Opportunus

Insights Report
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ESG Overview (Environmental, Social and Corporate Governance)

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Executive Summary

ESG stands for Environmental, Social and Governance and is effectively a form of social credit score for a business which enables businesspeople and investors to gauge the company's general ethics and the positive impact it has on society.

KPMG regards the ESG rating of an individual's business as critical for investors and expects that it will determine who can and will do business with you in the future. They also state that data and transparency will be critical to capture your commitment to ESG and to articulate the resilience and sustainability of your business to your stakeholders. This is all important to consider when running a business going forward. It is not worth risking getting left behind by this corporate ethical revolution. This notion of transparency is vital for there to be any sense of validity with ESG. This could include public reports on their social and environmental impact with clear, standardised, easy-to-understand metrics, such as carbon emissions, investments in training programs, and proportion of workers earning a living wage.

This report outlines the purpose behind ESG ratings and accentuates the real need for businesses, no matter the size, to take action to leverage sustainable business practices, whilst aiming for proud benchmarks such as carbon neutrality.

Overview

The inception of ESG dates back to 2005 in a landmark study entitled “Who Cares Wins,” following the former UN Secretary General Kofi Annan who wrote to over 50 CEOs of major financial institutions, inviting them to participate in a joint initiative under the auspices of the UN Global Compact with the support of the International Finance Corporation (IFC) and the Swiss Government. The goal of the initiative was to find ways to integrate ESG into capital markets.

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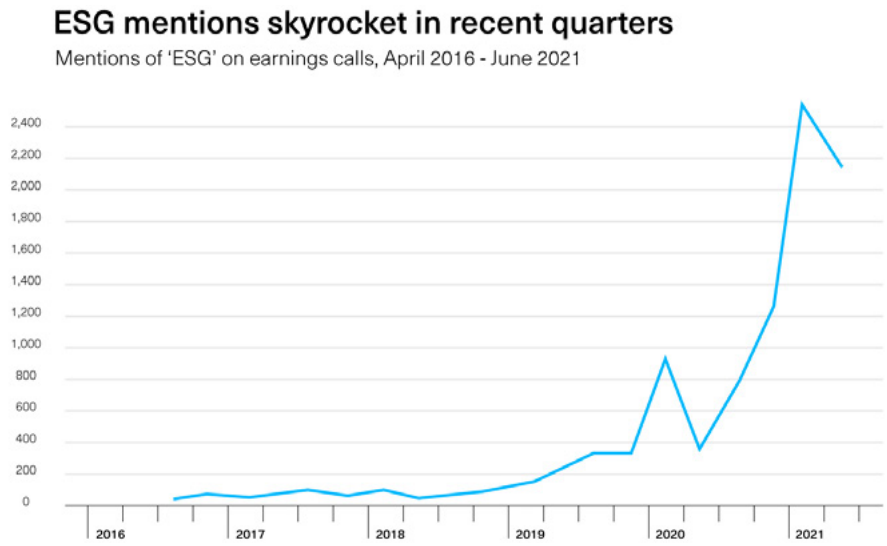

This concept is really starting to reach maturity and is beginning to reach mainstream discourse, with McKinsey regarding ESG scores as playing an increasing role in companies’ decisions around mergers, acquisitions, and divestitures. On a more trivial level, the topic ws even discussed on the US’

most listened to podcast, The Joe Rogan Experience, where ESG was blamed for perpetuating artificial "woke corporate interests."

As per CBS Insights, conversations about ESG have skyrocketed in the last year, as seen in the chart above, displaying the accelerating importance of these factors for businesses, especially those that are publicly traded or in the process of raising capital. Interestingly, ESG funds largely outperformed the S&P 500 during the pandemic with it becoming abundantly clear that consumers are becoming increasingly socially and environmentally conscious. Therefore, corporations and investors have to adapt to stay competitive.

Investors are increasingly using these ethical pillars as benchmarks to select companies that are better positioned to prepare for climate risks, avoid the market volatility associated with scandals or social backlash, or even outperform the broader market.

