Board Imperative Series

The Board Imperative: Partner with CSOs to drive value-led sustainability

EY

Building a better working world

By collaborating with Chief Sustainability Officers (CSOs), boards can help organizations realize the benefits of ESG and mitigate the risks.

In brief

- The Chief Sustainability Officer (CSO) role is crucial in helping organizations gain competitive advantage by putting ESG at the heart of value creation.
- To be effective, CSOs need to have a symbiotic relationship with the board. But EY research and interviews show that this relationship is still evolving.
- CSOs and boards can support each other in three ways: elevating the CSO role, prioritizing the ESG agenda and developing robust processes for disclosing data.

Organizations used to treat environmental, social and governance (ESG) as a fringe activity — an extension of corporate social responsibility. Now, ESG is integral to their strategy and operations and part of the social contract with their stakeholders. If executed well, it also represents a major commercial and growth opportunity. As a result, organizations and their boards are no longer asking: "Why be sustainable?" but "How can my business create value through sustainability?"

The Chief Sustainability Officer (CSO), or sustainability lead, plays a big part in answering this question and creating what EY teams call value-led sustainability. This role may not be directly responsible for the full breadth of ESG in an organization, but with the strategic imperative we've described and the reporting expectations many organizations face, it's becoming increasingly business-critical.

As such, both the role and the ESG agenda it promotes should have the full support of the board. Yet recent EY research shows a lack of communication, common understanding and priority setting between boards and CxOs in general. In a recent EY survey, around 43% of directors and senior managers at leading European companies cited a lack of board commitment to fully integrate ESG factors to drive long-term value as a significant challenge.

Our series, "The Board and the CxO," suggests practical steps boards can take to strengthen these crucial relationships. Having explored the dynamic between the board and the CRO in our first article, this second one examines how boards and CSOs can better support one another. Throughout, we use insights gained through research, along with interviews with EY professionals and selected clients, to suggest how boards and CSOs can improve outcomes for themselves and the organization at large.

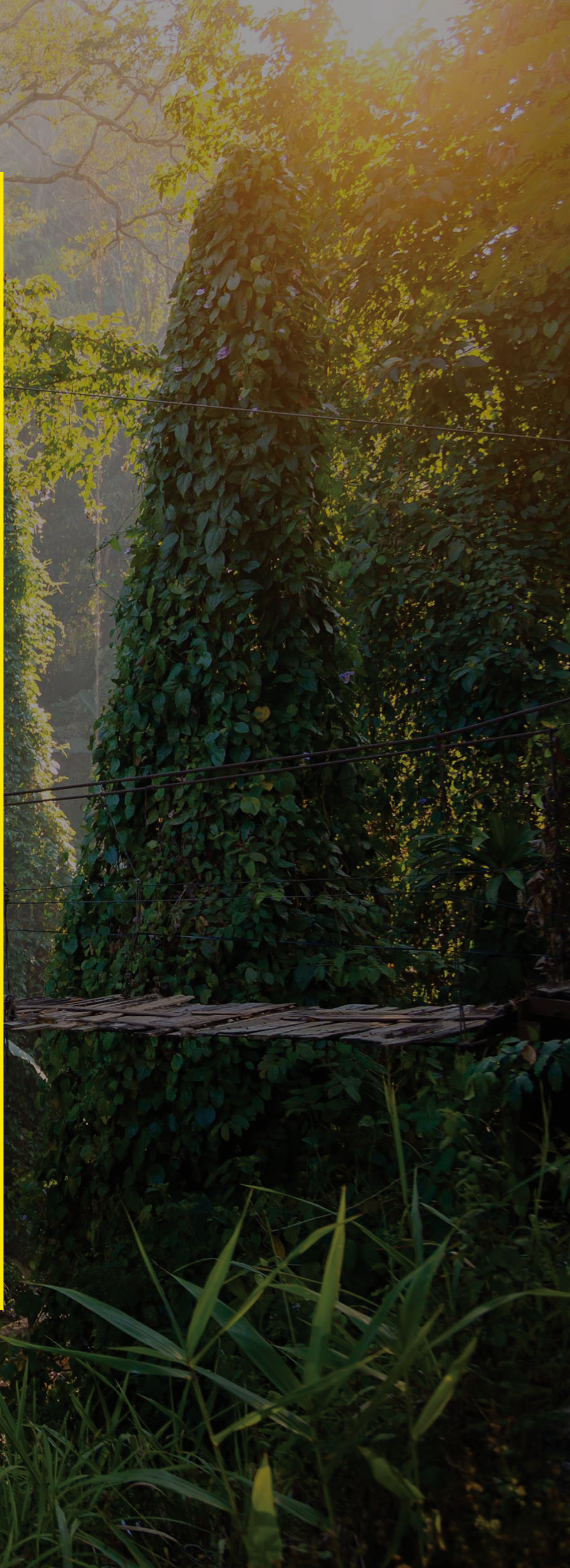
The role of the CSO

CSOs (or their equivalent) work to establish the organization's level of sustainability maturity. This includes its carbon baseline, and that of its suppliers, and the extent to which its ESG efforts bring societal benefits.

