ESG adoption and strategic integration in leading JSE listed firms:

Insights from interviews with executives and board members

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Disclaimer

Aligned with our mission, 'we build the people who build the businesses that build Africa', we facilitate open, multi-perspective conversations and the generation of thought leadership pieces, such as this white paper. However, the views expressed in this white paper are solely those of the author and not necessarily those of Henley Business School Africa and Risk Insights.

Foreword

The environmental, social, and governance (ESG) movement represents a fundamental shift in how businesses are financed and the correspondent nature of value creation and firm performance. Since 2005, climate-related risks across the globe have increased exponentially due to the Earth's average surface temperature rising at an accelerated rate in recent decades, primarily as a result of the burning of fossil fuels and deforestation. The rate of climate change and the impact on the planet has exacerbated risk management practices worldwide to make assessing ESG risks a top priority. Businesses are no longer judged on the basis of their economic performance alone, but on their sustainable economic performance. In other words, whether economic performance is obtained whilst preserving if not strengthening the environmental and social ecosystems within which the company operates and from which its continued operation depends. This requires significantly longer-term thinking and collaboration between businesses, government, and other economic and social agents. South Africa faces a unique opportunity to use ESG as a tool to strengthen the partnership between corporations, government, and all stakeholders to deliver sustainable change and solutions to the complex problems faced by society and the world, as we live in an interconnected society. If framed correctly, ESG can be a framework to ensure better-quality foreign direct investment that creates real sustainable value, whilst enabling the social and economic change the country requires. For this to be attained, continued dialogue is required between corporates, government, and third-sector organisations.

This research report was jointly commissioned by Henley Business School Africa and Risk Insights to contribute to the dialogue and debate on the topic. It is part of a wider joint research programme that aims to examine ESG adoption and practice among Johannesburg Stock Exchange (JSE) listed companies.

We hope that the insights and reflections contained in this report can increase the awareness and debate about the strategic importance of ESG not just in the business sector – although it is the focus of the report – but between business, government, and all other stakeholders. Furthermore, we hope that more debate can lead to effective collaboration towards a common purpose: the prosperity of the people of South Africa.

Steering Committee

Risk Insights, Henley Business School and Henley Business School Africa
Mr Kuben Naidoo - Deputy governor (South African Reserve Bank)
Mrs Itumeleng Monale - Chief operating officer (Johannesburg Stock Exchange)
Mrs Lullu Krugel - Partner, Strategy& and chief economist (PwC South Africa), ESG platform lead (PwC Africa)

Introduction

The purpose of the study was to explore how firms are adopting the ESG agenda and the challenges, tensions, dilemmas, and approaches faced by firms in integrating ESG factors in the strategy cycle. This report is the result of a research collaboration between Risk Insights and Henley Business School Africa. The research programme comprises three stages: i) an in-depth literature review; ii) interviews with senior business leaders from JSE listed organisations; and iii) a survey of the JSE listed firms.

This white paper systematises the insights obtained by the research team from the literature review and 15 in-depth interviews with senior business leaders from JSE listed firms. Various key themes emerged from this analysis, which are explored, supported by data from the interview material, and complemented by literature insights. The report is organised into five parts:

- The nature of ESG: interpretations and motivations for adoption;
- The board of directors and ESG strategy development;
- Implementing the ESG strategy: progress, challenges, and barriers;
- Communicating the ESG strategy performance; and
- Conclusion.

It is envisaged that these insights can help move the debate forward for South Africa.
The research team would like to thank the senior business leaders who participated in the study and shared their precious time, experience, and insights. A sincere appreciation to the members of the Steering Committee for their guidance and support in the development of the report.

Executive summary

This research report is the result of 15 in-depth interviews conducted with senior business leaders – board members and executives – of leading South African JSE listed companies during the second half of 2022. The analysis has placed the insights obtained from the interviews in the context of some current debates on ESG. Below is a summary of the study's findings.

The ESG concept is interpreted in several ways within and across companies as well as by different external stakeholders. The difficulty of developing a shared meaning of ESG and how it should be interpreted has implications for how companies strategise and operationalise ESG in a way that responds to the various interpretations held by stakeholders, including investors.

ESG is variously interpreted as 'a set of risk factors that impact strategy', a 'licence to operate', a 'source of competitive advantage', 'an opportunity to drive business efficiency', and 'values and part of business identity'. As a result of these diverse interpretations, ESG is being applied by business leaders in a very contextual and firm-specific manner.

Companies are feeling the pressure for ESG adoption and integration from numerous stakeholders, such as shareholders, regulators, government, clients, and consumers, as well as community groups and activist organisations. However, there is growing pressure from clients to keep up with competition. ESG is now being enshrined in tenders and contracts and becoming a de facto competitive requirement.

Boards of directors are focusing on increasing their diversity and independence to be best equipped to handle the different challenges emanating from ESG considerations. Boards are creating specialised committees, such as 'social and ethics' or 'environmental' committees, to provide oversight over corresponding ESG challenges, creating reporting structures from the executive right into the board – as required by Companies Act No. 71 of 2008 (Republic of South Africa, 2009). How this is achieved varies greatly, with some committees reporting to the office of the chief financial officer (CFO), others to the chief executive officer (CEO), and others to a strategy committee. All these reporting structures then report to the board or to different committees, depending on the nature of the issues.

