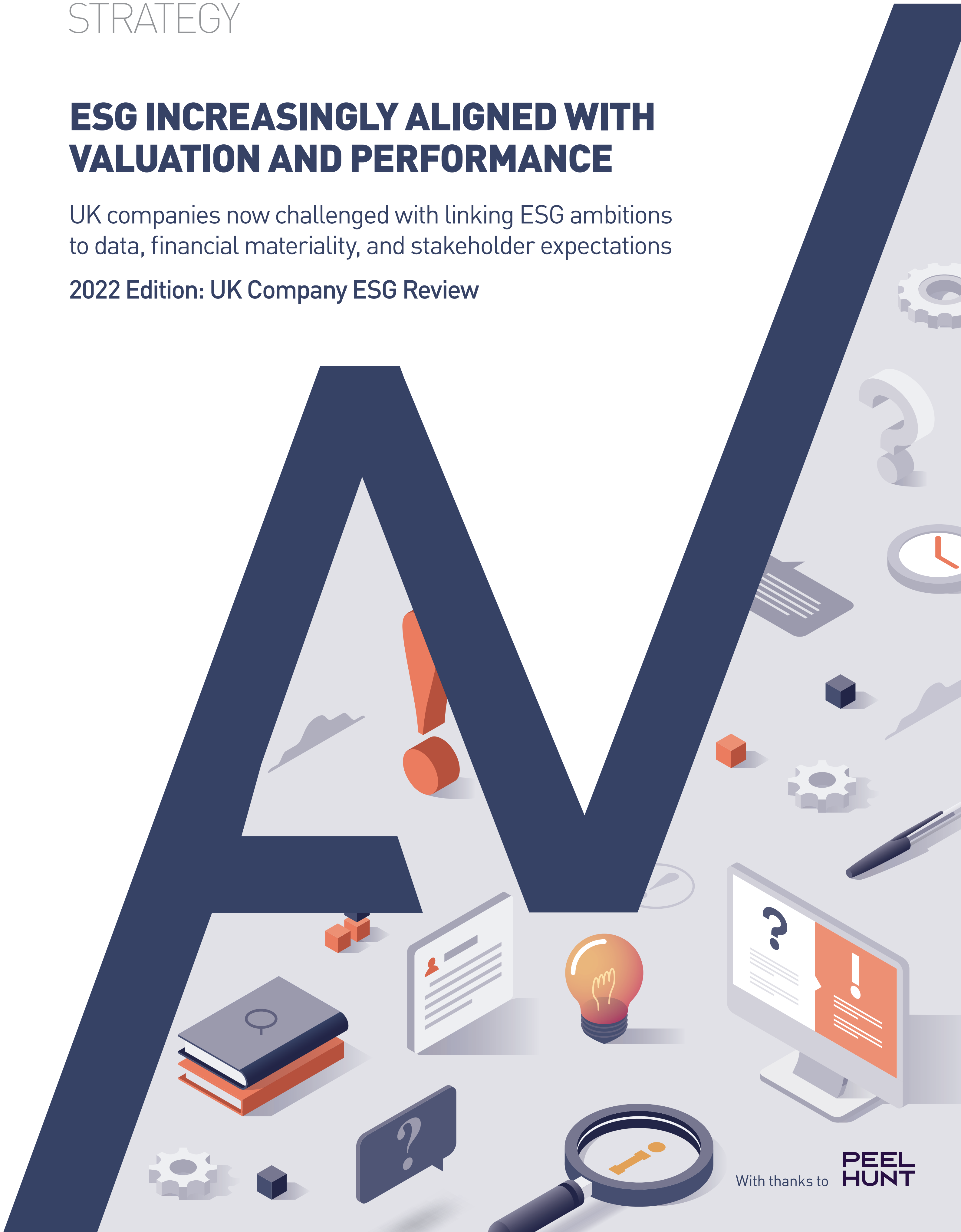
SIFA
STRATEGY

ESG INCREASINGLY ALIGNED WITH VALUATION AND PERFORMANCE

UK companies now challenged with linking ESG ambitions to data, financial materiality, and stakeholder expectations

2022 Edition: UK Company ESG Review



With thanks to PEEL HUNT

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FOREWORD

This is our second annual UK ESG Review, and we are pleased to report that we have expanded the coverage of both companies and sectors. This is important as the purpose of the Review is to provide a benchmark to Boards and management teams on the relevance of ESG; the best practice being adopted by your peers; and the direction of travel for consideration as you look to implement and embed ESG further into your own business.

Our findings leave no doubt that ESG has fully cemented its foothold in the Boardrooms and management teams of UK mid- and small-cap companies. We have been struck by how far companies have progressed with their ESG programmes, with clear evidence that it is being treated as a core element of management discipline and process. ESG has moved away from a more narrative, anecdotal, and qualitative approach, to instead focus increasingly on clear links to corporate performance and financial outcomes with proper data and targets. This has been driven by growing capital markets demands, a supportive regulatory environment and pressure from a broader range of stakeholders whose decision-making is being increasingly influenced by environmental and social responsibility. As our research has found, ESG is not just about responding to the capital markets, but now challenges and influences a company's licence to operate and reputational value.

ESG is evolving and will continue to place new and ever-changing demands on companies, meaning they will have to continuously refine their ESG programmes. Boards are expected to set the ESG agenda and hold the management to account on their ESG progress, which will require better informed and educated Board members and structures. ESG must also be more closely linked to Purpose and based on considerations of double materiality, which should be updated regularly. New measurements and targets will need to be created to understand and manage the increasing social influence. Understanding and measuring multiple stakeholder demands and expectations will need to become more formalised. These are just some of the areas of ESG we believe companies are going to need to continue to develop in the future.

We would like to thank Peel Hunt, a leading specialist in UK Investment Banking with a focus on the UK mid- and small- cap, for their support in garnering insight from 72 companies, across 17 sectors and with market capitalisations ranging from £22m to over £6.6bn. In addition to a detailed survey, interviews were also conducted with 17 companies, across a spectrum of market capitalisations and sectors, in order to enable a representative update on the current status of ESG in UK PLCs. Our impression is that those companies that participated are well advanced in their ESG journey and give a very good indication for how ESG practices are developing.

We hope this report furthers your understanding as you look to embed ESG in your own business. We will continue to evolve this annually in order to keep tracking the influence of ESG, and the main themes which are challenging UK Boardrooms each year.

Fergus Wylie
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KEY HIGHLIGHTS

80%

view ESG as positively aligned with shareholder returns, increasing from 54% in 2021, showing further evidence of the recognised impact on corporate performance and valuation.

86%

reference consumers, customers, and society as drivers of their efforts to develop and implement ESG programmes, overtaking the capital markets and regulation as a core reason to implement ESG.

65%

feel pressure from the workforce to implement ESG.

Not only is ESG viewed as a vital part of employee retention and attraction, but it is increasingly seen as having a significant role in a company's licence to operate and reputational value.

52%

describe their approach to ESG as focused on 'embedding ESG within strategy, with processes already in place to reduce risk and identify opportunities', however, only 13% would say they have ESG fully embedded within their business.

This demonstrates the challenge in embedding ESG, with metrics and targets, in the day-to-day operations, management processes, and across the value chain, to drive change.

86%

have established some form of a link between ESG performance and management remuneration, in a significant uplift from 25% in 2021.

Companies are still challenged with providing better data, targets, and greater levels of disclosure, with only 14% of those surveyed saying ESG is 'not at all' linked to remuneration.

71%

intend to invest more time or resources into developing ESG in the next financial year, despite the expected economic challenges, with 63% noting they have received more questions from investors on ESG matters over the last year.

Some forecast that ESG will benefit from the tougher economic situation as it will concentrate ESG on materiality and financial relevance.

OTHER INTERESTING FINDINGS

59% believe Environmental issues will have a significant or very significant impact on valuation and performance over the next decade, compared to 51% in Governance, and 39% in Social. However, a further 44% recognise that Social has a "noticeable" impact on valuation and performance in signs that social issues are growing in importance.

86% are publishing targets to measure ESG performance or are in the process of developing targets to communicate publicly. Progress is being made in a number of areas, in particular in Environmental, but as Social issues continue to grow in influence many corporates are struggling with setting tangible, measurable metrics in this area.

78% say that responsibility for ESG sits at the top of the organisation with the CEO and/or other C-suite, in recognition of the increasing importance and need to embed throughout the business.

68% ensure that ESG is on the Board agenda at least quarterly, with 32% talking about it more frequently than quarterly. Board members are now expected to take active leadership and responsibility to hold companies to account with stronger Governance processes in place through ESG Committees.

42% list lack of clarity and consistency in standards and frameworks as a hindrance in implementing an ESG strategy, followed closely by the challenge in responding to different demands from stakeholders referenced by 41% of companies. With growing demands and challenges of ESG, many companies feel disadvantaged to their larger peers, who often have greater internal resources to meet the varying demands of wider stakeholders. There is also a sense that the capital markets are more likely to recognise and place a greater value on ESG for larger companies.

83% of companies are currently implementing the recommendations of TCFD, significantly increased from 40% last year, driven in part by regulatory requirements, as well as broad support for its approach and understanding of the importance of addressing climate change. 68% have also made progress in assessing the financial implications of climate change.

ESG IS MORE CLEARLY LINKED TO MAXIMISING SHAREHOLDER RETURNS

As ESG as a corporate discipline continues to evolve, there is increasing recognition that it has a positive role to play in influencing shareholder returns, either as a factor of value creation or in driving higher resilience. This is a view shared by the majority of companies surveyed this year, with 80% viewing ESG as positively aligned with shareholder returns.

“It's clear to me that those businesses who are run well on a sustainability basis should drive higher returns in the long-term.”

“ESG will remain important because the question of 'what makes this a business I want to hold shares in for 10 years' is still what you have to answer and increasingly ESG is part of that response.”

“Shareholders are increasingly looking at businesses for signs that they are taking ESG seriously.”

“ESG is more aligned to shareholder returns now than a year ago.”

17% of companies view ESG as fully aligned with shareholder returns, compared to **3%** last year, which is a marked increase. The challenge is for corporates to ensure that their ESG efforts are communicated in a way which also makes clear that the impact and financial materiality of their approach has been considered, and that risks and opportunities specific to that company are driving the shape of their ESG programmes. This will include the need to develop metrics and KPIs to assist external stakeholders to track progress and ambitions.

“A year ago, it was a bigger issue about saving the planet, but now it's more about if you can combine saving money, with saving the planet then that is a better story to tell.”

“I try and explain what the financial link is between what we do on being a responsible business and how the business benefits.”

There is a growing understanding of how investors consider ESG in their investment processes, which is creating a challenge for corporates to demonstrate that they are taking ESG seriously and embedding the processes throughout their companies, linking these to sound financial principles.

“You need to think about the cost of doing business with carbon tax and other things like that. If you don't think about these things, frankly your stock will be less attractive and marketable.”

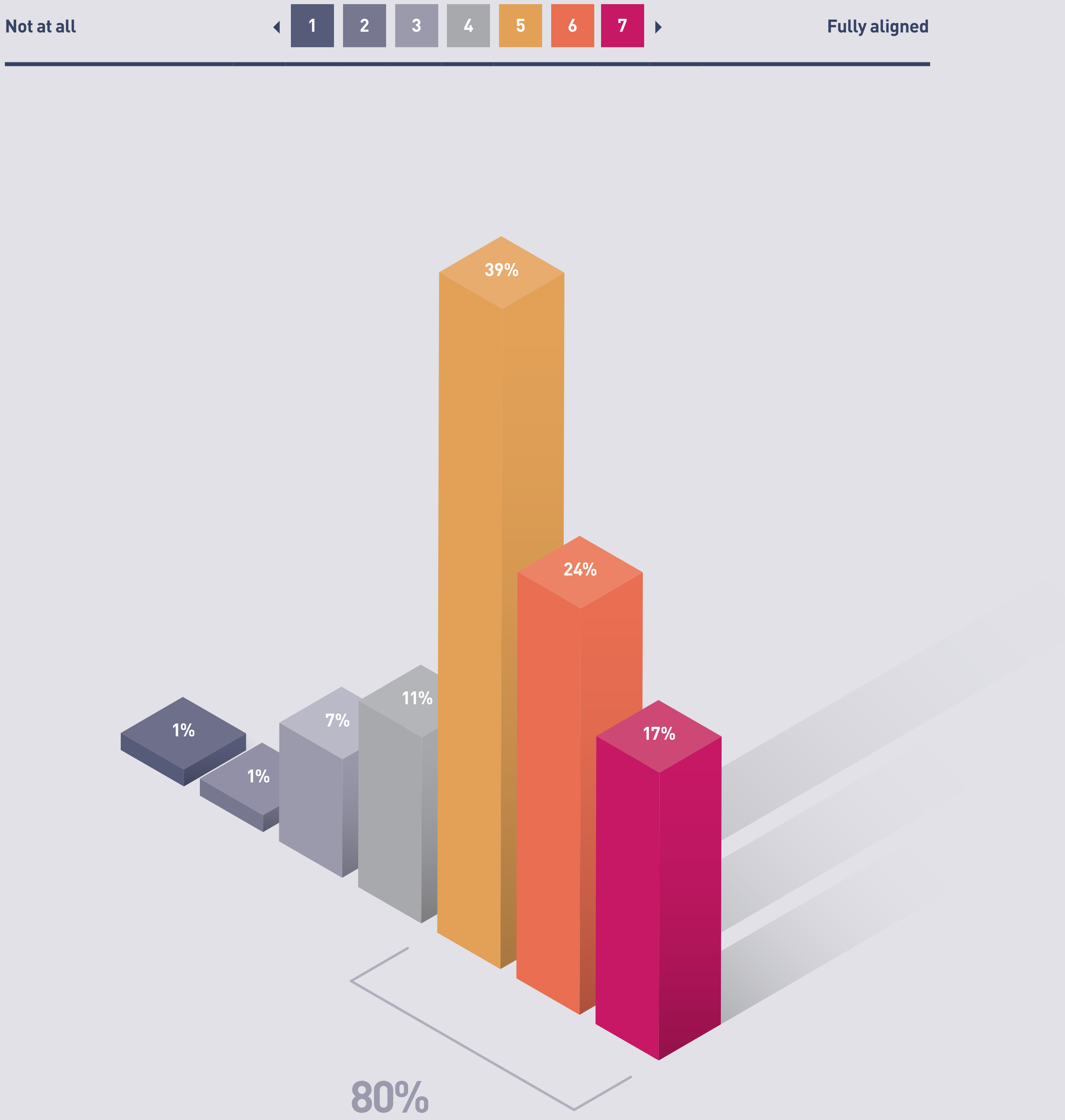
At the same time, companies understand that investors are looking for balance between being a responsible business and a profitable business. Companies are feeling increasingly confident to discuss the need for ESG to make commercial sense, while still feeling pressure from the capital markets to also focus on delivering shareholder returns.

