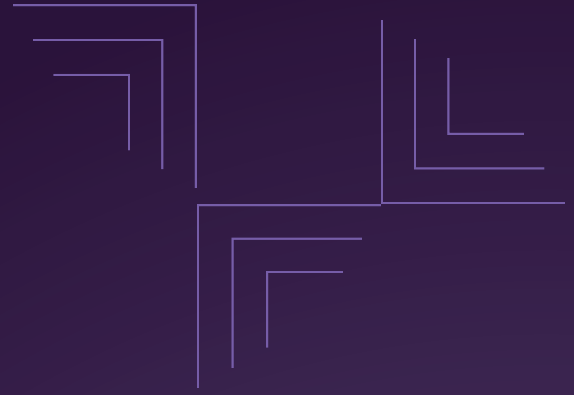
Galvanize



How the board can drive ESG improvement

Guiding a conscious organization

Table of contents

Organizations are paying attention to ESG priorities 3

ESG categories 5

How ESG became a critical business goal 6

Taking a proactive approach to ESG 8

Groups publishing ESG frameworks & related materials 11

Conclusion 14

Organizations are paying attention to ESG priorities

An ever-growing number of stakeholders—including employees, investors, consumers, and business partners—are forcing businesses to prioritize good corporate citizenship.

In fact, Deloitte's 2018 Global Human Capital Trends survey[1] revealed that 77% of the nearly 11,000 respondents cited good corporate citizenship as important, and 36% rated it as very important. So, from its impact on the environment, to the labor standards of third parties, to fairly selecting board members, everything an organization does and the way they do it is now under intense scrutiny.

Corporate citizenship is a company's ability to do social good and account for its actions–both externally (among customers, communities, and society), and internally (among employees and corporate stakeholders). And environmental, social, and governance (ESG) refers to the three main ways to measure a company's commitments to ecological sustainability, to its community, and to corporate governance.

It shouldn't be a surprise that ESG is now a critical business goal—it's been on a steady upswing for some time. Now, more and more, investors want information about a company's ESG performance, employees want ESG awareness woven into daily operations, and more consumers and business partners consider a company's ESG behavior when making purchasing decisions.

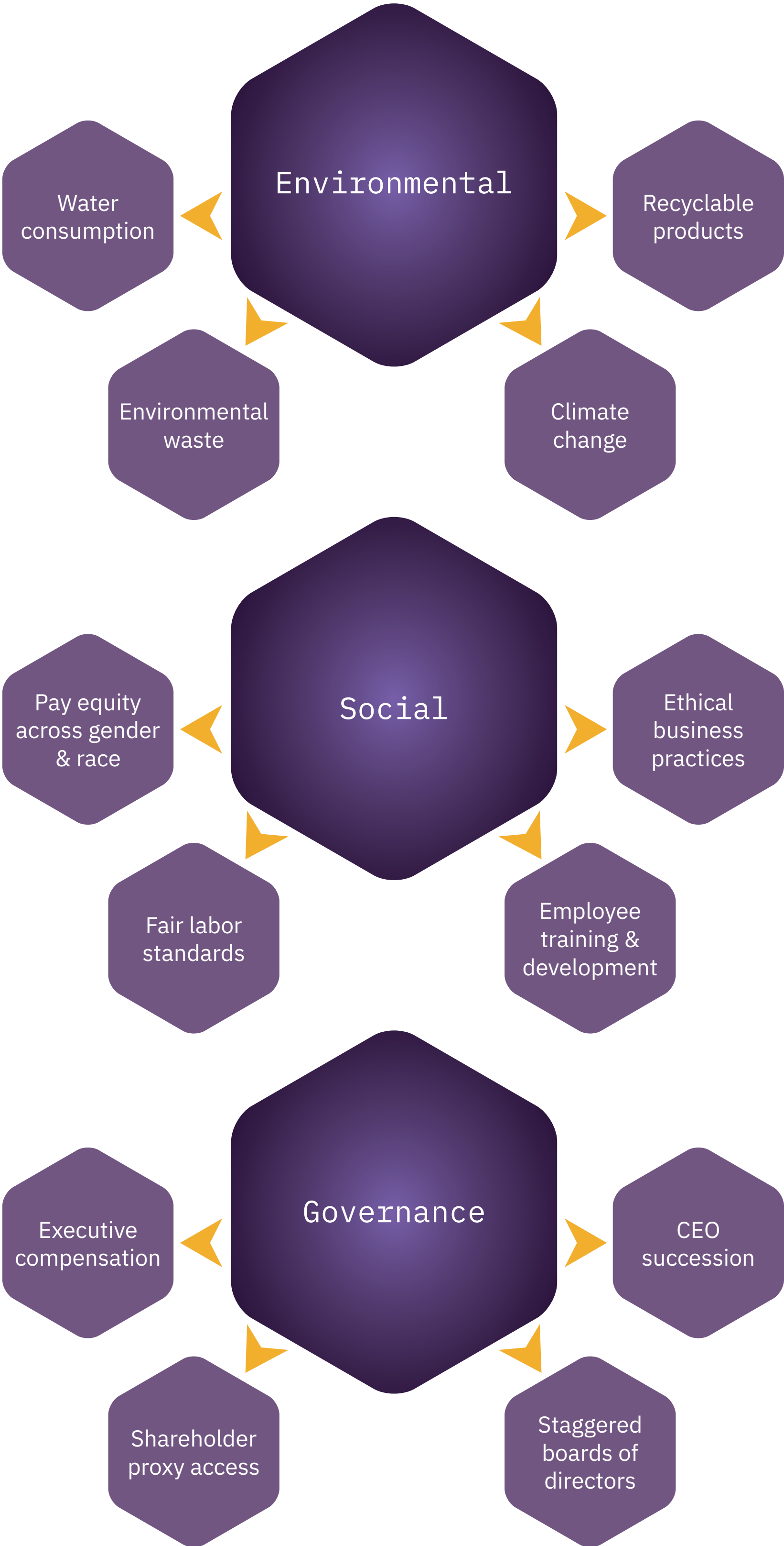
This means ESG concerns have landed on board agendas. But it can be challenging for boards to connect the huge list of ESG issues with operational objectives, business strategy, and organizational risk.[2]

