

[EMBO name] business brief

July 2024

Sustainable business, resilient future
How ESG leads to business success

A growing body of evidence demonstrates the various advantages to be gained from pursuing sustainable business models. As the pressure to embrace ESG (Environmental, Social and Governance) standards grows, this brief sets out the business case for sustainability and how (insert EBMO name) can help companies to achieve it.

Strong ESG performance means companies:

- ▶ Stay ahead of regulations
- ▶ Access finance
- ▶ Drive innovation
- ▶ Improve efficiency and risk management
- ▶ Build strong community and government relations
- ▶ Win consumers
- ▶ Enhance company reputation
- ▶ Attract and keep top talent

Why should businesses put sustainability first?

Stay ahead of regulations

More governments and regulatory bodies are imposing stricter regulations on environmental protection, social responsibility, and corporate governance. There is also a global trend to standardize and make sustainability reporting mandatory.

New regulations increasingly include supply chains, meaning that they affect companies of all sizes around the globe. While reporting requirements for small and medium-sized enterprises (SMEs) can be less onerous, pressure is mounting.

Proactive compliance by adopting ESG standards avoids penalties and legal issues. Importantly, it also prevents loss of market access.

- ▶ Three major stock exchanges in China (the Shanghai, Shenzhen, and Beijing Stock Exchanges) are introducing new sustainability

reporting guidelines. Large, listed companies will be required to report on ESG in their operations and supply chains, with the first reports expected in 2026.ⁱ

- ▶ In 2023 the European Commission’s Corporate Sustainability Reporting Directive (CSRD) came into force. It broadens who must report, standardizes reporting, and expands the scope of reporting to include the value chain. All large and listed companies, including SMEs and non-European Union (EU) companies with substantial activity in the EU, need to report in accordance with the European Sustainability Reporting Standards (ESRS). The directive is being phased in and will apply across the board from 2028.

In 2024 the Council of the European Union adopted the Corporate Sustainability Due Diligence Directive (CSDDD), which requires

companies to conduct human rights and environmental due diligence to address adverse impacts of their actions, including in their value chains worldwide. The new rules are expected to come into force in 2027.

- ▶ The US Securities and Exchange Commission (SEC) adopted new rules in 2024 that enhance and standardize climate-related disclosuresⁱⁱ. Public companies need to file climate-related disclosure in registration statements and Exchange Act annual reports. While the new rules do not cover supply chains, the laws of several US States, including California, do so. The SEC has also said supply chain emissions may be revisitedⁱⁱⁱ.

Access finance

Demand for strong company ESG performance from both financial investors and corporate lenders is growing, increasingly affecting businesses from small enterprises to large multinationals. This is partly because of regulatory pressure but also because more data regularly becomes available showing the positive impact of ESG on business performance^{iv}.

In recent years ESG investment has moved from the sidelines into the mainstream, and the trend is accelerating. Established ESG markets are growing, and new ones are coming on stream. Investments globally are expected to reach US\$ 50 trillion by 2025, representing one-third of the projected total assets under management^v.

Sustainability also plays a growing role in stock exchanges. Set up in the mid-2000's, the UN's Sustainable Stock Exchange Initiative^{vi} currently has 133 members around the world, all stock exchanges and derivatives exchanges, and the number keeps increasing.

Corporate loan trends follow a similar trajectory to those seen in investment. Companies that integrate ESG are more likely to obtain loans and potentially at a better rate from banks and other lending institutions.

For example, Sustainability-Linked Loans¹ (SLLs) offer cheaper borrowing if companies can meet agreed ESG goals such as reducing carbon emissions or improving board diversity. In 2022, the total value of SLLs globally peaked at US\$ 677 billion^{vii}. The increase in regulatory pressure is currently leading many banks to redesign their SLLs to ensure these loans delivery credibly on ESG^{viii}.

SLLs are just one example of how lenders are incorporating ESG into their ways of working. Others include the provision of green loans, ESG scoring models (which assess the borrower's potential ESG performance) and adhering to the UN Principles for Responsible Banking^{ix}.

The underlying message is that lenders are not just incorporating ESG in sustainability-focused loans, they are increasingly making ESG performance part of their overall corporate lending criteria.

▶ What is ESG?

ESG is a framework used to assess an organization's business practices and performance on sustainability and ethical issues.

