

ESG beyond E

- the rise of stakeholder
governance



The world cannot afford another COVID-19. It has already claimed almost three million lives worldwide and, according to the IMF, is likely to have cost \$32tr in lost output by 2025.

Using our previously published horizon scanning of a post-COVID new normal¹ and data from our recent ESG survey, we identify our clients' key priorities in their efforts both to respond to the increasing influence of stakeholders in the boardroom and to improve their pandemic resilience. In particular we find an increased role for the social and governance pillars of ESG.

Our findings align with recommendations from the World Economic Forum and others for an acceleration in the transition from shareholder to stakeholder-governance models.



68% of our clients have a corporate purpose beyond making money.



Improving **brand reputation** and competitive positioning rank more highly than finding new sources of revenue or cost saving among the expected financial benefits to flow from their ESG agenda.



Regulatory compliance dominates the expected non-financial benefits closely followed by **improving relations** with stakeholders and the role of ESG in wider society.



Corporate altruism is a defining difference between models of shareholder- and stakeholder-governance.



Respondents focus most of their attention on the **environmental** and **governance** pillars. Here they have a clear hierarchy of priorities which seem to reflect the existence of explicit regulation or strong guidance from a regulator. Their greatest difficulty is with the social pillar.



The need for **training** and **data** to achieve their goals was identified across all three pillars.

¹ See for example [A post COVID scenario analysis](#) (May 2020) and [A new normal for employment law](#) (October 2020)

