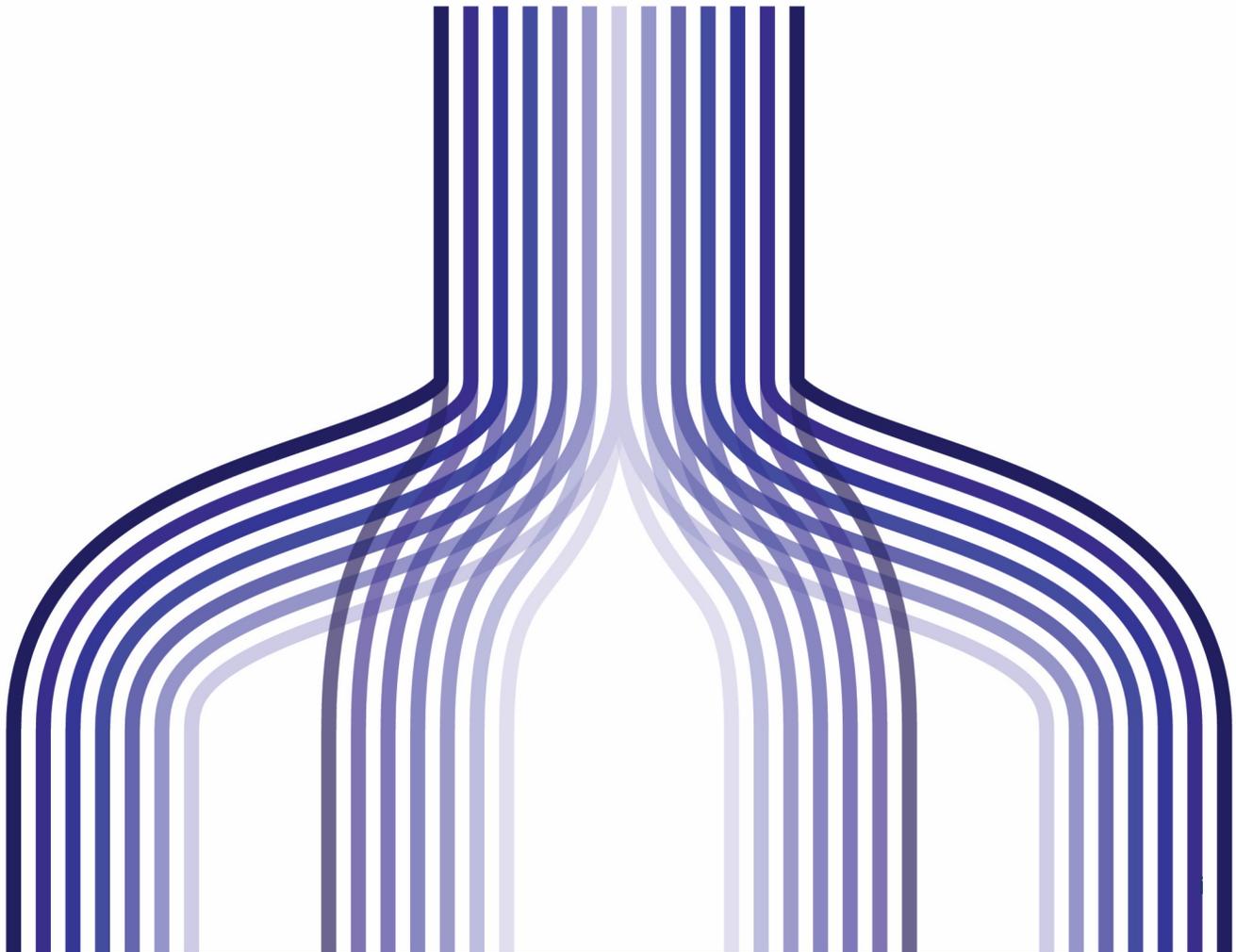


# **ESG and the Role of the Chief Human Resources Officer**

**A Best Practices Study of How Companies Are Linking  
Purpose, Strategy, Culture, and Human Capital Issues**

March 2019



# ABOUT THE ASSOCIATION

**HR POLICY ASSOCIATION** is the lead organization representing chief human resource officers of major employers, consisting of over 390 large and influential corporations doing business in the U.S. and globally. Collectively, our members employ more than 20 million employees worldwide and have a market capitalization of more than \$8 trillion. In the United States, Association members employ over nine percent of the U.S. private sector workforce.

These senior corporate officers participate in the Association because of their passionate interest in the direction of human resource practice and policy. Their objective is to use the combined power of the membership to act as a positive influence to improve public policy, the human resource profession, and the workplace.

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# PROJECT ON THE ROLE OF THE CHRO IN CORPORATE SUSTAINABILITY COMMITTEE

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# ESG: A GROWING C-SUITE ISSUE

*“The drumbeat is growing,”* characterized one CHRO. A survey of the landscape bears out his point. Investors are considering environmental, social, and governance (ESG) disclosures as a potential information source for extracting a competitive advantage, especially over the long term. Companies are integrating ESG as a remunerative facet of their business models—and as a risk management strategy. Employees, potential hires, customers, and consumers are reacting positively to ESG efforts by companies. And among many stakeholders, financial performance is no longer considered a tradeoff to ESG initiatives.

Government and investors have been paying increasing attention to ESG issues over the past fifteen years,



pointing to continuing attempts to develop ESG factors into quantifiable, reliable indicators of a company’s long-term viability (often referenced under the broad definition of sustainability). Examples of this attention include the 2005 United Nations Environmental Program (UNEP) report on fiduciary duty; the 2006 United Nations Principles for Responsible Investment (PRI),<sup>1</sup> which most large institutional investors have adopted; the UNEP’s Global Reporting Initiative,<sup>2</sup> which began in 2007, and seeks to create a framework for reporting ESG initiatives and a broader umbrella of issues known as corporate sustainability; increased attention to governance following the global financial crisis in 2008 and 2009; Blackrock CEO Larry Fink’s 2018 and 2019 letters to CEOs discussing the need for companies to articulate a corporate purpose<sup>3</sup>; the Center for

<sup>1</sup> UNEP FI, *Principles for Responsible Investment*. April 2006.  
[https://www.unglobalcompact.org/docs/issues\\_doc/Financial\\_markets/PRI\\_Brochure\\_electronic\\_version.pdf](https://www.unglobalcompact.org/docs/issues_doc/Financial_markets/PRI_Brochure_electronic_version.pdf)

<sup>2</sup> Global Reporting Initiative,  
<https://www.globalreporting.org/Pages/default.aspx>

<sup>3</sup> Larry Fink, “A Sense of Purpose.” January 16, 2018.  
<https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter>

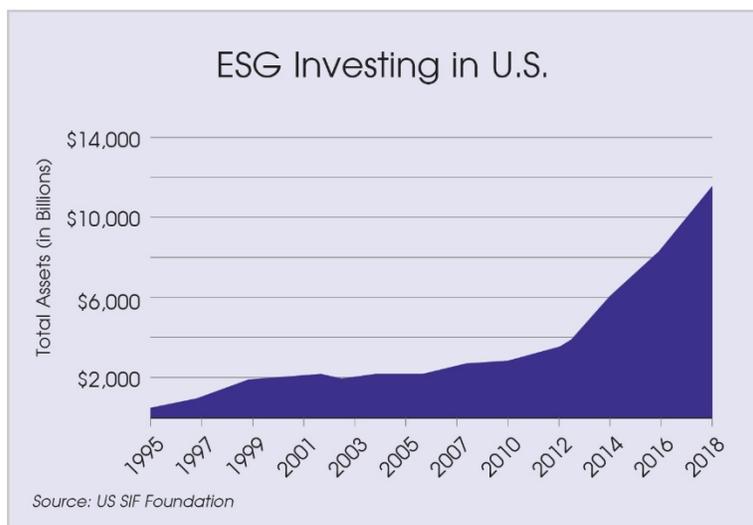
Inclusive Capitalism’s *Embankment Project for Inclusive Capitalism* report, which sought to “forge consensus on how to measure value beyond pure financials”; and ISO’s 2018 guidelines for internal and external human capital reporting,<sup>4</sup> among others. The drumbeat is indeed growing.

Notwithstanding this activity, the term “ESG” is still evolving, with differing views on various ends of the spectrum. Perspectives range from considering ESG to be an evolution of socially responsible investing (SRI) in possibly solving fiduciary issues inherent in SRI investing on one hand to considering it as more of a function of linking sustainability and/or Corporate Social Responsibility (“CSR”) efforts with financial performance on the other. For the purposes of this report, we will define ESG simply as environmental,

social, and governance-related efforts geared toward risk mitigation and a long view of corporate performance. This is also why investors are increasingly referring to ESG initiatives more broadly as “sustainability”.

