

SUSTAINABLE SUCCESS

Exploring environmental, social and
governance priorities for industrials
through COVID-19 and beyond

INTRODUCTION

Industrials are being hit hard by COVID-19 disruption, but commitment to sustainability will lead the sector to recovery.

Organizations have taken great leaps forward in relation to environmental, social and governance matters (ESG) in the past decade. CEOs have signed up to a new holistic definition of company purpose,¹ entire teams have been established to steward corporate social responsibility (CSR) and 75% of public companies now report on ESG goals.²

But COVID-19 risks stalling progress. As the pandemic has wreaked havoc on the global industrial, manufacturing and transportation (IMT) sector, profit warnings and production shutdowns, supply chain disruption and depressed demand have created a uniquely challenging operating environment. In response, some regulators are relaxing enforcement of ESG standards, and leaderships concerned only with stabilizing company performance risk losing ground on sustainability commitments.

We cannot ignore the economic challenge of the moment and the huge changes that have turned the world upside down in 2020. Yet the fundamental imperative to embed and prioritize ESG remains — and is arguably more important than ever, as COVID-19 has forced us to confront the fragility of our systems and norms. The human and environmental cost of continuing as before is clear.

While some stakeholders may lower their expectations in relation to ESG in the immediate term, others are raising the bar. Research indicates that companies already scoring well in relation to ESG have outperformed others during COVID-19³ and ESG considerations are increasingly influential in investment and purchasing decisions.⁴ Organizations also face additional pressure from their employees and customers to embed ESG practices and policies. In a 2019 study of US workers, more than 70 per cent said that they were more likely to choose to work at a company with a strong environmental agenda.⁵ Further data shows that 92% of customers would be more likely to trust a company that supports social or environmental issues and 88% would be more loyal to one that supports these causes.⁶

We believe that sustainability can be a lever of recovery and competitive advantage, where companies proactively consider ESG issues as part of their COVID-19 response and decision-making. More closely connecting sustainability and business models in future offers industrials the opportunity to reimagine supply chains, production and revenue streams — the basis for long-term reinvention and success.



Anahita Thoms
Global Sustainability Lead of the Industrials,
Manufacturing and Transportation Group
Dusseldorf
+49 21131116121
anahita.thoms@bakermckenzie.com



Dr. Nikolaus Reinhuber
Global Chair of the Industrials, Manufacturing and
Transportation Group
Frankfurt
+49 69 2 99 08 406
nikolaus.reinhuber@bakermckenzie.com

¹ Davos Manifesto, 2020

² Impact-Weighted Accounts Report 2019, Harvard Business School

³ Evidence links ESG performance to company, fund performance in crisis, FS Sustainability, April 2020

⁴ Blackrock shakes up business to focus on sustainable investing, Financial Times, 2020

⁵ Most millennials would take a pay cut to work at an environmentally responsible company, Fast Company, February 2019

⁶ Do Customers Really Care About Your Environmental Impact?, Forbes, 2017

IN THIS REPORT

This white paper explores sustainability through a COVID-19 lens, uncovering practical ESG considerations for recovery and beyond with insight from industry leaders and our experts.



The expectation that society places on the contribution of global companies like Philips has become larger, especially during the challenges that the world is facing today. The COVID-19 pandemic has made it ever more clear that we need to create a more inclusive and resilient world. As a leading health technology company, it is our purpose to improve people's health and well-being through meaningful innovation. We aim to improve 2.5 billion lives per year by 2030 and deliver superior, long-term value to our customers and shareholders, while acting responsibly towards our planet and society. We want to make sure that the world will be a better and fairer place to live in."

Martine van de Laar, Senior Director Sustainability, Philips

Topic	Key question	
Resilience: Foresight in a time of crisis	How can industrial companies navigate immediate ESG priorities and risks in relation to COVID-19 decision-making?	4
Recovery: Leveraging ESG	Will sustainable organizations be best positioned to overcome performance challenges arising from COVID-19?	6
Renewal: Building new sustainable revenue streams	What opportunities exist for industrials to build new sustainable revenue streams for the long-term?	8

WHAT DO WE MEAN BY ESG?

