VERACITY

NAVIGATING ESG CONCERNS AMID AND AFTER COVID-19

Historically, due diligence has been conducted as if through a microscope, scrutinizing subjects with laser focus. That is no longer enough. The novel coronavirus will affect every aspect of our lives, and it's already shown that in assessing risk, we must trade the microscope in for a kaleidoscope. The details are every bit as important as they were before the pandemic, but they are no longer so easily isolated. As ESG concerns become increasingly central to conducting business today, it is imperative that we broaden our view and consider the entire matrix of challenges of operating in a post-COVID-19 world.

AN EMPHASIS ON SOCIAL

COVID-19 has not only accentuated and expanded the bounds of ESG, but also created a host of new risks. Many of these are apparent today, others will emerge in time. We expect that in the new ESG environment, the Social dimension will gain particular importance, new disclosure requirements from governments, and greater emphasis from ratings agencies, employees, and activists. Concerns like workplace health, flexibility, and customer safety are now front and center. Pandemic preparedness and the caliber of available healthcare in markets of operation will become nonnegotiable priorities.

Stakeholder capitalism had been gaining momentum for some time; it is now part of the lingua franca of most corporates and investors. For example, as of 28 April, 286 companies and investors representing more than US$8 trillion in assets had signed a statement calling on the international business community to sharpen human capital policies with renewed focus on paid leave, workplace health and safety, job security, supplier/customer relationships, and financial prudence.

Core ESG Concerns

- Pandemic preparedness will become a chief concern for companies. These will include workplace safety protocols, access to high-quality healthcare in regions where workers live, and resilience to workflow interruption.
- Companies will be expected to "do the right thing" by their stakeholders even more than they were before. The EU is already codifying environmental and social expectations for corporate disclosure purposes.
- Governments must work together, but existing conflicts are preventing constructive collaboration.
- Expect to see increased government oversight of personal and corporate data, creating an entirely new set of privacy protocols and norms.

How firms perform during this time will have far-reaching reputational implications. Those who run afoul of stakeholder expectations, as Amazon has with worker safety, will be held to account. As companies make what they believe to be necessary layoffs, executive pay and share buybacks will likewise receive scrutiny and, in many cases, public and shareholder rebuke. Large, highly profitable companies that access government financing, as Shake Shack did (before recognizing its misstep and returning the funds), are already facing backlash. Proxy battles, pressure from investors and activists, and actions by employees and unions are certain to become key factors in the near future.

The pandemic is not a veil, and those looking to capitalize on the distraction it has caused will face the consequences as well. BlackRock and others have said they expect firms to maintain a realistic focus on ESG even now; in the last few weeks, alone, the asset manager has pushed to remove board members of multiple companies seen to be falling short on environmental and executive pay grounds. Short of acting to stave off disaster, firms would be ill-advised to use this period to do anything that might be at odds with their ESG aims or the expectations of key stakeholders that coronavirus is an inflection point to "build back better."

A NEW SCOPE OF GOVERNANCE BRINGS NEW RISKS

On the Governance front, new risk issues are emerging: The increased role of the state in managing economies and firms creates new opportunities for corruption at all levels. For instance, bribery may become even more common at ports to circumvent safety protocols and expedite the customs process. And, as governments look to quickly disburse extraordinary sums of money to spur economic activity, often with limited oversight, firms must remain vigilant in how they manage and spend any funds they might receive. Something may be legal, but that does not mean it's the right thing to do from a stakeholder or public perspective. In the new ESG environment, those perspectives are paramount.

As the world incrementally reopens and we inch toward a post-pandemic operating environment, operational challenges that did not exist six months ago will become standard. Historical experience tells us that what may be thought of as "emergency measures" today could be with us indefinitely. Surveillance and access to personal information, curbs on civil liberties, and restrictions on movement of people and goods could become the new normal.

ISSUES TO WATCH

We consider the following to be among the most salient considerations in the near, middle, and long terms. In some cases, the changes put in place today will become permanent.

