

Sustainable Value

Communicating ESG to the 21st Century Investor

Executive Summary

Increasingly, investors consider environmental, social and governance (ESG) risks and opportunities to be key factors contributing to the financial performance and long-term value of potential investments. This new reality offers the opportunity for companies to enhance their business and investor value through better strategies and communications on financially material ESG issues. Often, however, the information investors seek is lacking or incomplete, a disconnect that leaves value on the table for both investors and companies.

To gain insights into how to help companies bridge this information gap, the Morgan Stanley Institute for Sustainable Investing turned to first-mover companies that are already capitalizing on investor interest in ESG. This brief draws on interviews with some of these leaders, combined with a literature review, to provide analysis and insights that may

help companies better position their businesses in this space and avoid missing out on innovation and growth. Specifically, we highlight ways that corporate executives, investor relations (IR) teams and sustainability teams can better collaborate internally, and strategically communicate their ESG stories to analysts and investors.

ESG by the Numbers

Investor Value	Business Value
25% Global sustainable, responsible and impact investing grew by 25% between 2014 and 2016, to \$22.9 trillion. ¹	4.5% By 2050, sustainability-related business opportunities are expected to reach \$3 trillion—\$10 trillion annually—or up to 4.5% of global GDP. ⁴
75% 75% of active individual investors surveyed show interest in sustainable investing. ²	66% 66% of consumers globally report they are willing to pay more for products from companies committed to sustainability. ⁵
49% 49% of shareholder resolutions filed in 2017 focused on environmental and social factors. ³	



The Opportunity

We believe sustainability creates business value. A growing body of research demonstrates that resource-efficient companies produce higher financial returns than benchmark indexes. They also exhibit higher levels of innovation and corresponding margins, returns on assets and returns on equity.⁶ A 2015 Harvard Business School study of more than 2,300 firms found that companies that commit to and invest in strategic sustainability efforts have higher risk-adjusted stock performance, sales growth and margins — and that these sustainability activities drive business value.⁷ For example, in 2016, Morgan Stanley Equity Research found evidence that companies with high gender diversity have better stock returns and lower volatility.^{8*}

In order to maximize the business benefits of sustainability practices, disclosure and communications are critical. With investors increasingly taking note of ESG factors, companies that fail to communicate may miss out on benefits such as brand reputation, access to capital and investor interest.

Many institutional and individual investors are now interested in companies with strong sustainability credentials. A 2017 Morgan Stanley survey of active individual investors, for example, found that nearly three-quarters of investors believed companies with leading ESG practices may be better long-term investments, and approximately half believed that such companies were more innovative.⁹

Among investors, sustainability is an increasingly dominant focus. In the United States, environmental and social factors make up the fastest-growing category of shareholder resolutions,¹⁰ accounting for 49% of all shareholder resolutions filed in 2017. Of more than 850 shareholder resolutions tracked by EY's Center for Board Matters, the most common topics, after proxy access, included

reporting on lobbying activities and political spending, greenhouse gas emissions, climate-related risks and sustainability more generally.¹¹

Some governments, meanwhile, are emphasizing the importance of corporate ESG disclosure against the backdrop of the Paris Climate Agreement and U.N. Sustainable Development Goals, both agreed to in 2015. Whether the United States exits the Paris Climate Agreement or not, Europe is ahead in this regard, with the EU's Nonfinancial Reporting Directive requiring public companies to disclose a range of material information, including ESG factors, useful to investors including ESG factors. Globally, there were more than 180 sustainability-related disclosure regulations and other instruments in place across 45 countries in 2013, a threefold increase since 2006.¹²

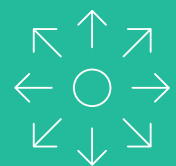
In addition to meeting investor interests and regulatory requirements, companies that turn their attention to sustainability strategy and reporting can tap into long-term opportunities for innovation and growth in sectors such as energy, health, agriculture and education. With global population expected to surpass 9 billion by 2050, demand for natural resources and basic services will grow.

Why ESG Matters to the C-Suite

While ESG factors are at times called "nonfinancial" or "extra-financial," how a company manages them can have financial consequences and impacts on business value, including:

- Access to capital
- Cost savings and productivity
- Risk management
- Revenue growth and market access
- Brand value and reputation
- License to operate
- Human capital and employee retention and recruitment
- Company value as an acquisition target
- Ability to acquire other high-quality companies

Source: "Model Guidance on Reporting ESG Information to Investors," Sustainable Stock Exchanges Initiative, 2015.



* Past performance is not a guarantee of future results.

Defining ESG and Sustainability



ESG: We view ESG as environmental, social and governance factors that arise from a company's operations, products or supply chain as potentially having financially material implications for business performance of interest to investors. In this brief, we use *ESG* (rather than *sustainability*) in discussing all relevant issues covered in corporate reporting and communications, as this is the term most investors use.



Sustainability: We view sustainability as a commitment to economic well-being in the present and the future, balancing society's needs today with the demands of tomorrow. Sustainability encompasses behaviors, processes, tools and technologies that achieve economic, social or environmental benefits, while sustainable investing mobilizes capital to businesses that engage in these behaviors and practices.

In this brief, we use *sustainability* as an umbrella term to cover management of all issues that companies variously categorize under sustainability, ESG, CSR (corporate social responsibility) and CR (corporate responsibility).

Identifying and Understanding Material Issues

Increasingly, leading companies recognize that sustainability risks and opportunities may have material financial implications for business performance — through direct effects on the bottom line, or corporate reputation, and license to operate. Many leading companies are evaluating their approach to managing sustainability through in-depth strategic assessments of material factors and how they affect business in the short and/or long term.

In order to think strategically about sustainability strategy, and how it aligns with core business strategy and direction, company leaders often look to external frameworks for guidance on which sustainability issues generate the most risk and opportunity for their businesses. The Sustainability Accounting Standards Board (SASB), for example, provides recommendations on material issues and disclosure standards for 79 industries in 11 sectors.

As an example, SASB's material ESG issues for a multinational manufacturing and services company would typically include:

Governance: business ethics and transparency, regulatory compliance, executive compensation, succession planning

Operations: accident and safety management, employee health and safety, diversity and inclusion

Products: efficient design and materials use, life cycle impacts, quality and safety, packaging

Supply chain: risk management, fair labor practices, materials sourcing

Once companies have identified the sustainability issues essential to business success, they can more strategically present to investors the benefits of sustainability.

The Disconnect

Business leaders generally acknowledge the importance of sustainability issues to corporate strategy, and the need for disclosure through vehicles such as the new recommendations of the Financial Stability Board (FSB) for transparent, standardized climate-related financial reporting by companies.¹³ Yet, while nearly all CEOs agree that sustainability is very important to business success, fewer have actively relayed its importance to investors. Ninety-seven percent of CEOs surveyed by Accenture Strategy and the U.N. Global Compact agreed that sustainability is important to the future success of their companies. Far fewer reported that their companies engage investors in the long-term value of such investments (64%) or could quantify the value of sustainability (59%).¹⁴

One explanation for this disconnect is that many company leaders remain skeptical of investor interest in ESG metrics. In the same CEO survey, only 10% cited investor interest as a top reason to pursue sustainability.¹⁵ This, in turn, helps explain why risk mitigation, consumer interest and reputation

remain for many firms the key drivers of sustainability communications. The resulting lack of a strategic, investor-relevant sustainability narrative can also reinforce, among investors, the view that companies are not willing or able to supply material ESG information related to business performance and long-term success.