While there are varying levels of board involvement on developing strategy, the overall approach is to give the initiative of strategy formulation to the CEO and executive team to provide challenge and

The ESG concept is interpreted in several ways within and across companies as well as by different external stakeholders.

oversight before the strategy is approved. Boards shape and effect executive strategic behaviour by setting the 'tone at the top'; setting and owning the corporate purpose and values; establishing strategic direction; deliberating broad ESG priorities and trade-offs; and setting executive compensation.

There are instances where a fracture or a misalignment emerges between strategy formulation on the one hand and the harsh reality of implementation on the other. What is 'strategised' and seen as good on paper faces tremendous tensions and trade-offs on implementation. This may call for a more active role by the board and the executive team ensuring support through the challenges of implementation and perhaps that more consideration is given to testing on the ground what is strategised in the first place.

ESG strategy is often referred to as one pillar or theme within a wider or overarching business strategy. This denotes that sustainability or ESG is subsidiary to the business strategy. With the exception of a few companies that have endeavoured an integrative approach of ESG and strategy, the overall approach to integrating ESG still seems to be 'bolt-on', rather than 'built-in'.

The progress with ESG strategy implementation is uneven across different parts of the business and across geographies, as they face different degrees of constraints and challenges related to specific industry dynamics and local implementation conditions.

There are instances where a fracture or a misalignment emerges between strategy formulation on the one hand and the harsh reality of implementation on the other.

This report identifies and briefly discusses three distinct categories of constraints challenging business leaders on ESG strategy implementation: i) Stakeholder engagement and dialogue challenges; ii) culture and people challenges; and iii) decision-making challenges.

Business leaders increasingly consider good corporate performance as a balance between financial and non-financial performance. External reporting is increasingly sophisticated and incoming external auditing and assurance on ESG is making many business leaders increase their readiness to be audited.

The nature of ESG: interpretations and motivations for adoption

The first theme to emerge from discussions with business leaders included differences in interpreting ESG and motivations for adoption. These differences are discussed below.

The nature of ESG: definitional concerns and practical implications

The ESG abbreviation was famously first used in 2004 by Kofi Annan, the former secretary general of the United Nations (UN). He formally invited 55 CEOs from leading financial organisations to join the UN Global Compact, the International Finance Corporation, and the Swiss government in an initiative to find ways to integrate ESG into capital markets (The Global Compact, 2005). Since The Global Compact (2005) report was published, ESG has become mainstream in the investment community. Bloomberg estimated that, in 2022, the total ESG-compliant assets under management was over $41 trillion, while PwC (2022) predicted that only by 2026 will asset managers reach $33.9 trillion of ESG assets under management. It is *evidently unclear* what to count as ESG-compliant assets. What 'ESG' really is has recently been the subject of much debate, with research suggesting the abbreviation is loosely defined to mean too many things to too many people, or that it has strayed away from its original purpose as a list of drivers of long-term value (Edmans, 2023) to become a political weapon and battlefield (Eccles and Crowley, 2022).

As the pressure from regulators and institutional investors mounts, corporates also face the difficult task of harnessing ESG and making it meaningful for their firms, which is true worldwide, including in South Africa. Interviews with business leaders confirmed this reality, with most arguing that ESG is 'nothing new' as it is just part of being a responsible corporate citizen. Unsurprisingly, South African businesses are acutely aware of how they impact and contribute to the wider society, given the country's specific sociopolitical history.

Nevertheless, it seems that companies have recognised and practised some form of ESG for many years, whilst struggling with the many meanings and purposes often ascribed to the abbreviation. Consequently, most companies use ESG in different ways that best fit their purpose and what they see as their strategic priorities, as revealed by the following business leaders: 'ESG is a very broad topic. And you can't really pinpoint any one issue because basically, ESG is just how do you manage the company' (Participant 1); 'A constant issue is how do you deal with analysts and the market? Because you've got so many different interpretations of ESG' (Participant 2); and 'The acronym [*sic*] of ESG loses a certain level of credibility in my opinion, not because it's not credible, but because of the way that it's been constructed. It's an art' (Participant 3).

Therefore, business leaders have the difficult task of designing an ESG strategy and narrative that meet the different variations in interpreting the term held by several investors and stakeholders. However difficult, there are some encouraging signs of convergency on reporting frameworks and guidelines internationally, as exemplified by the 2021 merger between the Value Reporting Foundation and the Climate Disclosure Standards Board to form the International Sustainability Standards Board, while others are pushing for sector-specific materiality and sustainability standards (Eccles et al., 2012). With time, these and other initiatives will hopefully allow for greater clarity and a level playing field.

It is important to note that ESG issues are highly contextual and in many cases company-specific – for example, the strategies to handle the same specific material factor will differ depending on the local context. Until such time when better clarity exists, frameworks and guidelines should be used as a starting point to make ESG relevant for each firm, not as something to purely attempt to comply or explain any incongruencies.

