ALUKO & OYEBODE

THE ABC OF ESG

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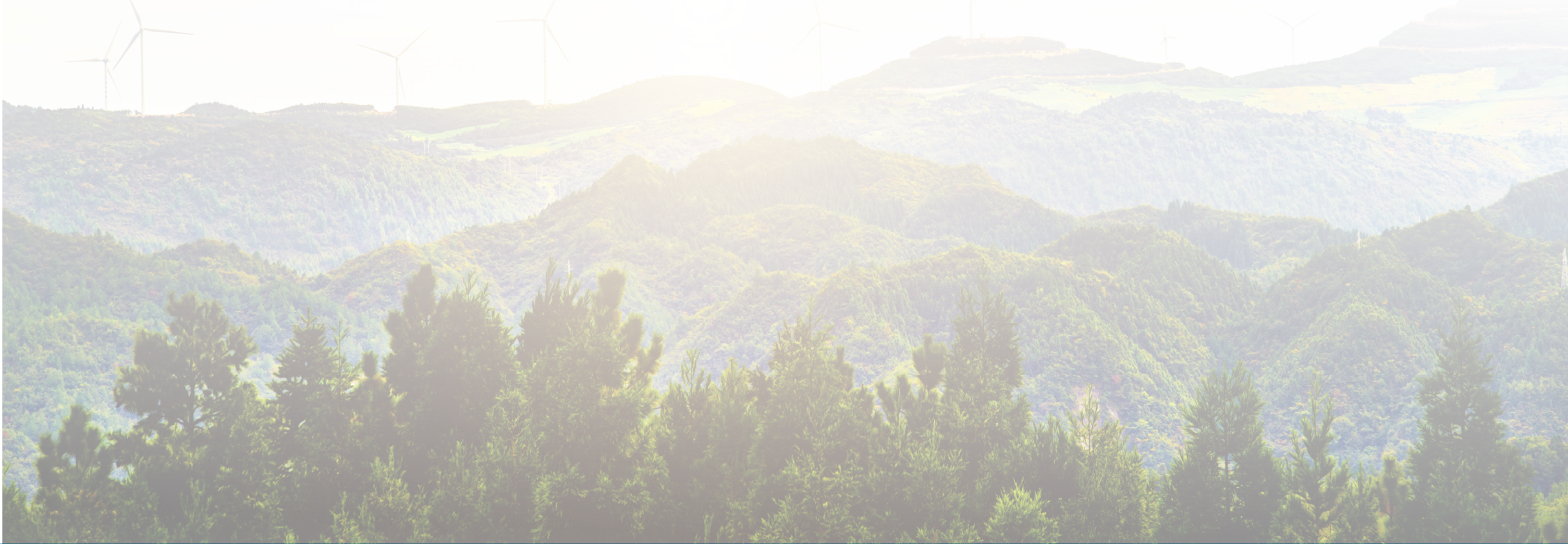
What is ESG?

The acronym ESG stands for Environmental, Social and Governance. It is a set of principles that guide a company's strategy, operations and activities, and guides the assessment of its impact on the environment, customers, stakeholders and the wider society.

The concept of "ESG" emerged from an initiative led by the United Nations and key financial institutions to integrate environmental, social and corporate governance factors into the strategies and operations of companies in the financial sector. This led to the creation of the 2004 report, **"Who Cares Wins: Connecting Financial Markets to a Changing World"** which provided key guidelines and recommendations for the integration of ESG factors into businesses.

ESG factors have evolved beyond the financial sector and are now applicable across all business sectors and industries. ESG metrics have become vital tools used in assessing projects and businesses for funding, for stakeholder engagement, as a determinant of social capital and also used by investors in making investment decisions.



