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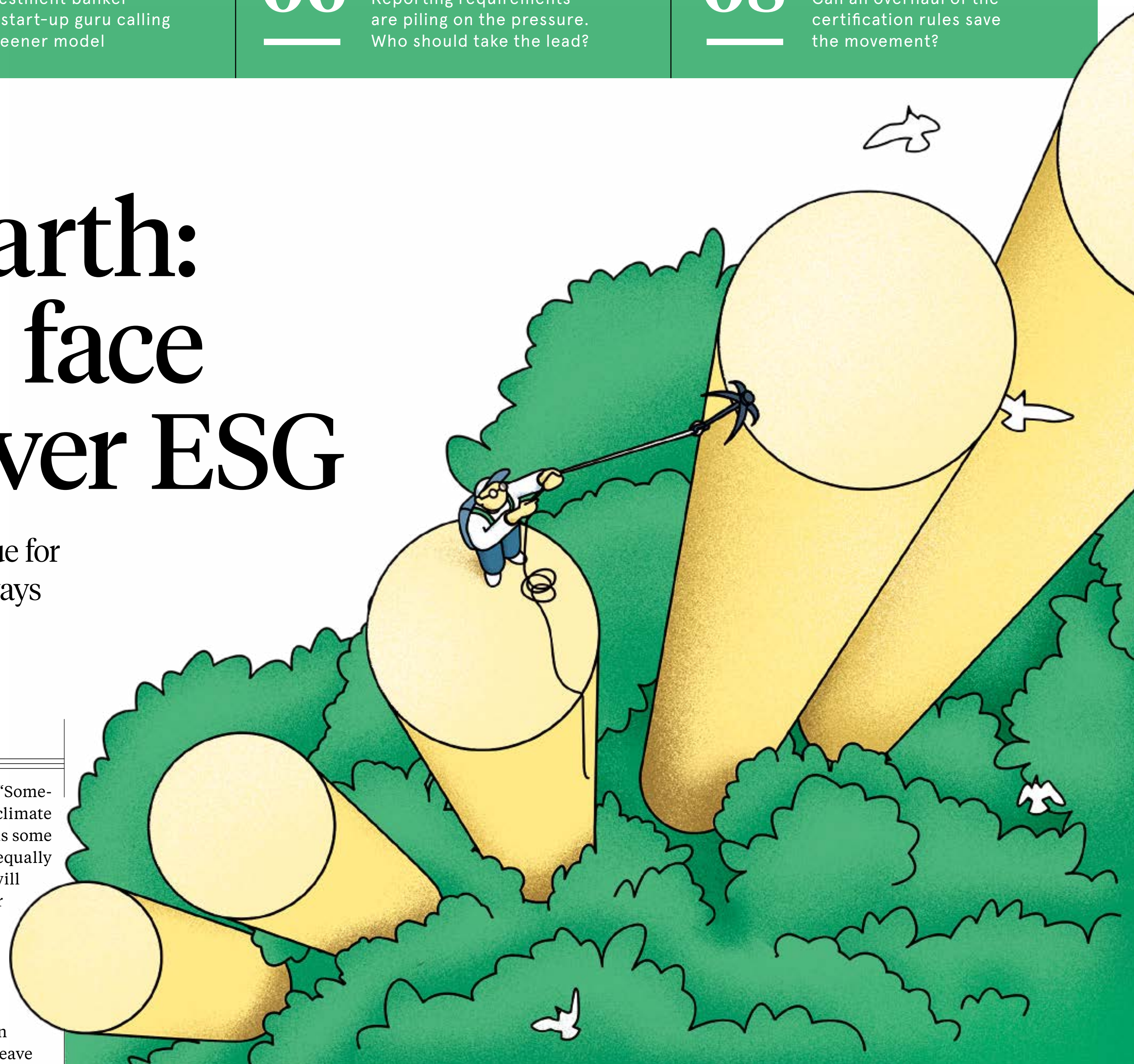
FINANCE

Costing the Earth: finance chiefs face tricky sums over ESG

CFOs must prove that ESG initiatives deliver value for money. But the benefits of sustainability don't always show up on the balance sheet

Ben Edwards



Faced with pressure from customers, regulators, investors and employees, many companies have ramped up spending on environmental, social and governance (ESG) projects. But as they work to integrate sustainability into broader business strategies, finance chiefs must still show that the initiatives offer good value for money.

This process might well be daunting for those at the beginning of their ESG journeys, especially if the exercise sets alarm bells ringing about the C-suite's commitment to sustainability. But according to James Stacey, a partner at sustainability consultancy ERM, there's no need to fret. Companies simply need to assess the return on investment (ROI) of their ESG initiatives in the same way they would judge other investments that could impact their future financial performance and success.

"Understanding ROI is all about understanding how the sustainability agenda or a subset of it – let's say carbon emissions and the transition to net zero – interacts with a business's revenue, costs and the assets and liabilities it's got on its balance sheet," he says. "At that level, where these issues are strategic drivers of future financial performance, the ROI exercise is the same as it is in other business circumstances."

But because different ESG issues have different degrees of financial impact on different types of business, there's no one-size-fits-all approach when it comes to measuring that ROI, Stacey says. "Something like carbon emissions and climate change will be all-pervasive, whereas some other sustainability issues can have equally significant material impact but will often be more specific to a sector or geographical context, rather than affecting all industries in a significant way," he says.

The ROI might not always be purely financial. For instance, as employees become more engaged on ESG topics, they are more likely to leave their jobs if they feel their employers' values are not aligned with their own, meaning that part of the value of any ESG initiative lies in the benefits it provides through staff retention.

"A big driver of our positioning on ESG is our people, and that's an unquantifiable ROI," says Tamsin Ashmore, CFO at Ultima Business Solutions, an IT services company. "There's a significant expectation across all of our employees that we as a business are doing the right things. For me, there's an element around this that is based on attraction and retention. We are a business with exceptionally low attrition, and that has an inadvertent P&L impact because the cost of rehiring people is significant."

The growth of sustainability regulations over the past decade means that the ROI of an ESG initiative could be as simple as maintaining your licence to operate, says Jaideep Das, a partner at ERM.

10%

The estimated reduction in the cost of capital for companies which perform strongly against ESG metrics

McKinsey, 2020

Take a business that has an outsize impact on a local community in a region that suffers from water scarcity, for instance. "If you're operating a highly water-intensive operation you might be creating a lot of jobs. But it will have an impact on the community's ability to draw on water resources," says Das. "There have been very well-run plants which have been stopped from operating either by regulators or by communities because of issues like that. So while there might not be a dollar benefit of tracking broader stakeholder engagement, it totally impacts their licence to operate."

There are other non-financial elements of ROI that should be considered, such as the organisation's ability to access funding now that lenders and investors are increasingly scrutinising ESG performance. "If a business wants to borrow money or is seeking investment, it needs to quantify its ESG impact or sustainability performance. Otherwise it becomes difficult to access capital," says Daniel Usifoh, co-founder of Axiom, an ESG reporting software provider.

Other ESG issues might not have a direct financial impact but could affect a company's brand reputation, impacting its ability to grow and attract new customers. "There is a business case for being robust and diligent around conduct and performance across those less directly financially impactful key performance indicators that don't have an immediate and obvious impact on revenue or cost," says Stacey.

Of course, some sustainability initiatives can have a direct financial ROI, even increasing a company's competitive advantage and boosting top-line growth. Das points to business-to-business (B2B) companies. "In the supply chains of customers with ambitious ESG goals, these companies are increasingly getting selected because their products and services will help their customers to reduce their carbon footprint or meet targets for the 'S' part of ESG."

Ultima, for instance, has a target that 75% of its products should help customers reduce their carbon footprint. In that instance, the financial ROI is straightforward: if customers are choosing to buy its products, it feeds through to revenue and the company's bottom line.

Efforts to reduce carbon emissions can also help deliver a direct financial benefit, either by reducing business travel expenses or electricity costs. "Energy consumption drives emissions and costs within internal operations. If you reduce energy consumption through ESG initiatives, your operational cost reduces as well," says Usifoh.

Of course, CFOs might not be able to point to such factors on a balance sheet, explains Ultima's Ashmore. "It's all in those hidden areas of the P&L, so you wouldn't be able to directly attribute it to ESG," she says.

It can also sometimes be challenging to access reliable data to track progress made on ESG initiatives and how that translates into ROI. "As an accountant, you want everything to be black and white and really clear. But we're still very much in a world where the robustness of reporting is not completely ironclad," she continues.

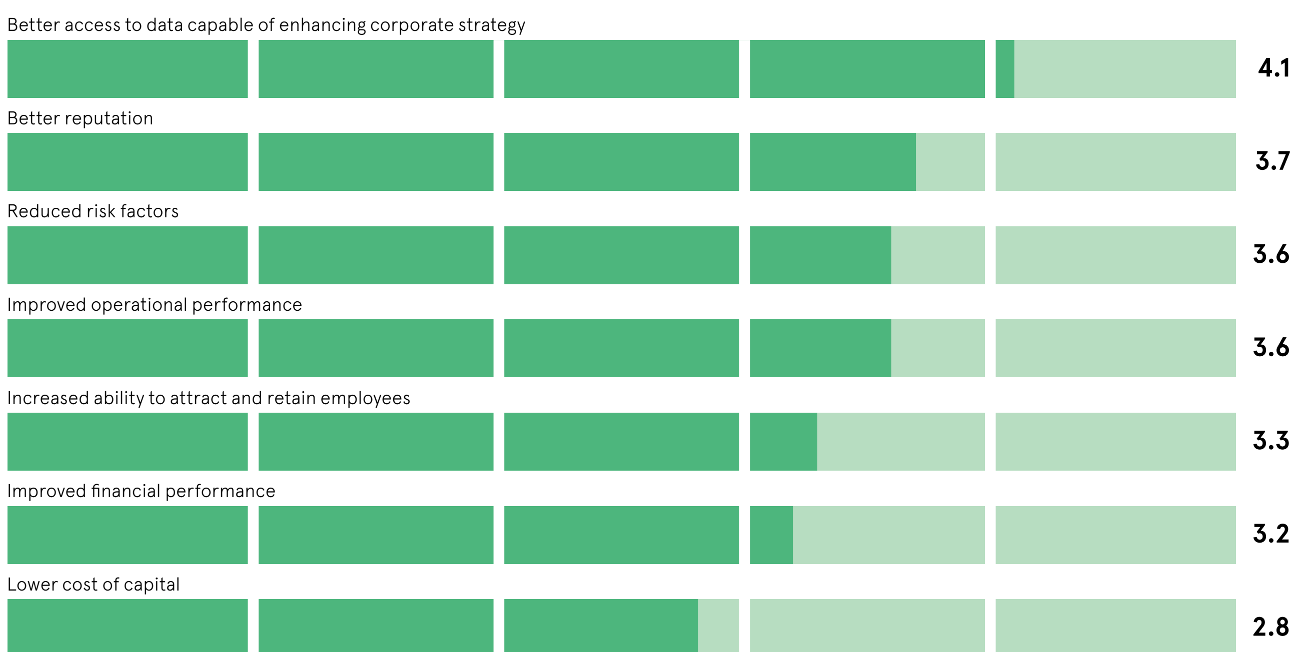
That is creating a backdrop where organisations can potentially massage their ESG figures and make their ROI look better than it is. "Everyone can show themselves in the best light that they choose to at the moment, and there's an element to ESG around how good is the marketing firm that is doing all of this for you," says Ashmore. "We've got to get under the hood of this, and that can only be done through regulation. Otherwise, you're just relying on organisations to be passionate about what they're doing."

Ultimately, if organisations can't accurately measure the impact of their sustainability initiatives – be it for assessing ROI or meeting stricter regulatory requirements – the implications could be severe. "This is no longer a 'nice to have'," says Usifoh. "Measuring ESG's financial performance is a must to remain in business in the long run." ●

> "As an accountant, you want everything to be black and white but the robustness of reporting is not completely ironclad

FIRMS REPORT A BROAD RANGE OF NON-FINANCIAL BENEFITS FROM ESG EFFORTS

Benefits of ESG initiatives by average score from 0 to 5, as ranked by US business leaders



ERM, 2022

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Commercial feature

Transparent ESG metrics power smarter fund investments

Asset managers must rely on evidenced insights to improve opportunity and risk identification, track ESG metrics, and report accurately to investors and regulators. Yet, many firms still grapple with inconsistent and unreliable data on sustainability

With more than $120 trillion worth of assets under management globally, investors have an important role to play in advancing environmental sustainability. Through impact investing, asset managers can encourage the allocation of capital towards improving – and proving – companies' green credentials and innovation, and play an essential part in tackling climate change.

