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10 Tips for How ESG Leadership and Staff Can Support Company Boards Guidebook

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Guidebook: 10 Tips for How ESG Leadership and Staff Can Support Company Boards

The importance and visibility of environmental, social and governance ("ESG") programs and initiatives in companies has grown dramatically in the past five years. While many companies have invested in ESG staff, program development and data systems, directors heavily rely on in-house ESG leaders and staff to educate and inform them on the issues.

This is a double-edged sword — it brings board-level visibility, credibility and status to ESG leaders/staff, while also putting a burden on them to communicate complex, ambiguous and potentially intangible matters in an effective way to what can be a difficult audience. ESG leaders/staff must recognize and address challenges in this regard that include:

- **Boards typically lack members with ESG expertise**. Directors don't usually come from professional environmental, climate science, supply chain, social risk or diversity backgrounds. Most frequently, directors claim corporate governance/compliance as their area of ESG expertise.

- **Board members frequently do not know what ESG issues their companies face**. Many directors exhibit a desire to know more about ESG issues, but don't know where to begin the process of learning more and drilling down on the specific ESG issues their companies face. ESG is a wide, confusing and ambiguous topic — communicating about it is a challenge.

- **Board members may not think "E" and "S" issues are important.** Directors may think "E" and "S" matters are day-to-day operational issues not rising to a strategic or board level. Virtually every industry is affected by ESG in some way, and ESG impacts can be strategic, financial and operational. Failure to recognize this may stem from a lack of understanding on the part of directors.

- **Ultimately, boards make important ESG decisions for the company.** Your job as an ESG leader or staff member is to provide directors with adequate information in the best context for them to understand ESG issues and make critical decisions. That means presenting information effectively, being prepared to answer

questions and sometimes accepting decisions/positions with which you may not agree.

Here are 10 practical tips on how ESG leaders/staff — who may be unfamiliar with working alongside their boards — can maximize the effectiveness of their presentations, messaging and overall communication to boards.

1. Present Good Data

One of the worst sins in ESG is presenting or disclosing data that is inaccurate, fraudulent and/or not validated. ESG data is by definition disparate, inconsistent and originates from many different parts of organizations. Some must be collected manually, some by automated scientific measuring equipment, and other data comes from a variety of IT systems. It is critical for companies to design and implement internal ESG data validation/verification procedures. At a minimum, ESG leaders/staff should work closely with internal audit departments — and other departments that may conduct various audits, site visits and evaluations (such as environmental affairs, health and safety, supply chain compliance, procurement, quality assurance, legal, etc.)

A new COSO publication on "Internal Controls Over Sustainability Reporting (ICSR)" provides guidance on how to expand a company's existing internal controls over financial reporting ("ICFR") to include sustainability information. Referencing COSO and/or ICFR when discussing ESG data controls/validation processes should resonate with directors, especially those on audit committees. At the very least, ESG leaders/staff should be prepared to explain how the presented/disclosed data was reviewed and validated as well as the ongoing information controls that are in place to prevent fraud and data tampering.

Of course, not all ESG information is verifiable or tangible, but you are still obligated to make best efforts at obtaining and presenting the best data you can. Screen out information or data that is too speculative, optimistic/pessimistic or that simply doesn't make sense. Compare data sets that purport to have the same scope and coverage for consistency. Apply professional skepticism — rely on credible sources and, where possible, ESG leaders/staff should review original data sources independently. This will be even more important when you are

asked to explain or defend the data or associated conclusions presented to the board. Furthermore, make sure selected ESG data is consistently tracked so that year-over-year trends can be identified.

Some companies undertake external assurance of ESG data and disclosures. This can be valuable and boards — especially audit committees — may prefer this approach. Even in these cases, internal controls and validation procedures should still be applied to ESG data. Remember that the company's information and disclosures are always the company's responsibility, even if it gets external assurance.

