NACD

ESG AND THE BOARD:
How Directors Can Help Companies Reach ESG Maturity

In partnership with: UL Solutions

About NACD

The National Association of Corporate Directors (NACD) is the premier membership organization for board directors who want to expand their knowledge, grow their network, and maximize their potential.

As the unmatched authority in corporate governance, NACD sets the standards of excellence through its research and community-driven director education, programming, and publications. Directors trust NACD to arm them with the relevant insights to make high-quality decisions on the most pressing and strategic issues facing their businesses today.

NACD also prepares leaders to meet tomorrow's biggest challenges. The NACD Directorship Certification® is the leading director credential in the United States. It sets a new standard for director education, positions directors to meet boardroom challenges, and includes an ongoing education requirement that prepares directors for what is next.

With an ever-expanding community of more than 23,000 members and a nationwide chapter network, our impact is both local and global. NACD members are driven by a common purpose: to be trusted catalysts of economic opportunity and positive change—in business and in the communities we serve.

To learn more about NACD, visit nacdonline.org.

About UL Solutions

A global leader in applied safety science, UL Solutions transforms safety, security, and sustainability challenges into opportunities for customers in more than 100 countries. UL Solutions delivers testing, inspection, and certification services, together with software products and advisory offerings, that support our customers' product innovation and business growth. The UL certification Marks serve as a recognized symbol of trust in our customers' products and reflect an unwavering commitment to advancing our safety mission. We help our customers to innovate, launch new products and services, navigate global markets and complex supply chains, and grow sustainably and responsibly into the future. Our science is your advantage.

To learn more about UL Solutions, visit UL.com.

Contributors

UL SOLUTIONS

Lukas Tunikaitis, Sustainability Consultant, Enterprise Sustainability

Adrian Wain, ESG Advisory Lead, Enterprise Sustainability

Elizabeth Czekanski, Senior Specialist, Thought Leadership

Michelle Delio, Manaing Editor

Shylo Bisnett, Senior Writer

NACD

Ghita Alderman, Associate Director, ESG Content

Rachel Dubbs, Senior Analyst, ESG Content

Acknowledgements

UL SOLUTIONS

Jennifer Scanlon, President & CEO

Robert Slone, Chief Scientist

NACD

Ellen Errico, Art Director

Margaret Suslick, Manager, Copy Editing and Knowledge Management

Foreword

I am part of a growing consensus among leaders that environmental, social, and governance (ESG) issues are intrinsic to both the short- and long-term growth of an organization and its value to its employees, customers, and investors.

At UL Solutions, we have long seen the value this focus brings to our organization and our customers. Our founder, William Henry Merrill Jr., challenged his leadership team to "do something for humanity." His words presaged the rise of ESG by nearly a century, and today are integral to our organization's mission and how we work with customers to drive ESG's potential through data transparency. We are very proud of this legacy as we continue our own ESG journey.

Corporate leaders, including boards of directors, play a critical role in advancing their organizations' ESG progress, and their support of executive management team efforts is critical. Directors must share in and help develop the organization's ESG vision to realize the value in investments and directives.

This report represents our collaboration with the National Association of Corporate Directors (NACD) and articulates the evolving role and responsibility of boards of directors in realizing the promise of ESG as manifested in successful corporate stewardship programs.

As a science-centric organization, UL Solutions is proud to share insights and examples that demonstrate how a dedicated board of directors can help build an organization's resilience, drive its profitable growth, and deliver on its potential to benefit all of humankind.

Jennifer Scanlon

President and CEO, UL Solutions

Jennifer F. Scanlon is president and CEO of UL Solutions. With a deep foundation in and commitment to science, technology and engineering, Scanlon leads UL Solutions in its ambition to become our customers' most trusted safety, security, and sustainability partner.

Prior to UL Solutions, Scanlon was most recently president and CEO of USG Corporation, where she also served as chief information officer (CIO). She led the company through a major international expansion, digital transformation, and sustainable evolution, enhancing its ability to meet customer needs.

Scanlon is a fierce advocate for STEM education and the benefits of diversity and inclusion. She sits on the board of Norfolk Southern Corporation and the board and executive committee of the Chicago Council on Global Affairs. She is chair of the Commercial Club's Civic Committee, where she is also a board member, and is a member of The Chicago Network, the Economic Club of Chicago, and the Commercial Club of Chicago. She holds a master of business administration from the University of Chicago Booth School of Business and dual degrees in government and computer applications from the University of Notre Dame.

Executive Summary

As companies begin to wrestle with the realities of environmental, social, and governance (ESG) topics, effective board engagement is an emerging factor in the successful implementation of corporate stewardship programs.

Boards of directors recognize that ESG factors are vital to the long-term health of their organizations as employees, customers, and regulators increase their focus on measurable change. This greater recognition must now mature into the meaningful transformation of company culture and business operations to enhance resilience and market differentiation. Boards of directors are now tasked with broadening their focus beyond reaping rewards for shareholders to more fully considering ESG-linked risks and opportunities. Lead directors must share in and help develop the organization's ESG vision to realize the value in investments and directives necessary to move the ESG needle. Ultimately, boards of directors represent a powerful ally in advancing their organizations' ESG progress, and their support of the executive management team's efforts is critical.

Read on to learn more about a typical ESG journey throughout three frequently observed growth phases: *Emerging*, *Evolving*, and *Leading*. Examine this topic through the stories of three organizations that have made measurable progress in ESG performance using an ESG journey navigator. This tool prepares boards of directors to help accelerate progress through these phases to mitigate ESG risks, realize opportunities, and meet the demands of current and future stakeholders.

Table of Contents

Challenge: Strengthening Organizational Resilience Through ESG

GROWING BOARD RESPONSIBILITY FOR ADDRESSING ESG ISSUES

ESG Pressure Wave 2.0

Stakeholder demands have resulted in a significant rise in the focus on environmental, social, and governance (ESG) issues. The importance of increasing the use of clean energy and improving efforts to tackle climate change has become a serious concern for many, from customers and investors to local communities and regulators. Topics like human rights, employee and product safety, and companies' ability to maintain strong relationships with people are becoming key factors for gaining the social license to operate. Similarly, corporate governance practices, with an emphasis on policymaking, influence, and strong business ethics, have gained significant attention, too.

In 2019, only 25 percent of the world's largest companies had board involvement in environmental matters, increasing to 73 percent in 2022.[1] At the same time, more boards are establishing separate committees to oversee the wide range of sustainability topics. US-based companies today lag behind their European peers regarding ESG/sustainability committees, but their numbers are rising each year. In 2022, 15 percent of S&P 500 companies had a dedicated ESG committee at the board level. Though this figure represents a small proportion and much lower adoption compared to 54 percent of UK companies in FTSE 100,[2] US companies still recorded a marginal increase of 2 percent compared with a year earlier.[3] Nevertheless, 58 percent of US public companies surveyed by NACD in 2023 indicated that prioritization of ESG issues by the board had increased.[4] This trend is also reflected in the rise of multiple-committee or full-board responsibility for overseeing ESG matters, as 51 percent of US companies reported using this multidiscipline approach to ESG governance.[5]

ESG initiatives result in changes in boardroom priorities and the introduction of new duties in pursuit of more oversight. Even when these efforts are welcomed by stakeholders, they may still result in friction, causing boardroom shake-ups. However, merely restructuring a board does not appear to result in the magnitude of change needed to avoid the worst climate change scenarios or to deal successfully with important social issues.

In 2023, more boards of directors started facing a level of ESG-related pressure unfelt in previous years, signaling a new rise in expectations for board oversight in these areas. From activist investors to stricter regulations to the threat of climate litigation, boards of directors are increasingly becoming the main target in many attempts to overhaul companies worldwide. For example, a board of directors may be viewed as not paying sufficient attention to preparing their company to meet low-carbon goals by 2050. When stakeholders begin to doubt a board's ESG intelligence and willingness to resolve material ESG issues, this can expose underlying weaknesses within the entire organization and result in demands for aggressive organizational change.

A recent analysis by Barclays revealed that the first half of 2023 saw a substantial increase in shareholder activism campaigns globally.[6] There were 133 activist campaigns recorded during the period, which stood above the four-year average of 108. Moreover, 81 director seats won by activist investors also stood above the four-year average of 78, which indicates that these aggressive campaigns continue to be successful.

