RHTLaw Asia

UNDERSTANDING AND ADOPTING ESG – AN OVERVIEW

Part I: The Evolution of ESG from CSR

Introduction

The genesis of both, Corporate Social Responsibility (**CSR**) and Environmental, Social & Governance (**ESG**) standards, is the same – adoption of practices and policies by corporations that are intended to have a positive influence on the world. Companies have historically looked at options to operate in ways that enhances society and the environment, instead of contributing negatively to them.

However, through the course of last few years, the focus has shifted from a purely outward-looking analysis to a more dynamic approach focusing on both internal and external factors of an organisation.

Generally, people get confused over the differences among concepts of ESG and CSR and often use them interchangeably. While both these concepts are related, each has its own definitive goals and characteristics.

In this two-part mini-series, we will delve into the concept of ESG, how it is distinct from CSR, why is it becoming important for companies to provide ESG-disclosures, and finally, we will look at the legal issues in respect of ESG-related disclosures and how ESG reporting can be both – a boon and a bane for companies.

CSR v ESG

CSR was the precursor to ESG. Without CSR, there would be no ESG. While CSR aims to make a business accountable, ESG criteria make such business' efforts measurable.

CSR is a form of self-regulation ensuring a company's actions have a positive impact on the environment, consumers, employees, communities, and the public sphere.

ESG takes on CSR and builds on it in a manner that takes it out of the realms of pure philanthropy, to a concrete set of numbers which can be used by investors and consumers alike in understanding a company's philanthropic, social and internal governance practices.

ESG provides quantifiable indicators (including sustainable, ethical and corporate governance issues such as managing the company's carbon footprint and making sure there are systems in place) to measure accountability. It applies numerical figures as to how companies treat their staff, manage supply chains, respond to climate change, increase diversity and inclusion, and build community links.

We discuss each of these concepts in detail below.

Corporate Social Responsibility

About a decade ago, CSR was the buzzword for sustainable business practices. An archaic and outdated term, CSR today mostly resembles a marketing tool, allowing businesses to make symbolic gestures.

In layman terms, CSR may be defined as a management philosophy for commercial firms which are making profits by utilising the resources of the society to give back to the society through philanthropy and charitable efforts. Through CSR programmes, philanthropy, and volunteer efforts, businesses would benefit society while boosting their own brands.

There is a misconception that CSR programmes are adopted only by large companies who have grown their business to the point where they can give back to society. Small- and mid-sized businesses have also created social responsibility programmes, although their initiatives have not often as well-publicised as larger corporations. Also, the more visible and successful a corporation is, the more responsibility it has, to set standards of ethical behavior for its peers, competition, and industry.

In fact, in 2010, the International Organization for Standardization (ISO) released a set of voluntary standards meant to help companies implement CSR. ISO 26000 clarifies what social responsibility is and helps organisations translate CSR principles into practical actions. The standard is aimed at all types of organisations, regardless of their activity, size, or location.

With the advancement of technology, it has now become possible to quantify a company's use of natural resources, conflict minerals, social composition and impact, and good governance. This is where ESG steps in.

Environmental, Social & Governance Standards

The acronym – ESG – refers to a trio of business measures used by socially conscious investors to identify and quantify the measures of a company's sustainability and societal impact, using metrics that matter to investors.

ESG issues are important to businesses that prioritise sustainability, and to investors looking for socially responsible investment opportunities. ESG issues are now becoming critical for compliance and risk managers as well as for potential investors, who now, not only need to see how a potential target company is doing financially, but are also assessing how a company is run, how it serves the society, how it impacts the environment and how all of these factors cumulatively determine the target company's overall performance.

The fallout of the COVID-19 pandemic has given businesses a chance to reassess almost every aspect of their operations. Consequently, ESG compliance has intensified in the wake of the pandemic as governments are now committed to a 'green' recovery.

Why has ESG suddenly become so important?

In principle, investing in ESG as a business isn't about making money. The purpose of ESG is to consider how ethical a company's practices really are, putting sustainability and moral principles above profit.

As mentioned earlier, ESG is the quantifiable measure of a company's sustainability and societal impact, using metrics that matter to investors as more and more millennial investors are choosing to back socially responsible organisations reflecting societal changes.

ESG investing is no longer considered a niche area or a strategy based solely on one's preferences or beliefs. Many "traditional" institutional investors are now employing ESG strategies because they think that it will help them understand the risks of the firms in which they invest. If investors and lenders can see that a company is run well and is managing risks that can impact resilience, they have confidence that the loan is at a lower risk. There's also a risk associated with *losing* investors due to lack of ESG awareness.

Investors aside, now consumers are also now willing to pay more for sustainable products. Purchasing decisions are increasingly being made keeping in mind social issues, meaning companies have to focus not only on the quality and cost of their products and services, but also on establishing sustainable, socially responsible, environmentally aware business practices in order to win and retain customers.

These emerging trends showcase the need for companies to provide more ESG-related disclosures.

Conclusion

ESG is going to play a critical role in how the built environment is managed going forwards. From inception, through design, building, occupation and disposal, ESG will need to be fully embedded into an organisation's decision-making. There is now a growing momentum, driven by asset managers, consumers, and employees alike, demanding transparent, purpose-led business practices that align with their own priorities.

In 2019, the Global Reporting Initiative[1] revealed that 93% of the world's largest companies by revenue already report on their ESG performance. That these corporations believe it is important to publish their work in this area reflects how central ESG has become to the way some of the larger MNCs have started conducting their businesses.

One of the positives to have resulted from the outbreak of the coronavirus pandemic has been the reduced travel and industrial activity which has had an encouraging impact on our environment. The pandemic has also taught us to check in on the people around us, to care for our communities and to put a greater focus on employee wellbeing.

As the world recovers from COVID-19, investors will not lose sight of sustainability and the trend of ESG issues will become more central to investing.

Prelude to Part II of this mini-series

In Part II of our "Understanding and Adopting ESG" series, we will look at how ESG reporting can both be beneficial as well as pose risks for a business entity. We will also discuss some of the common issues that the board of directors of companies face in respect of ESG disclosures and the legal challenges that commonly surface in respect of such disclosures.

[1] Available online at - *https://www.issgovernance.com/file/publications/ISS_EVA_ESG_Matters.pdf*

About the Author

Piyush Gupta
Foreign Lawyer
piyush.gupta@rhtlawasia.com
+65 6381 6865

Piyush Gupta is Foreign Lawyer and Head of RHTLaw Asia's Transportation & Logistics Industry Group. He is also part of the firm's Environment, Social & Governance (ESG) practice group.

Piyush has close to two decades of transnational experience in competition and antitrust law and is well-versed with the complexities of this area of law. He has advised multiple MNCs on their competition law issues and has conducted numerous competition compliance audits, trainings and workshops.

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