ESG CONSULTING

FAIRSUPPLY EXPLAINS

# The What and How of ESG Strategy

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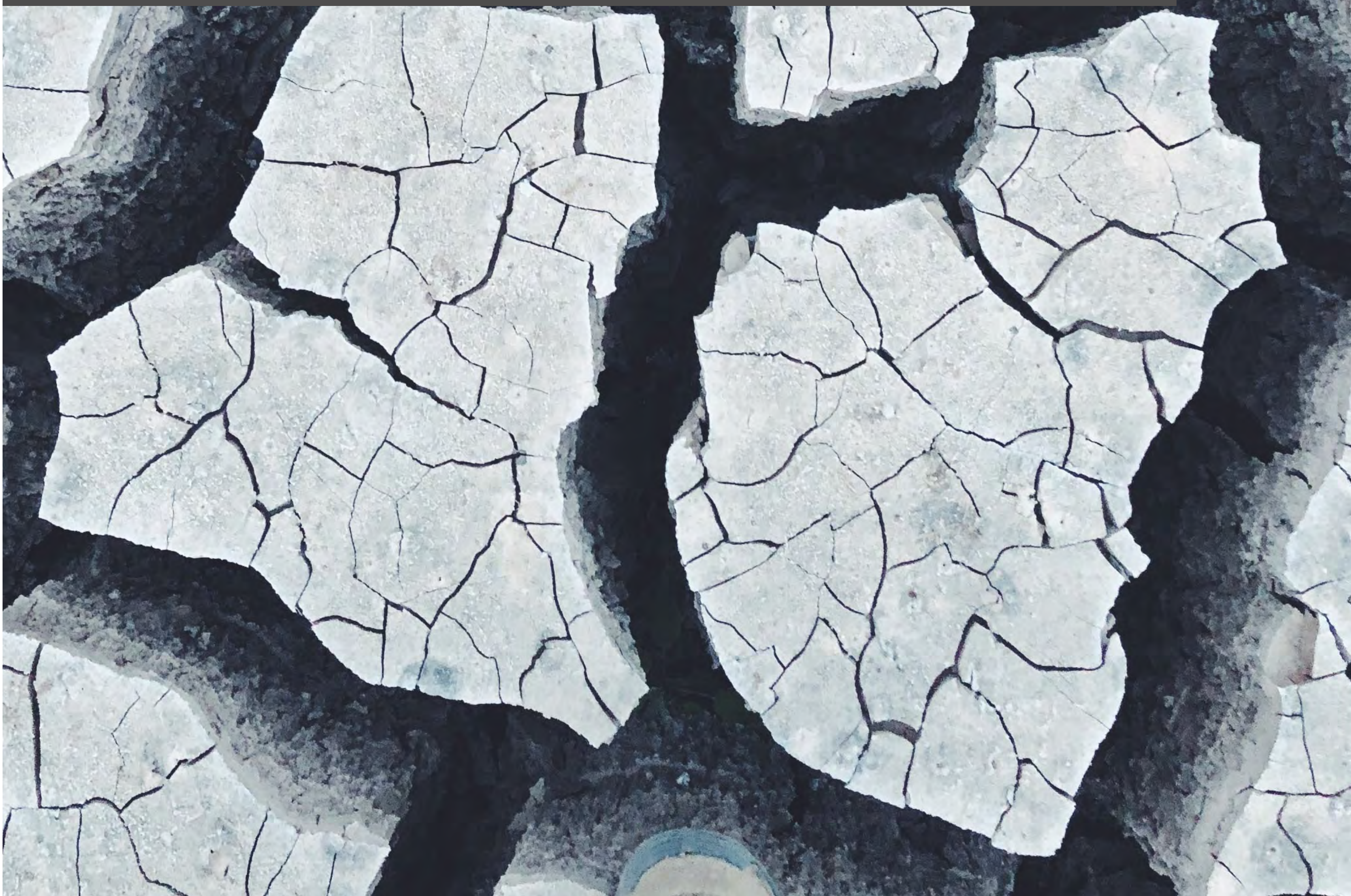


# Why this paper now?
# **ESG is not going away.**

## The What and How of ESG Strategy

By any reckoning – capital flow, Board and stakeholder engagement, regulatory change, Google search, to name a few – 2021 was a landmark year for ESG (environmental, social, and governance) issues. For companies the message is clear – ESG is not going away. (And it's not CSR.)

