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Investors Want to Engage on Sustainability — Are You Prepared?

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Few words in the world of corporate governance are as widely-used, with as many interpretations, as sustainability. Ten years ago, sustainability often referred to recycling and environmental programs. Today, sustainability is regularly used by investment managers to describe a universe of environmental, social or governance (ESG) factors and business practices that impact and enhance long-term corporate performance. Understanding the elevated importance of sustainability among issuers and investors, and how your board and management team can prepare for a successful engagement on ESG topics, is key to building a successful relationship with your largest investors.

The Rise of Sustainability

The rise of sustainability is inextricably tied to the growing influence of large institutional investors, particularly index funds, and the governance teams within them. Generally speaking, governance-focused asset managers now control more than one-third of the average public company's shareholder register. Recently, the world's three largest investors bulked up the staff of their governance teams dedicated to analyzing and meeting with portfolio companies, which included hiring individuals with expertise on environmental and social topics.

The heightened focus on ESG analysis and corresponding engagement is heavily influenced by the Principles for Responsible Investment (PRI). The PRI promotes "active ownership" (such as engagement and proxy voting) and "ESG integration" (which is intended to improve investment decision-making by linking the analysis of ESG factors with financial performance). What began in 2006 with 200 asset owners has grown to more than 1,600 global signatories, including investment managers, with more than $60 trillion in assets.

In September 2016, the PRI announced that it will de-list signatories if they do not show progress in implementing the Principles. Because being a PRI signatory is commonly a requirement for asset managers to win mandates from asset owners, this move may incentivize PRI members to increase the frequency and sophistication of their engagements and add momentum to the quest for ESG data that is comparable across companies and industries.

Market participants are also seeking to understand and quantify the link between ESG and financial value. An increasing number of data providers, consultants, credit rating agencies and nonprofits are assessing and rating companies on their performance on ESG criteria. Concurrent with that analysis is the emergence of academic and proprietary research which correlates effective ESG oversight with financial value creation, further encouraging investors to understand how companies link sustainability and business strategy.

Investors Take Action

These dynamics are already changing the market. Coalitions, including the Commonsense Corporate Governance Principles and Investor Stewardship Group, have been formed to issue guidance and perspectives on governance and sustainability issues. In addition, certain shareholder proposals on environmental and social issues are receiving high levels of support from a growing range of institutional asset managers. Importantly, within the past few months, both BlackRock and State Street Global Advisors have stated that if they do not perceive progress from issuers on sustainability initiatives in their engagement, they will consider voting against the nominating/governance committees of those companies.

Preparing to Engage

Given these trends, it is incumbent on issuers to take steps now to ensure that they are engaging effectively with their investors. Here are four ways to prepare:

- **Establish Clear Governance of Sustainability**. Investors want to know that their portfolio companies have effective governance structures in place to manage the development and execution of sustainable strategies. A coordinated program should be built with the following points in mind:
  - Employees across the organization need to be educated, aligned and incentivized toward common sustainability goals;
  - The financial risks and opportunities of sustainability activities need to be assessed for potential return on investment;
  - Metrics and systems need to be established to track progress against sustainability goals; and
  - The board and management should clearly identify who is responsible for sustainability in order to ensure the integration of sustainability considerations into strategic planning and incentives, as appropriate.

- **Identify the Material ESG Factors For Your Company.** It is critical to identify which ESG issues have the greatest potential to create risks or provide opportunities that may impact the long-term value of your company. Investors are increasingly looking to the Sustainability Accounting Standards Board (SASB), which provides industry-specific guidance on the most potentially material ESG factors in a given industry, and other disclosure standard setters for this information.

- **Tell Your Story.** Companies should be proactive in communicating with investors about sustainability. That means strengthening disclosure of sustainability governance, strategy, goals and performance in public filings and producing enhanced sustainability reports to demonstrate the financial materiality of ESG topics. Companies will also want to ensure internal subject matter experts are equipped to engage with investors and external rating agencies.

- **Keep Your Eye on the Future.** Today, investors frequently compare financial disclosures to material non-financial information contained in documents such as sustainability reports. One trend that is emerging to help ensure these disclosures are complementary is integrated reporting, which combines financial and sustainability disclosure in a single, cohesive document. While still nascent, this practice is intended to provide investors with a better understanding of the link among corporate business strategy, sustainability initiatives, and short- and long-term value creation.

From traditional governance factors like compensation, board composition and independence to environmental and social factors like energy efficiency and diversity, sustainability is now integral to every company's business model. As the market continues to incorporate, value and reflect the materiality of sustainability into investment strategy and engagement, companies that can effectively tell their sustainability story will be best positioned to succeed with the world's largest investors.

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About CamberView Partners

CamberView Partners is the leading provider of investor-led advice to public companies on engagement and shareholder relations, activism and contested situations, sustainability and complex corporate governance matters. CamberView helps its clients succeed by providing unique insight into investors' perspectives on long-term value creation, interpreting the evolving governance landscape and creating proactive strategies to stay ahead of investor challenges.

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