---

1 Jamie Smith, "*How committees are evolving to meet changing oversight needs*," posted to ey.com on Oct. 17, 2022. https://www.ey.com/en_us/board-matters/how-committees-are-evolving-to-meet-changing-oversight-needs

2 Gautam Naik, "More Than Half of FTSE 100 Companies Now Have ESG Committees," posted on Bloomberg.com on Sept. 4, 2022. https://www.bloomberg.com/news/articles/2022-09-04/more-than-half-of-ftse-100-companies-now-have-esg-committees

3 Deloitte, *Emerging Trends in ESG Governance for 2023* (Deloitte, January 2023). https://www2.deloitte.com/us/en/pages/center-for-board-effectiveness/articles/emerging-trends-in-esg-governance-for-2023.html

4 NACD, *2023 NACD Public Company Board Practices and Oversight Survey* (Arlington, VA: NACD, 2023). https://www.nacdonline.org/all-governance/governance-resources/governance-surveys/surveys-benchmarking/2023-nacd-public-company-board-practices-and-oversight-survey/

5 Deloitte, *Emerging Trends in ESG Governance for 2023* (Deloitte, January 2023). https://www2.deloitte.com/us/en/pages/center-for-board-effectiveness/articles/emerging-trends-in-esg-governance-for-2023.html

6 Barclays, "5 trends in shareholder activism that have emerged in 2023," posted on cib.barclays on July 19, 2023. https://www.cib.barclays/our-insights/5-trends-in-shareholder-activism-that-have-emerged-in-2023.html

Diligent Corporation, a software-as-a-service (SaaS) company, provided further insight into the most popular topics related to activist shareholder campaigns made against public companies during the first half of 2023.[7] The company reported that topics related to social issues have seen a significant number of investor demands, amounting to an 11 percent annual increase on the global scale. In the United States, ESG demands with the most significant increase over the year include board independence (50%), human rights (45%), diversity and equality (44%), and climate change and greenhouse gas emissions (22%).

The Root Cause of Heightened Pressure

Stakeholders, including broader society, are demanding that boards take more accountability for ESG due to concerns that organizations are not effectively mitigating ESG-linked risks and capturing ESG-linked opportunities. ESG factors are seen to contribute heavily to long-term enterprise-value creation. Whether a company is viewed as an ESG laggard or an ESG leader is increasingly expected to define the company's overall resilience in the long term.

ESG-linked risks include unfamiliar challenges, such as mitigating climate-related physical and transition risks. Poor ESG performance is likely to damage the company's reputation, limit its ability to attract top talent, or result in financial burdens such as carbon taxes. MSCI, a global investment service provider, analyzed historical stock price trends during the period of 2006-2013 and found that companies experiencing negative incidents related to governance, such as frauds or ethical breaches, tend to be more prone to very sudden and unrecoverable damage to their market valuations.[8] In July 2023, Clarity AI, a sustainability technology platform, released findings from its analysis of more than 10,000 ESG controversies identified in more than 1,500 companies globally between 2018 and 2022. The data showed that ESG controversies can lead to a decline in a company's market value by 2 to 5 percent within six months.[9] These controversies included governance topics such as ethical violations, conflicts of interest, and excessive management remuneration. The study also reviewed environmental concerns such as the volume of water used for production in water-scarce areas, as well as violation of regulations and failures to properly assess environmental risks and prevent habitat loss.

Whether a company is viewed as an ESG laggard or an ESG leader is increasingly expected to define the company's overall resilience in the long term.

Addressing ESG issues effectively offers a wealth of opportunities, including leveraging cost savings through the transition to renewable energy sources, establishing a strategic vision for a low-carbon future, improving the organization's reputation, increasing the organization's employee retention rate, attracting more customers through innovative products or services, opening new market opportunities, and raising overall competitive positioning. Effective ESG responses can also help an organization meet regulatory requirements and comply with applicable laws. The company must be guided by a competent board of directors to not only develop a strategic vision but also realize opportunities through ESG improvements. Their experience, expertise, and effective tools at hand to support the company provide them with a unique capacity to steer the organization toward sustainable development.

7 Diligent, *Shareholder Activism in H1 2023* (Diligent, 2023). https://learn.diligent.com/rs/946-AVX-095/images/InsightiaDiligent_ActivismQuarterly_H12023.pdf

8 Linda-Eling Lee, Guido Giese, and Zoltán Nagy, "Is ESG All About the 'G'? That Depends on Your Time Horizon," posted on msci.com on June 15, 2020. https://www.msci.com/www/blog-posts/is-esg-all-about-the-g-that/01920981576

9 Guillermo Velazquez and Jaime Oliver, "Measuring ESG Risk: ESG Controversies Lead to a 2% to 5% Stock Underperformance after Six Months," posted on clarity.ai on July 12, 2023. https://clarity.ai/research-and-insights/measuring-esg-risk-esg-controversies-lead-to-a-2-to-5-stock-underperformance-after-six-months/

Background: ESG Progression Path

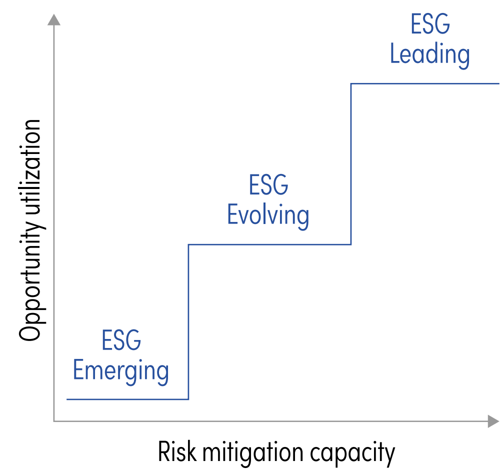
The ESG performance of companies can be evaluated through the lens of their ESG maturity, which reflects an organization's ability to take advantage of ESG-related opportunities and effectively mitigate ESG-related risks. Successful risk mitigation and opportunity realization are dependent on multiple factors, including the company's internal ESG knowledge, organization-wide commitment to sustainable value creation, transparent communication of ESG initiatives, and regular performance updates to stakeholders.

This report outlines three ESG maturity levels (Emerging, Evolving, and Leading) applicable to all companies during their ESG journey (see Figure 1). As companies progress through the phases, their ability to effectively respond to ESG-related risks and realize opportunities increases significantly, bolstering their organizational resilience to future unexpected events and putting them on a path to sustainable value creation.

Each member of the board of directors must be able to identify the company's current stage of ESG maturity and understand the factors that can influence progression to the next level. The remainder of this section outlines ESG maturity levels in more detail and reviews how an organization's capacity to deal with ESG risks and opportunities impacts progression from one maturity level to another.

FIGURE 1

ESG Progression Path



THREE LEVELS OF ESG MATURITY

A company's ESG maturity can be defined by how advanced the organization is on multiple operational factors, which together compose an essential set of activities enabling the ESG progression from one maturity level to another. While financial capital resources, together with market positioning, strong brand image, and a tight regulatory environment, can certainly help accelerate a company's ESG progression, other factors, such as company values, culture, and a company-wide awareness of ESG benefits, are usually the real catalysts for a successful ESG journey. In this section, each ESG maturity level is evaluated using the following three factors:

- ESG ambition, commitment, and action planning
- ESG data measurement and management
- ESG reporting

Emerging

Organizations just starting their ESG journey typically find themselves at the Emerging maturity level. At this stage, companies have limited knowledge and capacity to adequately address ESG issues. They tend to focus on capturing easy efforts to transition from traditional (and often outdated) corporate social responsibility initiatives to more advanced performance measurement against ESG factors and a future-oriented sustainability improvement action plan.

Hypothetical example: FoodCraft is a company operating in the processed foods industry. In response to growing customer demands for more environmentally friendly products, the company rolled out an internal training program to improve understanding of sustainable agriculture practices and their impact on its products. Also, to promote awareness and transparency, the company's environmental team started measuring greenhouse gas emissions from its direct operations and is planning to disclose them publicly next year as part of its first ever ESG report. Moreover, FoodCraft is increasingly concerned about operational risks in its supply chain, which is frequently affected by drought and unprecedented weather. In response, the company has mapped its supply chain locations with the highest potential exposure to physical climate change risks, but the company has yet to commit to investing in climate risk mitigation.