Fund managers' efforts, alongside government endeavours, are vital to improve permit systems, incentives and regulations, educational programmes to upskill populations on sustainability, and businesses' changes to standard practice.

Yet there are major hurdles for funds when it comes to directing investments towards achieving sustainability. Most notably, fund managers require a deep understanding of businesses' ESG performance, with forward-looking insights on potential upsides and risks, while being able to benchmark against the sector.

"The investment industry is under unprecedented pressure to advance sustainability and stop greenwashing, and it needs a much clearer picture to inform its decisions," explains Jonas Rooze, head of sustainability and climate research at BloombergNEF, a research provider focused on the low carbon economy.

Relevance

As expectations rise for funds to transparently deliver on ESG promises to investors, many are finding their own sources of information deeply lacking in nuance, robustness and actionability.

"It's becoming harder for them to effectively assess the winners and losers of the future, particularly in terms of the effects climate change and sustainable innovations will have on these businesses' long-term performance," Rooze warns.

"Much of the data is unreliable and oversimplified, simply looking at carbon emissions and pricing, which is a modelling shortcut."

Fund managers are constantly pitched newer data-based solutions to these challenges, many of which proffer a singular score summing up all aspects of sustainability. But in reality, one number can never encapsulate the totality of pertinent information, Rooze says. "Fund managers find themselves asking: is this data transparent? Can I really believe in it? Is it relevant? There are a lot of 'too good to be true' systems."

Instead, to be confident that they are making and holding sustainable investments, funds need a view of the much deeper forces at play, and of the likely material impacts of their choices. This means knowing how demand for products and services might shift given different societal trends and environmental conditions. It involves understanding where disruptive opportunities could arise or environmental risks emerge - not only for the businesses immediately affected, but for those further down the value chain.

Wide perspective

Clarity can only come from detailed and evidenced insights that are consistently calculated so that asset managers can analyse existing portfolios and prospective opportunities more precisely. "Very few companies tick all the boxes when it comes to sustainability, so funds need a much deeper appreciation of their assets under management and the opportunities on the table," explains Patricia Torres, head of sustainable finance solutions at Bloomberg.

"This necessitates a view of all sustainability aspects affecting those businesses, and these include their long-term climate change targets, internal and supply chain emissions disclosures, innovations around solar energy, batteries and biofuels, and the shifting regulatory mandates."

Leading fund managers are already working with Bloomberg to harness these insights, which are fully integrated within the Bloomberg Terminal. Users can access data, analytics, research and news across all asset classes – from corporate stocks and bonds, to municipal bonds and sovereign debt – applying it from initial scoring and filtering, on to management of assets, and up to the end stage of reporting.

As a result, they can swiftly move from a blinkered view of ESG as a risk topic alone, towards a perspective that incorporates the strong potential upsides in long-term growth, efficiency and competitiveness. Armed with these insights - at asset, fund, and sector levels - managers can find opportunities, track performance, spot red flags, adjust holdings, and report as needed.

"Fund managers typically have their own ESG scorecards, and they can slice and dice our data to complete them with accuracy, understanding exactly how they are positioned, what's changing, and giving them the ability to disclose actions to regulators and clients," Torres explains. "They need to know that every choice is justifiable, effective and explainable."

Bloomberg's data incorporates metrics aligned with all major global standards – including Sustainability Accounting Standards Board (SASB) disclosure standards, and the EU's Sustainable Finance Disclosure Regulation (SFDR) reporting, which mandates declarations on 'principal adverse indicators' covering a broad range of sustainable finance concerns.

> Fund managers absolutely need to know where their data has come from, so they can confidently take action

Timely, transparent data

On a daily basis, fund managers use Bloomberg's sustainability data in several core ways – from BloombergNEF insights on the low carbon economy, to standard-aligned indices and metrics. When considering new investments, they assess companies' current sustainability status and mid-to-long-term potential.

At any relevant point, they can spot changes in the sustainability credentials of their current investments. Whenever they receive requests for information from investors, they can transparently and robustly justify their decisions and explain performance – and at every regulatory stage, they can report confidently on all metrics.

Every part of this journey depends on verifiable accuracy. "Transparency is one of our core principles," explains Torres. "Fund managers absolutely need to know where their data has come from, so they can confidently take action. As well as being easy to access and interpret, our data can also be quickly interrogated down to its source."

The growing popularity of these effective insights, and the maturity with which many funds are using them, is seeing asset managers move away from a policy of mass ESG investment, towards a more targeted allocation of capital into credibly sustainable assets, Rooze notes. "There's a definite shift from quantity to quality. Fund managers know that as well as simply having the willingness to do better, using reliable tools means they can consistently make the right decisions," he says.

As funds play their important part in global sustainability efforts, Torres hopes there will be a concurrent rise in the determination of individual investors of all wealth levels. "As countries develop ESG skills and capacities, asset owners will powerfully drive transformation, through robust performance indicators and requests for information," she concludes. "Their demands on these priorities will have game-changing impacts on sustainability."

To find out more about transparent metrics and data for effective fund ESG investments, visit bloomberg.com/esg

Bloomberg

Q&A

Indexing the way: navigating new sustainable and ESG fund regulations

Data insights and indices can help give direction in a fast changing market, says **Chris Hackel**, head of sustainable indices at Bloomberg

Q What are the main ESG challenges for fund managers?

A There's been a proliferation of regulation around ESG, climate and sustainable funds. The introduction of disclosure and labelling, such as the EU's Sustainable Finance Disclosure Regulation (SFDR), is necessary to bring clarity and transparency. However, other regulations are still under development, leading to fund managers being hesitant to label funds.

We've recently seen a wave of funds downgraded from Article 9, the EU's highest sustainability designation, to Article 8. According to Bloomberg Intelligence, in the fourth quarter of 2022, roughly $57 billion of assets across more than 70 exchange traded funds were reclassified. Fund managers remain highly motivated to launch labelled ESG and sustainable funds, but in the near term we anticipate fewer Article 9 funds being created.

Q How can data insights and indices help?

A The Bloomberg Sustainable Indices team continues to create new indices that target specific objectives. Earlier this year, we launched the Bloomberg Global Aggregate GSS (Green, Social, and Sustainability) Bond Index, which includes only bonds that have their proceeds designated for environmental or social objectives. Many investment managers have retained the Article 9 designation for their green bond funds. We are also developing indices with our rich set of EU taxonomy fields, including what percentage of a company's revenues substantially contribute to aligned activities.

In the current environment, it's crucial that we make available all of the sustainable or ESG fields, factors, and data that fund managers need for regulatory labelled funds and products, and for indices based on their own priorities. Bloomberg has developed multiple tools on the Terminal with transparent methodologies, which fund managers can use to develop analytics, including on coverage and portfolio exposure to mandatory fields in SFDR reports, sectorial and aggregated carbon emissions of portfolios, or benchmarking of ESG debt decomposition in fixed income.

Q How have Bloomberg Sustainable Indices evolved?

A Sustainable and ESG investing approaches have changed at an incredible pace in recent years. Prior to that, sustainable investing was fairly straightforward, consisting primarily of values-based company exclusions or ESG score integration. Sustainable investing now also encompasses net-zero-aligned funds, impact investment, and themes from gender equality to clean energy.

As an index provider, we help fund managers advance sustainable investment through benchmarks that capture and represent performance and risk characteristics – alongside sustainable characteristics including ESG scores, principal adverse impacts, and emissions profiles. We aim to offer solutions for diverse approaches to sustainability, with a focus on transparency in our methodology and data.

Q How do fund managers use these insights to succeed?

A There are billions of dollars invested in funds and products referencing Bloomberg ESG, climate, impact, and thematically sustainable indices. Fund managers work with us because of the insights we provide, and because of their confidence in the quality and transparency of our solutions. There is tremendous innovation happening in sustainable investment, and Bloomberg offers managers the capabilities and flexibility to benchmark and meet specific targets.

Our indices also add value to the market by measuring and representing the dynamics of specific segments being impacted, as the world transitions to low carbon. Here, we use data and expertise from teams trusted by the investment community such as Bloomberg Sustainable Finance Solutions, BloombergNEF and Bloomberg Intelligence to inform index construction. We have launched indices focused on clean energy, renewables, transition metals and more.

> It's crucial that we make available all of the sustainable or ESG fields, factors, and data managers needed for regulatory labelled funds and products

Q What excites you about the future?

A Sustainable investing is still in its infancy. We're invigorated by working on new themes such as nature and biodiversity and the expansion of sustainable investment into different asset classes. Recent initiatives include a 'Carbon Tilted' version of our BCOM commodity index, as well as indices benchmarking commodities essential for climate transition. Development is underway on a version of the Bloomberg US Municipal Bond Index that integrates ESG scores, complementing our Municipal Impact Index. We're also researching climate and social themes in mortgage-backed securities.

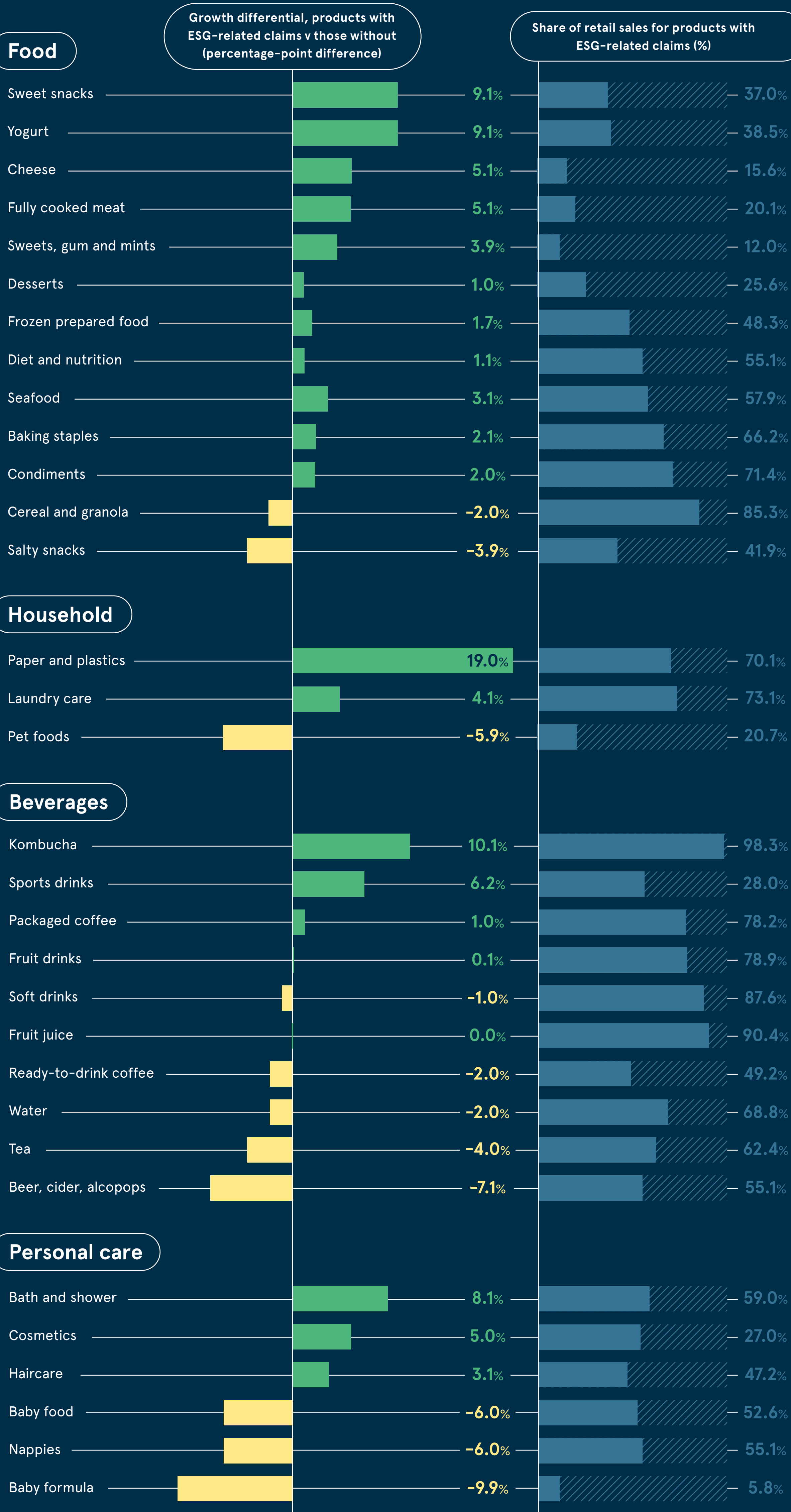
We are incredibly excited about the potential impact of sustainable investment on societies, economies, and the planet.

