# Beyond ESG

## Building More Confidence and Assurance in Corporate Sustainability Practices

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The term "ESG" is generally used to represent a set of criteria and screens that the investment community uses to evaluate a company's journey towards more sustainable business practices. ESG reporting frameworks have no doubt played a significant role in accelerating the movement of money towards ESG-compliant companies and have also clearly played a role in encouraging companies to raise their own standards.

## Why Move Beyond "ESG"?

It may be time to move beyond ESG. Recent literature, including this piece in the *Financial Times* has correctly focused on some of its inherent limitations, in particular the self-reporting nature of the information provided and the fact that this information is an imperfect replacement for objective, on-the-ground, third party due diligence. A number of high-profile examples have recently demonstrated that high ESG scores are not always an assurance mechanism against the risks of reputational damage from "bad" practice inside a company or within its broader circle of influence (e.g its supply chain, its partners, its customers).

## Typical Situations We See

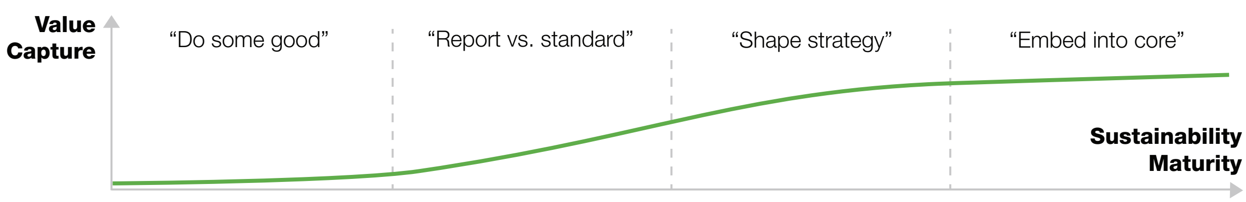
In our work, we observe corporates and financial institutions both starting to come to grips with the fact that while "good" ESG scores may be a step in the right direction, there is often a need to either fundamentally do more to push a sustainability agenda forward, and/or there is a need to build stronger risk management and assurance mechanisms that rely on better, more specific, and independent information on how the company's activities impact stakeholders.

Specifically, we encounter CEOs on a “sustainability leadership” journey, looking for a rigorous and objective third-party assessment of performance against core industry relevant sustainability criteria vs. peers, including identification of major risks and opportunities. We also encounter Chief Legal Officers and Corporate Affairs Directors looking to assess risk and/or build defensible positions on key environmental, social, and governance risks and opportunities for the company. Finally, we speak to asset management teams considering sector-level investment decisions across individual companies, who want more assurance that standards and mechanisms relating to key risks are met.

## What CRA Offers

Charles River Associates and its CEO Advisory practice Marakon (collectively, “CRA”), are uniquely placed to help. CRA has created a framework that establishes and specifically describes “what good looks like” with regards to sustainability leadership, including the typical organisational, governance, resource allocation, and incentive structures that sustainability leaders put in place to define robust agendas and embed them throughout their business in a way that enables sustainability leadership.

### Exhibit 1: The Sustainability Risk Maturity Curve




- Focused on supporting positive investor relations and “reputation”
- Primarily about reporting
- Limited overlap of sustainability agenda with broader business
- Loosely governed with limited policies and standards to enforce a standalone sustainability agenda
- Initiatives typically philanthropic