Evolving

This is the next ESG maturity level, where companies demonstrate higher engagement with sustainability topics and a wider integration of environmental and social factors across their operations. Collection and analysis of several years' worth of ESG data allow them to draw meaningful insights. Also, there is greater stakeholder involvement in identifying the most material ESG issues for the company, which helps shape the strategic ESG direction for the future. The continued improvement is further felt in the ESG reporting area, which is more aligned with international disclosure standards and frameworks, such as the Global Reporting Initiative (GRI), Task Force on Climate-Related Financial Disclosures (TCFD), and International Sustainability Standards Board (ISSB). Organizations can supplement their improved knowledge of ESG issues with more ambitious commitments to decarbonize operations across their entire value chains using science-aligned pathways. However, the ESG strategy is primarily focused on risk mitigation, with few opportunities utilized despite the increased capacity to do so.

Hypothetical example: MediTech Innovations is a global medical equipment manufacturer. As part of a continuous effort to improve its ESG program, the company recently engaged its stakeholders and conducted an ESG materiality assessment to identify which ESG topics are most critical to the organization.

The company then chose to prioritize employee health and safety by ensuring indoor air quality improvements within its manufacturing facilities and obtaining third-party-issued sustainable building certifications. Furthermore, following recent development toward convergence in ESG disclosure standards and frameworks, the company successfully tailored its sustainability reporting to align with an upcoming global baseline set by the international Sustainability Standards Board, an independent, private-sector body that develops and approves IFRS Sustainability Disclosure Standards. As a result, the company expanded its carbon inventory with Scope 3 emissions[10] and set ambitious carbon-reduction targets, but it has not yet created a supplier engagement strategy to drive the required decrease in emissions.

MediTech Innovations is also investing more in R&D aimed to improve product resource efficiency through the reduction of energy and water use and increased reusability through waste minimization. The company has begun sourcing more sustainable raw materials and is gradually reducing conventional plastic use. However, MediTech Innovations anticipates a wait time of two to three years until the production of more environmentally friendly products accelerates and they become increasingly available to end users globally.

Leading

Leading is the peak level of ESG maturity that only a few organizations manage to reach. After years of building ESG intelligence, a commitment to sustainability can be found in every decision throughout the organization. ESG performance is factored into management incentive plans, creating an accelerated transition to a low-carbon economy while supporting equally paced social development. Just transition strategies,[11] a set of principles, processes, and practices that support a shift from an extractive economy to a regenerative economy, are implemented to promote social safeguards through which workers' retainment and retraining are prioritized over their replacement. Likewise, suppliers are supported in the decarbonization process through close collaboration and information sharing instead of leaving them behind in the transition to a low-carbon economy. Responsible lobbying and sourcing policies, together with adequate capital and operational expenditure toward sustainable activities, form strong pillars of the company's resilience to future disruptions. Furthermore, companies reaching this ESG maturity level demonstrate advanced sustainability performance disclosures that are

[10] EPA, "Scope 3 Inventory Guidance," posted on epa.gov. https://www.epa.gov/climateleadership/scope-3-inventory-guidance

[11] See "What Is 'Just Transition'?," posted on climatepromise.undp.org. https://climatepromise.undp.org/news-and-stories/what-just-transition-and-why-it-important#:~:text=The%20International%20Labour%20Organization%20(ILO,and%20leaving%20no%20one%20behind.%E2%80%9D

now integrated with financial reporting to tell stakeholders one holistic story about the company's overall performance. Organizations at this stage manage to capture ESG-linked opportunities more successfully, improve their competitive positioning, and drive sustainable value creation for all stakeholders.

Hypothetical example: NovaDrive Automotives is an electric car manufacturer with a rapidly growing market share. In order to drive Scope 3 emission reduction across its global supply chain, the company implemented a sustainable procurement policy, which is now integrated in every purchasing decision. Similarly, to ensure compliance with human rights and fair labor practices across the full value chain, NovaDrive Automotives periodically assesses its suppliers' social risks. It engages suppliers with identified ESG weaknesses and collaborates to help them improve the sustainability of their operations.

Since 2021, NovaDrive Automotives has obtained third-party verification of its direct and indirect GHG emissions annually to secure the trust of investors and other stakeholders. The company has also implemented an internal carbon price[12] of $50/tCO2e. This is used to collect a pool of funds from different internal operations to finance R&D for electric battery performance improvements and evaluate the ROI of various projects.

Evalutation Factor: ESG Ambition, Commitment, and Action Planning

ESG Emerging	ESG Evolving	ESG Leading
▶ The ambition is to move away from CSR initiatives slowly and start ESG programs widely demanded by stakeholders. ▶ Company-wide ESG mobilization is minimal. The ESG training program is targeted at select people responsible for leading the agenda, e.g., HSE or sustainability manager. ▶ The senior management team is aware of the growing importance of the topic of ESG but is focused on other operational priorities. ▶ ESG is not widely integrated into other business functions, e.g., risk management, sourcing, or finance. ▶ Lack of stakeholder engagement on sustainability factors means incomplete identification of ESG issues important to the company. ▶ ESG integration into the organization's overall strategy is prevented at this stage because of the ongoing ESG discovery process to improve awareness and enhance the team's skill set.	▶ Following an improved understanding of the benefits associated with effective ESG risk management, there is a rising ambition to perform well on ESG factors. ▶ Company-wide ESG mobilization through training is extended to other business functions and the executive leadership team. ▶ ESG considerations are becoming more widely integrated into different business functions, such as risk management and sourcing. ▶ Materiality assessment is completed to understand most material sustainability issues impacting the company. ▶ A company's purpose and operations aim to contribute to the United Nations' Sustainable Development Goals[13] (SDGs). ▶ Investment in ESG programs increases, e.g., green energy procurement, community support, cybersecurity. ▶ The overall process of tackling ESG issues is still fragmented, with poor cross-departmental collaboration. ▶ Short-, medium-, and long-term ESG strategy is in place, but financial planning to support strategy delivery is not fully aligned.	▶ ESG is fully integrated into ways of working and the overall culture of the company. ▶ ESG is further leveraged to seize opportunities and create long-term value. ▶ ESG issues are addressed through close cross-departmental collaboration. ▶ Suppliers and other partnerships are carefully selected based on sustainability factors. ▶ Internal carbon prices are implemented to enhance strategic thinking and inform investment decisions. ▶ Strong ESG programs are leveraged to benefit from more favorable financing terms available under sustainable finance products, e.g., sustainability-linked bonds or loans. ▶ Annual ESG days are held with investors. ▶ A robust climate transition plan is in place and incorporates Just Transition principles, which lay the social groundwork for a net-zero economy.

[12] For more information, see "Internal Carbon Pricing," posted on c2es.org. https://www.c2es.org/content/internal-carbon-pricing/

[13] See "The 17 Goals" posted on sdgs.un.org/goals. https://sdgs.un.org/goals

Evaluation Factor: ESG Data Measurement and Management

ESG Emerging	ESG Evolving	ESG Leading
▶ Some basic metrics are starting to be measured, but there is limited historic data from which to draw meaningful insights. This usually includes the company's energy use in owned premises, Scope 1, and Scope 2 GHG emissions, and a few KPIs around charity activities, employee wellbeing, and training or tax payments. ▶ No ESG or carbon-specific targets are currently in place. ▶ A full discovery of ESG risks and opportunities and their financial impact on the company's operations is not completed. ▶ Data is primarily managed in spreadsheets, with no central depository for such information.	▶ GHG emissions measurement is extended with the inclusion of Scope 3 GHG emissions data, but the data sources used are of low quality and rely heavily on estimates. ▶ GHG emissions reduction targets are aligned with ambitious decarbonization pathways recommended by the scientific community, e.g., SBTi[14]-approved. ▶ Tracked metrics are now based on ESG topics most material to the company and its sector. ▶ KPIs are expanded to include the gender pay gap ratio and diversity and inclusion metrics. ▶ Sustainability data management software is used to collect and analyze the data.	▶ There is less reliance on estimates, and more accurate internal data is obtained. ▶ Scope 3 GHG emissions are calculated using primary data from partners in the value chain. ▶ The financial impact of identified ESG risks and opportunities is quantified. ▶ Climate analytics are enhanced using comprehensive climate scenario analysis. ▶ GHG emissions reduction progress is closely tracked against ambitious targets.

