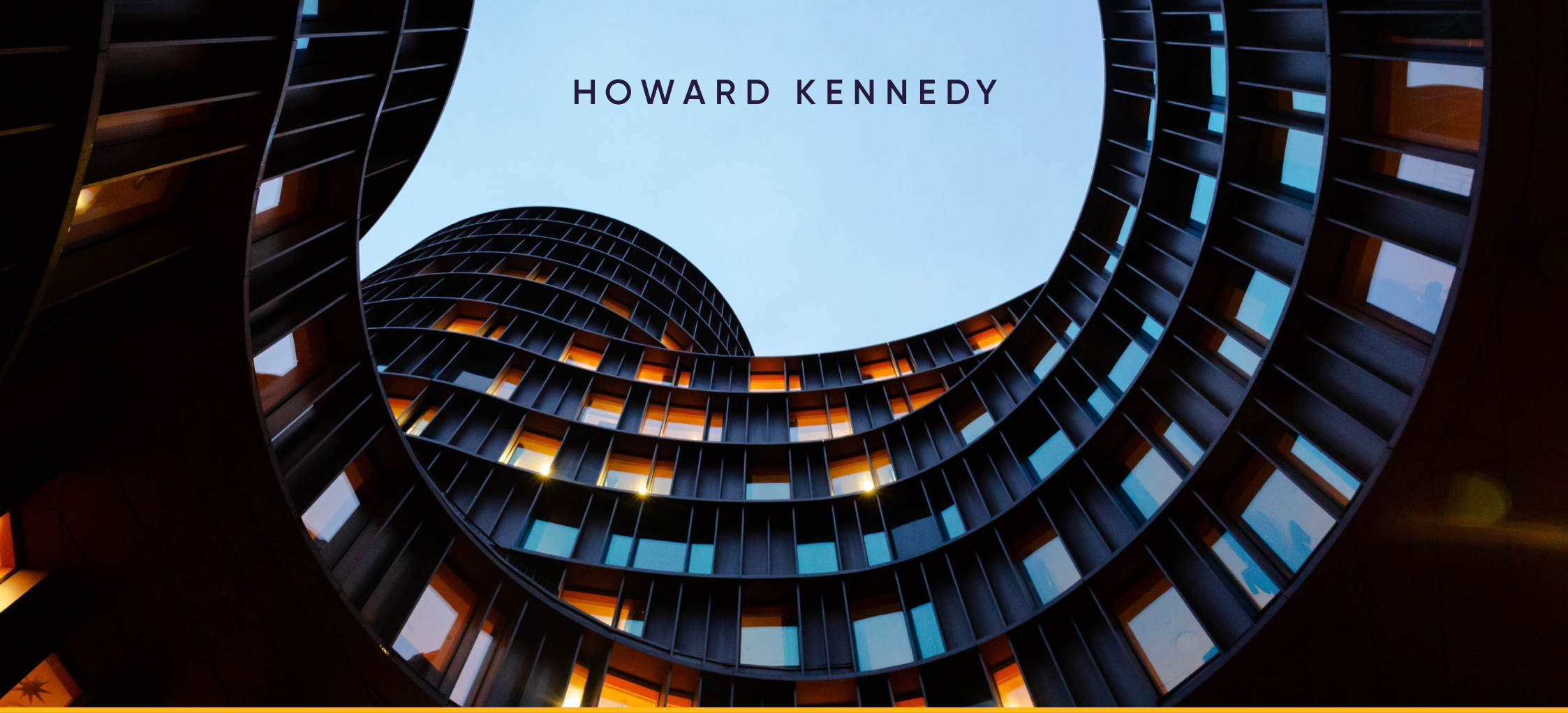


Doing Business Better:

The importance of ESG to businesses in 2023 and beyond

Introduction

Environmental, Social and Corporate Governance, or ESG, has never been more important to businesses worldwide. That is why, in partnership with TRI Strategy – the primary source of news, analysis and opinion for the Turnaround, Restructuring and Insolvency community – we surveyed business owners and directors on ESG. The participants in the survey came from a range of sectors, including professional services, financial services, and turnaround, restructuring and insolvency.