“Everything is aligning with being a responsible, long-term aligned sustainable business but if your numbers aren't going the right way no one gives a toss.”

“12 months ago, you almost felt a fraud to discuss ESG and profit and even if it conflicted with the profit motive it was almost somewhat irrelevant. Now it feels like all the stars have aligned. People might criticise you for focusing on profit and responsibility but from our perspective it has to be a win-win. As long as you practice what you preach.”

“We are able to take a clear view on ESG because of the fundamentals but also because we have a profitable business able to generate return. We have a dividend policy, we've done share buybacks and at the end of the day, shareholders invest in us because we generate a return for them. That is the harsh reality.”

HOW WELL ALIGNED IS ESG TO MAXIMISING SHAREHOLDER RETURNS?



CLOSER CORRELATION BETWEEN ESG, VALUATION AND PERFORMANCE

Looking at the drivers of shareholder returns, there is a clear understanding of the significant, and positive link between ESG performance and financial performance.

59% of companies believe environmental issues will have a significant or very significant impact on valuation and performance over the next decade, driven in part by regulatory requirements such as the Task Force on Climate-related Financial Disclosures (TCFD) and the push for Net Zero.

The current focus on Environmental issues is made more clear if you look at how companies score the issues across ESG. **28%** of companies view Environmental issues as having 'very significant' impact on valuation and performance, compared to **18%** across Social and Governance issues.

Social issues are less understood, but this is changing. **39%** of respondents consider it as having a significant or very significant impact on valuation and performance over the next decade. However, it is recognised that these social issues are carrying increasing weight within organisations. Post Covid, there is an emphasis on community, wellbeing, and mental health as much as there is on diversity and inclusion. Equally, as we explore later in this report, there is a clear recognition of the role ESG now plays in employee talent attraction and retention. Social's growing importance is demonstrated in that **83%** of those surveyed view social issues as having a noticeable, significant, or very significant impact on valuation and performance (Scores: 5-7). This is an increase from **52%** last year. However, the challenge remains in how to quantify social impacts and more closely correlate the performance of social issues to measurable targets and financial metrics.

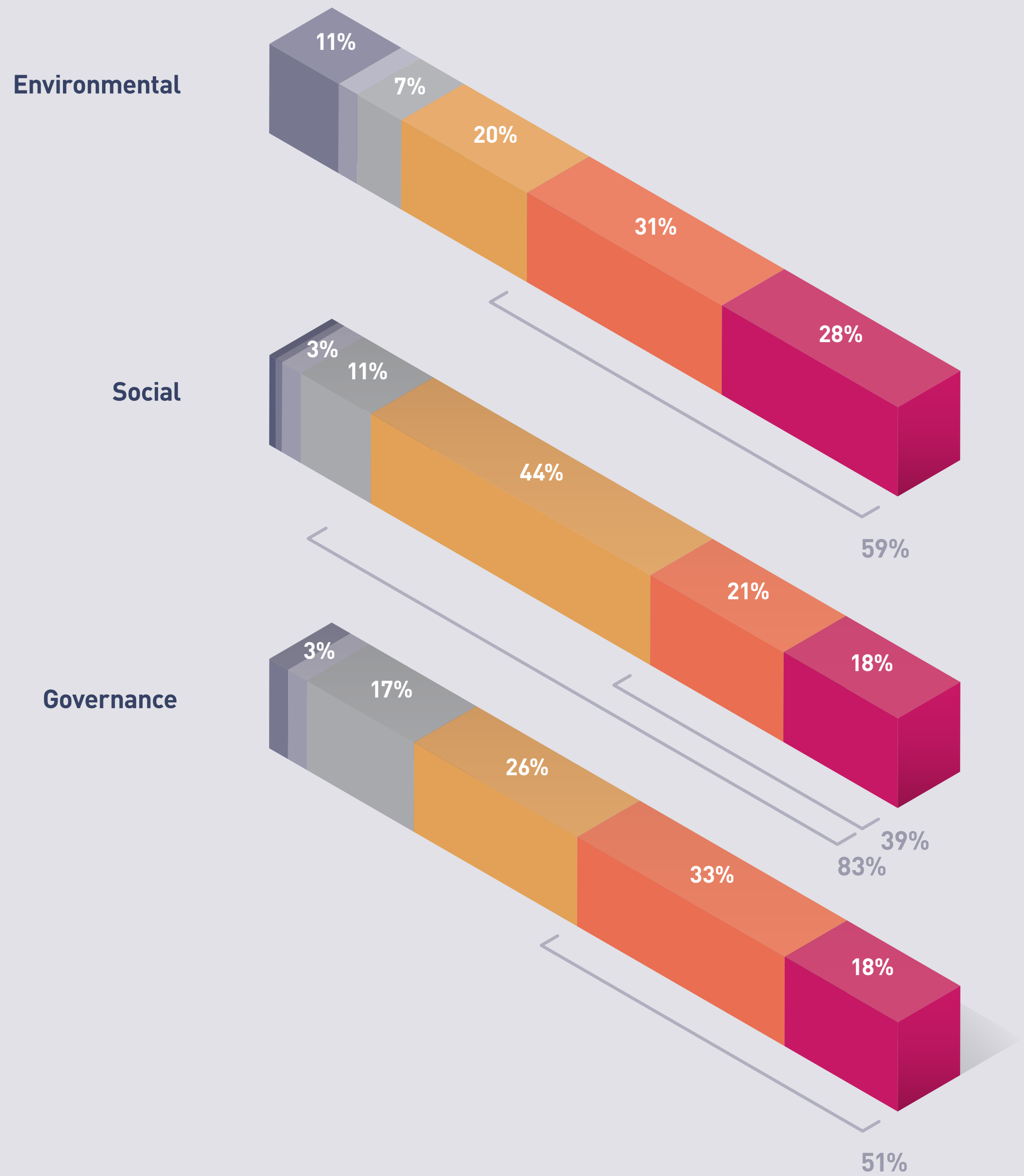
Governance as a practice within ESG continues to evolve and is becoming increasingly multifaceted, with **51%** of respondents viewing it as having a significant or very significant link to performance and valuation. Governance concerns itself both with the internal systems of practices, codes, procedures and taking account of stakeholder views, to now also include the governance of ESG itself. Putting in place proper Board oversight of ESG actions and objectives has become increasingly important, with companies taking different approaches to who holds responsibility for ESG within an organisation, and how it is measured, reported, and motivated through remuneration policies. We will explore all of these areas in more detail in this report.

83%

of companies view social issues as having a noticeable, significant, or very significant impact on valuation and performance

WHAT LEVEL OF IMPACT DO YOU BELIEVE ESG ISSUES WILL HAVE ON VALUATION AND PERFORMANCE OF YOUR COMPANY OVER THE NEXT DECADE?

No impact 1 2 3 4 5 6 7 Very significant



PRESSURE FROM ACROSS THE STAKEHOLDER LANDSCAPE TO IMPLEMENT ESG

Management teams are increasingly developing their ESG programmes in response to growing pressure and interest from a wider range of stakeholders.

The capital markets have historically been viewed as one of the main drivers of ESG, but this year there has been a marked shift to a more multi-stakeholder focus, driven in part by the growing influence of social issues.

Last year, **77%** of interviewees labelled the capital markets as the most important driver for implementing ESG. This year, this has declined slightly to **72%**. The more marked trend has been for customers, consumers, and society being referenced by over **86%** of respondents, with the challenge to corporates being to meet the different expectations of stakeholders.

“Clients and investors have really driven the agenda. I would like to think that we would have come as far as we have anyway, but if there wasn’t a market demand, I suspect we wouldn’t have done so. Having that strong demand from both of these stakeholder groups is really important.”

“Our customers really drive the agenda strongly for us. Some of it is around transparency and some around more specific projects which they are expecting us to cover.”

“With clients, one of the challenges is that we have a pretty diverse range of clients, and they don’t always want the same thing and they don’t always know what they want. There’s lots around carbon and Net Zero, but they say one thing and when you unpick it you realise, they mean something else.”

“We are increasingly receiving more and more questions from customers. Some of that presents a challenge in providing the disclosure and transparency we want to, but not always being able to from a business or IP perspective.”

To add to the focus on multiple stakeholder demands, regulators are also requiring increased levels of disclosures and transparency on ESG. **66%** of respondents this year referenced the regulators as putting pressure on to implement ESG.

“There is so much regulation coming down the line. It’s immense and it’s a lot for corporates to deal with in addition to running the business day-to-day.”

“If you don’t want to be a responsible business, why are you doing it? It’s often a regulatory requirement like TCFD, s172 etc that are pushing people into ESG. Those are the real things that our Board is focused on.”

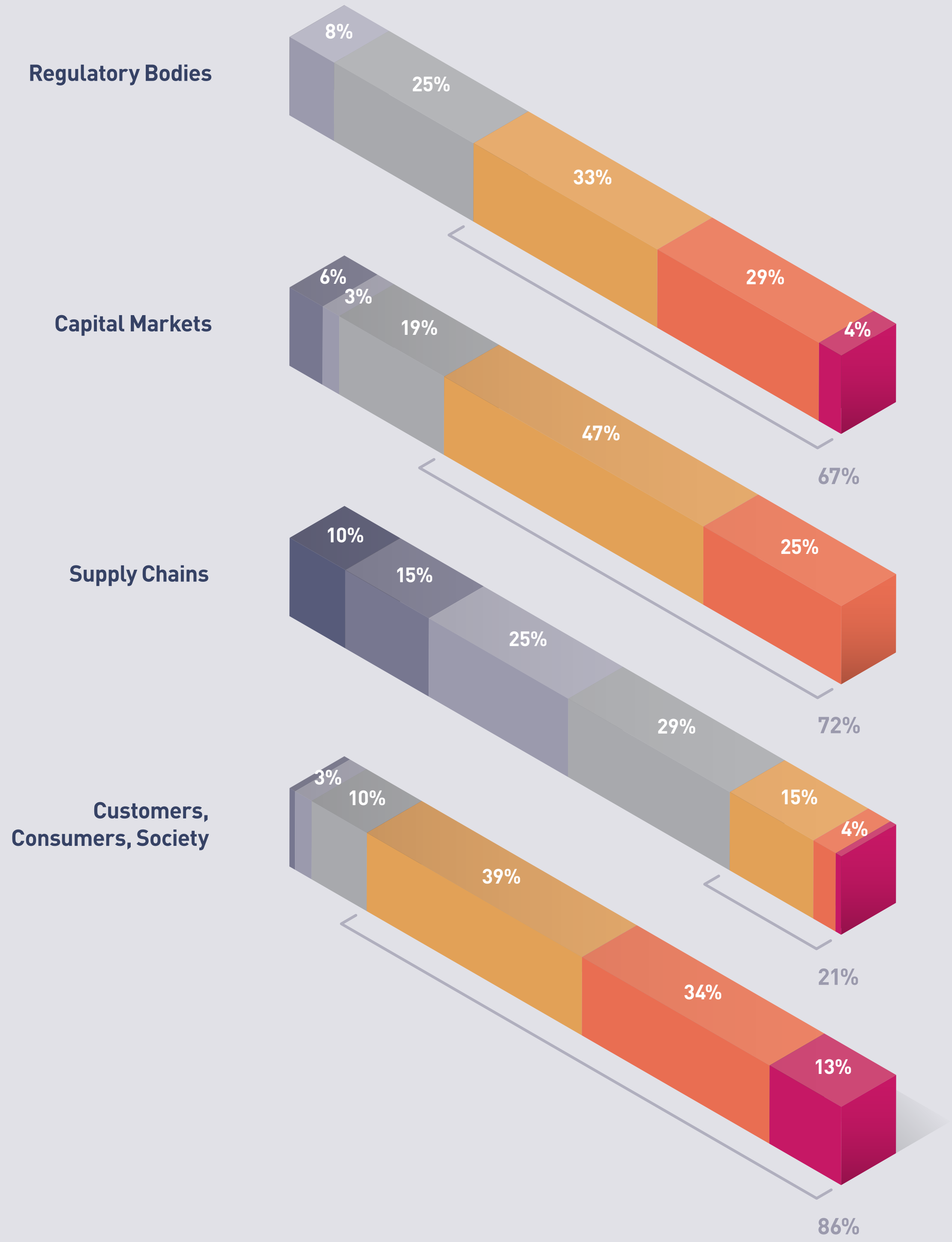
Interestingly, only **21%** of respondents referenced the supply chain as putting a lot of pressure on to implement ESG. However, reflecting the point on customers driving the ESG agenda, this does depend on where an organisation sits within the value chain.

“We don’t feel pressure from our suppliers. We’ll probably be putting pressure on them rather than the other way around. But in a positive way.”

“What our supply chain wants is certainty of their pipeline of work as well as all the hygiene factors on being paid on time. We just launched our ‘Net Zero Partners’ project earlier this year which is effectively a supply chain engagement programme. A lot of them aren’t interested in carbon emissions, and those who are, are much smaller and are grappling with it, so it’s about helping and upscaling them. But for many, their concerns are more commercial than ESG.”

HOW MUCH PRESSURE DO YOU FEEL FROM YOUR STAKEHOLDERS TO IMPLEMENT ESG WITHIN YOUR ORGANISATION?

No pressure 1 2 3 4 5 6 7 **Very significant**



ESG IS VITAL IN ATTRACTING AND RETAINING TALENT

While ESG has been seen as an investor relations fad in the past, it is now clearly a concept which must increasingly consider multiple stakeholders in its evolution and take into account a company's licence to operate and its reputational value.

This is further evidenced by one of the key takeaways this year being how corporates consider ESG as vital to their employee retention and attraction efforts. It is no longer just about competitive salaries and benefits. People are increasingly expecting their employers to be socially and responsibly active. Employers are expected to have and adhere to strong environmental, social and governance credentials, whether they be Net Zero programmes, wellbeing considerations or strong Diversity, Equity and Inclusion (DEI) policies. As many as **65%** referenced feeling pressure from the workforce to implement ESG.

