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Is ESG Receiving Sufficient Attention in North America?

North American companies not only lag behind their counterparts in Europe and Asia-Pacific on environmental, social and governance (ESG) matters but do so significantly. What does this “enthusiasm gap” mean, and should boards care?

Worldwide, there is awareness that ESG considerations will prove to be essential drivers and components of profitability and sustainable business over the next 10 years. The reality is, however, that the level of engagement with ESG — as an integral component of business strategy — is significantly higher outside of North America than within it, and to an extent that some may find surprising.

In a recent global survey conducted by the University of Oxford and Protiviti, 250 directors and C-suite executives widely dispersed across countries and business sectors overwhelmingly acknowledged ESG’s growing importance to their companies’ success over the next decade. But, as noted in the table on the next page, for every ESG factor addressed in the survey, North American respondents indicated less engagement with and commitment to ESG.

For example, only one in four North American business leaders surveyed is of the view that ESG strategy will be extremely important by 2032. But that number jumps to nearly six in 10 in Europe and seven in 10 in Asia-Pacific. Of particular interest, less than 40% of North American leaders expect greenhouse gas (GHG) emissions to *decline* over the next 10 years, whereas 81% and 88% of leaders in Europe and the Asia-Pacific region, respectively, have such expectations.

GLOBAL RESEARCH FROM THE UNIVERSITY OF OXFORD AND PROTIVITI[1]

	RESPONDENTS		
	North America	Europe	Asia-Pacific
ESG STRATEGY:			
• ESG strategy will be especially important by 2032	25%	58%	71%
• Costs of ESG operational/compliance activities expected to increase by 2032	50%	81%	88%
ENVIRONMENTAL MATTERS:			
• Environmental risk in the next 10 years will be low	39%	15%	18%
• Environmental risk spending to remain the same or decrease in 10 years	61%	21%	19%
• Change to corporate processes to reduce environmental impact is slight or none	36%	10%	15%
• GHG emissions over the next 10 years expected to decline	37%	81%	88%
SOCIAL MATTERS:			
• Future risk posed by social factors will be low	34%	19%	9%
GOVERNANCE MATTERS:			
• Changes in board composition are likely	44%	67%	72%

Similar gaps appear with respect to the assessment of environmental risk levels and expected corporate spend, process improvements to reduce the impact of company operations on the environment, the level of risk posed by social factors on the business, and the likelihood of board composition changes. This data raises two essential questions with implications for the future: What is driving the North American findings? And what are the implications for leaders and their boards?

What Is Driving the North American Findings?

The Oxford-Protiviti survey findings suggest that either North American companies are at a lower stage of ESG maturity than their European and Asia-Pacific counterparts or they underestimate the importance of external pressures — stakeholder engagement and government and regulator commitment — that appear to be key drivers for companies in other parts of the world.

[1] "Executive Outlook on the Future of ESG, 2032 and Beyond," the University of Oxford and Protiviti, September 2022: vision.protiviti.com/insight/protiviti-oxford-survey-shows-north-america-enthusiasm-gap-about-esgs-future-impact.

Two findings, in particular, offer insights that help explain the disparity. First, slightly more than half of North American participants said they believe ESG reporting will not be mandatory in 10 years, whereas almost all the European and Asia-Pacific respondents believe it will. Thus, the views of North American business leaders may be influenced by a belief that ESG disclosures will continue to be largely voluntary.

Second, stakeholder engagement is widely expected by European (67%) and Asia-Pacific (79%) companies to increase in 10 years' time. By contrast, 57% of the North American respondents expect their level of stakeholder engagement to remain about the same as today or even decline. For issues that are predominantly global in nature, this gap is troubling.

Companies in Europe and Asia-Pacific may be thinking more strategically about environmental and social objectives, recognising them as an imperative for building reputation and brand image and creating competitive advantage.

Whether one or both of the premises noted above is true, the outcome is the same: Many North American companies are laggards. Laggards generally engage in lip service, are reactive and rely on the minimum "quick fixes." If they don't walk the talk, they may eventually be exposed as "greenwashers" and pay the price of reputation loss, brand erosion, and fines or penalties that may accrue if their disclosures are found to be at odds with the facts. Companies focused on ESG with a regulatory compliance mindset are driven primarily by a risk and compliance perspective — a check-the-box approach that often lacks genuine commitment.