Given this context, forward-thinking companies are now asking, How does my organisation shift from a piecemeal and predominantly reactive engagement with ESG (behaviour which has historically typified CSR engagement) to one of strategic engagement?

We wrote this paper to address that question.

### We provide a framework your company can employ to develop an ESG strategy:

**a) What** is ESG and why a strategy is essential.
**b) How** to develop an ESG strategy:

**01 Scope**
Identify what ESG issues your company is going to prioritise

**02 Test**
Undertake internal and external stakeholder engagement

**03 Measure**
Develop an externally verifiable measuring effectiveness framework and associated reporting metrics to demonstrate ESG performance

**04 Operationalise**
Develop policies and operational processes to meet performance objectives

## What we mean when we say ESG

At its best and truest, ESG (environmental, social, and governance) is not a shallow buzzword that speaks to the core of responsible business practice. As the name implies, ESG covers a broad range of issues from carbon emissions and waste management, to modern slavery and community engagement, to corruption and executive remuneration.

A sound grasp of ESG is crucial for effectively managing associated risks and meeting legal obligations. ESG also presents significant opportunities for responsible corporate citizens to strengthen their public image and be at the forefront of sustainable innovation.

# Four core pillars of an ESG strategy

**An ESG strategy forms the foundation of a company's ESG approach. An ESG strategy is supported by four core pillars:**

**01**
**Value-aligned issues**

**02**
**Stakeholder engagement**

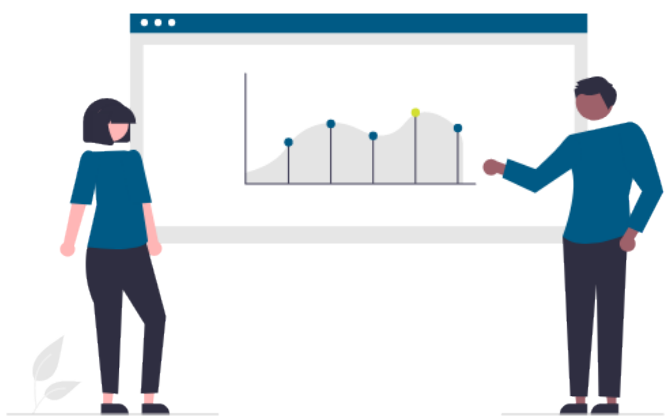
**03**
**Verifiable performance measures**

**04**
**Operational integration**

These pillars provide a measured approach to ESG that takes into account the business context to design achievable and impactful goals.

To realise lasting impact, ESG should be integrated into existing business practices, and measured to ensure efficacy.

International reporting standards such as the those from the World Economic Forum, Global Reporting Initiative, and the Sustainable Accounting Standards Board, deliver comparable and verifiable performance measures.



# Why ESG is essential, not an extra

The trend of private companies developing comprehensive policy frameworks in relation to "ESG issues" (environmental, social and governance) has spread rapidly across the full spectrum of global business. It can no longer be considered an 'optional extra' for entities that are serious about projecting a positive public image and contributing towards the attainment of broader societal goals.

> "By its nature, ESG is an area of corporate policy that covers an extremely diverse range of issues."

It does not readily lend itself to rigid categorisation that extends too far beyond the three pillars inherent in its name. This reality should be viewed as an opportunity for meaningfully tailored corporate responses that are sensitive to context and cognisant of the paramount importance of achieving meaningful impact, rather than an excuse to create policies filled with empty rhetoric that is expressed at such a high level of generality as to be, in practical terms, essentially meaningless.