Environmental, social and governance issues are recognized as key factors companies need to consider in relation to sustainability. Every organization needs to understand the impact these have on its operations and how to address them in their business strategies.



Environmental:

Factors include risks and opportunities in relation to climate change, natural resources, clean energy and technology, pollution and waste.



Social:

Factors include risks and opportunities in relation to human capital, community betterment, safety and security.



Governance:

Factors include risks and opportunities in relation to responsible finance, diversity and equality, executive pay, ownership, compliance and controls.⁷

⁷ ESG 101, MSCI, 2020



RESILIENCE: FORESIGHT IN A TIME OF CRISIS

Leaders in the IMT sector have made — and continue to make — fast decisions in response to COVID-19 disruption. From filling supplier gaps and renegotiating contracts to furloughing employees and shoring up cash flow, the pressure to make key moves quickly and balance often competing factors is high.

Avoiding missteps in relation to ESG in these areas may seem like a secondary concern, but failure to appropriately consider obligations and risks could lead to costly issues later — putting recovery in jeopardy. For example, in the scramble to strengthen the cash position, many companies sought to evoke force majeure clauses. China issued a record number of force majeure certificates by the end of February 2020.⁸ But quickly organizations found these decisions scrutinized for downstream human rights issues, leaving suppliers in precarious financial positions and workers facing unemployment and poverty.⁹

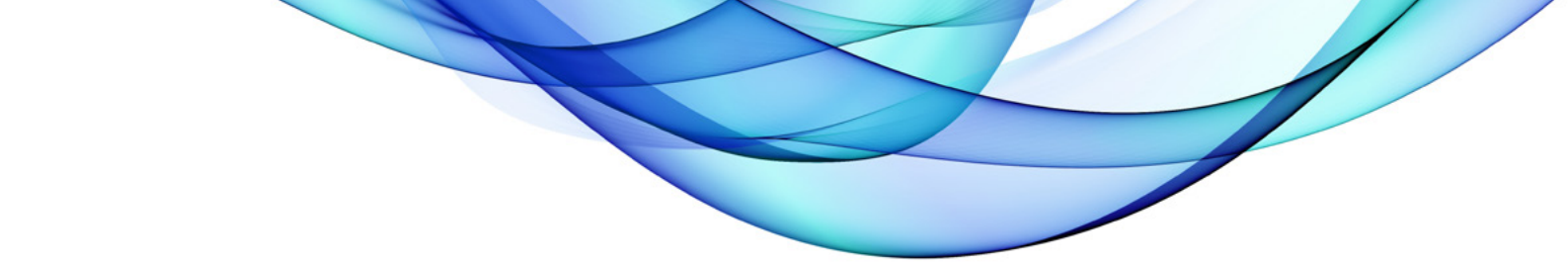


COVID-19 has created a very challenging operating climate. In the early days of the pandemic, establishing which borders remained open, ensuring essential goods could be delivered and working with clients to divert or warehouse non-essential cargo all required fast thinking. But sustainability was always part of the picture. As a family-owned company, we are inspired by our worldwide company values and passion for the sea in our approach to investing in sustainability. It starts with how we choose the most energy-efficient new build ships to meet the highest environmental standards and flows through to our ongoing work to stimulate and explore new fuels and technologies for future decarbonization. Meanwhile, we provide a full carbon neutral program to customers requiring this option.”

Nigel Fernando, Managing Director, MSC Shipping

⁸ China Issues Record Number of Force Majeure Certificates, Financial Times, February 2020

⁹ Anger at Huge Shareholder Payout as US Chain Kohl's Cancels \$150m in Orders, The Guardian, June 2020



"In the context of the pandemic, human rights related issues can arise in many business areas, including health and safety at work, responsible disposal of dangerous objects and privacy protection. In the European Union, expectations regarding the adherence to human rights will be further formalized in the announced EU Supply Chain Act, legislating for duty of care and mandatory human rights and environmental due diligence in the supply chain."¹⁰ **Anahita Thoms**

And while, in some regions, enforcement of certain ESG rules may be relaxed, the legal circumstances surrounding these decisions can change "on a dime." In the end, reputational risks may prove to be of greater consequence than government sanctions. Increasingly, organizations, their customers, employees and shareholders or investors are taking the lead on environmental issues rather than regulators.

