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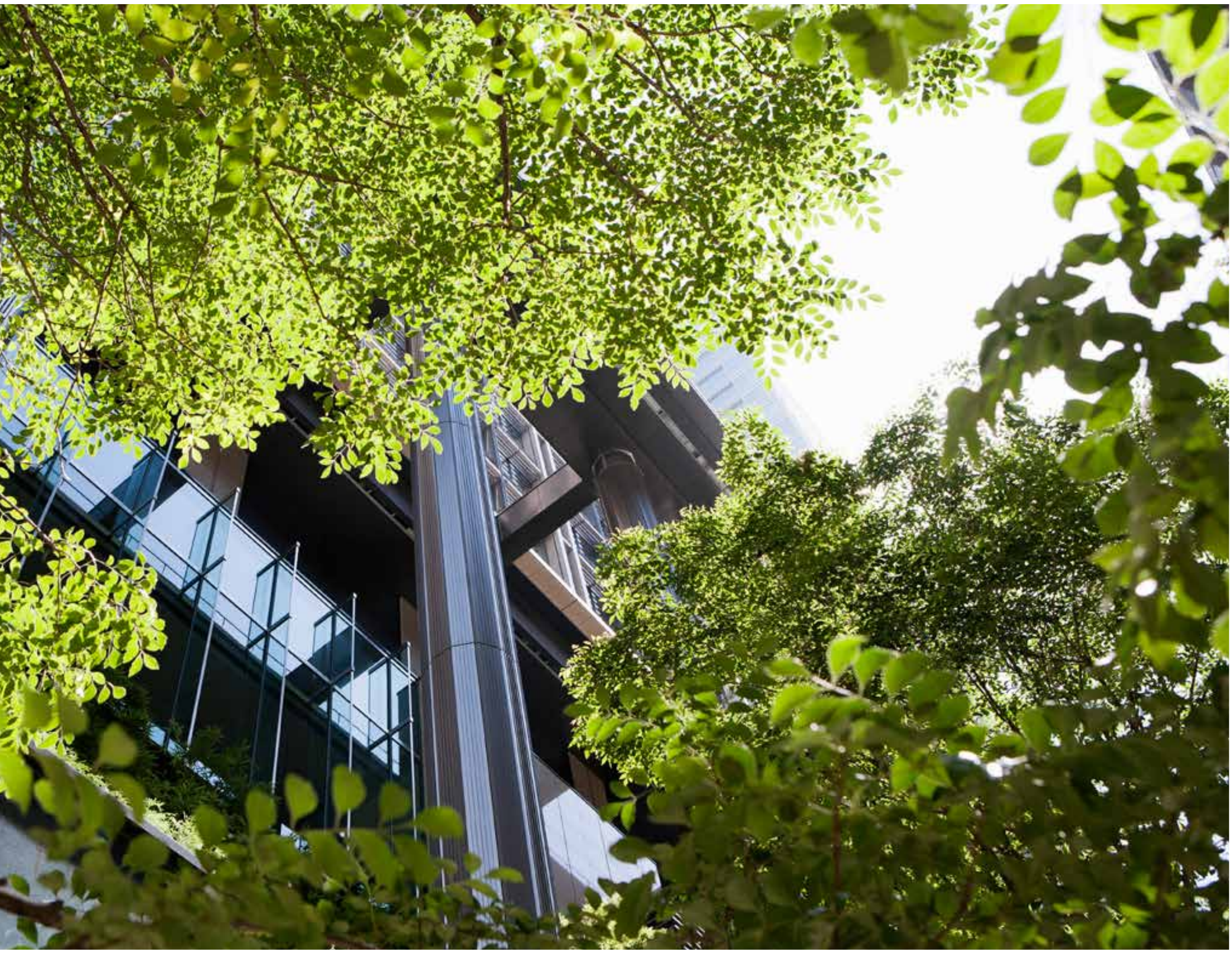
Credible ESG communication