However, it is important to regard that ESG is subject to a degree of inaccuracy, since it heavily relies upon self reported data. Regardless of some growing pains, it seems that this wave is coming. McKinsey is investing heavily into their consulting capabilities in the sector, Bain Capital have recently launched their "Social Impact Fund" to drive transformative social impact by applying Bain talent in partnership with the most innovative and effective organisations, addressing some of the world's most pressing

issues and there are a plethora of funds set up for the specific investing in companies that contribute to general social good.

As per Harvard Business Review, ESG represents something of a movement to reform capitalism and there has been a wave of converts in recent years. The Business Roundtable, which represents CEOs of the country's largest companies, from Coca-Cola to Wells Fargo, issued its Statement on the Purpose of a Corporation in the summer of 2019. In doing so, it joined a broad coalition from U2's Bono to the CEO of BlackRock, Larry Fink, who are aiming to ensure capitalism serves workers, customers and the environment as well as shareholders.

Of course this all sounds rosy, but at least for now, we'd be right to be sceptical about the true impact of this ESG revolution. Harvard Business Review questioned "what actually happens when investors with $100 trillion of assets commit to investing more responsibly?" Their answer? "Not much, at least so far." ESG critics would argue that it has birthed a culture of superficial "virtue signalling" leading to corporate farces like Pepsi's infamous tone deaf advert starring Kendall Jenner giving a police officer a can of coca cola at a protest.

Instances like this are indicative of the short term trend of businesses looking to invest in ESG simply to launder their reputations. Harvard Business Review cites research, from Soohun Kim and Aaron Yoon of the Korea Advanced Institute of Science and Technology (KAIST) and Northwestern University - Department of Accounting Information & Management respectively, that shows that investors who signed onto the United Nations principles

did not improve the social and environmental performance of their investments.

Yoon and Kim believe that signatories "use the PRI status to attract capital without making notable changes to ESG." Similarly, signatories to the Business Roundtable statement have performed no better than other companies in protecting jobs and worker safety during the pandemic. This does not discredit the overarching movement, to hold companies accountable for their ethics and behaviour, although as Harvard Business Review rightly states, tokenistic programs and philanthropic side projects erode the public's trust and invite backlash against the reform movement itself.

ESG was a movement meant to benefit the public good, however it risks becoming a buzzword co opted to keep maximising short-term profits.

As we mentioned before, ESG has begun to enter public discourse, with key personalities, like the US podcaster Joe Rogan, already questioning its integrity and important industry mouthpieces such as the FT's US finance editor Robert Armstrong warning people of the "fallacy of ESG investing," whereby society receives no benefit from this Panglossian do-well-by-doing-good story. Armstrong believes this only helps fund managers sell products and allows companies to polish their reputations while avoiding hard choices, whilst urging businesses to "follow your values, but keep your eyes open." Wise words indeed.

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will determine who can and will do business with you in the future.

They also state that “data and transparency will be critical to capture your commitment to ESG and to articulate the resilience and sustainability of your business to your stakeholders.”

This is all important to consider when running a business going forward. It is not worth risking getting left behind by this corporate ethical revolution. This notion of transparency is vital for there to be any sense of validity with ESG. This could include public reports on their social and environmental impact with clear, standardised, easy-to-understand metrics, such as carbon emissions, investments in training programs, and proportion of workers earning a living wage.

The extent of this transparency has an impact on your license to operate in the minds of the stakeholders around you such as; regulators, governments, and increasingly, NGOs powered by social media. This is an emerging concern for large businesses and the trend is only continuing, with social media users now able to lobby against brands that perhaps break their promises or act in a way that is in opposition to ESG values. Sometimes this can lead to something of a witch hunt but it also shows that consumers are beginning to hold businesses somewhat accountable for their actions.

