MHP Group

Capital Markets ESG *Insights*

April 2023

Welcome

In this latest iteration of the MHP Capital Markets' quarterly ESG Insights newsletter, we look at why Governance is an important aspect of ESG which shouldn't be ignored, especially in light of recent corporate catastrophes. We examine President Biden's Inflation Reduction Act in the US, and implications for both the UK and Europe. Finally, we discuss 'conscious quitting' and why corporates should pay close attention to the value of their human capital. We also feature RWS as this quarter's Client in Focus.

For any questions or feedback please contact us at **esg@mhpgroup.com.**

Why the *G* in *ESG* shouldn't be ignored

There have been of a number of examples of corporate car crashes in the media in recent weeks, with Governance red flags featuring heavily. Silicon Valley Bank's (SVB) high-profile collapse was attributed partly to some ***fundamental Governance failings***; notably, SVB was without a Chief Risk Officer for much of 2022, and had already been ***warned by the Fed regulators in 2019*** that its risk management controls were 'inadequate'.

Closer to home, UK 'tech success story' WANdisco was forced to ***suspend trading of its shares on AIM*** after "potentially fraudulent irregularities" were identified, with the Board subsequently retracting its prior guidance and announcing it had "no confidence" in their previous expectations.

WANdisco had previously been criticised for its corporate governance practices, with founder David Richards holding the posts of Chairman, CEO and President of the business. Critics have long argued that the separation of Chairman and CEO roles is critical to ensure adequate independent oversight and accountability, and have arguably been vindicated in this particular example.

'Overboarding' is another term which is in vogue from a governance perspective. There's no denying that having boards loaded with experience offering external views avoids company 'groupthink'. But doing the job properly takes time and effort, and good directors able to deliver are very much in demand.

Hence "overboarding" – according to the ***Corporate Governance Institute***,

*"**Overboarding** occurs when one person sits on too many boards, which diminishes their ability to serve the organisation effectively"*

and it is a real concern in today's corporate environment.

This is compounded by a sense that the prevailing tough economic conditions mean many businesses are vulnerable to bids, with corporate M&A massively upping the demands on directors as they assess and deal with approaches.

The ***UK Corporate Governance Code*** warns that if you are a full-time executive at a business, you should not take on more than one non-executive directorship in a FTSE 100 company or other significant appointment. There's no set limit on the number of roles chairs and other non-execs can hold, but the code guides that they must be able to devote "sufficient time to the company to discharge their responsibilities".

But in a world where ESG is monitored more closely and demands on directors are rising and their responsibilities growing, companies need to be more aware of just how many roles their board members have.

Although the Governance Code offers a get-out clause with its "sufficient time" wording, proxy advisers are taking an increasingly keen interest in overboarding.

Some, such as ISS, have developed points systems, where individuals can score up to five before they are considered overboarded. According to ISS's framework, a non-exec role scores one point, a chair two, and an exec role, three.

Such systems might be seen as blunt instruments that don't allow for exceptional individuals who are able to skilfully manage their commitments, assigning them higher scores even though they are still more than delivering for the companies on whose boards they sit.

However, in times of crisis – such as a hostile bid situation – a board role can become an almost full-time job. While it won't last forever, it will almost certainly mean temporarily dialling back time given to other companies where a board position is held.

There's no one-size fits all answer to define what the right number of boards to sit on is. Still, there are tales around the City of experienced people with the time to take on further roles turning them down for fear of being labelled "serial directors".

In an ESG era, and one where investors are increasingly litigious, perhaps the best test is the "sniff" one. How would one look if they took on that extra role, and what would their defence be if accused of being overboarded? It's a question that only directors can answer, but one that they need to be ready for.

Biden's Inflation Reduction Act: *a game changer for the green economy*

Last summer, President Joe Biden signed the ***Inflation Reduction Act*** (IRA) into law, with the aim of spurring investment in the United States green economy by earmarking $369bn in subsidies through grants, loans and tax credits to public and private entities.

Biden's Act has created dividing lines between itself, the EU and other partners, including the UK. However, the IRA has also catalysed the need for a green industrial strategy, forcing the UK and Europe to implement measures to mitigate a re-allocation of capital investment and divestment by corporates in the green economy.

