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The business case for ESG reporting for sustainable private companies

Private companies might be tempted to believe that environmental, social, and governance (ESG) reporting is less relevant to them than it is to public companies. After all, much of the discussions on ESG have been about proposed climate disclosure regulations impacting public companies.

But as it turns out, ESG reporting is relevant to private companies, too. Sustainability concerns may be top of mind for a range of private company stakeholders, including investors, customers, suppliers, and the communities in which these companies operate. Many stakeholders have pressured regulators to act, and regulators have responded with a variety of proposed and finalized reporting requirements, some of which impose requirements on private companies.

Developments like these indicate ESG has entered the mainstream and is likely here to stay. From customer conditions to value creation, here are five reasons to suit up and get ready for action.

1 Value chain asks

In recent years, more businesses are voluntarily participating in sustainability programs intended to reduce their own emissions and drive the production of clean energy from renewable sources. If your company interacts with businesses that have set sustainability goals, those businesses may ask you for information to ensure they are meeting their own objectives and reporting needs.

For businesses reporting emissions either voluntarily or pursuant to a regulatory mandate, certain greenhouse gas (GHG) information may need to come from outside the organization. Parties outside a company's direct control can comprise part of that company's overall carbon footprint. For example, a supplier's Scope 1 and 2 GHG emissions may be reflected in a customer's Scope 3 emissions. The accuracy of a business's emissions reporting may be partially dependent on the accuracy of the emissions information it receives from the members of its value chain.

For many businesses, emissions from indirect sources form a larger portion of its total emissions profile than those from direct operations. Suppliers prepared to furnish their Scope 1 and 2 information to their customers on demand may facilitate a better strategic relationship, especially if one or both parties are executing on decarbonization strategies. Private companies can have an enormous impact in driving emissions reductions and catalyzing a cycle of transparent, accurate, and complete sustainability data.

Sustainability risks and expectations companies face are broader than carbon emissions. An agriculture company, for instance, may have a business interest in maintaining healthy soil and water security. An apparel manufacturer may need to shield its reputation from labor exploitation. A biopharma company may be expected to scrutinize the safety and patient recruiting practices of its contract research organizations and other service providers. To the extent you interact with an organization as a supplier, as a customer, or as some other stakeholder, you'll likely influence or drive action on these sustainability risks and opportunities.

Either way, suppliers can expect to see more corporate buyers attempting to broaden their oversight of often sprawling value chains. That can extend to requiring emissions information and other ESG information as a prerequisite for project and contract bids. Some may offer help with setting up and refining suppliers' ESG programs, attractive financing terms for working capital, and other benefits to encourage suppliers to get sharper on ESG reporting.

What are Scope 1, 2, and 3 emissions?

Scope 1, 2, and 3 describe the different kinds of GHG (or carbon) emissions a company creates, directly or indirectly.

- **Scope 1** covers the emissions you make directly—for example, while running your boilers and vehicles.
- **Scope 2** is the category of emissions you make indirectly from the energy you purchase for your company's own use.
- **Scope 3** emissions are those associated with activities throughout your value chain—like the way the goods and services you buy are produced or what your customers do with your products.

2 Federal and state rulemaking

Is your company a contractor to the federal government? If so, the proposed Federal Supplier Climate Risks and Resilience Rule may be important to consider.

In November 2022 the Biden-Harris administration proposed the new rule in order to address and reduce GHG emissions within the federal government's supply chain. This proposed rule would require federal contractors with more than $7.5 million but less than $50 million in annual contracts to report their Scope 1 and Scope 2 GHG emissions. Larger businesses with more than $50 million in annual contracts would have to disclose Scope 1, Scope 2, and relevant categories of Scope 3 GHG emissions; disclose climate-related financial risks; and set science-based emissions reduction targets.

Furthermore, state governments are weighing in with proposed rules of their own. In early 2023, California lawmakers introduced three bills known collectively as the Climate Accountability Package. The Climate Accountability Package would apply to all US entities that have annual revenues in excess of $1 billion and do business in California. Subject companies would be required to publicly disclose Scope 1, Scope 2, and Scope 3 GHG emissions.

3 Sustainable investing and SEC rulemaking for registered funds and investment advisers

In recent years, sustainable investing strategies have increased in popularity and have emerged as a way for stakeholders (i.e., investors) to deploy capital to support companies that prioritize sustainability.

