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# Addressing Gender within Environmental, Social and Corporate Governance

## Report by Thrive's Research Hub

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# What is ESG?

Environmental, Social, and Governance (ESG) are considered the three factors central to measuring the social responsibility of a business, investment, or other corporate entity or transaction. It is becoming an increasingly important element to consider alongside financial factors. ESG may take the form of targets within an organisation, conditions within a contract, or metrics by which to rate investments.

Environmental ESG conditions look at sustainability issues such as company emissions, the way they treat animals, or water usage on a project. Social factors focus on human relationships, such as workers' rights, diversity and inclusion within a company, and looking at intersecting issues of gender, race, or LGBTQ+ rights. Lastly, governance considerations cover rules about transparency and the internal decision-making of an organisation, such as share classes and compliance procedures. As a collective, ESG is used as an umbrella term for any non-economic considerations that may be relevant to a business transaction.

The number of ESG investment products has increased substantially in recent years. Between 2017 and 2019, the percentage of both retail and institutional investors that apply ESG principles to at least a quarter of their portfolios increased from 48% to 75%[1]. In 2020, issuance of sustainable finance bonds doubled and volumes reached a record of $554.3 billion.[2] Deloitte predicts that ESG-managed assets could make up half of all managed assets in the United States by 2025.

One explanation for the growing use of ESG is simply that employees, consumers, and investors alike are becoming more conscious of their personal impact on environmental and social issues. As awareness of the climate crisis increases and mass social movements like Black Lives Matter gain traction, so do youth-led calls for employers and consumer-targeted companies to live up to their principles. In turn, adopting ESG targets boosts company reputation, which may raise the stock price and ensure investors' financial returns.

As well as managing company reputation, there is increasing evidence that shows that the growth of ESG can be an effective tool to avoid, or minimise the risk of, major regulatory issues; the Volkswagen emissions scandal or BP oil spill are two examples of business misconduct that could have been avoided by ensuring transparency and good practice in areas of ESG.

[1] https://www2.deloitte.com/us/en/insights/industry/financial-services/esg-investing-performance.html
[2] https://www.refinitiv.com/perspectives/market-insights/sustainable-finance-surges-in-2020/

# How does ESG affect the financing of a business?

The growing focus on ESG in recent years can be attributed to pressure from a range of stakeholders including customers and employees, investors, public institutions and regulatory bodies. Of these, investors represent a key stakeholder in ensuring the financing of a business. In order to fund business activities or make purchases and investments, businesses will often need to raise the money to do so from external investors. Asset managers or private banks often provide such investments, but only after carrying out an assessment of a business and its ability to pay back any money borrowed. Traditionally, these assessments were focused on revenue, profit and the companies' financial records; however, sustainability and other ESG factors are increasingly being incorporated into investors' assessments of a business and can directly impact the conditions of an offer. There is a growing body of evidence that highlights a correlation between companies with strong ESG policies and business success in the long term, suggesting such businesses are better able to cope with economic downturns.[3] Further research highlights the importance of ESG for client retention and influencing investors' decision-making, all of which ultimately impact a business's ability to finance its ventures.

In addition, new regulations are likely to play a key role in promoting ESG in companies in 2021. The EU Sustainable Finance Disclosure Regulation makes it mandatory for asset managers, private banks and other financial market participants to disclose the sustainability of their investments going forward. This brings ESG further to the forefront and, although current focus tends to be on environmental factors, other ESG factors are also being considered. Whilst there is some regulatory divergence from the EU by the UK, if the UK is to continue to access global markets and avoid potential reputational damage it will still have to adhere to the EU's regulations in this field.

Furthermore, in the US there is a growing number of companies exploring a new type of financial arrangement that connects better interest rates to company performance as it pertains to ESG criteria.[4] Though this is a new and still infrequent practice, its development demonstrates a shift in the focus of large investors who are considering a range of factors beyond solely profit. This is better understood as a shift towards 'sustainable finance', which

[3] https://www.bdbpitmans.com/insights/esg-what-is-it-and-how-will-it-affect-my-business/
[4] https://www.greenbiz.com/article/how-esg-scores-can-affect-cost-credit

will have a significant impact on how business is conducted and what considerations need to be made in financing decisions.

