ESG+C: A MANDATORY RESPONSIBILITY

Finding Value in Non-Financial Reporting

The EU's Non-Financial Reporting Directive requires around 6,000 large European companies to report annually on their sustainability performance.

With the new Non-Financial Reporting (NFR) Directive, the European Union is setting a precedent for the introduction of legislation as the means to accelerate the shift from the 'old' notion of CSR towards a more holistic, forward-looking and strategic approach for businesses to account for the impact they are making in their communities. In the future, environmental sustainability, social impact, governance and citizenship (ESG+C) performance are set to become a core component of companies' disclosure and reporting obligations.

*While over 75% of **companies** believe investors are more likely to invest in an organisation that reports the requirements effectively, only 7% of the **institutional investors** think that companies impacted by the EU non-financial reporting requirements are fully prepared for it.*

As of 2017, large public-interest entities (both listed and unlisted companies, banks, insurance undertakings and other companies that are so designated by the Member States) with more than 500 employees are required to disclose in their management report information on their policies relating to:

- Environmental matters;
- Social and employee aspects;
- Respect for human rights;
- Anticorruption and bribery issues, and;
- Diversity in their Board of Directors.

The legislation not only aims to encourage companies to embed ESG+C at the heart of their business strategies, but also provides a meaningful and comprehensive benchmark for investors and consumers to measure companies' ESG+C performance.

However, new research from FTI Consulting shows that investors believe companies are not fully prepared to address the new requirements, despite the implementation initiatives that are already underway. More critically, our research shows a fundamental disconnect between how both companies and investors understand and may value this when making investment decisions.

The research, which surveyed both companies and investors, highlights over 75% of companies believe investors are more likely to invest in an organisation that reports the requirements effectively, yet only 7% of the institutional investors think that companies impacted by the EU non-financial reporting requirements are fully prepared for it.

In 2017, policymakers, institutional investors and the public are expecting companies to play a more active role in public debates, including those around sustainability. So as well as complying with the proposed legislation, companies need to ask themselves a key question: "How can we effectively and thoughtfully communicate our sustainability efforts, and make it a key aspect of the value proposition?"

Key findings

Conclusion

The European Commission strongly believes it should actively promote the adoption of sustainable investment policies by both companies and institutional investors. To complement the NFR Directive, the Commission is developing guidelines to help companies determine how best to disclose their ESG+C efforts to their investors and consumers. A high-level expert group focussing on sustainable finance has been assembled to develop a comprehensive EU strategy to integrate sustainability considerations into the EU's rules for the financial sector.

The EU is not alone in its efforts. In Asia, the national stock exchanges of Singapore and Malaysia have also already introduced a similar light-touch framework for listed companies. The political momentum is there, and we can expect more action from policy makers and regulators around the globe in the coming years which will have an impact on investors and companies alike.

Whilst companies may already be performing well on some of these aspects, FTI research shows that investors currently are still insufficiently aware of these efforts. This is a missed opportunity, both in terms of creating value for shareholders and also providing transparency to stakeholders.

So how can businesses step up their game and ensure they are increasing confidence among investors?

1) Establish a business-focused ESG+C programme that fully leverages the link between financial and social performance

Financial performance remains the number one consideration for institutional investors upon investment decision making. But with growing regulatory and public pressure creeping in, the unavoidable link between businesses' financial and social performance becomes increasingly closer. Indeed, while the traditional concept of CSR falls quite low in the list of aspects institutional investors consider when making investment decisions (CSR ranks # 10 in a list of 14 considerations), investors pay more attention to issues such as corporate governance (at # 6) and stakeholder sentiment (at # 9 with a significant difference over #10). Aligning the company's ESG+C activity with business strategies and operational plans to ensure the new platform therefore becomes increasingly central to the overall success of the business, not just its reputation.

2) Develop effective communications that compellingly embed ESG+C as a core component of the investment proposition

While 93% of the companies feel they are prepared for the new legislation and 75% acknowledge that investors are more likely to invest in companies that adhere to the new rules, only 7% of the institutional investors surveyed believe that companies are fully prepared for the new rules. The remainder are either not perceiving or trusting this to be the case, reflecting that companies are overall failing to effectively communicate their commitments. If leveraged well, the new reporting obligations can indeed become crucial tool for companies to demonstrate their ESG+C commitments and performance.

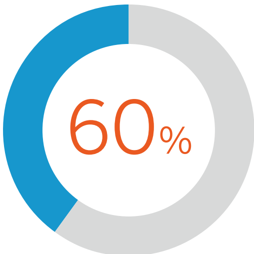
3) Implement a public affairs strategy that effectively manages the changing legislative landscape

Although the first reports under the EU's Non-Financial Reporting Directive are expected to cover activities conducted in 2017, less than 50% of the companies surveyed feel they are fully prepared for the new reporting obligations. Legislative and regulatory pressure is only likely to intensify around the globe, increasing companies' compliance obligations and potentially jeopardising their license to operate. Businesses' ability to manage and influence these legislative changes is essential for effective corporate governance and business planning, and ultimately increasing confidence among investors (who currently do not believe companies are adequately prepared for this new legislation).

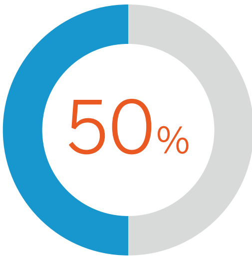
> Although a positive trend can be observed, the majority of large EU companies fail to adequately meet the growing demand from stakeholders (including investors, shareholders, employees and civil society organisations) for non-financial transparency.
>
> **The European Commission**

> The best businesses strategically manage all aspects of the business and ensure that their investors, as well as other constituents of the company, have enough information to understand the drivers of, and risks to, sustainable financial performance. They recognise that they are accountable to shareholders for the prudent use of the capital entrusted to them
>
> **BlackRock, the world's largest asset manager**

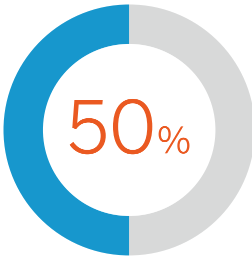
INVESTORS' VIEW



60% of investors recognise the 'value-add' of non-financial reporting



Half of investors are more likely to invest in an organisation if it adheres to non-financial reporting



Investors believe that 1 in 2 companies impacted by the new legislation are not prepared for it

COMPANIES' VIEW

9/10
believe they are performing well in both CSR and corporate governance

3 in 4
companies believe that investors are more likely to invest if it adheres to EU non-financial reporting

93%
of companies believe they are prepared for non-financial reporting legislation

METHODOLOGY

This research was conducted online by FTI Consulting's Strategy Consulting & Research team in London with the following audiences:

- n=1,602 respondents fully or partly involved in strategic decision making in publicly listed organisations, with 500+ employees in the EU. Respondents were based in the UK (n=550), Germany (n=549) & France (n=503). This research was conducted between 31st August – 28th September 2016.
- n=154 Global Institutional Investors with a sum total of US$10 trillion assets under management. This research was conducted between 26th September – 4th October 2016.

Please note that the standard convention for rounding has been applied and consequently some totals do not add up to 100%.

For further information on the research methodology, please contact: dan.healy@fticonsulting.com

Julia Harrison (Brussels)
Senior Managing Director

+32 (0)2 289 0877
julia.harrison@fticonsulting.com

Robrecht Vandormael (Brussels)
Senior Director

+32 (0)2 289 0977
robrecht.vandormael@fticonsulting.com

Dan Healy (London)
Managing Director

+44 (0)20 3727 1239
dan.healy@fticonsulting.com