



INSIGHTS

Prioritizing The 'G' In ESG: Governance Practices Companies Can Implement To Improve ESG Performance

April 10, 2023

Highlights

There is a growing focus on how companies can improve their governance practices to be more socially and environmentally responsible

Companies can implement a number of initiatives to improve ESG performance, starting with incorporating ESG factors and sustainability into decision-making, strategy and operations

Aligning corporate governance practices with stakeholders' ESG expectations and demands can enhance long-term prospects for resilience and sustainability

Corporate governance is an essential aspect of business that determines how organizations are managed, directed, and controlled. It involves a set of principles, practices, and processes that define the relationships between the company's management, board of directors, shareholders, and other stakeholders. Effective corporate governance is crucial for the long-term sustainability and success of any organization.

In recent years, there has been a growing focus on how companies can

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improve their governance practices to be more socially and environmentally responsible. Governance initiatives that companies can implement to improve their overall environmental, social and governance (ESG) performance intersect and overlap at various points. They are by no means exclusive. Rather, they are part of the much larger ESG toolbox; the success of these and other ESG practices will – like most other key performance indicators – depend on strong leadership, discipline, good data, and common sense.

Incorporating ESG Factors Into Decision-making

ESG factors have become an important consideration for investors and other company stakeholders. This involves consideration of environmental and social impacts when making decisions, in addition to (not as a replacement for) financial factors.

Regular ESG audits can be undertaken to assess companies' practices and identify areas for improvement, and to ensure their governance practices are aligned with their ESG goals. Companies that incorporate ESG factors into their decision-making process are [better able to identify and manage risks](#) and opportunities related to ESG factors, and more likely to be successful in the long term.

Establishing a Strong and Diverse Board of Directors

A board of directors is responsible for overseeing a company's management, in many cases, providing strategic guidance, and ensuring that the company's operations are aligned with its long-term goals. A strong, independent, and diverse board is essential to provide a range of perspectives and experience to guide the company's decision-making. This includes diversity in terms of gender, race, ethnicity, age, and professional background. A diverse board can bring a range of viewpoints and expertise to the company's decision-making, which can lead to more effective and innovative solutions, and better understanding of the needs and concerns of its stakeholders.

Best practices include establishing clear guidelines for the roles and responsibilities of board members, such as defining the scope of the board's oversight, such as overseeing the company's strategy, risk management, and ESG practices. The board should also be responsible for monitoring the company's impact on the environment, society, and stakeholders, as well as ensuring that the company's operations are aligned with its ESG principles.

Improving Transparency and Accountability

Transparent reporting allows stakeholders to understand a company's ESG performance and identify areas for improvement. This includes reporting on key ESG metrics such as carbon emissions, waste generation, water use, energy consumption, and employee turnover. Companies can facilitate transparency by reporting on their progress toward achieving their ESG goals and commitments. There is a growing emphasis on the potential for [AI and blockchain as tools to enhance transparency](#).

Establishing clear lines of accountability can help companies ensure that

their governance practices are aligned with their ESG goals. This includes implementing policies and procedures for decision-making, risk management, and stakeholder engagement. Accountability also involves holding company leaders and managers responsible for their actions and decisions.

Encouraging Stakeholder Engagement

Companies' engagement with their stakeholders, including customers, employees, suppliers, and communities should be a two-way dialogue, with companies listening and responding to stakeholder feedback. This will involve creating opportunities for stakeholders to provide input and feedback, such as through surveys, focus groups, social media and public consultations.

Engaging and collaborating with stakeholders can help companies gain valuable insights into ESG issues and develop more effective solutions. For example, by engaging with customers, companies can better understand their preferences and expectations related to environmental and social performance. Engaging with employees can identify opportunities to improve working conditions and promote diversity and inclusion. By engaging with suppliers, companies can ensure that their products and services meet environmental and social performance standards. Such collaboration can also help build trust and support among stakeholders, which is essential for long-term success.

Fostering a Culture of Ethics and Integrity

A culture of ethics and integrity refers to a set of values, principles, and practices that guide the behavior of individuals and organizations in a responsible and ethical manner. A code of conduct that outlines the ethical principles is the foundation on which such a culture is built. Such codes generally cover a range of topics, including conflicts of interest, anti-bribery and corruption, data privacy, and human rights; they often are accompanied by programs for training employees and communicating the code to other stakeholders.

Such codes are often augmented by whistleblower policies that allow employees to report any unethical or illegal behavior without fear of retaliation. Best practices for such policies include guidelines for reporting and investigating concerns and protecting the anonymity of the whistleblower.

Fostering a culture of ethics and integrity requires strong leadership and commitment from the top of the organization. Leaders should model ethical behavior and hold themselves and others accountable for ethical conduct.

Prioritizing Employee Well-being and Diversity

Companies prioritize employee well-being by providing a safe and healthy workplace, and offer fair compensation and benefits. This includes ensuring that employees have access to the necessary resources and training to perform their jobs safely, promoting physical and mental health through wellness programs, and providing support for work-life balance.

Diversity and inclusion should be prioritized for hiring practices and

training and development opportunities. Companies should also establish clear policies and procedures for preventing discrimination and harassment, and provide employees with resources for reporting and addressing concerns. Companies that prioritize employee well-being and diversity can attract and retain top talent, which can improve productivity and reduce turnover.

