ESG in focus: your essential guide

ESG trends, reporting frameworks, challenges, and opportunities

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Introduction

An estimated 88% of publicly traded companies, 79% of venture and private-equity backed companies, and two thirds of privately-owned enterprises have ESG initiatives in place (NAVEX Global).

Almost a fifth of small and medium-size companies are already using ESG standards (Companies Alliance).

Two thirds of customers say they will stop buying from companies that treat the environment, employees or the community in which they operate poorly (PwC).

With many reporting standards, adoption is very much compliance-driven. Finance departments adapt their processes (often somewhat reluctantly) purely with an eye on keeping the regulators happy.

ESG is different. Increasingly, organisations are using Environmental, Social and Governance factors to evaluate the sustainability and ethical impact of their activities. In most cases, there is no absolute requirement for this (so far, mandatory ESG reporting applies to a small number of public companies). But other companies are still embracing it. So why is this?

In part, it's about staying ahead of the curve. The direction of travel suggests that mandatory ESG reporting obligations will ultimately be extended to a much wider range of organisations. It makes sense to update reporting processes now, to avoid a rush further down the line.

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The what and why of ESG

ESG provides a framework for evaluating and disclosing information on an organisation's operations in three areas: environmental, social and corporate governance.

Environmental

This criterion concerns how companies use resources and manage their environmental impact. Key factors include energy efficiency, carbon emissions and waste management.

Social

This focuses on how an organisation manages and supports its people and culture, particularly in the context of the wider community. Factors to consider include workforce diversity, workplace conditions and opportunities, employee engagement, customer relations, data protection and privacy and wider community relations.

Governance

The governance criterion focuses on an organisation's internal systems of procedures, controls and safeguards (broadly, how 'well-run' the company is). It covers factors such as board composition, executive compensation, internal controls to prevent misuse of funds and regulatory violations. It also covers information transparency.

Sustainability and business: is ESG just ‘more of the same’? outcomes

There is nothing new about businesses attempting to establish their ethical credentials. Corporate Social Responsibility (CSR) is a prime example: the concept of companies integrating social and environmental concerns both in their business operations and in interaction with stakeholders. Similar well-established concepts include the 3 Ps Triple Bottom Line (people, profit, planet), and Diversity, Inclusion and Equity (DEI).

Companies often weave CSR policies into their messaging. However, they often lack quantifiable data to support the claims made. ESG differs from these precursor programmes in the following respects:

- CSR and similar concepts tend to be largely self-defined and self-regulated. By contrast, ESG works on the basis of disclosure standards governed by one of several reporting frameworks (see below).
- ESG is based on specific, comparable metrics.

So compared to earlier initiatives, ESG represents a marked change. It provides a robust method - with verifiable data in support - for demonstrating to investors, customers and other stakeholders just how effectively you are living up to your environmental and social responsibilities.

Reporting frameworks in focus

For financial years starting after 6 April 2022, ESG reporting based on the Task Force on Climate-Related Financial Disclosures (TCFD) is now mandatory for more than 1,300 of the largest UK-registered listed companies and financial institutions.

Globally, the number of ESG reporting provisions issued by government bodies has increased by 74% over the last four years. Regulators are steadily becoming more prescriptive in what they expect from companies. However, for most organisations, reporting still remains voluntary.

There are also multiple ESG reporting frameworks to choose from. Some commonly used ones are as follows:

Global Reporting Initiative (GRI)

Established in 1997, this was the first standard for sustainability reporting. Covering universal, sector-specific and topic-based standards, GRI is currently used by three quarters of the world's largest 250 corporations.

Sustainability Disclosure Requirements (SDR)

These standards were set up by the UK government in connection with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). Discover more in this government guide.

Streamlined Energy and Carbon Reporting (SECR)

Another initiative by the UK government, this framework seeks to streamline carbon reporting, while also making it easier for businesses to monitor and reduce carbon emissions.

The Workforce Disclosure Initiative (WDI)

Created by an investor collective, this aims to boost transparency and accountability by providing a framework for disclosing comprehensive and comparable workforce data.

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Choosing a framework

When deciding which specific framework and methodology to use for ESG reporting, you should bear in mind the following:

Local requirements

Look carefully at the actual and pending rules in place for the markets in which you operate.

Industry suitability

Some frameworks are designed to be sector-agnostic whereas others are designed for specific industries (e.g. financial investments or manufacturing). Look carefully at which framework represents the norm in your industry.

Your audience

Who is most likely to require ESG information from you? If you can report the most relevant content to major customers clearly and comprehensively, in a way that aligns with their own reporting methodologies, it can go a long way in strengthening commercial relationships. Find out what specific disclosures stakeholders require and use this information to inform your choice of ESG framework.