The survey specifically focused on:

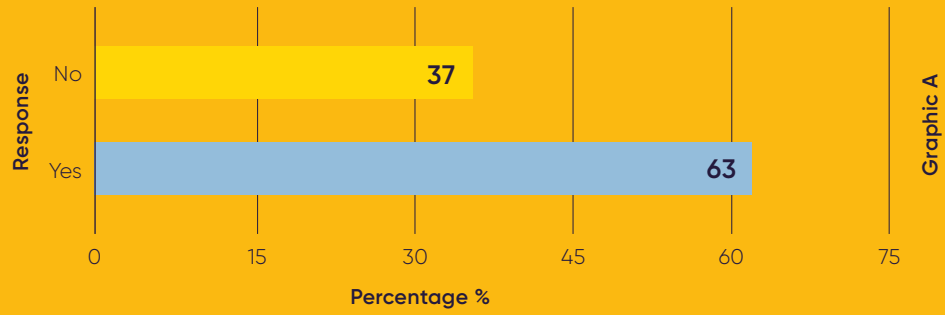
- **The role ESG plays within an organisation's commercial strategy;**
- **The efficacy of existing legislation in guiding businesses on their ESG obligations; and**
- **The impact of a possible recession on an organisation's ability to do 'business better'.**

The responses to the survey provide an insight into how ESG considerations have impacted business strategy, including recruitment and marketing; the extent to which profit remains the sole consideration for decision making; and whether increased legislation, regulation and/or guidance from industry governing bodies would be welcomed by the business community.

Here's what we found...

Survey results

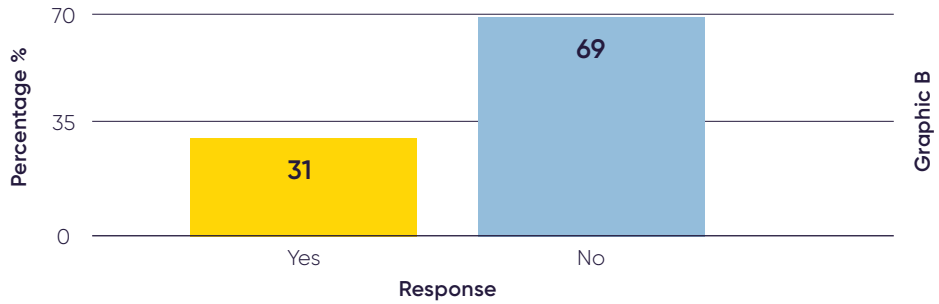
Does your company have an ESG policy?



The survey asked respondents to identify their business with one of 62 listed sectors, which fall into the following categories: financial services, professional services, construction, retail, consultancy, credit management advisory, real estate, manufacturing, debt collection, defence, restructuring turnaround and insolvency, and TMT. Across these sectors, almost two-thirds (63%) of companies already have an ESG policy in place.

Although a range of sectors were represented in our survey, a large proportion of respondents were from the financial services (31%) and professional services (22%) industries. This likely explains the high percentage of respondents to this question: financial and professional services firms have been early adopters of ESG strategies.

Does your company have a dedicated ESG officer?



