THE CONFERENCE BOARD

The Roles of the Board in the Era of ESG and Stakeholder Capitalism: Overview and Key Insights

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Introduction

This may be the most challenging—and interesting—time to serve on a US corporate board in the past few decades. Twenty years ago, boards were responding to the Sarbanes-Oxley Act, which followed the collapse of Enron and WorldCom, and a decade ago, they were focused on complying with a series of regulations stemming from the Dodd-Frank Act adopted after the 2008 financial crisis.

Today boards are responding to both a heightened focus on environmental, social & governance (ESG) issues[1] and a shift toward addressing the long-term welfare of multiple stakeholders.[2] This third wave of governance change is not primarily focused on compliance with new rules. Instead, it is characterized by addressing market forces—whether they be in capital markets, labor markets, or the market for goods and services.

Overview and Supplements

The insights in this overview and its supplements are based on 1) findings from discussions with and polls of a 2022 working group of over 240 executives from 137 companies, 2) data provided by data analytics firm ESGAUGE, and 3) a survey of 80+ general counsel and corporate secretaries. For more details, see About This Report on page 11.

The publication is divided into five parts:

- **The Roles of the Board in the Era of ESG and Stakeholder Capitalism: Overview and Key Insights**
- **Incorporating ESG and Stakeholder Interests into Board Business Decisions** (Supplement 1)
- **Optimizing Board Composition, Structure, and Capabilities in the Era of ESG and Stakeholder Capitalism** (Supplement 2)
- **Enhancing Board Information and Stakeholder Engagement in the Era of ESG and Stakeholder Capitalism** (Supplement 3)
- **Improving Board Evaluations of Corporate, Management, and Its Own Performance in the Era of ESG and Stakeholder Capitalism** (Supplement 4)

Insights for What's Ahead

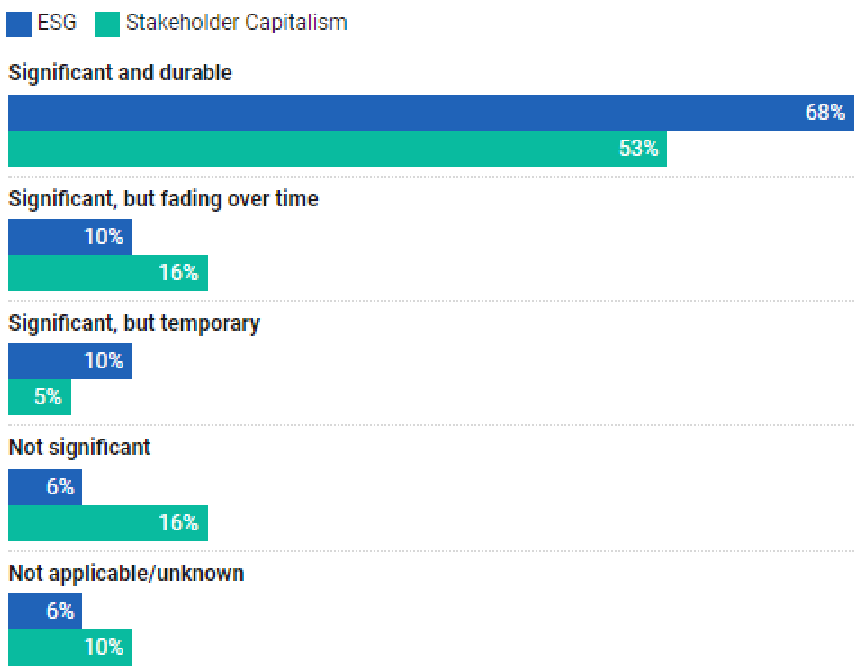
Today boards are expected to help chart the company's path in deciding which ESG issues to focus on and how to optimally serve the interests of stakeholders. The task before boards is not just to mitigate risk (e.g., the risk of noncompliance with rules), but to ensure that management seizes the opportunities created by this new environment.

The implications of ESG and stakeholder capitalism for boards

- **Both ESG and stakeholder capitalism are expected to continue to affect boards over the next five years, but ESG's impact is likely to be somewhat more durable and significant.** A total of 68 percent of respondents to our 2022 survey of 80 general counsel and corporate secretaries believe that ESG will have a significant *and* durable impact, while 53 percent say the same about stakeholder capitalism. About 20 percent say the impact of each will decrease over time.