Evaluation Factor: ESG reporting

ESG Emerging	ESG Evolving	ESG Leading
▶ Some ESG reporting standards and frameworks are considered, but disclosed KPIs and their methodology are not aligned with best practices, e.g., Global Reporting Initiative[15] or GHG Protocol.[16] ▶ The sustainability report is replacing corporate social responsibility (CSR) reports produced in the past.	▶ ESG reporting standards and frameworks are followed. ▶ The sustainability report is becoming more informative each year. ▶ ESG performance is disclosed to other external platforms, e.g., annual CDP questionnaires or S&P Global Corporate Sustainability Assessment.[17]	▶ Forward-looking metrics are disclosed and integrated into published reports. ▶ Reported ESG data is third-party verified. ▶ Consistent and high-quality reporting to external ESG platforms—e.g., CDP[18]—is maintained. ▶ Environmental and social impact is expressed in monetary terms using innovative accounting methodologies, which supplement standard reporting practices, e.g., Value Balancing Alliance.[19] ▶ The company's environmental impact often goes beyond climate topics and considers natural capital, e.g., loss of biodiversity.

14 See "Lead the Way to a Low-Carbon Future," posted on sciencebasedtargets.org. https://sciencebasedtargets.org/how-it-works
15 For more information, see the Global Reporting Initiative website. https://www.globalreporting.org/
16 See the Greenhouse Gas Protocol website for more information. https://ghgprotocol.org/
17 See S&P Global's "Corporate Sustainability Assessment 2023," posted on spglobal.com. https://www.spglobal.com/esg/csa/
18 Learn more on the CDP website. https://www.cdp.net/en/guidance/guidance-for-companies
19 Learn more on the Value Balancing Alliance website. https://www.value-balancing.com/

CASE STUDY 1: FROM EMERGING TO LEADING—DANONE'S ESG MATURITY PROGRESSION THROUGHOUT THE YEARS[20]

Global food and drink company Danone has long been an example of a true corporate ESG leader. In 2001, Danone established its program to advance sustainable development, Danone Way. The program began with close monitoring of subsidiaries' sustainability performance using different ESG metrics. Five years later, with improved awareness of the company's impact on the environment and society, Danone outlined its purpose as "bringing health through food to as many people as possible." Aligned with the relevant UN SDGs[21] and the company's values, this purpose served as a framework for progress during subsequent years. By 2013, Danone possessed a transparent and comprehensive sustainability reporting system and had set an ambitious target to cut emissions in half by 2020.

In 2009, Danone established the Danone Ecosystem Fund to foster close engagement with partners throughout its supply chain, including small farmers, suppliers, and transport operators. The fund contributed to 47 different projects worth $47 million (USD) in investment in 21 countries, which were aimed at promoting sustainable agriculture practices, waste management, and product distribution. Apart from strengthening Danone's value chain, these initiatives also helped create new jobs and allowed the company to credibly demonstrate the results of its ESG efforts rather than promote vague, unsubstantiated platitudes.

Danone's continuous ESG progression was followed by the publication of its first integrated report in 2016. A year later, a leader in the dairy product industry had five of its subsidiaries certified as B Corp, which made them legally accountable to balance profit and purpose. This marked an important step toward Danone's ambition to become one of the first multinationals with 100 percent B-Corp certification (which stands at 70% as of 2023).

The company managed to stay on top of new ESG standards and frameworks, adapting its management and reporting processes accordingly. In 2019, Danone took the next step in its ESG journey with the introduction of a carbon-adjusted earnings-per-share (EPS) metric. This meaningful performance indicator embeds environmental impact into the standard EPS financial metric. At the same time, Danone linked 20 percent of executive compensation to its social and environmental targets and adjusted its longer-term incentive plan to reward executives when the company maintained a high CDP score for environmental performance over three years.

By creating a resilient business model with a strong culture, purpose, and moral values across the organization, Danone has become a true sustainability champion. This approach has also helped Danone discover new streams of revenue by designing innovative products and generating value for a wider stakeholder group.

It is worth noting that even leading companies in the ESG arena may not always avoid criticism for not doing enough. In 2022, three environmental NGOs accused Danone of not sufficiently reducing its plastic footprint and called for the company to release plans for a complete phase-out of this material in their production. This illustrates how challenging it can be not only to reach excellence in ESG but also to maintain it. Boards and leadership teams must stay focused and aware of trending ESG issues, carefully considering the long-term impact of their decisions and innovating at all times.

[20] Danone, "Annual Reports Archives," posted on danone.com. https://www.danone.com/integrated-annual-reports/integrated-annual-report-archives.html

[21] See "The 17 Goals," posted on sdgs.un.org. https://sdgs.un.org/goals

ESG-LINKED RISK IMPACT MITIGATION

Risk Mitigation: Emerging

Companies at the Emerging maturity level are more vulnerable to risks from ESG issues—especially damage to reputation and market access. Increasingly, these problems stem from a lack of due diligence across the entire supply chain. Without visibility into supplier standards and business conduct, a company may get blamed for the poor practices of its suppliers, including unsafe working conditions, child labor, and environmental contamination.

At this stage, companies should prioritize clear reporting mechanisms and ensure that ESG data is reliable. Third-party organizations perform audits of this data and issue ratings that can impact competitive positioning in the market, affect creditworthiness, and lead to higher rates on insurance or loans. To overcome these risks, companies must accelerate the mobilization of their workforce and operations to swiftly create a stronger response mechanism before further amplification of ESG-linked risks—for example, by initiating training programs aimed at increasing employees' ESG knowledge, improving the robustness of KPI measurement methodologies through gap analysis, and performing peer assessments to better align ESG reporting with sectoral priorities.

Risk Mitigation: Evolving

Organizations at the Evolving maturity level can typically withstand the impact of ESG-linked risk more successfully. The major driver of this progression can be linked to ESG risks' incorporation into the wider enterprise risk management framework, allowing the company to monitor ESG-specific risks, assess their severity, and apply appropriate risk-mitigating actions. Nevertheless, fragmented ESG management processes across different departments and incomplete integration into the company's culture limit the growth of ESG-linked risk mitigation capacity. Also, ambitious goals to address ESG issues (e.g., rapid decarbonization) often become misaligned with an organization's financial planning, especially over the long term. Inadequate financial resource commitment to support these ESG strategies can raise investor skepticism and greenwashing concerns from wider stakeholder groups.

Risk Mitigation: Leading

Reaching the Leading level of maturity substantially increases an organization's ability to mitigate the impact of different ESG-linked risks. The key to this achievement is successfully embedding an ESG philosophy and strategy throughout all company operations, in alignment with the UN's Sustainable Development Goals. As ESG becomes a strategic driver of long-term performance, Leading-stage companies are more cognizant of ESG-linked risks. These organizations can mobilize quickly to create an effective response that reduces impacts on the bottom line.

ESG-LINKED OPPORTUNITY UTILIZATION

Opportunity Utilization: Emerging

Few ESG opportunities are captured by companies at this stage in their ESG journey, such as boosting employee morale and receiving stakeholder appreciation for beginning to respond to ESG issues. However, most of their focus is on how to increase their capacity to mitigate ESG-linked risks. Emerging companies have few resources, limited experience, and little alignment between their ESG vision and how to achieve it. To build ESG intelligence, these companies should dedicate ESG responsibilities and provide training that can increase capacity for capturing ESG opportunities later.

Opportunity Utilization: Evolving

Companies at this stage have a far greater ability to maximize the potential of ESG-linked opportunities. For example, once ESG is placed among the strategic imperatives of an organization, it creates an environment where innovation is actively pursued to unlock new revenue streams and/or reduce costs. One such area is increased investment in R&D, which can lead to the development of eco-friendly products based on the sourcing of more sustainable raw materials. This could further result in the premium pricing of products and increased reputation among customers, as seen many times in the retail, clothing, and food industries. Furthermore, companies in the ESG Evolving stage are poised to capture more cost savings in the longer term through accelerated use of renewables in pursuit of GHG emissions goals. On the social factor side, stronger support for the company's operations and expansion into new areas can be secured from the wider public if a company demonstrates more active engagement with local communities and understands their needs.

