Unlocking Growth with an ESG Competent Board

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Risk management is an essential responsibility for a board of directors, and more recently, investors have been urging corporate boards to broaden the range of risks to include environmental, social and governance (ESG) issues, such as climate-related exposure and supply chain risks. By taking a forward-looking approach and working to address emerging sustainability challenges, boards can unlock growth opportunities, according to influential proxy advisor Institutional Shareholder Services (ISS).

ESG has come to the fore of capital markets as companies shift away from shareholder primacy and embrace stakeholder capitalism, reflecting a commitment to shareholders, communities, employees, consumers and suppliers. Amid this transition, investors have also been driving directors to consider the management of ESG factors and establish frameworks that reflect the company's capacity to assess, monitor, measure and manage these risks.

“Regulators and investors alike will be increasingly focused on the ability of a business to operate in a carbon-constrained future and deliver products and services that are beneficial to both the environment and society,” Bonnie Saynay, Managing Director and Global Head of ESG Research and Data Strategy at ISS ESG, wrote in a recent ISS ESG report.

The global pandemic intensified the attention on ESG, with perhaps a greater emphasis on the social aspect than ever before, putting a spotlight on the issues of income inequality, human rights, as well as diversity and inclusion. Furthermore, as businesses were forced to accelerate their digital transformations, it exposed some ESG investment risks that boards should be addressing.

“The global pandemic has highlighted emerging areas of ESG investment risk, including cyber/ information security, supply chain, natural/ ecological disaster and climate-related exposure, geo-political and reputation/brand risk,” Saynay noted. “Boards have an opportunity to improve their skills in these critical areas.”

Having a board that is prepared to effectively manage and mitigate ESG risks can help facilitate growth by enhancing performance and shareholder value creation. A 2020 study by INSEAD and the University of Pennsylvania found that “firms with more robust risk oversight have higher [environmental and social] E&S ratings, are more likely to integrate E&S issues into their strategies and executive compensation contracts, and ultimately experience better E&S outcomes.”

Notably, proxy advisor Glass Lewis specifically called out E&S risk oversight in its '2021 ESG Voting Guidelines'. Starting this year, the firm will “note as a concern when boards of large-cap companies do not provide clear disclosure concerning the board-level oversight afforded to environmental and/or social issues.” Next year, however, Glass Lewis said it will “start generally recommend voting against the governance chair of a board who fails to provide explicit disclosure concerning the board's role in overseeing these issues.”

With investors and advisory firms more attuned to ESG risks, ISS ESG's Saynay noted that it will require boards to expand and improve their communications with investors, as well as establish programs and policies that tie ESG into the larger corporate strategy and measure sustainability-linked key performance indicators.

"Forward-looking investors and ESG-minded boards will be well equipped to capitalize on the opportunities sustainable, innovative, solutions-focused and resilient-minded companies will experience in the coming years, charting the path for future generations and serving as a model to other corporates' journey into sustainable best practice," Saynay noted.

The article has been authored for Nasdaq Governance Solutions by their internal team.

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