Rarely a day goes by without the financial news reporting on adverse reactions by businesses, investor groups, trade associations, lobbyists, think tanks and politicians around the world about requirements for commercial entities to file reports disclosing the extent to which their activities are affecting—or will affect—environmental, social and governance (ESG) matters in the local, national or global economic landscape.

Arguably such sentiments are now strongest in the U.S. following the issuance by the Securities and Exchange Commission (SEC) in March and May this year of two sets of draft regulations for publicly-held corporations as well as investment funds, respectively, for mandatory disclosure of their compliance with prescribed ESG standards. Similar constituencies are voicing similar concerns in Canada, Europe, the U.K., Australia, and many other locales.
This is hardly unexpected. After all, such government requirements are anathema to these parties because they believe reporting on these actions or inactions according to their alignment with ESG objectives and principles could affect the returns on their engagements with investors, customers, suppliers, workers, business partners and other stakeholders on which they depend for their business.

Of course, such returns can be positive or negative depending on the substance, magnitude and credibility of the firms’ reports.

Among most business executives and boards there is a presumption—the “maintained hypothesis” we economists like to say—that they will be negative. Indeed, from the scale, scope and frequency of public outcries from those parties about such ESG reporting and disclosure requirements, it is fair to say they assume such adverse outcomes are will be predominant.

But the converse also can be true: Firms who engage, or publicly commit to engage, in business activities that are aligned with ESG objectives and principles—and willingly, if not proactively, disclose reports on them in line with otherwise mandated standards—presume they stand to benefit in the marketplace by investors, customers, suppliers and the like.

Although the prevailing bet on the probability of such conduct being displayed is deemed to be much lower than the obverse, an assessment of business commitments made at COP26 in November 2021 suggests otherwise.

This raises two fundamental principles about the modus operandi underlying the rationale for the pursuit of government-mandated ESG reporting and disclosure requirements.

First, there is a belief that reporting and disclosure per se will create the necessary incentives for the sought-after operational changes in the ESG conduct of firms and that such incentives will be realized, thus inducing changes in the way firms function.

Of course, such changes will rarely, if ever, manifest themselves in the short-run within a modern business; indeed, they are usually complex, intricate and multifaceted undertakings. The process tends to be an evolutionary rather than a revolutionary one, particularly in large multinational enterprises, especially those who provide multiple products or services and operate in disparate geographies.

But the central point is this: whatever reporting obligations are taken onboard, there is a strong belief—almost zealousness—that the mandated disclosures and the reports generated therefrom are in and of themselves agents directly propagating fundamental business transformation leading to enhanced corporate sustainability. After all, this would seem to be the raison d’être for requiring such disclosures.

Yet even if that train of reasoning becomes a reality, the simple fact is that mandatory ESG reporting and disclosure simply are NOT substitutes for both embracing and actualizing sustainability in business operations.

In short, integrating sustainability operationally into an enterprise’s fundamental functions that engenders changes in production processes, hiring practices, disposal of waste, among other dimension, is a market action. Disclosure by firms about the degree to which they have complied with regulations according to prescribed reporting standards of course is important. But more likely than not, regrettably that amounts to a very different animal than transforming the DNA of the business.

In my view, within the plethora of the discussions about pursuit of mandated ESG disclosures among business associations, policy makers, regulators, standard setters, activists—and even in the business literature—this equivalence is assumed.

To be blunt, any backslapping, embracing and handshaking among ESG advocates induced from such disclosure requirements becoming the rule of the day are misplaced—no matter how good they may feel.

This does not mean that such reporting mandates are not sound objectives. Indeed, they should be pursued. What it does mean, however, is they are at best an intermediate step for sustainability practices to become integral to a business’ operations.

And a lot can happen along the way to derail such an outcome being a reality. This is exactly what I meant when I wrote in this space one year ago: “Sustainability Is Far More Than Just A Corporate Aspiration.”

Second, is it not out of the question to believe that in some cases, the ESG disclosure commitments required to be reported by businesses actually may well prove to be in the firms’, investors’, workers’, consumers’ and the society’s own best long-run commercial and social interests?
Put another way, what should be the stance of a public policy that requires ESG disclosure even in cases where businesses already undertake such reporting to their stakeholders *voluntarily or unilaterally*—that is absent the regulatory mandates—and whose operations in the market are already infused with sustainability practices?

In such instances, it might be tempting to argue this amounts to “regulatory burden.” Perhaps: after all, the strain on such businesses would be *de minimis*. At present, these cases (regrettably) likely will be rare. We should be so lucky.

What it *does mean* is government regulation for mandatory ESG reporting and disclosure should not be monolithic or a one-size-fits-all.