**INVESTORS** While major investors are still primarily focused on traditional financial performance, many have begun to ask questions of companies regarding their ESG initiatives and some are beginning to use ESG factors in qualitative performance assessments. This trend has been fueled in part by their pursuit to understand how ESG might provide quantitative and qualitative data helpful in understanding the long-term viability of a company’s business strategy. Investors are also actively exploring the concept because of more pressure they are receiving to

demonstrate that they are reinforcing sustainable practices among their portfolio companies. The numbers bear this out. In 2018, asset managers considered ESG criteria across \$12 trillion in assets—up 38 percent from 8.70 trillion in assets in 2016. From 2012 to 2016, sustainable investing grew 135 percent.<sup>5</sup>



<sup>4</sup> Clare Naden, “New ISO International Standard for human capital reporting.” International Organization for Standardization. January 15, 2019. <https://www.iso.org/news/ref2357.html>

<sup>5</sup> The Forum for Sustainable and Responsible Investment, “US SIF Foundation Releases 2018

Biennial Report On US Sustainable, Responsible And Impact Investing Trends.” October 31, 2018. [https://www.ussif.org/blog\\_home.asp?Display=118](https://www.ussif.org/blog_home.asp?Display=118)

As a result, many data analytics providers, investment firms, proxy advisory firms, and others are releasing ratings of companies based on ESG metrics. The two largest firms are Sustainalytics and MSCI, but other providers include Bloomberg, MSCI, ISS, and the Sustainability Accounting Standards Board, among others. Notwithstanding their efforts, the questions of whether and how ESG metrics could be used to determine the long-term outlook of companies' business strategies in an accurate, comparative manner are still far from settled. However, certain stakeholders advocate for this approach regardless. Growing regulatory burdens, dwindling natural resources, and the specter of climate change mean these trends by investors may continue to amplify.

**GOVERNMENT** Certain government policies, though not always intended to drive investment in CSR and ESG, are creating more pressure on companies to do so. For example, broad interpretations of joint employer liability and other policy mechanisms seeking to hold companies responsible for workers and activities outside of their payroll yet within their supply chain—a global trend—incentivize companies to similarly take a broad view of their supply chain liabilities. In the U.S. Congress, a bill introduced in 2018 by Senator Elizabeth Warren, the Accountable Capitalism Act, aims to reduce corporate focus on shareholder value and increase focus on other stakeholders. It mandates, among other things, that all companies over \$1 billion in revenue must include creating “a material positive impact on society resulting from the business and



operations” in their corporate purpose and operate under a federal charter and broadened concept of fiduciary duty that requires directors to balance the interests of shareholders with other stakeholders.

The U.S. government's view on whether ESG elements can be used in making investment decisions by pension funds and other fiduciaries is best described as developing. In 2010, the Securities and Exchange Commission first offered guidance on how climate change fits into existing disclosure frameworks. Chair Mary Schapiro said, “A company must disclose the significant risks that it faces, whether those risks are due to increased competition or severe weather. These principles of materiality for the bedrock of our disclosure framework.”

Meanwhile, a 2015 Department of Labor interpretation under the Employee Retirement Security Act (ERISA) provided that ESG factors can be an integral part of the analysis by a fiduciary when evaluating an investment, fiduciaries can incorporate ESG elements in investment policy statements and evaluations, and proxy voting and shareholder engagement “can be” consistent with a fiduciary's ERISA duties.

In 2018, however, the Department added significant qualifiers to this interpretation on the extent ERISA fiduciaries can consider economic and social benefits apart from investment return in making investment decisions or putting retirement choices into 401(k) plans. The new bulletin said, “*It does not ineluctably follow from the fact that an investment promotes ESG factors... that the investment is a prudent choice for retirement or other investors.*”

**SOCIAL CAPITAL** Trust in American institutions is collapsing. One survey found that U.S. trust in business, government, media, and NGOs fell 9 points from 2017 to 2018.<sup>6</sup> Yet it was business that lost the least amount of trust—another survey found Americans’ trust in large businesses actually *rose* four points in the U.S. from 2017 to 2018.<sup>7</sup> This general pattern holds true for other countries experiencing significant loss of trust in their institutions. According to a recent Edelman survey, “Globally, 75 percent of people trust ‘my employer’ to do what is right, significantly more than NGOs (57 percent), business (56 percent) and media (47 percent).”<sup>8</sup>



Workers, customers, and consumers are increasingly looking to companies for solutions to various and developing issues. This translates into customer and worker preferences, expectations, and behavior.

- Seventy-one percent of respondents to an Edelman survey said CEOs should take the lead on change rather than waiting for government to impose it.<sup>9</sup>
- A Nielsen survey found that 67 percent of workers globally prefer to work for socially responsible companies.
- Fifty-five percent of consumers indicated they are willing to pay extra for products and services from companies committed to positive social and environmental impact.<sup>10</sup>

The largest demographic cohort in the workplace, Millennials, were especially favorable to corporate commitments to sustainability.

Meanwhile, social media and other communication technologies have complicated maintaining a positive corporate brand. As one CHRO reported, “Anyone can ruin your brand overnight with one Facebook post.” In this environment, certain previously-safe products or business strategies

<sup>6</sup> Edelman, “2019 Edelman Trust Barometer.” January 20, 2019. [https://www.edelman.com/trust-barometer?utm\\_source=newsletter&utm\\_medium=email&utm\\_campaign=newsletter\\_axiosam&stream=top](https://www.edelman.com/trust-barometer?utm_source=newsletter&utm_medium=email&utm_campaign=newsletter_axiosam&stream=top)

<sup>7</sup> Gallup, “Confidence in Institutions.” 2018. <https://news.gallup.com/poll/1597/confidence-institutions.aspx>

<sup>8</sup> Edelman, “2018 Edelman Trust Barometer.” 2018.

[http://cms.edelman.com/sites/default/files/2018-02/2018\\_Edelman\\_Trust\\_Barometer\\_Global\\_Report\\_FEB.pdf](http://cms.edelman.com/sites/default/files/2018-02/2018_Edelman_Trust_Barometer_Global_Report_FEB.pdf)

<sup>9</sup> Ibid.

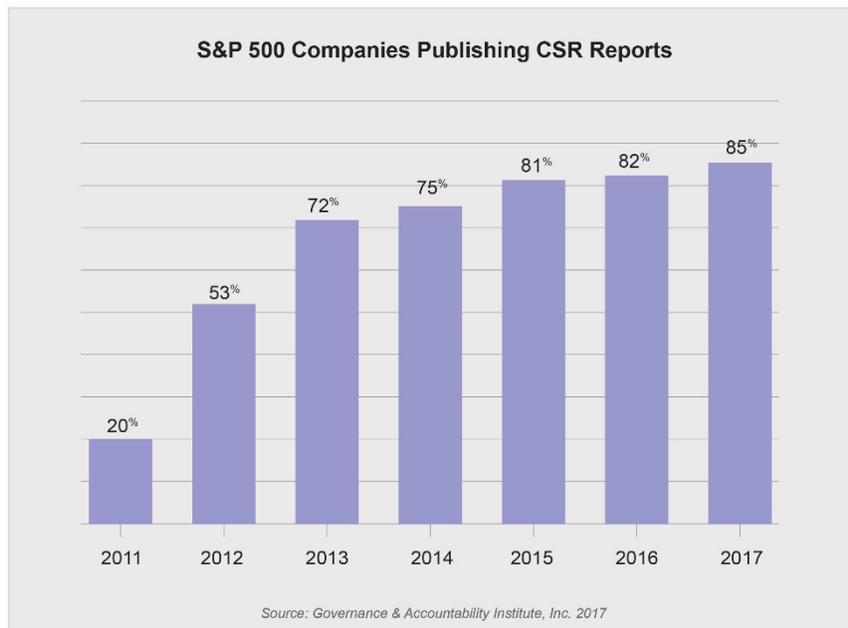
<sup>10</sup> Nielsen, “Doing Well by Doing Good.” June 2014.

<https://www.nielsen.com/content/dam/nielsen/global/apac/docs/reports/2014/Nielsen-Global-Corporate-Social-Responsibility-Report-June-2014.pdf>

may quickly become a reputational liability. Larger trends, such as workforce disruption, may expose companies to unfavorable messaging.

Yet the impetus to initiate ESG activities may more often originate within a company. Many have undertaken diversity and inclusion efforts long before ESG became a concept. As companies position their workforce, culture, and brand to meet business goals, investors and other stakeholders are taking notice.

**COMPANIES** At the center of these trends are large employers. Increasingly many are responding. Eighty-five percent of S&P 500 companies filed a CSR report in 2017—up from 20 percent in 2011.<sup>11</sup> Ninety-three percent of the world’s largest 250 companies now report on sustainability issues.<sup>12</sup> To the extent there are means to improve financial performance through ESG-related activities, companies are integrating them into their business strategies. And CHROs, who often serve as the steward of a company’s social capital, are leading many of these efforts.



