Corporate Governance and ESG

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Introduction

Corporate governance and ESG (Environmental, Social, and Governance) are two important concepts that are closely related to each other. Corporate governance refers to the system of rules, practices, and processes by which a company is directed and controlled. It encompasses the relationships between a company's management, its board of directors, shareholders, and other stakeholders, and the goals for which the corporation is governed. Good corporate governance is important for ensuring that a company is managed in an ethical, transparent, and effective manner, and that it maximizes value for all stakeholders over the long term.

ESG, on the other hand, refers to the three key factors that are used to measure the sustainability and ethical impact of an investment in a company: Environmental, Social, and Governance. Environmental factors include a company's impact on the environment, such as its carbon footprint and resource use. Social factors include a company's impact on society, such as its treatment of employees, customers, and suppliers. Governance factors include a company's management structure, executive compensation, and board composition.

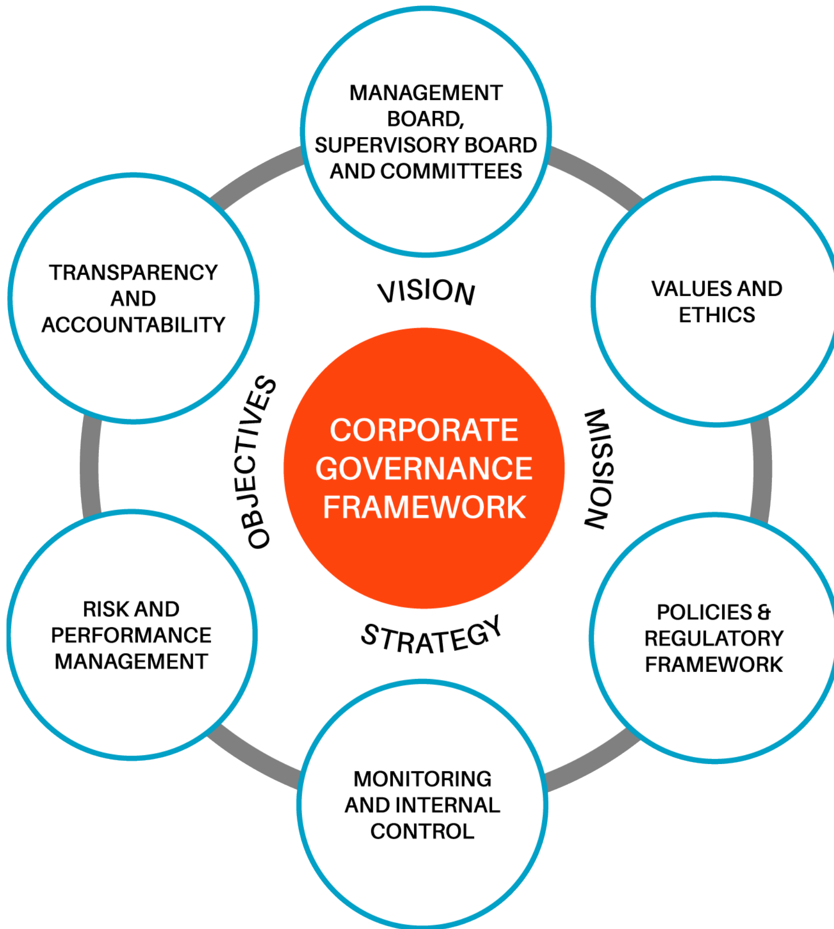

Figure 1: Corporate Governance Framework

ESG is becoming an increasingly important consideration for investors and stakeholders, as they seek to invest in companies that are aligned with their values and have a positive impact on the world. Good corporate governance is a key component of ESG, as it ensures that a company is managed in a responsible

and sustainable way, and that it is held accountable for its environmental and social impact. Companies that prioritize ESG factors are more likely to attract and retain investors, customers, and employees, and are better positioned to create long-term value for all stakeholders.

Figure 2: ESG

Contemporary Corporate Governance

Corporate governance is evolving to take into account changing business models, technological advancements, and stakeholder expectations. Here are some key trends in corporate governance:

1. Emphasis on sustainability: Companies are increasingly expected to integrate ESG considerations into their decision-making processes and to report on their sustainability efforts.

This requires a shift in focus from short-term profits to long-term value creation.

2. Board diversity: There is a growing recognition of the importance of board diversity in ensuring effective corporate governance. Companies are expected to have boards that reflect the diversity of their stakeholders and that bring a range of perspectives and skills to the table.