This eBook provides actionable ways that boards can proactively position ESG as a priority for all business leaders, through defined roles and ownership; taking a risk-based approach; and setting clear, strategic objectives.

[1] **Deloitte,** *2018, Global human capital trends*
[2] **Harvard Law School Forum on Corporate Governance,** *2019, The board and ESG*

ESG categories

Each organization will be affected by unique ESG challenges, but here are a few considerations in each category.



How ESG became a critical business goal

Before we get into the actionable steps, let's first look at how ESG has evolved over time.

REGULATORY & SHAREHOLDER PRESSURE

Regulators around the world have prodded companies to provide more ESG disclosure since the early 2010s. In the US, for example, publicly traded companies are supposed to disclose any material risks from climate change.[3] In China, state-owned enterprises have had to publish annual corporate sustainability reports since 2017. (China is planning to mandate ESG disclosure for all firms in 2020,[4] but that's not final yet.) The EU requires annual corporate social responsibility (CSR) reports from large companies as well.

That said, the stronger push for more attention on ESG performance clearly comes from other stakeholders. For example, BlackRock, the largest investment fund in the world ($7 trillion under management) said in January, 2020, that it's putting climate change and sustainable growth at the center of its investment decisions.[5] Socially responsible investment funds have mushroomed into more than $30 trillion in assets under management worldwide,[6] so BlackRock isn't alone.

ESG concerns are also popular with shareholder activists. For example, over the last 15 years, corporate America has seen anywhere from 175 to 225 ESG shareholder proposals in any given proxy season. Average support for those proposals rose from 12% in 2004 to 29% in 2019.[7]

[3] **Securities and Exchange Commission,** *2010, SEC Interpretive Guidance*
[4] **CFA Institute,** *ESG Disclosures in Asia Pacific, 2019*
[5] **Financial Times,** *2020, BlackRock shakes up business to focus on sustainable investing*
[6] **USSIF,** *2018, Global sustainable investment review*
[7] **Morningstar,** *2020, ESG proxy resolutions find more support in 2019*

CONSUMER HABITS & THE RISE OF MILLENNIALS

Ultimately, ESG demands from employees, consumers, and business partners affect companies on a daily basis. From a revenue perspective, nearly half of consumers told polling group Nielsen they are willing to change their buying habits to help the environment.[8] And when it comes to employee acquisition and retention, one survey in 2018[9] found that 90% of employees would accept less future income for work that's "meaningful."

That's especially true for millennials, who change jobs more frequently, and say they want to work for a company with a purpose. They (and Generation Z) are also savvy users and consumers of social media; they know how to manipulate it to advance their interests. This can expose organizations to reputational risk. (We've all seen social media campaigns erupt online, where a clever hashtag and outrage over allegations of human trafficking, environmental pollution, or sexist managers can leave a corporate reputation reeling.)

By 2025, millennials are estimated to reach 75% of the global workforce.[10] Those employees will become the managers and executives who set strategy and operations in the 2020s and beyond, and ESG will be at the core of these decisions.

This demand for an ESG focus from other stakeholders is crucial, because it shifts how the organization responds. When regulators push for ESG disclosure, companies view ESG as a compliance exercise. But, as a board, it should be seen instead as an opportunity to position the organization as taking a proactive, rather than reactive, stance.