"In the US, the gap between federal policy and company action on environmental issues is widening. While the Environmental Protection Agency (EPA) has indicated it will not be pursuing failures to comply resulting from COVID-19 operating challenges, companies should be conscious of the potential impact of walking back key ESG commitments on brand reputation, and aware that government pandemic-related enforcement relief is under vigorous challenge from environmental groups both through the judicial system and the court of public opinion. Adopting a "letter of the law" approach today and easing up on rigorous adherence to corporate compliance efforts could result in legal disputes later on and difficult conversations when leaders are pressed on choices made in balancing its operations priorities with regulatory obligations and ESG commitments."

John W. Watson

In this context, compliance investigations are expected to rise in the coming months — particularly in Asia Pacific, where markets are largely emerging from the initial stages of pandemic response. "We are expecting a particularly significant rise in investigations in relation to emergency procurement, government support initiatives and employment matters such as discrimination or harassment. Some companies have taken advantage of the lockdown to override their compliance policies — in most cases for good reason but in others, for their own benefit or to benefit others. We are seeing a rise in whistleblower allegations in relation to these issues but also generally, as tolerance for any misconduct has reduced when so much hardship is being felt."

Mini vandePol

WHAT IS THE ECONOMIC OUTLOOK FOR IMT?

According to research from **Baker McKenzie** and **Oxford Economics**, global output is expected to drop compared with Q4 2019 data. The downward trend is at 13% for automotive, 8% for both textiles and electronics, and 5% for headline manufacturing as well as for aerospace and other transport equipment. However, these sectors are also likely to see the quickest rebound as pent-up demand is released in line with a recovery in sentiment, and production ramps up to make-up for previously lost output, by H1 2021. Global manufacturing value-added output will rebound in 2021 with a 6% value-add in manufacturing output compared to 2019. In 2021, for Asia-Pacific (excluding China), this value is set to hit 4%, while the US may see up to 6% value-add and the pick-up in Europe is currently estimated at 5%. But it won't be a resumption of business as usual.¹¹

¹⁰ New Human Rights Laws in 2021, Promises EU Justice Chief, Euractiv, April 2020

¹¹ Supply Chain Resilience Holds Key to Recovery, Baker McKenzie, 2020

RECOVERY: LEVERAGING ESG

Sustainability is set to be a powerful guiding principle of COVID-19 recovery and a source of advantage for Industrials. In Europe in particular, plans for a “green recovery” are being woven into decisions on government support, economic stimulus and regulation.

“Once again, Europe has taken a leadership position on sustainability in relation to COVID-19—positioning efforts for post-pandemic economic recovery side-by-side with ESG. In May 2020, the European Commission unveiled a EUR 750 billion economic stimulus package that centers on its pledge to cut carbon emissions by 55% by 2030 and to “net zero” in 2050. This Green Deal will enact a series of initiatives designed to reach this target—from producing clean hydrogen and stepping up sustainable urban mobility infrastructure projects to investment in renewables.”

Christopher Jones

These efforts learn the lessons of previous crises in relation to sustainability and recovery — adopting the most effective strategies for success. Recent research from Oxford University compared green stimulus projects with traditional stimulus, such as measures taken after the 2008 global financial crisis, and found green projects create more jobs, deliver higher short-term returns per pound spent by the government, and lead to increased long-term cost savings. For example, clean energy infrastructure construction generates twice as many jobs per pound of government expenditure as fossil fuel projects around the world.¹²