Improve pandemic resilience through stakeholder governance



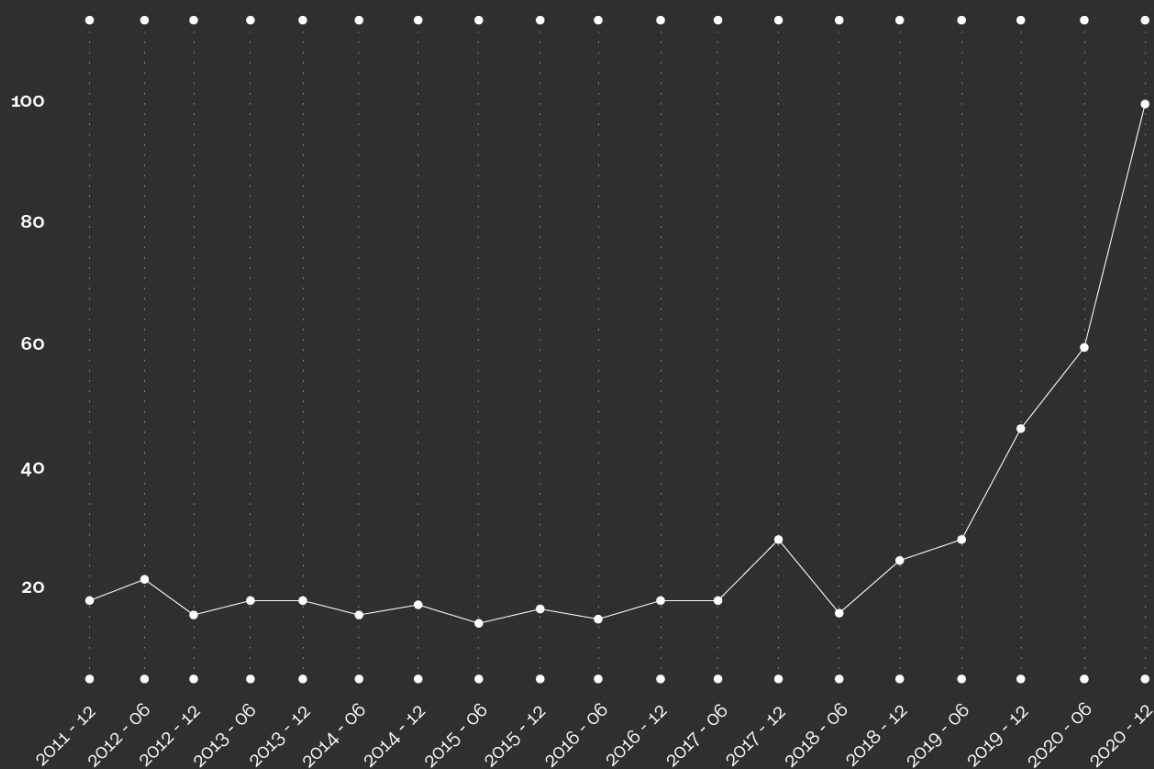
A checklist for directors

ORGANISATIONAL ACTIVITY	ELEMENTS TO CONSIDER
Corporate culture purpose, governance	<ul style="list-style-type: none"> • Review corporate purpose through the lens of stakeholder governance. • Improve stakeholder governance by integrating corporate altruism into corporate culture; identify key topics for key stakeholders. • Increase use of data and training to define, achieve and maintain ESG goals across all three pillars. • Align senior management reward and attainment of ESG goals across all three pillars.
Talent acquisition, retention	<ul style="list-style-type: none"> • Foster culture of creating social value. Can be a positive discriminator in attracting/retaining employees. • Improve diversity and inclusion across the whole company - not just senior management. Increasingly important for liability insurance, mitigating the risk of event driven litigation and for improving pandemic resilience: e.g., women are twice as likely to lose their jobs, and BAME people have a three times higher mortality rate. These are part of the human tragedy of COVID - and a cause of business disruption.
Corporate actions	<ul style="list-style-type: none"> • Recognise ESG credentials as an increasing part of transactional considerations for both offensive and defensive strategies.
Products, services	<ul style="list-style-type: none"> • Risk mitigation ie closing the gap between what it says on the ESG tin and what's inside.

ESG, COVID-19 and rebalancing corporate purpose

Even while the repercussions of the COVID-19 shocks reverberated around the globe during 2020, the level of interest in ESG accelerated to record highs as investors and other citizens grappled with what has been called the 21st century's first sustainability crisis.

Chart 1: Interest in ESG as seen in Google searches worldwide



Source: Google May 2021

By January 2021, global fund-flow tracker EPFR is reported to have shown that socially responsible investing (SRI)/ESG mandates almost trebled their inflows to \$170bn during 2020. Towards the end of 2020, a Blackrock survey showed investors representing \$25tr in AUM expected to double their allocation to sustainable assets by 2025.

Those flows will be driven in large part by expectations of improved financial performance from delivering better ESG performance. Analysis by [Institutional Shareholder Services \(ISS\)](#) has shown an approximate doubling of a company's profitability (as measured by the EVA margin²) for a doubling in its ESG performance (as measured by ISS).

That scope of the ISS measure of ESG performance and the agenda for improving pandemic resilience go beyond climate change and the loss of biodiversity. In the social and governance pillars for example, efforts to improve pandemic resilience will need to address the societal vulnerabilities exposed by COVID-19 including that women were twice as likely as men to lose their jobs during the pandemic and that death rates among BAME communities were three times greater than those for non-BAME.

² EVA = Economic Value Added and is defined as a company's rate of return minus its cost of capital

Our ESG survey - detailed findings

Corporate purpose - beyond making money

68% of our clients told us they have a statement of corporate purpose beyond making money.



Source: Simmons & Simmons May 2021

The finding has profound implications for corporate culture, governance and beyond. It resonates strongly with trends in corporate governance - and the rise in interest in ESG - that have been gathering pace since before the COVID-19 pandemic and have been accelerated by it.

In January 2020 the World Economic Forum launched its Davos Manifesto calling for companies to pay their fair share of taxes, operate zero tolerance for corruption and to uphold human rights throughout their supply chains.

