Reporting matters

Governance & risk deep dive

WBCSD 2019 Addendum Report

In partnership with

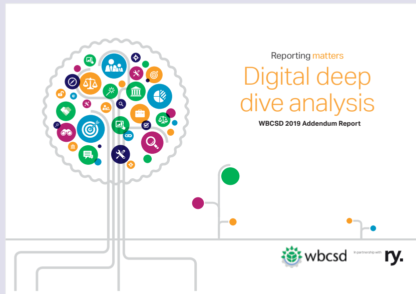
Governance & risk deep dive analysis

The current convergence of public pressure, government regulation and investor scrutiny has led to an explosion of information requests and reporting approaches to satisfy stakeholder needs. While this has made sustainability reporting an imperative for business, it has created a significant burden for reporters.

Good reporting enables companies to show how they have integrated sustainability into their business and to communicate the value of their work. This year, *Reporting matters* presents the evolution in reporting that WBCSD and its members want to see in response to the increasing complexity of the reporting landscape.

In the main report, we provide insights that aim to help companies navigate the new context through the lens of materiality, judgement and visual language. The three addendum reports explore distinct aspects of reporting:

- The role of risk and governance in internal decision-making and external disclosure;
- How sustainability strategy and target-setting is evolving as we approach 2020; and
- The future of digital reporting and emerging technologies.



Governance & risk deep dive

Reporting context

Ten years ago, the top global risks in terms of impact and likelihood barely touched on environmental, social and governance (ESG) issues. Today, in contrast, many of the top risks are either social or environmental.

We know the risk landscape is changing. Every year, the World Economic Forum releases its annual risk report. It lists the top risks in terms of impact and likelihood and can be used as an indicator of global risks affecting business.

Over the past decade, there has been a clear shift from predominantly economic risks (in blue) and social disease-related risks towards risks that are mainly focused on environmental, technological and social issues. In 2019, the top risks were extreme weather, failure of climate-change mitigation, natural disasters, data fraud and cybersecurity.

We know that these types of "non-financial risks" affect businesses and can have a clear financial and reputational impact. However, these risks can be difficult to financially quantify, which has meant that in the past, companies have struggled to define and manage these risks. Investors are increasingly recognizing that these risks are both real and significant – and are placing mounting pressure on companies to accurately disclose and manage these risks with the same degree of rigor applied to economic or financial risks.

Figure 1: risks in terms of impact and likelihood over time

Top five global risks in terms of likelihood

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
1st	Asset price collapse	Asset price collapse	Storms and cyclones	Severe income disparity	Severe income disparity	Income disparity	Interstate conflict with regional consequences	Large-scale involuntary migration	Extreme weather events	Extreme weather events	Extreme weather events
2nd	Slowing Chinese economy (<6%)	Slowing Chinese economy (<6%)	Flooding	Chronic fiscal imbalances	Chronic fiscal imbalances	Extreme weather events	Extreme weather events	Extreme weather events	Large-scale involuntary migration	Natural disasters	Failure of climate-change mitigation and adaptation
3rd	Chronic disease	Chronic disease	Corruption	Rising greenhouse gas emissions	Rising greenhouse gas emissions	Unemployment and underemployment	Failure of national governance	Failure of climate-change mitigation and adaptation	Major natural disasters	Cyber-attacks	Natural disasters
4th	Global governance gaps	Fiscal crises	Biodiversity loss	Cyber-attacks	Water supply crises	Climate change	State collapse or crisis	Interstate conflict with regional consequences	Large-scale terrorist attacks	Data fraud or theft	Data fraud or theft
5th	Retrenchment from globalization	Global governance gaps	Climate change	Water supply crises	Mismanagement of population	Cyber-attacks	High structural unemployment or underemployment	Major natural catastrophes	Massive incident of data fraud/theft	Failure of climate-change mitigation and adaptation	Cyber-attacks

