CHARTERED PROFESSIONAL ACCOUNTANTS CANADA

# On the Radar

## The Business Impact of Environmental and Social Issues

Societal, technological and geopolitical change, the impacts of climate change and the interconnectedness of these issues present risks and opportunities that must be understood and managed.

This piece pinpoints three key trends with environmental and social implications that are already impacting businesses and capital markets.

### 1. Evolving View of the Responsibility of Business in Society

Institutional investors, employees, customers, communities and governments increasingly look to corporations to:

- integrate societal issues into corporate thinking
- take responsibility for the impacts of their operations on society[1]

Corporations must ask relevant questions they may not have previously considered. For example:

- How do urbanization and demographics, energy costs, and availability of agricultural land, create business risks and/or opportunities?
- How do disease, poverty and/or illiteracy impact a company's workforce and productivity in supply chains?
- What are the business risks and opportunities associated with:
  - how a company's products affect people's lives

1 Based on a global survey of 11,000 business and human resource leaders, as well as interviews with executives from some leading organizations, a 2018 Deloitte study noted that organizations are increasingly judged on their impact on society. Deloitte Insights. 2018 Deloitte Global Human Capital Trends. *The rise of the social enterprise*.

- how a large infrastructure project impacts communities
- how extractive companies work with local indigenous communities
- how resource limits influence decisions?

The interdependence of society, economy, the natural environment and related inherent resource limits is becoming clearer, along with the implications of this for business.

> "To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society. Companies must benefit all of their stakeholders, including shareholders, employees, customers and the communities in which they operate."[2]
>
> **—Larry Fink, CEO of BlackRock**

It takes time to appreciate the environmental and social risks and opportunities related to megatrends. So, too, the social and environmental impacts of some business decisions and operations can take time to develop and become apparent. That is why a longer-term mindset in C-suites and boardrooms is required. A focus on short-term results can both create and exacerbate negative environmental and societal outcomes.

The landscape of environmental and social risks important to business is depicted in the World Economic Forum's annual Global Risks Report.[3]

Some of these issues may be important to all companies and some may be more or less important to particular industries. What is key is that companies navigate both the environmental and social mega-trends, and the industry and company specific issues to the benefit of their investors and other stakeholders.[4]

> Costco: "Do the right thing. It is a philosophy embedded in our culture… members of our leadership team and beyond realize the key to long-term success is not high margins; rather it is how you treat, engage, and include people: our members, our employees and our suppliers alike."[5]
>
> Costco's first sustainability principle is: "For Costco to thrive, the world needs to thrive. We are committed to doing our part to help."[6]

2 Larry Fink. *A sense of purpose*. Blackrock. January 2018.

3 www.weforum.org/reports/the-global-risks-report-2018

4 Some companies are beginning to prepare scenario plans to understand better the potential impact of megatrends and issues on future business strategies, operations and results.

5 Annual Report 2017. Costco Wholesale Corporation. CEO Letter to Shareholders.

6 www.costco.com/sustainability-introduction.html

## 2. Increasing Investor Interest in Responsible Investing

Institutional investors are becoming more sophisticated in the integration of environmental, social and governance (ESG) issues into their investment decision-making (also referred to as responsible investing). This movement is growing globally.

> Responsible investing in the United States grew to $12 trillion in assets under management in 2018, an increase of 38% in the past two years.[7] In Canada, there were over $2 trillion in responsible investment assets under management, an increase of 41.6% in two years. This represents over half of Canada's investment industry.[8]

As well, impact investing (a subset of responsible investing that seeks a social and/or environmental benefit in addition to financial gain), while still in its infancy in Canada,[9] marks a growing trend. Importantly, investors are committed to measuring and managing impact[10]—a trend that may affect corporate reporting.

> "Risks can come from financial as well as non-financial factors, and that's why analysis of ESG [environmental, social and governance] factors is integrated in our processes."[11]
>
> **—Ontario Teachers' Pension Plan**

Institutional investors are looking for reliable, comparable ESG information that will enhance their investment analysis, engagement and voting decisions. Currently, institutional investors purchase selected ESG data from third parties because corporate disclosures are not always providing the evolving ESG metrics and information capital markets are seeking.