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Credible ESG communication

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A Executive Summary

High ESG ambitions and performance can have positive effects on your company's public reputation and create a competitive advantage. However, it's important to remember that you need to keep your promises to remain credible. Failing to implement commitments can be very risky for your company: for example, being accused of greenwashing by the public. Credible communication requires transparency about your objectives, your pathways to achieving them, and how you'll be measuring your achievements. Your first step should be to establish where your ambitions lie, what your customers and clients are expecting from you, and what contribution you want to make to sustainability in the economy with your ESG strategy. Credible communication on your ESG objectives, strategy and performance is key to your company's success, as ESG is important for the reputation of your brand. Your clients, current and future employees, and other stakeholders all care about your ESG performance. Looking to the future, stakeholders and investors will increasingly judge you on your ESG performance: Respecting ESG criteria will no longer be considered as nice-to-have, but rather as a must for companies, especially in the financial sector.

Compliance with regulations on reporting is a cornerstone of ESG communication, but there is much more to consider: strategic positioning is at least as important. Public ESG commitments and your company's ESG ratings can help you stand out from your competitors. ESG commitments and ratings can also help you to stay on track with mandatory reporting, as this is often taken into account in relevant approaches and methodologies. But if you make a commitment, you need to follow through. Companies are subject to public scrutiny, and accusations of greenwashing are a major reputational risk. Therefore, it is crucial to make sure that your ESG positioning and approach to communication are credible and authentic. Failing to do so may lead to a major backlash, which will most likely have a negative effect on your business. With regard to ESG ratings, you should consider engaging with relevant rating agencies in order to ensure that your rating is as accurate as possible. Finally, it is advisable to integrate ESG into your entire organisational structure and your corporate strategy. This allows making use of synergies and creates a holistic approach to ESG.

B Key ESG communication challenges

Increasing regulation and growing awareness of environmental and social sustainability among the general public are putting more and more pressure on companies. In this context, how can you do justice to such a multifaceted topic as ESG? How can you efficiently and effectively build the foundations for future-proof and coherent corporate ESG communication?

The key factor here is your level of ambition. In order to create a credible public ESG presence, the first thing to do is to determine the scope of your ESG activities and goals. It's crucial that you do this carefully – your ESG objectives need to be achievable. You should also factor in potential market developments, future regulations and what your stakeholders really expect from you as a company. Once you've pinpointed your level of ambition, you can work out your next steps. The following sections examine the aforementioned questions in more detail, presenting various levels of ESG ambition and suitable solutions.

1 The complexity of ESG communication

ESG communication is an important factor in investment decisions, and credible ESG communication can drive up business value. It is therefore vital for companies to regularly communicate how ESG issues are being addressed and what improvements have been made. As demonstrated below, ESG factors play an essential role for a large number of stakeholders.

Investors and ratings agencies

- Increased demand for ESG performance and data.
- Growing competition for top ESG ratings.

Customers

- Rising awareness of ESG and growing demand for sustainable products.
- Contact opportunities with companies should be used to help customers understand ESG topics.

Distributors

- ESG is being increasingly integrated into the product development and target market identification processes due to changing customer preferences.
- Adjustments and updates of product information.

Business partners

- Need to comply with regulations regarding sustainable supply chains.
- Business partners are now being selected based on ESG criteria.

Competitors

- ESG criteria have become a key differentiator.
- Focussing on ESG is perceived as a competitive advantage.

Regulators and standard-setting bodies

- New sustainability regulations and standards are in force or are being developed making ESG reporting and communication more complex.
- Companies are being held more accountable and are increasingly being called out for greenwashing, which can create legal risks – e.g. sanctions for committing ESG fraud.

Media and press

- Corporate ESG communication is under constant media scrutiny.
- Increased transparency and scrutiny is making it easier to expose greenwashing and pinkwashing.
- Social media can rapidly expose improper behaviour in the context of ESG.

