

ESG Reporting Uptake in S&P/NZX 50 Index and Investor Perspective 2019



“Behaviour follows capital, shift the criteria to access capital and you will shift behaviour.”

– Julia Jones, NZX

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Foreword

Economic growth is important. As businesses and as a country we must continue to pursue it and measure it.

However it does not in itself guarantee the improvement in the wellbeing of our people, our communities or environment. Our first Wellbeing Budget in May helped underscore our approach.

New Zealand has solid rates of GDP growth relative to our peers but we must ensure we develop the quality of that economic activity. The Budget focused on priorities to improve well-being across our New Zealand communities and the environment - while supporting economic growth.

We must also make the most of new opportunities, which will grow exports and lift New Zealand's productivity. The world is in the midst of a technological revolution. Mobile positioning systems, sensors, robotics, big data, the internet of things and artificial intelligence are disrupting many occupations and business models. This technology will also help us achieve better environmental and social outcomes.

Businesses and Government must work together and help ensure economic growth contributes to social and environmental outcomes.

Globally we are faced with significant environmental, social and economic challenges, be they climate change, modern day slavery, trade tensions, or the slowing of large economies such as the United States and China.

Speaking in my role as Minister for the Environment, some of you may have heard me say before that I believe the economy is a wholly owned subsidiary of the environment not the other way around. This is especially so in New Zealand where our two largest sectors - tourism and primary production - clearly rely upon our natural capital. I made that point strongly, recently, when I launched our plan to stop the degradation of our waterways and restore them to good health over a generation.

Just as we measure the financial performance of a business we must also measure the environmental and social impact that comes from achieving financial performance.

Environment, Social Governance funds globally have about US\$31 trillion invested, demonstrating that a new wave of investors are looking for returns beyond financial reporting.

These ESG tools are used by the wholesale investment community both locally and internationally to access the value beyond return on a capital movement. Now global rating agency Standard and Poor's has acquired Truecost (which is a case study in this report) ensuring that the ratings placed upon organisations have a holistic focus.

I welcome NZX and Wright Communications' part in leading a discussion about the value of ESG in strengthening the place of responsible investing in New Zealand.

I would encourage all business to look beyond their strictly financial reporting when measuring their success and fully integrate environment and social wellbeing as well as governance capability into their strategic plans.



Hon. David Parker
Minister for the Environment,
and Trade and Export Growth

Introduction



Mark Peterson
Chief Executive Officer
NZX Ltd

A vital role for any stock exchange is to ensure capital can be invested with confidence into companies that provide opportunities for sustainable growth.

Today, investor confidence is increasingly driven by alignment with personal values and non-financial considerations. And, the ability of businesses to prosper over the long-term is materially reliant on a broader range of factors such as their stewardship of natural resources, looking after the wellbeing of their people and how they respond to customers' needs - matched with a high level of transparency and best-practice governance.

At NZX, we believe our success as an exchange operator and frontline regulator is defined by our ability to run an efficient marketplace, and by our commitment to ensure high standards of corporate governance, and social and environmental stewardship.

This is an important consideration for investors, and people in retirement savings schemes like KiwiSaver - who are wanting a deeper understanding about the business operations and the behaviours of companies.

Around the world, and here in New Zealand, we see opportunities opening up for businesses that are responding with quality Environmental, Social and Governance (ESG) reporting and positively addressing "what matters most" to investors.

As a listed company in our own right, NZX is open to analysis by international agencies which monitor exchanges from an ESG point of view. We welcome this scrutiny, and see it as a priority to consistently assess, manage and report to our shareholders and other stakeholders on material risks and potential we see for our business.

We also actively encourage and support listed issuers to report on environmental and social impacts, initiatives and risks via the NZX Corporate Governance Code. In 2016, the Sustainable Stock Exchanges initiative (SSE) invited NZX to be a partner exchange and make a voluntary public commitment to encourage our issuers to promote ESG disclosures.

In releasing this report, we hope to promote greater awareness of the value of ESG reporting and showcase examples of how businesses are responding to this opportunity.



Nikki Wright
Managing Director
Wright Communications

Sustainability reporting in New Zealand is becoming the norm, with increasingly high quality non-financial information published alongside an organisation's strategy and financial results.

There is no doubt ESG reporting ensures more purposeful communication about an organisation's economic, environmental and social impacts, as well as its performance.

We produce Sustainability Reports for a range of organisations and it's great to see more companies using gold standard reporting frameworks such as the Global Reporting Initiative (GRI) and/or Integrated Reporting <IR> to improve the quality and completeness of report content.

However, we strongly believe that New Zealand companies are lagging well behind their peers in Europe, North America and Australia when it comes to acknowledging and reporting on their exposure to environmental and social risks. A few are doing a great job in disclosing their approach to climate change, for example, but most are either sticking to the basic reporting metrics of carbon emissions or ignoring carbon and waste altogether.

As well as NZX-listed companies now being required to report on non-financial information, there is increasing recognition across all organisations about the value of sustainability reporting. It helps establish a reputation as a responsible business and contributes to brand positioning.