In the Davos meeting of January 2021, after COVID-19 had exposed a wide range of societal vulnerabilities and inequalities, Klaus Schwab (founder and executive chairman of the World Economic Forum) said;

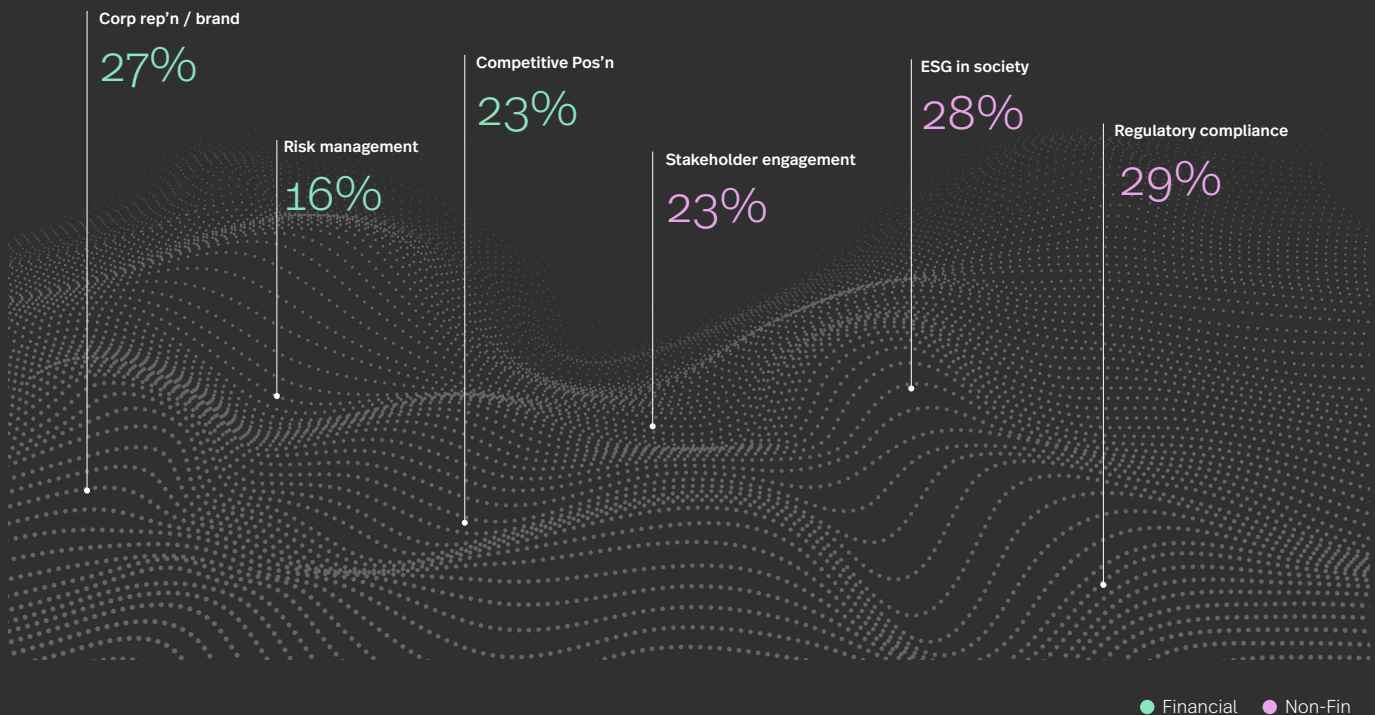
“we must rethink what we mean by capital - whether financial, environmental, social, or human”.

Our survey suggests that the majority of our respondents are aligned with that longer-term direction of travel.

Our ESG survey - detailed findings

Participants cited the following mix of financial and non-financial benefits they expected to flow from ESG.

Chart 2: Expected financial and non-financial benefits expected from ESG



Surprisingly, the factors associated with traditional shareholder capitalism ranked low on the list of ESG benefits. Factors such as better access to capital, generating sources of new revenue and or cost saving are historically among the primary motivators for shareholders.

