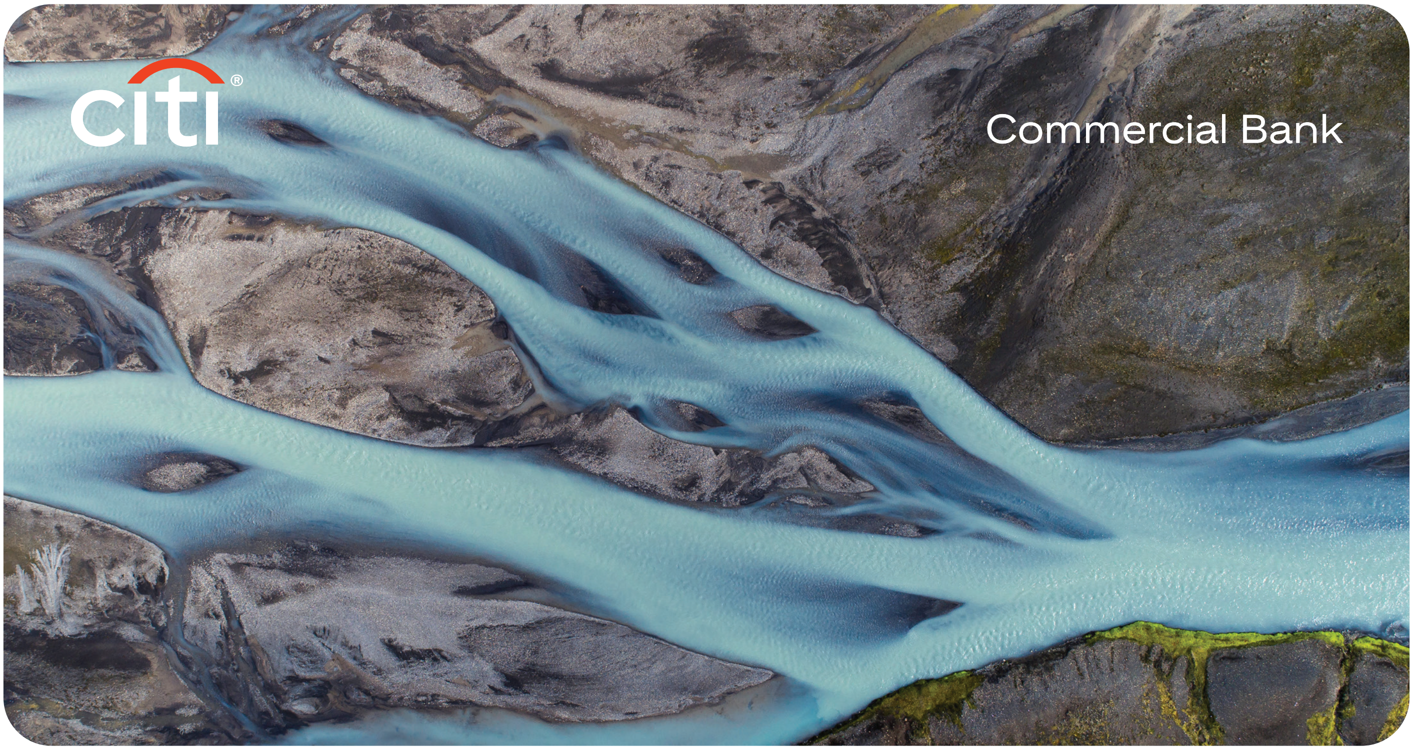

Starting early on ESG and sustainability strategies can support growth long-term for privately held companies

The risks and opportunities surrounding sustainability and environmental, social and governance matters, or "ESG," are increasingly becoming part of every company's journey. Regulation, customer preferences, societal shifts, and net zero commitments by many governments, corporations, and financial institutions, are changing the business landscape for many companies, including privately held companies.

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Currently, we are seeing more and more companies establish net zero commitments and taking steps to promote diversity and inclusivity across their workforce. In turn, this is incentivizing privately held companies to integrate ESG and sustainability into decision making earlier and earlier in their growth trajectory.

