ESG – This Driver of Value is Here To Stay

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ESG – Environmental, Social, Governance – refers to a set of criteria by which companies are evaluated, which considers the broader impacts of company operations on key stakeholders, specifically the E: environment, S: customers, suppliers, communities, and society, and G: leadership, employees, and shareholder rights. It can include corporate performance in a wide variety of areas, from reducing carbon emissions to fair labor practices to promoting board gender diversity. Socially conscious investors use these standards to screen investments.

ESG investing allows investors to align environmental and social values with portfolios as well as to gauge risks posed by climate change, workforce and supply chain issues, and corporate governance issues. At a time when climate change is viewed as "the defining issue of our generation" (McKinsey.com, 4/20/2021), and social issues such as diversity, equity, and inclusion top the corporate agenda, ESG performance can be a central lever for driving value.

Focus on ESG For Value Creation

Globally, assets applying ESG criteria to investment decisions reached over $40 trillion in 2020, double what they were 4 years ago. (P&I Daily, 7/2/2020) McKinsey reports a 63% positive effect on equity returns vs. 8% negative effect when focusing on ESG concerns. ESG can help companies add value in other ways as well (McKinsey.com, 11/14/19):

- Strengthening consumer preference – nearly 70% of consumers report they would pay up to an additional 5% for "green" products vs. the "non-green" alternative
- Opening new markets – authorities are more likely to award access, approvals, and licenses when they know companies are good stewards of the environment and communities
- Reducing energy costs – for example, the conversion of vehicle fleets to electric/hybrid engines can reduce fuel consumption

ESG should no longer be viewed as an impediment to business but rather as an important component of a strong strategy for growth.

Diversity, Climate Change, and the Need to Communicate

Of the many issues on the long list of ESG criteria, diversity and environmental impact appear to be major concerns among the investor community. (EY.com, 2/2/21) Diversity encompasses the board as well as the workforce, and considers race, gender, age, and lived experiences. Companies should be transparent and communicate regularly about recruitment and talent development strategies, as well as board recruitment initiatives to address diversity. Regarding climate change, scrutiny is being applied to a company's carbon footprint, how it sources and uses energy, mitigates waste and pollution, and conserves natural resources. It could even include the treatment of animals.

While there is no single global ESG reporting framework, the conversation is underway. John Coates, Acting Director, Division of Corporation Finance at the US SEC, in a recent article stressed ESG problems are global and so should be the solutions. (sec.gov, 3/11/21) Transparency and consistency in reporting how companies around the world are managing environmental and social risks are key to solving today's most pressing global issues.

ESG and Corporate Giving are Advantages for Executive Recruitment

As the Baby Boomer generation of corporate leaders retires and millennials take their place, companies whose values align with millennials are in a better position to attract top talent. Millennials have grown up in a world where concern for the environment is normative, diversity is valued, transparent communications are expected, and harnessing social media means individuals can impact corporate behavior. Only half of American adults under 40 now view capitalism favorably (Harvard Business Review, 3/4/21), and millennials seeking employment prioritize work with purpose, not just profit. "There are many benefits to investing in, developing, and implementing sustainable practices. ESG practices lead to greater social credibility and inspire employees to feel more connected to corporate values," says IMSA Search Global Partners Board Member Marianna Carbonari.

Corporate philanthropy is an important element of social responsibility and should be promoted. In 2020 despite COVID, many companies donated more to nonprofits than they budgeted (Conference Board, 2021), with more than half spending additional funds on pandemic response (58%) and addressing racism in the US (54%). What's more, over two-thirds of companies surveyed intend to maintain or exceed prior year giving in 2021, and the vast majority will continue to offer opportunities for volunteering. "To attract top talent today, companies should communicate about ESG performance and initiatives, as well as philanthropy and volunteering. The communication should take place across all channels – press releases, website, social media, blog posts, and more," says IMSA Search Global Partners President Monika Ciesielska.

Keeping ESG Front and Center

While corporate practices vary, focus on ESG has received the support of major corporate leaders around the world. Microsoft's Bill Gates, Blackrock's Larry Fink, and others have committed to the concept that corporations must play a major role in addressing issues such as climate change through innovations to drive carbon emissions to net zero. McKinsey & Company recently launched McKinsey Sustainability, a new client-service platform with the stated goal of "helping all industry sectors transform to get to net zero by 2050 and to cut carbon emissions by half by 2030." And at its annual meeting last year, the World Economic Forum launched its *Davos Manifesto* stressing "the importance of stakeholder capitalism as a response to the economic, social, and environmental challenges the world is facing."

ESG is front and center on the world economic stage. Companies must continue to embrace and expand ESG initiatives to protect brands, build businesses, and attract the very best leaders to navigate a fast-paced, ever-changing global economy.