THE POWER OF ESG MARKETING

As part of their marketing, brands are increasingly keen to highlight their environmental and ethical credentials – and for good reason. ESG claims can boost sales by up to 10%. Those brands which get it right, then, stand to gain a lot, including more return business and a more engaged customer base. But it's worth treading carefully, because it isn't all upside

IN SOME CATEGORIES, ESG CLAIMS CAN ACTUALLY HURT A PRODUCT'S SALES PERFORMANCE

Growth differential and prevalence of ESG-related claims, by product category (2018-22)

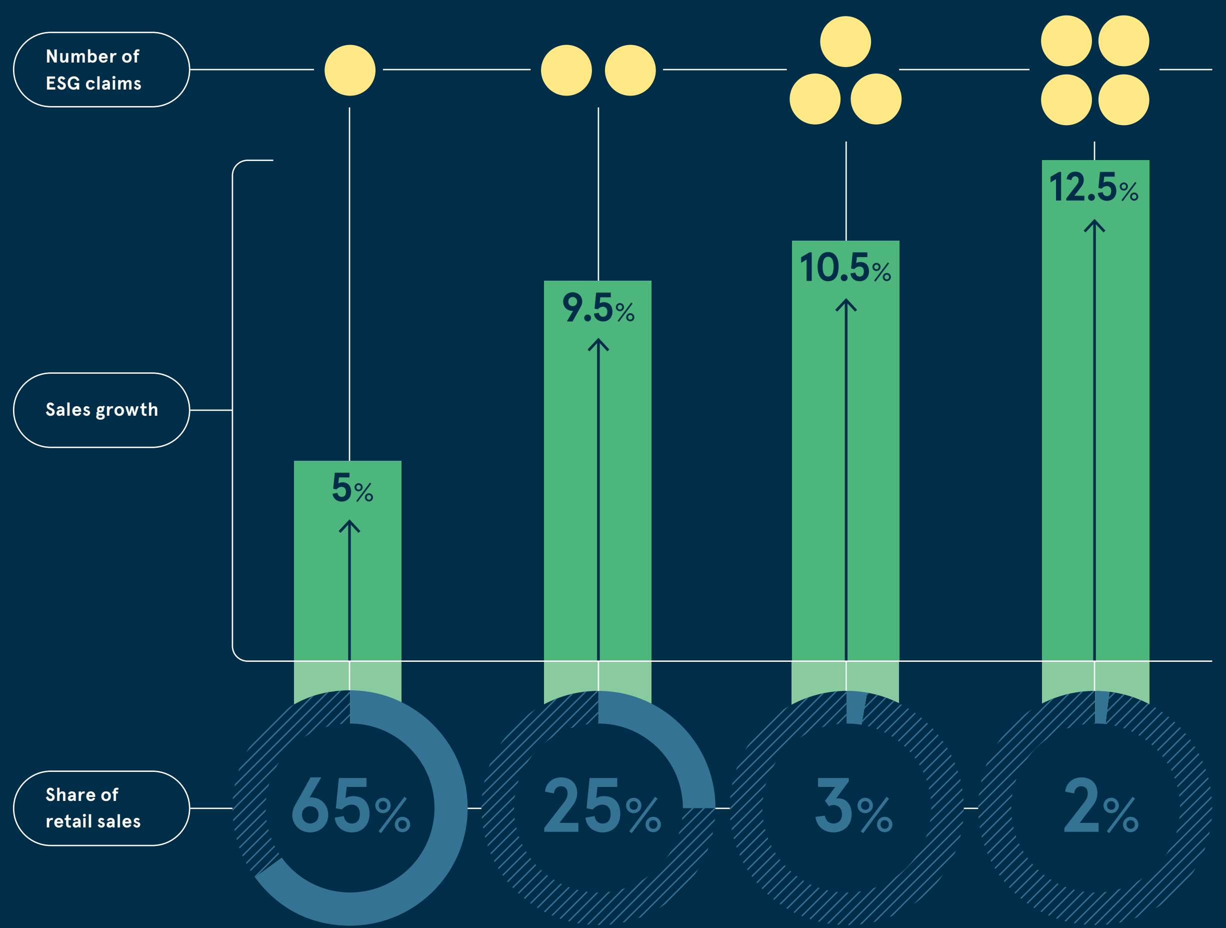


ACROSS THE BOARD, ESG CLAIMS HELP PRODUCTS OUTPERFORM THEIR COMPETITORS

Retail sales growth (CAGR, 2018-22)

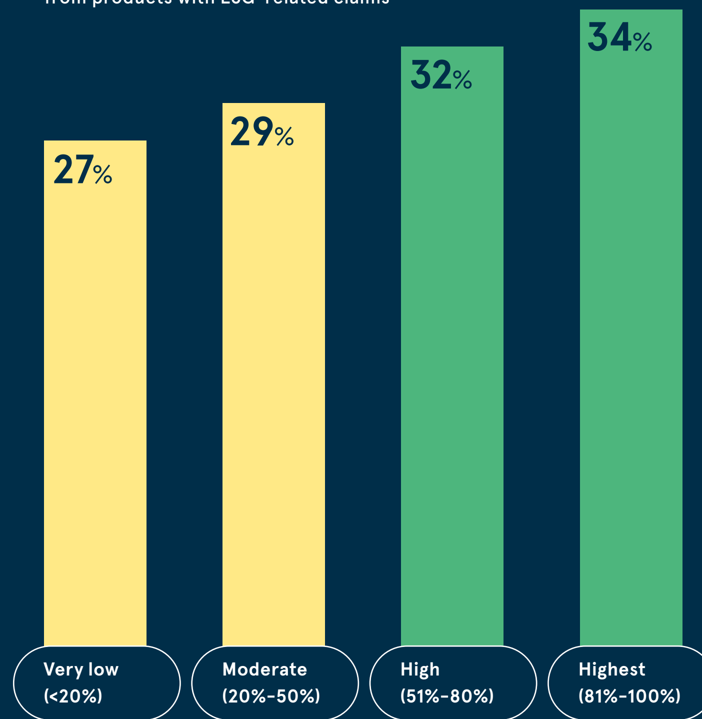
THE MORE ESG CLAIMS A PRODUCT MAKES, THE BETTER ITS SALES PERFORMANCE

Sales growth (CAGR) v share of retail sales, by number of ESG-related claims made per product, 2018-22



GREENER BRANDS ENJOY BETTER CUSTOMER LOYALTY

Brand repeat rate (%) by level of sales from products with ESG-related claims



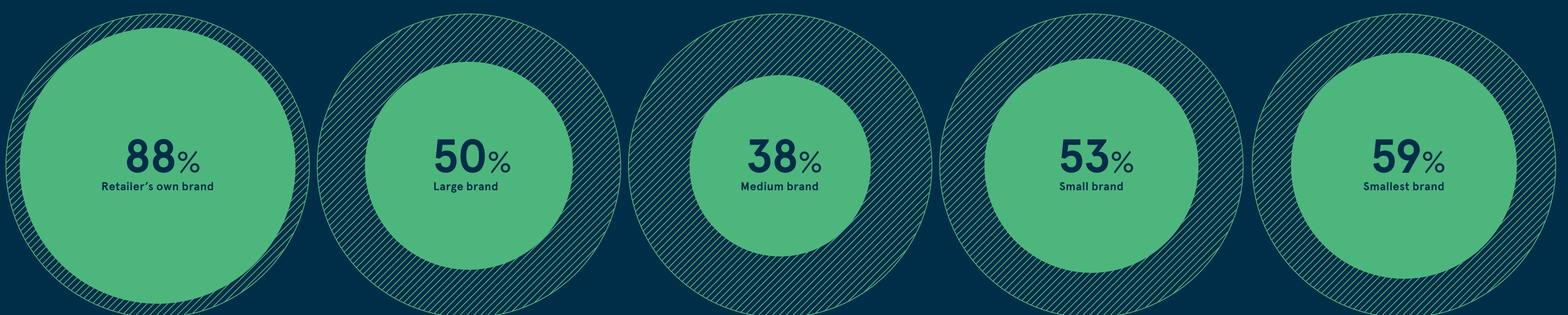
More unusual ESG claims, such as 'vegan' or 'net zero', can boost product sales by **8%**

Run-of-the-mill claims, such as 'environmentally sustainable', increase sales by just **2%**

60% of consumers reported being willing to pay more for sustainable products

ESG CLAIMS HELP SOME BRANDS MORE THAN OTHERS

Percentage of companies reporting outsized sales growth (CAGR) for products with ESG-related claims, by brand type

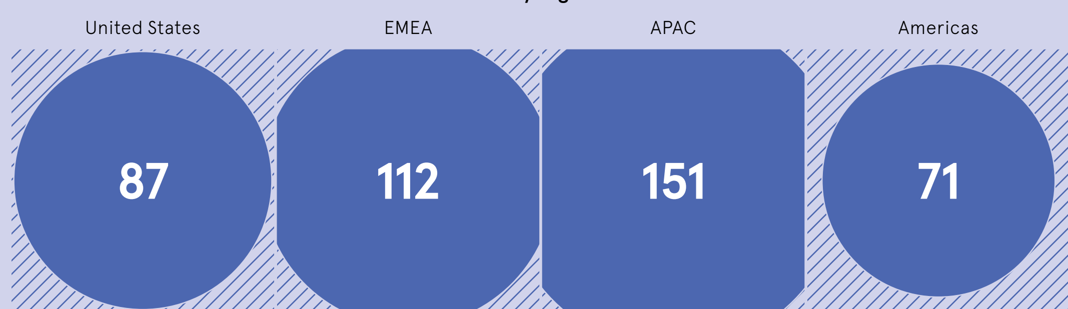


McKinsey, NielsenIQ, 2022

Commercial feature

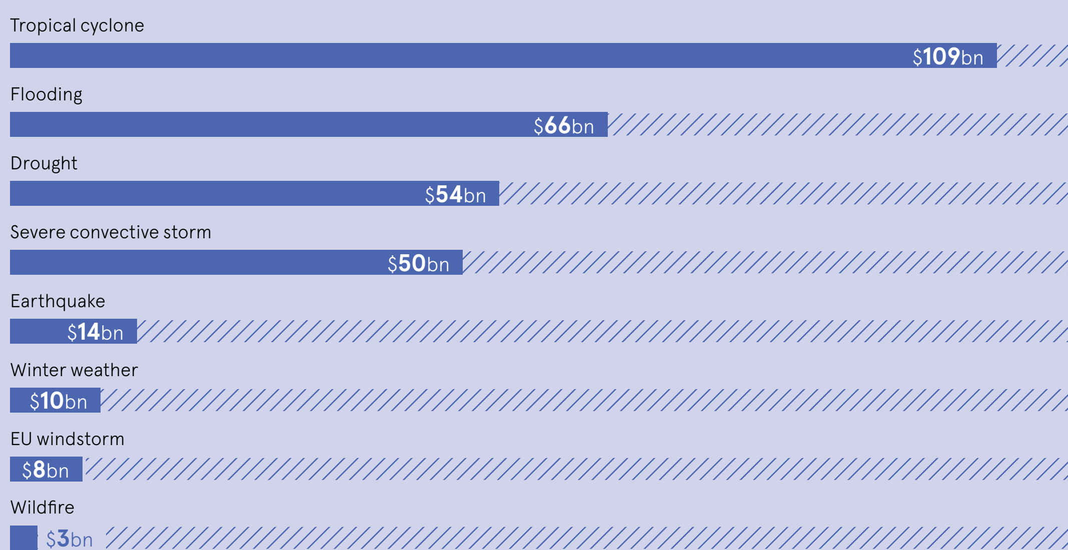
NATURAL DISASTER EVENTS REACHED FAR AND WIDE IN 2022

Number of notable natural disaster events recorded by region



The cost of catastrophes

Global economic losses by peril



Aon, 2022

Bracing for impact: lessons from a year of climate volatility

Extreme weather events are already making their mark on 2023 with devastating downpours and record-low temperatures. How are insurers gearing up for the next wave of climate risks?

When Hurricane Ian made its devastating landfall in southwestern Florida last September, no one could have anticipated the financial fallout. The storm caused an economic loss of more than $95bn, and an insured loss of $50 to 55bn – representing the second costliest insured loss event on record globally, surpassed only by its infamous predecessor, Hurricane Katrina.

From wildfires and droughts to heatwaves and hurricanes, the rate at which catastrophic weather events occur is increasing. A staggering $300bn in economic losses were attributed to climate-driven perils last year, leading top economists to coin this defining decade the age of "The Great Volatility".