They further support the CEO to determine which ESG areas to prioritize and subsequently embed them into the business strategy to protect and create value for stakeholders. Increasingly, those areas include broader ESG issues, including supply chain practices and workforce diversity and inclusion.

The CSO is also responsible for defining a sustainability action plan and making sure every function delivers on it by operationalizing sustainability. The plan should measure the true cost and opportunities of ESG in a way that's financially relevant. Lastly, with ESG activism on the rise, it's the CSO's job to understand where the organization's vulnerabilities lie and put strategies in place to mitigate those risks.

Clearly though, one person can't be directly responsible for the full breadth of ESG across an organization. CSOs therefore delegate responsibility for specific areas to individuals or teams, collating information from those sources and presenting what's most strategically relevant to the board and management team. In this sense, the role acts as a bridge between sustainability and business strategy.



Chapter 1

ESG has become a strategic imperative for organizations globally

As the focus on ESG has grown, so has the need for a symbiotic relationship between the board and the sustainability lead.

Over the last few years, the climate crisis has driven widespread changes in sustainability regulation and reporting. These changes have come through the EU's Non-Financial Reporting Directive (NFRD), as well as proposals for both the **EU's Corporate Sustainability Reporting Directive (CSRD)** and **new guidelines from the US Securities and Exchange Commission.**

The COVID-19 pandemic and COP26 further increased the strategic imperative, with many organizations committing to ambitious ESG targets that reflect priorities in their industry. For example, at EY, we're currently on track to reach the **target we set in January 2021** of achieving net zero carbon emissions by 2025.

Thankfully, however, this growing awareness isn't limited to environmental sustainability. According to an **EY survey,** around 84% of Chief Finance Officers (CFOs) and finance leaders said the pandemic increased expectations from stakeholders that their company will also drive societal impact and inclusive growth. As Steve Varley, EY Global Vice Chair – Sustainability, observes: "It's not enough anymore just to create a great product, at a great price. If you don't protect and create value for your people, suppliers and communities, as well as your business, you'll lose business to competitors that do."

Big gains are possible, but so are big losses

EY research shows that European leaders and boards recognize the potential benefits of responding to these pressures. Respondents cited "revenue growth driven by ESG-conscious consumers" as the main advantage of incorporating ESG factors into corporate strategy – above risk resilience.

At the same time, board directors and management teams are aware of the high cost of an ESG failure. Even before initiatives like the EU's Corporate Sustainability Due Diligence Directive (CS3D) come into force, the discovery of poor labor conditions in an organization's supply chain could cause irreparable damage to its reputation and bottom line. And in some jurisdictions more than others, board directors are increasingly concerned about their liability exposures.

Related article

How can boards strengthen governance to accelerate their ESG journeys?

With a spotlight on sustainability, European boards must address ESG factors to outpace competition and gain new sources of value creation.

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2021 EY Global Corporate Reporting Survey

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>
> **Steve Varley**, EY Global Vice Chair – Sustainability

In such a high-stakes environment, it's clear why increasing numbers are appointing CSOs, or allocating responsibility for ESG to a senior executive. But it's also clear that the role and its relationship with the board are still evolving.

For example, to help realize the opportunities and mitigate the risks of ESG, CSOs need to be strategically positioned – with a seat at the leadership table, appropriate levels of funding, and clear KPIs and reporting lines. Currently though, our research suggests that some organizations are yet to take these important steps.

Boards can do more to support the CSO – and the other way around

Finally, and crucially, CSOs need to have a symbiotic working relationship with the board, which means interacting closely to align ESG with the strategic direction of the organization. It also means board directors proactively support their CSOs to deliver on the agreed targets, at the right pace. In turn, it's incumbent on the CSO to help the board gain and maintain a better understanding of the ESG agenda.

