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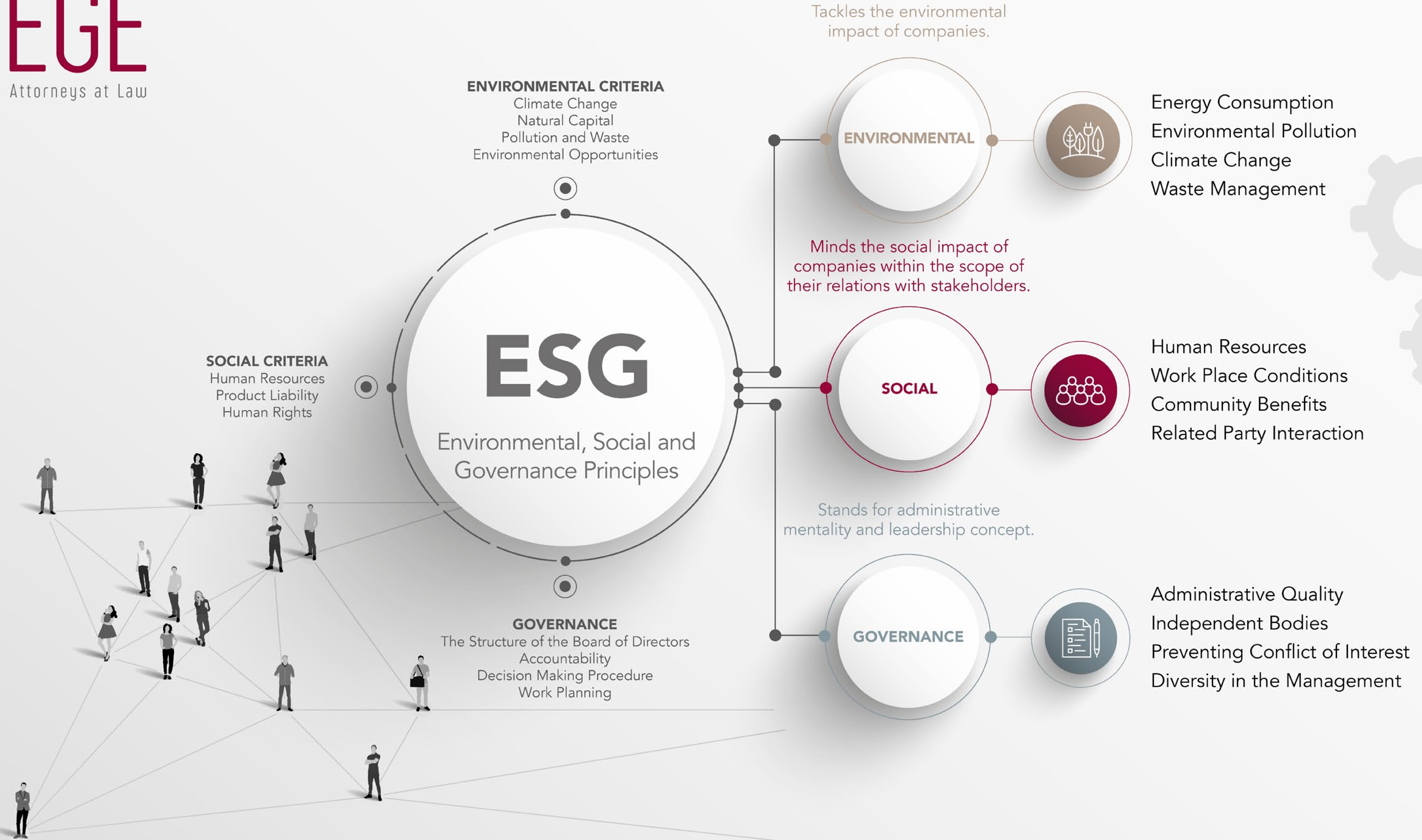
ESG | ENVIRONMENTAL SOCIAL GOVERNANCE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ENVIRONMENTAL CRITERIA
Climate Change
Natural Capital
Pollution and Waste
Environmental Opportunities
SOCIAL CRITERIA
Human Resources
Product Liability
Human Rights
ESG
Environmental, Social and Governance Principles
GOVERNANCE
The Structure of the Board of Directors
Accountability
Decision Making Procedure
Work Planning
Tackles the environmental impact of companies.
ENVIRONMENTAL
Energy Consumption
Environmental Pollution
Climate Change
Waste Management
Minds the social impact of companies within the scope of their relations with stakeholders.
SOCIAL
Human Resources
Work Place Conditions
Community Benefits
Related Party Interaction
Stands for administrative mentality and leadership concept.
GOVERNANCE
Administrative Quality
Independent Bodies
Preventing Conflict of Interest
Diversity in the Management

