Harvard Business Review
ANALYTIC SERVICES

PULSE SURVEY

Reaping Returns on Environmental, Social, and Governance Investments

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The imperative for responsible investing—for example, through environmental, social, and governance (ESG) frameworks—is becoming more mainstream. The broad demand for ESG adoption reflects the pressure organizations are now under from stakeholders who ultimately want a good global citizen.

Developing an ESG strategy, one which evaluates and addresses issues that affect an organization's operations and practices, and potentially its value, is still proving challenging.

The research by Harvard Business Review Analytic Services reflects the stage many organizations are at in their ESG journey. Though recognized as an important criteria for meeting the expectations of stakeholders, identifying the priorities and developing a cohesive ESG strategy is still in its infancy. Early adopters now have an advantage to capitalize on the opportunity by potentially attracting new partnerships, talent and investment, demonstrating quicker returns than those who have lagged behind.

Though measuring and demonstrating the success of ESG activities appears to be a challenge, it could be addressed by taking a standardized approach. This practice could be done by replicating similar processes that organizations already undertake, which would constitute some form of independent audit. By working with independent, third-party sources on a periodic basis, organizations can potentially receive ESG scores, providing stakeholders across the board with more clarity on efforts to be a good global citizen.

Independent verification would also provide feedback loops, where companies have the opportunity to gain deeper insights into which elements of their strategy are working and where they still need to improve.

What is evident is that stakeholders demand an ESG strategy and that it's now time to demonstrate these activities in practice.

Mohamed Jameel Al Ramahi
Chief Executive Officer
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Reaping Returns on Environmental, Social, and Governance Investments

Strong tailwinds of change are encouraging organizations to assume greater corporate responsibility for their impact on the world's natural resources, the well-being of employees, and ethical decision making in the boardroom. "The #MeToo movement, Black Lives Matter, climate change, a volatile political climate—these factors are driving much more of a focus on the environmental, social, and governance (ESG) impacts of business," says Tensie Whelan, a professor of business and society and director of the Center for Sustainable Business at the New York University Stern School of Business.

But along with external pressures to develop an ESG strategy are significant internal incentives to execute one successfully. "Businesses are recognizing the opportunities that sustainability represents," says Whelan. Among the rewards of a successful ESG strategy are enhanced brand reputation, new revenue streams, and greater interest from investors.

Organizations are taking note of the competitive advantages ESG strategies can provide. According to a December 2021 Harvard Business Review Analytic Services survey of 249 respondents familiar with their organization's ESG plans, 83% say their company's investment in ESG initiatives will increase over the next 12 months. Yet of these respondents, only 9% report having realized a financial benefit. The majority (41%) expect a payoff further in the future—in two to five years. A smaller percentage (23%) anticipate returns within the next two years, while 21% either are not currently tracking the financial benefits of ESG or simply do not expect to realize a return. **FIGURE 1**

HIGHLIGHTS

83% of executives say their **investment in environmental, social, and governance (ESG) initiatives will increase** over the next 12 months.

41% expect to see a **return on their ESG investments** in two to five years.

33% have only **recently started executing a formal ESG plan** or strategy.

Due to rounding, some figures in this report may not add up to 100%.

Eighty-three percent of survey respondents say their company's investment in ESG initiatives will increase over the next 12 months. Yet of these respondents, only 9% report having realized a financial benefit.

FIGURE 1

Environmental, Social, and Governance Returns Remain Elusive

Despite increasing investments in ESG, companies are slow to see results.

In your estimation, when do you expect your organization to realize a financial benefit from its ESG investments?

Source: Harvard Business Review Analytic Services survey, December 2021

In fact, as organizations adopt and work toward ESG objectives, many will face considerable challenges, particularly when it comes to determining tangible performance metrics, designing an actionable ESG framework, securing the right talent, and allocating responsibility for ESG efforts.

One-third of survey respondents have only recently started executing a formal ESG plan or strategy, while 27% of organizations have yet to put a formal plan in place. The after effects of the pandemic, from supply chain issues to rising customer expectations, will only deepen this divide between organizations ready to respond to global megatrends such as climate change, workforce diversity, and business ethics, and those that cling to the past.

This report examines how identifying tangible performance metrics, establishing dedicated leadership, devising an actionable framework, and training the right talent can help organizations execute an ESG plan that not only delivers long-term value but also prepares them for the future.

