Rising to the ESG Challenge: Towards Effective Governance

By Geraldine Ee , INSEAD Knowledge

Boards can drive the ESG agenda effectively by identifying what is material to their organisation and being willing to adapt along the way.

There is growing recognition that businesses have a pivotal role in driving the environmental, social and governance (ESG) agenda on the global stage, and leading organisations have stepped up to the challenge. However, companies and boards face new ESG challenges arising from Covid-19 and the protracted war in Ukraine. More than ever, board directors are indispensable in stewarding ESG agenda to drive positive impact in an increasingly volatile world.

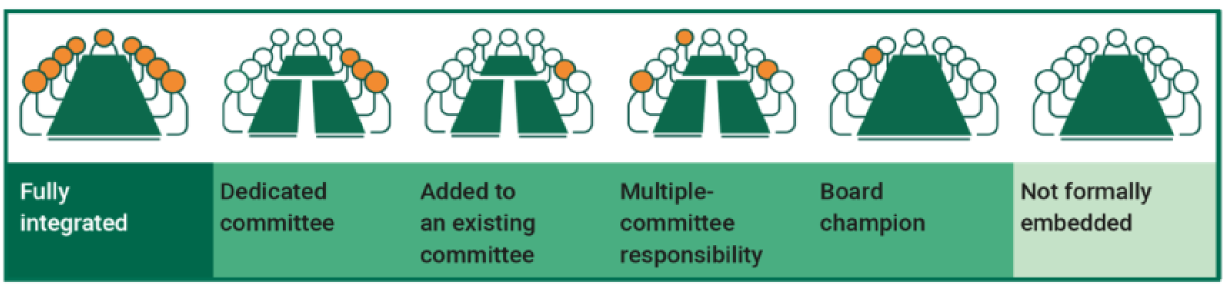
In a **recent joint study** by the **INSEAD Corporate Governance Centre** (ICGC) and BCG, 91 percent of board members said they want to spend more time on strategic reflection about sustainability. Yet 70 percent indicated that their boards are only moderately or not at all effective at integrating ESG into company strategy and governance. In fact, 43 percent of directors said the ability of the company to execute ESG strategies is one of the biggest threats to achieving ESG goals.

Not why, but how

These findings show that the biggest challenge to driving the ESG agenda is not about "why" ESG is important, but rather "how", said **Ron Soonieus**, ICGC Director in Residence and Senior Adviser with BCG at a **webinar on rising to the ESG challenges** organised by the ICGC and **Boards Impact Forum**.

Corporate boards struggle with ESG due to two main reasons, said Soonieus. One is the skills gap whereby those with board-ready credentials may not have the necessary ESG expertise (and vice versa). The other is the convergence of the high speed of change and complexity of change in ESG issues.

Soonieus outlined **six core governance models and complementary practices** that support the ESG agenda. Models include full integration, appointment of ESG committees, ESG representatives in committee or board champion, and no formal embedding. The **panellists**, with a collective wealth of board experience across industries and geographies, agreed that the business conditions and environment can influence the choice of model – there is no one-size-fits-all solution.



Six possible board structures. Source: BCG-INSEAD ESG Pulse Check (March 2022).

In some instances, an influential director who is passionate about climate change can raise relevant issues to the agenda, said **Johan Raslan**, an i ndependent director at Sime Darby Property Berhad of Malaysia. Even so, it is not always plain sailing. Directors need to stand up for what they think is right – even if they were the lone voice – in the face of not getting support, said **Susan Hooper**, the Chair of Tangle Teezer and Inter.Earth.

Don’t wait for perfect

With Covid-19 and Russia’s invasion of Ukraine, the “how” of ESG has changed fundamentally, said **Lise Kingo**, a non-executive director at Sanofi, Covestro and Aker Horizons. Businesses are faced with skyrocketing energy prices, unviability of certain markets and the need to take care of affected employees. How companies address the geopolitical agenda can also have less tangible – but no less important – impact on their reputation.

In today’s challenging conditions, boards will be working with incomplete and imperfect information. But leaders cannot afford to wait; they must adapt, said Hooper. “Don’t wait for perfect,” she said.

In fact, the ESG landscape is far from perfect. Soonieus noted that without a set of standardised framework, standards and ratings, it is hard to compare sustainability hygiene, control and practices. He cited the case of Volkswagen: The automaker’s reputation was tarnished by an **emissions scandal** (or “Dieselgate”) despite being one of the most highly rated in the industry.