Graphic B

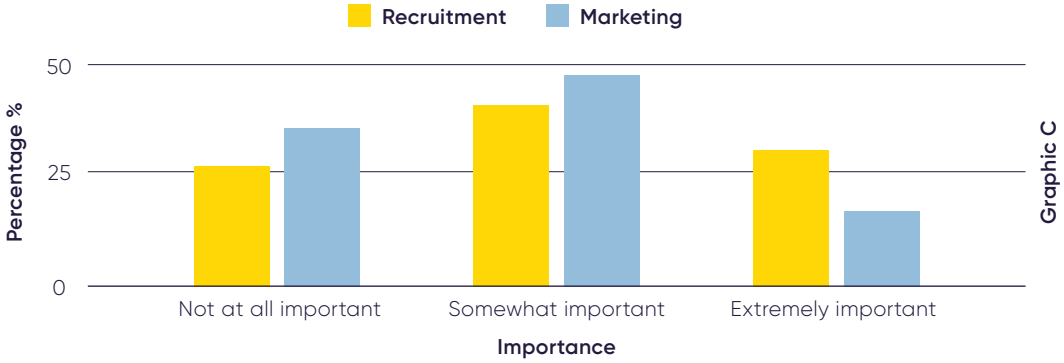
The survey shows that ESG considerations are increasingly important for businesses, so it is surprising to see that less than a third (31%) of the participants have a dedicated ESG officer in place. With expectations on ESG becoming more strident, we expect to see more companies appointing dedicated ESG officers in the year ahead. Such appointments not only present a clear signal that the business is taking ESG seriously, but can also make real changes to the company's culture and ways of working. Most importantly, a dedicated ESG officer would provide a company with the essential data necessary to more accurately record and monitor the impact of non-financial considerations on a business.

We are already seeing changes to the UK regulatory landscape to place a greater emphasis on ESG factors and companies are likely to face more scrutiny in the future, as well as more onerous reporting and disclosure obligations.

The FCA's October 2022 consultation paper on Sustainability Disclosure Requirements and Investment Labels is just one example. Amidst growing concern that FCA-regulated asset owners may be making exaggerated, misleading, or unsubstantiated environmental claims about their investment products, the FCA's multifaceted proposals send a strong message that sustainability features must be accurately labelled and marketed. The consultation paper also seeks to crack down on 'greenwashing'– meaning the practice of making deceptive or unsubstantiated environmental claims.

It is therefore important that companies take ESG seriously and all aspects of ESG are given sufficient influence at board level. Companies which merely pay lip service to ESG are likely to be caught out.

How do directors & business owners rate the importance of ESG to their recruitment & marketing strategies?



Graphic C

Although only 31% of survey participants have a dedicated ESG officer, a significant majority of respondents attached "medium to high importance" to the role ESG plays within their recruitment (72%) and marketing (66%) strategies.

ESG is seen as especially important when it comes to recruitment. This could be down to an increased awareness of ESG issues among younger professionals and graduates. This leads to an expectation for employers to hold the same values, and act on them.

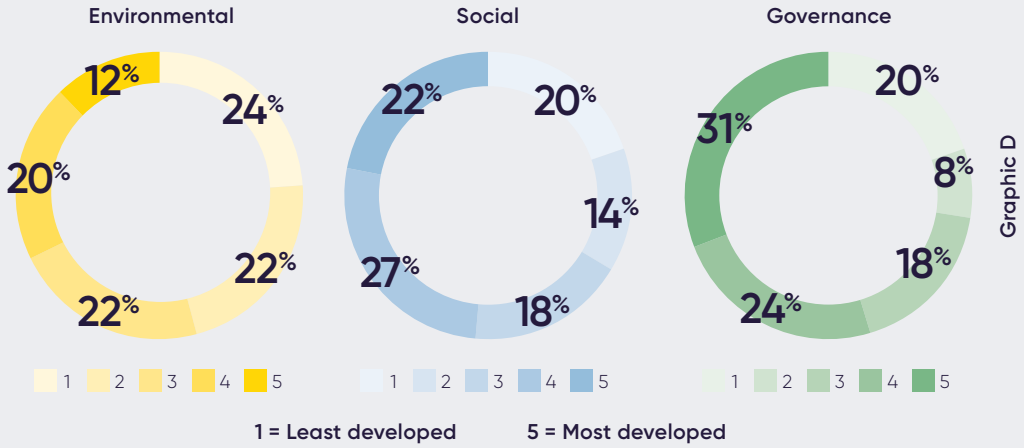
By 2029, the Millennial and Gen Z generations will make up 72% of the world's workforce, compared to 52% in 2019, indicating that ESG performance will only become more important in attracting and retaining talent[1].

