ESG: from intention to action

Preparing the organization for an ESG strategy

May 2022 | KPMG.nl/ESG

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Introduction

Commitment to sustainability is increasingly becoming a priority for companies worldwide. The cry from society to take responsibility is getting louder. Customers, banks, citizens, employees, and supply chain partners are demanding that companies make their production supply chains more sustainable. Stricter European regulations also reflect this. For example, the CSRD directive requires listed companies to report on their impact and include ESG targets in their business strategy from 2024 onwards (and large companies* from 2025).

For many companies, managing ESG is a task that extends beyond their own activities. For example, the lifecycle of products, the activities of supply chain partners and the safeguarding of human rights are also counted among companies' responsibilities. Companies that are serious about their impact therefore require a solid strategy to achieve their ESG objectives.

Once it has a properly thought out ESG strategy in place, an organization can focus on the value it creates and wants to create in the future, for both its shareholders and other stakeholders. On the one hand, this is about mitigating risks and maintaining a healthy business model in a changing world. On the other hand, it is about creating new value for individuals, society and the environment.

In this article, KPMG identifies three points of action that leaders can take now to prepare their organizations for an ESG strategy. This article is particularly relevant for organizations that are just embarking on their sustainability challenge or want to give it a boost. Implementing the points of action as outlined can be seen as one of the first steps in the transition to a sustainable, inclusive organization.

What is ESG?

ESG stands for *Environmental, Social and Governance* and represents the three principle areas of non-financial values on how companies are valued. Examples include CO_2 emissions, biodiversity, ensuring safe working conditions, and using transparent accounting methods. The commitment to these themes is an increasingly important factor in the valuation and choice of companies by investors, employees, consumers and governments.

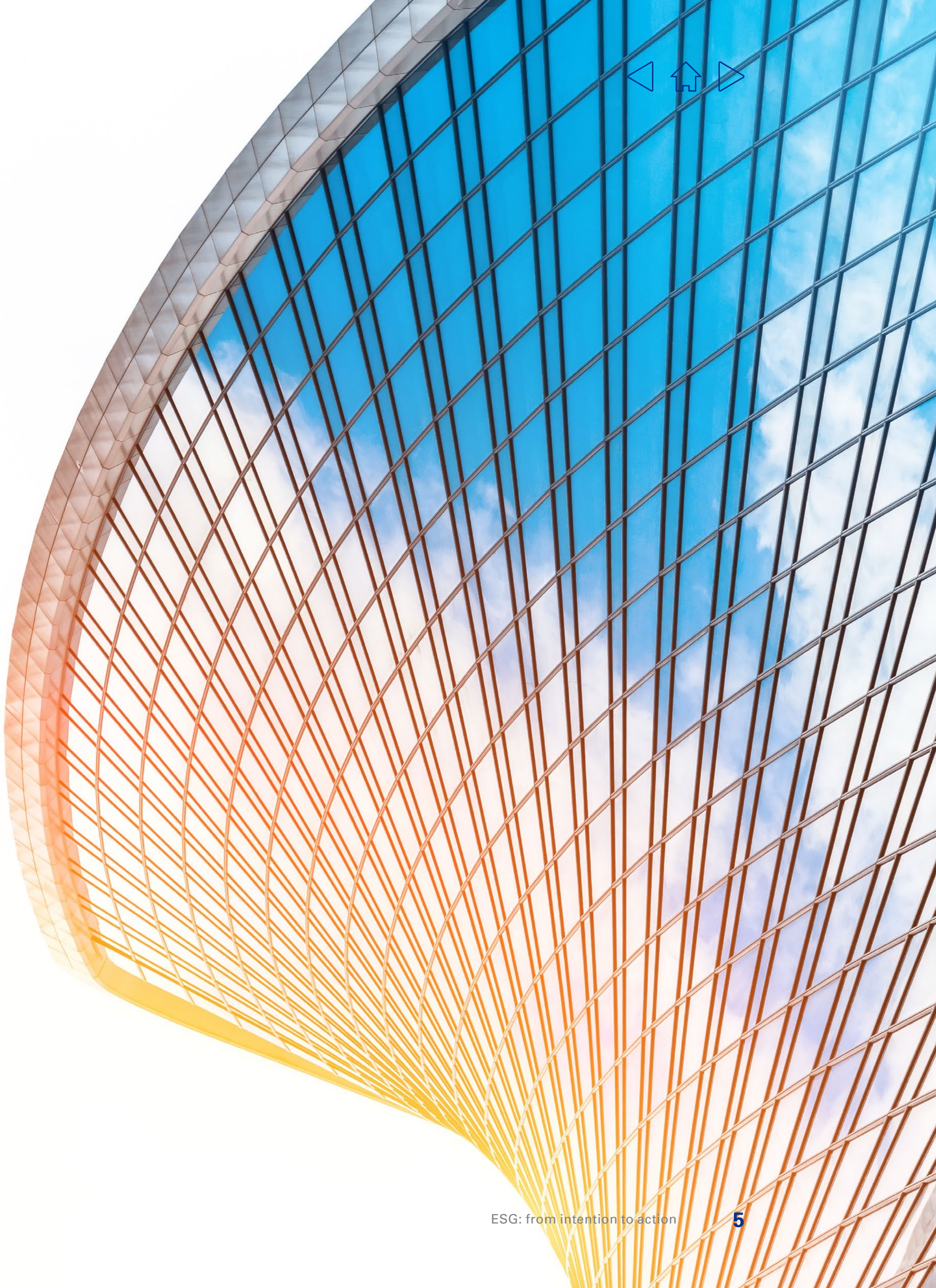
*https://home.kpmg/nl/en/home/topics/environmental-social-governance/corporate-sustainability-reporting-directive.html

