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Associate Editor: Fraser Tennant
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+44 (0)121 600 5910
riskandcompliance@financierworldwide.com
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ONE-ON-ONE INTERVIEW

INTEGRATING ESG, ERM AND STRATEGY - BEST PRACTICES AND LESSONS LEARNED



Gerry Zack

Chief Executive Officer

Society of Corporate Compliance and Ethics
& Health Care Compliance Association

T: +1 (952) 567 6215

E: gerry.zack@corporatecompliance.org

Gerry Zack is chief executive officer of the Society of Corporate Compliance and Ethics (SCCE) & Health Care Compliance Association (HCCA). He leads the global strategy and activities of SCCE & HCCA and its 18,500 members across 100 countries. He has more than 35 years of experience providing preventive, detective and investigative services involving fraud, corruption and compliance matters. He has worked in more than 25 countries with businesses of all sizes and in many industries, as well as with non-profit and nongovernmental organisations and government agencies.

R&C: Could you outline the benefits to companies of an enterprise risk management (ERM) approach that effectively incorporates environmental, social and governance (ESG) issues with business strategy?

Zack: What drives an organisation begins with understanding its mission and developing its strategy. Environmental, social and governance (ESG) is the perfect example of ‘risk’ as it is defined in risk management frameworks: potential events with a degree of uncertainty that can affect an organisation’s strategy and business objectives either positively or negatively. ESG can pose risks that would have adverse consequences while also presenting opportunities for organisations. In today’s environment, it is important for management to view ESG strategically by identifying where business strategy intersects with ESG issues and incorporating those considerations into strategy setting and decision making. ESG cannot be an afterthought or a separate consideration. ESG considerations need to be prioritised and made a part of strategy setting, which is then used to develop business unit objectives and metrics. An example illustrates this. Suppose we are a company that manufactures and sells a particular consumer product, and our product is well-regarded with sales generally increasing at a rather steady rate for many years. But we source important components of our products from a

supplier located in a country where human rights violations and poor treatment of workers is common. Until recently, this may not have been a critical issue for the company and had not affected our reputation one way or the other. What if news breaks that our supplier has been found to be engaging in horrible treatment of its workers? The risk of losing customers, sales decreasing, stock price declining and other adverse consequences increases. However, if we proactively roll out a new programme aimed at imposing a high standard for treatment of workers in our supply chain, and actively vetting, monitoring and auditing our suppliers before anything like this happens, not only will we avoid adverse effects, but the company may actually improve its customer, stockholder and employee position over what it historically has been. That is the environment that organisations are now operating in.

R&C: How important is it that the board and senior executives buy-in to the ESG mandate, and allocate investment and risk management resources to this area? Are they being influenced by regulatory developments on this front?

Zack: ESG issues first gained attention mostly in connection with investor relations, as something of potential importance to publicly traded companies. Shareholders were once considered to be the only stakeholder in connection with ESG issues. Times

have changed considerably. Today, customers and employees represent two very strong categories of stakeholders who are increasingly voicing their support for or opposition to companies in connection with ESG issues, and they are putting their money where their voices are. Other possible stakeholders who may be concerned about ESG issues are vendors and suppliers, business partners and local communities in which an organisation operates. In another important development, we have clearly seen a trend whereby governments are legislating and regulating certain ESG issues. As more ESG-related issues result in new laws and regulations, leadership will be forced to address them. Proactively considering them before they are mandated by law is the smartest approach. But the most important reason leadership needs to buy into the ESG mandate is that it will be up to them to do the hard work to ensure that the organisation meets public expectations and its own commitments. That means looking, top to bottom, at how the business is run and making the necessary changes.

R&C: To what extent are organisations changing their approach to ERM in light of recent crises such as the coronavirus (COVID-19) pandemic and the war in Ukraine?

Zack: The coronavirus (COVID-19) pandemic and the war in Ukraine are good examples of events that are completely out of any organisation's control, which can have a significant impact on the business. It is easier for us to consider risk events that we have some level of control over; an ERM function cannot possibly consider every uncontrollable event regardless of its likelihood. If they did, we would all have documented plans for an asteroid striking our planet. But each of these two events triggered secondary events, and many of those can be planned for. Supply chain disruption was one such secondary event. Enterprise risk management (ERM) can plan for that. And the supply chain disruptions, in turn, resulted in compliance issues as companies turned to quick-fix solutions. So, the key is not necessarily to identify and plan for every external event, but to attempt to identify and classify the secondary events that directly affect the organisation.

