Harvard Law School Forum on Corporate Governance

Genuine Commitment and Explicit Net Zero Targets

Posted by Rusty O'Kelley, Rich Fields, and Laura Sanderson, Russell Reynolds Associates, on Sunday, July 17, 2022

Tags: **Board leadership**, **Boards of Directors**, **Climate change**, **ESG**, **Stakeholders**, **Sustainability**
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Editor's Note: **Rusty O'Kelley** co-leads the Board and CEO Advisory Partners in the Americas, **Rich Fields** leads the Board Effectiveness practice, and **Laura Sanderson** co-leads the Board and CEO Advisory Partners in Europe at Russell Reynolds Associates. This post is based on a Russell Reynolds memorandum by Mr. O'Kelley, Mr. Fields, Ms. Sanderson, PJ Neal, Jemi Crookes, and Elena Loridas.

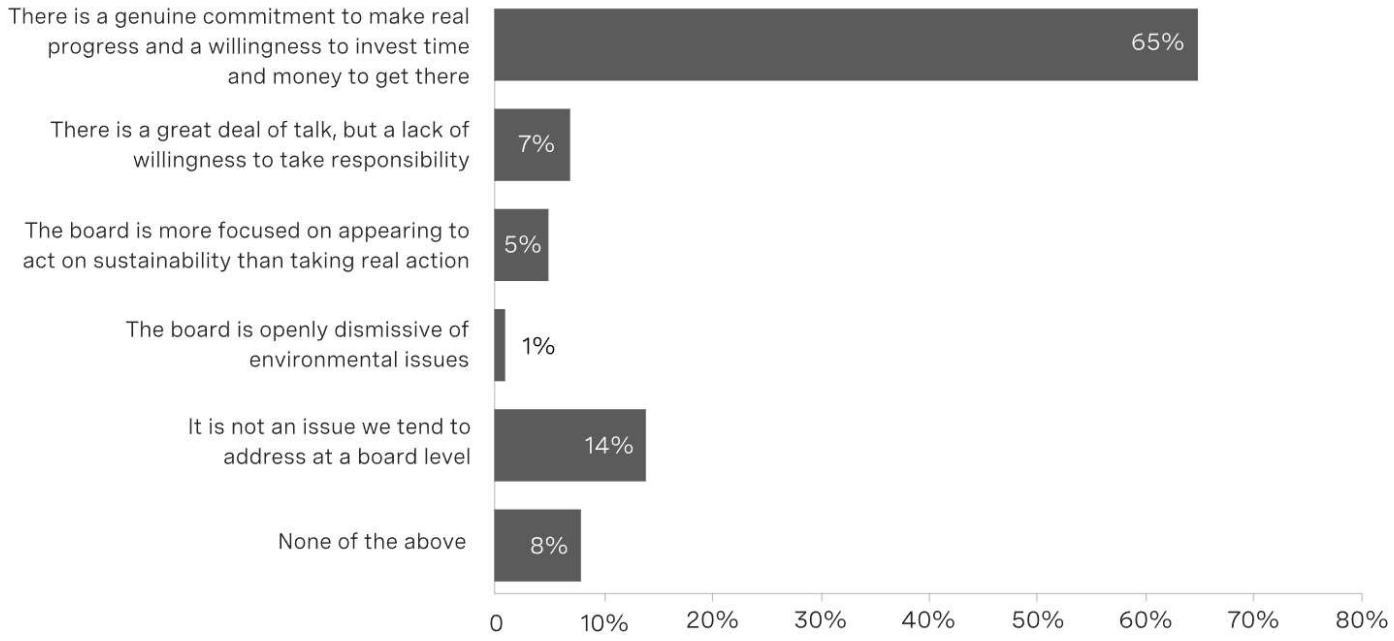
Related research from the Program on Corporate Governance includes **The Illusory Promise of Stakeholder Governance** by Lucian A. Bebchuk and Roberto Tallarita (discussed on the Forum **here**); **For Whom Corporate Leaders Bargain** (discussed on the Forum **here**) and **Stakeholder Capitalism in the Time of COVID** (discussed on the Forum **here**), both by Lucian A. Bebchuk, Kobi Kastiel, and Roberto Tallarita; and **Restoration: The Role Stakeholder Governance Must Play in Recreating a Fair and Sustainable American Economy – A Reply to Professor Rock** (discussed on the Forum **here**) by Leo E. Strine, Jr.

As pressure mounts from stakeholders, sustainability has never been a bigger focus for boards.

Investors, lawmakers, regulators, employees, and customers are all focused on sustainability, and often wonder if the board is doing enough to set up the company for long-term success in an increasingly sustainability-minded environment. Around the world—from regulators in Europe to the Securities and Exchange Commission in the US—governments are actively considering new standards for consistent disclosure on sustainability related topics. Our research shows that 73% of boards are discussing sustainability strategy at least once per year, and 65% of directors say their board is making a genuine commitment to sustainability.

Source: Russell Reynolds Associates' 2022 Global Board Culture and Director Behaviors Survey. "How often does your full board review…" N=956. 2022.

