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Brian Tomlinson
Tensie Whelan
Kevin Eckerle

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[SUSTAINABLE BUSINESS]

How to Bring ESG Into the Quarterly Earnings Call

Stop treating environmental, social, and governance strategies as a sidebar and integrate them into regular financial reporting.

BY BRIAN TOMLINSON, TENSIE WHELAN, AND KEVIN ECKERLE

Quarterly earnings calls need an overhaul. Management expends great effort preparing for them, investor relations officers view them as crucial venues for sharing the equity story — the strategic vision that provides a rationale for investing in the company's stock — and quarterly results still move markets. So why should these calls emphasize short-term profit-taking over long-term investments in employees, research and development, and sustainability, given that environmental, social, and governance (ESG) issues have direct, material effects on how well companies succeed in the long run?

We believe that companies must integrate ESG wholly into their business strategies rather than relegating them to a sidebar. But we also recognize that it's challenging for corporations to include more ESG information in quarterly earnings calls for a variety of reasons.

First, companies are in the habit of reporting on ESG through other channels, such as corporate websites, CDP (formerly the Carbon Disclosure Project), annual sustainability reports, and ESG investor calls. These channels may not require or receive the same level of analysis that earnings call disclosures do — and thus companies may be unaccustomed to reporting with rigor on ESG activities. Also, companies generally do not track ESG's financial effects but instead report on financials and ESG completely separately. The result is that ESG data may seem "soft" to some observers.

In addition, on quarterly earnings calls, companies may be playing to analysts who they assume don't care about ESG. CEOs often say that analysts do not ask for ESG information; analysts say that if the CEOs are not providing it, ESG issues mustn't be material to the business. Wherever the blame lies, the effect has been limited discussion and disclosure of ESG themes.

Nevertheless, companies are making modest progress. From 2018 to 2020, earnings call transcripts saw a 671% increase in references to ESG — and a 751% increase in references to diversity, equity, and inclusion (DEI).[1] Early evidence also suggests that companies' increased discussion of ESG issues correlates with enhanced ESG performance and that earnings calls are featuring more — and more specific — discussion on human capital, racial equity, and related DEI topics.[2] In addition, the COVID-19 pandemic has spurred the inclusion of ESG-related disclosures: Managers have found themselves talking on earnings calls about sick leave, holiday pay, hazard pay, and access to personal protective equipment.

Five Steps for Integrating ESG Into Quarterly Earnings Calls

Despite that recent progress, ESG information is still not fully integrated into the discussions on core business strategy and financials that quarterly earnings calls feature. To help public companies advance these efforts, we developed a five-part framework as part of a joint project between the New York University Stern Center for Sustainable Business and the CEO Investor Forum of Chief Executives for Corporate Purpose.[3] We also interviewed 35 executives from the investor relations, strategy, and corporate sustainability functions at 25 companies in 13 industries and tapped a range of sell-side analysts for their perspectives. The following five steps should offer guidance in tackling the challenges to better integrating ESG content into quarterly earnings calls.

1. LAY THE GROUNDWORK.

Participants in an earnings call are likely to receive ESG information more favorably if they have had prior encounters

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with ESG disclosure. Investors and management alike need a base level of comfort and confidence with ESG issues, and that kind of familiarity can be generated in several ways, beginning with consistently sharing sustainability data, usually in the form of an annual sustainability report. The report should provide key performance indicators (KPIs) on the most financially pertinent issues for the company, as well as the financial figures that link the company's sustainability performance with its financial performance.

Companies can also increasingly share financially relevant ESG disclosures in the proxy statement, to foster deeper, more valuable exchanges with investors. In retail, for example, pay equity, diversity, and other worker-related issues should be disclosed; for energy companies, data on climate change and preparing for a low-carbon transition (and associated regulations) is key.

Hosting ESG-specific calls with investors to educate them about how the company's ESG strategy delivers short- and long-term value not only deepens their understanding of the issues but also fosters connection with ESG-focused investors, building on year-round bilateral investor-engagement efforts. For example, as a result of its involvement in our project, commercial real estate company Jones Lang LaSalle hosted its first ESG webinar in fall 2018 and a second in 2019.

Finally, companies should integrate ESG content into the investor-day presentation, including comments from the CEO and CFO on ESG strategy and the financial results achieved.

We have collaborated with multiple companies, both on this project and in connection with our work on long-term value, that have laid the groundwork for earnings calls by developing ESG content proactively. We have found that these companies can reach into that preparatory work to extract key elements that are either "investor ready" or "earnings call ready." They can test new content in an ESG-focused call and then roll it out to investors more broadly. As a result, the companies expand the range of ESG themes on which they provide regular disclosure.

2. ADAPT THE EARNINGS CALL SCHEDULE. It's important to develop a smart plan for how to organize each quarterly call so that ESG matters are fully integrated. One option is to provide quarterly updates on key ESG performance and ESG-driven financial measures, such as revenues from more sustainable products and services, improved retention rates, and operational efficiencies through waste reduction.

Alternatively, companies can use one of the four quarterly calls to provide a deeper discussion of ESG. This will give participants greater insight into the implementation of long-term ESG strategies, broaden the discussion of performance, and offer more specific details on how recent ESG performance compares with expectations. Follow up on ESG themes and related financial performance on the rest of the year's earnings calls.