<sup>11</sup> Governance and Accountability Institute, Inc., “85% of S&P 500 Index® Companies Publish Sustainability Reports in 2017.” March 20, 2018. <https://www.ga-institute.com/press-releases/article/flash-report-85-of-sp-500-indexR-companies-publish-sustainability-reports-in-2017.html>

<sup>12</sup> Blaine Townsend, “From SRI to ESG: The Origins of Socially Responsible and Sustainable Investing.” 2017. <https://www.bailard.com/wp-content/uploads/2017/06/Socially-Responsible-Investing-History-Bailard-White-Paper-FNL.pdf?pdf=SRI-Investing-History-White-Paper>

# SUMMARY OF FINDINGS

**IN 2018, THE HR POLICY ASSOCIATION BOARD OF DIRECTORS** authorized the creation of “The Project on the Role of the Chief Human Resource Officer in Corporate Sustainability.” The Project seeks to provide a clearer distillation of the approaches companies have been taking with respect to corporate social responsibility and ESG issues. More specifically, it seeks to discuss these issues in the context of the role the chief human resource officer plays in helping determine corporate priorities in these areas and overseeing the execution of those related to corporate culture, corporate reputation, and human capital.

The first deliverable of the Project was to conduct a series of interviews with 12 public companies across different industries and with different approaches to these issues. The interviews always included the CHRO and frequently included the company’s head of CSR reporting or another individual whose work was integrally related to sustainability. The companies agreed to be interviewed “off the record” so that they could openly discuss their approaches to the issues, as well as their concerns and their recommendations.

Many later agreed to allow their names to be used in this report.

## ESG activities are deliberate

Contrary to a perception that companies “go through the motions” or “check the box” when it comes to engaging in or explaining their ESG and CSR activities, our interviews demonstrated that in the vast majority of cases, companies chart a deliberate approach on ESG issues. Most often, the company’s approach was based on its stated corporate purpose, company culture, and/or company values. Reflecting the evolution of current thought, several of the interviewed companies discussed “sustainability” in a broad sense, focusing on making sure the business can be perpetuated on behalf of the stakeholders who rely on it.

## ESG activities are frequently based on longstanding values

In several of our interviews, the values that framed the basis for the company purpose and for a company's ESG activities had their roots in the socially responsible values imbedded in the company by its founders or notable leaders. These values have been continually revisited and reinforced and form the basis for the company's action. For example, some of themes from company interviews include:

- *“Our founders were community minded, social activists and philanthropists and wanted the enterprise to be socially responsible.”*
- *“We were founded to assist a certain segment of the population.”*
- *“Our company has historically been focused on how it can give back to the communities in which we are located and in which our employees work.”*
- *“We were an early leader in our industry in being values driven, leveraging values as a source of innovation and cost savings while treating people the right way.”*

## ESG and CSR approaches are becoming more focused, aligned with corporate strategy

Many companies that have been involved in CSR and ESG issues for several years reported that in the last three years, they have focused their resources related to CSR and ESG on initiatives and efforts that will reinforce corporate strategy. Thus, many companies are addressing fewer issues, but allocating their resources to be more impactful for communities, employees, the environment, and the overall sustainability of the company. This integrated approach fosters greater accountability in the company toward good corporate citizenship while aligning employees and key stakeholders.

Companies newer to ESG and CSR, and/or that are becoming more transparent about their activities similarly report that their approaches are mission-driven but closely focused on reinforcing corporate strategy. Similar to those involved with the issues for many years, these companies described themselves as “humble” and focused on ESG issues because they are integral to the company's mission and ensuring the long-term sustainability of the enterprise. For example, one company discussed a pivot to “doing the right things for the right reasons all the time” and operationalizing that for the company.

## PRIORITY ISSUE AREAS

Our calls with CHROs and their CSR teams indicated the following seven areas are where their companies particularly focus on ESG and CSR issues.

**1. RISK MITIGATION** Just as investors are focused on material risks to the company that could impact the value of their investment, companies are focused on mitigating legal, ethical, and business risks, some of which are covered in the areas below. As a steward of the company's internal and external social capital, the CHRO adds an important dimension to risk mitigation discussions.

**2. TALENT** Companies are looking to adopt ESG and CSR policies that not only reinforce broader strategic issues but also reflect the values that are important to their employees and potential employees. In a recent HR Policy Association survey, companies reported that a leading ESG issue is "managing employee engagement regarding our ESG initiatives."

**3. DIVERSITY AND PAY EQUITY** In our interviews, roughly half of the companies specifically discussed their strategic focus on diversity and pay equity, and when written CSR reports are included, all companies discussed these as being priority issues to their workforces and/or for customers (especially in business to consumer companies and in those with extensive supply chains).

## 4. BRAND MANAGEMENT AND PUBLIC PERCEPTION

The companies interviewed discussed the fact that the linkage of ESG activities to corporate strategy by definition includes making sure that the strategic initiatives consider the external impact of corporate priorities. In consumer facing companies, the impact of the company's interactions with customers was a top priority. For example, CVS Health stopped selling tobacco products because they were viewed as inconsistent with the primary purpose of the company's brand. Others discussed human resources initiatives designed to help their employees, which impacted external interaction with customers. In the case of manufacturers that are not primarily customer facing, environmental, and sustainability issues and community involvement were more important to the company's brand.

**5. ENVIRONMENTAL STEWARDSHIP** For companies in manufacturing industries or consumer facing industries, addressing the company's environmental impact and taking steps to reduce that impact are important for many stakeholders. These include the communities in which they manufacture, suppliers, employees, potential employees, and investors. Although not an issue that CHROs deal with directly, the impact on the company's brand, as well as its attractiveness as an employer, make it very important in the industries it affects the most.

## 6. SUPPLY CHAIN CONDUCT/ MANAGEMENT

Companies that source the manufacturing of their products overseas or manufacture in multiple locations often focus on supply chain conduct. For CHROs, this implicates how the company engages suppliers, including the labor and human rights standards expected. During our interviews, in certain circumstances the supply chain function had primary responsibility for such issues, but often the CHRO is a ready partner, which also helps facilitate messaging back to the company's internal stakeholders as well as external audiences.

## 7. COMMUNITY SUPPORT AND INVOLVEMENT

Virtually all of the companies indicated that they support communities in which they have facilities. This is both an extension of being a good corporate citizen and a way of reinforcing the company's support for their employees. Some companies are more targeted in executing their community support strategies from headquarters to ensure consistency, while others set the parameters and delegate particular investment decisions locally. Regardless of how these initiatives are controlled, they may involve support for community health initiatives, family leave and child care, or address issues that are unique to a particular country or region. Some companies with large supply chains extend community investment to locations where contract manufacturers are located, reinforcing their roles as responsible employers.

## Company involvement in social policy beyond the business

Most companies we interviewed did not take a broad position on social issues that were not related to their business. However, where companies have engaged in taking a position on such an issue, the CEO typically led the company's involvement and drove the involvement due to a personal interest or passion for the issue. This is consistent with a March 2018 HR Policy survey of CHROs that found that less than 30 percent of companies believe they have a public responsibility on certain issues and in certain circumstances to take a public stand on an issue that does not directly relate to the company's business.

Even where the company has decided not to take positions on policy matters unrelated to their businesses, the CEO's interest in and leadership of ESG-related issues has a measurable impact on the resources devoted to the issues. In the majority of cases, however, when a company engaged on social issues, internally and/or externally, they did so in a way consistent with their corporate culture and purpose.

## The majority of CHROs play a significant role in ESG policy development

Chief human resource officers typically play a significant role in working with the CEO to cultivate culture, the company's employee brand (*e.g.*, through employee engagement and strategies to reinforce and improve the employee experience), as well as serving as a company business leader and the company conscience. Thus, it is not surprising that CHROs are closely involved in developing ESG and CSR policy at their companies.

Among the chief human resource officers we interviewed, most were involved either in leading the ESG activities at their company outright or serving as part of a multidisciplinary executive team that did so. A smaller but substantial number provided their input to another C-Suite executive who led the function. This is consistent with an August 2018 HR Policy Association



**of CHROs LEAD  
ESG FUNCTION**  
*outright or as part of a team*

Source: 2018 Mid-Year CHRO Survey

survey that found that more than half of CHROs surveyed were part of a multidisciplinary team, 9 percent led the function, and about one-third provided regular input to another C-Suite executive that led the function.

Several CHROs we interviewed in this latter category had a very close relationship with the executive managing the company's CSR efforts. This reflects the importance that human resources issues play in determining a company's ESG footprint. The CHRO role in ESG and CSR issues understandably is more prominent where the CHRO holds a dual role that includes communications, corporate citizenship or community affairs, which is not uncommon.

## CHRO role in shaping company response to a shareholder proposal focused on HR-related ESG issues

Regardless of the way ESG management is structured at a company, one point that came through in our interviews was the importance of the CHRO in helping shape the company's response to an ESG or CSR-related shareholder proposal that involves core HR issues. Three of the companies we interviewed discussed dealing with shareholder proposals

related to gender equity in the workplace, each from a different proponent. In each case, the CHRO discussed the importance of making sure the company's corporate secretary and/or general counsel and head of investor relations understood the impact on company practices of either agreeing to implement a shareholder resolution or coming to a settlement that requires changes in company practices. There may be (and often are) good reasons for agreeing to or settling a proposal. However, those we interviewed emphasized that the CHRO needs to be an effective internal advocate in working with the corporate secretary or general counsel, who are often concentrated on protecting the company's external reputation but may not always take into consideration broader internal effects.