Shifting paradigms

The pull of subsidies has already been too great for some companies: Volkswagen AG chose Canada (also covered by the Act) to build ***its first battery plant outside Europe***, while London-listed green hydrogen investor, Hydrogen One Capital, ***has confirmed it is now actively looking at US opportunities*** due to the preferential investment environment.

Although Rishi Sunak has ***expressed concerns that the Act could make UK and European markets uncompetitive***, and has voiced these to President Biden, business leaders and ***US climate envoy John Kerry*** argue that, instead of expecting major concessions from the US, the EU and other partners should take urgent steps to establish their own more attractive green investment conditions – the lack of which was widely criticised earlier this year after flagship EV startup Britishvolt ***collapsed into administration.***

This need for a response seems to be an attitude shared by businesses: ***a poll of UK business leaders*** conducted by the Institute of Directors found the vast majority would support a British version of the IRA, with a number of those stating that it would "level the playing field with the EU and the US".

Playing the green card

The EU has since responded with ***its own proposed set of measures***, the '***Green Deal Industrial Plan***' (GDIP) which includes subsidies to boost the adoption of green products and technologies, which, according to BloombergNEF, ***will add up to $1 trillion in spending this decade.***

The UK government, meanwhile, has ***delayed its response to the IRA***, and the EU's green subsidy plans, until the autumn but has set out plans to eradicate greenwashing in the financial sector alongside its 'green day' commitments to achieve energy security.

Shocked into action

The IRA poses an existential threat to the future of green industries in the UK and Europe, having already forced Great Britain and EU member states to ramp up green industrial strategies and commit to investing in the sector while also creating competition on a global scale.

Energy remains high on the business and media agenda as supply/demand pressures continue to impact the economy. The IRA is a seminal moment in the decarbonisation transition and corporates should continue to monitor the UK and EU responses to the Act, alongside the broader regulatory and legislative climate as Net Zero-related regulation such as the UK Green Taxonomy and TCFD come into force.

'Conscious quitting' and the value of human capital

Our ***last ESG Insights*** newsletter explored how corporate culture has jumped up the list of employee priorities. This quarter, we take a deeper look at this theme, and other corporate behaviours that are driving staff – millennials and Gen Z in particular – to seek greener pastures.

As human capital evolves as an asset of increasing importance to investors, we also discuss how talent drain and unmotivated employees caused by inadequate policies affect a company's risk profile.

'Conscious quitting'

Research by former Unilever CEO and long-time ESG commentator, Paul Polman, suggests that even in the face of intense macroeconomic uncertainty, employees are increasingly unwilling to compromise on their values and expectations when it comes to choosing who they work for.

Polman's '***Net Positive Employee Barometer***', published in February this year, surveyed c.4,000 workers across the UK and US on how important ESG is in their employment decisions. Results showed that companies are clearly failing to convince existing and prospective employees that they are good corporate citizens, with almost half of workers surveyed saying they believed senior management teams do not truly care about issues such as climate change and social equality.

Corporate purpose and culture, and crucially, how these are communicated, are key drivers of talent acquisition and retention. Younger employees in particular are calling out a lack of authenticity and ambition to do better among corporates when it comes to ESG priorities and are choosing to reject businesses that fail to prove otherwise.

Polman coins the phrase 'conscious quitting' to characterise the act of walking away from an employer based on perceived ESG failings. 'Quiet quitting' - of 2022 fame - saw employees quietly scaling back hours dedicated to work to the bare minimum in order to spend more time on other parts of their lives; 'conscious quitting' is its more active and potentially more damaging older sibling.

The threat of talent drain is considerable, with almost 50% of those surveyed claiming they were prepared to leave their current employment if they don't agree with its corporate values and behaviours.

The research seeks to understand the complexities of the motivations behind conscious quitting by taking a deeper look at employee perceptions and priorities. Understanding these should help identify achievable solutions for management to retain what many companies claim is their most valuable asset, human capital.

The report reinforced conclusions ***drawn a month earlier by KPMG***, whose own research showed that 50% of the 6,000 UK employees surveyed were influenced by ESG factors when making employment decisions. Among millennials, 'climate quitting' – the act of seeking a more environmentally friendly job – was highlighted as a growing trend. Shared values with one's employer were also a priority, with a huge 82% saying alignment on purpose and values was important to them.