In this brief, we address how companies can overcome this potentially damaging disconnect, and instead direct their sustainability communications and engagement with investors in ways that demonstrate value. With a focus on close and strategic collaboration between IR and sustainability teams, we offer actionable insights for companies on (i) the material information that investors seek and (ii) how best to provide it for them. The findings and case studies below and throughout this paper draw on interviews with investment analysts and companies that are leaders in effective ESG communications with investors. Their insights, and our conclusions, are backed up by an extensive review of relevant literature.

97%

While 97% of CEOs say sustainability is important to business success ...

59%

Only 59% say their companies can quantify the business value of sustainability ...

10%

And 10% cite pressure from investors as a major driver of sustainability practices.

Source: "CEO Study," U.N. Global Compact-Accenture Strategy, 2016.

Key Findings

Our analysis shows that companies are making significant strides in managing ESG issues and embedding sustainability practices across their organizations. However, in our view, when these efforts are not effectively communicated to investors, companies may miss opportunities to attract investor interest.

- **Investors and analysts want decision-useful ESG information from companies. In order to analyze sustainability value when judging overall business performance, their priorities include:**
 - A sharp and candid focus on financially material issues, risks and opportunities
 - Uniform metrics and reliable data within companies and across sectors that relate to business value and, crucially, enable a like-to-like comparison of performance on material issues
 - Alignment between quarterly and annual financial reporting and material ESG reporting to get a full, timely picture of company performance
- **The leading corporate reporting model of stand-alone sustainability reports is insufficient for investor needs.**
- **Executive and board leadership can be a game changer in communicating the ESG business case to investors.** Strong leadership also drives effective collaboration between IR and sustainability teams.
- **When IR and sustainability teams collaborate, both companies and investors gain.** IR teams are the gateway to investors. Building their sustainability and ESG knowledge, coupled with close cooperation with sustainability teams, allows companies to tell a full, consistent and strategic sustainability story to investors.

Best Practices for Addressing Investor Needs

Company leadership can:

Sell the business case for sustainability. Use high-level CEO or board communications platforms, such as letters to investors and quarterly earnings calls, to connect the dots between sustainability strategy, business value and financial returns.

Support best practice disclosure standards. Embrace or help lead investor-relevant sustainability reporting forums (such as the Sustainable Stock Exchanges Initiative) or industry standards (such as the Financial Stability Board's climate disclosure recommendations).

Upgrade ESG reporting to meet investor needs. Consider integrated reporting through the annual Form 10-K, or align timing of reporting on material sustainability issues with financial reporting. Introduce financially material ESG metrics into quarterly earnings calls or conduct separate ESG calls with key investors.

Structure organizations to maximize effective, investor-friendly ESG communications. Encourage close collaboration and knowledge sharing between sustainability and IR teams. Consider

positioning sustainability within core strategic departments such as innovation or business development, or ensure that sustainability team leaders have crosscutting influence as well as regular access to key executives, including the CEO and CFO and the board of directors.

Sustainability and IR leadership can:

Collaborate to better communicate the company's sustainability story to investors and analysts. To improve communications flow, consistency and impact, both teams should work on investor-targeted ESG content, stripping away nonrelevant information and stories.

Focus data collection and reporting on the decision-useful information investors want. Metrics should address material ESG performance, risk management, cost reduction and revenue growth opportunities.

Address the data comparability challenge. These key players are well-placed to promote the use of consistent, uniform and material sustainability metrics both internally and across their sectors.

Methodology

Our approach for this paper included:

- 1 Analysis of corporate and sector best practice standards, approaches and opportunities for providing investors with materially relevant information on environmental, social and governance (ESG) risks, performance and activities. In particular, we sought insights into demand and opportunities for better integration between, and communications by, IR and sustainability teams.
- 2 In-depth interviews with the three types of key players in this space: corporate investor relations (IR) team leaders, corporate sustainability team leaders and equity research analysts. Seven interviewees represented multinationals in the chemicals, household products, food, retail, hospitality and IT industries, and three interviewees were analysts.
- 3 A review of investor communications from companies in the health care, medical technology, retail and financial services sectors.

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NIKE, Inc.

Unilever PLC

What Analysts Say: Challenges and Barriers to Communicating ESG Value to Investors

Given the business case described above, companies with good sustainability stories to tell about their governance, operations, products and supply chains can benefit from investing in strategic communications about material ESG issues by capturing interest, and investments, from investors who factor ESG into their decisions.

While many investment professionals remain skeptical of engaging on ESG issues, interest is growing beyond the SRI and impact investing market. In a 2017 Morgan Stanley survey of active individual investors, 71% of participants believed that companies with good ESG practices may represent better long-term investments.¹⁶ Yet, investors and those who represent them are frequently dissatisfied with the content and quality of corporate ESG information flow. As a result, they turn to other sources for information and/or fail to take ESG factors into account when assessing companies' value and investment potential. Some of the

reasons for this data disconnect are beyond companies' control, such as a lack of mandatory reporting frameworks. Many can be addressed, however, by building a financially material business case around sustainability and proactively sharing it with investors.

Later in this paper, we share insights on how first-mover companies we interviewed are doing exactly that. First, we set the scene by describing the challenges and barriers to decision-useful ESG information that our literature review and analyst interviews revealed.

“ESG is a very important dynamic that every investor in [power and clean-tech] is now looking at.”

– **Stephen Byrd**, *Morgan Stanley Equity Research, North America*

Internal Challenges and Barriers

Companies often do not supply analysts and investors with adequate decision-useful ESG information. What emerged from our interviews and literature review was a picture of analysts and investors seeking a tighter sustainability reporting and communications focus from companies. Company leaders and IR managers may communicate with investors about sustainability issues as they arise, such as occupational safety or human rights in the supply chain (often not explicitly recognizing them as sustainability issues); however, investors who show interest in sustainability information across the board seek a more strategic approach. Specifically, they want companies to focus on material issues, risk management and business value — information that more closely mirrors the audited and data-driven financial reporting in corporate annual reports and forms 10-K.

The specific ESG information analysts and investors seek varies by sector, but broadly covers key governance issues (such as succession planning and executive compensation) as well as financially material risks and opportunities related to operations, supply chain and products.¹⁷ Instead, the

sustainability reporting default among leading companies is to publish comprehensive stand-alone reports with a wealth of detail on nonfinancially material programs such as philanthropy and employee engagement. Some companies we interviewed were also reluctant to invest in costly additional reporting efforts, believing many investors were not yet sufficiently interested in ESG communications. An IR leader in a consumer-facing industry told us: “I call it the epidemic of silent interest. Investor groups say they are very interested in information, but when I go to meetings, not much comes of it.”

While not all investors incorporate ESG in their analyses, companies are missing an opportunity by supplying the wrong information to those who do value ESG. Stephen Byrd, of Morgan Stanley Equity Research, summed up the disconnect between the information investors get from companies and the information they want. “Many companies will present themselves only in the best way possible. It’s not always clear what their [reporting] criteria are.”