CHROs also have a lens into the investor engagement process due to their role in helping develop and communicate the company's executive compensation plans. Several that were interviewed are responsible for engagement on compensation issues or are part of that team. Engagement on HR-related shareholder proposals or at least forming the response strategy should likewise be a core role for the function.

## Investor interest in ESG issues continues to grow, but approaches vary widely

Nearly every company mentioned investor interest and engagement on ESG issues. Where companies have proactively engaged with investors for a long period of time and have also had a longstanding reporting process for ESG and CSR activities, the companies reported very positive feedback. Companies overall reported that investors were primarily interested in their financial performance, and where companies have been effective at explaining how ESG and CSR initiatives reinforce, and add to, the company's strategy, the positive feedback is even greater.

Several of the companies we spoke to, ranging from those who are very sophisticated in ESG reporting to those who have more recently developed an ESG approach, indicated that they are getting more questions from the governance side of large institutional investors, especially the large index funds. However, most indicated that, for the most part, the investors are just beginning to develop their understanding on how human capital metrics are linked to strategy. Companies are getting questions on diversity, safety, gender equity, ethics, and turnover (with some issues, such as safety, varying depending on the company). However, the data that investors are often using comes from one of the ESG ratings agencies or a proxy advisory firm, such as ISS,

whose data and methodologies are not necessarily sound or consistent. Companies have reported the most success in showing generally how their HR initiatives are linked to company strategy and culture directly to investors.

Overall, the feedback from companies on investors is that this is an area that investors believe can generate valuable information that may provide them with a comparative advantage in the marketplace. Thus, they are trying to learn more about it. Some companies believe that investor demands for transparency will grow quickly, while others believe it will develop more slowly.

Regardless of company philosophy, however, our interviews showed that most companies are refining how they evaluate these issues and disclose their information. The most effective companies appear to be tying their purpose, strategy, and culture, along with select metrics (which mostly are already in their CSR reports), to punctuate their attention to ESG and CSR issues.

# BEST PRACTICE CASE STUDIES

## **THE FOLLOWING CASE**

**STUDIES** are derived from in-depth conversations with HR Policy Association member companies regarding their ESG philosophy and activities. Throughout, HR Policy has been able to identify repeating themes, which it has laid out in the previous section, “Summary of Findings.” Given the subject matter, some of the company identities are hidden. The case studies are presented in no particular order.

**CVS Health** has a “built in” perspective on ESG issues, with health being a natural area (though not the only area) in which it focuses its ESG and CSR efforts. To integrate this connection into its business strategy, the company considers choosing and navigating various ESG-related priorities and projects through the lens of its corporate purpose. Further, the company considers stakeholder engagement and materiality assessments as central to the ESG function and where key decision-making “begins and ends.” As discussed in our interviews, “ESG is a business function that supports the long-term relationship with key stakeholders and informs business strategy.”

In practice, the company employs materiality-based rules of engagement to assist in deciding which issues it will or will not engage on, assessing the importance of the area to key stakeholders and the relevance to the company’s long-term business goals. The company rarely engages in ESG areas that will not make a meaningful difference to the company. When it does undertake efforts that are not key priorities, it is for the purposes of risk mitigation. In these areas, the company seeks to get out ahead of trends that present a risk to their business, including brand risk. Having a reputation for engagement is an advantage on this front.

ESG responsibilities are distributed among the company’s officers. The CEO is engaged on how the company’s combined ESG efforts fit within the context of its overall strategy. The company’s determination of which ESG and CSR areas to engage in is presented to the board. The CHRO oversees the company’s corporate social responsibility and philanthropy efforts, including the company’s foundation. The CHRO works closely with the head of its ESG and CSR function, driving the bulk of its efforts in this area and spending a considerable amount of time internally with business

leaders to understand the long-term strategy of the business and where the CSR function can be externally supportive. Thus, the CHRO needs to have a point of view on societal issues that impact the company, the employees, and the brand, and having a good senior HR team is imperative. For example, the chief diversity officer spends a considerable amount of time reinforcing the company's diversity approach and driving results.

*"For someone to be successful in CSR and ESG you have to understand how we make money. This isn't about making donations, it's about the impact you can have."*

Externally, semi-annually, the company talks with ESG experts on issues such as human capital metrics. The company engages with key NGOs and gives them a "zone of opportunity" for engagement. Depending on the issue, the company may engage with suppliers. The company then reports to the Board on how it is spending its time on CSR and ESG issues.

CVS Health uses Global Reporting Initiative standards as a starting point for reporting its activities to various stakeholders. The content is configured specifically for different stakeholders, from the CEO to policymakers to nonprofit organizations. Relevant content is further repackaged to support enterprise needs, including for RFPs.

With regard to communicating with employees, the company integrates its content from its GRI reporting through employee resource groups across the company. Volunteering and team building opportunities are also utilized to reinforce to company's CSR perspective to its employees. The company has a robust employee engagement tool that allows it to gauge employee perspective on key ESG issues. Externally, the company's ESG efforts are having a positive impact on recruiting as well, with feedback from prospective employees being they are interested in the company due to its efforts in this area.

*"We recognize that the world of business and politics is becoming intertwined. At some point, if you don't take a stand on something, that's the same as taking a stand in the eyes of the public."*

Recently, the company pursued the decisive and sweeping business action to stop selling tobacco products in its stores, a move that aligned with its long-term goals through the lens of its corporate purpose, which took a significant amount of time to develop and implement. While aligned with the company's purpose and longer-term business imperatives, it cost the company significantly in sales in the short term.

To explain the decision to stakeholders, including investors, the company crafted responses appropriate for each one. To ESG investors, the company talked about the shared value the move generated. For traditional investors, the company pointed to the business case for making the move and had the evidence to prove their decision was value enhancing. The large majority of investors understood how the company's decision was important to its long-term success and the transition was successful.

**Dick's Sporting Goods, Inc.**, a retailer that historically has not been public about its ESG engagement issues, recently connected business strategy and corporate values through a decisive ESG-related action in response to a precipitating event. While an expression of the company's values, the decision attracted high levels of attention—some positive and some negative. Moreover, the long-term financial impact of the decision, whether positive or negative, remains uncertain.

This ambiguity helped instigate a process that led the company to a more deliberate assessment and understanding of its culture and customer base. As a result, the company changed its verbiage regarding employees and customers to better reflect its company's culture. It has developed further written statements in addition to what it already had, which proved to be an effective clarifying exercise. Because of these developments, the company is now engaging more effectively on other ESG-related goals.

Finally, Dick's Sporting Goods found that its previous stance of being humble regarding their ESG initiatives may have underserved its business strategy. It now is beginning to advertise its efforts

to enhance its brand to customers and to its employees. Not only does this approach help to create a better connection with both employees and customers, as well as the communities in which it has stores, the company projects that they will help it to become better positioned for the future. The gap between politics and business is narrowing, the company judges, and it is better to be prepared for that eventuality.

**General Mills, Inc.** Prior to developing its current ESG strategy, General Mills had taken a local approach to giving back to the community. This meant generally focusing its efforts on areas around its headquarters. Ten years ago, however, retail access points and consumer values began to evolve more quickly than had been previously observed. Moreover, the company had long since become global, extending its business operations beyond most of its giving efforts. Business leaders, including the head of the company's philanthropic organization, initiated a rethinking of the company's giving practices. More importantly, the company noted that consumers were interested in the origins of and ingredients in their products as preferences changed, that employees were paying attention because of their dedication to the company and their interest in seeing the company succeed, and that investors were increasingly taking a longer view of their business. For this reason, company leadership realigned the company's philanthropy and ESG activities as it revamped its business strategy to adjust to these new consumer tastes and more intense product competition.

*“The biggest thing we’ve done in this area in the past ten years is to come to grips with what ESG means for our business model and its intersection with society.”*

In doing so, the company identified three key enablers to help drive its consumer-first strategy: increasing food security and alleviating hunger, advancing sustainable agriculture, and supporting hometown communities. It further expanded the reach of its ESG-related initiatives to General Mills’ operations globally, including its supplier base. Due to this broad portfolio, the company prioritized where it focused its ESG efforts. Rather than focus on pleasing all interest groups, the company focused on issues that are important within its business model and consistent with its business purpose, which it had recently explicitly framed. In these areas, the company judged, it could either play a bigger role or would be more knowledgeable—or in some cases both—and would therefore be able to maximize its impact.

A year and a half ago, the board of directors’ public policy committee asked General Mills’ management to develop a framework to help determine what the company says on ESG-related issues and when they say it. The company first spent considerable time identifying its corporate purpose as a way of realigning company strategy and priorities, from the products it focuses on to its employee strategies.

Generally, when reviewing the materiality of a position to the business, the company considers whether it is aligned with the company’s purpose, consistent with its values, and how it compares to its industry and local peers. The company is generally faithful to these guidelines in its decision making, realizing there are unique circumstances or issues that, while not directly related to the company’s business model, are important enough to consider engaging. In these cases, a small group of company leadership, comprised of the CEO, CHRO, general counsel, and other relevant key experts (*e.g.*, head of diversity and inclusion) will make the call. As a result of this process, leadership is more willing to speak out on ESG issues, with the company’s messaging already having been developed on the foundation of the company’s values, and the messages having been aligned with the company’s purpose.