Happy human capital

The link between happy employees and company performance is something that has risen in prominence in recent years.

Dan Ariely, a behavioural economist, and former fund management executive, David van Adelsberg, created the ***Human Capital Factor (HCF)*** which measures workers' views of their employers by pulling data from multiple sources to assess employee sentiment. Subsequent research on HCF by JPMorgan found that companies with the highest HCF scores consistently delivered better returns for investors.

Investors are taking note. US firm Harbor Capital Advisors has launched two ETFs that follow an index created by Irrational Capital, the firm founded by Ariely and Adelsberg in 2017, which is made up of US companies with strong HCF scores. Ariely hopes an increasing focus on behavioural psychology by investors will also lead management teams to pay closer attention to factors that promise to get the best from employees.

Ultimately, the message to corporates is clear: act. Put ambitions into practice and communicate these clearly, and authentically, to both internal and external stakeholders. Empower employees to become part of the positive impacts you are making, or any plans to do so.

This will not only increase positive feeling towards the business, but also placate investors increasingly utilising human capital frameworks. Happy, motivated employees are likely to perform better for their companies, a key factor in ultimately providing investors with better returns.

Client in focus: RWS

RWS Holdings plc is a unique, world-leading provider of technology-enabled language, content and intellectual property services. Through content transformation and multilingual data analysis, its unique combination of technology and cultural expertise helps its clients to grow by ensuring they are understood anywhere, in any language.

RWS approaches ESG through the lens of its four corporate sustainability pillars: People, Community, Environment and Governance. These pillars are at the centre of its purpose to unlock global understanding.

ESG at RWS – one of the first companies to focus on double materiality

RWS has taken a highly focussed approach to ESG, targeting a few key areas where its actions can have real impact from the very beginning. It has undertaken a materiality assessment over the last three years, enabling the Group to focus its ESG strategy on issues which are most significant to its stakeholders, and business goals and risks.

THE RWS FOUR PILLARS OF SUSTAINABILITY

OUR ENVIRONMENT

- Reduce energy consumption and emissions
- Reduce waste, increasing re-use and recycling
- Take actions to improve the environment

OUR PEOPLE

- Attract, recruit and retain the best people
- Education and career opportunities
- Diversity, equity and inclusion
- Health and well-being

OUR COMMUNITIES

- Contribute positively to the communities in which we operate
- Partnerships to support and empower young people through education

OUR GOVERNANCE

- High ethical standards, including our supply chain
- High standards of client service
- Robust and secure infrastructure

Building on this, RWS has recently started to take account of double materiality, using Datamaran, the leader in this field, to carry out its materiality assessment.

Double materiality looks at the risks a company's activities pose to the environment and society, as well as those that the company potentially faces from the external environment, providing a dual lens from which to inform, organise, and prioritise topics within an ESG strategy.

RWS is one of the first companies to use their new survey, which is being shared with shareholders, key clients, suppliers and internal audiences.

ESG reporting and recognition

RWS was an early adopter of key industry sustainability reporting measures, having become a signatory of the Task Force on Climate related Financial Disclosures (TCFD) in 2021, ahead of it becoming mandatory in 2022, enabling stakeholders to understand the ways in which climate change affects the RWS business now, and in the future, as well as the steps that it is taking to address these risks. RWS also participated in the UN Global Compact Early Adopter programme in 2022 – testing and disclosing using the new platform ahead of roll out in 2023.

RWS has chosen to evolve its sustainability reporting in line with the SASB Standards. The Group is supportive of the SASB framework as it allows companies to provide comparable and consistent ESG-related data, including on data security, workforce diversity and engagement, and professional integrity.

Having committed to reducing carbon emissions by 55% by 2030, using FY22 as a baseline year, RWS has developed a reduction plan inclusive of scope 3 emissions, which derive primarily from procurement. In doing so, it is working more closely with suppliers to drive sustainability throughout the value chain.

Following the steps taken, RWS was recently awarded a Silver Medal by EcoVadis, positioning it in the top quartile of eligible comparative companies, and the Group achieved a B score in the latest CDP ratings.

Social impact of greatest relevance to stakeholders

The data-driven materiality analysis demonstrates that, as a people-focussed business, RWS' social impact is of greatest relevance to the Group and its stakeholders. As such, within its ESG reporting, RWS focuses on both People and Communities.

