The Notorious ESG

Business, Climate, and the Race to Save the Planet

Vasuki Shastry

THE NOTORIOUS ESG

At a time when 'woke capitalism' and the ESG construct are under attack, Vasuki Shastry gives his readers a comprehensive, yet easy-to-follow overview of the ESG landscape as a predicate to calling out the urgent need for the business community to play its part in combatting the climate crisis and furthering social justice objectives. By addressing head-on both the challenges and the imperatives of addressing the challenges, Shastry, with the benefit of his insider's perspective, provides a much needed and valuable roadmap for business leaders and their advisers to navigate the ESG landscape.

Mark Bergman, Founder, 7Pillars Global Insights LLC and former Head, Global Securities and Capital Markets Group, Paul Weiss

Vasuki Shastry has achieved the impossible: his book makes a serious topic both accessible and entertaining. It's a reminder to us all that we have to stop paying lip-service to ESG – the planet's survival depends on it. Every Chief Executive should be forced to read this and forced to question their approach.

Jonathan Charles, Communications Strategist, Broadcaster, and former Executive Committee Member of the European Bank for Reconstruction and Development (EBRD)

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Business, Climate, and the Race to Save the Planet

BY

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INVESTOR IN PEOPLE

For my late mother, and to Singapore.

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ABOUT THE BOOK

In terms of sheer hype, hoopla, and hysteria, ESG (or environmental, social, governance) has become the operating mantra for business in the developed and developing world. CEOs and C-suites have embraced ESG as the defining new way of doing business, underpinned by strong social purpose and a clear objective of doing well by doing good. The urgent, immediate global challenge of tackling climate change has raised the stakes with greater pressure to dismantle our carbon-industrial complex. The business community in America and Europe is also buffeted by unprecedented social pressures with demands from a millennial workforce for greater equity, diversity, and flexible working arrangements. Derided in some quarters as "woke capitalism," the adaptive challenge for business is to not merely to manage ESG risks but to fundamentally transform business models. In his new book, ESG expert Vasuki Shastry argues that short termism still rules, and unless the modern corporation radically changes to address environmental and social challenges, ESG will continue to remain notorious, infused with high prose and rhetoric, and with little substance and credibility. Citing Einstein, Shastry defines the current business approach toward ESG as driven by fear, greed, and stupidity. Fear, because businesses are feeling greater pressure to reform from investors and regulators. Greed, because ESG is also proving to be a massive business opportunity as the rise of sustainable finance attests. Stupidity, because every well-meaning corporate endeavor, however virtuous, will inevitably lead to excess. Making ESG great again will require bold ambition, a resolute commitment to curb greenwashing, and to include the voices and perspectives' of millennial staff, who stand to inherit a planet in grave climate peril. The generation gap is exemplified by the typical CEO of a modern corporation who is male, in his 50s, ruthlessly focused on delivering for the quarter, and hopelessly out of touch with environmental and social issues. A starting point for reform is greater diversity at the top and an acknowledgment that ESG should be the ABC of doing business.

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THE ABC OF ESG

What Is Driving the Hype, Hoopla, and Hysteria of Environmental, Social, Governance (ESG).

In the 1970s at the height of disco mania, *Time* magazine memorably described the phenomenon as the "noun, verb, and adjective" of the decade. As corporate gurus look back on the present decade, there are likely to be many contenders for the noun, verb, and adjective label of our times. The pandemic certainly looms large and so would the current crypto mania. However, in terms of sheer hype, hoopla, and hysteria in the business world, the rise of environmental, social, governance (ESG) would be the top contender for the label.

In an era of social media memes, Twitter trolls, and fake news, ESG has proven to be bullet proof by rallying the most cynical corporate tycoon, millennial staff, and the NGO sector around the proposition that business can do well by doing good. "Business can in fact be a tremendous force for good and make a huge contribution to solving the biggest problems facing our people and planet," says Paul Polman, former CEO of Unilever.[1] "Actually, this is the only way for business to be accepted in society, and it should always strive to have a net positive impact." During his tenure as Unilever chief, Polman positioned sustainability as the

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[1]Polman made these remarks to Mongabay, the environmental science and conservation news platform, October 19, 2020.

centerpiece of the consumer food giants strategy and also playing a critical role in rallying business around the United Nation's Sustainable Development Goals (SDGs) in 2015.[2]