A new regulation is on the horizon for many registered funds and investment advisers. In May 2022, the Securities and Exchange Commission (SEC) issued a proposed rule, "Enhanced Disclosures by Certain Investment Advisers and Investment Companies About Environmental, Social, and Governance Investment Practices." The proposal aims to provide investors looking to participate in ESG investing with consistent, comparable, and reliable information among investment products and advisers claiming to consider one or more ESG factors.

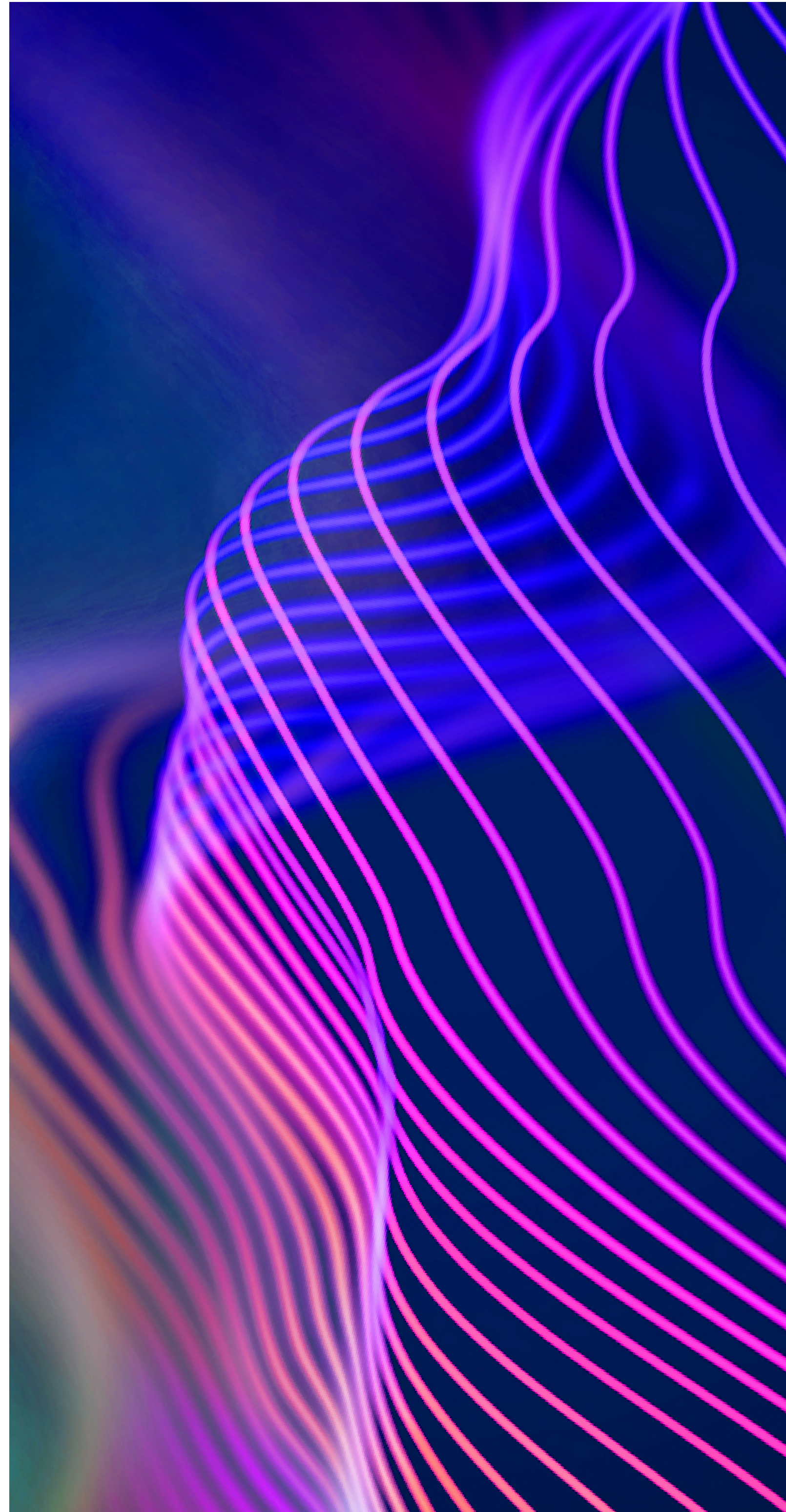
That would mean the registered fund and investment adviser may have to provide specific disclosures about ESG strategies in the fund prospectus, annual report, and adviser brochure. It also would mean using a standardized table so investors can compare ESG funds at a glance. If your private company is an investee or portfolio company of an in-scope registered fund, your private company may have to prepare and provide ESG information to your investor. The types of ESG information that your company may need to provide is dependent upon the investment strategies cited by your investor and could include, among other ESG information, greenhouse gas emission information.

