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The S in ESG

The role of HR

2021

The S in ESG – The role of HR

Environmental, Social and Governance (ESG) issues have risen in prominence in recent years. Climate change and environmental factors have been at the forefront of these developments. Now organisations are starting to pay more attention to the other aspects.

The S is about how organisations treat their workforce and their behaviour in business relationships, their supply chain and their interaction with their local community. This involves exceeding minimum legal compliance by adopting ethical business standards. This is not just the 'right thing to do'; research has shown that companies that adopt ESG standards financially outperform their competitors in the long term.

Conversely a failure to behave in an ethical manner can lead to costly reputational damage. Throughout the pandemic the media have been quick to highlight companies that have fallen short in the way they treat their workforce. Employers are being viewed differently because of the pandemic. Some have suggested a new "social contract" is emerging. However ESG is more than a response to the pandemic. Adopting ESG standards into an organisation is not simply about avoiding risks and negative publicity, but also about building opportunities for long term sustainable growth and inclusion.

One challenge for organisations is identifying what areas to measure with the Social aspect. Here are five options where HR can start the Social measurement process.

1. Diversity & Inclusion
2. Workforce Engagement
3. Modern Slavery
4. Executive Remuneration
5. Community & Social Value

1. Diversity and Inclusion

What is it?

Organisations need to ensure that they have policies to support a diverse and inclusive organisation, and that their culture matches the words laid out in these policies.

Why does it matter?

A failure to have a diverse organisation brings serious legal and financial risks, including the risk of discrimination claims, and the reputational risks that can accompany the publicity associated with this. In addition, organisations that fail to attract and retain a wide range of candidates are missing out on the best available talent.

It is generally accepted that diverse workplaces perform better. Group think is challenged when diversity of gender, race and other characteristics are brought together. Also for those operating in regulated environments, many regulators are now taking an active interest in this area. It is also going up the agenda of investors.

How can we measure this?

This is definitely an evolving area and there is no agreed package of metrics here. How an organisation measures success in relation to D&I will vary depending on how developed an organisation's diversity and inclusion strategy is, or if they have one at all. Collection of diversity data is essential for benchmarking, although it can be a challenge to persuade employees to disclose this. A measure could include for example gender pay gap reporting, and the number of women on their board. For example, FTSE 350 Boards should have achieved the 33% female board member target by now. There are also targets set by the Parker Review relating to ethnicity at board level, whereby there should be one ethnic minority board member by 2021. Other measurements include whether an organisation has employee networks in place, any awards that an organisation has gained such as a placing on Stonewall's Workplace Equality Index, or signing up to commitments like the Race at Work Charter, the 30% Club and the progress that has been made against any of these action plans.

We are also seeing companies move towards voluntarily reporting on their ethnicity pay gap and there is an expectation that pay gap reporting will move into other protected characteristics including disability. Social mobility is becoming more important as organisations take active steps in this area, with many collecting data in their diversity monitoring forms about employee background and schooling and setting targets for recruitment.

CMS can help you to develop a strategic equality and diversity plan. This is a wide area and in our experience organisations need to focus on where the gaps lie. We will work with you to understand your organisation, identify those gaps and determine discrete areas to target rather than trying to do everything at once. Up to date equality, diversity and inclusion policies are essential, in addition to regular equality training.

2. Workforce Engagement

What is it?

This includes how people are treated at work, their health and safety and how much an organisation engages with their employees about decisions that affect them.

Why does it matter?

This is about valuing people and understanding that people are central to the success of your organisation. Treating people well results in retaining talent, productivity, creativity, good mental health, as well as facilitating good decision making and enabling people to speak out when they see wrongdoing. For example, poor working cultures can be breeding grounds for poor working practices leading to whistleblowing complaints, absences and stress.

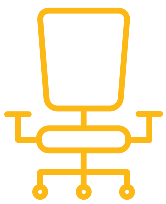
Creating good working conditions includes making sure people are paid in excess of the minimum wage, they are given additional benefits such as enhanced sick pay and supported with their mental and physical health. We have seen more and more employers invest in mental wellbeing programs to proactively support staff in the workplace, and devise leave policies that take into account caring responsibilities and a personal life beyond the workplace. But workforce engagement covers a wide area and extends, for example, to having effective data protection policies so that staff are confident their data and privacy are protected in the workplace and their data is processed transparently and securely.

How can this be measured?

There are a variety of ways to measure this. Getting feedback from and consulting with staff on what they think you are doing well and not so well are critical. This might be through an established employee forum or through trade unions. Corporate Governance reporting also favours workforce engagement measures, so there will often be an overlap with obligations under the Governance pillar of ESG.

Employee satisfaction surveys can also be a useful tool, and are often cited in annual reports as an index of how engaged employees feel within the organisation. Organisations may also wish to make a statement to explain whether they use zero hours contracts or how they hire casual or atypical staff to mitigate against concerns that vulnerable workers are exploited. There are various external standards that organisations can meet, such as the Mindful Business Charter and the Scottish Responsible Business Charter. Workplace awards such as The Best Company to Work For are another way of providing an external level of accountability.

CMS can help you by auditing your policies and processes, highlighting risk and suggesting solutions on best practice. Having robust reporting procedures is essential to understand whistleblowing complaints, in addition to effective processes for internal investigations.



3. Modern Slavery

What is it?

Modern slavery is the illegal exploitation of people for personal or commercial gain.

As well as specific offences relating to slavery, servitude, forced and compulsory labour and human trafficking the Modern Slavery Act 2015 places an obligation on certain organisations to publish an annual modern slavery statement setting out the steps that the organisation has taken to ensure that modern slavery and human trafficking is not taking place in its business and supply chains. This obligation is not limited in geographical scope and applies to any organisation carrying on all or part of its business in the UK, whether UK registered or not.