“ESG issues always rank very highly on employee surveys, and it seems they feel we're doing a good job on this. Staff are very interested and there is always a lot of engagement with any updates we provide in this area. We've even had people highlight in interviews and job acceptances that they have chosen us over competitors as a result of our work in this area.”

“Our people are absolutely interested in our responsible business piece. It comes up in recruitment very often in that people ask what we're doing. Pressure is probably the wrong word. Its more encouragement from our people.”

“People, retention, and talent recruitment is a key issue for our sector. But we probably need to drive this issue harder.”

“The one area, in the current labour market in particular, is people. We don't really talk about ESG internally, we talk about sustainability. Two of those pillars are around Health & Safety and our people. When we were coming up with the current strategy period, forecast and outlook, the single biggest constraint on that was People. If you take that broad view of sustainability there has to be a greater focus on: Where are those people? Where are those skills? How are we developing those engineers of the future, to support growth in the sector? I think the people angle often gets overlooked.”

It was also recognised that younger generations are more likely to make career decisions based on an employer's or potential employer's commitment to ESG issues. To capture the Generation Z and beyond, a company needs to be very clear on its ESG and sustainability drivers and positioning and behave accordingly. Getting the purpose and values right, and showing you are actively demonstrating those behaviours will be essential.

“On employees, you can't just say 'all employees' because your early careers have one set of priorities very much driven by a company being ethical and doing the right thing and then you have those at the middle or end of the careers who have very different priorities.”

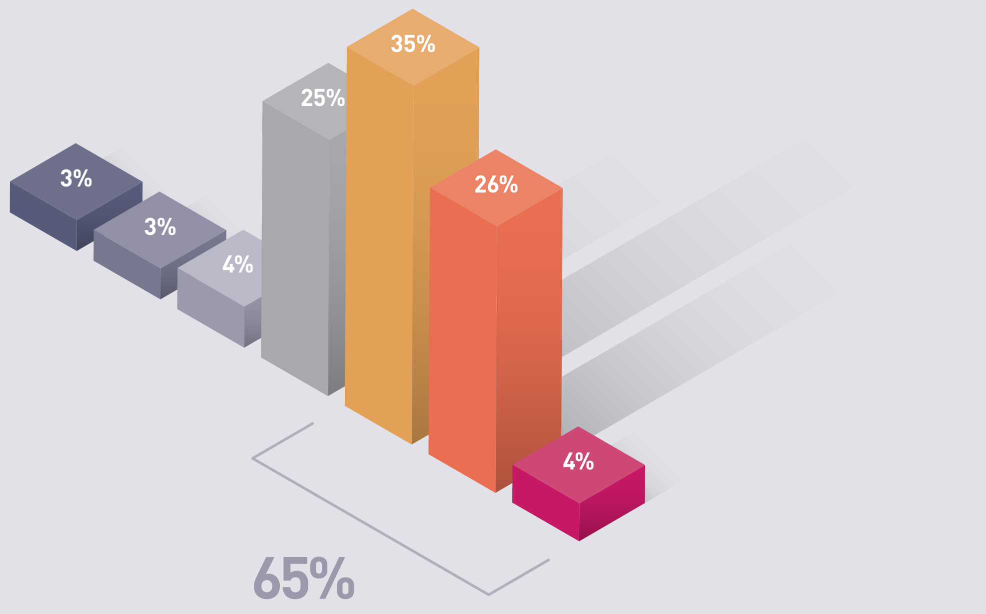
“Being a progressive company is attractive for younger people in particular. If we were doing a risk matrix, people would be the biggest material risk to the business and retaining and attracting them is therefore critical and one of the tools in our tool kit is being a responsible business.”

It was also made clear that ESG is equally as influential in employee retention with elements such as wellbeing, mental health, and DEI featuring highly. Employees need to see that their employers are taking its commitments seriously and behaving in line with their ambitions.

“Social is one area where we have done a little more than others, but we aren't talking about it publicly. Health and safety is critical to us and its one where you have to have the highest standards. The labour challenges at the moment are also playing a role so attraction and retention is extremely important and drives a number of factors. Wellbeing has been a big one ever since the pandemic – and we look at it from an emotional, physical, and financial standpoint. Inclusion and diversity this year has also been a big part – especially around retention. Its constantly evolving.”

HOW MUCH PRESSURE DO YOU FEEL FROM YOUR WORKFORCE TO IMPLEMENT ESG WITHIN YOUR ORGANISATION?

No pressure 1 2 3 4 5 6 7 **Very significant**



“We've done a lot of wellbeing stuff around flexible working, cost of living crisis, and there has been a lot of focus driven by the massive changes that are going on around us and how that impacts our people. Providing support to our people is something we have developed and focused on a lot and is very important in retaining our workforce.”

Going forward, management teams must develop their ESG programmes not only to attract certain investors and to meet regulatory challenges, but also to attract and retain talent; to meet customer and consumer demands; to engage with and involve their supply chain; and/or to build or differentiate their brand and reputation. Many companies now recognise that ESG is as much a protector and driver of social value as it is of enterprise value. In the future, the role of ESG related to a company's licence to operate and reputational value will likely require more comprehensive data and stakeholder measurement tools are introduced to an historically intangible area.

“I would actually quite like the conversation to be around 'this is good business sense' and it's about growth and business opportunity. It's not something woke or fluffy. It just makes good economic and commercial sense because this is how we are going to grow as a business and also how the economy is going to be successful.”

“"It makes good business. It is your social licence to operate.”

COMPANIES ARE FOCUSED ON EMBEDDING ESG IN STRATEGY

Last year, 26% of companies described their approach to ESG as 'embedded within our strategy, with processes in place to reduce risk and identify opportunities', with a further 26% of respondents only just starting to look at ESG. This year, 52% of respondents are focused on embedding ESG within strategy, with processes already in place, demonstrating how quickly corporates are responding to the challenge and have evolved their practices.

Throughout the research, we noted little difference in the approach to ESG when determined by market capitalisation.

"It's not just nice words on a website, and motherhood apple pie statements. It's more than that. I try and make it data driven, tangible, evidential, with case studies and more. It is a heavy lift, but we have the right ingredients, it's the right thing to do and so it's a real pleasure to develop our sustainability strategy."

"About three years ago we set out a new purpose and vision with four very clear strategic pillars. ESG resonates across the whole lot of them, and there is a clear definition of responsibility and responsible behaviour. We genuinely believe if we do this well, we can have an impact."

"We have a roadmap and a strategy that we have spent the last couple years agreeing with the Board and mapping out with consultants and we believe it can make real change."

"For us we see it as a necessity to get it right. We want to tell our story to our shareholders, but equally it's about our own risk management and strategy development as well. We need to pre-empt the risks to our business as we're at quite big exposure to some of the implications of climate change."

36% of respondents view ESG as growing in importance, with some processes, policies, and reporting in place, with an additional **10%** viewing ESG as a reporting requirement. This means just over **97%** of the companies we have surveyed have made some inroads into ESG, though many recognise that more progress needs to be made in fully embedding it across the business.

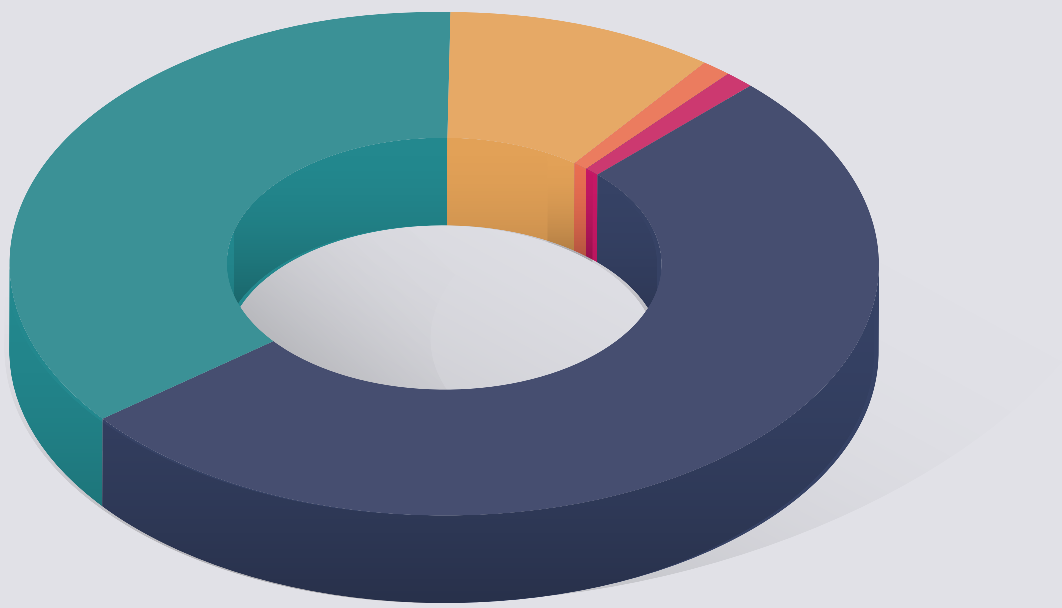
"Our position on this for now is quite cautious but fair. When we talk about strategy being embedded that is where we are less integrated. We have a strong understanding of the importance of ESG and there is no danger of it falling off the agenda, but we need to work on things like, influenced by TCFD, connecting business strategy and purpose with ESG. They are not completely at odds, and we have done a good job on governance and risk, but business strategy and growth strategy, is where it's less clearly defined."

52%

describe their approach to ESG as 'embedded within strategy with processes in place to reduce risk and identify opportunities'

WHICH OF THE FOLLOWING STATEMENTS BEST DESCRIBES YOUR FIRM'S CURRENT APPROACH TO ESG?

Embedded within strategy	52%
Some processes, policies and reporting	36%
Reporting requirement	10%
Just starting	1%
Unimportant	1%
Not started	0%



CHALLENGE REMAINS IN HOW TO FULLY EMBED ESG ACROSS THE BUSINESS

While 52% are embedding ESG within the strategy, only 13% would consider ESG as fully embedded within the business. This demonstrates the challenge and gap between understanding ESG and its importance and value to actually implementing and embedding it across a business and value chain. As with any change management initiative, it takes time and resource to embed fully.

The general belief is that, as ESG continues to grow in influence, and in relevance, it will become intrinsically part of the operational and strategic elements of a business. It is at this point that we believe ESG can be considered fully embedded, when it is part of the day-to-day operations and management processes and fully linked and supportive of corporate strategy and purpose.

“More and more it becomes operational and is about being sustainable as a business. It starts with sustainability, but we don't have a climate strategy, or an ESG strategy. We have one business strategy and if we're doing a business well, our material ESG priorities are a natural part of doing business right.”

“It's intuitive to us and yes, we need to integrate it more formally, but I suspect in 5 years' time we won't be talking about ESG because it'll be a given. It'll be there but we won't be making so much noise about it from a marketing perspective. You just have to get on and do it.”

“We are not going out to the world to say we think about ESG in all our decisions, because we're not there yet. But we're working on it and in the end, we won't need a Responsible Business Strategy because it'll just be part of our regular strategy.”

At the moment, corporates are focusing on really understanding the drivers of ESG, on assessing the implications of risks and opportunities related to ESG for the business, and on setting realistic and deliverable ambitions and targets, before setting out significant detail to external stakeholders.

“The approach we are taking is, we are not a trailblazer, but equally we are not a laggard. We are quietly confident. We're not just throwing things out there. We consider things carefully and have an action plan to deliver on them.”

“We are reluctant to not go too far out there with what we know is potentially not good quality data.”

“We are taking a fundamental approach to it, so when we fully understand what it means to the business, we will be more confident about saying something about it. We're committed to transparency, but it has to make sense.”

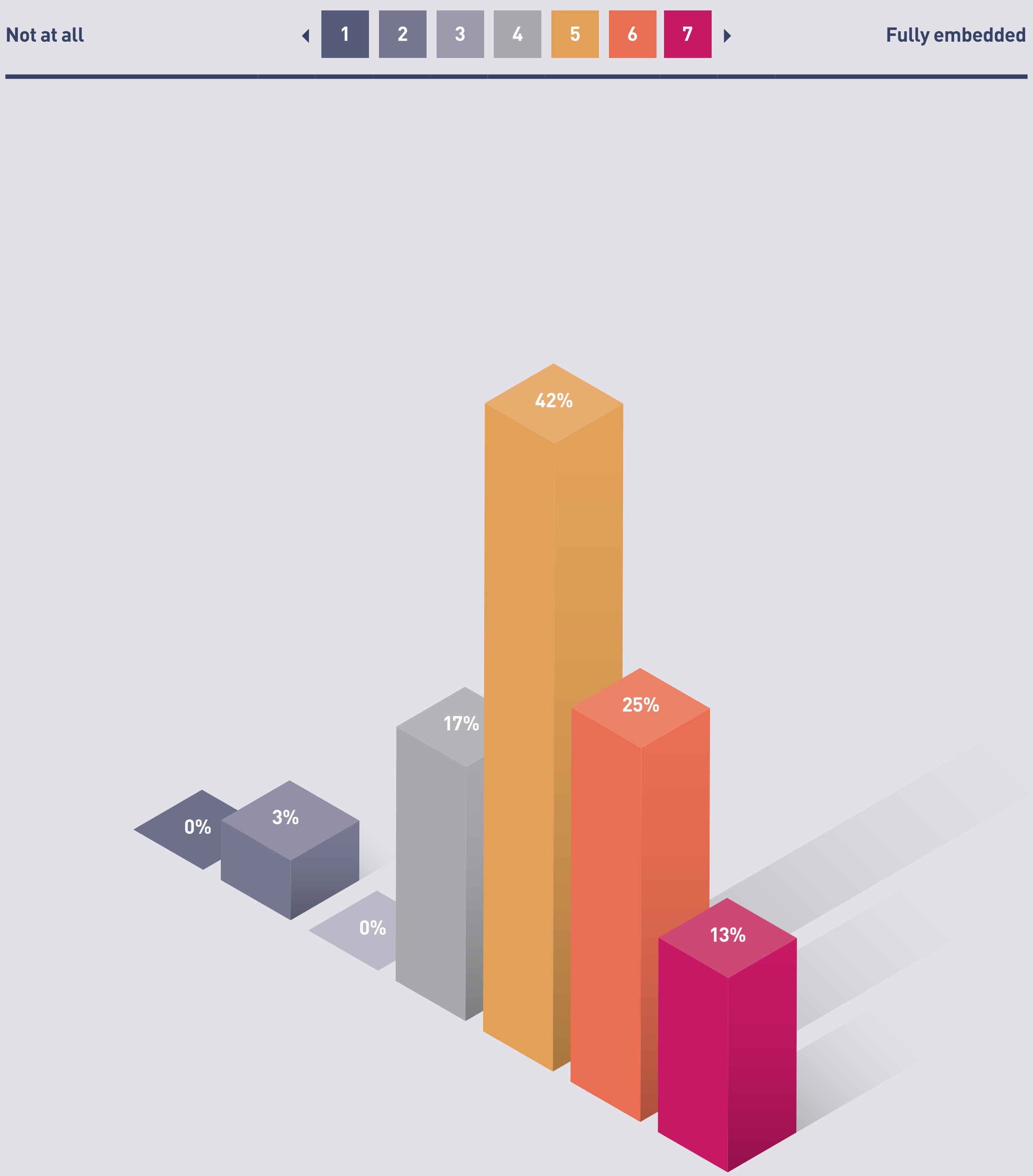
“We need to get more comfortable with being uncomfortable and everyone is facing the same challenges on what to say and when to say it.”