[8] **Nielsen.com,** *2018, Was 2018 the year of the influential sustainable consumer?*
[9] **BetterUp.com,** *2018, Workers value meaning at work*
[10] **Catalyst,** *2019, Demographic trends in population and workforce*

Taking a proactive approach to ESG

Now that we've clocked the catalysts of ESG, let's review some actionable ways that boards—as stewards of long-term enterprise value—can guide an organization toward forward-thinking ESG.

01 Identify & gather the right functions

ESG issues affect the general betterment of those inside and outside of the organization, plus they influence and are influenced by so many different functions (e.g., finance, legal, HR, risk, compliance), so the first step would be to identify those functions within your organization. Next, decide on who does what.

02 Define roles & ownership

Who should lead the charge on ESG issues? The honest answer is that it depends. Each organization needs to find whatever oversight and leadership model works best. But regardless of who owns it, the board's role is to set the tone at the top.

At the board level, most companies still have the typical structure of audit, compensation, and nominating and governance committees—and ESG somewhat touches all of them, but doesn't fully fit within the charter of any of them. For example, environment, health, and safety (EHS) risks would fall under the "E" of ESG, and could go to the audit committee. Pay equity is part of the "S" and goes to the compensation committee. Diversity on the board falls under "G" and goes to the governance committee.

At the executive or managerial level, oversight can be just as siloed. Identifying who would craft and execute on the strategy can help define the board's direction, expectations, and levels of support, as well as uncover possible gaps and risk.

The business functions that touch ESG issues could include:

+ **Procurement,** working to find ethical and reliable suppliers.
+ **Legal,** reviewing contracts with suppliers and customers.
+ **Human resources,** monitoring pay equity, workforce diversity, and workplace bullying.
+ **Compliance,** implementing uniform ESG policies and investigating allegations of misconduct.
+ **Audit,** measuring an organization's ESG posture on everything from climate change to fair labor standards to workforce diversity.
+ **PR or investor relations,** monitoring stakeholders' attitudes or statements about the company's performance.
+ **Business operating units,** trying to obey ESG policies and procedures while doing their usual work for the enterprise.

This expansive and very incomplete list shows the untapped opportunity in every corner of the organization to be proactive on ESG issues. And the board must mandate the executive commitment and effective leadership of ESG in each of these corners.

The organization will be more successful in the long term by ensuring that the business areas responsible for risk management are able to develop—and begin executing on—a thoughtful and effective strategy.

By defining the roles and ownership within each function, the board can provide support and leadership (e.g., perhaps a new public policy or risk committee that oversees ESG), and management can provide structure—like an executive-level ESG committee, with members from all relevant business functions.

03 Set objectives & adopt frameworks

Clearly defined and established objectives are critical to an effective ESG strategy. Some might be dictated by regulations, like publishing an annual sustainability report that includes certain ESG metrics. Other objectives might be agreed to after negotiations with stakeholders (e.g., committing to curb greenhouse gas emissions to end a fight with investor activists).

Specific ESG objectives could include:

+ Reducing the company's consumption of water, fossil fuels, or toxic chemicals
+ Using more recycled materials in production, or making final products more recyclable
+ Assuring ethical sourcing in the supply chain, including investigating allegations of forced labor
+ Achieving pay and promotion equity across racial or gender lines in the workforce
+ Aligning executive compensation with long-term, sustainable business growth rather than short-term financial targets.

Organizations can also adopt particular ESG frameworks as part of their commitment to ESG goals. For example, a business might adopt a certain ESG framework as part of a larger decision to publish a sustainability report for various stakeholders and investors. That framework would include numerous ESG objectives—anything from climate change to fair labor to good governance—where the company tries to advance its progress on those objectives over the longer term.

By adopting frameworks, the organization can show stakeholders that it's making attempts to be a good corporate citizen, as defined by those ESG groups who publish the frameworks. The more widely used and accepted the organization's chosen framework is, the easier it will be to show that the company is at least trying to take ESG seriously (even if progress is slow).

Groups publishing ESG frameworks & related materials

The Sustainability Accounting Standards Board, which publishes sustainability standards for 11 major industries and dozens of subsectors, focusing on items that are materially financial to businesses.

The OECD's Due Diligence Guidance for Responsible Business Conduct, published in May 2018.

The Global Reporting Initiative, which has published ESG standards since 1997.

ISO 26000, a standard that offers guidelines for ESG issues, but isn't certifiable like other ISO standards.

The Corporate Human Rights Benchmark, an annual ranking of companies' ESG efforts based on disclosures those companies make to investors.

