How can ESG maximise and protect value through a sustainable recovery?

Prior to the COVID-19 pandemic, sustainability was already becoming a key topic for the financial world and that has now been accelerated in a remarkable way. As many countries begin to ease lockdown rules, it is an important time to reflect on the changes being seen and consider why factoring environmental, social and governance (ESG) risks and opportunities into investment and management decisions is more critical than ever.

This inaugural webinar in a series run by leading law firm Ashurst, sustainability consultancy Sancroft and environmental consultants RSK, was particularly timely as the panellists explored how ESG can maximise and protect value through a sustainable recovery. Three key themes emerged.

Time to rethink value

In the past, investment decisions were based largely on a narrow definition of financial performance and prospects of a business. However, investors are beginning to rethink what truly gives a business value. COVID-19 has brought forth a change that was already in motion long before the pandemic began. Businesses can no longer ignore their role in society and the impacts they have on the environment as investors increasingly become proficient in recognising material ESG risks and opportunities. The characteristics and drivers of what will determine the success of a business in the future are changing.

Across their clients, the panellists have seen investors take a more holistic approach to their investment decisions. As attitudes towards value change, and access to and availability of ESG information is growing, investors increasingly incorporate ESG performance into financial analysis to assess the future viability of businesses and obtain a more detailed picture of the underlying properties of an investment. In doing this the overriding focus becomes sustainable long-term returns which encourages investors to prioritise overall resilience and move beyond the legacy focus on a single issue, let that be corporate governance or climate change. There is an opportunity for businesses to measure ESG performance over time to bring attention to their improvements in ESG performance and highlight their long-term value to investors. Stakeholder demands in terms of ESG are becoming more visible and changing rapidly, therefore businesses and investors must stay one step ahead and take these demands into account.

What gives value to a business and the characteristics of a successful business in the future is not the same as today. As investors continue to rethink value, a system has been created in which externalities must be looked at from a holistic perspective.

‘S’ is finally stealing the spotlight

The social aspect of ESG has grown in importance in recent years and COVID-19 has amplified the attention being drawn to social issues within businesses and the wider society.

The ways of working and socialising were transformed during the lockdown period and there is still some uncertainty around how this will change as rules ease and businesses begin to reopen. One thing that has become clearer is that digital technology is here to stay and adoption rates have skyrocketed among previously sceptical demographics. In the space of three short months digital technologies have been accepted across all aspects of life; becoming the centre of how we work, shop, socialise and maintain a sense of intellectual curiosity.

Social disruption from political instability and the global rise of populist movements will have to be faced by businesses in order to operate in the modern world. There has been a call for the ‘S’ to become a more prominent part of business operations and financiers will have to find ways to fund these transitions. In making this shift, the panellists anticipate businesses will have to rethink the workplace concept and go beyond health and safety of workers towards holistic wellbeing - which also caters to the mental health and social needs of employees. This is becoming increasingly important for organisations and will have lasting impact on how they work in the future.

Although there have been positive shifts in business because of the current pandemic there are still challenging times ahead, with the IMF projecting a deep global depression. The panellists reflected on the 2008 financial crisis, highlighting the key distinction that the crisis of 2008 resulted from a failure of market governance while the incoming depression did not. COVID-19 has amplified existing inequalities creating a humanity crisis, and the social implications will be different, as will the routes to recovery.

As businesses move from a state of emergency to emergence there will be challenges, however it is important to remember and build on the positive social aspects that have come with a new way of life. When a community suffers a shock, the initial focus is on what has been lost but as they gradually come to terms with the new circumstances, new value is placed on the things that have been gained and these things are defended and maintained when life begins returning to normal.

New opportunities await

Throughout history, moments of real change have occurred when problems are turned into opportunities and challenges do not act as a burden but an incentive to become better.

This year, for the first time the World Economic Forum's (WEF) Global Risk Report found the top five global risks in terms of likelihood and four of the top five global risks in terms of severity to be all environmental. A pandemic has not been featured among the top WEF risks since 2015 and COVID-19 has shown how devastating global shocks can be for businesses when they are unprepared. This has also reminded us that climate change impacts will likely be more severe and are already manifesting today, so building resilience is paramount if we are to learn anything from the current crisis.

It is important to remember that there is no going back to a world that is no longer there. This discussion has explored how the COVID-19 pandemic and climate change have brought about shifts in the ESG landscape and what this will mean for businesses and investors. It is no longer acceptable to deny or ignore ESG and the risks and opportunities of ESG that will likely continue to be integrated into business strategies and operations rather than be treated as a separate entity.

In addition to taking a more holistic approach when making investment decisions, there are also opportunities to invest in specific sustainable projects. Although the concept of green finance is relatively young in terms of corporate bonds and loans, since the first green bond was issued in 2014 there has been a 574% increase year on year in the issuance of social bonds that are being raised by governments and financial institutions to fund focused solutions.

For investors, the concept of resilience must be kept front of mind in the decision-making process. The panellists brought forward three important questions that businesses must consider when building resilience in their operations. Do they have robust, reliable leadership? Does their workforce have the skills to be adaptable in times of crisis? Do they have the right technology and systems to overcome external shocks? Whether it be a pandemic, climate-change related hurricanes and flooding or protests for justice, resilience means being prepared for and ready to thrive in such difficult times. Investors must be critical as to whether a business has plans in place to overcome these shocks and remain successful.

It is also important to consider the time horizon of opportunities. For example, the technologies that support the transition toward a low-carbon economy do have expiration dates. Greener technologies will continue to be deployed around the world at a rapid pace but we need to accept that some of these technologies will only serve a role in the next 20 to 30 years; before they are replaced by the next generation of even greener ones.

Although it will not be without its challenges, particularly in these uncertain times, there are immense opportunities for businesses to adapt, become better and more relevant.

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This inaugural webinar took place on 1 July 2020 and the presented the views of an excellent panel comprising:

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