Key factors for success include stronger ESG governance and greater alignment between the business strategy and material ESG issues. Overall, other stakeholders, including local communities and employees, stand to benefit from the company's improved ESG intelligence.

Opportunity Utilization: Leading

At this stage of maturity, companies are finally realizing significant benefits from their ESG investments. Employees at all levels now share an appreciation for the positive impact ESG can have on the company, which engenders support for additional initiatives and investments. Factors such as internal carbon prices drive the search for and greater adoption of sustainable alternatives. Incorporation of ESG factors into the long-term compensation plan of the executive management team is another effective tool used to ensure that the C-suite places ESG among their top priorities. Also, many organizations at this stage are ahead of their competitors in the amount of carbon reduced beyond their value chain to accelerate the global transition to a 1.5°C world.[22] This is achieved through significant investment in carbon removal projects such as reforestation and soil carbon sequestration. Leading companies attract top talent, suppliers, and customers who all want to build relationships with a sustainable partner. Additional financial benefits come from access to capital secured through sustainability-linked loans and bonds that offer favorable terms that can be used to accelerate additional sustainable investments.

> Employees at all levels now share an appreciation for the positive impact ESG can have on the company, which engenders support for additional initiatives and investments.

[22] See "The Paris Agreement," posted on un.org. https://www.un.org/en/climatechange/paris-agreement

Effective ESG Response: Role of the Board

FOSTERING A SUSTAINABILITY MINDSET ACROSS THE ORGANIZATION

A sustainability mindset is a foundation for accelerating the organization's adoption of long-term thinking that drives broader stakeholder value creation. Progression along ESG maturity depends a lot on an organization's devotion to achieving positive, long-lasting environmental and social outcomes. The success of an organization's ESG strategy requires every employee to incorporate environmental and social considerations into day-to-day decision-making and feel personally invested in a more sustainable outcome. This is usually led by integrated leadership committed to igniting a sustainability mindset throughout the organization and deploying all available support tools to facilitate successful ESG outcomes.

The board of directors is uniquely positioned to foster a sustainability mindset across the organization through long-term strategic planning, resource and investment allocation, and the formation of impactful policies. However, despite the accelerator pedal for ESG progression being positioned under the board's foot, the same board's decisions often tap the brakes. EY's 2022 survey of 200 European companies revealed that the major internal challenge organizations face in generating long-term value through ESG is the lack of commitment from the board to make strategic decisions that fully integrate these factors.[23]

These findings are echoed in a global study published by the Boston Consulting Group in 2022. The study revealed that 43 percent of surveyed directors do not believe that their organization has the ability to execute ESG goals, primarily blaming their lack of knowledge of ESG issues, cost increases, organizational culture, and management's commitment before pointing out the commitment of the board.[24]

> The success of an organization's ESG strategy requires every employee to incorporate environmental and social considerations into day-to-day decision-making and feel personally invested in a more sustainable outcome.

When a board of directors begins considering ESG initiatives, it should start by asking fundamental questions about the far-reaching impacts of ESG (see ESG Journey Navigator for Boards on page 17). Of course, the board will not be able to answer them all, but impact-centered questions should serve as a guide. This holistic perspective will organically facilitate a sustainability mindset among board members and spur the development of a robust ESG strategy and model priorities for the rest of the organization.

[23] Julie Linn Teigland and Andrew Hobbs, "How can boards strengthen governance to accelerate their ESG journeys?," posted on ey.com on Feb. 17, 2022. https://www.ey.com/en_gl/attractiveness/22/how-can-boards-strengthen-governance-to-accelerate-their-esg-journeys

[24] BCG INSEAD, *Directors Can Up Their Game on Environmental, Social, and Governance Issues* (BCG INSEAD, March 2022). https://web-assets.bcg.com/7e/71/fc29b62542e6bac1732ebd890bbc/bcg-directors-can-up-their-game-on-environmental-social-and-governance-issues-mar-2022.pdf

EXPANDING SKILL SETS AND DIVERSITY IN THE BOARDROOM

A board of directors must reflect honestly on its level of ESG competence and how it can be employed to unlock new sources of enterprise value generation. ESG is a newer concept for many boards, and boards of directors generally lack significant knowledge in this area. For example, PwC recently discovered that just 27 percent of boards in the United States have a full understanding of ESG and its implications.[25] These findings might explain the increase in legal claims against directors and their breach of duties related to ESG, including a lack of reasonable care, skill, and diligence when responding to climate change issues.

Companies tend to mitigate such litigation risks through directors and officers (D&O) insurance. However, the high volatility seen in average D&O premium costs over the last two years can add complexity to financial projections. Also, despite a drop in D&O insurance premium costs in 2022, underwriters are starting to evaluate insurance renewals more carefully, as ESG-related claims are predicted to increase in 2023.[26] With upcoming ESG reporting regulations, such as the proposed SEC climate change rule[27] or the EU CSRD,[28] the risk of noncompliance rises; therefore, as part of their insurance renewal process, companies will be expected to prove that they have a robust ESG program in place.[29] In response, companies must require board members to increase their ESG knowledge and skills in the boardroom to protect both directors and the company as a whole from legal claims and heightened premium costs.

A strong governance model is one of the core parts of ESG and often the main factor in determining the success of environmental and social sustainability strategies. Organizations must be more cognizant of their board composition and the adequacy of board members' skills. It is crucial that board members continue to educate themselves on ESG matters, as recruiting new members from dissimilar backgrounds and with diverse experience may not always be possible when attempting to broaden a company's ESG knowledge and skill set. A broader range of expertise, whether built internally or through external recruitment, brings new views into the boardroom and improves directors' stewardship. A recent study of European companies examined the board composition of organizations with more sustainable business practices. It found that these boards included more women and environmental experts as well as shorter board tenure and a younger average age.[30]

---

25 PwC, "PwC's 2022 Annual Corporate Directors Survey," posted on pwc.com. https://www.pwc.com/us/en/services/governance-insights-center/library/annual-corporate-directors-survey.html

26 Clyde & Co. LLP, "ESG claims under D&O policies will increase significantly in 2023," posted on clydeco.com on Jan. 4, 2023. https://www.clydeco.com/en/insights/2023/01/esg-claims-under-d-o-policies-will-increase

27 SEC, *The Enhancement and Standardization of Climate-Related Disclosures for Investors*. https://www.sec.gov/files/rules/proposed/2022/33-11042.pdf

28 For more information, see the "Corporate Sustainability Reporting Directive." https://eur-lex.europa.eu/eli/dir/2022/2464/oj

29 Allianz Commercial press release, "Key risk trends for directors and officers in 2023: potential recession, cyber and ESG concerns," posted on commercial.allianz.com on Dec. 13, 2022. https://commercial.allianz.com/news-and-insights/news/directors-and-officers-insurance-insights-2023-press.html

30 Julie Linn Teigland and Andrew Hobbs, "How can boards strengthen governance to accelerate their ESG journeys?," posted on ey.com on Feb. 17, 2022. https://www.ey.com/en_gl/attractiveness/22/how-can-boards-strengthen-governance-to-accelerate-their-esg-journeys

ESG JOURNEY NAVIGATOR FOR THE BOARD OF DIRECTORS

This section presents examples of what questions directors on the board should ask themselves in regard to different focus areas or topics and what potential decisions they could make to help the company succeed at each ESG maturity level. Collectively, these considerations should help boards identify actions required to spur advancement to the next ESG maturity level.

ESG Emerging Navigator

Questions directors should ask themselves to drive ESG progression:

Focus area	Questions to ask
Strategic direction and board role	▶ How will ESG drive our ability to change with the times and continue to lead? ▶ What is our most positive—and most negative—impact on the environment and society? ▶ Who is accountable for ESG performance within our organization, and what tools do they need to be successful? ▶ How can our current business model support sustainable goals while maintaining long-term shareholder value? ▶ How can our company's activities in the short, medium, and long term align with the UN's 17 Sustainable Development Goals (SDGs)? ▶ How would ESG rating agencies rate our performance, and what impact might that have on our reputation? ▶ How might our organization's response to ESG challenges affect our competitive positioning? ▶ How will regulators change corporate sustainability disclosures in the next one to three years? Are we on track to successfully comply?

