



ESG, risk, and return

A board's-eye view

Audit Committee Institute



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“Pronouncements from major institutional investors and rising expectations from society at large make it clear that environmental, social and governance issues are a priority.”

ESG, risk, and return

Pronouncements from major institutional investors and rising expectations from society at large make it clear that environmental, social and governance issues are a priority. Yet, companies and boardroom discussions are moving at different speeds in addressing ESG issues, with the strategic importance of ESG varying widely by company and by industry.

To dig further into this issue and to get a better sense of how directors view the importance of ESG and whether companies are embedding ESG initiatives into their core business processes, the Audit Committee Institute polled nearly 900 board members and business leaders from 41 countries worldwide. The findings, detailed in the pages that follow, capture the views of directors, CEOs, and other C-suite executives. Three overriding messages stood out.

First, while major institutional investors continue to emphasize the importance of ESG issues to corporate performance—and as a key to long-term value creation and preservation—**half of directors and executives surveyed believe that a focus on ESG issues tends to improve company performance and competitive position.** Still, ESG is on the radar: Over half say that the primary factors driving their company's focus on ESG are reputation risk or the potential impact of ESG issues on the company's brand, as well as expectations of customers, employees, and other key stakeholders. The challenge, then, is how to expand the ESG conversation beyond risk to also include return.

Second, **ESG initiatives appear to be at the periphery, rather than integrated into the core of the business.**

Companies are struggling to integrate ESG issues into their core business processes—strategy, operations, and risk management. This is perhaps not surprising since only half see a correlation between ESG and long-term performance. Among the greatest challenges to achieving this integration, survey respondents said that ESG is viewed as a “soft” brand/marketing issue, is disconnected from core business processes, and is not a priority. We also found that ESG initiatives lack performance measurements and KPIs, and are de-linked from decisions about compensation and capital allocation.

Finally, given the importance that investors assign to the management of ESG, the board has a key role to play in leading the company forward on these issues. Survey respondents cite **significant room to enhance board oversight of ESG**—primarily by making ESG a strategic priority, clarifying board/committee oversight responsibilities, and improving tracking and internal and external communications regarding the company's ESG efforts.

We hope you find these survey results helpful as the basis for a robust boardroom discussion.

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Five takeaways



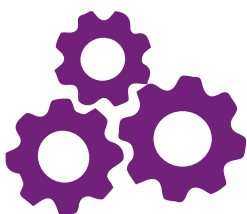
Less than half directors and executives surveyed believe that a focus on environmental, social, and governance (ESG) issues tends to improve company performance. While major investors continue to emphasize the link between ESG issues and long-term corporate performance, only 47 percent of respondents stated that companies focused on ESG issues tend to outperform competitors, and even fewer said investor pressure had increased their company's focus on ESG.



The main drivers of ESG focus are pressure from customers and employees, and the potential impact on the company's reputation. More than half (52 percent) of respondents said a primary factor driving their company's focus on ESG issues was expectations of customers, employees, and/or other key stakeholders. For 54 percent, the potential impact (positive or negative) of ESG issues on the company's reputation/brand was also a primary driver, 43 percent said that their company's ESG focus was part of normal risk and compliance activities.



The greatest challenges to addressing ESG as a strategic issue include viewing it as a soft brand/marketing issue, lack of priority of ESG at the business unit leader level and pressure to deliver short-term results. One quarter of respondents said viewing ESG as a "soft" brand/marketing issue was a significant challenge to addressing ESG as a strategic issue, 32 percent by pressure to deliver short-term/quarterly results, failure to connect ESG issues to core business processes (25 percent) and 29% by lack of priority at the business leader level.



Companies are struggling to integrate ESG issues into their core business processes—strategy, operations, and risk management. Slightly less than a quarter of respondents said their company has integrated ESG into its core business processes to a great extent. Another 55 percent said ESG issues are only somewhat integrated into the company's core business, and 7 percent said that ESG was not integrated into the core business areas and they have no plans to do so.