Top five global risks in terms of impact

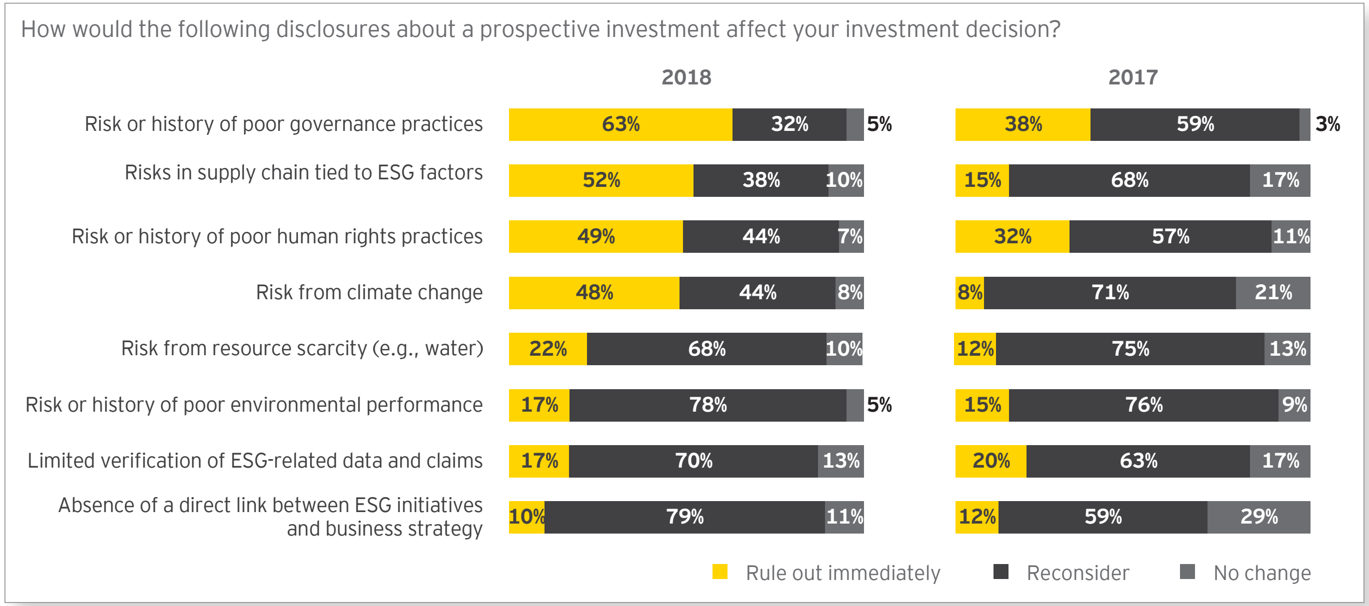
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
1st	Asset price collapse	Asset price collapse	Fiscal crises	Major systemic financial failure	Major systemic financial failure	Fiscal crises	Water crises	Failure of climate-change mitigation and adaptation	Weapons of mass destruction	Weapons of mass destruction	Weapons of mass destruction
2nd	Retrenchment from globalization (developed)	Retrenchment from globalization (developed)	Climate change	Water supply crises	Water supply crises	Climate change	Rapid and massive spread of infectious diseases	Weapons of mass destruction	Extreme weather events	Extreme weather events	Failure of climate-change mitigation and adaptation
3rd	Oil and gas price spike	Oil price spikes	Geopolitical conflict	Food shortage crises	Chronic fiscal imbalances	Water crises	Weapons of mass destruction	Water crises	Water crises	Natural disasters	Extreme weather events
4th	Chronic disease	Chronic disease	Asset price collapse	Chronic fiscal imbalances	Diffusion of weapons of mass destruction	Unemployment and underemployment	Interstate conflict with regional consequences	Large-scale involuntary migration	Major natural disasters	Failure of climate-change mitigation and adaptation	Water crises
5th	Fiscal crises	Fiscal crises	Extreme energy price volatility	Extreme volatility in energy and agriculture prices	Failure of climate-change mitigation and adaptation	Critical information infrastructure breakdown	Failure of climate-change mitigation and adaptation	Severe energy price shock	Failure of climate-change mitigation and adaptation	Water crises	Natural disasters

Economic · Environmental · Geopolitical · Societal · Technological

Source: Adapted from World Economic Forum. **"The Global Risks Report 2019."** 2019.

