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Countering Sustainability Backlash
Part 1: Clap Back

By Douglas Hileman, FSA, CRMA, CPEA

Backlash against Sustainability – or any "ESG" issue – is now widespread. States have restricted considerations for their pension fund investments. Companies have backtracked on public statements and commitments, reduced staff or eliminated departments altogether. Recent posts for Sustainability leaders have suggested achieving consensus, and tying Sustainability to business value.

This sounds like trying to convince someone that a man actually did walk on the moon. Gentle persuasion won't work – it hasn't so far, so why would it now?

Some readers will remember the kitschy advertisement for "clap on, clap off!" light fixtures. A broad array of stakeholders "clapped Sustainability on", and the backlash drivers have "clapped it off." It's time to clap again. Although it may not be your nature, Douglas Hileman Consulting LLC (DHC) suggests you **clap back**. Challenge the drivers of backlash to explain why they aren't using it. Some points below.

1. SASB did some heavy lifting for you.

The SEC requires disclosure of material risks in the annual Form 10-K. Investors and other key stakeholders looked for these disclosures for years, largely in vain. A common objection was "Sustainability is so complicated, we can't figure it out, there's no data." In my view, that was just lazy.

SASB (now part of the ISSB) took a nobler approach. SASB started with a mission of (DHC's description, not theirs) "OK, *we'll figure it out for you*." SASB began with the longstanding definition of "materiality" as set forth in a U.S. Supreme Court decision. SASB recognized that applicability of Sustainability – and materiality arising from it – varies by sector and industry. SASB performed considerable research, released draft standards for public comment, reviewed and considered the comments.

SASB released the last of 77 industry standards in 2018. Each industry has about a dozen topics, some are qualitative and some are quantitative. The disclosure topics are designed to convey **decision-useful information to primary users of financial statements**, so they can compare data at a company over time, and across companies.

As far as these material[1] risks go, Sustainability professionals are trying to help senior management do their jobs. Why would you insist on refusing the help of Sustainability professionals?

[1] This is "single" materiality – not "double materiality" as required by EU regulations.

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2. Diversity and Inclusion broaden the talent pool and is good for business.

This topic is perhaps the favorite foil for the "clap off" crowd. Approximately 85% of CEOs are straight white men. White men are approximately 30% of the population; straight white men are 5 – 10% less than that. That's a big gap.

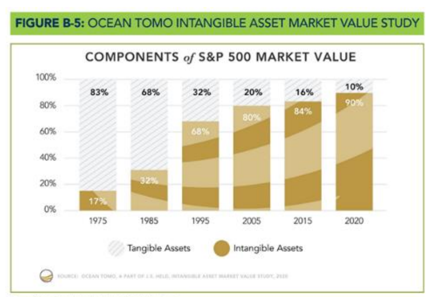
Despite advances in technology (including AI), companies still face intense competition to attract and retain talent. If ~70% of customers don't look like the C-suite or employees, what products, services and markets are companies missing because of lack of different perspectives and sets of experience?

Why would companies send negative signals, whether they are intentional or unknowing, or overt or covert, to the majority of the workforce? Why would companies not want to invest in education, internships and broader engagement to cultivate talent?

CEO turnover is only about 10% per year[2]. It takes time to accrue the experience for the role. Early investment in the pipeline is essential. If the supply were doubled (or tripled!) for the same number of CEO vacancies, might that help bring CEO compensation back from the stratosphere? Diversity and inclusion align with the fiduciary responsibilities boards have to the company and its shareholders. DHC wonders what, exactly, they are afraid of?

Don't settle into a defensive rut. Clap on as part of your effort.

3. Sustainability commitments and performance are drivers of intangible value.



Fifty years ago, the majority of a company's value was in plant, property and equipment (PPE). Today, 90% of the value of market cap of the S&P 500 is intangible value. This is the value of the company's brand, reputation, and investor confidence in companies' ability to make money well into the future.

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[2] From Crist Kolder Associates Volatility Report 2023; accessed 8/14/2024 at https://static1.squarespace.com/static/62164a05607c3e5978f251ec/t/65aaa75180c77354ba1f9351/1705682770449/2023_Volatility_Report-FINAL.pdf

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Companies position themselves to accrue and maintain intangible value with strategies, marketing, actions and communications. "Sustainability" – or its now-maligned cousin "ESG" – is simply a monitor for "all things non-financial."

Retail tried this in the 1980s. It didn't end well, and it was mercifully brief. Retailers gain value from branding. This includes store brands. Who doesn't know (and love!) Kirkland!

If a company completely eliminates Sustainability, what are you left with? Exchange traded funds are popular. If they all include the same equities, in the same proportion as their market cap, then why do BlackRock, Vanguard come up with all those names? Why not just "Fund"?

We all put shoes on our feet – why not just by "shoes"? Shoe companies obsess over shoe materials, design, colors, tread, and shoelaces (or Velcro). Some are designed for a specific sport or purpose; others are for general purpose. Nike and Adidas do this because it creates intangible value.

Sustainability initiatives are not so different. Are the objectives to meet compliance requirements, ensure continuous availability of raw materials, ensure data security and privacy for users, or attract talent for innovative research? If Sustainability seems like a heavy lift, that's because it is. Data and information are unstructured. Robust internal controls can improve reliability of data and information – including helping Management run a more effective and efficient organization.

Douglas Hileman Consulting LLC (DHC) has a message for the naysayers: Ditch Sustainability and go back to generic if you like. You might like this sign for your door.

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