In this brief note, we highlight the importance of integrating ESG issues into a company's strategy and discuss the opportunities that can arise from having a coherent ESG strategy as part of a company's growth journey.

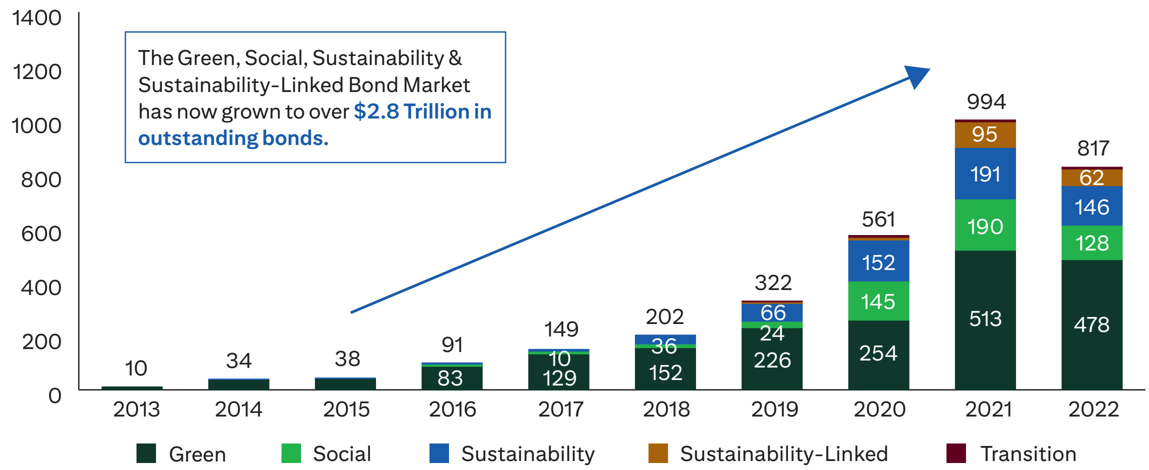
The Rise of ESG

What started as a trend in ESG and sustainability-linked capital markets is now expanding into other financial services, allowing companies to incorporate ESG considerations throughout their treasury management, capital raising, trade finance and deposits.

There has been a sharp increase in capital being raised with sustainable financial instruments. There has been an extraordinary growth in the issuance of green bonds, social, sustainability bonds and sustainability-linked bonds as shown in the diagram on page 2.

Sustainability-linked loans and revolving credit facilities, where interest rates can change depending on achievements in sustainability targets, are also becoming well-established, and Sustainable Supply Chain Finance is a growing opportunity for companies.

We are also seeing a growing number of companies making net zero commitments and developing transition strategies, which will have impacts across their value chains. Some companies also find it useful to join the Science Based Targets initiative, which is



Source: Citi, Dealogic.

an organization that works with companies to define and promote best practice in emission reductions and net zero targets in line with climate science. As of September 2023, over 6000 companies have either committed to net zero or set science-based targets to reduce their emissions through this initiative*.

Many financial institutions, including Citi, have also committed to net zero which will lead to reductions in financed emissions across their lending portfolios over time. This means lenders will seek more detailed ESG and climate disclosures about emissions and business strategies over time from their borrowing clients and their clients' value chain.

New regulations can also create increased demands for companies to calculate and disclose ESG metrics. Much regulation has impacted primarily larger or publicly listed companies. For example, the Corporate Sustainable Reporting Directive (CSRD) in the EU will make businesses more accountable by obliging them to disclose both how sustainability issues affect their performance and their own impacts on people and planet. This directive applies to European companies with any two of the following: over 250 employees, 40 million Euros in turnover and a balance sheet of over 20 million Euros. The directive may also apply to certain parent companies of non-EU groups that include a European subsidiary or branch or that are listed in the EU. Another example is the proposed rule by the U.S. Securities and Exchange Committee (SEC) called 'The Enhancement and Standardization of Climate Related Disclosures for Investors'. While a final rule is expected to be announced later in 2023, the proposal currently has a clause that would ask firms to make climate-related disclosures at the time of an initial public offering. These regulations can also affect private companies indirectly who are embedded in the ecosystem as suppliers to public listed companies that will need to provide climate-related disclosures.