- ▶ **Environmental (E):** Conservation of the natural world. This includes e.g. energy use, waste, pollution, natural resource conservation, and treatment of animals.
- ▶ **Social (S):** Consideration of people and relationships. This includes the company's relationships with its employees, suppliers, customers, and the communities where it operates. It includes factors like respect for human rights, labour practices, diversity and inclusion, health and safety, and community engagement.
- ▶ **Governance (G):** Standards for running a company. This covers issues such as executive pay, audits, internal controls, shareholder rights, effectiveness of the board of directors, risk management, and transparency.

ESG reporting is the process by which companies disclose their performance in each of these three areas.

¹ SLLs are loans for general corporate purposes and not limited to sustainability projects. SLLs track sustainability-based key performance indicators and measure these against targets that were negotiated when the loan was agreed. Depending on performance, the company is then rewarded or penalized with interest rate adjustments.

Drive innovation

ESG is a catalyst for business innovation. Adopting ESG standards leads to an organizational culture where employees think creatively about reducing waste, improving efficiency, community impact, and developing new products and services that align with the company's sustainability goals. Research on China's listed companies, for example, shows that strong company ESG performance positively influences green innovation^x.

Moreover, companies that embrace ESG clearly recognize the importance of diversity and inclusion in the workplace, which reflects the 'Social' component of ESG. Inclusive and diverse company cultures have a significant positive impact on the bottom-line because, among other things, they foster innovation^{xi}.

Improve efficiency and risk management

ESG strategies lead to cost savings and enhanced financial stability through operational efficiencies and risk management. ESG practices include identifying and managing risks related to environmental, social, and governance factors, ensuring long-term resilience and business continuity.

- ▶ **Environmental Risks:** Addressing issues like climate change, resource scarcity, and pollution, can mitigate risks that could lead to financial losses.
- ▶ **Social Risks:** Focusing on labour practices, community relations, and customer satisfaction can prevent reputational damage and operational disruptions.
- ▶ **Governance Risks:** Strong governance frameworks reduce risks related to corruption, fraud, and mismanagement.

ESG practices help businesses stay agile and responsive to evolving market conditions, maintaining their competitiveness. For example, sustainable business practices can help companies combat rising operating expenses and reduce costs by improving resource efficiency such as energy consumption and water usage^{xii}.

Build strong community and government relations

Incorporating ESG principles into business strategies builds stronger communities, which in turn impact the bottom-line^{xiii}. Community engagement means working together with local groups and social organizations to address key issues affecting the community's well-being.

For instance, companies with environmental sustainability initiatives help to reduce pollution, manage waste responsibly, increase the use of renewable energy and conserve natural resources, among other things. Other businesses are involved in education and training programmes, improving healthcare provision, building infrastructure or emergency relief. All these initiatives contribute to healthier and more sustainable communities.

This positive community impact creates a collaborative environment where companies can operate more smoothly and efficiently, reducing the risks associated with regulatory changes and community opposition. Businesses are better positioned to influence policy development that aligns with their strategic goals and can ensure that regulations are favourable and predictable. Supportive government relations can also facilitate, for example, faster permitting processes, access to incentives, and better infrastructure support.

Win consumers

It's not just investors and lenders looking for ESG performance, consumers are too. They increasingly prefer sustainable products and companies. Consumers, particularly younger people (who are both current and future consumers), increasingly support brands that share their values and actively contribute to societal and environmental well-being.

Company investment in ESG initiatives can therefore open new markets and customer segments that prioritize sustainability. One study found that a majority (85 per cent) of consumers in 17 countries has already shifted purchase behaviour towards being more sustainable, with the shift being more significant for younger generations^{xiv}.

In addition, consumers are willing to pay more for sustainable products. A study encompassing 31 countries, found that four-fifths (80 per cent) of

consumers say they are willing to pay nearly 10 per cent more for sustainable produced or sourced goods^{xv}.

Enhance company reputation

Strong sustainability performance builds and maintains company reputation in several different ways^{xvi}.

- ▶ **Customer loyalty:** Consumers are more loyal to brands that demonstrate responsibility and sustainability. A company's dedication to ethical practices beyond profit also increases consumers' trust.
- ▶ **Brand differentiation:** Strong ESG performance differentiates a company from its competitors, making it stand out from the crowd.
- ▶ **First mover advantage:** Where a company is the first to embrace ESG, or do something new around ESG, it gains a competitive edge.