When preparing communications to your board, specifically ask yourself about the source of the data and how it has been reviewed/validated. It helps to apply professional skepticism here — ask questions and review original data to the extent possible/appropriate. Don't forget that human errors in transcribing data from a spreadsheet or report into a PowerPoint slide are common. Avoid those by taking a little extra time to make sure that you aren't creating your own errors in otherwise good data.

2. Be Flexible

On occasion, boards won't want to discuss what you prepared even after you invested time preparing information, charts and spreadsheets. You may also find yourself presenting the same information/data more than once, or answering the same question(s) multiple times. Changes in direction are likely, too — something that was important may no longer be important, or boards may ask about new issues rather than current program status.

Not all issues are relevant to every company and directors do not need to be educated in every category. While a comprehensive understanding of ESG issues affecting the company can be useful, boards have limited time and resources and should narrow their focus to which ESG issues are relevant to them and their corporation at large.

It might be easy to get frustrated. ESG leaders/staff should keep in mind that they are the ESG subject matter experts, not the board; educating them is one of the most important roles ESG leaders/staff have. Much about ESG is new and leading edge; there is still a lot of learning boards have to do. Also remember that boards typically meet

quarterly and the directors have other responsibilities in between those meetings.

Things do change — in the company, regulatory environment and even because of geopolitical upheaval. Maintain an open mind about unanticipated change.

How flexible ESG leaders/staff are for the board directly impacts both the program and the company. It would be prudent to consider in advance "what if" scenarios and determine at least initial responses to unanticipated changes or requests. Don't get frustrated.

3. Communicate in Their Terms, Not Yours

Boards operate from a top-down approach and need information that frames ESG issues in a big picture context. Some details/technical supporting information may not be necessary and there is generally no need for directors to possess granular knowledge on any single ESG issue.

Avoid technical or scientific discussions during your initial presentation. Certainly, you need technical data as backup if needed, but it is best not to start with that. ESG professionals tend to continually present facts repeatedly, "yelling" them louder and louder, "delug[ing] the listeners or readers with ever more facts, statistics, figures and ominous projections." But economist Per Espen Stoknes pointed out that "facts and information are perceived independently of the quality of underlying science." Acknowledge that perception in your communication approach.

Likewise, you should avoid ESG jargon, acronyms and abbreviations. This can be hard for ESG professionals as we are immersed in our own language and communication style; however, this doesn't translate well outside of the ESG sphere. Leave the jargon to your internal departmental discussions. Where it is necessary to introduce ESG jargon, acronyms and abbreviations (hopefully, on a very limited basis), take time to clarify or define them. You may also want to reconsider using "hot" business buzzwords, as well. Most of these are already overused by the time they become popular and more frequently than not, tend to make the speaker sound less credible (this may not be true in all industries, however).

Understand that your directors are not environmental, climate or social risk experts. Nurture their information needs — don't alienate them by how you communicate. Talk to your directors in plain language, but be very careful that you aren't perceived as condescending or talking down to your board. That won't go over well. It can even be helpful for ESG leaders/staff to read up on behavioral economics and linguistics to improve how to speak in ways that help get your message across.

4. Help Directors Understand ESG From Different Angles

Boards provide oversight of and guidance to executives on key business issues. They judge the importance or materiality of issues. To do so, they need to understand different contexts of why something is important to different stakeholders. Since directors are not inherently ESG experts, it is incumbent on ESG leaders/staff to help them understand complex issues, including what different priorities different audiences/stakeholders may have.

- **Why should the company care about this issue?** Seeing the real impact of ESG on other corporations may be persuasive in communicating to your board.
- **Who are other stakeholders voicing the concern/issue?** While the board's main focus is the company and its shareholders, the actions of other stakeholders can have direct impacts on the company's strategy, finances and operations. Many times, local communities actively voice concerns that can seem unimportant or perhaps too localized. But there can be a cumulative impact (*i.e.*, multiple communities voicing the same concern) or a catastrophic event that brings previously low-priority issues to the forefront. A recent example of this is that Norfolk Southern's ESG materiality assessment process excluded consideration of local communities through which their rails pass. Communities were not considered an important stakeholder.
- **What are the potential risks and costs of ignoring this issue?** Not all ESG issues can be easily boiled down into dollar outcomes, but for those that can be, quantify them appropriately and realistically. Tip #5 discusses this in detail.

