Investor Relations

The Great Divide: Are Boards and Investors Aligned on ESG Issues?

By Phyllis Deiso

Today's investors often focus on environmental, social, and governance (ESG) issues. This focus may be in addition to, or even a higher priority than, projected short-term returns. ESG issues encompass matters such as energy use, pollution, and water conservation, while social matters span a variety of topics, including community volunteer work, harassment in the workplace, and diversity. And, of course, governance is generally laser focused on transparency in disclosures.

Are boards likewise focused on ESG matters? The vast majority of boards are concerned about the importance of good governance and transparency as part of their fiduciary responsibilities. However, data from the *2017–2018 NACD Public Company Governance Survey* indicate very few boards consider social or environmental issues as top trends that will impact business performance over the next 12 months. The survey results suggest that "most boards continue to see these challenges as peripheral to near-term business success, despite increased expectations about corporate sustainability from investors and declining trust in business among the broader public." Instead, boards often are more directly focused on matters such as industry changes, possible business model disruptions, changing global economic conditions, and cybersecurity threats.

Although there certainly may be a divide in the focus of investors and boards when considering ESG issues, this is not to say that boards and the companies they serve are oblivious to the consumer dynamics surrounding these subjects. Indeed, today's hotel guests are now invited to participate in sustainability by reusing towels—the happy confluence of good business and a corporate social conscience. Rather, it is more a question of the priority assigned to such matters at the board level—arguably, depending on the company, a priority that does not seem aligned with that of investors.

In other matters, activist investors can influence how companies do business. For example, the say-on-pay rule requiring an advisory shareholder vote on compensation every three years means both boards and investors are focused on executive compensation. Some investors also may view the say-on-pay vote as a mechanism for expressing their views on the issuer's economic performance. While compensation committees have long been focused on executive pay, it is certainly true that there is increased sensitivity to compensation optics and performance measures as a result of investor vocalism.

The basic, overarching responsibility of directors is to act in what they reasonably believe to be the best interests of the company and its shareholders. This responsibility requires the exercise of prudent business judgment, and a critical factor in exercising good judgment is having appropriate and complete information. Has the board taken the pulse of investor groups? One information-gathering mechanism is appointing a board representative who interacts with investor groups and large institutional investors. Of course, all investor-related information needs to be balanced with the company's views on long-term growth and other initiatives. With the relevant information in hand, the board can make an informed decision regarding its focus.

Also, because investor groups don't always have full insight into what the board is discussing, perhaps being more open about the use of judgment in making decisions will narrow the divide. Boards may want to consider going beyond what is required in the proxy disclosures. For example, activist investors may want more diversity. Board actions or strategic initiatives in this area may not be evident to investors or may not be a particular strategic focus for specific reasons. Boards can provide more disclosure in the proxy about the diversity considerations in proposing a director candidate (e.g., diversity of gender and diversity of talent).

Former U.S. Securities and Exchange Commission Chair Mary Jo White once advised, "engagement with shareholders provides very valuable feedback and insights. Engagement with shareholders should mean more than just mailing out the annual proxy statement and conducting the annual meeting. It should mean proactive outreach, and clear, direct, and honest communications about how and why decisions are being made. And the board of directors is—or ought to be—a central player in shareholder engagement."

Investors and directors are sometimes separated by a great divide, but a bridge can always be built through thoughtful and deliberate communication.

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