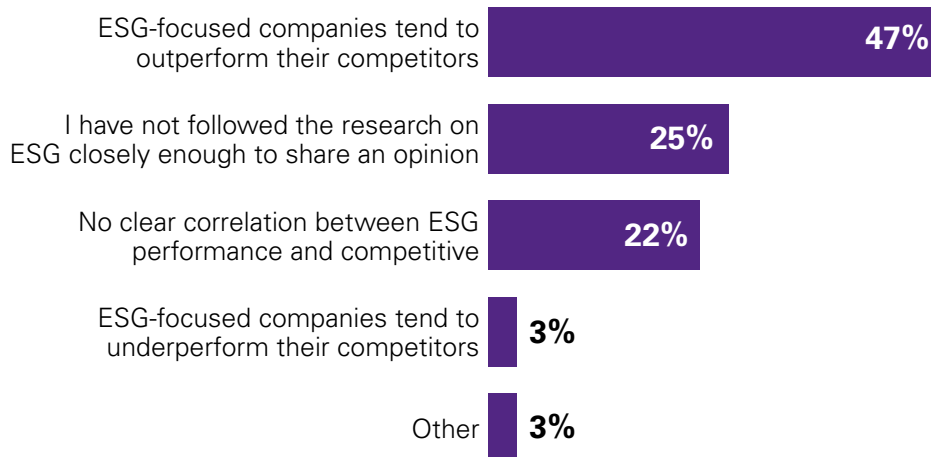


Board oversight of ESG could be most improved by making ESG a business priority, clarifying oversight responsibilities, and improving information flow. Only 11 percent of respondents said their board oversight of the company's ESG-related risks and opportunities is robust. Respondents cited three steps that would most improve their board's oversight: viewing ESG as a strategic issue/business priority, clarifying board/committee responsibilities for oversight of ESG issues, and improving the company's tracking of ESG issues and related communications to the board.



Less than one in two directors and executives surveyed say that a focus on environmental, social, and governance (ESG) issues tends to improve company performance.

In your opinion, how does a focus on ESG issues impact company performance?



Source: ACI Global Pulse Survey ESG, risk and return - April 2018

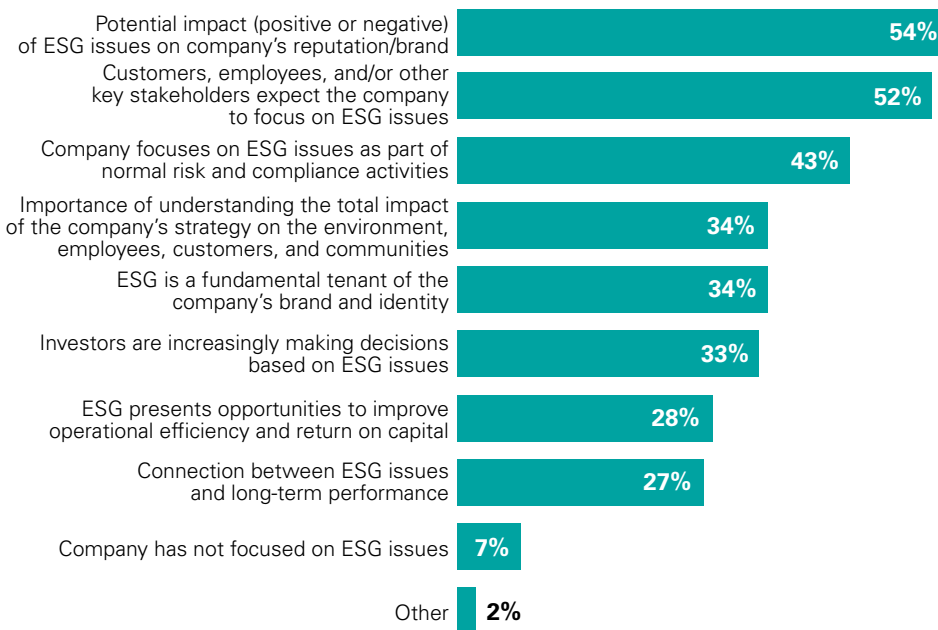
While major institutional investors continue to emphasize the importance of ESG issues to corporate performance—and as a key to long-term value creation and preservation—many directors and executives see ESG primarily as a risk and reputation issue (see page 4). Only 47 percent of respondents say that ESG-focused companies tend to outperform their competitors. And 22 percent say there is no correlation between ESG and company performance, and 25 percent have not followed the issue enough to express an informed opinion. Directors and executives of larger companies are more likely to see a correlation between ESG and company performance—as over 50 percent say that ESG-focused companies tend to outperform their competitors.

