CEOs at the Helm of ESG

Leading the Sustainability Transformation

It's a new era for CEO leadership on ESG. Externally, the environment is more fragmented and challenging. Internally, CEOs face fresh financial, governance, and communication hurdles as they integrate sustainability more deeply into their business. It is no longer enough for CEOs to focus on satisfying investors' concerns or to view ESG mostly as a means of mitigating risks. This era calls for CEOs to focus on ESG-related business opportunities, assess the ROI of sustainability investments, engage the board as thought partners, collaborate effectively with business partners, and decide how to integrate a sense of purpose in the corporate culture and communications.

Trusted Insights for What's Ahead™

- **CEOs should maintain their focus on ESG-related business opportunities**. With competing and sometimes conflicting demands from stakeholders, it is critical for CEOs to keep their companies focused on the opportunities associated with the sustainability transformation of their businesses to prevent them from getting distracted by external "noise" on ESG.
- **As companies integrate sustainability more deeply into their businesses, expect greater diversity in their public commitments**. To date, corporate sustainability initiatives have been marked by a relatively high degree of consistency, especially with respect to reducing GHG emissions. Going forward, CEOs should expect their sustainability initiatives to be shaped less by international agreements and national disclosure

regulations and more by customer demand, the state of sustainability in their industry, and the interplay of technology and sustainability.

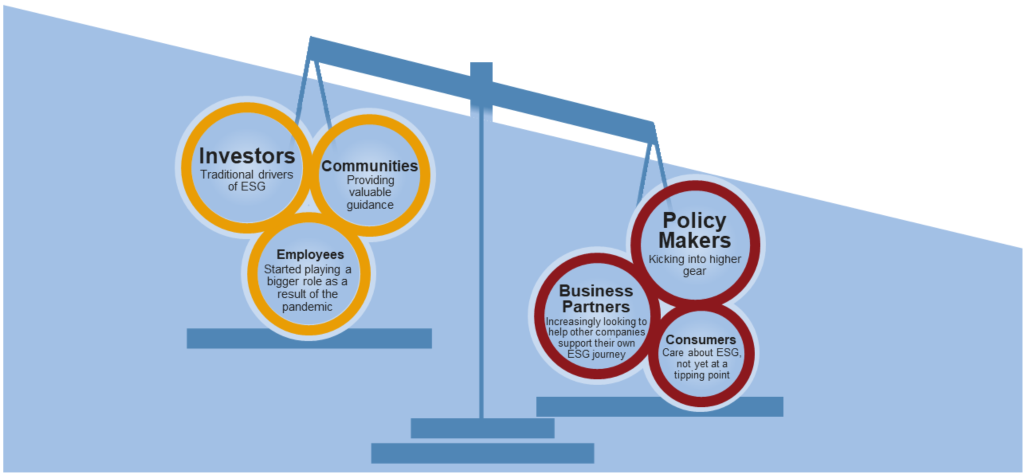
- **B2B companies may lead B2C companies in the sustainability transformation**. Consumer demand, especially in the US, continues to be driven more by price and quality than sustainability. By contrast, business customers—often under regulatory pressure—are prioritizing sustainability. Companies in B2B markets should be prepared to move quickly to meet that emerging demand.
- **While companies are increasingly held accountable for delivering returns on their ESG initiatives, they lack a consistent methodology for measuring and reporting on the ROI of ESG**. As a start, companies can use existing operational key performance indicators (KPIs) to quantify the financial return on their sustainability investments. CEOs can ensure their financial, sustainability, and business functions work together to define and calculate the ROI of the company's sustainability initiatives.
- **CEOs should meet the board where it is on its sustainability journey**. Directors come to boards with significantly different levels of understanding of environmental and social issues, in contrast to their more consistent levels of knowledge in areas such as strategy, governance, and finance. CEOs should begin by gauging their board's current level of fluency in relevant sustainability topics rather than assuming a level of knowledge and/or interest.
- **Compared to traditional business objectives, companies need increased levels of horizontal and vertical collaboration to achieve their ESG goals**. Especially in industries where technology plays a significant role in driving (or impeding) sustainability, companies may find value in collaborating with competitors to mitigate risks, share resources, and foster collective innovation. It's pivotal that companies approach such collaborations with the same level of strategic, financial, and governance rigor with which they approach other business partnerships.
- **While having a corporate purpose can help inform a company's business strategy, companies need to be at the right stage to be able to define and implement a purpose statement**. A purpose statement that defines the broader societal reason or why a company exists can turbocharge a company's sustainability efforts but can backfire if it is adopted prematurely before the company has the strategy, governance, and programs in place to implement such a purpose.