The indiscriminate nature of climate catastrophes has made one thing clear: no business is an island, and collaboration between public, private and societal forces will be critical to executing successful resilience strategies.

Collaborations on catastrophe risk modelling

In 2022, the 'protection gap' – the percentage of global economic losses from natural catastrophes not covered by insurance – stood at 58%, according to recent research from Aon. Despite increasingly prolific climate threats, the company's annual Weather, Climate and Catastrophe Insight Report revealed a vast amount of uninsured risk across sectors.

Risk management and mitigation strategies are essential components of sound governance and operational integrity. Critically, as climate concerns take centre stage, cross-industry collaboration will play a pivotal role in helping communities, governments and businesses to increase their resilience to catastrophe events.

Dan Dick, global head of property analytics at Aon's Reinsurance Solutions, believes that this process begins with obtaining the best possible understanding of these events, often through cutting-edge technology. "Just as we need new ways to protect against climate change, we also need a new approach to understand the risks," he says.

Although the insurance industry already implements catastrophe risk modelling to assess the potential physical impact of events before they occur, there is now a demand for models that will project further into the future, offering a holistic picture of possible socio-economic outcomes.

Beyond the physical consequences of extreme weather events, researchers are now exploring how human behaviour and policy action may limit or aggravate the damage done. Comprehensive risk data can effectively mitigate severe losses that threaten insurers' solvency and their obligations to their customers and communities.

Dick describes how a better and more extensive application of climate-related modelling will help private and public corporations become more sustainable, allowing them to make more informed decisions around future risk mitigation strategies. "We've adopted a new way of understanding risk so we can better help our clients manage it," he explains. "Instead of only taking academic research and interpreting it to enable us to develop our solutions, we are funding the ongoing research into the impact of climate change on certain perils to help generate better information and insights for forward-looking models."

Aon's collaborations with universities and colleges feed emerging research directly into the insurance industry to inform new approaches to underwriting risk. Dick acknowledges that not all risk can be mitigated. However, evidence-based insights from leading academic collaborators will be a boon to business rebuilding in the aftermath of catastrophic events.

Dick explains: "That collaboration extends beyond research partnerships because we encourage our research partners to publish their findings in the public domain rather than keeping them for our own, private use." Crucially, knowledge is power, and responses to natural disasters benefit from a wealth of information. "This way, climate perils can be better understood – and responded to – in a holistic way," he continues. "These collaborations recognise climate change as a global problem and that better understanding will allow us to help our clients make better decisions around climate risk."

In practice, the traditional proprietary approach to building solutions is now being augmented by powerful academic research that helps to enrich the knowledge used across markets. Aon's own Impact Forecasting team is building catastrophe modelling solutions by using such collaborative research to inform model development.

For instance, in the wake of Hurricane Ian, analysts and engineers confirmed that window shutters rated for high wind pressure and debris impacts were critical to structure survivability. Targeted insights such as these can help to evolve or reinforce existing building regulations, such as the Florida Building Code, which since 2009 has required most homes in Southwest Florida to have window protection.

Proactive approaches to climate risk

For insurance companies, explaining the 'why' and 'how' behind risk strategies is imperative, not only for compliance purposes but to take action and effect meaningful change in response to evolving risk.

Reduced risk means two things: costs come down, and resilience gets a bump. Moreover, added resilience makes way for sustainable innovation. For businesses and communities, this goes beyond the scope of protection against losses from storm damage. Understanding climate change risk can encourage the adoption of low-carbon technologies and renewables that can mitigate the damage toll of future disasters.

Aon's research puts the scale of the disruption to communities, governments and businesses into perspective. Australia and South Africa recorded their costliest insurance events last year; Europe saw 19,200 heat-related fatalities; and Windstorm Eunice claimed $3.4bn in insured losses. Rebuilding after such devastation is always urgent, offering little time for planning.

And between a global pandemic and ongoing economic volatility, budgets must be factored into response capabilities according to insurance payouts and government assistance.

Dick espouses a more proactive approach to dealing with risks where insights about climate change can help clients expedite decision-making when disaster strikes. "Preparing for climate risks – particularly in business – can begin long before any loss," he says. "Take real estate, for example, which is heavily carbon reliant. By incorporating potential changes into the ongoing maintenance of a building, change can be planned for sustainably and within a budget."

He continues: "These changes could be the addition of solar arrays to roof spaces, using rainwater capture for internal use and to reduce runoff, or finding alternatives to an ageing air conditioning system. These innovations can contribute to a more sustainable and resilient future."

Implemented properly, proactive climate risk management has the potential to inform all stages of planning. Dick notes its capacity to drive governance standards, bolster ESG compliance and engagement, and transform a business into a sustainable organisation with a continually improving risk management mindset.

In early 2023, the world has witnessed extreme flooding in Auckland and devastating storms across the south-central United States. As climate disruptions continue, collaboration between industry, clients, government agencies and NGOs will be essential to delivering relevant coverage and risk management strategies to forge more sustainable future for climate innovation.

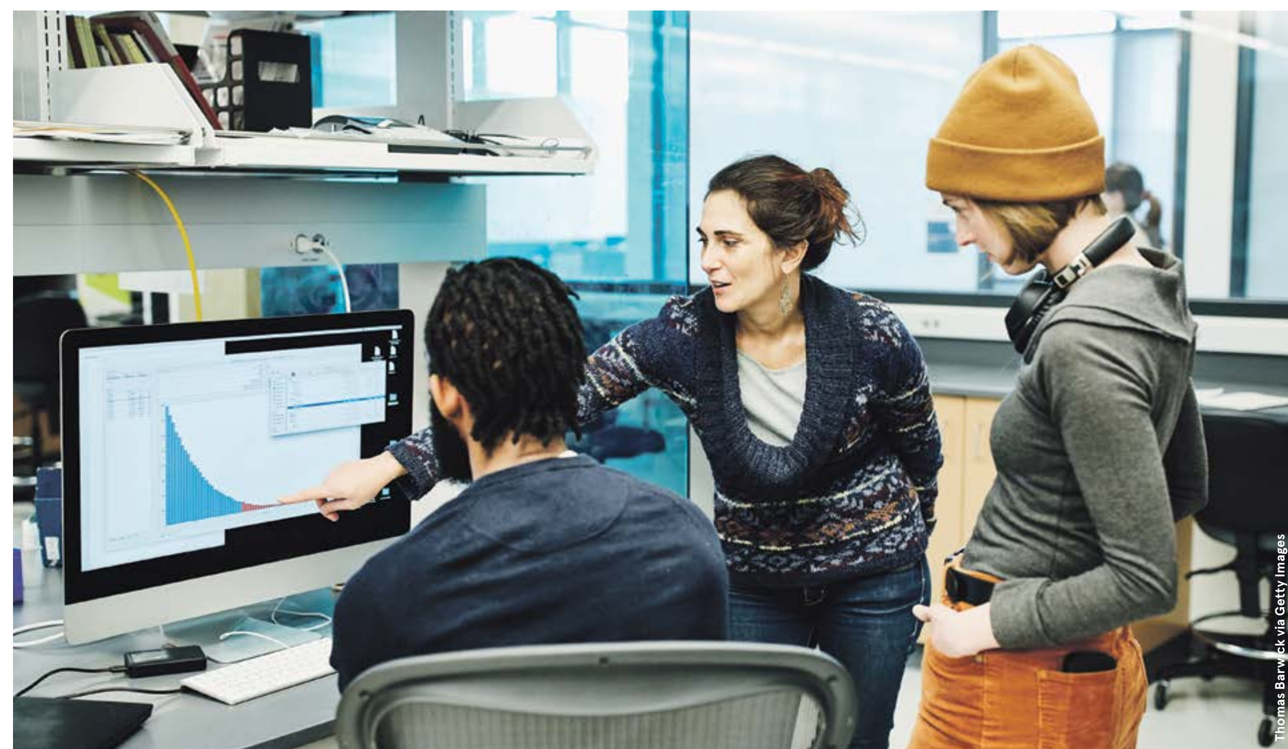
$313bn

The direct economic losses resulting from natural disasters in 2022

58%

The 'protection gap': percentage of the above losses not covered by insurance

Aon, 2023



Thomas Barwick via Getty Images

DATA-SHARING

Private data for public good

There are valuable insights to be gleaned from the data held by companies that could be used to help tackle climate change – and other vital issues. That's why a new partnership of companies is working to facilitate public-private data-sharing and problem-solving

Mark Ballard

We're all used to seeing world leaders gathered on a stage at events like COP27, talking up the prospects of a deal they've just negotiated to reduce collective carbon emissions. Unfortunately, nothing much ever seems to come of it.

Fundamentally, that's because legislators and the public sector aren't the only ones with the power – and responsibility – to fight climate change. The private sector has skin in the game too and might be better placed to do something about it. For one thing, businesses probably already have a decent sense of their own environmental footprint. Sharing that information could enable much more meaningful progress against climate change.

A handful of companies has joined forces to promote that very idea. The Industry Data for Society Partnership (IDSP) proposes to revive some of the public-private collaborations which used data to help health services respond to the Covid pandemic, then repurpose them to fight climate change and tackle other urgent social issues.

Led by Microsoft and Rolls-Royce spin-off R² Factory, which specialises in data services, it brings to the UK a public-private model of collaboration which has been honed over the past decade by multinational organisations running relief projects in developing countries.

LinkedIn is another of the seven firms behind the IDSP, having worked alongside Microsoft on a World Bank project to prove the value of this model for development efforts. In this setup, private tech companies and local government bodies formed collaborative teams, using their collective in-house data to generate potential solutions to specific social and environmental crises. A flagship project saw a team of big tech data experts help local officials fuse public and private data sets to reduce deaths from traffic incidents in the Kenyan capital Nairobi.

Microsoft brought the model to Plymouth in December 2022, hosting a hackathon among defence firms local to the naval town. The participants worked together to merge public databases to create a socio-economic map, helping local officials better target aid to people in crisis.

The Plymouth event demonstrated what is possible from this kind of collaboration, the Institute of Analytics said in February. But big companies are still "too often unwilling to share their data and resources for the greater good".

To help the cause, the IDSP has recruited two more UK firms: utilities Northumbrian Water and UK Power Networks (UKPN). Both are already committed to releasing data for the public good because regulations require them to.

Others in the scheme include Hewlett Packard Enterprises, which rents supercomputer resources to researchers building computer models to predict where the climate crisis will disrupt the food chain.

Similarly, Microsoft has contributed its Planetary Computer, a cloud computing service designed to help scientists and public officials make informed decisions from a suite of environmental data sets, which are housed within Microsoft's global network of data centres. If successful, this would be Microsoft's "biggest contribution to the protection of ecosystems", it said last year: a global environmental monitoring tool. LinkedIn has brought to the partnership behavioural data that it provides to national statistics offices and which, via the World Bank, helps public officials to see which industries are going green or not.

But are public bodies ready to make use of this kind of data from the private sector? In 2021, the World Bank admitted that some of its data collaborations were being hindered by a lack of experts with the skills to use the data that private firms were bringing to them. UK data experts have also warned that the same issues are blighting Britain's opportunities in this regard. As a result, the partnership has made upskilling a key part of its remit.

> The climate crisis is not a closed loop. We need access to different data sets, and we need to work collaboratively to do something about it

Matt Webb, head of enterprise data management at UKPN, says that his organisation found such varying levels of data competence among the 260 local councils it has worked with in south-east England that it developed a web portal to help them. Data experts can access UKPN's data via the portal to use in their own analyses, while less data-literate officials can use the portal's tools to analyse it in situ.

Webb points out that the utility recently earmarked all its data sets as "assumed open" for public use, to satisfy the terms of its operating licence renewal. That even meant sharing data for which UKPN could discern no obvious use, but which others might be able to exploit. "Our data has value beyond our uses and beyond our perception," says Webb. But equally, "It would be foolish to push everything out," he says, as users would be swamped by it and it would be expensive for UKPN.

To tackle the concern over costs, UKPN's portal is intended to be self-service so that the utility needn't serve data requests manually. The portal is only populated with data that has passed risk assessments designed to prevent breaches of the regulations, of intellectual property and privacy law, and of information kept confidential to protect the critical energy infrastructure.

Now it's a matter of getting other big companies to make their data sets open to the public. The partnership's leaders told a conference of software developers in January that doing so would help businesses cut carbon emissions. Concerted action could even offer companies visibility of emissions across their supply chains.

