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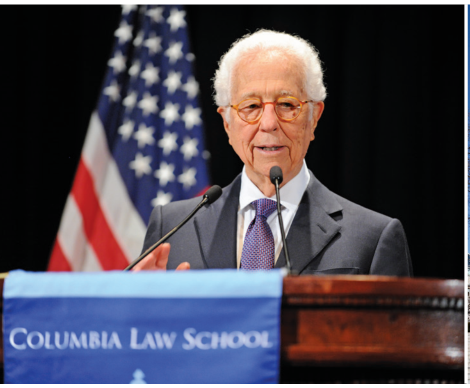

10th Year Anniversary Essay

“Environmental and Social Sustainability in the Boardroom”

COLUMBIA LAW SCHOOL

About the Essay

This essay is part of a series written for the Millstein Center's 10-year anniversary. Each of the essays explores a topic or issue that the Center has addressed over its past decade of work. The essays' authors have all been on the front lines of the changes addressed and were often directly engaged in the Center's activities.

This publication provides general information and should not be used or taken as legal advice for specific situations that depend on the evaluation of precise factual circumstances. The views expressed in this report reflect those of the authors and not necessarily the views of the Millstein Center, Columbia Law School, Columbia University, or the Center's partners and supporters.

The Millstein Center would like to thank the article's author, Jon Lukomnik, for his time and contribution. The Millstein Center would also like to thank Robert Kueppers for serving as editor for this essay series.

Environmental and Social Sustainability in the Boardroom

By Jon Lukomnik

The last 10 years has seen a remarkable shift in the attention and importance of social and environmental issues for public corporations. This has meant an increased focus by boards on these important matters.

Climate change, human rights, corporate political influence, and inequality are just some of the issues that are being raised by shareholders and other stakeholders. As calls for corporate transparency grow, how boards incorporate these issues into their decision making processes, disclose them, and address them from a risk perspective will continue to garner attention.

Let's take advantage of the tenth anniversary of the Millstein Center to step back from the day-to-day noise to understand how fundamental expectations on companies have changed in the last decade. And to take a chance and predict how they will change again a decade from now.

Perhaps no other subject has moved from the fringe to the mainstream of American business as much as environmental and social sustainability. According to the Sustainable Investments Institute (SI2), some 195 environmental and social proposals came to votes at public companies in the US in 2007. Barely ten of those proposals received as much as 20% of the vote. This past year, 239 such resolutions came to a vote, and a majority of them received more than 20%.[1]

Yes, proxy proposals are just one indicator, but there are other data points that, when taken together, suggest that sustainability has moved into the mainstream of American business. Here are just a few:

- The CFA institute notes that nearly three quarters of investment professionals consider environmental, social and governance factors in making fundamental investment decisions, such as whether to buy or sell a company's shares or buy their bonds.[2]
- A Conference Board study reported that for S&P 100 companies that break out revenues by product line, sustainable product and service revenues are growing six times as rapidly as traditional products and services.[3]
- Board level oversight of sustainability issues is becoming commonplace. By 2014, more than half the Boards of S&P 500 companies had acknowledged specific accountability for environmental and/or social issues, according to an SI2/IRRC Institute report.

Indeed, the fact that companies even have sustainability policies is so commonplace that we forget what a sea change this represents. Just a few generations ago, such issues were clearly the purview of government, not business. Economist Milton Friedman was lauded for explicitly opposing such corporate sustainability initiatives. "The social responsibility of business is to maximize its profits," he wrote. Today that seems almost quaint. Business leaders understand that sustainability is a way to maximize profits over the long term. At this September's leadership summit of the National Association of Corporate Directors, the plenary sessions had titles like "Conscious Capitalism" and "Higher Purpose Corporations".

So we have come a huge distance in ten years. The question is why? Why have issues such as climate change, human rights in the supply chain, corporate political influence and income inequality become board issues? The very fact that these types of issues were traditionally thought to be the province of government, not business suggests one potential explanation: Governments everywhere seem less powerful than they once did. Yet the demands for sustainability norms of conduct remains constant. Here in the US, the polarization and resultant gridlock in Washington has civil society looking for levers of policy elsewhere. The devolution of social policy to State Houses has been widely remarked upon, but the millions of shareowners and customers and citizens who feel business affects their lives more than government is huge, and the pressure for businesses to be involved in the sustainability debate is at least equal in scope to the state government phenomenon.