As a result, he and other analysts we interviewed are turning to noncorporate sources, such as regulatory reports, trade associations and publicly available customer feedback, in pursuit of what they consider unbiased, decision-useful information. They incorporate this information into risk analysis and stock reports for investors, alongside corporate data. Byrd explained his team's approach this way: "Some companies publish sustainability reports and some share ESG information in their Form 10-K. Many work very hard to get included in leading sustainability indexes. We don't take any one of these measures at face value. We dig deeper for the full story, using impartial sources like regulatory reports."

This phenomenon was documented on a global scale in a 2015 survey of more than 3,000 corporate managers and investors in organizations from over 100 countries, conducted by MIT Sloan Management Review and the Boston Consulting Group. They concluded that "investors are beginning to seek out and develop their own stories about corporate ESG performance in lieu of companies connecting their sustainability performance with their financial performance," and "a wide range of investment organizations—from retail investors to asset managers to institutional investors—are making investment decisions using new assessment tools that connect ESG performance with corporate performance, some designed by investors themselves."¹⁸

This state of affairs not only creates more work for analysts but reduces companies' agency in telling their own sustainability stories to investors. In terms of generating business value, and stimulating investor interest, companies miss out when they don't provide the financially material ESG data investors want, in a form that is easily accessible and decision-useful.

"The most common [ESG] question I get from investors is 'how do you see this creating business value?'"

– **Head of Investor Relations**

Too little comparable ESG data exist across sectors. Another related stumbling block is the lack of comparable ESG data across companies and sectors. Unlike financial reporting, ESG reporting by leading public companies is not dictated by disclosure regulations, such as those governed by the U.S. Securities and Exchange Commission (SEC). As a result, the ESG information that peer companies publish can be difficult for analysts to compare in terms of risk management and business value. Companies often compete to be included in specialist rankings, such as the Dow Jones Sustainability Index, that shed some light on companies' performance by sector, but analysts

"We do not have access to consistent ESG factor-specific data that we can use to quantify and compare performance. We comb through whatever we can get our hands on to show how companies' approaches and metrics vary."

– **Vincent Sinisi**, *Morgan Stanley Equity Research, North America*

and investors generally do not consider these sufficient.¹⁹ Further muddying the waters, unlike financial information, voluntary ESG data are often unaudited by companies beyond health and safety statistics and greenhouse gas emissions.

Our interviews with analysts highlighted this lack of comparability as a major impediment. We asked equity research analysts what would help them better integrate ESG performance into their investor communications. Byrd put "standardizing data" at the top of his list. "I'd love to see coordination among companies across a sector so we have a uniform, comparable set of information." Penelope Butcher, a European equity research analyst at Morgan Stanley, concurred: "We can usually get corporate IR teams to provide [greenhouse gas] emissions data. But when it comes to doing comparative analysis of topics like union representation or long-term succession planning, it's much harder. IR teams say, 'We can't give it, or we don't have it.'"

In some sectors, industry initiatives are emerging to address the comparability challenge. For example, in June 2017, the high-profile Task Force for Climate-Related Financial Disclosures of the Financial Stability Board (FSB) published its final recommendations for publicly traded companies (see case study, page 16). By engaging with industry groups and peers to provide comparable, uniform metrics, companies may benefit from increased analyst and investor attention to tracking ESG performance.

The timing and metrics of financial reporting and sustainability reporting are misaligned. Another common investor complaint is inconsistency between how and when companies report financial data, metrics and risks compared with sustainability data, metrics and risks. As a result, they say, it is challenging to view a company's health holistically. Among our interviewees, analysts highlighted more coordinated reporting of key ESG data alongside financial data as a key means to improve investor engagement. The concerns fall into two categories: the types of metrics published and the timing of reporting.

The norm for major public companies is to publish a mandatory annual report and quarterly financial results alongside separate voluntary sustainability reports that are generally annual or

biennial and trail financial reports by several months. Several of our corporate IR and sustainability interviewees deemed comprehensive sustainability reporting, including metrics, sufficient for investor purposes. But equity research analysts painted a different picture. They pointed out that this lack of alignment results in parallel internal data-collection processes, with different deadlines, usually led by separate IR and sustainability teams. This, in turn, impedes coordinated disclosure of material ESG data alongside financial data, which would be the most decision-useful format for investors looking to get a holistic view of a company's current and future business value.²⁰ Investors are further disadvantaged by the time lag common in reporting ESG information materially pertinent to a company's performance.

Compounding the misalignment challenge, our analysis indicated that sustainability reports tend not to include

the kinds of quantitative metrics — comparable across time within a company and across peer companies within an industry — that analysts and investors require. The lack of reliable and consistent metrics can be a problem even in areas like climate change, where most leading companies do report quantitatively. The FSB's Task Force on Climate-Related Financial Disclosures, for example, found that "users of climate-related financial disclosures commonly identify inconsistencies in disclosure practices, a lack of context for information, and [not comparable] reporting as major obstacles to incorporating climate-related risks as a consideration in their investment, credit and underwriting decisions."²¹

Consistent and timely metrics can aid year-over-year comparisons of performance and enable ESG integration into financial performance analysis by investors.

"Every time we publish a sector stock note, we take ESG factors into account. We ask, 'What is the relevant ESG value, and how will it transfer into business benefit?' If companies would report more often than annually on ESG topics, for example by adding two to three pages in their quarterly results, that would allow for more real-time discussion with investors of ESG value."

– **Penelope Butcher**, *Morgan Stanley Equity Research, Europe*

External Challenges and Barriers

Investor interest varies by region and sector. Despite the overall picture of a surging market for sustainable investment, investor interest in corporate ESG activity and business value varies both by region (with Europe ahead of the United States and Asia) and by sector. Unsurprisingly, investor interest appears strong in industries such as energy and utilities. In our interviews, analysts working in the power, technology and transportation sectors reported high investor interest. Corporate sustainability team leaders from other sectors, however, were less sanguine. One interviewee put it this way: "It's important that the information is pulled — asked for by investors — rather than just pushed out by us. That will help move the conversation more, generally, both within firms and between IR and investors on telling corporate ESG stories better."

This perceived lack of interest can undermine companies' willingness to spend time and money collecting material ESG data and reporting on it in a more robust and timely way. "At the moment, most companies do not externally verify all their sustainability data," pointed out one sustainability team leader we interviewed. "We do verify some indicators, and it's quite

pricey. It can be hard to make the case for ESG data assurance when investors are not really asking companies for it."

In addition, investor interest often has a regional bent, with stronger focus in Europe than in the United States and Asia. The MIT Sloan Management Review survey exposed this regional divide, finding that almost half of publicly traded companies in Europe integrate ESG into investor communications, while just one-fifth of U.S. companies do.

While citing growing interest from U.S. investors, the sustainability team leaders we interviewed unanimously reported more investor engagement and knowledge in Europe. "Mainstream analysts are not asking enough questions [on ESG topics]," said one. "They are leaving intelligence on the table." Interviewees gave a range of reasons for the disparity, including different risk exposure and regulatory pressures. Europe has more mandatory ESG disclosure regulations in place than the United States, which presents a challenge in comparing companies' ESG performance and transparency that we discuss below. Given the global nature of today's companies, this can be a significant disadvantage for investors.