A number of studies have documented that companies with strong ESG performance tend to have a more stable and loyal investor base, lower cost of capital, and better access to financing. Studies also show benefits in terms of employee engagement and customer purchasing behavior, which are vital to competitive advantage and long-term performance. Taken together, the importance attached to ESG by major institutional investors and the growing body of research documenting the benefits of ESG performance send a clear message to companies and their directors: ESG issues need to be a priority, and how a company manages these issues is a strong signal to investors of how well the company is run and its long-term financial sustainability. Companies around the world appear to be listening, as some of the largest global companies are now publicly emphasizing the strategic importance of ESG to their business and the EU requires member states' listed companies, as from 2017, to disclose non-financial information in or together with their annual reports. We expect more companies to follow and more countries and regions having regulation established.



The primary drivers of company focus on ESG are pressure from customers and employees, and the potential impact on the company's reputation.

What are the primary factors driving your company's focus on ESG issues? (select all that apply)



Source: ACI Global Pulse Survey ESG, risk and return - April 2018

More than half of respondents cited stakeholder expectations (52 percent) and potential impact on reputation/brand (54 percent) as the primary drivers of their company's focus on ESG issues. For many companies, the focus on ESG is simply part of normal risk management and compliance activities (43 percent).

It is not surprising that over half of the respondents say that the primary factors driving their company's focus on ESG are related to risk management—including reputation risk, the potential impact of ESG issues on the company's brand, and expectations of customers, employees, and other key stakeholders. Most ESG initiatives that seek to improve the organization's impact on the environment and society start from a risk mitigation perspective. Managing brand and reputation risks, as well as regulatory and compliance risks are top of mind for many companies. But by focusing only on risk, companies may be missing the "opportunity train" and failing to develop sustainability strategies to address ESG concerns.

“As sustainability issues are becoming core business issues affecting a company’s competitive positioning, they need to be integrated at the core of the organization with board oversight.”

To what extent has investor pressure caused your company to increase or decrease its focus on ESG issues?



Increased to some extent	26%
Increased to a great extent	9%
Neither increased nor decreased	22%
Investors have not communicated their views on ESG issues	27%
Decreased focus	1%
Not sure	12%
Other	4%

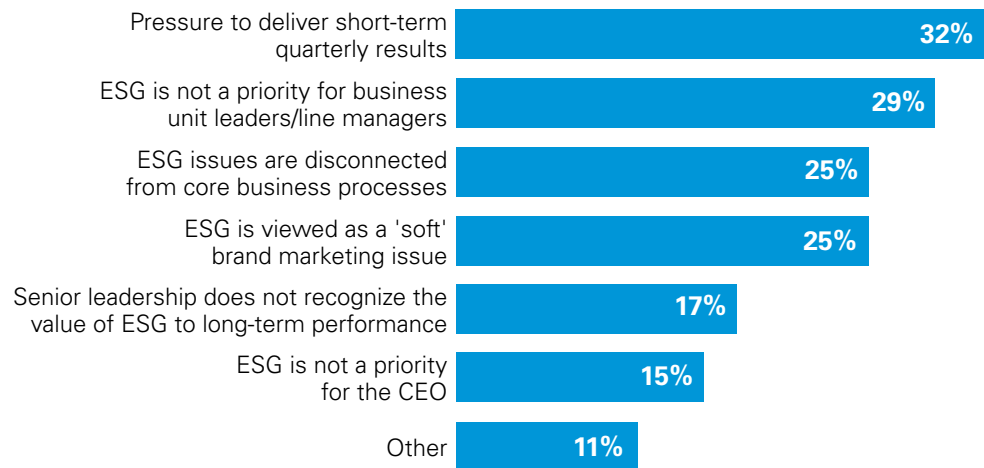


“ Companies that have successfully embedded ESG initiatives into strategy and operations view the integration of these initiatives as imperative to long-term value creation. ”



Viewing ESG as a “soft” brand/marketing issue, pressure to deliver short-term/quarterly results, and ESG not being a priority for business unit leaders are among the greatest challenges to addressing ESG as a strategic issue.