Broadening the perspective on sustainability

What society understands by 'sustainability' has changed considerably in recent years. Where once the term was used exclusively to refer to issues related to climate and nature, today it is also increasingly used to refer to social issues such as human rights, a living wage and community building. This shift is also visible in leading international reporting standards such as GRI, SASB and ISO 26000. These standards also offer more possibilities to report on social indicators.

The motivation behind this shift to a broad definition of sustainability is twofold. On the one hand, governments, agencies, and forward-thinking companies are increasingly reasoning from the holistic perspective that a better environment and better social conditions all serve the same overarching goal: the creation of a livable planet for all. On the other hand, investors are increasingly choosing to assess the risk profile of companies using a wide range of non-financial criteria. Globally, there is the rising number of risks (such as extreme weather, migration and growing digital inequality) that all impact on a company's financial performance. With an appropriate ESG strategy, a company can make the right provisions and mitigate these risks.

To develop a solid ESG strategy, it is essential that there is a broad understanding within the organization of the various ESG themes and how they are interrelated.



It is also important to be aware that in some cases ESG objectives will conflict with each other. For example, the pursuit of a social objective, such as the ambition to only manufacture products locally, may conflict with an efficient environmental policy based on sourcing from the greenest producer.

In many cases, there is no single solution. Management will have to weigh up the pros and cons in line with the organization's purpose, vision, and mission in order to arrive at a suitable solution. It is important that there is an understanding within the organization about the complex situations that may arise. This means that in some cases, room must be made to discuss this complexity.

In any case, companies will need to take a broad look at sustainability. After all, they are increasingly being asked to take responsibility for their own impact. In a globalized world, looking away from social problems further down the supply chain (such as the violation of human rights in sweatshops) is simply no longer tolerated. Investors, consumers, and governments expect companies to act with integrity and no longer pass on their responsibilities to their supply chain partners.

Start immediately: Engage in dialogue

Engage in a dialogue about ESG and its importance if you are not already doing so. In most companies, various departments will already be doing so to a greater or lesser extent under headings such as Corporate Social Responsibility (CSR) or social return. You can also broaden your view of ESG issues by entering into a dialogue with supply chain partners about their sustainability ambitions. Based on this dialogue, your purpose, vision, and mission can be adjusted so that they clearly reflect how your organization wants to contribute to humanity, the environment and society.

Practical examples

ESG scan as a prelude to strategy

KPMG carried out an ESG scan for Euronics International, a group of companies with retail outlets in many European and Asian countries. This scan quickly highlighted the key themes for these companies' ESG strategy. The scan considered activities throughout the supply chain, (new) legislation, the activities of competitors and the requirements of investors and consumers. The insights from the scan thus formed the basis for a comprehensive ESG strategy that the companies drew up in cooperation with representatives from the various countries.

Integration of ESG and business strategy

Givaudan – a market leader in fragrances, flavors, and colorants with a factory in Naarden – has the following mission statement: 'Creating for happier, healthier lives with love for nature. Let's imagine together'. KPMG helped Givaudan to adjust its old ESG strategy based on new insights and to fully integrate it into its business strategy for 2025. As a result of this integration, Givaudan is able to better target its efforts towards achieving both its commercial and ESG objectives. Sustainability has also become a focus area for the entire organization. Buyers and salespeople, for example, now take on tasks that used to be the responsibility of the sustainability team alone.

