Showtime for ESG

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During these difficult times, many articles and research papers highlight how leaders should behave during a crisis, from speedy decisions, to adapting boldly to the new normal, taking ownership of problems, taking care of their teams and leading with authenticity. All laudable efforts. But when revenues drop overnight, factories (and whole economies) come to a halt, employees need to tele-work on a massive scale, warehouses are inaccessible, bills pile up and cash is short, there is a missing piece in the puzzle of the coronomics of running and governing a business during an unprecedented crisis: investors.

Remember the discussion on moral money, green money and ethical investing? Purposeful business? Maybe we do remember responsible capitalism or the call for business to be rooted in purpose and the environmental, social and governance (ESG) factors representing risks and opportunities in creating sustainable value. ESG encapsulates what corporate purpose is all about and COVID-19 has brought ESG to the forefront: now more than ever, it's showtime and center stage for ESG.

In this devastating pandemic, there are two main reasons why ESG is key. In normal circumstances, ESG represents environmental (water consumption, contribution to the climate transition or circular design of products and services), social (community impact, inclusion, respect for human rights or combating modern slavery) and governance (director independence, executive compensation, disclosure, short and long term financial health of a business) factors increasingly informing investment decisions and the running of a business.

In the current *coronomics* circumstances, ESG boils down to what can make or break the very existence of a business.

ESG is key in that it can be the guiding light of a much needed investor and governance behavior. COVID-19 has been called the acid test of responsible capitalism and the ESG test we have been waiting for. It is also showtime for ESG because now more than ever directors need their investors: they need to know capital providers are there by their side, they need to use the knowledge and financial power of investors to navigate this crisis. Directors of large and small companies need to reach out to their capital providers to calmly make evidence-based decisions that are needed today and that will inevitably have long-term consequences.

Study on alignment between corporate purpose and investor stewardship

Between 2017-2019 I conducted a study among members of the boards of Swiss listed, blue chip corporations and their institutional investors. Entitled "Director Engagement with Corporate Purpose: The Contribution and Potential of Institutional Investors", the study discovered how directors engage with corporate purpose and how investor stewardship can support their engagement, as important steps for corporations to create value for society as well as investors. I interviewed and observed 'in action' board members (including chairs and vice-chairs) and C-level representatives of global investors, such as sovereign wealth funds (Europe and Asia), large index funds (USA), pension funds and asset managers (Europe). This study found that investors and directors of listed companies understand corporate purpose as sustainable value creation along financial, social and environmental dimensions, in the short and long term. Purpose is neither about moral obligations, nor about "doing good", rather it encapsulates how companies create sustainable value. The study shows how directors engage with purpose and with their shareholders, and the role investors can play in keeping directors engaged on value creation.

What behaviors are needed on the part of investors?

Investors have the opportunity to show what it means to invest with purpose, to invest in companies (rather than in stocks), to be patient about the disruption in value creation that businesses face, but also to ask for executive pay cuts or voluntarily give up part of their pay, as Schroders and Amundi have respectively done in order to navigate this crisis. Investors can forego or agree to delay dividend payments, inject much needed liquidity in a business, help negotiate and extend credit lines.

Members of the board of directors now have an increased duty to reach out to their shareholders to discuss and agree the best course of action to navigate this crisis. Holding virtual AGMs is only one, formal, way to do so, giving investors the opportunity to raise questions formally and in real time. Most importantly, investors and directors can jump on virtual meetings to advise and lend a helping hand to their companies, becoming part of the solutions needed to survive 21st century challenges.

Investors have the right and duty to remain close to directors, who, in turn, must remain close to the business and its people. Investors and directors need to understand what is going on and figure out how they, their knowledge and network of connections, can be brought to bear to sustain the existence of their companies and respective eco-systems of employees, customers, suppliers, partners and communities. Investors can and must create a sense of calm for those governing and steering a business. In a world that is grappling with the short and long-term effects of COVID-19 (among other challenges), the consideration of ESG in investment and business decisions is vital, as ESG sits at the core of value creation.