By contrast, companies in Europe and Asia-Pacific may be thinking more strategically about environmental and social objectives, recognising them as an imperative for building reputation and brand image and creating competitive advantage. They are more likely to embed sustainability into strategy and product development to create breakthrough innovations and operating models that support the business and drive ESG and financial performance.

Are North American respondents correct that ESG disclosures are likely to remain largely voluntary in terms of substance and content? Perhaps, but the Securities and Exchange Commission (SEC) in the United States is likely to mandate additional climate disclosures soon and increase the robustness of human capital disclosures with additional guidance. Are they correct that stakeholder engagement is likely to wane? That seems unlikely given near-daily reminders of the impact of climate change and social unrest and the significance placed by younger generations, in particular, on working for and buying from socially responsible companies.

What Are the Implications for Leaders and Their Boards?

With the economic and geopolitical turbulence occurring in the marketplace, the agenda is crowded in the C-suite and boardroom. That said, there are several questions directors should ask to ensure that the CEO and management team are taking the long view in leading the way to a sustainable business in a changing world. While these questions apply to all public companies worldwide, private companies with initial public offering (IPO) aspirations, and companies that answer to customers with an interest in a sustainable supply chain, they're particularly important for North American companies in light of the aforementioned research.

Are we waiting for regulators and stakeholders to tell us what to do? The fundamental issue for boards: What's the right answer for the company over the long term, irrespective of the regulatory or stakeholder environment? Should it make a difference whether ESG reporting is mandatory or voluntary? Companies with a wait-and-see mentality regarding ESG priorities run the risk of conveying to their stakeholders a lack of vision and values.

Are we prepared to invest in GHG emissions reductions — or not? While ESG implementation and reporting maturity varies by company, the Oxford-Protiviti survey discloses that 63% of North American respondents expect their company's GHG emissions to remain the same or increase in 10 years' time versus only 19% and 12% for their European and Asia-Pacific counterparts, respectively. It's interesting that 10% of North American respondents believe emissions will *increase* over the next 10 years. Only 7% of North American respondents said they believe environmental risks will be extreme in 10 years' time, whereas for Europe and Asia-Pacific it is 23% and 34%, respectively. Further, 50% of respondents in North America believe that costs of ESG operations and compliance will remain the same or decline over the next 10 years, yet another significant gap (Europe and Asia-Pacific are 19% and 10%, respectively).

The disparity on issues that are global in nature suggests European and Asia-Pacific companies are prepared to invest more in addressing environmental issues than companies in North America. How will that play out with respect to attracting and retaining younger generational talent, responding to customers' sustainability information requests, and addressing the transparency that regulators are almost certain to demand with mandatory disclosure requirements? Directors should engage management in candid strategic conversations regarding corporate purpose and values relating to environmental and social matters. After that, they should engage in discussions around goal-setting and accountability.

Are inertia, indifference or short-term thinking limiting our ability to move beyond past conventions and the status quo? Are North American companies constrained by short-termism driven by a focus on "making the numbers"? Are CEOs primarily focused on accomplishing growth and profitability objectives that may not currently be —

or appear to be — germane to ESG priorities, rendering ESG as an afterthought? Using age demographics of "over 50" and "under 50," the survey noted younger executives are more attuned to the growing importance of ESG. For example, 60% of business leaders under 50 believe ESG will be extremely important to business success in 10 years, whereas only 42% of those over 50 have that view.

The question arises: Are short-term thinking and generational distinctions impeding broader strategic thinking? To that end, boards should encourage more diversity of critical thinking in the C-suite and boardroom.

Have we given sufficient attention to ESG's implications for the future? For sure, ESG has its share of critics and naysayers. Some are quite vocal, such as the 19 state attorneys general focused on an institutional investor's use of ESG screening to facilitate capital flows.[2] Others argue it is a distraction from more pressing global issues such as energy prices, inflation and supply chain congestion, all of which have been exacerbated by Russia's war against Ukraine.[3] Still others assert ESG is too difficult to measure. While all of these and other contrarian points merit consideration and acknowledgement,[4] ESG strategy and reporting should be about competitive position and sustaining relevance of the business over the long term.