Employees

- Employees are increasingly attracted and retained by companies with a strong sense of purpose and responsibility.
- Employees want to feel like they are contributing to increased sustainability through their work.
- Demands for an inclusive and diverse corporate culture and work environment are growing.
- Companies need to keep promises made to employees – failure to do so may lead to termination and in extreme cases, whistleblowing.
- The lack of skilled workers makes it particularly important to address these issues, and requires companies to focus on sustainably integrating employees from different countries, religions, cultural backgrounds and work cultures.

NGOs and civil society

- Public campaigns or legal cases against companies involved in greenwashing.
- NGOs and activists are calling for corporate action on sustainability (e.g. ending financing for fossil fuels).

To meet stakeholders' high expectations around ESG, strategic communication of sustainability-related information is a must. The amount of information you disclose and the range of sources you use both have an impact on the external perception of your ESG efforts. Various different sources and communication channels can be used, including your corporate website, pre-contractual information, marketing materials. ESG ratings and commitments are particularly valuable ways of communicating your ESG efforts, as are mandatory sustainability reports. ESG ratings can reveal a broader set of sustainability-related information than is possible with traditional financial analysis; ESG commitments strengthen your reputation by setting sustainability objectives; and many regulations now require organisations to disclose certain information in order to increase transparency. More detail on these three aspects can be found below.

2 Opportunities for communicating your ESG performance

The following section goes into further detail about various ESG initiatives and commitments. These have a direct influence on how you communicate ESG performance as a company, and they can serve as authentic proof of your company's ESG credentials.

ESG commitments are a key opportunity to communicate ESG performance. These can be described as voluntary engagements companies make in order to improve their performance and reputation around sustainability. Numerous commitments have been developed by various bodies, such as industry initiatives or the United Nations (UN). The Net-Zero Asset Owner Alliance (NZAOA), the Principles for Responsible Investment (PRI) and the UN Global Compact are among the best-known ESG commitments. The NZAOA is an initiative in which members commit to transitioning their investment portfolios to net-zero greenhouse gas emissions by 2050, in line with the Paris climate goal of limiting global warming to 1.5°C. The PRI were established by the UN, and consist of six ESG principles focussing on good governance, accountability and integrity that can be integrated into investment practices. Finally, the UN Global Compact has ten different principles addressing human rights, anti-corruption and environmental issues, designed to encourage companies to integrate sustainable and socially responsible policies into their strategies and operations and to report on them. The Global Compact is based on the UN Sustainable Development Goals (SDGs).

There are many and diverse ESG commitments, but they all share the goal of improving ESG performance by giving guidance on how to implement certain standards within a company. It is important to identify all commitments that your company has made – even if they were made by a parent company – and to be aware of what these commitments require. You can also consider joining additional initiatives and commitments in order to improve your ESG performance and reputation, as commitments are an important component of how you are viewed by outside stakeholders, but keep in mind joining too many initiatives that you cannot fulfil can lead to unreliability or even greenwashing.

ESG ratings are another credible and important source for ESG communication. These assess your company's performance according to various ESG criteria. There are many different ESG rating agencies such as MSCI, Refinitiv, Sustainalytics and Bloomberg. Your ESG rating plays a key role for your investors and stakeholders, as they help investors to assess potential risks and their return on investment. A company with a good ESG rating will therefore be more attractive for investors, and also for customers, who increasingly demand good corporate ESG performance. However, not every ESG rating is the same, and your company's score may vary drastically between the different rating agencies: this is because each agency has its own methodology for calculating ratings, and these methodologies are not always made transparent. You should therefore use scores from at least two different agencies to reliably assess your company's ESG performance. The European Commission is aware of these issues and is working on legislation to enforce more transparency in the ESG ratings market.

In regulatory terms, sustainable finance is mainly being driven by the European Union's (EU) 2018 and 2021 sustainable finance action plans, as well as by the European Green Deal, which aims to make Europe the first climate-neutral continent by 2050. A number of regulations have already been introduced or are being finalised around reporting, risk management and product disclosure, such as the EU Taxonomy Regulation, the Corporate Sustainability Reporting Directive (CSRD), the Sustainable Finance Disclosure Regulation (SFDR) and the European Green Bond Standard.

