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No Longer a 'Nice to Have': ESG and What It Means for Life Sciences Companies

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Introduction

In April 2022, the U.K. Health Secretary, Sajid Javid, announced plans to prohibit the United Kingdom's National Health Service ("NHS") from buying goods and services connected with forced labour or human trafficking. This came in response to highly publicised concerns that, during the frenzy created by the COVID-19 pandemic, the NHS purchased billions of pounds worth of protective health equipment and lateral flow tests manufactured in China, which may have been produced under forced-labour conditions. Foreshadowing Mr Javid's actions in the U.K., on 23 December 2021, the Uyghur Forced Labor Prevention Act was passed into U.S. law, which created (amongst other things) a rebuttable presumption that goods even partially manufactured in China's Xinjiang Uyghur Autonomous Region are the product of forced labour.

These measures are widely considered positive symptoms of the environmental, social and governance ("ESG") narrative cementing itself within today's zeitgeist on both sides of the Atlantic. While the ESG effort has long been on the rise, more recent regulatory and legislative activity have underscored the breadth of the ESG lens—a lens that, in the wake of the global pandemic, is honing in on the pharmaceutical and life sciences industry. Indeed, society and regulators alike expect companies across the sector—regardless of size and stage of commercialization—to have these issues well in hand, and to have already taken positive steps to fully and meaningfully integrate ESG into their corporate structure, ideology, and supply chain. Efforts like the NHS ban and beyond demonstrate that across the industry, those who fail to meet expectations will face significant challenges and likely meet swift retribution, including from consumers and regulators.

In this article, we consider how life sciences intersects with the ESG discourse; where more may need to be done; and what positive action the industry has already taken. We conclude by identifying four actions that all life sciences companies should, at the very least, be considering.

How does life sciences intersect with the ESG discourse?

ESG philosophy captures the "key dimensions of wider sustainability; that is, how people, planet, prosperity and purpose come together to meet the needs of the present without compromising the needs of the future".[1] Fuelled by the ambitions of the Paris Climate Change Agreement and the global outcry for social justice, the ESG moniker has elevated its constituent issues beyond vague commitments of 'corporate social responsibility', to positions of fundamental corporate significance. ESG presents industry-agnostic issues that demand reaction across the economy, not least from the global life sciences community, already one of the most regulated and enforced sectors in the world.

Environment

Experts estimate that collective public-private investment of $100-$150 trillion globally through to 2050 will be required if we are to meet the objective of limiting global warming since pre-industrial levels to 1.5 degrees Celsius. That is the goal to which signatories of the Paris Climate Change Agreement committed themselves. The role of the life sciences sector in that global challenge might well be underestimated: analysis carried out in 2019 revealed that the top 15 pharmaceutical companies emitted 55% more greenhouse gases per million dollars of revenue than the automotive sector;[2] and it is believed that 4% of global greenhouse gas emissions come from the healthcare sector.[3] Moreover, supply-chain logistics, single-use equipment, medical waste more generally (including through packaging) and water-intensive pharmaceutical production are examples of the drivers of life sciences' carbon footprint. As the global pandemic posed increased concerns through factors such as the surge of disposables including personal protective equipment, many across the industry announced or continued to promote strategies to combat these concerns, in addition to long-standing efforts to support the global effort to reduce greenhouse gas emissions.

Social

Fundamentally, the "S" aligns with the central purpose of life sciences: promoting access to drugs, treatment, medical safety and medical information. Indeed, multinational pharmaceutical companies have a long history of promoting humanitarian efforts that cut straight to ESG's social component, but the effort must be both internal and external. This means that, as well as championing access to healthcare and medicine, life sciences companies must ensure that they are constantly striving to (amongst other things) protect and promote a diverse workforce, and maintaining an ESG-compliant supply chain.

Governance

Less nuanced from a life sciences perspective, the "G" seeks to ensure that companies have clear, accessible and appropriate systems, procedures and policies in place that: monitor support for the "E" and the "S"; eradicate fraud, bribery and corruption; and otherwise promote an operationally effective and diverse organisation. Not only is the "G" vital for a regulatory compliant, diverse and ethical company, but strong governance credentials develop sustainable corporate operations, which in turn help promote commercial success. The same type of governance infrastructure that has shown so well on the compliance front across the sector should also be in place for broader ESG purposes.

How will life sciences feel the ESG effect?

Investment

There is a vast and growing amount of global capital allocated through ESG-focused funds, which can be made available to life sciences companies (particularly emerging companies) that claim genuine ESG credentials and seek to better the world around them. Investors are increasingly focused on the real-world impact of their investments, and not simply the binary dilemma between risk and return.

Life sciences companies should equally consider where they can distribute their own capital reserves. The acquisition of smaller bio-techs provides opportunity to support emerging companies and their research and development. This can help to advance pharmaceutical development, encourage innovation, and, in turn, serve to accelerate the purchasing party's ESG credentials through the integration of ESG-conscious initiatives. Of course, any potential investment calls for careful and thorough due diligence efforts to ensure that acquisitions do not unintentionally increase ESG risk.