Other explanations include the hangover from the great global financial crisis of 2008 and the realization by large asset owners—as well as companies—that significant social and environmental issues have material impact bottom-line impact. Contrary to Milton Friedman's statement, companies can not directly manage profits. Rather, they need to use the tools and levers at their disposal to run their businesses effectively, and profits are the result of that. There is an increasing recognition that sustainability issues represents risk and opportunity, so the tools and levels are calibrated to deal with sustainability issues.

That said, it would be foolish to assume the next ten years will be more of the same. Straight line predictions based on the past is the one path the future never takes. If anything, we can expect an acceleration of the factors which have made sustainability a mainstream business and boardroom issue: continued central government relative weakness and accepted bottom-line materiality. Moreover, the explosion of social media will turbocharge those factors, particularly as gen X, gen Y and millennials become dominant in society. And technology will change everything.

What, then, should we expect, ten years from now?

1. **Materiality Reporting.** The growing acceptance of sustainability as a risk/opportunity factor that can drive profits and losses will mean convergence around sustainability reporting centered on financial materiality, such as the key performance indicators proposed by the Sustainability Accounting Standards Board. You won't have to wait ten years to see the first real results: Bank of England Governor Mark Carney chairs the Financial Stability Board. He has tasked a number of financial heavyweights, including Bloomberg LP founder Michael Bloomberg and former SEC Chair Mary Schapiro, to look at standardizing climate-related financial disclosures. Bloomberg and Schapiro have repeatedly said they expect to have draft standards by 2017 and expect a number of national regulators around the world, primarily national stock exchanges, to adopt them shortly thereafter.
2. **Assurance, integrated reporting and informational packets.** Reporting on financially material sustainability KPIs will be the table stakes. But it's possible that three additional developments will change the reliability, relevance and format of sustainability information. First, there will be increasing calls for assurance of those factors. Indeed, the AICPA is already hard at work at a practice guide for attestation engagements on sustainability information. Second, once a company agrees to report financially-material KPIs it will move toward integrated reporting which reveals how sustainability and finances work together, since the hard work of doing so—determining which sustainability measures are key to its specific business—will already be done. Third, the limited KPIs that may be reported under materiality for financials will not satisfy civil society organizations. Sustainability reports currently produced by companies will morph into informational packets able to be instantaneously organized into customized reports, videos, charts, etc. designed both for deep-research NGOs and for customers, sup-

pliers, employees and others who will consume that information in totally new ways. Suppliers interested in your supply chain management, or an environmental NGO interested in your water use policy, will have deeper information available, without having to wade through a dense report on all your sustainability initiatives.

3. **New technology.** New technology will affect sustainability in ways that would have seemed like science fiction just a few years ago. Which company will be the first to promote the cleanliness of its facility with an augmented reality device showing—literally—what the local environment would be like without its environmental remediation efforts? Perhaps it will use real-time drones to fly over various facilities, reporting an array of environmental statistics. Perhaps the internet of things will monitor the supply chain. Drones, virtual reality, augmented reality, the internet of things; these will all have sustainability applications, and companies will be expected to use them. Or will it be corporate critics who adopt new technology?

4. **The world is flat and getting flatter.** When the Rana Plaza collapse in Bangladesh killed more than 1000 people in 2013, a number of people took pictures of the clothing labels found in the manufacturing plant's rubble, so that consumers and advocates in the US and elsewhere in the developed world could pressure manufacturers and retailers to improve safety around the globe. Today, when you walk into a store, you can use a phone app that scans a product's UPC and tells you the product's history and if there is an organized boycott against it or the manufacturer. Not surprisingly, it includes a boycott of American companies which have refused to join "The Accord on Fire and Building Safety in Bangladesh". That's just one small example of how technology will bring social and environmental issues from around the world to your customers, suppliers and employees. Smart companies will become expert at both curating (rather than controlling) content around their sustainability issues and at monitoring that content as an early warning system of real-world threats and opportunities.