Maintaining Focus on ESG Business Opportunities

Factors affecting today's ESG landscape

The center of gravity in ESG is shifting. In recent years, companies have faced pressure to address ESG issues from many different stakeholders. Now, investors, who played the leading role in driving the ESG agenda, are playing a less prominent public role, while regulators and business partners are kicking into higher gear.

The Scales of Sustainability Are Tipping



Source: *CEOs and ESG: At the Helm of Driving the Sustainability Transformation*, The Conference Board, 2023

- **Institutional investors** have traditionally been one of the most important drivers of ESG, but they've reduced and refined their public advocacy.
- **Employees**, who once put significant pressure on companies to address social and other sustainability issues, continue to play an important, yet more episodic, role.
- **Regulators** have stepped up both their pro- and anti-ESG regulations.[1]
- **Business partners** emerged as an even more important constituency in seeking action and consider companies' sustainability performance when selecting new suppliers and renewing contracts.[2]
- **Consumers** in the US continue to prioritize basic purchasing criteria, such as price and quality, over sustainability features. To the extent they focus on sustainability, they care most about how companies treat their workers and communities.

At the same time, companies face growing opposition to ESG efforts (ESG backlash) *and* skepticism (claims of greenwashing). Indeed, according to recent research by The Conference Board, about half of surveyed US companies have experienced ESG backlash, and 61% of companies think it will stay the same or increase over the next two years.

A framework for integrating sustainability into a company's business

CEOs and their companies can capitalize on ESG-related business opportunities by integrating sustainability into the firm's business strategy and operations. We are currently at the relatively early stages of a sustainability transformation of business driven by a combination of regulation and market forces, which may eventually match the magnitude and impact of the digital transformation of business. One way to think about the business opportunities associated with this sustainability transformation is to focus on the three areas where a company's business intersects with ESG:

- **The marketplace**, which includes a firm's business strategy, products and services, and procurement activities. This is where companies may find the biggest opportunities but have variable levels of control.
- **The workplace**, which includes a firm's workforce, operations, and associated policies and processes. Here, companies have greater control and can seize immediate opportunities, but the impact is inherently limited.
- **The public space**, which includes a firm's political activity, corporate citizenship efforts, and public communications. This is where companies can have significant impact, but opportunities involve significant risk.

Integrating ESG Into Business Strategy and Operations

Source: *The Role of the CEO in Driving ESG*, The Conference Board, 2022

ESG can be a driver of competitive advantage both to engage customers and attract and retain talent. Indeed, as pointed out by a CEO roundtable participant:

> » *Integrating ESG into the company's products and services can differentiate the company from its competitors, which in turn can have a direct business impact. At the same time, it can help the company become an 'employer of choice,' as companies that are perceived to have a conscience about the future of the world and to be advocates of sustainable change have an advantage in employee recruitment and retention.*

To date, companies' sustainability efforts—especially with respect to reducing GHG emissions—have been shaped significantly by international agreements and are therefore relatively consistent. However, as our discussion with CEOs revealed, three key factors are affecting companies' sustainability initiatives and the extent to which they can integrate ESG into their business going forward: customer demand, the degree to which the industry has embraced sustainability, and the state of technology.

