Feature

Board diversity and climate change

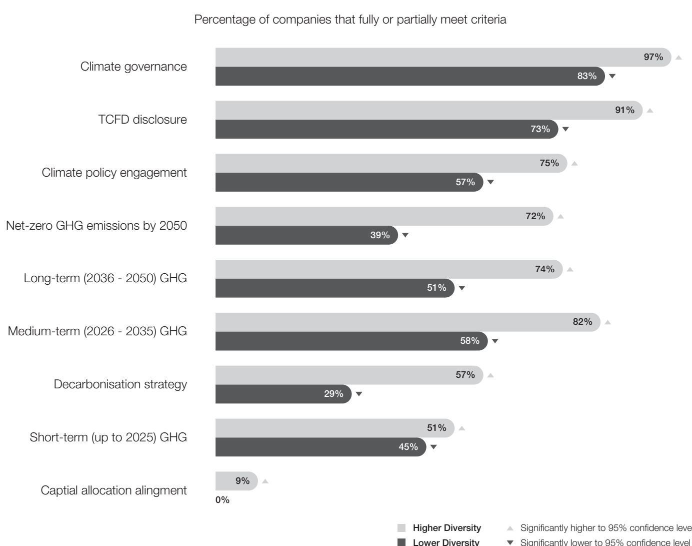
Helena Wayth and **Rajalakshmi Subramanian** share the findings from their recent research which finds that more diverse boards drive greater company climate action.

Regardless of the outcome at the United Nations Framework Convention on Climate Change, COP26, this month companies will need to act on climate change with greater rigour, speed, and substance. While the spotlight is on commitments and capital, more emphasis is needed on the leadership to effectively steward the decarbonisation of the economy, starting with company boards.

Governments have set out their net-zero plans and will push more responsibility onto businesses' shoulders. However, many companies in the world are not ready to respond. Those that are, have more diverse boards. This is one of the key insights from research conducted by sustainability consultancy A Bird's Eye View and non-profit BoardReady. The study analysed publicly disclosed data from 159 global companies identified by the Climate Action 100+ initiative as responsible for over 80% of corporate greenhouse gas (GHG) emissions against the initiative's net-zero benchmark indicators, and their board's composition.

The research identified four critical levers – greater board diversity, more formalised climate governance, prioritisation of reporting and disclosure, and climate performance incentives – boards can use to improve company engagement across all critical climate action indicators. The results, based on performance-based evidence, provide a compelling case for change, not only relevant for global companies but also for medium and smaller businesses as they consider how to transform while continuing to perform.

Board diversity drives greater and more holistic company climate action



As companies look to accelerate their transition to net-zero, the evidence suggests the more gender and age diverse a boardroom is, the better the quality of challenge, debate, and more holistic decision-making on climate. Yet company boards are not diverse enough. Considering these findings and the mammoth transition task ahead, this is a risk and an opportunity. Only 41% of the global companies assessed have at least 30% of board seats held by female directors. European companies are most progressive with 59% in comparison to North America with only 37%, however Asia had none. Thirty-six per cent of the companies have boards with a median age under 60 years; European and Asian companies each with 48%, while North America has only 12%.

Geographical differences could be a reflection of gender representation quotas, policies, and company laws in a number of EU countries and the UK over the last decade. In North America, new US State legislation and Stock Exchange rules require or recommend increased board diversity. New initiatives such as the UK Government's intention to raise female director targets to at least 40% of every FTSE board, extending the Hampton-Alexander review recommendations, will also drive this forward. One of the consequences of policy on board gender diversity could be greater board engagement on climate.

But can a more gender diverse board change the tone at the top to provide the prioritisation and constructive challenge needed on climate? Female directors bring a different perspective on climate across the board function according to a 2020 survey of US directors of public companies by PwC. They are significantly more likely than male counterparts to think about climate change in the context of strategy formation, board Enterprise Risk Management discussions, and the inclusion of environmental goals in executive compensation plans.

Boards need more formalised climate governance and incentive mechanisms in place

To stimulate the enormous change required by business, huge investments will be required by both the public and the private sector, guided by the right incentives and policy framework. Heads of business have been calling for governments to align and collaborate on climate as seen in the recent open letter to leaders of G20 countries, the world's biggest emitters, by over 600 companies from across the region. Governments must co-operate to create a level playing field. With tensions rising about how to pace the transition and the trade-offs, is board composition in big business enough to change the conversation, shift behaviour and business models?