It is not only the 'E' in ESG that is growing, we are also seeing the dramatic 'Rise of S', which captures everything from gender diversity to poverty and hunger, with focus not only on a company's own operations, but also throughout its supply chains. This is a huge opportunity for mid-sized companies to show how their activities impact not only the planet but also people.

The ESG landscape mid-sized companies are navigating is becoming increasingly complex, with evolving disclosure frameworks in different jurisdictions, as well as escalating expectations from stakeholders.

*Source: Science based target initiative.

The Opportunities of ESG

At Citi, helping our clients navigate the challenges and embrace the opportunities of our rapidly changing world is fundamental to our mission of enabling growth and economic progress. This work is central to how we help our clients fortify themselves for the future.

Opportunities that can arise from incorporating ESG into a company's business strategy include:

- **Improved access to capital** – Simply by assessing ESG risks and making improvements – such as becoming more resource and water-efficient and using less packaging – companies may be able to lower their cost base and develop more resilient business models.

  In addition, a well-conceived and communicated ESG strategy that improves strategic opportunities and reduces risk, can help make a company more attractive to ESG-focused investors thus potentially both improving access to capital and reducing the cost of that capital.

- **Increased consumer engagement** – The influence of consumers is growing, as they consider what to buy, why they buy it, and where they purchase their goods. Consumers are increasingly demanding to know and understand what ingredients are going into their food products as well as where their products are sourced from (2). Understanding how important consumers view ESG is essential for B2C companies.

- **Growth opportunities** – A business which commits to become net zero usually will need to ensure that its supply chain and distribution network are also heading toward net zero. In essence, this means companies committed to net zero will often either work with their current suppliers to help them reduce their emissions (with potentially positive pricing/volume/trade finance terms to do so), or at the other extreme, those that will work with them (3). A private company that supplies goods and services to these large companies will ultimately need to calculate and disclose their emissions and other ESG issues that are material, if they want to maintain these clients. Incorporating ESG issues early into business strategies also has an added advantage of potentially attracting new clients to their business as these clients look for sustainable suppliers.

- **Attracting and retaining talent** – Having a clear purpose, above and beyond maximizing profits, is increasingly an expectation of employees, especially millennials and Gen Z. Embracing ESG can be an important way to bring a significant sense of purpose to employees' lives, helping to ensure companies can hire the best talent and retain them.
  ESG is expanding in its complexity, and whilst measuring and disclosing ESG issues might seem daunting at first, it can make business sense to do so. It should be seen as a fundamental part of running a successful business where returns are sustainable in the long-term.

Guidance

For companies, ESG is a process and a journey which can entail longer-term strategic targets, shorter-term milestones (and reporting on the same), on which they can take all stakeholders, from the providers of capital to customers, consumers, suppliers, and employees.

Companies don't have to do this alone.

Citi Commercial Bank has the practical experience of helping clients implement many of the changes including how to embed ESG into an organization's operational, financing and treasury strategies.

In Conclusion

It can be advantageous for privately held companies, especially those with global operations or ambitions, to integrate ESG into their business decision making and start early for several reasons. Companies can:

I. Position themselves for new regulations and requirements as they come

II. Benefit from the weight of capital now linked to ESG strategies

III. Adapt to changing consumer preferences to stay attractive to customers and competitive to peers, both public and private

IV. Improve business resilience

V. Attract new clients that are looking for sustainable suppliers

If privately held companies put in the work and embrace sustainability and ESG into their business strategy, it can help them to build a business with premium returns which are sustainable for the long term, with strong corporate purpose, and a demonstrably positive effect on the environment around us, and on society as a whole.

For more information about how Citi Commercial Bank can assist you and your team, please Contact Us.

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