Sustainability and ESG: Potential drivers of reputational risk in the food and drink sector

Food and Drink Practice
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**Introduction**

In the last decade, the food and drink sector has evolved drastically to satisfy ever-changing consumer preferences and demands. Through advanced packaging techniques and technologies, as well as increased efficiency in the production process, consumers now have access to an enormous and diverse range of products. As with many other industries, the food and drink sector has unintentionally contributed to the depletion of natural resources, causing imbalance to ecosystems and biodiversity loss; however, this has increased in recent years due to the rapid advancements in the sector.

Businesses in all sectors are increasingly facing regulatory and stakeholder scrutiny and pressure to address and account for existing and emerging environmental issues in their operations and reports. Food and drink businesses are no different. In response to the shifting attitudes and perceptions, the sector is increasingly incorporating sustainability practices and environmental considerations into their corporate objectives and strategies, to reverse some of the damage inflicted and contribute to a future of conscious development and growth.

When it comes to making positive changes, businesses must consider the risks associated with their environmental social and governance (ESG) strategies. In a world driven by instant connectivity and direct accessibility to boundless information, organisations are at risk of reputational damage predominantly triggered by their stakeholders’ opinions, around sustainability decisions and actions. Given the increased transparency in sustainability reporting, ability to compare and evaluate efforts across competitors, as well as the perceptions regarding adequate sustainability practices, the reputation of food and drink businesses is particularly vulnerable. Therefore, it is crucial that businesses employ risk management strategies in order to manage and mitigate against these exposures.

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**The importance of sustainability and Environmental, Social, Governance (ESG)**

In light of the increased environmental awareness and concerns, the food and drink sector has gained significant attention, as it is considered as one of the major contributors to sustainability issues. From “farm to fork”, the sector seems to be “responsible for 30% of global energy consumption, contributing to 60% biodiversity loss, 60% of land conversion, 70% of nutrient overloading, and 30% of climate change, as well as to more than 50% of water eutrophication – a process where lakes and rivers receive excess nutrients and begin to collapse”. Despite the volume of resources utilised and the damage inflicted throughout the process, one third of the grown, procured, and processed food is wasted. The mentioned consequences are limited in comparison to the vast environmental and social implications also associated with the sector’s operations and processes.

While the sector has a significant impact on the environment, its operations are heavily reliant on surrounding environmental conditions. Therefore, the witnessed changes in corporate priorities and the traditional operational models are aimed at both leaving a positive impact, as well as ensuring the continuity and survival of businesses in the long run.

Considering the multi-dimensional implications of sustainability, in 2015, the UN introduced the Sustainable Development Goals (SDGs), a set of 17 goals aimed at “ending poverty, protecting the planet, and ensuring prosperity for all”. To enable countries and corporations to reach the specified goals, a series of targets – 169 in total – were allocated to every goal. While the UN’s SDGs are inclusive and applicable to all, Environmental, Social, Governance (ESG) criteria have received significant attention in recent years, especially in the wake of Covid-19. According to a research by DWF, a leading law firm, the number of ESG mentions had jumped by 148% in the most recent annual reports for UK countries, compared with the previous year, proving the increasing interest in and importance of ESG considerations.4

ESG is regarded as a major factor in measuring the impact of corporate sustainability, whereby every component evaluates a set of external consequences arising from the organisation’s operations and decisions. The (E) component focuses on the business’s environmental consciousness, including its carbon footprint, waste management processes, water and land usage, as well as the impact of the involved supply chain. As for the (S) component, the focus is on how an entity manages its social relationships, i.e. its relationship with stakeholders, including its employees, suppliers, clients and communities in which it operates in. Lastly, the (G) element is concerned with the adequacy of implemented policies, principles and rules concerning both the organisation and its stakeholders.
ESG impact on business performance

The impact of an organisation’s ESG decisions is both internal and external; ESG risks are shown to have a direct impact on corporate performance, as well as the surrounding environment.

