WHY IS EUROPE AHEAD OF THE UNITED STATES ON THE ESG CURVE?

As the importance of ESG factors grow for consumers and investors, new research from NAVEX Global suggests that it is organisations based in Europe who are leading the way

> "[Businesses] recognise that prioritising ESG is an investment in competitiveness and future success

The uncertainty and organisational disruption caused by the COVID-19 pandemic has driven many business leaders to prioritise survival over all other factors. But as businesses re-emerge from crisis mode, these "other factors" – such as environmental, social, and corporate governance (ESG) – are rising in importance, especially among consumers and investors.

"Global standards and regulations may be nascent, but businesses aren't waiting," says Bob Conlin, president and chief executive officer at NAVEX Global. "They recognise that prioritising ESG is an investment in competitiveness and future success."

New research from NAVEX Global confirms that ESG is rapidly becoming an essential boardroom topic. Gauging the opinions of 1,250 managers and senior leaders at organisations with more than 500 employees across the US, United Kingdom, France and Germany, our data suggests that it is firms headquartered in Europe that are leading the way when it comes to ESG – but why?

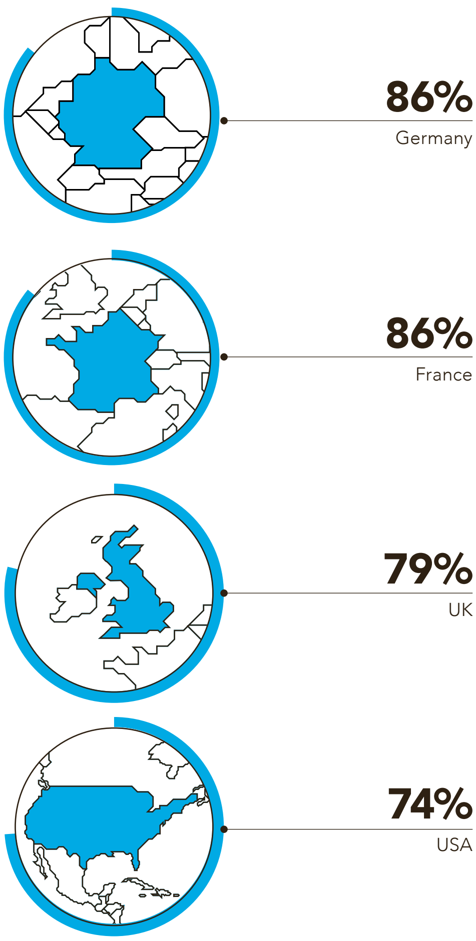
European ESG maturity

A key finding from our research is that European firms are more likely to have an ESG programme in place than their counterparts in the United States.

On average, 81% of the organisations surveyed have a formal ESG programme

ESG adoption is higher in Europe than in North America

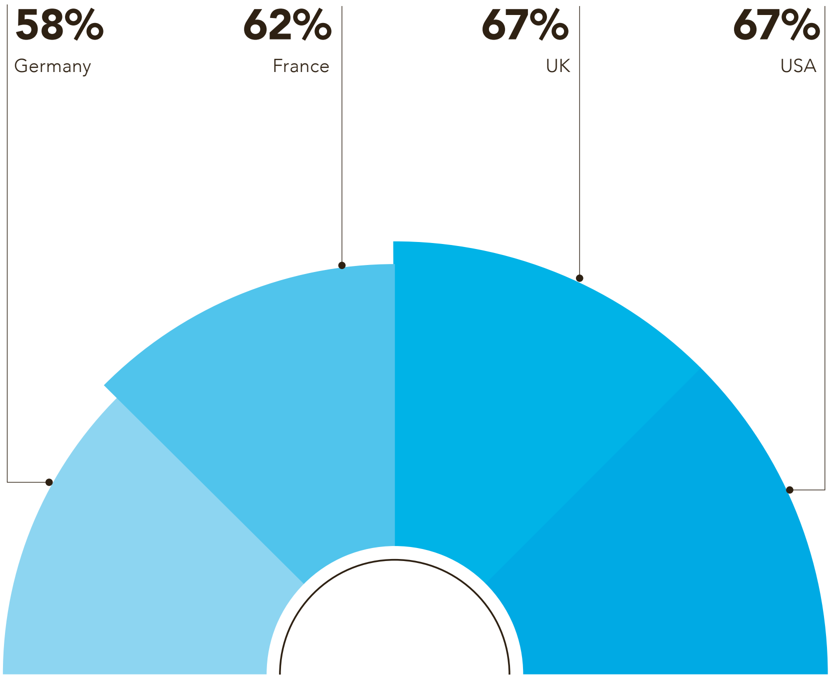
Percentage of respondents whose companies have formal ESG reporting processes in place