An Emerging Effort-Outcome Gap

There is a growing mountain of empirical evidence that the old ways of conducting business are no longer working. Organizations that once focused exclusively on increasing short-term shareholder value are fast recognizing the importance of combining ambitious financial goals with broader ethical values to win over investors and satisfy an eco-conscious population.

"Business itself, whether investors or corporations, are increasingly recognizing the opportunities that sustainability represents," says Whelan.

Given this new way of thinking, many organizations expect to gain significant benefits from successfully executing an ESG strategy. Yet many aren't seeing the outcomes they hope for from their ESG efforts. In fact, while the majority of survey respondents' companies (61%) aim to enhance their brand reputation with an ESG strategy, only 55% have done so to date. **FIGURE 2** There's an even bigger gap when it comes to the second-most desired outcome: 56% expect their ESG efforts to improve their impact on society, and only 40% say they have actually achieved this goal. And while 34% cite greater interest from investors as an objective, a mere 29% have accomplished as much.

Chief among the challenges preventing organizations from achieving their ESG-related goals is the difficulty in linking ESG efforts to tangible financial outcomes. For instance, 42% of respondents report that their organization struggles to measure or track the performance of ESG initiatives, and 41% say they struggle to make an ESG framework actionable. **FIGURE 3**

"There's a huge demand for ESG work, but many of today's mid-size and large companies aren't even sure how to go about it," says Kym Lew Nelson, a senior lecturer of negotiations at Harvard Business School and CEO of the KLEW Co., a procurement consulting and training company.

Additionally, 40% of respondents encounter difficulty identifying clear key performance indicators (KPIs), and 34% cite quantifying the returns on ESG investments as a barrier to success.

One potential explanation for these difficulties is a lack of universally accepted and consistent reporting standards for ESG practices. "We don't have standards like we do for accounting practices," says Robert Eccles, professor of management practice at the University of Oxford's Said Business School, whose work with the nonprofit organization the Sustainability Accounting Standards Board aims to set consistent standards for reporting ESG performance.

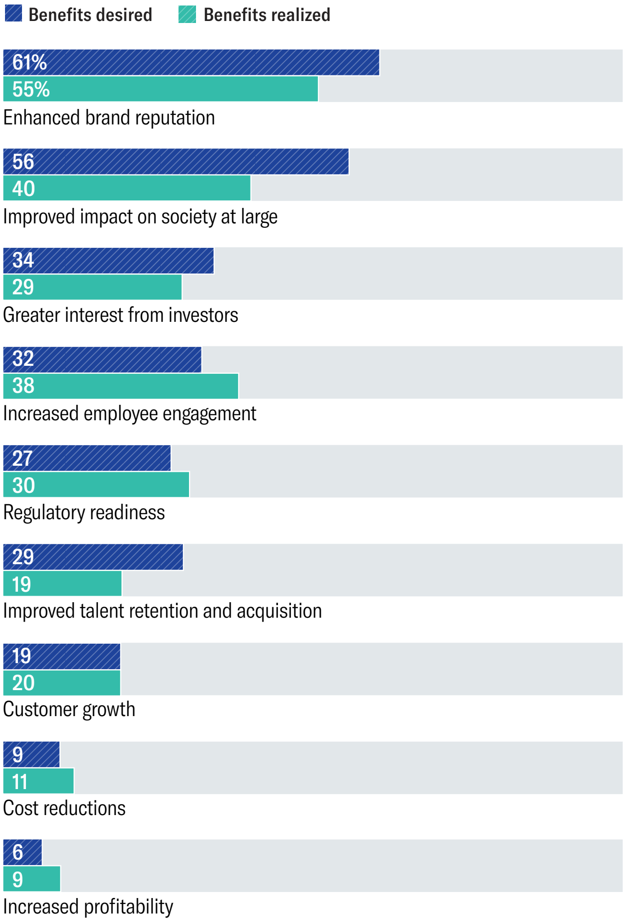
FIGURE 2

ESG Outcomes Fall Short of Expectations

Respondents aren't realizing the benefits they had hoped for from ESG initiatives.

What business benefits does your organization most aim to realize from its ESG efforts?

What business benefits has your organization realized to date from its ESG efforts?