5. **Technology will change the expectations of your shareholder base.** So-called "robo-advisors" are taking market share from traditional brokers and financial advisors. These computer programs suggest specific stocks, funds, ETFs and other securities. Increasingly they are adding ESG functionality to their programming. One start-up robo-advisor is going so far as to add a number of functions to create communities around corporate sustainability issues, for example, by making it easy to tell friends why you bought or sold a stock based on an environmental issue, or voted a certain way on the proxy resolution. The goal is to create a community of like-minded investors. It doesn't take a great leap of logic to understand that such a community will discover how to agitate for its viewpoint with the company at the center of its discussion. By the way, the robo-advisor isn't doing this only because it believes in sustainability as an investing issue, it also believes that this type of affinity community can decrease its cost of customer acquisition. On the institutional side, a number of technology start-ups have begun using big data and machine learning to monitor a company's ESG reputation in real time. Some are already being used by major institutions to inform buy/sell/engage decisions.[4] Looking at the CFA data about how many analysts now look at ESG data, you can expect such analyses to become commonplace in the future.

Of course, the slightly jokey truism that "he who predicts the future is doomed to eat ground glass" should be a warning that not all—and perhaps none—of these predictions will actually come true, at least not in the specific form described. But the twin drivers of 1) increased focus on sustainability as a core component of corporate business strategy and 2) a world with more sustainability data and more analysis, and with the ability for it to be delivered in ways that would have been science fiction a decade ago, seem inevitable.

ENDNOTES

[1] Heidi Welsh, 2016 Proxy Mid-Season Review The Harvard Law School Forum on Corporate Governance and Financial Regulation (2016), https://corpgov.law.harvard.edu/2016/09/09/2016-proxy-mid-season-review/ (last visited Aug 30, 2017).

[2] CFA Institute, *Environmental, Social, and Governance (ESG) Survey* (2017), www.cfainstitute.org/learning/future/pages/esg.aspx (last visited November 16, 2017)

[3] Thomas Singer, *Driving Revenue Growth Through Sustainable Products and Services* (2015).

[4] **Disclosure:** The author serves on the advisory board of one such firm, and its information and analysis has just been integrated into the ThompsonReuters platform.

About the Author

Jon Lukomnik: Jon Lukomnik has served as executive director of the Investor Responsibility Center Institute (IRRCi) since 2008. He and the Board of Directors have led the organization to become a leading source of objective academic and practitioner research on an array of investment issues to enable investors, policymakers and stakeholders to make data-driven decisions.

Mr. Lukomnik received the International Corporate Governance Network award for excellence in corporate governance, and the National Association of Corporate Directors twice (2011 and 2012) named him one of the 100 most influential people in American corporate governance. Other awards include recognition by Ethishpere Magazine and Global Proxy Watch.

In addition to his responsibilities at IRRCi, Mr. Lukomnik is the managing partner of Sinclair Capital L.L.C., a strategic consultancy to the investment management industry, corporations and institutional investors. He writes a column for Compliance Week, and he is a member of the Standing Advisory Group of the Public Company Accounting Oversight Board.

Previously, Mr. Lukomnik served as investment advisor to the New York City pension funds. He chaired the executive committee of the Council of Institutional Investors, and he co-founded and served as a governor of the International Corporate Governance Network.

His new book, *What They Do With Your Money: How the Financial System Fails Us and How to Fix it* has been praised by former UK Prime Minister Gordon Brown, former Senator Chris Dodd, former Barclays' chairman Sir David Walker, Vanguard Founder Jack Bogle, former Royal Dutch Shell chairman Sir Mark Moody Stewart, and Yale Chief Investment Officer David Swenson, among others. It has received editorial kudos from numerous publications, including *The Economist*, *Forbes*, and *The Financial Times*. He also is the co-author of the award-winning book, *The New Capitalists: How Citizen Investors Are Reshaping the Corporate Agenda*.

About the Millstein Center for Global Markets and Corporate Ownership

The mission of the Millstein Center for Global Markets and Corporate Ownership is to bring world class scholarship, research and academic rigor to the vital task of restoring and strengthening long-term financing of innovative and durable public corporations, which are the underpinning of economic growth.

For more information, please visit **www.law.columbia.edu/millsteincenter**.

Columbia Law School

Millstein Center for Global Markets
and Corporate Ownership

435 West 116th Street, Room 536
New York, NY 10027

Phone: 212-854-3119 | Fax: 212-854-2368
millsteincenter@law.columbia.edu

WWW.LAW.COLUMBIA.EDU/MILLSTEINCENTER