ESG Pillars

E	S	G
Carbon Foot Print	Community Contribution	Corporate Governance
Waste Management	Stakeholders	Board Composition
Water Conservation	Corporate Social Responsibility	Policies & Compliance
Climate Protection	Diversity Equity Inclusion	Shareholder Values

ENVIRONMENTAL

These factors address and assess a company or an organisation's utilisation of natural resources and its impact on the environment. They consider the reduction and depletion of natural resources, habitat destruction, environmental pollution reduction and the direct impact of a company's operations and products on the environment. Some of the positive impacts may be reflected in a company's waste and effluents management, water conservation, climate change mitigation, reduction of carbon footprint and other environmental pollution measures. For companies with only office bound activities that may be in the service or technology industries, without factory, production or manufacturing operations, the "E" pillar could address their power sources utilisation and efficiency, use of plastics, paper and other single use items; management and disposal of electronics batteries etc; travel practices and their overall carbon foot print management.

SOCIAL

These are factors that affect a company or an organisation's relationship with key stakeholders including shareholders, customers, employees, and the community. Social factors include labour practices (hiring, promotion and remuneration, employee health, safety, and wellbeing etc.), adoption of Sustainable Development Goals, data privacy, diversity, equity, and inclusion as well as corporate social responsibility initiatives and community relations. For many companies, these factors are integrated under their company's corporate social responsibility programmes and also articulated and implemented through their corporate policies and culture framework.

GOVERNANCE

This refers to how a company or an organisation is led and managed by its shareholders, directors and officers. Governance factors include corporate governance policies and compliance frameworks, board composition and diversity, organisational policies and practices related to transparency and accountability, risk management, internal controls, stakeholder engagement and rights, policies and stance on anti-bribery and anti-corruption, reporting and disclosures, and its code of ethics and compliance with applicable laws and regulations.

Why is ESG important?

Sustainability of Businesses:
The adoption of ESG principles enables businesses adopt and institutionalise sound business practices which in the long term help them to operate more efficiently, reduce costs, increase profits and improve long-term viability.

Legal and Regulatory Requirements:
Companies in various sectors are mandated by law to adopt specific ESG factors. These include codes of corporate governance, environmental impact assessment regulations, sustainability reporting and so on. Companies must comply with the set requirements.

Stakeholder Expectations:
Stakeholders and investors are holding companies accountable to higher standards and best practice. Companies are required to demonstrate their commitment to sustainability as well as the adoption and implementation of certain ESG standards. Companies that fall short are at risk of negative press and public censure.

Funding and Investment Opportunities:
Increasingly, investors and lenders are considering ESG factors in evaluating and deciding on which companies to invest in thereby restricting or limiting financing options for companies not incorporating ESG standards. By not adopting good ESG practices, a company reduces its own access to general financing and further will be unable to avail itself of green funding for projects or its business in general.

Risk Management:
The incorporation of ESG helps businesses identify, minimise and manage sustainability risks and risks related to environmental, social, and governance issues.

Climate and Environmental Concerns:
The rising concerns regarding environmental degradation and climate change necessitates collaboration and demands deliberate efforts from the private sector. Companies cannot be passive any longer.

International Standards and Principles:
Various international standards, adopted as best practice, require the incorporation of standards on ESG such as the United Nations ("UN") Global Compact Principles, UN Principles on Responsible Investing, International Labour Organisation Conventions and International Financial Corporation Performance Standards.

Impact on Stakeholders:
The adoption of ESG increases the positive impact of the business on its stakeholders which lead to positive outcomes such as increased employee engagement and retention, increased customer loyalty and support from critical stakeholders.

ESG in Nigeria

There is no single framework or law for ESG in Nigeria, however, a number of laws and regulations address the pillars of ESG such as the following:

Constitution of the Federal Republic of Nigeria 1999 (as amended) ("Constitution")- This is the grund norm and supreme law of Nigeria that governs the country's legal, social and political system and from which other laws gain their validity. The Constitution contains key provisions on ESG factors such as Chapter 2 on Fundamental Objectives and Directive Principles of State Policy and Chapter 4 on Fundamental Human Rights.

Climate Change Act, 2021 ("CCA")- The CCA applies to and creates key obligations for the government and its agencies and public and private entities within Nigeria on the development and implementation of mechanisms geared towards fostering a low carbon emission, environmentally sustainable and climate resilient society.