“In the EU, there is a tradition of analysts focusing on environmental issues. In the U.S., there is not much talk about sustainability. If ESG comes up, the questions are about governance or lobbying.”

– **Corporate Investor Relations Manager**

Lack of standardized, sector-based reporting frameworks is an obstacle to reliable, comparable ESG information. A further roadblock for companies and investors looking to build business value from sustainability is the absence of mandatory and globally comparable reporting frameworks for ESG data. Voluntary reporting, including selective data disclosure, allows companies to release only favorable information and—unless data is audited by a third party—makes it difficult for investors to verify the accuracy of ESG information. It can also act as a disincentive for companies that are willing to invest in quantifying and reporting material ESG data, since peers would not be required to do so. This is further

complicated by corporate legal teams that are often reluctant to report voluntary data. Frustration among the investment community has led to calls from influential players, including asset managers and institutional investors, for policymakers to support standardized ESG metrics and disclosure requirements, similar to international accounting standards.²²

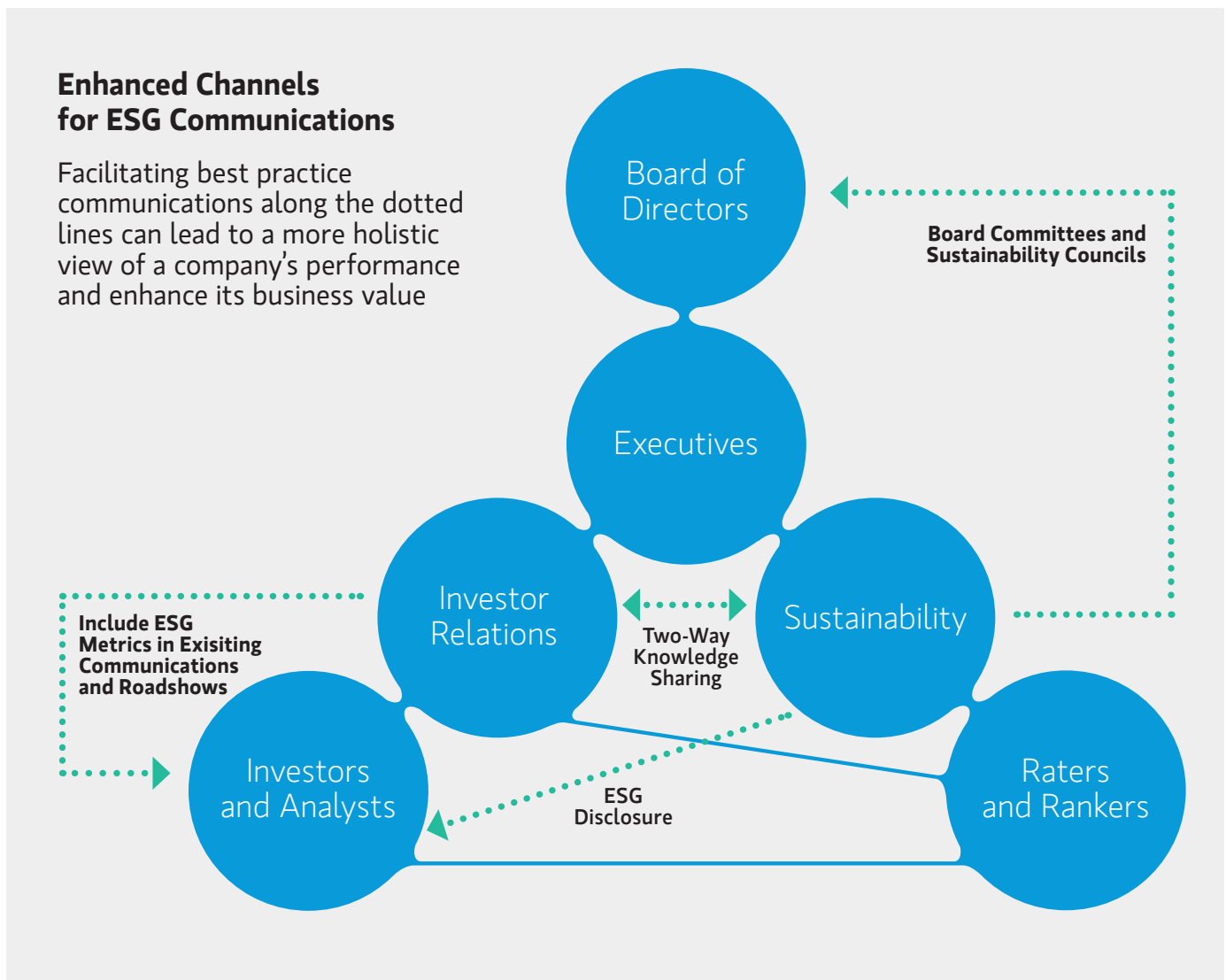
Our interviewees, both analysts and corporates, expressed similar concerns. While not necessarily embracing regulation, several interviewees pointed to the need for a standard approach to ESG reporting, at the sector level, that involves cooperation among companies, investors and regulators.

“We need a standardized approach to help companies separate out what investors are looking for, and enable investors to access this information. Coming up with this will probably take a combination of perspectives and input from analysts, companies and regulators, such as the FDA for the food sector.”

– **Vincent Sinisi**, *Morgan Stanley Equity Research, North America*

Communicating ESG Value: The Role of Key Company Players

How can companies address the challenges and barriers identified above and meet investor needs for ESG information? How can they convey the business value of their activities in this area of growing strategic, investor and regulatory interest? And how can they improve internal coordination and knowledge sharing in ways that improve understanding of how sustainability can positively affect business strategy and value? In answering these questions, “who” is as important as “how.” Based on our interviews, the Morgan Stanley Institute for Sustainable Investing believes that three internal players — company leaders, investor relations teams and sustainability teams — hold the key to successful investor ESG engagement that communicates and builds business value.



Company Leaders

Corporate leadership is often behind the curve in taking advantage of the benefits of proactively communicating about sustainability to investors. The business value of sustainability is increasingly clear. Among the most compelling evidence is the 2015 Harvard Business School study of more than 2,300 firms, which found that companies that commit to and invest in strategic sustainability efforts have higher risk-adjusted stock performance, sales growth and margins.²³ Yet, many executives remain skeptical of investor interest in ESG metrics. And while large majorities of CEOs tend to agree that sustainability is very important to their companies' business success, fewer have put that value in business terms. For example, nearly 90 percent of respondents to the 2016 MIT Sloan Management Review survey considered a sustainability strategy essential to remaining competitive (and 60 percent of corporations had developed such a strategy), yet, only 25 percent had developed a sustainability business case.²⁴ This implies that while company leaders believe that sustainability has value, they haven't articulated it in a business-relevant way. Similarly, a CEO survey by Accenture Strategy and the U.N. Global Compact found that 97 percent agreed that sustainability is important to business success, but only 64 percent were actively engaging investors on its long-term value.²⁵ Our findings suggest that as more CEOs and directors understand the business value of their sustainability efforts, it may propel a shift in communicating the ESG business case to investors, and drive effective collaboration across corporate teams.