ESG and stakeholder capitalism are durable trends

Q: How would you describe the impact of ESG issues / stakeholder capitalism on the board over the next five years?



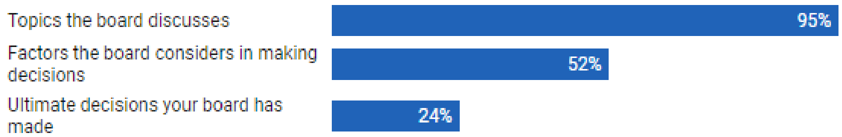
Pre-meeting survey - 80 Respondents

Source: The Roles of the Board in the Era of ESG and Stakeholder Capitalism Working Group •

- **The focus on ESG issues and the long-term welfare of stakeholders has changed discussions at almost all boards, affected the factors boards consider in making decisions at about half the boards, and changed the outcome of decisions at about one-quarter.** Where it has affected board decisions, it has often accelerated them—meaning boards have moved more quickly on environmental or employee-related issues.

ESG and stakeholder capitalism affect board discussions

Q: To date, how have the focus on ESG and concern about the long-term welfare of stakeholders affected your board's deliberations? (Check all that apply)



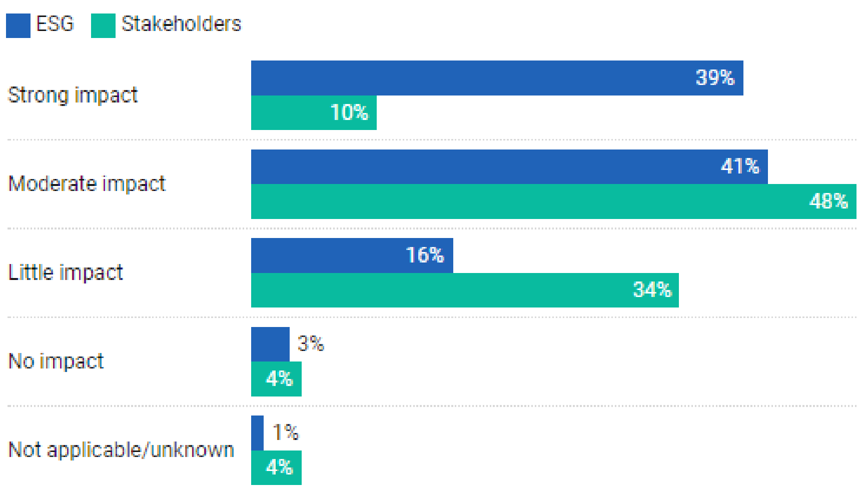
In-meeting poll question - 42 Respondents

Source: The Roles of the Board in the Era of ESG and Stakeholder Capitalism Working Group - Session 2 •

- **Generally, companies believe their boards have done a better job of incorporating ESG topics into their decisions than of incorporating the interests of multiple stakeholders,** particularly when it comes to strategic and business planning, and external and internal communications. When it comes to decisions on product/service offerings, however, boards seem to be considering stakeholder perspectives more than ESG.

ESG is having a stronger impact than stakeholder capitalism

Q: To what extent has the increased focus on ESG issues / consideration of the interest of multiple stakeholders affected your board of directors in the past two years?