ESG describes a set of socially desirable factors used to measure company performance in terms that greatly surpass traditional financial yardsticks. Whilst there is no definitive list of ESG goals or measures, the three categories of ESG are, in various forms, increasingly integrated into corporate processes.

It is antithetical to the core spirit of ESG for a company to seek to achieve bare minimum legal compliance for regulatory requirements or standards, including those that may potentially impact upon sustainable business practice.

# How to Develop an ESG Strategy

The foundation of an effective ESG strategy is supported by four pillars: value-aligned issues, stakeholder engagement, verifiable performance measures, and operational integration. These pillars ensure that the ESG strategy can be achieved within the scope of the organisation, while meeting the needs of key internal and external stakeholders including regulatory bodies, investors, and the wider community.

## 01 SCOPE

### Identify what ESG issues your company is going to prioritise

A non-exhaustive list of some commonly included considerations under each of the three branches is as follows:

- **Environmental:** carbon and other greenhouse gas emissions relating to human-induced climate change; biodiversity impact; habitat destruction (including deforestation, ocean acidification and desertification); waste disposal and management; water and other natural resource consumption.

- **Social:** the promotion and protection of human rights; modern slavery issues; supply chain transparency; labour standards; diversity and equity in the workplace (including at the executive and board levels); community relations; data stewardship and privacy; occupational health and safety in the workplace; social justice issues.

- **Governance:** effective corporate leadership to achieve positive environmental and social outcomes; anti-bribery and corruption measures; board structure, composition and oversight; executive remuneration; political lobbying and financial contributions.

In an influential White Paper published by the *World Economic Forum* in September 2020[1], the increasing prominence of ESG in mainstream corporate operations is described:

> "At the heart of [the ESG] exercise is the belief that the interrelation of economic, environmental and social factors is increasingly material to long-term enterprise value creation. Investors and stakeholders now expect companies to report on non-financial issues, risks and opportunities with the same discipline and rigour as financial information."

1 World Economic Forum - Measuring Stakeholder Capitalism - Towards Common Metrics and Consistent Reporting of Sustainable Value Creation: WHITE PAPER, September 2020, available at: https://www3.weforum.org/docs/WEF_IBC_Measuring_Stakeholder_Capitalism_Report_2020.pdf

## 02 TEST
### Undertake internal and external stakeholder engagement

There is widespread recognition that the unprecedented circumstances of the global COVID-19 pandemic have served to further magnify the importance of companies implementing robust ESG frameworks.

For a company pursuing ESG, the net is cast broadly in determining who constitutes a relevant stakeholder. **Each company has, at a minimum, at least five impacted stakeholder groups:**

- customers
- employees
- suppliers
- shareholders
- affected communities

Governments and other regulatory bodies can also be added to this list.

Ongoing, meaningful engagement with each key stakeholder group is critical to an effective ESG approach. Like the stakeholders themselves, such dialogues must occur not only within the company, but well beyond it. External engagement, featuring clear and critical dialogue where a company is questioned and challenged, is particularly important. Such engagement is essential for developing a holistic understanding of the evolving context in which the company is seeking to implement its ESG strategy, and to demonstrate that more than just lip service is being paid to the pursuit of ESG goals.

> "True progress in virtually every area of ESG performance can only be achieved through extensive collaboration with the full spectrum of company stakeholders."

## 03 MEASURE

### Develop an externally verifiable measuring effectiveness framework and associated reporting metrics to demonstrate ESG performance

A defining feature of ESG is that it is intended to provide a meaningful platform for a company's actual sustainability performance to be evaluated against specific, non-financial, standards. Despite this, and perhaps due to the relative scarcity of direct legal compliance and regulatory frameworks to govern much of the ESG reporting landscape, there has, to date, been a stark absence of comparable and consistent approaches for measuring and assessing ESG performance.

ESG reporting frameworks, though in their infancy, act as a valuable reference point when developing tailored performance measures. A company that is committed to meaningful ESG progress should seek out relevant performance measurement standards that are as uniform and independently verifiable as is reasonably practicable. Doing so provides a company with a credible way of demonstrating that it is making genuine progress on sustainability issues and helps a company to prepare for future standardised measures.