There is clear evidence that investors are taking a keen interest in the evolving risk context. A study done by EY highlighted that 97% of institutional investors evaluate non-financial disclosures when they make investment decisions. The top risk issues for investors in 2018 were associated with poor governance, supply chain, human rights practices, climate change and resource scarcity.

Figure 2: governance, supply chain, human rights and climate change are the main ESG factors in investment decision-making



Source: Adapted from EY. "**Does your nonfinancial reporting tell your value creation story?**" 2018.

The increasing prevalence and severity of ESG issues is putting pressure on companies to respond and increasing complexity at board level. To stay ahead, boards must adapt their business models and strategies to improve their companies' resilience over the long term. Sustainability is rarely integrated into governance and internal control processes. This can lead to sub-par disclosure around governance and gaps in reporting on a company's long-term value creation.

Figure 3: the top three areas investors want boards to focus on in 2019

1 **Board diversity – investors push for diverse directors as focus on board composition continues**

2 **Company-relevant environmental and social issues, particularly climate risk**

3 **Human capital management – investors seek to understand how boards are governing talent and culture**

Source: Adapted from EY. **"What investors are expecting from the 2019 proxy season."** 2019.

There is strong evidence that investors have expectations about what boards should focus on. In 2019, we saw many shareholder resolutions relating to ESG-related issues. The top issues investors are pushing for relate to board diversity, company-relevant information on climate change and human capital management.

Within this context, WBCSD has recognized a need to conduct projects in risk management and governance.

Enterprise Risk Management (ERM)

We've seen a significant shift in the global risk landscape in the past ten years, with social and environmental risks now making up the majority of top global risks. This shift is requiring companies to apply their existing risk management frameworks to ESG-related risks. However, many organizations are still limited in how they identify, prioritize, manage and – where relevant – disclose these risks.

To address this challenge, we partnered with the Committee of Sponsoring Organizations of the Treadway Commission (COSO) to develop **Applying Enterprise Risk Management to Environmental, Social and Governance-related Risks**. It helps risk management and sustainability practitioners apply ERM concepts and processes to ESG-related risks.

Visit WBCSD's **Enterprise Risk Management** project page to learn more.

Governance & Internal Oversight

The board is responsible for ensuring that day-to-day management is aligned with long-term value creation. Stronger integration of ESG impacts and dependencies can enhance their ability to do so.

We hosted the inaugural "Towards Sustainability: A New Curriculum for Boards" Conference with INSEAD in April 2019. This two-day event focused on boards' responsibilities and on validating what a curriculum for board members committed to such a responsibility might look like.

We also published **The state of corporate governance in the era of sustainability risks and opportunities**. It looks at how different jurisdictions promote effective governance practices, how companies meet these expectations and how they can integrate sustainability into corporate governance systems.

Visit WBCSD's **Governance & Internal Oversight** project page to learn more.

Governance & risk deep dive

The state of reporting on governance and risk

In this age of increased scrutiny of ESG risks and board governance, disclosure on governance, risk and ESG issues more generally has become extremely important. This year, we collected a range of data alongside our standard review process to provide a snapshot of the current state of reporting on ESG-related risks and governance of ESG within member companies.

Risk

As part of our analysis, we identified the sustainability topics considered material in each of the 159 reports reviewed and compared these with publicly available risk factors in annual reports and 10-k filings. Our purpose was to assess alignment between what are considered material sustainability topics and actual risk factors, according to legally binding filings. Excluding privately-owned companies meant we reviewed a total of 134 companies for our risk alignment work.

Overall findings

Nearly three quarters (74%) of companies reviewed didn't mention a link between their materiality and risk processes, but our analysis found only 11% have zero alignment between their material issues and risk factors. This reflects that there is often a link between risk and sustainability – even if it is not formally acknowledged.

Over half (57%) of companies aligned between 10-50% of their material issues with risk factors. Only 4% showed strong alignment, with more than 80% of their material issues appearing in risk disclosures.

Table 1: overall alignment of material sustainability topics and reported risk factors

Alignment	# of companies	% of companies
0%	15	11%
1-20%	16	12%
21-40%	42	31%
41-60%	38	28%
61-80%	18	13%
81-100%	5	4%

Overall, the average degree of alignment between material issues and risk factors was 39%. This represents a 10% increase from the average alignment score in 2016 (29%), when WBCSD first undertook similar research. The proportion of companies with zero alignment between materiality and risk has fallen by 24%.