Wright Communications is proud to help organisations ensure their sustainability reporting is relevant and meaningful.





The use of Environmental, Social and Governance disclosure is becoming more important in relation to investment decisions alongside other financial and strategic information.

Through an ESG report, issuers can show investors that they are equipped for the long term and are ready to respond to risks and take advantages of opportunities.

An ESG report is also particularly useful for communicating an organisation's environmental and social impact and management approach to a wide range of stakeholders including customers, employees and regulatory authorities.

In this first report on ESG reporting we look at the state of ESG reporting within the S&P/NZX50. We ask what or who is driving non-financial performance reporting, what are the barriers to best practice and provide a number of case studies that provide insights into the world of ESG reporting.

For this report we reviewed the ESG content of the most recent - 2018 or 2019 - annual reports or standalone ESG reports for all companies in the S&P/NZX50. Just as ESG reports are often a work in progress, it is conceivable that the 2020 ESG Report will be expanded to cover a larger group of equity issuers or non-listed organisations.

Additionally, to gain insights into the drivers for ESG reporting, we surveyed the Company Secretaries of the S&P/NZX50. Again, given the modest response to the survey (one third), we intend to extend this survey in 2020.

This 2019 ESG Report was prepared jointly by NZX and Wright Communications. For reasons of comparability and consistency with international markets, both organisations have a desire to see a wider take up of ESG disclosure and reporting in New Zealand.

State of the nation

September 2019: It has been 22 years since Shell first introduced the world to the concept of a triple bottom line reporting with a sustainability report entitled People, Planet and Profit.

But after more than two decades of development, of talk, of new frameworks being created, how far has sustainability or ESG reporting really come in New Zealand?

In this survey on ESG reporting in New Zealand, we found that, in general, companies have shown some improvement in identifying non-financial topics that matter to investors and the metrics that most accurately measure progress and performance.

Our survey of the S&P/NZX50's most recent annual reports and standalone ESG reports found a wide variety of disclosure levels, frameworks and approaches to sustainability reporting. There was no one dominant approach or framework deployed. Although some industries are providing a greater level of information, others are either struggling to find relevance or gather information, or have determined that ESG reporting is not a priority for them.

Until recently, the need to report on a company's environment and social impact has been driven either internally by sustainability managers or externally by stakeholders such as regional councils who require a public record of compliance disclosure or NGOs who, ultimately, accede to a social license to operate.

But increasingly, there are new pressures on companies to improve their non-financial performance, their progress on social and environmental impact and their reporting on these matters.

The pressures are coming from investors around the world who are expecting more detailed and useful reporting of non-financial performance information. A responder to our survey of Company Secretaries said increasingly, "investors are looking for proof points of delivery against our strategy and more data". Another said shareholders wanted more information on waste management, energy consumption (\$), corporate governance standards and gender equality.



28/50

We found that in the past year, 28 out of the S&P/NZX 50 Index companies reported on climate change risk.

181

CEO members of the US Business Roundtable recently committed on paper to "lead their companies for the benefit of all stakeholders - customers, employees, suppliers, communities and shareholders."



40+

of the top 50 companies reported on a range of social issues from gender diversity to pay equality and modern slavery.



17

Of the 50 reports analysed for this survey, acknowledged the use of the Global Reporting Initiative.

\$181b

Responsible investment in New Zealand continues to grow with \$181 billion of associated assets under management, representing 72% of total professionally managed assets of \$261 billion.



95%

of KiwiSaver investors think ESG factors should be considered when investing.

Increasingly, access to capital via investors is being accounted for by the perceived environmental, social and governance risk to a business. A responder to the survey said there was a focus on climate-related financial disclosures.

There has been a marked shift in investor awareness of ESG issues, there is space for further improvement in New Zealand compared with other capital markets

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Responsible investment in New Zealand, for example, continues to grow with \$181 billion of associated assets under management, representing 72 percent of total professionally managed assets of \$261 billion. This is a threefold increase in the \$58 billion invested in responsible funds only five years ago.

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If further evidence of investor interest is required, the Responsible Investment Association Australasia (RIAA) recently assessed 25 New Zealand investment managers for their approach to ESG integration. Eight were applying a leading approach. A 2016 RIAA KiwiSaver study found that 95% of KiwiSaver investors think ESG factors should be considered when investing. As a result, more KiwiSaver products to meet investor ESG preferences have been released in the past year.

The business benefits of ESG reporting, according to the survey of Company Secretaries, included providing a single source of truth for stakeholder inquiries and creating eligibility for participating in ESG-rated indices.

Pressure is also being applied by customers and suppliers. For example, the New Zealand Government's sustainable procurement policy is explicit regarding environmental outcomes. It has a goal that all vehicles it buys should be emissions free by 2025.

While dairy may no longer be New Zealand Inc's single largest export revenue earner, the country's agribusiness remains a vital part of the economy. Although New Zealand's food production is often painted here as a global player, in reality this country produces a tiny fraction of the world's food and its customers can go elsewhere.