In 2021, DWF surveyed 480 senior executives across eight sectors from around the world. The survey revealed that 59% of the sample reported loss of work because of ESG issues within the business, 40% found it difficult to recruit talent because of an external perception that their ESG policies are weak, and 46% said that stakeholders, such as regulators, employees, customer or suppliers, have increased pressure on ESG matters.5

In addition to the mentioned findings, access to capital is a growing concern for businesses, as investors increasingly rely on ESG scores in determining whether to pursue an investment or not. Companies are receiving pressure from investors during their annual meetings, as the requirements to disclose ESG related information, such as their carbon emissions or inclusion efforts, are becoming more stringent. Such restricted access is also seen in the insurance sector, as insurers require more information regarding a business’s ESG strategies upon assessing the risk and setting the premiums.

However, a significant obstacle to implementing appropriate ESG metrics is that the data used to measure and report on is not unified. Even where data is on hand, the metrics available vary across, and even within, regions. DWF’s survey emphasised the associated complexity with ESG reporting, whereby 63% said that competing geographical standards present a challenge and 54% found that the lack of a universal benchmarking service as a problem. Moreover, 70% of respondents revealed that they are yet to choose a disclosure framework to work with.

With the growing regulatory and stakeholder demand for adequate sustainability and ESG reporting, the available frameworks are vast and different. The available frameworks are developed by NGOs, business groups and other specialist bodies; therefore, they differ in the areas of focus and the metrics proposed.

Some of the existing frameworks include the following:

- The Financial Stability Board’s ‘Task Force on Climate-related Financial Disclosures’ (TCFD)
- The Task Force on Nature-related Financial Disclosures (TNFD), which considers loss of biodiversity and the degradation of ecosystems
- Global Reporting Initiative (GRI), which has sought to improve sustainability reporting to ascertain a company’s impact on the economy, environment, and people
- International Sustainability Standards Board, which seeks to create a universal standard for environmental impact
- Climate Disclosure Standards Board (CDSB) framework
- CDP framework
- Sustainability Accounting Standards Board (SASB) framework

These entities are designed to make the impact of ESG more transparent, and in turn, improve the ability to assess risk at companies when it comes to ESG. Although these frameworks enable businesses to improve their reporting abilities, enhancing both the transparency and clarity of the shared data, it also causes confusion and hesitation, as there is no uniform language of communication. Businesses are expected to carefully select the frameworks that address the topics and metrics that stakeholders are concerned with and interested in. Inadequate reporting, from a stakeholder’s perspective, could result in various negative outcomes, such as restricted access to capital, reduced client trust and loyalty, loss of talent, reputational damage etc.

Value of corporate reputation

In a public-facing sector, such as the food and drink sector, the publicly reported experiences and reviews play a significant role in influencing consumer behaviour and loyalty towards a brand.

A strong positive reputation results in a stronger competitive advantage, better performance on the stock market and enhanced financial performance. When the business’s character is not in line with the shifting expectations, the reputation-reality gap widens, and the risks increase. The reputation-reality gap poses a substantial risk, as failing to live up to the predominant perceptions will threaten the business’s performance and desirability to the main stakeholders. Reputational risks could result in devastating outcomes for the business, including “loss of income, reduced customer base, and an inability to retain or attract talent”.6

Corporate reputation can be categorised into two types7 – the perception of internal capabilities and the perception of character. In the sector, the capability reputation relates to whether the quality and value of the offered products meet consumer perceptions. A mismatch between consumer expectations and reality is likely to cause significant reputational damage. For example, if a product is perceived to be sustainable in terms of its “minimal environmental impact”, but is otherwise, the brand is likely to experience a loss in its customers’ loyalty and trust, as well as receive significant regulatory scrutiny, which will negatively impact its reputation.

Character reputation relates to the organisation’s decisions and accomplishments, i.e. are they doing what they said they would do? For example, if a business publishes a statement, proposing a set of operational changes that aim to enhance its sustainability practices, failing to implement those changes challenges the business’s integrity and credibility across its stakeholders, which will result in reputational damage.

In brief, there are three determinants to reputational risk exposure:8

1. Does the organisation’s reputation exceed its true character?
2. How much did external beliefs and expectations change?
3. What is the quality of internal coordination?
ESG and reputational risk

Failing to fulfil the reported ESG commitments may significantly impact brand reputation. Meeting the business’s ESG objectives results in several short-term achievements, such as inclusion in ESG-focused investment funds, positive media coverage and customer approval. However, since these objectives are often highly publicised, over-promising may lead to disastrous reputational damages, especially if a strong reputational risk management programme is not adapted.