Source: Harvard Business Review Analytic Services survey, December 2021

FIGURE 3

Barriers to ESG Success

Connecting EGS outcomes to cold, hard numbers tops the list of challenges.

What are the greatest challenges your organization has faced in executing its ESG efforts?

Source: Harvard Business Review Analytic Services survey, December 2021

Sixty-seven percent of survey respondents agree that their organization "is in need of talent with experience and expertise in ESG." Yet 47% say their organization has difficulty finding the right personnel to manage ESG efforts.

FIGURE 4

A Split Decision

Organizations can't seem to agree on how best to implement ESG initiatives.

What role is primarily responsible for the successful implementation of your organization's ESG initiatives?

Source: Harvard Business Review Analytic Services survey, December 2021

Whelan stresses the issues with putting ESG principles into practice. The problem, she says, is when organizations "approach ESG as a tick-the-box exercise as opposed to determining, 'What are the material ESG issues for us as a business? How do they create risk? And how do they create opportunity?'"

Whelan explains the difference by way of comparing an apparel company that develops a corporate policy on handling chemicals during the manufacturing process to one that not only invests in nontoxic and biodegradable dyes that are safer for the planet, but also sells these solutions to competitors in the circular marketplace. It's the difference between paying lip service to ESG and "building ESG into a business strategy," she says.

A Lack of Consensus on Leadership

Despite ESG's increasing popularity, many organizations are split on how best to manage their initiatives.

One-third of survey respondents cite the CEO as the person primarily responsible for the successful implementation of ESG, while 23% rely on a cross-functional ESG-dedicated team to oversee activities. Ten percent say responsibility is shared across the organization, and another 10% say they have an ESG-dedicated chief executive. Seventeen percent say some other C-level executive, such as a chief operating officer or chief financial officer, is primarily responsible for the job. **FIGURE 4**

This lack of consensus is more likely to stem from an absence of options than a plethora of opinions on who should manage ESG efforts. Sixty-seven percent of survey respondents agree that their organization "is in need of talent with experience and expertise in ESG." Yet 47% say their organization has difficulty finding the right personnel to manage ESG efforts—talent that is essential to effective implementation.

Steps to Reap Value from ESG

Failure to properly track ESG performance, a poorly deployed ESG strategy, and a dearth of qualified talent can substantially hinder an organization's ability to reap long-term value from ESG. Fortunately, these hurdles can be surmounted by

> **"What companies should be thinking about is whether they've identified the material ESG issues that are important to their industry," says Robert Eccles, professor of management practice at the University of Oxford's Said Business School.**

implementing best practices that recognize an organization's financial goals, ESG progress, senior leadership, and talent.

Choose metrics that match your ESG goals.

Today's organizations rely on a wide array of metrics to track ESG success. Sixty-one percent of respondents say that their organizations rely on ESG-specific metrics, such as carbon emissions, product recalls, and employee diversity levels, to determine whether they are staying true to their ESG story. A smaller segment of respondents use criteria such as improved corporate reputation (39%), improvements in regulatory compliance (28%), and third-party metrics (24%) to gauge success. Even fewer—14% of respondents' organizations—look to enhanced financial performance and increases in capital investment (12%) as important yardsticks for measuring ESG performance.

The reality is metrics cannot be all things to all people. "It's a lot more complicated when it comes to sustainability," says Whelan. "A water waste metric might be really important for one type of company and next to negligible for another." Rather, the trick is to determine the material issues—the governance, sustainability, and societal factors—that are most likely to impact the financial performance of an organization within a specific sector. A manufacturer of consumer-packaged goods, for example, may be most interested in measuring the environmental or social impacts of its products and services on impoverished communities. A software company, on the other hand, may be more likely to consider business ethics, such as anticompetitive practices and intellectual property issues, as a barometer of their commitment to ESG principles.

"What companies should be thinking about is whether they've identified the material ESG issues that are important to their industry," says Oxford's Eccles.

Connect the financial dots.

Hard, cold numbers are not enough. Companies must also link material ESG metrics to tangible financial and operating outcomes. "Many companies are reporting on ESG and they're reporting on financial outcomes, but they're not reporting on how these two relate to one another," says NYU's Whelan.