# How does ESG affect the regulation of a business?

Regulation exists to promote the public interest for people, economic growth, and the environment. It affects numerous sectors, including education, utility provision, and the financial system. Where regulatory bodies are statutorily established, the government can achieve its policy objectives in these areas. On the contrary, self-regulating markets poses the risk of companies acting in a manner contrary to the public interest.

New trends and increasing awareness of ESG translates to pressures on both investors and companies, and mirrors increasing regulation of company behaviour in relation to these trends. For example, ethical consumerism reached £98bn in 2019.[5] In addition to increased attention from investors, regulators are likewise introducing initiatives aimed at promoting sustainable development for businesses in line with ESG.

Examples of Regulatory Responses

The Financial Conduct Authority's (FCA) main aims involve "enhanc[ing] the integrity of the UK financial system" and "promot[ing] competition in the interests of consumers".[6] It recently introduced investment profiles to include ESG within how they judge investors,[7] and further introduced reporting requirements aligned with the Task Force on Climate-related Financial Disclosures.[8]

Gender Pay Gap reporting is an example of government-led regulation to promote gender equality in the workplace. Regulators' responses can be seen developing in the same area. The FCA is working towards formalising its regulatory approach to diversity and inclusion alongside the Prudential Regulation Authority.[9] This ties in with its Public Sector Equality Duty as a public body.[10] The Competition and Markets Authority (CMA) appears to be taking

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[5] https://research.ethicalconsumer.org/research-hub/ethical-consumer-markets-report
[6] https://www.nao.org.uk/wp-content/uploads/2017/09/A-Short-Guide-to-Regulation.pdf
[7] https://www.fca.org.uk/firms/climate-change-sustainable-finance
[8] https://www.fca.org.uk/firms/climate-change-sustainable-finance
[9] https://www.fca.org.uk/news/speeches/why-diversity-and-inclusion-are-regulatory-issues

[10] https://www.fca.org.uk/news/speeches/why-diversity-and-inclusion-are-regulatory-issues

similar steps in this direction, beginning with its own Equality, Diversity and Inclusion Strategy 2020-2024.[11]

The CMA has also taken steps to address environmental sustainability within its regulatory framework. It recognised that some businesses are deterred from pursuing sustainability agreements because the competition law framework can be difficult to navigate. Thus, it issued information to help businesses understand where the dangers of competition law lie in relation to sustainability agreements. This is demonstrative of how regulators may be inclined to address ESG trends within their frameworks.

How does regulation impact businesses?

It is suggested that new ESG requirements and investor demands will affect companies' ability to raise capital.[12] With increased reporting and disclosure requirements comes greater scrutiny of a company's strategy and activities. Raising capital through any means will become challenging as a result. Furthermore, as with any regulatory change, there is an added business cost associated with increasing investments in time, money, and resources to assess ESG risks and prepare for changing obligations.

Possible future responses to trends

The G7 Summit 2021 will see discussion on the climate emergency, health, Covid-19 recovery, free and fair trade, girls' education, and sustainable development financing.[13] The outcome of these discussions may influence future trends or set in motion legislation around the world that could further influence ESG and regulatory responses.

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11 https://www.gov.uk/government/publications/cma-diversity-and-inclusion-strategy-2020-to-2024/equality-diversity-and-inclusion-strategy-2020-to-2024

12 https://assets.kpmg/content/dam/kpmg/xx/pdf/2019/09/impact-of-esg-disclosures.pdf

13 https://www.g7uk.org/policy-priorities/

# What happens if a business fails to meet its ESG obligations?

Enforcement of ESG obligations depends on the obligation itself and its source. They can be more or less stringent; from legal obligations, such as the UK's legal requirements on annual gender pay gap reporting, to internal corporate targets, such as soft targets to have a target percentage of women board members. The consequences of not meeting obligations can therefore vary widely. More serious consequences might involve regulatory enforcement, for example the U.S. SEC (Securities and Exchange Commission) recently set up a Climate and ESG enforcement task force to deal with ESG-related misconduct. A less serious, but nevertheless harmful, consequence is reputational damage. These consequences can be divided into three categories: financial, legal and reputational.

