Explaining the Rise of Sustainability on the Board Agenda

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Rise of Sustainability on the Board Agenda

Traditionally corporate decision making has been very much based on financial outcomes, but increasingly corporate decision making is based on sustainability considerations. We are seeing that across corporates, especially in terms of how they engage with different shareholders and stakeholders. In this briefing, we will be looking at how sustainability considerations are really coming into the corporate strategic decision making process. But to really understand that, we need to look at the reasons for this transformation we are seeing across the globe, and, particularly in larger companies.

Government Policy and Legislative Change

Internationally, we are seeing governments implement sustainability regulation, and that's really getting at increasing accountability and transparency in this area. At the moment, there are 2,600 pieces of legislation, according to the most recent studies from the Grantham Institute at the LSE, and this legislation is based on climate change risks and sustainability risks. Two thirds of that legislation has been introduced in the past 10 years. At the moment, the focus is very much on disclosure and reporting, and we expect that trend to continue. For example, the UK requirement for listed companies to make a statement on a 'comply or explain' basis in respect of their alignment with the recommendations of the Task Force on Climate Related Financial Disclosures. These recommendations have a very holistic view of how companies should look at climate change risk, and how they need to govern themselves in order to mitigate those risks.

Greater Appreciation Amongst Business Leaders for Climate-Related Risks and Opportunities

We are seeing large companies, and particularly those that are listed, already looking at sustainability risks and reflecting that in their annual reports and their accounts. That trend actually started before the legislation was brought in. There's also been a real trend from much more defensive [approach], requiring the disclosure of information, to looking at this from a much more proactive approach, looking at climate from an opportunities perspective. For example, we are seeing that in the energy transition. We are also seeing corporates having to react to changes in consumer behaviour and consumer choice. Corporates are doing this on their own initiative. There is very much a general trend to put sustainability at the top of the corporate agenda, and that is definitely driven, in part, by stakeholders and shareholders.

Shareholder Expectations and Behaviours

It was initially institutional shareholders who we saw really driving this change. That was because they increasingly looked at their investee companies, sort of scrutinising their stewardship and their sustainability credentials. But, then, there has been a shift to a much broader climate related activism, and that's really been shown in the number of climate related resolutions that we have seen in the last year or so. This in itself has made directors really think about how they need to consider these factors in corporate decision making processes.

Litigation Risk

In terms of climate litigation, we have seen an increase in the number of climate cases, which has doubled since 2015. Initially, a lot of the cases were very much about trying to bring changes, reflecting societal changes. But, more recently we are seeing that the litigation is going a lot broader and looking at different reasons for bringing such litigation. That could be incorrect reporting or a breach of fiduciary duty, looking at how companies have considered the cost of minimisation and adaptation, and, more broadly, just looking at how these risks have been considered in decision making processes. At the moment, the focus is still very much on companies where there is high fossil fuel use and companies where they are extracting mining or minerals, but increasingly we can see that some of the arguments that are being used in these cases could be read across into other sectors that have got their own sustainability challenges. More recently, we are seeing that insurers, banks and asset managers are also coming into the firing-line in terms of climate change litigation. When we cast our minds back to the tobacco litigation of the 1970s, it really is something where corporates are concerned about the risk of this litigation and are taking steps to avoid it.