Focus area	Questions to ask
Senior management role	▶ Does the executive management team have sufficient competence to lead our company through the ESG journey? ▶ Is the management team aware of ESG challenges and the UN SDGs? ▶ What oversight of the company's impact on the environment and society is assigned to the management team? ▶ Has it already started mobilizing the company's response to ESG risks? ▶ Is management effectively communicating with the board on ESG? Is there a process in place to go about this?

Focus area	Questions to ask
Operational processes	▶ Which team is responsible for driving our ESG agenda? ▶ Does the appointed team have the necessary skills to help the company start measuring and managing its impact on the environment and society? What training is required to help this team successfully transition from CSR to ESG reporting? ▶ Is the methodology for capturing ESG KPIs based on the highest-quality standards and industry best practices? ▶ Have we started quantifying climate transition risks? Do we know our operation's direct carbon footprint (Scope 1 and Scope 2 emissions)? ▶ Does the company follow UN Global Compact principles to meet fundamental responsibilities in the areas of human rights, labor, environment, and anti-corruption? ▶ What other KPIs do we use to track environmental and social sustainability performance? What do they reveal?

Focus area	Questions to ask
Performance reporting	▶ What is the internal ESG reporting process like? ▶ How frequently is ESG performance reported to the management team? ▶ What is the external reporting process like? Does it present useful information to our stakeholders and transparently communicate our company's progress? ▶ How do reported ESG metrics compare against the performance of our peers? ▶ What do our results show about our ability to mitigate ESG risks, and where are our biggest areas in need of improvement?

ESG Emerging: Decisions to Consider

- Recommend or require that the company publish an annual sustainability report.
- Ensure that sufficient support is available for the team leading the ESG agenda. Support tools can include the provision of expert-led ESG training or engagement with external consultancies to drive ESG program improvements.
- Set up an internal ESG performance communication channel for effective oversight.
- Include ESG in the board meeting agenda. Discuss progress and next steps regularly.

ESG Evolving Navigator

Questions directors should ask themselves to drive ESG progression:

Focus area	Questions to ask
Strategic direction and board role	▶ Which ESG topics are most important to our employees, investors, customers, vendors, and local communities, and what risks and opportunities do they present? ▶ How do our largest investors integrate ESG into their decision-making, and what do they expect of our ESG performance in the short, medium, and long term? ▶ What governance structure changes are needed to ensure effective oversight of our ESG performance and enable us to proactively respond to potential risks? ▶ Are the carbon reduction targets in line with scientists' goals of limiting global warming to 1.5°C by the end of the century? ▶ What investments are required to help the company stay on track with the carbon reduction target? ▶ How resilient is the supply chain? Has a supplier ESG risk assessment been completed, and have weak points been identified? ▶ What do stakeholders think of the ESG strategy and performance so far? ▶ Are the company's other strategies aligned with ESG goals and timelines? ▶ What is the employee retention rate? ▶ How engaged are we with the local communities where we operate, and how do we contribute to their wellbeing? ▶ How exposed is our company to cybersecurity risks?

Focus area	Questions to ask
Strategic direction and board role	▶ What support tools can the board of directors utilize to accelerate the company's ESG progression? ▶ What knowledge and training do board members need to support and advance progress despite rapid developments in ESG?

Focus area	Questions to ask
Senior management role	▶ How diverse is the executive management team? Does it feature people with a wide variety of backgrounds and complementary perspectives? ▶ What action is the senior management team taking to promote closer cross-departmental collaboration on sustainability matters? ▶ Does the management team have sufficient resources to accelerate the ESG program? ▶ Does the leadership team demonstrate ESG-centered thinking every day?

Focus area	Questions to ask
Operational processes	▶ What are the key sources of the company's Scope 3 GHG emissions? What's the plan to reduce them? What's the environmental impact of products as determined by life cycle assessments (LCA[31])? ▶ How is the company integrating ESG-specific risks into its enterprise risk management framework? ▶ What measures are in place to avoid greenwashing? ▶ Is there a robust data security and data use policy for confidential personal and client data? ▶ What protection measures have we put in place to prevent cyberattacks? What are our response plans in the event of a security breach? ▶ What methods are used to engage employees and track their satisfaction?

Focus area	Questions to ask
Performance reporting	▶ Is the sustainability report transparent enough to meet stakeholder expectations? ▶ How does current ESG performance compare to that of previous years? Is the company demonstrating progress toward its most pressing ESG issues? ▶ What progress is being made toward Task Force on Climate-Related Financial Disclosures[32] (TCFD)? Do investors consider our progress sufficient?

ESG Evolving: Decisions to Consider

- Request that the team undertake an ESG materiality assessment and identify the most material ESG topics to the organization.
- Introduce an ESG policy that clearly defines the company's approach.
- Define a diversity, equity, and inclusion (DE&I) policy to ensure a supportive workplace environment with equal opportunities for different groups of individuals. Introduce specific DE&I goals for the board and the management team to lead by example.
- Invest in ESG software to help streamline the data collection and reporting process.
- Expand the ESG training program to other teams—especially risk management—to increase ESG knowledge across the company.
- Review the performance of key ESG KPIs and progress against targets at each board meeting.
- Implement a TCFD framework to strengthen the board's oversight and overall reporting of climate-related information in anticipation of evolving regulations.
- Promote the acceleration of Scope 3 GHG emissions measurement and reporting to ensure that the company can compete in a low-carbon economy.
- Work toward setting long-term carbon reduction targets in line with the most ambitious climate science, e.g., targets approved by the Science-Based Target initiative (SBTi).[33]
- Set ESG training goals for the whole board.

31 LCA helps reveal the carbon impact of a product throughout different stages of its life, from production to its use and disposal.
32 See the recommended disclosures. https://www.fsb-tcfd.org/recommendations/#core-recommendations
33 See "Lead the Way to a Low-Carbon Future," posted on sciencebasedtargets.org. https://sciencebasedtargets.org/how-it-works

ESG Leading Navigator

Questions directors should ask themselves to drive ESG progression:

Focus area	Questions to ask
Strategic direction and board role	▶ What are our competitors doing in the ESG space? What ESG opportunities can we realize that our competitors can't? ▶ What does innovation look like within the industry we are operating in? ▶ Can the company leverage its ESG performance and strategy to benefit from sustainable finance innovation and more attractive financing terms? ▶ What financial impact would different climate scenarios have on our assets? Which assets are likely to become "stranded" by climate change and face early retirement? What proportion of total asset value is at risk? ▶ Is the company's financial planning aligned with ongoing sustainability initiatives and a net-zero economy?[34] ▶ Are the operations and vision of key supply chain partners aligned with the company's ESG goals? ▶ What is our carbon offsetting strategy, and can it help reduce emissions beyond our value chain? ▶ Does our ESG performance place us among the leaders in the sustainability space? ▶ How much of our annual revenue is related to sustainable products/services? How is this figure changing year over year? ▶ How diverse is our whole organization, and does it offer equal opportunities for all?

Focus area	Questions to ask
Senior management role	▶ Does the management team successfully align ESG priorities with other company goals? ▶ Do the management team's key decisions reflect long-term thinking? ▶ Is our long-term incentive plan structure adapted to successfully promote a sustainability mindset for the management team members? What proportion of their compensation is tied to ESG performance?

[34] See "The Race Is on for a Net-Zero Economy," posted on un.org. https://www.un.org/en/climate-action/race-net-zero-economy

Focus area	Questions to ask
Operational processes	▶ Is the company using internal carbon pricing to enhance strategic thinking and inform future decision-making? ▶ Is the company actively participating in industry collaboration to address ESG issues collectively and pursue sustainable innovation? ▶ Are suppliers selected based on their ESG performance? What actions are we taking to address poor ESG performance from current suppliers? ▶ Does the onboarding process for new employees include ESG training? What is the process for keeping employees informed of and engaged in ESG topics important to the company? ▶ Has the team considered publishing an integrated report? If so, what is the action plan for enabling this report to be produced in the future? ▶ What methods do we use to stay updated on stakeholder ESG priorities? Have stakeholder priorities changed since the last materiality assessment?