Companies must also keep ESG values in mind when terminating employment contracts. The recent P&O Ferry controversy highlights that it is no longer acceptable for companies to make decisions based purely on financial considerations. Non-financial considerations, such as the social impact of job losses and respect for workers' rights, must also be taken into account. Poor handling of dismissals, and a disregard for social considerations may result in extensive reputational damage, as well as civil and criminal investigations.

Compared to recruitment, the respondents to our survey saw ESG as less important to their marketing strategies. This is surprising given rising consumer awareness and the UK government's drive to crack down on greenwashing, but may reflect the fact that many of the respondents represent non-consumer facing industries.

[1] https://www.marshmclennan.com/insights/publications/2020/may/esg-as-a-workforce-strategy.html

How would you rate your Environmental, Social and Governance policies (as individual policies) in terms of their development?



Graphic D

The Environment Act, COP26 and Net Zero commitments dominated headlines in 2021, and led to an influx of policies and regulations. It is perhaps surprising then to see that "environmental" came out as of lower concern compared to the social and governance elements of ESG. Environmental factors are increasingly seen as likely to be the most legislated and regulated area of business activity.

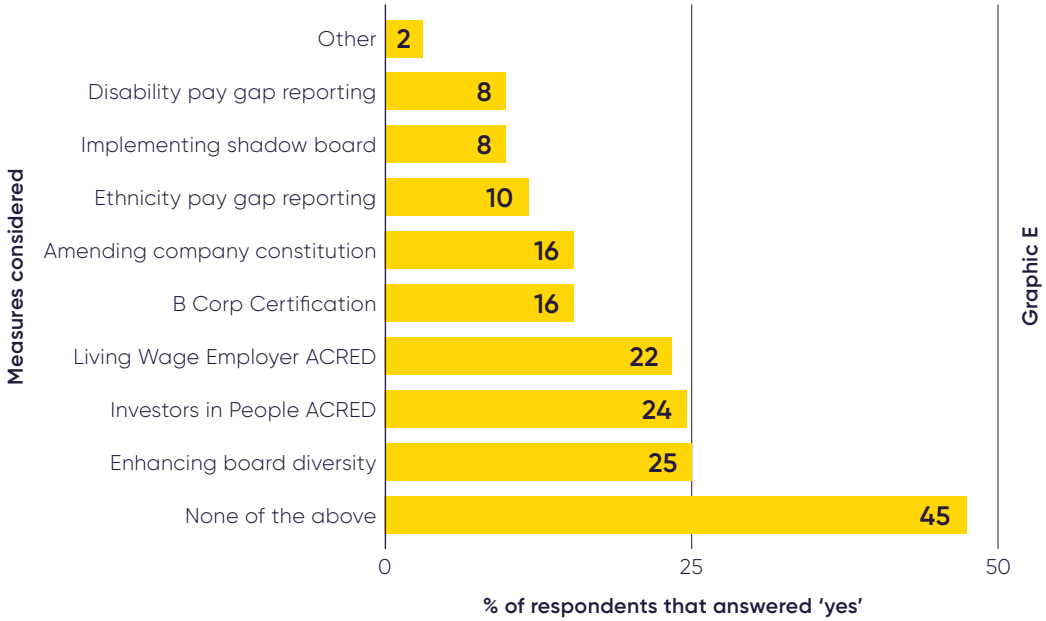
In June 2022, we saw the European Parliament and the Council of the EU reach a provisional agreement on new sustainability reporting rules for companies. The reform of the EU's Non-Financial Reporting Directive (introduced in 2014) will require large companies to report on environmental issues as well as human rights and governance criteria.

