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The ESG honeymoon is over

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In the court of public opinion, the business world is losing trust but still has more trust than the government. This may help explain why the recent push around corporate social responsibility has given rise to a new optimism for progress around major social issues like inequality or climate change: Perhaps, if the business world does its part, we can meaningfully address these issues.

Recent commentary, research, and reporting, however, suggest this optimism may be misplaced, or worse, a smokescreen that will prevent us from actually solving these problems.

"Most of ESG in this country right now for investors and companies is greenwashing," says Susan H. Mac Cormac, partner at Morrison & Foerster in San Francisco and chair of its energy, social enterprise, and impact investing practices. "There are a ton of people who are just putting up [an attorney] who used to be an environmental lawyer, and it's all compliance-based, checking the box."

Tariq Fancy, the former head of sustainable investments at BlackRock, a firm that many see as being on the forefront of the new era of stakeholder capitalism and corporate accountability, wrote a scathing review of these efforts from his view behind the curtain.

Fancy wrote that ESG investing represents “a highly profitable and fast-growing business line for BlackRock and other financial institutions” and that even the most ambitious funds that are thoughtfully pursuing sustainable investing are “a drop in the bucket against a tidal wave that was going in the opposite direction.” He noted the irony of flying on private jets to “hock low-carbon investment products.”

Inessa Liskovich, an economist who Fancy interviewed to be the lead ESG researcher at BlackRock, concluded that there are no conclusions to be made on the connection between ESG and profit right now. At best, she says, it is economically “a luxury good”—something that is nice to have if you can afford it.

Baruch Lev, an accounting and finance professor at NYU’s Stern School of Business, previously explained to me that the companies that are strongest in ESG or CSR tend to simply be the ones that are the most profitable. If that’s the case, companies like Google, Facebook, and Netflix have a responsibility to lead in ways that go beyond throwing money around.

A corporate ESG strategy that is merely investing in sustainable funds or supporting nonprofits isn’t enough, nor is divesting from “bad” businesses. Philanthropic capital efforts are far too small to make a difference against the urgent spectre of climate change, as Mac Cormac, Fancy, and many other ESG skeptics have stated. Unless businesses are willing to move away from the practices that are causing the most harm, the rest of their efforts are noise.

“If you have a good policy around ESG, great,” Mac Cormac says. “But I want to change your whole operations.”

Fancy wrote: “When our leading experts conclude that a certain highly lucrative business activity is a grave danger to society, the machine ‘innovates’ to protect its profits any way it can. … the fact remains that if the referees won’t penalize players for doing business in a way that yields huge profits at our collective expense and then playing down those negative side effects, they’ll generally keep on doing it.”

Businesses can make philanthropic commitments for 1% of their profits and push as many CSR initiatives as they can afford, but as long as they are collectively destroying the environment, deploying artificial intelligence irresponsibly, and lobbying against regulations that would develop stronger environmental and social responsibility standards, they're just building facades.

Philanthropy or divestment are not strong enough on their own to address the climate issue, and with the many ethical failings of the technology and internet companies that have contributed to inequality and social disarray, a stronger level of accountability is necessary in order to secure a stable future via responsible business.

"There's a difference between excusing yourself of something you do not wish to partake in and actively fighting against something you think needs to stop for everyone's sake," Fancy wrote.

The most responsible companies are the ones doing the latter.

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Ask an academic

What is the best way for new leaders to build trust with their teams?

When a new leader starts their job, conventional wisdom suggests they want to build up their trust as high as possible. Recent research suggests a more modest approach could work better.

Kurt T. Dirks, vice chancellor of international affairs and leadership professor at Washington University in St. Louis, recently co-authored a study on trust and expectations for leaders and how those factors change over time. The study, recently published in *The Journal of Business Ethics* and summarized in this article, collected data at four different points in time from 500 individuals on 130 teams at the U.S. Military Academy in West Point. Squad members reported on their trust in their direct leader. Additionally, leadership one level above the unit leader responded about unit effectiveness.

What they found was that most leaders who started with higher-than-average trust experienced a decline in trust over time, and those that started with lower trust but were able to build it over time succeeded. This suggests that companies installing a new leader should think about how they work to build trust in that new leader before they even start. The research also covered how new leaders can build trust over time.

The Modern Board spoke with Dirks to learn more.

Kurt T. Dirks (prof at Washington University in St. Louis)Courtesy of Kurt T. Dirks

Do the findings of your study mean that new managers should try to curb expectations when starting a new job?

Kurt Dirks: Expectations and trust can come from all different places when you walk into a new role: maybe reputation or what people are saying about you in the press, what you've done in the past, the relationships that you might have, and then maybe even what you look like. … some of those things you can't do much about. The thing you can do is purposely set expectations for what they should expect from you over the next few months, but be cognizant to not try to over-inflate or overpromise and set clear and realistic expectations.

What can managers do to build trust when they start and across their tenure?

KD: No matter where you start out, in terms of trust, there are certain behaviors which are really important when they start out. One of them was investing time to build personal relationships with subordinates, which may not be surprising but it just turned out to be so crucial in this notion of building early trust, and talking about values… those sets of behaviors really mattered. And there's the set of implications around managing expectations.

If new leaders want to keep expectations modest, how does someone who comes in with a great resume curb the high levels of trust that come with being associated with those prestigious institutions?

KD: It's important to just be very clear about expectations, what the next few months will look like, being honest about the challenges, and what performance monitoring will look like. Clarity of lots of communication early on can help overcome some of the assumptions that people may walk in with.

This study was conducted at the US Military Academy at West Point, is that very applicable to corporate business leaders?

KD: Many of the dynamics of trust and leadership we have found across nearly every study ... We've seen it in sports, we've seen plenty of health care teams. Other colleagues have done it with restaurants and Fortune 500 companies. The dynamics of trust and performance and the factors which drive trust seem to be fairly constant across organization types of organizations and organizational cultures, and there is even actually quite a bit of similarity across national cultures.

What are the connections between trust, ethics and performance?

KD: We saw those leaders who were either maintaining high trust, or more importantly rapidly building trust, discussing their values and living up to those values. We probably can call that having integrity … The individuals who talk about their values, how they connect with the company's values, and grow their moral values are the ones maintaining trust and driving high performance.