CORPORATE REPORTING

Pressure on companies for information relating to ESG and sustainability opens the door to a new era in corporate reporting. Investors are demanding more fulsome disclosure on topics such as corporate purpose, culture, stakeholder interests, reputation risk and intangibles that impact companies' strategy and long-term performance. Companies are expected to provide detailed explanations and metrics on specific topics such as climate change, diversity, compensation and human capital management, including how these topics are linked to business strategy and financial results. At the same time, the marketplace continues to expect a degree of standardization that allows for comparability similar to that achieved through financial reporting and the audit. How all this can be accomplished is very much an open question.

State Street Global Advisors described the situation in May of last year when it launched its proprietary "R-Factor" for environmental and social scoring:

> . . . there are significant limitations to the data that has been available about companies' and issuers' ESG practices. Governments don't require companies to formally report on ESG and climate-related data. As a result, *companies are on their own to determine what is material to business performance* . . . There are numerous third parties that provide ESG data and ratings, but these data providers have different methodologies with varying degrees of transparency. [Italics added] **[https://www.ssga.com/cash/ref_doc/esg-in-money-markets.pdf?ts=1556712921867]**

Today, nearly a year later, with the 2020 annual meeting season fast approaching, the situation remains largely unchanged. What has changed, however, is the continued mobilization of international opinion confirming the importance of ESG and sustainability issues and the need for companies to report and measure them, without consensus on how to do so.

In the face of investor demand for ESG information and metrics, individual companies face a bewildering array of choices and little consistent direction from regulators or NGOs. Both regulatory and private-sector efforts to achieve standardization and comparability are still fragmented, leaving companies "on their own" to determine how best to tell their story in company reports and at shareholder meetings.

Companies looking for external guidance in developing appropriate ESG/sustainability content should consider the following sources:

1. **The World Economic Forum International Business Council**
Chaired by Bryan Moynihan, Chairman and CEO, Bank of America, the WEF IBC Task Force, in collaboration with Deloitte, EY, KPMG and PwC, published a consultation draft in January 2020 entitled "Toward Common Metrics and Consistent Reporting of Sustainable Value Creation." This report endorses the Davos concept of "stakeholder capitalism" and proposes a detailed set of "core metrics" and "expanded metrics" for the purpose of enabling companies to address ESG and sustainable value creation in their ". . . mainstream reports and proxy statements and integrated into core business strategy ;and governance processes." **[https://www.weforum.org/whitepapers/toward-common-metrics-and-consistent-reporting-of-sustainable-value-creation]**

2. SSGA's R-Factor Scores

In his January 28, 2020 letter, SSGA CEO Cyrus Taraporevala describes the firm's proprietary R-Factor as ". . . a transparent scoring system that measures the performance of a company's business operations and governance as it relates to ***financially material and sector-specific ESG issues***." SSGA is deliberately making R-Factor scores available to companies for the purpose of ". . . providing a roadmap to incorporating sustainability into the company's long-term strategy." The R-Factor score can be a useful starting point for companies seeking to understand how their current ESG policies and reporting are viewed by one of their most influential investors. The score and the sources from which it is derived can also provide a roadmap for planning an engagement campaign with SSGA and other large investors. **[https://www.ssga.com/us/en/individual/etfs/insights/informing-better-decisions-with-esg]**

3. SASB and TCFD, as recommended by BlackRock

BlackRock CEO Larry Fink's annual letter to CEOs **[https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter]**, published January 14, 2020, demands accelerated ESG disclosure by portfolio companies and states a clear preference for the use of SASB's materiality standards and the climate disclosure framework of the Task Force on Climate-Related Disclosures (TCFD). As we have indicated in previous publications, BlackRock's criteria can also serve as a starting point for companies developing their own customized reporting methodology and content.

4. Benefit Corporations and Certified B Corps

Benefit corporations, which are authorized in 35 U.S. states and the District of Columbia, were launched in 2007 to promote not only profit and shareholder return, but also a wide range of stakeholder, social, community and environmental benefits. Businesses can also become "certified as B Corps," a category that has attracted global interest, including such high-profile companies as Unilever and Danone. The rise of the sustainability movement suddenly lifts the curtain on B corporations and brings the concept into the mainstream for listed companies. The CEO of one recent convert cited the company's ability as a B Corp to "meet higher standards of social and environmental impact, transparency and accountability to stakeholders, rather than just shareholders." This statement is exactly in line with the goals of BlackRock, SSGA and other institutional investors seeking improved corporate reporting on sustainability and ESG issues.

5. Integrated Reporting

The global Integrated Reporting movement [integratedreporting.org] is gaining traction as both a management technique ("integrated thinking") and a method to develop holistic corporate reporting. As discussed in a previous publication, **[https://www.morrowsodali.com/insights/a-common-sense-approach-to-corporate-purpose-esg-and-sustainability]** integrated reporting provides a framework and techniques needed for companies to overcome internal barriers and establish collaborative procedures that produce the kind of holistic narrative required for effective ESG and sustainability reporting. Integrated annual reports and integrated sustainability reports are being produced by leading companies in all markets around the world.

While third-party perspectives are useful, the starting point for corporate reporting must always be internal. Individual companies should start with an analysis of their business fundamentals and circumstances, their strategy and goals, their risks and opportunities and, most important, their owners and stakeholders. As a precedent and model for producing the type of customized content and metrics required for ESG/sustainability reporting, we suggest that companies look to the practices they have developed for explaining their executive compensation plans and conducting say-on-pay engagement campaigns. The effort to explain in detail how pay and performance are linked and how pay anomalies are rooted in business strategy requires managements and boards to analyze investor expectations, prepare a customized narrative and then engage directly with shareholders. We have found this discipline to be effective for a wide range of governance issues where a good business case is needed to rationalize decisions that diverge from best practice standards or proxy advisory firms' policies. Similar customized communications and engagement programs have been effective for dealing with activists and for marshaling shareholder support for M & A transactions. We believe that this type of disciplined, proactive approach will develop around ESG practices and sustainability reporting as well.

Conclusion

For the immediate future there is no single path to effective ESG/Sustainability reporting. New ideas and new metrics are evolving so rapidly that today's suggestions are likely to be outdated tomorrow. The goal, however, is fixed. Sustainable funds, sustainability indices, academic studies and media stories verify that sustainability improves performance – all confirm that "Sustainable investing" is here to stay.

John Wilcox,
Morrow Sodali Chairman,
New York, US

ABOUT MORROW SODALI

Morrow Sodali is a leading provider of strategic advice and shareholder services to corporate clients around the world. The firm provides corporate boards and executives with strategic advice and services relating to corporate governance, shareholder and bondholder communication and engagement, capital markets intelligence, proxy solicitation, shareholder activism and mergers and acquisitions.

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CONTACTS

If you would to like assistance refining your existing ESG disclosures, please get in touch with one of our experts.

US
+1 212 300 2470

EMEA and LATAM
+44 20 71006451

APAC
+61 2 8022 7940