Consumers of New Zealand's food are increasingly asking questions about its provenance and sustainability. Many of our primary producers know that the more sustainable their product, the greater dollar value it can derive. Alternatively, a poor environmental or social record could result in those customers looking at other suppliers for their dairy or meat protein.

New Zealand companies – and those particularly exposed to international markets – are generally not operating independently.

Most are part of a complex supply chain between a natural or manufactured resource and the end consumer. How a company interacts with its suppliers, how it sources its raw material and how it processes those resources are of increasing interest to investors, suppliers and customers.

Global markets appear to be in a heightened state of fragility. From trade wars between the US and China, the rise of nationalism in Europe and a seeping economic downturn, domestic economies are under pressure.

Gaining a deeper understanding of a company manages its ESG risk is behind many of the questions now being asked at investor presentations. Investors are interested in decision-making related to supply chain, human rights and climate change risks. In particular the impact of climate change on business is one risk that is now drawing the attention of investors.

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However, in our survey, we found that in the past year, only 28 out of the S&P/NZX 50 Index companies reported on climate change risk and, in most cases, the disclosure was focused on carbon emissions targets and initiatives to reduce emissions from operating activities.

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Few companies have yet to explore and explain the longer-term risks to their business from climate change and potential climate change regulations. However, 34 companies said they had a target to reduce carbon emissions.

A smaller number still (19) were a signatory to the Climate Leaders Coalition – a group of New Zealand companies that have committed to carbon emission reduction targets.

The purpose of a business is also under scrutiny. For many consumers and young investors, the ultimate purpose of a company is broader than delivering annual profit and dividend growth to shareholders.

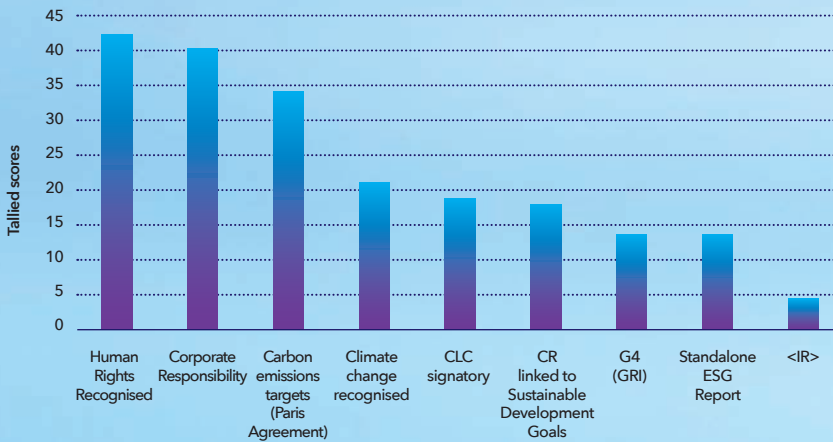
In a radical departure from the principle that the paramount duty of directors is to shareholders, 181 CEO members of the US Business Roundtable recently committed on paper to “lead their companies for the benefit of all stakeholders – customers, employees, suppliers, communities and shareholders”. Significantly, the list included Exxon Mobile, Walmart, Boeing and Amazon.

The 2019 reporting activity of the S&P/NZX 50 Index reflected a similar thinking in New Zealand corporations. More than 40 of the top 50 companies reported on a range of social issues from gender diversity to pay equality and modern slavery.

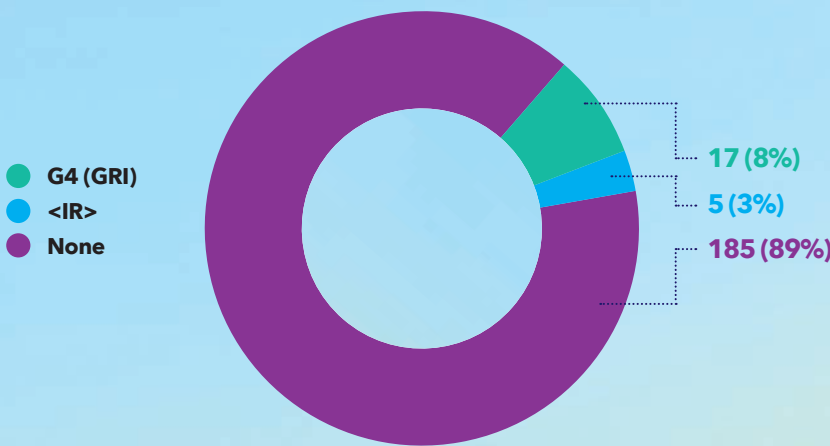
Most companies now report on the gender diversity of their boards, senior management and employees. Gathering and publishing this data is straightforward and has become normalised for most reporting companies.



ESG Metrics - Number of ESG topics within the reviewed reports



The percentage of S&P/NZX 50 Index using the recognised GRI or IR Framework for ESG reporting



On the other hand, a more troublesome disclosure is in the area of pay equality and remuneration. The NZX Corporate Governance Code recommends companies to report Director’s fees and Chief Executive remuneration.

