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ESG: The monster to be tamed

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ESG—environmental, social, and governance—has become the buzzword among businesses today. With Europe leading the way, U.S. companies are quickly catching up. Meanwhile, regulatory authorities are working hard to create standards that apply everywhere. The Securities and Exchange Commission (SEC) in the U.S. has recently increased its involvement in monitoring and regulating this area, leaving many companies unsure about their next steps. Adding to the uncertainty, California has introduced the new California Climate Accountability Package.

If your company is new to the ESG scene and in the early stages of building your program, you're not alone. The main challenge for most companies is figuring out how to collaborate across the different silos of the business involved in ESG, all aiming for the common goal of a robust ESG program.

ESG has changed over time

During the COVID-19 years—when many individuals found themselves compelled to work from home—the social facet of ESG gained heightened importance. Investors began posing more inquiries related to diversity and inclusion. Various social issues arose, spurred by events like the tragic murder of George Floyd. Employee privacy took center stage as companies attempted to implement measures to monitor their workforce, ensuring they were working as claimed. Essential workers—forced to operate in potentially unsafe conditions due to the virus—brought attention to concerns about working conditions, health, and safety.

After the peak of the COVID crisis, investors shifted their focus primarily toward the environmental aspect of ESG. Most ESG frameworks concentrate predominantly on environmental factors. While some elements of the social and governance pillars are included, the emphasis remains on the environmental pillar. In its proposed ESG rules, even the SEC predominantly addresses reporting on carbon emissions rather than diversity, equity, and inclusion (DEI) statistics, executive compensation, or other *social* and *governance* topics.

However, this does not imply a prolonged exclusive focus on the environmental aspect, as social issues have recently caused trouble for companies. Target experienced a significant drop in earnings in 2023, with a 5.4% decline in Q2, including a 10.5% online drop and a 4.8% decrease in foot traffic.[1] The controversy surrounding a Pride Month collection of children's clothing led to a downgrade of their shares.[2] Bud Light retail sales plummeted by up to 42% in certain U.S. metro areas in the four weeks ending on July 22, 2023, after partnering with a transgender influencer during a social media campaign.[3] If a company within your industry sees a value reduction due to ESG-related concerns, investors will be vigilant to ensure your company is not susceptible to a similar situation.

Why is ESG important?

One of the significant challenges associated with ESG programs is the momentum they gather—once aboard the ESG train, stopping becomes difficult. For instance, if your company releases its inaugural ESG report in a given year, shareholders and investors will anticipate subsequent updates to demonstrate ongoing progress in the following years. This sets a precedent, imposing additional annual responsibilities on your company. It becomes imperative for the company to be ready to consistently prioritize and allocate funds to sustain the program once initiated.

Gaining support for an ESG program can be challenging. Without illustrating why the ESG program is crucial for your company, building a robust ESG program becomes an uphill task. Levels of awareness and understanding about the significance of ESG vary among individuals. The recent incidents involving Target and Bud Light highlight situations that have led people to question the importance of ESG, making it a potentially politicized and polarizing topic based on individual perspectives. Striking a balance between adhering to ESG values and managing potential reputational risks is a challenge all companies must confront when articulating the program's significance. Having the C-suite or CEO aligned with the ESG concept—along with investor interest in transitioning toward a more sustainable company—can significantly bolster the program's credibility.