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Now is the Time for Companies to Strengthen their Approach to ESG and Sustainability

Environmental, social and governance (ESG) criteria have become a focal point for companies, especially as COVID-19 highlights the importance of overlooked social factors. Fortunately, there are steps organizations can take to enhance ESG and sustainability performance while demonstrating how they put their values to work.

The definition of environmental, social and governance (ESG) criteria and their role in a company's value and business strategy have evolved over the past two decades from an issue of debate to one of necessity. In many geographies, implementing tangible ESG programming and reporting has evolved from a compliance obligation to a key part of a corporate strategic agenda.

The way in which a company utilizes its ESG framework to create value continues to drive dialogue in boards and beyond as it moves from a voluntary approach to one that in some jurisdictions is increasingly subject to mandatory reporting. On the "E" issue of climate change, for instance, international agreements and national policies are deliberately driving a transformation of select global economies. Governance has also evolved, with best practices clearly identified and tracked.

For social "S" factors, however, companies are varied in their approach. While some sectors with clear supply chains and operational footprints have long emphasized safety or human rights observance, others have defined social as community giving or corporate values. As recently laid out by corporate governance experts at FTI Consulting, the broad use of the term "social" may have contributed to a failure to conceptualize the "S" in ESG, leading to an absence of focus and measurement from the market. That dynamic has changed overnight.

Today, ESG policies play a fundamental role in the decision-making processes for companies. In 2019, an incremental USD$70 billion is estimated to have been invested in ESG funds. The mere fact that ESG investing is anticipated to top $50 trillion in the next two decades confirms that the criteria have shifted from margin to mainstream. These factors are no longer simply a "nice to have," but rather a pivotal part of a company's performance and evaluation.

A Multi-Stakeholder Approach to Growing Social Factors

Unlike E and G factors, "S" issues have often been difficult to define on corporate agendas, capturing a range of issues that vary by sector from community giving to matters of human rights. Their impact and value are often hard to quantify but, gotten wrong, pose irreversible reputational damage to stakeholder confidence and long-term value.

Now is a moment to lean on corporate principles and take a proactive position that mitigates risk and advances reputation. Organizations taking a stance on social issues must meet the expectations of each stakeholder group for both current performance and future ambitions. This has been seen with issues from protecting workforces through COVID-19 to applying principles in the light of racial injustice. In this sense, we have witnessed the transformation of the S tenet of ESG from "social" to "stakeholder."

Expectations and a focus by investors and other market participants, such as rating agencies, on S factors will grow as scrutiny of companies continues to rise across stakeholder groups and the world adapts to a rapidly changing business landscape. This new normal creates opportunity to focus attention on S issues that enhance all stakeholder relationships, from employees and regulators to customers and suppliers. Nevertheless, companies cannot ignore their efforts on environmental and governance since ESG issues are interconnected.

Navigating the New Norm Through an Effective ESG Program

An effective ESG strategy enables businesses to improve performance, manage risk and enhance market position, addressing all stakeholders, inspiring investor confidence and enhancing shareholder value. Below are five key considerations for companies, as they develop their ESG strategies.

- ***Material Issues***. Companies should be mindful of issues that are considered material by internal and external stakeholders. The material impacts of ESG issues may include topics that are financially, as well as environmentally and socially, material. These categories of issues are not mutually exclusive, and companies need to maintain a long-term perspective to evaluate the extent to which stakeholder impacts can affect their ability to operate and preserve value.
- ***Board and Management Oversight.*** Demonstrating leadership and oversight of ESG management at the top levels of the organization, including the board, shows the company's commitment to "walk the talk" on sustainability. The oversight of ESG issues may vary across companies depending on specific needs and circumstances, and — just like with the management of ESG issues — a one-size-fits-all approach is not recommended. However, it is important for companies to formalize an ESG oversight structure in order to effectively assess ESG-related risks and opportunities.
- ***Innovative Programs and Policies.*** The establishment of innovative programs and policies to advance a company's ESG criteria requires a well-coordinated approach. Companies should review such programs and policies as investments that will yield long-term returns and not as compliance costs. In that regard, any new programs and policies must also be authentic to how a company operates not only to ensure the program is viable over the long-term, but also that it is credible with all key stakeholders.
- ***Metrics and Goals.*** The management axiom "you can't manage what you can't measure" applies to ESG management as well. ESG metrics and goals should be driven by the materiality assessment. The purpose of adopting such metrics and goals should not be driven by a reactive effort to appease ESG rating agencies or reporting frameworks. While third-party guidelines can help organizations develop their thinking around ESG management, companies need to decide on what measures better allow for improved implementation of the strategy while also facilitating effective oversight.
- ***Integrate ESG Programming with Communications.*** Utilize ESG programming to identify new communication channels to build stakeholder relationships, enhance reputation and bolster investor confidence. There is now a range of ESG and sustainability standards, metrics and assessments, but these are often poorly linked to corporate stakeholder engagement strategies. Conversely, ESG strategies based solely on performance will miss the dynamic and direction of public policy or stakeholder sentiment beyond investor interests.

Stakeholder demands are growing. As ESG becomes even more integral to financial performance and investor expectations, an organization's approach to ESG will only grow in importance as well. In such extraordinary, uncertain and unsettling times, effective management of ESG will contribute to sustainable business resilience. This stakeholder-conscious approach is now the new normal.

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