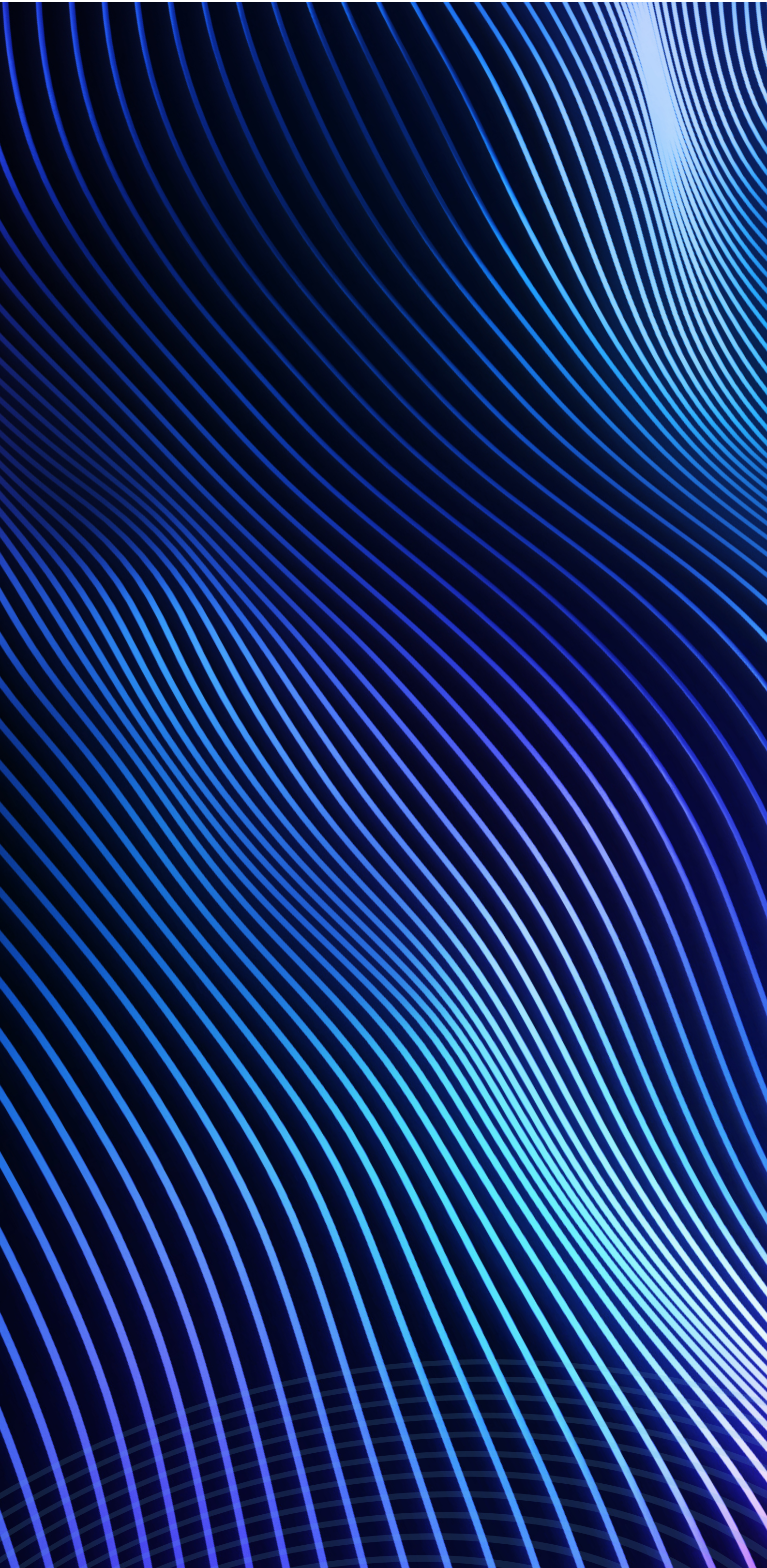
4 Regulations for multinationals

For multinationals, the regulatory environment in the United States isn't the only concern. Jurisdictions around the world have finalized and pending regulations that may mandate ESG-related reporting and disclosure. Companies should consider implementing a process to identify and track the regulatory activity in this evolving landscape.

