Key Takeaways – ESG Center

The Monetary Impact of ESG Performance

Center Briefing for ESG Center Members Held Under the Chatham House Rule

Wednesday, September 28, 2022

The ESG Center held a Briefing on "The Monetary Impact of ESG Performance," which explored the challenges and opportunities associated with quantifying corporate environmental, social, and governance (ESG) performance in monetary terms. The discussion was led by Pamela Passman, Chair, Corporate and Managing Director at APCO Worldwide; Jeff Zelkowitz, Executive Vice President at APCO Worldwide; and Steve Lippman, ESG Engagement Director at Microsoft.

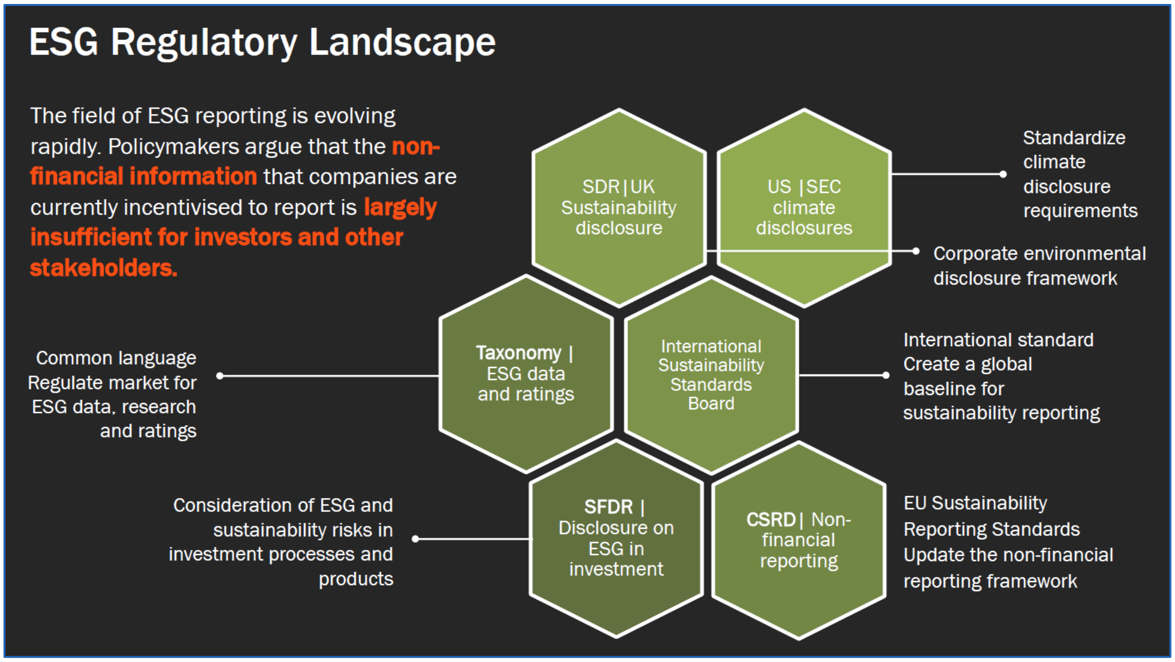
The key takeaways from the Center Briefing are below.

Mainstreaming of ESG

1. **Across industries and geographies, firms are embedding ESG into their operations, financial modelling and decision- making.** According to McKinsey, more than 90 percent of S&P 500 companies and 70 percent of Russell 1000 companies publish ESG reports.

2. **ESG activities can impact firm value in several ways.** Positive ESG performance can improve process efficiency, reduce material and energy consumption, motivate and retain employees, foster customer loyalty, boost brand equity and reputation, drive innovation and product differentiation, maintain license to operate, and attract investment.

