ESG Will Outlive Its Critics

Tim Mohin

GEORGIE FROST: Where, if anywhere, is ESG heading? Since the 1960s, the principle of investing our money and doing business responsibly and sustainably has been growing in popularity, morphing from a regulatory operation to a core business activity. But recently, ESG has experienced a backlash, notably in the US where it’s become a big political issue. While we may be losing the acronym, have we lost the principle? I’m Georgie Frost, and this is The So What from BCG.

TIM MOHIN: There are a number of things that we’ve always sort of trotted out as the value statement, and those are getting more and more measurable and bigger each and every year. So nowadays, corporations across the world see the responsibility ethic as a must do, not a nice to do.

GEORGIE FROST: Today I’m talking to Tim Mohin, partner and director in climate and sustainability at BCG.

TIM MOHIN: Back in the beginning, corporations weren’t to be trusted, they were to be regulated. And as a sort of lifelong environmentalist, I wanted to help the environment. And so you had a choice back then. You could be an NGO that stood on the gates and sort of raised their fist and yelled at companies, or you could be a regulator and actually try to mitigate some of the externalities that companies still to this day have.

So I chose a regulator. I became an EPA regulator, and I worked on air quality for many, many years and had the fantastic opportunity to work on some of the foundational issues of our time, like the Clean Air Act, which is still very much with us today. And that’s what kind of started me in this business. So it started with regulation, then companies started moving faster than governments and they started to get into this sort of corporate social responsibility trying to prove their green credentials to anybody who will listen.

And then finally now where we are, as you stated in the beginning, ESG or sustainability has become part of the mainstream of global commerce, of corporate strategy. And that’s why I’m at BCG. That’s what’s so interesting about where this is going.

GEORGIE FROST: I’ll let you into a little secret and the listeners into a little secret. When we were discussing this podcast, I initially wrote the question, "Is ESG over?" But that was deemed to be perhaps a little bit harsh, so we changed it to, "Where, if anywhere, is ESG heading?" Is it over? Is it done as an acronym? Before we get into the principle of it, because it does seem to be, it’s become almost a toxic phrase.

TIM MOHIN: We may have come to that point with the term because the term: Environmental, Social, Governance—what does it actually mean? It’s so many different things.

GEORGIE FROST: What does it mean?

TIM MOHIN: Well, it actually does have meaning. So as one of the OGs of this space, I often get asked this question. And there is meaning to all of these terms. But in essence, for sort of a broader audience, it’s about 30 to 35 different topics that have all been mashed together. And they can be as disparate as where companies pay their taxes and what they do to protect the environment from climate change. So when you mash all of those things together and then say, "Okay, this is one thing," it actually doesn’t make a lot of sense. And so it’s really easy to vilify, and that is in fact what has happened.

GEORGIE FROST: I want to get a little bit more, without getting too political, this is not a political podcast, but how we reach that point when you think about really what the principles of ESG, the fundamentals mean, and I suppose this is where we get into the “have we lost the principle of it?”

TIM MOHIN: That’s such a good question because the principles have not been lost. I think we have a branding problem, because ESG became sort of
synonymous with, "This is corporations trying to do good and investors trying to invest in a way to make our economy work with our environment and social needs."

Those principles are still very much with us today and still very, very important. The branding issue has really gotten us into this problem where some people have decided this is a very political issue and you’re either for it or against it or it’s woke or it’s not woke. Whatever. I think what we’re seeing in practice at BCG is that companies have not changed at all. In fact, we’re seeing an increase in what companies are doing behind the scenes.

GEORGIE FROST: So what are companies doing behind the scenes?

TIM MOHIN: Well, a great example is diversity, equity, and inclusion. We’re seeing increases in companies taking on that set of issues to make sure that we have a diverse, inclusive, and safe workplace. Those kinds of things are bedrock to how companies operate. They’re not going away.

GEORGIE FROST: Are you concerned, though, while it does seem to be holding up, the principles seem to be holding up, are you concerned though that the bad publicity will mean that sustainability comes off the agenda? Or actually it’s now proved that it can bring value and you can’t do business without it?