Surveillance: Governments across the globe have enacted far-reaching surveillance and data collection measures to assist with contact tracing, to monitor virus clusters, and to enforce quarantines. The powers granted to various authorities to carry out these efforts puts a whole range of capabilities at governments' disposal that are not likely to be rolled back.

Privacy: Many new curbs on privacy will remain in place long after the need for contact tracing is over, and will be used in new ways. There are questions about where data is kept, who has access to it, and whether and when it is deleted. Government requests for new types of information may become commonplace.

Civil Liberties: We have already seen a number of governments use the coronavirus as a pretext for taking on wide-ranging powers, many of which are being used to settle political scores that have little to do with COVID-19. According to Human Rights Watch, journalists and others have been arrested in Bangladesh, Cambodia, China, Egypt, Ethiopia, Turkey, and Venezuela for expressing opinions about COVID-19. Even the US Department of Justice sought emergency powers over immigration.

Global Travel Restrictions: Beyond the widespread shutdowns that are in place today, we can expect that heightened controls will be in place for years to come. The Emirates airline is conducting blood tests for passengers, and there has been talk of "immunity passports" that would enable those who have had contracted the coronavirus to travel more freely. We may also see restrictions on what can be brought on board flights.

Foreign Investment Protocols: We should expect new measures meant to protect strategic industries and champion national companies, and to keep certain investors out. We have already seen new investment restrictions in Australia, India, Italy, and Spain, among others.

Supply Chains: Global supply chains have seen major disruptions, and the coronavirus has reinforced concerns about firms' overreliance on China. Efforts to diversify are likely to be accelerated, though the virus's detrimental impact on other markets will make that diversification even more difficult than it was before the pandemic. We expect to see a boom in domestic manufacturing of essential goods and new technological solutions.

Market-based Inadequacies and Role of the State: Across the globe, governments' hands-on involvement in managing economic fallout is expanding. In some markets, the government is taking equity in failing companies or entire industries. While such responses may be warranted, state-run outfits often come with new corruption and bribery concerns. These need to be vigilantly monitored and guarded against.

Absence of Political Leadership and Cooperation: The very institutions built to mitigate crises and enable international cooperation have largely failed just when they have been needed the most. We are likely to see radical changes in how these institutions are structured, led, and managed. Entirely new institutions and arrangements will emerge.

Emerging Markets: People in emerging markets are suffering in unique ways, usually away from the media spotlight. Access to food, adequate healthcare, and the challenges of migrant and manufacturing workforces are all exacerbated by the current pandemic. When the global lockdown is finally lifted, it would be foolish to assume that manufacturing will resume quickly. Instead, entire governments are likely to fall as a result of the health, economic, and social crises that will ensue even after the immediate threat of COVID-19 has passed.

Existing Issues: The pandemic did not press a pause button on the problems already ravaging critical parts of the world. Wars in the Middle East remain at a fever pitch. Dissidents in Hong Kong are still being arrested. The US and Iran are still trading barbs. If anything, the pandemic has only made these issues worse.

PUTTING ESG RISK MANAGEMENT INTO ACTION

As the COVID-19 pandemic ushers in new ESG and risk management paradigms, it will be incumbent on firms in the first instance to test crisis measures through legal, ethical, and ESG lenses.

Over the medium-term, it will be critical for firms to be deliberate about identifying the range of stakeholders relevant to their business and understanding their influence and interests, particularly around a broader and evolving set of environmental, social, and governance issues. Likewise, independent validation of ESG attentiveness within a firm's supply chain, among partners, and by prospective acquisition and investment targets will be both legally and reputationally essential.

Finally, as multinational firms get back to work, it will be vital to assess the pandemic's residual risks on a market-by-market basis—as each jurisdiction emerges from the crisis at a different pace and with distinct characteristics—to gauge and adapt to their interplay, and to stay abreast of those political and regulatory developments yet to come as a new normal takes effect.