Focus area	Questions to ask
Performance reporting	▶ Does the company's sustainability or ESG report allow investors to assess our overall impact on the environment and society in monetary terms? Does it contain forward-looking information? ▶ Have ESG opportunities been quantified? ▶ Are the company's carbon emissions in line with set decarbonization targets? ▶ Is the company narrowing the pay gap between its CEO and the lower quarter of employees? ▶ Does the company's ESG performance demonstrate a significant contribution to the UN SDGs followed by the company? ▶ Is ESG data verified by a reputable third party?

ESG Leading: Decisions to Consider

- Introduce a sustainable procurement policy to advance ESG integration into sourcing decisions.
- Develop a responsible lobbying policy to ensure that lobbying is transparent, accountable, consistent, and legitimate. A robust policy should consider the wider public interest and not just the needs of the organization. This would better demonstrate commitment to corporate responsibility and will strengthen trust among relevant parties and stakeholders.
- Tie the executive management team's short- and long-term incentive plans to ESG performance.
- Set diversity, equity, and inclusion goals across all levels of the organization.
- Encourage the implementation of the integrated reporting (IR) framework[35] to connect financial and nonfinancial data.
- Prepare a comprehensive climate transition plan.
- Seek external verification for reported ESG data to increase stakeholder trust.
- Launch annual ESG Days with investors.
- Receive regular ESG updates from the management team on progress against ESG goals, initiatives, and their generated impact.

[35] See the "Integrated Reporting Framework," posted on integratedreporting.org. https://www.integratedreporting.org/resource/international-ir-framework/

CASE STUDY 2: THE BOARD'S ROLE IN DRIVING ØRSTED'S SUSTAINABILITY TRANSFORMATION

Ørsted was once a coal-intensive Danish power company, but today, it is often praised for its extraordinary business transformation to become one of the most sustainable companies in the world. In response to the impact of climate change, Ørsted began a 30-year journey to change its power mix from 85 percent fossil fuel to 85 percent renewable energy. By 2019, the company had achieved this key transformation milestone, 20 years ahead of schedule.

Ørsted's board of directors played an important role in supporting the management team's strategy and approach and continues to do so today. The board of directors embarked on a steep learning journey as they endeavored to leave fossil fuels behind and enter the realm of green energy.

Many stakeholders were initially skeptical, including the Danish government, Ørsted's main investor at the time, but the board's commitment to this transformation was steadfast. It embraced the need for significant, rapid reallocation of capital toward green assets such as wind turbines. Aggressive investment in renewable energy was a vital factor for such a fast flip of the energy mix. At the same time, Ørsted experienced a 40 percent decline in operating profit and took on a new CEO, just three years into the transformation. The board appointed a new leader, who was also committed to Ørsted's environmental agenda and was able to advance the strategy while strengthening financial performance.

The board also made changes in compensation and tied its executives' short-term incentive plan to ESG performance. In 2022, Ørsted's nomination and remuneration committee increased the weight of ESG KPIs in the incentive scheme to match financial KPIs. The board also pressed for sustainability to become a key driver in procurement decisions and introduced a 100 percent renewable energy use requirement for all suppliers by 2025 alongside the broader ESG code of conduct for business partners. These actions demonstrate how the board fostered a sustainability mindset across the whole organization.

Today, Ørsted is a global leader in offshore wind production and one of the largest renewable energy companies in the world. Since its IPO in 2016, the company's market capitalization has more than quadrupled.

CASE STUDY 3: HOW A PRIVATE US CLOTHING RETAILER NAVIGATED ESG RISKS AND OPPORTUNITIES

ESG opportunity: Leveraging ESG as a unique selling point

Privately owned and sustainability-focused US clothing company Reformation (Ref) is well-known for its ambitious mission to "bring sustainable fashion to everyone." In an industry infamous for its negative environmental and social footprint, leveraging sustainability as a main business driver is not an easy task. However, Ref shaped its core strategy and investment decisions around a sustainable business model for more than a decade, securing customer loyalty and showcasing profitable growth built on a premium pricing model. Beyond the use of eco-raw materials in production and sustainable packaging, which are deemed to be the main drivers of the premium price tag for the company's manufactured clothes, some other ESG activities of Reformation play an equally important role in the company's overall success.

First, very engaging environmental and social programs with stakeholders—which involve Reformation's suppliers and customers—strengthen the company's social license to operate. Close collaboration with suppliers through knowledge sharing helps them to improve their environmental management systems, increase resource efficiency, and transition to renewable energy sources, thus contributing to the creation of a greener and more resilient supply chain in the clothing industry. Suppliers are also asked to participate in independent, third-party social assessments to ensure fair, safe, and healthy working conditions. On the customer initiative side, customers have been offered opportunities to experience manufacturing operations themselves through public tours of Ref's Los Angeles factory, further enhancing the company's transparency and customer trust. Moreover, as part of its efforts to reuse old clothes more widely, in 2023, Reformation introduced a $5–$25 credit to customers if they return their used Reformation products to the company at the end of their life for recycling purposes.

Secondly, the company's environmental stewardship goes further than its value chain, as demonstrated by heavy investments in high-quality carbon removal projects around the world to offset emissions. Most important, Reformation demonstrates very transparent sustainability reporting, with reports published publicly every quarter—an unusual practice even among the largest public companies, which are often subject to stricter ESG reporting requirements than private firms. Also, Reformation is often praised for not shying away from highlighting negative aspects of its products' environmental impact rather than populating its reporting with only positive results.

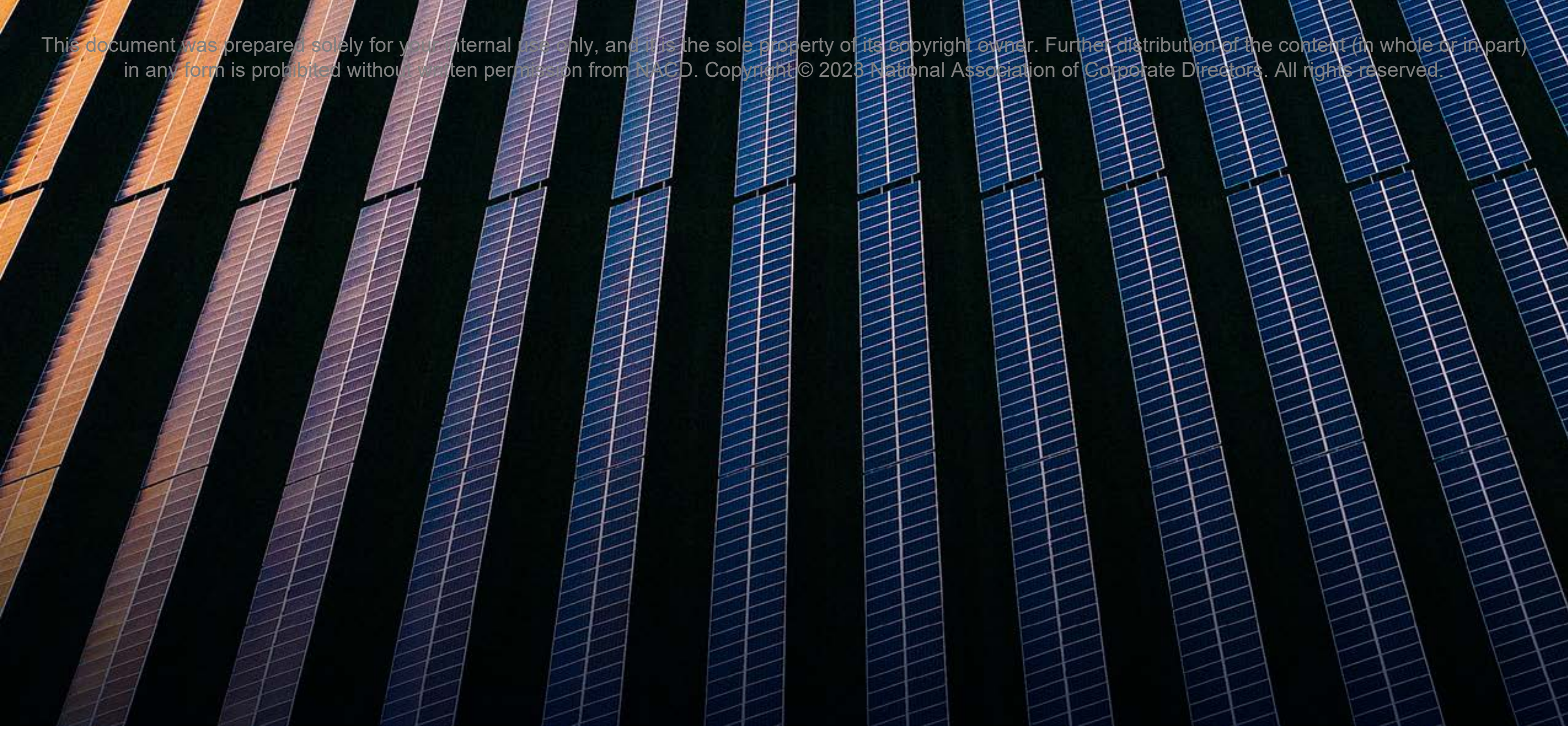
Overall, delivering a strong performance on the environmental and social front throughout the years has helped Reformation win the loyalty of customers and experience profitable growth, despite targeting a niche market of womens wear only. Reformation's case is a good example of how operations conducted sustainably can be turned into a driver of value creation. Similarly, it proves that people are willing to pay more for sustainable products, especially when they are provided with a regular and more transparent overview of the carbon footprint and social impact their purchased product carries. This case study also presents a strong reason why private companies must pay the same level of attention to ESG matters as public organizations do, and why they should not wait until external pressures force them to take action. The sense of urgency or responsibility to conduct operations more sustainably must be felt equally by all companies.