Are our strategy and core values aligned with our narrative to the street? Long-term rewards are unlikely for laggards. Stakeholder messaging on ESG matters should be founded on purpose, commitment, principles and integrity. Greenwashing has a cost. While over 80% of American consumers are concerned about the environmental impact of the products they buy, 53% sometimes or never believe companies' environmental claims.[5] Vague slogans, fluffy language, pretty evocative pictures, lack of proof and over-the-top claims are some of the signs of potential greenwashing, not to mention ineffective investor relations.

Is ESG integrated with the business, or is it window dressing? The company should integrate relevant ESG considerations with the overall corporate strategy and put in place appropriate people, processes and systems infrastructure to address and report appropriate objectives, metrics and targets. ESG initiatives and considerations should be factored into performance expectations, monitoring and reward systems. If they aren't, ESG is relegated to a mere peripheral add-on to the business and will likely be under-resourced and subject to check-the-box compliance.

[2] "19 GOP Attorneys General Slam BlackRock Over ESG Investments," by Amy Resnick, Chief Investment Officer, August 9, 2022: www.ai-cio.com/news/19-gop-attorneys-general-slam-blackrock-over-esg-investments/.

[3] "The Net-Zero Transition in the Wake of the War in Ukraine: A Detour, a Derailment, or a Different Path?" by Hamid Samandari, Dickon Pinner, Harry Bowcott and Olivia White, McKinsey, May 19, 2022: www.mckinsey.com/capabilities/sustainability/our-insights/the-net-zero-transition-in-the-wake-of-the-war-in-ukraine-a-detour-a-derailment-or-a-different-path.

[4] "The ESG Debate: Where Does Your Company Stand?" *The Bulletin*, Protiviti, October 2022: www.protiviti.com/US-en/insights/newsletter-bulletin-v8i2-esg-debate.

[5] "What Is Greenwashing?" by Carlyann Edwards, *Business News Daily*, August 5, 2022: www.businessnewsdaily.com/10946-greenwashing.html.

Is the board organised appropriately to engage in strategic conversations regarding ESG strategy, execution and reporting? Research in the United States of S&P 100 board committee charters noted that 93 companies incorporated ESG oversight into one or more committee charters, with 67% of those companies spreading oversight responsibility across two or more committees.[6] As ESG reporting increases in importance, directors should ensure that the board's structure brings together the reporting and operational elements into a coherent overall message to achieve a "complete board view." This may entail establishing a new committee, altering board composition and educating existing members to sharpen the board's focus.

The "enthusiasm gap" with their European and Asia-Pacific counterparts suggests that many North American companies do not view ESG as a forward-looking disclosure framework.

With the continued proliferation of climate-related phenomena, the days of climate change denial are over. This is a data-driven call to action. Sustainability is a strategic capability for addressing evolving stakeholder expectations by increasing the focus on and providing full transparency into relevant ESG priorities. A compelling sustainability strategy supported by targets and goals for the future has become table stakes. Boards have a duty of care and a duty of loyalty to ask the tough questions. The seven questions posed above demand the attention from boards that recognise there is a critical link between ESG and resilience, innovation and growth. Companies lacking transformative thinking on the sustainability front risk alienating customers and employees alike, particularly among younger generations.

The "enthusiasm gap" with their European and Asia-Pacific counterparts suggests that many North American companies do not view ESG as a forward-looking disclosure framework. The world has changed such that companies had best focus on how they can carve out a leadership role that will resonate with investors, attract talent and retain customer loyalty — a role they can execute with intention and that will underpin a differentiating story to investors.

[6] "Board Committee Oversight of ESG," Exequity, March 16, 2022: www.exqty.com/newsroom/board-committee-oversight-of-esg.

How Protiviti Can Help

Sustainability presents multidimensional and complex challenges, with varying levels of understanding across industries and companies. Protiviti works closely with organisational leaders to effectively evaluate what ESG means for their organisations, with an emphasis on helping to build, implement, execute, monitor and report on ESG objectives that will evolve and grow with the business. Our focus is on helping clients understand the bigger picture and clearly identify where they can have the greatest impact on society and the environment while maximising performance.

Our global ESG solutions enable sustainability in a way that positively impacts the organisation and the communities in which it operates. Protiviti offers a holistic and integrated approach: ESG strategy and planning; operations, ESG performance and improvement; and ESG governance and reporting. For more information, see www.protiviti.com/US-en/business-performance-improvement/esg.