



Center for Board Effectiveness

On the board's agenda | US

An interview with Tensie Whelan,
Clinical Professor of Business and Society;
Director, Center for Sustainable Business,
NYU Stern School of Business

As once-radical concepts of social investing and sustainability-as-strategy become more mainstream, many corporate boards shift their focus to understanding and implementing environmental, social, and governance frameworks and metrics. The impact of sustainability on key financial decisions has increased in M&A, capital allocation, and capital raising;¹ all topics high on the minds of today's board members.

The board's role in governing, monitoring, and measuring sustainability has become increasingly necessary and complex. Deloitte US Sustainability and Climate Change leader Scott Corwin and Center for Integrated Research senior manager Derek Pankratz sit down with accomplished sustainable business scholar, Tensie Whelan to discuss considerations and priorities for boards. >



Tensie Whelan is Clinical Professor of Business and Society and the Director of the Center for Sustainable Business at NYU Stern School of Business, where she is bringing her 25 years of experience working on local, national, and international environmental and sustainability issues to engage businesses in proactive and innovative mainstreaming of sustainability. Tensie has been recognized by Ethisphere as one of the 100 Most Influential People in Business Ethics and was a Citi Fellow in Leadership and Ethics at NYU Stern. She has served on numerous nonprofit boards and corporate advisory boards.

Editor's note: Professor Whelan's participation in this publication is solely for educational purposes based on her knowledge of the subject, and the views expressed by her are solely her own.

1. *Sustainability and the board: What do directors need to know in 2018?*; *On the board's agenda*, Deloitte Global Center for Corporate Governance, March 2018.



What's your overall take on corporate sustainability today?

Thinking about corporate sustainability, we're light years ahead versus 10 to 15 years ago. I do believe that we are seeing a paradigm shift, and companies are recognizing that this is existential and important for their competitiveness, for their future, and for other stakeholders. Investors are clearly seeing this as critical, and some regulators are finally beginning to pay attention. We do see progress, but we have a lot further to go. While we have the commitments, we are not scaling up fast enough.

How is the board's role evolving? Are they equipped to fill this role, equipped to provide oversight for companies?

My research from 2018 demonstrated that of the 1,188 *Fortune* 100 board members, only 6% had environmental credentials.² Only three board members had climate change credentials, only eight had cyber security credentials, and only two had water credentials. What we see on these boards is a complete misalignment with the key issues. For example, looking at the property and casualty insurance industry, where clearly climate change is a huge issue for them, nobody with any kind of environmental climate experience is on the boards we looked at.

Over and over again, in virtually all sectors, we're seeing a lack of ESG credentials. It isn't that somebody needs to be a climate change scientist, but they need to understand the material issues for their company, the questions they need to ask, and where they can get expertise. That's really the board's role: to ask those key questions around what constitutes strategic risk and opportunity. And if they don't know to ask the questions, that's problematic.

Are boards not targeting and getting the professionals with these skills and knowledge, or is there a shortage of people that actually have the knowledge and would likely sit on boards?

I think part of the challenge is that boards tend to be composed of retired C-suite executives, and they were actively running their companies 10 to 15 years ago. While certainly there were companies active on ESG back then, it wasn't seen as the material set of issues that it is today. Those leaders tend to not prioritize it, and many of them are still skeptical. I think we have that kind of inherent challenge.

Are there qualified people available? Absolutely. There are lots of companies that have been run sustainably and whose former CEOs did a good job transitioning those companies. There are also CSOs

(chief sustainability officers) now with lots of experience in the space, and there are investors who are ESG investors who could bring that perspective. There are also civil society players who work with businesses and have deep expertise in particular environmental or social issues. I think that there are plenty of opportunities, but there's a very traditional mindset currently when looking for board members. That's changing with the diversity focus—bringing in more women and more racially and ethnically diverse people—and some recognize you also need to expand out from that former-CEO profile. But, from what I see, there's less proactive recruiting around ESG credentials.

Is this an oversight, or is it symptomatic of the fact that ESG issues are not in the DNA of these organizations yet?