The EU appears to be ahead of the pack as an early adopter of ESG regulation, whereas the UK has instead sought to align itself with international standards.

The UK is developing its own domestic green taxonomy and ESG disclosure regime. It was the first jurisdiction to mandate the Financial Stability Board's (FSB) Task Force for climate related disclosure and has already embarked on its regulatory and legislative journey as we can see in the Companies Act 2006, the updated UK Corporate Governance and Stewardship Codes, the Disclosure and Transparency Rules, and the London Stock Exchange Listing Rules. In November 2020, when he was Chancellor, Rishi Sunak announced a plan to ensure mandatory climate related financial information disclosure by 2025, which would be phased in from 2023.

However, it is difficult to assess the environmental impact of a single business' strategy, and change is often hard to implement. These concerns are reflected in the results of our survey in terms of how confident businesses feel about their sustainability efforts.

Have you considered enhancing your ESG credentials?

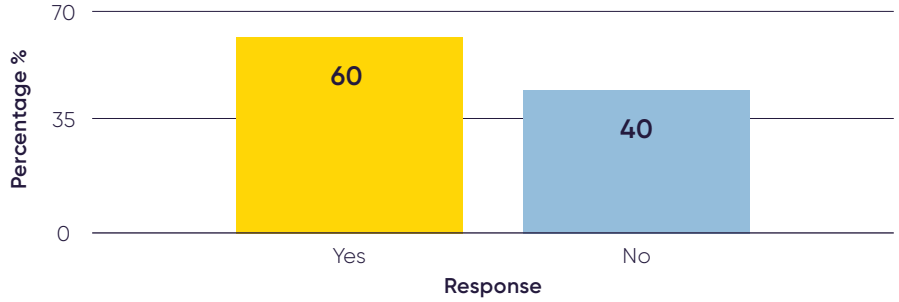


As ESG has become more prominent globally, we have seen more measures to encourage businesses to invest in ESG measures. The FCA's April 2022 policy decision (PS22/3) reflects the regulator's focus on speeding up the pace of change around diversity and inclusion in financial services recruitment. In the future, firms may be obliged to meet board diversity targets or explain in their annual financial report why such targets have not been met. Targets could include having at least 40% of the board being women, at least one of the senior board positions being held by a woman, and at least one board member being from a minority ethnic background.

Are we at a tipping point?

When survey respondents were asked if they were clear on the relationship between their ESG policy and the duty of their directors under section 172 of the Companies Act (to promote the success of their company), 60% reported a good understanding.

Are you clear on the relationship between your ESG policy and the Directors' duties under Section 172 of the Companies Act (the duty to promote the success of the company)?



Graphic F

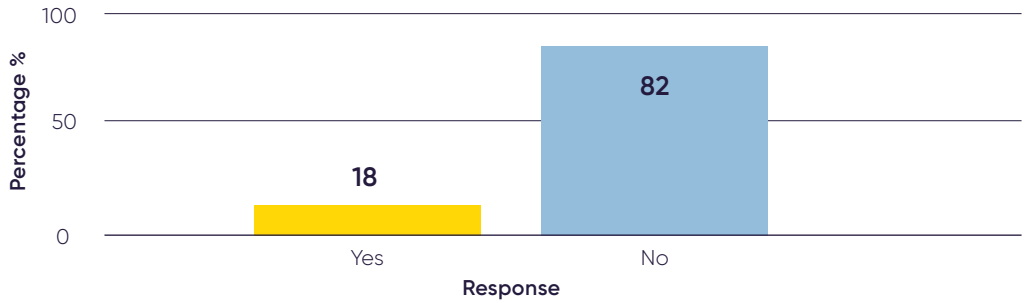
This could reflect the pressure companies and individual directors are facing to stay on top of ESG developments and justify the positive impact of their business.

