Executive Summary Notes - March 2022

HOGGETT BOWERS

Reputational Risk & ESG, Two Sides of the Same Coin

An Interview with Michelle Leavesley (Director of Organisational Risk & Resilience, M&G Plc.)

It is deemed at least a third of corporate value is down to brand and reputation alone, how accurate is that and what elements contribute to reputation?

It has been proven that corporate reputation directly contributes to the market cap of listed organisations and unsurprisingly those performing best attribute a higher value to reputation – some up to two thirds of their value. However, the factors that we are judged on reputationally are changing, perhaps linked to the pandemic. A recent report by the Reputation Dividend demonstrated that factors such as how we treat our people, attract talent and innovate are increasingly gaining value over the more traditional areas such as the financial strength and stability of an organisation.

We also know that reputation through the pandemic has increased in value across the financial sector (some say by as much 8%) because people care how we have treated our people.

There is a growing thought that ESG should be moving away from a bottom-up rules-based approach, towards a vision based, top down, outward looking strategy. In your experience, is this now common place or still aspirational?

The holy grail is to have an effective top down and bottom up approach that perfectly blend and inform decision making throughout the business. My own view would be that the bottom up got an early head start in some businesses on account of the drip feed of early draft standards, rules and speculation on what the regulatory landscape would be and the sense of urgency some felt to jump in to start solving problems without taking a step back to plan strategically or effectively.

However, there needs to a strong sense of purpose and strategic direction from top down to ensure the consistency in the decision making that impacts on our ESG footprint. This also avoids the knee jerk responses to commitments, targets and allegiances that were so prevalent across businesses on a range of ESG topics in the early days.

Fundamentally our purpose needs to drive our decision making to ensure that we are authentic and living our truth as a firm. We should make a difference on things we genuinely believe in and can influence change. Reputation is built on the principle of trust and if you don't know what a business stands for, a stakeholder can't build trust.

The foundations of trust need a holistic approach:

- What do we stand for?
- Where are the red lines?
- How do we engage with the world and differing communities?
- How do we turn this into meaningful actions?
- What are our stakeholders' expectations and needs?

If we fail to act consistently in how we deliver these foundations we begin to undermine trust or worse can lose trust completely. This can result in losing customers, employees, the licence to operate and increase market risk.

Shareholder activism is increasing across UK listed companies. Is there a difference in companies with a strong corporate reputation in how they respond to ESG activism?

I believe so. Those with strong reputations and sense of purpose are more confident in how they define and engage with activism. No doubt AGMs are taking a new path to demonstrate more openness. However, activism can come in all guises both external and internally from our employees. Activism can also be really helpful in uncovering blind spots and flagging issues that matter most to our stakeholders. When we think of the word 'activist' we tend to think of the extreme versions of what we see on TV but in reality activism can be simple, proactive actions that individuals take to change their workplace, community or the world for better. We must also remember that it is not an issue of size or scale as highlighted in an example of a charity who faced resignations from some of their Board at their AGM on account of their sponsorship with BP – ESG issues impacts on all businesses and organisations of any size and stature. Therefore, the capacity for activism disruption is very real and should not be underestimated or only considered in terms of shareholders alone.

These days what a company says on ESG is not enough, how do you meet the expectations of differing stakeholders and deliver on this?

First you need to define and understand who your stakeholders are? Understand what are their direct experiences and/or indirect perceptions (e.g. external influences such as ratings or influencers)? We need to speak in their language and in their tone of voice to be more inclusive.

Not only is it a matter of consistently meeting but also understanding how stakeholder expectation and tolerances on ESG is shifting? As people become more aware or educated on ESG issues their needs and expectations will change. It is crucial to be aware of these shifts and stay on top of them. We must also be honest and transparent in how we meet these needs or we face the issue of greenwashing.

Another important consideration of listed firms is how they respond to Section 172 of the Companies Act. There is coalition championing a proposed change from 'promoting success' which can be interpreted as more of a shareholder focus to 'advance the purpose' of a business which brings in a wider range of stakeholders to be considered and feels more aligned to the focus on ESG. Regardless of the outcome, the conversation generated as given much greater focus to stakeholder groups and today consideration of the employee group is now considered as critical in decision making.