3. **The ESG reporting landscape is consolidating and moving towards more consistent and mandatory disclosure**. Key developments include the standardization of sustainability reporting frameworks by International Sustainability Standards Board (ISSB) (which will be voluntary in the US and EU, mandatory in other jurisdictions); adoption of the Corporate Sustainability Reporting Directive (CSRD) by the European Union, which expands mandatory sustainability reporting; and proposed SEC climate-disclosure rules in the US. In this global network of reporting, it is likely that most companies will find themselves impacted by one or more of the proposed disclosure regimes.



Source: APCO Worldwide

The Need to Monetize ESG Performance

4. **There is a growing pressure for US companies to measure and express the positive and negative impacts of ESG in dollar amounts.** Distilling ESG into monetary currency values will:
   - Help managers place impact into the wider business context.
   - Enable stronger alignment with internal financial and accounting systems.
   - Facilitate better understanding of environmental and social issues by non-experts.

5. **Current ESG reporting does not fully communicate long-term value creation and monetary impact, due to a disconnect between financial and non-financial reporting**. According to EY's Global Corporate Reporting Survey, 46 percent of investors consider the disconnect between ESG reporting and mainstream financial information to be reducing the usefulness and effectiveness of ESG disclosure in general. This investor dissatisfaction has widened over time, despite steady increases in the quality of corporate reporting.

6. **As the financial costs for meeting corporate environmental and social commitments increase (such as through addressing Scope 3 emissions), boards and senior managers are more attentive to the economic implications of setting ESG goals and strategies.** In addition to quantifying negative externalities, companies require data to convey the positives of ESG performance in monetary terms – such as improved efficiencies, reduced risk, increased revenues, and long-term value creation.

7. **Pressure to quantify ESG performance and demonstrate return on investment will become more acute as the world enters economic slowdown in 2023, and competition intensifies for resources.** When the monetary value and tangible return on investment is demonstrated, ESG can be embedded more effectively into business strategy and operations.

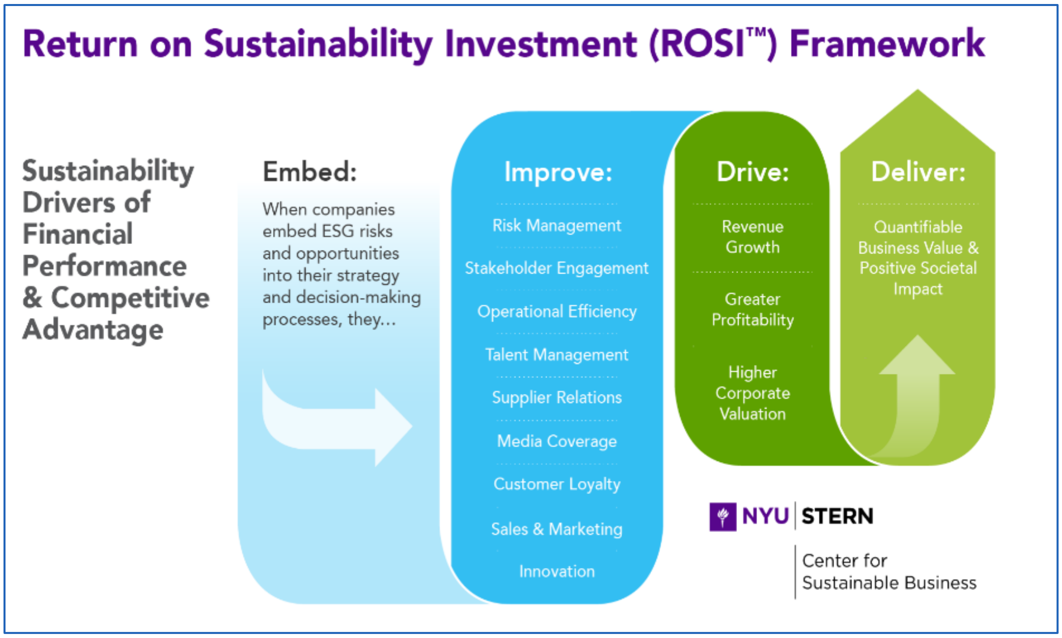
Approaches to Quantifying the Monetary Impact of ESG

