The S in ESG

Thriving in the next frontier of shared value

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Ibec Global is pleased to introduce The Global Compass, a quarterly editorial for business leaders that succinctly outlines how current megatrends will shape business in the foreseeable future both in the EU and beyond. It also provides high level guidance as to key developments to watch out for, how to steer business efforts in the right direction, and next steps for the C-suite as they plan their international engagement strategies.

This piece is the natural evolution from our previous Divergence Watch, which mapped insights in the changing EU-UK relationship, and adopts a broader focus that enables business leaders to grasp geopolitical risks and opportunities that stem from today's fragmented world.

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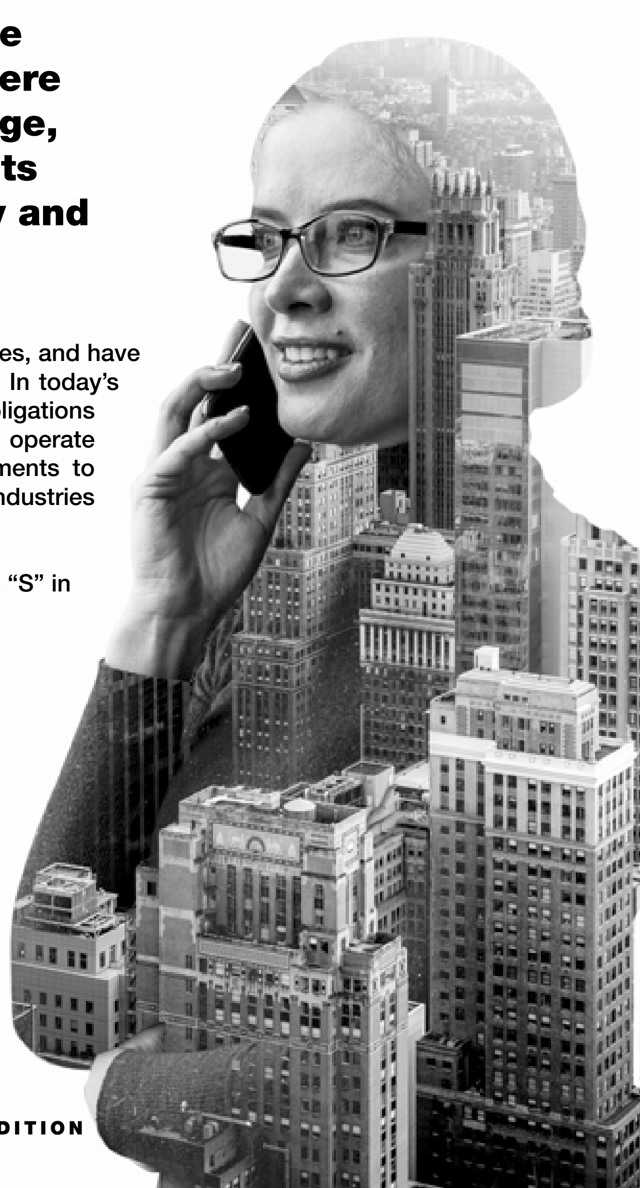
Major trends are shaping the ecosystem of your company's social interactions

With ESG conversations dominating the investor relations and regulatory spaces, sharpening the social pillar of your strategy—the « S » in ESG—should be on top of your agenda. The 2021 BNP Paribas ESG Global Survey points in this direction: 59% of respondents indicated brand and reputation motivate their ESG investments. But a lot has changed in the last two years, and three major trends make a strong case for upping your game through the "S" factor.

First is a business reality: across all industries many people have fundamentally questioned their careers, their working preferences, and their aspirations since Covid-19. To move from the Great Resignation to a "great comeback", our ability to foster a positive, flexible, and meaningful corporate culture holds the key to addressing labor shortages, skills mismatches, and employee turnover. Citizens look for value and purpose at work. The companies that best respond to this call will be more productive and attractive to shareholders.

Society has also significantly shifted in the last decade. Generation Z consumers wield significant purchasing power—it has doubled in the last 3 years according to Bloomberg— and they put sustainability and inclusion as values they want companies to proactively embody.

And older generations care as well: we live in times of total transparency, where mistakes in terms of a company's image, treatment of employees, or its products can damage bottom lines both quickly and durably.