One finalized rule that is important to understand is the Corporate Sustainability Reporting Directive, or CSRD. If your company has operations in the European Union (EU), the CSRD may require you to provide multiple new disclosures.

The CSRD is designed to facilitate uniform sustainability reporting. Sustainability reporting under the CSRD will impact more companies and will be far more extensive than what most companies maintain today. The CSRD can affect US-based companies with as little as one subsidiary or branch in the EU (listed or not).





The CSRD applies to all EU companies and their EU-based subsidiaries that meet the following general scoping requirements:

- Large companies or large groups (i.e., a company including all its subsidiaries on a consolidated level) that meet at least two of the following:
  - Greater than €20 million balance sheet total
  - Greater than €40 million net turnover
  - Greater than 250 employees
- Companies with listed securities in the EU other than “micro-companies.”

Further, regardless of the general scoping criteria documented above, a non-EU parent company will be subject to the CSRD if the following criteria are met:

- The company has substantial activity in the EU, which is defined as net turnover greater than €150M in the EU for each of the last two consecutive years, and
- The company has at least:
  - One subsidiary that meets the general scoping requirements included above or
  - One branch that generated net turnover greater than €40 million in the preceding year.

In addition, companies may have to prepare to provide the US parent’s consolidated reporting to the EU.

Companies have to begin reporting under the CSRD as early as 2024, and the requirements are extensive. They include up to 84 key performance indicators, approximately 1,100 ESG metrics, and a newer concept of “double materiality.” Additionally, assurance won’t be phased in—limited assurance over all reporting sustainability information will be required from the start.

Multinationals may also consider keeping an eye on the activities of the International Sustainability Standards Board, or ISSB. The ISSB, a sister board to the International Accounting Standards Board, was formed in 2021 by the IFRS Foundation to develop a global baseline for sustainability disclosure standards. Many global regulators, including in Europe and Asia Pacific, are awaiting the finalization of certain of these standards in 2023. They have indicated they intend to mandate sustainability reporting under these standards. Some of these regulations may affect private companies in the jurisdictions in which they operate.