Strong and visionary leadership from CEOs, CFOs and directors can be a game changer for ESG investor communications and broader business value. Our literature review and interviews reveal that company leaders who are actively and strategically engaged—both internally and externally—in framing, executing and communicating sustainability activities make a huge difference to analyst and investor engagement.

This impact can be felt in several ways. Internally, board committees and executives that actively oversee sustainability strategy and communications set the direction and tone for the importance of these issues to the company. This has a trickle-down effect on the key internal players in investor communications, the investor relations and sustainability

teams, not to mention legal and compliance groups and broader functional teams across an organization. Our interviews suggest that when senior executives are actively engaged, for example, by chairing sustainability oversight committees, then sustainability and IR teams are more likely to collaborate closely and proactively on investor engagement, including ESG and financial reporting, and investor calls and meetings.

A director of sustainability described the dynamic this way: "Our CEO reviews the sustainability report and our corporate secretary has also played a strong role in pushing the conversation forward in terms of involving senior management in ESG topics. We were one of the first companies to do an ESG roadshow meeting with investors ... and [my team] has worked hard to get aligned with IR. In the past, if an investor wanted to talk about ESG topics, the IR team would add me to the call. Now, they proactively add me to calls, and we attend investor conferences together."

In the case of first-mover companies, including most of our corporate interviewees, leadership goes further by embracing sustainability as part of the core business model. Executives take different approaches to executing this internally. As our case study examples on page 14 demonstrate, there is no one-size-fits-all approach to what this means for internal organization, or for reporting to and communicating with investors. How leaders in each company choose to act is based on alignment with business strategy, the sector context and what customers and other stakeholders want and expect. What they do have in common is close collaboration and alignment on ESG investor engagement across all key players.

Externally, both company directors and executives can make a big impact on investor perceptions of ESG performance. To do so, they use the high-profile, strategic communications vehicles at their disposal, including statements to shareholders, speeches and direct communications with key investors, such as quarterly earnings calls. Proactive investor engagement by company leaders can enhance first-mover firms' commitment to sustainability as a business driver. It can also help bridge a communications gap when companies do not yet produce integrated material and sector-comparable ESG reporting in the way that many investors increasingly demand.

"Having a seat at the [leadership] table is critically important. I have regular meetings with the C-suite and report directly to the CEO, who is a strong advocate for ESG issues."

– Corporate Sustainability Vice President

Investor Relations Directors

IR teams typically do not include sustainability when communicating business value and financial performance to investors. IR departments are the gateway to corporate communications with investors. Without their informed engagement, companies cannot effectively communicate the value of sustainability to current and future business performance. Yet, only a small minority include ESG data or sustainability information when talking about company performance. A 2015 survey by the National Investor Relations Institute (NIRI) found that only 24% of IR professionals were tasked with telling investors about the value of sustainability to the company's bottom line. Nearly 80% did not regularly include sustainability talking points in investor presentations, and almost half said they did not believe a sustainability strategy was necessary to remain competitive in their industry.²⁶

Without strong direction from company leaders, IR teams tend to wait for investors to raise ESG topics. This can lead to a chicken-or-egg scenario, with IR teams believing investors are not interested in material ESG information, and investors assuming IR teams are not willing or prepared to provide such data. IR teams' caution and reluctance in this arena can also lead to the lack of cooperation with sustainability teams. "[Effective cooperation] really depends on the investor relations team being open and ready, and whether or not they are skeptical about [ESG] issues," one sustainability director said. Her peer in another industry reported looking for more proactive outreach from her IR colleagues: "I would like our IR team to light a fire under our largest investors and help them reach out to us for ESG information the way our major customers do. This would help us have more conversations internally about why communicating these issues is important. There would be a domino effect."

The level and content of IR efforts to communicate ESG value to investors depends on how important sustainability is to the company's business strategy and model. Our analysis and interviews suggest that, for companies where ESG is not core to business strategy, IR communications (through vehicles such as forms 10-K) tend to focus on risk mitigation and compliance. In other words, for those firms, investor communication is driven by traditional governance factors related to company reputation.

Where sustainability drives business strategy, innovation and product development, IR communications, unsurprisingly, tend to be broader, higher profile and more strategic. IR managers at such firms may include material sustainability strategies, benefits and metrics in integrated reports, board or CEO letters to shareholders, investor presentations, calls and roadshows, and executive speeches at business forums.

For example, one IR manager for ESG topics, at a company where "sustainability is closely embraced by our senior management," frequently passes on top-level sustainability insights to investors: "Our Corporate Sustainability Board, which provides strategic oversight and direction, is chaired by a member of the board of directors. We have meetings every two weeks or so and I distill relevant [sustainability] messages for the financial analyst market."

When knowledge is regularly transferred across IR and sustainability teams, the value to both companies and investors is greatly enhanced. Some large companies, where sustainability is core to business strategy, employ IR team members, who are sustainability specialists, to communicate with shareholders. Others rely on close collaboration between the two teams to produce comprehensive, consistent, investor-friendly information across a range of vehicles. At several companies we interviewed, the teams worked jointly on forms 10-K; annual, integrated and sustainability reports; investor relations website content; and investor presentations and roadshows. For example, one director of sustainability noted, "For the [sustainability] report, I work with the IR team to make sure relevant information is the same as in the 10-K. I am also on the 10-K committee, and I work closely with our governance team on the proxy statement. Our IR website links to the [sustainability] page and vice versa."

This uniform approach allows companies to tell a consistent, positive and strategic sustainability story to investors. (See also Three Models for Integrating the Business Case for Sustainability into Investor Communications, page 14). It can also address some of the consistency challenges investors complain about when seeking to gauge how sustainability affects a company's business value.

"Because we stuck our necks out years ago with sustainability targets, we have to be well-prepared and accountable across sustainability subjects. Every year when we report progress, the ESG team prepares a comprehensive set of questions and answers. This provides IR with more than enough material for investors' needs. [With investors] we focus on how sustainability creates value by driving growth, lowering cost, reducing risk and promoting trust."

– Corporate Head of Investor Relations

Sustainability Team Leaders

Sustainability team leaders are more effective in influencing investor communications when they have a crosscutting role. Sustainability professionals play an increasingly important role in S&P 500 companies, the vast majority of which now publish, at minimum, an annual sustainability performance report.²⁷ As experts on sustainability strategy and ESG reporting topics, their role is more effective when their activities and input are not siloed, but broad and crosscutting. Our findings illustrate how these teams, and especially their leaders, can enhance messaging to investors through collaboration with their IR colleagues (see section above) and others. Increasingly, companies where sustainability drives revenue are involving sustainability team leaders not just in IR communications, but in branding, innovation and business development. One company we interviewed combines innovation and sustainability functions in a major division that includes the development of enterprise strategy and metrics, government affairs, branding and investor relations. This allows the sustainability team to contribute to high-level strategy and messaging across all these functional areas.