The Task Force on Climate-Related Financial Disclosures, which offers several pieces of guidance about how to calculate climate-change risk and report them to investors.

04 Track, report on, & improve ESG strategy

This is where the board can really add value. Because ESG is an enterprise-wide effort that touches many parts of the business, boards can bring their combined experience and strategic guidance to help these different functions come together around a common goal.

To do this, the organization must use technology to coordinate all of those moving parts, and report back to the board on the progress and achievement of objectives. Without technology, this effort will fail. There are simply too many parties, debating too many issues, to succeed with ESG using manual processes.

For example, say the company wants to crack down on human trafficking in its supply chain to comply with the anti-slavery statutes cropping up worldwide. That might involve collaboration across:

1. **The legal department**, to review contract language used with suppliers.
2. **The procurement team**, to confirm that all suppliers have accepted the language and certified their compliance.
3. **The compliance team**, managing whistle-blower hotlines that receive allegations of human trafficking.
4. **The legal team** again, to confirm that necessary disclosures meet regulatory requirements.

To coordinate so many moving pieces, business areas need a specialized governance, risk, and compliance (GRC) platform that can deliver several capabilities, and allow for easy, real-time reporting back to the board.

In addition to purpose-built software to manage this strategy, boards should also require:

Trustworthy reporting to guide decision-making

ESG improvements will in most cases involve a considerable amount of data, drawn from multiple business processes or functions (as shown by the human trafficking example earlier). This data feeds reporting and keeps boards informed on progress. So boards must mandate that audit and risk teams use data that's trustworthy—which means a single repository, that can classify evidence and documentation in a clear, easy-to-follow structure.

Regular communication & updates

Along similar lines, the organization needs to facilitate these teams with collaboration tools that let them coordinate across different locations or different business functions. Boards must mandate clear and regular updates from their committees, as miscommunication is always a risk in large organizations, and that's especially true for something as new and evolving as ESG.

Clear evidence of goodwill efforts

As discussed, ESG frameworks already exist. Organizations can use those frameworks to quickly uncover weaknesses, instead of starting from scratch. But it's important to note that a single weakness can cut across multiple business processes, and can involve a complex series of remediation steps to fix. So, GRC software guides those business process owners through the remediation. They monitor progress and escalate the issue if something doesn't get done. This provides a number of documented checks and balances around ESG issues, so the organization has evidence of its efforts and the board isn't faced with a surprise reputation-damaging crisis that could have been avoided.

The bottom line is, when an ESG controversy flares up, either as a regulatory probe or a scandal publicized widely on social media, stakeholders will demand to see evidence of an organization's efforts. With dedicated technology, GRC teams will be set up for success as they move toward a more "ESG-aware" way of operating.

Conclusion

There's no better time than the present to get your ESG house in order. By being proactive, your organization can get out ahead of some pretty major risks like business disruption, compliance, or reputational damage—before ESG regulations increase and organizations need to run to catch up.

No company can ever achieve ESG perfection. But there is tremendous opportunity for ESG improvement—step by step, year after year, as the enterprise weaves ESG objectives and awareness into its business operations and processes, and becomes increasingly more conscious.

The HighBond platform by Galvanize creates stronger security, risk management, compliance, and assurance.

It connects governance, risk, and compliance (GRC) professionals with the answers that drive change—so they can work better together and protect the organization.

For an assessment of how your organization can integrate Galvanize technology to achieve your business goals and support enhanced governance, risk, and compliance, call 1-888-669-4225, email info@wegalvanize.com, or visit wegalvanize.com

Galvanize

ABOUT THE AUTHOR

Matt Kelly

CEO, Radical Compliance

Matt Kelly is an independent compliance industry analyst and consultant who studies and writes about corporate compliance, governance, and risk management issues.

He maintains a blog, RadicalCompliance.com, where he shares his thoughts on business issues, and regularly speaks on compliance, governance, and risk topics.

In 2018 he won a Reader's Choice award from JD Supra as one of the Top 10 authors on corporate compliance. Before starting Radical Compliance, Matt was editor of Compliance Week, from 2006-2015.

ABOUT GALVANIZE

Galvanize delivers enterprise governance SaaS solutions that help governments and the world's largest companies quantify risk, stamp out fraud, and optimize performance.

Our integrated family of products—including our cloud-based governance, risk management, and compliance (GRC) solution and flagship data analytics products—are used at all levels of the enterprise to help maximize growth opportunities by identifying and mitigating risk, protecting profits, and accelerating performance.

wegalvanize.com

©2020 ACL Services Ltd. ACL, Galvanize, the Galvanize logo, HighBond, and the HighBond logo are trademarks or registered trademarks of ACL Services Ltd. dba Galvanize. All other trademarks are the property of their respective owners.