- **What can be gained by addressing this issue?** Managing ESG can appear to be all about risk reduction, but in many cases, there is potential value to be gained. Tip #7 discusses considerations in finding and quantifying opportunities.

- **Is this issue material?** Boards need to understand what ESG issues are material and why. Typically, materiality is referring to issues that could be financially material to the company (again emphasizing the importance of Tips #1, #5 and #7). However, some stakeholders may prioritize issues that are not financially material or are not estimable (such as placing a value on nature, species of flora/fauna or human health impacts of the company's claimed contribution to global warming). Be prepared to objectively defend broader materiality determinations/questions including offering perspectives that the board may not have considered.

5. Be Realistic About Risk Mitigation Values

ESG can be presented in business terms as risk reduction or business growth opportunities. Ceres provides one framework for beginning to identify ESG risks. They developed a list of ESG categories which include:

- **Physical Risks:** Risks associated with physical operations and facilities. Examples: Chemicals used at a facility may create fire or explosion risk. A factory that was previously not located in a flood zone, but due to changing weather patterns is now at heightened risk of flooding.

- **Supply Chain Risks:** Risks from suppliers/vendors or the downstream lifecycle of a corporation's product/service. Example: A supplier of raw materials that utilizes forced labor poses potential supply chain disruption risk in the event the supplier is shut down or the supplier is prohibited from importing their goods/materials into the country.

- **Reputational Risks:** Risks that threaten the goodwill or consumer confidence of a corporation. Example: A corporation targeted by a diversity advocacy organization may find that fewer

customers are willing to do business with them if the company does not have a diverse board.

- **Regulatory Risks:** Risks related to compliance with regulatory frameworks that govern a corporation's activities. Example: A corporation that does not follow regulations relating to employee safety faces legal risk of fines, penalties and legal fees.

- **Litigation Risks:** Risks that arise from legal liability (primarily from third parties) surrounding ESG issues. Examples: A company may be sued for bodily injury, health/safety, fraud or diversity/discrimination claims. Directors may be sued if the company does not meet climate/emissions reduction commitments.

- **Business Transition Risks:** Business risks/lost opportunities faced due to shifting cultural norms, ESG mandates or climate management. Example: A company fails to assess impacts of the shift to non-fossil energy sources, therefore missing out on meeting customer demands or business opportunities or facing higher energy costs.

- **Human Capital Risk:** Risks associated with the cost of high turnover or inability to attract talent. Example: A corporation faces a high-profile sexual misconduct allegation. In response, many of the women working at the corporation leave their jobs and the corporation struggles to attract strong women candidates.

Quantifying the value of risk reduction efforts has always been something more of an art than science, but boards are frequently intimately involved in helping senior management determine risk tolerance levels and benchmarks. Directors tend to be well-versed in traditional risk management programs of their companies.

Recent studies by the World Business Council for Sustainable Development ("WBCSD") show that ESG leaders/staff tend to make their own risk valuation determinations. Among the conclusions made by WBCSD:

- Although companies have sustainability professionals working to address ESG-related risks and issues, they struggle to get these into risk management discussions.
- Little collaboration exists between a company's risk and sustainability practitioners.
- ESG risks managed and disclosed by internal sustainability staff are *considered less significant than conventional risks*, leading to a bias against ESG-related risks.