The scope of a director's duty to promote the success of the company under section 172 of the Companies Act 2006 was considered in the recent Supreme Court case of BTI v Sequana. The case prompted a conversation on not only a director's duty to creditors, but also in what circumstances the exercise of a directors' fiduciary duty to the company will entail consideration of the interest of additional stakeholders, beyond shareholders.

The overarching takeaway from Sequana has led to speculation that growing political and socio-economic pressure on directors to promote long term value creation entails environment, social and governance considerations over and above the idea of shareholder supremacy.

As we are seeing this move from shareholder primacy to all-encompassing stakeholder decision making, we asked our survey participants whether their company has "adopted a 'triple bottom line' approach (profit, people, planet) to measuring business performance."

Has your company adopted a 'triple bottom line' approach to measuring business performance?



Graphic G

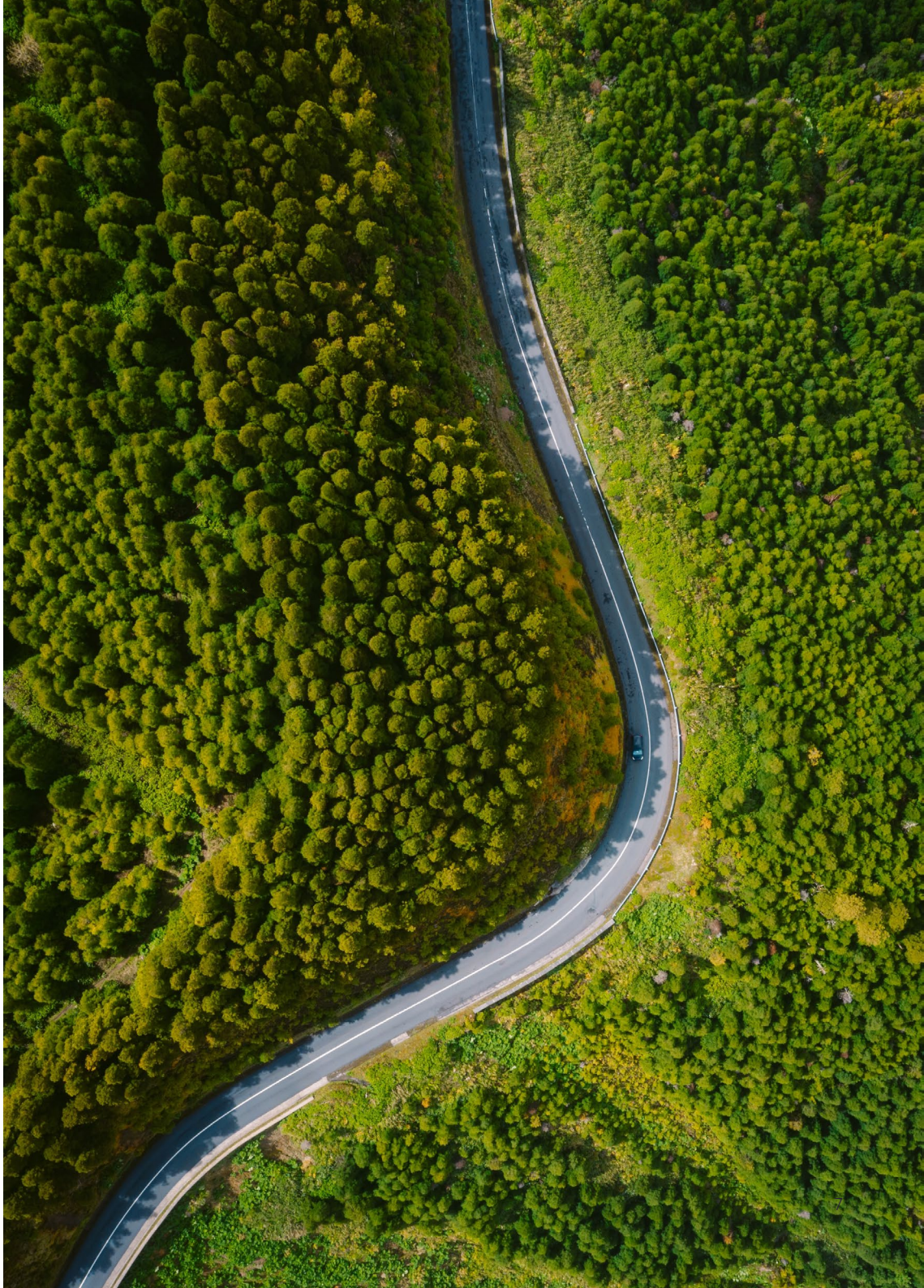
Whilst the majority of participants answered "no", there is significance in 18% of respondents holding profit, people and the planet in equal regard. Without the cultural and social impacts arising from the Covid-19 pandemic, a 'fourth industrial revolution' in tech/communications and the growing impact of climate change, there may have been a belief that ESG stood in the way of profit. Today, many view profit through the prism of long-term sustainability, achieved by taking into account both people and planet.

