can ESG factors influence financial performance

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The following points categorise the main components of ESG (Environmental, Social & Governance factors) methodology and assess the potential impact they may have on financial performance:

Environmental Factors

Key Considerations:

- Efficient resource management and pollution prevention
- Reduction in carbon emissions and climate impact
- Environmental reporting/disclosure

Benefits for Financial Performance:

- Avoids or minimises environmental liabilities
- Lowers costs/increases profitability through energy efficiency
- Reduces regulatory, litigation and reputational risk

Social Factors

Key Considerations:

- Workforce: diversity, health and safety, labour management, human rights
- Product integrity: safety, product quality, emerging technology issues
- Engagement in community philanthropy

Benefits for Financial Performance:

- Workplace: improves productivity and morale, reduces turnover and absenteeism, and the potential for litigation and reputational risk
- Product integrity: creates brand loyalty, increases sales based on product safety and excellence.
  - » **Unilever** – By expanding the availability of their 'One Rinse' products to over 50 million households in water-scarce countries, Unilever have pledged to reduce water usage in the laundry process.
- Community impact: improves brand loyalty and company reputation
  - » **Vodafone** – Vodafone's Farmers' Club is helping over 770,000 farmers improve their yields and income by informing them about effective growing techniques, weather forecasts and crop prices.

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Governance Factors

Key Considerations:

- Executive Compensation
- Board accountability
- Shareholder rights
- Reporting and disclosure

Benefits for Financial Performance:

- Aligns interests of shareholders and management hierarchy
  - » **Enron** – Enron developed a dysfunctional corporate culture that became obsessed with short-term earnings to maximise bonuses. Management were compensated extensively using stock options, causing employees to create expectations of rapid growth to create the illusion of reported earnings that were beating Wall Street expectations.
- Avoid unpleasant financial surprises or "blow-ups"
  - » **RBS** – After the UK government purchased 81% of the group, it emerged that it had posted the biggest loss in corporate history (£24.1 billion) under the previous chairman who was renowned for lavish spending. It was also discovered that he had no technical bank training, nor formal banking qualifications.
- Reduce reputational risk
  - » **BP** – Following the Deepwater Horizon oil spill in 2010, the company was criticised over its poor safety record and its reluctance to engage with investors on the issue.

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