Supersector findings

With an average of 48% of material issues appearing as risk factors, the basic resources sector is leading the way. The utilities and energy supersectors, with averages of 47% and 45% respectively, are the sectors with the next greatest alignment. Food, beverage and tobacco companies had the lowest alignment, averaging 29%.

Table 2: breakdown of alignment of material sustainability issues and reported risk factors by supersector

Supersector	Alignment
Automobiles & parts	35%
Basic resources	48%
Chemicals	38%
Construction & materials	42%
Energy	45%
Financial services	41%
Food, beverage & tobacco	29%
Health care	39%
Industrial goods & services	34%
Misc.	43%
Technology	35%
Utilities	47%

Topic category findings

To facilitate our analysis, we recategorized all the material issues identified in this year's reports into 12 groups. The most likely topic to appear in both a company's material issues and its risk factors was *Climate change*. In just over half of cases where *Climate change* was identified as a material topic, it was also acknowledged as a risk factor.

The three material issues categories with the next greatest alignment with risk factors were *Governance* (48%), *Economic* (41%) and *Labor practices & decent work* (36%). By contrast, the topics with the lowest level of alignment were *Human rights* (15%) and *Society* (8%). Material issues categorized as *Ecosystem services & biodiversity* also fared poorly, with only 20% of such issues appearing as risk factors.

Table 3: breakdown of alignment of material sustainability issues and reported risk factors by topic category

Topic category	Frequency of issue in materiality	Average alignment
Climate change	8%	54%
Governance	15%	48%
Economic	16%	41%
Labor practices & decent work	15%	36%
Product responsibility	9%	34%
Renewable resource use	5%	34%
Supply chain practices	5%	29%
Non-renewable resource use	4%	23%
Ecosystem services & biodiversity	4%	20%
Waste & effluents	5%	20%
Human rights	7%	15%
Society	7%	8%

Governance

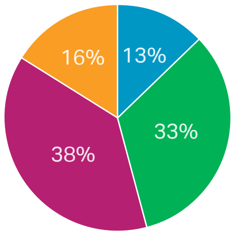
We took a deep dive into the governance disclosures included in annual reports, sustainability reports and 10-k filings of all 159 companies in our review sample. Our analysis of the integration of sustainability into governance practices focused on three key areas: board responsibility, board engagement with material ESG issues and executive compensation. The measures on board responsibility and engagement were designed to assess adoption of practices advocated by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) **supplementary guidance on ESG-related risks**.

Board responsibility

We assessed the extent of board responsibility for ESG issues and graded each company on a scale of one to four, where one represents no evidence of sustainability responsibilities and four indicates that a company has a board-level ESG committee (or equivalent) and that the head of the ESG department (or equivalent) regularly reports to the board. A score of two was given to companies where the Head of ESG (or equivalent) reports directly to the CEO or board.

Over half of companies analyzed scored three or above, with 54% of companies having at least an ESG committee (or equivalent) that is a part of the Board.

Table 4: distribution of board responsibility scores

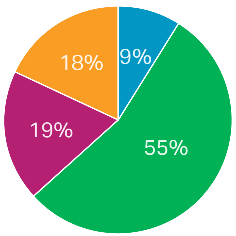


Board engagement

The extent to which sustainability issues are reviewed and discussed at board meetings was scored on a scale of one to four. A score of one was given to companies that do not regularly review ESG issues at Board level. A score of two indicates that the CEO or Board sign-off on formal sustainability reporting with a handful of material ESG issues potentially discussed at board meetings. A score of three or four measures the proportion of material ESG issues discussed at board level, identified as either below or above 50%, respectively.

In our analysis, the majority of companies (55%) scored a two, indicating that the current dominant practice is for the CEO or Board to have oversight of formal sustainability reporting, however regular and in-depth discussion of sustainability issues at board-level is lacking.

Table 5: distribution of board engagement scores*



Executive compensation

Across the 123 companies we analyzed, we found that 37% link executive variable compensation to ESG performance. However, there was no evidence of any company doing the same for board-level compensation. In order to further incentivize board responsibility and engagement with sustainability, linking board compensation to ESG performance would be a positive next step.