When they have a direct line to company leaders, sustainability directors can shape and enhance strategic messaging to investors. Sustainability team leaders have specialist knowledge especially relevant to long-term trends and drivers of business value. It helps to engage investors who can play an important role in providing a different, fuller picture than the relatively short-term focus of IR communications based on quarterly earnings and annual financial performance. Our analysis shows that this is happening at first-mover companies, where sustainability leaders are helping shape executive communications.

A director of sustainability and community engagement described her input into executive speeches as a key way of reaching investors as well as wider audiences: “Our core values address social responsibility. When our CEO and other executives speak in Davos or at [other global] forums on topics such as environmental performance or preparing youth for jobs, we are the go-to team to provide them with content and messaging.” Her counterpart at another firm described “an appetite for leading the industry,” which enabled the company to get ahead of issues such as renewable energy purchasing and conflict minerals.

What Companies Can Do: Best Practices for Meeting Investor ESG Needs

How can companies best provide decision-useful information to investors and analysts, and address the challenges and barriers we have identified? How can the key players identified above act and collaborate in ways that maximize efforts to meet investor needs? The following section draws on our insights and the experiences of first-mover corporations to provide actionable approaches for company leaders and sustainability and IR directors to consider. Several of our interviewee companies already use or combine these approaches in making an effective business case for sustainability, both internally and to their investors. Our case study showcases three models — focused respectively on sustainability as a core business driver, integrated reporting and executive leadership.

Three Models for Integrating the Business Case for Sustainability Into Investor Communications

1

The Sustainability as Business Driver Model

Among first-mover companies in some industries, sustainable design increasingly drives innovation and, in turn, product development and sales. As part of the core business model, sustainability offers a way to interest shareholders in companies' long-term strategy and business value. A global consumer goods company, whose sustainability and IR representatives we interviewed, takes this approach, describing sustainability as a "powerful engine for our future growth." To reflect this prominence and business value in terms of organizational structure, in 2015, company leaders merged product innovation and sustainability in the same function — Sustainable Business and Innovation (SB&I). The firm's chief sustainability officer is also the VP, Innovation Accelerator. Oversight and direction of sustainability strategy and performance is at the highest level, via a Sustainability Performance and Disclosure Committee. Members include the chief administrative officer and general counsel, chief financial officer, chief operating officer and chief marketing officer.

The SB&I function facilitates an enterprisewide, integrated innovation and sustainability strategy, and is responsible for reporting and disclosure, working closely with the firm's small investor relations team. This cohabitation of innovation and sustainability implies a long-term view of

sustainability as a driver of performance and growth — not simply a risk or compliance area to be measured and reported quarterly or annually.

As the sustainability team leader explained, "SB&I brings together all the relevant corporate functions and external partners to build shared understanding of the company's sustainability goals. We are stratospheres beyond the old view that [sustainability] is about company reputation." The company's long-term sustainability goal — to double the business with half the environmental impact — is driven by the potential for business value. "Down the road, we can see a constrained natural resource supply. By looking to create a closed-loop [manufacturing] system, we see an area of competitive advantage."

Sustainability's prominence is also reflected in investor communications. The CEO's letter to shareholders in the 2016 Form 10-K highlights "sustainable innovation" as the company's manufacturing driver, while its biennial sustainability report includes an executive summary targeted at helping investors "understand the connection between business and sustainability strategies." According to the IR team leader, the multiplicity of sustainability communications, combined with executive leadership, "makes our job extremely easy in speaking with investors."

2

The Integrated Reporting Model

Integrated reporting is increasingly the disclosure mode of choice for sustainability-first movers across sectors. It has been adopted by several of our interviewees, including a leading global chemical company where sustainable products are viewed as a key driver of business growth. The company has a designated IR manager for ESG topics, whom we interviewed. “Many analysts and investors are interested in our sustainability solutions/products because they offer enhanced margins and future growth. Our business therefore cannot be separated from sustainability considerations, which is why we have incorporated sustainability performance into our annual report since 2007.”

In 2013, the company developed a materiality matrix with input from 350 external stakeholders, including investors as well as 90 sustainability experts. According to the IR manager, “We boiled these down to 10 key topics, and then organized our annual report around these most material aspects of

our business.” The integrated report is prepared by the corporate communications team in close collaboration with IR. The IR team’s ESG specialist also works closely with the sustainability strategy team (part of corporate group strategy) on sustainability messaging and communications concepts for the financial community.

Reflecting the business value of sustainability, the company recently spent three years categorizing its 60,000 product applications into sustainability accelerators, performers (products that meet internal sustainability standards) and challenge products (which face future natural resource constraints and that the company plans to phase out over time). In communications with investors, the specialist IR manager emphasizes the company’s game plan “to expand our accelerator products, which have higher growth and margins as well as sustainability benefits.”

3

The Executive Leadership Model

The game-changing role of company leadership in promoting the business value of sustainability was a key finding of our interviews. The leadership of several interviewee businesses prioritize sustainability, and executives, including the CEO, CFO and company secretary, engage proactively both internally and with investors and the public. At one firm we interviewed, where the head of the company’s sustainability function is on the executive team, the sustainability team regularly meets with the leadership to review strategy. The board of directors has a regulatory and public policy committee mandated to review environment and social factors twice a year.

According to their director of sustainability, this top-level buy-in has been critical to raising sustainability’s profile and communication, both internally and externally. “We are lucky to have effective collaboration between Investor Relations,

the [sustainability] group and our company secretary, whose role is very important in supporting [sustainability] internally. [Externally,] ESG topics are integrated into our formal financial reporting. The chairman of the board’s yearly letter to shareholders always features content related to ESG issues. We also provide information in the 10-K, annual report and sustainability report, and all shareholder communications feature content related to ESG management.”

The IR team also includes a speaking slot for ESG issues in twice-yearly, half-hour calls with the company’s “top 25 or so” institutional investors. “Stakeholders and investors appreciate the board committee’s formal charter to cover these issues,” reports the director of corporate citizenship. “Increasingly, on our calls, the largest investors [are] asking high-level questions about ‘E’ and ‘S’ topics as well as the ‘G.’”

What Company Leaders Can Do

Sell the business case for sustainability. Our findings clearly illustrate that strong and visionary leadership from CEOs, CFOs and board members can have a game-changing impact on ESG investor communications and related business value. This is particularly true externally, where company directors and executives can leverage high-level communications platforms, such as statements to investors, speeches and quarterly earnings calls to have an impact on investor perceptions of ESG performance and the strategic value it brings to the company. Or when companies collaborate on high-profile, cross-sector initiatives such as The B Team, which seeks to catalyze a “better way of doing business.” As one sustainability team leader put it, “It really helps that we have executives out there in the world talking about key [sustainability] issues, such as workplace diversity and inclusion in a strategic way. Investors see that we are vocal on these issues; that it is not just reporting.”

Boards can be especially effective in raising a company’s sustainability profile with investors and their related comfort level. They can showcase commitment to high-quality reporting and top-level strategic input and oversight, and lend weight and credibility to claims about sustainability commitments and performance.

