

Are You Ready for HR's Increasingly Significant ESG Role?

HR Executive | Brian Sommer | August 28, 2023

Talk to a lawyer, and ESG is a legal matter. Talk to an accountant, and it's a finance matter. And, if you talk to a supply chain person, ESG is a transportation matter. While many executives have an opinion on what ESG requirements are, the reality is that it crosses a large number of expertise areas within a firm. Interestingly, HR may have one of the most significant roles to play.

ESG by the numbers

The three categories of ESG data are best understood as:

- **Environmental:** Firms must capture their full environmental footprint. They need to identify their greenhouse gas emissions, trash/scrap generated, water used and/or placed in sewers, etc. This is frequently what people think of when they hear ESG reporting but it's actually just a subset of what's required.
- **Social:** Social data requirements are focused on the relationships between a company and its employees, its suppliers' employees, the communities it impacts, its customers and others. This people and community focus is squarely in HR's wheelhouse.
- **Governance:** These are the controls and other safekeeping protections that help a company maintain an outstanding compliance record in meeting its environmental and social commitments.

While a CHRO, and HR generally, may have little responsibility in environmental matters, their roles in the other two pillars will be significant.

Mandatory vs. discretionary reporting

For many years, organizations have reported a number of discretionary CSR (corporate social reporting) data points. For example, they would mention the awards the company won as a best employer, the diversity of the workforce or its Glassdoor rankings. Some firms touted the charitable acts of their employees while others might have highlighted the firm's efforts in funding a local community school for disadvantaged children. All of these are good things and certainly should continue but what you must report is now becoming more consistent across companies and more regulated.

Mandatory data elements also make it harder for a firm to selectively chose what it does or does not want to report. This is an interesting byproduct of the newer reporting requirements. Now, firms must tell the whole story and not just the best parts of it.

The ESG data HR possesses

Businesses will likely lean on CHROs and HR organizations to provide a number of data elements for ESG-related reports.

HR leaders must identify all of the data points they will need to complete these reports (and that could be a long list!). They'll also need to identify where that data exists, if at all, in their current HR, ERP, EHS and other systems. Some values will need to be pulled from a number of subsystems and aggregated while others may require the use of third-party databases (e.g., to get key supplier information) or complex calculations (e.g., You might need to pull paid-time-off usage data from hundreds of workers whose time is in various local payroll systems just to calculate how much total time employees spent on community service initiatives.). And don't forget that some of this data will be in different time zones, languages, currencies, etc. Here's just one challenge: How do you define diversity in all of the countries your firm operates in?

HR's people connections

The board will look to HR (and CHROs specifically) to not only pull all of this data together but also to understand, in detail, what suppliers are doing with their workforces and the communities where they operate. No other part of the firm should know more about subjects like engagement, livable wages, ethical behavior, forced labor, safety incidents, benefits, etc. than HR.

HR will likely partner with supply chain/procurement personnel to adjust the firm's mix of suppliers as new information about those suppliers becomes available.

If it doesn't already, HR should understand the firm's use of temporary, contracted, 1099 and other non-traditional workers. Are these people receiving a livable wage? What kind of working conditions do they toil in?

Another concern area involves the firm's use of outsourced labor. HR may get tasked to evaluate the working conditions, pay scales, hiring practices, diversity and more that each outsourcer has. Are these firms treating employees (and the communities they live in) fairly?

ESG requirements will make HR's scope and data needs expand materially.

A way to look at HR's ESG concerns

In researching a new book on ESG, I noted how consultancy McKinsey, in its 2021 Sustainability Report, wants to "add years to life and life to years." That concept is not only elegant but highly aspirational. It could also be a great way to frame your initial ESG social efforts.

Using McKinsey's concept, is your firm helping employees and their families:

- Get access to healthcare?
- Get access to critical supplies during a pandemic?
- Acquire elder or childcare?
- Eat better?
- Stay fit and exercise?
- Have a positive mental health?
- Get time to recharge (e.g., vacations)?
- Achieve a reasonable work/life balance?

These are the programs that should be reported upon.

Building off of McKinsey's prior theme, the next level of reporting might follow this concept: "add years and value to careers." Is your firm:

- Providing performance reviews and career plans to all employees at a minimum of once a year?
- Offering continuing education to employees?
- Ensuring upward and timely career progression for all employees?
- Creating a safe place for people to work?
- Providing relevant and timely reskilling and upskilling opportunities to its staff?
- Preventing any harassment of employees?
- Making opportunities for employment and advancement open and equal for everyone?

