A GUIDE TO ASSESSING ESG INTEGRATION

The 8 essential elements of integrative thinking

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Framework

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INTRODUCTION

While "ESG integration" can refer to a number of approaches to measuring and managing corporate performance and accountability, the definition we apply here refers to embedding environmental, social, and governance (ESG) considerations into business strategy, operations, and product and service offerings.

Though the essence of this concept is not new, the term "ESG integration" itself reflects several emerging realities that promise to permanently alter corporate management practices:

- **Investor interest in ESG is rising**
- **ESG-related activities that used to generate headlines have become table stakes**
- **Stakeholder pressure to address ESG issues is not going away**
- **Emerging standards are focusing on correlating ESG and financial performance issues**
- **A growing body of research is establishing the business value of ESG performance**

Over the course of a decade of advising major companies, interfacing with other experts, and conducting research, we at Framework LLC have identified eight key elements of an integrated business model. Taken together, they can serve as a springboard, roadmap, and measure of companies' maturity in integrating ESG considerations into their business strategy and operations.

Each element involves multiple performance aspects and related metrics. And of course, each contains a complex set of issues unto itself that potentially require years of effort to address, and to which no simple checklist can do justice. This brief self-assessment guide, however, can be applied as a simple first step to recognize areas of strength and potential improvement for your company.

1. Governance

- Do ESG considerations inform and underpin corporate strategy?
- Does the Board consider ESG issues in its charge to deliver value to shareholders?
- Do the CEO and board have ultimate, engaged oversight of ESG?
- Does the governance structure ensure cross-functional work and communication?

Sample relevant indicators: Percentage of independent directors; number and percentage of women on board; CEO duality

2. Accountability

- Is there established ownership of material issues?
- Are ESG metrics built into individual performance goals and evaluations?
- Are there established companywide policies and guidelines for addressing material issues?

Sample relevant indicators: ESG-linked board and executive compensation; clawback provisions; current materiality analysis in place

3. Integrated risk management

- Is there a formalized risk management process that incorporates materiality analysis/ESG issues?
- Are material issues considered legitimate risks and presented as such in 10-K/20-F?

Sample relevant indicators: Supplier ESG guidelines; board oversight of ESG issues; material issues listed as risk factors in 10-K

4. Financial alignment

- Is finance actively involved in measuring financial value in ESG performance?
- Is a shift to long-term thinking and planning underway?
- Are long-term goals communicated to investors?
- Is the company de-emphasizing or stopping quarterly financial reporting?

Sample relevant indicators: Inclusion of ESG metrics and progress on goals in quarterly financial statements; application of the precautionary principle in strategic planning; use of ecosystems services valuation in cost-benefit analyses

5. Stakeholder engagement

- Is there an established and published commitment to stakeholder engagement?
- Is systematic and ongoing stakeholder engagement undertaken, including with detractors of influence?
- Is stakeholder input used to inform materiality analysis?

Sample relevant indicators: Readily available contact information on corporate websites and communications materials; participation in/support for collaborative industry/NGO initiatives

6. Innovation

- Are awareness and utilization of environmental and social considerations built into the R&D process to facilitate idea generation and innovation to address material issues?
- Is the business model able to adapt to capture opportunities and new markets presented by attention to material issues?
- Does the company reward innovation that addresses ESG and material issues?

Sample relevant indicators: R&D expense relative to revenue and EBITDA; capex relative to revenue; use of Life Cycle Assessment (LCA)

7. Integrated disclosure

- Does reporting outline business model, long-term strategy, future opportunities, challenges, and uncertainties?
- Is materiality analysis incorporated and results discussed as they relate to business strategy and operating environment?
- Is context for material issues and performance provided?

- Does reporting communicate financial impacts of ESG performance?
- Does reporting establish connectivity between past, present, and future performance?

8. Metrics and KPIs

- Are long-term and interim goals to address material issues in place?
- Are goals cascaded throughout operations?
- Is progress on goals tracked?
- Has financial impact of performance on material issues been identified?

Sample relevant indicators: carbon intensity; scope 3 emissions; water intensity; employee turnover rates and costs

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