The key is for finance teams to see the bigger picture when squaring a company's finances with sustainability metrics. Whelan offers the example of a manufacturer whose investment in sustainability involves recycling the plastic components of its products. This initiative not only reduces reliance on costly virgin resources but also helps the manufacturer avoid having to purchase new materials—an equally important way to justify investment in ESG initiatives, she asserts.

Transparency is key—no matter what.

Investors and other stakeholders are increasingly calling on companies to disclose more about their sustainability and

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ESG efforts. Yet a company can reduce its carbon footprint while simultaneously earning a low score on diversity and inclusion. In this case, Whelan says honesty is the best policy. "Authenticity is really important to today's younger generations, especially Millennials and Generation Z," she says. All of which, she adds, requires "being more transparent about where you are [in the ESG process]—even if it's problematic."

Appoint strong and dedicated leadership.

Whelan recommends appointing an executive to oversee ESG efforts while at the same time embedding responsibility for ESG across the organization. "You will always need a chief sustainability officer (CSO) and require employees across the company to build ESG into their deliverables and workplans as appropriate for their business units," she says, adding that establishing an ESG "center of excellence" comprised of business leaders from across the organization can help set ESG targets for employees and ensure they receive the necessary training and incentives to achieve these goals.

Establish the right chain of command.

While CSOs often report to a company's public relations or marketing team, Eccles says a chief financial officer is a more fitting candidate for the CSO to report to. "If sustainability is core to your corporate strategy, then it's not about turning off the lights at night, giving everybody a day off to work in the community, or planting some trees," he says. "Rather, it's about the capital allocation process in your company, which is managed by the CFO." In fact, a strong CSO-CFO relationship can encourage organizations to embrace a wider array of nonfinancial metrics, such as carbon footprint and pay equity, when determining where to invest financial capital.

Invest in an ESG-savvy team.

Human capital plays an important role in melding corporate goals with ethical values. "As more and more companies build out ESG investing programs, many are discovering that they don't have enough people trained in ESG," says Whelan, noting that academic institutions are stepping up by offering ESG certification and training to a new generation of students.

Organizations should look for an individual with that rare blend of business acumen, industry knowledge, and ESG expertise. "What you want is a person who knows the industry, understands what the material ESG issues are that contribute to financial performance, can speak financial-speak, can speak sustainability-speak, and who you can put in front of investors," says Eccles.

In addition to hiring ESG-savvy employees, Whelan recommends organizations create an advisory board packed with members who can "challenge you, who have different perspectives, and don't have any kind of fiduciary responsibility" to the company so that they might advise the CEO and board members on the direction of its ESG strategy.

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Preparing for Tomorrow

Organizations are no longer being forced to choose between earning strong financial returns or having a positive impact on the world. The majority of survey respondents say their organizations are taking advantage of this new paradigm by increasing their investments in ESG initiatives. But reducing greenhouse gas emissions, enhancing labor relations, and funding innovation are merely table stakes for earning the interest of investors and the loyalty of employees. Challenges abound, including tough-to-identify metrics, scarce talent, and a lack of consensus on who should be at the helm of an ESG strategy.

Hurdling these obstacles is a tall order, but one that must become an inextricable part of how a company conducts business to keep pace with a changing world. ESG success requires "commitment at the board level, CEOs who understand sustainability, clear views on materiality, a commitment to targets, and a devotion to the resources necessary to achieve them," says Eccles.

METHODOLOGY AND PARTICIPANT PROFILE

A total of 249 respondents drawn from the HBR audience of readers (magazine/enewsletter readers, customers, HBR.org users) completed the survey.

Size of Organization

29%
10,000 or more employees

9%
5,000 – 9,999 employees

24%
1,000 – 4,999

9%
500 – 999 employees

29%
499 and fewer employees

Seniority

27%
Executive management/board members

30%
Senior management

41%
Middle management

2%
Other grades

Key Industry Sectors

15%
Manufacturing

14%
Financial services

10%
Technology

10%
Business/professional services

8%
Education

8%
or less each other sectors.

Job Function

25%
General/executive management

10%
Consulting

9%
Finance/risk

All other functions are less than 8% each.

Regions

35%
North America

27%
Europe

22%
Asia Pacific

6%
Latin America

6%
Middle East/Africa

3%
Other

Figures may not add up to 100% due to rounding.

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