Regulators are also looking into increasing company social disclosures, and have an arsenal of options to design rules to address any societal issue. In today's fragmented world, the oversight of supply chains and related obligations become increasingly challenging for multinational corporations that operate in global markets. Technological progress will incentivize governments to regulate even further whenever they perceive jobs and national industries might be at risk.

As individuals, society, and regulators change, all eyes are set on the "S" in ESG.

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Identifying and meeting stakeholder and shareholder expectations

Social factors are reshaping business, making stakeholders the key to understanding how to make progress in this field. Company leaders must do two things to achieve this goal. First, they need to fully grasp the complex web of interconnections that affect a company's standing on social affairs.

Business leaders should have proactive strategies to address how they lead their engagement with their employees, customers, suppliers, and investors. These stakeholders are central to a company's success. Second, they need to devise ways to address current shortcomings and risks while future-proofing their strategy.

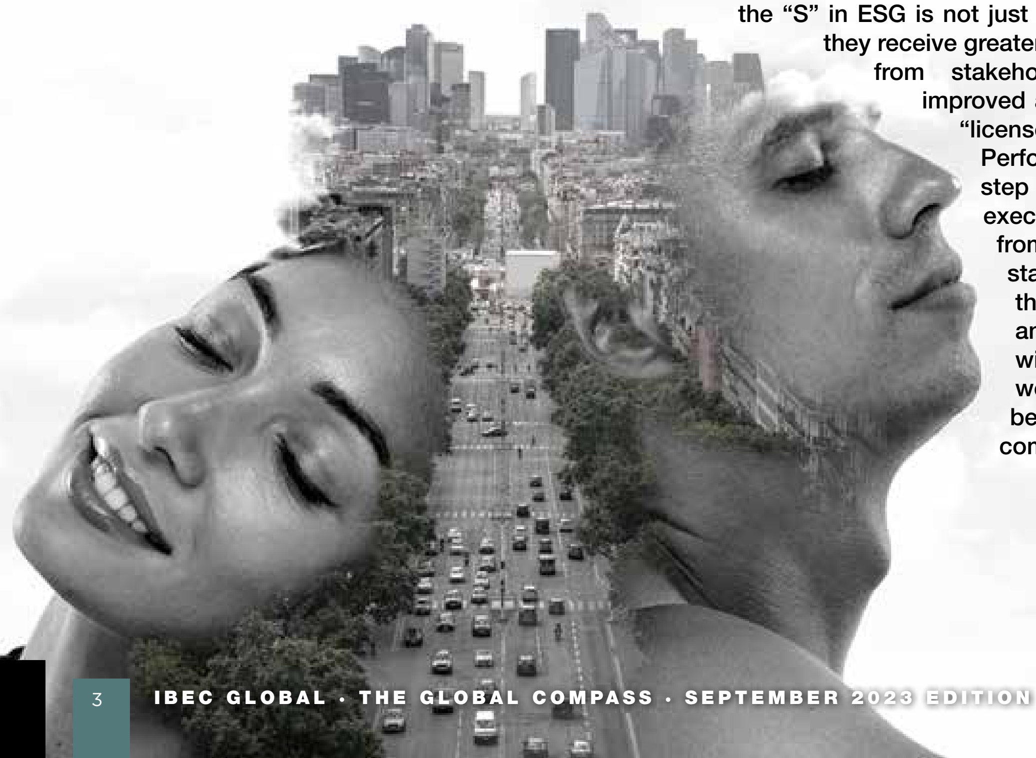
What makes the S so different is that it is as internally as it is externally relevant for the company.

While access to shareholder capital has been the bread and butter for success, a company's reputation and performance can be severely damaged by falling short on stakeholder demands.

Growing expectations on companies to deliver a "profit with a purpose" mission are not a fad—they are here to stay.

Stakeholders carefully choose now which companies they will buy from, invest in, or partner with based on how well they are tackling social challenges. This goes beyond image building exercises as stakeholders demand substantive numbers and impactful projects that make a tangible difference. From an investor relations perspective, portfolio managers now seek for the most effective options to comply with new and forthcoming regulations to favor assets that are considered best practices in terms of ESG criteria. Stakeholder and shareholder expectations have redefined the paradigm as to what companies do and how they communicate. It is now imperative to go several steps beyond Corporate Social Responsibility efforts to deliver a transformative purpose-driven agenda.