ESG practitioners must learn about their company's internal risk management benchmarks and strategies before trying to calculate risk reduction benefits on their own in a vacuum. It may be tempting for ESG staff to aggressively inflate the value of avoiding a potential loss without working with internal risk management staff or aligning values with existing well-vetted risk management benchmarks. Avoid using theoretical costs (such as costs to society or valuations of the loss of species). Risks of inaction can also include being a target for shareholder proposals (the SEC has recently made it more difficult for companies to exclude ESG-related shareholder proposals from consideration) and negative votes against directors. Ironically, because of the current anti-ESG sentiment in some states and corners of the public and financial community, the same risk exists for companies that undertake ESG initiatives.

Directors tend to see through garbage economics quickly, damaging the credibility of ESG leaders/staff — ruining the message and any truly valuable risk management insight stemming from ESG.

6. <u>Foster Realistic and Business-Centric Targets/Goals</u>

Some ESG goals and targets may be established by boards and sometimes the board simply approves those developed by management. Either way, ESG leaders/staff play an important role in making sure boards understand what those goals entail.

Many times, ESG targets and goals can be long-term — such as GHG emissions reductions or supply chain social responsibility improvements. These can also be more aspirational than practical or achievable. The long-term nature of some (like Net Zero 2050) mean

that today's boards and senior executives almost certainly won't be around to see the ultimate fate of those targets/goals. Directors may defer meaningful action (and associated expense) on long-term ESG issues and take small steps in the short term. This can present a conundrum to ESG leaders/staff.

On the one hand, stakeholders are more sensitized to this "kicking the can down the road" approach to ESG and are less willing to accept it. Investors and ESG ratings firms are more aggressively evaluating how companies are implementing long-term climate programs, not simply whether they have written programs.

On the other hand, directors may propose ESG goals that are too aggressive and not operationally realistic or achievable.

In either case, it may be necessary for ESG leaders to push back or challenge boards about some of the targets/goals they propose. This must be done in a professional, respectful and evidence-based manner. Discuss matters like:

- Technological limitations
- Changes in the company's risk profile
- Potential impacts on contracts, legal agreements and loan/bond covenants
- Financial statement impacts and other disclosure implications (currently and under proposed SEC rules)
- Aspects outside the company's direct control
- Known and potentially unknown costs
- How the proposed targets/goals compare to peer companies
- How the proposed targets/goals may impact ESG ratings or be inconsistent with investor ESG strategies
- Metrics for the proposed targets/goals
- Potential supply chain impacts

- Potential impacts on employees

In the end it is the board's responsibility to approve the goals and company management/staff to execute on them. The ESG leader has an obligation to ensure the board has sufficient and appropriate information with which to make a considered decision.

7. **Be Realistic with ESG Opportunity Values**

When developing financial values of ESG-related opportunities, maintain a level of professional skepticism. Avoid presenting eye-popping values as the board will likely see them as not believable or reasonable, again sabotaging the credibility of the ESG business case. Overly optimistic business cases based on stacked conditional or unreasonable assumptions should be avoided.

Generally speaking, you should avoid linking ESG opportunities to stock price increases. There is much controversy on this point and the multitude of credible studies on the matter come to different conclusions. There are too many factors in capital markets — many of them based on irrational human behavior — to be able to isolate the stock price impact of ESG initiatives, especially in the long term.

Similarly, assumptions of pricing premiums based on "green" or sustainability attributes should be avoided. There are a few cases where green price premiums do work (*e.g.*, organic food), but those are the exception rather than the rule.

Instead, focus on opportunities where ESG initiatives build on business fundamentals such as:

- New products that meet a demonstrated need
- Administrative cost savings
- Operational cost savings
- Expansion into new markets
- Margin improvement

It is best to not create unrealistic financial expectations in the minds of directors when discussing ESG opportunities or defending program expenses.

8. Be Careful with Consumer Survey Data

When presenting information about ESG-oriented product opportunities (new or modified products or reaching into new markets based on product ESG attributes), it is tempting to use consumer survey data. But there are risks with doing so that should be carefully considered if you plan on using that data as a basis for a business case, strategy change or relying on it when presenting to boards.