What are the greatest challenges to addressing ESG as a strategic issue at your company? (select all that apply)



Source: ACI Global Pulse Survey ESG, risk and return - April 2018

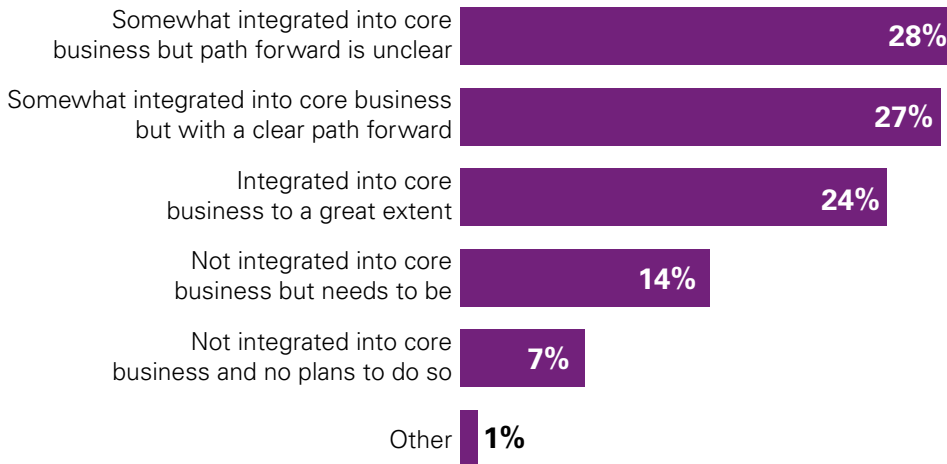
Based on these survey findings, addressing ESG issues as an economic imperative and a key to long-term financial sustainability are hampered by perception and more immediate concerns. A quarter (25 percent) of respondents cite the view of ESG as a “soft” brand/marketing issue as one of the greatest challenges to addressing it as a strategic issue, while 32 percent of respondents cited pressure to deliver short-term/quarterly results as an impediment. ESG not being a priority for business unit leaders is also picked up by nearly one third (29 percent) of our global respondents. Twenty-five percent indicated that ESG issues are disconnected from their company’s core business processes.

Companies that have successfully embedded ESG initiatives into strategy and operations view the integration of these initiatives as imperative to long-term value creation. Achieving such integration requires companies to shift away from a “business-as-usual” approach, which often involves trade-offs, potential disruptions, and an innovative mindset. Transitioning from a view of ESG as a non-core, brand issue to one that recognizes potential opportunities from integrating ESG into strategy and operations could require new skills and expertise as well as different KPIs and scorecards.



Companies are struggling to integrate ESG issues into their core business processes—strategy, operations, and risk management.

To what extent has your company integrated ESG issues into its core business processes, i.e., strategy, operations, and risk management?



Source: ACI Global Pulse Survey ESG, risk and return - April 2018

Less than a quarter of respondents say their company has fully integrated ESG issues into core business processes. This is perhaps to be expected when only half see a correlation between ESG and long-term performance. While many companies have developed ESG initiatives, these initiatives are often disconnected from the core business strategy. ESG initiatives appear to be at the periphery, rather than integrated into the core of the business, lacking performance measurements and KPIs, and de-linked from decisions about strategy, compensation, and capital allocation.

“Integration is key,” Harvard Business School Professor George Serafeim told the ACI in an interview. “As sustainability issues are becoming core business issues affecting a company’s competitive positioning, they need to be integrated at the core of the organization with board oversight.” By integrating ESG issues into strategy, business leaders and boards can bring the same focus and discipline to the management and oversight of these ESG initiatives as they do to other strategic initiatives aimed at creating long-term value.

Areas of focus for ESG integration (less than 30% integrated in the business)

Resource and capital allocation	26%
Shareholder engagement/communications	22%
Product development/service offerings	23%
KPIs/corporate performance metrics	19%
Executive compensation incentives/metrics	10%
ESG has not been integrated into any areas of the business	7%



Board oversight of ESG could be most improved by making ESG a business priority, clarifying oversight responsibilities, and improving information flow.

What would most improve your board's oversight of the company's ESG-related risks and opportunities? (select all that apply)



Source: ACI Global Pulse Survey ESG, risk and return - April 2018

Given the increasing importance that investors and other stakeholders assign to the management of ESG, boards can play an instrumental role in helping companies oversee ESG-related risks and opportunities and their alignment with the business strategy. According to survey respondents, there is significant room for boards to improve oversight, primarily by making ESG a strategic priority, clarifying board/committee oversight responsibilities, and improving the company's tracking and internal and external related communications on these issues.

Companies—and boardroom discussions—are moving at different speeds in addressing ESG issues today. But wherever a company is on this journey, the board can help the organization move forward by focusing on the big picture. Which ESG issues are of strategic significance to the company? How is the company managing ESG-related risks and opportunities and embedding ESG into strategy and culture to drive long-term performance? How is the company “telling its story” to investors and other stakeholders?