Fortunately, many business leaders are already approaching ESG in this way, emphasising the most contextually relevant aspects to their businesses and the local implementation conditions. In this sense, ESG is seen as a tool with specific functions, as outlined in Table 1.

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Table 1: The many interpretations and motivations of ESG (interview data)

ESG as…	Explanation	Quotes
…a set of risk-factors that impact strategy	ESG is seen as risks that impact the business strategy. That is, ESG is not part of the strategy, but impacts on it.	• 'There's an overall acknowledgement that, "Wait a minute, this could impact our business strategy"' (Participant 4). • 'The main purpose is to create shareholder value. You take risks, creating the shareholder value, and some of those risks have got an ESG element' (Participant 5). • 'Everything is just basically a discounted cash flow stream; it doesn't really matter which sector you're in. There's nothing more romantic than that' (Participant 7).
…a licence to operate	ESG is a matter of survival. Not adopting it is not an option and means losing the legitimacy and trust from stakeholders to continue in business. In this way, ESG is deemed part of the strategy.	'Informally, around about 2018/2019, we started thinking that we should formalise this, because we saw it as a licence to do business. It's a matter of business, strategy and business integrity' (Participant 6).
…a source of competitive advantage	ESG is creating new market opportunities and is thus an integral part of strategy to access new market opportunities and differentiating from competitors.	• 'ESG features in there as an opportunity. For example, currently, now there is a big drive for the global economy to move to renewables. And most of our clients already have made this commitment' (Participant 5). • 'It's no longer a nice to have. Some people are starting to wake up to say it's also a differentiator, it can help differentiate and be part of a company's competitive advantage. You know? So, I think that shift is starting to happen' (Participant 4).
…an opportunity for business efficiency (cost reductions)	Investments to achieve ESG goals need to make economic sense in terms of efficiency (including competitive advantage).	'I think if a company does not see sustainability as a way to cut cost, you're never going to get sustainability into business. So, it's got to be seen to be economically viable. Because … if it's not economically viable, just don't do it' (Participant 2).
…values and part of identity	ESG is part of the founding values and who we are, and is deeply embedded in culture.	• 'ESG is not new to us. It's something that's been part of the DNA of [the organisation] for decades' (Participant 8). • 'The [organisation] culture understands and just does things. And that's part of the problem is that the ESG stuff is so entrenched in the [organisation] culture, you don't see it as anything other than normal' (Participant 8).

ESG adoption drivers: performance or compliance?

Our participants were asked which group of stakeholders they believed was putting pressure on their companies to accelerate the integration of ESG factors into strategy and different aspects of the business. Much like previous research (Morais et al., 2020), this study found that senior business leaders feel various pressures to adopt and integrate ESG factors into the business. However, do adoption drivers induce performance behaviour or compliance? Data from this study suggested a mixed picture, but a trend is emerging. While the pressure from *long-term shareholders and investors* as well as *government/ regulators* is expected and is partly driving the adoption of ESG, there are very tangible reasons to think about ESG as part of a company's competitive strategy, irrespective of the sector of activity. This represents a major change from three or four years ago in the UK, where ESG was seen by many companies as a fashion and a compliance exercise to appease regulators and investors (Morais et al., 2020). *Pressures from customers and competitors* are becoming more salient for most businesses. Whether the business model is tender-based with other large firms or governments, or whether the firm is part of the supply chain of other industries that wish to lower their Scope 3 emissions, ESG criteria are beginning to be enshrined in tenders and contracts, and thus becoming a de facto competitive requirement, as outlined by participants:

> Every year, the kind of work that we do is all tender-based, right? You present a tender that is not in line with the latest developments in being environmentally friendly, you're not going to win the work. So, you get the pressure from your customers, from your marketplace.
> (Participant 9)

> Many of our clients and principals have their own ESG ambitions and targets that they've set for themselves. And the only way they're going to achieve their targets is if their entire supply chain, in which we're a big provider, supports that process. So, many of our client contracts [include ESG requirements].
> (Participant 10)

> You want to be your own disrupter. Spaces are closing for people who have got a high carbon footprint without plans in place as to how they're going to reduce this.
> (Participant 14)

Even in consumer goods businesses, customers are reportedly more aware and there is intense benchmark vis-à-vis competition of ESG factors' performance and how consumers perceive them. *Company employees* have also emerged as a significant force for the adoption and integration of ESG by their companies. Specifically, young talent is now significantly more aware and concerned about how the companies they work for conduct themselves in relation to numerous ESG issues, such as decarbonisation and diversity.

> Especially with the young engineers, you get a lot of questions about what is the purpose of the company, what's your stance on carbon, decarbonisation.
> (Participant 5)

> [A] lot of people now want to work for a responsible company. So, if you don't have the right ESG practices and processes in place, you will not attract the right talent into your business or retain talent in your business.
> (Participant 11)

While the pressure comes from employees, the business leaders highlighted a competitive motive for attracting talent and integrating ESG with the employer value proposition. Consequently, competition for clients, consumers, and employees emerges as an increasingly significant reason for firms to adopt and integrate ESG into business.