Overall, the sustainability leaders we interviewed for this article reported having adequate support from the board. But they acknowledged that directors could do more to provide "strategic interconnectedness" on ESG, including considering issues beyond climate change.

Boards seem to be moving in the right direction. **Almost half now discuss and report on ESG at every meeting,** compared with 15% two years ago. Yet 68% of board chairs and non-executives said that there are significant differences of opinion within the leadership team on balancing short-term and long-term priorities. One interviewee referred to this as "balancing profit and purpose."

These findings, along with the insights from our interviews, show that the level of maturity in these relationships varies widely. They also suggest that there are gaps between the board and the management team, which a closer working relationship with the CSO (or equivalent) could help to address.

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2022 Long-Term Value and Corporate Governance Survey

Chapter 2

Three ways boards can work with CSOs to build a win-win situation

The potential gains and losses from ESG affect the board as well as the CSO. By engaging on key issues, they can help each other to succeed.

We've organized the ways boards can support CSOs (and vice versa) under three themes, each with practical actions for boards.

1. Elevate and enable the CSO role

Organizations don't need to have a dedicated CSO per se, but they must make someone (ideally on the C-suite) responsible and accountable for ESG. That person needs to both understand the topic and have the executive-level influence to deliver results for the organization. Here are some actions boards can take to enable the CSO or equivalent role:

Allocate responsibility for ESG to a committee (or committees)

Appropriate governance is vital, as Amy Brachio, EY Global Deputy Vice Chair – Sustainability, explains: "Putting governance in place that reflects the importance of the CSO role will send a strong message to stakeholders about how seriously the organization takes ESG."

That means assigning ESG oversight to a specific committee, or sharing it across committees, with clearly defined roles and responsibilities for each. For example, a global company we spoke to has renamed one of its board sub-committees to include the word "sustainability."

Upskill the CSO on board governance

Whatever the governance model, the board should help the CSO to understand the structures in place for overseeing, measuring and disclosing ESG – and how they can contribute. For example, they could ensure the CSO has regular meetings with the risk and audit committees for managing ESG risks and complying with regulation.

Work with the CSO to deliver on the G of ESG

Strong corporate governance and transparent communication are key to making sure organizations are ethical and outperform their less-well-governed peers. That's why asset managers pay so much attention to governance: in a 2021 Russell Investments Survey, 80% said it led their ESG-related decisions. And according to Insightia, 67% of all the companies subject to ESG activist demands in 2021 were dealing with ones around governance.

Make ESG a measure of executive performance

The board can reinforce the organization's commitment to upholding the highest ESG standards by working with the CSO and the compensation committee to build its goals into executive remuneration and incentive plans.

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Amy M. Brachio, EY Global Deputy Vice Chair, Sustainability

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>
> **Alan Haywood,** Senior Vice-President ESG, BP

2. Prioritize the ESG agenda and learn from each other

A CSO's success depends on the board and the management team spending quality time together regularly. They need this time to discuss, determine and agree upon the organization's ESG risks, as well as the opportunities to drive differential value. Here are some specific actions they can consider:

Work with the CSO to make ESG core to the business strategy

It's the CSO's job to present and make the case to the board for why their ESG strategy is the right one for the organization. Making the link between sustainability and strategy will help to engage them. In return, the board should make sure ESG is fully integrated into the business strategy for the now, next and beyond.