Chief Executive salary levels receive annual attention from New Zealand media, and the reporting is often incomplete or without appropriate context. In 2018 one Chief Executive decided to take the plunge and provide more information on his and the executive team’s remuneration (see Z Energy case study page 16). Part of his reasoning for providing more remuneration detail was related to timing; incentive payments were often paid in years following the incentive period and did not necessarily reflect the current performance of the company.

Sector specific trends

While the surveyed group of 50 large companies is a relatively small sample (compared to all listed companies or all businesses in New Zealand) it was possible to discern a higher interest in ESG reporting in specific sectors.

The energy sector – dominated by Mixed-Ownership Model (MOM) companies and former State-owned companies – tended to produce higher levels of disclosure across all ESG metrics.

Operating mostly with substantial renewable assets, often on the fringes of National Parks and wilderness regions, the four largest so-called Gentailers have, for a long time, reported in detail on their environmental impact and compliance with resource consents. As a result of the MOM process they have also set a high bar on governance reporting.

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Banks and other companies operating on both sides of the Tasman also had comprehensive ESG content in their reports. The Australian owned banks have been producing highly-detailed ESG reports for more than a decade and are good examples of ESG disclosure.

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At the other end of the scale, two industry groups (with a few notable exceptions – See Kiwi Property case study page 14) stand out with a large opportunity to improve engagement of ESG reporting. These are software companies and multi-functional property companies, including retirement village/aged care operators.

Recognised standards

For the most part, large New Zealand companies are finding their own way when it comes to structuring or organising their annual and ESG reports. Of the 50 reports analysed for this survey, only 7 acknowledged the use of the Global Reporting Initiative (GRI) standard and five were prepared according to the Integrated Reporting framework.

There is an array of international standards, guidelines and frameworks that have been created by various bodies, including the International Integrated Reporting Council (IIRC); the GRI, based in Amsterdam; the Climate Disclosure Standards Board; and the Task Force on Climate-related Financial Disclosures.

But without one globally accepted set of standards for all forms of non-financial information, investors are not always in a position to compare companies on a like-for-like basis. If companies are disclosing different types of data and using different measurements, it makes it almost impossible to establish comparisons or to identify trends. In many instances, governance risk is better reported than social and environmental risk.

A higher adoption of globally-recognised standards or frameworks such as GRI or IR makes sense. Investors who are increasingly aware of ESG-related risks are more likely to view companies that comply with these international standards more favourably than those that are less than transparent about how their business is governed and their environmental and social impacts and commitments.

In the long term, it may be normal for investors to sell down those assets that do not comply with international disclosure and reporting standards.

More ESG disclosure?

With the wide range of ESG disclosure levels currently provided by S&P/NZX 50 Index companies, the opportunity exists for many to provide more relevant information to investors and stakeholders.

The investor focus on ESG represents a long-term transition, rather than a short-term trend. Leading reporting companies recognise there is a pathway towards best-in-class reporting and are prepared to take a long-term view.

Globally recognised standards are likely to play a part in investors' decision-making. Nobody would question that a company that understands its material risks is going to be a better-run company than one that does not. ESG risk is a fundamental part of this equation and if a business fails to pay sufficient attention to it, it is unlikely to be successful in the longer term.

Today's annual report fulfils a number of important tasks – to communicate a company's business strategies, its governance and management of risks, its approach to environmental and social impacts and, of course, present an accurate and fair statement of its financial performance. As we expand the reporting focus the target audience grows beyond shareholder and analyst to a wider stakeholder group.



The advent of social media and associated campaigns is playing a new role in terms of corporate reputation and social impact. One issue in social media can cause reputational damage. Companies are no longer able to hide behind flak-catching PRs.

Whether it is open and transparent recruitment practices or the impact of climate change, investors, consumers and stakeholders are demanding greater insight into all risk factors and impacts.

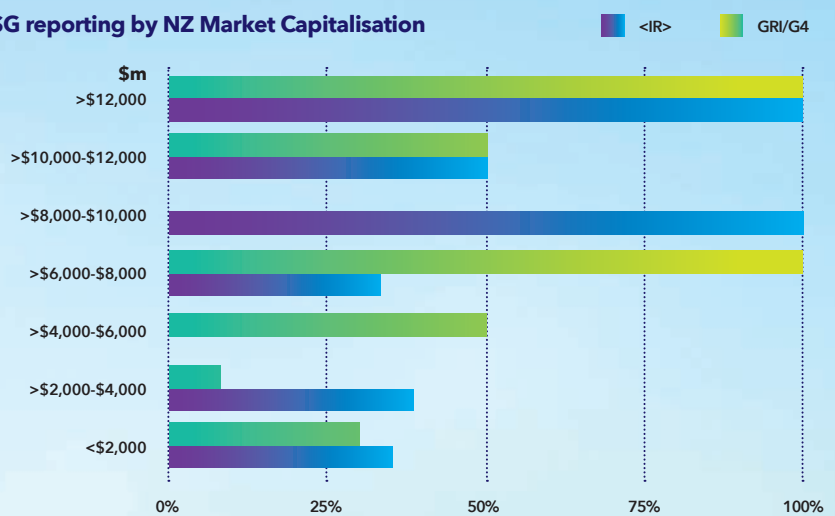
Telling positive stories about a company's philanthropic work and failing to mention non-compliant activity or glossing over material issues will not convince investors who want a clearer idea of what they are investing in.