<u>Financial</u>

As mentioned in section 2, failure to meet ESG obligations could negatively impact investments and a company's ability to finance new projects and therefore ESG obligations may be enforced through contracts. For example, in a project finance contract, sustainability conditions may be enforced through incentives or sanctions. If a company keeps emissions under a threshold, they might access a lower interest rate for the loan. On the other hand, if the company increases emissions they may be penalised with a fine or a higher interest rate. In some cases, breaching ESG obligations may amount to breach of contract, making the agreement invalid.

<u>Legal & Reputational</u>

As ESG issues become increasingly pervasive in company strategies and the global financial system, current trends suggest there will be a sustained rise in litigation related to such matters.[14] ESG-related litigation is time-consuming, costly and can also be hugely damaging to a company's reputation and goodwill, regardless of the outcome.

In the UK, there are specific obligations placed on larger companies, such as annual reporting requirements. Not publishing such information where required is unlawful and employers that fail to report on time, or report inaccurate data, risk enforcement actions by The Equality and Human Rights Commission that could lead to court orders and fines.

Reputational risks are also a powerful incentive for publishing such figures as awareness of social issues and access to information increase (including knowledge of non-reporting

[14] https://www.lw.com/thoughtLeadership/ESG-litigation-roadmap

companies). Therefore, it becomes essential for companies to fulfil their obligations and to be ahead of the curve. Failure to do so can have a negative impact on the business no matter how strong the business model or how established the company.

Overall, the consequences for a business that fails to meet ESG obligations vary, matching the variety of ways in which ESG principles may be included in business and finance.

# How does gender fit within ESG?

Gender equality in the workplace is not a new phenomenon and sits within broader discussions related to ESG in business. ESG goes beyond charitable acts and the provision of pro bono services; it seeks to change the corporate mindset by creating an environment in which employees are valued and supported equally, and social and environmental issues are effectively monitored in company practice. In this respect, gender sits at the heart of ESG considerations and includes representation and transparency, intersectionality, pay gap reporting, and gender-based violence and harassment in and out of the workplace.

Public companies are under great pressure to be more transparent regarding pay and diversity within the workplace.[15] Diversity across senior managerial positions and within boards of directors are scrutinised by investors and the public who are increasingly able to access information on companies. Equal gender representation, particularly of BAME women, on corporate boards and in leadership roles has a positive impact on businesses and future generations and acts as a key motivator for companies to address gender as part of their ESG strategy. There is a demonstratable link between representation of women at the highest levels of business and the profitability and stock prices of a company.[16]

A specific area of ESG that has received considerable attention is the gender pay gap. In the UK, the government has taken steps towards progressing gender equality in the workplace with the Equality Act 2010 (Gender Pay Gap Information) Regulations 2017 which seeks to highlight and address discrepancies in pay between male and female colleagues. Pay gap reporting, however, does not necessarily distinguish between the experiences of BAME women as shown by ethnicity pay gap reporting. The ethnicity pay gap is largest in London

[15] https://www.spglobal.com/en/research-insights/articles/how-gender-fits-into-esg
[16] https://www.spglobal.com/en/research-insights/articles/how-gender-fits-into-esg

at 23.8 percent and smallest in Wales at 1.4 percent[17]. Companies can improve their gender pay gap reporting by taking into consideration intersectional dimensions such as ethnicity too.

While addressing the gender pay gap is an important step, gender within ESG is much broader than this. All social aspects much be considered from a gendered perspective and addressed as such within the ESG framework and beyond. One such example is addressing issues of gender-based violence and harassment that employees face both within and outside of the workplace. A report by TUC found that 52 percent of women had experienced unwanted sexual behaviours at work, a number which rose to 63 percent for women aged 16-24[18]. Similarly, companies can work to better protect employees from gender-based violence outside of the workplace as part of their ESG strategy. Domestic abuse equates to a £14 billion loss of economic output annually in the UK[19] but, despite this, continues to be largely unaddressed by companies.