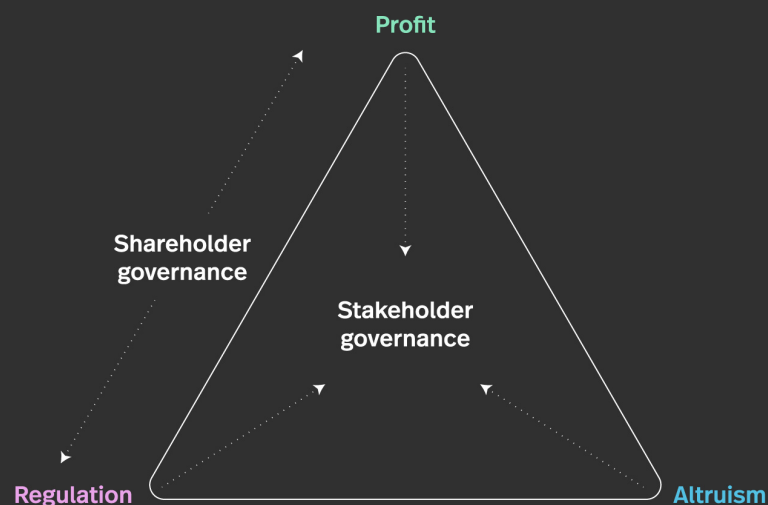
The dominant factors, both financial and non-financial, fall broadly under the headings of regulatory imperative (compliance), intangible financial factors (brand, competitive position) or into a grouping suggested by Klaus Schwab at Davos-21 when he spoke of a broader definition of capital to include environmental, social or human.

A new feature for the new normal landscape

Improving the role of ESG in society and stakeholder engagement do more than just nod towards a greater role for stakeholders - itself one of the strongest among the expected non-financial benefits. They suggest a third element - corporate altruism - to add to the traditional drivers of shareholder governance, the profit motive and regulatory compliance, in the development of a model for stakeholder governance.

The graphic below offers a representation of a possible relationship between the three elements.

Chart 3: Stakeholder governance - a virtuous pyramid



Our findings suggest that post COVID-19 organisations will increasingly exist for the greater good of all stakeholders and not only for shareholders. The organisational and regulatory challenges of that transition may be profound - particularly in the likely tensions arising between altruism and the profit motive.

Opportunities for stakeholder activism

A shift towards a stakeholder governance model means it's not just shareholders who will have influence over corporate behaviour. For example:

- **consumers:** [an IBM/NRF survey](#) (Oct 2020) found 40% of US consumers are purpose-driven - willing to pay a premium for a product or service that aligns with their values. They may also avoid the products and services of companies whose values do not align with their own;
- **employees:** talent acquisition and retention ranked as the fourth highest financial benefit expected to flow from ESG. A global survey by [Mercer \(March 2021\)](#) found that almost 40% of employees are motivated by strong corporate values, mission and purpose and that 36% favour companies that focus on social equity and environmental protection. Our survey data showed that talent retention/acquisition ranked just outside the top three non-financial benefits expected to flow from an organisation's ESG agenda;
- **insurers:** the rise of stakeholder activism is reflected in a report from [Allianz \(December, 2020\)](#) that identifies diversity and other ESG factors as one of its "5 Mega Trends" for Directors and Officers liability insurance in 2021. In a separate report ([Litany of new risks, December 2020](#)) Allianz warns companies to "be on guard for event driven litigation caused by...inaction on diversity (and) poor sustainability performance" with consequent (negative) effect on their liability insurance, the flip-side of stakeholder activism.