A final group of stakeholder pressures includes the communities where businesses operate. These communities place significant expectations on firms in terms of helping boost local employment, helping create more resilient local economies, and ensuring the local environment gets preserved.

> ESG is of course ticking the government's and the regulator's box, as you can imagine, because everyone now wants to make sure that you give back to your communities, that it's not just about social licence to operate.
> (Participant 10)

The business leaders who participated in this study revealed a significant focus on helping communities thrive.

The board of directors and ESG strategy development

The second significant theme that emerged from the discussions held with business leaders is the role of the board of directors in ESG strategy formulation and how it contributes to the strategic direction of the company.

Building the board and the top management team for ESG

Diversity and independence
Building and developing the board to oversee ESG has been described by business leaders as requiring a hard look at building *requisite diversity* due to ESG's complexity and emergent nature. With significant attention now being paid to *competency greenwashing* (Schumacher, 2022), it is difficult for firms to hide behind fancy titles for which incumbents have no matching skill sets. Although it is not always easy or fast to build a board or a top management team with all the requisite skills and experiences required, some business leaders explained that board and managerial education on different topics is encouraged and even mandated to ensure directors and managers continuously broaden their knowledge and skills.

ESG also poses significant challenges to *director independence* and some business leaders have highlighted that they are moving in the direction of strengthening board independence. Regarding independence, participants stressed a director's *fiduciary duty* as being imperative. Furthermore, it emerged that how this fiduciary duty is to be met is currently more nuanced, as ESG requires a change in how directors balance judgement in terms of short- and long-term value, and different groups that affect and are affected by their companies' activities. In attempting to balance social, environmental, and economic issues in the short, medium, and long term, business leaders face significant – and sometimes insurmountable – dilemmas that appeal to personal values and world views, rather than just financial judgement.

Reporting structures and accountability

Companies are creating varying reporting structures and accountability around ESG, as prescribed by Companies Act No. 71 of 2008 (Republic of South Africa, 2009). At the board level, there are two approaches. The first concerns *specialised board committees* on specific ESG issues. For instance, governance committees provide oversight on governance matters; social and ethics committees oversee matters pertaining to social responsibility and business conduct; risk committees are consulted about specific risks; and, for companies that have them, climate committees scrutinise proposals related to, for example, climate change and decarbonisation. The second approach is to have an ESG committee at the board that will *integrate all the different aspects* into the same oversight framework over ESG. Data suggests there is no indication that one approach is better than the other.

> ESG is no different than managing your employees, managing your relationships, having good cybersecurity, good governance, good risk management practices, good remuneration. And you do have experts that run with that and need to make sure those people stay accountable for it. But it gets reported, it gets reviewed, goes to certain committees. We don't have a single committee.
> (Participant 15)

Reporting structures at the senior executive team also vary. Although it is clear the CEO is accountable, some teams have ESG under the CEO's office, while in others it is under the CFO's office. In other teams, ESG still falls under the office of a corporate sustainability officer. As Participant 1 revealed, 'I report to the group's chief risk officer who, in turn, reports to the group's chief executive officer'.

ESG teams tend to be very small, acting more as points of integration, change agents, and initiative monitors. The *accountability is devolved to the divisions' and business units' leadership*, who are required to address ESG concerns at their level, considering their very specific conditions and challenges.

Developing the ESG strategy

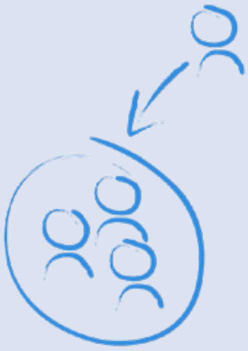
Strategy development emerged as a process where ESG is often seen as a pillar or a theme of business strategy. The board's role is often defined as overseeing and challenging the strategy, with the development process being effectively owned and led by the executive team. The process reveals there is still not a full integration of ESG into strategy, but more of a bolt-on approach in most companies. However, the board sets the tone for strategy by articulating the purpose and the values to be observed when developing strategy, as well as determining the board's ESG priorities to preside over strategy development.

While literature has documented varying degrees of board involvement with strategy development (McNulty and Pettigrew, 1999), it is understood that today's boards face pressure to get more, not less, involved in setting the business's long-term strategic direction.

The process of strategy formulation

The process of strategy formulation is not unusual. It is owned by the business and the C-suite, and developed with the input of the next one or two leadership layers. Once the strategy takes on a finalised shape, it goes to the board for challenging against purpose, values, and what the board sees as priorities. This is typically done in a two-day strategy away session. After it has been signed off, the strategy goes back to the business for ensuring detailed business plans across the business to deliver on the strategy. Most participants referred to not changing the strategy dramatically very often, preferring more incremental steps even when big disruptions happen, such as COVID-19.