B-Corps

Although the uptake of the ‘triple bottom line’ approach amongst our participants is reasonably low, on a greater scale, we have seen a significant rise in interest in the B-Corp movement; the stakeholder-led campaign focused on the belief that businesses impact and serve more than just shareholders.

Whilst only 16% of our survey participants said that they had considered seeking a B-Corp certification (see graphic E above), this statistic may not necessarily be representative of London-based businesses in general, as B-Lab recently announced that London is now the B-Corp capital of the world.

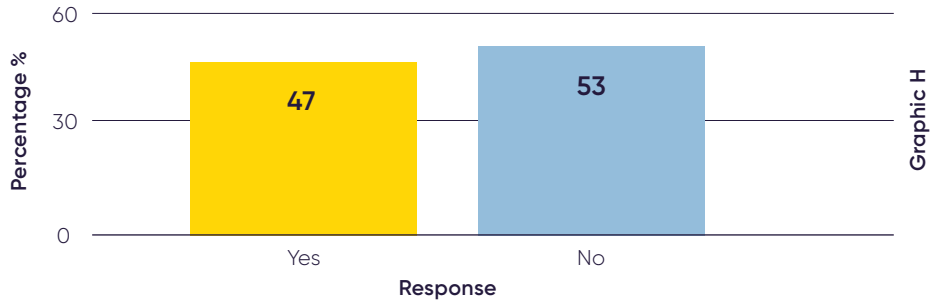
Last year alone, 50,000 new companies registered to use the B-Impact Assessment to understand how they measure up against high environmental and social standards – almost a 40% increase over the two years prior. Additionally, there are now over 4,300 certified B-Corps globally, with 30 public companies certified (15 of which had their IPOs in 2021), reflecting the growing conversation in the financial sector around wider ESG principles.



A shift to increasing regulation

There is a divide among respondents around ESG focused regulation, as 47% of respondents said that they would welcome "an increase in legislation / guidance on social and governance issues" as it would be deemed valuable or useful for their business.

Would an increase in legislation/guidance on social and governance issues be useful for your business?



Graphic H

Commercial appetite for expanding regulation is ordinarily low, but perhaps on social and governance issues, companies are eager for clearly defined standards. It also suggests that businesses are looking to industry governing bodies for guidance and benchmarking in what are still somewhat unfamiliar situations.

B-Corp certification is not mandatory, but there appears to be a clear direction of travel, with increasing 'hard law' legislation and regulation (e.g. the Bribery Act and the Modern Slavery Act), joining with pressure from consumers, investors, lenders and employees who seek to influence the company's operations and its impact on the community and environment.

We have also seen the campaign for a "Better Business Act" gather impetus, calling for a director's statutory section 172 duty to be extended to put the interests of other stakeholders, such as the environment and wider society, on par with those of the company's shareholders.