Sneha Ramamurthy, a Rolls-Royce software designer, told developers that the firm has been working with councils to reduce the scope-three emissions in its supply chain, partly to satisfy regulators. Industry has a huge role to play in dealing with the climate crisis, she says. Companies need to see beyond their organisational boundaries and the governance rules that define the use limits of their data. "The climate crisis is not a closed loop," she says. "We need access to different data sets and we need to work collaboratively to do something about it."

That also goes for companies in industries that don't have regulations which require them to share data, says Simon Geale, executive vice-president of supply chain consultancy Proxima. "A lot of companies have realised that climate change is bigger than them. We're seeing far more collaboration in this space than ever, but not a huge amount of data sharing."

It's time, then, to change that mindset. "A lot of data is hidden for competitive advantage," Geale explains. "Supply chains are complicated. We can't get there overnight."

Up to

23%

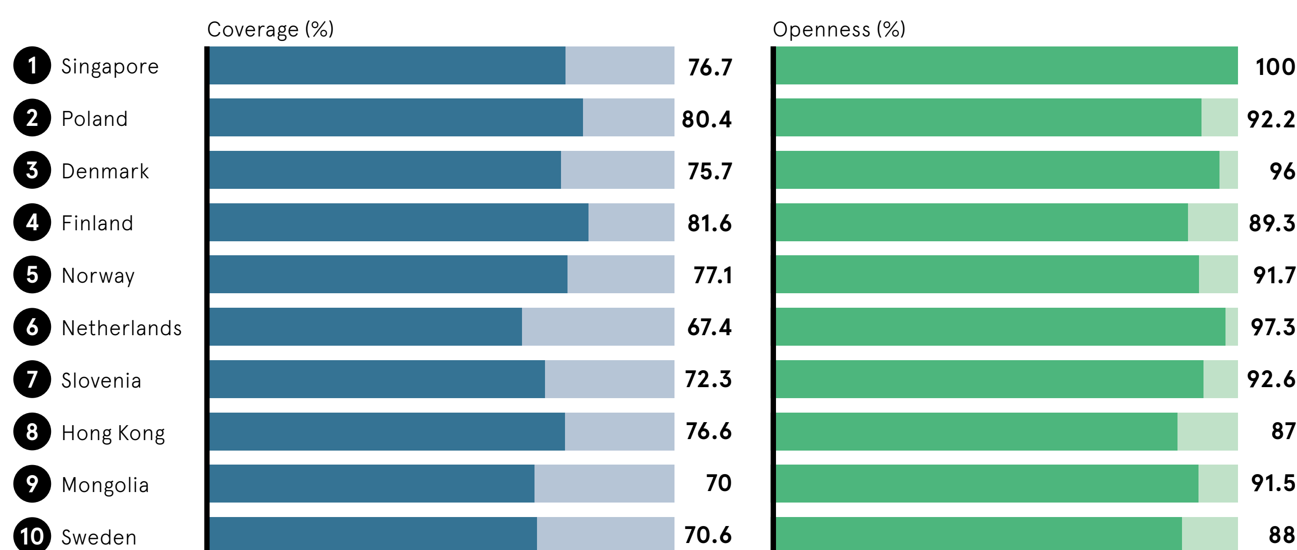
of humanity's CO_2 emissions may be being overlooked due to inaccurate or partial data

Washington Post, UNFCCC, 2021

FOR GOVERNMENTS, FULL DATA-SHARING IS EASIER SAID THAN DONE

Open Data Watch, 2022

Top 10 governments for coverage and openness of open data policies



INTERVIEW

'Marginal improvements to current practices won't really do anything'

How do you create a profitable but sustainable business? Build impact goals and link them to financial success, says **Gordon Eichhorst**, investment banker turned start-up guru

Emily Seares

With a CV featuring the likes of Goldman Sachs and Morgan Stanley, Gordon Eichhorst is perhaps the last person you'd expect to call for a rethink of capitalism. But after working closely with sustainable start-ups, he thinks that something's got to change.

Eichhorst now heads up three businesses: Opto Impact Ventures, an investment management fund which focuses on impact investing; Chorus Angel Network, where experienced investors can invest directly into impact start-ups; and Impact Central, a six-month accelerator programme for impact entrepreneurs.

And he now believes that impact business models are a blueprint for the future.

"We have these huge and increasing problems – whether that's to do with the climate or various social issues – but the structure of how money is flowing is not resulting in enough business resources being directed to solving them," he says.

Charitable giving doesn't go far enough, Eichhorst says. It's about £10bn a year in the UK, he notes. That's less than 0.5% of the country's GDP of around £2.2tn. "So when people say, 'We're going to try to solve some of these problems by giving to charity', that just doesn't reach it. There's just not enough money being deployed," he argues.

ESG targets are another much-hyped approach. These are often favoured by larger, publicly listed companies, but they also fall short because they're "more backward-looking", Eichhorst continues.

"The problem with a lot of large companies is that they have inertia," he says. "They've been around a long time and have spent billions of pounds investing in factories and supply chain structures. They're looking at their business operations and making marginal improvements to current practices, in line with an ESG framework. Investors then think, 'I'm investing in these companies, so I'm ticking these ESG boxes'."

But this will no longer cut the mustard with consumers, says Eichhorst. Eventually, they will look at large, global brands and think that they "haven't really done anything".

An impact business model differs from a conventional 'for profit' business because it operates with a double bottom line, focused on both profit and impact. Not only do the business and the mission side of it run alongside one another, but they're mutually reinforcing. Eichhorst calls this structure 'collinearity', meaning that as the business grows, it naturally increases its impact.

To illustrate his meaning, Eichhorst cites an example of non-collinearity. Imagine a business pays out 1% of its profits to charity. "In that scenario, they can decide whether or not to pay that 1%," he explains. "It would not change the business."

Instead, Eichhorst says that properly embedded collinearity increases the business's growth potential, as the impact and the financial side compound each other. "That to me is a better investment than just a pure financial investment today, because there's so much public interest in businesses doing more and acting in the right way," he says.

> The start-up itself doesn't need to outcompete the multinational conglomerate. What it needs to do is demonstrate a business model that works

New Ground Coffee, which was shortlisted for the UK Roaster of the Year in 2022, came through the Impact Central accelerator. Its business is coffee roasting but its impact is training and employing ex-offenders.

After an initial investment of £60,000, the brand started out making a turnover of £10,000 a quarter in 2019. Sales revenue has since grown to more than £200,000 a quarter, despite tough market conditions. It's approaching £1m this financial year.

"The brand has grown 20 times," says Eichhorst. "Lots of people have tried to start coffee roasters, and most of them have failed. New Ground's impact and their work with ex-offenders benefits them as a company and creates a USP. Not only do they have an amazing product, but they also have an amazing story."

New Ground's products are now sold worldwide, including via Selfridges in the UK. As of February 2023, it was approaching 10,000 hours of living wage employment given to men in the prison system.

Building this kind of purpose into the bottom line can be a USP, but also helps to future-proof the business. Eichhorst says this is particularly important given that "more than 45% of gen Z consumers are suffering from what we would call eco-anxiety".

Julian Boaitey agrees. He's another Impact Central alumnus, having founded ethical skincare brand Yendy Skin in 2021 with the mission of "revolutionising the supply chain for small-scale female farmers in sub-Saharan Africa".

Consumers now demand more from brands, he says. "They're becoming increasingly conscientious about sustainability and want to know more about the journey the ingredients have taken in order to get to the finished product."

Every product sold by Yendy Skin contains at least one 'African superfood' ingredient, traceable from farm to bottle. There's also a commitment to fairer working conditions and fairer pricing for farmers.

"The aim is to build a business that ultimately focuses on a triple bottom line of people (all our stakeholders); planet (the natural environment and sustainable packaging materials); and profit (return for shareholders, creating employment, and generating innovation)," Boaitey adds.

The impact model is not without its challenges. For example, how do you accurately assess the impact?

"The impact side is not a straightforward measurement," Eichhorst admits. "For example, if you could either improve 1,000 people's lives slightly or transform 10 people's lives completely, how do you compare the two?"

New Ground Coffee has an overarching goal of reducing re-offending across the Thames Valley area. It has so far enjoyed a 100% success rate with the ex-offenders it employs.

For Boaitey, measuring impact poses a challenge. "There are dozens of impact frameworks and methodologies that can be adopted to formalise the assessment process," he says. "For now, though, our key driver and measure of success is growth."

Eichhorst accepts that survival is imperative at this early stage. "You can't shortcut time, as start-ups need time to grow," he says. And it's still early days for this business model too, meaning the investment opportunity and the pool of available cash remains relatively small.

He is often asked how the start-ups could make a difference when they are so tiny.

"The point is that the start-up itself doesn't need to outcompete the multinational conglomerate," he says.

"What it needs to do is demonstrate a business model that works in terms of being both profitable, so that it can grow, and one that can also make a real difference in an impact way," Eichhorst says.

"If it can, investors will support it. And as consumers support the brand, the products will start to get traction.

"Ultimately, it will force the larger public companies to respond because it will start hitting them financially," he comments.

That, then, is Eichhorst's endgame. For sustainable capitalism, it seems that survival of the fittest is still the ultimate rule.

Skin in the game The Impact Central programme helped Julian Boaiety to set up Yendy Skin, a successful ethical personal care brand that relies on female farmers in Africa

Commercial feature

Building a B Corp: where environmental innovation meets social sustainability

In the pursuit of true sustainability, here's how one organisation is bringing its ESG strategy full circle – and why others should follow suit

Recycling Lives fragmentiser breaks down and separates materials for further processing

A UK recycling centre HQ'd in Preston provides a portal into a new world where environmental innovation, social sustainability and profitability work together in harmony.

On the surface, it doesn't look like a prosperous new land. Men and women in high-vis jackets and safety helmets operate car bailers, giant cranes and forklift trucks, and warehouses of dismantled electronic devices, car engines, and packaging await the next step of their second purpose in life. But this is a land of opportunity, with many of the workforce finding their own fresh start here.

Alongside the company's workforce, current and former offenders, as well as other people from disadvantaged backgrounds, are learning new skills to get back on track.

This is the home of Recycling Lives, a recycling and waste management company whose unique business model is harnessing environmental innovation and social sustainability as part of the drive towards profitability. The business has 23 sites across the UK and is the largest end-of-life vehicle (ELV) processor in the UK. Last year, it achieved B Corp certification in recognition of its ethical, social and governance excellence.

"ESG is at the heart of everything we do," says CEO Gerry Marshall. "It has always been hugely important that we make a genuine, positive difference on both a social and environmental basis – it's the reason we exist. We've found that neither of these things is mutually exclusive to being a profitable business. We can do good business by doing good."

It's a heartwarming and hopeful story during an important moment for businesses that have been tasked with reaching net zero by 2050. Data from RepRisk shows that one in five cases of corporate risk incidents linked to ESG issues stems from greenwashing - a term coined for businesses that make unsubstantiated claims about their sustainability credentials for financial and reputational benefit.

> It has always been hugely important that we make a genuine, positive difference on both a social and environmental basis. Neither of these things is mutually exclusive to being a profitable business

Greenwashing and the backlash that guilty businesses have faced have caused another growing problem and created a new term for the sustainability dictionary: greenhushing. Research published by climate solutions provider South Pole last year revealed the increasing prevalence of greenhushing around corporate climate targets. Covering 1,200 large businesses with net-zero targets, the research found that 26% of companies who had applied to the Science Based Targets Initiative had not published information about the new targets on their own websites or reports.

So, how does Recycling Lives live and breathe its ESG strategy to ensure that commitments are met? To achieve B Corp status, businesses are required to meet rigorous societal and environmental standards across five key impact areas: environment, governance, workers, community and customers. It's a demanding and scrutinous process that only around 1,100 UK businesses have passed so far.

Marshall says a strategic internal audit is key before going public with grandiose plans. "Becoming a B Corp is the gold standard for anyone going down the ESG route," says Marshall. "Along with the process of compiling our first ESG report, the B Corp pathway made us accountable and enabled us to take a step back and look at ourselves to see what we were contributing in terms of emissions and what we were actually contributing to society. We did an internal audit, and that gave us a benchmark to measure ourselves against and a plan to reduce emissions and add social value."

Social value at the company is intertwined with sustainability and productivity. It employs people who are released on temporary licenses from prison as well as those who have been permanently released from custody. They are paid a living wage and offered opportunities to develop their skills, confidence and self-sufficiency across its recycling sites. And it's working.

The approach has reduced average re-offending rates among their workers to less than 5%. This far outdoes national average rates: up to two-thirds of prisoners in the UK re-offend, and around 28% find work upon release.

