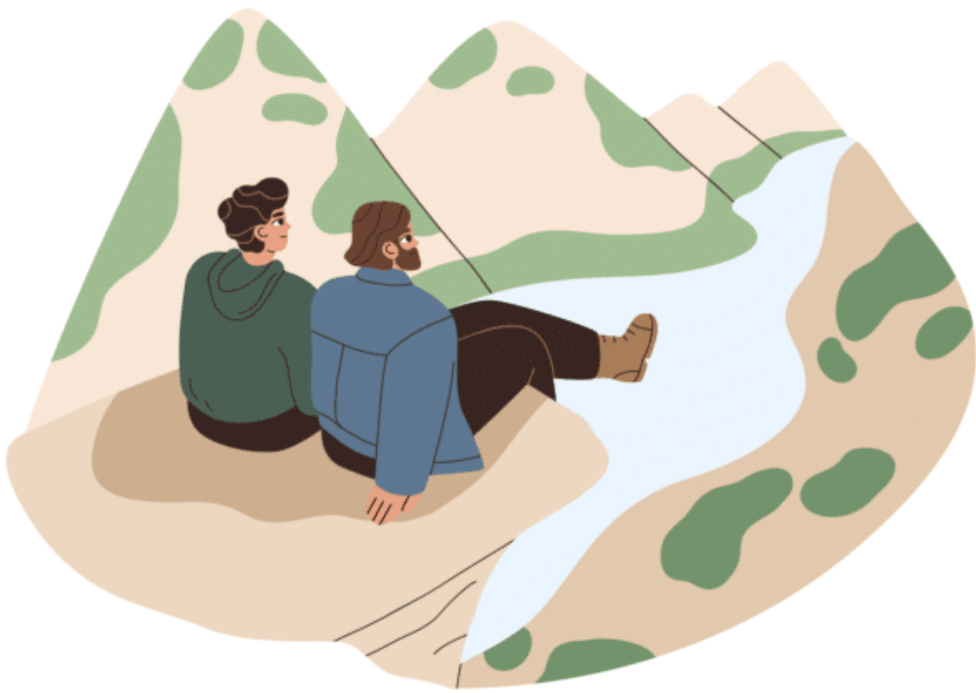
New Priorities: ESG and Sustainability for Family Businesses

By **Andreas von Specht** - 2022-04-07



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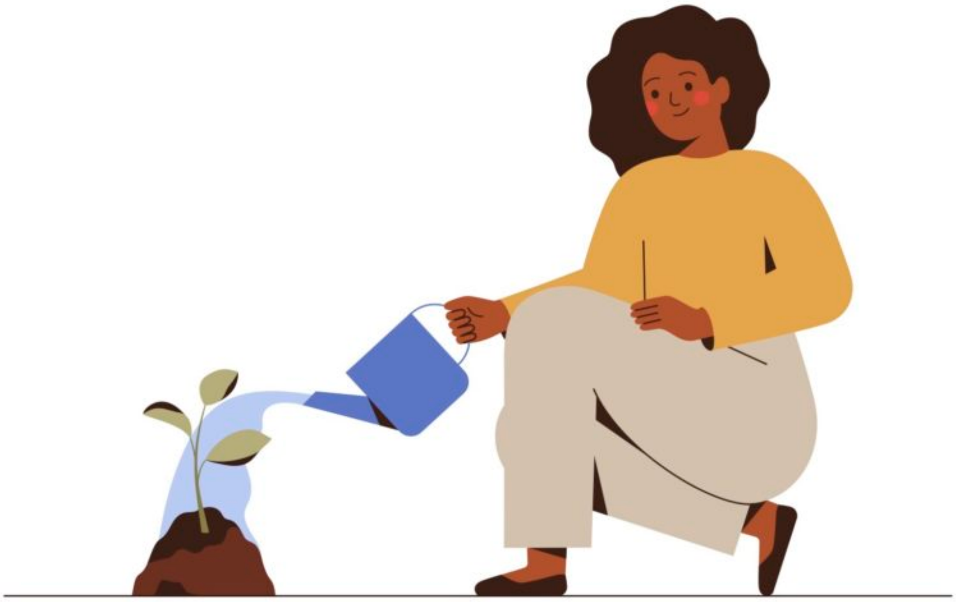
Editorial by Andreas von Specht

About two years ago, I received a call from the CEO of a listed family company: Would we have experience in identifying and evaluating top managers in the ESG environment? They wanted to expand their board accordingly – preferably with a woman.