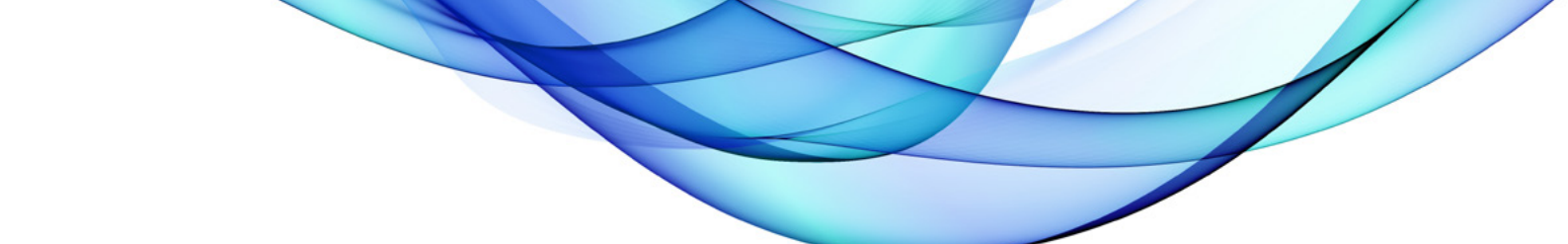


ESG issues should be considered as investment risks as much as a reputational matter. As a global investment company headquartered in the Middle East, Mubadala has formalized its approach to responsible investing and is embedding a framework that supports its ESG strategy into investment decisions and its asset management processes. We inspire our businesses to leave a long-term, lasting positive impact in the communities where we deploy capital.

The pandemic has brought into sharp focus the need to protect vulnerable people and assets, and to accelerate the journey of organizations toward increased sustainability and resilience.”

David William Crofts, Executive Director for Enterprise Risk Management, Mubadala Investment Company.

¹² Will COVID-19 Fiscal Recovery Packages Accelerate or Retard Progress on Climate Change?, Oxford Smith School of Enterprise and the Environment, May 2020



"Looking beyond COVID-19, the risks and opportunities linked to climate change will likely be even more significant than the effects we are currently seeing as a result of the pandemic. Therefore we must commit to reducing future shocks where we can do so. Integrating climate risk management into risk management systems is a key way that entities can reduce exposure while also identifying and pursuing opportunities." **Ilona Millar**

It is also true, though, that sustainability will be equally important to industrials as they look to reshape their existing operations for post-pandemic success. "All companies are being forced to assess whether their businesses are right sized given current market realities. Effective long term decisions on reducing, consolidating and relocating manufacturing capacity can only be made with due consideration of ESG issues, including climate, supply chain and energy opportunities and challenges. The scope of our counsel to clients has expanded exponentially to address these business critical dynamics." **John W. Watson**

For organizations looking to access finance and move toward recovery, sustainability will also be key. Aside from accessing government aid, private investors globally are increasingly minded to ESG. Embracing sustainability can therefore provide a valuable edge in the "fight for capital." Nowhere is this more critical than in Africa, where COVID-19 threatens to disrupt the growth story of the region.

"Access to capital will be critical to corporate recovery and to ensuring key industrial and infrastructure projects in Africa can continue — how to mobilize capital from local savings pools, shore up development finance from the IFC, IMF and World Bank, and direct green bonds are now important questions for leaders in the region. In the fight for capital, embracing sustainability can be a source of competitive advantage. Funding in some areas is contingent on meeting certain global ESG standards and other investors have followed this lead — requiring documented, planned policies and processes in relation to ESG. The market for green and sustainable bonds is also likely to expand in the coming years. In an effort to drive investment and make it easier to list and trade sustainability-linked instruments, for example, the Johannesburg Stock Exchange plans to offer new sustainability bonds."¹³ **Wildu du Plessis**

In Asia Pacific too the "currency" of ESG is growing in the current environment. "Various investment funds, including high value pension funds, will now scrutinize a company's ESG track record before determining whether and where to invest. The COVID-19 crisis has been a valuable lesson in considering longer-term investment strategies and embedding sustainable and ethical business practices as a bedrock of value. Not just nice to have but must have in relation to meeting stakeholder demands." **Mini vandePol**

“

As a company, a key focus area is to be an ESG enabler — particularly from an environmental perspective. We capture methane and transform it into energy, allowing logistics companies using diesel to use an alternative fuel source, reduce greenhouse gas by up to 90% and saving money in the process. South Africa requires further government support to level up ESG, prioritizing renewables and instating consistent and ambitious requirements for organizations operating here. Our economy is the 8th worst polluter in the world on a CO₂ per \$ GDP basis according to the World Bank."