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WHY is ESG important?

Risk Management

Factors such as climate change, depletion of natural resources, and societal expectations can impact a company's operations. A strong ESG strategy can help minimize these risks.

Competitive Advantage

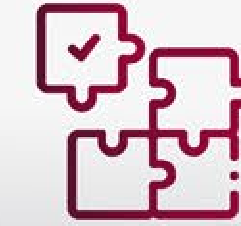
Companies that anticipate sustainability trends and adapt to changing regulatory environments have a competitive edge. Such companies can access new markets and benefit from opportunities like cost reduction.

Investor Preference

Investors now pay greater attention to ESG factors. Various financial products focusing on ESG have emerged, including green bonds, ESG index funds, and sustainability-oriented investment funds. Investors evaluate investment decisions not only based on financial performance but also on a company's environmental and social impact.

Business Efficiency

ESG strategies encourage companies to utilize their resources more efficiently. Practices such as energy efficiency, waste reduction, and minimizing environmental impacts can lower operating costs and enhance efficiency.



Social Contribution

Companies with high ESG performance develop sensitivity to societal needs and thus fulfill their social responsibilities. These companies improve employee well-being, contribute to local communities, and support sustainable development.

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Factors to Consider for a High ESG Score

Research has found that the success of a company in addressing ESG risks is also a good indicator of management quality. Better management quality leads to a higher ESG score.

Under the Environmental Dimension

- Contribution to climate change
- A company's utilization of natural capital
- Pollution and waste management
- Use of green technologies and renewable energy

Under Social

- Health, safety, and human capital development
- Product and consumer safety
- Community relations
- Social opportunities

Under Governance

- Corporate governance fairness and accountability
- Transparency and ethics

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Person or Department Responsible
for ESG Compliance

Initiating ESG Programs
ESG programs typically start at the board level or executive management level, led by the CEO, COO, or CFO.

Areas of Responsibility
To ensure the company's Diversity, Sustainability, and Governance (DSG) compliance, various positions and departments undertake specific responsibilities.

ESG Consultants
They specialize in diversity, stakeholder management, and corporate governance. They stand out with strong experience and business acumen. They possess business development and project management skills.

Legal Department
Oversees the implementation of ESG strategies and compliance with ESG laws. Plays an important role in providing consultancy to top-level management.

Sustainability Officer or ESG Leader: Directs and coordinates the company's ESG programs.

HR Department: Oversees and supports Diversity, Equity, and Inclusion (DEI) programs.

ESG Consultants: Assist the company in achieving its ESG goals.

Legal Department: Ensures the implementation of ESG strategies and compliance with ESG laws.

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ESG Data Tracking and Reporting Structure
Road Map

01

Your company's internal policies, business plans, and audit criteria should be collected and evaluated for their compliance with industry requirements. If there are any outstanding issues, new procedures should be identified to overcome them.

02

The specific ESG requirements for the sector in which your company operates should be assessed to determine which ones are particularly important for your company. This will also help determine the legal obligations that your company is subject to.