Through committee oversight and shareholder communications, boards can demonstrate that both business risks and opportunities are being monitored at the highest levels.²⁸

Adopt best practice disclosure standards. Transparent disclosure of material ESG information, in line with sector standards, is one of the most effective ways company leaders can help meet investor needs and address the data comparability challenge. To demonstrate commitment, CEOs can join ESG financial reporting forums, such as the Sustainable Stock Exchange Initiative (SSEI), which includes more than 60 partner exchanges. They can also disclose information in line with industry standards designed to provide investors with comparable financially material information, such as the SASB industry standards. Further, stock exchanges themselves have enhanced their own guidelines for ESG reporting in recent years; for example the London Stock Exchange issued good practice guidance through its Global Sustainable Investment Centre and the Hong Kong Exchange strengthened the guidance in its Listing Rules.

Investing in this area can bring significant benefits for companies as well as investors. For example, the FSB’s Task Force on

Standardized ESG Reporting: Climate Disclosure Recommendations From the Financial Stability Board

To help investors, lenders and insurance underwriters navigate the complexities of how climate risk and opportunity affect corporations, in June 2017 the Financial Stability Board’s Task Force on Climate-Related Financial Disclosures published its final recommendations for best practice standardized reporting.³⁰ Global representatives of large banks, insurance companies, asset managers, pension funds, large nonfinancial companies, accounting and consulting firms, and credit rating agencies took part. The report calls for consistent corporate climate disclosure in four material, decision-useful areas:

1

GOVERNANCE

Governance: around climate-related risk and opportunity.

2

STRATEGY

Strategy: how climate factors affect business strategy and financial planning.

3

RISK MANAGEMENT

Risk Management: processes used to identify, assess and manage climate-related risks.

4

METRICS AND TARGETS

Metrics and Targets: for assessing and managing climate risks and opportunities.

The task force framed its practical guidance for near-term adoption, seeking to improve investors’ ability to appropriately assess and price climate-related risk and opportunities, and to avoid the potential for climate-related market turbulence. Companies are urged to publish climate-related financial disclosures in their mainstream (i.e., public) financial filings, fostering shareholder engagement and broader use of climate-related financial disclosures. Currently, there is little consistency on climate-related reporting, making it difficult for investors to know which companies are most vulnerable to climate change, which are best prepared, and which are taking action.

Climate-Related Financial Disclosure concluded that better company information on climate-related risks used by investors, creditors and underwriters can help “improve market pricing and transparency, and reduce the potential of large, abrupt corrections in asset values that can destabilize financial markets.” In 2015, Morgan Stanley Equity Research took ESG into account to raise price targets for three mainstream brands.²⁹

Such standards are voluntary. A step further for companies would be to get involved in discussions about mandatory sustainability disclosure frameworks that may be on the horizon. While CEOs may be wary of such a move, leading investors view regulation as delivering much-needed standard data with which to compare rival companies’ performance. For example, BlackRock has urged policymakers to establish “a framework that enables stakeholders and market participants to develop detailed ESG standards and best practice guidelines.”³¹ Given the growing business case for sustainability, CEOs of first-mover companies might consider such an approach as a logical extension of their reporting commitments.

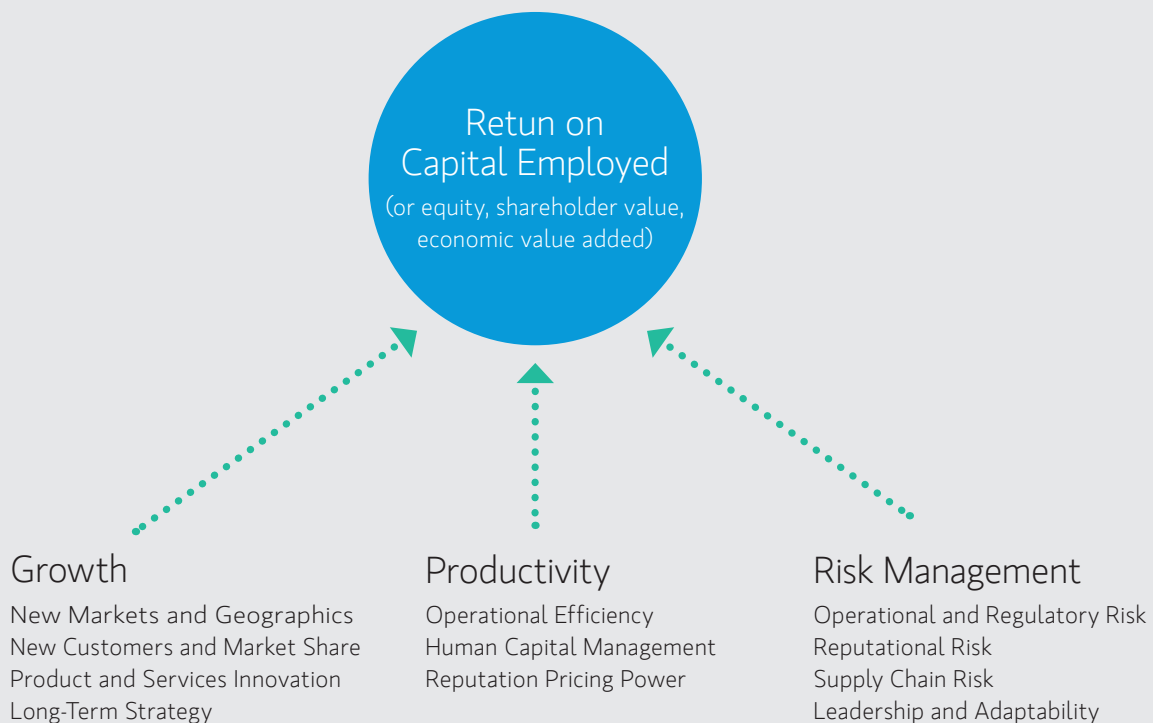
Upgrade reporting to meet investor needs. As discussed earlier (see What Analysts Say: Challenges and Barriers to Communicating ESG Value to Investors), traditional, stand-alone sustainability reports are generally not meeting investor

needs for targeted, timely and decision-useful information. How can businesses best address this challenge? Three effective approaches that executives could consider if they are serious about upgrading investor engagement include:

1. **Integrated reporting**
2. **Aligning financial and ESG performance reporting**
3. **Incorporating ESG issues and performance in quarterly earnings calls with investors**

Our analysis suggests that for many first-mover companies, including several interviewees, integrated reporting has become the sustainability disclosure mode of choice. By including strategic and material ESG information centered on risk, business opportunity and performance data in their forms 10-K or annual reports, companies can provide investors with an all-in-one picture of business performance and direction. Elevating ESG communication this way also signals its importance to business strategy and value. “Our business cannot be separated from sustainability considerations, which is why we have incorporated

Demonstrating ESG Financial Impact: The UN Global Compact’s Value Driver Model



Source: “Communicate the value of sustainability to investors,” UN Global Compact, <https://www.unglobalcompact.org/take-action/action/value-driver-model> accessed September 2017.

sustainability performance into our annual report since 2007,” said one investor relations manager. Other interviewees, however, pointed out challenges to generating data robust enough to meet 10-K reporting standards. “I still see a challenge for many U.S. companies with putting environmental data like [greenhouse gas] emissions or water use directly into regulatory filings at this point,” commented one director of sustainability. “This is due to the fact that ESG reporting is still maturing for many companies and that assurance standards for ESG data are evolving.”