Environmental Impact Assessment Act, 1992 ("EIA")- The EIA sets out the general principles, procedure and methods to enable the prior consideration of environmental impact assessment on certain public or private projects.

Companies and Allied Matters Act, 2020 ("CAMA")- The CAMA is Nigeria's key legislation that regulates the formation, operation, and governance of companies in Nigeria. CAMA contains key sections on ESG such as Section 305(3) on duties of directors which specifically requires directors to ensure that their company's operations are not detrimental to the environment in the community where it is carries out business operations, Section 398 on publication of financial statements and Sections 342-347 on actions for the protection of minority against illegal and oppressive conduct.

Petroleum Industry Act, 2021 ("PIA")- The PIA provides for the legal, governance, regulatory and fiscal framework for the Petroleum Industry in Nigeria. The PIA contains provisions on ESG such as Sections 234- 257 on host communities' development, Section 261 on the charge of hydrocarbon tax and many other provisions that fall under the ESG preview.

The Securities & Exchange Commission Nigerian Sustainable Finance Principles, 2021 ("NSFP")- The NSFP provides key principles on sustainable finance to improve economic prosperity and competitiveness while contributing to protecting and restoring ecological systems, enhancing cultural diversity and social well-being. For example, Principle 1 creates the framework for environmental, social and governance (ESG) considerations and Principle 3 focuses on human rights, women's economic empowerment, job creation and financial inclusion.

The Nigerian Stock Exchange Sustainable Disclosure Guidelines, 2018- The Guidelines contain provisions for sustainability reporting and disclosure by companies listed on the Nigerian Exchange which encompasses economic, environmental, social and governance factors.

The Nigerian Sustainable Banking Principles, 2012 ("NSBF")- The NSBF contains key principles adopted by banks, discount houses, and development finance institutions which aim to foster positive development impacts to society while protecting the communities and environment in which financial institutions and their clients operate. The principles include environmental and social risk management, environmental and social footprint, human rights, environmental and social governance and reporting.

Codes of Corporate Governance- Codes of Corporate Governance such as the Nigerian Code of Corporate Governance 2018 and sector-based Codes such as the Code of Corporate Governance for Banks and Discount Houses and Code of Corporate Governance for the Telecommunications Industry provide detailed requirements on corporate governance for companies.

How ESG affects Businesses:

Risks, Challenges and Opportunities

ESG is material to companies. Its impact can be felt in the company's bottom line and will affect its long-term sustainability and viability.

	Challenges	Opportunities
Risks	Where a company is non-compliant with ESG prescriptions, the risks may be immediate or long-term and the impact can vary depending on the issue and sector involved. For example, the assessment of environmental risks for companies in the oil and gas industry will differ from the assessment for banks and technology companies.	The integration of ESG is a viable risk management tool for companies and organisations. Companies that incorporate ESG factors in their strategy and operations are better placed to identify and manage risks that threaten the business.
Investment	Investors are increasingly applying ESG factors in financial analysis and in deciding on the companies to invest in. Companies that do not incorporate ESG standards are at risk of losing out on investment opportunities which may impede growth opportunities.	Businesses that understand and incorporate ESG practices are more likely to attract investors and have access to business opportunities and opportunities for increased investment in areas such as impact investing and sustainable finance.
Green Funding	The growing concerns about environmental degradation, climate change and sustainability have led to the creation of financing structures and funding (such as grants, bonds and loans) specifically targeted at green initiatives and businesses focused on sustainability, climate change mitigation and environmentally friendly technologies, products and services. Due to the nature of green funds, businesses that do not incorporate ESG factors and provide qualifying products or services will be unable to access green funding.	There is a steady increase in funding for green initiatives which creates opportunities for funding for companies, organisations and governments such as green grants, green bonds, green mortgages, green loans etc.