03

Employees responsible for ESG initiatives should be identified, and an internal approval and monitoring system for their activities should be established. You can refer to the 3rd post in our series to see who can be part of this working group.

04

A system should be established to gather all the necessary data for building the ESG strategy and to assess progress over time.

05

Specific ESG goals for your company should be set, and these objectives should be taken into account in budget planning. Internal meetings should be held quarterly to monitor the progress.

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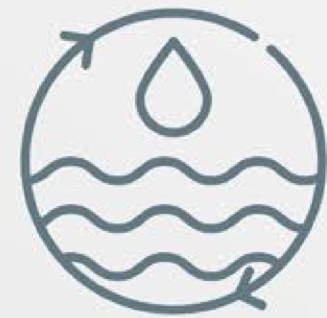
Environmental and Social Reporting Obligations

Corporate Sustainability Reporting Directive (CSRD):

- Companies with more than 500 employees operating in the EU are required to report their environmental, social, and governance performance.
- In the future, it is expected that the scope of CSRD will be extended to include smaller companies and other businesses engaged with covered companies.

EU Taxonomy:



- It includes regulations that define activities contributing to environmental objectives.
- It covers criteria such as water, energy, waste management, biodiversity, and others.

Sustainable Finance Disclosure Regulation (SFDR):

- Designed to reduce greenwashing and steer financial markets towards sustainability goals.
- Emphasizes sustainability aspects in companies' financial disclosures.

Global Reporting Initiative (GRI):

- Enables companies to identify their impacts on climate change, human rights, corruption, and more.
- Establishes the most widely-used sustainability reporting standards.

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Evaluation of Specific Risks in Environmental, Social, and Governance (ESG) Factors

Specific risks related to Environmental, Social, and Governance (ESG) factors play a critical role in Due Diligence (DD) assessments and encompass significant criteria that vary by sector. In developing markets, the increasing emphasis on environmental, social, and governance factors contribute to the expansion of risk assessment in the business world.

The goal of ESG due diligence (ESG DD) boils down to a few important tasks:

Important Notes:

- The integration of ESG topics into DD varies based on the companies' level of integration. A ready-made ESG DD package should be customized according to transaction objectives and risks.
- Health, safety, and environmental issues have been part of DD for the last 20 years, but ESG factors have gained prominence more recently. This change is attributed to heightened customer expectations, environmental concerns, and rising resource costs.

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ESG and M&A

Premium Valuations:
According to a new survey by global professional services firm KPMG, which found that over half of respondents reported that they have cancelled deals due to material findings during ESG due diligence, and that nearly two thirds of investors would pay a premium for companies aligned with their ESG priorities. When ESG due diligence results demonstrate strong ESG performance, this is often already factored into the target's valuation. This situation could lead to a scenario where the investor acquires a company at a value higher than initially indicated by the valuations.

Reputational Advantage:
ESG and human rights concerns have the potential to greatly influence a company's image, influencing its appeal to investors, customers, and other involved parties. Likewise, acquiring a prospective company with a strong history of ESG performance and ratings could contribute to enhancing the acquirer's own ESG reputation. More and more, prominent M&A transactions encounter heightened public examination and possible negative reactions due to worries about environmental harm, violations of human rights (especially related to labor conditions in less developed nations), or inadequate corporate oversight.

Bargain Tool:
Demonstrating a proactive stance towards sustainability can serve as a fundamental distinguishing factor. This goes beyond just attracting valuable supplier partnerships or meeting growing customer expectations. It also extends to appealing to potential acquirers who are actively working on enhancing their ESG performance records. At the same time, companies with strong ESG awareness can also leverage this advantage when determining the value of a deal.

Capital Opportunity:
Clients now assign greater importance to ESG-related risks compared to previous years. As a direct result, companies with a favorable ESG narrative find themselves in a stronger position to attract investments, such as renewable energy firms, for instance.

