Corporate Finance Institute®

Introduction to ESG Case Study

Answer Key

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The answers below provide general key concepts that would be included in a correct response. There is room for interpretation here, but the key and essential components of a correct response are described below:

What do you think are the top material ESG risks facing the three-company portfolio?

- **Climate Change and/or Natural Resource Scarcity:** All three companies face physical risks from climate change, such as:
    - CFC: Physical climate change risks to their distribution infrastructure and natural resource product inputs, like water for beverages, agriculture production, and baking.
    - DDI: Their coastal location puts the asset at increased risk for physical damage from flooding, hurricane winds, and intensified storms.
    - PP: Physical climate change risks to distribution infrastructure presents a direct risk to PP's management of customer product distribution.

- **Labor Management:** All three companies face risks regarding their management of the labor force, such as:
    - CFC: With 65% of their drivers outsourced, this labor population presents a risk to corporate reputation as any negative behaviors or incidents will damage the brand and CFC's customer retention.
    - DDI: The labor force's utilization of public transportation could present a business continuity risk if this transportation system is disrupted due to climate change impacts, transportation system labor strikes, or public funding cuts that impact its reliability and accessibility.
    - PP: With a 30% turnover rate, labor management is a risk to business continuity and customer retention due to the impact each employee has on fulfilling the correct order for the customer across multiple supplier and product categories. Since PP does not mediate any disputes between customers and third-party sellers, the labor force's retention and fulfillment accuracy can be a risk to PP's corporate reputation, customer and market opportunities, legal action, and lost productivity.

- **Transparency & Reporting:** Given the information presented on each company's current ESG-centric efforts, the lack of transparency and reporting regarding each company's approach to ESG governance, strategy, risks, and opportunities, is a risk to corporate reputation, license to operate, valuation, and each company's ability to secure capital. CFC, DDI, and PP all face these risks due to the limited transparency and reporting on ESG issues.

To reduce risk across the portfolio, what kinds of engagement objectives would you recommend? In other words, what expectations would you recommend your management team communicates to these portfolio company leaders to ensure ESG risks are managed?

The correct response to this question will be open to interpretation and articulated in different ways, yet the key concepts that would be included in a suitable response are described below:

- **Climate Change Strategy:** Whether direct physical risks or the indirect risks to vital natural resource inputs for product development, all three companies face significant climate change risks. An engagement objective regarding a company's climate change management strategy would support immediate and long-term risk management.

- **Employee Engagement & Welfare:** All three companies rely on a large and consistent labor force for their daily operations. Disruptions due to labor strikes, labor availability, whistleblowing controversies, and the personnel logistics associated with labor heavy businesses are all risks to business continuity.

- **Supply Chain Management:** All three companies have significant procurement needs and the wide range of suppliers to each company presents a wide range of potential risks to manage. An engagement objective regarding the company's supply chain management, and specifically the management of supplier environmental and social impacts, would mitigate supply chain risks across the portfolio.

- **Product Safety and Customer Welfare:** All three companies either produce products directly or procure a variety of materials to create value for the customer (like DDI's procurement of building suppliers). Greater comprehensiveness and clarity on company actions to guarantee product safety and customer welfare would reduce the risks and direct costs involved in product recalls, lawsuits, and loss of saleable merchandise, as well as the indirect costs associated with customer losses, brand damage, regulatory fines, and lost social license to operate.