Stefano Marani, CEO and Managing Director, Renergen

¹³ JSE to Evolve Green Bond Segment to All-encompassing Sustainability Segment, JSE, February 2020

RENEWAL: BUILDING NEW SUSTAINABLE REVENUE STREAMS

As the old adage goes, never waste a crisis. Long-term transformation and renewal in the sector should go hand-in-glove with delivering on ESG priorities. New opportunities exist in drone technology, AI, supply chain digitalization and more for those organizations that can access capital and unleash it to adapt. Lean, agile and efficient are the watch words of the new economic order — especially in IMT. Where sustainability can deliver these outcomes, we will see companies accelerate toward a new reality and commercial success.

Research indicates that “Industry 4.0” could have an estimated value-creation potential for manufacturers and suppliers of USD 3.7 trillion in 2025 and hopes are high that it could bring the next industrial revolution.¹⁴ But capturing this value poses a challenge. Some industrials have been slow to embrace innovation in the past for fear of going too far, too soon and leaving key stakeholders behind.¹⁵ Despite the economic challenge of the moment, disruption arising from COVID-19 can be a catalyst for bold action. There is now a window of opportunity for industrials to upend traditional market and shareholder expectations, invest in transformation and capitalize on lower barriers to entry and expedited approval for new sustainability-driven revenue streams and processes. This is especially apparent in supply chains, where COVID-19 has revealed significant scope to digitize for speed, environmental impact and ESG accountability.

“The future of supply chain is digital. As well as offering efficiency and the ability to counter supply failures quickly, end-to-end transparency of the entire supply chain will be critical to oversight on ESG issues — demonstrating compliance with key regulations and reporting on duty of care obligations to relevant stakeholders. We expect to see a rise in tracking tools to help map the movement of goods in real time, as well as cloud solutions, Internet of Things (IoT) systems and block chain ledgers designed to generate a holistic picture. Many companies will also be investigating supply chain dependencies and considering how more sustainable production methods, circular manufacturing and customer-administered 3D printing can diversify the supply chain and ease pain points in the event of future crises.” **Anahita Thoms**



The right usage of data and technology has a significant impact on companies' ESG efforts. We have been very successfully embracing AI and other advanced tech in the legal department, be it in relation to bribery or ethical concerns, and will be using it even more in the future, as it gives us much faster insight into whether certain transactions need to be investigated further.”

Matt Galvin, Global Vice President, Ethics & Compliance, AB InBev.



The pandemic has put into perspective what is important and has been a chance for many businesses to recalibrate and reset. It has been a reminder for businesses to realize that planning and decision-making must factor in a more well-rounded, sustainable approach. In Abu Dhabi, we are building for the long-term. We believe in creating the optimal business environment to allow companies to thrive in a region with enormous opportunity. Sustainability factors heavily into all our decision-making, whether in companies or major projects we support, opportunities we facilitate or programs we develop. The work we have done at ADIO to bring AgTech pioneers to the region to support sustainable food solutions, for instance, is a good example of this.”

Jamie Levy, General Counsel, Abu Dhabi
Investment Office

REIMAGINING SUSTAINABLE BUSINESS IN THE MIDDLE EAST

“Long-term shifts in relation to sustainability have been happening in the Middle East over the last few years, catalyzed by a changing mindset, a desire to build new revenue streams — beyond oil — and operate more freely in the global marketplace. Sustainability is becoming a core consideration for companies in the region — especially in construction and energy, where end customers, investors and others are demanding greater environmental transparency in relation to tenders and bids. We are also seeing new environment-centered roles popping up in senior leadership, pioneering projects like Masdar City championing renewables and clean infrastructure, along with the region’s first climate change lawsuit filed in Egypt. The transfer of businesses from one generation to the next will further accelerate this mindset in the Middle East, especially among those large family-owned conglomerates.”