General Mills views internal and external communications of its approach to ESG instrumental to reinforcing its brand, and the brand connection is the reason it has decided to engage on particular issues. The company uses various internal communications vehicles, including its website, an intranet site, intranet social media (for example, leaders participate in chat rooms), and traditional social media. Further, it shortened its corporate sustainability report, which had run at more than 300 pages, and published a version for employees. Additionally, the company reinforces its message through messaging at meetings as well. Corporate leaders also engage in public forums on its ESG strategies, actions and impact. Finally, the communications

team began making more use of leveraging longstanding partnerships with NGOs and other groups who may help on ESG issues. In doing the above, they draw from the company's history to demonstrate these activities have a longstanding, genuine source.

Recently, General Mills made a change to the contextual focus of these communications efforts. Rather than talking about the dollar amount given, the company now focuses on the impact of its ESG-related initiatives. That way, employees and other stakeholders can understand the difference being made. It further focuses the messaging on three areas, examining the company's impact in these areas and pulling the company's difference from their contribution.

*“When you have passionate employees advocating for change in a certain area, giving them insight into how such decisions are made has been very helpful to us.”*

The company is forthright about its ESG efforts in conversations with ESG investors and activist groups. Meanwhile, it has not yet seen an increase in the number or types of questions asked relating to ESG activities, or for more or different human capital metrics from mainstream investors. The company considered this likely due to its concerted efforts to clearly link practice and purpose, and clearly demonstrate growth from that link. This is particularly important not only to investors, but to employees as well.

*“We found the sweet spot between practice and purpose. Everything is clear, and we can link it to growth, which is particularly important for both investors and employees.”*

General Mills considers its communications efforts as part of laying down the groundwork for future initiatives, while recognizing that it is the external drivers of change that are driving changes in the marketplace. For a company with a consumer-first strategy, the ability to adapt is therefore paramount to future success.

**HP Inc.** has made significant efforts in achieving diversity and supporting its communities since its founding. From an early stage, the company sought to improve the value proposition for its employees and customers and to ensure that its supply chain was free of questionable practices. This early stance was, and is, essential to the company's culture.

Today, HP is seeing consumer demand, employee preferences, and government regulations shift toward favoring ESG activities. Younger prospective employees are beginning to expect ESG-related efforts from the company, as it is a factor in their decision to work for it. For current employees, the company's sustainability impact strategy in particular is driving their engagement.

HP's ESG efforts are housed in the supply chain organization and driven from a business perspective to fuel innovation and growth (both especially important in the tech sector). HR is a very close partner with respect to diversity, labor standards, pay equity, and community impact. For example, the company agreed to report more information with respect to gender diversity as the result of negotiating the withdrawal of a shareholder proposal offered by an issue-based shareholder.

*"Our ESG efforts are driven by a business perspective more than anything else."*

ESG efforts are spread throughout the organization, with leaders doing interesting work bringing to life their ESG strategy in unique ways. This includes reinforcing ESG as part of company culture by dedicating time in its employee engagement meetings to its ESG initiatives.

Recently, HP held its first conference call for shareholders on ESG and corporate responsibility, with dozens of shareholders listening in globally. The call stimulated one-on-one conversations with investors. It also generated a very positive reception from employees. The company views this general development as an important part of its culture going forward as well as a driver of innovation.

*"You have to own your message—otherwise others will do it for you, and your data won't be as helpful."*

ESG activities have also become a sales criterion in some government and private sector RFPs, and therefore have driven business results. Winning contracts has allowed the company to quantify the business impact of its ESG initiatives. The investment community, and particularly long-term investors, have responded with enthusiasm to seeing a quantified impact on business.

Investors have also responded positively to ESG activities, such as the diversity of the company's board, which has also translated into better business results. The company's investors are additionally interested in:

- Its environmental efforts, which are positively impacted by the company's innovation;
- How its efforts regarding supply chain oversight impact costs, productivity, the environment, etc.;
- How the board stays connected to corporate culture; and
- The company's evolving efforts on diversity and inclusion.

One particular investment group suggested that the company institute board oversight on ESG activities, which served as an impetus to change the board nominating process. Based on setting goals and meeting them, long-term investors have doubled their investments in the company.

In order to decide whether to engage in particular areas, HP has developed an articulated strategy with three key pillars of focus. In addition, the company internally publishes a materiality report on ESG issues, then plots these against major public issues. Those items in the “upper right-hand corner” of the graph, so to speak, are the areas in which the company takes action.

**Johnson & Johnson** is a broadly-based healthcare company, operating in multiple business segments. Its ESG efforts are unified across these segments by an articulated statement of its values embodied in the company’s Credo, a document which is the basis for the company’s management philosophy and guides goal setting and reporting in this area. This document also serves as a way to ground the Company’s discussions with investors on ESG activities and business matters. As a proactive measure, the statement of values has allowed Johnson & Johnson to enjoy more full control of its initiatives, and the data it has chosen to disclose has consequentially been more insightful.

*“Our performance lends credibility to our message. We know that if you do all the things we believe in the right way, the shareholder will receive the right return.”*

In order to determine in which ESG areas to engage, Johnson & Johnson initiated an assessment of the most important topics for reporting. The assessment included a survey sent to more than 1,500 internal and external stakeholders, including customers, vendors, and large investors, to determine the areas of largest significance based on Johnson & Johnson’s business model. The company received a high response rate, at 25 percent, and meaningful answers. The data, which was not weighed by group, assisted the company in goal setting and indicated areas of high stakeholder interest.

Many issue areas asked about in the survey were deemed as important by both internal and external stakeholders. For example, product safety, quality, and reliability ranked high for both groups. Other issues varied in importance by stakeholder group. The company is aware that many of the trends in the survey will fluctuate in importance by stakeholders over time, and that once reporting begins, it is difficult to reverse, and therefore approaches its decision to engage or report on these issues with appropriate thought.

With regard to discussions with investors, Johnson & Johnson’s financial performance lends credibility to its long-term strategy and supports the Company’s approach to ESG activities. In order to illustrate that corporate leadership is guided in their decision making by increasing company value over the long term, Johnson & Johnson discusses its significant investment in research and development, its approach to acquisitions, and approaches to providing greater access to its products

by patients and consumers. The Company reports that its emphasis on long-term value creation is reinforced by its focus on performance and capital allocation as well as on issues such as human capital priorities, including diversity and gender equity.

**ManpowerGroup**, founded as a socially responsible B2B service company, has reported on its efforts on ESG-related issues from the beginning. However, the company has noted a shift toward giving dimension to these efforts through metrics and pressure to report on issues, especially human capital metrics, that the company has not previously reported.

*“The question boils down to: are we going to follow or are we going to lead with regard to data disclosures?”*

Both internal and external stakeholders are driving this change, as well as social forces, including a lack of trust in corporations, younger employees expecting transparency, and the rise of social media and the concurrent impact on companies’ brands. Other drivers include clients taking a greater interest in the subject as a way to protect their own brands, cybersecurity, and the risk of the elimination of jobs by technology. Because government seems incapable of providing relief in the face of such trends, certain investors are wary that companies need to mitigate the negative impact themselves or risk damage to the company’s brand.

During the interview, ManpowerGroup observed that there has clearly been a progression in how large investors have engaged on this issue. Three years ago, several governance officers of ManpowerGroup’s large investors began asking about gender diversity at the company, and specifically about the management team, leadership, and the board. These queries were answered verbally for the most part. Two years ago, the company fielded more questions about diversity regarding women, as well as engagement survey results (noting that investors wanted the results but were not terribly familiar with such surveys or how to interpret them). Last year, many more questions were asked that required quantitative answers, including questions regarding female representation, pay equity, employee training, the average pay rate for nonexecutive, nonmanagerial employees, promotion rates, and board diversity and age. ManpowerGroup believes that in time, companies will be expected to disclose the data their investors are asking them to disclose, but this gives companies an opportunity to help educate investors on what data is material to the company.

*“Having shareholders in balance with customers in balance with employees is deeply embedded with who we are.”*

Recognizing that ManpowerGroup provides services to other companies, clients are starting to inquire about human capital metrics of the companies within their supply chains—including ManpowerGroup—more frequently. Five years ago, only one client had such a

request. Today, 56 percent of clients request an audit. This suggests that companies are looking more deeply into their supply chains from the perspective of compliance assurance steeped in concerns about protection of the brand.

ManpowerGroup's board is also pushing to see more data in areas such as pay differentiation and diversity. These areas have the attention of the lead director. Increased focus by the board and company on these areas, as well as disclosure regarding the company's approach, is likely. Employee resource groups are also requesting more data on these issues, underscoring that these are issues important to the leadership and to the workforce generally.