Opportunities: ESG as a strategic lever

Embracing ESG can benefit your business in the following ways:

Customer relations

According to PwC, almost half of consumers (and up to two thirds of millennials) weigh up companies' ESG records and use this information to inform their buying decisions. By supplying data-backed evidence to demonstrate how you are tackling environmental and social issues, you can generate a potentially valuable competitive advantage.

This also applies to business customers where your services will form part of their supply chains. If you can show that you are ready and willing to provide all the disclosures they require for their own ESG reporting, this can be a significant factor in your favour compared to less well-equipped competitors.

Securing capital

ESG-mandated assets may make up half of all professionally managed investments by 2025 according to Deloitte. It is now standard practice for lenders and investors to have ESG criteria hardwired into their decision making processes. Those institutions are calling for more transparent, evidence-based information from companies about their ESG efforts. By embracing ESG reporting, the chances of securing financing or investment is likely to be significantly enhanced.

Attracting talent

Since the pandemic, it has become very much a seller's market in recruitment - particularly when it comes to sought-after technical roles. Younger employees are especially likely to be drawn to companies that align with their values on sustainability and other social goals.

Savvy applicants will do their research. If you can demonstrate a commitment to measuring your progress and bringing about change in areas such as diversity, employee wellbeing and use of resources, it can actively encourage the brightest to apply.

Cost reductions

Tracking metrics such as fuel consumption and carbon footprint enables you to identify areas of waste. Armed with this knowledge, you can focus on optimising your processes in areas where any changes made will have the greatest positive impact (e.g. streamlined packaging, smart lighting systems or route optimiser tools for fleet vehicles). What's more, it's almost certainly the

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Metrics to measure

What should you be tracking and reporting on as part of any ESG initiative? The specifics will depend on factors such as your sector, operating model and the concerns of external parties (e.g. regulators, investors and customers). Some of the most common topics covered by ESG metrics are as follows:

Environmental

- Greenhouse gas emissions
- Energy consumed
- Total weight of waste materials produced
- Total water consumption
- Contaminants produced
- Volume of material recycled

Social

- Pay equity (e.g. average salary by ethnicity and gender)
- Workforce ethnicity/gender breakdown at different levels of seniority
- Percentage of workforce covered under collective bargaining agreements
- Health and safety (e.g. recordable incident rate)
- Data around community involvement (e.g. contributions to local causes)

Governance

- Audit accuracy rates
- Volume and type of regulatory non-compliance instances detected internally
- Cybersecurity and data protection breaches detected and details of remedial actions taken
- Director remuneration: e.g. annual total compensation ratio of CEO to median for all employees

Reporting challenges

What obstacles should finance teams be aware of when seeking to implement ESG reporting?

Be aware of the following two major challenges:

Multiple frameworks

The whole point of ESG reporting is to demonstrate your performance in a comparable way. Currently however, there is no single, universally-applicable framework for doing this. Ultimately, to meet the different demands of, say, investors and regulators, you may need to report in accordance with multiple frameworks.

Data collection

How many hours of pro-bono community work did your executives undertake last year? How much fuel was used by your fleet? What are the carbon equivalents for your production operations, taking into account your supply chain as well as internal operations?

Answering these questions represents a massive challenge. It requires the ability to collate and interpret data from right across your organisation, and potentially also from partners from across your supply chain. If the information you need is scattered in silos across the business, it's going to be very difficult indeed to provide the type of trustworthy, joined-up picture that stakeholders will expect you to deliver.

Building your capabilities

- Identify the ESG issues that are most relevant to your business (a 'materiality assessment'). This should be a collaborative process involving customers, partners, employees and investors to see what is important to them.

- Look carefully at your sector's regulatory requirements and the expectations of investors and other stakeholders before deciding on which ESG framework to follow. Prepare to be flexible: the framework best suited to your business in five years' time may not be the same as today's.

- In practice, ESG is more than just reporting. Getting it right will likely involve taking a long hard look at your data collection, consolidation, analysis, planning and forecasting capabilities. If you are still grappling with siloed data and manual, spreadsheet-based processes, it makes sense to update your capabilities before trying to embark on any major ESG reporting initiative.

- A mish-mash of isolated, widespread and incongruent data within your business will make ESG reporting especially difficult. Consider updating your planning capabilities so that financial and operational data is accessible via a single platform.

- What if we were to near-shore part of our production to reduce our organisational carbon footprint? What if we were to increase pay for a specific grade of employees to reduce a gender imbalance? For planning, look closely at building up your predictive analytics capabilities. If a proposal to boost your ESG score is on the table, these capabilities should give you the ability to assess its full implications from both a financial and operational perspective.

What next?

ESG is not just another 'regulatory headache'. Actively embracing it can help you provide the transparency that stakeholders increasingly demand, boost business resilience and help improve overall company performance.

With expertise spanning compliance, data integration, ERP implementation and wider finance transformation, Millennium Consulting is ideally placed to help your organisation on its ESG journey. For a full and frank assessment of your goals and requirements, speak to us today.

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