CADWALADER

Study Explores Links Between a Company's ESG Focus and its Financial Performance

May 23, 2023

By Jason Halper
Partner and Co-Chair | Global Litigation

By Sara Bussiere
Special Counsel | Global Litigation

A **recent study** by Bain & Company and sustainability ratings provider EcoVadis "examined how various aspects of sustainability and ESG activities—things like setting ESG targets, tracking results, embedding sustainability into management processes, procuring sustainably, and putting in place programs to reduce carbon and improve diversity, equity, and inclusion—correlate with both ESG outcomes and financial performance." The study concludes that, for the companies surveyed, 80% of which were private, "ESG activities have no strong negative correlations with financial outcomes; in fact, they are associated with encouraging revenue growth and EBITDA margins." The Study was geared to the private equity industry, with the authors observing that "investment policies of 70% of the limited partners surveyed by Bain & Company and the Institutional Limited Partners Association in 2021 included an ESG approach."

Researchers found the following four correlations between ESG activities and financial results:

1. Companies that focus on sustainable procurement within their supply chain are more profitable, with margins of three to four percentage points higher than those that do not have a comparable focus on their suppliers' ESG efforts.
2. Companies in the carbon-intensive industries of the natural resources, transportation and industrial goods sectors that use more renewable energy have higher EBITDA margins. This is particularly the case in the EU where there is a carbon tax and therefore lowering emissions directly impacts that expense.
3. Companies in the top 25% of their industry for executive team gender diversity have annual revenue growth that is approximately 2% more than companies in the bottom

25%. These companies' EBITDA profit margins are also approximately 3% higher.
4. Companies with high levels of employee satisfaction have a projected three-year revenue growth up to five percentage points higher than those with less-satisfied employees and margins as much as six percentage points higher. Benefits that promote the highest employee satisfaction, aside from fair pay and a safe work environment, are career training, mental and physical healthcare, childcare, and educational opportunities.

"These findings should motivate companies at all levels of ESG maturity to redouble their investment in accelerating their sustainability journey," said Sylvain Guyoton, chief rating officer at EcoVadis in an **April 17 statement**. "For companies in nascent stages, this means developing sustainability management systems with policies, action plans and reporting. Companies at mature stages can pursue more advanced capabilities such as regenerative resource management and product circularity. Ultimately, cascading these practices into their value chains can support, for example, Scope 3 decarbonization and circularity initiatives, and also puts those trading partners on the same path to value creation."

Taking the Temperature: While the Study's target audience is private equity, we frequently discuss investor interest in ESG issues, including shareholder activity. For example, in April, climate activist shareholder group Follow This filed shareholder resolutions seeking stronger energy transition strategies from oil majors BP, Chevron and Shell. In January 2023, As You Sow sent climate-focused shareholder resolutions to five major U.S. banks, Bank of America, Goldman Sachs, JP Morgan Chase, Morgan Stanley and Wells Fargo, requesting that they disclose their climate transition plans. In 2021, the board of Rio Tinto backed shareholder resolutions requiring the company to set emissions targets consistent with the Paris Climate Accords and suspend memberships in industry associations that lobby against climate change action. We also have previously discussed how ESG-related activism is developing in certain industry sectors, such as the insurance sector **and the pensions sector in the UK.**

Whatever one's position on the strength of the link between a company's relative ESG focus and its financial performance, we continue to hold the view that directors and officers need to inform themselves about material climate-related issues as part of their overall governance responsibilities. Doing so will permit boards and management to assess and act on material sustainability risks and opportunities. Among other things, directors and senior executives should focus on climate-related governance (i.e., monitoring and assessing material risks and opportunities), data collection/assessment (including alignment with SBTi or other data standard setters) and disclosure (including necessary caveats or qualifications on articulated climate goals) to avoid litigation exposure. Data collection, in particular, is a challenging area, which we have commented on frequently. Companies relatively new to ESG reporting will likely incur significant one-time costs in developing data gathering and reporting infrastructure, as well as ongoing costs tied to periodic reporting, particularly given the lack of consensus **regarding what constitutes high-quality data.**