TIM MOHIN: It’s a hundred percent about value, and it’s always been about value. I made the switch, as I said in our introduction, from a regulator to working in corporations many, many years ago. And when I made that switch, half of my friends said, "Oh, Tim, you’ve sold out. You’re working on the wrong side." I’m like, "No, no, no. You don’t understand. Companies really, really do care about this stuff." And they do.

And so what we’re seeing is that kind of caring is continuing to happen, but it has to have value. There was a paper written, gosh, it was probably 15 years ago now, Harvard Professor, Michael Porter and Mark Kramer worked on this paper called Shared Value, and basically it started with the premise companies are not charities, but in order to benefit the environment, they have to benefit themselves. And looking at it through that lens, it’s like enlightened self-interest. How do companies then continue to make progress on these environmental and social issues?

And I think it’s a very important paradigm and it’s still with us today. For example, we saw the company that’s kind of been at the crosshairs of this political debate, BlackRock, actually increase their business in so-called ESG investing over the last six months. It’s actually been one of their biggest growth areas. And BlackRock is trying to rebrand. They’re trying to call it transition finance now. So maybe we haven’t quite landed on the brand yet because I’m not sure that rolls off the tongue, but it is a branding issue.

GEORGIE FROST: Does branding matter? I suppose if you are a company and you are setting out your model and your objectives and your agenda, you need something, don’t you, some language to give to shareholders to give to stakeholders?

TIM MOHIN: It’s real easy to be against a three-letter abbreviation like ESG. It’s harder to be against something like sustainability or corporate responsibility, which are all terms that we’ve used to essentially define the same things we’re talking about here.

GEORGIE FROST: So how should leaders then be approaching this? How can they get value from ESG, sustainability, whatever we want to call it, how can they get value?

TIM MOHIN: Well, there’s value and there’s values and they’re very, very different. All the companies that I’ve ever worked for, and some of the biggest ones in the world, start with values. And those values basically instruct their culture and how they do business. And I think that’s the core of it.

If we’re going to be ethical, if we’re going to be good at business and good for the people who work in our business and the people around our business, and those are kind of the essence of all the different corporate value statements I’ve ever seen, then we have to then put those values into our business culture, into our business processes. And that’s what we’re seeing in companies all over.

That’s why I said about the diversity, equity, and inclusion, it’s a fantastic example. Because for years it wasn’t an issue and we just sort of went on and then we look around and everybody looks like each other, and all of a sudden we realized we’re way away from what our market needs or wants and so we decided that we need a diverse
workplace. And there were study after study showing that that actually added value to not only the corporate life but the corporate business.

And so those are the kind of things that I think are going to continue, but it really starts from values. What is your company about? What is your culture about? How do you do business? And then how do you embody that in all of your operations?

GEORGIE FROST: How do you measure values achievement? Because it is very difficult to change what you can't measure. And I think this is some of the issue with why people have turned away from ESG is because oftentimes you can't measure it in certain areas. Obviously, there are some that you absolutely can. Certainly the diversity of your workforce, you can. But in other areas, not so much.

TIM MOHIN: Well, first of all, you're good at what you do. You ask the right question. I spent a lot of my time working on this exact issue. The old moniker, you manage what you measure, is very, very true. It's not just in corporate life, it's just about in any institution, any business. What gets measured, gets managed, we know that. But I was the CEO of a company called the Global Reporting Initiative, GRI.

GRI has been around a very, very long time, and its entire purpose is to measure corporate responsibility. And so at the beginning, I kind of mentioned that there were probably 30 to 35 different topics under this broad header of ESG. Each one of them has measurement. They're all a little bit different. They all have an accounting procedure and a reporting procedure and all the boring stuff. But they're all measurable.

And what's happening now, and this is the part that I find so interesting, as this whole movement has gone into the mainstream and received that backlash that comes with going into the mainstream, what you're seeing is some of those measures get entrained into things like financial reports. This week as we are recording this, we had a new final rule from the US Securities and Exchange Commission that would require all companies to report on their climate emissions, all listed companies.