Today's investors know that companies are not perfect. A company that admits it has a number of 'work ons' is viewed more favorably than a company that publishes scant information.

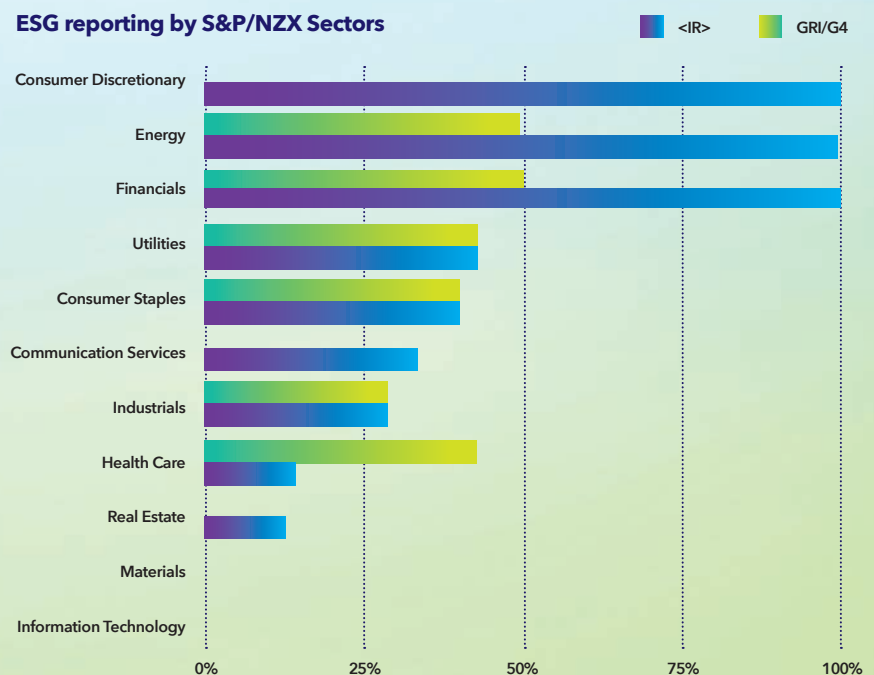
Good practices such as transparent and comparable ESG reporting play a role in building a better and more sustainable economy.

A participant in the survey of Company Secretaries summed up the business benefit precisely; "ESG reporting reassures investors that risks, arising from the use of a wide range of capitals that companies depend on to create value, are not only well-understood but well-managed".

ESG reporting by NZ Market Capitalisation



ESG reporting by S&P/NZX Sectors



CASE STUDY

Z energy pushes envelope on disclosure



Mike Bennetts
Chief Executive Officer



The further away from New Zealand an investor is, the more interest they are likely to have in the non-financial performance of Z Energy, says the company's Chief Executive Mike Bennetts.

He says the importance of non-financial information for the investor audience has grown significantly in the past two or three years. Particularly for offshore investors, while New Zealand investors and analysts are clearly lagging the rest of the world.

"Annual reports are no longer the preserve of shareholders. They are very much a stakeholder report. We're also finding that fund managers are taking far more interest in our ESG disclosures," he says.

Mr Bennetts cites the example of an Australian fund manager who was off-setting the carbon liability of all investment stock in a fund in order to produce and market a carbon neutral investment fund. When the fund manager read that Z Energy was off-setting and reducing its own operational emissions with a view to being carbon neutral by 2020 he realised he would be able to save quite a bit of money.

"I realise that's a bit of an outlier, but the capital markets are moving in that direction. To be honest, this has not been part of the conversation with the investment community in the past. But it is now, and we are getting more direct questions on our carbon liability and risks," he says.

There are also direct business benefits of increasing ESG reporting and disclosure. Both major account customers - such as fleet operators - and supplier-partners are asking for detailed information on Z Energy's ESG performance.



“If you have it all in the Annual Report it saves time and resource having to pull together information every time you tender or respond to an RFP. Having a verified report is convenient and efficient,” he says.

Z Energy pays active attention to feedback and conversations with its stakeholders. The senior leadership team meet every quarter to discuss in detail concerns and other matters raised by stakeholders. Major issues are dealt with and recorded into a materiality table.

“We think it is more efficient to have an on-going process rather than have a once-a-year materiality review.”

Mr Bennetts said an example of this process feeding back into the ESG content was the inclusion of a climate change statement. The decision to include this statement, for the first time in the 2019 annual report, was

made during the year in response to stakeholder feedback and guidance from the McGuinness Institute, a policy consultancy and think tank.