A firm’s sustainability reputation is very important in consumer purchasing decisions, especially for sustainably minded consumers. A study has shown that 79% of consumers are concerned about an organisation’s sustainable manufacturing practices, 64% are concerned with transparency, while 88% believe that brands should help them become more environmentally friendly and ethical in their daily lives. Businesses are seen as enablers of achieving sustainability, as 43% believe that brands currently make it more difficult to be sustainable. Although businesses are increasingly involved in developing and implementing green initiatives, the fear of being accused of greenwashing or being perceived as disingenuous often discourages businesses from heavily promoting these initiatives. An added difficulty in consumer perceptions is the perceptual gap between the business’s actual and perceived sustainability efforts.

Furthermore, failing to detect signs of changing stakeholder beliefs and expectations, or denying their validity, is management oversight, which has significant repercussions and consequences on the overall business. The attitudes of stakeholders tend to vary depending on region and country, due to the varying exposures, regulations, and cultures. Hence, another source of reputational risk is poor coordination of decisions made by different business units and functions. If one group creates expectations that another group fails to meet, the company’s reputation can suffer.

Another important factor that is likely to impact brand reputation is the speed of sustainable change – how fast are you adapting? Being a first mover in the realm of sustainability may be particularly beneficial to the organisation’s financial and sustainability reputation. The behaviour of leading companies within the sector plays a significant role in forming and changing stakeholder expectations. Therefore, a change in competitor sustainability policies and priorities may cause a rapid shift in consumer expectations, negatively impacting the demand for businesses adhering to the old standards.

The timing of unrelated decisions can also put a company’s reputation at risk, especially if it negatively impacts stakeholder perceptions and judgment. Businesses are expected to have social and environmental awareness, bearing in mind any external issues that concern their main stakeholders, as well as could impact their performance. For example, during social movements, any corporate decisions, actions or statements that either contradict or not acknowledge the preached cause is likely to cause significant reputational damage, as they are perceived as insensitive and disconnected from reality – driven by profit rather than the surrounding social values.

Lastly, poor internal coordination inhibits a company’s ability to identify changing beliefs and expectations. In a well-run organisation, individual functional groups not only have direct communication with various stakeholders but are also actively trying to manage their expectations. Therefore, if no one is overseeing the coordination process amongst the varying functions, the likelihood of disparity between the ongoing activities, the implemented decisions and the actual stakeholder expectations will increase.

The role of social media

Considering the speed by which information is shared, the role of social media in sharing that information, and the importance given to the opinions and thoughts of public figures and social media influencers, especially amongst Millennials and Generation Z, protecting corporate reputation has become difficult. Consumers are increasingly using social media platforms to not only form their perceptions regarding certain products, but also share their experiences and evaluate the food they consume. Publicly shared experiences could either enhance or destroy the reputation of even the largest, most prominent businesses within any sector, with just a click of a button.

There are various examples of celebrities and influencers causing a drastic shift in stakeholder perceptions and behaviours, as well as impacting brand performance, due to their shared opinions and attitudes about a product. One of the recent examples is Cristiano Ronaldo’s reaction to the placement of two Coca-Cola bottles in front of him during a press conference. The famous footballer publicly replaced the bottles with water instead. This simple act significantly impacted Coca-Cola’s market share, causing a $4bn drop in its market value and a 1.6% decrease in its share price.
D&O exposures

Companies that have been caught in the crosshairs of advocacy groups, employees, and shareholders have been subject to litigation and campaigns focused on ousting executives, or else targeting director remuneration. Businesses also face regulatory interventions and investigations into supply chains, environmental impact, and disclosures related to social and climate issues.

Increased attention on ESG has meant insurers are taking a more guarded approach to D&O policies, seeking more information on a company’s current and future strategies in terms of environment, social, and governance issues.

Questions D&O insurers may ask businesses

Do you have a carbon neutral strategy and how is it communicated?