Pre-meeting survey - 80 Respondents

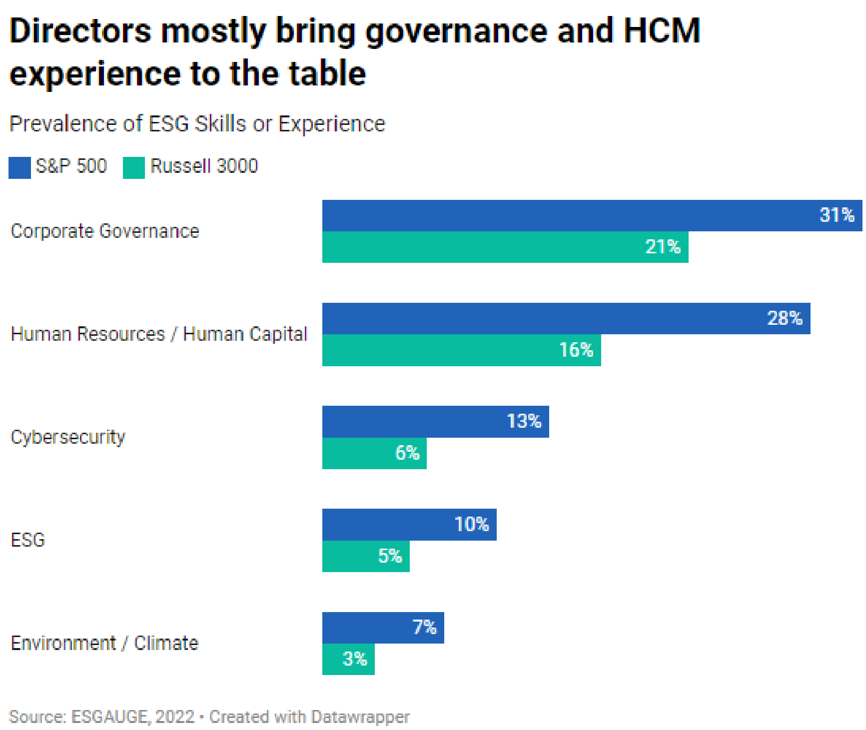
Source: The Roles of the Board in the Era of ESG and Stakeholder Capitalism Working Group •

- **Boards have ample legal leeway for considering a broad array of ESG issues and stakeholder interests—as long as their actions align with long-term corporate interests.** Indeed, a greater legal, business, and reputational risk for boards is to *fail* to take into consideration ESG issues—especially when those are "mission critical."

- **The board's increased focus on ESG factors and stakeholder perspectives/ impact does not fundamentally change the line between the board and management.** The board still has broad decision-making, oversight, and advisory roles, but now it's addressing a broader array of topics and engaging more directly with stakeholders (investors, as well as employees and potentially others) than before. Boards will increasingly look to management for more information on these new topics, including reports that track progress on issues.

Board composition, committee structure and leadership, and capabilities

- **Eighty-seven percent of the S&P 500, and 61 percent of the Russell 3000, disclose that their directors have ESG experience in one or more of the following six areas: corporate governance, human capital, cybersecurity, ESG in general, climate, and the environment.** Based on those disclosures, 31 percent of S&P 500 directors have corporate governance experience, with human capital not far behind at 28 percent. Only 7 percent of S&P 500 directors have either climate or environmental experience, but given the SEC's proposed disclosure rules, we can expect that number to rise.



- **A key question companies will need to address: What are the criteria for qualifying as having ESG experience?** As many ESG topics are rapidly evolving, companies will want to carefully assess the depth, breadth, and recency of experience. This will likely require more than just including ESG-specific questions in the annual Director & Officer questionnaire but should also involve a candid discussion of the criteria with the board's governance committee and full board.
- **While corporate proxy statements tend to emphasize the *diversity* of "hard" skills and experience of the board, the company and board are also well served by having directors with certain attributes *in common*.** These include a

clear understanding of the role of a board, strategic business experience, intellectual curiosity, and a willingness to "do the work." Boards should be especially cautious in recruiting directors whose views on sustainability were cemented at a time when it was a siloed discipline.

- **The nominating/governance (nom/gov) committee currently leads the way in shouldering ESG responsibilities, but this is likely to evolve over time as companies continue to experiment with different approaches to address the shifts toward ESG and stakeholder capitalism.** Even where boards are temporarily allocating ESG responsibilities to the nom/gov committee, they should consider whether that committee has the right composition and resources to do its job successfully.

Responsibility	Company disclosure rate	Most frequently assigned to	Most prevalent category	Most frequently assigned to
General ESG responsibilities	39%	Nom/gov committee	ESG oversight	Nom/gov committee
Environmental issues	9%	Nom/gov committee	Climate	Nom/gov committee
Social issues	20%	Nom/gov committee	Corporate political activity	Nom/gov committee
Governance-related issues	80%	Audit committee	Ethics & compliance	Audit committee
HCM issues	52%	Compensation committee	Talent recruitment & development	Compensation committee