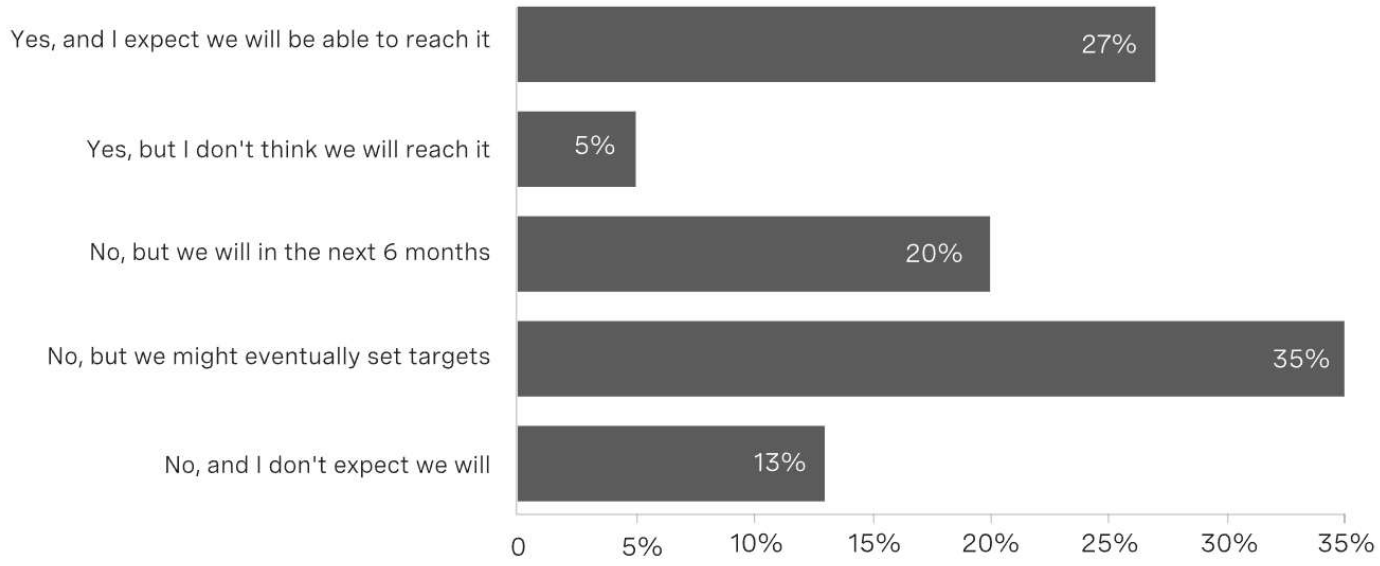
How would you characterize your board's attitude towards environmental sustainability?



Source: Russell Reynolds Associates' 2022 Global Board Culture and Director Behaviors Survey. "How would you characterize your board's attitude toward environmental sustainability?" N=951. 2022.

This commitment is critical to meeting evolving sustainability disclosure and performance requirements, whether set by investors, regulatory bodies, or others. Of particular focus is commitment to Net Zero targets, the goal established by the Paris Agreement to limit global warming to 1.5 degrees Celsius compared to pre-industrial levels. More than two-thirds of boards—68%—have not set a Net Zero target date, and only 27% have set targets that they believe their companies will achieve. While that may seem concerning, it is important to note that only 5% of directors explicitly said they did not think their company will reach its Net Zero target dates; 20% will likely set their targets in the next six months, and another 35% anticipate doing so at some future date.

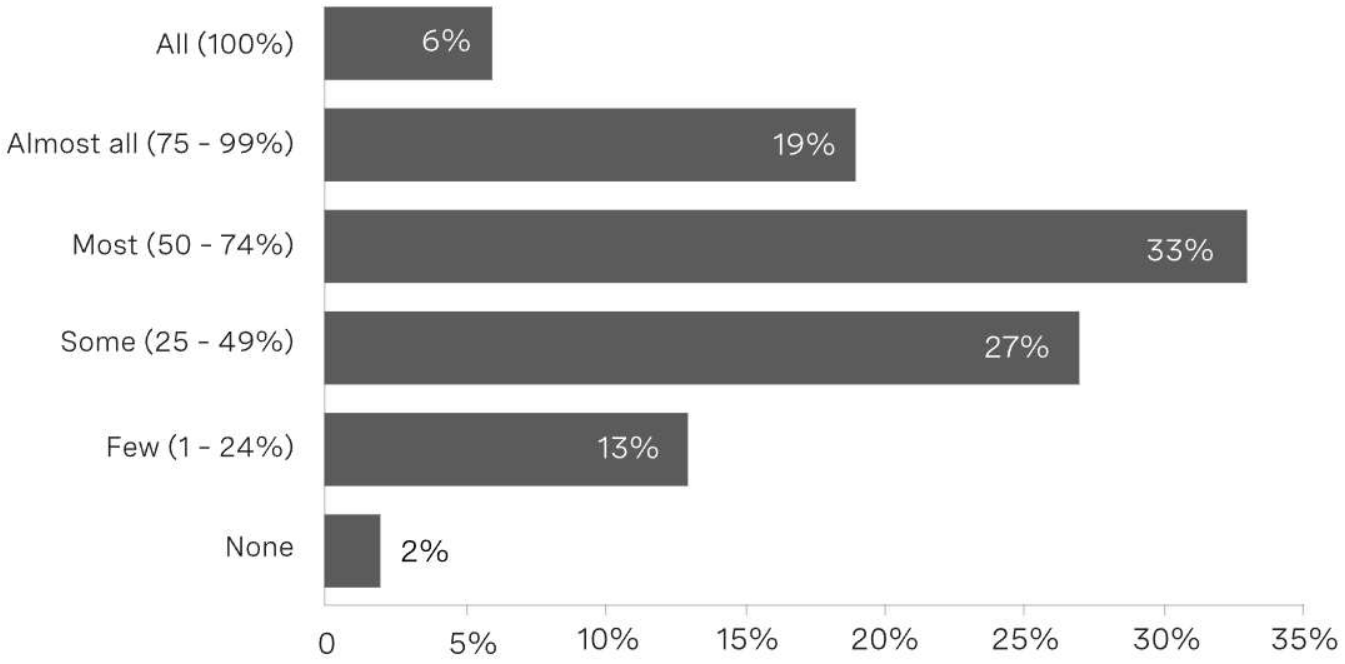
Has your board set a Net Zero target date yet?