Attract and keep top talent

Companies with strong ESG commitments are more attractive to top talent who seek meaningful and

responsible employment, positively impacting the bottom line. The social component of ESG, which focuses on company culture, community engagement, and diversity and inclusion, is particularly influential when it comes to recruiting and retaining talent.

Businesses that, for example, embrace diversity and inclusion outperform those that do not. Improved retention and reduced absenteeism, as well as higher levels of employee productivity, engagement, and creativity, play a big role^{xvii}.

- ▶ Businesses with high cultural and ethnic diversity on executive teams are 36 per cent more likely to outperform rivals on profitability^{xviii}.
- ▶ Higher levels of employees feeling like they belong can lead to a 56 per cent increase in job performance^{xix}.
- ▶ In 2019, the ILO surveyed almost 13,000 businesses in 70 countries. Of those companies that track the quantitative impact of gender diversity initiatives promoting women in management, nearly 74 per cent report a profit increase of between 5 and 20 per cent^{xx}.



Sustainability unlocks opportunities.
Get on board.

How we can help to set your business up for sustainability success

Adopting ESG is more than a box ticking exercise. (Insert EBMO name) can help companies integrate ESG into their business strategies and mainstream it across all operations. (Insert EBMO name) services such as training and tailored advice help companies to (amend list below to reflect EBMO offer):

- ▶ Understand major ESG issues and the current situation around ESG investment, lending, and relevant regulations.
- ▶ Identify materiality, in other words, those ESG issues that are most relevant to the company's operations and which stakeholders care about the most.
- ▶ Develop and embed a ESG strategy.
- ▶ Find and implement the right ESG reporting framework and tools and collect ESG data.

ⁱ White and Case [ESG in APAC: 3 Trends to Watch in 2024](#), 7 March 2024.

ⁱⁱ US Securities and Exchange Commission [SEC Adopts Rules to Enhance and Standardize Climate-Related Disclosures for Investors](#), 6 March 2024.

ⁱⁱⁱ SupplychainDive [How the SEC Climate Change Rules Will Impact Manufacturers' Supply Chains](#), 12 March 2024.

^{iv} See for example Robert G. Eccles, Ioannis Ioannou, and George Serafeim [The Impact of Corporate Sustainability on Organizational Processes and Performance](#), 2014.

^v [ESG Assets Rising to \\$50 Trillion Will Reshape \\$140.5 Trillion of Global AUM by 2025, Finds Bloomberg Intelligence](#) Bloomberg, 20 July 2021.

^{vi} For more information, please see the UN's [Sustainable Stock Exchange Initiative](#).

^{vii} [Environmental Finance Data 2022](#).

^{viii} [Loans Linked to ESG Face Overhaul by Under-Pressure Banks](#) Reuters 10 November 2023.

^{ix} UN Environment Programme Finance Initiative, [Principles for Responsible Banking](#).

^x Liping Wu, Xingchen Yi, Kai Hu, Oleksii Lyulyov, Tetyana Pimonenko [The Effect of ESG Performance on Corporate Green Innovation](#), Business Process Management Journal, 3 June 2024.

^{xi} ILO [Briefing Note – How to Maximize the Business Benefits of Diversity and Inclusion](#), 2022.

^{xii} Witold Henisz, Tim Koller, and Robin Nuttall [Five Ways that ESG Creates Value](#), McKinsey Quarterly 14 November 2019.

^{xiii} Boston Consulting Group [Effective Community Engagement: Lessons from the Natural Resources Industry](#), 2012.

^{xiv} [Global Sustainability Study 2021](#), Simon-Kucher 2021.

^{xv} [Consumers Willing to Pay 9.7% Sustainability Premium, Even as Cost-of-Living and Inflationary Concerns Weigh: PwC 2024 Voice of the Consumer Survey](#), PwC, 15 May 2024.

^{xvi} See for example Global Partner Solutions' [How ESG Benefits a Company's Reputation and Brand Image](#).

^{xvii} ILO [Transforming Enterprises Through Diversity and Inclusion](#), 2022.

^{xviii} CBI website accessed on 4 June 2024 <https://www.cbi.org.uk/our-campaigns/advance-your-firms-di-goals-with-real-action/>.

^{xix} CBI website accessed on 4 June 2024 <https://www.cbi.org.uk/our-campaigns/advance-your-firms-di-goals-with-real-action/>.

^{xx} ILO [Women in Business and Management: The Business Case for Change](#), 2019.