Survey respondents

Results are based on a survey of 866 respondents conducted during August–December 2017.

Company role



Board member

45%

Lead independent director
non-executive chair

10%

CEO

10%

CFO

12%

Chief Risk Officer

5%

Chief Compliance Officer

8%

Chief Sustainability Officer

2%

General counsel

4%

Other C-level/ senior
management

4%

Company type



Public company

51%

Private company

41%

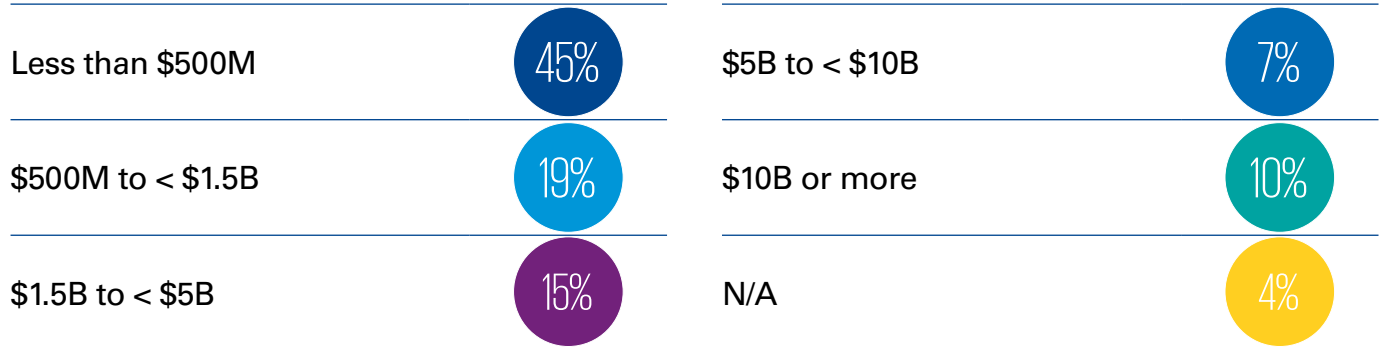
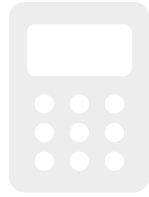
Not-for-profit

7%

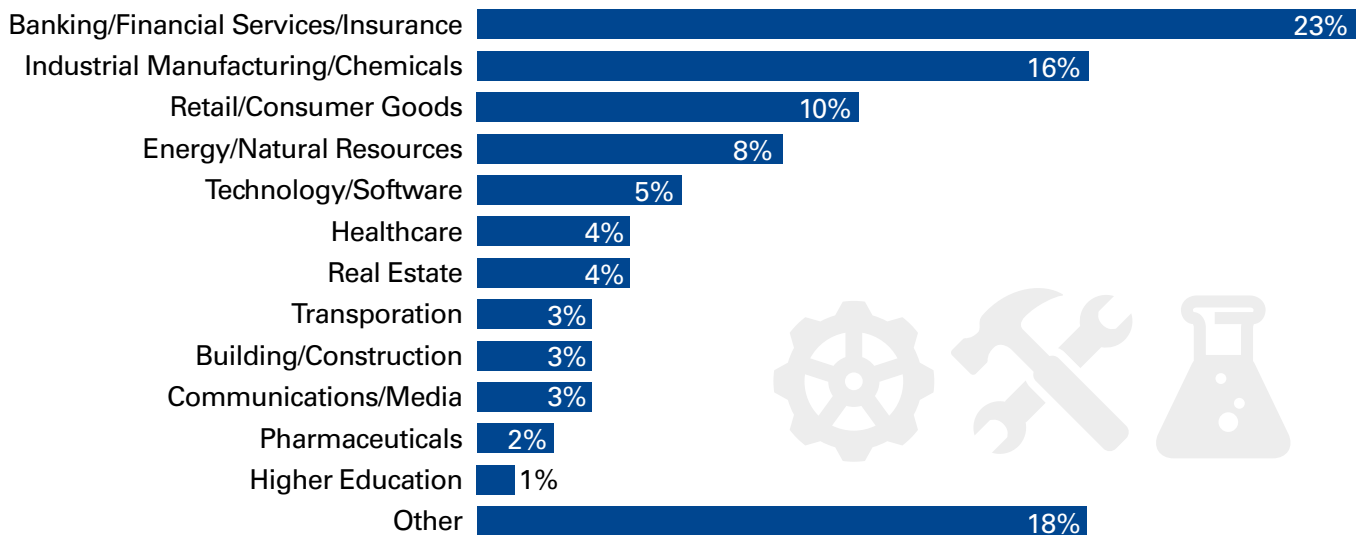
Other

1%

Company revenue



Industry/sector





Appendix: Country results

This appendix contains detailed data from 15 countries that received at least 20 survey responses. Survey data from all 41 participating countries are included in the TOTAL column.