Since the launch of the SDGs, business interest in all things development, climate, and ESG have soared. But as this book will argue, sustaining this interest over a longer period is already proving to be challenging. For now, the primacy of shareholder and shareholder value, the iron-clad governing principle of business in America and Europe for decades has been replaced by stakeholder capitalism, something fuzzier and harder to define because it promises to be all things to all people. Shareholder and stakeholder interests do align in the long term, according to Bruce Simpson, a senior ESG[3] advisor of McKinsey, "If you have happy employees, collaborative suppliers, satisfied regulators, and devoted consumers, then they will help you deliver higher benefits over a longer-term period." However, he acknowledges that it is hard to satisfy everybody in the short-term: you have to make trade-offs between purpose and profit. "But in the long term, we don't believe this trade-off exists."

For now, the burgeoning ESG Consultants Complex is bursting over with keywords and phrases – social purpose, responsible business, sustainability, greenwashing – which I hope to unpack in the next few chapters. Integrated reporting, an entirely new way of presenting financial and nonfinancial performance has become all the rage. Sustainability standard-setters, in the private and public sectors, are falling over each other in presenting templates to better measure impact. No ESG conversation is complete in New York, London, or Berlin without someone speaking about the merits of the Sustainability Accounting Standard Board's materiality matrix or the Task-Force for Climate-Related Disclosures (TCFD), which is aimed at getting sharper and precise climate data from listed companies, or the European Union's incredibly complex taxonomy

[2]For the uninitiated, the UN membership adapted 17 Sustainable Development Goals in 2015, a "shared blueprint for peace and prosperity."
[3]Putting stakeholder capitalism into practice – McKinsey podcast, January 7, 2022.

for sustainable activities. For business itself, their approach toward ESG is being defined by what Einstein[4] once described as three of the "great forces" ruling the world – fear, greed, and stupidity. Fear, because businesses are feeling the pressure from investors and regulators and don't want to be left behind in the ESG race; Greed, because ESG is also a massive business opportunity as the rise of sustainable finance demonstrates, with an estimated $3 trillion of assets under management and attendant concerns over greenwashing, which we will discuss later; Stupidity, because every corporate endeavor, however virtuous it might seem, will inevitably lead to excess.

There are the skeptics and the cynics of course, who dismiss the entire phenomenon as "woke capitalism" or worse a "scam," as Elon Musk memorably described it after his electric car company Tesla was excluded from the S&P ESG Index, with oil major Exxon Mobil still in it. In short, business appears to have a love-hate relationship with ESG with plenty of lovers and plenty of haters. As a polarizing topic, ESG just about mirrors the world we live in.

Before we delve in-depth into this topic, it is useful to describe what exactly I mean by the business community, which I will reference throughout the book. It is an expansive term to describe the traditional private sector in Europe and America – the conglomeration of listed and unlisted companies involved in every imaginable (and unimaginable) business activity. This includes heavyweights in the Fortune 500 and leading businesses in Europe which span the globe and comprise the modern tribe of the multinational corporation. It includes the financiers, the technologists, the service providers, the manufacturers, energy generators, and new generation upstarts who seek to disrupt all of the above.

The definition of what comprises the business community gets cloudy and murkier the further afield one travels from the shores of America and Europe. China has shown the way in recent years that state-owned capitalism can be a worthy counterweight and competitor to traditional Western free enterprise-driven capitalism. While China does have a genuine group of purely private

[4]The quote by Einstein is widely cited, including in *The Guardian*, October 23, 2008 (Fear is the new mindset of the irrational world of finance).

enterprises, the tech majors Alibaba, Tencent stand out in this regard, recent efforts by Beijing to curtail their power signals that state capitalism will dominate in the years ahead. State-owned enterprises in China, India, Indonesia, Mexico, Brazil, Nigeria, and other emerging markets coexist side by side with the private sector but dominate economic activity and are large consumers of capital and labor. They are typically involved in energy and finance, giving the politicians and technocrats who run these enterprises, vast power and privileges. While purists will fulminate at my rather expansive definition of what constitutes a modern business enterprise, it would be a mistake to exclude state-owned firms from the mix of firms who can provide solutions to mitigating climate change and in overall ESG compliance. In my book both purely private and purely state-owned enterprises are both part of the ESG problem and part of the potential solution.

