KPMG

Building ESG trust with investors

KPMG Board Leadership Center

ESG has taken its place firmly at the forefront of many board agendas as the COVID-19 pandemic stretches into a third calendar year. According to a recent KPMG Board Leadership Center (BLC) survey, nearly three quarters of directors agreed that a focus on ESG is important to long-term performance and value creation, and 86% said that their companies can meet the needs of stakeholders in a socially responsible manner while generating superior financial results.[1]

Even as boards and management teams work to address a myriad of pressing ESG issues—such as employee health and well-being, corporate culture in a hybrid work environment, climate change, and diversity, equity, and inclusion (DEI)—investors are raising their expectations for ESG-related progress, reporting, and accountability. In other words, investors want companies to "show their work" and their plans on ESG, even if they are early in their journeys.

Lex Suvanto

Catherine Costakos

To find out more about investors' evolving approach to ESG, the KPMG BLC spoke with Lex Suvanto, managing partner and CEO, and Catherine Costakos, senior account supervisor, Edelman Financial Communications. In this Q&A, Suvanto and Costakos offer their views on what directors can do to help their companies earn and retain the trust of shareholders as boards and management teams face increasing scrutiny around how they oversee, manage, and disclose ESG issues.

For example, Edelman's most recent Investor Trust report finds that 71% of investors believe the board should be held accountable for maintaining a company culture, and 72% believe that employee activism within a company indicates a healthy corporate culture. "Boards must understand the value of using data to get a fuller picture of the health of the company's culture," said Suvanto.

Below is an edited excerpt of the conversation.

KPMG BLC: Your survey had some particularly striking findings around how investors perceive the current state of ESG disclosures. What did you find, and what can boards and management teams do to help build or improve trust when it comes to ESG-related disclosures?

Suvanto: According to our survey, 86% of U.S. investors question the accuracy of companies' ESG disclosures, and 91% look for instances of when companies don't deliver on their ESG disclosures and promises. In addition, 90% of U.S. investors report that they subject ESG to the same scrutiny as operational and financial considerations. To improve investor trust around ESG disclosures and promises, we recommend that boards first determine the frequency of updates they wish to receive from management. Establish a cadence for the board to receive updates on ESG strategy and performance, including updates on strategic shifts (annual review suggested); progress (midyear and year-end reviews suggested); investor priorities and engagement (pre- and post-proxy season suggested); and reporting and disclosure (annual review suggested).

[1] KPMG BLC, Views from the boardroom: 2021 pulse survey, 2021, p. 5.

Second, we recommend boards ask about management's approach to disclosure. Eighty-four percent of U.S. investors feel that companies are not disclosing enough ESG information. Understand what ESG goals, progress, and related metrics the company is disclosing, and where. Consider which disclosure framework or standards, if any, are being followed. Do disclosed ESG metrics receive third-party assurance—and, if so, from whom and at what level of detail?

KPMG BLC: In 2021, we saw heightened shareholder attention to climate issues, including increased numbers and support of climate-related shareholder proposals, say-on-climate proposals, and votes against directors for lack of climate action.[2] Given this attention and the potential for new SEC rules on climate disclosures, what questions should boards be asking management this year about the company's approach to, and disclosure of, climate information?

Suvanto: Boards and management teams should be prepared for continued scrutiny on climate action during the 2022 proxy season. Ninety-four percent of the investors we surveyed expect the companies that they invest in to establish and communicate a plan for achieving net-zero emissions, and 92% are concerned companies are not effectively executing on their net-zero pledges.

Some of the questions boards might ask include:

- What is the organization's process for identifying, managing, and capitalizing on climate-related risks and opportunities? How is this process integrated with strategy-setting?
- How do the company's current climate disclosures measure up to investor preferences?
- How is management preparing for future SEC rulemaking on climate disclosures?
- What publicly stated goals has the company made regarding climate? How is progress on those goals measured and disclosed? How is the organization mitigating the risk of litigation stemming from climate disclosures?
- What internal controls are in place to ensure accurate collection and disclosure of climate-related metrics?

KPMG BLC: The movement for racial justice, the COVID-19 pandemic, and the resulting economic uncertainty brought greater focus to how companies approach the "S" in ESG. What does a good process look like as boards and CEOs think through when they will (or will not) take a public stance on social issues?

Costakos: Expectations for CEOs are evolving, and the data reflect that. Seventy-eight percent of investors in this year's survey expect companies to speak out on social issues, even if they do not directly impact the business. Additionally, 65% of investor respondents said CEOs should hold themselves accountable to the public and not just to the board of directors or stockholders. And 66% said CEOs should take the lead on change rather than waiting for government to impose change on them.

We are seeing CEOs not only taking a stand on societal issues but also taking action by making commitments, forming partnerships, and helping communities in areas where they have the ability to make a difference. We use six filters to evaluate if speaking out, taking action, or standing down on a social issue is appropriate: company values, employee interests, stakeholder expectations, the state of the business, prior commitments, and industry considerations.

Should the CEO speak out? Considerations for the board

Company values: What are the company's values and how would taking a public stand fulfill these values?

Employee interests: What issues does the entire workforce—not just the most vocal employees—care about?

Stakeholder expectations: Which societal issues matter most to the company's customers and other priority stakeholders?

State of the business: What is the company's financial state, and how would taking a public stand potentially impact this? How closely aligned is the issue to the company's core business strategy? Is the company able to recruit and retain the talent it needs to fulfill its strategic ambitions?

Prior commitments: What social issues has the company spoken publicly about, and what issues has the company made public commitments around?

Industry considerations: What are the industry norms related to the issues under consideration? Are there industry peers or organizations that the company can partner with on certain initiatives?

Source: Edelman

[2] Subodh Mishra, "Proxy Season Climate-Related Voting Trends Report," Harvard Law School Forum on Corporate Governance, September 29, 2021.

Looking ahead to the 2022 proxy season, boards should keep in mind the growing importance investors are placing on ESG as integral to strategy—especially climate- and DEI-related issues—and investors' desire for more transparent ESG reporting. Public statements and goals alone are insufficient; they must be backed by metrics and disclosures, with controls and procedures to help ensure accuracy and consistency.

As expectations around ESG continue to evolve, boards play an important role in helping their companies build and maintain shareholder trust.

The views and opinions expressed herein are those of the interviewees and do not necessarily represent the views and opinions of KPMG LLP.

About the KPMG Board Leadership Center

The KPMG Board Leadership Center (BLC) champions outstanding corporate governance to drive long-term value and enhance stakeholder confidence. Through an array of insights, perspectives, and programs, the BLC—which includes the KPMG Audit Committee Institute and close collaboration with other leading director organizations—promotes continuous education and improvement of public and private company governance. BLC engages with directors and business leaders on the critical issues driving board agendas—from strategy, risk, talent, and ESG to data governance, audit quality, proxy trends, and more. Learn more at kpmg.com/us/blc.

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