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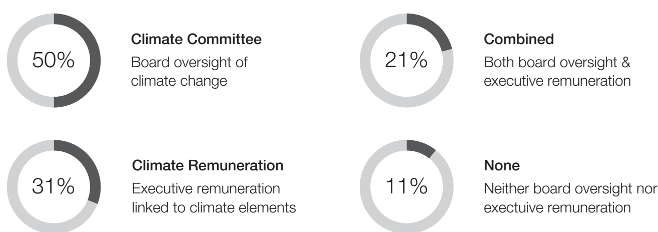
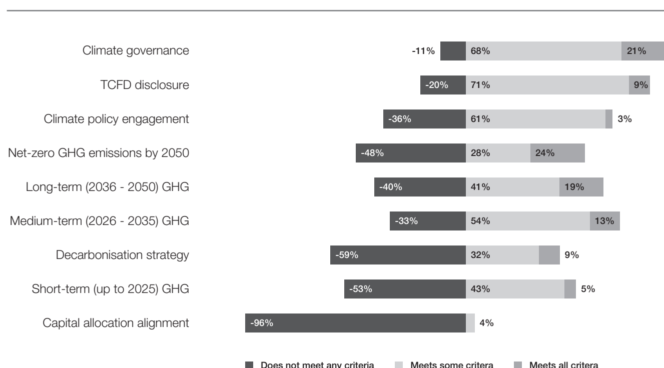
To bring out the best in a board, some believe its critical to have a 'true believer' Chair who fosters an inclusive culture to maximise diverse views, encourage debate, and importantly set the board agenda, oversight, and accountability on climate. The study supports the need to put climate at the heart of strategy and the board. It found companies with more formalised climate governance, board oversight and executive remuneration linked to climate action are performing better across all climate action indicators.



Not surprisingly companies with climate linked executive remuneration perform better on the critical short- and medium-term GHG reduction targets as well as decarbonisation strategies, than those without. However, of the companies assessed only 50% have board oversight on climate change, 31% have executive remuneration linked to climate, and 21% have both board oversight and a remuneration scheme in place.

Close the gap between company net-zero commitments and capital allocation

While record levels of 'green finance' are being mobilised, the study found a significant disconnect between company net-zero commitments and the alignment of future capital allocation. Eighty per cent of the global companies researched have or will implement the Task Force on Climate-Related Financial Disclosures (TCFD) recommendations, and over 50% have made some level of commitment to net-zero GHG emissions by 2050. *Only* 4% have disclosed future capital allocation plans aligned with their reduction targets.



The findings suggest stakeholder and policy pressures are influencing company behaviour towards climate risk disclosure and reporting, but this not yet leading to substantive action or investment. It also suggests boards and executives don't yet sufficiently understand the complexity of climate-related risks, the magnitude of change or the requisite governance and financial mechanisms required.

Governments are moving to make key voluntary disclosure requirements mandatory such as the TCFD framework, first introduced in 2015. Several countries have already enacted the framework into law. In July G7 countries agreed to mandate TCFD disclosure and reporting. In the first week of November the UK Government announced mandatory climate disclosures for the largest financial institutions and UK listed companies from 2022.

To achieve their net-zero GHG emission targets, substantial financial and structural adaptation may be required by companies. Previously identified by some as a reputational risk, the significance of climate change is being elevated and directly linked to financial performance. From the EU taxonomy's proposed carbon border tax; to the world's first net-zero corporate standard from the Science Based Targets Initiative (SBTi); to the newly formed Glasgow Financial Alliance for Net Zero (GFANZ) aiming to raise capital and integrate climate change in every financial decision.

Announced at COP26, an International Sustainability Standards Board (ISSB) is being formed and will start operating in 2022. Its remit: to develop sustainability disclosure standards to ensure consistent, globally comparable information across industries and financial markets for investors.

A convergence of policies, standards and financial pressure will require more concrete measurement and action from companies to reduce their GHG emissions; scope 1 & 2 (direct emissions from owned and controlled sources and indirect emissions from the purchase of energy for operations respectively), and 3 (all indirect emissions in the value chain).

The world is watching as they look at global companies for bold actions and strong inclusive leadership. Company engagement on climate is increasing. The transition to net-zero still has a long way to go, as does the need for better stewardship on climate. Investors have reason to vote and demand more board gender diversity, science-based decarbonisation strategies, climate risk disclosure from audit firms and performance linked remuneration.

The key lever starts with more diverse boards willing to challenge themselves and put climate at the centre. For companies with diverse boards, have you brought out the best of what you have? For those lacking, it's time to transform starting with the board!

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