And the US is not alone, even though it's the world's largest economy still, we're seeing that kind of thing happen across the world. So measurement is critical. There's not one answer because there are so many different topics. How you measure climate is different than how you measure diversity, for example. But each of them does have defined measurement techniques.

GEORGIE FROST: How significant was that SEC, long-awaited climate-related disclosure rules announcement?

TIM MOHIN: While it was long awaited, there was about a two-year period from the time that the SEC said they were going to do this and they issued a proposal, to when it actually came out. And you say to yourself, "Okay, what's the big deal?" Because we know with US politics, it's already been litigated. So the ink wasn't even dry and we had lawsuits. So this is just going to get entrained into that political situation.

I think what's interesting is the signal that it sends. The signal that it sends is that sustainability, ESG, whatever moniker we put on it has become part of global commerce, that investors care about this information because in this information is risk and opportunity. And that's what investors want to see, and they don't want to see it in some sustainability report that is a hundred pages long and full of pretty pictures of children planting trees. They want it in the sort of crisp, comparable, reliable disclosures that they're used to in financial statements. So that's why I think it's so big.

We are seeing the exact same thing happening in other capitals. The European Union is far ahead of the US in terms of requiring this kind of information in financial reports. China just came out with their own sustainability reporting regulation. Then you could go on. The UK, Japan, Singapore, Hong Kong, Australia, all of these capitals have basically said, "If you want to list your company in our capital market, you must disclose at least climate and in some cases even more."

GEORGIE FROST: I don't want to say was that the missing piece, but was that a significant piece that was missing in making this truly mainstream?

TIM MOHIN: It is. There's no question in my mind that once the worlds of finance and sustainability come together, be it on just one or two metrics, climate change is the top of mind for most people, then that's the camel's nose under the tent, then we've cracked it. Because all of a sudden you've aligned the power of capitalism, which...that is the
institution we have, to the needs of the world. When you can align capital to sustainable business practices, then we’ve cracked it.

GEORGIE FROST: In all your experience when you speak to companies, what sort of percentage are we talking about that are would you say truly on board with this, not just something nice in their reporting statements, this is meaningful change? Is business on board with that?

TIM MOHIN: Yeah. Your question belies an interesting point, which is what do people feel? Having worked much of my career in business, I can say that people are people regardless of whether they work in big corporations, run big corporations, or if they work on the NGO side or if they work on the government side or whatever.

They’re still people and they still have their values with them. And what I saw when I worked for some of these big companies is that there was a lot of morality, there was a lot of moral outrage when we found things that were wrong in our supply chain and we wanted to go fix them right away.

And that really matters. So companies are not just robots for profit, they’re run by human beings. And human beings want to leave a legacy and hopefully a legacy for good, unless they’re just sociopaths. But we generally don’t have those. We have good people running good companies and they do care.

Now, do they care beyond their own aligned incentives? Sometimes yes, sometimes no. You see that with some companies like Seventh Generation, Tom’s Shoes, the companies that really are built on a brand around doing good. But most companies, they have this, as I used the term before, enlightened self-interest, where in fact, by doing good, they’re doing well and they know that it attracts, retains, engages employees, for example. It builds the brand, it helps build the customer base.

There are a number of things that we’ve always sort of trotted out as the value statement, and those are getting more and more measurable and bigger each and every year. So nowadays, corporations across the world see the responsibility ethic as a must-do, not a nice-to-do.

GEORGIE FROST: You mentioned there about supply chains, which makes me think, and I don’t want to go into Scope 1, Scope 2, Scope 3, etc., but it’s hard enough to measure and stay true to your own values and within your company. But when you think about global companies now, there’s so many points along the way that you don’t have control over, particularly if you’re not an enormous company with enormous influence over other companies. If you’re a small-medium company, but that does have a supply chain, then it’s very difficult, is it not, to really make a big impact, or is it?

