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ENVIRONMENTAL, SOCIAL AND GOVERNANCE(ESG) SUSTAINABLE TRENDS: WHAT IT MEANS FOR COMPANIES IN UGANDA TODAY.

"To be successful, it is no longer sufficient for a company to exist to maximise returns."

The concept of wider stakeholder rights as introduced by the 2006 UK Companies Act heightened the requirement for companies to look at the impact of their decisions on stakeholders including employees, environment and community when considering what is best for the companies' owners.

Climate change has also pushed the environment, sustainability and governance to the forefront of most if not all company agenda. What this means is that companies, investors and stakeholders world over can no longer conduct business without evaluating their impact on the environment, social factors and climate change.

Companies that adopt the ESG framework stand to attract increased investment opportunities, build customer loyalty, improve financial performance, foster talent retention, gain competitive edge over other businesses, and make operations sustainable. These companies usually have a good reputation and socially and legally compliant.

The Ugandan Story

Kampala, the capital city of Uganda

Uganda is still in its nascent stages of ESG adoption with just a few corporate entities embracing this kind of framework as they do business. Some of entities at the forefront include financial Institutions and the Central Bank of Uganda.

At the recently concluded 17th Annual General Meeting (AGM) of Stanbic Holdings Ltd held on 2nd June, 2023, the sustainability report highlighted Stanbic's efforts to drive sustainable and inclusive economic growth through its Social, Economic and Environment strategy(SEE).This strategy aims at supporting growth of Ugandan businesses, job creation and encouraging clients to save and invest for the future wealth generation. Some of the interventions that have been rolled out include the National Schools championships, green financing and the Stanbic business incubator to mention but a few.

The Deputy Governor of Bank of Uganda at the 27th Annual Seminar of the Institute of Certified Public Accountants of Uganda noted that as a central bank, they had noted than an inevitable transition to an environmentally sustainable low carbon economy would have significant implications for the financial system. He further stated that the Central Bank would be working with Financial Institutions to promote ESG standards in the financial sector so as to positively impact the long-term sustainability in the value chains of the economic sectors. By incorporating these sustainability issues, the 'bottom line' of financial institutions will reflect the creation of shareholder value beyond profitability.

So, what is ESG and how can companies drive the ESG agenda to create long-term value for investors and all stakeholders alike in Uganda?

Definition of ESG

Environmental, Social and Governance (ESG) is a framework used to assess an organization's business practices and performance on various sustainability and ethical issues. It also provides a way to measure business risks and opportunities in those areas. These factors evaluate companies on how far advanced they are with sustainability.

The environmental criteria considers how a company safeguards the environment, including corporate policies addressing climate change, while social examines how it manages relationships with employees, suppliers, customers, and the communities where it operates. The Governance criteria deals with a company's leadership, executive pay, audits, internal controls, and shareholder rights.

Namanve Industrial park

How companies can drive the ESG agenda?

Companies may consider doing the following in order to drive the ESG agenda for them to create long term value for investors and stakeholders. This is because putting sustainability at the core of how companies operate has a positive impact their business performance.

1. Carry out a sustainability impact measurement.

With consumers, investors, employees, customers and regulators alike demanding action, and the duty of the directors to exercise reasonable care, skill and diligence in promoting the success of the company they lead. Boards need to look into the operations of their companies and their impact on the eco-system to understand the activities that are most likely to impact the business as well as the ESG related risks. Boards now most importantly need to possess the skill to assess the ESG risks involved. Such analysis and skills will then guide the formulation of strategies that shall will create long-term value and transition the company to provide sustainable value.

Simon Mingay, a research vice president at Gartner indicated that the corporate world is going through a rapid pace of change in how it thinks about and addresses sustainability and other ESG investing areas.

This requires recruitment of diverse and ESG competent directors by expanding the board selection matrix to include candidates with experience and exposure to material ESG issues, matters for board deliberation should incorporate ESG issues and the formalization of a governance system that captures ESG factors. The Company Secretary should also ensure that there is information available for directors to understand the materiality of ESG issues specific to the company as well as ensure continued stakeholder engagement on relevant ESG issues within the company. With these in place, Boards will then be able to set and oversee ESG targets by ensuring that ESG is an integral part of the overall business strategy.

Adoption of ESG factors may however lead to reduced revenue and reputational damage while giving rise to cost cutting measures as well as exploitation of new business opportunities.

2. Formulation of a business and operating model that incorporates ESG and Reporting as a key enabler.

Companies must ensure that they have in place a robust business model that addresses key risks that may arise with the transition to a sustainable and reasonable future. The business model adopted should be able to identify the opportunities and risks as well address management of the ESG related risks and ensure that the services do meet the sustainability goals and requirements for the future.