All of these regulations focus on providing disclosures on ESG metrics and performance, and on fostering transparency. Their aim is to take sustainability reporting to the same level as financial reporting in the future. These disclosure frameworks guarantee more transparency and accountability, but they also make more data collection necessary. Insufficient or inaccurate data can have serious consequences, and lead to companies being accused of greenwashing.

Greenwashing & Pinkwashing

There is no generally agreed definition of greenwashing, but the term greenwashing is typically classified as corporate misconduct in which a company's own sustainability performance is exaggerated or misrepresented. The basic tenor therefore always includes some kind of miscommunication, and the corresponding exploitation of information asymmetries between companies and customers. This type of miscommunication can also encompass the social and governance dimension, an example for this is "Pinkwashing". Pinkwashing entails communicating wrong or exaggerated information about ESG, it occurs when companies position themselves as LGBTIQ+[1] friendly but do not actually live up to their promises, instead failing to make meaningful investments or take action to ensure a more diverse and inclusive workforce.

There are many other ways of misrepresenting sustainability performance, but they can all be classified into the so-called Seven Sins of Greenwashing[2]:

1. Hidden trade-off
2. No proof
3. Vagueness
4. Worshipping false labels
5. Irrelevance
6. Lesser of two evils
7. Fibbing

Greenwashing is very risky, with the potential for severe negative impacts on a company's reputation. Committing any of the seven sins listed above can have serious consequences, even if your company's actions are driven by a lack of knowledge rather than malicious intent – for example, lack of data availability as this still brings the credibility of your ESG communications and performance into question.

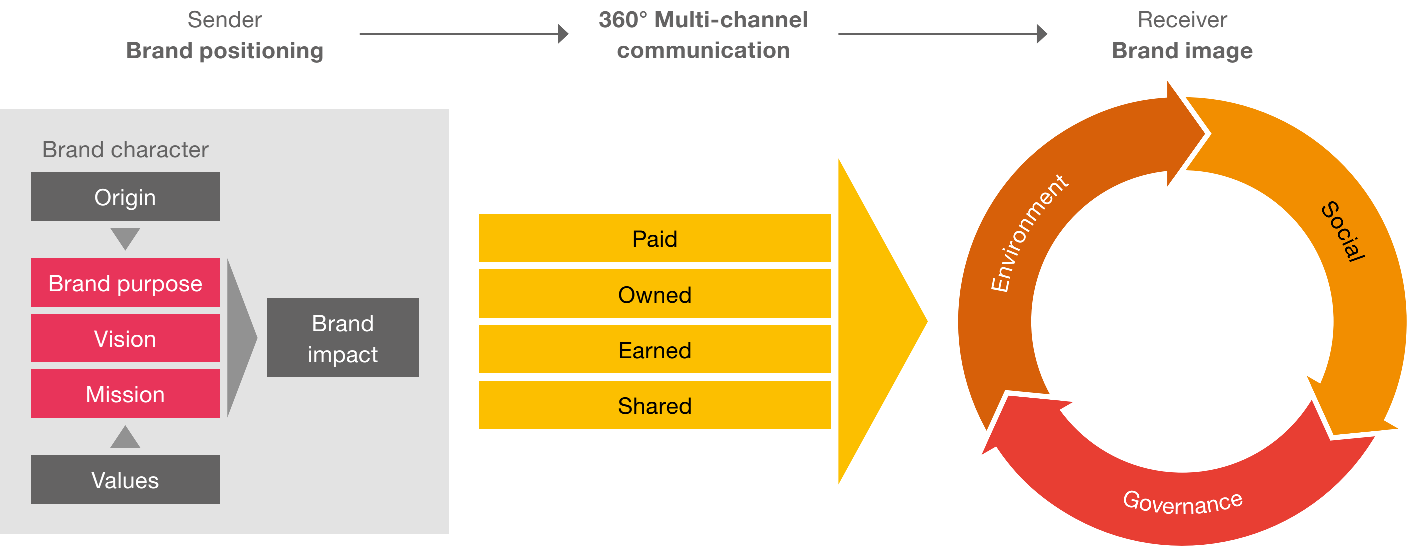
Further insights into this issue can be found in our current blog series, *"ESG products in focus: current market dynamics, SFDR and greenwashing risks".*

