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# A board's guide to oversight of ESG

The past few years have seen increased focus from investors on environmental, social, and governance ("ESG") principals, especially as a driver for value creation amongst private companies. An ESG programme is often wide-ranging and priorities may differ from industry to company, but the obvious content of ESG programmes covers:

- climate change and environmental impact;
- fostering diversity and inclusion initiatives; and
- managing human capital.

Given the heightened focus from investors (and regulators), ESG is now a critical boardroom topic – boards need to show that their commitment to ESG starts at the highest level of the company. Management teams need to ensure that their companies' ESG programmes are well-defined, appropriate for the company and take account of any relevant material risks.

A 2021 PwC survey reported that 72% of private equity investors always screen target companies for ESG risks and opportunities at the pre-acquisition stage, and 56% have refused to enter general partner agreements or turned down investments on ESG grounds.* It is therefore widely accepted that good ESG performance can give private companies a competitive advantage and a robust programme is a strong indicator of future success.

## ESG is now an inextricable part of how companies do business

ESG issues are now embedded throughout companies' operations, as they cover such diverse areas including energy management, company ethics and employee wellbeing. They are therefore inextricably linked to company strategy and the creation of sustainable long-term value.

As a board has a responsibility to act in the best interests of its company, it may wish to oversee the following ESG matters:

- **Clear and consistent strategy** – a board should shape the company's ESG narrative by aligning the company's purpose and long-term strategy with consideration and measurement of ESG objectives. Additionally, articulating an ESG-focused strategy can help a company to connect with its stakeholders, who are becoming ever more concerned about ESG issues. For B2B businesses, their customers may also face policy pressure on ESG and so will be keen to deal with like-minded organisations.

- **Management of risks** – a board should understand ESG risks throughout the organisation, and should seek to implement a feedback mechanism for identifying, assessing and mitigating those risks. For companies with enterprise risk management ("ERM") solutions, a board should review whether these solutions adequately address evolving ESG risks. A board should particularly oversee ESG risks and opportunities in the context of capital allocation decisions.

- **Measurement of performance** – a board should ensure there is a transparent mechanism for internally tracking ESG goals. Furthermore, a board should seek reporting on the company's external performance through benchmarking against peers and competitors. For larger companies, a board may wish to appoint a standalone ESG committee or taskforce that is accountable for ESG performance, with members having appropriate capacity, interests and skills.

- **Incentive structure** – a board can explicitly connect its ESG programme to company performance by adopting ESG metrics in its incentive plans, which signals the importance of ESG issues at the company to potential investors and employees.

## The ESG Challenge: Measurement of Success

While ESG programmes are of increasing strategic importance for private companies, a board's measurement of its company's ESG programme can be challenging given there is no universally standardised ESG metric.

Regulation in the UK public markets requires listed companies to make standardised disclosures in line with the recommendations from the Task Force on Climate-related Financial Disclosures; however, most private companies set their own goals or use the UN's Sustainable Development Goals as a benchmark for their progress.

A board should therefore be mindful of balancing achievable goals and strategy, with meeting established ESG expectations, in order to remain attractive to employees and investors. As certain standards and frameworks converge, a board should also periodically review the adequacy of its company's ESG programme.

## Conclusion

A strong ESG programme and sufficient board oversight is critical for sustainable value creation. As performance on ESG issues has become a key benchmark used by potential acquirers to assess a target company's success, boards should keep ESG at the heart of their decision-making and their companies' risk management strategies.

* https://www.pwc.com/gx/en/services/sustainability/publications/private-equity-and-the-responsible-investment-survey.html

**Contact us**

RDarwin@sidley.com