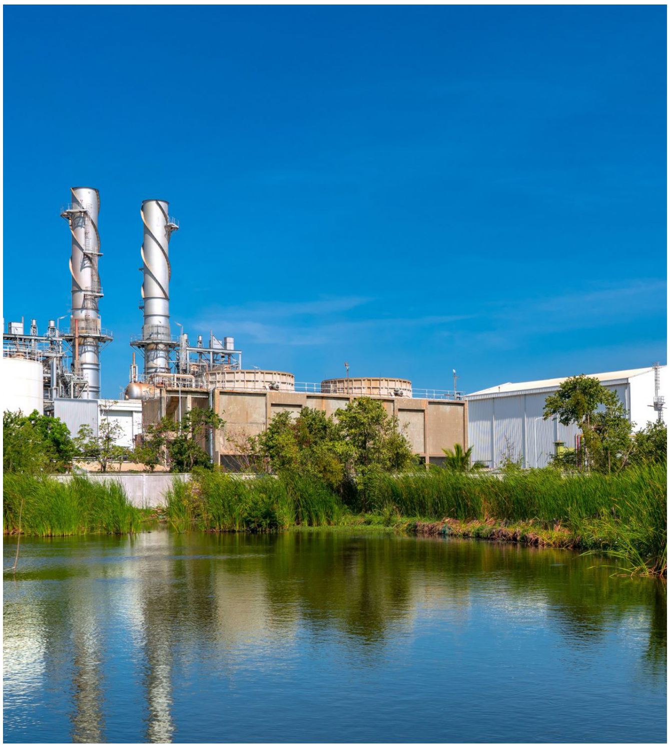
This however requires companies to plan and invest in information, research, technology, and human resource to be able to achieve this. It is very important for the human resource to appreciate 'why ESG' in order to foster institutional cultural change.

Assessment and evaluation of the companies ESG performance will be guided by the qualitative and quantitave measures in place. The qualitative measures include company commitment to diversity including board diversity, equity and inclusion, labour practices, executive compensation as well as ethics and compensation and its impact on the local communities where it operates while the quantitative measures which are directly measurable include the company's investment in renewable energy, greenhouse emissions, energy and water usage to mention but a few. All the above factors help to determine the most important opportunities and risks for the business and its stakeholders in the short and long term respectively.

Change in the business model comes with changes in reporting by the company. Companies will now have to include in their periodic reports all matters ESG and how they have impacted the business, environment, people and community in which they operate. Those in unregulated spaces may consider using global financial reporting standards while those in regulated spaces like Financial Institutions will be guided by the Central bank as the regulator. Information on the performance of these companies in Uganda will then be analyzed by overseas investors to compare with financial statements of similar entities in other jurisdictions before investment decisions are made.
The expectation therefore is that the periodic reports must be relevant, comprehensive and reliable giving the true affairs of the company within a given period for this goes to the root of the company's reputation and long-term success.

Good financial reporting also facilitates comparability of data since funding may be sourced from across the globe. This information is very important because investors need to know and trust who they are dealing with. The Boston Consulting Group in the ESG & Compliance White Paper – April 2021 opined that it is those businesses that recognise risk in ESG that are likely to be with us the longest.

3. Ensuring that the company is protecting the environment by taking action on climate change, sustainable consumption, production, and management of natural resources.



Since Environmental factors involve considerations of a company's overall impact on the environment and the potential risks and opportunities it faces because of environmental issues, such as climate change and measures to protect natural resources, companies have to pay more attention to how they are reducing energy consumption, transitioning to renewables sources, and taking immediate action on emission production.

Investors and customers today are very keen to know what the company policy is on recycling and management of waste, efforts to combat

global warming, cutting emissions and decarbonizing before they can committee. They need to be satisfied that the company is operating in a manner that is geared to reducing it's ecological and biodiversity impact through action
on land and water use, waste and pollution, material and chemical consumption for sustainable development. These are the ESG investing factors that are influencing investment choices today globally.

4. Adoption of policies that impact on people and the communities in which it operates and its overall positive contribution.

Social factors address how a company treats different groups of people like employees, suppliers, customers, communites and measure its social and economic benefits beyond financial performance to demonstrate its value to society.

These social factors include fair pay for employees, diversity, equity and inclusion programs employee experience and engagement, workplace health and safety, data protection and privacy policies, fair treatment of customers and suppliers, customer satisfaction levels, community relations, including the company's connection to and impact on the local communities in which it operates, funding of projects or institutions that help poor and underserved communities, support for human rights and labor standards.

Companies therefore need to critically think of how best to positively impact the employees, shareholders, suppliers, customers and communities' members, as well as focus on establishing, measuring and achieving both qualitative and quantitative sustainability goals.

5. Adopting of sound Governance systems and structures.

Well-defined corporate governance systems can be used to balance or align interests between stakeholders and can work as a tool to support a company's long-term strategy. These governance factors examine how a company polices itself, focusing on internal controls and practices to maintain compliance with regulations, industry best practices and corporate policies.

Therefore, to ensure sustainability, companies need to be more intentional and have in place a good, robust and diverse leadership/management team that will promote effective decision making ensure financial transparency and integrity, regulatory compliance, risk management, ethical business practices including whistleblower policies and rules on corruption, bribery and conflict of interest to mention but a few in order to deliver long-term value, align financial and society performance, ensure accountability, effective decision making and compliance. They also may need to consider as part of good governance that their remuneration and financial incentives are connected with all the ESG factors.

This because we have seen the effects of poor governance on companies which have included loss of investor confidence, decreased share price, low returns, economic and social losses, poor reporting and disclosures and the eventual collapse of companies.

Conclusion

Environment, Social and Governance (ESG) factors are non-financial performance indicators that companies are using to measure sustainability and ethical impact of their activities, it is therefore very critical for companies today to embrace and optimally manage ESG issues as a factor of corporate responsibility to society in order to create long-term value.

Companies therefore need to move to adopt to the changing times by making it a business-as-usual phenomenon and not a competitive edge. Failure to do so will not only lead to loss of business but also failure to tap into investment capital. ESG and sustainability are here to stay.

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