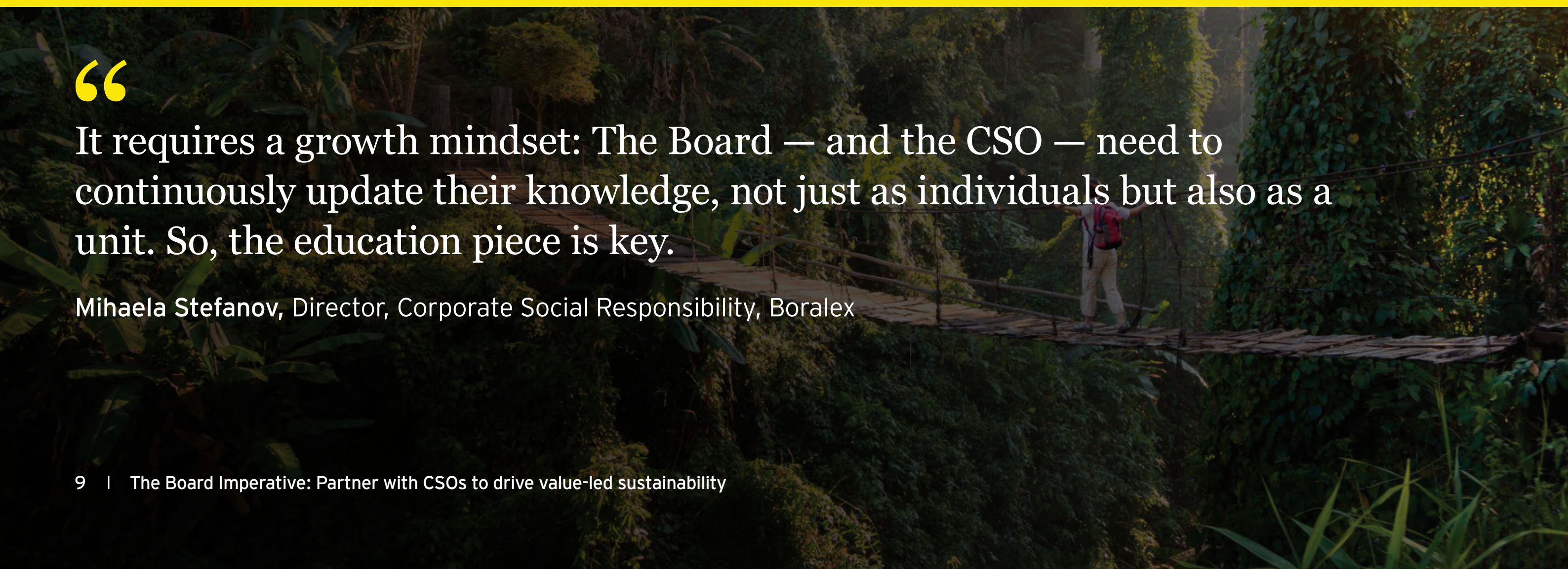
Alan Haywood, Senior Vice-President ESG at BP, recommends CSOs make the link between sustainability and strategy. "In today's world, as we navigate the energy transition, strategy and sustainability are going hand in hand," he says. "It's helpful to bring them under the same umbrella, under the same leadership, to drive progress at pace as we engage the board."

Build directors' knowledge around ESG

It's critical that boards educate themselves on ESG. As Mihaela Stefanov, Director, Corporate Social Responsibility, Boralex, puts it: "The world of ESG is complex and rapidly evolving. It requires a growth mindset: the Board – and the CSO – need to continuously update their knowledge, not just as individuals but also as a unit. So, the education piece is key."

If necessary, directors should consider establishing an advisory board or recruiting someone with relevant expertise to sit on the main board. That body or person should also support the CSO directly.

CSOs can - and should – help by using their in-depth knowledge to educate the board (and the wider organization) appropriately. This will give board directors the working knowledge of ESG they need to be able to ask questions and offer challenges. To support these efforts, one organization we spoke to ran an annual environmental sustainability week, including hands-on workshops and addresses from external subject matter expert.



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3. Develop robust processes for collecting, managing and disclosing ESG data

Today's investors are looking for clear evidence of action on ESG issues, whether it's net zero carbon emissions or pay equality. But while 89% of respondents in an EY investor survey want global standards to become mandatory, this reality is a still a way off.

Take climate disclosures: The International Sustainability Standards Board (ISSB) responsible for developing the IFRS Sustainability Disclosure Standards was only formed in late 2021. As the EU's Corporate Sustainability Reporting Directive (CSRD) enters into force later this year, sustainability reporting will start in 2025 (based on 2024 data).

The following actions could help boards bridge the gap until international standards for climate disclosures are in place, while getting ahead of regulation relating to other areas of ESG:

Encourage a close working relationship between the CSO, finance function and audit committee