Many companies have already started adapting to the “green economy” with initiatives that target improved sustainability and clear targets for carbon emission reductions. Being able to show a clear intent to achieve carbon reduction targets in a clear time frame will demonstrate a strong environmental initiative. The way companies promote these initiatives will also assist in making them more attractive. Transparency regarding environmental disclosures is essential, with the minimum being an inclusion of sustainability and climate strategies in a company’s annual report. Beyond this, companies with dedicated sustainability reports, clear, forward-looking strategies to tackle environmental issues within it, and other shareholder disclosure material will all help in demonstrating good environmental and social management.

Is the board and management responsible for ESG issues?

The ESG-driven impact on D&O insurance is largely down to reputational risk, tied to concerns over negative events a company may face. Consequently, businesses should demonstrate an actively engaged board with clear oversight of a business’ ESG strategy, pre-emptively addressing major supply chain, labour, or environmental issues. Having a dedicated ESG officer as part of a management team is a common move to address this. The position demonstrates a company’s willingness to improve ESG standards within itself and provides a clear point of contact for ESG related strategy progression, along with providing a board a clear liaison for ESG activity. Another route businesses can consider is basing remuneration and other compensation on ESG targets.

Are there clear commitments to diversity and human rights?

These days, insurers are looking beyond environmental concerns when it comes to assessing D&O coverage. Racial and gender issues, as well as labour practices are equally important to insurers as environmental concerns. It is therefore essential that companies take these factors into account when communicating with stakeholders and the wider market. Early transparency and communication is crucial when it comes to disclosing the possible implications a company’s finances may face regarding fines, lawsuits, or investigations into facets of the business which tap into social standards.

Insurers will want to know how often reviews of suppliers and working conditions of domestic and international factories are, along with clarity in the company’s ethical stance on modern slavery. Diversity initiatives focusing on representation of women and people of colour on the board and in management will also be seen as green flags to insurers, while wider social initiatives focused on community projects assist in tapping into a company’s social prowess.

How do you monitor supply chains for good ESG practice?

Businesses that use domestic or foreign supply chains will also benefit from monitoring and auditing these facilities to ensure ESG will be cost-beneficial to businesses in the long-term. Essentially, companies want to ensure that the supply chains they partner with do not possess any major red flags, be that regarding climate or social components. Carrying out annual in-person assessments of factories should be a minimum for companies with partnering supply chains. Visits to sites will allow companies to gauge the working conditions of supply chains, while businesses should also investigate the working culture of supply chains and the regions they operate in to ensure workers are not being subjected to human rights violations. Companies should also consider the environmental impact supply chains have. Ideally, companies will have already sought to optimise the supply journey for minimal carbon footprint impact, with a minimum move being an audit of suppliers’ climate impact, and targets for them both to move towards minimising this.

Having an engaged relationship with supply chains will keep companies in good stead when it comes time to renew D&O policies. Companies taking a proactive approach to their partners will help to engender confidence in insurers.
Reputational risk management

Due to the acceleration and amplification of bad news through the media, an urgent and coordinated response is critical, as reputational damage is inflicted faster and deeper than ever before. Businesses must acknowledge that meeting stakeholder expectations is not enough to safeguard corporate reputation. Inaccurate reporting by the media or unfair attacks from special interest groups may significantly damage a business’s reputation, consequently hindering stakeholder perceptions. Hence, reputational risk management is an important organisational function.

Unlike other loss events and perils, reputational harm is triggered by unpredictable incidents that are hard to quantify or characterise. Therefore, a proactive risk management approach is required, as it safeguards businesses across their reputation life-cycle. As discussed in KPMG’s “Safeguarding Reputation: Are you prepared to protect your organisation?” report, the actions and decisions of an organisation are the main determinants of survival if an adverse event was to materialise. To ensure reputational resiliency and minimise the impact of reputational harm, the following management activities are recommended.

