The Roles of the Board in the Era of ESG and Stakeholder Capitalism: Supplement 3

Enhancing Board Information and Stakeholder Engagement in the Era of ESG and Stakeholder Capitalism

In partnership with:

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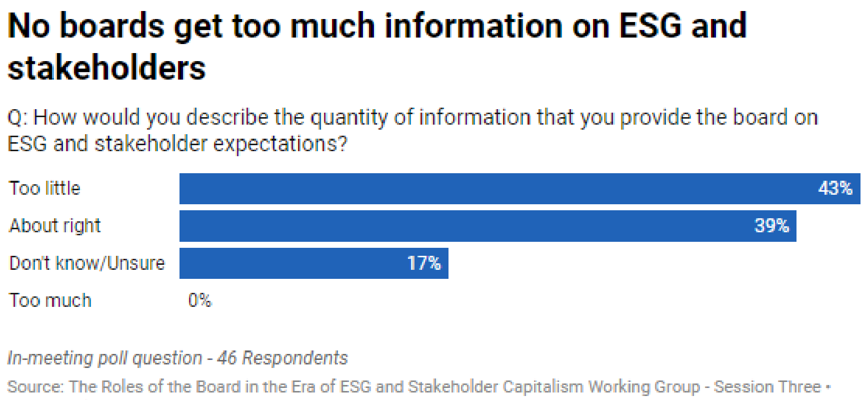
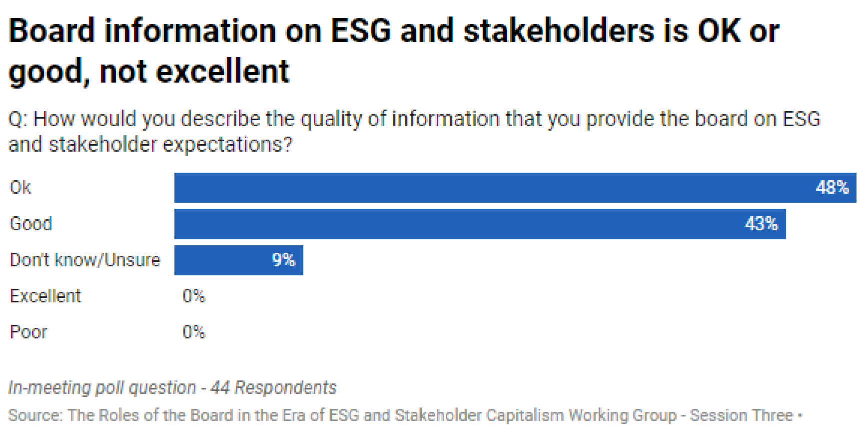
Are Boards Getting the Information They Need?

Boards tend to get *too little* (or just *about the right amount* of) information about ESG and stakeholder expectations, according to respondents to our working group poll. None of the respondents believe their board receives *too much* information.



Moreover, the working group participants believe that the information on ESG and stakeholder expectations is of acceptable quality. Even though most respondents (48 percent) say the quality of information is just *OK*, another 43 percent deem it to be *good*. None of the respondents believe that it is either *excellent* or *poor*.



Improving Communications to the Board and Board Engagement on *ESG topics*

Companies can stimulate ESG discussions at the board level by:

- **Initiating board discussions of the company's purpose.** A company's *mission* is what the company does, its *vision* is what it hopes to accomplish, its *values* are reflected in how it acts, and its *purpose* is why it does what it does.[1] Successful purpose statements—which are often linked to a broader societal goal—are outward facing, forward looking, and inherently optimistic. As such, they are natural springboards for product innovation and can help guide board decisions.
- **Integrating ESG into strategic planning and operating/capital budget processes**. This will then automatically feed into the CEO dashboard and board agenda—and thus drive accountability.
- **Using human capital management as a natural starting point to integrate ESG and stakeholder views into board decisions.** Just 21 percent of participants in an informal 2022 Human Capital Center working group poll said they have a human capital management strategy that is reviewed at the board level.[2] But having a strategy that addresses the company's current workforce, the workforce that will be needed to execute the firm's strategy over the next three to five years, and how the company plans to get there is a way of addressing several key ESG issues as well as the expectations and welfare of a key stakeholder group: employees.
- **Incorporating ESG into compliance and risk management discussions at the board level**. According to a report issued by the ESG Center, boards generally engage well with risk and compliance, but less so with sustainability.[3] However, as companies' focus on ESG grows, so does the natural intersection of these three areas. Discussions with the board on compliance and risk can integrate ESG issues.

Source: *Aiming for Alignment in Compliance, Risk, and Sustainability*, The Conference Board, May 2022

Engaging the Board on *Stakeholder Views*

Companies are naturally responsive entities, but they shouldn't just react to the latest pressure from a single stakeholder group; otherwise, the board (as well as investors and others) will wonder who is running the show. It is therefore critical for management to put stakeholder views in the context of the company's business goals and explain how the response aligns with the firm's long-term strategy.