In our firm, ESG has, in the meantime, developed into a major topic, and we have brought on board a new colleague who specialises in this area and whose expertise is particularly in demand at the moment.

In a business context, ESG encompasses three dimensions: Environmental, Social and Governance. In other words, it is the framework for responsible, corporate action that reconciles social and environmental concerns in business operations. ESG affects all areas of a family business, from the supply chain and production to sales, marketing, finance and HR.

More and more family business leaders are confronted with the fact that 'stakeholders' expect them to actively contribute to solving global challenges. The bar is higher than ever, and they are expected to take responsibility – not only for their company´s financial performance but also for societal goals, for a better world.



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ESG in Practice

Family business leadership at the top level also includes responsibility for developing and implementing an ESG strategy: to position companies as leading providers of sustainable, responsible, and innovative products and services – and to demonstrate exemplary corporate governance. The top priority of an ESG strategy is to enhance corporate performance by entering new markets and expanding existing ones, and to minimise reputational, regulatory, legal, and financial risks. In addition, it aims to strengthen relationships with policymakers and civil society representatives, particularly in the home country, but also in key markets for sourcing, production, or sales. Finally, the ESG strategy must be meaningful and transformative so that management and employees can understand, embrace, and ultimately implement it.

'Decarbonisation' is the top ESG issue. It is strategically highly relevant and carries significant risks. Transformations towards climate neutrality require holistic and transparent approaches at the family business management level. Products and services need to be reviewed, as do production processes and the working environment along the entire value chain. Singular CO_2 targets alone are not enough; the path to achieving them must be backed up by quantifiable milestones.

New Priorities

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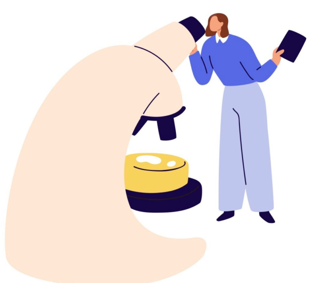
Shareholders, especially from the next generation, are increasingly making sustainability a hard investment criterion. Consumers want to buy products and services that are as sustainable as possible. Top talents want to work for companies that have a clear sustainability-orientation as part of their 'purpose'. Moreover, regulators are increasingly sanctioning unsustainable business practices.

This fundamental transformation must be steered and fuelled from the top. This quickly becomes a question of company owners´ and top executives´ attitude and leadership. There are three interrelated areas of action here. First, the foundation must be laid, and sustainability must be anchored in leadership skills and culture. Then there should be a plan for how to align sustainability priorities with the core business. And finally, the transformation and desired change must be enabled through intensive communication of the goals in all directions – and the encouragement of all stakeholders.

Under the Microscope



NGOs, activists, and influencers are spreading the news of actual (or perceived) corporate misconduct via social media at breakneck speed all over the world. Employees not only demand secure and well-paid jobs but also expect a sense of purpose, new forms of work, and ethically sound forms of corporate governance. Customers use their consumer power to initiate morally-grounded boycotts via the Internet, *Image via Shutterstock*

which can cause entire sales markets to collapse. Investors demand not only attractive returns but also diversity in management and sustainability in strategic orientation. On the capital markets, there is a clear shift toward environmentally and socially responsible investments. Investors increasingly include ESG criteria in their analysis of securities, evaluating and taking into account the social, ecological and ethical consequences of investments made by companies and governments.

The 'state' is actively getting involved itself. Many family business executives complain that their immediate environment has become louder, more demanding, and more complex and that 'the pressure of expectations' has increased dramatically. Activist funds and debt investors, insurers and business partners are demonstrably demanding sustainability and the accelerated decarbonization of business models. Threats are being made to end relationships, place new boards, and halt new financing. Climate neutrality is becoming the new triple-A rating: a must-meet performance metric. Major institutional investors have turned into true ESG advocates and are making specific demands of family business CEOs.

Sustainability First

Family businesses and medium-sized entrepreneurs have to muster the courage and foresight to place sustainability at the centre of their own company's strategy. Where companies have not yet been directly targeted by activists or been fortunate enough to avoid bad press, the pressure to act may not be felt. However, the belief still widespread among some family businesses that SMEs and start-ups can sit out ESG reporting obligations after January 1, 2021 – because they sit below the current legal threshold of 500 employees – is risky.