Incorporating Sustainability Into Strategy and Operations

Sustainability refers to the responsible management of social, environmental, and economic factors to ensure the long-term health and well-being of people and the planet. Incorporating sustainability into strategy requires consideration of the environmental and social impacts of business operations, products, and services. This includes assessing operations to identify areas for improvement and establishing clear goals and targets for reducing environmental impact, such as reducing greenhouse gas emissions or improving water efficiency.

As part of their sustainability analysis, there is a growing movement by companies to consider the life cycle of their products and services, from production to disposal. This means considering the environmental and social impact of raw materials, manufacturing processes, packaging, transportation, and disposal, and prioritizing the use of sustainable materials and processes. Increasingly, regulators are imposing Extended Producer Responsibility (EPR) obligations beyond the point of sale for different products and waste flows.

Sustainability management systems (SMS) can be implemented to help companies identify, monitor, and manage their environmental and social impacts. Companies can use an SMS to establish policies, procedures, and practices that support sustainability goals. An SMS typically consists of four components: planning, implementation, monitoring, and review. By identifying sustainability risks and opportunities, companies can develop more effective strategies to manage those risks and capitalize on opportunities.

Emerging best practices include establishing a sustainability committee or task force to oversee sustainability efforts and ensuring that sustainability considerations are integrated into all aspects of the company's operations.

Prioritizing Supply Chain Sustainability

A company's supply chain can have a significant impact on the environment, society, and stakeholders. By prioritizing [supply chain sustainability](#), companies can reduce their environmental impact, improve conditions for workers, and support local communities.

Some ways companies can prioritize supply chain sustainability include incorporating clear guidelines for suppliers, such as sustainability criteria for raw materials and products and feasible goals to reduce emissions. Companies can also establish mechanisms for suppliers to report sustainability data and progress and implement programs to monitor supplier compliance. As regulatory disclosure requirements increasingly extend to supply chains, companies are collaborating with suppliers to identify areas for improvement and support them in implementing

sustainable practices. This can include offering training and capacity-building programs, providing technical assistance, and incentivizing sustainability performance through procurement contracts.

Investing in Renewable Energy and Energy Efficiency

Investing in renewable energy involves transitioning to clean energy sources, such as solar, wind, and hydropower. This can help companies reduce their greenhouse gas emissions and support the transition to a low-carbon economy. Companies can invest in renewable energy by installing renewable energy systems on their own facilities, purchasing renewable energy from third-party providers, or participating in renewable energy programs, such as green power purchasing programs.

Investing in energy efficiency involves reducing energy consumption and waste through the implementation of energy-efficient practices and technologies. This can help reduce costs associated with energy consumption and waste disposal. Examples include energy-efficient lighting, insulation, and HVAC systems, as well as the implementation of energy management systems and employee education and training programs. Companies can also improve operational efficiency and reduce waste by implementing energy management systems and employee education and training programs.

Investing in renewable energy and energy efficiency can help lower energy costs, reduce carbon footprints, and improve operational efficiency.

Aligning Executive Compensation With ESG Performance

Traditionally, executive compensation structures have focused on short-term financial metrics, such as earnings per share and quarterly revenues. However, in recent years there has been strong stakeholder pressure to prioritize companies' long-term sustainability and performance. As a result, there has been a shift toward [aligning executive compensation with ESG performance](#) and incentivizing executives to prioritize ESG factors and hold them accountable for achieving ESG goals.

To achieve this alignment, companies can establish clear, relevant, and meaningful metrics for measuring ESG performance, such as greenhouse gas emissions reduction targets, diversity and inclusion goals, or community impact goals. Companies can then tie executive compensation to achieving these metrics, such as by linking executive bonuses or stock options to ESG performance.

Moreover, aligning executive compensation with ESG performance can help companies comply with sustainability regulations and standards, such as the United Nations Sustainable Development Goals (SDGs), the Global Reporting Initiative (GRI) standards, and the [forthcoming International Standards Sustainability Board \(ISSB\) sustainability disclosure](#) standards. Additionally, companies can use executive compensation as a tool to drive cultural change and build a sustainable business culture that prioritizes ESG factors.

Takeaways

Governance, which has always been central to good business management, has historically adapted to meet changing societal norms. In recent years, with the growing attention on social and environmental responsibilities, governance – the G in ESG - has evolved apace to prioritize, implement, and provide oversight for developing E and S business practices. The need for governance to continue to adapt will accelerate further as ESG disclosure and reporting requirements continue to transition worldwide from voluntary to mandatory.

This evolving landscape underscores the importance for companies to continually review and update their governance policies, practices and procedures to address these social and environmental challenges by:

- Incorporating ESG factors into decision-making
- Establishing a strong and diverse board of directors
- Improving transparency and accountability
- Encouraging stakeholder engagement
- Fostering a culture of ethics and integrity
- Prioritizing employee well-being and diversity
- Incorporating sustainability into strategy and operations
- Prioritizing supply chain sustainability
- Investing in renewable energy and energy efficiency
- Aligning executive compensation with ESG performance

By implementing some of these (and other) governance initiatives, companies can move toward alignment with the increasing ESG expectations and demands of stakeholders, which should also enhance companies long-term prospects for success, resilience, and sustainability.

For more information, please contact the Barnes & Thornburg attorney with whom you work or Bruce White at 312-214-4584 or bwhite@btlaw.com.

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