### **Marriott International, Inc.**

derives its business philosophy and principles from its culture and history. The company has not deviated from this perspective since its founders instilled in it a culture of social responsibility and community-mindfulness well before CSR or ESG were formalized as concepts. Marriott International began engaging in environmental and human rights issues as long as 15 years ago. However, as with several companies we interviewed, while the company had developed impressive efforts in certain areas, the good intentions of having an impact on these areas was muted by diffuse efforts championed by corporate leaders that were not unified by a common set of principles. Thus, three years ago, Marriott International found that its CSR and ESG-related activities were not sufficiently aligned with either the company's business strategy or corporate philosophy. From the company's viewpoint, this resulted in excessive opportunity costs with regard to both the business and philanthropy perspectives.

*"We see the work in this area inextricably linked to our business strategy and how we get the public to want to become customers."*

Corporate leadership, led by the Global Chief Communications & Public Affairs Officer and the CHRO, redesigned the company's ESG efforts to underline them as an element of company culture and more fully integrate them into the business model. The CEO charged that in this redesign, Marriott International's many units worldwide should make its core values "come to life in their own way." Therefore, the changes were designed to be locally-driven, while being united through a common set of four principles. Based on these principles, the company's core values were expressed in a way that engaged employees through regular communications that reinforced the company's role in society. Further, broad parameters were set to allow the various parts of the company to innovate and execute the company's ESG principles in their own ways, abiding by the concept of "don't kill the joy" of employee involvement in these efforts. In addition to achieving the CEO's vision, this helped form company culture around the newly revamped ESG efforts.

*"The question was, how could we derive value from our company and culture?"*

An example of this strategy is a subtle change in verbiage. Rather than call their ESG efforts "social responsibilities," and measuring effort, the company re-

designated them as “social impact.” This and other such strategies to locally implement their ESG strategy produced results. The company began seeing its various units incorporate this vision, unprompted, in their own ways.

In addition, the company is determined to lead in ESG areas where it chooses to engage, rather than allow the government or society to force action. This has allowed it the luxury of choosing where, when, and how to engage, and to be able to explain why to stakeholders in a way that is aligned with the company’s stated purpose and principles. Marriott International’s proactive approach and record of engagement allow it to clearly and firmly articulate its views. This gives the company more operating room when deciding whether to invest in particular ESG areas, an important advantage where there is significant public pressure, or even internal interest. This extends to items often used to pressure companies, such as codes of conduct. Because the company has proactively crafted its own code of conduct, which is robust, it has the ability to take a broader view in deciding whether to sign.

## **The Procter & Gamble**

**Company** Like other companies interviewed, P&G’s ESG efforts developed over time out of the founders’ efforts to give back to their local communities. These efforts were so integral to the company that, as the result of these early efforts, a national charity was spun off from the company and now partners closely with P&G globally. P&G has since evolved its efforts to integrate community support through charity with its core operating principles. Diversity and inclusion (which had been a focus going back 40 years) have been a core element of its approach and pay equality, and

more recently sustainability, was also connected with the company’s core operating principles.

Today, the execution of P&G’s ESG efforts is significantly more strategic. The company has identified five areas of focus, two of which are designed to enhance brand value through stepping forward on issues of importance to its customers.

Previously, the company’s brands developed and pursued individual priorities, but the impact was much more diffuse. Today, a “citizenship board,” comprised of the CEO, chief human resources officer, chief legal officer, and other senior officers, sets ESG strategy and determines where funding and company initiatives will be focused. In this way, the company ensures that the initiatives it chooses to pursue receive the funding and support necessary to accomplish the intended goals. The company communicates this process to stakeholders, with consistent success.

*“It’s important to define the process—otherwise, five issues can easily become 50.”*

P&G does not consider outside pressure to be a significant motivator for deciding in which areas to engage. Rather, the link with the company’s brands, which drives marketing value, and a desire to do good motivate the company’s actions. While the company does occasionally engage on issues where there is stakeholder pressure to do so, it still places a high value on being differentiated by the impact of its efforts. Therefore, it will only engage if the impact aligns with the company’s perspective.

With regard to reporting human capital metrics, the company assesses whether to do so with an eye on managing risk. It has done sufficient self-reporting to feel confident in various areas, while extensively sharing the actions it has taken to promote gender equity and diversity within the company and with suppliers and customers.

**VF Corporation** Seven years ago, VF Corporation, a consumer goods manufacturer with a broad supply chain of global contract manufacturers, followed its longstanding corporate mantra in creating a role to seek ways to become proactive regarding the company's environmental footprint and social impact on communities where it has a presence. Subsequently, two years ago, the then-new CEO declared a purpose-led agenda and prioritized the integration of sustainability and focused ESG efforts into the company's business strategy, unprompted by outside pressure. The CEO's initiative led to a unified approach among the company's many brands. In addition, the company has expanded and accelerated its sustainable sourcing practices.

*"If an opportunity doesn't help us achieve our purpose, we're not going to do it. It's a lens through which to say yes and to say no."*

VF Corporation focused its sustainability efforts on four pillars—water use, waste, energy use, and thinking about what happens to its products after they are used. The company also manages a global program for responsible and sustainable

sourcing, where it has sought to use its size and scale to bring other organizations into its initiatives. It also has sought, directly and in partnership with non-for-profit organizations, to help particular communities where products are manufactured on issues most important to them, such as health care, childcare, and clean water.

In taking these steps, the company's strategy took a broader, more holistic perspective. It partners with other organizations to achieve its goals globally. It looks to become a leader on these issues and has engaged in external messaging on its activities through its brands. The company's purpose and strategy also guide the company to make more precise strategic decisions regarding what it will and will not do—for example, businesses to enter or exit. The company's purpose in particular has enabled it to align its activities on CSR and ESG with its overall business goals.

With respect to investors and outside organizations, the company has a predominant shareholder, which agrees with its approach. The company has also presented its approach in regular investor meetings, and investors are beginning to ask more questions about the company's ESG approaches. The company engages regularly with NGOs and does not shy away from engagement globally.

VF Corporation views this business-oriented approach as self-sustaining. The more financial success it reports, the more flexibility it has to engage in sustainability. The more it successfully integrates sustainability into its business model, the more success it will have, and this leads to better financial performance. In turn, this leads to being able to do more in sustainability.

The company's senior-most leadership is involved in this area, including the CEO, CHRO, chief legal officer, the head of the supply chain, and the head of sustainability. The CHRO leads in the capacity of the head of HR as well as an executive of the company who is part of the executive team in setting overall business strategy. Specifically, the CHRO is responsible for the activation of the company's purpose for its employees. The CHRO also works with the Sustainability & Responsible Sourcing leader and with the CEO and other executives on the ESG and CSR efforts inside the company.

With regard to worker issues, as part of its CSR approach, the company addresses workers that have a role in handling the product at any point in the supply chain, who number more than one million. The company's standards for these workers is set high for third party contractors, and the company engages in education efforts to communicate its standards to suppliers and monitors their conduct, including ending business with sites that do not comply. For its own employees, the company is looking to expand its value proposition across full-time and hourly segments in order to ensure a desirable and consistent worker experience. Yet the company also seeks to respond to specific needs of its various worker groups.

**COMPANY A** is a global manufacturing company with many long-tenured employees and a strong presence throughout the United States. Having been in business for well over 100 years, it considers extending its success far into the future to be an integral aspect of its business philosophy (sustainability broadly defined) and plans to do this, in part, by engaging in ESG initiatives more

deliberately as an integrated piece of its business strategy. In order to create guideposts for how the company thinks about operationalizing ESG initiatives, a few years ago Company A developed five areas of strategic focus. At the center of the strategic focus is sustainability of the raw materials needed to manufacture its products. Other areas, such as diversity and inclusion, are similarly integrated into its business model through this mechanism.

*"We developed an inside-out philosophy. When an issue impacts our company, that's what we want to engage on."*

As a part of this integration, five years ago, the company reassessed its philanthropic investments and consequently refocused them toward serving the company's constituencies, especially customers, suppliers, and employees. Using data points from the UN, employee sentiments, focus groups, and elsewhere, the company established four key areas of engagement: health and well-being, disaster relief, hunger, and literacy. The investments made in these areas are aligned with the company's business strategy from either a value creation or risk management perspective.

In order to better understand Company A's vulnerabilities with regard to public ESG issues, the company's CHRO, general counsel, and head of government relations recently began meeting as a group to explore the issue and the has decided the company should engage publicly in certain contexts. For

example, the group decided to make a statement when the United States opted out of the Paris Climate Accords, as energy use and sustainability is a central aspect of the business model and the company had more aggressive internal targets for reducing emissions than the accords specified. As a B2B company, however, Company A does not make efforts to publicize itself as being on the cutting edge of the issues in which it engages. Further, the CEO does not consider it his role to speak out on most ESG issue areas, recognizing the diversity of opinion within the company's workforce. When the company does make public remarks, it draws from its focus on value creation, its mission, and its values to articulate its position rather than using the language of outside sources, which may be more provocative.