TIM MOHIN: It’s incredibly difficult. And I can remember even working for some of the big companies I mentioned before, we thought it was impossible, and yet we found ways to do it. Probably the best example is, I worked in this very large company at the time and we were sitting around a table and trying to figure out how we would get a handle on behaviors, social behaviors, labor behaviors, environmental pollution in that first line of suppliers, that very first tier that were making our products.

And then we had a session in the meeting where we invited some NGOs to come in. They came in and said, ”It’s about these minerals that are mined in conflict areas, and you need to be in charge of dealing with these conflict minerals because this is truly egregious. And we were like, ”Oh my gosh, we can’t even get a handle on our first tier. How are we going to get all the way back there to deal with these issues that are truly egregious in the war-torn mining fields in Africa?”

But it was a challenge. And when we went back to our corporate leaders, all of them said, ”This is so egregious that if it’s in any part of our supply chain, we want nothing to do with it. And in fact, we need to solve it now.” So I use this example to give you a sense of how collective action through business can work.

We actually created an organization still very much with us today, I was the chairman of the board of it for a while, called Responsible Business Alliance that was able, through collective action of bringing a buyer-supplier together, large, small, didn’t matter, to trace and track all the way back so that we would have an idea of where our materials were coming from, and then we could take action to not only just avoid those materials, but to actually help those places where the materials came from be better.
And so that’s a good example, but it’s not the only example. Obviously companies have been working on this for some time. Sadly, many of the issues that we have in terms of labor and human rights are still very much with us today. They’re still growing in some cases. So the work is not done. In fact, it’s never done.

Georgie Frost: So this is about defining values, collaboration, hard and long work. But you mentioned obviously the role of regulators. What can governments and regulators do to ensure that we’re still on target? I assume you think we are away from where we were at the start, which is companies aren’t to be trusted but regulated. I assume we’re not quite still there, but we do need regulation, don’t we? We do need government action.

TIM MOHIN: We do. And I think that there has to be many tools in the toolbox because the problems are so big. And so I do think that there is a strong role for government regulation. I think the question is what kind of regulation? So we’ve been talking a lot about transparency, and that is very much the regulation du jour, if you will. Everybody’s saying, "Oh, if we just report on this stuff, then it’ll get better." Will it? Do we know that?

It is one method, sunshine is the best disinfectant. So if we just put it out there, it’ll get better. But I think that’s not the only way. We still need to have good old command and control. If you’re emitting too much, we’ve got to cut your emissions. That’s what I sort of cut my teeth on many, many years ago.

But I think one of the more advanced and potentially more effective ways of creating government policy is by objectives and incentives. And this is what you’re seeing in the US with the inaccurately named Inflation Reduction Act, which is really the largest climate bill the world has ever seen, at least the US has ever seen, and continues to bring incentives in terms of tax credits and direct grants for environmental technologies that boost not just the environment, but help the economy as well. That’s the kind of incentive-based policy that I think really works.

GEORGIE FROST: Tim, finally, I said it at the start, but where is this all headed?

TIM MOHIN: Yeah, it’s a great question and of course no one has a crystal ball. But when I do think about my long career in this space and the trend lines that I’ve seen, is that sustainability is only becoming more and more prominent, more and more important, and more and more embedded and ingrained into everyday life.

We see it from consumer choices on the grocery store shelves. We see it in the halls of commerce where we’re talking about embedding climate into financial reporting. We see it in almost everyday life. And so to me, that’s an up and to the right story. I’ve been around long enough to know that there’s no straight lines in any kind of trend. There’s bumpiness, and we talked about this in terms of the backlash and that kind of thing. But I do think that trend line of increasingly worrying about people and the planet and integrating that into everyday life is where we’re heading.

GEORGIE FROST: Is that the advice you would give leaders, that this could be a bumpy path, but stick with it?

TIM MOHIN: That is the advice I would give leaders. Stick with it, stick with your values, because it does return value to the company if you stick with your values.

GEORGIE FROST: Tim, thank you so much. And thank you for listening. We’d love to know your thoughts. To get in contact, leave us a message at thesowhat@bcg.com. And if you like this podcast, why not hit subscribe and leave a rating wherever you found us? It helps other people find us too.