Several corporations have in the past three years adopted a broader lens to social factors that affect their company, and actively pursue dialogue and cooperation across business units. Their approach to addressing the "S" in ESG is not just an afterthought, and as a result they receive greater trust and backing from stakeholders, which translates into improved access to capital and a secured "license"—even ability—to operate. Performing perception audits is also a step in the right direction. Companies executive committees can also benefit from understanding how influential stakeholders see the company, the sector, and how the products and services they provide align with social imperatives. Identifying weaknesses and learning from best-in-class examples can set the company in a forward- acting path.



3 What makes the “S” so central

The poly-crises context we live in has made governments intervene in areas that faced until now little to no regulation. Rating agencies consider the financial consequences that “S” factor risks bring to corporations, and governments are developing standards for disclosing “S” factor information. The focus of policymakers so far on environmental regulation—the European Commission’s June 2023 Sustainable Finance Package as a recent example—is broadening towards social factors.

Political developments in Europe are also accelerating regulations that intersect with the need for robust social strategies in ESG. The rise of right-wing populist parties across key European and G7 countries has prompted new policy proposals that could greatly affect how companies operate. The new economic policy focus not only aims at promoting manufacture in Europe, but also affects global trade relations. Countries are leading political efforts on what they think is the best way to secure jobs for electoral purposes and pick industry champions. For companies, these developments mean heightened scrutiny as to how and where they produce goods and services, to whom they sell them, and whom they employ. In a nutshell, the social and stakeholder factors behind the “S” in ESG had never been as central as they are now.

This supranational engagement also trickles down to local markets, since European countries must meet the pillars of EU social rights regarding employment, digital training, and social inclusion by 2030. This area of action extends beyond Europe: the International Sustainability Standards Board just published last month global disclosure standards, which are largely compatible with Europe’s.

Geopolitics matter, too. The EU shares aspirations with other democracies like the United States, aiming to prioritize social considerations. However, it faces the allure of significant investments in domestic manufacturing from China, which has been accused of undermining human rights. This tension becomes especially apparent when looking at the EU’s Forced Labor Act, which stems from the increasingly complex EU-China relationship, seeking to impose bans on the marketing of goods made with forced labor. Such bans have already been established in the United States and Canada. The current shape of the restriction is far-reaching, and it is likely to have a direct impact on companies’ potential selling activities in the EU as it will apply to all products including their components, regardless of the sector or origin. This act also implies an increased obligation of suppliers and distributors to identify and prevent the occurrence of forced labor at every stage of the supply chain.

What is at stake goes beyond mere reputational risks: such regulatory measures addressing social factors can present substantial material risks and existential threats should non-compliance occur.

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Perfect timing to make an impact

A proactive approach towards social and stakeholder considerations in your ESG strategy will not only help you position your company as a leader in the field, it will also anticipate different regulatory trends and commercial threats. All companies regardless of their industry suffer from global fragmentation and divergent approaches that make business operations more costly, complex, and uncertain.

The more companies adopt strong ESG strategies the more these actions will collectively form a strong basis to advocate for regulatory harmonization across borders to improve socioeconomic outcomes and stability in global markets.

As companies' executive teams see the benefits that come from robust ESG strategies, we are starting to see a movement from activity-based company efforts to evidence-based results. This is a substantive change as it is no longer enough to announce a series of well- intentioned initiatives. It is now essential to convey what is being done, show and measure how it works, and the type of lasting impact that it will have on society. This context provides timely opportunities for companies to shape their social contributions – both internally and externally – before external stakeholders do it for them.

It is about mitigating legal and reputational risks as much as it as about articulating a proactive vision that will stand the test of turbulent times with both shareholders and stakeholders. Various ESG criteria of the reporting frameworks and ratings agencies are a useful guide, but ultimately, the best way to move forward is for you to take the steps you believe are genuinely in the best interest of your company, the people that work for it, and the wider stakeholder community it interacts with and serves. For example, attracting and retaining talent is no longer mainly an HR issue, it is a business leadership opportunity that will differentiate top performers from the rest. Not every decision will meet the expectations of every stakeholder, but it is a good place to start.

Rethinking and refining our employment, supply chain due diligence, and social impact strategies is no longer a "nice to have" factor but an essential element of corporate strategies.