3. Increased stakeholder engagement: Companies are expected to engage with a wider range of stakeholders, including employees, customers, suppliers, and communities. This requires a more inclusive and collaborative approach to decision-making.

4. Technology and innovation: Technology is transforming the way companies operate, and corporate governance needs to evolve to keep pace. Boards need to have the skills and expertise to understand and oversee technological risks and opportunities.

5. Transparency and accountability: There is a growing expectation for companies to be transparent about their governance practices, including executive compensation, board composition, and decision-making processes. Companies are also expected to be accountable for their actions and to have effective systems in place for managing risk.

Overall, corporate governance in the new era is focused on creating long-term value for all stakeholders, rather than just maximizing short-term profits. It requires a more inclusive, collaborative, and transparent approach to decision-making,

and a willingness to adapt to changing circumstances and stakeholder expectations. These points bring sustainability to the forefront, but from the perspective of stakeholders. It is increasingly becoming impossible to focus on shareholders only consequently not sustainable. This has propagated concept of ESG being at the centre stage. It is thus imperative the present boards have this on their agenda.

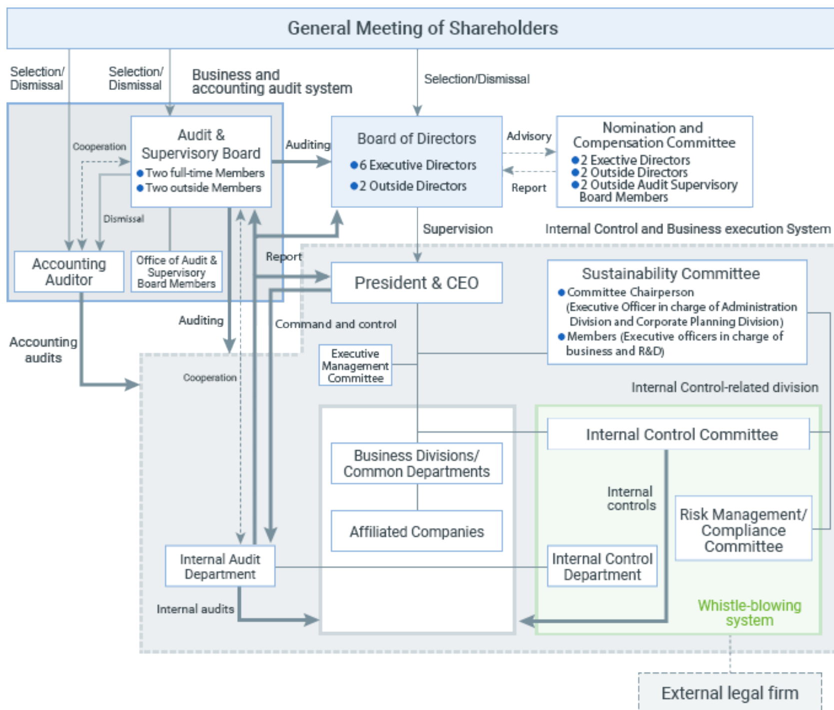

Figure 3: Corporate Governance System incorporating ESG

The Nexus Between Profits and Principles

Corporate Governance and ESG represents what Johnson Lambert referred to as 'the intersection between profits and

principles". The awareness in the recent past on the ESG issues has driven companies to review their system of values and ensure that they reflect evolving stakeholder priorities, especially on climate change and social justice. ESG reflects a shift in how companies evaluate the risks that could impact their organisation and how they are evaluated by their stakeholders on how they respond to environmental and social issues.

Companies that proactively embrace ESG may be better positioned in the market. While ESG is deemed costly, it is increasingly becoming a profit too. Investors and business partners are increasingly seeking to work with (and may be willing to pay a premium for) companies that demonstrate a commitment for ESG issues in operational perspective. A company may also position itself as preferred employer, especially for the new generation of employees who prefer to work with companies with values putting environment and social issues at the forefront. Regulation and rating agencies have also placed emphasis on corporate responsibility and ESG from risk and governance perspective.

Whereas ESG can bring competitive advantage amongst diverse stakeholders, it is centered on the quality of leadership. It requires support and accountability from the top leadership and those charged with governance as a prerequisite for success. Companies therefore need to develop a strategy to deliver on ESG programs.