Conclusion

It is encouraging to see companies integrating sustainability into their governance practices via a board-level ESG committee. However, there is room for improvement in translating this into consistent and comprehensive board-level discussion of material sustainability topics.

The effective incorporation of ESG issues into risk factors can enhance sustainable governance practices and inform board discussions and decisions. The strong alignment between materiality and risk factors on *Climate change* is encouraging but progress is needed on topic categories such as *Human rights* and *Society*, where the effects on companies may not be as tangible as those posed by physical climate change risks.

We hope to see more companies linking executive and board remuneration to ESG performance in the future. This will add individual responsibility to existing board-level responsibility for sustainability. With 2020 being the last year of the UN's Decade of Biodiversity, we also hope to see greater alignment around *Ecosystems & biodiversity* issues to ensure risk management comprehensively reflects sustainability risks, and that businesses become better equipped to manage them.

*Figures do not always add up to 100 due to rounding.

Governance & risk deep dive

Greif discusses governance & risk

Greif is a world leader in industrial packaging products and services. Based in Delaware, OH, USA, Greif has a global reach with nearly 300 operating locations in 43 countries with 17,000 employees. In May 2019, Greif participated in an implementation workshop with WBCSD on how to apply ERM concepts and processes to ESG-related risks. We caught up with Aysu Katun, director of sustainability, to understand the key takeaways of the workshop.

GREIF

PACKAGING SUCCESS TOGETHER™

Why did you decide to participate in an implementation workshop?

At Greif, we continually want to raise awareness of sustainability, the importance, depth and breadth of ESG risks, and the need for increased focus on ESG-related risks across our business. We wanted to understand the current status of our risk alignment: how well the "business" risks surfaced from our ERM process align with our ESG risks. We also wanted to gain a better understanding of the steps we can take to better align and integrate our ESG risks into our ERM process, and therefore our businesses.

The workshop was a great opportunity to bring colleagues together from different functions such as risk management, operations, environmental health and safety, finance, innovation, legal/governance and investor relations and different levels of the organization. It provided an environment where they could think about sustainability and ESG risk from their unique perspective and explore how we can collectively integrate sustainability more fully into our operations, strategy and innovation.

> The workshop was helpful for us to broaden our perspective on the way we assess and prioritize our risks.
>
> **Aysu Katun**

What were some of the key lessons learned? How do you see this workshop supporting Greif in its integration of environmental, social and governance risks into the wider risk management process?

The workshop was helpful for us to broaden our perspective on the way we assess and prioritize our risks. Historically, we had bundled all our ESG risks under one category in our risk prioritization process. We now understand this approach may not be the most effective or accurate way of assessing our ESG risks.

Another key learning resulted from the exercise where we assessed risks based on our preparedness to handle instead of likelihood that an event would occur. This was an important shift in perspective and one that we may employ in our risk assessment process going forward.

A big "a-ha" moment for many of the participants was the result of the board game we played. It clearly showed how integrating sustainability into a company's strategic priorities, vision and investment decisions can have a direct impact on the company's bottom line and company valuation.

We now have a better understanding of our gaps and some of the areas where we can make changes quickly such as improving communication between the ERM team and our Executive Leadership Team and the Board, improving internal communication of ESG risks and having regular discussions of ESG risks with the innovation, procurement and strategy teams.

People in our organization now have a much better understanding of our ESG risks and the importance of integrating them into our business. This is a huge step forward. They are better positioned to incorporate ESG risks into their own decision-making processes. We also have a clearer, shared understanding of why and how to incorporate ERM and ESG risks more deeply into our strategic framework.

More generally, how can broadening the lens of risk management and integrating sustainability into governance structures support the long-term success of the company?

Long-term success is just not possible without a full understanding and integration of ESG risks – the threats they pose to operations, reputation and financial health and the opportunities they create.

For example, we identified climate change and severe weather events as one of our main ESG risks. To minimize the potential impact, we established a Natural Disaster Recovery Protocol called We Got Chu. Administered by representatives from sales, marketing, customer service, operations and logistics in conjunction with business unit leadership, We Got Chu manages risk and business continuity through inventory and production redundancy capabilities, facility risk assessments and proactive labor relations.

