ESG: Impact on Companies Doing Business in America and Why They Must Care
When the environmental, social and governance (ESG) movement first began to take shape across corporate America nearly three decades ago, it was primarily an add-on practice for a handful of large public companies looking to implement socially responsible initiatives. Used as a financial term, ESG defined how investors evaluated companies’ impact on broader society. While the original purpose remains true today, ESG has evolved from a supplementary practice into an ethos, guiding business strategy for large and small companies alike.

Businesses and corporations should consider adopting and investing in Environmental, Social and Governance (ESG) to ensure their sustainability and improve ethical impact over the long term.

A focus on ESG can help a company understand the positive impact and manage the risks its operations have on customers, investors, employees and communities. It is another way to assess the success of a company beyond the balance sheet and examine how it impacts the broader society at large. A company with a strong ESG program can gain credence among customers, especially millennials who seek to do business with responsible companies, and attract younger employees who are seeking jobs with companies that share their values.
Corporate governance

Measures a company’s systems and processes, which ensure that its board members and executives act in the best interests of its long-term shareholders. It reflects a company’s capacity to direct and control its rights and responsibilities through the creation of incentives, as well as checks and balances that generate long-term shareholder value.

Environmental

Measures a company’s impact on living and nonliving natural systems, including the air, land and water, as well as complete ecosystems. It reflects how well a company uses best management practices to avoid environmental risks and capitalize on environmental opportunities that generate long-term shareholder value.

Social

Measures a company’s capacity to generate trust and loyalty with its workforce, customers and society. It reflects the company’s reputation and the health of its license to operate, which are key factors in determining its ability to generate long-term shareholder value.
What’s driving ESG?

Consumers demand action

Consumers are driving the growth of ESG, as they increasingly look to align themselves with private and public companies they believe are transparent in their business practices and serve a greater social purpose. The millennial generation, in particular, is leading the charge in holding companies accountable for their actions. Millennials are known to consider a company’s record for socially responsible behavior before joining as employees, buying its products and investing in its stock.

With the unemployment rate the lowest it’s been in decades, talent attraction and retention have become top-line concerns for executives in nearly every industry. As competition for talent heightens, aggressive salary and benefits packages may not be enough to lure top performers to new companies. Companies with a robust ESG focus will be at an advantage, as many people, particularly younger generations, seek to work for companies with a strong social purpose.

Most consumers believe that companies should address ESG issues

- 94% Gen Z
- 87% Millennials
- 86% General population

Most consumers believe that companies should address ESG issues.
Millennials expect transparency in a company’s supply chain, ingredients and business practices, forcing companies to not only become more responsible themselves but also partner with other organizations that align with their socially responsible principles. Millennials are also seeking sustainable investments* that reflect their values, influencing 401K options and investment advisors.

Not far behind is the 13-to-25-year-old cohort known as Gen Z, which exhibits stronger ESG preferences than other groups. A recent study revealed that 94% of Gen Z respondents believe companies should address ESG issues, compared to 87% of millennials. In addition, when comparing products of similar price and quality, 92% of Gen Z consumers would switch to a brand that supports ESG issues versus one that does not.¹

**Stakeholders seek intangible assets**

Today a company’s valuation is not just based on tangible assets. Stakeholders have ongoing concerns for the future and are looking to companies to align business strategies with the greater good of the communities they serve. By addressing issues such as income equality, product safety, gender diversity, environmental sustainability and more, investors believe companies have a greater chance of long-term success.

Institutional investors have also shifted their focus in recent years to ESG investments. For example, retirement funds and endowments are increasingly moving to ESG funds as they seek intangible assets.

According to a recent U.S. Trust study,² half of high-net-worth investors consider social and environmental impact an important part of investment decision making, an increase from 45% in 2013. In fact, six in 10 of these investors feel their investments can have a strong influence on society, and two-thirds believe private capital from socially motivated investors is a way to help hold public companies accountable for their actions and results.

**Private companies must get involved**

While investor interest in ESG is forcing public companies to rethink their business strategies, these factors have permeated beyond Wall Street and into Main Street, and private companies now too must take ESG into consideration.

Private companies should consider ESG for the implications it may have on relationships with their public partners. Public companies are frequently taking into consideration the principles of their private partners across their supply chains and only investing in those that align with their ESG goals and values.

The impact private companies can have on ESG stretches far beyond environmental issues and can in fact affect the communities they serve. When guided by this framework, private companies can avoid sustainability risks and improve consumer trust and brand reputation.

ESG can also provide tremendous benefits for a company’s workforce by luring younger employees who are seeking jobs with responsible companies that share their values to positively contribute to society and the environment.