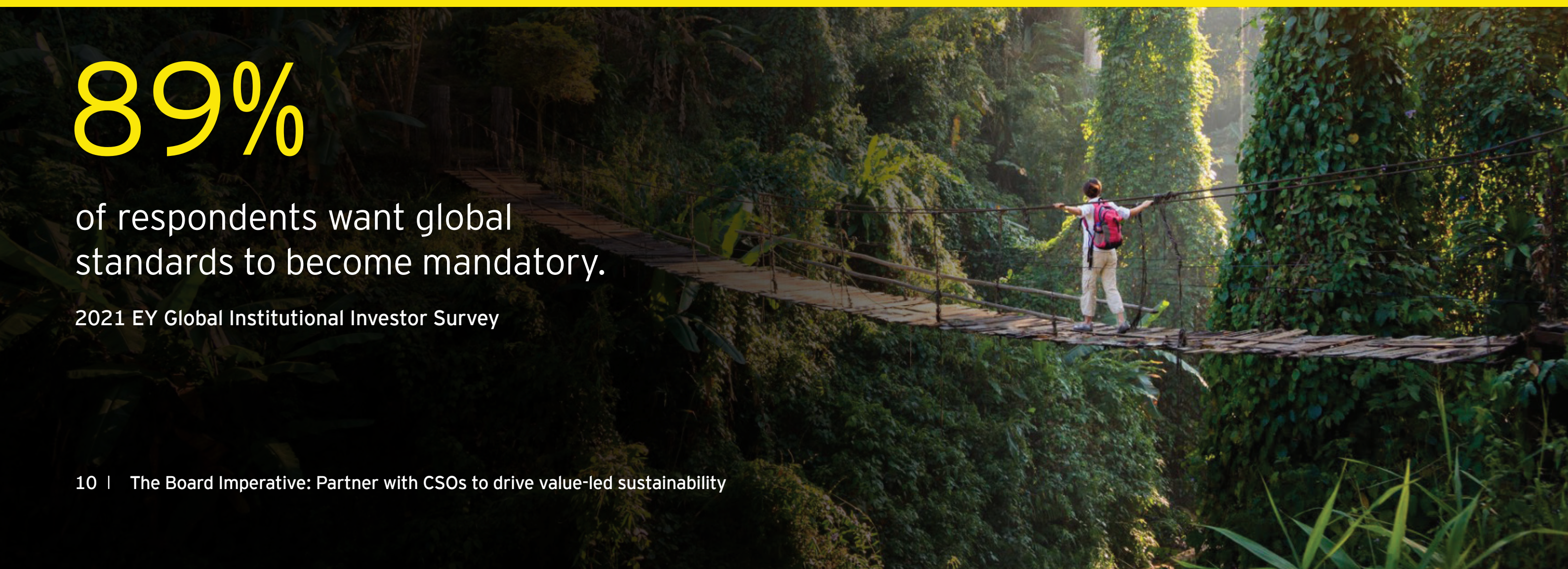
This will ensure the organization complies with emerging standards and regulation relating to the E of ESG. Regular scenario planning, including for net zero and decarbonization, will help to identify and mitigate the associated risks before they occur. And better engagement with investors will allow the CSO to demonstrate how the organization is improving disclosures – potentially creating a source of competitive advantage.

Support the CSO with articulating ESG impacts in financial terms

One sustainability lead we spoke to observed that, up until now, a legal requirement to report has been driving many organizations to act. Without regulation around disclosing data on ESG areas like social impact – or effective ways of collecting, analyzing and linking that data to financial performance — organizations may be dissuaded from trying.

As another interviewee pointed out though, things that aren't financially material now could become so in the future. Boards and CSOs that want to gain a first-mover advantage over their competitors should investigate how the latest data and analytics could help them achieve this. They should also work with the CFO to build an integrated and efficient approach to non-financial reporting for tomorrow's needs, as well as today's.

Finally, CSOs need to work with the CFO to help create the business case and change programs needed to transition the company to a more sustainable operational footprint: for example, lower greenhouse gas emissions. We find there's often a gap between the company's stated ambition and the financial resources, skills and technology needed to achieve it.



