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ESG Matters... Now What?

A five-step framework for tackling the ESG puzzle

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This much is no longer up for debate: environmental, social, and governance issues factor into corporate performance. Numerous studies confirm that organizations with strong ESG records tend to have a more stable and loyal investor base, lower cost of capital, and better access to financing. An analysis by Boston Consulting Group finds that top performers in ESG enjoy valuation multiples 3 percent to 19 percent higher, all else being equal, than median performers, and margins up to 12.4 percent higher. We also know ESG issues matter to an ever-broadening swath of stakeholders, including many of the world's largest investment managers, as well as Millennials and iGens—increasingly influential and discerning consumers and employees.

Still, even for conscientious CEOs and boards of directors, integrating ESG into corporate strategy and culture isn't easy. ESG continues to mean different things to different people. Transforming it from an ancillary issue siloed in some distant corner of the enterprise to a broad core competency requires significant and sustained effort. And there's no single model corporations can pluck from the shelf.

These challenges are understandable. ESG is complicated because business is complicated. Issues affecting a corporation's performance and its impact on the greater good can vary dramatically from one enterprise to the next. Tensions inevitably exist between the long-term aim of some ESG initiatives and the short-term performance pressures on many corporate managers. In a recent KPMG poll of board members and senior executives, only 29 percent were confident their company was aware of and effectively managing ESG issues that pose a material risk to their company's performance and reputation.

Still, getting ESG right is doable. The KPMG Board Leadership Center, in collaboration with Professor George Serafeim of Harvard Business School, has developed a five-step framework that can guide CEOs and corporate directors in shaping a company's ESG approach—understanding why it matters, what it looks like, and how it connects to long-term performance. The key components:

- ***Level setting.*** How issues are framed impacts our understanding of why they matter and how we address them. By agreeing on a definition of ESG and its importance, managements and boards can set the stage for progress. And by framing the discussion in business terms—risk, opportunity, efficiency, financial performance—they can help short-circuit preconceptions, politics, and personal views.
- ***Assessment.*** A roadmap is essential to a productive strategy. After identifying ESG risks and opportunities material to their business, companies will want to focus on the two or three that are most strategically significant. These will vary from one enterprise to the next. At companies competing on the basis of differentiation and strong brands, for example, boards may find their time best spent monitoring issues that impact brand value. At companies competing on price, they may wish to focus on factors that impact cost structure.
- ***Integration.*** Too often, ESG initiatives remain peripheral to core corporate activities and so do not contribute directly to a company's competitive advantage. By integrating ESG programs into business strategy and the incentive programs driving it, companies can bring the same focus and discipline to them as they do to other strategic initiatives. Integration efforts should include two broad areas: employee selection and behavior, and organizational processes and routines.
- ***Stakeholder communications.*** Shaping the company's key ESG messages in the context of strategy and long-term value creation can reinforce the connection between ESG and corporate performance. Although no single framework has emerged for reporting ESG information, boards should understand how management decides what to disclose and how its accuracy is verified—and ensure that progress updates, results, linkage to strategy, and an explanation of how ESG initiatives benefit the company and its stakeholders become part of the company's communications. Keeping ESG front-and-center is particularly important in competing for talent because it matters to employees—from rank-and-file workers to senior executives.
- ***Board oversight.*** Make sure there's a "home" for ESG oversight, whether it's with the chairman, lead director, governance committee, ESG committee, or somewhere else in the board structure. Effective oversight hinges on having the right people in the boardroom, supported with quality information to enable appropriate oversight.

Our report, "ESG, Strategy and the Long View: A Framework for Board Oversight," explores these topics in greater detail. Get your copy at KPMG/us/BoardLeadershipCenterESG, or contact us at us-kpmgmktblc@kpmg.com to learn more about how KPMG can help your company close the gap between its ESG strategy and stakeholder expectations.

> *"Top ESG performers enjoy higher margins and valuation multiples."*

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