THEME ARTICLE

Board's ESG Strategy for Creating a Sustainable Corporate Future

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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

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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.

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