[1] Lesbian, gay, bisexual, transgender, queer, intersex and others
[2] UL Solutions (2007): Seven sins of greenwashing

C Implementing a credible ESG communication strategy

As we have seen, there are various challenges to implementing a credible ESG communication strategy. Approaches to mastering these challenges are presented below. Of course, these solutions are not an exhaustive list: it's essential that you develop your own vision as a company of how you want to position yourself regarding ESG communication. Your positioning needs to consider both stakeholder expectations and your existing communication channels.

Fig. 1 Brand communication



Holistic ESG communication addresses internal and external stakeholders, each of whom has their own information needs and approaches ESG with different attitudes. Stakeholder-specific messaging and selecting suitable channels for communication are therefore crucial. Changes must be communicated sensitively, in a dialogue-oriented manner and tailored to stakeholder needs. More details are shown in our idealised brand communication process in Figure 1. When positioning your company, you need to consider the company's purpose, vision and mission, as well as existing communications with your customers and how your brand image is being received.

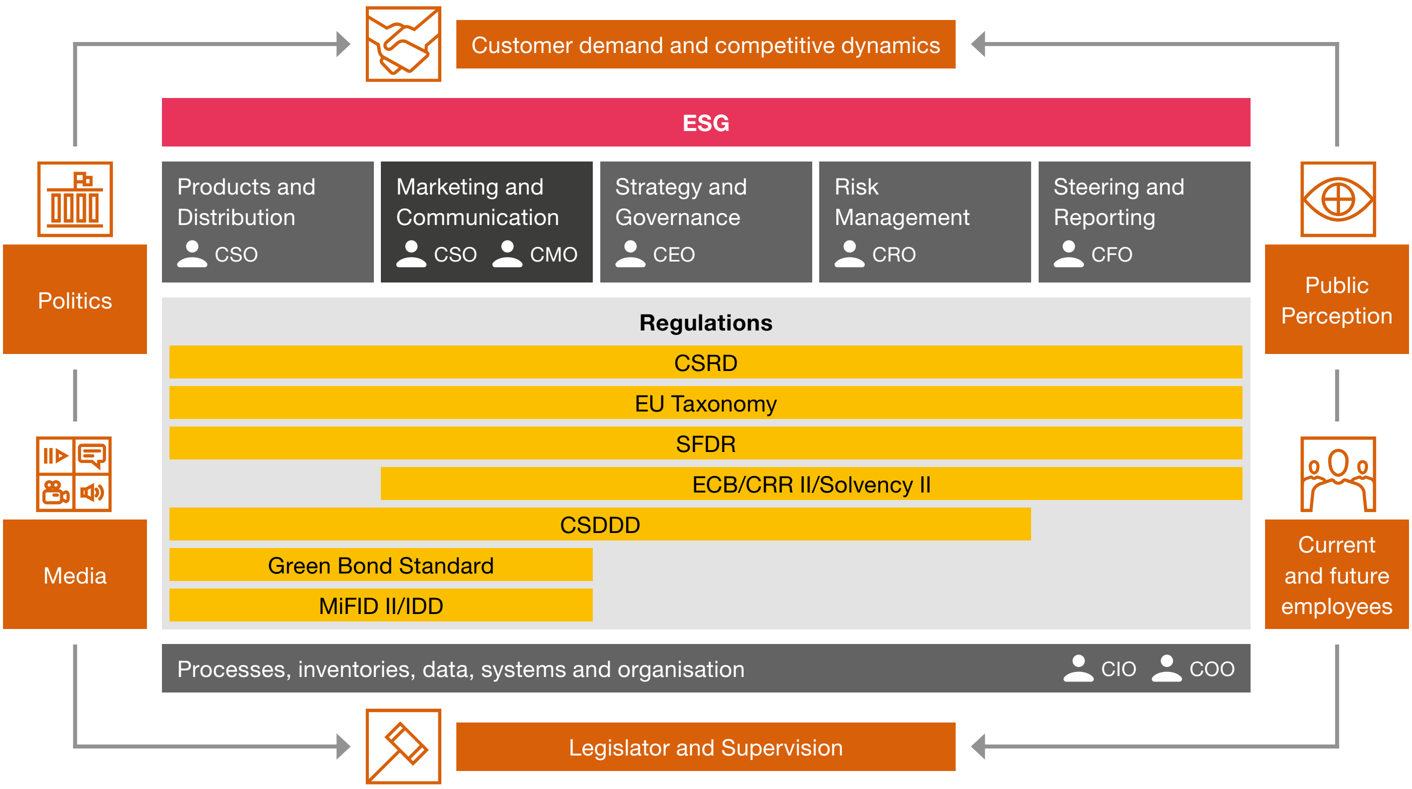
Based on this vision for ESG communication, a coherent storyline tailored to different stakeholders with different information needs can be developed. The communication strategy that you draw up must be in line with the level of ESG ambition in your company.