To what extent will corporate reputation be driven by ESG disclosures in the future? How will businesses manage this?

Undoubtedly, ESG disclosures of any kind both regulatory and public will have an impact on reputation. It creates the shop window for stakeholders to see into a business. However, I would come back to the point on the importance of trust. It should not be the disclosure itself that shapes reputation but the actions we take to maintain, improve and/or address any issues arising from the disclosure. As long as companies are honest, open and transparent their reputation should be reinforced. Therefore, robust communication is critical in and around disclosures to explain the context, with strong oversight of the data, systems, interpretation applied alongside the measures and monitoring. In Risk oversight this means in addition to being diligent on the 'what' we also consider 'how' the business is communicating to support the disclosure process to maintain and build trust.

Are companies really delivering on the S in ESG?

This is why I like the ESG approach as a benchmarking tool as it reminds us that there is an S and G because it can feel like these are forgotten! Some may argue that the E gets more attention from the regulators on issues like Climate change, but we have also had a strong focus on customer outcomes for a number of years, but it wasn't badged as ESG whilst sitting in the S so perhaps we need to reflect on what we are already doing? That said, I do believe as a business we have increasingly more social dilemmas to face – the pandemic and the invasion of Ukraine demonstrate how import social issues are. People are more socially aware, and businesses are now factoring in how they treat employees in their dividend reports, under their health and wellbeing agenda. That said it is important that as risk managers we consider the inter dependencies across the E, S & G as they are closely interlinked and there is a risk in separating them out that they become siloed.

What part is technology playing on advancing the ESG and reputational agendas?

Reputation is owned by the stakeholders not the business. Therefore, their perception is their reality. Much of this perception is being influenced online in digital channels. Today, everyone has the ability to self publish – customers, employees, suppliers, leading to a whole new marketing approach linked to influencers.

Social media and fake news are key areas of focus. Being able to live the moment in real-time and publish instantly. This drives activism and has huge implications.

Technology also has an important part to play on the metrics and quality in relation to the decisions we make on sustainability. We must ensure that all data providers are keeping their sources up to date. Currently there are a relatively small number of data providers and that could create a risk of reliance and issues if they have technical challenges.

You joined M&G as Director of Organisational Risk & Resilience from a commercial brand and marketing environment. How has this helped you in your risk role and in tackling ESG Challenges?

My technical training in brand and marketing gives me a number of things. Firstly, as a marketeer you are trained to look at the business through the eyes of a stakeholder – that is your default position and essential in risk when evaluating the impact of key decisions on stakeholder groups across a range of ESG issues. Secondly, historically brand was used as a key control to safeguard reputation but today it is diluted so I understand how to build an effective oversight environment with Brand, Marketing and Corporate comms in the new world and work together to build the new controls required in a socially and digitally activated world. Thirdly, marketeers understand psychology, human behaviour and customer touchpoints essential in tackling the behavioural aspects of reputation.

I am also known for my involvement with sport and this has really reinforced the importance of culture in delivering on ESG. Sport instinctively understands the issues, are reliant on their local communities and are more successful if they reflect the communities they serve. The three lines of defence model exists in Sport too – namely that you have a first line sports team/ coaches and support staff, generally a second line of Board/Exec and then generally a third line in the form of oversight and checks from a Governing Body. Amazing how transferable skills are from a sports environment to a risk function.

Therefore, I deliver diversity of thought to the risk leadership team and help to push risk managers beyond their comfort zone to embrace the new world of risk that exists in and around the execution organisationally of the business. The bottom line is that Reputational Risk exists beyond the operational processes in the behaviours and communication they adopt with many examples of how these areas can be those that cause the detriment to a firm, so I expect more people in my mould joining risk teams in the future.

Michelle Leavesley, Biography:

Michelle has over a decade of experience in the boardroom, as Independent and Senior Independent Non-Exec Director. She is a pioneer in Organisational Risk Management and as a Senior Leader in M&G Plc., tasked with challenging traditional risk managers to think differently in tackling a range of new strategic, people & stakeholder risk areas including Culture/Behavioural, Digital & Social Communications, Environmental, Social & Governance (ESG) and Reputational Risk.

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