NAVEX Global 2021

Most businesses will place a greater focus on ESG during the coming year

Percentage of respondents who said their organisation would increase their focus on ESG factors in 2021



NAVEX Global 2021

in place, with Germany and France leading the way on 86%. The UK is not too far behind, with 79%. Our findings suggest that companies in the US trail those in Europe, with just 74% of businesses saying they have operational ESG programmes.

This aligns with research from Bloomberg Intelligence, which finds that ESG is an increasingly critical focus for investors, especially in Europe, which currently accounts for half of all global ESG assets, estimated to be worth in excess of $18 trillion by the end of 2021. Sustainable investing now accounts for almost a quarter of all assets under management (AUM), according to the US Sustainable Investment Forum.

Indeed, NAVEX Global data underlines how important a sustainable approach to the 'Environmental' element of ESG is, with countries in Europe pursuing initiatives in this space more aggressively than in the US. For example, 57% of firms in Germany name Environmental factors their biggest ESG focus area, with the numbers being similar in both France (54%) and the UK (55%). In the US however, we see a drop off, where it is still the top priority but only named so by 43% of respondents.

Despite currently lagging behind Europe, our research suggests that the appetite for addressing ESG occurring within Europe is now expanding Stateside. Two-thirds (67%) of respondents in the US and the UK indicated that their companies would increase their focus on ESG factors in 2021, compared to 62% in France and 58% in Germany.

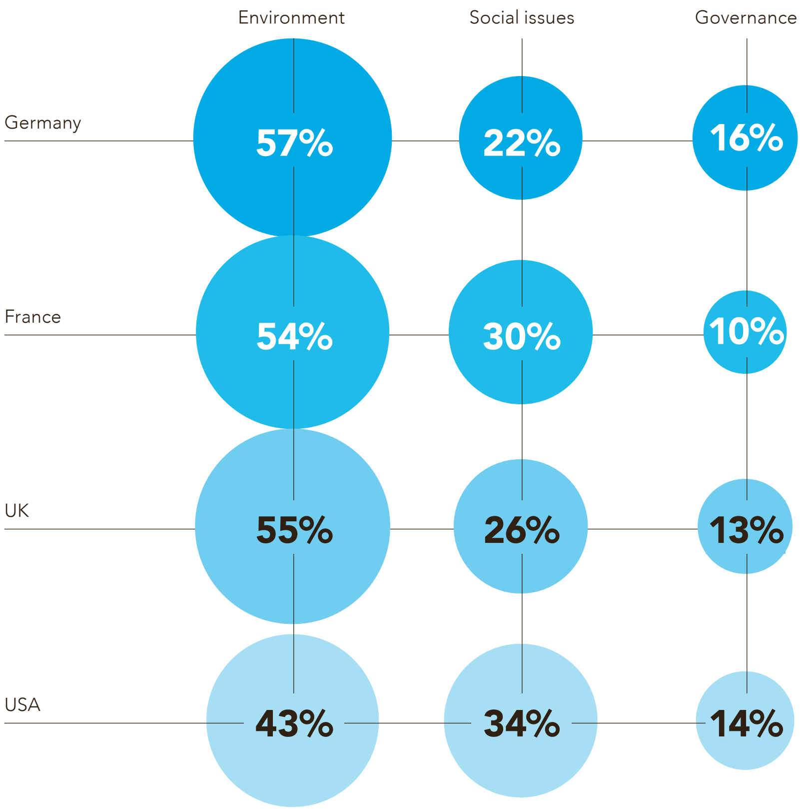
European ESG action

The implementation speed of ESG programmes, whether in the US, Europe or other regions, will ultimately depend on the pace of lawmakers. The European Union, for example, has pre-existing umbrella legislation for non-financial reporting, in terms of ESG-related regulations – including the non-financial reporting directive, the sustainability-related disclosures regulation and the conflict minerals regulation, the latter of which came into force at the start of 2021. Crucially, though, there is no legally binding, cross-sectoral directive among EU member states to report on ESG strategies, and the same is true in the UK.

