FiscalNote | Executive Institute

Sustainability at a Crossroads

Shifting Trends in Sustainability & the Corporate Response

Introduction

Sustainable business practices have become a central focus for many industry leaders because they are a means to mitigate potential risks that may impact corporations over the next few decades. Driven by investors and consumers, global corporations recognize climate change as a growing business concern and promote environmental, social, and governance (ESG) initiatives in response. Viewed as an unnecessary obligation a decade ago, the political and social pressure on private companies to prioritize sustainability now dramatically influences corporate strategy.

Despite an apparent increase in the need for organizations to integrate sustainability into corporate decision-making, private companies often struggle to effectively measure and communicate sustainable business practices to external stakeholders. These inefficiencies threaten public image and the perception of credibility among investors. One way corporations address these issues is by forming coalitions made up of private companies and non-profit organizations in an attempt to establish industry norms.

This white paper discusses the lack of uniform sustainability standards and describes how coalitions of NGOs and global companies are shaping sustainability norms, in the face of regulatory activity.

The Current Landscape

US presidential discourse and legislative initiatives around environmental issues sparked an increase of public interest in corporate sustainability. President Obama addressed sustainability issues in his 2009 Joint Session of Congress speech and every State of the Union speech while in office.[1] He also announced the Climate Action Plan, a national plan to address climate change in the US and the Clean Power Plan, a national limit on carbon pollution from power plants. During this time, the US Congress also passed legislation requiring companies to cut energy waste, reduce air and water pollution, expand the clean energy economy, and decrease carbon pollution.[2]

Political activity and lobbying expenditure on environmental issues continue in the Trump administration. For example, though President Trump is currently attempting to roll back the provisions of 83 regulatory rules, total environmental lobbying expenditure remains high. [4]

The sustained increase in lobbying expenditure seen in Chart 1.1 indicates that corporations are responsive to growing political and legislative prioritization of sustainable business practices.[3]

Total Environmental Lobbying Spend

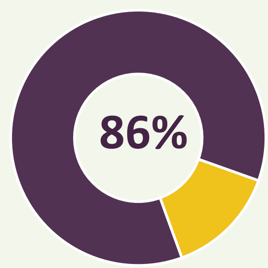
The international community also prioritizes sustainability. In 2000, the UN Global Compact designed a blueprint for corporate sustainability standards. The Compact was the world's largest coalition of businesses, civil society, and UN agencies promoting sustainable business practices. Additionally, in 2015, the UN agreed to the Paris Climate Accords to combat climate change and accelerate the transition to a low carbon economy.

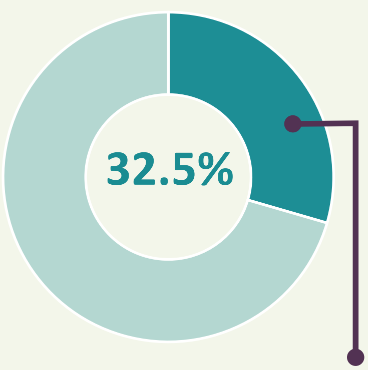
At the regional level, the EU is emerging as a progressive voice in environmental regulation. For example, Directive 2014/95/EU requires companies to disclose social and environmental policies and practices[5]. Despite developments in environmental standards and reporting, the UN's global assessment of environmental rule of law finds that weak legislative and regulatory enforcement to be a global trend that is exacerbating environmental threats.[6] As a result of weak enforcement, companies focused on ESG initiatives to attract investments and improve shareholder confidence rely on a wide-ranging set of sustainability reporting frameworks. The lack of standardization among multiple frameworks results in arbitrary metrics and prevents efficient ways to measure corporate responsibility.

Sustainability Standards

The process of making corporate sustainability legible to investors and consumers involves three stages: standard-setting (determining what to measure), assurance (ensuring the quality of that measurement), and disclosure (reporting the results transparently), with external rating agencies providing a fourth optional summary function. Competing or insufficient frameworks at each level are creating an overall lack of standardization in reporting on sustainable business practices.

While 86% of S&P 500 companies publish sustainability reports, it is nearly impossible for consumers and investors to compare companies in a standardized way.[7]





The quality of reporting varies, with less than "a third (29.5 percent) of... available disclosures contain[ing] performance metrics" and the remaining two-thirds of reports using boilerplate language or company tailored narratives.[11]

Complex standards: Alongside landmark governmental guidelines like the UN Global Compact and EU Directive 2014/95, there are now over four hundred voluntary sustainability standards across the world, often overlapping within the same industry.[8] On the topic of green buildings alone, different sustainability standards are preeminent in Australia, the US, the UK, and Malaysia.[9] While third-party verification of these corporate sustainability practices has increased, overall assurance is inconsistent. The Global Reporting Initiative (GRI) is widely recognized as the global leader in sustainability disclosure. Yet, between 2015-2016, only 32.5% of all GRI reports were externally assured.[10] Even with assurance**,** GRI allows companies to avoid disclosure on sustainability performance as long as they explain the reason for omission.