17 https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/articles/ethnicitypaygapsingreatbritain/2019

18 https://www.tuc.org.uk/sites/default/files/SexualHarassmentreport2016.pdf

19 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/918897/horr107.pdf

# What tangible steps can a business take to address gender within their ESG agenda?

Areas that likely experience the most gender-based discrimination are those which either rely on largely numbers of women or those which are traditionally male-dominated.[20] However, aside from ethical reasons to do so, all businesses can benefit from taking steps within their ESG agenda to address gender. Research shows that greater diversity amongst employees results in greater profitability and value creation.[21]

What do ESG investors look at?

To understand what businesses can do, we must use what ESG investors prioritise as guidelines for effective ESG management. People are one of the four key pillars that dictate the ESG metrics looked at by sustainable investors.[22] This includes various issues ranging from diversity reporting and wage gaps to the health and safety of employees and labour rights.

To address gender, a social investor may look at equal opportunities at work, the pay gap, the education and training provided for a workforce, risks of forced labour, and the facilitation of access to medical and healthcare services for employees, amongst others.[23]

What are the tangible steps a business can take?

The most effective diversity and inclusion strategies take an intersectional approach and integrate initiatives throughout the entire employee experience, from recruitment through to retirement.[24] The steps suggested here are not an exhaustive list of actions.

A company should first look at its current performance through reviewing disaggregated data,[25] and assess where its strengths and weaknesses lie. Once this is done, it can make active changes to address these weaknesses.

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[20] https://toolkit.cdcgroup.com/esg-topics/gender/

[21] https://www.mckinsey.com/business-functions/organization/our-insights/delivering-through-diversity
[22] https://www.alva-group.com/blog/the-esg-metrics-that-matter-most-to-investors/
[23] WEF_IBC_Measuring_Stakeholder_Capitalism_Report_2020.pdf (weforum.org)

[24] https://blogs.idc.com/2020/07/08/the-relationship-between-sustainability-esg-the-employee-experience-and-diversity-and-inclusion/
[25] https://www.weforum.org/agenda/2020/07/diversity-inclusion-equality-intersectionality/

The potential steps a business can take can be divided into four main areas: education, employment lifecycle, initiatives, and culture.

Education

Businesses can take steps to provide education throughout employment to ensure equal access to opportunities at more senior levels[26] and tackle inequalities that may act as a barrier to securing a role in the first place.[27] Businesses can create a cohesive education strategy that includes development plans for each employee.

Employment Lifecycle

Businesses can ensure that policies on recruitment and employment are thorough. They should include non-discrimination policies and a merit-based approach to recruitment and retention.[28] There should be guidance on how to write job advertisements free from implicit gender bias and using diverse job boards to reach a wide audience.[29]

The terms of employment included in contracts should be fair. This involves including clauses on regular fair-pay reviews, parental leave, and access to facilities and services appropriate to gender needs amongst others.[30]

Initiatives

Often, initiatives to ensure diversity and inclusion 'stay at the grassroots level'.[31] Businesses should ensure they commit to implementing these initiatives. For example, they can create dedicated diversity and inclusion committees and steering groups to guide the company's aims and ensure objectives are met.

If feasible, another valuable initiative could be sponsorship and mentorship programmes for both those within and outside of the organisation.[32]

Culture

An inclusive culture is essential to address gender within a company's ESG agenda. Diversity numbers may suggest inclusivity, but truly promoting inclusion requires implementing continuous listening and engagement surveys and designing ways to measure

[26] https://www.quantumworkplace.com/future-of-work/diversity-and-inclusion-best-practices
[27] WEF_IBC_Measuring_Stakeholder_Capitalism_Report_2020.pdf (weforum.org)
[28] https://toolkit.cdcgroup.com/esg-topics/gender/
[29] https://toolkit.cdcgroup.com/esg-topics/gender/
[30] https://toolkit.cdcgroup.com/esg-topics/gender/
[31] https://www.quantumworkplace.com/future-of-work/diversity-and-inclusion-best-practices
[32] https://www.quantumworkplace.com/future-of-work/diversity-and-inclusion-best-practices

the impact.[23] Further, a business needs to ensure that there are accountability mechanisms and grievance processes in place in case something does go wrong.[33]

**Afterword**

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[33] https://toolkit.cdcgroup.com/esg-topics/gender/