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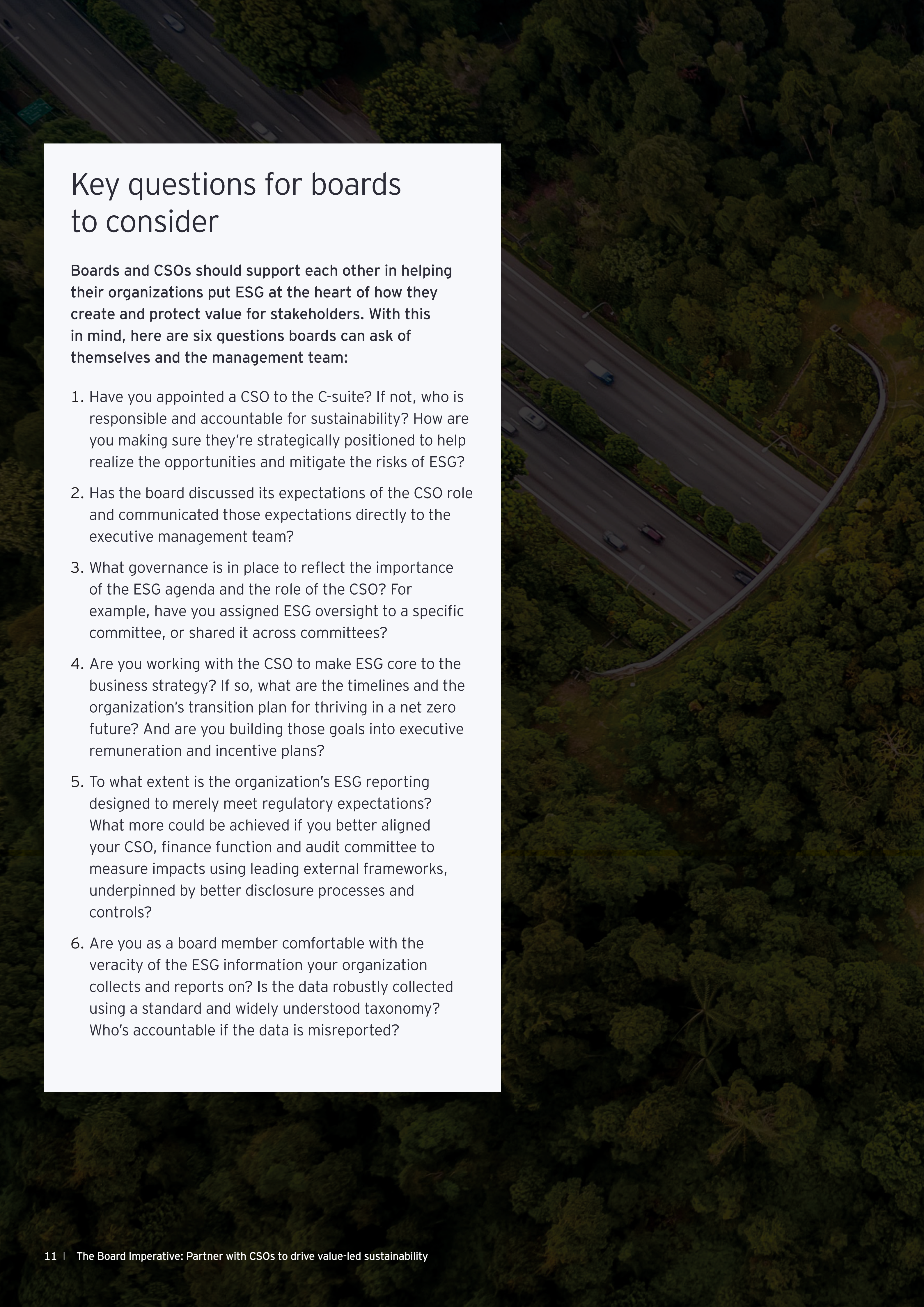

Key questions for boards to consider

Boards and CSOs should support each other in helping their organizations put ESG at the heart of how they create and protect value for stakeholders. With this in mind, here are six questions boards can ask of themselves and the management team:

1. Have you appointed a CSO to the C-suite? If not, who is responsible and accountable for sustainability? How are you making sure they're strategically positioned to help realize the opportunities and mitigate the risks of ESG?
2. Has the board discussed its expectations of the CSO role and communicated those expectations directly to the executive management team?
3. What governance is in place to reflect the importance of the ESG agenda and the role of the CSO? For example, have you assigned ESG oversight to a specific committee, or shared it across committees?
4. Are you working with the CSO to make ESG core to the business strategy? If so, what are the timelines and the organization's transition plan for thriving in a net zero future? And are you building those goals into executive remuneration and incentive plans?
5. To what extent is the organization's ESG reporting designed to merely meet regulatory expectations? What more could be achieved if you better aligned your CSO, finance function and audit committee to measure impacts using leading external frameworks, underpinned by better disclosure processes and controls?
6. Are you as a board member comfortable with the veracity of the ESG information your organization collects and reports on? Is the data robustly collected using a standard and widely understood taxonomy? Who's accountable if the data is misreported?

Summary

Once a fringe activity, environmental, social and governance (ESG) is now central to how organizations create and protect value for their stakeholders. The rise of the Chief Sustainability Officer (CSO) or equivalent reflects this shift, but EY research suggests that the board could do more to support this crucial role, and vice versa. We suggest three key areas where they can help each other succeed: elevating and enabling the CSO role; prioritizing the ESG agenda; and developing robust processes for collecting, managing and disclosing ESG data.

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