The protocol requires each facility to maintain alternate supplier lists for the top 35 materials they use, identify back-up Greif production facilities, provide production documentation for all products made in the facility, maintain a Recovery Checklist and complete sales order transition templates.

This is just one example of how the identification of an ESG risk, development of a risk mitigation plan and integration into our business is helping to make our business more resilient and create long-term value.

Given the global challenges we face and the megatrends that are unfolding, integrating sustainability into all business structures – not just governance – is key for an organization to become and remain resilient and create value in the long term. One could argue that sustainability should be a driving force of strategy, innovation and value creation.

Why is reporting on ERM and sustainability governance to external audiences important to Greif? And to what extent are the key material issues presented in your sustainability report aligned with the risk factors in legal filings?

Reporting on ERM and sustainability governance enables us to understand of our risks and determine ways to manage and mitigate them through our strategy and operations. Based on WBCSD's analysis, our current alignment is at 60%.

Being more transparent about risk management builds trust and strengthens our relationship with customers. It enables them to manage their own risks better and provides opportunities for us to collaborate to mitigate shared risks.

Greater transparency also allows us to foster relationships with the investment community, improves our ESG scores and demonstrates leadership when it comes to improving transparency in our industry.

Governance & risk deep dive

Acknowledgments

WBCSD team
Authors: Austin Kennedy, Francesca Jaworska

Research analysts: Benn Hogan, Essi Paunisaari, Maria Ana Campos, Caroline Von Celsing

Managing Director and Senior Management Team, Redefining Value & Education: Rodney Irwin

Editorial support: Andy Beanland

We would like to express our sincere thanks to all WBCSD staff, member companies and partners who kindly contributed interviews, quotes and support throughout the review and editorial processes.

Radley Yeldar team
Ashleigh Gay, Director of Sustainability Strategy
Jessica Channings, Sustainability Analyst
Stephanie Wilson, Designer
Oscar Vera, Production Manager
Siobhan Janaway, Senior Project Manager

Governance & risk deep dive

About the research partners

This project is a joint collaboration between WBCSD and Radley Yeldar

About the World Business Council for Sustainable Development (WBCSD)

WBCSD is a global, CEO-led organization of over 200 leading businesses working together to accelerate the transition to a sustainable world. We help make our member companies more successful and sustainable by focusing on the maximum positive impact for shareholders, the environment and societies.

Our member companies come from all business sectors and all major economies, representing a combined revenue of more than USD $8.5 trillion and 19 million employees. Our global network of almost 70 national business councils gives our members unparalleled reach across the globe. WBCSD is uniquely positioned to work with member companies along and across value chains to deliver impactful business solutions to the most challenging sustainability issues.

Together, we are the leading voice of business for sustainability: united by our vision of a world where more than 9 billion people are all living well and within the boundaries of our planet, by 2050.

www.wbcsd.org

Follow us on **Twitter** and **LinkedIn**

About Radley Yeldar

We're an independent creative consultancy working to create a world that believes in business. For over 30 years, our team of 200 experts has worked with multinationals, start-ups and public bodies to solve complex challenges through a unique blend of technical expertise, compelling communications and standout creative. As an integrated communications agency with leading sustainability expertise, we combine inspiration with evidence to create belief among all audiences. We help our clients define their strategy, bring it to life and report credibly.

www.ry.com

Follow us on **Twitter** and **LinkedIn**

Disclaimer

This publication is released in the name of WBCSD. It does not, however, necessarily mean that every member company agrees with every word.

This publication has been prepared for general guidance on matters of interest only and does not constitute professional advice. You should not act upon the information contained in this publication without obtaining specific professional advice.

No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication and, to the extent permitted by law, WBCSD, its members, employees and agents do not accept or assume any liability, responsibility or duty of care for any consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this.

World Business Council for
Sustainable Development
Maison de la Paix
Chemin Eugène-Rigot 2B
CP 2075, 1211 Geneva 1
Switzerland

Radley Yeldar
24 Charlotte Road,
London, EC2A 3PB
United Kingdom