“I feel like a lot of companies are doing stuff and intentionally not saying anything and we're in that space. We're doing lots, and getting our ducks in a row, but we want to be confident in it and when we're confident we'll tell everyone.”

“We don't want to do these things as tick box exercises. We want to do these things because they make sense, because they're right for us, and align with what our staff believe in, and our Board believe in. We want to be really honest about where we are. We want to do things right, but we want to be realistic.”

“We want to be best practice; but I wouldn't see us as being trail blazers but compared to the large caps we would be watching what they are doing.”

TO WHAT EXTENT DO YOU BELIEVE ESG IS EMBEDDED WITHIN YOUR BUSINESS?



ESG IS PART OF REMUNERATION, BUT IMPROVEMENT IS NEEDED TO DEVELOP METRICS

How ESG is linked to remuneration is a key indicator as to how well ESG is embedded in a business. With 75% of companies not including ESG in remuneration policies in 2021, this year, only 14% consider ESG 'not at all' linked to remuneration. There remains, however, a clear disparity between companies in terms of how far advanced they are in linking ESG and other non-financial targets to management pay, and in what approach they are taking.

Overall, there is recognition that ESG should be considered as a component in rewarding management performance, but many companies have not progressed as far as to link to specific metrics and are instead starting with a qualitative approach. There is, however, an intention, and expectation, to continue to evolve this, in line with ESG strategy and programmes, and to eventually develop more detailed KPIs.

"We do have some link to remuneration, but it's not based on any quantitative measures, it's more a qualitative assessment on how well we're progressing against our framework and our wider strategy."

"ESG is disclosed as an element of the scorecard for the executive committee. The remuneration committee does take into account, increasingly, ESG factors in how they consider performance and awarding remuneration. It's more a qualitative assessment, using quantitative input if needed."

"We probably need to address the LTIP and look to have at least 10% attached to a specific ESG metric."

Choosing ESG measures for pay continues to be a challenge for Remuneration Committees and many have yet to set out management pay policies which include ESG measures. In particular, corporates are battling with how to set targets; the availability of reliable data and supportive evidence to motivate and support decision-making, and how to ensure targets are measurable, achievable, and linked to realistic dates.

"ESG and executive remuneration is quite a fast-moving topic. I am having conversations with our Rem-Committee, and we're all agreed that we would like to do it and we will have the capability to do it. We talked about doing it this year but given this is the first year we have robust data, we did not feel we were in a position to see trends and set realistic dates and targets for it so it's something we will look to develop next year."

"The reason people struggle with the Remco is that they don't know how to set and value KPIs. It can't just be an MSCI rating so what is it? That is the challenge for Remco's. If you make ESG 20% of remuneration, how do you mark it? How do you evaluate it? How do you set salary accordingly?"

"How to tie it to the LTIP is the biggest challenge. It is all being discussed, and the Remco is trying to work out the best approach."

86%

of companies have established some form of link between ESG and executive pay

Despite the recognised challenges, many companies have made considerable progress in evolving ESG and non-financial targets into their remuneration policies with measurable environmental, social and governance targets. Linking ESG to pay is seen as a way to hold corporates and their senior executives to account for the commitments they make. For most, the approach has been a link to short-term bonuses or LTIPs, or both, with up to 20-30% related to ESG. In this survey, across sectors, the most frequently referenced ESG metrics included carbon emissions, NPS scores, health and safety measures, and people-related metrics related to DEI or attrition rates.

"We have an element in bonus payments, which is a little more subjective, although linked to specific objectives. We have a dozen ESG objectives which are all SMART with proper targets and measurable, and we have a newly introduced LTIP on a PSP plan where 25% is ESG net carbon zero targets and others which are specifically measured."

"In the short-term bonus, we consider ESG. There is a safety and sustainability component. We updated it this year and are introducing an up to 20% element of the LTIP linked to ESG. We haven't yet defined what metric that will be based on, but we think it will be emissions."

"For the first time this year, for the Executive Director and Executive Committee colleagues, 20% of annual bonus targets are linked to non-financial measures, five of which are loosely sustainability linked. These were all announced in our most recent results presentation."

"This current financial year is the first year that we have had any ESG elements within the bonus plan, but it's still a relatively small percentage, a single figure, of the overall criteria. We don't have many metrics within ESG, so we are effectively looking at Scope 1 and Scope 2 right now."

"ESG is not just a nice to have. We need to see ESG becoming a bigger component of executive remuneration. I think it's about 10% of my KPIs, whereas the rest are on how I engaged operationally and financially and if I engaged with shareholders and the other typical KPIs."

In those companies who have made more significant inroads in developing effective remuneration polices linked to ESG, the next step is in extending those targets across the organisation to ensure the wider workforce is motivated to achieve corporate ESG ambitions.

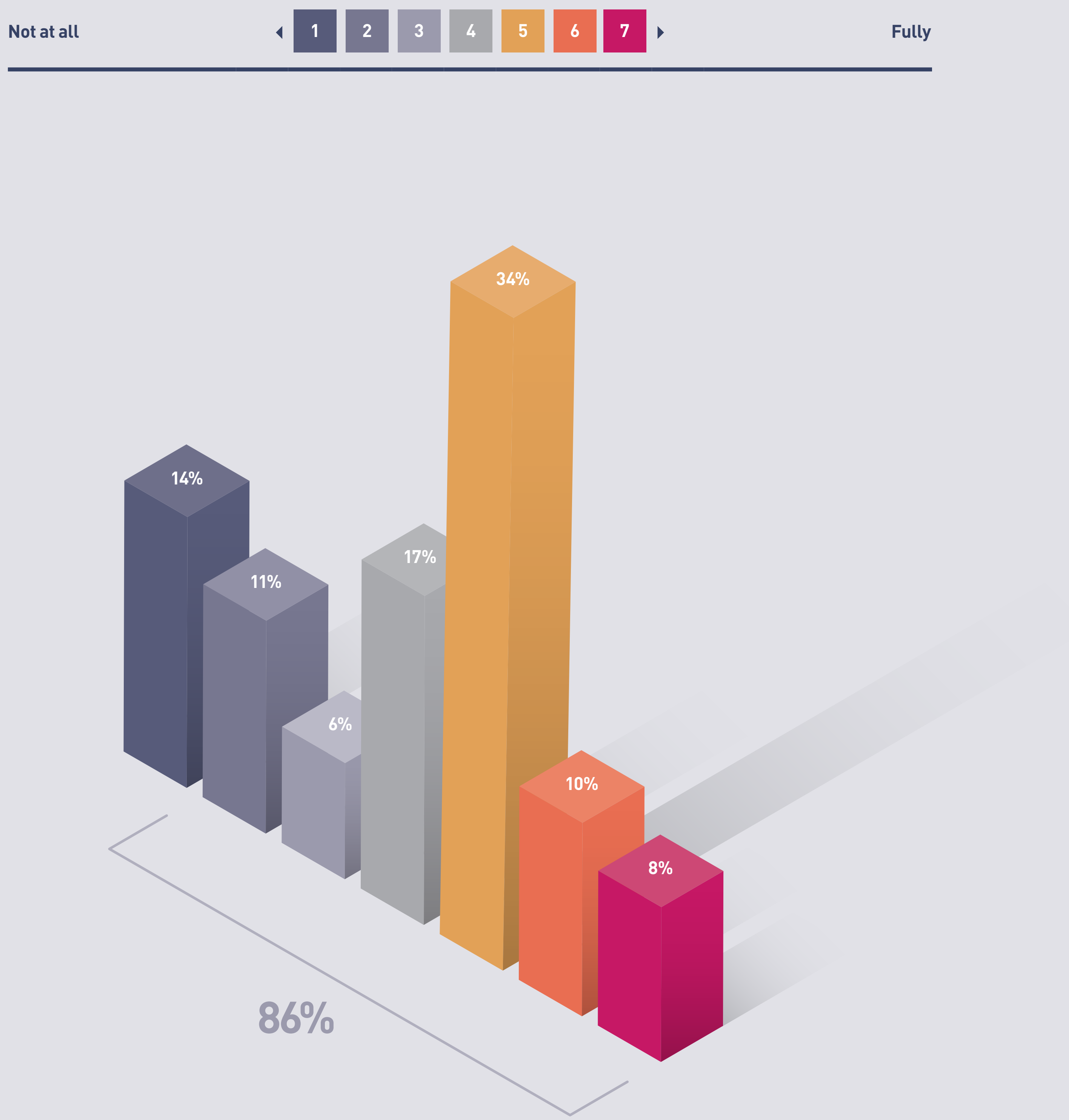
"What we need to do is filter the targets across the wider business. It shouldn't just be executives who are measured on non-financial targets. We need to live and breathe these things across the whole business. We can't achieve change meaningfully unless we bring our employees with us."

"Linking ESG to remuneration is done within the bonus scheme. 25% of the annual bonus scheme is based on non-financial ESG targets. ESG is definitely there, but this is the first year it's been made that explicit and goes down across the first 1000 people."

Overall, there is agreement that including ESG metrics in executive pay packages is a tangible way to evidence a company's commitment to its ESG ambitions. There are however challenges in ensuring that metrics and the focus of remuneration policies are there to support wider ESG objectives and are linked to material issues specific to the company in order to motivate the right impacts and behaviours. Any non-financial targets should be directly linked to strategy and ESG priorities, not set arbitrarily in order to tick a box, or to meet a stakeholder demand. Getting it right is important, as the level of interest in this area will only continue to rise, not only from investors but also from broader stakeholders.

ESG IS PART OF REMUNERATION, BUT IMPROVEMENT IS NEEDED TO DEVELOP METRICS

TO WHAT EXTENT IS THE LEADERSHIP TEAM'S REMUNERATION DIRECTLY LINKED TO THE COMPANY'S ESG PERFORMANCE?



ESG NOW FIRMLY ESTABLISHED ON THE BOARD AGENDA

As interest from investors, customers, consumers, and other stakeholders continues to grow, ESG has become a standing Board and/or Committee meeting agenda item, whether in specific Sustainability/ESG Committees or in the Audit and Risk processes. 68% of companies ensure ESG is on the Board agenda at least quarterly, with 32% talking about it more frequently than quarterly.

"We published our first sustainability report this summer and so there's more engagement on it internally. It's also a standing item on the board agenda. I update the Board monthly on ESG items. Sometimes there's rather in-depth detail to provide to the board but sometimes it's difficult to provide tangible updates. It almost feels like it is a must to have it on the agenda, but you also need to be driving things forward."

"We meet every 4 to 6 weeks. Quarterly isn't quite enough given the constant changes to the regulatory landscape and more than monthly feels a little overkill."

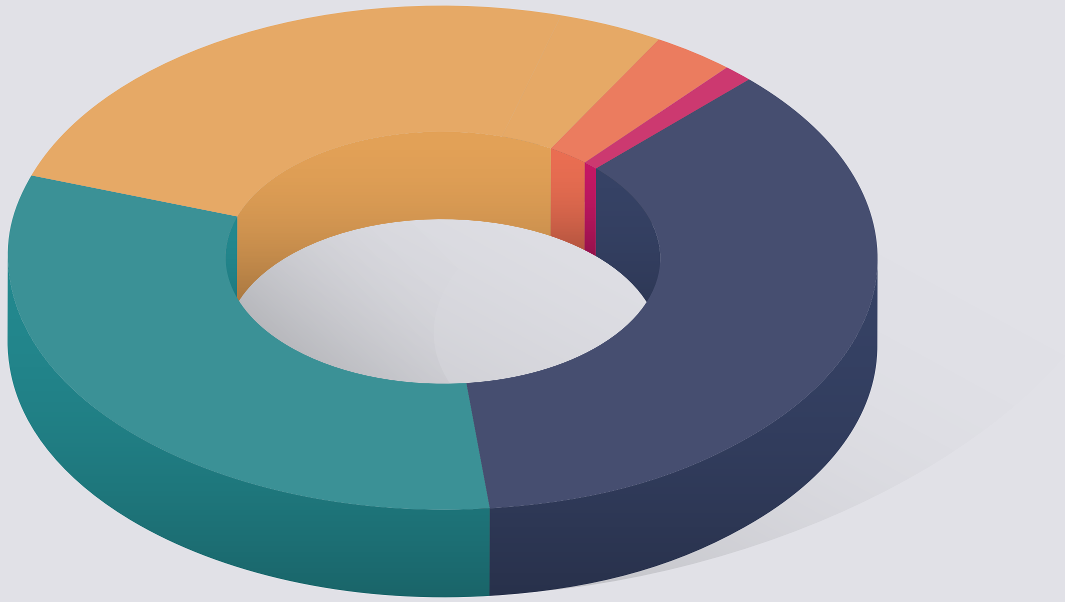
"Our ESG Working Group meets about 6 times a year, at least, and updates are given to the Board after each time."

While this is a continued positive trend on last year, there is still disparity in the approach taken and the level of detail covered. For **24%** of companies surveyed, ESG is still only discussed at Board-level twice per year. We expect to see this evolve in future years and become a more frequent and in-depth discussion item, especially as governance and regulatory pressures continue to increase.

Equally, as ESG continues to become more closely aligned with the overall strategic drivers of a business, and is seen less as a separate practice area, ESG-related issues will land on the Board agenda more frequently. In addition, as regulation drives more alignment between ESG disclosures and financial implications, there will be a requirement for the Board to understand in more detail the potential financial implications of ESG initiatives and objectives, tying ESG much more closely to the more regular financial calendar and capital markets updates.

