MCG Talks ESG – Part 2:
Steps You Can Take Now to Build or Improve Your ESG Program

In the first installment of the "MCG Talks ESG" series, we focused on how ESG and sustainability issues might apply to your company, regardless of your size, industry, or status as a public or private entity. We started by discussing the differences among the various terms, including "ESG" (environmental, social and governance), "corporate social responsibility" and "sustainability," and we suggested factors to consider when identifying or refining your company's ESG priorities. We also discussed key reasons why ESG topics are so important right now, including the increased pressure that companies are under from different stakeholders, the rising importance of "impact investing" strategies, and the ESG ratings and potential shareholder proposals confronting public companies. In this installment of the "MCG Talks ESG" series, we are picking up where we left off – identifying or refining which ESG and sustainability strategies are material to your business and your various constituencies – and discussing practical steps you can take in order to implement these priorities. Upcoming installments of the "MCG Talks ESG" series will walk you through preparing for SEC-mandated climate risk disclosures and the basics of SASB and TCFD reporting.

Step 1 – It's time for a gap analysis.

Regardless where you are in the process of developing or improving your ESG program, if you haven't conducted a "gap analysis," or a survey of how your company is performing in various ESG areas, then it's time to do so. Having a complete picture of how your company's policies and practices compare to others in your industry, stock index or any other group is the critical first step in identifying which priorities you and your team want to pursue. Every party who is interested in your company's ESG performance, from investors to employees to third-party rating agencies, understands that it is impossible to tackle all of the issues at once, but the process of setting your priorities should be reasoned and thoughtful. If you conduct a gap analysis using an objective and comprehensive framework, you can consider your company's performance in all ESG categories, which then allows you to decide which categories are the most relevant to your company's strategy and your stakeholders at this point in time. You can then choose which actions and improvements to pursue first, and these choices will be well-informed and purposeful.

In order to conduct a gap analysis that examines a company from all ESG perspectives, you need a comprehensive framework of ESG policies, metrics and principles. Institutional Shareholder Services (ISS) is a proxy advisory firm that provides proxy statement analyses and voting recommendations to institutional shareholders. ISS publishes a "QualityScore" for almost all public companies in the three areas of Governance, Environment and Social, which scores measure the quality of a company's disclosures on these issues and identify key omissions. See "Step 4 – Disclose, Disclose, Disclose" below for additional information regarding the importance of disclosure of your ESG program and the progress made on your ESG goals. The QualityScores are based on hundreds of factors that vary by region, are defined by industry group, and reflect best practices as determined by ESG specialists. Additionally, the Environment and Social (E&S) QualityScores take into account specific factors identified by the Global Reporting Initiative (GRI), Sustainability Accounting Standards Board (SASB) and Task Force on Climate-related Financial Disclosures (TCFD). Even though ISS formulates a company's QualityScores by evaluating the company's disclosures and comparing such disclosures to those of its peers, companies can use these factors as indicators of the universe of ESG issues that investors, employees and others might care about.

We have used the ISS QualityScore framework to conduct a number of gap analyses for public and private companies, regardless of their size and their current level of disclosure. For public companies that already have Governance and E&S QualityScores, the gap analysis involves reviewing all of the data points in the various "pillars" and identifying where the company is losing points. For private companies, the gap analysis involves identifying the relevant data points (i.e., factors that evaluate a company's policy or performance in a certain area) and then working with the company's management to understand the company's efforts in those areas. To illustrate the breadth of this framework, the Governance QualityScore factors are organized under the "pillars" of Board Structure; Compensation; Shareholder Rights; and Audit/Risk. The Environment QualityScore factors are organized under Risks and Opportunities; Carbon and Climate; Natural Resources; and Waste and Toxicity; and the Social QualityScore factors are organized under Human Rights; Labor, Health and Safety; Stakeholders and Society; and Product Safety, Quality and Brand. For public and private companies alike, the gap analysis allows the company to understand the ESG areas in which it is performing well, whether compared to peers or competitors or a stakeholder's expectations, and the relevant ESG areas in which there is room for improvement. Once you understand your company's strengths and weaknesses, it is time to prioritize and plan.

Step 2 – Begin with the end in mind.

It is easiest to describe how to use the results of a gap analysis most effectively by way of a simple example. The Widget Company (TWC) is a small, privately-held manufacturing company, and the gap analysis shows, among other things, that (i) a majority of TWC's board of directors is not independent from management, (ii) TWC does not have any programs in place to use energy more efficiently and (iii) TWC does not have any mechanisms in place to monitor employee satisfaction. In the first installment of the "MCG Talks ESG" series, we suggested some factors for companies to consider in order to identify and refine the specific ESG-related improvements that are material to your business and your various constituencies. Your efforts are more likely to enhance value if, in deciding which actions to take, you consider your company's profile, your primary motivation for change at this time, your company's appetite for change and who will be leading the effort.