ESG risk: Imprudent treatment of DE&I and how it placed a company's reputation on the line

Despite the praise for sustainable practices over the years, Reformation was found to overlook the importance of an inclusive culture with equal opportunities for all its employees, which led to a racism scandal in 2020. After a few employees publicly criticized the brand and its founder and CEO for race discrimination and the facilitation of a culture with no progression opportunities in the company for Black people, Reformation's reputation and customer loyalty were on the brink of collapse.

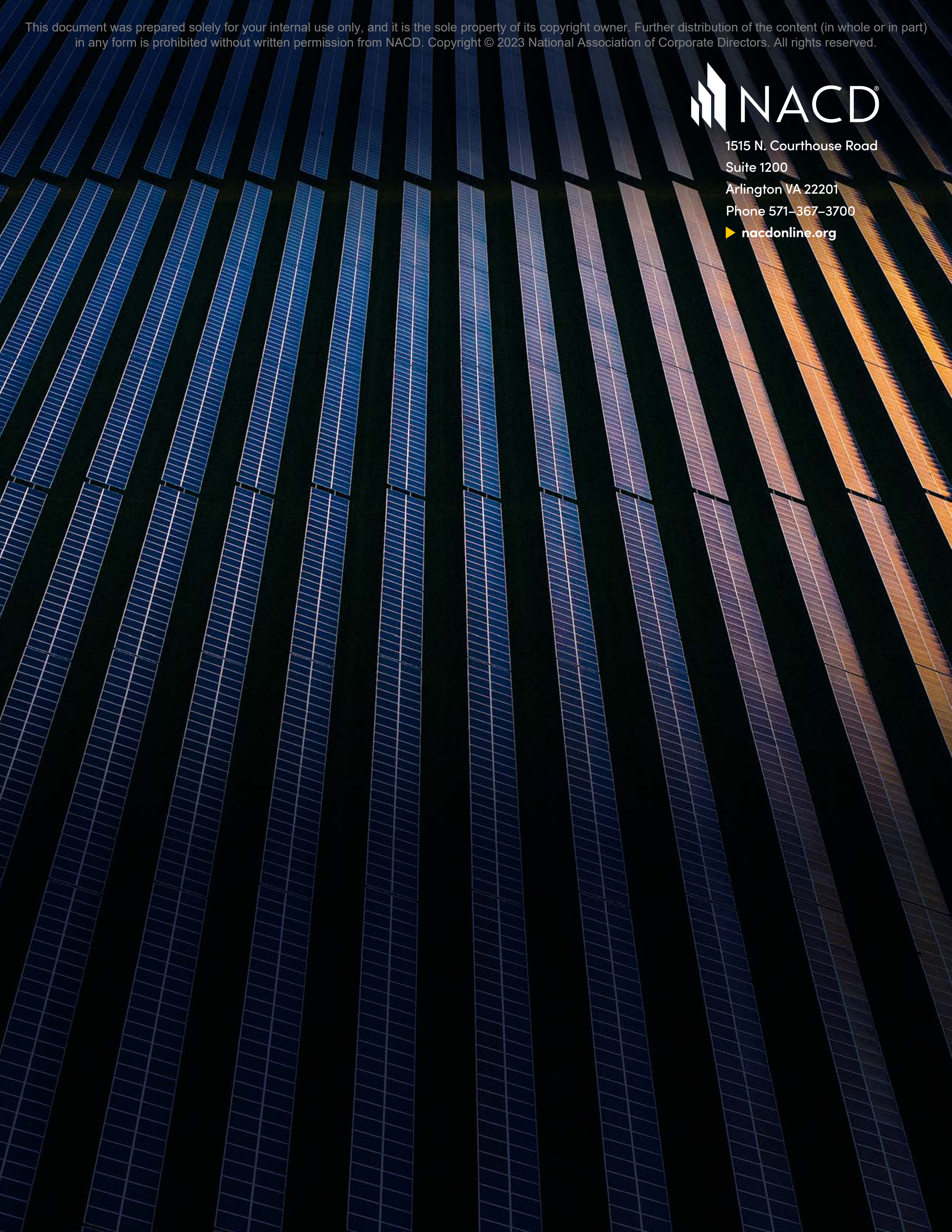
The board of directors had some serious work to do to save the company. It started with the replacement of the CEO, followed by the introduction of the diversity, equity, and inclusion board committee to improve the oversight of equal opportunities for all. The restructuring also included the appointment of a senior vice president of talent acquisition and diversity, equity, inclusion and belonging (DEIB). Today, the company hosts regular DEIB office hours that allow Reformation's employees to talk about all things DEIB. Moreover, the company expanded the employee satisfaction survey with DEIB questions to ensure more effective management of the matter in the future. Further steps included the creation of a partnership with a specialist firm to drive company-wide training on DE&I. A few years into the process of redemption, the team demographics—along with equal progression opportunities for all—provide a completely different picture of the company's DE&I profile.

There is a high likelihood that the shadow of the racial inequality scandal would not be hovering over the company's history today if Reformation had had a more effective and inclusive ESG risk management process in the first place. This, together with more proactive board oversight of DE&I matters earlier, could have played an important role in risk prevention. Examples of board actions that could have been taken include providing support to the management team in defining DE&I commitments, setting up a training program and ensuring a functional employee grievance mechanism. Nevertheless, the company's reactive response in the aftermath of the event, including remediating actions put in place by its board to address the root cause of the scandal, helped restore public trust. The company demonstrated that it possesses features of adaptability and preparedness to learn from its mistakes. This story presents a great example of the vital importance some social factors can carry in today's corporate environment and, if mismanaged, how quickly they can threaten a company's reputation.



Conclusion

The board has a powerful role to play in driving a company's ESG maturity and contributing to the creation of a resilient business model. When this influence is exercised properly, the board can advance the company's adaptive capacity required to make measurable impacts on some of humanity's most pressing challenges: climate change and social inequality. However, a more ESG-centric strategy can also help a company identify and maximize new opportunities. Boards of directors can spur important actions that help companies make steady progress through the three phases of ESG maturity and emerge as true winners in an ever-changing business environment. A successful ESG journey takes time, knowledge, and new skills to transform the mindset of an organization from top to bottom, but progress must start now. Delays only put a company at greater risk of losing out on opportunities to make necessary changes.



NACD
1515 N. Courthouse Road
Suite 1200
Arlington VA 22201
Phone 571–367–3700
nacdonline.org