A Material Difference: The Distinction Between CSR and ESG

ESG Global Advisors

The terms "ESG" (Environmental, Social and Governance) and "CSR" (Corporate Social Responsibility) are often used interchangeably. What is the difference and why is it strategically important for companies to understand the distinction?

CSR vs. ESG - What is the Difference?

CSR is not a new concept. For decades, companies have faced increasing pressure from stakeholders to act in an environmentally and socially responsible manner. The main audience for CSR represents a broad range of stakeholders, including employees, customers, suppliers and local communities. The areas of interest, expectations and associated information needs of these diverse stakeholders can differ significantly.

What is new is the financial community's growing awareness of the impact of environmental and social factors on a company's financial value. As a result, investors increasingly seek to take into account the potential impact of those factors on profitability or the company's valuation over short- and long-term timeframes.

What is ESG?

The growing awareness of the impact of ESG factors on financial value has led to investor focus on this topic. ESG is a subset of financially material CSR factors that are of interest to capital market participants, including shareholders, bondholders, lenders, insurers, proxy advisors, rating agencies and financial regulators.

Simply put, CSR tends to be focused on values, whereas ESG is focused on value. Financial materiality is the distinction between these two concepts. There can be some overlap between CSR and ESG factors, as whether the company is acting in an environmentally and socially responsible manner may impact value. Importantly, CSR factors may evolve over time to become material ESG factors – the boundary between CSR and ESG factors is not static and therefore CSR issues must be identified and monitored. In this age of instant transparency, this evolution can occur faster than ever before.

To illustrate this point, consider these recent examples of ESG factors with material financial implications for companies:

- **Wynn Resorts** – In January 2018, allegations of sexual misconduct by the CEO, Steve Wynn, were followed by a 10% stock price decline[1] and his eventual resignation in February 2018.[2] While the company had policies in place on sexual harassment, an alleged lack of board oversight and enforcement of these policies allowed it to become a material ESG factor.[3]
- **Energy Transfer Partners** – From 2014 to 2017, opposition from the Standing Rock Sioux Tribe to the proposed Dakota Access Pipeline resulted in global media attention, protests related to environmental and social concerns, and significant delays. While the company adhered to laws and regulations, the total cost of the project ballooned to an estimated $7.5 billion, with the company's stock price declining by 20% over the period of the protests.[4]
- **Facebook** – In 2019, the Federal Trade Commission imposed an unprecedented $5 billion penalty, as well as operational and governance restrictions on the company, to settle its investigation of data privacy breaches.[5] While the company had policies in place to protect user data, a lack of compliance led to a digital privacy breach affecting 87 million users.

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1 https://www.washingtonpost.com/news/business/wp/2018/01/26/wynn-resorts-shares-plummet-after-steve-wynn-accused-of-sexual-misconduct/?noredirect=on
2 https://www.cnn.com/2019/04/03/us/wynn-resorts-massachusetts-gaming-commission/index.html
3 https://www.reuters.com/article/us-wynn-resorts-ceo-lawsuit/wynn-resorts-board-sued-for-failing-to-investigate-chief-executive-idUSKBN1FR32U
4 https://www.colorado.edu/today/2018/11/26/dakota-access-pipeline-controversy-cost-companies-least-75-billion-study-finds
5 https://www.ftc.gov/news-events/press-releases/2019/07/ftc-imposes-5-billion-penalty-sweeping-new-privacy-restrictions

Why is ESG Important?

The integration of material ESG factors in investment decisions is becoming mainstream within the global investment community. In Canada, professionally managed assets with an ESG integration strategy are now $2.1 trillion (or 51% of total professionally managed assets), representing 42% growth over a two-year period.[6] The United States is experiencing a similar trend with $12 trillion of professionally managed assets using ESG integration strategies, representing one out of every four dollars professionally managed – a 38% increase since 2016.[7] Amid growing recognition that ESG can impact a company's value, there is growing acceptance that integrating ESG is a core part of a prudent investment process.

Implications for Companies

Companies need to manage and report on ESG and CSR through the appropriate channels. For CSR factors, disclosure is typically in voluntary, non-financial reports such as CSR or Sustainability Reports. For public companies, material ESG factors should be included in disclosure that is targeted to investors, which may include the Annual Report, proxy circular or other regulatory filings.

It is important for companies to treat material ESG factors consistently with other material factors, such as financial and operational performance. Material ESG factors should be integrated into the existing risk management processes of the company and subject to the same internal controls and procedures as other material information.

Board Oversight of ESG vs. CSR

The board of directors is responsible for ensuring that all material risks, including material ESG risks, are identified and managed. Whether the risk is related to climate change, employee relations, or relationships with suppliers or consumers, if it is material to the company, it should be subject to board-level oversight. Similarly, as part of its responsibility to oversee corporate strategy, the board should ensure that environmental and social factors that may represent strategic opportunities are appropriately considered. With respect to broader CSR factors that are not considered material, the board should ensure that it has appropriate governance and reporting structures in place so that it can appropriately oversee how management is identifying and monitoring those issues over time.

About ESG Global Advisors

ESG Global Advisors bridges the gap between companies and investors on environmental, social and governance (ESG) factors. A multi-disciplinary team with significant investor and corporate experience, we are uniquely positioned to offer expert advice to companies and investors on material ESG factors that drive long-term value, including climate change. We assist companies and boards of directors with:

- Understanding how investors integrate ESG factors into investment processes and stewardship
- Developing strategies for managing material ESG factors to generate superior long-term value
- Developing approaches to ESG-related disclosure and engagement with shareholders

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6 https://www.riacanada.ca/research/2018-canadian-ri-trends-report/
7 https://www.ussif.org/files/Trends/Trends%202018%20executive%20summary%20FINAL.pdf