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Why ESG Matters (Fifth of a Series)

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Now we come to the G in ESG. Governance's link to environmental and social goals was cemented by the sub-prime debacle and resulting GFC. Corporate malfeasance and lack of transparency propelled the need to identify future responsible ESG parties and enforcement.

The challenge, as one expert told us, is while governing considerations are most in focus and more universal for investment teams, they don't always grab the attention or headlines global warming or diversity do. But without accountability and benchmarks for material risks and opportunities, there would no way to track success or hold companies responsible.

Here's how a partner in a venture fund dedicated to ESG investments put it: "Governance is the foundational element of the ESG triumvirate, though seemingly the least sexy of the three. Good corporate governance generally comes down to the need to be accountable and transparent, both at a board and executive level."

The good news is disciplines found under the governance umbrella – for example, accounting, enterprise risk management, or legal and compliance – are hardly controversial. Corporate accountability is also driven through standard mechanisms such as board independence, shareholder rights, board oversight of management, and executive compensation.

Today's complexity of corporate matters such as cyber security and reputational risks via social media are challenging the most competent of boards and management teams. Establishing best practice in governance is often a starting point to meaningfully managing any E or S issue.

As E&S issues are increasingly attached to corporate vision and mission statements, boards and managers are being held responsible for them. Governance, as the "foundational element," sets the tone at the top for board diversity. It also drives key performance indicators (KPI) tying them to executive comp and outlining more explicit board oversight for climate risk and sustainability.

As ESG demands from investors and stakeholders grow (see our *Chart of the Week*), a burgeoning industry has developed to help companies with governance practices. Accountants, law firms and consultants all pump out thought leadership pieces across a plethora of esoteric topics (*IIRC, anyone?*). But, as one study reported, not necessarily with agreement on "a common baseline for disclosure standards consistent across jurisdictions and industries."

Along with corporate advice comes investor-centric tools. Rating agencies offer grading systems on how well companies perform against benchmarks. But it is also certain that lack of agreed-upon standards and making ESG numbers look better than they are ("greenwashing") will be continuing headwinds to identify which ESG issues should in fact be governed and assessing what good governance looks like.

Next week: We take a deeper dive into ESG disclosure and regulation.