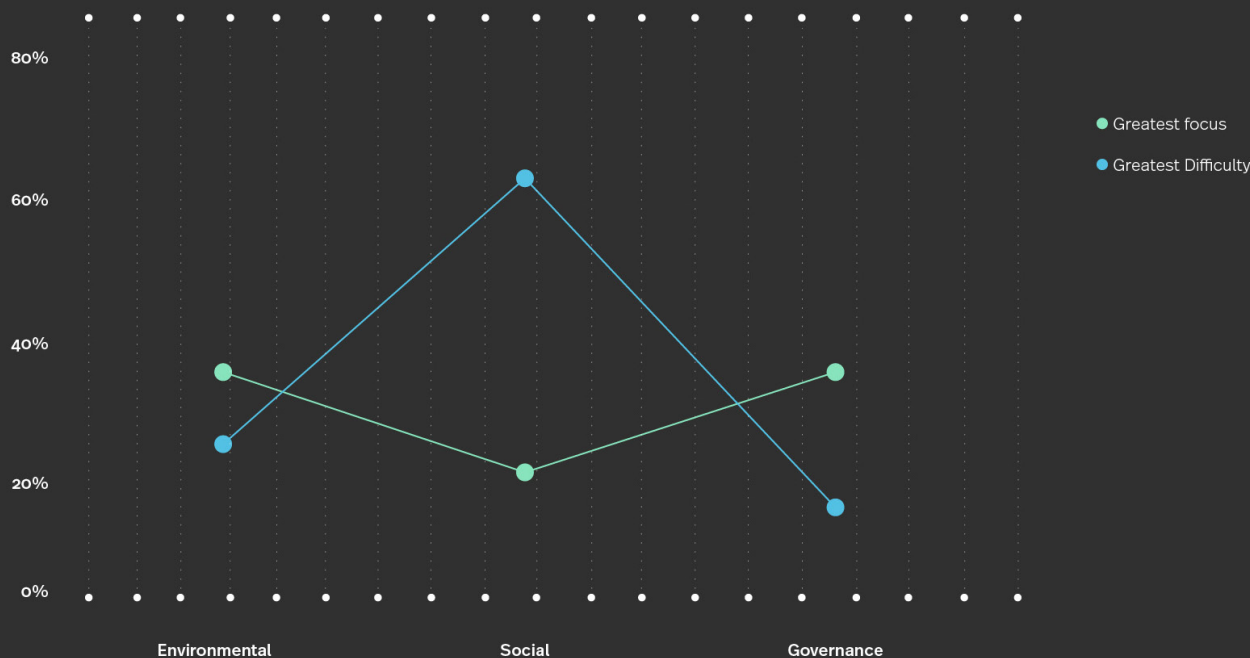
Looking at those examples and others it may be that stakeholder activism acts as a spur to corporate altruism in delivering stakeholder governance for the post-COVID-19 new normal.

The three pillars of ESG: the focus and the difficulty



We asked our survey respondents to rank the three pillars of ESG in terms of their focus level and the difficulty they faced with each one.

