TALKING ABOUT THE LONG TERM, EVERY QUARTER?

HOW TO DISCUSS ESG AND LONG-TERM PERFORMANCE GOALS ON EARNINGS CALLS

The COVID crisis has caused comprehensive disruption. Corporations have had to respond to a broad set of challenges from keeping the lights on to protecting their employees. Reporting teams have had to adapt in real time and provide the markets with informative updates during significant uncertainty.

By Brian Tomlinson

BRIAN TOMLINSON
Director of Research,
CEO Investor Forum
Brian develops executive-ready research to enable issuers to reorient their disclosures toward the long term. His publications provide principles, frameworks, and management approaches for the practice of long-term disclosure and integration of ESG issues. Brian has a decade of experience as a corporate finance attorney. He has an MPA from Harvard Kennedy School and a BA from Oxford University.

REFERENCE LIST

- **Practical Guide "Disclosing environmental and social issues in the proxy statement": bit.ly/332UXFD**
- **Paper "ESG and the Earnings Call: Communicating Sustainable Value Creation Quarter by Quarter": bit.ly/3bAtlvy**
- **Research Paper "The Economic Significance of Long-Term Plans": bit.ly/3lUxn6t**

ESG themes have been at the core of the crisis. This has caused many companies to accelerate their engagement with ESG. This amplifies existing trends in disclosure. We've seen more ESG information appearing with greater frequency in proxy statements and 10-Ks. The adoption of the SASB standards is enabling more and better ESG disclosure across a variety of other disclosure formats like investor day presentations. Corporates are also convening investor-focused ESG calls to enable deeper dives into the detail of the ESG story.

Though the volume of ESG information being disclosed has certainly increased, ESG has tended not to be part of the quarterly earnings call. In the United States, reporting earnings quarterly is mandatory and issuers convene earnings calls to enable senior management to provide context and set clear expectations for future earnings.

The earnings call is important. Investor Relations officers identify it as the most important forum for telling the issuer's story to the capital markets – it is also a significant focus of senior management time. After all, short-term earnings do move markets and negative earnings surprises do cause significant share price declines.

Integrating ESG issues into the earnings call is difficult. In our paper, ESG and the Earnings Call, we identify why these disclosures are necessary but we also note that they are not without complexity.

Our conversations with sell-side analysts (a key audience for earnings call disclosures) highlighted several challenges. Limited or low quality disclosure on ESG made meaningful discussion and analysis difficult; the time horizon and inter-period availability of ESG information made it harder to incorporate ESG data into valuations; and there was an expectation that discussions of ESG themes in earnings calls would be boilerplate; a time-consuming distraction from core financials required to update valuation models. The issuers we spoke to worried about disrupting a well-orchestrated dialogue with analysts; finding time in an already crowded agenda; and the comparability of relevant ESG metrics and ensuring that the data fairly represented the issuer's performance in reference to their peers (SASB and TCFD were widely identified as part of the solution to these comparability concerns).

Recommendations

The COVID crisis has given ESG more prominence in the earnings calls of more issuers; it has compelled reflection on ESG themes (from human capital to supply chain sustainability). In our research report – ESG and the Earnings Call – we conducted a pilot disclosure project with issuers. Building on that, we make recommendations to issuers in four categories to enable this ESG momentum to continue. Given that ESG themes underlie how a company creates value, key ESG information should be part of earnings call disclosures.

First, establish the foundation for success by getting C-suite support, conducting a materiality assessment to identify the most financially-material ESG issues, developing a robust strategy and execution plan to mitigate the risks and capture the opportunities presented by those most financially material issues, and implementing the technical systems that will enable the recording, auditing, and reporting of ESG information.

Second, build towards the earnings call by integrating ESG and long-term strategy content into existing disclosures in a sequential manner (from sustainability report to proxy statements, to investor day presentations, to ESG-specific webinars/presentations, to earnings calls) to build comfort and confidence with the investor base, as well as management.

Third, share ESG-specific questions with your sell-side analysts to shape the Q&A discussion and more regularly bring ESG and long-term strategy into the conversation.

Finally, develop a plan for how you will use each of the four earnings calls in the fiscal year. For instance, provide quarterly updates on key ESG performance and financial measures in three of the four quarters, but use one of the four calls (either Q1 or Q4) to provide a deeper discussion of ESG and long-term strategy and how recent performance compares to expectations. By acting on these recommendations, the objective is to make ESG and long-term strategy content, including the impact of ESG execution on financial performance, a consistent component of your value creation narrative.

Earnings calls and stakeholder capitalism

The expectations of corporate behavior have been changing over the past decade making a deeper integration of ESG into valuation even more critical. The expansion of disclosure on ESG themes is part of a, to date, incomplete response to enhanced social expectations. Given that companies are increasingly identifying a stakeholder outlook, the audience for earnings calls is arguably no longer just sell-side analysts and their institutional investor and hedge fund clients.

The emerging stakeholder paradigm means that disclosures across formats need to reflect the purpose-led, stakeholder approach a company seeks to follow (and must do so credibly and consistently); as companies such as Nestlé have begun to do on their earnings calls. Through sharing ESG information on earnings calls, issuers are able to provide a more comprehensive understanding of their long-term value frameworks. It allows managers to tie together the near-term execution and the long-term outlook. Our markets (and regulators) increasingly expect companies to have a long-term, forward-looking approach. After all, the megatrends that our companies and societies are exposed to are unavoidable and will emerge over the long-term (e.g. the transition to a low-carbon economy, and unprecedented automation).

Issuers spend significant time to ensure that the markets understand their value proposition – a core function for investor relations, corporate sustainability and audit functions. That understanding will be incomplete without ESG being integrated into it in the key disclosure forums and directly connected to value. To be consistent and meet the expectations of many categories of institutional investors, ESG should be a consistent, integrated feature of earnings call disclosures.