In your opinion, how does a focus on ESG issues impact company performance?

	Total %	US %	Brazil %	Japan %	China/ Hong Kong %	UK %
ESG-focused companies tend to outperform their competitors	47	30	69	33	34	32
ESG-focused companies tend to underperform their competitors	3	3	3	0	6	0
No clear correlation between ESG performance and competitive advantage	22	30	14	26	28	18
I have not followed the research on ESG closely enough to share an opinion	25	33	9	40	31	43
Other	3	4	6	1	1	7
TOTAL n	882	119	109	107	71	44



What are the primary factors driving your company's focus on ESG issues? (select all that apply)

	Total %	US %	Brazil %	Japan %	China/ Hong Kong %	UK %
Potential impact (positive or negative) of ESG issues on company's reputation/brand	54	55	67	42	52	60
Customers, employees, and/or other key stakeholders expect the company to focus on ESG issues	52	56	64	38	42	67
Company focuses on ESG issues as part of normal risk and compliance activities	43	42	50	27	49	62
Importance of understanding the total impact of the company's strategy on the environment, employees, customers, and communities	34	37	35	41	24	31
ESG is a fundamental tenant of the company's brand and identity	34	36	39	26	32	44
Investors are increasingly making decisions based on ESG issues	33	34	42	25	30	24
ESG presents opportunities to improve operational efficiency and return on capital	28	28	37	21	30	27
Connection between ESG issues and long-term performance	27	27	35	15	18	24
Other	2	4	3	3	3	4
Company has not focused on ESG issues	7	10	1	20	1	4
TOTAL n	883	120	109	107	71	45

	India %	Colombia %	Mexico %	Spain %	Ireland %	Israel %	Argentina %	Belgium %	Korea %	France %
	59	88	52	69	32	43	44	58	70	55
	3	3	3	7	4	0	4	0	4	0
	15	6	12	17	29	43	19	33	9	25
	21	3	33	7	36	14	33	8	13	20
	3	0	0	0	0	0	0	0	4	0
	34	33	33	29	28	28	27	24	23	20

	India %	Colombia %	Mexico %	Spain %	Ireland %	Israel %	Argentina %	Belgium %	Korea %	France %
	35	39	42	61	70	36	52	67	65	62
	44	33	45	54	63	57	52	67	57	67
	47	39	61	32	41	43	41	50	30	52
	26	27	24	32	48	29	22	29	30	29
	35	21	36	50	41	4	37	46	9	71
	18	33	27	36	33	25	30	25	17	48
	44	21	21	14	22	18	37	21	13	29
	26	21	27	25	11	32	22	38	30	24
	3	0	0	4	4	4	4	0	0	0
	0	6	9	7	4	7	0	4	4	0
	34	33	33	28	27	28	27	24	23	21



To what extent has investor pressure caused your company to increase or decrease its focus on ESG issues?

	Total %	US %	Brazil %	Japan %	China/ Hong Kong %	UK %
Investor pressure has increased company's focus on ESG issues to a great extent	9	5	16	1	10	0
Investor pressure has increased company's focus on ESG issues to some extent	26	24	33	11	23	22
Investor pressure has decreased company's focus on ESG issues	1	0	1	0	1	0
Investor pressure has neither increased nor decreased company's focus on ESG issues	22	31	25	10	27	33
Investors have not communicated their views on ESG issues	27	27	16	54	28	22
Other	4	3	3	2	4	13
Not sure	12	10	7	22	7	9
TOTAL n	885	120	109	108	71	45



What are the greatest challenges to addressing ESG as a strategic issue at your company? (select all that apply)

