climate action.

The Prime Minister also, presented the concept of one word – LIFE – which means Lifestyle for Environment. What is needed today is mindful and deliberate utilization, instead of mindless and destructive consumption and he advised the path that is best covered by ESG.

ESG Agenda and Rating

Climate change discussion has given ESG a greater push. As businesses have come center-stage to achieve Net Zero Target, ESG concept and implementation has become important. ESG issues continue to integrate with strategic business imperatives. The pandemic and climate change have highlighted the importance of sustainable and resilient business models to support the economic recovery, basing on insightful reporting to provide stakeholders with a clear understanding of models, while making informed investments and taking other related decisions. Investors and bankers are having expectations on ESG disclosures, and companies are expected to have systems and data based information to ensure authenticity.

ESG Rating Agencies have important role. An important issue is "How can the data of Rating Agencies be rated." Whether they are using the latest data or not is a key issue. They have to correlate hundreds of data points. Successful agencies will be those remaining ahead of the curve. Rating of different agencies will seldom converge and comparisons with other agencies is not an option. Benchmarking becomes difficult. Though SEBI is expecting top 1000 companies to submit 'Business Responsibility and Sustainability Report (BRSR)' to report annual sustainability progress. It is expected that about 200 top companies will create their own system and manpower. Their reports will be true and factual. A large number of software companies will also mushroom to support other 800 companies prepare their reports. The validity or reliability will be difficult to ascertain. Each of the software companies will write their algorithm and create their models. So the output will be constrained by their models and the data points used by them.

India Ratings and Research (Ind-Ra) has announced the launch of its integrated disclosure that show how environmental, social and governance factors impact individual credit rating decisions. These disclosures will be part of rating action commentaries (RACs) for all entities having listed securities whose ratings will be assigned or reviewed effective 1 January 2022. It will be based on total 14 comprehensive ESG sub-factors considered a part of this disclosure: 5 of these are environment related; 5 are social related and 4 are governance related. Environmental factors include: Greenhouse gas emission/air quality; energy and fuel management, water and waste water treatment; waste and hazardous materials; and exposure to environmental impacts. Social factors include: community relations and social access; customer welfare, product safety, data security; labour relations and practices; employee well-being; and exposure to social impacts. Governance factors include: operational execution; governance structure; group structure; and financial transparency.

Rating of companies for their ESG involvement may become a significant factor in decision making.

** **Mr. Pradeep Chaturvedi** is the Vice President of the Institute of Directors.*