8. **Quantifying the monetary impact of ESG successes or transgressions requires innovative approaches to accounting, strategy, financial modeling, impact measurement, and public reporting.**

9. **An important ongoing initiative is the [Harvard Business School's Impact-Weighted Accounts Project](), which aims to capture in monetary terms the *external* impacts of a company's ESG efforts.** Impact-weighted accounts are line items on a financial statement, which are added to supplement the statement of financial health and performance by reflecting a company's positive and negative impacts on employees, customers, the environment, and society at large. Impact-weighted accounts produce an integrated view of performance which allows investors and managers to make informed decisions based not only on monetized private gains or losses, but also on the broader impact a company has on society and the environment.

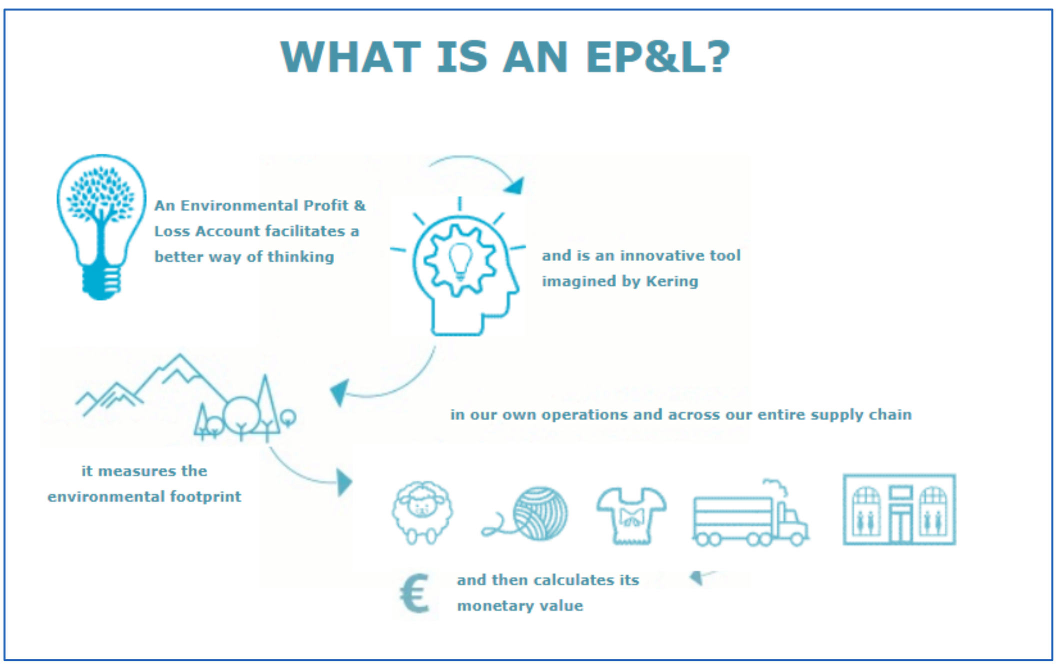
Source: Harvard Business School

10. **The NYU Stern Center for Sustainable Business has developed a [Return on Sustainability Investment (ROSI) methodology]() to address the *internal* monetary impact on a company.** ROSI is designed to be a simple yet comprehensive process that identifies material sustainability strategies and the changed practices resulting from those strategies, and then applies a monetization process to calculate monetary values for intangible and intangible benefits. ROSI helps embed sustainability into core business strategies and improve valuation by investors.



Source: NYU Stern Center for Sustainable Business

11. **Many leading companies are innovating in calculating the monetary impact of ESG. For example, Kering has developed an Environmental Profit & Loss (EP&L) tool that quantifies the monetary value of environmental impacts as an enabler of its sustainable business model.** The EP&L approach measures carbon emissions, water consumption, air and water pollution, land use, and waste production along the entire supply chain – and then converts these metrics into monetary values to quantify the use of natural resources. Kering shares its methodology with other companies, to encourage a general movement towards greater sustainability.



