The GRI Perspective

Taking the 'anti-woke' debate seriously: Why business risk and ESG accountability go hand-in-hand

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It was only a matter of time before ESG (Environmental, Social and Governance) became 'politicized'. Texas, along with several other US states, has made headlines for introducing laws that discourage ESG related investments.

Some of the voices against ESG developments come from seasoned entrepreneurs and politicians and should be taken seriously. While there can be political or ideological disagreements, if we listen to both sides and stick to the facts, then common ground can be found. GRI believes this can be achieved in ways that account for the interests of business, investors and other stakeholders. Why? **Because effectively managing business risks and ESG issues go hand-in-hand.**

Fiduciary duty

Some of the arguments of those opposing ESG being 'forced upon businesses' can be summarized as follows:

- It's unconstitutional;
- ESG politicizes business;
- Leads to lower returns on investments;
- That business is there for profits and shareholders, and nothing else.

What has triggered attention in the US is the claim by some lawmakers that asset managers neglect their fiduciary duty to shareholders when making ESG focused decisions. As Senator Bob Hall dramatically claimed, ESG poses an "existential threat" to the economy.

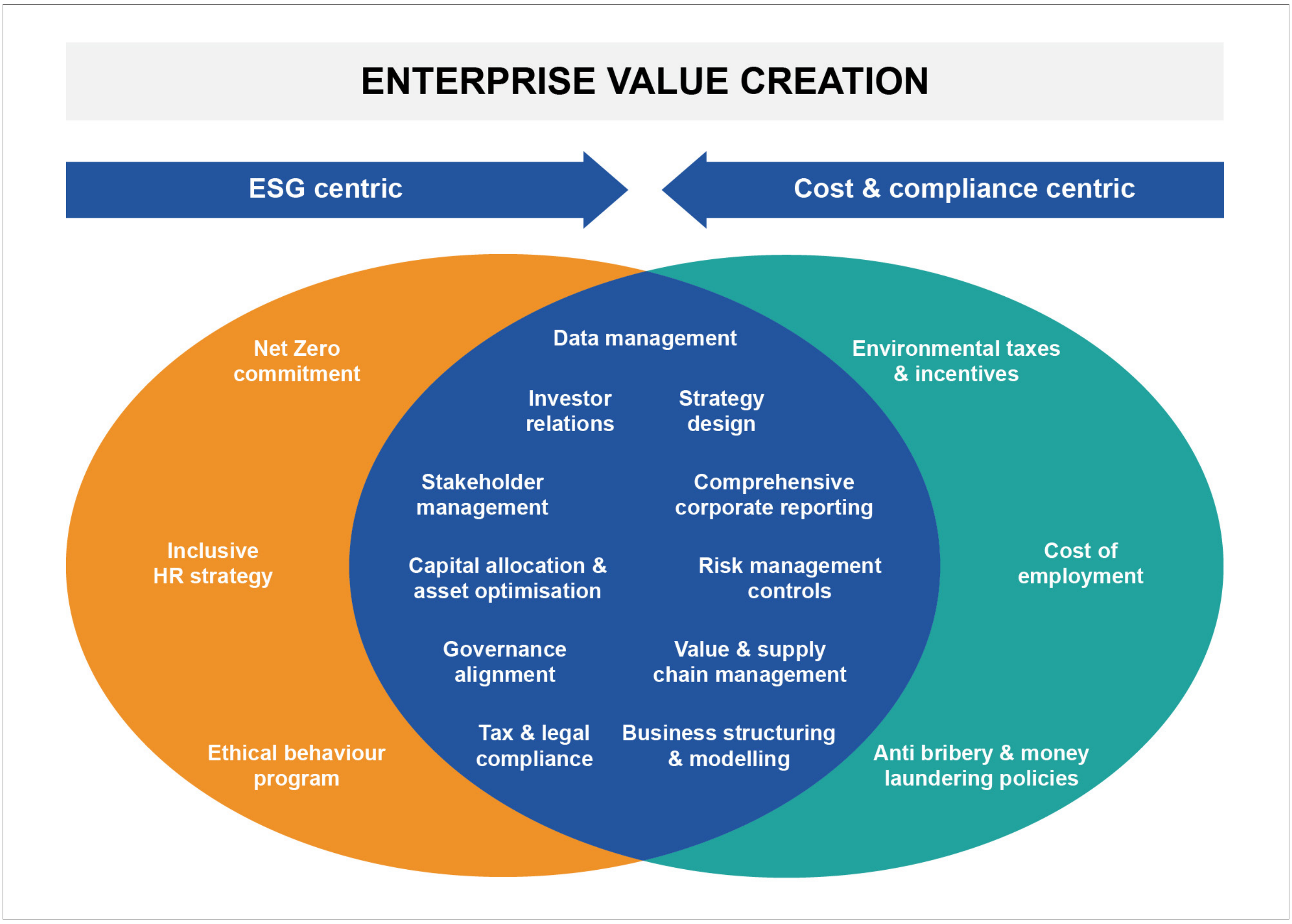
Everyone is, of course, entitled to their opinion, but what is surprising is that even the two largest asset managers in the US - Blackrock and State Street - did not have a compelling narrative on why investing in ESG savvy companies is, in fact, adhering to their fiduciary duty. Especially since the answer is this simple: **ESG is about proper risk management.**

