Chemical Watch
an enhesa. company

Why ESG matters for chemicals management professionals?

14 July 2022

Simon Tilling, partner in international law firm Steptoe & Johnson, looks at the rise of ESG and how it means the role of product stewards and chemicals management professionals will become more important to organisations

©WrightStudio stock.adobe.com

Few working in the chemicals sector won't have heard of 'ESG'. The letters themselves stand for environment, social and governance, but it has a specific meaning. The term originates in the financial sector, where it captures the idea that assessing several environmental, social and governance factors can tell you a large amount about the long-term sustainability of a business – and therefore the prospects for a good return if you were to invest in that business.

There is no defined list of ESG factors – it varies from business to business. But there is financial data to suggest that looking beyond financial performance into sustainability factors can yield greater returns, and ESG is therefore having a significant impact on the allocation of capital.

The consequence of the embrace of ESG by the financial sector is that investors are asking questions. Whether companies are public or private, if outside capital is deployed, their leaders are likely to be quizzed on the business' sustainability efforts. In order to remain competitive for investment, answers must be provided.

In the financial sector, much work is under way to standardise ESG reporting, to create robust, transparent, decision-useful data. Financial regulators are taking a close interest in what constitutes good and bad practice and enforcing against those in the latter group. In some jurisdictions, governments are using legal instruments to make certain ESG disclosures mandatory. For example, in April 2022 the UK became the first country in the G20 to mandate disclosure of climate-related financial risks for both companies listed on stock markets and the largest private companies. Similar measures are coming in the US and the EU.

Of course, increased disclosure of ESG factors puts information into the public realm that will be used by all stakeholders in society: employees, customers, consumers, the supply chain and, of course, NGOs. Ambitious

> "The consequence of the embrace of ESG by the financial sector is that investors are asking questions. Whether companies are public or private, if outside capital is deployed, their leaders are likely to be quizzed on the business' sustainability efforts

companies will create expectations that need to be fulfilled. Less ambitious companies may find themselves in the line of fire.

The practical result of these developments is that business leaders across the sector are prioritising ESG, and product stewards and chemicals management professionals will have a big role to play in how companies respond to them.

Sustainable chemistry and ESG

There are a wide variety of factors that make up ESG, from avoiding forced labour, to anti-corruption measures and carbon footprints. For the chemicals sector, sustainable chemistry is very much one of those factors, and one of the least well-understood by the finance sector.

The chemical industry is aware of the danger of simplifying its complex and nuanced products into 'good' and 'bad' chemistries. Indeed, in many jurisdictions, industry is seeking to educate legislators, regulators, NGOs and the public about the complexities, and product stewards are at the forefront of that debate.

Now, there is a new group to educate: investors. In our experience, many ESG investment policies include consideration of sustainable chemistries, from raw materials through to consumer products. Deals can fall through, and investment in the chemicals sector can be lost, because flags are raised by ESG committees regarding the chemistry in products that investors and their advisors don't know how to address. It is not that the questions raised are wrong: it is that traditional teams of corporate advisors do not know how to answer them. This is one of several areas where specialists in chemicals regulation can add significant value for a business.

A role for experts

There are many ways that product stewards and chemical management professionals can participate effectively. Here are just three:

1. Ensure consistency between regulatory engagement and stakeholder engagement

Sustainable chemistry is already front of mind for many in the chemicals industry, as the sector addresses legislative and policy agendas. Both the EU's chemicals strategy for sustainability, and the UK's forthcoming chemicals strategy, have 'sustainable chemistry' as a core focus.

As lawyers, we work closely with product stewards and technical experts to help navigate this evolving regulatory agenda, often communicating with regulators on how to apply scientific assessment within the legal frameworks, and challenging misunderstanding of the law, or its misapplication to the scientific facts.

Such efforts can be substantially undermined if wider corporate messaging is inconsistent. Increasing ESG disclosures and reporting can heighten this risk, especially if ESG is siloed into a 'marketing' function, or subcontracted to outside experts and counsel who do not understand the business. Product stewards can be an essential link within the business, with the skillset in science communication to help shape the wider corporate messaging, and with the contacts and connections to draw on specialist external support.

2. Actively participate in corporate acquisitions and divestments

At a conference for the chemicals sector earlier this year, one of the UK's largest institutional investors explained its ESG investment policy was not to invest in companies involved in unsustainable chemistries. How, though, did it decide what was unsustainable? The answer given indicated a reliance on various blacklists promoted by NGOs.

The consequence is sobering. Access to capital may now depend on whether the business has any connection with chemistries on lists compiled by NGOs, possibly with little or no assessment of the circumstances of the connection such as use, exposure or volume.

Thankfully, most investors are prepared to dig deeper. As lawyers, we have been instructed to do precisely this, once flags have been raised by ESG investment committees. We have been able to satisfy them that investments initially thought to be high risk are sound bets, once properly understood from an ESG perspective. A well-run ESG committee will ask for more information, so that the issue can be properly assessed. This is where product stewards can again add real insight and provide real value to their companies.

3. Help safeguard the business against adverse claims for 'greenwashing'

Another area of increasing risk for companies is 'greenwashing' – that is to say the overstating of the environmental performance of a product line, or of the company itself. Many greenwashing claims arise from over-enthusiastic marketing and communications functions. Product stewards are the experts in the business, who truly understand not just the products but also the wider regulatory regimes that govern the products. This offers yet another opportunity to add value to the business, both through personal knowledge and through the contacts and connections who can add specialist external support.

It is also important to note that many greenwash claims are not well-founded. Just as in other areas, robustly defending the business – and its product lines and chemistries – from such claims is essential to preserve business value. Often those complaining do not understand a business's products and processes. A robust evidence base is needed to defend greenwashing claims, along with a big-picture strategy and sound advocacy. Product stewards and other regulatory professionals have often played a key role in successful outcomes.

Conclusion

The rise of ESG as a tool for investment decisions is both a risk and an opportunity for the chemicals sector. For companies prepared to embrace it, there is a transformative amount of capital in search of a home. Business leaders will be looking to those within the business to help with an ESG programme, and product stewards, with their expertise, skills, contacts and connections, are well placed to support.

The views expressed in this article are those of the author and are not necessarily shared by Chemical Watch.