## International Standards and Reporting Frameworks

The lack of international consensus to date regarding ESG disclosures has resulted in the emergence of a relatively large number of frameworks for company reporting. Some of the more widely recognised international approaches include standards by the *Sustainability Accounting Standards Board,* the *Global Reporting Initiative*, and those derived directly from prominent international law and policy instruments such as the *United Nations Sustainable Development Goals* (SDGs) and *UN Principles for Responsible Investment.*

Over the past several years, in line with the explosion in mainstream corporate interest in pursuing ESG, there have been significant, coordinated efforts to create uniformity and standardisation for ESG reporting frameworks. A particular focus has been on the development of an internationally accepted set of universal, industry-agnostic, ESG metrics.

> "The World Economic Forum has developed a set of 21 core and 34 expanded metrics for ESG reporting that are built around key thematic pillars of Governance, Planet, People and Prosperity.[2]"

The 21 core metrics are mainly quantitative standards, which relates to information types already being reported by many companies and/or otherwise reasonable capable of being measured. These core metrics focus largely on the nature and impact of activities occurring internally within a company.

2 See World Economic Forum - Measuring Stakeholder Capitalism - Towards Common Metrics and Consistent Reporting of Sustainable Value Creation: WHITE PAPER, September 2020, available at: https://www3.weforum.org/docs/WEF_IBC_Measuring_Stakeholder_Capitalism_Report_2020.pdf

### The following are samples of the Forum's core reporting metrics from each of the key ESG themes:

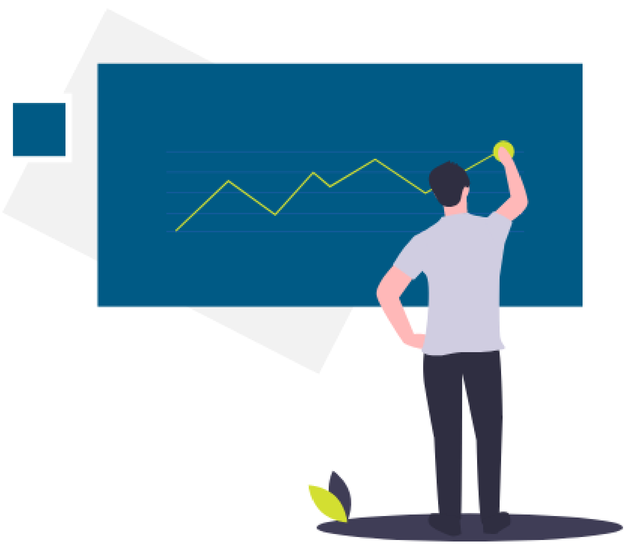
- **Governance – Ethical behaviour – Anti-corruption**
  Total percentage of governance body members, employees and business partners who have received training on the organization's anti-corruption policies and procedures, broken down by region. Total number and nature of incidents of corruption confirmed during the current year, but related to previous years; and total number and nature of incidents of corruption confirmed during the current year, related to this year.

- **Planet – Climate Change**
  For all relevant greenhouse gases (e.g. carbon dioxide, methane, nitrous oxide, F-gases etc.), report in metric tonnes of carbon dioxide equivalent (tCO2e) GHG Protocol Scope 1 and Scope 2 emissions. Estimate and report material upstream and downstream (GHG Protocol Scope 3) emissions where appropriate.

- **People – Dignity and equality**
  Risk for incidents of child, forced or compulsory labour. An explanation of the operations and suppliers considered to have significant risk for incidents of child labour, forced or compulsory labour. Such risks could emerge in relation to: a) type of operation (such as manufacturing plant) and type of supplier; and b) countries or geographic areas with operations and suppliers considered at risk.

- **Prosperity – Community and social vitality**
  Total tax paid. The total global tax borne by the company, including corporate income taxes, property taxes, non-creditable VAT and other sales taxes, employer-paid payroll taxes, and other taxes that constitute costs to the company, by category of taxes.