Both business strategy and financial investment are fundamental to a successful, integrated ESG strategy but should be approached as an investment that is designed to create value. Recycling Lives' top-level and day-to-day business decisions are based on its socially and environmentally sustainable ethos. It has invested in the development of groundbreaking technology that aims to reduce the organisation's waste, lower and potentially eliminate energy costs onsite and create a new income stream by selling renewable energy back to the grid.

The company recycles upwards of 180,000 cars per year, but up to recently, that process created landfill from the automotive shredder residue (ASR). While it recycles the parts it can, the remaining ASR amounts to about 25% of end-of-life vehicle mass. Currently, Recycling Lives is able to recover 20%, leaving 5% which goes to landfill due to its complex make-up. However, that 5% is now being addressed through the business' energy-from-waste solution, which uses ASR to generate power and create green hydrogen through thermal treatment technologies to reduce waste-to-landfill.

Recycling Lives is now in the process of scaling up its energy from waste plant and aims to have its first production model operational later this year. The final stage of the model will see banks of repurposed batteries from electric vehicles (EVs) used to store renewable energy produced by the process and power the purpose-built EV de-pollution facility at the 15-acre recycling park headquarters in Preston.

"We've invested very heavily in innovation," says Marshall. "We're aiming to have our first operational plant up and running by the end of 2023, and we'll be generating power across our other main plants during 2024 and 2025, thereafter working on providing power back to the grid over the following 12 to 18 months. We're looking to achieve zero per cent landfill from ASR within four years." That investment looks set to pay off.

This breakthrough was made possible thanks to its ongoing collaboration with academics at The University of Central Lancashire. Having also worked with Renault Trucks to deliver the UK's first ever 100% electric skip transporters, it's clear that collaborations have been key to the success of Recycling Lives' circular strategy, and could also be the secret to businesses across the UK meeting their own ESG goals and accelerating their journey to net zero.

As pressure builds on businesses to plan, communicate and deliver on their net zero pledges, Recycling Lives is providing a trusted ESG roadmap to a more profitable and sustainable future for others to follow.

For more information visit recyclinglives.com

C-SUITE

ESG reporting: whose job is it anyway?

With reporting requirements ramping up, businesses are under more pressure than ever to get to grips with sustainability. But who should take charge in the C-suite?

Cath Everett

Sustainability legislation is mushrooming at a record pace. The growing regulatory reporting requirements are putting many businesses under strain, particularly during difficult economic times. So who in the C-suite should take responsibility?

This year alone, the UK's Financial Reporting Council – which regulates auditors, accountants and actuaries – plans to significantly tighten its ESG reporting rules for large companies, as contained in the UK Corporate Governance Code.

Momentum is also gathering behind a proposed Better Business Act which would amend and replace section 172 of the Companies Act 2006. This could theoretically require private-sector organisations in the UK to take real ownership of their social and environmental impacts.

The EU, meanwhile, has a raft of new regulations either coming into force or looming on the horizon. Chief among these is the Corporate Sustainability Reporting Directive. From next year, most companies with operations in the EU will be required to publish regular reports on their sustainability activities, in line with a rolling timetable based on size.

The real marriage made in heaven is when the CFO partners closely with the CEO

The picture today appears mixed, with everyone from CEOs to CFOs, chief sustainability officers (CSOs) and even chief people officers taking the lead. Company secretaries and general counsel are also increasingly engaged in due diligence and information disclosure activities due to rising levels of litigation and greenwashing investigations.

Paul Crewe is executive director and CSO at sustainability consultancy Anthesis Group. He thinks that in an ideal world, reporting responsibility should lie with the CFO, which is increasingly the case.

"Financial data and ESG reporting are intrinsically linked … given the increase in mandatory reporting, the CFO's role in taking an overall lead on ESG reporting is one that is increasing," he says.

The CFO is also best placed to support investment in the organisation's sustainability impact programmes. Where such investment is significant, responsibility for reporting often broadens to include responsibility for enabling the wider sustainability vision, Crewe adds.

But in his view, the "real marriage made in heaven" is when the CFO partners closely with the CEO. This was the set-up when he served as the CSO of Sainsbury's, where he reported in to both positions.

The CEO's role in this instance was to set the broader sustainability vision, take overall accountability for the direction of travel and drive change. As CSO, Crewe's focus was on engagement, communication and embedding the strategy.

This included making the leadership team aware of emerging standards, new legislative requirements and market trends. But it also entailed supporting functional heads to ensure that they were clear about the part they played in delivering the strategy.

Bupa has taken a somewhat different tack. Group CEO Iñaki Ereño laid out the private healthcare provider's sustainability vision and kickstarted its adoption when he took the role in 2021. But chief sustainability and people officer Nigel Sullivan takes day-to-day responsibility for the strategy, as well as chairing the company's Sustainability Steering Committee (SSC).

The SSC reports in to both the chief executive's and the board's sustainability committees. Its role is to drive Bupa's progress towards its ESG goals, while it also oversees all aspects of mandatory and voluntary ESG reporting.

Glyn Richards, who reports to Sullivan, is group director of sustainability. Part of the thinking behind adding sustainability to his boss's brief in May 2021 was that "ESG isn't really a separate subject – it's about how we run the business," Richards says.

He believes the company's 85,000 employees play a major role in embedding ESG matters into the overall operations and culture. What's more, because the majority are employed in customer-facing roles, they act as advocates for sustainability beyond company boundaries.

"It's hugely powerful in terms of behavioural and system change, so marrying the sustainability and people agenda makes sense," Richards says. "It's about making the entire business more sustainable."

To help embed this change across the organisation, Bupa ensures that representatives of each of its market units sit on the SSC and not only implement and embed strategy locally but also report back quarterly on outcomes. To support the company's decarbonisation agenda, the group CFO – another key SSC member – manages a separate sustainable finance team. This handles carbon accounting and forecasts the carbon impacts of major business activities, including mergers and acquisitions.

Legal and professional services group Ampa achieved B Corp status at the start of this year, meaning it now has a legal obligation to consider the impact of business decisions on all stakeholders, including employees, customers and the environment.

Its head of sustainability oversees reporting on quarterly targets, which are set across the organisation's three ESG streams of people, environment and communities. Other reporting requirements are overseen by functional heads, but all data is signed off by group CEO Sarah Walker-Smith and her COO. Accountability for the overall "responsible business agenda", meanwhile, falls to the wider board, explains Walker-Smith, who isn't convinced that current reporting standards hit the mark.

"There's statutory reporting, but I don't think it goes far enough and it needs to be more joined up," she says. "The measures we've set ourselves go further than that. The question of whether we're a responsible business is at the heart of our strategy."

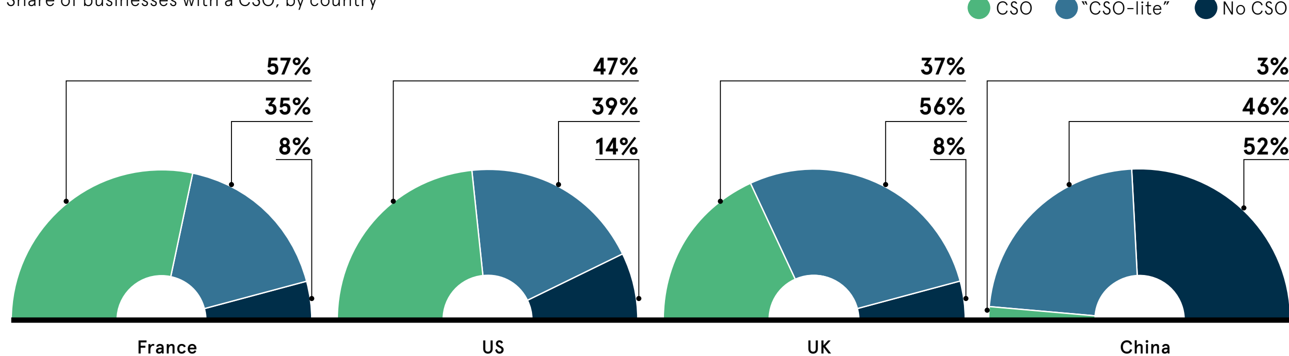
As a result, the group chooses not to use the term 'ESG' as it implies sustainability is an add-on rather than "in the DNA of how we do business", Walker-Smith says. "Winning hearts and minds" across the group is what makes the difference, she says.

The 'hearts' element, for instance, involves communicating the company's purpose in wanting to "drive change in the business for good", Walker-Smith says. The 'minds' aspect means understanding that to achieve commercial success in the medium to long term, you simply have to behave responsibly as a business.

"The war for talent is rife, customers are asking for it too, and increasingly stakeholders are expecting businesses to operate in this way. It's clearly the direction of travel, so you might as well own it," Walker-Smith concludes.

THE UK IS IN THE MIDDLE OF THE PACK FOR ADOPTION OF THE CSO ROLE

Share of businesses with a CSO, by country



PwC, 2022

Commercial feature

Bringing sustainability to the internet of things

Long-range, low-power sensors are helping to make the internet of things more sustainable

The internet of things (IoT) powers countless sustainability benefits, from smarter cities to monitoring industrial emissions. It helps farmers use less water and makes supply chains more efficient. But as the number of devices connecting the physical and digital world increases, it raises an important question: is the IoT itself sustainable?

This is an issue that Semtech's solutions address. Over the past decade, the company's long range (LoRa) technology has radically expanded the scale and scope of the IoT. It powers sensors that can transmit data over distances of 100 miles or more using the unlicensed spectrum – far further than a Wi-Fi-based sensor and without the coverage constraints associated with cellular networks.

Rugged low-cost LoRa sensors are also less power-hungry than WiFi, Bluetooth, 4G or 5G. "The beauty of LoRa is that it's essentially an asynchronous technology," says Mohan Maheswaran, CEO of Semtech, which was named Frost & Sullivan's Global Company of the Year in 2022 for its IoT hardware.

"It goes to sleep and it doesn't do anything until it has a designation, for example there's too much water or there's a fire. Then it wakes up and tells the network, 'I've got a problem'." This means that power consumption is brought down significantly.

The sustainability of sensor deployments hasn't typically been part of the conversation around IoT, which has focused more on the benefits they can unlock. "Increasingly over the past few years, customers, whether using it on a large farm or in a city, not only want to have the sensing capability, they also want to deploy sensors everywhere and to have those sensors feed data into the cloud where they can they apply analytics and look at pattevrns and make decisions," says Maheswaran.

If this rise in the number of sensors isn't approached in a power efficient way, it could add an unfortunate environmental downside to all the important sustainability applications they can support. The powerful – yet low-power – capabilities of LoRa are therefore crucial for building a sustainable IoT.

If businesses can reduce waste, reduce power and make things more efficient, then they can bring down their use of natural resources. That's real sustainability

There are a "tremendous number" of use cases around the world, believes Maheswaran. Big enterprises are deploying LoRa sensors to reduce the amount of water and electricity they use and improve their carbon footprint. The combination of long range, low power and long battery life also makes LoRa particularly well-suited to IoT applications in hard-to-reach or harsh environments.

A network of rainwater-monitoring LoRa-powered devices powers a recently developed drought early warning system for remote New Zealand and South Pacific Island communities, for example. LoRa sensors are also ideal for identifying where water resources are being wasted. "Businesses know how much water is leaking or being lost," says Maheswaran. "They can then use wireless technologies to sense that change and do something about it."

The same principles apply to air quality monitoring. "One of the first use cases of LoRa was in China for pollution control," Maheswaran explains. "Cities were asking: how do we know that our air quality is bad and what can we do about it?" The data provided by LoRa sensors enabled these cities to tell certain manufacturing facilities to slow down their operations – or even shut them down completely – when the air quality reached harmful levels.

No technology can solve every problem, of course. When it comes to transmitting larger amounts of data, such as video, cellular-based IoT solutions with a higher bandwidth are preferable. Thanks to its recent acquisition of Sierra Wireless, Semtech now has both sides of this equation covered. The deal brings together Semtech's LoRa technology with Sierra Wireless's cellular-based IoT business, meaning the firm can provide both low-power unlicensed spectrum solutions and higher performance ones that use the licensed spectrum.

While sustainable IoT might not have been on the corporate agenda over the past decade, the increased focus on ESG performance means it certainly will be in future. "If businesses can reduce waste, reduce power and make things more efficient, then they can bring down their use of natural resources," says Maheswaran. "That's real sustainability."

For more information visit semtech.com

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Materiality: the new yardstick for sustainability

The EU's new corporate sustainability reporting directive will expose many businesses to the concept of non-financial materiality. How will this impact your ESG efforts?

Tim Cooper

The EU's incoming Corporate Sustainability Reporting Directive (CSRD) has sparked a feisty debate. That's because the new rules feature a twist on a key concept in corporate reporting – materiality.

