1. Overview

Sometimes company management can be reluctant to engage with fund managers on environmental, social and governance (ESG) factors. This reluctance can be caused by a variety of factors including capacity constraints, lack of familiarity with ESG or a failure to understand the materiality of ESG to their operations. Understanding the source of such resistance, and the specific ESG risks and opportunities that a company faces, allows the fund manager to respond with empathy to such reluctance, and provides a platform for informed discussion about a more proactive approach to the management of ESG factors.

- Frequently encountered causes for resistance
    - **Capacity constraints:** Company management may be concerned about the consequences of committing staff or other resources to addressing ‘additional’ ESG factors. Perceived cost implications or additional calls on management time can also create reluctance to engage.
    - **Misaligned responsibilities:** Responsibility for ESG matters may reside with the wrong business function. For example,responsibility for community engagement may fall to the environmental manager, who does not have the skillset or time to engage with the community.
    - **Management intransigence:** Lack of management understanding, support or commitment to ESG matters. Management may not understand or be convinced by the business case. They maybe unaware of how good ESG management can add value to their business.
    - **Business case:** The ESG business case might not have been made for the company (this can also be caused by misunderstanding the financial value drivers behind ‘sustainability’ or ‘impact mitigation’). It is better to focus on how good ESG management can mitigate risks, reduce costs or offer opportunities to increase topline revenues or profits.
    - **Cost:** Management may have concerns that the outcomes from ESG due diligence (DD) could place additional strain on capital expenditure (capex) which may already be tight. This is often coupled with concerns that costs will be incurred immediately (rather than reduced over time – as is usually the case).
    - **Staff incentive schemes:** These can be in conflict with the objectives of an

environmental and social management system (ESMS) or action plan if they encourage and reward activities or behaviours that contribute to ESG risks and impacts. For example, production staff might be incentivised to maximise production with no regard for waste generation or energy use. Or the occupational health and safety (OHS) manager might be financially incentivised to reduce reported incidents.

- **Competition:** Management may believe they are being asked to do more than their competitors and that this will make them uncompetitive.

2. Building an understanding with the company

It is important that fund managers engage carefully with regards to ESG factors to establish deeper trust, greater awareness and to solidify existing relationships. Care should be taken not to overwhelm management and ESG agendas should be presented in a measured and structured way that reassures companies that ESG management need not be disruptive or onerous. Good ways to establish a positive dialogue include:

- Initiate dialogue early
    - Start conversations about ESG at the beginning of the investment process.
    - Be clear that ESG matters are central to the business process.
    - Describe how ESG improvements can result in improved efficiencies, better worker relations and productivity, better management and improved oversight.

- Align expectations
    - Clarify ESG expectations and be prepared to explain the fund’s standards as well as the likely DD and monitoring processes.
    - Emphasise that the goal is to integrate ESG management into existing business practices rather than create new and burdensome functions. New policies and

improvements to management systems will occur over time.

  - Ensure that the deal officer, ESG officer and any other representatives of the fund communicate the same expectations and are consistent in their messages.

  - Listen to management's view of their key business needs and seek to align the discussion of ESG matters with their overall strategic ambition.

  - Work with financial controllers to quantify how addressing ESG risks and impacts can positively influence financial performance.

- Speak of past upside associated with ESG improvements
  - Present a short list of opportunities/solutions linked to ESG performance based on prior experiences.

  - Connect with other companies in the portfolio that have overcome similar issues.

- Link action plan to added value

  Position good management of ESG matters as an operational and strategic value driver and as a way to enhance the business through:

  - Reducing costs by more efficient use of resources and improved production processes.

  - Fulfilling supply chain expectations that require higher ESG performance.

  - Complying with current local and international legislation and regulation and proactively planning for future changes.

  - Improving the company's image and brand, bringing positive public relations outcomes.

- Increasing employment productivity and reducing staff turnover.
- Increasing favourable customer reaction.
- Reducing environmental and social risks and liabilities.
- Providing a safer working environment and reduced incident/accident rates.
- Enhancing staff environmental awareness, which is good for staff morale and retention.

- Ongoing focus
  - Encourage companies to incorporate ESG accountability and roles into job descriptions, and particularly KPIs. Where appropriate, link it to remuneration. This is especially important at senior management levels where leadership and commitment to ESG management can determine the success of the business.
  - Find areas to provide management with positive feedback on their ESG management.
  - Look for opportunities to gain a public profile for the company's ESG efforts.