HOW OFTEN DOES ESG FEATURE ON THE BOARD AGENDA?

Quarterly	36%
More frequently than quarterly	32%
Half-yearly	24%
As important matters arise	4%
Annually	3%
Less frequently than annually	1%



BOARDS ARE FACING NEW DEMANDS IN THEIR ROLE TO DRIVE ESG

As ESG continues to evolve, it places companies under increasing scrutiny, meaning Boards are being confronted with new expectations and requirements on their time and knowledge.

With ESG horizons leaning more towards the medium and long-term, the Board (and executive management) must also take into account factors beyond the usual one, three, and five-year strategic outlook. With this new focus, a new mandate has been placed on the Board to oversee and drive ESG. The findings of this report are seeing the Board rise to the challenge: **67%** of respondents this year reference the Board as putting pressure on them to implement ESG, with most seeing the Board as very collaborative and engaged.

“All our Board members are on other Boards, and so are realising this is a recurring question. If you haven't been educating yourself then where have you been?”

“We set up a Sustainability and Ethics Committee which bought an attention and focus to it and they're prompting and probing and challenging management on what we're doing and ensuring we're doing it well. It took us two years to set out the Terms of Reference for the committee and to really narrow it down and be forward looking. They have taken on a lot of education and are ensuring that there is a very strong evolution at the Board level.”

“The Board are very engaged. They go to a lot of educational seminars around this and one of our NEDs is signed up to climate training. They are also happier now because we have a full-time Sustainability Director who is passionate about the role and our ambitions, and so they are getting frequent updates and insight and have to do less pushing as it's in hand.”

“I am really impressed by our Board. They are well educated and the thing that makes my job much easier is the authenticity. The individuals are absolutely committed and genuinely believe if we're going to do it, we should do it right.”

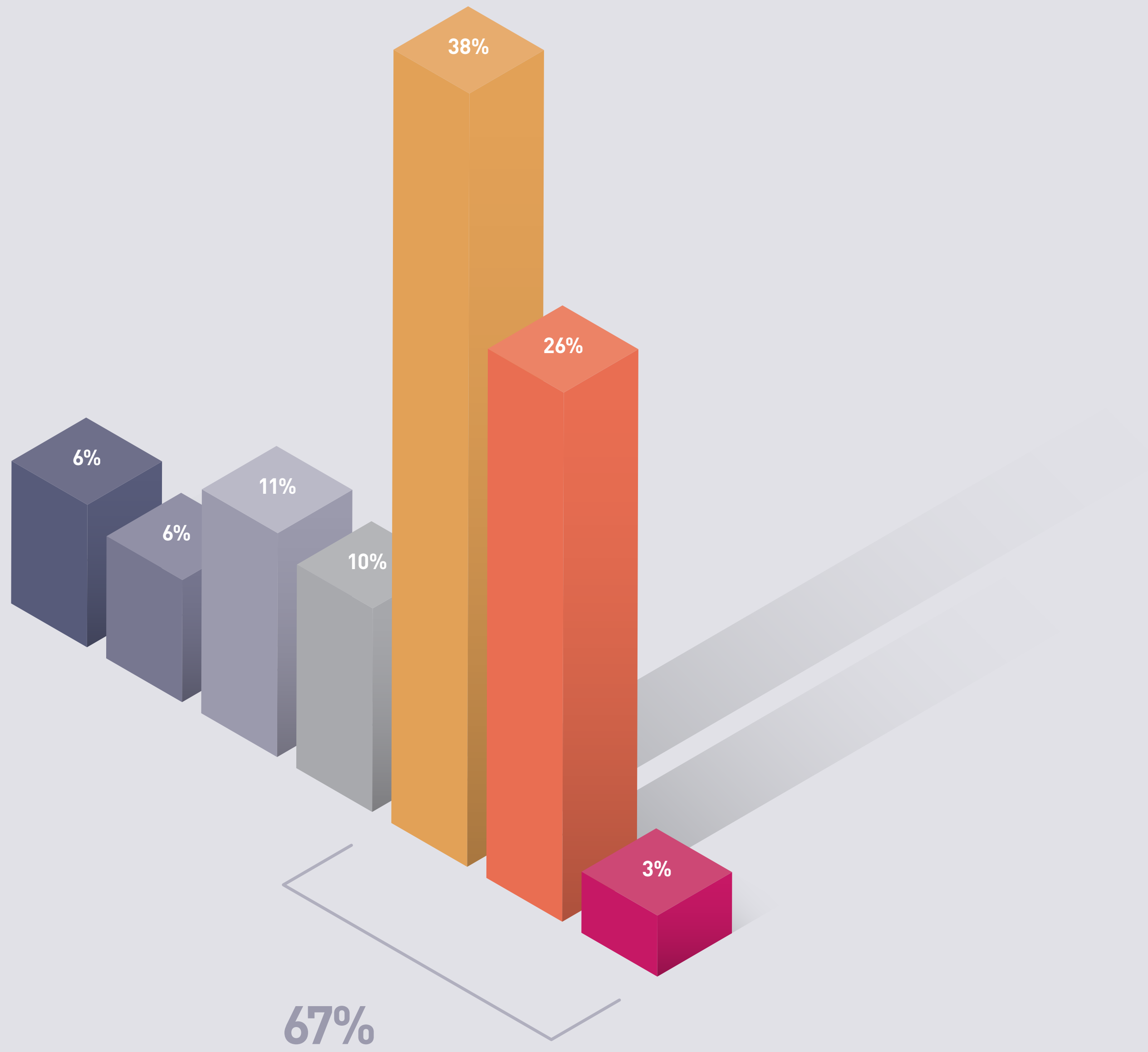
“There is very little pressure from our Board because there's an understanding that it needs to be done so we're all alongside each other working together to make it happen.”

“We are bringing our Board on a journey in some respects. They have a lot of experience in other areas but we're also doing parallel training as we don't have climate experts. We are trying to put in place Board Committees and to bring them along, so they are equipped to hold us to account. We do now have a ESG Committee and someone responsible for those matters but really, it's about the exec team pushing the Board rather than the other way round.”

“The business is driving it forward through our Responsible Business Council, but there is real buy-in from the Board. The business drives everything forward, but the Board is very into it all. Different members of the Board will champion different areas like the environment, DEI. They're all over it. It's very important.”

HOW MUCH PRESSURE DO YOU FEEL FROM YOUR BOARD TO IMPLEMENT ESG WITHIN YOUR ORGANISATION?

No pressure 1 2 3 4 5 6 7 **Very significant**



The Board and Executive Management has an important role to play in ensuring accountability at all levels for corporate strategy and the related ESG issues, with a need to also understand the risks and to capitalise on opportunities. The tone from the top can make the difference in how successful an ESG programme is, and for most corporates, the responsibility for ESG sits firmly at the top of the organisation with CEO and or C-Suite being referenced by a total of **78%** of respondents, with Board-level Committees being the most referenced vehicle for C-Suite involvement and oversight.

“We have a Sustainability Committee and that should be taken just as seriously as the Audit Committee, Remuneration Committee and the other committees.”

“The Board has now got a dedicated ESG Committee but trying to define the scope was quite difficult. Frankly if your biggest risk is people, you're discussing that all the time anyway. That's why its embedded in the strategy and what we do.”

“We have really good Non-Exec and Exec involvement in the various governance forums that we have. Our Senior NED chairs our employee forum; our FD chairs our carbon reduction and social value forums, and we have NED involvement in our carbon forum, plus another NED comes to our Risk Committee. So, there is really good engagement right from the PLC Board and down. That is the strongest thing with our governance is very active Board level engagement.”

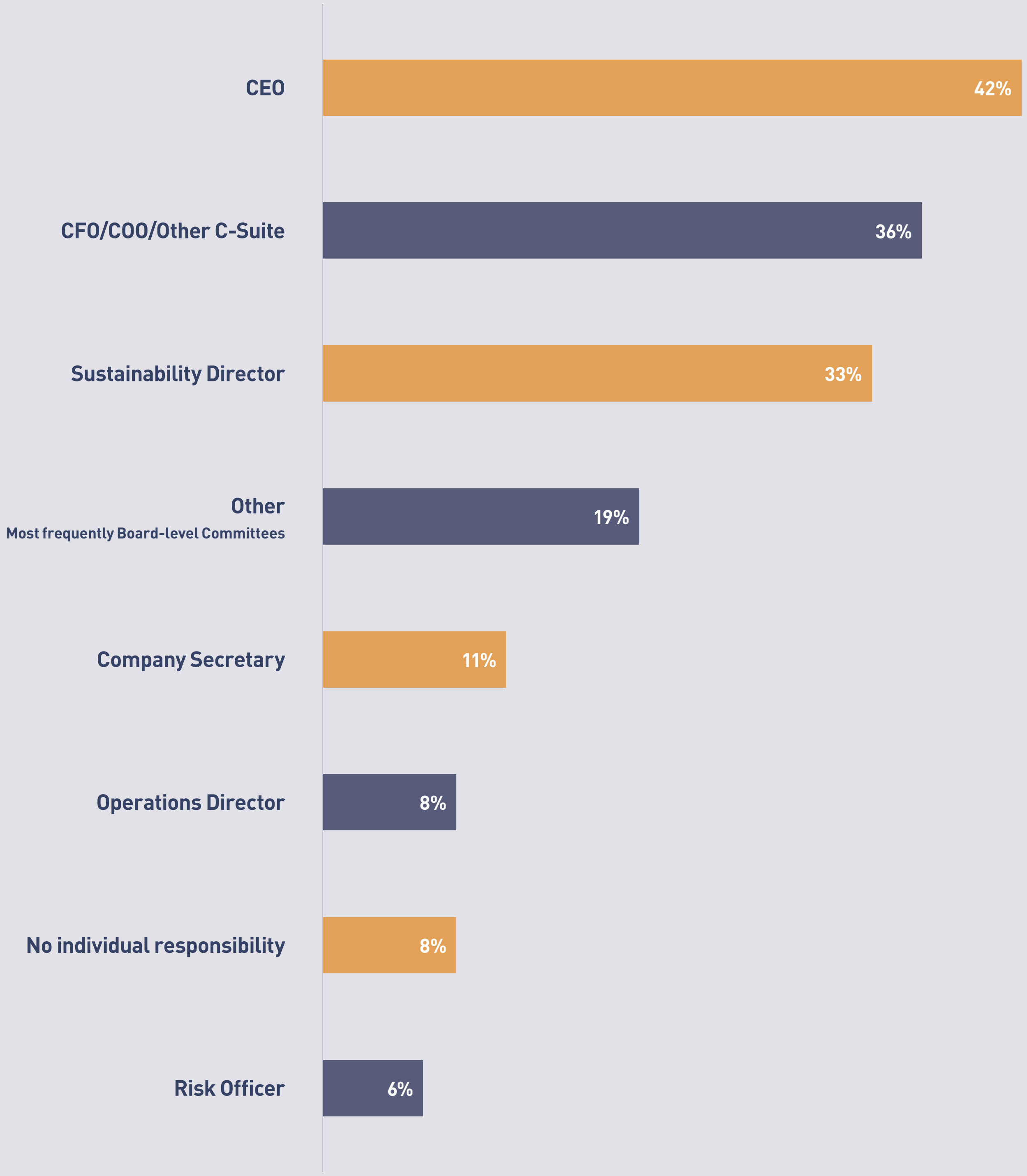
“The Board has now established its own Board ESG Committee and then there's the executive committee which reports in and manages ESG staff across the business.”

“The 'green team' has existed in various forms for a few years now, and now there's the ESG Committee which has existed for a little over a year now. That came out of the materiality assessment which raised ESG governance as a key issue.”

As a clear indicator of how far ESG has evolved from a compliance and risk-based approach to encompassing a wider remit, **33%** of companies also referenced having a Sustainability Director in place with responsibility for ESG. Although there is a clear shift of responsibility towards the C-Suite, or to a more specialised role, Company Secretaries, Operations Directors, and Risk Officers still also play an important role in ESG with **11%**, **8%** and **6%**, respectively, mentioning these roles as responsible for ESG.

“We have an ESG committee – not at Board level but as a management committee. We have representatives from across the company on it so whatever is going on in the ESG world whether its relevant to one part or across the business.”

DOES SOMEONE IN YOUR ORGANISATION HAVE RESPONSIBILITY FOR ESG? IF SO, WHOM?



SIGNIFICANT PROGRESS MADE ON TCFD AND FINANCIAL MODELLING

The Taskforce on Climate-Related Financial Disclosures (TCFD) continues to gain traction with 83% of companies confirming they are currently implementing its recommendations.

This is a notable change from last year when **40%** of respondents noted they had started to adopt its guidance. This trend will partly reflect the introduction of the Financial Conduct Authority (FCA) rule for premium listed companies to include a statement in their Annual Reports on whether they have made disclosures consistent with the TCFD recommendations, or to explain why not. The first disclosures against the FCA rule were published in early 2022 and has prompted many non-premium listed companies to follow suit.

“Our focus at the moment is full compliance with TCFD because emissions are such an important part of our story and the oil & gas industry story in general. The plan is to have full TCFD disclosure in the next Annual Report, which is next year.”

“We have just published our Annual Report this week in which we did TCFD for the first time and looked at the impact of climate change. As we said, our number one risk is kind of also our number one opportunity.”

“We went through TCFD for the first time this year. We did a qualitative analysis of our business and will evolve it to look at quantitative over time. But certainly, the dialogue around TCFD in the market is really positive as it forces people to talk more, disclose more and is creating more of a level playing field. Very happy to see the UK lead on this and it looks like the ISSB will follow through on these standards and may create a more international standard.”

There is clear acceptance of TCFD as a framework. Of the companies we surveyed, it was the most frequently referenced framework, partly due to the regulatory requirement, but also as a result of it being viewed as providing high-level principles for consistent, clear, and efficient climate-related disclosures to stakeholders. It is seen as positive that the onus is in the hands of the corporate itself to decide how it wants to approach TCFD. While broadly accepted as a concept and intention, many companies are still recognising the complexities involved in TCFD, including risk identification, scenario modelling, and financial implications.