Many participants made it clear that there is still a way to go to ensure ESG is fully integrated into strategy for most businesses. ESG – or sustainability strategy, as some participants called it – is often one of many pillars of the business strategy, something 'added' to the existing strategic framework. *In this sense, ESG is still in many cases 'bolt-in', rather than 'built-in' with strategy formulation*, as highlighted by these participants' views:



When we looked at our sustainability strategy, that fits under the overarching strategy.
(Participant 4)

Sustainability and ESG is actually one of the five pillars [of the strategy]. And, you know, in the past, it was, you know, a couple of things here and there. Now, we want to make it mainstream.
(Participant 12)

Through this journey, the moment we made it a pillar of our strategy, [I decided] we now need to have a focused ESG strategy for the business.
(Participant 10)

Businesses tend to differentiate between the business strategy and the ESG strategy, with the latter being subsidiary to the former. ESG is seen as something that may help or hinder a competitive positioning in the marketplace and, as such, is considered an element of strategy, *but not the strategy per se*. Businesses conduct extensive materiality assessments and focus on the ESG factors deemed most financial material to the business. In this sense, ESG is mostly viewed as a set of risks to the value creation strategy that need to be mitigated or eliminated in the short, medium, and long term. There is still a long journey ahead before businesses can claim their products and services are 'sustainable'.

The journey we're going through now is to actually develop ESG-based products and services. So have that a lot more than deliberate into the product development, so that they can put a bottom-line figure to it.
(Participant 4)

Setting the corporate purpose and values
The key instrument for *boards to have a decisive influence on strategy development is by setting the purpose and values of the company* in a way that provides a clear indication to the incumbent CEO and management team of the key strategic assets and the expected priorities and behaviours, and in sending an important signal in terms of long-term strategic direction and resource allocation.

We've started work probably about five years ago, around our purpose and put a lot of work into the group's purpose. We believed that was the most important thing that we needed to get right. And that people needed to align behind.
(Participant 12)

We've always had that discussion around what is our contribution you know, the broader society level…. What is our purpose as a company?
(Participant 9)

The corporate purpose and values help the board assess priorities and trade-offs.

Determining strategic priorities and trade-offs in ESG

While setting the corporate purpose and values is a first fundamental step, boards also determine the broad strategic priorities and trade-offs that provide direction to management.

ESG may manifest itself in different ways. When you look at environment, reducing emissions is important for any company. But at the same time, when you look at the Maslow's hierarchy of needs of an African person, climate change is not at the top, you know, so it then comes down to say, 'Okay, so how does this manifest in an African context?' Is it about climate justice, climate resilience, rather than necessarily climate change? So, it's, it's these debates that are ongoing … you know, from the ESG, the social is probably the top thing.
(Participant 4)

As a group, we've made a decision that we will not participate in coal purchase, because now … the Paris agreement identified especially thermal coal as the problem. So, we took that policy and then we got some of the managers coming up with opportunities in South Africa, and South Africa still relies on coal as the base load. It was quite a conflict for us. Then we had to refine our policy to say that in South Africa, we will support the just transition.
(Participant 5)

Sometimes, one of the *biggest determinations by the board is a policy position related to matching the priorities of the business with those of the country or region*. This typically means prioritising social factors over environmental ones. Nevertheless, for companies that are significantly exposed to external markets or for which complying with environmental aspects is a matter of survival, prioritising social aspects may not be as straightforward.

The board must *determine the broad priorities and how they play out in the medium to long term*. For some boards, this may mean closing businesses that are profitable, but not strategic; while for others, it may mean completely pivoting away from the core business. A good way to test if a strategy will work is by engaging stakeholders in the development and/or implementation stages.

Engaging stakeholders: top-down and reactive

A key question is the extent to which stakeholder voice is sought as an input to strategy development. Stakeholders include not just shareholders and the board, but also the government and its agencies, clients, suppliers, and local communities across the value chain. Stakeholder engagement looks different, depending on the group of stakeholders. For shareholders, analysts, and customers, there is more direct engagement, with roadshows and private engagements often happening. These groups have a greater level of voice and influence over strategy formulation:

We've got a stakeholder engagement framework, right? The stakeholders that have been very vocal in terms at the strategy are your analysts and shareholders. But if you take other stakeholders – like your communities, your employees – it has been more us telling them what we are doing in terms of our strategy, and updating them … also in terms of our sustainability report. But the stakeholders that I found to be really wanting to know and challenging are the shareholders, the analysts.
(Participant 5)

We co-created the strategy with all our business partners, using peer analysis and stakeholder feedback, so that we knew what the whole stakeholder universe expected of us. And the other trade-off was also managing stakeholder expectations. A lot of the work we've done on the strategic side was aligned to stakeholder requirements. So, a lot of our stakeholders, whether it was investors, at-the-time clients, principals, customers, we were ahead of the curve in some instances, but it was really trying to align their expectations to this fundamental shift.
(Participant 10)

Employees and communities as stakeholder groups are also heard, but the engagement is more top-down and pushed by the firm to inform of particular initiatives. In other words, employees and communities are mostly considered on the implementation of strategy. Moreover, evidence has emerged of some reactivity of businesses in responding to stakeholders as issues emerge, rather than anticipating challenges by including stakeholders in the solution design. However, there is also deep local engagement:

> *Our internal operational strategies don't often affect local communities in the sense of operationally how we would work internally. But if we were to open a store, in a community, there is definitely a consultative (process) and community engagement and buy-in.*
> *(Participant 11)*

> *We've got different levels within the organisation that are engaged with different stakeholders right across the entire ambit of the business.*
> *(Participant 7)*

Stakeholder engagement is clearly an important aspect of strategy, though different groups of stakeholders seem to be considered at different stages. For instance, shareholders, analysts, and customers are considered at strategy formulation, while employees and communities are engaged with more around implementation challenges.

