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CSOs

VS

CSR

How a new breed of executive  
is revolutionizing value creation  
through ESG

## CSOs vs CSR: How a new breed of executive is revolutionizing value creation through ESG

In a shrinking number of the dustier boardrooms of Corporate America there remains a myth that Environmental, Social and Governance (ESG) issues are a distraction to 'core business'; that addressing them is a trade-off against more value-creating activities. By contrast, value-focused companies have looked at the evidence and established that stronger performance in *material* aspects of ESG correlates with stronger shareholder returns.

The concept of materiality is critical to the returns. This *isn't* CSR. Perhaps fairly, perhaps unfairly, CSR has come to be associated largely with philanthropy-driven community efforts. In contrast with the positive value-correlation of strong *material* ESG performance, the evidence does suggest that an excessive focus on *non-material* issues correlates with *lower* returns. No, what this *is* is a purpose-driven, material, meaningful focus on the issues that matter to the business and its wider stakeholders. That's how smart businesses avoid the trade-off and create value; and this is what has catapulted these issues into the boardroom and into the mainstream. A new breed of executive is focused on creating as much value as possible.



### The rise of the CSO

A new "C" joined DuPont's CEO, CFO and COO in the C-Suite when the company appointed its first Chief Sustainability Officer (CSO) over a decade ago. Few companies followed suit immediately afterwards, but recently the number has begun to increase rapidly. More than 44 CSOs<sup>1</sup> have been named by US publicly traded companies with the number of CSOs shooting up by more than 65% last year alone. The rise of the CSO demonstrates that an increasing number of issuers, including AIG, Blackstone, McDonalds, Nike, General Mills, PepsiCo and 3M, recognize the value in taking sustainability seriously and integrating ESG considerations into their core business strategy.

Typically, the CSO leads its company's ESG efforts across the organization and often reports to the CEO. When a company has a CSO who has real authority and is actively engaging with stakeholders, it shortens the feedback loop in decision-making and helps drive up performance in those material issues that are closely related to value creation.

"Companies are monitoring the impact they're having environmentally and on society, and the appointment of the CSO reflects an underlying need for companies not only to monitor but also improve their performance," says a post in Harvard Business School *Working Knowledge*.<sup>2</sup>



### Into the mainstream

This transformation is not being driven solely by the companies themselves. Investors have adopted ESG into mainstream analysis. Once the sole preserve of Socially Responsible Investors (SRI) it is now comfortably the norm. Businesses that fail to address these issues can no longer satisfy themselves that they're 'in the pack' – they're right at the back. As Tim Mohin, Chief Executive of the Global Reporting Initiative (GRI),

<sup>1</sup> Weinreb Group reasearch, December 2018

<sup>2</sup> [www.forbes.com/sites/hbsworkingknowledge/2014/10/08/what-do-chief-sustainability-officers-do/#3138914b33ab](http://www.forbes.com/sites/hbsworkingknowledge/2014/10/08/what-do-chief-sustainability-officers-do/#3138914b33ab)

notes, “A recent Oxford study concluded that more than 80% of mainstream investors now use ESG data for decisions.” According to CNBC, that figure is 89% for millennials.<sup>3</sup>

Speaking at a Barron’s roundtable, Erika Karp of Cornerstone Capital put it another way. “Someday,” she said, “it will be hard to imagine a time when investors didn’t study environmental impact, workplace culture, and reputational risk as part of their routine due diligence of companies.”



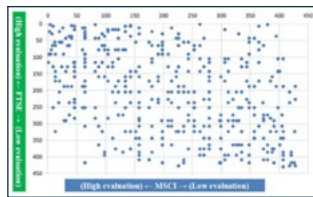
## ESG-related disclosure is simply not good enough yet

It all sounds good in theory. But investors are completely underwhelmed with disclosure. Only a few years ago, the Global Sustainable Investment Alliance reported that an astounding 93% of investors were dissatisfied with disclosure of ESG-related risks/opportunities that could affect business models.

That indicates a big disconnect between what investors want and how issuers are responding:



EY research on non-financial reporting



CLSA Comparison of FTSE and MSCI ESG scores quoted in FT Alphaville

This disconnect points to a bigger issue – traditional CSR reporting isn’t meeting investors’ needs. Nor are the ESG/CSR ratings agencies (yet) the answer as their assessments still vary widely according to the issues they focus on as this analysis published in the FT’s Alphaville shows.

Clearly, CSOs have a major task at hand.



## Getting material

One of the biggest issues is the concept of materiality. Though it’s at the heart of both CSR reporting and ESG there are two slightly competing kinds of materiality:

- + What’s material to stakeholders including NGOs, employees, customers, consumers, and communities
- + What’s financially material to investors

Businesses need to better align these concepts of materiality if they’re going to truly meet investors’ needs. Charlene Lake, CSO and senior vice president of corporate social responsibility at AT&T, says CSOs are facing increased pressure to respond to these new and diverse demands. “We are working to become more efficient as needs grow, but we are also encouraging other departments to engage more fully in social and environmental sustainability initiatives – and we’re seeing that happen,” she said.

<sup>3</sup> <https://www.cnbc.com/2019/07/29/morgan-stanley-offers-new-tool-to-let-advisors-measure-esg-goals.html>



## Moving toward a solution

Clearly, issuers need to get a handle on what investors really want. In our research among investors, we've found that the traditional CSR reporting lean toward social and away from governance is being upended. We interviewed investors in the US, Asia, and Europe, and what we found was eye-opening: by far the most important issue for the typical company is governance. As one investor put it, "G is still so much more important than E&S. You can't have E and S without it coming through G. That is the prism for looking at how good and sustainable a company really is." Another was more succinct: "Governance is 5x more important than E and S."