- **Customer demand**: What it means to be sustainable differs by industry and company. For example, customers in some industries are simply demanding sustainable products/services, and it's rather easy for companies to make their offerings and operations more sustainable, whereas in other industries, companies have a harder time discerning what the "sustainability angle" might be.
- **The degree to which the industry has embraced sustainability**: Some companies may (have to) become a first mover, especially in those industries where ESG-related growth opportunities are not all that obvious. Such companies will need to make a concerted effort to bring customers along the way. But even if customers do not immediately buy the firm's sustainable products/services, many will appreciate the company's commitment to sustainability, which in turn can positively affect the firm's reputation and bottom line.
- **State of technology**: Technology plays a vital role in the sustainability transformation, but there's tension between the two. Technology can help a company to reduce its environmental footprint, improve its resource efficiency, and develop new sustainable products and services, among other things. But in some industries, existing technologies are not efficient or sustainable enough, and new technologies are still too expensive or difficult to deploy.

Challenges associated with integrating sustainability into the business

As CEOs navigate the shifts toward ESG and stakeholder capitalism, one challenge is determining *what* and *whom* to prioritize first.

- **What issues to focus on**: With the list of ESG topics constantly expanding and comprising more than 200 issues, CEOs and their companies need to employ a “corporate strategy filter” to cut through the noise. Indeed, every company should use its own strategic goals to evaluate and prioritize information, as it will help to focus the company’s attention on those opportunities that are most important to its success.
- **Which stakeholders to focus on**: Given the divergent interests of different stakeholders, it’s almost impossible to meet—or even be guided—by the expectations of all stakeholders. Effectively managing stakeholder expectations requires a tailored approach: while it’s pivotal for companies to meet the expectations of some stakeholder groups (including their regulators and investors), they may want to employ a different approach for other stakeholder groups (e.g., ensuring there’s a constructive dialogue with each of them and serve the interests of most of them).

Moreover, there’s a mismatch between the emerging regulations and business success. ESG regulations and reporting frameworks are largely disclosure-driven rather than business-driven. Disclosure regulations can lead to a compliance (or “tick-the-box”) mindset that may lead companies to pay too little attention to the business opportunities associated with ESG.

The politicization of ESG, especially in the US, is another complicating factor. As one European CEO remarked:

> » *The need for, and opportunities associated with, action is more widely acknowledged in Europe, leading to a greater recognition that the public and private sectors need to work together to effectuate sustainable change.*

The ROI of ESG

The complexity of calculating the returns on ESG initiatives

It is no longer sufficient for companies to be responsive to stakeholder expectations regarding sustainability; they are increasingly held accountable for responsibly delivering shareholder returns on their sustainability investments. Some companies are therefore revisiting their business models or adjusting commitments because their original sustainability goals were too ambitious and/or too expensive.

While there are countless academic studies demonstrating the economic benefits of ESG, companies lack a consistent methodology for measuring and reporting on the ROI of ESG. Indeed, calculating the returns generated by sustainability initiatives may be more complex than that of many other initiatives, not least because companies typically employ various sustainability initiatives at the same time, which often generate multifaceted impacts and intangible benefits that are challenging to attribute and quantify accurately.

> While recognizing the benefits of ESG initiatives, CEOs often prioritize other initiatives that have a clearer ROI. For example, though 49% of surveyed CEOs globally say the transition to renewable energy will be significantly positive for their firms, accelerating the shift to renewable energy sources is not a high internal priority for most—globally it ranks 24th on a list of 27 internal priorities.

The degree of complexity of calculating the ROI of ESG also depends on where the company is on its sustainability journey. At one end of the spectrum, if sustainability is at the core of a company's business model, measuring return may be equivalent to the overall ROI of the business. At the other end, the exercise may be straightforward if sustainability is a discrete and siloed effort. But it is more complicated if, as is the case at most companies, a firm is in the process of integrating sustainability into the business. This requires careful consideration to define what constitutes a sustainability investment. It is also important to determine what is meant by ROI. As noted by one CEO:

> » *Not all ESG initiatives are focused on generating financial return—sometimes the company just wants to realize a positive societal or environmental outcome.*

In those instances where "success" isn't (meant to be) measured in terms of financial measures, companies nonetheless need to be clear about how initiatives are serving the company's interest.