Source: The Conference Board / ESGAUGE, 2023

Communication and engagement

- **Boards tend to get *too little* (43 percent) or just *about the right amount* (39 percent) of information on ESG and stakeholder expectations, according to a poll of participants in the Working Group on the Roles of the Board in the Era of ESG and Stakeholder Capitalism.[3]** None of the respondents believe their board is receiving *too much* information.
- **The information on ESG and stakeholder expectations is of acceptable quality.** Even though the most common response from poll respondents (48 percent) is that the quality of information is just *OK*, another 43 percent deem it to be *good*. None of the respondents believe that it is either *excellent* or *poor*.[4]
- **Boards cannot possibly address all of the more than 200 issues across "E," "S," and "G" (nor should they), which is why management should set reasonable expectations for board fluency in ESG**. Management can use three main filters: 1) focus on areas that are strategically important to the company, 2) understand that the level of required knowledge will depend on the company's position on each issue and how far it wants to go: to comply with the law, to reduce costs, to manage reputation, or to become an industry leader; 3) recognize that education takes time, so fluency will increase along with the maturity of the firm's ESG program.

- **Companies can enhance communications to the board and board engagement on ESG topics in various ways**, including through 1) the board's discussion of the company's purpose; 2) integrating ESG into strategic planning and operating/capital budget processes; 3) human capital management (and, if applicable, mergers & acquisitions): both are natural starting points to integrate ESG and stakeholder views into board decisions; and 4) incorporating ESG into compliance and risk management discussions at the board level.
- **Keeping the board informed of stakeholder views requires a combination of direct board engagement and data.** According to data from The Conference Board and ESGAUGE, slightly over 50 percent of S&P 500 firms disclose director engagement with shareholders. Directors also have opportunities to meet formally and informally with employees. And some firms have established community advisory groups, allowing community leaders to meet with members of management and the board. But management should also focus on what kinds of data the company is collecting on the views of customers, business partners, employees, and others on relevant environmental and social topics—and how to build that into regular reports provided to the board.
- **Companies should take a fresh look at how they describe the scope of and reasons for their shareholder engagement.** The vast majority of S&P 500 companies (79 percent) disclosed in their 2022 proxy statement that getting feedback on *governance* and *executive compensation* was the main reason to engage with shareholders. However, shareholder engagement often goes beyond these topics and indeed focuses on environmental and social topics.

Effectiveness and evaluation

- **Boards are evaluating their company's performance in ESG, but their assessment is somewhat rudimentary and fragmented,** according to working group participants. Indeed, although a majority of poll respondents (56 percent) indicate that their board evaluates their company's ESG performance,[5] almost half (48 percent) believe their board is only doing an *OK* job.[6] By contrast, only 28 percent believe their board is doing an excellent or good job, and 9 percent indicate their board does not evaluate their firm's ESG performance at all. Companies are already collecting a significant amount of information on key ESG topics (employee health & safety; diversity, equity & inclusion; compliance), and a first step may be to present that information to the board, along with financial and operating results, to be used as part of the board's annual review of corporate performance.
- **The assessment of the company's ESG performance will depend on the maturity of the overall ESG program and the company's position on each issue.** Indeed, there will be a different degree of evaluation, depending on how deeply ESG is embedded in the company. Particularly in areas where the company is taking a leadership role, the board should consider the firm's impact on its own long-term welfare, as well as on its stakeholders, society at large, and the natural environment.
- **Boards are evaluating the company's relationship with its stakeholders in a somewhat piecemeal manner**. Indeed, 60 percent of poll respondents indicate that their board doesn't have a comprehensive process for evaluating the company's relationships with stakeholders, and instead discusses stakeholder relationships on

an ad hoc basis (versus 8 percent of respondents who say their board does have a comprehensive process in place).[7] As with ESG topics, management can include a report on how the company is addressing multiple stakeholders as part of the board's annual review of the company's performance.

- **Boards can evaluate the company's relationships with stakeholders in various ways.** They can assess the *quality of the relationship* with each stakeholder group; whether the company is serving its stakeholders' *interests*; and if it is meeting its stakeholders' *expectations*. In all cases, the board should be aware of the state of the company's relationship with stakeholders. But the company's ability to meet expectations or serve the interests may vary by stakeholder group.
- **Boards can use their holistic approach to succession planning as the model for their annual evaluation of the CEO's performance**, rather than conducting a review focused on compensation alone. The CEO has the primary responsibility for conducting such a holistic review of his or her reports, but the board should be aware of the CEO's assessments.
- **Boards don't need a separate questionnaire on how they are fulfilling their own roles with respect to ESG and stakeholder views, but they should consider building these topics into the traditional board and committee self-evaluations.** Boards might want to add questions to existing evaluations, including whether the board has a good understanding of—and consensus on—the ESG issues that matter most and how to balance various stakeholder interests.