Chart 4: ESG pillars - focus and difficulty

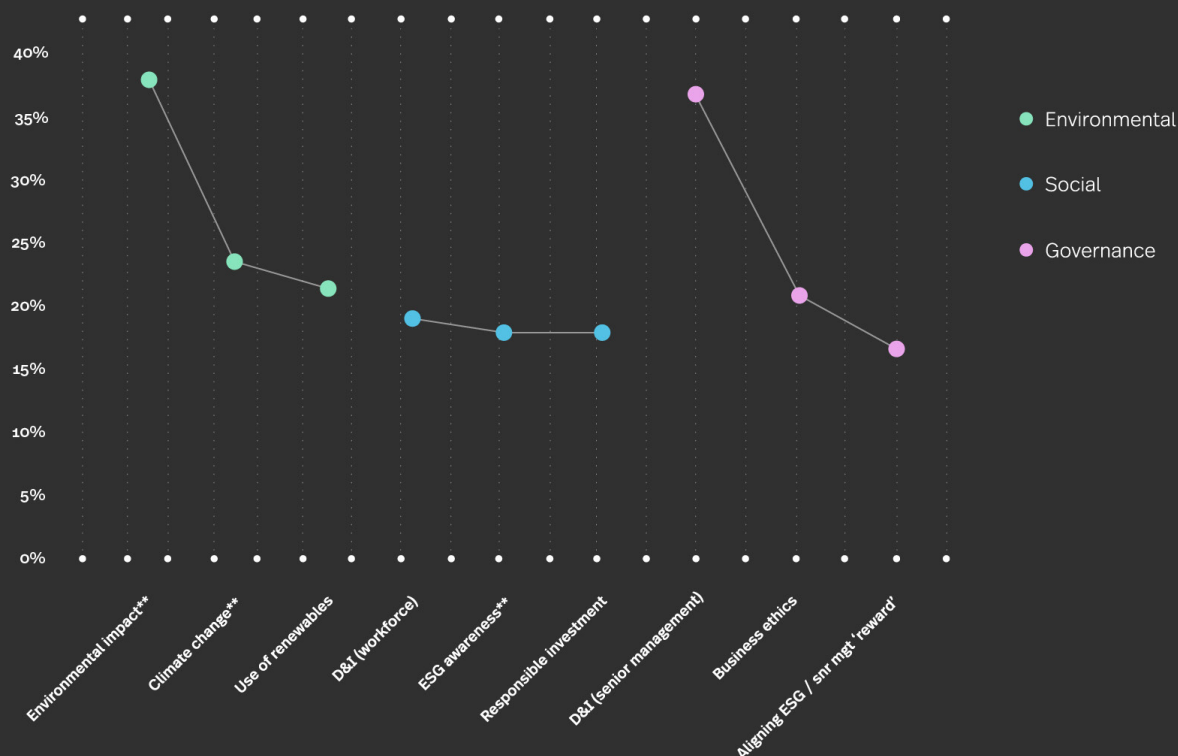


It was perhaps no surprise that the greatest focus was on the environmental and governance pillars. This is where most regulation or regulatory oversight seems to be focused eg SFDR, SMCR, SRD2 and expectations of the PRA that firms allocate senior manager responsibility for managing climate risk.

And yet it is within the social pillar that many of the vulnerabilities and inequalities revealed by COVID-19 are to be addressed, notably the inequalities of outcome around ethnicity, gender, and income groups. If the world is to improve its pandemic resilience it will need to focus more on the social pillar - even in the absence of regulation.

Top three priorities within E, S and G

Chart 5: Top three priorities



There is clear leadership of priorities in both the environmental and governance pillars. But this does not exist in the social pillar where the top three priorities have equal weight and are much lower than the main priority of the other two.

The most obvious explanation is the existence of significant regulation in both the environmental and governance arenas. That suggests that to fully achieve the transition to stakeholder governance, there may need to be an enhanced regulatory framework within the social pillar to provide a road-map towards its ambitions.

A challenge for diversity and inclusion

Increasing diversity and inclusion amongst senior managers is cited as a much more clear priority than it is for the general workforce.

That may reflect the different regulatory regimes within each of the governance and social pillars but, if organisations are to improve their pandemic resilience it is likely they will also need to close the gap on diversity and inclusion between the two pillars.

Organisations will need data and training

The need for data and training is evident in our results. In chart 5, the items marked with ** are those which imply or explicitly call for data or training. Meeting objectives to reduce environmental impact or to mitigate climate change will be tested against a number of metrics including those identified by regulation - SFDR for example.

The priority to increase diversity and inclusion among all employees implies the need for appropriate data to track progress.

Integrating the results of any data analysis into an organisation's workflow and reward structures will play a vital part in defining success for improving pandemic resilience in a post-COVID-19 new normal.

Immediate priorities: Important v urgent

As one client said to us at the height of the second wave of the pandemic:

“ESG is important, but not urgent.”

- Major European Financial Services company

It was a reflection of the existential threat many companies were facing from the pandemic.

Our survey was conducted towards the end of 2020 and we recognise that short-term priorities may have shifted in the interim. However, the longer-term ambitions beyond making money are less likely to change and the need to improve an organisation’s pandemic resilience could soon become more urgent particularly to a much broader stakeholder-base.