*"We use the language of our company rather than the language of society. We don't go into provocative mode. We don't let circumstances determine our response."*

The board is involved with Company A's ESG efforts, especially through its public policy and environment committee, which is briefed on this topic at nearly every meeting. This year, for the first time, corporate leadership presented to the full board its diversity numbers and strategy as an integrated part of its long-term business strategy. Without improvement in attracting a diverse workforce, they believe, the company will struggle to achieve its long-term goals.

*"Investors want to be able to follow your thinking. They want to know that the way they're thinking about their investment is the way we're managing their investment."*

With regard to investors, Company A is receiving more ESG-related questions, and assumes at this point that investors would like to hear about the company's ESG efforts as part of rounding out their understanding of the company. Further, as a result of the company's long-term strategy, the company attracts investors who have a similar long-term view. Understanding investors' investment thesis helps Company A communicate the company's strategy to investors. Not surprisingly, the company finds that investors primarily are concerned that the way they are thinking about their investment aligns with the way it is being managed.

Looking forward, Company A plans to invest in initiatives that yield capital returns as well as environmental returns. And while the company does not yet include pure human capital metrics as part of its sustainability goals, if discussions on such metrics become more prevalent, it plans to provide information that explains how human capital issues are consistent with the company's strategy, and thus control the message.

**COMPANY B**, a financial services corporation, uses a triple bottom line approach, maintaining a balance among shareholders, customers, and employees in its business strategy. Further, its culture is based on being a premium brand, which carries with it certain expectation in areas such as safety, security, and transparency. In making decisions in this area, Company B's board gives the corporate officers a large amount of leeway. These characteristics drive the company's strategy on ESG issues.

Company B's officers take responsibility for ESG issues in their related areas. The CHRO leads employment and other HR issues. The chief legal officer ("CLO") and the corporate secretary, meanwhile, take the lead on major legal issues, corporate governance issues, including shareholder resolutions, with input from company issue experts. As often happens in many corporations, the more conservative approaches of the corporate secretary and CLO, and their desire to protect the company's reputation, may lead to situations where the legal team is willing to negotiate the withdrawal of a shareholder resolution at the expense of a significant policy shift that impacts other aspects of the company's operation, including human resources. This is where the CHRO needs to play a strong role in explaining the implications of such a negotiation. Having a strong internal reputation allows the CHRO to play a critical role in such discussions, even if it is determined that it is in the best interests of the company to negotiate a withdrawal.

This came into play recently when Company B received a shareholder resolution asking it to disclose gender equity information. Although the company typically would oppose such

resolutions, this time there were contextual factors that made the issue a closer call. There were good reasons to oppose a settlement, especially maintaining the approach adopted and implemented by the HR team. However, the greater societal focus on gender equity issues, along with decisions made by companies in several consumer-facing industries to negotiate a withdrawal in similar situations, led the company to do the same. However, it did so on its own terms and did not blindly follow the approach that several other companies had taken.

Company B typically does not respond to external pressure, relying instead on the company's strategy, culture and the needs of the business to drive decision-making. Recently, for example, the company expanded paid parental leave. The move was made to attract a talent base that is important to the company's business strategy and maintain the company's brand and culture. In making this decision, pleasing certain shareholders was not among the company's priorities, though the company seeks to make decisions that are in the interest of the majority of its shareholders, and it will explain the change externally.

Indeed, Company B's major investors are not typically focused on these issues. However, investor interest is growing, as evinced by the increase of ESG-related questions asked from the 2017 proxy season to the 2018 proxy season. Yet, the proportion of ESG-related questions to financial performance-related questions is still extremely small, with perhaps one question in 60 being focused on an ESG area. At this point, the company's investors seem more interested in learning about the company's business

strategy and growth opportunities than communicating strong views on ESG.

*“Materiality is where this function begins and ends and is as important as purpose in deciding to choose and navigate our priorities and projects.”*

However, younger workers, who comprise the majority of the company’s workforce, are looking to Company B to speak out on ESG issues. Although the company has not historically done so, the leadership is considering whether a public voice is warranted in certain circumstances.

**COMPANY C**, an industrial manufacturer in multiple different industries, has been focused on sustainability, broadly defined as a business strategy for ten years, corresponding to the direction set by the then-incoming CEO. The governance of ESG-related work is directed by a committee of the board of directors and decisions are taken with the oversight of both external and internal councils on which the CHRO sits. Roughly four years ago, Company C refined its pragmatic approach. This involved benchmarking (both formally and informally), running materiality assessments (assigning priorities that were both qualitative and quantitative), and assigning “next generation targets.” By 2014, these targets were successfully aligned with all areas of the company across its value stream.

Company C, which is a collection of different businesses, views sustainability as the “north star of what binds the

businesses of the company together,” and core to its business strategy. It understands global trends such as urbanization, resource scarcity, and climate change have a direct impact on its business, along with social drivers such as a more diversified workforce, and positions its business as being able to uniquely contribute to addressing those trends. To address these trends within the business context, the company integrates sustainability into product and solution designs to meet specific needs of the industries it serves, as well as social and environmental areas, adjusting processes and operations such as product development to achieve sustainability goals.

Company C seeks to create a competitive advantage through its ESG initiatives from a long-term perspective. It chooses to invest in evolving but enduring trends to design a business strategy that will also endure. This includes efforts regarding diversity and inclusion, which helps the company with its workforce development goals, as well as reducing the company’s environmental footprint. At times, however, the company will listen to what is important to its employees in making decisions on where to focus its activities.

*“If we are serious about solving those problems then we’ll be serious about how we integrate it into our business.”*

Company C’s sustainability initiatives are ultimately directed by a committee of the board of directors, and corporate decisions are made by the company’s

executive committee, on which the CHRO sits. Various officers within the company are responsible for different parts of the ESG function, with the CEO being chiefly responsible, as he sets the focus on how long-term investments yield a return from an environmental sustainability approach. The CHRO, who also has responsibility for corporate and public affairs, directs company initiatives on CSR, the “social” aspect of the company’s sustainability efforts, and parts of its efforts in governance, as well as the company’s messaging on ESG. Further, Company C utilizes an external sustainability council composed of 10 leading global experts, which provides advise and expertise on ESG strategy and trends. Their meetings are attended by the CHRO, who reports the essence of the discussions back to the executive committee.

Company C will speak publicly on issues that are directly relevant to the company’s sustainability strategy, to the company’s business strategy, and/or are essential to the company’s values. For example, diversity and inclusion has been a focus for many years and there is a board-level commitment to the issue. Input from employee resource groups may lead to an external comment consistent with the company’s overall values. The same goes with gender parity and equity issues, which, similar to the diversity and inclusion issues more broadly, are important to a diverse pool of labor that have the necessary STEM-specific skills.

With regard to investors, Company C’s strategy is to attract long term investors, which will include ESG investors and those that align with the company’s values. There is an appetite among investors, the company has found, for a comprehensive strategy that includes sustainability for long term growth. The company tells investors a holistic story regarding its ESG efforts and business strategy, which is received enthusiastically by investors.

For past few years, Company C’s investors have expressed an interest in the company’s culture, in the capabilities of the workforce, and other areas. More recently, investors have been asking about corporate values and the #MeToo movement. They are most interested, however, in how the operations are done in a differentiated way, and typically whether the company can deliver on its financial goals. With regard to ESG, the company feels that investors are still searching for a model that can be used across companies.

# ROLE OF THE CHRO ON ESG ISSUES

**THE CASE STUDIES ABOVE REINFORCE** that chief human resource officers often play a pivotal role in how companies address and manage ESG and CSR matters, with nearly two-thirds of CHROs either part of a C-Suite team determining ESG priorities or having primary responsibility for managing the issues. Several factors have led to an increase in the importance of the CHRO role on ESG matters. These include the growing corporate focus on corporate purpose and culture; the increase in external focus on ESG issues by investors and other stakeholders; the impact of social media on a company's brand for both consumers and employees; and the greater expectation that corporations and corporate leaders, especially CEOs, will fill the void left by government inaction, just to name a few.

Part II of this Guide reviews the role of the CHRO based on the best practices drawn from the interviews and other discussions. It focuses on the following issues:

- *The role of the CHRO by the numbers,*
- *CHRO as steward of shaping and reinforcing company culture,*
- *CHRO as steward of the company's social capital, and*
- *CHRO as Counsellor to the CEO.*

## The Role of the CHRO on ESG Issues by the Numbers

An August 2018 survey of HR Policy Association CHROs provided some clarity as to the role human resource chiefs currently play on ESG issues. A clear majority—63 percent—either are part of a multidisciplinary team responsible for overseeing the company’s policies on ESG or have primary responsibility for the issue. Another third provide input to an executive with responsibility over ESG issues. Just five percent reported having no role on ESG issues.

The survey results reinforce the broader organizational role that the head of human resources plays. This includes having a broader responsibility for the social capital of the company as part of their core role in overseeing talent, capability, and company culture. Most of the CHROs we interviewed discussed at length how the company’s ESG approach was an outgrowth of the strategy of the company but also consistent with the company’s HR philosophy based on that strategy as informed by company purpose.

