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What is the Business Case for Addressing ESG?

By Todd Roessler

As discussed in the last blog post, there are many reasons to address ESG, but does it make business sense? In deciding whether or to what extent to address ESG issues, a business case must often be presented. What is the value proposition in evaluating the benefits, costs, risks, and opportunities of ESG? Does it make financial sense? Like other ESG issues, there is no simple answer.

First, ESG issues can impact shareholder value, so *not* addressing ESG can impact a company. By not addressing climate change or social issues, companies are affecting communities and consumers, and they are taking action. Laws and regulations are evolving and regulatory agencies are increasing enforcement initiatives. Despite efforts to mitigate climate change, the climate will continue to change. Companies must adapt and become more resilient to protect their physical assets and value chain. Each of these impacts shareholder value.

Second, as discussed, many investors now care about a company's bottom line as well as its efforts to address environmental and social issues. A company that has a large carbon footprint and has not prepared for the climate transition will be impacted by the regulatory environment and consumer preferences, which will lead to underperformance in terms of value. These types of companies will have less access to capital.

Third, addressing ESG issues can drive growth. For example, it can build trust with regulatory agencies, resulting in a more efficient permitting process. It can also attract loyal customers and increase retention and productivity of employees. Finally, a recent analysis by KPMG has shown that addressing environmental issues is the most direct link to creating financial value. Although investing in renewable energy requires upfront capital costs, these costs can be partially offset through tax incentives and more favorable financing. Reducing carbon emissions, waste, and water use can improve efficiency, which lowers operating costs and margins. Companies must have a long-term investment horizon and be willing to bear the cost of short-term investments to realize long-term value.

Finally, some reports suggest investing in highly-rated ESG companies is financially beneficial. So how do we measure ESG success? Do we look at the glossy sustainability reports that show smiling faces and green spaces? These reports often tell us the good news and leave out the bad news. ESG rating agencies are on the rise, but with all the different rating agencies, who should you trust? We will get into that issue later, but bottom line is that there really isn't enough data to draw correlations between a company's ESG efforts and its financial performance. We need to better understand how a company's efforts to address these issues impacts its financial performance.

In addressing ESG issues, companies will need to move beyond looking at financial performance with a narrow lens and broaden its perspective to a wider group of stakeholders and issues. By doing this, companies will create long-term value.

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