If sustainability disclosure is separate from financial disclosure, how can reporting be choreographed to serve investors’ needs best? Given our findings about the critical importance to analysts and investors of being able to review financial and ESG information together, one option for company leaders is to mandate publishing both types of data for the same reporting period. This approach would not only provide investors with a complete picture, but also align and coordinate internal IR and sustainability team processes in collecting and disclosing these metrics. Contemporaneous reporting allows corporate sustainability and IR teams to refine ESG metrics year to year, in line with investor needs.³²

In addition, CEOs, CFOs and directors can instantly elevate sustainability in investor perceptions of business value by discussing material ESG information in quarterly earnings calls. As two Harvard Business School researchers have pointed out, this simple action would provide “as clear a signal as there can be that a company is

focused on a sustainable strategy, not a sustainability strategy.”³³ As a first step in this direction, some companies are holding quarterly earnings-style calls with investors focused solely on material ESG factors. To assist the process, the UN Global Compact and Principles for Responsible Investment (PRI) have developed a tool for companies to connect their sustainability strategies to financial objectives and overall performance (see graphic on page 17).

Structure organizations to deliver effective, investor-friendly ESG outreach that maximizes business value. As we have seen, close collaboration between sustainability and IR teams makes for more effective ESG communications and outreach to investors. Likewise, when sustainability directors can influence high-level corporate messaging, both investors and companies benefit. Our findings illustrated several ways company leaders have structured teams and reporting mechanisms to maximize sustainability communications. These include:

- Positioning sustainability teams in core business departments, such as innovation or business development
- Ensuring sustainability team leaders have crosscutting influence, including with IR teams
- Enabling regular access for sustainability directors to key executives, including the CEO and CFO

For examples, see Three Models for Integrating the Business Case for Sustainability into Investor Communications (page 14).

What Sustainability and IR Directors Can Do

Collaborate to better communicate the company’s sustainability story to investors and analysts. Perhaps the biggest takeaway from our interviews with analysts is that companies are not adequately providing the decision-useful ESG information sought by more and more investors. Improving the flow, content, consistency and impact of sustainability communications with analysts and investors is therefore an urgent task for both IR and sustainability team leaders.

For sustainability teams, steering annual sustainability reports and/or other key departmental communications toward a sharper focus on material issues—with data that are consistent across corporate communications—would better serve investor needs and support IR colleagues. At present, sustainability reports often present an optimistic view of performance that includes much nonmaterial information and may border on public relations. Since these reports are often meant to serve a broad set of stakeholders, another approach is for ESG teams to provide an investor-targeted executive summary or appendix of financially material data, or to couple sustainability reports with more targeted investor-specific communications, such as Form 10-K content.

For example, one IR manager we interviewed receives bimonthly briefings from a high-level Corporate Sustainability Board

from which he “distills relevant messages for the financial analyst market.” At a different global company where sustainability drives product development, investors receive ESG communications via a comprehensive, metrics-driven sustainability report and supporting website information on material issues and risks to the business and stakeholders. “We publish so much information; it is more than enough for what we need in IR to answer investor inquiries.”

Sustainability teams can deepen the knowledge of IR colleagues acting as the gateway to investors, while IR teams can advise sustainability colleagues on the content and language that analysts and investors find useful. Our interviews with first-mover companies illustrate the multiplier value of ESG and IR teams working together on a broad suite of consistent, investor-targeted ESG content, including sustainability reports, forms 10-K, investor presentations or calls and executive messaging.

Focus data collection and reporting on the decision-useful information investors want. The metrics that companies provide should address material ESG performance, risk management and business opportunities relevant to the sector.

Corporate teams should collaborate to provide as much quantitative data as possible, so that investors can more easily compare such information across time within the same company or with similar data from other companies. Quantitative data can also be used in risk assessment and investment valuation. Similarly, IR and sustainability teams can shape data collection and reporting to include decision-useful context, such as relevant internal and external trends. The model guidance on ESG reporting from the Sustainable Stock Exchange Initiative, for example, urges companies to place information in the context of:

[Historical Company and Industry Trends](#)

[Related Corporate Goals](#)

[Relevant Ratios](#)

[Industry Averages](#)

[Financial Results/Performance³⁴](#)

In-house sustainability experts can diagnose pertinent SEC disclosures and help IR teams provide improved metrics and deeper analysis for investors, including shedding light on the long-term business value that sustainability strategies can deliver. IR directors can act as intermediaries between external analysts and key investors on the one hand, and in-house sustainability teams on the other, in determining what specific data and analysis best serve the former's needs.

Companies may find value from proactively disclosing negative data or challenges rather than leaving analysts to uncover them elsewhere. For example, Stephen Byrd, of Morgan Stanley Equity Research, reported a positive outcome from working closely with an energy company that openly admitted to operational challenges. "A lot of investors were happy with them for being up-front and transparent. If there is an operational issue, we would prefer that companies lay out the facts, rather than hiding things."

Promote the use of uniform sustainability metrics.

Sustainability and IR directors are well placed to join forces in promoting the use of consistent, uniform and material sustainability metrics—both internally and across their sector. One way to do this is to adopt sector standards that focus on material issues in sustainability reporting or to contribute to their development. For example, the SASB has released provisional sustainability accounting standards for 79 industries in 11 sectors that focus on sustainability issues most likely to have material effects on companies' financial condition or operating performance.³⁵ Index providers, such as the U.K.'s FTSE Russell, also generate high-quality ESG data to drive the analytics and indexes that institutional investors are demanding. While this might increase a company's reporting burden in the near term, reporting to a sector-wide standard with a materiality focus could increase investor interest and engagement in ways that deliver business value over time.

Finally, ESG and IR directors can use their influence with company leaders to champion the merits of aligning publication of annual or quarterly financial performance and material ESG data. As our analyst interviewees reinforced, this would significantly help companies to provide a fuller picture of overall business performance and value to investors.

Conclusion

In our view, companies that make business value the backbone of sustainability strategy and communications position themselves for long-term success. Our findings confirm a growing recognition among analysts, investors and global businesses that sustainability can significantly affect a company's value, and reveal rising analyst and investor interest in how ESG risks and opportunities factor into corporate performance. At the same time, investors often lack the decision-useful information needed to judge the long-term value of a current or potential investment effectively based on ESG factors.

The disconnect between supply and demand is due to several interconnected challenges. These include companies' failure to focus ESG reporting and disclosure tightly on material issues, lack of standardized metrics and reliable data within companies and across sectors, and misalignment between financial and sustainability reporting cycles. As a result, analysts and investors are dissatisfied, and companies are missing an opportunity to tell a holistic sustainability story that enhances business value.

Global companies have the players in place to bridge the ESG information gap—executives and board members who are increasingly fluent in sustainability risks and opportunities, IR teams and sustainability. This paper points out several paths forward, through insights and models provided by the first-mover companies we interviewed. With a focus on close collaboration between these key players, we offer actionable insights for companies on (i) the material information that investors seek, and (ii) how best to provide it for them. The time is ripe for global corporate leaders to deliver what many of their investors increasingly want.

For more information and work from the Morgan Stanley Institute for Sustainable Investing, visit morganstanley.com/sustainableinvesting.

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Disclosures

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