Post-Merger Governance:
The acquirer's internal policies might necessitate alterations to the target company's governance framework, and any ESG concerns identified during the due diligence phase must be resolved. The integration endeavors should encompass overseeing the sustainability objectives of the merged entity, and the workforce initiatives should prioritize employee welfare and retention.

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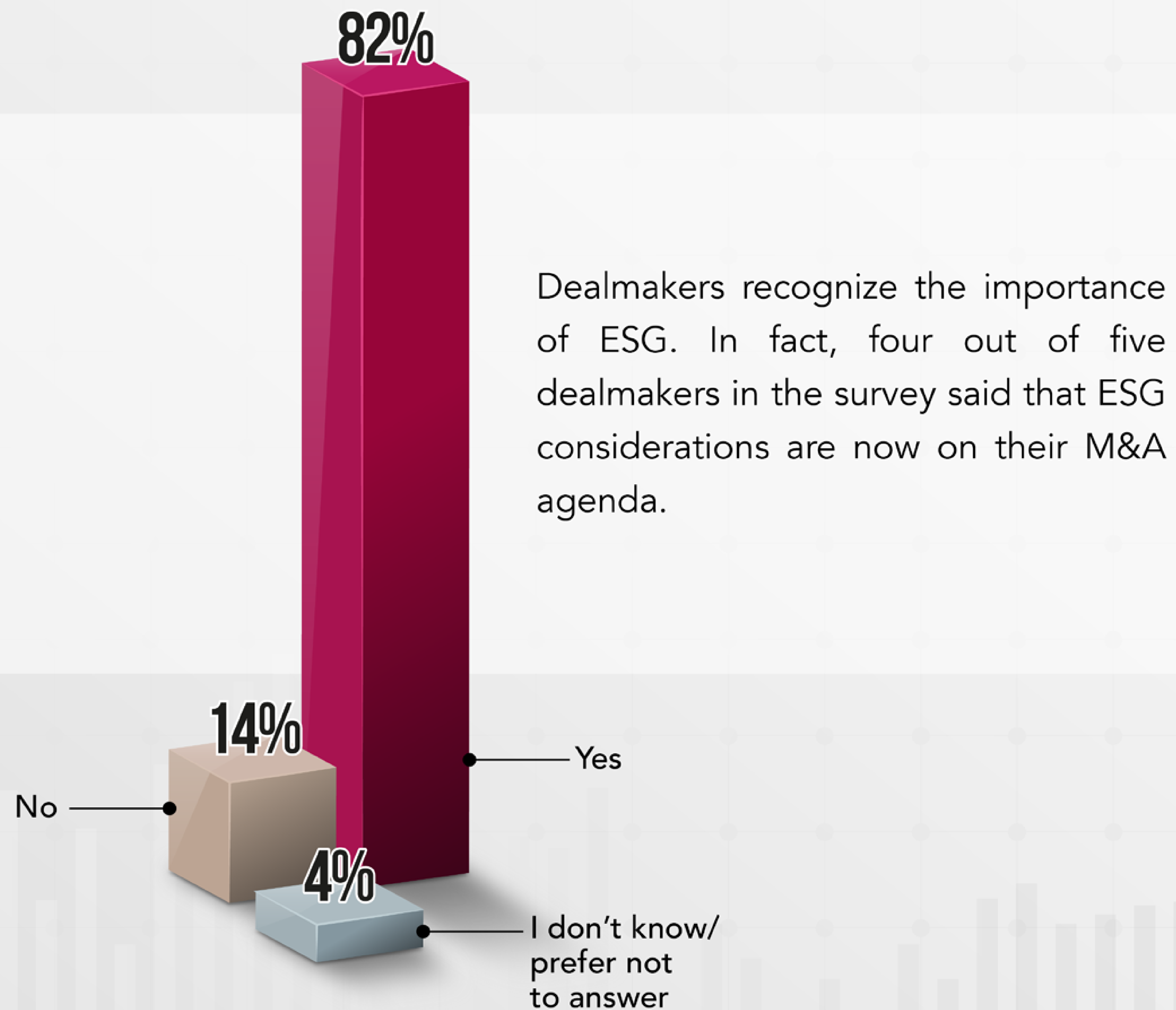