> "Risks and opportunities for long-term capital differ fundamentally from those for short-term capital. Metrics also differ: short-term metrics tend to be more accessible and reliable, but they often do not capture disruptive changes in economies or markets. These long-term disruptive changes include climate change, cybersecurity, demographics, and many other factors."[12]
>
> **—Excerpt 2018 Summit on Focusing Capital on the Long Term**

7 *Report on US Sustainable, Responsible and Impact Investing Trends 2018*. US SIF. October 2018. Page 1.

8 *2018 Canadian Responsible Investment Trends Report. Responsible Investment Association*. October 2018. Page 6.

9 According to the 2018 Annual Impact Investor Survey, capital invested in 2017 exceeded U.S.$35.5 billion with growth of 8% expected in 2018.

10 Global Impact Investing Network. *Annual Impact Investor Survey 2018*. Page XIII.

11 www.otpp.com/investments/responsible-investing/our-principled-approach

12 Summit 2018 Focusing Capital on the Long Term. FCLTGlobal. New York. 28 February 2018. Page 20.

Three noteworthy developments in reporting about ESG issues include:

- Asset owners, asset managers and companies have begun to report on climate-related matters as recommended by the Task Force on Climate-related Financial Disclosures (TCFD).[13]
- Increasingly, corporations are presenting their responses to the UN Sustainable Development Goals (SDGs) in their sustainability reports.[14]
- Companies (and investors) are using the standards for identifying financially material environmental and social issues by industry sector provided by the Sustainability Accounting Standards Board (SASB).[15]

## 3. The Contribution of Stakeholder Engagement to Long Term Value

Knowing how environmental and social issues impact stakeholders[16] and understanding stakeholders' expectations[17] of companies can contribute valuable insights for identifying strategic opportunities and risks and creating long-term value. It can also help to build trust, brand reputation and resilience.

> "Effective engagement with non-shareholder stakeholders is equally vital to sustain the long-term interests of an organization and to ensure that a board discharges its management oversight responsibilities."[18]
>
> **— CPA Canada Stakeholder Engagement Briefing**

Transparency and engagement are key to developing and retaining trust with stakeholders. In today's market, attention to social media is particularly important. Information posted on social media can be misleading or even deceptive with often little time to fact-check and respond. More engaged stakeholders are more likely to support and trust company responses.

13 www.cpacanada.ca/en/business-and-accounting-resources/financial-and-non-financial-reporting/mdanda-and-other-financial-reporting/publications/tcfd-overview

14 www.undp.org/content/undp/en/home/sustainable-development-goals.html

15 https://materiality.sasb.org

16 Stakeholder categories include capital providers, customers, employees, suppliers, communities, Indigenous Peoples, and governments. Non-governmental organizations can also impact companies and stakeholders.

17 For example, millennial or Generation Z talent want to work for companies that make a positive impact in society. 2018 Deloitte Millennial Survey. Page 2.

18 CPA Canada. *Director Briefing—Stakeholder Engagement*. Andrew J. MacDougall, LLB and Josh Pekarshky. 2018. Page 1.

> "The real difference between shareholder activists and non-financial stakeholders can be seen in the power of social media to shape the discussion. Non-financial stakeholders concerned with environment, social and local issues can often gather more online support for their concerns than activist shareholder can gather for theirs."[19]
>
> **—CPA Canada Stakeholder Engagement Briefing**

## Responding Strategically

Successful companies and boards are adept at handling the interconnectedness and complexity of the business issues related to environmental and social matters. They challenge their existing models. They bring together diverse stakeholders with different points of view. They take the time to develop, adapt and test innovative approaches and behaviours. And they dialogue and report strategically with investors and other stakeholders.

Boards and executives that recognize and monitor trends such as those outlined in this publication will be better equipped to provide effective oversight of how their companies are dealing with environmental and social issues. And importantly, their companies will be better positioned to create long-term, sustainable value.

19 IBID. page 4.