The business community in developed and developing countries of course do not speak with a unified voice when it comes to saving the planet from negative climate change and in pursuing good corporate behavior. This is a community with sharply diverse voices and perspectives about how workers should be treated in the twenty-first century, the origins of the climate catastrophe, and its impact. In conversations with climate skeptics, many of whom reside in the corporate sector, I am often struck by their naivete and lack of interest in understanding climate change. Their dismissive talking point is often about today's relatively benign weather, wherever it happens to be, as proof that global warming is either faked or hyped up. In emerging markets, business leaders also tend to underplay the two other pillars of ESG – social and governance, where the emphasis is on treating employees and customers fairly and in ensuring that the company is governed by strong internal rules, processes, and Board oversight.

My own claim to infamy in the ESG field stems from my time at the International Monetary Fund, where I witnessed first-hand how much power is vested with multilateral institutions in shaping our economic future, and most recently at a large international bank where I ran what is confusingly referred to as sustainability – a catch-all phrase meant to explain how the institution is playing its part in being more sustainable and in building pathways away from an entrenched portfolio of carbon-intensive activities.

The challenge I have figured out is in the framing and the question must be asked early and urgently – is ESG a massive virtue-signaling operation where business is embracing the narrative to do good but tangible evidence of real progress is hard to come by? The evidence is unsurprisingly mixed. By the yardstick of talking the talk, the corporate sector in America is certainly not shying away. Data research firm Fact Set searched for the term "ESG" in the conference call transcripts of all the S&P 500 companies that conducted earnings conference calls between December 2021 and April 2022.[5] "Of these companies, 155 cited the term 'ESG' during their earnings calls" Fact Set notes "This number marked the highest overall number of S & P 500 companies citing 'ESG' on earnings calls going back at least ten years." Fact Set analysts also dug deeper by analyzing the longer-term ESG track record of the 155 companies. Their conclusion: "Based on Q4 2021, it would appear that companies that are making more progress on their ESG initiatives and scoring higher of ESG ratings may be prone to discuss their ESG initiatives and their progress during their earnings calls." This still begs the question – what about the majority of companies listed on the S & P 500, which are *not* mentioning ESG in their earnings calls? Are these companies content with their existing strategies which underplays the value of ESG considerations in operating a large, complex industrial enterprise? Or are the CEOs of these storied corporations outright ESG or climate deniers, stymying progress for the corporate sector as a whole?

To answer these questions, one must understand the power dynamics of business in America and Europe, which are radically different from that of emerging markets. Vast swathes of business in the developed world in America and even in Europe, a continent traditionally reliant on bank lending, is owned by shareholders, not of the mom and pop variety, but by a very small group of large institutional investors. This elite group comprises giant pension

[5]Fact Set Insight Commentary – Do S & P Companies That Discuss "ESG" on Earnings Calls Have Higher ESG ratings? April 18, 2022.

funds, asset managers, sovereign wealth funds, private equity funds, and family offices owned by billionaires. In the US alone, over 80% of the market capitalization of the broad Russell 3000 index is owned by these large institutions, and around 80% of the large cap S&P 500 index.[6] In dollars, this works out to $21.7 trillion and $18 trillion respectively, a staggering amount which in a nutshell showcases the vast power vested in this group of institutional investors. The institutional investors are not necessarily all American, although they tend to dominate the pack. In Europe, large asset managers and insurers like Abrdn, Axa, Allianz, and Norway's pension fund are significant investors with the clout to influence corporate behavior. This elite group of institutional investors would be incomplete without name-checking giant sovereign wealth funds such as Singapore's GIC and Temasek, Saudi Arabia's Public Investment Fund, Abu Dhabi's Mubadala, and the Qatar Investment Authority.

In this small group, no one looms larger than Larry Fink and BlackRock. For the uninitiated, BlackRock is the world's largest asset manager with a phenomenal $10 trillion in assets under management. It's investment reach extends far and wide into the developed and developing world. When Larry Fink, the all-powerful CEO of BlackRock picks up the phone and calls one of the CEOs of the vast companies in his portfolio, he is never placed on hold or asked to leave a message. The CEO on the other side of the line quivers, and I have witnessed this first-hand, and is often anxious to reassure Fink that all is well on his patch and no nasty surprises await. When Fink or one of his top lieutenants come calling in person, companies bring out the finest silver and their shiniest investor deck to showcase performance. Although the corporate sector in Europe, Japan, and emerging markets are less reliant on equity markets and more on traditional bank lending, global-minded companies still bow to BlackRock because of the firm's sheer convening power in arranging capital. The 345-odd companies in the S&P 500 not citing ESG in their earning calls better watch out.