1 Going beyond minimum regulatory requirements

As described in chapter B.2, the EU has started developing various ESG regulations to meet the expectations of various stakeholders, including ESG aspects throughout company value chains.

The first step is to educate yourself on the role of financial institutions in protecting and restoring biodiversity and ecosystems, as well as current and future minimum requirements under applicable regulations, in order to set your level of ambition.

Fig. 2 ESG affects the entire organization (example EU Regulations)



The regulations – in particular the EU Taxonomy, the CSRD and the SFDR – affect all business units of a company, including marketing and communications, products and distribution, strategy and governance, risk management, and steering and reporting (see Figure 2).

Non-compliance with these regulations can result in significant fines and reputational damage. However, just complying with regulations cannot be considered a differentiator in the market: it is advisable to go beyond this and integrate ESG into the company strategy. Creating innovative ESG products or offering ESG solutions allows companies to become frontrunners in their markets, making a high level of ESG ambition such as this into an opportunity for a truly unique selling proposition.

As described in chapter B, the various ESG commitments deal with a variety of sustainability issues, and financial institutions are now required to adopt certain ESG processes. The next section further describes how to use these commitments and ESG ratings to bolster your company's reputation in the field of ESG.

Case study: sustainable brand positioning in the German financial sector

Situation: one of our clients, a large German financial institution, was developing a new product/service offering that needed to be strategically positioned on the German market. This new, innovative offering was targeted at young digital pioneers with high levels of affinity to ESG, so the market positioning and communications around the launch needed to be precise and well thought out. The danger of greenwashing needed to be avoided at all costs.

PwC added value: we conducted a strategic analysis of the relevant target groups, drew up personas, developed customer journeys and clearly mapped out customer interests, pain points, needs and affinity towards different ESG aspects of the new product/service. We proposed various different ways of brand positioning (e.g. house of brands or branded house marketing), and presented the pros and cons as well as operational and strategic implications of each of the proposed solutions. This also included recommendations for organisational and structural changes to improve the client's processes and responsibilities in order to successfully position the new product/service offering on the market.

End result: our analysis provided the financial institution with a clear ESG vision, business case and roadmap regarding possible ways forward. We precisely analysed the product/service offering in ESG terms from the perspective of various target groups, and suggested several potential brand and communication strategies. Taken together, this work provided the board with a foundation for decision-making on how to proceed with their new offering.

2 Strengthening your ESG reputation with strong ESG ratings and public ESG commitments

If your company holds the ambition of strengthening its ESG reputation and going beyond just meeting legal requirements, working on strong ESG ratings and signing up to public ESG commitments can be very effective ways of demonstrating this ambition. It is important to consider how you communicate sustainability issues and how ESG can create value for your business model.