The Z Energy Annual Report made this clear: “The McGuinness Institute believes that all listed issuers should report on climate change in a standardised and comparable way. We support this, so we have used its recommended framework in our report.”

Another, and potentially more fraught, disclosure driven by stakeholder questions was executive remuneration.

In its latest Annual Report Z Energy discloses not only the Chief Executive’s total remuneration but also that of the ‘named officers’ of the company.

Z Energy also disclosed the CEO’s fixed remuneration ratio to Z permanent employees median fixed remuneration.

“We were getting more pressure from investors and the Shareholders Association for greater salary details. And the media are always reporting CE salaries and sometimes getting it wrong because of incentive payment timing issues. So I asked some key investors what they wanted to see and decided to be more transparent about my pay and our key exec’s pay,” he says.

Mr Bennetts admitted it was a “struggle” for some of his colleagues to see their salary and incentive payments printed in the report. The public disclosure would have a personal impact for some.

There was no legal requirement to disclose but he wanted to be transparent and, secondly, was keen to find a way to publish short and long-term incentives that matched the year they were for, not necessarily the year they were paid out. The Annual Report acknowledged on its second page the guidance received from the New Zealand Shareholders Association CEO Remuneration Reporting Framework.

“In the end having more ESG information in the marketplace means investors, analysts, media commentators and members of the public can have a more informed discussion with the company.”

CASE STUDY

A sustainable outlook



Clive Mackenzie
Chief Executive Officer



Kiwi Property is the country's largest listed property company, with a portfolio including office towers, shopping centres and mixed-use communities. With its scale and reach, the business understands it has an important role as a sustainability advocate.

Founded 25 years ago, Kiwi Property Group has been listed on the NZX since it corporatised from Kiwi Income Property Trust in December 2014. The company has operated a sustainability programme for 16 years.

The drive for sustainability and ESG reporting at Kiwi Property started with the Board, which recognised the importance of being ready for change and wanted the business to be at the forefront of sustainable developments.

The Kiwi Property Directors recognised environmental sustainability would be important to the company's long-term performance.

Kiwi Property Group Chief Executive, Clive Mackenzie, says many investors are aware of the company's success in reducing its energy, waste and water footprint.

"An increasing number of investors are taking ESG and climate change factors into account when making and pricing investment decisions," he adds.

Responsibility for sustainability sits at the executive team level, rather than being devolved down into the workplace where it could, over time, lose impetus and focus.



Kiwi Property produces a standalone ESG report because it believes in sharing its learnings and sustainability story with investors and the property sector. The Kiwi Property Group ESG report focuses on the company's impact and performance across the dimensions of people, the planet and profits.

The company reports on its sustainability strategy and now that strategy is woven into the company's overarching business strategy. This report has been drawn from a FSTE4Good framework, augmented by CDP.

Clive Mackenzie says the ESG report itself needs to be sustainable. It should be aspirational but also appropriate for the size of the business. Kiwi Property has a three billion-dollar portfolio but the business itself is relatively lean with around 170 employees, so the length of its ESG report reflects its internal resources.

The report focuses on how Kiwi Property contributes to its communities, reduces its environmental footprint and delivers sustainable returns to its shareholders.

Kiwi Property reports on several key environmental metrics such as energy consumption, waste, water use, and carbon emissions. It also reports on human resource metrics such as lost time injuries, gender and the ethnic diversity of its employees.

In the past seven years, Kiwi Property has halved its carbon footprint but says achieving further emissions reductions from its operations and property development will become increasingly challenging.

General Manager, Asset Management, Linda Trainer says one of the biggest challenges Kiwi Property faces in achieving its sustainability targets comes from the need to include tenants and customers in programmes such as plastic reduction or energy conservation.

“Our commitment to sustainable investment means we need to ensure our places have strong community engagement, have sustainable infrastructure, minimise their footprint, encourage biodiversity, and have strong investment qualities,” she says.

After addressing water, waste and energy inputs and outputs, Linda says Kiwi Property then broadened its view of sustainability to encompass its communities and to incorporate the concept of “bringing places to life”.

Kiwi Property Group is reviewing its sustainability strategy and looking at costs, timeframes, human resources and targets over the next two to five years.

CASE STUDY

The importance of ESG reporting



Nigel Greenwood
Chief Financial Officer



Dairy producer Synlait is acutely aware of the need to address the sustainability requirements of its international customers while also increasing the disclosure of its environmental, social and governance (ESG) performance.

The company's Chief Financial Officer Nigel Greenwood says "demanding" would be too strong a word for it, but there is definitely increasing pressure from investors for greater ESG disclosure and, from customers, for better environmental performance.

"We get few requests from our New Zealand investment base on ESG issues. Whereas Australia is clearly changing. In the past 12 to 24 months the Australian institutions have been talking to us more about ESG reporting," he said.

"Some of the institutions have hired expert ESG analysts who are turning up at our investor days or roadshow presentations. Those that don't have ESG analysts are now asking about sustainability matters.