As a start, take a practical approach

There are different ways to look at the ROI generated by sustainability initiatives. Companies can begin by mapping their sustainability efforts against their KPIs—including customer loyalty, access to capital, employee engagement, and brand reputation—to quantify the financial return on their sustainability investments.

Communication is an important component in realizing a positive ROI for ESG efforts. Clear communications, coupled with impactful storytelling, can result in greater brand appeal, customer loyalty, and employee satisfaction and productivity, among other outcomes.

Engaging Constructively with the Board on ESG

First stop: Meet the board where it is on its sustainability journey

Successfully embedding sustainability into the business requires the board's buy-in, which may take time to achieve. Indeed, while having the board's commitment to sustainability signals to both internal and external stakeholders that it's a priority, it may take considerable effort to shift the board's mindset to view sustainability as an integral part of the business strategy.

CEOs and management can help by assessing and adapting to the board's current level of knowledge and commitment to sustainability and by increasing directors' fluency in ESG, for example, by 1) educating the board on the ESG issues that tie to the firm's main risks and opportunities; 2) supporting board attendance at external education programs and events; and 3) engaging outside providers to deliver trusted and objective information, benchmarking, and advice.

> Companies should consider the relationship between management and the board as a partnership rather than an oversight model. Indeed, boards do much more than oversee management. They make decisions, provide advice, and increasingly engage with investors, and, in some cases, with employees and communities. Engaging the board as a strategic partner can facilitate a transformation of the board's mindset from a focus on risk mitigation to one centered on identifying and capitalizing on opportunities.

Collaborating Effectively with External Business Partners

Addressing ESG-related opportunities and risks is not an endeavor that companies can (or should) undertake in isolation. Indeed, with 69% of procurement executives taking sustainability performance into consideration in their procurement decisions, and with EU regulations forcing thousands of US companies to have discussions with their upstream and downstream business partners on ESG, companies have both an obligation and opportunity to collaborate on sustainability. But, as our discussion with CEOs revealed, in order for those collaborations to be effective, it's critical that companies approach them with the same level of strategic, financial, and governance rigor with which they approach other business partnerships.

Compared to traditional business objectives, companies need a heightened level of horizontal and vertical collaboration to achieve their ESG goals. As a recent ESG Center Chatham House Rule discussion revealed, to ensure that companies can pursue their own ESG objectives with the "bigger picture in mind" (e.g., trying to achieve broader societal goals in addition to their own business success), they should look at collaborations with industry peers and other industries, and with both upstream suppliers and downstream customers. This approach is likely to lead to more meaningful and durable progress toward ESG objectives than merely complying with a fragmented regulatory environment.

Especially in those industries where technology plays a significant role in driving (or impeding) sustainable change, companies may want to consider collaborating with their competitors to manage risk, share resources, and spur collective innovation. As one CEO noted:

» *In industries heavily impacted by technological advancements, investing in the 'wrong' technology can be costly. By collaborating with competitors, companies can share the burden of R&D costs by pooling their resources, knowledge, and expertise. But by doing so they are walking a fine line, because at the same time, such collaboration may lead to loss of a company's competitive advantage.*

Deciding Whether and How to Adopt a Corporate Purpose Statement

Corporate purpose as driver of sustainability

Having a clearly defined purpose can help inform a company's business and sustainability strategy, which in turn can help inform the company's approach to sustainability.

According to our survey of CEOs around the world, US CEOs have ranked "revisiting purpose" as one of the top 10 internal priorities in 2023, and the number of companies with purpose statements are growing: as of 2019, 22% of the S&P Global 1200 had one, up from 2% in 2011. Regardless, it's critical for management to think through the practical costs and benefits of having such a defined purpose, as well as ensure they can follow through on their commitments.