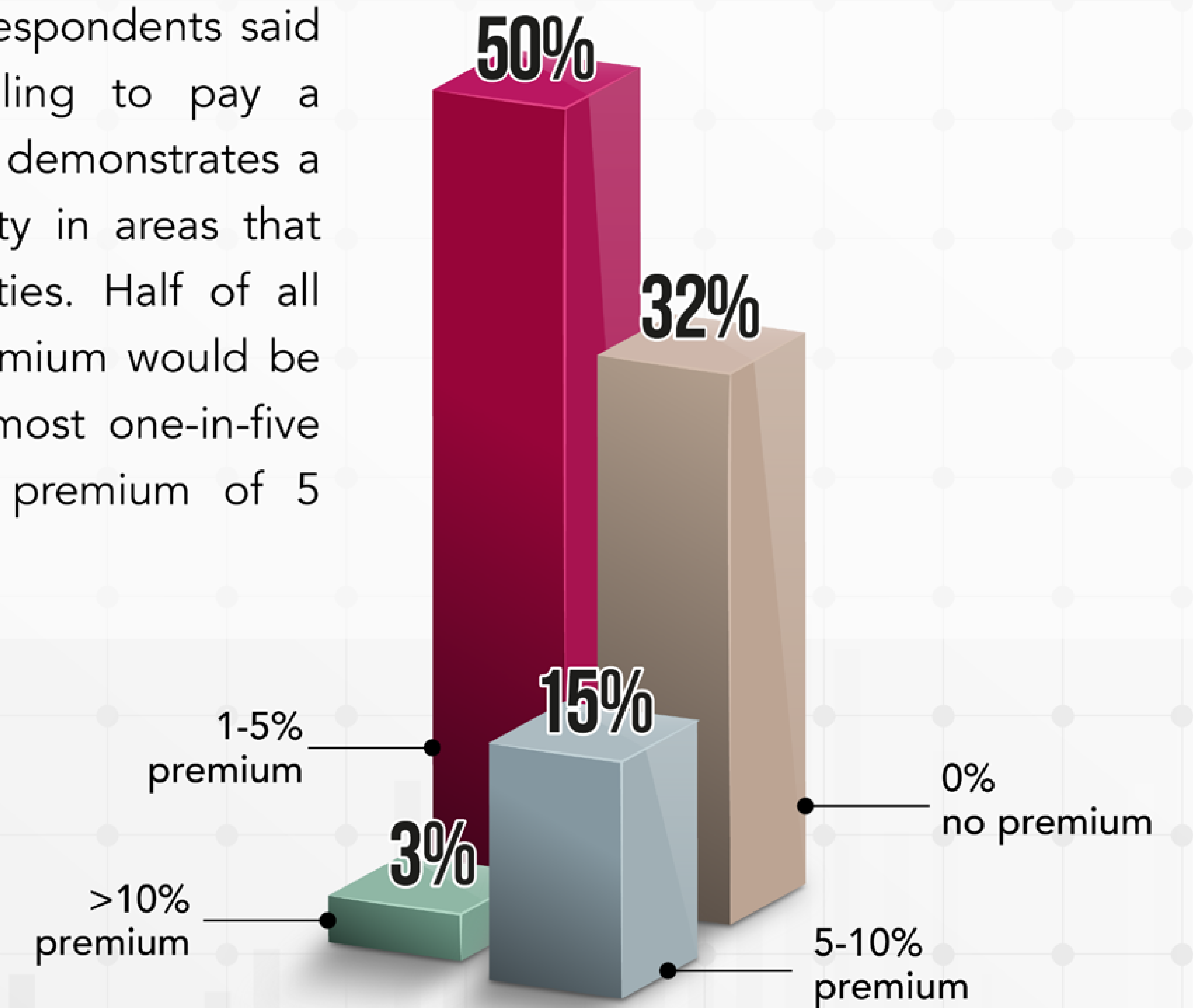
ESG in Numbers

KPMG has conducted a research with more than 150 companies actively engaged in merger and acquisition transactions in the Europe, Middle East, and Africa region regarding ESG. Here are the results:



Dealmakers recognize the importance of ESG. In fact, four out of five dealmakers in the survey said that ESG considerations are now on their M&A agenda.