“TCFD is great in terms of what it is trying to achieve. We're fully supportive of it but like any reporting initiative, it takes time to get sophisticated at it. We did our first report in April and we're working on our next version for Spring. There are some serious complex elements to it in terms of scenarios and we're trying to be careful about how we are approaching it. It will be a process and not one we are fully on top of yet but we're learning as we go.”

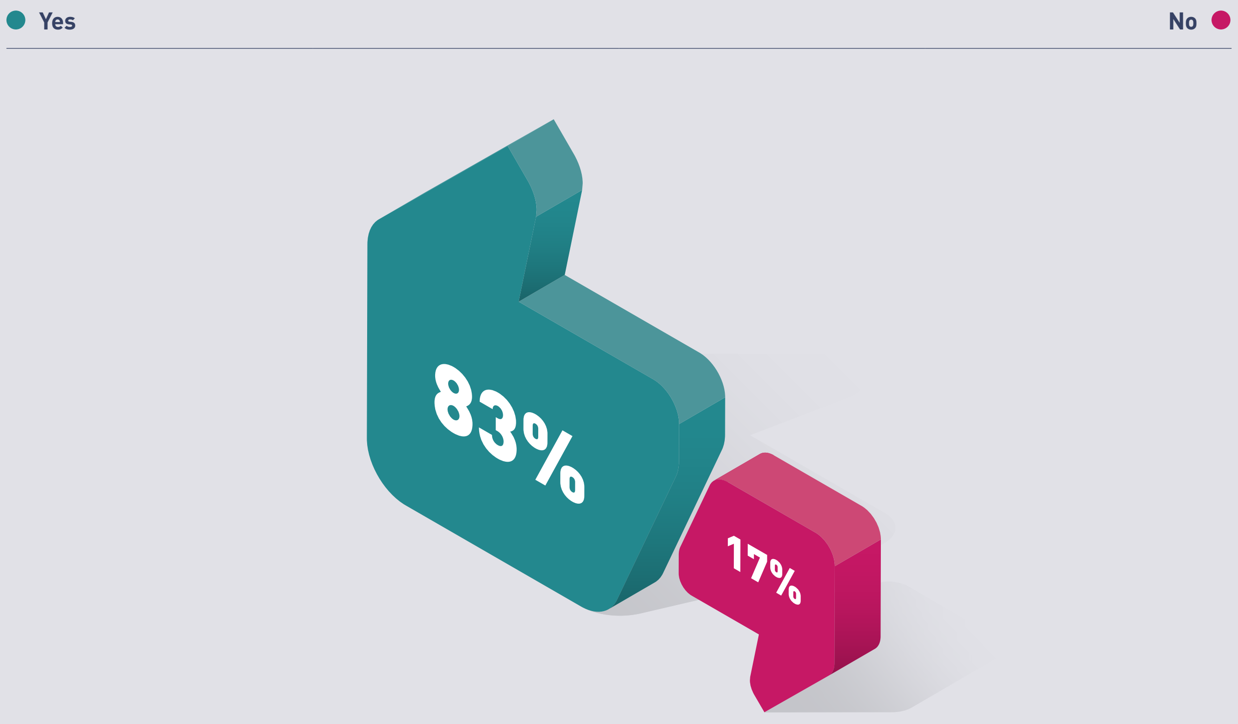
“TCFD, what they're asking for is really, really good, and companies have to think about it, but it's complex so will take some time to get right.”

“We are focusing our efforts on TCFD compliance. We use the other frameworks out there to identify materiality, like SASB. And there is clearly a difference between what rating agencies use and what investors use but TCFD appears to be the most meaningful set of guidance for us to focus on.”

“We have TCFD which fundamentally I agree with, and unusually it's been well presented in terms of the guidance given to how to follow it, but I do have some questions as to how auditors are perhaps assessing whether you are following the guidelines or not.”

Given the regulatory pressures, and the interest from the capital markets in this area, there are also many corporates looking for external support to navigate the more complex and technical areas to ensure quality of analysis and disclosure. This is in part due to a resource challenge which exists in the mid- and small-cap sectors which we will discuss later in this report.

ARE YOU CURRENTLY IMPLEMENTING THE RECOMMENDATIONS OF TCFD?



“TCFD is a journey. We have engaged a consultant at the moment who are helping us to go through the scenarios and risks and opportunities and what learnings we can accumulate before we make change. We're doing all the right things. It's just being able to communicate and manage those processes.”

“TCFD is very labour intensive. It's a question of resource and a question of what we can do as a company of our size. We are currently doing all the work internally but then it's a question of what a company of our size discloses. We're doing scenario analysis and introducing Scope 3 emissions.”

“We have to get external help with TCFD. Last year we did Stage 1 and this year we are doing all the scenario modelling because it's what you have to do. It's another laden of regulatory burden and cost.”

“TCFD was a large piece of work for us this year. This was our first-time reporting and there's been a lot of lessons learned. We're about to publish our first TCFD this year, and the piece of work we need to improve is the models. We don't have proper scenario planning and models – we know it's a shortcoming and have enlisted external service providers to help with it.”

We expect the majority of the companies who are not yet disclosing against TCFD to do so in the near future, with some using the regulatory timeline gap to test-run the TCFD process before moving into more public disclosures.

“We will not do TCFD until we need to. There is more than enough documentary and disclosure requirements to deal with before having to do that.”

“We have been going through the TCFD process a year ahead of time, to try to understand where the tricky areas for us are to focus on ahead of the mandatory deadline for us which is next year. There are a few areas which come out as potential issues, like shipping and logistics or increases in storm intensity which appear on most scenarios we look at. We have started to identify some of these issues, and so far, nothing is low risk – everything is medium or high.”

“It is very difficult to keep a track on what a carbon transition plan will look like and what is coming down the road, to predict the shape of it, how things will align, picking the right time to prepare yourself for it etc. We did a scenario test run for TCFD a year earlier than we had to which I think is super useful, but we can't predict everything in advance.”

“I think climate is here to stay. Regardless of the pace of progress, our consideration is that business will need to pay more attention and address it, which you see in all the regulatory requirements coming up. We need to make progress with TCFD and we're looking at Scope 3 at the moment. It is something we're putting time and effort into understanding it better.”

In line with the clear trend towards TCFD as a leading climate-disclosure framework, there has also been progress made in the number of companies who have started to model the financial implications of climate change to their business.

While much of this work is not yet publicly disclosed, it is promising that as many as **68%** have started this process internally. It is however acknowledged that there are many difficulties in analysing the financial impact of climate events and in linking scenarios to tangible metrics. This is likely to take shape over time, with financial implications continuously evolving as the internal data and understanding of climate change evolves.

“We get the risk management bit and how to look at it in terms of how climate affects your business and we've done some work already internally to understand how those risks might impact our business, more the transitional than the physical ones. What we haven't got to yet is quantifying those risks and knowing what that means in pounds, shilling, and pence.”

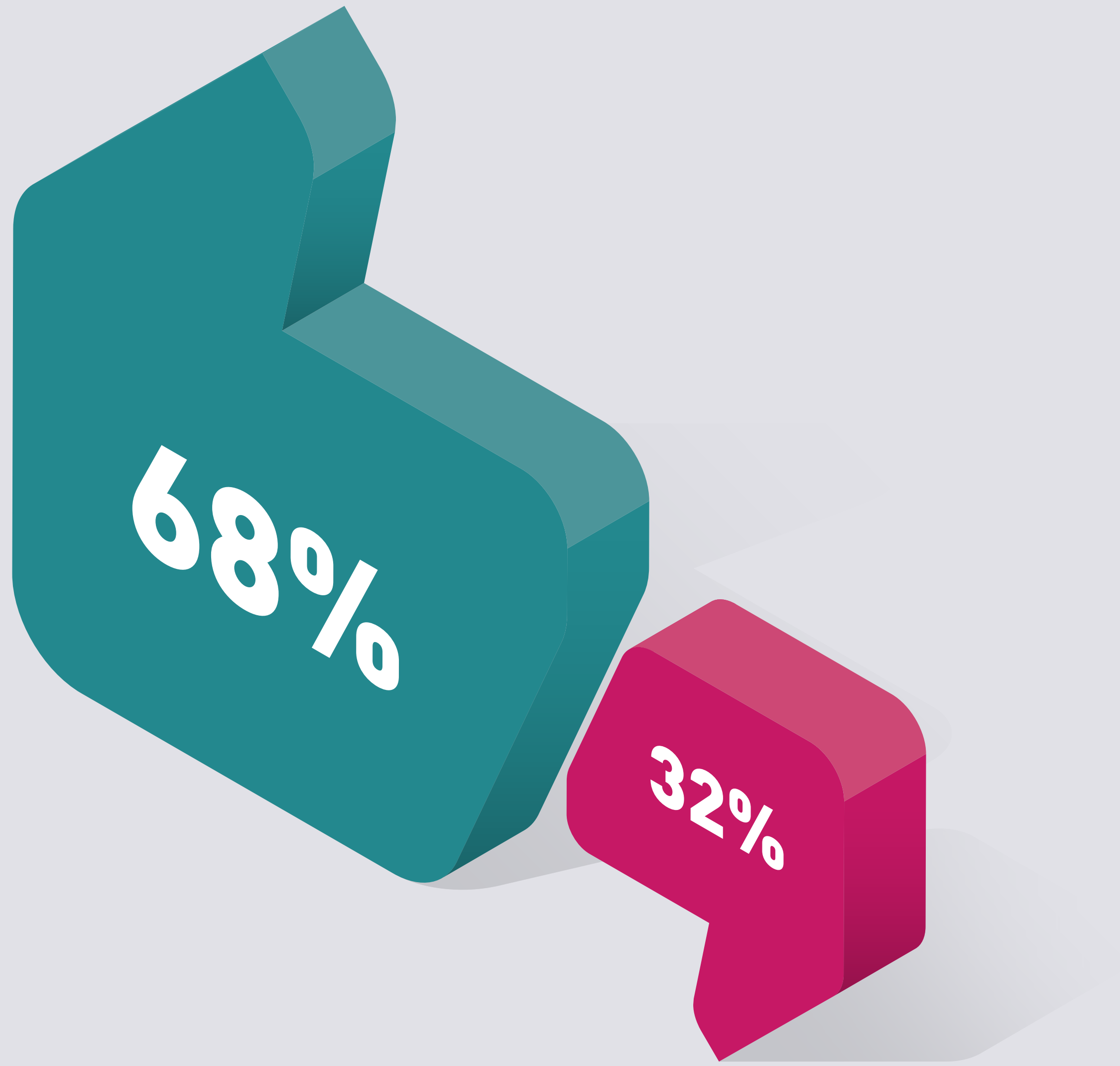
“We have done a bit of work on scenario planning and risk analysis and assigning a risk figure is quite straightforward but when you put that into bottom line numbers its quite challenging. We are looking at cost of expenditure for the Net Zero programme in comparison with the broader light of carbon tax and what it will look like in future. We need to keep updating it to ensure it remains relevant and keep putting context to what is the bigger picture and how do we fit in.”

“There will be things like the implications and impacts, that we'll all be thinking about at night, but might not be all written down. It's those things and then linking it financially. We're still a small business with a small financial team and they've got a lot going on with FX and energy and more. It's just a journey.”

“If you looked at our CDP response, and a piece of work we were doing last week on TCFD, intuitively from a risk perspective, when you get into the transition risk piece and the market piece, I feel like that is where the risk is and where we're challenged. It's when you get into it on what is material, what is capex, what is the payback – those are the questions you need to ask. We need to look at it strategically.”

HAVE YOU STARTED TO MODEL THE FINANCIAL IMPLICATIONS OF CLIMATE CHANGE TO YOUR BUSINESS?

Yes No



DEVELOPING TARGETS FOR ESG IS STILL A CHALLENGE, IN PARTICULAR IN SOCIAL

Measuring and tracking ESG performance is a challenge and an area that requires continual improvement if data collection and reporting are to become more correlated to financial performance and to remove the threat of greenwashing – by investors and corporates.

Many companies have made progress and are now publicly committing to targets while **35%** of respondents are in the process of developing targets but are not yet in a position to articulate them publicly. Unsurprisingly, given the regulatory endorsements to disclose more on carbon emissions and the pathway to Net Zero, these two areas were referenced by **43%** and **44%** of respondents, respectively, as areas in which corporates have published targets. Within the Social area, **42%** of respondents reference Diversity, Equity, and Inclusion (DEI).

"You will see that we don't split out DEI separately, but we will from now on now that it's become much more of an issue and has become its own material issue."

"Certain areas are absolutely fundamental like governance, and there are certain areas of social that you have to get right as well, like DEI."

"We have an annual or biannual engagement survey and we're able to see progress from that and set targets. We also have gender targets for leadership, our organisation and Board. They're not all public but it is something we have internally."

Outside of DEI, other social issues are on the rise, in particular following highly visible social movements of recent years, and as a result of living and working practices changing following Covid-19. Employee wellbeing is no longer a nice-to-have but is considered a vital part of any employee engagement programme and its related policies. The challenge lies in collecting relevant data to demonstrate that wellbeing initiatives are working. This year we found that **21%** of corporates have published targets related to wellbeing, following Health and Safety (24%), and Training and Development (24%).

"On a wellbeing perspective, we have committed to revising and sharing a new strategy. When we completed our ESG strategy, we undertook a materiality assessment and at the top of that by both our external partners and our employees was that we needed to get the wellbeing aspect right. It was much more wellbeing, over health and safety aspects."

"We have an employee NPS score and are regularly asking our employees how they are feeling across a number of different questions and looking to improve that over time."

While the challenge to quantify social aspects is clear, there is a need to go beyond the traditional health and safety management and employee attrition statistics, to consider elements such as mental health, physical wellbeing, flexible working policies, training, and development programmes, as well as the physical work environment.

"I would expect if anything, that the 'S' is still an ongoing and developing question and one that is hard to measure. We can talk about employee retention and what are you doing to look after your employees but it's more than that. It would be good to get more colour on what investors are expecting."

"We will always look at data on absence, utilisation of our employee assistance programme, and engagement with resources we have, but for me it's about pre-empting stress and burnout across the business and stopping things becoming an issue before it becomes one. There has to be a human element to it."

Part of the challenge in developing effective targets lies in generating the "right" data internally and having in place the appropriate structures to facilitate this process. This does not only apply to social aspects but across the spectrum of ESG targets and performance measurement.