When it comes to ESG ratings, you should consider asking the following questions:

- **Do you know of any existing ESG ratings for your company? Was your company the driving force behind these ratings?**
- **If so, which methodologies are the basis for your rating?**
- **Are you already cooperating with any ESG rating agencies? Would it make sense to do so?**

To ensure that relevant data can be collected for an accurate rating, you should try to actively work together with an ESG ratings agency of your choice.

For public ESG commitments, you should consider asking the following questions:

- ? **Have you already signed up to any public ESG commitments?**
- ? **If your company is a subsidiary: do you know which commitments your parent company has made?**
- ? **What commitments have been made by your competitors?**
- ? **How do you communicate these commitments to your customers and stakeholders?**
- ? **What kind of commitments make sense for your company and for your image?**

It's unwise to join initiatives promoting ESG commitments without considering their implications for your company, and whether the commitments can actually be fulfilled. Instead of making as many commitments as possible, it's better to choose just one commitment that is most relevant for your business model and stakeholders and fully implement it.

!

Commitments

When considering committing to a public ESG initiative, you should ask the following questions to determine whether the commitment will add value for your company or not.

Business strategy: How does the commitment fit into your business strategy? Does it add value, and if so, how?

Business areas: How will the various different areas of your business areas be affected? What will the commitment entail?

Pros and cons: Have you considered all the pros and cons of the commitment? Do the pros outweigh the cons?

Stakeholders: What will the value of the commitment be to your stakeholders?

Communication: How are you going to communicate your commitment?

3 Setting up a holistic sustainability framework

Your company's ESG ambitions should be reflected in your corporate strategy, particularly if you have a high level of ESG ambition. Integrating sustainability into business processes and corporate structures helps to create clarity, and allows you to make better use of synergies. Your goal should be to create a structure that clearly combines strategic objectives, disclosures and data requirements related to ESG to create long-term value. On top of this, innovative solutions such as new product design processes, production methods or HR processes need ESG to be fully developed and lived within the corporate environment.

The approaches outlined in chapter B.2 above are important building blocks for implementing a coherent ESG communication strategy within your company. The following four-step approach provides guidance on how to successfully establish a holistic sustainability framework and how to create the best possible external perception of your ESG performance.

The first step should be to establish a common understanding of your company's status quo, to serve as a baseline. This includes conducting an as-is analysis of your current capacity and corporate processes for disclosing sustainability information. It's also essential to identify what the relevant financial and non-financial regulations require in terms of sustainability reporting. Having a baseline technical approach for sustainability disclosures, with KPIs and metrics, is an important cornerstone at this stage. Your analysis of the status quo should also include understanding your existing ESG commitments, as well as industry-specific benchmarking using relevant methodological criteria from ESG ratings agencies.

In the second step, you need to develop processes to ensure compliance with applicable ESG regulations. Gaps can be identified from your as-is analysis carried out in step one. It is essential to close these gaps; otherwise, your company may face reputational damage or even penalties, as described above. To ensure that all organisational units and their staff are involved, it is advisable to conduct workshop-based gap analysis to overcome knowledge deficits and create a common understanding.

The third step towards an integrated ESG communication strategy is to develop a target operating model. In this stage, it is important to take your ESG ratings and public ESG commitments into account, analysing which ESG commitments are a good fit for your company. When carrying out this analysis, it is also important to consider your sustainability disclosure operating model, your overall strategic ambitions and the data technology that you have available. It is therefore vital to create appropriate IT structures and internal communication processes.

In the fourth and final step, you need to draw up an implementation roadmap for all ESG-related communication, integrating all three previous steps. This should also be accompanied by a uniform reporting process.

In summary, integrating sustainability into the corporate structure primarily makes sense for companies with high levels of ESG ambition. Some effort is required to cover all relevant areas, especially to create the necessary IT and governance structures. Once successfully implemented, however, this delivers a clear ESG structure. This structure enables synergies to be exploited and ensures homogeneity, ultimately creating long-term added value.

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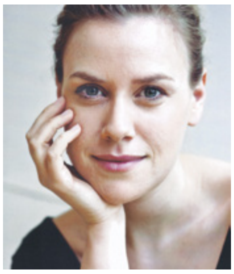

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