More than two thirds of respondents said that they would be willing to pay a premium for a target that demonstrates a high level of ESG maturity in areas that align to their ESG priorities. Half of all respondents said that premium would be between 1% and 5%. Almost one-in-five said they would pay a premium of 5 percent or more.



The content is extracted from the "2022 EMA ESG Due Diligence Study" of KPMG.

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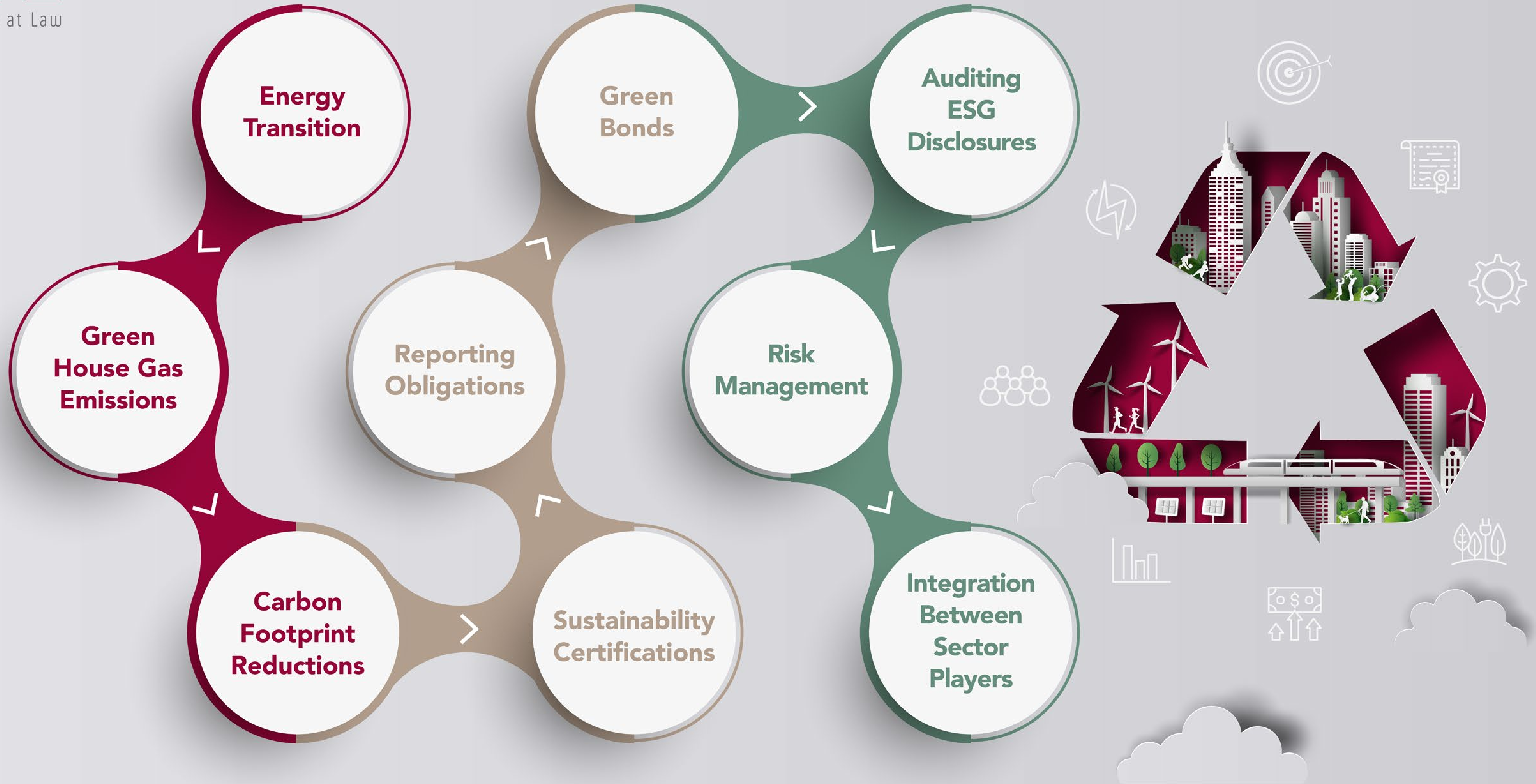
2023: Rapidly Changing Dynamics in the Energy Sector and the ESG Approach