5 Value creation

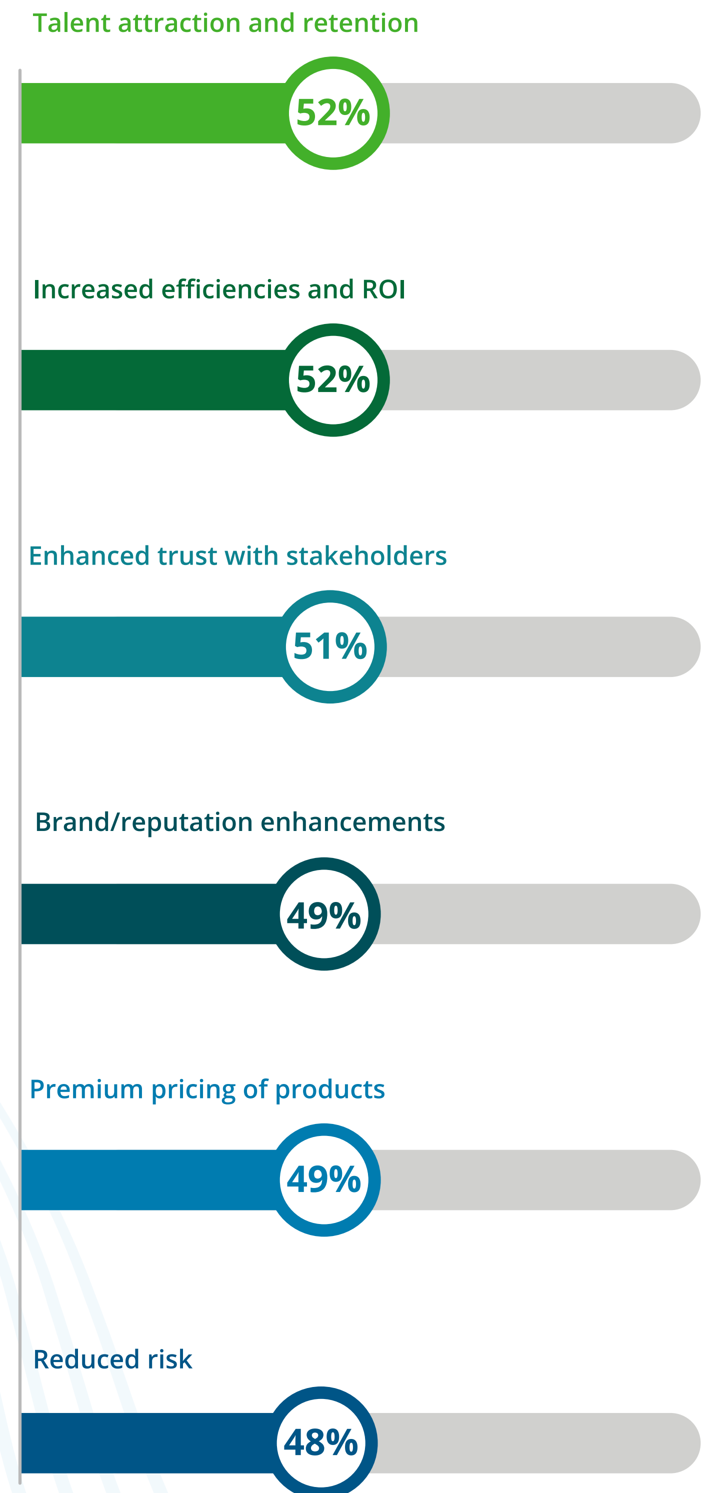
The conversation around ESG tends to gravitate toward the current and on-the-horizon regulations. However, it is important to acknowledge that the recent rush for regulatory mandates is the direct result of continual stakeholder interest in sustainability matters and demand for more transparency underlying current sustainability reporting.

Regardless of whether a company will be imminently impacted by regulations, general sustainability initiatives within a company's operations and governance programs can create business value such as, positive market reputation, strategic relationships with value chain participants, and capital market attractiveness. For private companies seeking to raise capital, those able to furnish information on ESG factors may be better positioned to respond to investor requests; many investors are incorporating ESG data requests into their investment diligence procedures.

Recently we surveyed more than 2,000 C-level business leaders, or CxOs, to gauge their concerns and actions on ESG. We discovered that organizations are feeling broad pressure to act on climate change from across their stakeholder groups. Sixty-eight percent say they feel a large to moderate degree of pressure from consumers and clients. Organizations are also feeling pressure from their shareholders and investors (66%), employees (64%), and civil society (64%).