[6]The 2017 data cited above is from Pension & Investments.

Using geopolitical phraseology, BlackRock is the unquestioned investment superpower and Fink is a combination of Henry Kissinger, Metternich, Machiavelli, and even the Pope – the *uber* power broker, diplomat, and ideologue of our age who dispenses homespun wisdom and advice on what CEOs and companies under BlackRock's stewardship should do and should not do in terms of improving performance and overall do-goodery. One of the more remarkable developments over the past decade has been Fink and BlackRock's unconditional embrace of ESG as an organizing principle. In late January each year, and I exaggerate (only a little bit), the most eagerly awaited event for CEOs of BlackRock's portfolio companies is the arrival of the "annual letter" from Fink, equivalent to the encyclical issued by the Pope on weighty spiritual and societal matters. Fink's penmanship and prestige has not yet reached the Pope's or Warren Buffet levels,[7] but the BlackRock CEO has used his powerful platform to persuade, influence, and cajole portfolio companies to place ESG as the fundamental operating principle in managing their business. Here is a classic sampler of Finkese from his 2020 letter to CEOs,[8] which emphasized the importance of climate action and sustainability. "We believe that all investors, along with regulators, insurers, and the public, need a clearer picture of how companies are managing sustainability-related questions" Fink wrote "The data should extend beyond climate to questions around how each company serves its full set of stakeholders, such as the diversity of its workforce, the sustainability of its supply chain, or how well it protects its customer data. Each company's prospects for growth are inextricably linked from its ability to operate sustainably and serve its full set of stakeholders." Lest the recipients of the Fink letter were tempted to ignore or side-step his advice, Fink had the following to say in bold. "Given the groundwork we have already laid engaging on disclosure, and the growing investment risks surrounding sustainability, we will be increasingly disposed to vote against management and board directors when companies are not

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[7]Buffet, known as the "sage of Omaha," attracts a huge investor following globally. They all converge to his annual shareholder meeting like devotees to a religious cult.

[8]Larry Fink's 2020 Letter to CEOs – A fundamental reshaping of finance.

making sufficient progress on sustainability-related disclosures and the business practices and plans underlying them."

Fink's warning about the risks of corporate inaction notwithstanding, there are prominent segments of business in America and Europe who are either misreading or ignoring his message altogether. Take global banking heavyweight HSBC as a recent example where there is a disconnect in the rhetoric at the highest levels of the bank. HSBC's website makes the bold proclamation that the bank is committed to a "sustainable future" and dedicating between $750 billion and $1 trillion to help clients on this journey. "We are setting out an ambitious plan to prioritise financing and investment that supports the transition to a net zero global economy – and helps to build a thriving resilient future for society and businesses," the bank declares. Stuart Kirk, a senior bank official who was the Global Head for Responsible Investing, did not get the memo or chose to subvert the institution's climate agenda. Speaking at a "Moral Money" event organized by the *Financial Times*,[9] Kirk let loose by noting that in his 25-year banking career, "there was always some nut-job telling me about the end of the world," likening the climate crisis to Y2K which fueled fears about a widespread computer glitch at the turn of the millennium. "Unsubstantiated, shrill, partisan self-serving, apocalyptic warnings are ALWAYS wrong," Kirk wrote in the slide presentation. To be sure, comparing the climate crisis (which is truly apocalyptic based on current trends) with the Y2K kerfuffle (which threatened to temporarily disrupt our online world) is ridiculous, but Kirk's fulminations illustrate a much bigger problem – a sizable section of the business community are ESG and climate deniers, or, like Kirk seemingly underplays the importance of the two.[10]

Even in grey London, where the talk about today's weather is the most popular icebreaker with strangers and acquaintances, Kirk is not alone. There is a formidable group of City grandees, bankers, traders, and assorted asset management types who are either climate skeptics or outright climate deniers. In the run-up to the

[9]HSBC Banker attacks climate "hyperbole," *Financial Times*, May 22, 2022.
[10]To be sure, Kirk's employer has reaffirmed its commitment to combating climate change and has placed him under suspension.