Duty to who - and why

Before assessing whether a stronger focus on sustainability issues in investment decision-making diminishes fiduciary duty, we have to understand what that even means. A 'fiduciary duty' refers to the relationship between a company (e.g. asset manager) and the beneficiary on whose behalf they act. This usually means shareholders, but other stakeholders are also included because they could seriously influence business' ability to create value. Managing relationships with these groups is not easy, since it is, among other factors, about managing expectations.

1. **Shareholders** generally want a return on their investment while their money is capably managed.
2. **Other stakeholders** are a much more varied group and include customers, suppliers, communities, employees, civil society and governments. Depending on their interests, public information will be used to assess if their specific objectives are served by the business or not. This can but is not always only financially related.

Many interests result in multiple needs and the bottom line is that the fiduciary, in acting on behalf of shareholders and its other stakeholders, cannot make everybody happy, therefore we need to balance these needs.



ESG as an enabler for risk management

There is an increasing understanding that ESG related risks can have significant value enhancing and destructive effects. For example, climate conditions such as droughts, heatwaves, floods and fires have negative effects on business and society, as is the case for social unrest created by inequality or corruption. This interdependency can be summarized by the saying ***'you cannot run a successful business in a dysfunctional society'***. A solid understanding of ESG related risks helps investors to understand the opportunities, trade-offs, and costs involved.

The concept of risk management is an age-old process of identification, analysis and acceptance or mitigation of uncertainty. There is a multitude of risks, quantifiable and unquantifiable, systemic or individual, in absolute and relative terms. **Regardless of whether the risks stem from non-ESG or ESG related topics, they have to be managed**. Why? Because risks are inseparable from returns.

Let's look at three examples:

1. If an investor in retail does not take the effects of global warming into account in their energy procurement strategy, they may face exploding costs. This could be from heating or cooling needs, or the roll-out of new energy and environmental taxes.
2. An investor in platform organizations assumed the company had appropriate HR policies in place. Social unrest on the work floor is disruptive and costly. In times when it is difficult to find qualified staff, topics like fair pay, social inclusion, diversity, and the right to organize all impact the ability to attract and retain employees.
3. An investor in a mining company discovers their anti-bribery policy is insufficient. Monitoring and testing did not take place and an employee bribed a local official. Media attention, criminal investigations and the withdrawal of licenses to operate are likely to happen.

These three examples each cover the letters E, S and G. If management has not taken these issues into account in their risk management policies, it would be malpractice. Investors expect that the board will take seriously its fiduciary duty by mitigating these risks. Therefore, accounting for investor interest can be perfectly in synergy with managing broader expectations of stakeholders, as outlined in sustainability strategy. Why? **Because good stewardship is about taking care of the fiduciary duty towards investors, society and the environment.** That is a 'win-win' situation for all.

Rising above the rhetoric to achieve balance

As the standard setter for impact reporting, GRI believes that the debate around ESG should not be about 'woke' or 'not-woke'. Instead, we need a discussion on what is good business practice. And we need to listen to all sides.

Just as there are arguments to be made for the benefits of pro-ESG legislation, questions from the anti-ESG lobby should not automatically be written off. Hearing billionaire oilman Bud Brigham testifying during the public hearing in Texas, it seems much of the frustration does not stem from the fact that focusing on broader sustainability issues is bad per se, but the immediate blaming and framing of what's bad (oil and gas business) and what is good (green energy business).

When doing business, proportionality in decision making is key. Just as you cannot invest only in 'doing good' without taking your bottom-line position into account, you also cannot focus on profits alone without considering the socio-environmental impacts. Poor governance and a short-term profit focus will, over time, have serious negative effects on your ability to continue to create value for investors. That is why comprehensive, reliable and transparent reporting on sustainability impacts adds value for investors and society, and thus business. It is up to the company to decide if they want to use GRI's standards or not. **Often it is not ESG that politicizes business, but politicians who politicize ESG.**

How we can help

The GRI Standards are the world's most widely used sustainability reporting standards – adopted by more than 11,000 companies worldwide, including 78% of the of the largest 250 companies and 68% of 5,800 leading companies, according to recent research from KPMG. GRI enables companies to report on their impacts on the economy, environment and people, to enable business, stakeholders including investors to make informed decisions, based on facts not perceptions.

The GRI Academy offers professional and certified training on how to apply the GRI Standards, while a range of support services are available. You can also keep up to date with GRI events that cover policy engagement, standards developments and more.

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To find out more about GRI and opportunities to engage with us, please reach out to: info@globalreporting.org

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