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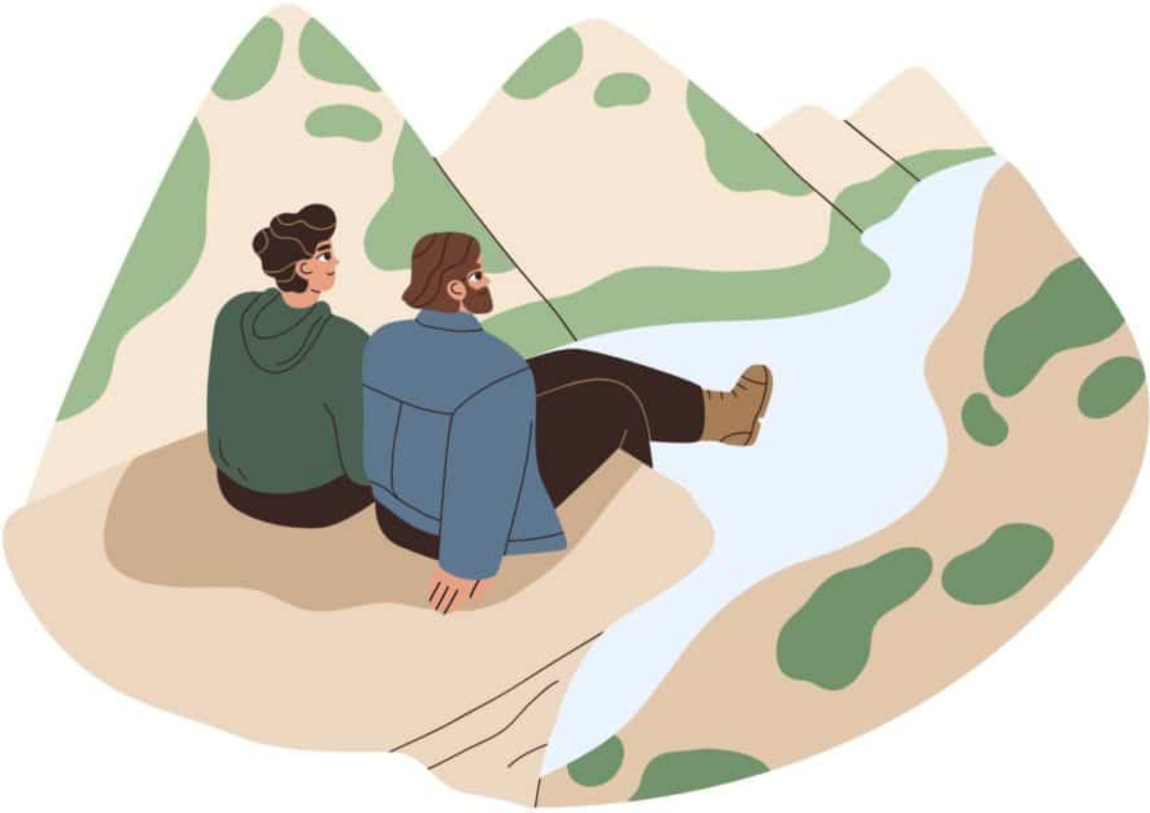
The days when strict requirements only applied to large corporations in the spotlight of the capital markets are over. Financial institutions, investors and customers are paying attention to ESG criteria or aligning their investments with them, increasing the pressure on companies to disclose non-financial metrics regardless of size. The capital markets are thus becoming drivers of structural change in the real economy. The worse the rating, the more expensive the loan; in some cases, financing is no longer available for unsustainable investments. This continues in the supply chain. As suppliers, SMEs will have to prepare for more extensive reporting and disclosure obligations to their customers.



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Employees, top talents, customers, suppliers, financiers – in the long term, none of them will tolerate a family business management that is unwilling or unable to advance the organisation in the direction of sustainability. To meet this challenge as a family business owner, it is essential to become a "change agent" – and rally leaders around you to help drive the sustainability agenda.

We meet many leaders in family businesses and SMEs for whom sustainability has always meant taking responsibility for the long term. With ESG as a megatrend, they now have a chance to lead their organisations and their employees into a future that is more hopeful, more viable and more just – and, in the process, also more value-creating.

In 2011, Andreas founded AvS – International Trusted Advisors, an international boutique firm, supporting clients with the evaluation of Senior Executives, NEDs and Boards– and all matters related to ownership advisory and family governance.

Andreas is a native of Hamburg, where his extended family is still the largest shareholder in Germany's oldest private bank (Berenberg). Prior to founding AvS, Andreas advised some of Europe's most influential family enterprises in his career at Egon Zehnder.

Andreas von Specht, image courtesy of AvS Advisors