"We are starting to hear from Australian institutions also that if you don't have an ESG report they simply won't invest in your company."

Mr Greenwood says investors are seeking more information. They know that sustainability issues are directly linked to a social licence to operate

and to long-term investment profiles. "So, if you don't address that you'll be out of business."

Synlait's Director of Sustainability and Brand, Hamish Reid, says the company has developed a sustainability strategy and is looking at a sustainable business model for the long term.

"We know that this is becoming increasingly important to consumers - our own research tells us that 18-year olds - our next generation of consumers - believe that business purpose is more important than profit."



Mr Reid said the original impetus to develop a sustainability strategy came from the company's co-founder and former Managing Director, Dr John Penno.

Two years ago, as Synlait approached its 10th anniversary, Dr Penno took time out to think about the next 10 years and challenges facing the business. He was aware of the extractive nature of intensive dairy farming in Canterbury, where just under 200 of Synlait's milk suppliers are based. He was concerned about climate change and social issues such as milk tankers on the roads. He was also thinking about the long-term economics of the business.

"Our large European customers such as Nestlé and Danone are talking more and more about sustainability issues that they face in serving their highly educated consumer base. The essential message from those customers is, if you can do it better (i.e. more sustainably) we will pay you more for your products," Mr Reid said.

Since then Synlait has been working hard to figure out how and when to implement sustainable initiatives and technology. For example, this year it commissioned New Zealand's first large scale electrode boiler at its Dunsandel site.

Mr Greenwood says the retail consumer's view and the investor view are becoming more aligned. "We feel we're in a good space in that sense and we don't need to do anything additional - we are already committed to a sustainable strategy," he said.

Reporting focus

Synlait's 2019 Annual Report had more sustainability content and the company is working towards transitioning to integrated reporting over the coming years. It acknowledged that the transition to integrated reporting is a journey, and one which the whole business needed to go on. The company has also signalled a commitment to enhance its sustainability reporting.

Mr Greenwood says "analysts want to see an annual report with top line measures on sustainability targets and non-financial performance while the ESG analysts want a detailed ESG report.

"We're comfortable with that approach. We know the market expects companies to be progressing towards more comprehensive reporting. No one is expecting you to get it perfect first time. It's got to be appropriate and right for the business, not a box ticking exercise."

Quality assurance


Synlait had its Greenhouse Gas Inventory audited and verified by a third party (Deloitte).

"Our directors need to have confidence in the data they are signing off in annual and sustainability reports, so assurance is on the table," Mr Greenwood said.

"I have zero doubt that, in time, companies will be required to have their sustainability reports externally audited."

AN INVESTOR PERSPECTIVE

In this section we examine
a range of views from
the investor community.



**ESG is a marriage of
values and returns, bringing
together those seeking
investment for their values
and those seeking to
invest in values that will
bring a good return.**

These case studies have a New Zealand and global perspective showing the growing appetite of ESG investment and the varying stages of engagement from the business community. It was very clear from all that although ESG investment is an incredibly sensible tool to enhance business and manage risk, it has also proven to be an effective mechanism to shift behaviour as behaviour follows capital. If you shift the levels to access capital, you will shift behaviour.

Within these case studies were five key themes that emerged:

1. 1 size fits 1 – E, S and G are three very different topics and within each there are sub-sets of the industry and its stakeholders make up the materiality analysis or the who cares about what. Layer on top of all of this a multitude of ways to screen the investments and you have unlimited combinations. For an issuer it reinforces the need to be very targeted with your ESG focus; for the investor it highlights the opportunity to personalize and tailor your investment portfolio to match your values.

2. Strong governance is king – There is a plethora of topics and sub-topics but there was one very common core topic that the investment community considered a catalyst for success; governance. Strong governance empowers the right performance drivers. If you have the right governance structure, mechanisms and incentives you have the right foundations to enact the most relevant E or S topics for your organisation.

3. If you can't measure it, you can't risk-manage it – Don't fall into the trap of putting so much focus on a 'story' and then miss the basic measures. One Asset Manager stated "forget the reporting, just give us a page of relevant metrics." Reporting the stories are important to give background but it's essential you follow the correct frameworks so you understand the measures that are important for your stakeholders. Avoid the temptation to fill in space with lots of nice-to-have stories that don't link back to relevant measures. Focus on communicating the company's material issues and how they are managed.

4. Ethics will only get you so far if you don't have returns – The expectations on returns is just as high, if not higher, for ESG as it is for any mainstream investment. The asset managers wouldn't engage if there were no returns, as there is no point in adding ESG into their investment portfolio if they are not going to get strong returns. Connected to returns is the fiduciary responsibility of an asset manager; investments can develop inherent risk if only financial risks are focused on and significant non-financial risks could be missed that could damage returns.

5. Shine a light on the imperfections – All the asset managers mentioned the desire to see organisations that clearly understand and are prepared to disclose their areas for improvement – current and emerging. This would demonstrate that organisations are aware of risks. If these risks are material, it's important to also disclose the strategies and timelines to mitigate them.