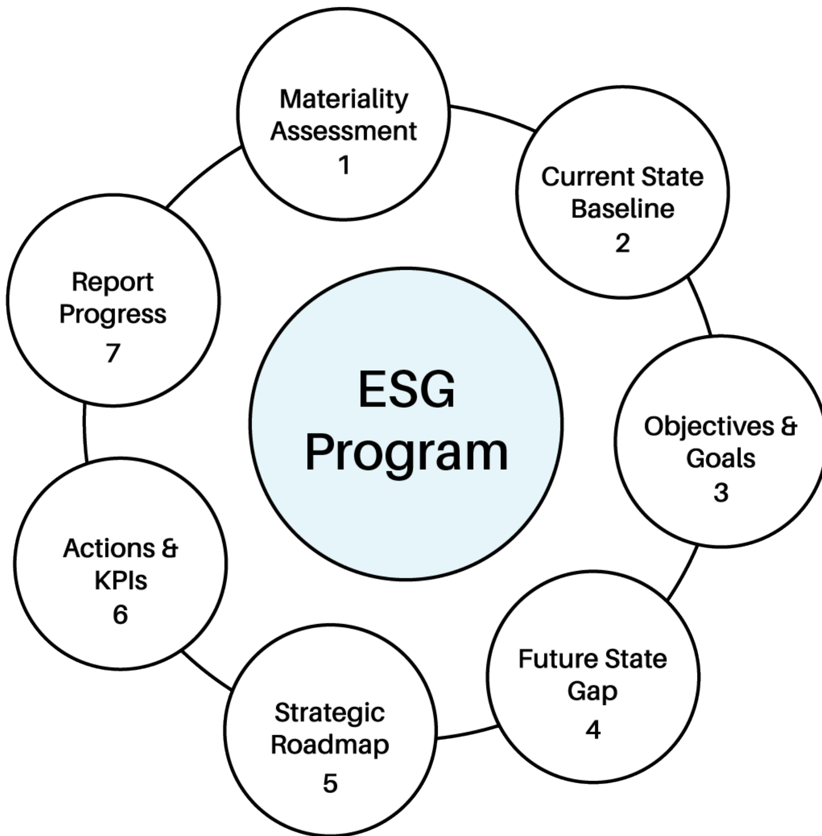

Figure 4: 7 steps to develop and implement ESG Strategy

The starting point for ESG is assessing materiality then the baseline i.e knowing where the organisation is regarding key ESG metrics. It requires an honest assessment of the ESG landscape in the organisation. The big question will then be: Where does the board want the company to be and what incremental steps should it take? This future-state response will result in short- and long-term goals with key accountability checkpoints along the way. The board will set the strategic objectives incorporating

these, but the management will provide implementation role, taking short-term incremental steps to take the organisation to where it needs to be as they remain accountable to the board.

The board culture and composition have a key bearing on the success of the sustainability journey. A diverse board improves the dynamics of the organization by offering different perspectives which may make problem-solving easier and can generate innovative ideas and solutions. To maintain an independent and engaged board, best practice includes having clearly defined roles and expectations of board members. Members need to be evaluated for conflict of interest and the board chair needs to be rotated regularly.

Regarding ESG, board members may consider asking the right questions to make an impact on ESG strategy. What are we doing to be a good company and how are we getting better? What are doing to take care of environment, our customers and other stakeholders? How does ESG fit into our organisational structure? By viewing ESG as a strategic objective, leaders can build a common language around the company's values and understanding of what the company wants to achieve and how each person fits into the larger picture.

When a company and its board are committed to ESG, they are upholding their responsibility to evolving stakeholder priorities. Leading by example helps to maintain a good reputation and can actually increase long-term profitability and brand loyalty. However, challenges can and should be expected

along the way. The differentiating factor that will impact an organization's success and growth is the organization's response. In a workplace, there may be four different generations with very different values working on the same team. Remaining transparent and setting clear expectations, as well as checking in through every step, may help ease employees through any transitions.

It can also be difficult to carve out time to focus on priorities that may not immediately impact the bottom line and could cost money up front that are for the greater good of the company, the environment and the community. However, every little bit counts, and measuring and tracking your progress is crucial. Organizational change can be measured and shared quantitatively through finance reports, ratios, and ratings. It can be measured qualitatively through engagement via surveys and town hall meetings. When employees feel heard they are more satisfied with their work. When they and other stakeholders understand the values of the company, they are more likely to support them.

No matter how big or small your organizational goals are when it comes to ESG, a thorough self-assessment is always the first step. Once that is complete, it's important to consider the state of your current board, set goals for the organization, explore areas of opportunity and maintain transparency every step of the way. Though the foundational stages may be challenging, a company with an ESG strategy that reflects modern

times reassures shareholders, invites coveted talent, and upholds social responsibility for the betterment of everyone.