Significance for You and Your Business

As per KPMG Vice Chairman and Head of Audit for China, David Ko, as ESG enters the mainstream and more stringent ESG reporting requirements come into effect, it is time for companies to review both their ESG reporting and performance in a holistic manner. Ko suggests a systematic approach to the management of such issues, which in turn will help the board understand the implications of the accompanying risks, and cash in on the opportunities brought by various ESG topics.

As a business, it is important to be aware of this emerging trend and remind yourself to leverage your own positive organisational practices in your brand communications. KPMG articulates this ESG process into three stages;

Get the Basics Right, Strengthen the Core and Communicate the Efforts.

Looking at this, it's important to implement a coherent approach to managing and communicating your own ethical practices.

Getting the Basics Right

KPMG rationalises this as "setting a common ground where the company and its key stakeholders understand and agree on the definition of 'ESG'." This will likely look different for companies of various scales and industries, for instance a bank's approach would be rather different to a medium sized accounting firm's approach. The adoption of a coherent strategy must come from the top down with managers setting the tone.

As a consulting partner, at Opportunus, we can help identify, prioritise and validate the most material ESG issues that your company should focus on, so as to

optimise the use of resources.

Strengthening the Core

This step involves the proactive management and ongoing discussion of ESG related topics within your business. There is incredible value in adopting a formulated approach to identify, assess and respond to ESG-related risks in your business operations. Thus, we can assist you in setting certain goals and communicating agreed strategies throughout your organisation.

At Opportunus, we also offer PR services, which goes hand in hand with the leveraging of ESG for growth. Thus, we can help you and your business by discussing with you this emerging concept to ensure you have a level of thought and a vision for positive impact in your business strategy. This could include looking at your supply chain, working to be more sustainable or investing in wellbeing solutions for your workers.

Communicating the Efforts

At Opportunus, aside from acknowledging the potential for ESG to be a force for positive and sustainable change in modern businesses, we also see implementation as an opportunity for growth.

The success in this is to communicate your positive actions effectively. Harvard Business Review made a pertinent point, that tokenistic ESG gestures will only serve to damage trust in the long run as consumers

become increasingly aware of the business practices of the brands they patronise, therefore it is imperative that a communication strategy is not superficial but effectively leverages truly positive processes that the business have thoughtfully implemented.

Around the globe, a third of all professionally managed assets, roughly $30 trillion, are now subject to ESG criteria. Between April and June of 2020 alone, investors poured more than $70 billion into ESG equity funds, vastly exceeding recent annual flows. These numbers reflect a growing awareness, among companies, investors, and shareholders alike, that to remain viable, businesses must think about and manage their impact on the planet in new ways.

Sustainability is the new goal and according to this emerging consensus, ESG strategies and effective measurement of ESG performance is the way to achieve it.

As this revolution is beginning to affect the bottom lines of businesses, its importance will inevitably increase.

Closing Words

At the moment, ESG is most important for large multinationals, publicly traded companies and those seeking to raise capital. However, that does not mean that SMEs should not be looking at formulating and communicating an ESG strategy.

Firstly, it is good practice to actively manage your business environment, the impact your business has on society and your company's general governance. Secondly, as consumers become increasingly engaged regarding the ethical practices of the business they patronise, it is imperative that your communications are effective in leveraging their positive ESG. For small and medium sized businesses, there may not be the same degree of short term danger in not investing in an ESG strategy, however there is considerable upside.

For instance, a well branded, trendy coffee shop can benefit significantly and stimulate growth with effective advertising, strong social media presence and an effective PR strategy, leveraging sustainable and ethical practices such as replacing all of their takeout cups with Vegware and promoting ethically sourced coffee. Regardless of the current end product, whether that be meaningful change or futile gestures by companies attempting to launder their appearance somewhat,

ESG is a movement with positive interests at heart, and it is undeniable that it is entering the mainstream with big businesses starting to deploy significant time and capital on the matter.

Therefore, going forward it's important you are aware of this emerging trend and we urge you to adopt and leverage sustainable business practices, whilst aiming for proud benchmarks such as carbon neutrality.

End Notes

Endnotes

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Thank You.