Changing the Climate in the Boardroom

By **RON SOONIEUS** and **DAN CULLEN**

New research reveals that many boards are failing to walk the talk when it comes to the importance of climate change, but there is hope in the horizon.

Through the Glasgow Climate Pact, nearly 200 countries have agreed to strengthen their targets for cutting greenhouse gas emissions. Companies around the world must act – and their boards must show leadership. How have directors coped with climate change to date? How far is the issue integrated into corporate governance and management processes? And what practical steps can boards take to make real progress on addressing climate change?

INSEAD and Heidrick & Struggles sought to answer such questions in a recent global survey of 300 board directors. The study focused specifically on climate change, rather than the broader "sustainability" or "ESG".

The results revealed a stark fact: With respect to climate change, there is a big gulf between what many directors say and what they do. Nevertheless, there are reasons to be optimistic.

1. Climate change is moving up the agenda.

Climate change has become a firm fixture on most board agendas. Some 75 per cent of respondents believe the issue is "very" or "entirely" important to the strategic success of their companies. Furthermore, 63 per cent report that their board has a clear understanding of the risks and opportunities that climate change presents to the business. In addition, 60 per cent claim that they and their fellow directors are "very" or "entirely" aligned on the importance of the issue and what to do about it.

That three out of four respondents grasp the strategic importance of climate change should be a cause of optimism. New regulations are coming, corporate governance codes are changing, activist investors are reshuffling boards, and there is even talk of directors being held personally liable for corporate greenwashing. Acting on climate change is becoming part of a company's licence to operate.

On the flipside, 72 per cent of respondents say they are "very confident that their company will meet its climate change goals". Is this confidence misplaced, or are the goals ambitious enough?

2. But there is a lack of targets and inadequate reporting.

Take carbon emissions reduction. A startling 43 per cent of the sample admit that their companies are not yet working to such targets (although

some are in the process of setting targets). Moreover, half of the respondents say they are satisfied with current reporting to the board on climate change. Note that "reporting on climate change" includes the impact of wildfires and floods on the business, as well as the business's impact on rising global temperatures.

Boards need to insist that executives set ambitious and realistic decarbonisation targets, while ensuring that they are balanced with overall business targets. If expertise allows, they should specify the gold standard: Scope 3 targets that cover the entire value chain, from suppliers' operations to employees' commuting. Only 16 per cent of the sample currently have targets in this category.

Boards should also insist on better reporting. Alongside updates on overall decarbonisation performance and impact of climate change on the entire portfolio, directors should demand more specifics. What are the likely effects of climate change on a given product or facility? What is the risk of that facility becoming a worthless "carbon-stranded" asset?

In order to evaluate such reports, boards will almost certainly need to educate themselves. In fact, 85 per cent of those surveyed say their boards need to increase their climate knowledge. And 46 per cent say their boards do not even know enough about the implications for financial performance.

3. Climate expertise is not sufficiently prioritised.

Some of the more alarming findings uncovered by the survey are as follows.

- 69 per cent say climate knowledge is not a formal requirement for joining or staying on their boards.
- 65 per cent say climate expertise is not a formal requirement when recruiting a new CEO.
- 74 per cent say climate change is not (or is only slightly) integrated into executive performance metrics.
- 49 per cent say climate change is not (or is only slightly) integrated into the company's investment decisions.

The good news is that there are many easy measures that boards can implement. These include adding climate (and wider ESG) knowledge to the board's competency matrix; requiring climate expertise in the next CEO search; creating climate-related key performance indicators for executives – with bonuses attached; and considering climate change in every major decision, whether about new investments or old assets.

Why, then, have so few acted already?

It could be that boards are only paying lip service to climate change. However, it is more likely that directors are overwhelmed by the complexity and scale, thus failing in their climate and wider ESG responsibilities. Most likely, boards are caught in a vicious circle, where climate experts may lack board-level business experience, and directors may be deficient in climate knowledge.

On climate change, and many other topics (from cyber security to diversity, equity and inclusion), boards must rethink who can add value to a board beyond traditional requirements. If adding director expertise is not an immediate option, boards must find other ways to inject knowledge, from external specialists to advisory boards to crash courses at business schools.■

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