Reputation life-cycle

1. Business as usual
2. Adverse event
3. Media/social media reaction
4. Change in stakeholder perception
5. Financial impact

Prevent adverse events and enhance reputation
- Monitor changing stakeholder sentiment
- Build resilience
- Mind your communication
- Enhance your brand

Try to limit the damage
- Fast internal communication
- Setting up a rapid response to the media
- Pinpoint and contain the problem

Try to limit the damage
- Rapid communication with the media (and on social media)
- Take ownership
- Counter inaccuracies
- Set the tone

Manage stakeholders
- Respond to negative sentiment (including micro targeting)
- Listen and take on board
- Cover all bases

Re-build reputation
- Strengthen corporate brand
- Enhance internal culture
- Analyse and learn from the event

Reputation management activities

Source: KPMG & Lloyd’s (2020). Safeguarding reputation: Are you prepared to protect your reputation?
In addition to the activities found in the diagram the following overarching actions are proposed as part of the proactive risk management approach:

1. **Proactive signal sensing**

Considering the rapidly changing consumer perceptions of sustainability, as well as the changing regulatory landscape and ESG reporting standards, failure to consider consumer perceptions can result in significant reputational damage. Failure to adapt to the changing legal landscape and reporting requirements can have the same effect. Hence, it is essential for businesses to practice proactive horizon scanning, to detect any changing in order to proactively control a situation before it exacerbates.

2. **Building resilience**

Reputational risk is considered as the “risk of risks”, as it is often triggered and magnified by the lack of resiliency and harmony across the whole organisation, including the varying functions and divisions. Improving reporting and communication, both internally and externally, narrows the reputation-reality gaps, which drives value creation for shareholders.

3. **Creating a culture of responsibility**

The responsibility of preventing and mitigating the impact of reputational risk lies within the whole organisation. As the risk is not confined to the actions and decisions of one division or function, it could result from any vulnerabilities existing across the business. Hence, emphasising the accountability of all employees and staff, as well as allocating clear and defined responsibilities in building resiliency across the various functional areas could significantly reduce the risk of reputational damage.

4. **Training at all levels**

A single word or action that is perceived negatively by stakeholders is enough to cause reputational damage. Therefore, it is critical for businesses to regularly train all employees to better manage and deal with situations that could give rise to reputational harm, especially instances of negative media exposures. Administering scenario-based training will give employees insight on potential adverse events, the pace of event progression, the impact of such events, and most importantly, the impact of their actions on either magnifying or reducing the consequent reputational damage.

5. **Understanding the impact of every stakeholder group on the organisation’s success and operations**

Reputational damage will impact a business in different ways. For example, the perceptions of consumers will impact their demand for certain products, which could increase or decrease revenue. The perceptions of investors will impact the organisation’s access to capital and funding, which could either facilitate or inhibit its growth. The pertaining perceptions could also impact employee behaviour, whereby it could either enhance or reduce employee loyalty and retention, consequently effecting the efficiency of production and the quality of products. Considering the impact of stakeholder perceptions will enable businesses to adequately prepare for and respond to adverse events that could result in reputational damage.

By managing activities and actions, food and drink businesses will not only safeguard their balance sheets against rapid and sudden losses but will also protect and strengthen their relationships with the varying stakeholders as they further understand their needs, perceptions, and expectations.

Furthermore, an equally important element of risk management is risk transfer. Considering the impact of reputational damage on a business’s financial performance, growth, and survival, finding a comprehensive insurance cover is critical to adequately protect a business against all possible scenarios that could result in reputational harm.

### Reputational risk insurance

Reputational risk insurance is relatively new in comparison to the traditional lines of insurance and is often written on a “named-perils” basis. However, identifying all perils that could give rise to reputational damage is often difficult, if not impossible.

To address the limitations of the existing reputational risk insurance products, Lockton’s Crisis Management team worked closely with Beazley, a leading insurer in reputational risk, in developing a new solution to address the entire life-cycle of a crisis. Beazley provides businesses with crisis management expertise to help manage and mitigate their reputational risk exposures. If a crisis were to occur, substantial coverage for loss of profits is provided, including a sublimit for advice on reputation remediation.

Beazley’s solution is triggered by reputational harm, which is defined as “any loss or damage to the reputation, standing or status of the insured organisation, or to the respect, goodwill, or favour rendered to the insured organisation”. The product adapts an “all-risks” approach, suitable for those with a strong, identifiable, and public-facing brand, and are operating in competitive environments.