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Key Findings

The survey conducted during the preparation of the Report confirms that corporations (regardless of its' sector) undertake ESG due diligence as part of their usual investment process.

Compliance and performance metrics on ESG matters are most commonly found in supply contracts and shareholder agreements, and this is likely to increase as a consequence of increased pressure to disclose and report on carbon budgets.

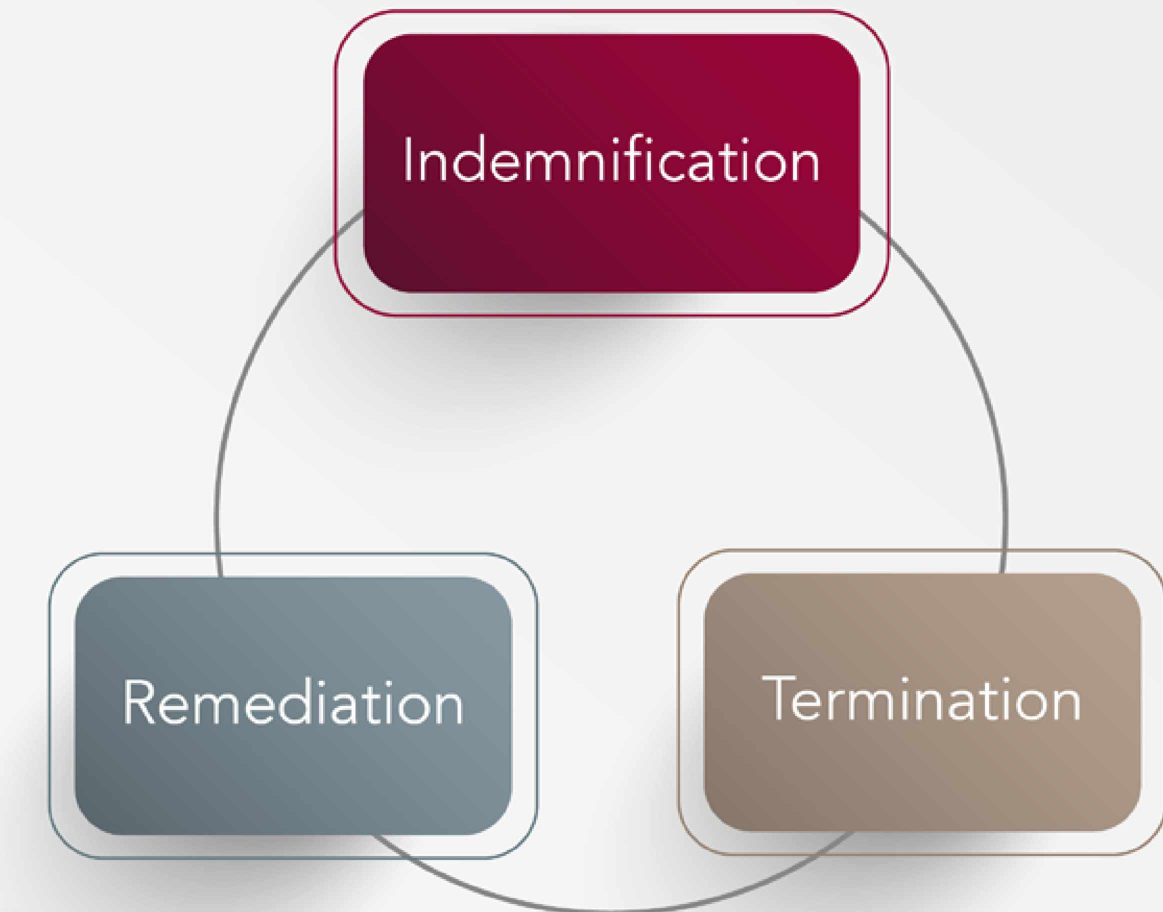
Some respondents noted that the results of ESG due diligence can cause corporations not to enter into contracts with the relevant counterparty. Responses to the survey also noted a significant use of ESG warranties across different size organisations and sectors.