Ultimately, the choice of standards and frameworks depends on what is material to the company, although this can also change, said Soonieus. Agreeing, **Noora Al Marzooqi**, Vice President for Group Strategic Investments at Abu Dhabi National Oil Company, said the choice hinges on what is most relevant to the company’s operations, where it operates in, and the local regulatory requirements. She agreed that it is critical to maintain a mindset of continuous evolvement.

Due to the speed of change and moving KPIs, boards need to recalibrate how they see materiality and what could have crucial impact on the business on a regular basis, said Kingo.

How to prioritise

Given the complexity of each pillar of E-S-G, “How do you prioritise the asks, demands and expectations of different stakeholders?” asked **Sonia Tatar**, Executive Director of the ICGC and **INSEAD Wendel International Centre for Family Enterprise**, who co-moderated and hosted the webinar. With external pressures from regulators, stock exchanges and sovereign wealth funds among others, Raslan cautioned that boards should not be overburdened.

With increasing expectations from a diverse pool of stakeholders, boards can expect competing demands and ultimately, not everyone will be satisfied, said **Nicolas Naudin**, a non-executive director of Human Cell Design, a Toulouse-based pharmaceutical company. Boards need to be "courageous" in prioritising, arbitration and explaining their decisions. "The growing pains of ESG will lead to more effective ESG governance," he said.

Kingo said companies should prioritise issues that are most applicable to them, the region where they operate and where the biggest material risks lie. For instance, companies with heavy production would focus on the environment and energy, while pharmaceutical companies would focus on social aspects such as access to healthcare. Raslan explained how priorities would vary by geography. Based in Malaysia, he highlighted the importance of social issues such as human trafficking and the treatment of foreign workers in South-east Asia. To address such sensitive topics, he stressed the importance of access to trusted internal reports.

Kingo noted that the "Environment" in ESG tends to be more tangible and relatively "easier" to deal with, and therefore generally gets more attention. On the other hand, "Social" is not getting enough attention despite worsening social inequality. Companies may also be blind to the "Governance" imperative, said Kingo, as they fail to see how it relates to the environment or responsible business. However, recent geopolitical developments have shown that companies need better governance to prepare for any unforeseen challenges, she added. These can affect decisions such as which markets to operate in, where to locate production sites and how to improve employee welfare, among others.

Video of Q&A moderated by Sonia Tatar. View full webinar ***here****.*

Walk the ESG talk

Boards should incorporate ESG targets into business strategies and consider how it affects the organisation, operations, people and community they operate in, said Al Marzooqi. In fact, the focus on ESG should be a corporate purpose and not just an agenda item. To Naudin, consistency is imperative to integrating ESG into the heart of strategy. He stressed the need for consistency between the ESG ambition and the business strategy, such that ESG is reflected across the organisation, from innovation to communication, remuneration, capital allocation and investment.

Thankfully, boards do not need to reinvent the wheel. They could adapt from best practices such as the World Economic Forum's **climate governance principles**, which serve as a framework for corporate boards, suggested **Liselotte Engstam**, Chair of Boards Impact Forum, who co-moderated the webinar.

Naudin challenged boards to look beyond the company's performance and consider a value-chain perspective, taking into account the upstream and downstream impact of the business. This holistic approach presents an opportunity to take a deep dive into operations and innovate across the entire eco-system.

Said Al Marzooqi: "We need a mindset shift and see ESG not as a risk to be mitigated, but an opportunity."

Watch the full "Rising to the ESG challenges: Routes towards effective governance" webinar ***here****.*

Sign up to attend ICGC's next event, ***Governance Imperative in a New World Order****, at INSEAD's Fontainebleau campus from 25 to 26 November 2022.*

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About the author(s)

Geraldine Ee is a senior editor at INSEAD Knowledge, where she works with INSEAD faculty to bring diverse business insights to leaders and the business community.

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The ICGC harnesses faculty expertise across multiple disciplines to teach and research on the challenges of boards of directors in an international context. The centre also fosters global dialogue on governance issues, with the ultimate goal of developing high-performing boards. Through its educational portfolio and advocacy, the ICGC seeks to build greater trust among the public and stakeholder communities, so that the businesses of today become a strong force for good for the economy, society and the environment.