Risk Insights – ESG and Sustainability Spotlight

An overview for UK businesses and insurance brokers

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Foreword

We all have an incredibly important part to play in ensuring we have a sustainable environment and planet for the future, building a society that works for everyone and creating fair and sustainable companies that work for the whole economy. Over the last few years, we have seen businesses and brokers of all sizes seriously considering both their practical and moral obligations in relation to environmental, social and governance (ESG) and it is one of the most critical issues to face businesses today.

At Aviva we've worked hard to create purposeful, green propositions to support a better tomorrow. These include our Property Owner insurance solution to support residents living in blocks of flats with combustible cladding, our support for electric vehicles, our renewables portfolio and the future of mobility.

ESG is a critical part of Aviva's agenda, especially our commitment to becoming a net zero insurer by 2040. I believe, if it isn't already, it will soon be a critical part of our clients' and insurance brokers' agendas. Companies cannot afford to ignore ESG, particularly as its importance continues to grow across government, partners and supply chains, and in the public's consciousness.

There is an increasingly clear link between strong ESG credentials and financial performance. This enhanced performance may come from ESG-related investment or changing cultural mindsets, but either way there's now publicly available data clearly supporting the connection.* I strongly believe that with external factors such as investor and customer sentiment, ESG-minded businesses will attract a greater market share – and greater funds for growth as stakeholders look towards more ethical sources of goods and services.

That's why we've created this ESG Spotlight bulletin. It provides a high-level overview of some of the ESG-based findings of the Aviva Risk Insights Report 2021. I believe ESG is a path towards sustainability, not just environmentally and ecologically, but also as best practice for the long-term health of businesses of all sizes. This is a crucial moment for us all to look at changing our behaviours as a business community, and together we will rise to the challenge.

Mark Fellows
Chief Underwriting Officer for Financial Lines

*McKinsey & Company 'Five ways that ESG creates value'

Risk Insights
Methodology

This research was carried out in partnership with YouGov during August and September 2021. 1,251 business owners, executive level managers and individuals with significant decision-making power responded primarily to online surveys.

Business revenue

Throughout this report, we've split business sizes into three categories:

- **Small** – businesses with less than £10m in annual revenue
- **Medium-sized** – businesses with between £10m and £250m in annual revenue
- **Corporates** – businesses with an annual revenue greater than £250m.

Region

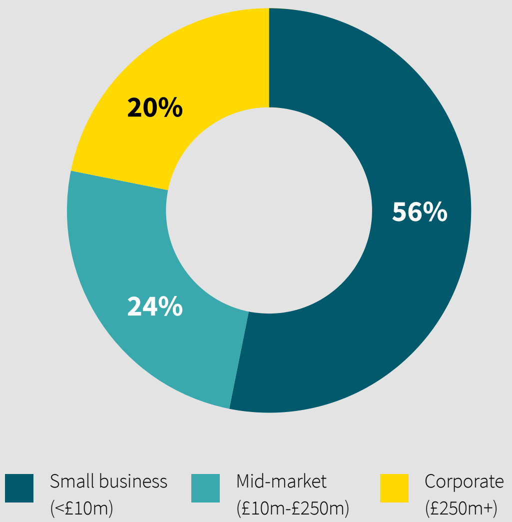
A wide geographical spread was sought where feasible.

Sector

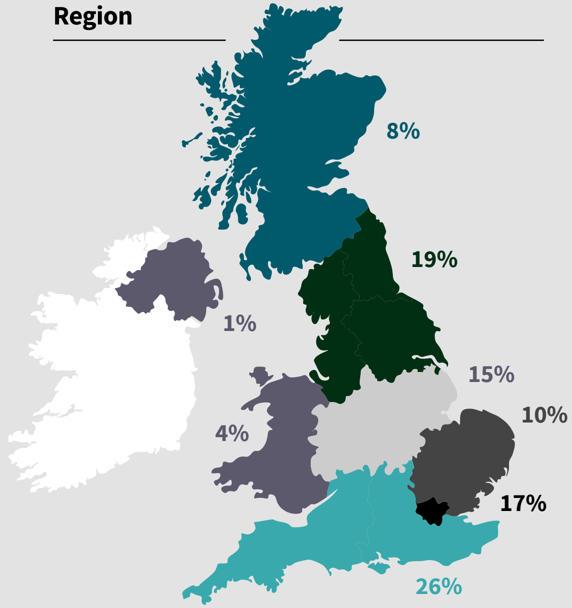
We also categorised businesses into nine broad, but analytically useful, industry sectors. Responses have been weighted by YouGov to ensure even results across sectors.

We spoke to business leaders across a wide variety of industries and regions to get a full picture of the threats and opportunities to UK businesses.