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*Impact investing and/or Environmental Social Governance (ESG) investing has certain risks based on the fact that ESG criteria excludes securities of certain issuers for nonfinancial reasons and therefore, investors may forgo some market opportunities and the universe of investments available will be smaller.
Material ESG issues vary substantially across industry sectors

Some ESG issues are considered to be universally important. Good governance, workplace and product safety, nondiscrimination and anticorruption, diversity, responsible waste management, and cybersecurity are among them. But some industries are in the bull's eye for others, probably because of past bad actors or because their impact is exponentially more significant than in other sectors. Even within an industry, specific sectors may have additional material issues.
Effective ESG programs strategically select areas of focus based on factors that are most material to their business and customers. Companies can build an effective ESG program by considering the following four factors:

- **Stakeholders**
- **Materiality**
- **Risk and Opportunity**
- **External Pressures**

**Start with the stakeholders**

It’s obvious that ESG concerns can stretch across an entire company, including its operational footprint and supply chain. So how do you choose from the long list? A formal materiality assessment is a good option. Feedback from your company’s stakeholders—including employees, customers, public officials, regulators, investors, executives and industry experts—is essential in understanding what ESG issues are most important to them. Then, this feedback is overlaid with business interests and a company’s stated values and mission. Once the ESG focuses are established, align company messaging to key stakeholders so they know the company is aware of its impact and is responsibly addressing its ESG priorities.
Classify risk and opportunity

It is important to create criteria different from traditional financial metrics. Nonfinancial materiality considers all external and internal elements that might affect intangible value. This extends to actions that might result in regulatory consequences, lost trust from stakeholders, the ability to attract and retain employees, how the market perceives the company’s competitive position and its status as a preferred vendor. Adopt metrics that work to monitor and measure the social and environmental impact of a company.

Demystify materiality

In some cases, influential industry and investor groups already have defined “material” topics. Groups: CDP (formerly the Carbon Disclosure Project) catalogs environmental performance; SASB represents the interests of investors and presents material topics for 79 industries in 11 sectors; Dow Jones Sustainability Index posts scores of companies on Bloomberg’s financial screens; and Global Reporting Initiative promotes ESG reporting. SASB has an engaging interactive materiality map that collectively looks at material topics by industry sector and subset. Industry trade groups, especially those that address specific social and environmental issues and operating standards, also can provide guidance about issues that warrant resources and attention.

Consider external pressures

Regulators and other entities have pushed for more transparency and action to address issues. For example, the Securities and Exchange Commission wants relevant companies to address their use of conflict minerals, climate change and greenhouse gas emissions and child labor oversight.

For smaller companies, B Corp certifies companies that have met its standards for environmental and social performance, accountability and transparency. The process helps companies define what issues are most material. It is also recommended that the materiality assessment process be publicly shared. This demonstrates that a company has engaged with stakeholders for their feedback, has considered how to prioritize issues and is prudent in how it allocates company resources to ESG.
A look ahead: emerging ESG facts and trends

As macro forces continue to push businesses to address stakeholder demands for transparency, socially conscious programs and responsible practices, what is on the horizon for ESG? Forward-looking companies can capitalize on the following emerging ESG trends to manage risk, grow value and create opportunities:

**Corporate transparency is now mainstream.**

Almost 85% of the companies in the S&P 500 Index® published sustainability or corporate responsibility reports in 2017, according to the Governance and Accountability Institute. Consumers also are paying attention to ESG disclosures, especially when they are delivered on labels and on company websites, to determine a company’s trustworthiness and integrity.

**Credible sustainability leaders are hot prospects for acquisition and capital investment.**

From small organic food companies purchased by large CPG corporations, to emerging all-natural cleaning products acquired by historic companies, mergers and acquisitions have been rampant among traditional companies looking to align themselves with sustainability-focused businesses.

**ESG, sustainability and corporate responsibility are ubiquitous business terms.**

Since ESG also overtly encompasses governance, investors are the drivers of more prominence for ESG specifically.

**Activists will continue to force companies to consider their transparency and ESG policies.**

They already have successfully used social media campaigns and shareholder resolutions to force companies to act. Many restaurant and beverage companies have recently pledged to eliminate the use of plastic straws in the coming years following environmental activism and reports highlighting the harm plastic straws do to the earth’s oceans, birds and sea mammals.

**Entrepreneurs will lead the way toward innovative ways to leverage ESG strategies.**

Entrepreneurs have the flexibility to build ESG commitments into their frameworks and missions of the company.
“For our company, we see ESG as good business—running a company that people feel is a good investment, creating sustainable growth in our business and finding innovative ways we can deploy our own capital to address global challenges. We understand our prosperity is linked inextricably to the communities we serve and the challenges they face. Therefore, the value we create must also be shared to be sustainable long-term.”  

Anne Finucane, vice chairman at Bank of America

Why we’ve adopted ESG

At Bank of America, we are guided by a common purpose to help make financial lives better through the power of every connection. We deliver on this through a focus on responsible growth and environmental, social and governance leadership. Through these efforts, the company is driving responsible, sustainable growth by addressing some of society’s biggest challenges—helping communities thrive through job creation and fostering economic mobility, investing in the success of employees and supporting the transition to a low-carbon, sustainable economy—while managing risk and providing a return to clients and its business.

As businesses of all sizes search for sustainable growth, ESG delivers a strategic framework. Public or private—by understanding the factors that are most material to the success of a business and its constituents, executives can build an ESG strategy that helps capitalize on opportunities while mitigating risk and improving the ethical impact a company can make in the long term.