

A new era of capitalism, highlighted through the rise in influence of ESG, is creating new demands on Leadership teams.

We offer four guiding principles that are easy to implement as part of a Leadership programme to responsibly manage and measure ESG criteria for both public and private companies.

Economic history will mark 2019 as the year recognised for the arrival of the new era of capitalism. Many Leaders admit it was the year that they first truly felt the need to reconsider what is the purpose of their business, above and beyond the singular focus of maximising shareholder returns.

Most Leadership teams, and the Board, are now confronting the challenge of how best to deal with this sudden new demand on their time and expertise. They would like, without significant cost or disruption, to find a solution that takes into account the growing influence of ESG issues from a broader set of stakeholders and can support their decision making, strategic direction and corporate narrative.

The difficulty is they are facing an opaque landscape. The speed of arrival of the new era of capitalism has outpaced the development of best practice. This is further compounded by a raft of new frameworks, indices, metrics and standards appearing from different interested parties. Companies and investors alike grapple with achieving the most appropriate approach to implement and report on ESG matters. It also hasn't helped that 2019 was a year where the economic and political climate created numerous shorter-term strategic and operational issues to occupy a significant amount of management time.

The reaction, not surprisingly, from Leaders varies considerably. Some embrace this new era of capitalism as a core pillar of competitive advantage that fits their strategic goals and their branding. To others, it is a welcome opportunity to realign their strategy and business model. A number see it purely as a new cost of doing business and a factor of more regulations. And then there are those who find it frustrating or ignore it, believing it as another company's problem, not relevant to their business.

But the reality is Leadership teams and corporate Boards will have little or no place to hide. The arrival of new regulations, increasing shareholder and social influence and a demand for greater corporate transparency, means the new era of capitalism and ESG criteria will become increasingly influential on both corporate performance and valuation. Whatever individual views are on the business relevancy of this new era of capitalism or on environmental responsibility, even if you don't accept it as a driver of business value, it is impossible to ignore it as a significant component of future risk.

In response to this lack of clarity, we offer four guiding principles for the Board and leadership team to consider as part of best practice.

1. **Build the solution that is right for your business.** Many Leadership teams have approached this new form of capitalism from a reporting standpoint and to satisfy those who demand “tick-box” responses. This is a very short-term solution to a longer-term challenge. The demands of the new era of capitalism should not be focused solely on reporting, but about fundamentally changing business behaviour. Reporting should be the finish line, not the starting point. Every business is different and how it should build its response should be tailored to that business and its mid/long-term corporate strategy. Similarly, to date, there is no singular agreed scoring mechanism accepted by all shareholders and influencers, so how can you provide answers to satisfy all of them? Each organisation must decide what is right for their business, adopt KPIs that are appropriate for them and explain their approach. In the short-term, some “tick-boxers” may be offended but hold to your approach and narrative, as it will bring competitive advantage in the future.
2. **This is a journey, not a short-term immediate response.** Even for those Leadership teams who have built a successful approach to broader stakeholder return within their model, this has taken years to embed and will continue to evolve. There is no immediate quick-fix and those that try and adopt such an approach, often to satisfy reporting requirements, will get caught out in the future. Behavioural and strategic change take a long-time to implement throughout a business and no realistic shareholder or influencer expects an instant solution. The new era of capitalism is based on a longer-term investment viewpoint, so build your solution and explanation to match that timeframe.
3. **Don't rely on old or repackaged data.** The Leadership team and the Board are responsible for, and must manage, the demands of the new era of capitalism. It is, therefore, fundamental that the insight used for decision-making and strategy is owned and created by the Leadership team, tailored to their specific requirements.

To date, many Leadership teams satisfy themselves by using disparate internally and externally sourced data that is brought together within the business to try and build a single picture. This generally includes staff surveys, customer Net Promoter Scores, trust indices, media sentiment, and investor views. This data will soon not be fit for purpose. It is usually not designed to answer the questions the Leadership team should be asking; it is not sufficiently independent; and importantly by its nature, it is historic and does not meet the demands to actively manage risk. Nearly all businesses that have had significant risk events over the last few years will have had this form of data provided to the leadership team and Board. Most likely, it showed reasonably strong and supportive responses. Yet, due to the incorrect questions being asked, or the long passed “sell by date”, none of these identified issues or enabled the Leadership team to respond to them in time.

Potential new legislation also makes the amalgamation of traditional data sources even more questionable. If the recommendations from the Brydon Report into the audit profession are enacted and, as forecast, the UK adopts laws similar to Sarbanes-Oxley on personal responsibility of Directors for publication of mis-statements, then the quality of insight used and published by the Leadership team is going to have to be far more robust and will be subjected to far greater scrutiny.

4. **The environment will dominate the next decade and beyond.** This is not about whether you are a believer or a sceptic, it is about the power of social movement. It is impossible to deny how climate change and environmental practices are starting to play a key role in the social conscious. This will only increase and become more influential in stakeholder behaviour. Also, the emergence of new approaches and practices such as the FSB's Task Force on Climate-related Financial Disclosures are already helping to ensure that scrutiny of environmental issues remains firmly under the spotlight from an investor perspective.

Shareholders will expect clear insight and narrative on both how the business is embedding environmental objectives within its strategy and how the business is managing its environmental footprint. Consumers of all products and services are already beginning to build these factors into their decision-making. Leadership teams must gain insight into how they are managing this key driver, both within their business and supply chains, and integrate this into the overall corporate strategy, positioning, risk profile and narrative.

As we start 2020, we enter a decade that is going to transform the role of business in society. Businesses will either adopt these changes due to a deliberate change in strategy and behaviours or be forced to do so in response to continual pressure from regulation, consumerism, society and shareholders. The new era of capitalism, together with the rise in influence of ESG, has just begun.

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