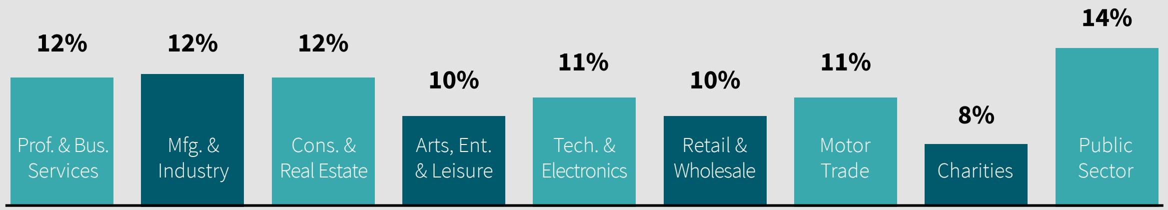
Business revenue



Region



Sector



Base: All respondents 2021 (1,251)

ESG as a business issue

ESG is a term typically used in an investment context to denote the non-financial aspects of a company's performance that are key contributors to its bottom line. Environmental (e.g. pollution), social (e.g. labour standards) and governance (e.g. board diversity and accountability) are the three factors commonly used to measure the sustainability and social impact of a firm. A company's ESG approach is increasingly important to boards, management, employees, government, regulators, customers and potential business partners.

Most businesses are well versed in being held accountable by stakeholders, but the increasing importance of ESG demands even greater scrutiny of internal controls, business culture and customer sentiment. Looking to the future, ESG will present not only new challenges, but also new opportunities across all industry sectors – with positive action now having a profound impact over time for clients and brokers alike.

Ignoring ESG can no longer be seen as a viable option. Inaction from the business community could have a detrimental effect on the environment, macro-economics, geopolitical risk, supply chain and social mobility. It's realistic rather than pessimistic to assume that one or more of these issues will impact every business over the coming decades. Failing to take steps to prepare is likely to put adverse strain on current business strategies, with those who don't act at risk of being left behind.

*53% of businesses had 'a little', 'a fair amount', or 'a great deal' of knowledge about ESG in 2020, rising to 60% in 2021
**44% of the Retail and Wholesale sector have at least 'a little' knowledge of ESG, compared to 75% of the Public Sector

Our research shows that the prioritisation of ESG as a business issue is currently low among UK businesses, with only 10% naming it as one of their top priorities. While businesses are demonstrating a year-on-year increase in ESG knowledge,* there are notable differences in knowledge levels between businesses of varying sizes across all sectors. Businesses that are familiar with ESG are most likely to be already focusing on diversity and inclusion (D&I) policies (36%), improving health and safety for employees (36%) and improving waste management (33%). Our research also highlights that, on average, businesses that have undertaken ESG initiatives have experienced positive impacts.**

How worried, if at all, are you about each of these risks to your business?

As the diagram below shows, ESG has many component parts that can materialise as a threat through multiple channels. Over 60% of businesses are now worried about a shortage of skilled workforce, climate change, business interruption and environmental risks – all key components of ESG.

The impacts of ESG

Every business sector, whether large or small, has the potential to be affected by ESG-related factors, regardless of how remote they may seem at present. Aviva clients and brokers could start considering what these factors may be, how they can impact the business and how best to mitigate them.

Below are some of the most common ESG impacts that have the potential to affect Aviva clients and brokers.

Impacts on operations

- Supply chain disruption (what happens if a key supplier cannot meet contractual obligations, does the business have a back-up?)
- Increased costs (what elements are at risk of significant fluctuation?)
- Stranded assets (can your business easily diversify?)
- Labour force issues (retention and recruitment)

Impacts on financial performance

- Decreased profitability (how much can your business afford to lose/ borrow?)
- Less resilience (can additional vulnerabilities be exposed?)
- Compromised long-term sustainability (what is the impact on your 3-, 5- and 10-year financial projections?)

Impacts on reputation

- Lower market sentiment (if customers were to demand an environmentally aligned version of your product or services, are you able to deliver?)
- Weaker green credentials vs. competitors (do ESG-related factors form part of your competitor analysis?)
- Less investment potential (with investors increasingly seeking to enhance their own ESG-related output, would your business still align with changing behaviours?)

Impacts on compliance

- Compliance with widening ESG regulations (how can your business stay abreast of regulatory changes and risk management opportunities?)
- Demands for increased disclosure/transparency (is your business ready for disclosing more than is ordinarily required?)
- Potential legal exposure and/ or increased costs (what contingencies are in place to fund this?)