Identify all stakeholders

To draw up an ESG strategy, the organization must have a clear overview of who the (indirect) supply chain partners and stakeholders are. After all, a company does not operate in a vacuum; its own business activities and those of supply chain partners all affect people, the environment and society. An ESG strategy must consider both the direct and indirect effects of the business activities. For example, consistently enforcing low rates on suppliers may result in more

child labor and poorer conditions for workers further down the supply chain.

It is therefore important to compile an inventory of who the company's supply chain partners are, and who, in turn, are their supply chain partners. Talk to all the parties about their expectations, goals, and obstacles. Working together can offer many advantages. For example, many companies have been working with suppliers for a long time on implementing sustainable agricultural practices. This results in higher margins for farmers and allows companies to reduce the ecological footprint of their products.

Also, look for stakeholders outside the supply chain. Many stakeholders are strongly influenced by the activities of the company. For example, NGOs, (local) politicians and trade unions can be important parties to work with to achieve ESG objectives. In the transition to a sustainable economy, such parties are increasingly emerging as unexpected allies. At the same time, not involving these stakeholders poses a risk because they can actively oppose a company's plans. This cooperation often takes place in so-called multi-stakeholder initiatives, such as the 'Better Cotton Initiative', in which the largest clothing, sports and textile companies work together with NGOs to grow cotton in a sustainable way all over the world.

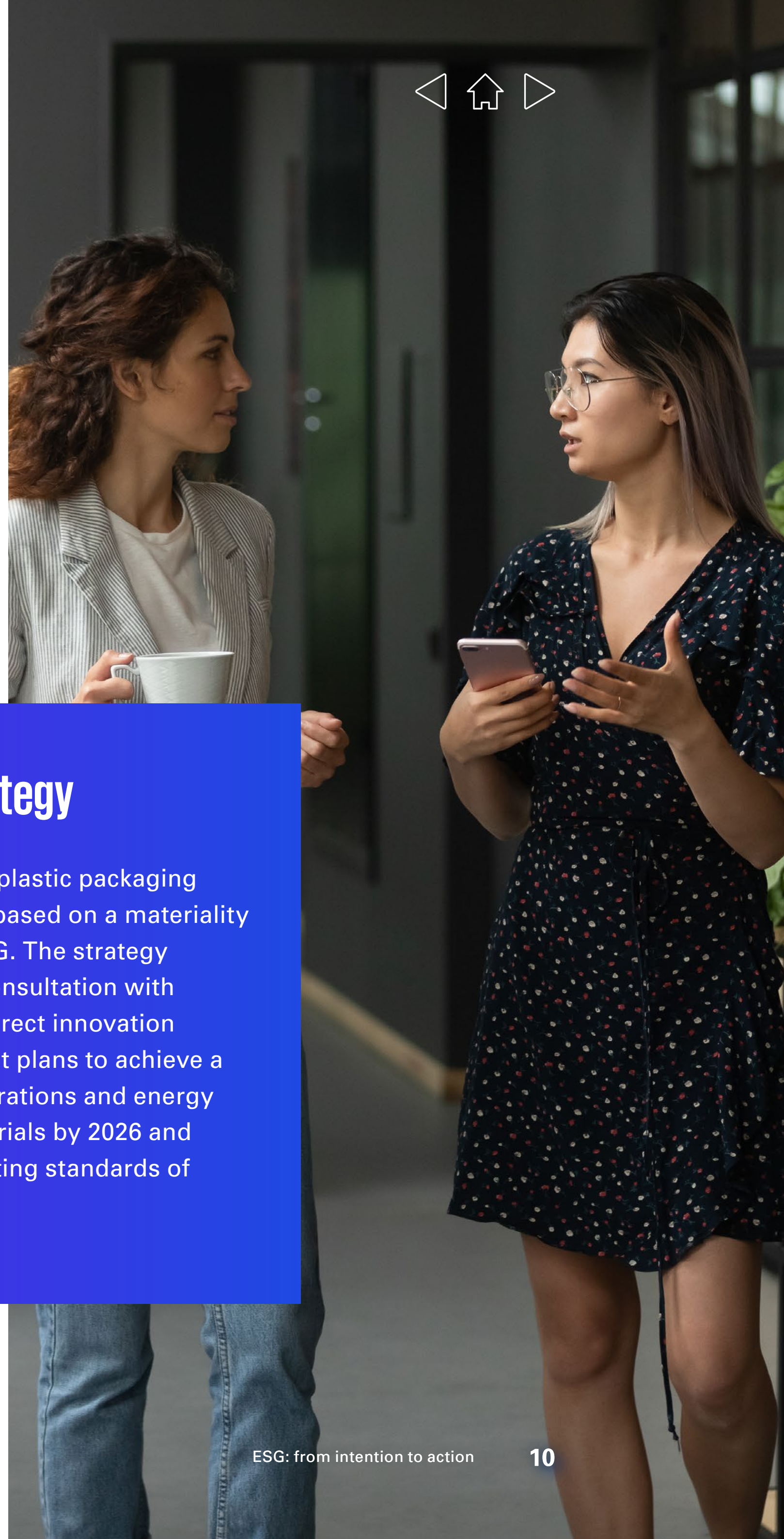
Start immediately: Seek out stakeholders and engage in dialogue