Conclusion

The heightened focus on ESG issues and the long-term welfare of multiple stakeholders are presenting US corporate boards with unprecedented challenges—and opportunities. The following eight actions can help companies and boards as they navigate these two fundamental and related shifts in capitalism:

1. **Consider how the board can build ESG and stakeholder perspectives into existing processes.** This involves mapping the board's current roles and responsibilities; taking inventory of the board's current approach to ESG issues and stakeholder views; and considering how to further integrate ESG and stakeholder views into existing areas of responsibility and processes.
2. **Develop a framework for making business decisions that incorporates a multistakeholder focus and considers the company's key ESG issues.** M&A is a good place to start in incorporating ESG and stakeholder perspectives into board decisions.
3. **Prioritize general strategic business experience and industry knowledge—rather than specialized expertise—when enhancing the board's composition**. Having specialist directors can be counterproductive if the rest of the board defers to them too much. Directors who know the various roles of the board and who really understand their firm's industry will be better suited to ensure the board has appropriate oversight of the company's key ESG risks and opportunities.

4. **Allocate ESG responsibilities thoughtfully.** This includes 1) addressing the full board's role with respect to ESG; 2) allocating ESG responsibilities to several board committees to avoid overburdening one committee; 3) assigning the responsibility for the *coordination* of ESG responsibilities to either the board or a board committee; 4) keeping corporate governance documents up to date; and 5) discussing committee rotation and committee chair succession.
5. **Enhance (or maintain) board fluency in ESG and knowledge of stakeholders**. Educate the board as needed on ESG issues that tie to the firm's main risks and opportunities, and have directors engage directly with their firm's stakeholders to hear firsthand about their attitudes toward the company.
6. **Improve communications to the board, and the board's engagement, on ESG topics and stakeholder views**, including through 1) facilitating the board's discussion of the company's purpose; 2) integrating ESG into strategic planning and operating/capital budget processes; 3) incorporating ESG into compliance and risk management discussions at the board level; and 4) putting stakeholder views in the context of the company's business goals and long-term strategy.
7. **Ensure the board understands the breadth and depth of internal and external ESG-related communications** as well as the processes by which management seeks to ensure the accuracy and consistency of those communications.
8. **Ensure the intensified focus on ESG and stakeholder capitalism is reflected in the board's processes for evaluating the company's, senior management's, and the board's own performance.** It's especially important that the board's assessment of senior management's performance and its own performance tie back to the evaluation of the company's performance.

About This Report

In 2022, The Conference Board, in collaboration with Morrow Sodali and Weil, Gotshal & Manges, convened a working group of over 240 executives from 137 companies who met over the span of six months to discuss, under the Chatham House Rule, the evolving roles of the board of directors as companies navigate the widened focus on ESG issues and the simultaneous shift to a multistakeholder form of capitalism.

The first session on May 19 focused on the impact these trends are having on board discussions and key business decisions. The second session on September 13 addressed how companies are responding to these trends in board composition, committee structures and leadership, and capabilities. The third session on October 13 focused on the two connected topics of (1) informing the board on ESG issues and stakeholder expectations and (2) the board's role in the company's communications and the board's own direct engagement with stakeholders. The fourth and final session on November 15 addressed how boards can effectively evaluate the company's, senior management's, and their own ESG performance and relationships with stakeholders in this era of ESG and stakeholder capitalism.

This overview and its four associated supplements provide findings and insights based on those discussions, as well as data provided by data analytics firm ESGAUGE, and the results stemming from a survey of general counsel and corporate secretaries (with over 80 respondents) and several in-meeting polls.

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[1] Merel Spierings and Paul Washington, *The Role of the CEO in Driving ESG*, The Conference Board, November 2022.

[2] Charles Mitchell at al., *Toward Stakeholder Capitalism*, The Conference Board, December 2021.

[3] Forty-six respondents.

[4] Forty-four respondents.

[5] Thirty-two respondents.

[6] Twenty-nine respondents.

[7] Twenty-five respondents.