Impacts on risk management

- Emerging ESG-related risks (how resilient is your business and what level of agility does it have to react to change?)
- Transition (what key steps are required to become an ESG-positive business, and how resilient is your business to make those changes?)
- Execution risks (what further evaluations are required pre-execution to establish whether client and investor sentiment has changed?)

Unpacking the data

How are UK businesses approaching ESG-related risks?

Our research suggests that with more pressing economic concerns taking priority, it's been difficult for UK businesses to turn their attention to ESG-related risks. But could this mean they're overlooking the threat they pose? And the positive impact experienced by those who have undertaken ESG?

Are UK businesses paying enough attention to ESG-related risks?

How much do UK businesses know about ESG?

How are UK businesses benefitting from their ESG activity?

The potential effects of not taking action

Taking action on and investing in ESG can be seen as an immediate drag on costs which mitigates against a distant risk. And, as we all know, it's a challenge to convince businesses to invest against an unquantified long-term scenario.

However, some risks such as changing customer sentiment, disclosure obligations, stranded assets and disruption to supply chains can be deemed as immediate concerns. If addressed, they're more likely to have positive long-term impacts on a business. In fact, studies have shown that early ESG movers have increased top-line growth and reduced cost.*

Although non-action can seem like the easier option, there's evidence to suggest the difference between two otherwise similar businesses becomes visible if a competitor moves forward with an ESG-positive agenda. Ultimately, the key question to consider is: where will customers, investors and insurers place their trust as collective decision-making becomes increasingly influenced by ESG?

The positive effects of ESG on insurance

Aviva Commercial Lines has always looked to partner with businesses and brokers that demonstrate a strong risk governance and culture and, looking across both social and governance risk classes, these elements continue to be key metrics for demonstrating risk quality. However, we now believe that a business's approach and attitude to environmental risk and planning will be a differentiator between clients over the coming years.

According to a study by the World Wildlife Fund (WWF), most corporations have only just started their journey to a positive ESG proposition. So, the question is not about where a business is now, but where it's headed and how it plans to get there. The more transparent and measurable a business's ESG Key Performance Indicators (KPIs) are, the clearer their path will be to a good outcome. From an insurer's viewpoint, strong risk management and mitigation credentials will always be viewed favourably.

*McKinsey & Company 'Five ways that ESG creates value'

Summary

For brokers and clients alike, ESG is increasingly going to be a core part of business life. Those that can demonstrate good ESG credentials will be beneficial not only to society, but also to the business communities in which they operate. Businesses that can demonstrate good ESG practices are more attractive to their respective partners and customers, and as the shift to a more ESG-positive position continues, many larger businesses are expecting their partners, supply chains and even clients to align with their ESG goals. Our research shows more and more businesses are seeing ESG as a part of the solution – a route to growth and a viable mitigation to some of the biggest risks they face.

The business case for ESG is a strong one, with much of the contemporary research confirming that businesses demonstrating positive ESG credentials have a greater likelihood of success in their long-term commercial aims.

While the environmental and social aspects of ESG have strong ties to stakeholder sentiment and are undoubtedly important to address, good governance sits at the heart of an effective implementation of ESG initiatives. Embedding ESG efforts at board level allows the organisation to set a systematic approach to achieving its ESG goals, as governance is an important facilitator in tying together an organisation-wide ESG approach.

Businesses that are ESG market leaders take the approach of understanding and responding to stakeholder needs, have strategies in place to take a systematic approach to achieving their ESG goals, and have clear reporting to communicate their goals and how they've performed against them.

*McKinsey & Company 'Five ways that ESG creates value'

Companies that have ESG at the core of their operations can generate stronger top-line growth by:

- attracting more customers
- having better access to resources
- having better business partnerships
- lowering operational costs by being more energy-efficient
- being subjected to fewer regulatory restrictions
- gaining access to potential government subsidies and support*

And, from an employee perspective, they're likely to experience a boost in productivity through:

- a more motivated workforce
- being able to attract a wider talent pool
- increasing investor returns through taking a more conscientious and better long-term view of investing*

How we can help

Insurance with Aviva is designed to help businesses manage their risk exposure. So, by benchmarking against industry peers and providing insights into best practice and potential headwinds, we aim to give our clients and brokers confidence in their strategic decision-making.

And of course, working with and by being insured with Aviva, clients can take advantage of our environmental credentials when reviewing their own carbon footprint as part of their overall supply chain.

What key ESG metrics could your business start benchmarking?

Three steps to building your ESG strategy

Contact us

For guidance on key risks, you can access our library of Loss Prevention Standard documents free of charge on our website – or speak to our in-house team of risk management experts.

Visit the Aviva Risk Management Solutions website at **aviva.co.uk/risksolutions**

aviva.co.uk

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