As the figure below illustrates, a company's purpose and reason to exist—in other words its "why"—can guide its "what" (strategy, including ESG business opportunities), "where" (marketplace, workplace, public space), "how" (mindset, knowledge, capabilities, values, and behaviors), "which" (e.g., operating, financial, and ESG goals), and "whom" (stakeholders). These are the elements of a sustainable corporation.

Elements of a Sustainable Corporation

Source: *CEOs at the Helm of ESG: Leading the Sustainability Transformation*, The Conference Board, 2023

A word of caution

A company needs to be at the right stage, however, to be able to define and implement a meaningful purpose statement. Having a well-defined purpose can be particularly helpful as companies reach the stage of integrating sustainability into their corporate culture. However, before a company seeks to implement a cultural transition, it first needs to have its governance structure, business model and strategy, and basic sustainability programs and policies in place.

Moreover, while a purpose can drive business growth and competitiveness, companies face the risk of being accused "purpose-washing" if actions don't align with stated values. And a purpose statement is not the only means that can serve as a company's North Star. As one CEO commented:

> » *We don't have an explicit purpose statement (yet), but we do have clearly defined values and company-wide priorities that drive our sustainability strategy and approach.*

Conclusion

As the overall environment for corporate ESG initiatives evolves, it presents a fresh set of challenges for CEOs. The external pressures CEOs face are significantly different from just two years ago. At the same time, companies' internal approaches to ESG are evolving as companies further integrate sustainability into their businesses. This translates to CEOs needing to:

- Assess more carefully the business case for ESG at their company;
- Take into greater account external factors (such as the level of customer demand) that will determine the potential pace of the sustainability transformation of their business;
- Focus more on business opportunities, not just risks, related to ESG;
- Assess the ROI of their sustainability investments;
- Ensure the board is fully engaged as a thought partner in these endeavors; and
- Articulate the company's ESG strategy (and potentially its purpose) in a way that drives shareholder value.

As CEOs take a more proactive ownership of ESG at their firms, investors and other stakeholders have an increased responsibility to invest time in understanding each company's tailored and nuanced approach to ESG.

About This Report

Last year, The Conference Board ESG Center held a roundtable exclusively for CEOs to help them navigate the challenges they were facing in driving ESG at their firm. It led to a report on The Role of the CEO in Driving ESG, which broke new ground on topics such as how best to integrate ESG into a company's business strategy and operations, effectively engaging the board on ESG, and communicate the company's ESG story to multiple stakeholders.

A lot has happened since then, which is why, on October 10, the ESG Center held its second annual (and first trans-Atlantic) Chatham House Rule roundtable convening with CEOs to discuss how they can: 1) maintain focus on ESG-related business opportunities amid a shifting landscape, 2) calculate the ROI of ESG, 3) constructively engage with the board on ESG, 4) effectively collaborate with external business partners, and 5) decide whether and how to deploy a corporate purpose statement.

This report provides findings and insights based on that discussion.

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Endnotes

[1] The EU continues to lead with regulations that have broad and extraterritorial reach. For example, the Corporate Sustainability Reporting Directive (CSRD) will likely cover up to 50,000 firms, up from approximately 12,000 under the Non-Financial Reporting Directive (NFRD), and will extend to not only EU-based companies but also subsidiaries of non-EU companies that have significant EU operations, with additional reporting requirements at the parent level in 2028. In the US, California has become the first state mandating climate change-related disclosures (including on scope 3 emissions). Additionally, the SEC will soon either adopt or propose new disclosure rules on topics such as climate change, human capital management, and board diversity. For an overview of recent and upcoming ESG regulations, see our online calendar.

[2] Companies subject to the CSRD will be required to assess their impact on a wide range of ESG areas (described in ten separate standards) upstream and downstream in their value chain, which means that they will be seeking information—and action—from their business partners.