	Total %	US %	Brazil %	Japan %	China/ Hong Kong %	UK %
Pressure to deliver short-term/quarterly results	32%	29%	36%	31%	26%	40%
ESG is not a priority for business unit leaders/line managers	29%	13%	25%	37%	43%	16%
ESG issues are disconnected from core business processes	25%	27%	25%	16%	17%	21%
ESG is viewed as a "soft" brand/marketing issue	25%	35%	17%	9%	30%	21%
Senior leadership does not recognize the value of ESG to long-term performance	17%	13%	23%	33%	13%	21%
ESG is not a priority for the CEO	15%	14%	15%	14%	29%	21%
Other	11%	17%	14%	8%	6%	26%
TOTAL n	858	112	105	105	70	43

	India %	Colombia %	Mexico %	Spain %	Ireland %	Israel %	Argentina %	Belgium %	Korea %	France %
	12	16	12	10	14	4	11	25	22	10
	35	34	27	31	32	18	22	17	43	29
	0	0	0	0	0	4	4	4	4	0
	15	13	30	14	18	18	22	25	4	19
	21	19	15	28	29	43	11	21	17	14
	6	16	6	3	7	4	0	0	4	5
	12	3	9	14	0	11	30	8	4	24
	34	32	33	29	28	28	27	24	23	21

	India %	Colombia %	Mexico %	Spain %	Ireland %	Israel %	Argentina %	Belgium %	Korea %	France %
	53%	24%	21%	25%	29%	32%	44%	35%	43%	11%
	28%	33%	12%	29%	21%	36%	28%	35%	17%	44%
	25%	21%	33%	18%	29%	29%	12%	26%	74%	33%
	31%	18%	24%	32%	36%	36%	32%	26%	17%	17%
	3%	12%	9%	11%	14%	14%	20%	4%	26%	0%
	3%	6%	6%	11%	7%	21%	8%	9%	17%	11%
	13%	21%	21%	18%	7%	0%	8%	4%	0%	22%
	32	33	33	28	28	28	25	23	23	18*

*Small base size. Findings directional only

Q

To what extent has your company integrated ESG issues into its core business processes, i.e., strategy, operations, and risk management?

	Total %	US %	Brazil %	Japan %	China/ Hong Kong %	UK %
Integrated into core business to a great extent	24	23	29	10	21	29
Somewhat integrated into core business – but with a clear path forward	27	23	32	17	28	18
Somewhat integrated into core business – but path forward is unclear	28	33	26	24	32	31
Not integrated into core business – but needs to be	14	9	11	35	8	11
Not integrated into core business – and no plans to do so	7	11	1	12	8	11
Other	1	1	1	2	1	0
TOTAL n	883	120	109	107	71	45

Q

What would most improve your board’s oversight of the company’s ESG-related risks and opportunities? (select all that apply)

	Total %	US %	Brazil %	Japan %	China/ Hong Kong %	UK %
Board as a whole needs to view ESG as a strategic issue/business priority	42	29	45	40	46	42
Improving company’s tracking of ESG issues and related communications to the board	33	29	31	32	31	31
Clarifying board/committee responsibilities for oversight of ESG issues	31	29	38	25	20	38
Adding board member(s) with specific ESG-related skills/experiences	18	10	25	17	15	16
Forming a separate committee to focus on ESG issues	17	4	18	10	23	11
Better board engagement with investors/ shareholders on ESG issues	15	13	16	20	17	7
Board oversight is robust	11	23	12	8	10	11
Other	5	7	6	6	3	7
TOTAL n	880	117	109	106	71	45

	India %	Colombia %	Mexico %	Spain %	Ireland %	Israel %	Argentina %	Belgium %	Korea %	France %
	41	39	24	36	15	11	26	25	9	43
	35	21	33	21	30	36	15	46	22	33
	18	21	24	18	30	29	41	4	43	19
	6	9	15	14	22	11	15	17	26	5
	0	9	3	11	4	14	4	8	0	0
	0	0	0	0	0	0	0	0	0	0
	34	33	33	28	27	28	27	24	23	21

	India %	Colombia %	Mexico %	Spain %	Ireland %	Israel %	Argentina %	Belgium %	Korea %	France %
	47	45	36	41	29	46	26	50	30	33
	21	15	36	45	46	21	41	29	57	38
	35	42	27	21	25	36	22	29	22	38
	15	12	18	34	25	18	26	0	35	10
	35	24	18	21	0	32	22	8	9	19
	15	9	6	28	7	7	15	17	17	5
	18	6	12	3	14	7	7	17	9	5
	0	6	3	0	4	4	0	4	0	19
	34	33	33	29	28	28	27	24	23	21

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