	Challenges	Opportunities
New Businesses and Opportunities	The evolution of the concept of ESG and sustainability has created new business opportunities and opened new markets. Companies that do not assess and incorporate ESG factors will be unable to access these new markets and business opportunities	The growing need for sustainable practices, products, businesses and services has led to business opportunities in sectors such as renewable energy, recycling, waste management, pollution prevention, sustainable agriculture, carbon trading and so on. Businesses that incorporate ESG are able to access these opportunities.
Regulatory Compliance	Companies that fail to integrate ESG factors into their businesses are at risk of non-compliance with regulatory requirements which can lead to penalties (such as fines, suspension and withdrawal of operational licences) that threaten the sustainability of the business and lead to reputational and financial losses.	Integrating ESG factors helps companies comply with regulatory requirements and remain in good standing with regulators.
Cost	Non-incorporation of ESG by companies can lead to the increase in operational expenses and costs that come with ESG-related risks.	The incorporation of ESG helps companies manage operational costs, pre-empt risks and manage challenges in a cost-efficient manner.
Business Operations	ESG-related risks can affect business operations. For example, incidences of unrest and protests may evolve from breaches of social principles, pandemics, flood, and other natural disasters may evolve from environmental harm and in most cases lead to the disruption of business operations.	Businesses that incorporate ESG are able to avoid or mitigate the crystallization of risks that disrupt business operations. Companies with good sustainability frameworks have in place business continuity plans to navigate such ESG risks.
Reporting and Ratings	Companies are required to disclose and report on the implementation and performance on ESG factors. Rating metrics have also been developed to assess levels of implementation by companies. The failure of companies to report or the attainment of low level ratings will earn a company a poor reputation, and may lead to reduced investor interest, lower valuations or impair the share price.	Accurate reporting and high ratings on ESG position for a company makes it attractive for investment, instils public and stakeholder trust, positive brand recognition or goodwill.

ESG Compliance

To identify, integrate and comply with ESG requirements, companies should carry out the following:

ESG Identification and Analysis	Identification and assessment of ESG materiality, risks, and opportunities to the company's business in order to develop a tailor-made ESG strategy for the company.
ESG Program Design and Execution	Design and implementation of ESG programs, policies and risk management tools that align with the identified ESG strategy for the company.
ESG Assurance and Monitoring	Periodic audits, tracking and evaluation of ESG policies, framework practices and performance.
ESG Capacity Building	Continuous training and capacity building on ESG related trends, best practices, regulatory compliance requirements and reporting disclosures.
ESG Reporting	Disclosure of information about a company's environmental, social, and corporate governance performance.
ESG Due Diligence	Assessment of a company's ESG risks, framework, practices and implementation in order inform decisions to be made regarding a company such as decisions on investments, mergers, and acquisitions.

Conclusion

"A better inclusion of environmental, social and corporate governance (ESG) factors in investment decisions will ultimately contribute to more stable and predictable markets, which is in the interest of all market actors." - '**Who Cares Wins: Connecting Financial Markets to a Changing World Report 2004'**. The incorporation of ESG factors into the strategies and operations of companies and organisations is essential to manage risks, remain competitive, and grow profitably and sustainably.

Increasingly, ESG and sustainability are also informing investment decisions, opening new markets and sources of funding which can only be accessed through the integration of ESG strategies. It is therefore an imperative for companies and organisations to embrace ESG. It is also essential to determine the ESG approach most suitable and tailored to the company or organisation's needs, size, business/industry, and attendant risks. To ensure this, it is expedient to adopt the key elements of ESG compliance (ESG Identification and Analysis, ESG Program Design and Execution, ESG Assurance and Monitoring, ESG Capacity Building, ESG Reporting and ESG Due Diligence).

Finally, sustainability for humanity and the planet has been deemed achievable and ESG for companies and organisations plays a crucial role in reaching the recommended sustainability targets. All are required or even compelled to participate.

For further enquiries and information on the applicability and incorporation of ESG factors and compliance into your business, please contact Adeolu Idowu, adeolu.idowu@aluko-oyebode.com

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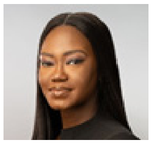

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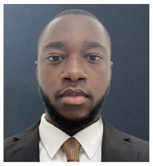

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