Continuing with our example, since TWC is a small, privately-held company, there is not much motivation or pressure to add independent directors to the board at this time. However, TWC has been receiving pressure from members of the community in which the company operates and from TWC's customers to be more proactive in considering the company's impact on climate change, and TWC's management is aware of the increased competition it is facing for skilled workers. So, after considering the results of the gap analysis described above, TWC's management and board of directors decide to prioritize increasing energy efficiency and monitoring employee satisfaction.

Even though TWC has decided to take action in the short-term in these specific areas, it can return to the gap analysis in the future to address other issues such as the lack of director independence.

When identifying and refining your company's ESG priorities and implementing an action plan, it is worth emphasizing the importance of beginning with the end in mind. If your team starts with the action of "adopting an environmental policy" instead of the end goal of "considering and potentially reducing our impact on the environment," and you do that with a number of policies on different topics, there is a risk that you end up with an odd assortment of policies and procedures that seem to have been adopted for adoption's sake instead of a program that truly reflects the company's priorities. There is no one-size-fits-all approach to an ESG program, so what works for your peers or competitors might not make the most sense for your company. Turning your ESG priorities into an action plan requires taking a critical eye to the various ways you can achieve a goal and deciding which actions make the most sense for your company at this time.

Step 3 – Get the right people involved.

Once you have utilized the results of a gap analysis in order to develop your company's ESG priorities and decide on an action plan, the next step is getting the right people involved. Someone at the company needs to "own" each ESG-related action or improvement, and who that person is will depend upon the size and sophistication of your company. Large companies with well-developed ESG programs will likely have individuals with more specialized roles – for example, someone in the in-house legal department might be the right person to oversee an initiative to increase diversity with third-party service providers and someone on the operations team might be the right person to implement a waste water management program. Smaller companies or companies who are just starting on their ESG journeys might need to rely on a general counsel or another member of management to spearhead most of the new programs and policies. What matters is that there is someone who is responsible for implementing the action or improvement, as well as monitoring ongoing compliance and making changes as needed. In the words of Mr. Shirley in National Lampoon's "Christmas Vacation," "Get me somebody. Anybody. And get me somebody while I'm waiting."

This "point person" at the company can then build the appropriate support team, whether it is others at the company, members of the board of directors, or outside counsel. Some ESG initiatives might benefit from the advice and counsel of a third-party consulting firm, and these firms can assist companies with implementing a specific policy or developing and branding an entire ESG program. The importance of building the right support team for an ESG initiative or broader program cannot be overstated, as it is better not to adopt a policy than to adopt it and not follow through with what the policy purports to do. This support team can not only ensure that the policy is being complied with, but also provide feedback regarding whether the action is achieving the intended results.

Step 4 – Disclose, disclose, disclose.*

**But only if it's true!*

The final step that you can take right now is to improve the disclosures regarding what your company is already doing in the ESG space. Companies that are just starting to think about ESG typically want to wait until they have a more advanced program in place before enhancing their disclosures, but what investors, customers, third-party rating agencies and other stakeholders want to know is that your company has started the process and is thinking about these issues. The same principle applies to companies with robust ESG programs that are considering various improvements – it is important to convey that your team is thoughtfully considering what changes can be made to ensure that the program achieves the company's various ESG-related goals as they may evolve over time. Private companies might want to consider adding a "Corporate Social Responsibility" or "Sustainability" subsection to their corporate website if they don't have one, and this can be where you describe your company's commitment to these issues and your current efforts to identify and begin acting on the company's ESG priorities. Public companies can often enhance their ESG-related disclosures in their Form 10-K and proxy statement, again, keeping in mind that the goal is to demonstrate "progress not perfection."

There is an important cautionary note that accompanies this encouragement to enhance your company's ESG-related disclosures: you can face liability for any untrue statements. Regulators both in the United States and abroad have begun honing in on companies' ESG disclosures, and ESG-related shareholder and consumer claims are on the rise. Any misleading disclosures can also cause you to lose credibility with stakeholders. Thus, it is important that you not only have the right people focused on developing your program, but that you also establish an internal system for reviewing any ESG disclosures before they become public. Where applicable, your ESG disclosures should include appropriate disclaimers and clearly delineate between the concrete actions that your company has already taken and any aims that are more aspirational.