Can boards afford purpose and sustainability during the pandemic?

While in crisis mode, some may doubt that companies can continue to focus on improving their environmental, social and governance (ESG) performance. But there's good reason to believe that ESG is an astute indicator of corporate resilience.

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Being a board member has never been harder. The COVID-19 pandemic is a once-in-a-lifetime challenge for board members and corporate leaders. As the pandemic spread,

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corporate leaders had to react quickly, assess how it would affect their business, and make quick but momentous decisions to keep their companies operating. In some cases, especially in the worst affected industries, e.g., air transportation or tourism, they are fighting to stay alive.

Given the bleak outlook, a reasonable question has been raised about whether corporations should shelve the numerous sustainability initiatives aimed at improving their environmental and social performance and focus on keeping the lights on. 2020 was going to be the year of corporate purpose, and even financial investors were increasingly joining other stakeholders in asking corporations to improve their environmental, social and governance (ESG) performance. A skeptic would now look back at all this as a luxury we could only afford in prosperous times. As a recent Financial Times debate puts it: "It's a lot easier to put purpose above profit when cash is flush and times are good." Are we going back to just profit and forgetting purpose in the pandemic and post-pandemic world?

This question is especially timely, as most corporations are now slowly exiting from crisis mode and starting to evaluate more medium- and long-term scenarios. Should they rethink their commitments on social and environmental issues? The enormous number of layoffs and furloughs seems to indicate that most boards are doing just that, at least in terms of their commitment to their people. Environmental commitments are stickier, but it is likely that boards are facing similar tradeoffs on the environment too: should we scrap the CO2 emission reduction technology investment we had planned? Should we go for cheaper (and dirtier) energy sources?

Obviously, the specificity of each case requires an in-depth analysis, and it might be dangerous to generalize. Yet, we already know enough on the resilience of firms to major crises to suggest that boards should stick to their social and environmental commitments and, in some cases, double-down. Resilience is a firm's capacity to absorb the blows from a crisis and quickly recover in terms of economic and financial performance. Cash and low debt, for instance, make for more resilient firms. But social and environmental performance (two key aggregate dimensions of sustainability) also play a role. For instance, several studies on firm resilience on the 2008-2009 financial crisis had already suggested the importance of social and environmental commitments. One study shows that, during the 2008-2009 recession, non-financial firms with higher sustainability investment had 4% to 7% better stock returns. Following the recession, another study finds that firms that kept investing in R&D and sustainability performed better in post-crisis years.

Perhaps. But isn't the pandemic different? Does anything we learned from the past crisis

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apply now? Fortunately, researchers have already started to study the resilience of firms to the pandemic and, so far, all the evidence points to the importance of sustainability. One study of U.S. firms finds that a one standard deviation increase in Environmental and Social (ES) ratings leads to a higher stock return of 2.1% on average. This effect is even stronger for firms with high advertising expenditures (a proxy for investment in brands and customer loyalty). Another study of 6,000 global firms shows that firms with high ES scores had a 2% higher stock price two months after the outbreak, compared with similar firms with low ES scores. Finally, using data collected in 11 languages across thousands of news sources in 47 countries, another study shows that during the market collapse, firms with more positive media sentiment of their labor, supply chain and operating response to the COVID-19 crisis had less negative returns.

Why would financial markets favor companies with higher sustainability ratings, and punish companies that might otherwise appear to be more conservative with their cash? Shouldn't they be primarily concerned about the financial viability of the firms they invest in? They are. And this is exactly why they are investing more in firms that honor their commitments to all stakeholders: employees, customers, suppliers, but also the natural environment and future generations. Employees and customers are more likely to stick with the firms that did not disappoint them during the crisis. Furthermore, at least in Europe, the post-pandemic recovery funding will be increasingly tied to the EU Green Deal, the policy framework that will guide our response to climate change, and thus even public funding is more likely to go to more sustainable firms.

Given these arguments, financial investors are now considering ESG as good an indicator of corporate resilience as higher cash holdings and lower financial leverage. A recent report by BlackRock, the world's largest asset manager, analyzed the resilience of the ESG stocks and concluded: "This period of market turbulence and economic uncertainty has further reinforced our conviction that ESG characteristics indicate resilience during market downturns."

Of course, board members and corporate leaders should consider how environmental and social commitment fit with their own unique purpose and strategy. And there will always be short-term opportunities for contrarian strategies and arbitrage deals. Yet, the fiduciary duty of board members is to steward the corporation for the long term and, under that time horizon, can they really afford the risk of NOT investing in sustainability?

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