Source: Russell Reynolds Associates' 2022 Global Board Culture and Director Behaviors Survey. "Has your board set a Net Zero target date yet?" N=962. 2022.

In recent years, investors have been clear that sustainability and climate risk is the responsibility of the full board. Rather than having a sole "ESG director" or "sustainability director," expectations are increasing for the entire board to bring a minimum level of sustainability awareness—if not expertise—to their work, using it to identify both risks and new opportunities for value creation. In our survey, directors reported feeling confident that their board collectively has sufficient expertise to address the sustainability issues facing their businesses.

What percentage of the directors on your board have the skills and experiences necessary to address the sustainability issues facing your business?



Source: Russell Reynolds Associates' 2022 Global Board Culture and Director Behaviors Survey. "What percentage of the directors on your board have the skills and experiences necessary to address the sustainability issues facing your business?" N=949. 2022.

While 58% of directors in our survey said that a majority of the directors on their board have the necessary skills and experiences to address sustainability, it is unclear if that is perception or reality. Corporate governance analysts have reported a lower-than-desired level of directors with sustainability qualifications or relevant experience on major boards today. But, to the extent that skill or capability gap exists, it may be closing: Our recent research with nominations and governance committee chairs found that 63% say sustainability is now a critical leadership competency for prospective directors, and the majority surveyed said that the competency is more important now than ever before.

It's clear that boards have work to do to build confidence among their management teams, investors, and other stakeholders as to their ability to effectively manage sustainability. What is less clear is whether this requires directors to personally possess technical sustainability expertise, or whether effective management can be enabled by the board's reliance on outside expert advice when needed. As the sustainability leaders and laggards of each industry become increasingly easier to identify, the market will likely provide a useful measurement for the importance of sustainability credentialing for the board.

From Insights to Action

In our study on **The Board's Role in Sustainable Leadership**, we identified actions for boards to take in order to strengthen their engagement with and oversight of corporate sustainability activities, including:

1. Proactively engage with external stakeholders about sustainability to ensure you understand their priorities and concerns
2. Embed sustainability into all discussions with the CEO and executive team
3. Establish a purpose-driven culture at all levels that looks at issues through a sustainability lens
4. Educate directors on sustainability
5. Apply a sustainability lens to corporate strategy decision-making

6. Identify key material factors based on the business, setting goals and establishing clear metrics for tracking progress toward them
7. Structure the board to engage meaningfully on sustainability
8. Change compensation models to account for sustainability targets
9. Prioritize a sustainability mindset when hiring directors
10. Prioritize a sustainability mindset when hiring CEOs

As investors and stakeholders continue to advocate for sustainability efforts, and as expectations grow for corporations to play a central role in making the world a better place, board leaders must find ways to enable and drive sustainability in the corporation. By engaging thoughtfully around these 10 actions—which relate to the issues of board leadership; board culture; purpose, strategy, and risk alignment; structure and process; and people and composition—board leaders can ensure that their company "does well by doing good."

Methodology

Over 1,100 supervisory board-level directors from more than 41 countries participated in the Russell Reynolds Associates' 2022 Global Board Culture and Director Behaviors Survey, with 55 percent of respondents based in Europe, 27 percent in the Americas, 12 percent in Oceana, 3 percent in Asia, 2 percent in Africa, and 1 percent in the Middle East. Industries represented included financial services (26 percent of respondents), industrial and natural resources (22 percent), consumer (11 percent), technology (11 percent), healthcare (10 percent), and professional and business services (6 percent). Forty-four percent of respondents' companies had annual revenue over $1 billion.