Executive compensation and ESG

Part of developing strategy is also agreeing on how it will be monitored and what executives will be rewarded for. Despite significant work around ESG, ESG-specific metrics have yet to make it into the executive compensation arrangements for some firms. For others, this is already a reality, but because there is a bolt-on approach to ESG, key performance indicators are few and often not necessarily built into the business strategy. However, it is expected that more companies will systematically integrate ESG performance metrics into executive compensation arrangements in the coming years.

Implementing the ESG strategy: progress, challenges, and barriers

The discussions with senior business leaders identified some patterns, challenges, and barriers to ESG strategy implementation. These are detailed in the next few subsections.

Progress is uneven across geographies, divisions, and sectors

Implementing ESG is riddled with challenges and barriers, which often make for slow progress that is uneven across various parts of a business and different geographies where businesses operate. The following feedback was given during the interviews:

> *ESG is more embedded in corporate and investment banking rather than retail. The reason for this segment seeing more progress relates to the much larger size of transactions and the adoption of the Equator Principles. The credit policy includes E&S [environmental and social] risk screening for certain size of transactions and things have to be considered. A number of countries, in addition to South Africa, are well developed in this, particularly Kenya, Mauritius and Angola.*
> *(Participant 1)*

> *We deal with this at a group level, and then you got to deal with specific country requirements … so if you take the South African company requirements, I think you've got the act and those kinds of things that you have to be very, very mindful of.*
> *(Participant 9)*

Implementing ESG depends on the specifics of different business units and on the local conditions for implementation on each geography. Hence, even within the same firm, progress will differ in varying parts of the business. ESG depends on local conditions, such as the availability of good government-built infrastructures like roads, sanitation, electricity, and security as well as the availability of skills and local businesses that can complement initiatives. For ESG to work, a true partnership and dialogue between corporate South Africa, the South African government, and other stakeholders need to be forged to enable local implementation and global coordination by firms.

Implementation challenges

A fundamental challenge that sits between the formulation and implementation of strategy concerns *the buy-in, engagement, and alignment between what is strategised at one level and the reality of execution at another*. Some participants referred to this lack of dialogue as those who strategise and formulate strategy and those who have to face the often-insurmountable challenges, trade-offs, and dilemmas of implementation. These participants opined:

> High-level strategies need to be workable and operationally doable. So, I think there's a fine balance between what is strategised and what's decided [operationally]. …those who strategise, aren't necessarily the executors.
> (Participant 11)

> I don't think the tensions necessarily existed more in the formulation of the strategy. I think it's in the implementation of the strategy.
> (Participant 4)

> As much as you know, from farmers' central office from a strategic level perspective, though there is an understanding of what ESG is the … test comes into when you've actually got to operationalise it and get the people that are at the unit itself to actually understand what we are asking them to do terms of our ESG strategy.
> (Participant 13)

The above excerpts point to two aspects that require careful consideration. Executives at different levels face tremendous pressure and difficulties to realise the implementation of ESG principles that may seem reconcilable at strategy formulation stage, but that look very different at implementation and operational levels, facing often unanticipated constraints. This finding is crucial, as *the board should provide significant support and guidance on strategy implementation, not just formulate a strategy that is often untested and then monitors execution at a distance.* Top executives and managers throughout the organisation need not just buy in, but need to be coached on how to handle the realities of implementation and report that feedback to the board.

Besides this critical *disconnect between formulation and execution of strategy*, firms implementing ESG strategy face numerous other challenges and barriers. These challenges concern: i) engagement and dialogue with powerful stakeholders resulting in policy or regulation not being sensitive to business challenges; ii) significant organisational culture and people challenges (including silo thinking, competition for resources among divisions, mindset, engagement, and skill sets); and iii) decision-making challenges (including data availability and handling trade-offs and dilemmas). These challenges are outlined in Table 2 and briefly discussed in the subsections that follow.

Table 2: Challenges to ESG strategy implementation

Categories of challenges	Description
Stakeholder engagement and dialogue (to reduce uncertainty)	• Engagement and dialogue with regulators resulting in a lack of clarity around what is expected • Engagement and dialogue challenges with government/government agencies resulting in policymaking incongruences or contradictory incentives • Engagement and dialogue challenges with other stakeholders, such as trade unions, that delay decision-making not for the right reasons
People and culture	• Breaking down silo cultures to enable the implementation of ESG strategy across business departments • Challenges concerning people's and leadership's mindsets that are still trapped in less ESG-friendly mental models • Challenges ensuring buy-in and engagement into some of the ESG principles/new ways of working right across the company • Lack of availability of talent with the right skill sets (which need to be developed, taking more time)
Decision-making	• Lack of availability of data to measure ESG performance and aid decision-making • Different decision-making levels unable to handle trade-offs and dilemmas resulting from having to think in a more triple-bottom-line way