Materiality is used to judge the impact that a specific business risk or opportunity could have on a company and its shareholders, typically in financial terms, and therefore whether they should include it in corporate reports. For example, the cost of switching suppliers post-Brexit could be large and may affect your profits and shareholders' decisions. But the cost of choosing one item of stationery over another is small and therefore immaterial.

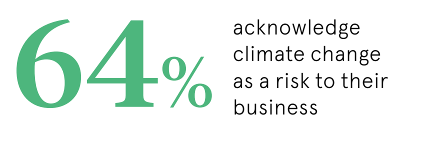
This will be familiar terrain for many businesses. But CSRD is set to broaden the concept. Not only does it relate to a non-financial subject matter – sustainability – but it covers companies' risks and their own impact. But what does all this mean in practice for companies affected by the new rules, and how should they start getting ready?

What is non-financial materiality?
Non-financial materiality has been around for some time. Lots of companies already use it to help decide which sustainability risk factors to include in their corporate reports, based on how likely those risks are to affect users' decisions.

Popular voluntary sustainability frameworks, including those from the Task Force on Climate-Related Financial Disclosures (TCFD) and the Global Reporting Initiative (GRI), also guide companies to use materiality assessments. But the EU's rule-makers are going further. Their Sustainable Finance Disclosure Regulation (SFDR) already mandates investors to consider material sustainability risks, forcing them to seek disclosures from companies about these risks.

And now the CSRD, in phased enforcement from January 2023, will require large businesses operating in the EU to measure and report non-financial risks and impacts, as well as their responses to them.

of the world's 250 largest companies already carry out some form of sustainability reporting



acknowledge climate change as a risk to their business

recognise social factors as a risk to their business

KPMG, 2022

What is double materiality?
The CSRD departs from relying on the concept of "double materiality" – how sustainability issues might create risks for the company, plus how the company's activities impact people and the environment.

Crucially, double materiality recognises that the reach of corporate activity extends beyond finance and investors, affecting employees, customers, suppliers and communities. It also aims to tackle greenwashing.

Double materiality assessments already significantly affect investors' decisions.

"Most of our financial services clients now follow the SFDR and TCFD disclosure requirements," notes Pratap Singh, head of private markets services at Acuity Knowledge Partners. "The impact will be a large pool of funds diverting to businesses that positively impact the environment and society."

Why is double materiality contentious?
Double materiality has sharply divided investors and companies worldwide. In contrast to the EU regulator, the International Sustainability Standards Board (ISSB) has ruled out the concept.

As Michael Herskovich, global head of stewardship at BNP Paribas Asset Management, explains: "The debate is about whether we're only interested in how events affect companies' financial prospects, or in how corporate actions affect society, the environment and other companies. We support the [EU] approach and have challenged the ISSB to take a more holistic view."

A spokesperson for International Financial Reporting Standards (IFRS), which created ISSB, says it is working with the GRI and the EU to achieve interoperability. "There is a memorandum of understanding with GRI, and ISSB is working with the EU to achieve interoperability. So it can and is working alongside double materiality reporting," said the spokesperson.

Where should companies start?
Several reporting frameworks, including the GRI and TCFD, provide guidance and tools to assess non-financial materiality. Material risks might include threats to the business's reputation, strategy and business model, while impacts might include familiar problems of carbon emissions and waste.

A materiality assessment should also include a view of the likelihood of an event and the timeframe. Companies are warned not to exclude factors such as climate change because they are long term. And it might involve regular work and more communication with stakeholders. Research by reporting platform Workiva found that 49% of senior decision-makers now review materiality every three to six months to keep up with changing stakeholder views.

Singh notes that Acuity's materiality assessment process begins with prioritising critical issues. The team then identifies the key stakeholders for each issue and sends them questionnaires. It ranks the results for those issues, benchmarks against peers and the wider industry, and performs deeper, hands-on research on particular topics using primary and secondary data and stakeholder interviews.

A similar approach is followed at Workiva. "Early in our ESG journey we engaged with internal and external stakeholders to assess the materiality of value drivers," says Mandi McReynolds, the firm's vice-president of global environment, social and governance. "We identified that ESG progress directly affects an organisation's ability to gain capital investment. So we measure our success on this front partly by how many ESG investment funds include Workiva."

A company's sector influences how it assesses materiality. BNP Paribas' ESG analysis concentrates on sectoral differences; it shows that climate change is the most material factor in the real-estate sector, while human capital management is what's on the line in commercial services.

What are the challenges?
Determining non-financial materiality is littered with challenges. Humperdinck Jackman is managing director at advisory firm ESG PRO. He says it tends to take three years to implement diligent TCFD reporting because of the governance, risk and related processes that need to be in place before meaningful climate scenario modelling can start. "But businesses are woefully unprepared. They haven't assembled that data, nor for other ESG factors such as energy use, governance, employee management and human rights."

> The debate is about whether we're only interested in how events affect companies' financial prospects, or in how corporate actions affect society, the environment and other companies

Insufficient data can undoubtedly lead to an inaccurate picture of ESG impacts and perceptions of greenwashing.

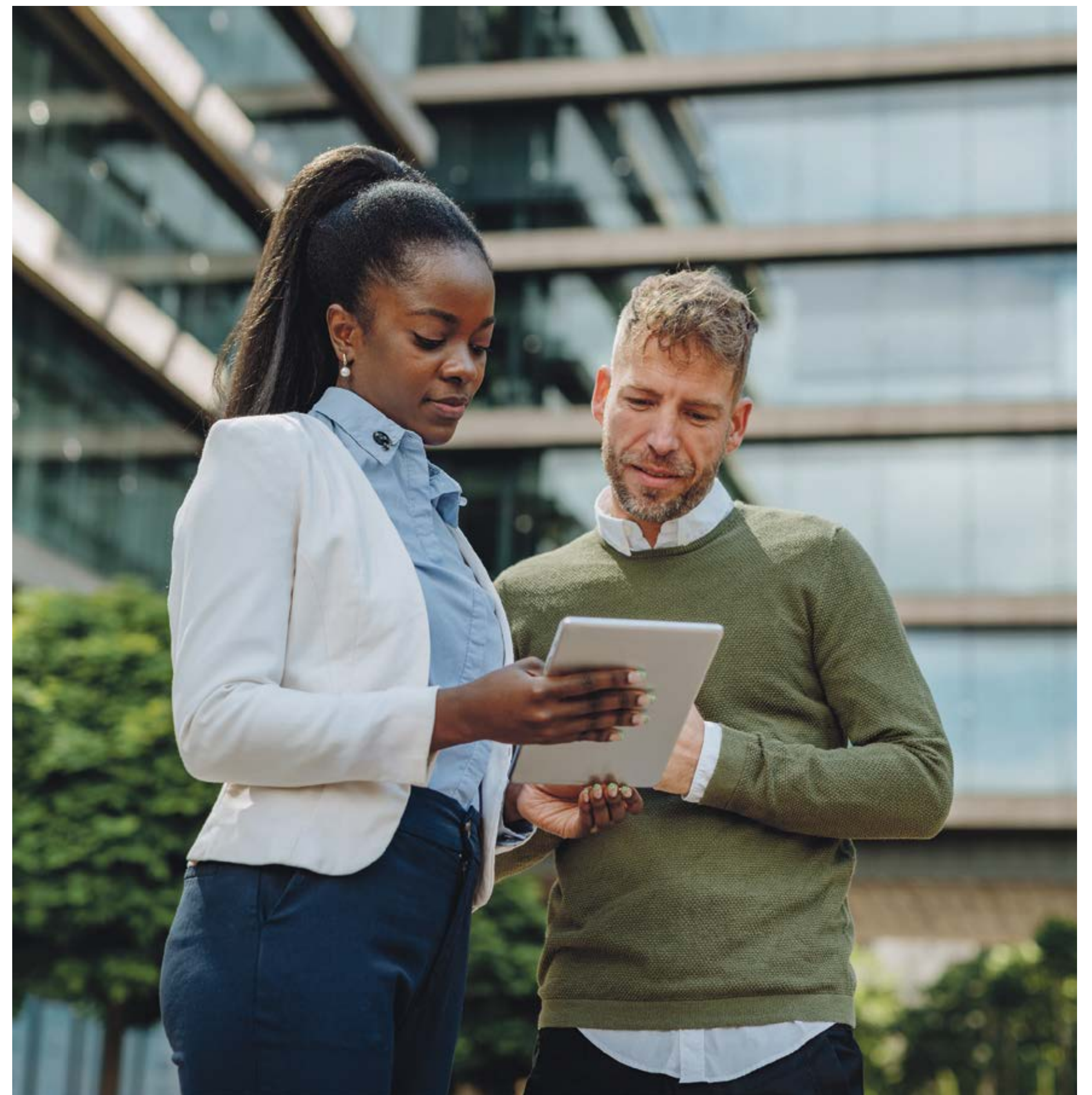
David Harrison is a fund manager at the Rathbone Greenbank Global Sustainability Fund. He thinks that double materiality reporting varies substantially in quality and scope. "We see some good practice, where reports explicitly and transparently link capital expenditure to decarbonisation, for example. But others are vaguer, with no tangible metrics," he says.

Daphne Biliouri-Grant, a senior adviser at risk consultancy Sibylline, warns firms not to try measuring everything at once if they're new to materiality assessments. It's better to start by assessing a handful of items most relevant to the company, she advises.

Where next?
Academics and politicians have proposed measuring triple or context-based materiality, which looks at ESG impacts even more widely: for example, how climate or biodiversity changes might affect a company's entire supply chain or business ecosystem. Triple materiality is not yet clearly defined and most companies say it's not currently on their agenda but could be an area for development in the future.

The focus now is to meet the challenges of double materiality in the EU and find ways for unaligned standards and regulations to work alongside. That means disclosure requirements are likely to develop rapidly as data and practice improve. As Harrison says: "We would be wary of anybody claiming to have all the answers at this point." ●

Commercial feature



Think fast, build slow: how corporate sustainability strategies actually work

Leaders can face a degree of decision paralysis when walking the talk on sustainability. But there are routes to make operationalising sustainability second nature

In the world of stocks, shares, funds and finance, applying environmental, social and governance criteria to build a comprehensive picture of long-term performance is fast becoming the norm. These new metrics for determining value signify a change in the air, and for many businesses, growth looks a lot greener than it used to.

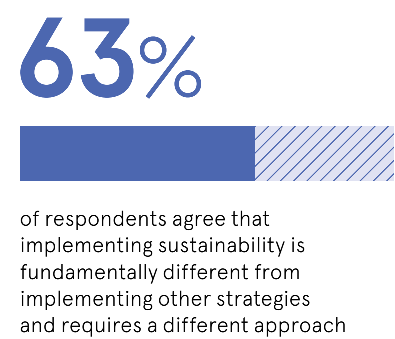
Despite the common understanding that companies today should always strive for sustainability, the question of how to actually operationalise it across the organisation – by a certain date – is another story.

According to a soon-to-be-released Harvard Business Review Analytic Services study that is being sponsored by global change consultancy Daggerwing Group, 63% of respondents agree that implementing sustainability is fundamentally different from implementing other strategies and requires a different approach.

This might be attributed to how business leaders often must choose between delivering on revenue expectations today, or allocating resources to pursue sustainability goals tomorrow, says Michelle Mahony, managing partner at Daggerwing Group.

"There are real headwinds that can hamper corporate sustainability efforts, currently: inflation, supply-chain disruption, rising energy costs, the war in Ukraine and greenwashing, to name a few. And on top of that, these challenges make the calculus between short- and long-term gains even more complicated," she says.

To ensure that sustainability doesn't get lost in the quagmire, Mahony argues that it must be integrated into strategic thinking at a foundational level. She says: "Overcoming these challenges requires a true paradigm shift. Businesses must move on from viewing sustainability efforts as something of an add-on to seeing them as an intrinsic part of how the company makes decisions and conducts business."



of respondents agree that implementing sustainability is fundamentally different from implementing other strategies and requires a different approach

Harvard Business Review Analytic Services, 2023

Managing targets over time
In principle, Mahony argues that sustainability is inherent to building a sustainable business. That's the mindset that organisations must adopt as they work towards achieving sustainability goals. Otherwise, external factors have the potential to create friction and threaten an organisation's ability to recover and succeed.

"Leaders increasingly need the ability and agility to course-correct while simultaneously keeping their eyes on the sustainability prize over time," says Mahony. "A growth mindset in this context is critical, as it will be necessary to experiment, to learn fast, fail fast, and adjust."