ESG - more than just a good thing to do

The importance of ESG is evident. The world is changing and ESG is now an important measure of business performance. It drives investor and consumer confidence, as well as influencing investment strategies. It is also an important consideration for risk management, recruitment, and marketing – as the results of this survey show.

We have discussed in this report why ESG policies are important for the recruitment and retention of talent, as employees want to work for employers with the same values. The same can be said for consumer and investor behaviours globally. Businesses that fail to adapt to consumer and investor expectations are likely to see a drop in demand for their goods/services in the long term.

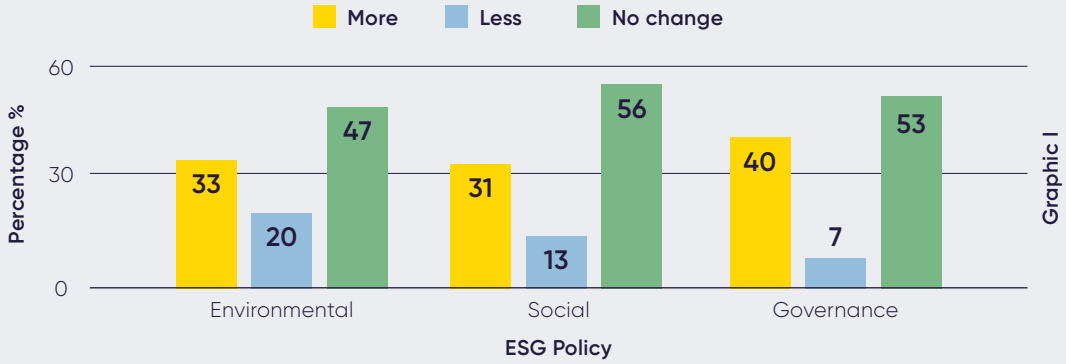
In difficult economic times and with insolvency numbers expected to increase in the year ahead, we are likely to see greater scrutiny of director's decision making, more shareholder activism and more businesses failing where ESG risks are a contributing factor.

There are a number of recent examples which highlight how an organisation's failure to properly implement or follow an ESG policy can negatively impact its performance and reputation. One notable example is the England and Wales Cricket Board's finding in May 2022 that Essex County Cricket Club had fallen "significantly short" of targets to tackle racism and promote inclusion and diversity in cricket, and that sanctions may be considered if sufficient progress is not made within agreed deadlines. The collapse of FTX is another example of how a panorama of failed governance policies can have a significant negative impact on a business and cause that business to fail.

What priority will be given to ESG in a recession?

Of the participants in the survey, 69% said that they were concerned about the impact of a potential recession on their company, but ESG would remain a priority. As the fear of a deeper recession in the UK grows and insolvency numbers rise, it is reassuring to see that most businesses recognise the importance of ESG. This suggests that the importance of sustainable long-term growth has become embedded in businesses.

In terms of your company's ESG policy, will the following issues become more or less of a priority in an economic downturn?



Graphic I

Conclusions

The results of our survey highlight the growth of ESG and its increased prominence in the corporate world, but also some of the challenges that lie ahead. With cost pressures and a changing regulatory environment, the shift towards sustainable business is far from easy. Companies can no longer make decisions based on financial factors alone. Profit goals must now be viewed with long-term sustainability in mind.

Establishing, refining and developing robust ESG policies and practices requires commitment and investment. Companies must consider their wider impact as central to their business strategy, not as an added extra or a good thing to do.

Thank you to all that participated in our survey.

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Notes:
The Survey: In November 2022 TRI Strategy conducted a survey of 62 business owners, directors and those in significant decision-making roles, including General Counsel and Heads of Operational Risk. Respondents were spread across the sectors of Financial Services, Professional Services, Restructuring, Turnaround and Insolvency, TMT, Retail, Real Estate, Manufacturing, Construction and Utilities.

About Howard Kennedy

We are a London based law firm specialising in providing straightforward advice to entrepreneurial businesses and individuals on domestic and international matters, whatever the legal challenges they face.

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