Take concrete steps to identify which ESG issues are important for both the company and its stakeholders. This is also called a ‘materiality analysis’. It is important not only to not make assumptions, but also to enter into a real dialogue with various parties in the countries where the company is active. This can vary from an online survey and panel discussions to circle discussions in local communities where foodstuffs or important metals come from.

Until recently, the main focus was on the company’s impact on people, society, and the environment. Nowadays, the focus is increasingly on ‘dual materiality’, whereby the financial impact of e.g. climate change, desiccation and loss of biodiversity on the company is also systematically mapped out. This double materiality analysis will become compulsory for many listed companies under the new European legislation on ESG reporting (CSRD) from 2024 onwards (for large* companies from 2025).

Materiality analysis and ESG strategy

Schoeller Allibert makes innovative reusable plastic packaging and has recently developed an ESG strategy based on a materiality analysis performed in cooperation with KPMG. The strategy contains clear objectives and is based on a consultation with stakeholders. The company can now better direct innovation and clearly report on progress. For example, it plans to achieve a 90% reduction in emissions from its own operations and energy purchases by 2025, to use 35% recycled materials by 2026 and to be 100% circular by 2050. In addition, exacting standards of integrity are applied to protect its people.



*https://home.kpmg/nl/en/home/topics/environmental-social-governance/corporate-sustainability-reporting-directive.html

Plan for an uncertain future

Investing in ESG is about working on several tasks simultaneously, each with its own complexity and its own horizon. When drawing up an ESG strategy, organizations must therefore not only look ahead, but also become comfortable with an inherent uncertainty about the future. This calls for an open attitude towards different future scenarios in order to increase the agility of one's own business model.

Technological developments, changing regulations and innovations in the supply chain are all uncertain factors that have an impact on achieving objectives and must therefore be included in the strategy. The achievement of circularity objectives, for example, will depend greatly on the innovative strength of supply chain partners. It is also not always clear how quickly new legislation in other countries will lead to a smaller footprint or better working conditions among suppliers. It is vital to ensure that the organization is prepared to take extra steps where necessary.

A good ESG strategy works with different timelines. Short-term objectives inherently require different solutions from long-term ones. Short term objectives often require optimization, whereas in the long term, overarching system changes will need to be identified. For example, the goal of 'CO_2 neutral within three years' is often only achievable by partly compensating for emissions, and 'fully Net Zero and circular within twenty years' requires innovations that involve radical changes in the production process. Social objectives also require diverse and imaginative solutions depending on the timeframe. In the short term, 'a living wage for all employees in the supply chain' will mainly lead to pilot projects and obtaining guarantees from a select group of suppliers. In the long term, it is important for such an objective that innovation takes place in the supply chain, for example by developing more economical products or more efficient processes. When developing a strategy, it is important to look at both between short-term optimization and long-term system changes.

Start immediately: Draw up scenarios

Draw up scenario analyses based on global trends and developments into possible future scenarios. Then map out the time path for achieving important overarching goals. When drawing up the objectives, make a distinction between goals that the organization is happy to commit to and hard obligations dictated by regulations.

Scenarios help plan for future risks and opportunities. Pinpoint the greatest uncertainties for the future. This differs in each organization and industry, but all companies will have to deal with technological developments, climate change, and stricter regulations.

Conclusion

In 2022, for many companies the question ‘whether’ to take the next step in sustainability has been replaced by ‘how’. Risks such as climate change and stricter requirements from legislators, banks, investors, and consumers require companies to proactively address ESG in order to ensure that the organization contributes to a better living environment for people, the environment and society, with less inequality and combating climate change.

Since focusing on ESG is such an integral step that affects all parts of the organization, the right preparation is essential. The above points of action are the first concrete steps that leaders can take to develop an ESG strategy. They help the organization find its course in an uncertain future from a holistic mindset. Only by critically reviewing their own activities and those of their supply chain partners will companies be able to carve out their place in the transition to a sustainable economy.

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