What is ESG Investing?

ESG & Sustainability Transformation

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What is ESG Investing?

ESG is an acronym that stands for Environmental, Social, and Governance. ESG gained traction after the United Nations released its Who Cares Wins report in 2005, and its fortunes have been steadily growing until recently. For example, there has been a fivefold increase in internet searches for ESG since 2019, even as searches for "CSR" (Corporate Social Responsibility) have declined — a concept that previously reflected greater corporate engagement rather than changes to core business models. Across all industries, geographies, and company sizes, organizations have been allocating more valuable resources to improving ESG. More than 90% of S&P 500 companies now publish some form of ESG reporting, as do about 70% of Russell 1000 companies (according to a McKinsey report). ESG encompasses a wide range of issues that can have a direct or indirect impact on financial relevance. Some of the issues covered by ESG reporting include resource management, supply chain management, organizational health, safety policies, and building trust through transparency.

Corporate social responsibility (CSR) and ESG are similar but distinct enough that the terms should not be used interchangeably. CSR is a set of driving factors behind a company's internal operations. However, it does not use external certifications to demonstrate that it meets specific expectations. In contrast, ESG uses external assessments to determine compliance.

The biggest difference between CSR and ESG is the inclusion of governance issues in the latter. CSR primarily focuses on social and environmental concerns to improve how an organization impacts society. While investors may use either CSR or ESG to determine investments, ESG provides additional information about a company's actions to allow investors to gain more data about the specific ways a business addresses environmental, social, and governance issues. ESG itself is an umbrella term for a company's environmental and social impact, as well as how strong and transparent its governance is in terms of corporate governance, executive pay, audits, internal controls, and shareholder rights.

It measures how your company integrates environmental, social, and governance activities into its operations, as well as its business model, impact, and sustainability.

Two decades ago, when the Euro was created and the European market was formed, foreign languages became the skill du jour in the job market. More recently, JavaScript, Python, and other programming languages have become differentiators. Now? ESG certification is becoming the new must-have requirement for modern careers, especially those in finance.

The three components that make up ESG are environmental, social, and governance.

Environmental

The environmental aspect focuses on how a business minimizes its negative impact on the environment.

It covers a business's products/services, supply chain, and operations. ESG allows a business to target different areas within its organization and implement more ethical and sustainable practices.

Examples of environmental business practices include:

• Reducing energy consumption and using renewable energy sources to become a net zero emissions organization.

• Developing greener products and services.

• Switching to zero waste products or sustainable packaging using biodegradable materials.

• Reducing carbon emissions by switching to LED lighting.

• Encouraging recycling and reducing waste going to landfills.

Social

The social dimension focuses on workplace culture and how a business impacts wider society. Organisations can make a positive contribution to social equity, investing in fair and equitable opportunities and conditions for employees, those working in their supply chains and local communities.

Equality and fairness are central to this dimension and examples of social and ethical business practices include:

• Ensuring products are safe and customer data is secure.

• Preventing abuses in the supply chain, such as labour rights, including modern slavery and freedom of association.

• Providing health, safety and wellbeing training and support.

• Promoting equality in the workforce with diversity and inclusion policies.

• Investing in local community projects, such as funding education initiatives.

Governance

Governance refers to the decision-making, reporting and logistics processes used to run a business.

It also looks at the ethical conduct of the business and the transparency of the company with its stakeholders about its operations.

Governance is linked to the environmental and social aspects of ESG in that it looks at the transparency and decision-making behind them.

ESG governance standards ensure a company uses accurate and transparent accounting practices, pursues integrity and diversity in selecting its leadership, and is accountable to shareholders.

ESG investors may require assurance that companies avoid conflicts of interest in selecting board members and senior executives, do not use political contributions to gain preferential treatment, or engage in illegal conduct.

Examples of good governance practices include:

• Reporting accurately to stakeholders on financial performance, business strategy and operations.

• Holding business leaders and managers accountable for risk management and performance.

• Conducting business ethically, such as preventing bribery.

• Ensuring diversity in any leadership team and being open about executive pay.

• Ensuring good governance in your business can attract investors and your supply chain, and good governance practices can also help enable businesses to grow.

Key Pillars of ESG

While talking about ESG, People, Process and Product have been considered as the key pillars. Equal employment opportunities and gender diversity represent People. An opportunity to promote social inclusion enhances the conducive working environment of the organization. Process stands for screening impacts through multiple criteria. It ensures that investments are less harmful to the community and environment and do not lead to negative consequences in society. It also indicates the management system and democratic process of the organization. Product stands for the accountability and responsiveness of the organization to investors towards customers. The process of handling complaints and freedom of choice of customers are also considered.

The foundation of ESG and Sustainability is Value, Governance, Transparency and Stakeholder Inclusion. On the other hand, the pillars of Sustainability can be broadly classified as:

• Ecological footprint of operations.

• People in the workplace.

• Product and customer stewardship.

• Supply chain responsibility.

• Systemic social issues.

• Community engagement.

• Disclosure as a catalyst for change.

• Advocacy.

Some of the most commonly used ESG frameworks and standards include:

• Global Reporting Initiative (GRI).

• Carbon Disclosure Project (CDP).

• Climate Disclosure Standards Board (CDSB).

• Sustainability Accounting Standards Board (SASB).

- Task Force on Climate-related Financial Disclosures (TCFD).
- UN Principles for Responsible Investment (PRI).
- World Economic Forum (WEF) Stakeholder Capitalism Metrics.

To learn more about ESG and sustainability-related models, please contact **YTT Consulting**!