Many CHROs thus incorporate the external lens of managing or helping manage the ESG approach as the company as part of their HR strategies. The CHROs that had direct responsibility for ESG issues had responsibility for strategy; overseeing the company’s ESG, CSR, and philanthropy functions; or had broader responsibility for global citizenship.

### CHRO role in ESG matters:

**54%** Part of a group responsible for overseeing ESG policies

**32%** Provide HR perspective to an executive responsible for ESG, but do not have a formal role in crafting policy

**09%** Primary responsibility for overseeing ESG initiatives

**05%** No role in crafting ESG policies and practices

*Source: 2018 Mid-Year CHRO Survey*

The CHROs that did not have direct responsibility were typically part of a multidisciplinary team—often an executive committee—closely connected with the decisions at hand, such as public affairs, the general counsel, or similar roles. Anecdotally, it appears that increasingly CHROs in larger companies are taking responsibility for these issues, given that many of the issues are directly related to the CHRO’s role. For new CHROs, developing a point of view on these issues and incorporating an external lens will be increasingly important, keeping in mind that this approach should be calibrated for the size of the company, its global scope, and the industry in which it is involved.

## The CHRO as Steward of Company Culture

A core responsibility of the CHRO is to work with the CEO and senior management team to establish the culture of the organization consistent with its corporate purpose to achieve company strategy. In the wake of recent scandals involving companies such as Wells Fargo and Equifax, the rise of the #MeToo movement, and the focus on sexual harassment and gender equity and representation, the role of company culture has received considerably more attention both inside and outside companies.

The recent Conference Board “Blue Ribbon Panel Report on Culture as a Corporate Asset”<sup>13</sup> described culture as a “unifying force” between the company’s values, purpose, and individual actions.<sup>14</sup> The report urged that “Directors and company leaders should take a forward-looking, proactive approach to culture oversight in order to achieve a level of discipline that is comparable to leading practices in the management and oversight of risk.”

Meanwhile, a report by the Council of Institutional Investors referenced the importance of culture in combating sexual harassment,<sup>15</sup> and a recent BlackRock statement on human capital metrics engagement indicated that the investor would ask Directors how the

board assessed the company’s human capital management strategy so that it helped foster a healthy culture.

Although the company’s culture is best set by the CEO, and each corporate leader has a role in driving the culture, the CHRO is uniquely positioned to assess whether individual leaders and the organization are effectively moving company culture in the right direction. CHROs also have the ability to help shape culture through the talent they recruit; through the development opportunities provided to employees; and through performance management, incentives, recognition, and other rewards tools designed to reinforce desired performance and behaviors. In fact, in the recent HR Policy CHRO survey, companies were asked what impact the focus on culture has had in their companies, and 73 percent reported it had led to a change in performance management and

### FOCUS ON CULTURE



Share of CHROs who say focus on culture led to changes in performance management, rewards programs

<sup>13</sup> National Association of Corporate Directors, “Blue Ribbon Panel Report on Culture as a Corporate Asset (2017).”

<sup>14</sup> *Id.* at 10.

<sup>15</sup> Council of Institutional Investors, “How Corporate Boards Can Combat Sexual Harassment,.” March 2018.

[https://www.cii.org/files/publications/misc/03\\_01\\_18\\_corporate\\_boards\\_sexual\\_harassment.pdf](https://www.cii.org/files/publications/misc/03_01_18_corporate_boards_sexual_harassment.pdf).

rewards programs. Thus, CHROs clearly play a role in setting key policies related to culture and also in explaining how a company's policies reinforce its culture and approach to human capital issues in its disclosures.

### Your greatest challenge in implementing or disclosing ESG:

- 36%** Assessing consumer/client reaction
- 22%** Prioritizing ESG issues
- 22%** None of the above/other
- 14%** Managing employee engagement

Source: 2018 Mid-Year CHRO Survey

## The CHRO as Steward of a Company's Social Capital

Another aspect of the CHRO role with respect to ESG involves serving as a steward of the company's "social capital," or the economic benefits generated by human interactions. Social capital is reinforced in part by how the company's culture, approaches, and policies are perceived

internally. However, an increasingly important part of a company's social capital is how the company is perceived externally.

CHROs often have the responsibility for considering the internal and external implications of corporate decisions, especially regarding how those decisions impact corporate reputation with respect to human capital issues, factoring in company purpose and strategy. Historically, ESG issues have been looked at by boards and the finance discipline at companies primarily as an enterprise risk management issue. However, increasingly, a company's social capital can have a measurable impact on financial success,<sup>16</sup> as well as the ability to recruit top talent in an increasingly competitive marketplace.

This role requires CHROs to understand the company's strategy and finances and be ready to defend HR policies that are critical to executing that strategy. To be effective, CHROs need to develop good working relationships with their C-Suite peers and understand when they need to oppose a suggested decision as contrary to company strategy.

For example, this can happen when the company receives a shareholder proposal involving human capital issues. It is not unusual for the corporate secretary or general counsel to move to negotiate a settlement to the proposal to have the proposal removed from the company's proxy. However, in certain cases, agreeing to a settlement may undermine company policy and create inconsistencies internally that are

<sup>16</sup> Henri Servaes and Ane Tamayo, "The Role of Social Capital in Corporations: A Review." *Oxford Review of Economic Policy*, Volume 33, Issue 2, 1

April 2017, Pages 201–220, [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2933393](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2933393)

more harmful to the company. Consistent with our CHRO interviews, the most effective companies have prioritized the issues their companies will focus on for ESG issues consistent with the company's purpose and strategy, and these priorities are handled as consistently as possible in such circumstances.

HR Policy Association's 2018 mid-year survey found that companies face a wide array of challenges in implementing or disclosing their ESG/corporate social responsibility initiatives. According to the survey, assessing their consumer/clients' reactions to such moves and prioritizing which ESG issues to focus on were top concerns. However, many other companies considered other challenges to be greater, including managing employee engagement regarding the company's initiatives. The results reinforce the importance of consistent implementation of policies and that clear communication is essential in reinforcing the internal social capital of the company when a policy change is made.

## The CHRO as Counsellor to the CEO

The CHRO plays an important role as confidant to the CEO, and with respect to ESG issues, that extends to CEO educator and counsellor as societal expectations shift and newer CEOs are more willing to be publicly visible on certain issues. Historically, CEOs preferred to stay away from

commenting or taking a stand on societal issues unrelated to the company's business. In certain cases, this has become more difficult where societal and business issues intertwine. Regardless, research shows that the public expects public facing companies—brands—to take a stand on societal issues to a greater degree. This expectation is often tempered by the reality that companies have employees and customers that come from many perspectives, and a public position that certain groups of individuals may applaud may offend others.

Several of the CHROs we interviewed indicated that their companies sought to avoid taking positions on social issues not related to the company's operations to avoid offending employees or customers. This must be taken into consideration, and it reinforces the importance of the company's values and purpose as well as its process for setting ESG priorities.

The CHRO role as CEO counsellor becomes more important as new CEOs are more open to taking public positions on social issues. With respect to the companies we interviewed, in some cases, the CEOs of the companies led the initiative because of a strong belief that the company needed to act publicly; in other cases the CEO believed he should promote the initiatives developed by the sustainability function, HR, or a consortium; in others, the CEO function had historically taken a limited approach to such public action, but as a new CEO took over, that perspective changed.

In one case, a new CEO expressed a desire to be more visible on social issues and started a process for carefully identifying how best to engage. In VF's case, as discussed above, the new CEO's strategy was based on sustainability, which incorporated ESG issues into the roadmap for growing the company. In yet another example above, Company A, the CEO believed strongly in making sure that the company's approach to ESG issues is clearly disclosed, but does not believe it is appropriate to speak for employees on issues unrelated to the company.

Regardless of the approach a company takes, the CHRO needs to be informed about external trends, internal company initiatives, and employee perspectives, and keep the CEO apprised of times when it may be appropriate for him or her to make comments to the different audiences or for a communication to go out from the CHRO or another executive.

# ESG PRESENTS NEW OPPORTUNITIES AND CHALLENGES FOR CHROS

The role of CHROs in helping their companies align corporate strategy with their values, purpose, and culture becomes even more important as ESG issues take on greater prominence. The expectation that investors, customers, governments, and other outside stakeholders will pay greater attention to a company's ESG footprint makes CHRO understanding of the external context critical to helping shape the company's approach.

Similarly, in many companies, employees are paying more attention to their companies' ESG footprint, meaning that the internal audience is increasingly important as well. As leading companies have focused their ESG approaches by adopting principles-based approaches, prioritizing key issues and disclosures has become slightly easier.

Looking to the future, the growth in stakeholder interest in ESG issues foreshadows new challenges for companies and CHROs. The ESG rating industry, currently in its infancy, may make it more difficult for companies to tell their particular ESG stories in context to the extent investors and other stakeholders push for standardized reporting. Further, as one CHRO we interviewed predicted, certain stakeholders may seek more reporting on human capital issues, further forcing a discussion regarding relevance and context. CHROs will be called upon to help shape both internal and external approaches while working closely with their CEOs and fellow C-suite executives.