People – *The value of diversity*

RWS encourages collaboration and engagement between all its colleagues and partners. This year, its Group-wide engagement survey achieved a response rate of 85%, and a 69% favourable employee engagement score (the external average benchmark is 72%).

Being part of a vibrant, globally diverse community, RWS sees the value that is gained from people's differences. It operates dedicated Group-wide inclusion pillars, each with their own Employee Resource Group (ERG) to provide feedback into the Group diversity, equity and inclusion plans, and support initiatives that are bespoke to their pillar.

RWS is also mindful of the importance of diversity at the most senior levels in the organisation; the Board is now 50%:50% (Female/Male), following the appointment of new Chief Financial Officer Candida Davies.

Community – *RWS Foundation, Campus and Scholarships*

In the last year, the company's philanthropic initiatives have been consolidated under the new RWS Foundation. Donations by RWS and the RWS Foundation in 2022 amounted to £300,553. RWS encourages its colleagues to volunteer in the community, and has also progressed its focus on education, now partnering with over 700 universities and sponsoring 50 language students via the RWS Campus and RWS-Brode scholarship programmes, which inspire great futures in localisation and support students to complete degrees in modern languages.

In case you *missed it…*

On February 28th, the FTSE women's leaders review published its ***Achieving Gender Balance report***. According to the report, women's representation on FTSE 350 boards stood at 40.2%, marginally above the 40% target. The report ranks the UK in second place internationally for women's representation on boards. However, top roles are still largely dominated by men, with only 21 female chief executives in the FTSE 350.

On the same day, the ***CMA launched a consultation on antitrust rules for sustainability agreements***. Currently, competitors are afforded exemption from the Competition Act 1998 if agreements are in place that yield benefits which outweigh anticompetitive effects. Following on from this, the CMA is reviewing its draft guidance where agreements produce environmental sustainability outcomes. The Consultation period ends on 11 April.

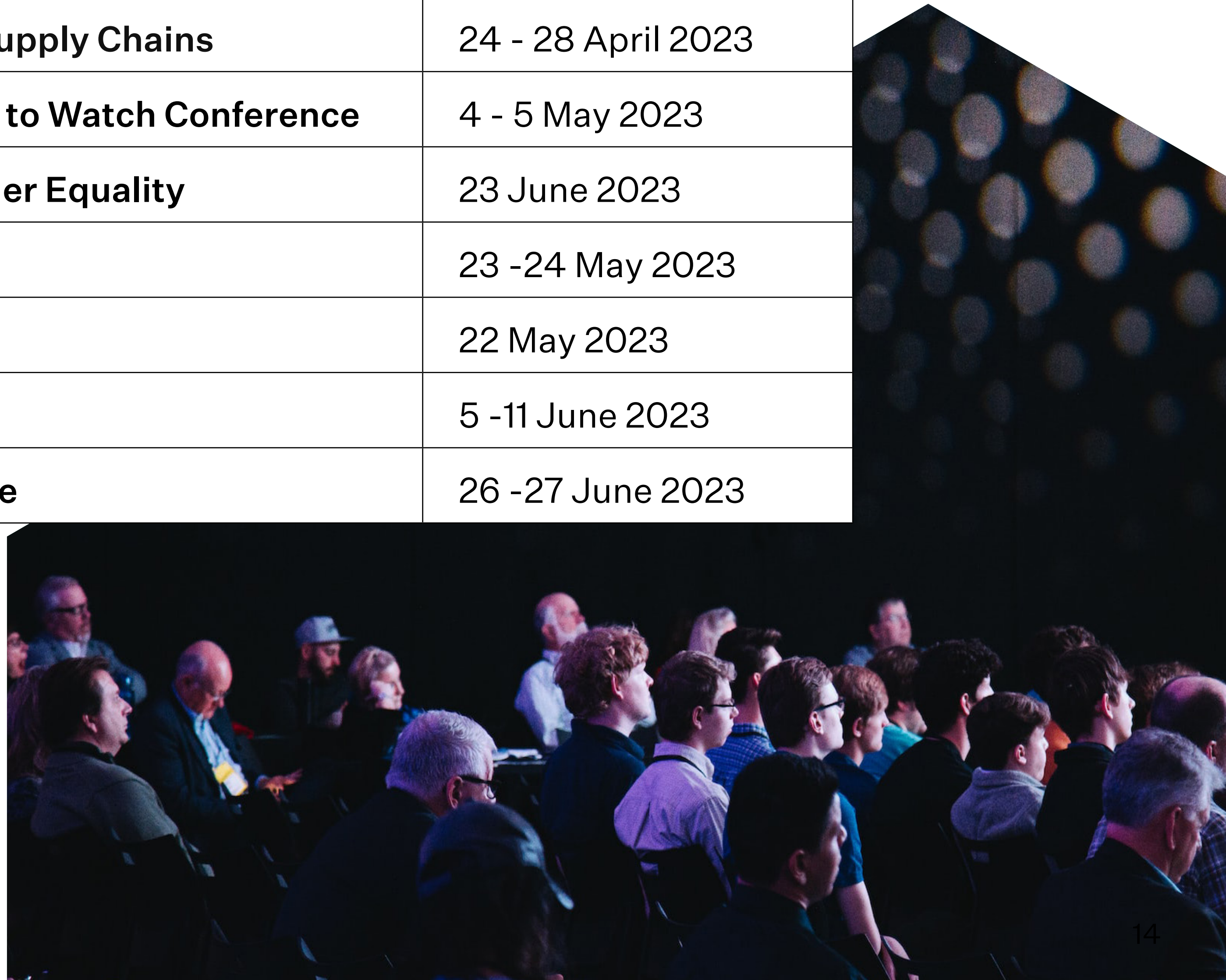
On the 20th of March the IPCC launched its ***Climate Change 2023: Synthesis Report***, which summarises findings from all six of its reports since the IPCC assessment cycle began in 2015. According to the report, while nationally determined contributions have reduced the speed of emissions, global temperatures are still highly likely to surpass the 1.5 degree target before 2050. The IPCC identifies priority areas for action, encouraging businesses to deploy and scale solutions to limit emissions.