Another tactic is to focus the CEO segment of the call on a high-level view of corporate purpose and how the company builds value by engaging stakeholders on the most material ESG issues. For example, Nestlé has featured key elements of its shared value and sustainability approach on earnings calls since the first quarter of 2019.

How a company adapts its earnings call schedule will depend on whether its ESG data is available on a quarterly basis and on the extent to which ESG issues are key to the strategies or products being discussed. By framing ESG appropriately alongside broader themes, such as shared value and corporate purpose, management clearly signals that ESG is a core business strategy and that it influences how the business is run.

3. REPORT ON — AND FULLY EXPLAIN — THE RETURN ON ESG INVESTMENT. Disclosures on ESG progress alone will not interest most analysts. Instead, set out the longer-term plan at the outset by explaining the substantive ESG issues the company is managing. Then report on the financial impact of ESG efforts, as appropriate. For example:

- If you're investing in your employees to reduce attrition, disclose how much money has been saved by improving retention rates. Benchmark the retention rate against the rates at other companies in your sector.
- If you're investing in meeting targets for reduced carbon emissions, report on energy savings associated with initiatives such as new manufacturing processes. Adopting circular business models in an apparel business, for example, can reduce waste disposal costs, improve customer loyalty, and reduce acquisition costs for new, younger customers. In commercial real estate, greener buildings can command rent premiums.
- If you're investing in a more climate-resilient supply chain, disclose the reduction in supply chain disruptions caused by climate-related severe weather or drought, for example, and the revenues retained because your business can maintain continuous supply in the face of such events.

Understanding the return on ESG investments is likely to require new ways of collecting financial data. The CFO's office will have to work closely with the ESG team and other divisions to develop additional financial metrics and reporting systems. The company will also need to monetize intangibles such as risk mitigation (which will require creativity). The Stern Center's Return on Sustainability Investment (ROSI) methodology offers one approach to making such calculations.[4]

4. DEVELOP CROSS-FUNCTIONAL COLLABORATIONS. Greater ESG-related disclosures often force functions within a company to work together. For instance, investor relations and corporate sustainability functions may need to codevelop content, such as a summary of the company's materiality assessment and single-slide summaries of how the company is investing to grow value by addressing the most pertinent ESG issues. The sustainability teams can convey the technical specifics, and the investor relations teams (who understand the expectations of the earnings call audience) can assist in conveying technical content in a clear, concise format that analysts can use. For example, a logistics and transport company might report on its efforts to reduce greenhouse gas emissions and also save money through planning more energy-efficient routes and converting to electric vehicles.

Another key opportunity for collaboration is when CFO and sustainability teams jointly identify KPIs that facilitate ROI calculations for individual ESG investments in order to show how those investments generate value for the company. The sustainability teams will probably need to educate the CFO teams about frameworks, such as the ROSI methodology, that help companies estimate the value of sustainability. As part of the Stern Center's work with the automotive sector, for example, we found that no one was collecting the financial data associated with waste-reduction strategies that lowered the costs of primary materials and waste disposal.

Management can take various steps to foster stable internal processes for collaboration. For example, it might convene ESG working groups or task forces that meet at regular junctures throughout the year to pull together relevant teams and data. Also, some boards of directors have ESG written directly into the remit of the full board, in addition to allocating ESG oversight to particular board committees (usually the nominating and governance committees), ensuring that ESG is not orphaned at that key level of strategic oversight.

5. TREAT THE EARNINGS CALL AS THEATER. The earnings call is a highly staged, tightly managed spectacle. The company and the analysts are key players in the drama. Consequently, if management teams are adding ESG as a strategy element, it's important to enlist the help of analysts to shift part of the quarterly conversation toward longer-term ESG themes. Relevant tactics could include approaching the sell-side analysts — the most vocal participants on the earnings call — in advance. Urge them to ask questions relevant to the corporation's ESG story. For example, you could prompt an analyst to ask how the company is investing in products and services that reduce customers' greenhouse gas emissions, and how the company is forecasting the growth in sales of those offerings.

Some companies have begun expanding the scope of investors engaged in earnings call discussions. For instance, Tesla encourages its retail investors to submit questions on its earnings calls by providing them a platform to do so easily, thereby broadening the conversation.[5]

Remember: The earnings call is an event. You want to involve the participants in a way that advances your ESG goals. That may mean orchestrating what happens to some degree — not with a deceptive aim, but to ensure that the ESG story is told in a way that informs and animates everyone who is present.

SOUND PERFORMANCE ON material ESG issues and those issues' direct relationship to financial performance will increasingly be seen as critical components of the corporate story. Over time, management teams will view differentiated sustainability strategies as sources of competitive advantage. Investors will undoubtedly want to quantify the value of this advantage, and they will expect management to compellingly explain that value and all of the ESG components that contribute to it on the quarterly earnings call. We hope that our recommendations help you make that event reach its greatest potential for your company, its investors, and its other stakeholders.

***Brian Tomlinson** is director of research for the CEO Investor Forum at Chief Executives for Corporate Purpose. **Tensie Whelan** (@tensiewhelan) is a clinical professor for business and society and the director of the New York University Stern Center for Sustainable Business. **Kevin Eckerle** (@kevineckerle) is the director of ESG performance and operations at Bayer Consumer Health. He was employed by the Stern Center for Sustainable Business at the time when the research described in this article was conducted. Comment on this article at https://sloanreview.mit.edu/x/62417.*

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