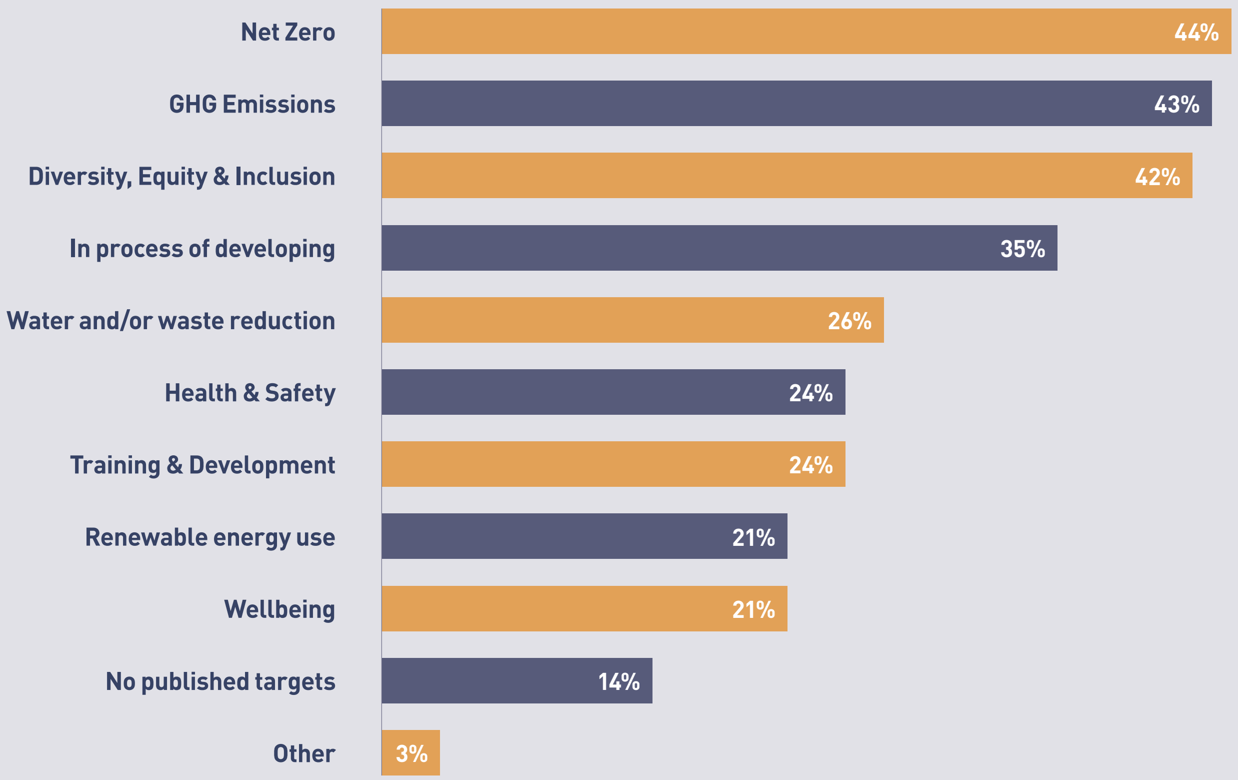
"The data challenge internally and externally is tricky. We have a complex group. It's our UK customer driving the agenda and us trying to stay on the front foot with it and choosing our own priorities that we can focus on. We can't treat every issue the same, but we need to make sure we do enough and want to standardise as much as possible."

"The thing I spent most of my time on is data and reporting. One of the challenges is that the data and reporting processes are still fairly immature. You look at things like DEI and it's a relatively easy metric, but some of the stuff around carbon is hard to do until we have a really good handle on the data and assurance."

"The whole issue of materiality wasn't applied well previously. Our problem was a lot of our metrics were wishy-washy words and we're now focused on tons, and kwh and actual numbers. The only bits we're battling on are emissions and energy usage. Once that's done, we'll publish very detailed and considered targets."

As we have highlighted in the report, the area of social materiality and the development of social data and targets needs to be improved and linked more closely to the licence to operate and reputational value. As ESG evolves and the influence of social issues on performance and valuation becomes increasingly evident, we expect companies to have to quickly communicate their approach to understanding and measuring progress in this area.

IN WHICH AREAS DO YOU HAVE PUBLISHED TARGETS TO MEASURE YOUR ESG PERFORMANCE?



DISPARITY OVER FRAMEWORKS

Pressure continues to grow for companies to provide increasing levels of transparency to their wider stakeholders on their ESG actions, metrics, and ambitions. As a result, ESG frameworks and standards have been adopted by many to provide more structure and consistency on disclosures.

There is however clear disparity over which frameworks companies are choosing to align with, the approach they are taking, and the requirements each framework demands from the companies themselves. The challenge also lies in balancing the opinions and requirements of multiple stakeholders as to which framework they consider to be the "best" and use in their own analysis and decision-making processes.

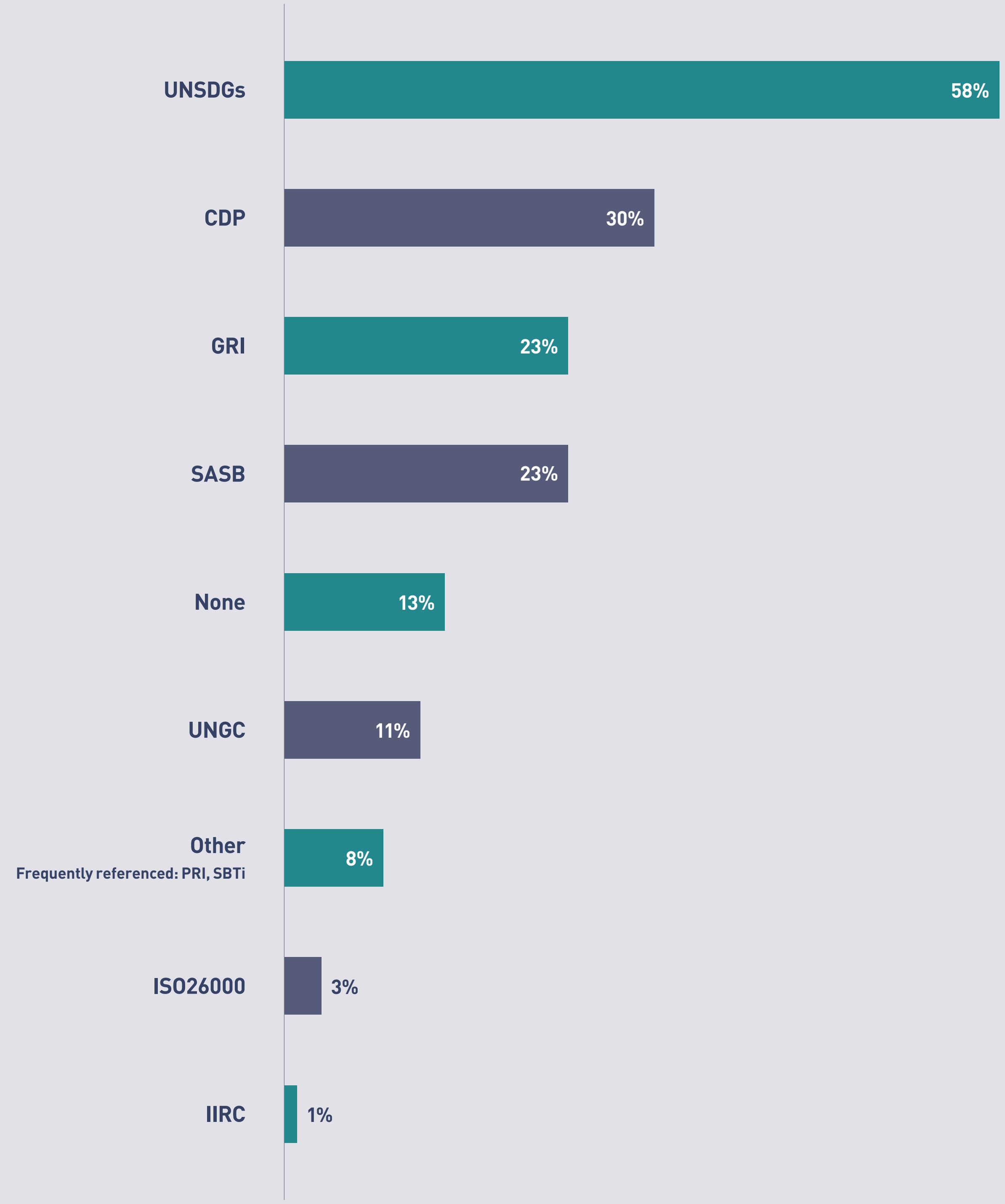
As Environmental issues continue to challenge management with increasingly technical demands, numerous climate-specific disclosure frameworks have been developed, the most prominent of which is TCFD which we have discussed earlier in this report, and with which **83%** of companies surveyed are aligned. After this, CDP (formerly known as the Carbon Disclosure Project), a not-for-profit with a focus on data and content collection for climate reporting and managing environmental impacts, has become increasingly popular with **30%** of companies surveyed working to complete the CDP questionnaire.

CDP is very much aligned with TCFD, and both will apply the International Sustainability Standards Board's (ISSB) climate disclosure standard in their work.

Outside of environmental issues, the headline goals, and supportive targets of the UN Sustainable Development Goals (SDGs) have established themselves in the corporate lexicon of many UK PLCs. It is the most frequently referenced framework, after TCFD, with **58%** of respondents noting that they align with the SDGs. Designed to solve sustainable development challenges, the SDGs are broadly used by companies to guide their ESG actions and ambitions, linking their ESG strategies to one or more of the 17 goals, and the supporting 169 targets.

The two leading standard setting agencies for sustainability reporting, SASB Standards (SASB) and the Global Reporting Initiative (GRI) Standards were referenced by **23%** of respondents, respectively, with the majority choosing to reference one or the other. Only **5%** of companies surveyed, would consider themselves as aligning to both of these, despite the two working closely to highlight the benefits and opportunities of using the two sets of standards together to fulfil reporting needs.

WHICH (IF ANY) ESG FRAMEWORK DO YOU ALIGN TO?



DEMAND FOR CLARITY AND CONSISTENCY

As the previous chapter highlighted, ESG is placing demands on corporates to adhere to the requirements of different standards, frameworks, ratings, and indices, as well as the demands of different stakeholders. The lack of clarity and consistency in these is considered to be the most significant hindrance to implementing an ESG strategy, with 42% of companies listing it as a factor.

The corporates we engaged with have echoed recent well-documented calls for increased standardisation with hopes that the ISSB, announced at COP26, will be successful in developing sustainability disclosure standards that can be used around the world. This trend continued at COP27, with growing calls for globally consistent standards to be created and mandated, with the ISSB being challenged to also mesh with recent regulatory rules being finalised at EU-level to report on ESG factors.

The challenge is to establish a framework than enables disclosures to investors and wider stakeholders to be measurable, clear, and understandable. This challenge is felt intensely at Board and management levels.

“I am hoping it becomes more mature and established and that the ISSB sets out, similar to accounting standards, this is the framework in which you report your sustainability standards and put your processes and systems in place. You have some KPIs and another set of metrics and reduce the amount you have to report on.”

“It's really hard to tell what is happening and what the various standardisations are saying and what people expect of corporates.”

“To be able to more clearly tell our story to investors in a more unified and clear approach would be really helpful.”

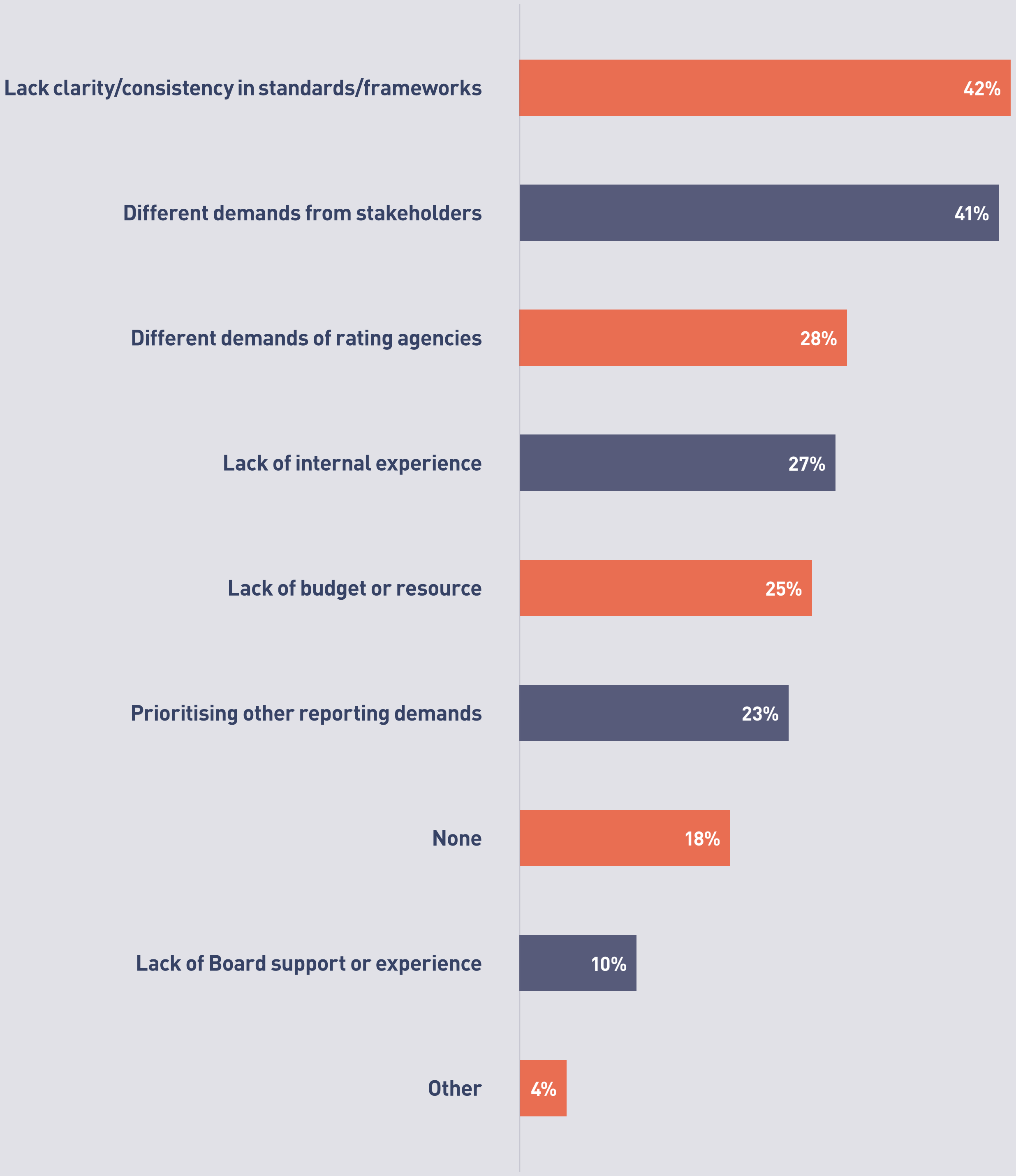
“I would like to see greater standardisation of reporting requirements and greater economic incentives for the big issues, as much as we can get around renewables incentives and standardisation basically.”