The third level of reporting looks outward. Your firm should look at what is happening to its contracted labor and suppliers' employees (i.e., add years, life and value to those who serve your firm, directly or indirectly). Does your firm:

- Avoid any use of slave, prison or forced labor and also prohibit its suppliers from doing so? How many sites did your firm personally inspect last year?
- Ensure 1099 contract workers are paid living wages and treated fairly?

HR's ESG reporting challenges

Sadly, the state of the art for many firms is an annual ESG documentation effort. A team of people are tasked with pulling together the data values needed on specific regulatory reports. The technologies many teams use, if you want to call it that, are spreadsheets and paper.

One firm I observed has a team of 14 people who fan out over the firm's global operations to scour the firm and its systems for key data elements. This takes several weeks at year-end and takes these people away from their regular jobs. They load data into spreadsheets and then merge all of these individual spreadsheets into a cohesive view of the company's ESG posture. It's an environment rife with double-counting, errors and missing data elements.

This approach is not sustainable long-term and may suffer from serious audit/audit trail issues.

Other firms are using more automated tools that allow team members to post to a shared ESG data warehouse where the software will automatically map the data to key fields in regulatory reports.

The HR ESG strategy

Just "reporting" ESG statistics won't cut it long-term. HR will need to be "doing" something about any deficiencies it spots. In fact, the need to be doing something will hit sooner than you think.

Why? Once the board or the executive committee has two or more years of statistics handy, they will want HR to dig into the year-over-year (YOY) variances and determine the root causes of these changes. For example, if your engagement slips materially YOY, can you really tell leadership why? Likewise, if you start seeing more suppliers have unacceptable labor practices,

is that due to better analytic data or has your firm's supply chain materially (and unfavorably) changed?

You might find problems with new acquisitions, a return-to-office policy or any number of other factors. But, you will need to understand what is changing in your people-based ecosystem.

Likewise, HR and HR-IT will need a new technology strategy. The old systems might have been acceptable for capturing data within the firm but do little or nothing to capture external data about contractors, suppliers, etc. Additionally, HR's IT infrastructure for ESG reporting will likely need a number of new integrations, specialized ESG reporting software, enhanced HR analytic software and more.

The long-range goal should be to have an ESG reporting and monitoring environment that:

- Operates in real-time, not once a year, with real-time (not annual) data;
- Utilizes detailed, not highly aggregated or averaged, data;;
- Possesses automated process workflows that trigger appropriate HR follow-up; and
- Detects problems as they are happening, not a year or more after they happened.

If you start your ESG (and broader HR) strategy process by determining your future end-state, you will likely focus first on what HR should be doing for the firm and then back into how HR will also support better HR reporting. Stringing together a number of poorly planned incremental reporting efforts regarding ESG will result in a suboptimal solution full of spreadsheets, paper, missing integrations and little added business value.

Start your strategy journey by asking questions such as:

- How can we learn more about all levels of our suppliers? And, if we discover adverse information, how will we deal with it? What should those processes look like?
- How can we get out of the ESG data collection process and focus HR professionals on the social and governance issues we must address instead?
- What should we do to have an ESG story that is better than that of some of our suppliers, customers and competitors?
- What's the state of the art in ESG technology today, and what will this look like in three, five or 10 years?
- How will specific HR roles change in a more regulated ESG reporting world?
- What happens to our recruiting and employment brand if we adopt a more ESG-forward posture? Can this help us in our war for talent?

Final thoughts

ESG requirements are growing rapidly with more countries piling on. The regulatory burden is growing and showing no real sign of abating. Smart companies are getting ahead of this and smart HR leaders are doing so, too.

Consumers are expecting better behavior from companies regarding ESG matters. And, this extends even down to your firm's recruiting brand. A recent Esker study reported that "employee expectations for sustainability in the workplace are heightening," meaning that

“those companies that don’t deliver may undermine their ability to recruit talent, attract investment or win business as a vendor, partner or supplier.”

In fact, the organization found in a survey that 58% of respondents planned to factor a company’s commitment to sustainability in their choice of employers in the future, up from 44% who considered this before taking their current job. It’s especially important to younger workers, with 71% of workers under 35, including 81% of women in this age group, planning to consider sustainability.

If your excitement level over generative AI has calmed down, it’s time to refocus HR on immediate but strategic challenges—like winning the war for talent, creating resilient organizations and getting a real plan for ESG. The time is now.