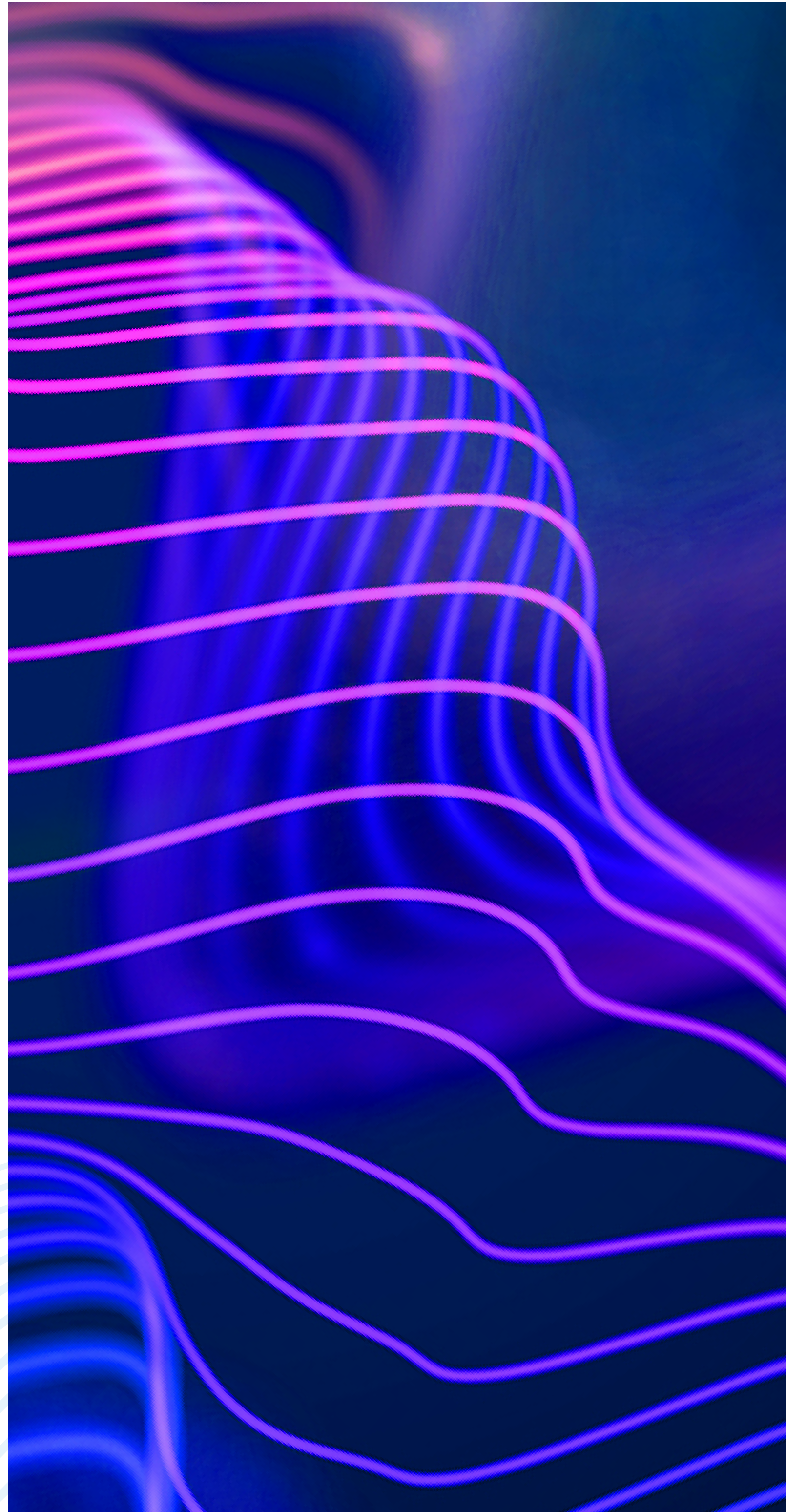
Against that backdrop, business leaders expect a range of benefits from enhanced ESG reporting (see figure 1).

Figure 1: Business outcomes that leaders expect due to enhanced ESG reporting



Source: Deloitte research and analysis

To underscore these results, a 2021 meta-study found that ESG performance improves financial performance (likely due to more innovation and better risk management) and makes companies more resilient to a downturn. Additionally, the recent Inflation Reduction Act provides billions in investments for companies that help pave the way to a low-carbon future.



Meeting the moment now
ESG is becoming an integral part of the business environment for private companies. What should financial leaders consider?

- **Inventory your requirements.** Determine what's required within your regulatory jurisdiction(s) and/or the demands of your value chain.
- **Assess timing and set up processes for monitoring.** Determine the timing to comply and establish a process to monitor newly issued, proposed, changed, or finalized requirements on an ongoing basis.
- **Assess gaps in reporting and develop the optimal data governance strategy.** As the potential data required to provide such information can be significant, determine whether more robust data governance models that may be implemented will emphasize the quality needed to meet this challenge as well as to enable repeatable processes to execute upon.

Establishing a cross-functional team is also important to successful implementation journeys. We recommend considering individuals directly charged with sustainability and ESG (if they exist) as well as those in finance, compliance, audit, controllership, legal, tax, and strategy.

Let's talk

Reach out to Deloitte for additional information. We welcome your questions on any of the topics covered in this article as well as related ones like building net-zero plans, managing physical and transition risk, activating equity internally and externally, and more. Wherever you are in your ESG journey, accountability today can position your business for a more resilient tomorrow.

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Endnotes

1. Tensie Whelan et al., *ESG and financial performance: Uncovering the relationship by aggregating evidence from 1,000 plus studies published between 2015–2020*, NYU Stern Center for Sustainable Business and Rockefeller Asset Management, 2021.

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