R&C: What principles, tools and techniques can help organisations improve their risk management and strategic planning processes?

Zack: From a principles standpoint, I strongly agree with David Renz, director emeritus at the Midwest Center for Nonprofit Leadership and Henry W. Bloch School of Management at the University

of Missouri in Kansas City. Dr Renz emphasises the importance of moving away from a risk management approach aimed at preserving value in favour of risk leadership, which focuses more on value creation. To me, this transition is critical. Otherwise, risk management will continue to be viewed the way it is in many organisations – as a function that solely focuses on avoiding or minimising the damage from risks that arise in connection with planned programmes, products or services. Risk leadership integrates the consideration of risk with the strategy-setting processes of organisations, assisting in the creation of value. This is not a shift in technique as much as it is a change in mindset within an organisation. From a tools and techniques standpoint, most organisations utilise one of the two most widely accepted risk management frameworks: the ERM framework from the Committee of Sponsoring Organizations (COSO) of the Treadway Commission, which were revised in 2017, or the ISO 31000, Risk Management – Guidelines, which were revised in 2018. Both are good and thorough, with many similarities and some notable differences. Neither is perfect, yet either provides a solid foundation that allows for customisation to meet an organisation's unique challenges and needs. One thing I appreciate

about the COSO framework is its recurring focus on integration with strategy and value.

R&C: How should organisations go about integrating ESG issues into their ERM framework, and ensuring that these considerations are aligned with their strategy? What steps can they take?

“If an organisation is already focused on environmental, anti-corruption and other elements of a sound ESG framework, it should leverage what it already has in place.”

*Gerry Zack,
Society of Corporate Compliance and Ethics
& Health Care Compliance Association*

Zack: ESG integration begins by answering a question: which ESG issues are inherently related to the organisation's mission and strategy? This is often driven by an organisation's products and services, its customer-base and other factors. Next, determine which ESG issues are important to stakeholders – investors, employees, customers,

the local communities in which the company operates and then any broader public segments that could be relevant. Sometimes, organisations find that certain ESG issues that are important to a group of stakeholders is something that had not ever been considered as being associated with its strategy or its products and services. If it is important to a key stakeholder group, it now needs to be integrated into strategy setting. In other words, sometimes ESG considerations need to be aligned with strategy. In other cases, strategy needs to be adjusted to align with ESG issues. Like with many issues, one of the keys to this is being proactive. Wait for a group of stakeholders to criticise something and it may already be too late. Reactions and responses develop quickly. Communicating with key stakeholder groups before any criticism is aimed in your direction is an important first step in this integration, followed closely by incorporating ESG-related discussions into strategy-setting processes. Also, do not forget that most of the issues embodied within ESG are not new. If an organisation is already focused on environmental, anti-corruption and other elements of a sound ESG framework, it should leverage what it already has in place.

R&C: What potential downsides might befall companies that choose to overlook ESG issues as part of ERM and strategic planning?

Zack: Potential downsides are significant and not limited to publicly traded companies. Investors are often already factoring ESG issues into their decisions about a company. But failing to develop an ESG strategy can have repercussions among other critical stakeholders, with employees and customers increasingly considering ESG-related issues. Companies that fail to address this rapidly developing area run the risk of significant loss in value and loss in human resources as employees find better companies to work for and customers find suppliers that set a higher ESG standard. Avoiding considering ESG issues does not simply fail to capitalise on value creation, it runs a serious risk of loss in value for the organisation.

R&C: What is the outlook for ERM and ESG in today's complex, uncertain world? What major trends do you expect to dominate this space over the coming years?

Zack: In 1978, The Who released the Pete Townshend song, 'Who Are You'. Companies can no longer answer the question "who are we?" with a simple "we're a manufacturer" or something similar. "Who are you" now also means, "what do we stand for and why should someone work for us?" And the question of why someone should buy the company's product has become much more complex than

a simple price and value comparison. Whether it goes by ESG or eventually a new term is coined, the importance to multiple stakeholders of the issues underlying ESG are here for the long term. Rather than viewing them as separate from the business, they need to be viewed in connection with strategy. And the ERM model that many organisations use also needs to adapt to one that focuses on integration with strategy and the creation of value for the organisation. I am optimistic that it will. **RC**