“They want to see best practice which by any definition creates averages. The onus has to then be on the company to describe why it's not average or why it's doing certain things.”

42%

believe the lack of clarity and consistency in standards/ frameworks is a hindrance to implementing ESG

WHICH OF THE FOLLOWING FACTORS DO YOU BELIEVE HINDER YOUR COMPANY IN IMPLEMENTING ITS ESG STRATEGY?



In addition to the challenge of understanding and disclosing against multiple frameworks, is navigating differing views and demands from the stakeholder universe. **41%** of respondents listed different demands from stakeholders as a factor which could hinder the development of ESG strategies. As we have explored earlier in this report, the pressure for companies to develop and embed ESG is coming from a broad spectrum of stakeholders, each with their own views on priorities and preferred approach.

“There is an increasing push for SASB which we haven't used as disclosure framework as yet, but their material topics are different from the ones we consider material to us, and it also differs from our customers who have different areas of focus, so it's a hard trend to get on board with and communicate in a way which satisfies everyone.”

“The biggest frustration is that ESG is seen as this one homogeneous thing, but it moves at different speeds, and requires different things and progresses at different paces.”

“Every single research house is now introducing their own ESG screening tools into their research. There's one webcast after another on how they're doing it, and what they're looking for, but very rarely do I see anything in the standard analyst note on how their ESG screening has looked at a stock.”

“It is difficult to navigate – what is the point of all the disclosures that people need us to make and what are we actually getting to? What is getting achieved? I think targets could make a difference, but also putting it into context for a firm like ours.”

This challenge also incorporates the pressure within the value chain to provide greater detail on carbon emissions as the importance of Scope 3 continues to grow.

“We get given more and more questionnaires to fill in by our customers. Especially as we work for big companies who tend to have big procurement teams who have energy to put into getting us to fill in those things.”

The third most referenced hindrance to implementing ESG strategies was listed as the different demands of ESG rating agencies, noted by **28%** of those surveyed. Scrutiny of ESG ratings is intense, and the criticism from many is that the ratings cannot capture the entirety of ESG performance and do not consider the sensitivities of ESG which are unique to each organisation. The impression is that too often the ratings and investment community hide behind a “tick box” approach and are not engaging beyond the data, and that it is more about providing access to information than actually effecting positive change in the world.

“The ESG rating universe is the biggest issue. I forgive them for being a nascent industry but the lack of consistency and comparability for ESG ratings and the effort by some of the large companies to actually evaluate and engage is frustrating. Essentially, if they can't find it on your website, they assume it doesn't exist and mark you down. Which turns the whole process into a tick-box-compliance thing. There needs to be further oversight, review, and standardisation.”

“If it's about writing a policy and publishing it on the website. It's not changing the dial or how your contribute to the business or society.”

“I really dislike the box-ticking. Whatever we do I really want it to be authentic and honest. I really hope we never get marked down for doing that, but it seems inevitable.”

41%

list the different demands of stakeholders as a hindrance in implementing ESG strategy

“There is very little alignment across some of those ratings and analysts. Some are very resource intensive so it depends where it falls in the calendar year if we can engage. If you spend days on it, you can improve your scores and they do help to flag what they want to know in advance which helps from a reporting perspective, but you can still get very different results. You're essentially not being scored on performance but on disclosure and it's just how they weight it all.”

“You have to target rating agencies and indices you want to comply with, and which standards you want to apply which are all fairly unethical in consulting on how you score well on their own schemes. What I want to do is get us in a position to externally reflect what we do internally. Some of it is getting things on to a website, that an AI bot can scrape and download into a score for the rating agencies and some of it is less tangible.”

Linked to the calls for standardisation and measurement of ESG, is a growing concern that this could also place further burden on corporates to respond to the auditing and assurance industries, and their views on how future potential ISSB guidance should be interpreted and communicated.

“I want to see more on standardising metrics and KPIs. All this stuff coming down the line from the ISSB is good. I worry slightly, based on a couple calls and seminars that I've been on, that it will get out of hand particularly with our colleagues in the assurance industry and it will become a huge revenue generator for them and will create overly onerous assurance processes. I can see that happening.”

“We do need some kind of assurance regime, because as non-financial data becomes more important, the user of that information has to be able to rely on it. But it has to be proportionate.”

LEVEL OF INVESTOR QUESTIONING IS INCREASING

A majority of respondents (63%) have recognised an increase in investor questioning on ESG matters over the last year. A third state that there has been no change, with only 3% noting there may have been a reduction in investor interest in ESG issues.

“When we're speaking to shareholders and presenting back results, ESG is something we're talking about consistently. It comes up not just in financial results. In terms of the value, we're trying to create for shareholders that ESG piece is embedded.”

“I have not found any decline in interest from investors. There is a steady increase. Not just from investors but also from institutions, Moody's, Sustainalytics, and others. Some of the issues may be put on the back burner in economic crises, but I don't see them going away. I see a general increase and think that'll just continue to grow.”

“ESG has not been a key driver of our engagement with the capital markets historically, but we recognise that this is changing and that it should change.”

“I think we have noticed a trend on every roadshow that we tend to get more questions on ESG. E is fairly well defined although there is a bit of alphabet soup out there still, but it's the S bit that is least clear.”

“In none of our investor meetings has anyone ever raised ESG by saying those letters, but people want to know you're governed well, that your policies and procedures are in place, and people want to know how we've considered our products and those we're coming to market with. All of that is utterly fundamental to what people will ask about in our investor meetings but no one will say to us 'what is your ESG strategy?'”

There is also a sense that some of the perceived increase in questioning from the capital markets is more directed from rating agencies or sustainability analysts looking to plug information gaps, and not to necessarily seek strategic guidance on big picture ESG ambitions and actions.

“During the IPO there were some questions, but we've not had many since. We provided a lot of the obligatory information on diversity and ESG and other things. I think maybe we're not being asked a lot because we've said a lot and maybe also because of the nature of our business.”

“I would say from my relatively narrow specialist role – I am seeing an uptick in queries, questionnaires, and interest specifically from sustainability research investors and analysts and rating agencies. Our CFO is saying he's getting very little questions on ESG. So that is the balance between the two. We may get pretty standard surveys on 'are you looking at these two issues' from investors and we can always respond to them.”

We would expect to see the level of interest and questioning continue to increase as reporting and disclosure pressures continue to rise, and the importance and materiality of ESG to business strategy, operations and financial performance continues to grow.

OVER THE LAST YEAR, ARE YOU RECEIVING MORE OR LESS QUESTIONS FROM YOUR INVESTORS ON ESG MATTERS?

ESG INVESTMENT WILL CONTINUE

Despite the challenging economic environment, 71% of corporates expect to invest more time and/or resource into developing ESG in the next financial year. 22% expect to see no change to current levels with only 7% of those surveyed expecting to reduce investment in time or resource.

"The acid test is that it's fine when times are good, as everyone can make the right noise around ESG from an investment and business point of view. But will people be as interested when times are not as good and there's more headwinds in the economy and the capital markets are in a different place? How committed are people to ESG? The next 12 to 24 months will be the real test of this. Ultimately, when the times are tough, what gets shelved first if you've got capex projects for environmental projects and you say you have to conserve capital?"

"What I have been impressed by is that for such a fast-growing concept, and intangible to some extent, ESG could easily be shelved in a moment of crisis. What is good is that this agenda is only escalating, and people recognise that for long-term, commercial, sustainability these things have to be embedded."

"There is a potential benefit in the slowdown of the economy in that there is more time to dedicate to understanding the baseline to your company and what the plan is and to really get behind the ESG strategy and its targets."

There is general recognition that ESG is important and will continue to garner interest from stakeholders across the value chain, but there is also an understanding that the economic environment may challenge some companies to take a different or more considered approach to how they prioritise actions and targets.

IN THE CONTEXT OF THE CURRENT ECONOMIC ENVIRONMENT, DO YOU BELIEVE YOUR ORGANISATION WILL INVEST MORE OR LESS TIME AND RESOURCES INTO DEVELOPING ESG IN THE NEXT FINANCIAL YEAR?

IS ESG TIPPED IN FAVOUR OF THE LARGE CAPS?

While there is broad support for the concept of ESG, one of the findings from this report is that many in the mid- and small-cap space believe that they may be at a disadvantage in terms of ESG, compared to their larger competitors and peers. This is not because of lesser ESG strategies but because of the demands on an organisations resource to effectively deliver ESG is significant.

As we have explored earlier in this report, this imbalance is in part exacerbated by the pressures on companies to evidence their ESG delivery through various indices, ratings, scorecards, and questionnaires originating from across the stakeholder landscape, requiring significant resource to stay on top of, but not necessarily leading to moving the needle in terms of the impact on people, planet, or performance.

“There is an overall challenge in green and sustainability, in that there is a positive correlation between ratings and organisation size, as there is more resource in bigger organisations to be able to report, rather than actually doing anything differently. Mid-caps won't get as high a rating or have as high scores on things like board diversity and so are harder to invest in.”

“On the climate side, it's a bit more challenging as there are global frameworks and standards in place now which are supposed to help but those requirements are very data driven and require a lot of time and resource. So, if you don't have that structure or resource or have that data in place, then you can very quickly get stuck.”

“Internally, more resource would be fantastic. We are a medium mid cap, so we are slightly limited in that sense.”

“We are held to the same standard as a Barclays or a Lloyds and we're a small cap company. I refuse to spend thousands of pounds to use the accreditation of something to prove we're aligned with lots of objectives. We can do it all and align with thinking and I can agree with the objectives but why do we have to pay to prove it.”

“There is value in disclosure for ourselves in things like CDP and a couple other ones, but with many we just have to do the best we can and keep an eye on the scores we get as we just don't have the resource or time to engage in improving them.”

“It's the challenge in midcap. When you talk about impact, they want green, but they also want super green with high profits and no risk. That's the challenge. So, I think impact funds are directing more funds at the better big companies, rather than the midsized companies who will still make a great contribution but can't necessarily deliver the financial returns in the same way.”

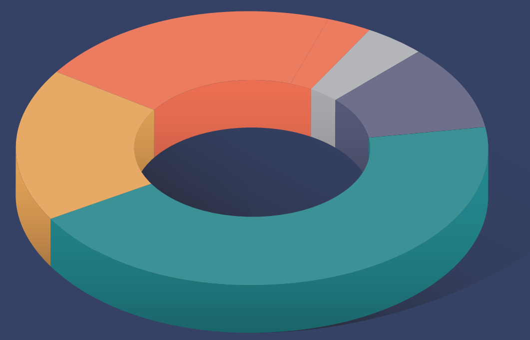
Overall, there is a general sense that the economies of scale are unfairly tipped towards the larger caps with bigger budgets and bigger teams to meet and satisfy the challenges of ESG and that the capital markets are not yet structured to recognise the benefit or positive impact that mid- and small-cap companies are bringing from implementing their ESG programmes.

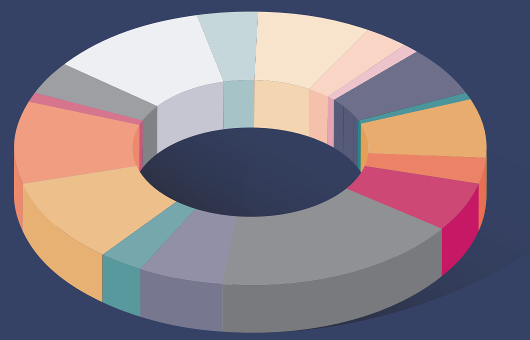
THE RESEARCH SCOPE

SIFA Strategy, with the support of Peel Hunt, surveyed 72 companies listed on the London Stock Exchange, spanning 17 sectors and a broad spread of market capitalisations ranging from £22m to over £6.6bn.

The process included a quantitative survey, supported by our technology partner Intrinsicx, which also provided opportunity for added commentary and was followed up with detailed interviews across a broad spectrum of the respondents. The survey, interviews, and analysis of findings were conducted from September to November 2022.

Throughout the review we have drawn some comparisons to last year's findings where possible, however we caution that these should be seen as a trend line rather than a direct statistical comparison given the different sample bases. We have also not drawn-out specific sector details in order to provide a clearer overview of the status of ESG across the mid- and small-cap universe. If you would like a more detailed sector perspective, please contact us and we will happily talk you through our findings.





MARKET CAPS

10%	< £100m
44%	£101 to £500m
18%	£501m to £1bn
21%	£1bn to £5bn
3%	> £5bn
4%	Unknown

SECTORS

6%	Building & Construction
1%	Chemicals
7%	Consumer
3%	Consumer/Leisure
6%	Energy
17%	Financials
6%	Food Producers
3%	Healthcare
10%	Industrials
9%	Investment Banking
1%	Media
4%	Metals & Mining
11%	Real Estate
4%	Retail
8%	Technology
3%	Travel & Leisure
1%	Utilities

SIFA STRATEGY

About SIFA Strategy

We facilitate the understanding, implementation, and embedding of ESG within a business. Our team of consultants work at Board, committee, and management levels, supporting and challenging our clients as a trusted adviser. We deliver a range of services as integral parts of wider ESG programmes or as standalone projects. Our purpose is to support our clients to be sustainable and successful.

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PEEL HUNT

About Peel Hunt

We are a leading UK investment bank that puts long-term success above short-term gain, helping good companies succeed and delivering outstanding results. We have three business areas, but we act as one Peel Hunt.
Our integrated approach combines expert research and distribution, a range of investment banking services, and an execution services hub that provides liquidity to the UK capital markets. ESG sits at the core of our strategy and is rooted in the values and behaviours which have informed our culture for more than a decade. We not only look at our responsibilities as the direct impact of our operations but we also focus on the wider influence and impact we can have through our work with our corporate and institutional clients, including supporting our corporate clients to develop and manage their own approach to sustainability.

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