FCA reviews of benchmark requirements are ongoing. In Q1, firms have struggled to implement the FCA's ambitious new ESG regime. March 20th saw a letter distributed to benchmark administrators, condemning the ESG-related disclosures.

Finally, on the 30th of March the Government ***announced its plan to achieve net zero, outlining policies on energy security and green finance***. The announcement lacked a response to EU and US subsidy packages for renewables, with Jeremy Hunt stating the world was playing 'catch-up'. The Government's plan, internally known as Green Day extends the ECO levy to support energy efficiency in low-income homes and introduces policies which position the UK as a leader in green finance. Ultimately, the autumn budget will determine whether government strategy satisfies the Climate Change Committee's (CCC) report on net zero.

Upcoming *key events*

Event	Date
The Chartered Governance Institute ‘ESG Summit’	27 April 2023
Bloomberg Green Summit 2023	26 April 2023
2023 Forum on Responsible Mineral Supply Chains	24 - 28 April 2023
Investment Week’s Sustainable Funds to Watch Conference	4 - 5 May 2023
The Times Top 50 Employers for Gender Equality	23 June 2023
FT Moral Money Summit 2023	23 -24 May 2023
International Biodiversity Day 2023	22 May 2023
EU Green Week	5 -11 June 2023
CBI: Accellerating Net Zero Conference	26 -27 June 2023



Link to previous

MHP Capital Markets ESG content

[MHP ESG Insights: January 23]

[MHP ESG Insights: October 22]

[MHP ESG Insights: July 22]

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[MHP ESG Insights: January 22]

MHP Capital Markets

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Oliver Hughes
Head of Capital Markets

Rachel Farrington
Director / ESG Specialist

Eleni Menikou
Director / ESG Specialist

Robert Collett-Creedy
Associate Director / ESG Specialist

Contact Us

esg@mhpgroup.com
020 3128 8100

MHP Group

MHP Group is an integrated communications agency built for the Networked Age – a world that's increasingly connected, complex, polarised and activist.

We lead the way in the application of behavioural science to solve communications challenges. We create strategies and multichannel campaigns to engage every audience, from consumer to policy maker, and from stakeholder to shareholder. With 200 specialists in London and San Francisco, we are trusted by many of the world's leading businesses and brands.

Contact MHP

020 3128 8100
hello@mhpgroup.com
mhpgroup.com

@mhpc
mhp-communications