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Markets Will Favor ESG Visionaries

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Today's leaders are setting priorities and mobilizing strategies related to environmental, social, and governance (ESG) matters, which are certain to shape the future of business. As corporate sustainability practices continue to evolve, an organization's ESG-backed success requires a long-term view extending beyond compliance.

ESG: a competitive boon or compliance burden?

As ESG reporting guidelines continue to be refined by regulators, compliance has become increasingly prevalent in conversations about ESG—with varied responses from business leaders. Companies on one end of the spectrum will take a limited, "check-the-box" approach, complying with regulators' ESG requirements. Opposite that, leading organizations will choose to integrate ESG considerations into their near-term strategies and long-term vision to drive innovation and differentiate the brand for customers, employees, and investors.

COMPARING ESG MINDSETS

Responding to ESG Regulations	Shaping Strategic ESG Differentiation
▶ Timing constrained to reporting and audit cadences	▶ Longer-term view and timing
▶ Compliance-minded	▶ Customer, employee, and investor-minded
▶ Follows the lead of regulators	▶ Company-led ESG strategy
▶ Viewed as a compliance cost or constraint	▶ Viewed as a brand-defining investment

What's at stake when a company merely focuses on compliance: losing out to a competitor already envisioning and enacting a strategic approach to ESG. By contrast, when a company elevates its ESG program beyond regulatory compliance, it can maintain a leadership position or uncover new opportunities to establish an even stronger market presence.

AN ESG-BACKED FUTURE OF FINANCE

Market-making opportunities will arise from environmentally and socially responsible efforts, especially as investors and lenders continue to view ESG elements as necessary for reasons beyond reporting requirements. As ESG literacy expands, investors will be able to make informed decisions that consider the long-term value offered by sustainability-focused organizations.

In addition, companies' ESG assertions (such as those related to climate change or diversity and inclusion) will influence existing and potential investors and lenders, particularly as reporting methods become more standardized and transparent. By anticipating this trend, companies can better position their access to capital through strong ESG programs.

STEPPING UP SUPPLY CHAIN STANDARDS AND PROFITABILITY

In addition, ESG influences on the supply chain are likely to become a key differentiating factor. A large organization (for example, a major consumer products manufacturer) might drive positive environmental changes by evaluating its entire supply chain—from raw materials through distribution. When assessing commercial partners, the organization will expect all players in the supply chain to demonstrate awareness and transparency regarding performance indicators and make sure that business methods align with the manufacturer's environmental standards.

Further, effective organizations will not accept their suppliers' data at face value but will employ methods to verify ESG efforts and reporting are, in fact, being carried out. This extra layer of scrutiny can bolster the common good, avoid pitfalls such as corporate headline risks (brands being associated with a vendor whose ESG standards are not up to par), and motivate all businesses within the ecosystem to mobilize and improve ESG programs. While ESG-focused supply chain partners reduce some near-term risks, there is—and should be—a financial incentive. In the long term, organizations that are focused on ESG now have the opportunity to shape sustainable business practices that drive profitability. Ultimately, as these trends permeate the market, companies lagging in ESG strategy will find reduced market relevance.

TOP IMPACTS WILL VARY BY INDUSTRY AND CONTEXT

Prioritization of environmental or social outcomes is no longer reserved for large or public companies. Private equity-backed and middle-market organizations will be impacted as well. For manufacturers and consumer products brands, environmental and supply chain matters might be most critical to address, whereas for some services organizations and in sectors heavily reliant on human capital, social elements of ESG may be the highest priority.

ESG and sustainability efforts will also impact employee recruitment and retention efforts. Overall, it can shape a more diverse and inclusive workplace, and it can demonstrate that the ESG approach for a workplace is in alignment with employees' own values. These employee engagement and retention factors—backed by ESG principles—will be particularly important within service sectors like business consulting. The same holds true for any other scenario in which the workforce is the most differentiating component of a company.

FUTURE-READY COMPANIES MUST ACT ON THE RESEARCH

The business value of environmental and social responsibility has been repeatedly touted to analysts and executives alike. For example, diversity-related initiatives (part of the "S" in ESG) can improve innovation, employee retention, and other valuable aspects of a business. But, like eating more vegetables or exercising regularly, knowledge of best practices **does not always translate to action**. Even when organizations take action—for instance, when bolstering corporate environmental efforts—many **companies find it difficult** to communicate consistently among stakeholders and measure progress effectively.

Establishing ESG approaches anchored in strategy

As ESG programs become more common and regulated, companies should proactively shape their approaches. To their credit, many companies and individuals have already been overseeing facets of ESG and sustainability, perhaps labeled under different names (diversity and inclusion programs, environmentally conscious manufacturing and supply chain initiatives, corporate social responsibility efforts, to name a few), which means that many ESG matters are not new. The new and evolving element is the additional rigor and bundling of these concepts.

TACKLING ESG WITH RIGOR AND RELEVANCE

Formalized ESG efforts are unfolding rapidly, with many **European** organizations already well underway, while companies in the US are largely in the analysis phases and piloting formative approaches. The ESG journey for most companies will begin with stages of analysis and decision-making followed by phases of investment.

INITIAL STAGES OF IMPLEMENTING ESG

When implementing and refining ESG efforts, the maturity levels of businesses and appointed ESG leaders will vary. Companies just getting started will likely center their attention on developing coherent policies and approaches

Among the vast realm of ESG factors, each organization will need to sift through the possibilities to measure, then select and hone priorities. Here, a targeted approach is paramount. A company should not set out to tackle hundreds or dozens of ESG initiatives. Leaders should identify a limited number of core elements to measure and track progress over time.

An organization should lay out its roadmap for ESG success in the context of business strategy. Then, as with any other important plans, the organization should create market-facing visibility for the ESG program and integrate incentives, such as tying ESG successes to compensation. This approach will enable the organization to mature as the ESG priorities become part of its fabric and culture.

To implement ESG effectively, organizations must tailor applicable standards and frameworks, and they can draw from a well-established starting point. That said, the established standards are currently undergoing a quickened pace of change as regulators in the United States and across the globe coalesce around more clearly-defined and comprehensive ESG reporting methods.

Championing and implementing ESG programs will be a journey that offers unforeseen benefits beyond compliance. Future-minded business leaders view ESG as a strategic cornerstone that will reshape possibilities and create renewable value and success for all stakeholders.

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