To navigate this complex ecosystem, ESG rating agencies try to standardize the reporting process by scoring companies based on their sustainability performance. Nonetheless, many agencies fail to explain their evaluation methods adequately, especially in regard to the methodology by which different criteria are weighted. Without a transparent methodology, agencies provide inconsistent reports.[12]

These conflicting reporting and rating standards can confuse investors or even provide contradictory information, disincentivizing investment. Because investors increasingly use sustainability metrics as a proxy for financial performance, this risk is financial as well as reputational.[13]

Given that an estimated "81% of global [consumers] feel strongly that companies should help improve the environment" it is critical that companies have credible mechanisms for developing, carrying out, and transmitting their sustainability strategies.[14]

The Collaborative Response

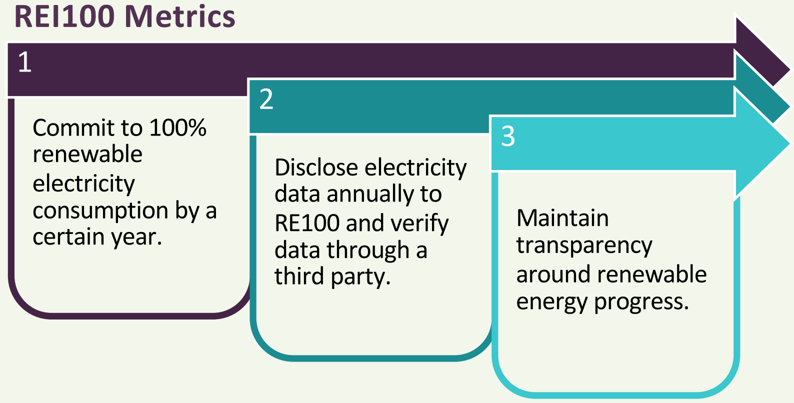
Coalition-led initiatives are filling the gap between environmental policy and industry norms. Companies like Siemens, General Electric, Shell Group, and Duke Energy are taking an increasingly proactive approach to reduce emissions, approach to reduce emissions, sometimes surpassing the reporting requirements imposed by the EST rating agencies.[15] As a result, companies that prioritize these proactive environmental practices are experiencing increasingly positive socio-economic returns on their sustainable strategies.[16] There are four defined environmental strategies that correspond to the different stages of a company's transition to environmental responsibility.[17]

- **Traditional (Compliance) Approach:** Aimed at meeting the obligatory requirements set by the government.
- **Preventive Approach:** Goes beyond obligatory requirements in order to prevent possible ecological risks.
- **Strategic Approach**: Corporate ecological policy becomes a part of its overall strategy and is aimed at utilizing new possibilities.
- **Sustainable Development Approach:** Aimed at securing the role of the "environmental leader" and aligns its environmental policies with solving global and national problems of environmental protection.

Coalitions provide companies a path to preventive, strategic, and sustainable development approaches. We Mean Business, SBT, and RE100 are global nonprofit coalitions driving initiatives like commitment to 100% renewable energy, low carbon technology investment, responsible climate change policy, and reporting information. As an example, more than 1,400 companies including Google LLC, Barclays, Wal-Mart Stores, and Coca-Cola European Partners have committed to We Mean Business.[18] Likewise, the coalition Science Based Targets (SBT) provides over five hundred companies with externally verified reduction targets and guidance on aligning with the Paris Climate Agreement goals.[19]

Another example of coalition formation is RE100, led by The Climate Group. This coalition is committed to the use of 100% renewable electricity. Similar to SBT, the organization provides companies with concrete metrics to monitor their corporate sustainability strategy.[20]

REI100 Metrics



Due to the lack of legislative and regulatory enforcement on sustainable business practices, coalitions are emerging leaders in the context of setting uniform environmental standards and reporting requirements. **This trend suggests that governments may integrate policies created by coalitions into legislation and regulation. It is likely that companies who commit to sustainability coalitions will be more prepared when governments begin to enforce environmental regulations.**

Takeaways

In order to be best positioned for long-term market success, companies need to embrace sustainability as a business strategy. As the current environmental, social, and political landscapes evolve, companies are expected to increase involvement in sustainable business practices. This trend can be observed today in the formation of coalitions where corporations and nonprofits in many sectors come together to create industry norms.

With major issues like carbon emissions, renewable energy, and plastics at a crossroads — corporations are being put in a position in which they must evaluate and acquire the tools and methods to forge sustainable best practices as a way to mitigate risk.

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