Of course, there are sectoral differences – and this is where materiality most comes into play. Environment and climate are enormous concerns for energy investors, for example, while social issues – especially relating to data privacy and security – are huge for tech. But there was a remarkable consistency in investor focus on governance beyond those highly sector-material issues.



## Geographic differences require a resolute focus on value

Interestingly, our research showed some geographic divergence. In Asia and Europe, concerns about social impact were on a rapidly increasing trend, with investors in high-climate-risk sectors suggesting they'd even sacrifice short-term returns for stronger social impact. By contrast, investors in the US very firmly would not. In either case, companies need clear disclosure and data to show how they're generating value and managing risk. Another job for the CSO.



## The CSO has a big task ahead – and they're ambitious to get moving

According to research by the Weinreb Group, as of December 2018 three quarters of CSOs were internal hires. A CSO that understands the business from the inside may be better positioned to understand how ESG factors impact the business. But it's important to note that those homegrown CSOs come from a range of backgrounds, including marketing and supply chain, and the perspectives and priorities they bring to the role will have an impact on their approach to ESG strategy.

We believe the increase in focus on material issues is behind the rise of the CSO as companies seek more material, higher value-creating activities. This could not come at a better time. We know that ESG is no longer a trade-off. The UN Principles for Responsible Investment (UN PRI) has presented research showing that strong material ESG strength correlates with clear alpha. But there's also a warning: excessive focus on non-material issues can be value-neutral or even dilutive. Ultimately the businesses that will seize the opportunities best are those that understand most clearly what they need to do and then pursue it with unrelenting focus.

To learn how MerchantCantos can help you gain a better understanding of the role of ESG in sustainability reporting, get in touch with us at [newyork@merchantcantos.com](mailto:newyork@merchantcantos.com).

# Getting a handle on ESG

Focusing on the most important issues is the key to driving long-term value.

## Understand your own objectives (and stakeholders) for ESG; and any gaps

- + Who are my most important **stakeholders**? Who do we need to engage with? What do investors think?
- + Which regulations, **benchmarks** and frameworks should we review? How do we benchmark against peers, competitors and others?
- + What are the **material issues** for my business and the wider sector?



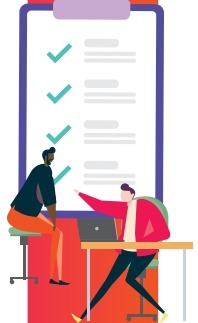
## Develop your approach to address any issues, gaps or opportunities

- + What needs to be developed **strategically** to strengthen the approach?
- + What **policies** need to be updated or developed?
- + What **actions** need to take place?
- + What are our **goals** and targets?



## Putting it into practice key questions to ask

- + What **channels** are our audiences using?
- + What **tools** do we need to influence what stakeholders think, feel and do? Do we need film or animation? Digital? Hard copy materials?
- + How can we build meaningful **dialogue**?
- + How do we **act** on feedback?
- + Who are we reporting to? Under which regulatory and non-regulatory **codes**?
- + How do we get stakeholders the information they need? What **formats** should we use?
- + What do we need to do to report a **transparent**, rich, concise and compelling story?



**Communicate**  
with key stakeholders.  
This goes beyond reporting –  
dialogue, not just broadcast

**Report**  
transparently your policies,  
impact, performance, etc.

# What we do in ESG

Advisory	Communications & reporting	Engagement
<p><b>Input</b></p> <ul style="list-style-type: none"><li>· Stakeholder gap analysis</li><li>· Investor audit</li><li>· Peer group review</li></ul> <p><b>Process</b></p> <ul style="list-style-type: none"><li>· Reporting frameworks</li><li>· Stakeholder engagement</li><li>· Materiality analysis</li><li>· ESG strategy</li></ul> <p><b>Outputs</b></p> <ul style="list-style-type: none"><li>· Meeting external benchmarks (Sustainalytics, MSCI, FTSE4Good, Dow Jones)</li><li>· Mission, values and purpose</li><li>· Metrics &amp; KPI analysis (SASB, GRI, bespoke)</li></ul>	<p><b>Comms</b></p> <ul style="list-style-type: none"><li>· Integrated annual report</li><li>· ESG reports</li><li>· Sustainability and CR reports</li><li>· ESG portals and websites</li><li>· Gender Pay Gap and Modern Slavery</li></ul> <p><b>Reports</b></p> <ul style="list-style-type: none"><li>· Brand and positioning</li><li>· Animations</li><li>· Vision films</li><li>· Executive films</li><li>· Report and narrative writing</li></ul>	<p><b>Stakeholders</b></p> <ul style="list-style-type: none"><li>· Workshops and roadshows</li><li>· Intermediary engagement</li><li>· ESG stakeholder committees</li><li>· Capital markets days</li><li>· Board presentations</li></ul> <p><b>Issues &amp; campaigns (plastics, coal, water, D&amp;I, etc.)</b></p> <ul style="list-style-type: none"><li>· Issue and crisis communications</li><li>· ESG &amp; issue campaigns</li><li>· Campaign planning</li><li>· Signature activity</li><li>· Long-form documentary and film series</li></ul>

## Contact details

### New York

#### Nina Eisenman

Director, Client Services

[neisenman@merchantcantos.com](mailto:neisenman@merchantcantos.com)

+1 917 774 1424

### San Francisco

#### Allison Gabrys

Director

[agabrys@merchantcantos.com](mailto:agabrys@merchantcantos.com)

+1 248 961 3978

### London

#### Ian Roe

Director, Sustainability

[iroe@merchantcantos.com](mailto:iroe@merchantcantos.com)

+44 7834 502389

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