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Trends in board ESG priorities: Comparing the U.S. and Europe

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This post is a guest-authored commentary piece discussing the findings of Diligent Institute and Spencer Stuart's 2023 report, [Sustainability in the Spotlight: Has ESG lost momentum in the boardroom?] This is the third blog in a series of global commentary pieces analyzing how the global results compare with ESG practices and oversight in specific regions.

The recent global report published by Diligent Institute and Spencer Stuart reflects the global evolution of firms and their boards of directors in ESG matters, focusing on the organizational approach, boardroom actions, strategy and future state, and oversight structures, evidencing, moreover, significant differences in terms of ESG (environmental, social and governance) that have been presented up to now between the United States and Europe.

Regarding these focuses and considering the differences between the United States and Europe, we share our comments contributing additional insights on the European side from our perspective in Spain.

Organizational approach

This is perhaps one of the big differences between the two jurisdictions. On one hand, directors in the U.S. see ESG matters more as a risk to be mitigated, while European directors see ESG as an opportunity to take advantage of. Some premises for these results may be related to the regulatory landscape in the U.S., which is more fragmented, with regulations that vary between states and federal agencies. While there has been some progress at the federal and state levels in the United States, the regulatory environment is generally less proscriptive and comprehensive. In contrast, Europe generally has a more homogeneous legal framework and regulations due to its involvement of the European Parliament as a supranational body that integrates and addresses ESG issues compared to the United States. In addition, European countries have adopted various agreements and treaties that enforce environmental and social standards, such as the European Green Deal (2020), the Paris Agreement (2015), and previous treaties (Lisbon, 2009; Amsterdam, 1999; Maastricht, 1993).

Narrowing in on Spain, the country operates within the comprehensive regulatory framework of the European Union, which includes various ESG regulations and directives. These regulations set clear expectations for companies to integrate ESG considerations into their operations and non-financial reporting. This significant difference in regulatory frameworks can influence how firms in each country see ESG issues as risks or opportunities.

Boardroom actions

According to the above and concerning the study, another piece of evidence related to ESG issues is that the Boardrooms have a more social focus (S) on the part of the U.S., compared to an environmental focus (E) on the part of Europe. This is reflected in the additional evidence that the reports on ESG matters are annual by the USA, with a more compliance focus, while Europe tends to be quarterly, with a systematized process that combines compliance with operations and business. In addition, the negative perception of the surveyed directors from the U.S. is that "too much time" could be spent discussing ESG issues, while those from Europe do not see it that way.

This could be reflected in the fact that on U.S. boards, there is also increasing awareness and concern about ESG issues. However disruptive cultural factors and an emphasis on individualism and the free market have influenced public perception and the velocity of change. In addition, the U.S. has a diverse and dynamic industrial landscape, with a more significant presence of sectors such as technology and finance, where ESG considerations can be perceived mainly from the focus on talent capture, retention, and succession, that is, focused on the individual experience, knowledge, and value creation of crucial talent (i.e., CEO, the Top Management Team, and the members of the Board of Directors).

On the other hand, over several decades, Europe faced significant environmental challenges, such as pollution and scarcity of resources, due to conflicts, recessions, and geopolitical integrations. This experience emphasized environmental protection and the need to incorporate sustainability actions. In addition, Europe has a significant presence in industries such as automotive, trade, and tourism, which have faced environmental scrutiny throughout their value chain, resulting in stricter regulations and industry standards that have been systematized and disseminated worldwide. Furthermore, Europe has a long social and environmental activism history, leading to increased public awareness and concern for accountability regarding ESG issues. This has contributed to society, in general, demanding that firms operate sustainably and responsibly. Indeed, progressist cultural factors and social values can shape how firms address ESG issues. For instance, in Spain, there is a cultural emphasis on social welfare, solidarity, and sustainable development. This social context may have influenced the public perception of firms and created expectations of responsible and sustainable business practices, bringing their accountability closer to systematization of shorter periods (e.g., quarterly) and assuming the debate on these issues as part of the corporate strategies.

Indeed, the premises described lead us to confirm the results of those surveyed in Europe, where they affirm that almost 90% are incorporating environmental metrics and 43% social metrics in their plans, compared to 46% and 23% in the U.S., respectively.

Strategy and future state

Regarding the orientation to consider that ESG metrics lead to an improvement in security valuation, only 15% of U.S. respondents agree with this statement. In comparison, 34% of European respondents confirm it.

In addition, only 42% of U.S. directors think that these metrics should be included in security valuation, while 73% of European directors affirm this inclusion. These results could suggest a greater emphasis on short-term financial performance in the U.S., and the integration of ESG into investment decision-making has been slower to gain traction across the market. While ESG investing is gaining traction in the US, the level of demand from institutional and individual investors and the integration of ESG matters may slow down due to multiple variations and needs between industries and companies.

On the other hand, European investors often prioritize long-term sustainability and responsible investing, leading to an increased demand for companies that align with ESG principles. This demand is driven, in part, by the strong presence of institutional investors, such as pension funds, which have integrated ESG considerations into their investment strategies. Focusing on Spain, the Spanish market has witnessed a growing demand for ESG investments and sustainable finance. Institutional investors, such as pension funds and asset managers, have integrated ESG criteria into their investment strategies, encouraging companies to address ESG issues. This demand incentivizes Spanish companies to incorporate ESG practices into their business models and demonstrate their commitment to sustainable and responsible practices.

For these reasons, it is reflected that the U.S. predicts a more conservative focus on ESG issues and its linkage of ESG to business impact. In contrast, Europe predicts a stronger focus on ESG and a more significant linkage of ESG to business impact.

Oversight structures

Regarding oversight of ESG issues, the U.S. considers 45% that the Board assumes responsibilities and general oversight of ESG, while in Europe, the affirmation is 55%. Likewise, the U.S. grants responsibilities to the nominations and governance committee by 27%, while Europe does the same with specialized committees such as Sustainability or ESG by 31%. Indeed, when talking about the evolution of oversight structures on ESG issues by the Boards, Europe leads by 41% compared to 23% in the U.S. In addition, the increase in committees and discussions on ESG issues is more significant in Europe than in the U.S. These results potentially reflect the shareholders-stakeholders orientation between the U.S. and Europe. In the U.S., corporate governance has historically been more focused on shareholder primacy, prioritizing the maximization of shareholder value. This difference in approach influences how companies in each region address ESG issues and allocate resources, as well as the prioritization of the agendas of their Boards and Committees (e.g., audit committee and nominating committee), which may have led to a narrower focus on financial performance rather than broader ESG considerations. However, there is a growing shift towards a stakeholder-oriented corporate governance model in the U.S.

On the other hand, European corporate governance traditionally emphasizes stakeholder interests, considering the impact of business decisions on a broader set, including employees, communities, and the environment. In that sense, Spanish companies, influenced by the broader stakeholder-oriented approach to corporate governance in Europe, often strongly emphasize addressing social and environmental issues. They recognize the importance of considering the interests of various stakeholders, including employees, communities, and the environment, in their decision-making processes. In fact, as part of the results of Europe that the study reflects, we confirm for the Spanish case, shared responsibilities between the Board and the specialized committee on sustainability or ESG for environmental issues, and the Committee of Nominating and Remuneration -CN&R- (mandatory since 2014) for social issues.

In conclusion, we believe that this study, *Sustainability in the spotlight: Has ESG lost momentum in the boardroom?* is a fundamental contribution to reading by decision-makers and policymakers interested in ESG issues.