Studies have demonstrated that consumers change behavior when they know they are being observed (such as in a survey scenario). Other research by Nobel laureate Richard Thaler confirms "people become more likely to conform when they know that other people will see what they have to say." If customers know they are being observed in a survey scenario, they tend to act in the "right" way in choosing between an obviously sustainable option and one that is neither obvious nor sustainable. Therefore, even the process of testing consumer preferences injects bias into results — "the mere-measurement effect is a nudge," according to Thaler. Case in point: past surveys about consumer willingness to pay more for certain environmentally preferable product attributes have proven inaccurate when compared to actual purchasing behavior.

One note of caution about AI-generated information on consumer preferences and similar concepts. It is unclear what types or levels of data validation or other controls are embedded in AI algorithms. Given AI's emphasis on gathering and processing existing data, governance/validation probably hasn't been given due consideration. At this time, it wouldn't be prudent to rely on AI-generated information on consumer preferences without conducting extensive independent due diligence on the AI's response.

9. Present ESG Information in Relation to Your Industry

It can be useful to consider ESG issues impacting your entire industry. Industry benchmarking and competitor actions tend to resonate with

directors. When communicating ESG information to your board, it is prudent to research in advance what ESG issues are seen as relevant to your industry. Directors may not know the story when it comes to ESG issues in your industry, especially considering many directors come from different industries. A vital component of helping directors do their job is to make sure they understand ESG trends, risks and emerging developments within the company's own industry and possibly others.

- **What ESG issues do investors and shareholders in your industry expect your board to know?** Investors are increasingly scrutinizing ESG and pushing for corporations to develop their ESG initiatives. ESG ratings organizations are also assessing director experience/knowledge on specific matters like climate and DEI. Research investor trends in your industry to get an idea of what knowledge investors expect your board to have. Data on proxy voting, shareholder activism and ESG ratings can be good sources of this information — as well as any ESG feedback received during shareholder outreach programs.

- **What ESG initiatives are competitors and peers implementing?** Learning about what ESG issues other companies in your industry are addressing can give you a good idea of what you should be paying attention to. Even so, keep in mind that each company — even within the same industry — does not always face the same issues or expectations. Unique aspects of businesses, settings, geographies, shareholders, customers and public perception shape ESG matters/concerns specific to individual organizations. Corporate ESG/sustainability reports and websites are good sources of this information.

- **Where does your company sit on the ESG maturity spectrum?** Figuring out where your ESG initiatives stack up in comparison to your industry and/or peers can provide valuable information to the board. It is better to rely on peer company corporate ESG/sustainability reports and websites than on ESG ratings due to the wide variability in ratings methodologies. At the same time, ESG leaders should know if their board is particularly focused on any ratings and should be prepared to discuss them. Learning that you are behind on ESG gives you a reference point

for improving your ESG programs. Similarly, learning that you are ahead is a good indicator that your ESG policies are working as intended.

Industry associations, publications and information services are useful information sources.

10. Be Clear, Concise — and Brief

This may be the most difficult aspect of all. ESG issues are typically complex and involve many interrelationships, assumptions and corporate activities. Professionals in the space usually have spent years learning about these facets, but explaining the complexities to others can be tough. However, that may not be needed in a board setting.

Following Tip #3, you will be most effective if you communicate concisely and briefly. Not everything needs a detailed explanation like technical staff usually expect. ESG leaders/staff should develop presentation information at a high level, but have plenty of pages of data and backup information in their back pockets to answer questions from directors. If needed, the technical materials can be added to the board material appendices of related information directors can peruse at their convenience. Many times, the ability to present and explain complex issues briefly is viewed as having mastery of the topic. Finally, board meetings can be long, multi-day events and sticking to your allotted time is key to staying on schedule and retaining the board's attention. Brevity is central to that.