Another innovative feature to this product is the addition of Polecat’s AI-infused intelligence platform, which enables businesses to proactively monitor and manage reputational risk. Polecat is a leader in ESG and emerging risk intelligence, delivering industry, competitor, and stakeholder insight, which organisations need to make better strategic decisions. By distilling massive amounts of live, open-source data into actionable reputation insights, Polecat helps businesses:

- Put corporate reputation at the heart of strategic decision-making processes
- Understand how the brand is viewed across ESG, Reputation and Risk lenses, to uncover opportunities and perils that define current business performance
- Pinpoint the key external stakeholders (e.g NGOs, Activist Investors etc.) involved in conversations around insured perils and to gain perception of the corporate brand across these groups
- Gain foresight around issues happening on the horizon, to better plan crisis responses
- Improve the speed and efficiency on delivery of insight around changing trends
Considerations

As the environmental and social concerns rise, the concepts of sustainability and ESG will become deeply embedded within the decisions and actions of every business, regardless of the size, sector or location. Thoroughly understanding and addressing the internal and external implications is critical for ensuring the continuity and success of a brand, as corporate reputation is also at risk. The following considerations should be acknowledged, to continuously preserve and enhance corporate reputation in light of the sustainability evolution and shifting stakeholder attitudes and expectations.

Your brand reputation is not only dependent on your actions and decisions

The involved supply chain plays an important role in forming an organisation’s brand reputation. The activities and statements of suppliers are equally significant in impacting stakeholder perceptions and attitudes regarding a specific brand. Therefore, it is critical for businesses to ensure that they share the same values and objectives with their suppliers, as their actions will subsequently reflect on the overall brand image.

Do not underestimate the power of social media

Although social media platforms could pose significant reputational risks, such platforms serve as an advantage for businesses, as it is a channel for communicating with stakeholders, to further understand their unfiltered thoughts and opinions regarding a brand. Such platforms can also provide significant volumes of data, which enables organisations to improve and evolve their brands in line with the changing preferences and perceptions. Dedicated responsibilities should be allocated to consistently monitor and examine the social media landscape.

Internal coordination and communication across the varying functions ensures harmony

It also reduces potential disparity between the company’s decisions and actions.

Everyone is accountable for protecting and improving corporate reputation

All employees, from associates to executives, should be systematically trained on all issues relating to corporate reputation, as well as the shared values and priorities.

Anticipate, prepare, respond

Considering the complex nature of reputational risks, and the limitless sources that could give rise to reputational harm, businesses should anticipate and prepare for the worst-case scenarios, as well as consistently improve and update their crisis response plans to reflect the evolving risk landscape.

Learn from those that have suffered

Anticipating all reputational harm events is impossible; therefore, it is crucial for businesses to actively identify and examine any ongoing adverse events amongst their peers and competitors, to appropriately prepare for any similar scenarios that they might endure. It is also important to learn from one’s past. Post an adverse event, businesses should analyse the gaps in their response strategies and identify any weaknesses that should be addressed and improved.

Moreover, in addition to the internal management considerations, the risk transfer element should also be addressed. In preparation for the underwriting process, the following questions should be considered, as the outcomes may impact the acquired insurance terms and conditions, as well as the premium allocated.

- Does the business have public image exposure?
- In terms of crisis planning, how will the business respond from an operational perspective? Are the adapted plans up to date and in line with the changing contextual conditions and digital landscape?
- Does the business have a detailed response methodology that systematically identifies and addresses potential reputational risk issues and scenarios?
- What are the adapted employee training procedures? Are frontline employees adequately trained to deal with negative media coverages?
- How quick can a business report a potential reputational damage incident? Is the process monitored?
- What is the business’s loss history? How did the crisis response plans change consequent a loss event?
- How are the responsibilities assigned for handling social media coverage and the public space? What are the structures in place?
- How are suppliers evaluated and managed? How will the actions and decisions of suppliers impact the organisation’s reputation?
- Are the adapted reputational risk management frameworks reactive or proactive?

As the environmental and social concerns rise, the concepts of sustainability and ESG will become deeply embedded within the decisions and actions of every business, regardless of the size, sector or location.
References


7. KPMG & Lloyd’s (2020). Safeguarding reputation: Are you prepared to protect your reputation?


Get in touch

To learn more about any of the information above, or to find out how Lockton can help you mitigate these risks, please do not hesitate to get in touch with us.

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Independence changes everything