I don't think it's in their DNA yet. To the extent the conversation is happening, they're saying, "Well, we can learn this stuff, and we can hire an expert on it." It is probably more than picking up a newspaper every day, but there are a growing number of ESG credential trainings that are offered, including one from NACD (National Association of Corporate Directors) on ESG-competent boards. I do think that there's a growing interest to provide that education, and interest from board members to get up to speed on the topic.

Where does ESG belong on the board?

When you look at board committees such as risk, nominating, governance, and compensation, ESG is likely relevant to all of them. Non-financial reporting is going to become a bigger piece of the audit committee's work. The risk committee will need to understand the material ESG risks and how to manage different stakeholders. On the compensation side of things, they will need to look at how the company is building KPIs around ESG into the business strategy and including targets for executive compensation to get this to flow down through the organization, tying performance on ESG to compensation is a critical element.

But I also think ESG needs a separate committee for most industries, because this is a key strategic issue in terms of both risk and opportunity. The board needs to understand what those risks and opportunities are and how the executive team is implementing against them in a rapid, transformational way. This is changing so fast that the board needs to be looking at trends and targets quarterly to make sure that the pace of change in the organization is commensurate with what is happening externally. This cannot be done in just five minutes of another standing committee meeting, so I do think ESG needs a separate committee. ➔

2. Tensie Whelan, *U.S. Corporate Boards Suffer from Inadequate Expertise in Financially Material ESG Matters*, NYU Stern School of Business Forthcoming, January 1, 2021, last updated March 1, 2021., Available at SSRN: <https://ssrn.com/abstract=3758584> or <http://dx.doi.org/10.2139/ssrn.3758584>.

Let's talk about measurement. Many organizations don't factor in avoided, future costs from taking certain actions, but if they did, many sustainability measures that seem impossible and irrational today may become "no-brainers."

Absolutely. One interesting example is around water. A company was trying to see if a technology could reduce the amount of water used in their factories. The factories were in water-risky areas; in fact, they actually had one in Sao Paolo shut down due to water issues. And they knew how much it cost them to be shut down for several days. But they couldn't get the internal rate of return (IRR) argument right for their decision-makers around purchasing this new technology, even though the company had made water stewardship commitments. They were only looking at the cost of the water going in and the cost of water going out.

Then we worked to see the whole risk picture, so that they could turn the avoided risk into monetary gain. By moving all that water around, they were using a lot of energy, and they also needed to have a special permit in case they ever went over their water allotment. If they actually implemented the technology, they would no longer need that special permit. In their internal pitches to the CFO, they weren't including these points. They were just not used to thinking that way. Additionally, sustainability people may not speak the language of finance, so you also could have a communication challenge. This could exacerbate the challenges of getting those two different groups, along with manufacturing and whosoever in charge of supply chain and the other relevant elements, on the same page. It is this complex ecosystem, and you've got to bring together the right data and elements for all to have a common understanding.

There are many examples of these kinds of "win-win" actions that make sense from both an environmental and financial perspective. But if we only do the things that make sense in a specific financial framework, is there a risk that it will still leave us far short of what we ultimately need to achieve?

I do think that it will be hard to economically justify all investments at the scale that's needed, in terms of 100% return on investment. This is particularly true for the very short-term focus that many have right now. Maybe if every company had the capital structure of a pharmaceutical company, where it might take 20 years for R&D to yield a profit and they're set up to manage for a long-term investment cycle. But many other companies are not, and boards and executives will need to figure out how they will shift to a longer-term investment cycle. We know this investment will pay off, but maybe not in the three years they've grown to expect. I think for the more massive sustainability investments, we need a longer ROI time horizon.

I also think that some investors talk out of both sides of their mouths right now. They say that they are embracing ESG, but then they may demand short-term results. This may be a problem, as we really need investors to get behind the longer-term perspective. With sustainability and climate change, you have an ongoing problem. It will likely take a combination of government enforcement, investor commitment, and board education and oversight. In order to make these challenging shifts at the enterprise scale, I think it will take a dedicated combination of strategies. ➔



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