This intersection of stability and adaptability is also pertinent for addressing greenwashing concerns. Coherence and consistency are vital, but businesses need to be ready to respond to changes in real-time. And if a company's longer-term sustainability ambitions appear out of step with, or irrelevant to, its short-term actions, then doubt surfaces, and trust sinks in.

"Setting some aspirational goal for a date in the relatively distant future to achieve a certain percentage cut in carbon emissions, for example, is not enough. It can look like an organisation is kicking the can down the road, as time appears elastic, even infinite," Mahony explains. "Concrete, yearly goals, involving every function, are what gets a company where it needs to be, on time and on target."

Embedding sustainability into the DNA of the company
To convert ambition into action and intention into implementation, there is no quick or simple fix. Mahony states: "Any organisation that assumes it can just slap an off-the-shelf solution on top of its existing goal-setting, structures and strategy is in for an unpleasant shock. Employing a one-size-fits-all approach simply does not work. Different stakeholders will be uniquely impacted and, therefore, will require different levels of effort at different times."

This all connects to the relationship between strategy and culture. As Mahony says: "Strategy is what you are trying to achieve, purpose is why you are doing it, and culture is how it happens."

She continues: "From a sustainability perspective, we see a lot of efforts now being connected to a greater purpose or values where the impetus is on doing good for the world and the planet. And that's great! But it is not sufficient, and it will not rally everyone until it is truly part of the DNA, or the fabric, of the business and culture."

Operationalising sustainability strategy
To truly operationalise sustainability strategies and build them into the fabric of an organisation, Daggerwing adopts a "horizontal and vertical change strategy," as Mahony calls it.

To do this, Daggerwing first fosters accountability at the senior leadership level, making sure to incentivize senior leaders to achieve sustainability goals while balancing the long- and short-term priorities.

> Any organisation that assumes it can just slap an off-the-shelf solution on top of its existing goal-setting, structures and strategy is in for an unpleasant shock

Second, it's essential to create collective accountability, expanding beyond the diverse portfolios of the leadership team. "It is a good thing to have a governance body that is driving the work, but the accountability must be collectively owned by all leaders, and ideally, each and every employee must be engaged and invested in the success," says Mahony.

This process of building support across the business then calls for an appraisal of current processes and a decisive plan of action that is made to measure. This development stage should account for the needs of different functions and divisions to ensure that the transformation is embedded universally.

Finally, this change strategy gets woven into the organisation's ethos and day-to-day decision-making.

Mahony concludes that conversations around sustainability tend to pick up momentum on Earth Day and during widely-publicised environmental summits. But for these strategies to bear fruit, they must be continuously activated, ingrained and embraced at every level of the organisation.

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RESPONSIBLE BUSINESS

Has the B Corp movement got too big?

There are now more than 6,000 B Corps globally – including, controversially, numerous multinationals. Will an overhaul of the certification process help the movement remain a force for good?

Sam Haddad

In 2007, when the first companies achieved B Corp certification, all of them were small or medium-sized, with bold, purpose-driven agendas, as exemplified by the outdoor clothing retailer Patagonia. Today, 90 of the 6,000-plus B Corps are multinationals, and their staff represent almost a third of the workforce of all B Corps.

One of their number is Nestlé-owned coffee brand Nespresso. The brand's certification as a B Corp last year was the straw that broke the camel's back for many in the movement, prompting an open letter signed by 30 existing members urging B Lab to make the certification process more stringent or risk undermining the whole endeavour.

"The movement has reached a point where it needs to step back and critically reassess its purpose and how far it is living up to its potential," says Dr Malu Villela, a senior research associate at the University of Bristol's School of Management.

Villela understands the anger of some B Corp members when Nespresso achieved certification. But she doesn't think that bringing multinationals on board is necessarily a bad thing – as long as they raise their standards from what would usually be expected of such organisations and don't settle for incremental change.

> The movement has reached a point where it needs to step back and critically reassess its purpose

"The traditional CSR approach used by many multinationals has social and environmental goals at the periphery rather than at the core of the business," says Villela. She saw a similar response when she was researching B Corps in Brazil and the large cosmetics firm Natura received certification. Smaller beauty brands questioned the value of that award, she says.

Her research in Brazil left her unconvinced that the existing certification process encourages companies to make radical changes. "The high scores in the certification process do not necessarily lead to improvements in the critical areas that needed attention or roadmaps for further improvements," she says. Instead, she thinks that certification too often serves as a mechanism to improve external relationships with investors and clients, rather than improving workers' lives and helping communities and other stakeholders via social and environmental projects.

James Ghaffari, director of growth and product, B Corp, at B Lab UK, acknowledges that the existing certification process needs reform. A new iteration, he says, will be released in 2024. He points out that the online impact measurement tool, which is one of the central parts of certification, is already on version six, so these are by no means the first tweaks B Lab has ever made.

But this will be the biggest evolution of the standards so far, driven by the urgency and scale of challenges such as the climate crisis and growing inequality.

"A deeper review and engagement with our stakeholders was important to fully understand exactly what leadership would be necessary for the future of purposeful business," Ghaffari explains.

Brewing up a storm Nespresso's B Corp certification provoked ire due to reports of child labour on coffee plantations

Caique de Abreu via Getty Images

The first consultation around the new standards began last year and involved canvassing not only existing B Corp members, but also other experts drawn from academia, industry, business and government.

"So far, the process has reached about 1,200 different individuals," Ghaffari says. "We're trying to prove a model that is a different way of operating. One in which businesses take ownership of their impact on people and the planet. We need all businesses to get on board with that," he adds.

For Villela, if B Lab's new certification model is to be radical enough, it needs to include minimum standards so that companies are unable to simply pick and choose standards according to what suits their business – for example, having a great work culture but a poor carbon footprint.

Ghaffari confirms that minimum standards will be included across 10 categories and that the implementation will be phased to allow all the companies to make sure that they are meeting the new criteria. "There will be a high level of rigour," he says. "We want businesses to see and understand that this is really a holistic look at a company's impact across these minimum requirements," he explains.

Is there a scenario where a brand which is currently a B Corp won't meet the new standards? Ghaffari replies that most B Corps aren't just signed up to one certification model but to a set of principles and values that are shared across the B Corp community. "Everyone in the community is aware of the scale of the challenge and therefore the scale of impact that we need to try and create to respond to that," he says.

All of this comes as B Lab attempts to reach out more widely. Ghaffari points to the fact that the B Corp community has grown by welcoming larger businesses which have a desire for change. Such an expansion is essential, he says, given the scale of transformation that is required.

"A certain level of environmental and social performance from a large company brings a huge lift in positive impact," he says. "Large businesses provide that heft not only in terms of moving their own impact, but also through the influence they have with their stakeholders and their engagements on a policy level."

But the doors have not been thrown open to everyone and anyone. Ghaffari insists that companies working in certain sectors will still be prohibited from becoming B Corps, including coal mining, tobacco, pornography and firearms.

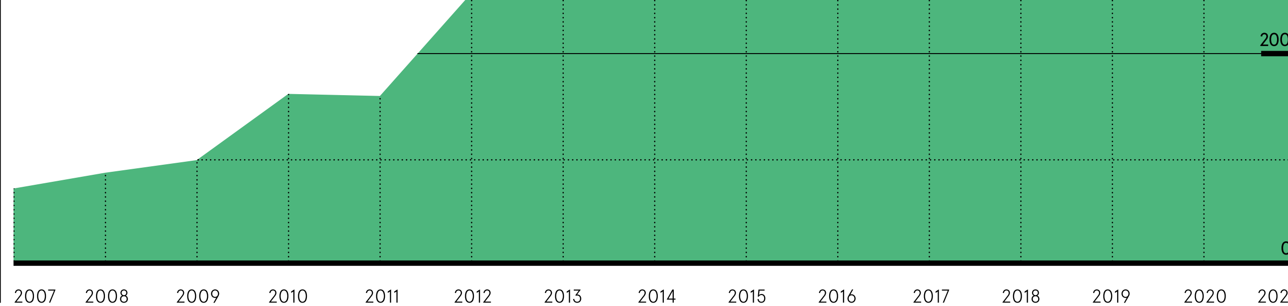
Ghaffari says too that purpose-led businesses remain on board and will have a key part to play in guiding the future of the movement. In December, for instance, more than 150 senior B Corp leaders signed an open letter disputing an article in *The Times* which had suggested that the B Corp gold standard encouraged greenwashing: "B Corp is more than a certification, it means being part of a community working towards a shared goal," the letter stated.

Villela believes that the movement's biggest positive – in addition to requiring businesses to amend their articles of association to prioritise social and environmental impact alongside financial returns – has been the collaboration and networking it has encouraged between companies. That ranges from regional working groups such as those Villela studied in Brazil, to industry or issue-specific groups. She thinks this could be a route to broader systemic change in business, through working with other sectors and movements.

She also suggests that B Lab explores ways to measure success that go beyond metrics and ranking. "It should look towards deepening values, principles and ethics, which it has become too technocratic about," she says. In Brazil, she says she heard B Corp members talk about the movement "having soul". "Maybe that's been diluted now, but they should push further in that direction," she says. "Not just to help to build change within the network and beyond it."

BUSINESSES ARE ACHIEVING B CORP CERTIFICATION AT A RECORD RATE

Number of new B Corp certifications, per year



B Corp, 2022

Hey imposter

Ever feel like you're pretending?

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Q&A

Why ESG investing needs specialist managers

How can investors navigate the increasingly complex world of sustainable investing? Heptagon Capital's partner and chief investment officer, **Arnaud Gandon**, and fund manager **Alex Gunz** discuss

Q What is Heptagon Capital?

AGa Given the growth of commoditised products in financial services, our core business lies in identifying truly exceptional boutique managers who focus on risk-adjusted returns rather than on a benchmark. We look for managers who are below the radar in our regions and are not previously accessible to our investors. Our approach has helped us grow to $12.4bn (£10.3bn) of assets under management and advice since we started in 2005.

Today, specialisation is even more important to us in ESG investing. It's not easy to find investment partners in this field because they require a different mindset and established firms with legacy products have struggled to adapt.

Q How do you integrate sustainable investing into your strategies?

AGa ESG means different things to different investors. Some want strict screening, others want an impact approach, some are flexible. To provide investors with a balanced approach, we have a variety of ESG products with distinct styles and strategies. They might be value-focused, growth-oriented or flexible with blended styles.

AGu Take the Heptagon Future Trends Equity Fund, which I manage. The strategy incorporates an assessment of businesses based on sustainability and ESG factors. We exclude controversial areas such as alcohol, tobacco and firearms. We also have a proprietary sustainability database and checklist that complements publicly available data.

Q What risks and opportunities are emerging in ESG regulation and how are you responding?

AGa ESG investing is increasingly complex with many emerging regulations, standards, ratings and labels. A clear philosophy and investment view are important. That's why our funds use proprietary frameworks.

Qblue Global Sustainable Leaders is our first Article 9 fund, meaning it complies with the EU's highest sustainability standards. The fund takes a systematic, quantitative approach to ESG integration.

According to Morningstar, 307 Article 9 funds (worth €170bn - £150bn) were downgraded to Article 8 in the final three months of 2022. That trend is accelerating, with a further €99bn downgraded in January 2023 as many fund managers have underestimated the complexity of reporting requirements.

A new fund that embraces sustainability as a core principle, such as Qblue, can set standards. It can become a leader compared to those that have had to adapt to the more demanding Article 9 standards. Having launched only 12 months ago, the Qblue Fund has been highly successful with investors and already has $440m (£365m) under management.

Q What are the most exciting investment themes for the next 12 months?

AGu One theme would be the move towards sustainable and alternative energy. We are big investors in wind and solar power, and the 2022 correction made some valuations in these sectors much more attractive. Net-zero greenhouse gas emission commitments cover 90% of the world economy, but renewables' share of electricity generation is only about 10%. There is a long way to go.

Another theme is food scarcity. About 2 billion people lack adequate access to food, but 75% of what we eat comes from just five animal proteins and 20 plant sources. We need to think about food more intelligently by, for example, investing more in sustainably farmed salmon, which has more protein and health benefits and a lower carbon footprint than other protein sources.

Q Your funds have generally performed well versus benchmarks — why?

AGa When we recruit a new manager, externally or internally, they must be highly differentiated from passive investments such as index trackers. Anything in between has no place.

We tend to favour managers with highly concentrated portfolios, for example Alex holds only 25 names on average. Our managers' holdings are more differentiated from benchmarks, so they don't hug the index. And they generally have low portfolio turnover as the managers stick to their long-term convictions. These attributes give us an opportunity to generate good performance versus the market.

We will continue to upgrade our existing funds and managers are always looking for exciting new sustainable products.

For more information visit heptagon-capital.com

HEPTAGON Capital