A significant matter is that as companies face increasing scrutiny over their ESG credentials, an increase in litigation of contractual ESG clauses is likely. However, companies may face hurdles to determine the scope for quantification of losses for breach of ESG obligations.

Consequences of Breach

In terms of ESG clauses providing for consequences of a breach, the Survey revealed a mixed use of termination, indemnification and remediation provisions.

As regulations in the ESG (Environmental, Social, and Governance) domain become more stringent, it is anticipated that termination clauses related to the violation of ESG commitments will become more prevalent, leading to a greater reliance on these clauses for termination purposes.



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Where are the ESG Provisions Hidden?

Preambulary Clauses (Whereas Clauses):

These clauses serve to provide context and background for the document, outlining the reasons and considerations that led to its creation. Parties can undertake various obligations by specifying certain characteristics through these clauses. Deviating from these specified qualities may not always lead to contractual termination, but it can still be subject to compensation unless otherwise stipulated.

Jurisdictional Clauses:

The most common 'jurisdictional' clause related to ESG states that an investment must be made 'in accordance with the law.' Especially considering the increasing comprehensiveness of environmental and social obligations in legislation every day, it is important to note that, even with this simple sentence, companies commit to an expanding set of ESG obligations.

Substantive ESG-related Standards:

These standards may vary from being voluntary to deeming action necessary. Examples include 'maintaining an environmental management system,' 'upholding human rights in the host state,' and 'acting in accordance with core labor standards.'

Institutional Provisions:

These provisions may anticipate the establishment of arbitration-like mechanisms for resolving the parties' demands within the scope of the contract. The structures anticipated here are generally already adopted in international agreements signed by the nations to which the parties are subject. Accordingly, parties may agree on an already envisaged framework for resolving ESG-related issues.

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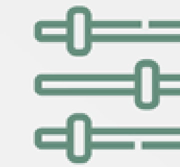
ESG KPI Strategy

1.Define

Define precise and quantifiable objectives that resonate with the core values of your organization or fund, align with industry standards, and meet the expectations of your investors.

2.Set

Tailor your selection of ESG KPIs to harmonize with your fund's objectives and adhere to industry-leading practices. Leverage industry specific ESG frameworks, standards, and benchmarks to pinpoint pertinent KPIs that align seamlessly with your goals.



3.Collect Data

Integrate data management systems that facilitate the gathering, analysis, and reporting of pertinent ESG data. Explore portfolio monitoring tools, employ robust data verification processes, and leverage third-party audits to bolster the accuracy and reliability of your data.

4.Monitor, Evaluate, Improve

Consistently oversee and assess the performance of both the fund and portfolio companies in relation to the defined ESG KPIs. Iteratively fine-tune your ESG KPIs and objectives by incorporating feedback, staying attuned to emerging industry trends, and adapting to evolving investor and industry expectations.

Source: https://www.allvuesystems.com

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