Governance in ESG Context

Muhammad Junaid Shekha, FCMA
Head of Internal Audit,
Yunus Textile Mills Limited
(Part of YBG)

The Global Risks Perception Survey 2022-2023 (GRPS), administered by the World Economic Forum, captured the top 10 risks in the two-to-five-year landscape. With regard to environmental risks, the GRPS's results are alarmingly revealing: (i) 5 risks in the next 2 years and (ii) 7 risks in the next 5 years, including 4 among the top 5.

Keeping in mind the GRPS's results, an important question arises – what emerging risks are businesses exposed to? Based on these findings, ESG/Sustainability is an immediate answer. Although some in the fraternity undervalue the significance of ESG as a risk and question its relevance to a company's business model, the need to evaluate and address ESG concerns remains critical. Failure to seriously address ESG concerns poses a significant threat to the long-term sustainability and survival of the business.

Risk and governance are integrated concepts, making a strong case for addressing ESG risks through a proper and formalized governance framework. A suggestive governance approach for ESG is outlined in IFRS S1, issued by IASB and adopted by SECP for phased implementation in Pakistan, commencing from the accounting period beginning on or after January 01, 2025. To support its ESG agenda, a company can take the following steps to strengthen its governance structure:

Business Strategy

A company typically follows a business strategy centered on its mission and vision statement. It is important to integrate its ESG strategy within the broader business strategy. This approach not only increases focus and generates greater visibility toward ESG concerns but also fosters engagement at various levels within the organization. A company's ESG strategy, similar to its business strategy, should be reviewed, revised, and updated periodically to ensure alignment with its overarching goal of sustainable growth. It is also essential for a company to factor stakeholders' expectations regarding sustainability into its strategy. Consequently, a company should pay particular attention to its interactions with stakeholders and evaluate them for key insights into how their views on sustainability are evolving.

Stakeholder Engagement

A constantly changing business environment, particularly due to the proliferation of social media platforms, underscores the need to establish and maintain strong engagement with stakeholders. This enables companies to better understand shareholders' expectations and adjust their business strategy accordingly. The company should first identify its stakeholders using a defined methodology. This is one of the most critical activities forming the foundation of the entire ESG program. Stakeholders will differ across companies; they vary from company to company, sector to sector, and according to business ideology. For example, stakeholders for an insurance company differ from those of a textile manufacturer and exporter, due to differences in customer base, product offerings, and regulatory frameworks. Once stakeholders are identified, the next step is further categorization, prioritizing engagement with major stakeholders first.

Material Topics

The next step involves engaging major stakeholders and understanding their ESG-related expectations. Companies can use different engagement methods, from personal meetings to well-crafted questionnaires. These questionnaires are key tools, enabling the company to plan and prioritize actions that meet stakeholder expectations and serve them better. The company must emphasize the importance of completing these questionnaires and encourage stakeholders to participate fully. Once responses are collected, they should be filtered to create a prioritization hierarchy, and a plan should be devised to address them. This provides a holistic view for the company of what stakeholders expect with respect to ESG. This is crucial because otherwise a company may undertake ESG initiatives without aligning them to stakeholder requirements and expectations.

Targets

Based on key stakeholders and their material topics, the company should set targets achievable within the next three to five years. This helps the company in the following ways:

- Better visibility to align resources with stakeholders' expectations
- Prioritization of milestones based on what is material and important, keeping stakeholders' expectations in view
- Integrating ESG into culture, business plans, and execution
- Setting budgets for ESG initiatives
- Breaking targets into manageable phases to monitor periodic progress

Conclusion

Once a company decides to embark on its ESG journey, it is important to identify stakeholders and their material areas of interest. The next step is to break these into KPIs so that progress can be routinely monitored. Building a strong governance structure around ESG at various levels ensures constant discussion and regular reporting, including at the Board level. The Board, CEO, and senior executive team have to take the lead, ensuring this agenda penetrates to the bottom of the organization.

About the Author: Muhammad Junaid Shekha *is a Fellow member of ICMA with a keen interest in governance and ESG. He is currently associated with Yunus Textile Mills Limited (part of YBG) as Head of Internal Audit, where he reports to the Board on matters related to controls and governance.*