Stakeholder engagement and dialogue challenges

The discussions with the business leaders revealed that dialogue and engagement (or lack thereof) between businesses and government policymakers, regulators or even trade unions are crucial for firms to implement ESG initiatives because it sometimes creates uncertainty and a lack of clarity. One participant shared:

> *I think the regulatory industry has gotten totally out of control. I was talking to one of the investment companies and ... their compliance department is now bigger than the analysis department. And that's when you know things have gone crazy. (Participant 2)*

Another stakeholder is government and how firms engage with government so that policymaking is sensitive to industry issues and congruent with policymaking in different governmental areas. One retailer explained how government objectives and policymaking are sometimes at odds and create difficulties in meeting ESG goals. Other leaders emphasised the need to work with government to ensure not just the policy and regulatory conditions, but also the infrastructures that are a baseline condition for firms to meet ESG goals.

> *If you want to supply any food product into a major retailer, you have to have a food safety audit [which can cost] up to R50 000, R60 000, and the small suppliers can't do it. Some of them we help through our foundation. But, generally, they can't. The government, on the one hand, is saying we want high food safety standards, and on the other hand, they said, that we want to build small business.*
> *(Participant 2)*

> *How do you help [the government] to help yourself? And I guess, from a sustainability perspective, that's one of the strategic challenges. You also have a government, your regulators and you don't really fight with your regulator....*
> *(Participant 15)*

The government is one of the largest contributors to carbon emissions by having coal as an electricity producer, that sends off so much emissions into the air. The fact that we have loadshedding so often, resulting in us having to run generators using diesel, due to lack of infrastructure that the government has not provided … it's all due to lack of infrastructure, lack of planning, lack of foresight. (Participant 11)

The above issues with ensuring dialogue with key stakeholders to enable alignment and remove unnecessary constraints to implement ESG were often referred to and extended to other stakeholders.

Culture and people challenges: silos, mindset, engagement, and skills

A second cluster of challenges refers to issues of culture and people, specifically silo cultures, leadership mindset at different levels, and employee engagement and skills. As business leaders are increasingly being confronted with the need to make choices and trade-offs between short and long term, and relative economic, social, and environmental impacts, the mindset is evolving. One interviewee expressed, 'I think the trade-offs are naturally [leading to] fundamental mindset shift' (Participant 10). However, the mindset shift does not happen overnight from everyone in leadership positions across the business. There is a recognition that it will take time to really transform leadership mindset and engagement with a new way of thinking about the business:

> *Sustainability is a marathon and not a sprint, because of the fact that there's different levels of maturity in leadership, you have some people that get it from the word go, they're interested, [they're] engaged, there are others that are still thinking about just the bottom line.*
> *(Participant 4)*

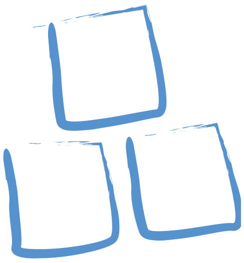
> *You always have people that think short-term profits are more important than long-term issues. How do you get more people on the right side? Luckily, from the top, we've got the right leadership and the right mindsets, but to execute organisation-wide, you sometimes still have people that you still need to bring along.*
> *(Participant 12)*

A related challenge is to embed new ways of thinking and working across varying functions with very different time horizons and ways of looking at performance, such as production or sales and research and development.

> *Sustainability relies on being able to work across different functions. And everybody has their own priorities. So, when you are bringing them in for an integration of this nature, you're competing with their mindset and there's always cultural nuances, and organisational integration, you know, of trying to get functions to think united to have that common purpose, and to pull in the same direction with the same priority and intensity as you.*
> *(Participant 4)*

Other problems related to people and culture concern the workforce's skill set, which requires upskilling and more collaborative ways of working, but also ensuring alignment and engagement across a whole organisation around ESG. This is particularly difficult in large businesses and those operating in multiple national jurisdictions.

Decision-making challenges: data availability and handling trade-offs and dilemmas
A final cluster of challenges relates to decision-making. On one level, *the political nature of ESG often appealing to the personal values of decision-makers* is highlighted. On another, how different educational and professional backgrounds drive differences in how ESG is approached and decided upon. Some of the participants' feedback included:



ESG and sustainability – people project a lot of their own ideologies on this topic and so decision-making is difficult as driven by beliefs and value sets. There are certain professional and institutional logics also, such as a domination of accountants, lawyers, engineers that have particular approaches and beliefs to approach complex problems.
(Participant 1)

And the biggest trade-off was that we were going to have to make big decisions now to close businesses, not because they were not profitable, but because they were not strategic, right? And if you close businesses that are profitable, but not strategic, they will impact your short-term financial performance, right?
(Participant 10)

Another dimension that makes decision-making more challenging pertains to measurement challenges of data availability on which to base decision-making around ESG providing oversight, as outlined by the below participant:

It's been good at capturing financial information, but not necessarily all the non-financial information, especially in a fast-emerging world where suddenly, under TCFD [Task Force on Climate-Related Financial Disclosures], or the IASB [International Accounting Standards Board], you have to capture new things, and your systems aren't developed for that. So, there's a lot of work going on improving data so that there can be a governance element in there as well.
(Participant 12)

In summary, challenges of dialogue and articulation with powerful stakeholders, culture and people, and decision-making are besetting senior leaders as they attempt to implement and embed the ESG strategy.