Supply chains

Life sciences is an industry that has historically sought to leverage low-cost territories to create a financially efficient supply chain. In some instances, these practices may not neatly fit within an effective ESG policy, and may require the rethinking of manufacturing processes, logistics, factory locations and the sourcing of labour so as to secure an agile and sustainable supply chain. Technology, including artificial intelligence, can be leveraged to efficiently retool or better align operations in lower-cost geographies. Relatedly in the context of supply-chain management and investment overseas, companies must be mindful of potential parent company liability for the acts of their subsidiaries whether at home or abroad.

Regulatory/legislative/executive action

As a burgeoning area of regulatory compliance, ESG agendas continue to evolve across the globe. In the EU, the Corporate Sustainability Reporting Directive is currently in draft,[4] and once enacted will require large companies to regularly report on their ESG-related activities. In comparison, both the SEC and FCA have introduced a swathe of sustainability disclosure requirements in the finance sector, but such interventions have been less pronounced in other industries. Further disclosure-related regulation seems inevitable.

Demonstrative of executive action, on 9 July 2021, President Biden signed an Executive Order on "*Promoting Competition in the American Economy*", principally aimed at the interests of American workers, businesses, and consumers. The President specifically identified the pharmaceutical and life sciences industries as a particular focus area, noting the heightened cost of prescription drugs and healthcare services said, in part, to be driven by the misuse of patent and other law to inhibit or delay competition.

Reputation and consumer pressure

Perhaps most critical, companies deemed to engage in non-ESG-compliant activities are likely to face the swift force of the market's invisible hand as capital and customers divert to competing brands. It is estimated that the market for ESG data services alone reached the US$1 billion mark by the end of 2021, and with such immediacy of data, consumers and investors alike are empowered to monitor and assess companies' ESG risk ratings.

ESG has the potential to generate business-critical reputational damage, which has previously been put into sharp focus through the experience of multinationals smeared across the press. Striking are the billions in fees, compensation payments and penalties that corporations could be liable for, but the enduring legacy of any company caught up in an ESG scandal will be a severe loss of trust.

What Now? Four Considerations for All Life Sciences Companies

Companies across the sector should take steps to assess their ESG status and develop a comprehensive approach tailored to their business strategy. This should include:

1. **Assess, Understand, and Strategize:** All companies should take the time to consider how their operations and strategies touch ESG "hot spots", including in particular: the critical points in the supply chain; governance and diversity footprint; and environmental impact. With this understanding, companies should develop a risk-based strategy, which aligns company-specific culture and values with key ESG initiatives. Consider how your status and strategy would be viewed by healthcare professionals, patients, investors, and enforcement authorities.

2. **Know Your Customers and Vendors:** To many in the industry, supplier due diligence and good governance are anything but new concepts. Yet all too often, these efforts are restricted to considerations of bribery and corruption, sanctions, and politically exposed

persons. Pause to consider current 'know your customer' and 'know your vendor' efforts; do they reflect the current panoply of risks—including ESG? Are existing efforts and results reviewed for ESG concerns and red flags? Consider providing enhanced controls, training and resources to those involved in vendor and customer review efforts.

3. **Increase Awareness and Enhance Structures:** For decades, evaluating a business strategy has had a clearly defined and well-understood rubric far removed from questions of human slavery, diversity, and environmental impact. Companies should take concrete action from the boardroom to the field to ensure colleagues understand the structures, risks, and red flags associated with ESG. Fundamentally, this starts with ensuring that ESG-centric procedures and policies are in place, that employees are adequately trained and that there is methodical oversight to ensure policies are implemented and followed.

4. **Watch Your Public Statements:** As issues relating to ESG have become increasingly popular focus areas for investment and cultural focus, more and more companies have—quite rightly—posited campaigns to focus employee and public attention on these issues. However, as highlighted by recent regulator attention, companies must carefully ensure their internal and public statements on these issues are accurate and not falling foul of disclosure obligations.

As underscored by these considerations, the key to success in the ESG arena is preparedness. The above efforts will position life sciences companies to build on their patient-focused values so as to thrive amid the increasing scrutiny of regulators and public opinion. Wherever a company currently finds itself in its ESG journey, the mandate from regulators on both sides of the Atlantic is clear: ESG is no longer a corporate social responsibility 'nice to have'; rather, it is a business imperative. Life sciences companies must understand their exposure and meaningfully integrate strategic solutions, or face competitive retribution and regulatory scrutiny.

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[1] U.K. FCA's paper "*Strategy for positive sustainable change*", November 2021.

[2] Lotfi Belkhir, Ahmed Elmeligi, "*Carbon footprint of the global pharmaceutical industry and relative impact of its major players*", Journal of Cleaner Production, vol 214, 20 March 2019, pages 185-194.

[3] AstraZeneca Sustainability report 2021: https://www.astrazeneca.com/content/dam/az/Sustainability/2022/pdf/Sustainability_Report_2021.pdf.

[4] Read our colleagues' article here.