Regardless, uptake remains impressive. Germany's Bayer, Italy's Eni, and Anglo-Dutch Unilever are held up as exemplars of companies driving ESG strategies in the EU. Bayer is lauded for its approach to sustainability and energy use, while Eni leads the way with its health and safety and carbon emissions performance. Unilever achieved one of

> "Despite currently lagging behind Europe, our research suggests that the appetite for addressing ESG occurring within Europe is now expanding Stateside

The importance of ESG factors to business reputation vary by country



NAVEX Global 2021

> "Europe has a wide range of non-governmental and non-profit organisations that work with businesses on ESG initiatives

the highest ESG evaluation scores – 89 out of 100 – awarded by ratings agency S&P in late 2019.

Further, compared to the United States, Europe has a wide range of non-governmental and non-profit organisations that work with businesses on ESG initiatives. The Organisation for European Economic Co-operation (OECD), for instance, champions ESG, and this work influences EU legislative developments. Others, such as the World Economic Forum (WEF), work with businesses to develop ESG strategies.

While European organisations are currently more proactive regarding ESG programmes compared with the US, having so many initiatives can create confusion or dilute focus. This in turn can result in less comprehensive reporting that doesn't paint the whole picture – but consumers and investors want to see high levels of visibility and transparency.

Mandatory disclosure is coming, though – and soon. Mark Carney, the former governor of the Bank of England and now a United Nations special envoy on climate, agreed that regulation is needed "to stop greenwashing", when speaking at the Financial Times Weekend Festival, held in March 2021.

One of the core objectives for COP26 – which the UK is hosting in Glasgow this November – is to "get all G20 countries to have pathways to make this mandatory so that the market has consistent, comprehensive and comparable climate disclosure," says Carney.

Upcoming legislation and ESG next steps

With an ever-evolving regulatory landscape, it's not straightforward for leaders to work out what a business needs to do and how to do it. There have been attempts to legislate ESG reporting previously, but success has been limited – not least because countries did not want to disadvantage themselves.

This attitude is one reason why the new mandatory supply chain due diligence law recently approved by the German Cabinet (and expected to be passed by Parliament very soon) raised so much debate and criticism with business lobby groups.

In a statement, the Association of German Employers said, "[It] is a dangerous national route that puts German companies at a severe disadvantage in European and global competition.

The direction of travel is clear in the EU. In a recent vote the EU Parliament backed the legislative initiative report paving the way for a new EU directive on mandatory supply chain due diligence. The lawmakers called for an urgent adoption of an EU-wide binding regulation that would require companies to identify, address and remedy the ESG risks in their supply chains. The new law is expected to follow in the coming months. However, as with other EU-wide directives, there will be a two-year transposition period before it finally comes into effect.

"It makes better business sense to be compliant and proactive before laws are passed

"It is only a matter of time before ESG regulations become binding," says Vera Cherepanova, an ethics and compliance consultant at Studio Etica based in Milan, Italy. She advises businesses to clean up their processes and focus on strategies: "Everybody wants to anticipate the changes and the prospect of greater scrutiny, but while regulators are contemplating the new law, it makes better business sense to be compliant and proactive before laws are passed."

But before acting, Cherepanova recommends business leaders take stock and audit their existing ESG programme to better understand the necessary actions to take.

"You should be clear about your current standing and determine your visibility regarding ESG risk and supply chain," says Cherepanova. "When you have that understanding, you can take the next steps and make changes. The end goal should be going further than any legal requirements, engaging with suppliers, and offering greater transparency to all stakeholders."

Conclusion

The good news is that many businesses are already taking a proactive approach. Our data finds that 64% of organisations expect to increase their ESG focus in 2021, while a similar amount – 63% – plan to increase spending on their ESG programme this year.

While firms headquartered in Europe lead the way, organisations in the US are turning their attention to ESG initiatives as they look to catch up. But what's abundantly clear is that business leaders, wherever they are in the world, must go beyond traditional corporate social responsibility and sustainability initiatives to win the hearts and minds of consumers, investors and employees alike.

Collecting, tracking and reporting on your ESG metrics will help you make informed decisions about your ESG programme. Discover how NAVEX ESG could help you get started at navexglobal.com

NAVEX Global is the worldwide leader in integrated risk and compliance management software and services. Our solutions are trusted by thousands of customers around the globe to help them manage risk, address complex regulatory requirements, build corporate ESG programmes and foster ethical workplace cultures.

NAVEX GLOBAL®