The Evolution of ESG: Impacts for Boards and Directors

By Milene Firbank, Anthony DeCandido and Jake Salpeter

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Boards must be prepared to take a more comprehensive and strategic approach to sustainability.

As ESG standards have gained prominence in recent years, directors are increasingly being asked to weigh in on a host of new and often complex issues. Companies are also looking more granularly at specific ESG activities and taking a more sophisticated approach to reporting and compliance.

While large organizations have focused on this trend extensively over the last decade, middle-market companies have been catching up in recent years. In an effort to understand these underlying trends, RSM conducts a quarterly Middle Market Business Index (MMBI) survey that regularly includes questions focused on executives' ESG strategies and priorities.

For the most recent survey, 407 interviews of middle-market executive decision-makers in a broad range of industries were completed from July 5 to July 26, 2022.

Navigating ESG is Becoming More Complex

One of the top-line insights from the latest survey is that trendlines did not necessarily follow the previous year’s data. Indeed, comparing the 2022 survey results with 2021’s results shows that the middle market has recognized that stakeholder expectations on ESG are evolving.

Navigating the ESG ecosystem is becoming increasingly complex. Still, on the whole, the data revealed that the middle market continues to prioritize ESG and that a growing majority of respondents are providing external reporting on their ESG performance (up from 77% in 2021 to 88% this year). Organizations, however, are likely being “more careful about stating their goals and are striving to collect evidence that verifies their efforts,” according to the MMBI report. This is especially important as stakeholders become more discerning.

“Some companies might pull back on their ESG disclosures because they’re worried about greenwashing accusations,” RSM Canada economist Tu Nguyen said in the report. “So they might be waiting until they have sufficient data to prove that they’re taking the steps that they claim they are.”

This comes as no surprise. Benchmarks for ESG practices continue to be raised as the market matures. This reflects heightened expectations among consumers, employees, investors and policymakers for improved reporting of important ESG metrics. Expectations for businesses to operate sustainably are rising even as the landscape becomes more complex.

These numbers indicate that ESG remains a priority, with performance reporting, ESG plans and commitment to reporting all on par with previous survey measures.

But the latest survey shows a focus on certain ESG efforts more than others, as well as interesting disparities in ESG investment levels between smaller and larger middle-market firms. Limited resources, energy and time are leading the middle market to focus on specific and realistic ESG objectives, which also leads to more intentional ESG outcomes.

While the proportion of organizations with formal plans/strategies regarding commitments to ESG initiatives increased over the last year from 66% to 70%, those with a formalized plan to address all of the company’s ESG concerns decreased from 72% to 56%. Those broad concerns have been replaced with more focused ESG strategic planning that targets some, but not all, objectives, rising from 41% to 59%.

This suggests that organizations are choosing to invest in more focused, incremental steps toward enacting sustainable transformation as opposed to opting for radical change that would tackle every objective at once. This strategy reduces the likelihood that a company would be accused of false or misleading statements about the state of sustainability, or greenwashing, and enables it to focus its resources on topics like climate change and DEI.

Interesting disparities also exist among the ESG causes that organizations support. For instance, the most drastic change in ESG causes is the support for community organizations, increasing from 36% to 50%. Other popular causes include environmental issues, youth issues and educational support. Disparities in the topics that organizations choose to focus on can largely be credited to a discrepancy in material topics from one organization to the next. Indeed, best practices dictate that organizations start with ESG risks that are most material to their industry and stakeholders, and that closely align with their corporate values.

ESG Considerations for Boards and Directors

As ESG performance becomes more important, it is imperative that discussions centered on ESG be integrated into board agendas and strategic planning. Oversight on ESG initiatives should be a key role for boards because investment in ESG initiatives should be perceived as part of the long-term profitability of a business. Discussions should evolve beyond short-term value maximization. In addition, as ESG becomes more regulated and integrated in financial disclosures, boards will need to keep abreast of internal ESG management to ensure compliance.

Another critical role that boards can play is to reward ESG progress. By integrating ESG metrics into compensation, boards can promote the valuation of a triple bottom line that values not only profits, but also social and environmental performance. Directors need to set the tone for the organization, demonstrate that leadership prioritizes sustainability and, most importantly, show that these initiatives drive organizational value.

As ESG continues to proliferate across the market, companies are becoming more sophisticated and selective around specific ESG initiatives most relevant to their key stakeholders. As boards consider ESG, they must be prepared to take a more strategic and comprehensive approach. Companies that develop ESG strategies and improve their disclosures stand to reap the benefits from managing the compliance requirements of ESG while also having greater impact.

Milene Firbank is a senior associate, ESG advisory services, and Jake Salpeter is a manager, ESG advisory services, at RSM Canada.

Anthony DeCandido is a partner, ESG advisory services, at RSM US LLP.