The Forum's 34 expanded metrics involve measuring ESG through value chains that are significantly wider in scope. These are a more advanced way of measuring and communicating sustainable value creation.



### Which framework is right for you?

Despite such significant progress towards uniformity, the landscape for regulating ESG disclosure remains a place of continual, often rapid, evolution. This is readily attributable to the breadth of reach of ESG factors and the reality that they cover such a diverse range of activities that, in practical terms, some may not be relevant to a particular business and its effect on communities.

Consequently, and despite the value of pursuing uniformity and consistency in ESG reporting, it remains desirable for each company to develop its individual criteria for determining the scope and content of its ESG disclosures. The approach of a company blindly adopting some kind of generic ESG precedent or checklist is doomed to fail.

Whilst striking the balance between an approach to ESG reporting that is both specifically tailored and appropriately deferential to international efforts towards uniformity is bound to involve a process of trial and error, companies should pursue a systematic approach from the outset.

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## Developing an ESG Strategy

ESG strategies should be developed with the same degree of careful planning and consideration as any other business strategy.

> “Far from being aspirational and idealistic, a successful ESG strategy needs to be grounded in the realities of what is achievable for the company within the scope of their operations. ”

### Effective ESG strategies will be:

#### 1. Realistic and Achievable

When developing an ESG strategy, particular care should be taken to develop clear procedures for ensuring that the company’s actions match its publicly stated ESG goals. Whilst forward-looking statements involving future commitments are a foundational component of ESG strategy, great care must be taken to ensure that such statements are appropriately described with appropriate disclaimers and realistic qualifications.

An important aspect to effective ESG implementation is ensuring that a healthy dose of realism is applied to each and every ESG-related goal. This can often be difficult given the (literally) world-changing nature of sustainability objectives at the core of ESG. However, it is crucial that companies are diligent in always maintaining an inseverable nexus between aspiration and achievable action.

Such an approach protects companies against making unrealistic commitments, which presents as perhaps the greatest area of risk (both from a legal and reputational perspective) in the current ESG environment.

### 2. Clearly defined procedures and responsibility

Practical steps that should be implemented from the outset in a company's ESG framework include: clear procedures and chain-of-command for internal monitoring of ESG commitments; educating all internal stakeholders on the risks associated with ESG 'over-promising' and 'under-delivering'; and ensuring that all ESG disclosures are treated with the same level of scrutiny for factual accuracy as any other publicly released corporate disclosure.

### 3. Specific and Relevant

There is no doubt that the implementation of effective SDG strategy and frameworks is one of the most practical means by which private companies can ensure that the 'rubber hits the road' in the implementation of high-level international principles such as the United Nations' Sustainable Development Goals.

However, rote recitation of these Goals (and other similar high-level international instruments such as the UN Principles of Responsible Investing), accompanied by bald statements that a company is committed to making a positive contribution towards them, is not a substitute for specific measures that are capable of direct implementation in the particular context in which the business is operating. Companies should exercise a higher degree of ownership, including undertaking a process of identifying the most applicable SDGs, and determining how, in practical terms, these goals can most impactfully influence the carrying out of their operations and engagement with the broader community.

## 04 OPERATIONALISE

### Develop policies and operational processes to meet performance objectives

Many companies that are in the early stages of formalising their ESG strategies and frameworks will not (and should not) start with a blank sheet of paper. Common internal governance policies that can readily be integrated into an overarching ESG strategy include policies relating to (naming but a few) Professional Conduct, Anti-Bribery and Corruption, Occupational Health and Safety, Modern Slavery and Supplier Code of Code of Conduct.

A successful ESG strategy integrates into existing business practices and can be used to inform decision making and strategic planning across all facets of the business.

**Your resident experts...**

At the foundation of all responsible business practices lies a strong ESG strategy. FairSupply can guide you in developing a clearly defined ESG strategy with achievable goals that are relevant to your business operations. From legal compliance and policy development to risk analysis and strategic planning, FairSupply is your ESG partner.

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