At the same time, public officials may well want to give due recognition to such instances so counterpart firms in that sector, or firms in different sectors can learn how best-practice performance of operational sustainability is executed.

It is hard to overstate this point. It should not be seen as a heroic feat—nor a naïve one—for the C-suite and the boardroom of the modern corporation to fully embrace and execute on sustainability as a *core, perhaps the core*, operational mandate of the business for which they are responsible.

What does this mean in practical terms? *As I have argued earlier,* pursuit of corporate sustainability entails undertaking *operational* decisions that lie at the core of a business’s day-to-day functions that, *taken together*, serve to maximize the business’s *long-run growth* as well as assessing their *impacts* on the firm’s long run performance across an array of dimensions, both *financial and non-financial*.

The emphasis being placed on *taken together* and *long run* is key. Firms who are most effective operating sustainably are those who invariably and consistently make their decisions so as to maximize the long-run commercial *and* non-economic—that is, ESG-related—returns on the use of their assets, both human and non-human.

There is a major rub here—especially in the case of the U.S. Our prevailing market policies, institutions and expectations are nested in “short-termism.” The SEC’s requirements for quarterly financial reporting establishes powerful incentives for myopia in business strategy and shareholder expectations. Absent a change in this arena, *which many of us have called for*, the inertia to overcome and adopt a long-term time horizon is both ingrained and formidable.

If one accepts these propositions, two key insights should leap out.

First, successful attainment of ESG and sustainability goals requires a fundamental understanding that ESG and sustainability are *not just matters of engaging in risk-mitigation but also of pursuing growth maximization*. In a word, corporate executives, board directors and, investors must think of ESG and sustainability initiatives as opening new doors of opportunities for *business growth*, not as constraints to abide by with as little effort as needed to fulfill them.

Second, truly embracing sustainability means that C-suite executives and board directors carry out their missions through an *integrative* lens, one that cuts across a business’ principal functions; its markets, both on the input and output side; and its geographic footprint.

Thus, the firm’s Chief Sustainability Officer (CSO) should be located in the *C-suite* working closely with the CEO, and his/her role should be truly a *globally integrated* one—in every sense of the word: across product and input markets as well as across geographic markets. It is not too far-fetched to think of the *role of the CSO as the “Integrator-in Chief.”*

So, too, should be the role of *boards*’ Sustainability Committees, which, unfortunately, are seen as novelties in the boardroom. Indeed, we in the U.S. are far away (actually very far away) from an SEC requirement for public company boards to have directors who are “qualified sustainability experts” akin to the SEC rule for boards to have “qualified financial experts” engendered by the Sarbanes Oxley statute coming out of the financial crisis of 2007-8. While it may seem extraordinary for U.S. securities law to develop mandates for *non-financial* experts on boards, we may well soon see one for *cybersecurity*.

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The SEC’s proposed regulations for ESG reporting and disclosure by public companies and investment funds constitute a watershed moment about the growing importance of sustainability in U.S. businesses and markets.
But as salient a development as this is for the globe’s largest economy, it is really just the start of a long list of critical items on the sustainability agenda to be tackled by the U.S. and other advanced countries inasmuch as ESG reporting and disclosure are not substitutes for businesses engaging in meaningful actions to enhance the sustainability of their operations through enterprise transformation.

To this end, here four items requiring attention:

- **Harmonization** of the different sets of existing sustainability standards and reporting requirements around the world should be placed high on the agenda.

- C-suite executives and boards of directors must fashion the systemic integration of businesses’ financial and “non-financial” metrics and performance—each of which are critical elements of the lifeblood of the modern corporation and the ecosystem in which it operates.

- The global development and education of qualified professionals who are expert practitioners in the monitoring and evaluation of businesses’ progress in enhancing operational sustainability should be a priority. The skills and hands-on experience required for these functions differ markedly from those necessary to conduct financial audits. Financial audits center on retrospective evaluations, whereas assessing progress in achieving sustainability is necessarily both retrospective and prospective. At the same time, in contrast to conducting financial audits, an interdisciplinary set of skills is required for appraising the systemic integration of sustainability into business functions.

- There is a need for an independent dispassionate forum to foster the global exchange of ideas, learning from one another, and forming consensus on ways to discharge common critical tasks for monitoring, evaluating and discharging the operational integration of sustainability into business functions. Such a forum should be multilateral, multinational, and cut across industry sectors, and be comprised of business executives and board directors; sustainability standard setters and regulators; sustainability experts and practitioners steeped in sustainability evaluation and monitoring; financial auditors; investor, environmental, labor, social and consumer interest groups; among others.

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