Source: Kering

12. **A growing number of companies are implementing internal carbon pricing, to quantify ESG impacts and drive strategic change.** An internal carbon price (or *carbon fee*) places a monetary value on greenhouse gas emissions, which firms can then factor into investment decisions and business operations and prepare for the low-carbon transition. According to CDP, nearly half of the world's 500 biggest companies by market capitalization are putting a price on carbon, or are planning to do so within the next two years.

13. **Carbon pricing is most impactful when embedded into a company's business strategy. Microsoft is a pioneer in this space, using internal carbon fees as a strategic tool to realize its goal to become carbon negative by 2030.** Microsoft tracks its emissions across all scopes (including the wider value chain) and uses that information to charge its business groups a certain amount in carbon fees. The internal carbon fee quantifies the impact of ESG in monetary terms, and incentivizes reductions in energy use and carbon emissions while creating a fund to directly invest in climate change mitigation. Microsoft's internal carbon fee adjusts and evolves over time – including redesign and increase in 2022 to accelerate scope 3 emissions reduction.

Source: Microsoft

14. **Microsoft's approach to carbon pricing can be replicated in many other industries and companies, including organizations with smaller budgets and personnel.** Microsoft's model is based solely on consumption – there are no credits to track or trade. The basic formula is universal (*carbon emissions multiplied by carbon price equals carbon fee*), and can be tweaked to fit an organization's structure, financial processes, and individual goals. Microsoft shares its approach publicly, to encourage take-up elsewhere.

15. **Ultimately, the key goal for all companies using internal carbon pricing is to quantify the carbon impact of operations and make individual business divisions accountable for the financial cost to offset emissions.** This contributes towards cascading ESG accountability throughout the wider organization and financial accounting systems.

Organizing for Success

16. **To quantify the monetary impact of ESG performance, companies must strengthen the connections between the sustainability / ESG and strategy / finance functions.** This is not just because those areas often administer core planning and budgeting processes, but because they are key to identifying and pursuing future business opportunities. There is significant room for improvement in this regard: previous research by The Conference Board shows that the internal connection between sustainability and finance is often weak, and US sustainability teams spend little time interacting with the finance function.

Which of the following functions does your sustainability team spend the most amount of time interacting with? (Select the top 5)

	All N=104	US n=48	Europe n=49
Business units	**70%**	**63%**	**73%**
Communications	**59**	**58**	**59**
Investor relations	**52**	**58**	47
Supply chain / procurement	43	**50**	35
R&D / product development / engineering	38	35	37
Human resources	34	33	33
Public affairs / government relations	33	25	45
Legal	30	42	22
CEO	29	21	39
Strategy	28	17	39
Finance	20	10	29
Marketing	17	25	8
Other	14	19	10
Country/region leadership	13	6	20

Source: The Conference Board
Note: Figures shown are the percentage of respondents who selected each function. Bold indicates at least half of respondents selected that function. "All" column also includes responses from Asia-Pacific which are not shown.

Source: The Conference Board

17. **Companies benefit from cross-pollination between accounting and environmental expertise.** The gradual incorporation of environmental, social, and governance metrics by accountants is a positive signal that ESG is maturing into an established business discipline, which allows for comparable and auditable information. Regulatory developments will further accelerate this coalescence, in both Europe and the US.

18. **A strengthened capacity for sustainability reporting may be required to fully communicate the monetary impact of ESG to external audiences.** Companies can use a variety of channels to tell their ESG and sustainability story, including annual reports, annual SEC filings, corporate website, press releases, case studies, social media, intranet, investor presentations, news articles, conferences, customer meetings, and others. The specific needs of stakeholders will determine the best channels to use – recognizing that lengthy ESG and Sustainability reports are increasingly outdated and limited in utility.