At the time of the survey the list of immediate business priorities ranked as follows:



Preparing to meet SFDR
deadlines



Dealing with COVID-19



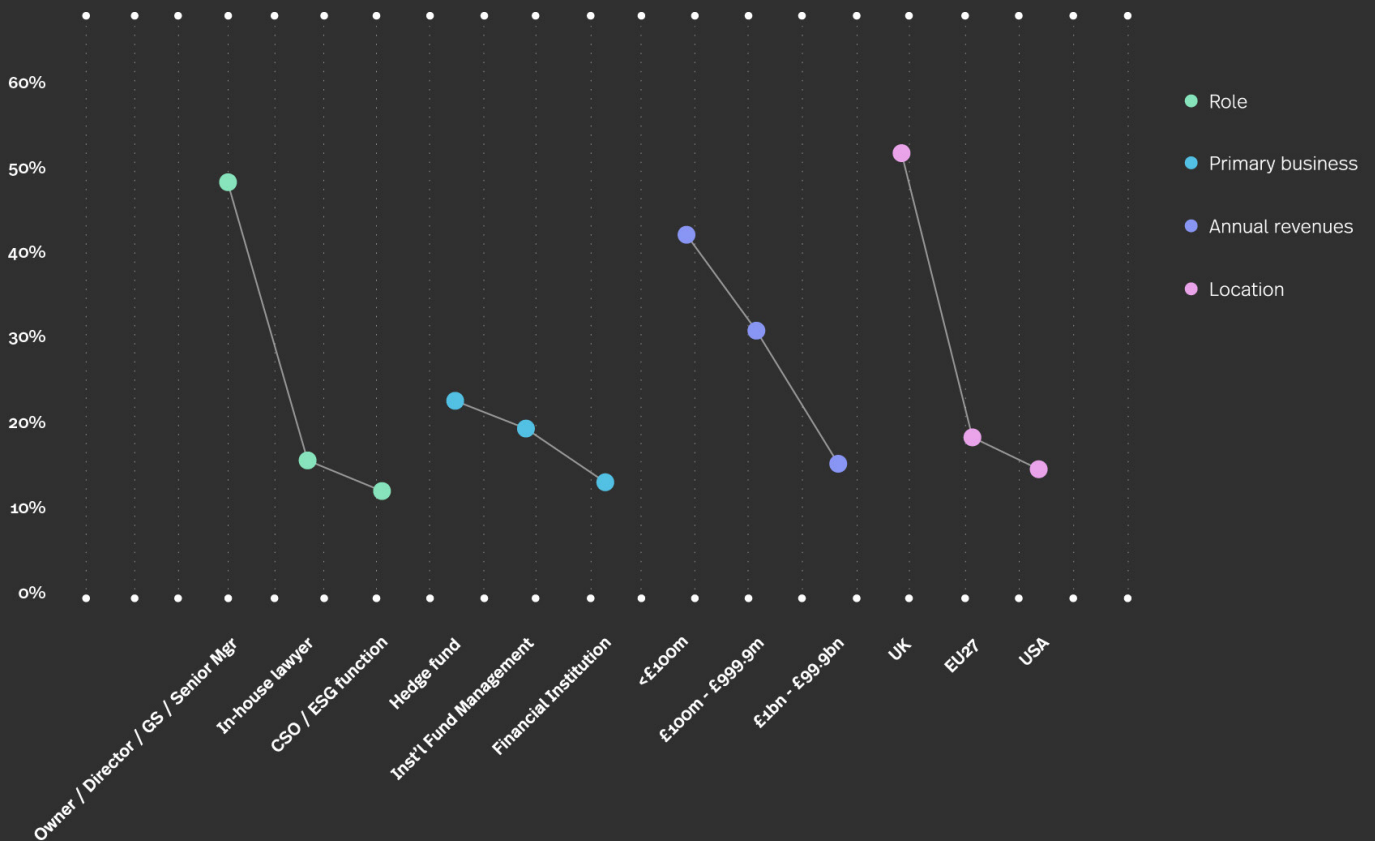
Preparing for post-Transition
Brexit

Survey demographics



The survey data used in this report alongside our horizon scanning, come from a small pilot survey among 101 Simmons & Simmons clients.

Chart 6: Top three types by category



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