Both organisations that are required to publish a modern slavery statement and those that aren't should carry out due diligence into their business and supply chains in relation to such issues, and put in place measures to prevent, identify and remediate such exploitation.

Why does it matter?

Investors do not want to be associated or seen to be profiting from companies that derive high margins through poor working conditions or exploitation of workers, or condone such behaviours in their supply chain. Many are now choosing to invest, do business or associate themselves with organisations which treat these issues as a matter of priority.

How can this be measured?

The contents of an organisation's modern slavery statement, which an organisation is required to publish on its website, is one clear area in which its commitment to this issue can be measured. However, even for those organisations that are not required to publish a statement, the approach they take, as reflected in their staffing policies, codes of conduct and terms of business can give an insight into their stance on this issue.

The Government has opened a central Modern Slavery Statement Register where organisations can make their modern slavery statements available for public review (as well as publishing them on their own website). Currently, publishing on the central register is voluntary but it will become mandatory and will be used by the Home Office to measure compliance. Plans are also in place to strengthen the law in this area to mandate the contents of modern slavery statements, introduce a single reporting date for all organisations and introduce harsher penalties for organisations that do not comply.

Even without such harsher penalties, organisations that are exposed as being involved in modern slavery face significant reputational damage, which can have wider repercussions on their brand, share value and investment potential.

CMS can help you with advising on the application of the transparency requirements to your organisation and its wider corporate group, preparation of a modern slavery statement and related policies, your related commercial terms of business and auditing your suppliers to identify and address any such issues.

4. Executive Remuneration

What is it?

Executive pay forms part of both the 'Social' and 'Governance' aspects of ESG. While there are rules regulating this area in areas like the financial services sector, which sits very much in the Governance category, the Social aspect requires looking at what society expects companies to do about executive pay and what is, and what is not, acceptable behaviour.

Why does it matter?

Shareholders are looking at executive pay in relation to the gap between workers and executives and the overall financial performance of the company. With the pandemic there has been an expectation that all involved should 'share the pain' across the workplace hierarchy. Although the UK furlough scheme did not prohibit bonus payments to senior staff as a condition of payment, on the whole it was not seen as acceptable for companies to take public money, pay their staff 80% of their wages, and then pay their executives large bonuses. Of course, some companies did do that, but it often resulted in negative publicity.

There are other tricky issues to consider, e.g. should clawback and malus provisions be used on bonuses that were paid out before the impact of the pandemic was seen, and should companies ensure that participants in LTIP/share option schemes do not get 'windfall gains' if share prices rebound once the impact of the pandemic subsides?

There is also the question of whether (and, if so, to what extent) ESG metrics (covering, for example, diversity, health & safety, environment, etc) should be applied to executive incentives. On the face of it this seems like a good idea and it has been adopted by many companies, but there is some debate about whether such metrics are necessary or effective, given that ESG objectives will (in any case) often be aligned with existing metrics and ESG metrics are fairly new and, as such, universally understood standards have not yet emerged.

How can this be measured?

In their annual reports, all premium listed companies in the UK must 'comply or explain' when it comes to the principles of the UK Corporate Governance Code. Many other companies comply with the Code on a voluntary basis. One of the Code's principles is that "Remuneration policies and practices should be designed to support strategy and promote long-term sustainable success. Executive remuneration should be aligned to company purpose and values, and be clearly linked to the successful delivery of the company's long-term strategy."

In the FS sector, regulators will expect firms to have considered how they will manage the impact of the pandemic on bonus pools and individual remuneration.

Quoted companies are required to publish an annual remuneration report setting out actual payments to directors and details on the link between company performance and CEO pay. This report must also state how the company intends to implement its remuneration policy in the current financial year. This report is subject to an advisory vote.

Lastly, many companies are required to issue a statement relating to section 172 of the Companies Act 2006. This section imposes the well-known duty to "promote the success of the company for the benefit of its members as a whole", whilst having regard for stakeholder groups such as employees, customers, suppliers and the wider environment. The Section 172 statement needs to explain (at a fairly high level) *how* decisions were taken and this could, for example, cover remuneration issues, such as the use of metrics.

CMS can help you by reviewing your executive pay arrangements, remuneration policies and Section 172 Statements.

5. Community and social value

What is it?

Corporate Responsibility programs are a key aspect of demonstrating that you are making good progress and a meaningful contribution to the changes your stakeholders value. It can include things like employee volunteering in your local community, supporting charitable organisations through fundraising and in-kind support, supporting young people to develop skills essential for the world of work, advancing social mobility and engagement in sustainability activities that lessen impacts on the environment.

Why does it matter?

Businesses do not exist in isolation. Increasingly it matters how a business supports its stakeholders working collaboratively to maximise social impact. The pandemic has radically changed how we look at work on many levels. We now have a greater blend between home and office, as our working community has grown; stretching from cities to suburbs and beyond. The pandemic also accelerated our commitments further as organisations helped support their local communities. We saw hotels working with food banks and offering accommodation to key workers, businesses supporting vulnerable customers with free home deliveries, and employees helping to run mass vaccination sites.

Employees want to work in an organisation that is socially responsible and has a broader purpose. Studies have shown that positive social impact equates to higher job satisfaction. Organisations that look at long term skills and employability will benefit by working with schools and universities through mentoring and outreach programs. This is about long term investment and creating opportunities.

How can this be measured?

The United Nations Sustainable Development Goals contain a list of 17 different goals that apply across all areas of ESG and are a framework for doing good.

There are a variety of ways organisations can measure progress against these goals including signing the UN Global Compact. There are other national organisations such as Business in the Community who can help with measurement and standards.

At CMS we pride ourselves on collaborating with clients in this area. If you want to speak to us about opportunities for collaboration, then please get in touch.

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