Investor stewardship is about protecting and enhancing the value of the assets entrusted in one's care. When stewardship takes the form of "engagement" with boards, exercised around ESG topics, investors are able to demand directors' attention. Investors can do so if they "walk the talk" or do what they say, are knowledgeable about their companies (both through research and first-hand relationships), establish and nurture strategic relationships with directors (chairs and vice-chairs, in particular), and keep an investment time horizon aligned with corporate purpose.

Surprisingly, the study also shows that what matters more for engagement is the stewardship approach rather than just the size of the investor (assets under management) or of their investment (percentage of voting rights), and that smaller investors are able to demand attention from boards provided that they are deemed credible by the companies.

Credibility in the eyes of directors is paramount. To be credible, investors need to have senior individuals leading engagement efforts, show companies that they know the fundamentals of the business they are invested in and be open to advise, discuss, agree and learn. Investors need to limit the use of proxy advisors, making them one element of voting decisions, rather than the element, as directors regard proxies as "box tickers", and tend to distance themselves from investors who solely rely on proxies.

What behaviors are needed on the part of directors?

Concerning how directors can engage with investors, what type of directors engage is as important as how they engage. The study indicates that engaged directors are proactive and authentic, interested and concerned, passionate, energetic and committed to sustainable value creation. They are or want to become knowledgeable purpose and ESG factors, while ensuring that the company remains compliant with laws and regulations.

These directors have a down-to-earth mindset, a positive predisposition towards the unknown, see opportunities and risks in uncertainty, have a personal value system of respect for self and others, for the natural environment and of accountability for one's actions. They view investors as sources of capital who need to be attracted and retained, rather than shareholders who happen to acquire stocks.

Engaged directors are resilient, courageous, and not afraid of questioning the status quo. They go beyond the information executives feed them, dig deep and are hands on, wanting to understand the people and processes behind information packs, so that they can make evidence-based decisions.

These directors see themselves as serving the company and invest a significant amount of time in the role. Time matters and 'overboarded' directors, those serving on many boards, can be too busy to remain engaged. Engaged directors are motivated, competent and understand what is going on in society. Surprisingly, directors' exposure to the knowledge or circular economy, industry 4.0 and new generations' expectations are much more important to engagement than their biological age.

Engaged directors speak up, are confident in their own abilities and resolute in driving the company forward. They possess strength of character and will. Engaged directors agree with their C-level how they work together in the interests of the company, are big-picture thinkers and feel they can make a difference. They value their mental as well as structural independence, as an independent frame of mind allows them to challenge the status quo and make informed decisions.

How do these directors engage with investors? First of all, directors do not get distracted by the flavor of the day, resisting being pulled in different directions by a headline, tweet or Facebook post. Instead they engage strategically and on principle, because they see investors as equal partners in value creation. They reach out to them on individual issues as well as on general topics, listen and discuss necessary trade-offs. Second, because what motivates these directors to serve on a board are the challenges of bringing the company into the future, making a difference, and learning from fellow directors and investors, engagement with investors takes a clear learning route.

Engaged directors acknowledge that "nobody can know it all" and engaging with investors also means asking for help. Because engagement needs to be coordinated, it normally rests with chairs, supported by vice-chairs. As front liners, they initiate and nurture strategic dialogue with investors. In other words, they proactively manage investors as part of strategic decision making and crisis management, rather than waiting for investors to knock on their door.
Discussions with investors go well beyond quarterly reports and sales forecasts: they include ESG topics such as the climate transition, employee mental health during massive remote-working or how to rebalance an excessive dependency on a single-country supply chain, as these can impact the bottom line and are relevant and important. Chairs and vice-chairs' feedback on investors' meetings helps directors to remain engaged.

Conclusion

The study is a timely contribution to current discussions on the purpose of corporations and the role of directors and investors in creating sustainable value. Evidence indicates that both have a critical role to play in creating value that is more socially inclusive and not so dependent on the exploitation of the natural environment. Director engagement is never 'done', 'complete' or 'achieved", therefore, it needs to be supported and encouraged, so that corporate purpose can sit at the heart of strategic decision-making for value creation. The study also shows how pivotal it is for investors (large and small) to limit the use of proxy advisors, exercise their stewardship duties through engagement with companies and to dedicate time and money to investing in companies (and their directors), rather than in stocks.