

ESG Advice Note

COVID-19

Why Now is the Time to Look at COVID-19 Through an ESG Lens

In the middle of a crisis, is a focus on ESG urgent or a distraction?

Putting off major ESG risk scanning exercises or ESG communications efforts until the world is “back to normal” is risky business. The COVID-19 crisis is profound and far-reaching, and the difficult decisions your business makes today will define your tomorrow. The same principle applies to the way that you disclose your principles and decision-making to the markets. You want to make the right choices and tradeoffs to ensure the sustainability of your company in the short and long term, but you also want your customers, investors and regulators to support and understand your strategy and give you the benefit of the doubt as you struggle through a time of uncertainty alongside peers who are competing for the same investment dollars, talent and attention.

Companies that have previously done a good job thinking through ESG strategy and the purpose of their companies in society are in a better position to emerge more resilient from the COVID-19 pandemic, because they are used to framing their choices through the lens of critical risks and opportunities and stakeholder perceptions.

Although you may feel too busy to focus on ESG decisions and disclosures right now, this is precisely the time to integrate ESG considerations into your strategic planning and key performance indicators, rather than thinking of ESG as a stand-alone, nice-to-have area of activity. Investors we’ve spoken to think governance and ESG commitments are more important than ever, that COVID-19 in some ways is an “ESG acid test.” While most companies today are focusing on the major risks factors in their sector and company, some companies are clearly less prepared than others and will fail. Companies who face crisis and controversies will have to face up to angry stakeholders or activists. A subset of those who are well-prepared will still make the mistake of failing to properly disclose and communicate about their commitments, tough decisions and great work, and they will suffer from misunderstanding and a lack of trust. Companies get credit for moving in the right direction and showing transparency; they are expected to not only have policies but disclose metrics and progress toward those policies and goals.

What leaders need to know about ESG today

It's AGM season, and votes are at stake. Proxy voting advisory firm Glass Lewis predicts that some public companies could see proxy vote outcomes affected because of business disruptions caused by the virus, and BlackRock has warned that in times of crisis like COVID-19, shortcomings in leadership are more apparent than ever and they will crack down on ESG matters by:

- Holding companies accountable for not articulating publicly how sector-relevant sustainability risks and opportunities, for instance those identified in the SASB framework, are integrated into business strategy
- Voting against re-election of senior NEDs who haven't ensured that disclosure of environmental risks are in line with the Taskforce on Climate-related Financial Disclosures (TCFD)
- Voting against pay policies that aren't correlated with long-term performance

The "S" in ESG is more important than ever – think about PEOPLE.

- In the past, governance and environment factors seemed to get more attention than social ones such as employee rights and fair treatment of customers and suppliers. During the COVID-19 crisis, workers have been demanding better health and safety protection, and millions of workers are now unemployed and finding out they have a limited safety net. Social issues are serious and profound.
- Groups of investors are urging companies to "prioritize safety, paid leave and the maintenance of business and employment relationships to support communities and the markets as global pandemic unfolds."

Controversies and perceived leadership shortcomings won't be easily forgotten, and your pandemic response could be scrutinized and criticized. Investors and ESG ratings agencies keep track of controversies in the media and often accept the reporting at face value – therefore correcting inaccuracies and getting your own story out there is critical. Here are some examples of COVID related controversies that are likely to cause ESG scores and reputations to take a hit:

- Essential workers strike to protest health and safety conditions
- Companies fire employees who are critical of their COVID responses
- Consumers complain about price gouging
- Security guards are accused of racism for trailing certain customers wearing masks but not others
- Contact tracing apps and temperature detection devices spark privacy concerns
- Companies face criticism for taking Paycheck Protection Program/CARES Act loans
- Unproven drugs are on sale to unsuspecting desperate customers online

Climate change is not off the agenda – in fact, the coronavirus crisis holds profound lessons that can help us address climate change – if we make greater economic and environmental resiliency core to our planning for the recovery ahead. Prevention is so much less costly than responding to a crisis of the magnitude of a pandemic or climate change. But now that we are in it, expect to see the pandemic influence the pace and nature of climate change.

Risk resilience and ESG fundamentals

This crisis is a test of resilience for all leaders and governing bodies. Speed, judgement, empathy, and good execution are needed in equal measure. Below are top tips for corporate leaders as they shore up ESG strategy and communications during the crisis.

1. **Identify critical vulnerabilities.** Every company should be upfront about where their organization is most vulnerable to the crisis now and in future. For those in travel and hospitality, this crisis is a direct hit to

revenue and consumer behavior. For manufacturers, there are major labor and supply chain disruptions with which to reckon. In healthcare and technology, the crisis presents opportunities that require huge investment and uncertain payoff, and possibly privacy concerns. Name your critical vulnerabilities and innovation opportunities and articulate your strategy to address them. Use SASB as a guide on which areas are critical in your sector.

2. **Articulate your company's role in the society at large, and relate it to how you earn revenue.** Often a crisis – and a global one like this one – is the crystallizing event a company needs to clearly see what role it can or should play in society. Perhaps you realize that you can solve a problem, or bring disparate groups together, or meet a very basic and burning need. And aside from your overall corporate purpose, what specifically can your business do to positively impact public health, mitigate the severity of the economic slowdown, reduce the deepening of inequality in society, or reassure stakeholders?
3. **Imagine worst case scenarios and prepare “just in case.”** Although you don't want to think too pessimistically, it is a board's role to manage risk and be prepared for worst-case scenarios. Take a long-term view of what could go wrong and how you can guard against it. If and when things go wrong, you will have a plan to handle, explain, and bounce back.
4. **Show visible leadership and good governance at Chairman and CEO level.** Stakeholders in your company need to feel confident that the company is being steered by strong leaders who are open, accessible, and compassionate. Moreover, they want to see governance mechanisms in place that ensure you have committed, diverse board members who take their fiduciary and social responsibilities seriously in crises. If the board and its committees are lacking in any critical expertise, now is the time to shore them up. Also expect executive remuneration policies to be under a bright spotlight when so many workers are furloughed or unemployed. Finally, don't squander this critical time to expose more executives to board-level decision making, just by inviting them to the room or the table.
5. **Keep good records, set goals and track your progress.** Do not forget to catalog all of the crisis-related issues you face, how you are responding, and what lessons you are learning from the coronavirus crisis. In the heat of a crisis situation, teams can forget that they are living through an extraordinary time in history that will shape their company for years to come. You will need to document your triumphs and difficulties and create transparent accounts of them in your ESG and financial calendar communications.
6. **Make your disclosures easy to find, correct inaccuracies in the public domain, and engage with the ratings agencies who are publishing opinions about you.** All listed companies can request ESG and governance ratings reports from MSCI, Sustainalytics, as well as voting recommendations from ISS and Glass Lewis during proxy season. If you spot out of date or inaccurate material that they may be quoting or relying upon, put in the effort to vet and rebut it. You want to be the best source of information about yourself.