**Key Drivers of Maturity**

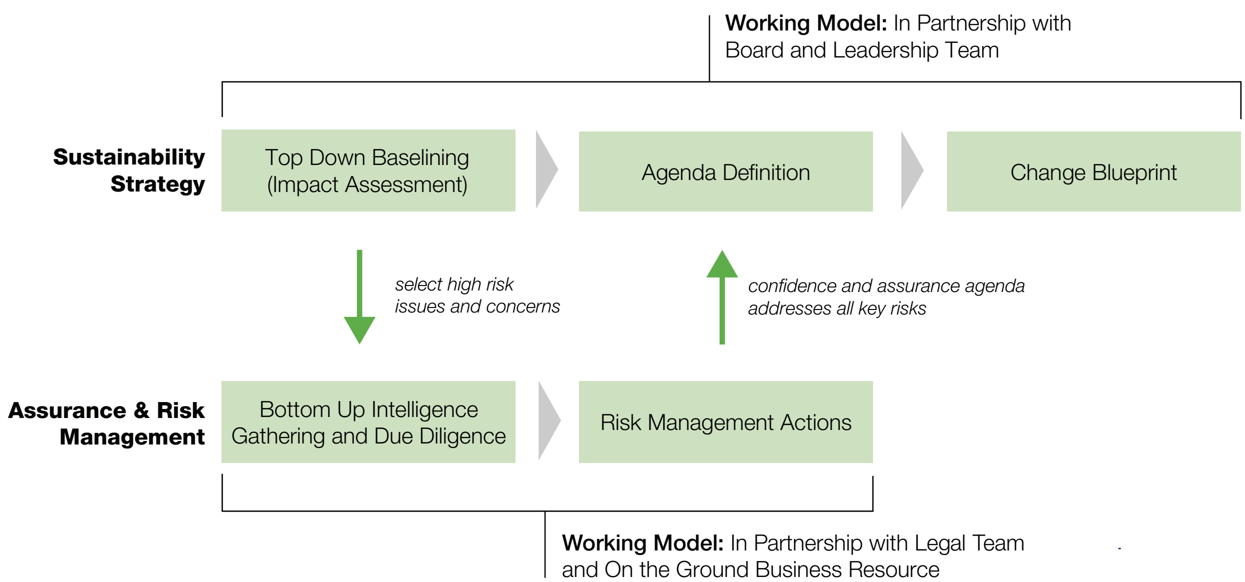
- High reporting standards and transparency both internally and externally
- Adoption of best practice risk management systems
- Centralized and well resourced risk management function with high visibility on BU activities
- Robust materiality and risk assessment through broad stakeholder engagement
- Translation of risks into clear policies
- Continuous communications and engagement internally and externally to motivate and increase awareness
- Adoption of investment standards with sustainability risk a critical lens on resource allocation decision making
- Integration into risk governance model, e.g., core agenda item on Board Risk Committee
- Creation of sustainability linked incentives

- Sustainability tightly linked into strategy, e.g., embed into strategic plan (lens on strategy vs. separate from strategy)
- Viewed as a source of competitive advantage and driver of differentiation
- Codified policies and standards in place, and holds units to account
- Capability sits at executive level, reporting to CEO with line into Board

CRA is then able to support that capability with an on the ground, robust investigative capability that uses different approaches (public record research, social media analytics, traditional investigative work and human intelligence gathering) to objectively assess a business' adherence to both the framework and its true exposure to relevant industry risks and opportunities in the sustainability space. That analysis and insight is then channelled back to the Board room, where it can be used as an effective starting point for conversation on moving forward plans and decisions.

We have the combined experience of partnering with CEOs and Legal and Corporate Affairs teams of many multinationals in sensitive sectors including Energy and Utilities, Food and Agriculture, and Industrials, as well as experience working on behalf of a number of leading Investment Firms and Asset Managers. A case study from this work is illustrated below.

## Exhibit 2: The CRA Offer



## A Case Study

**CRA was retained by a UK plc to provide a top down and bottom up review of group risks and their impact on the company's sustainability agenda.**

In consultation with the executive team and the Board and on the back of an assessment of group governance, process, and policy mechanisms and an evaluation of their peer-set, we worked to define an industry-leading sustainability agenda, and a set of mechanisms for embedding that agenda at all levels of the organisation. This exercise also identified that there were residual reputational risk concerns relating to the labour conditions in the group's supply chain and, thus, adherence to UN Sustainable Development Goal No. 8 – effective measures to eradicate forced labour, slavery and human trafficking – and potential exposure under the UK Modern Slavery Act. The existence of operations in challenging international operating environments added further concerns.

The decision was made at board level to then continue with a comprehensive information gathering exercise encompassing their global operations to understand if these overseas operations posed any reputational risks. The test case for this decision was a targeted supply chain investigation into their manufacturing operations in Turkey.

The investigation was conducted without the prior knowledge of the manufacturing operations to ensure that conditions were not artificially enhanced for inspection. The investigation included an exercise where an imitation prospective employee applied for employment to gather primary source information relating to employment conditions on offer. Enhanced due diligence of the senior management of the operations were also conducted. These exercises included a review of their reputation and integrity, and political connections. The report led to recommendations for the specific manufacturing operations in Turkey and more broadly for issues in the global supply chain. These recommendations were then used to add "teeth" to the top-down sustainability agenda, and enhance the Board's confidence regarding residual and potential reputational risk.

## To Learn More About CRA's Capabilities

If you would like to learn more about CRA's capabilities in the sustainability and assurance domains, please contact Nick Panes, Vice President in Risk Investigations Analytics, or Christine Delivanis, Vice President at Marakon.

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