Andrew Mackenzie

¹⁴ Capturing Value at Scale in Discrete Manufacturing with Industry 4.0, McKinsey, 2019

¹⁵ Back to the Future, Baker McKenzie, February 2020

CONCLUSION: ALIGNING COVID-19 RESPONSE AND ESG ACTION

Environmental, social and governance issues are apparent at all stages of COVID-19 response and require careful consideration from industry leaders. But questions of business performance and stability are also ultimately questions of sustainability. These ideas are not opposed; in fact, those organizations that find productive and purposeful connections between business models and ESG, and that embrace sustainability as part of recovery may even be better positioned for long-term success.

"COVID-19 will pass. Arguably, climate change will be a bigger challenge for the global community in the long term. However, the pandemic is having an effect on how businesses will look after ESG issues. All indicators show that those businesses with a more active focus on ESG will do better. It is becoming a question of competitive advantage. This change will be driven by intrinsic motivation of business leaders and by extrinsic factors, in particular clear demands from institutional investors, the next generation of talent, as well as from customers, and by a changing regulatory framework."

Nikolaus Reinhuber



"The sustainable corporate strategy at Daimler pursues a holistic approach and takes all factors into account, ranging from environmental to social and governance aspects. In terms of environmental sustainability, we have our "Ambition 2039," which includes a CO2-neutral new car fleet by 2039. The electrification of our car fleet is a key factor here. Additionally, our commercial vehicles in the triad markets, Europe, Japan and North America, will also be CO2-neutral up to 2039. While we have consistently driven toward our strategic goals in terms of electrification and digitalization, COVID-19 has accelerated this development. We have to move even faster now and cannot afford to lose any more time. The Paris Climate Agreement is more than an obligation — it is a conviction and we set a clear course to contribute to climate protection."

Eckart von Klaeden, Vice President / Head of External Affairs, Daimler AG

KEY COVID-19 RESPONSE CONSIDERATIONS FOR IMT LEADERS



- Do decisions arising from COVID-19 disruption sit comfortably within our governance systems, purpose and values?
- What ESG risks, compliance issues or legal challenges may we be exposed to as a result of our COVID-19 response?
- How can we demonstrate consistency in our ESG commitments in this moment of crisis?

- Can our sustainability reporting work harder, enabling us to access new sources of capital?
- What opportunities are we missing to leverage ESG performance for business recovery and competitive advantage?
- What government stimulus is available to us and are there additional sources of capital that we can draw on using our sustainability record?

- Where will demand for our products and services be in future?
- How can more sustainable approaches, tools or products enable us to access new revenue streams?
- What technology can we apply to the current business model to drive more sustainable, efficient or transparent outcomes?

KEY PARTNER CONTACTS



Anahita Thoms

Global Sustainability Lead of the Industrials, Manufacturing and Transportation Group

Dusseldorf

+49 21131116121

anahita.thoms@bakermckenzie.com



Dr. Nikolaus Reinhuber

Global Chair of the Industrials, Manufacturing and Transportation Group

Frankfurt

+49 69 2 99 08 406

nikolaus.reinhuber@bakermckenzie.com



John W. Watson

Chair of the Global Environmental Practice Group

Chicago

+1 3128612646

john.watson@bakermckenzie.com



Wildu du Plessis

Head of Africa Steering Committee

Johannesburg

+27 11 911 4301

wildu.duplessis@bakermckenzie.com



Ilona Millar

Head of Global Climate Law & Finance

Sydney

+61 2 8922 5710

ilona.millar@bakermckenzie.com



Christopher Jones

Energy Regulatory and Antitrust

Brussels

+32 26393611

christopher.jones@bakermckenzie.com



Andrew Mackenzie

Arbitration, Construction and Offshore Litigation

Dubai

+971 44230068

andrew.mackenzie@bakermckenzie.com



Mini vandePol

Head of the Asia Pacific Compliance & Investigations Group

Hong Kong

+852 28462562

mini.vandepol@bakermckenzie.com

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