Some additional considerations for management to keep in mind:

- **Keeping the board informed on stakeholder views requires data.** Management should assemble data the company is collecting on the views of employees, customers, business partners, and others—about the company itself and about relevant environmental and social topics—and build those data into regular reports provided to the board. After all, boards don't have unlimited time to engage directly with the company's stakeholders.
- **To gather additional data on stakeholder views and perspectives, companies can leverage the channels already in place for collecting core business information.** For example, a company's salesforce may very well collect information on customer views and expectations that goes beyond "ordinary" product/services needs or complaints. Additionally, as business partners are increasingly considering sustainability when choosing suppliers, it can be helpful to report to the board on those discussions, as they can have significant financial consequences and lead to ideas for business innovation.
- **To capture information on employee sentiment, companies should consider going beyond the employee engagement survey to focus on an in-depth assessment of corporate culture.** The employee engagement survey and/or retention/turnover rates can render useful information, but these data points alone often don't paint a complete picture. Management and boards may want to go the extra mile in understanding their firm's (evolving) culture through, for example, in-depth culture assessments and recurring pulse surveys on specific topics. Additionally, some companies are experimenting with moderated employee roundtable discussions to collect information on company culture as well as employee expectations more broadly.

The Board's Role in Reviewing and Approving ESG Communications to Stakeholders

The board's role in communications and disclosure is expanding as a result of the increased focus on ESG and stakeholder capitalism. But whereas the board *needs* to review and approve the ESG-related disclosures made in SEC filings such as the 10-K and proxy statement, it doesn't have to review all CSR/ESG reports. It is helpful, however, for the board to understand the breadth and depth of internal and external ESG-related communications and the processes by which management seeks to ensure the accuracy and consistency of those communications.

Having a broader picture of ESG communications and their supporting processes can be helpful in several respects:

- Those communications often contain important commitments (e.g., with respect to climate or diversity, equity & inclusion goals) with which the board should be comfortable, especially since these may have an impact on the company's strategy and bottom line.
- The SEC is increasingly focused on inconsistencies in disclosures made across a company's various communication channels, including on climate change.
- These communications can present the risk of (being accused of) greenwashing.

How to Ensure Consistency in ESG Disclosures

Audit committees will likely be responsible for ensuring the company has appropriate processes in place to support disclosures made in SEC filings. Beyond that, companies are adopting different approaches to help ensure consistency in ESG disclosures. Some companies have their internal audit department conduct periodic analyses of ESG disclosures across their various communication channels. Other firms have developed a framework to facilitate a multidisciplinary review of ESG disclosures. And others ensure all communications with respect to a particular ESG topic (e.g., human capital management) come from a "single source of truth" (e.g., the HR department).

Effective Board-Stakeholder Engagement Practices

Board members can supplement the data they receive from management by directly engaging with investors and other stakeholders.

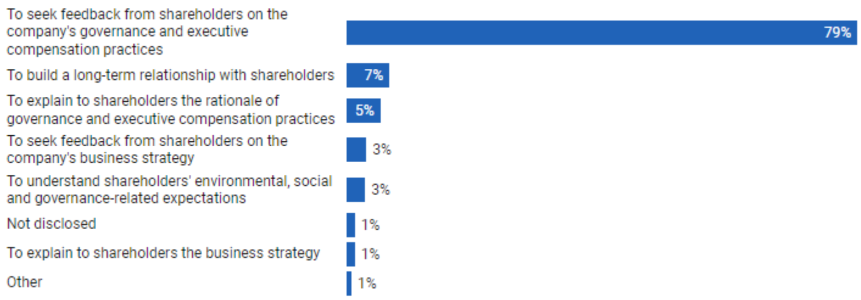
- **It is important for directors to share the information they gather during engagements with *shareholders* with the rest of the board.** Slightly over 50 percent of S&P 500 firms disclose that their directors are having direct conversations with shareholders.[4] But even at firms where the lead independent director routinely meets with major investors, the rest of the directors can feel left in the dark about those discussions. Management can help ensure the takeaways from those conversations are shared with the board, and that the board and relevant committees have time to discuss them.
- **Directors are increasingly meeting with *employees,* which can be energizing for the employees as well as directors themselves.** Engagement with employees (e.g., through employee resource groups, site visits, or town halls) can help the board get a feel for employee views, create a more transparent corporate culture, and build mutual confidence. Other interactions, such as one-on-one interactions or meetings with departments (e.g., audit committee chair with internal audit) can help inform succession planning.
- **At some firms, directors are meeting with communities**, including through established *community advisory groups*, which allows directors to meet with community leaders in local markets.

Director-Shareholder Engagement Disclosure: Room for Improvement

There is room for companies to expand the scope of their disclosures on shareholder engagement. For example, 79 percent of S&P 500 companies that disclosed information on their shareholder engagement practices in their 2022 proxy statement indicated they were looking for feedback on *governance* and *executive compensation*. This suggests that the motivation to engage with shareholders is largely tied to shareholder voting (e.g., on director elections and say-on-pay). But we know that shareholder engagement often goes beyond governance and focuses on environmental and social topics. Companies should take a fresh look at how they describe the scope of and reasons for their shareholder engagement.

Shareholder engagement focuses on governance and executive compensation

Stated reasons for shareholder engagement (S&P 500)



Data drawn from proxy disclosures between January and September 2022

Source: ESGAUGE • Created with Datawrapper

Similarly, companies can be more transparent about the actions they are taking in response to such engagements. Almost half of S&P 500 companies (47 percent) do not disclose this information. But of those that do, most companies indicate they have made some changes to their executive compensation practices (37 percent) and have adopted (or enhanced) ESG practices (29 percent).

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[1] Thomas Singer, *Purpose-Driven Companies*, The Conference Board, October 2020.

[2] Rebecca Ray et al., *Telling the Human Capital Management Story: Toward a Strategic Competitive Advantage*, The Conference Board, October 2022.

[3] Merel Spierings, *Aiming for Alignment in Compliance, Risk, and Sustainability*, The Conference Board, May 2022.

[4] According to 2022 data provided by ESG data analytics firm ESGAUGE.