Communicating the ESG strategy performance

Corporate reporting and communication have emerged as something business leaders speak about comfortably, as the level of sophistication of reporting is already high in many cases. Interestingly, business leaders are shifting their views on the nature of corporate performance and how that is increasingly reflected in corporate reporting. Another interesting aspect is how many business leaders have mentioned the emergence of international norms for non-financial audits. Both these aspects are briefly discussed in the following subsections.

The nature of firm performance and corporate reporting

Business leaders have realised that the nature of 'good' corporate performance is changing. These leaders are now focusing efforts on achieving strong financial and non-financial performance and emphasising ESG performance. Stakeholders are increasingly holding companies to account for how they create economic value:

> *We've got both financial and non-financial targets. Sometimes you can make the financial targets without the non-financial targets. A good outcome would be to do both.*
> *(Participant 12)*

> *Good corporate performance is – just to sum it up – is not just financial, but it's also about the focus you give to the holistic view of strategy, people, planet, and digital.*
> *(Participant 10)*

> *When you focus only on profits, you're not assured that you will get them if you're also not focusing on ESG. So, for me, it's not either or, but both together at the same time.*
> *(Participant 14)*

Despite the measurement difficulties that still exist for many firms, the reporting is in many cases very sophisticated. Nowadays, the focus of corporate reporting is on showing a good balance between financial and non-financial performance, and a level of transparency that enables scrutiny by stakeholders.

ESG external auditing: a game changer?

Business leaders have emphasised the emerging requirement to have ESG data independently audited, as it happens with financial accounts. Some of the participants stated:

> *I think the dilemma is how do you measure? We are developing matrixes for that, to measure it. I mean, we will be required to have the numbers audited at some point.*
> *(Participant 15)*

> *I think ESG is not a policy [that] is part of doing business ... which is why it needs to be audited by the auditors at the end of the financial year. It needs to be part of doing business. I think how the audit profession works needs to have a serious relook to use the audit process to probe your business, not to just necessarily look at what's happened in the past in your business.*
> *(Participant 2)*

For many, this will be a game changer and a deterrent against greenwashing in corporate reporting.

Conclusion

The ESG agenda is gradually becoming more embedded in businesses as competitive requirements, not just as regulatory compliance or a means to appease a few investors. While corporate South Africa has made good progress, there remains a long way to go. At the macro level, two significant challenges emerge, as outlined below.

When in this report we mention different world views and mindsets, we specifically refer to the mindset of shareholder value maximisation versus the mindset of sustainable value creation, but also to the Global North versus Global South debate and issues like climate justice. There is a shared view that South Africa and other developing countries have less of a moral obligation to tackle climate change urgently as the problem has been born by the rich Global North. Consequently, the dominant understanding is that for South Africa, the priority is the 'S' or social in ESG, as this is where there are more significant and pressing challenges. Tackling environmental issues with vigour may mean less ability to resolve social issues. However, the opposite is also true – as social gets prioritised, the inability to tackle environmental concerns may mean a loss of competitive advantage or constraints in exporting goods and services to more mature markets, in turn impacting social issues, such as employment. These views were found to permeate business leaders and determine how ESG is pursued.

There needs to be a true partnership between government and corporate South Africa in creating the conditions (i.e., the regulatory framework, infrastructure, and legal mechanisms) to enable firms to have the baseline conditions and complementary assets to deploy effective ESG strategies that can create long-lasting value. Most of the challenges in the ESG categories require solutions that are co-created between government, business, and the third sector. According to the most recent PwC (2023) Global CEO Survey, many CEOs report partnering with governments and non-governmental organisations to tackle issues, such as sustainable development; diversity, equity, and inclusion; education; climate change; infrastructure development; and public safety.

These two challenges require close attention at a more macro level. At the company level, there has been progress and, in many cases, a better formalisation of initiatives that were already in place for a long time. Nevertheless, progress is not equal within and across businesses and for larger businesses across geographies. This is largely because various degrees of challenges and barriers to implementing ESG exist.

Boards need to find ways to be more aware of and provide more advice on the challenges facing executives on strategy implementation and bridge the gap between what is strategised and the reality of implementation. There is still work to be done in integrating ESG into the full business strategy so that we can speak of a sustainable business strategy and not separate business and ESG strategies.

More research around workforce skills and leadership mindsets at all levels is required, with greater engagement with stakeholders to aid decision-making, and not just engagement to inform of decisions already taken. It is imperative to empower individuals to make ESG decisions at all levels. As ESG audits and external assurance gradually become mandatory, firms need to continue to invest in creating the infrastructure to measure and gather ESG performance data to enable more systematic management and reporting of ESG issues.

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