Global behaviours

The global landscape has changed significantly over the past two decades when it comes to indexation and ESG. And over the past few years these two aspects of the investment landscape have merged to provide valuable insights and options for the market.

Our Index partner S&P Dow Jones Indices (S&P DJI) has a rich history in this area that began in 1999 by pioneering ESG indexing with the launch of the Dow Jones Sustainability Index (DJSI). S&P DJI continue to lead sustainable indexing solutions with a suite of more than 150 headline ESG benchmarks, shaping the sustainable investing landscape.

One of the major changes taking place is the move from exclusionary-based investing to a more nuanced approach to broad market ownership that weight is based on company performance on ESG. The key driver and aid to this change in approach is underpinned by the increased development of ESG data and ratings methodology. However, according to BNP Paribas Securities' annual ESG survey, the surveyed asset owners top barrier to ESG integration was data as 66% of their respondents raised this as their largest concern. In addition, inconsistent data across asset classes and conflicting ESG ratings were the main challenges in transforming data into insights.



According to the Global Sustainable Investment Alliance (GSIA) latest global financial analysis, sustainable investments, which include environmental, social and governance (ESG) and impact investing, has surged worldwide by more than a third since 2016, reaching assets of more than **US\$30 trillion** at the start of last year. The importance of issuer reporting and standardized/globalized data sets has escalated.

From a listed issuer perspective, it would be beneficial to the market and the issuer to align their reporting with international standards and methodology to ensure that they are considered for these investment vehicles and the indices that are either used or benchmarking or tracking.

According to GSIA, over 60% of Australian and New Zealand managed assets include ESG criteria, with a growth from under 20% in 2014, compared to the US the local market has emphasised the importance of including ESG in the investment decision. [See Fig.1]

RobecoSAM which has partnered with S&P DJI for a number of years currently does the research and data-gathering for most of the S&P ESG Indices, and from a local perspective only 23 of our S&P/NZX 50 index is currently covered. This would either be due to Issuers not reporting sufficiently/ not completing the survey from RobecoSAM or not forming part of RobecoSAM's research universe. We are currently working with S&P DJI

to enhance the data and coverage of the screened universe which will aid with the launch of a suitable, diversified and representative index to the market. Which in conjunction with Passive product providers would be used as the Index for a local passive solution giving ESG exposure to the investment community, and would hopefully be taken up by the rest of the community as a suitable benchmark, (see Fig.2).

Fig. 1 Global sustainable investing assets, 2016-2018

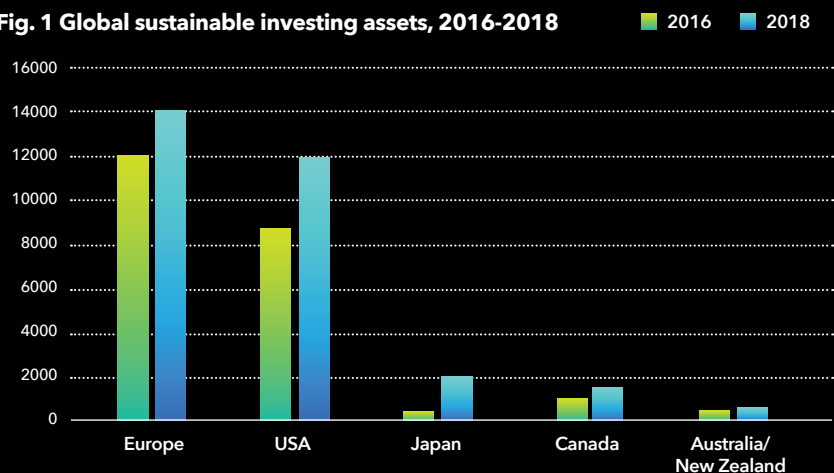
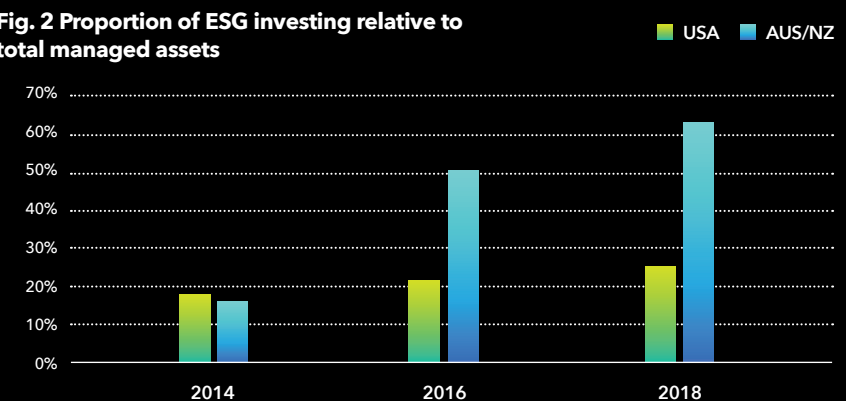


Fig. 2 Proportion of ESG investing relative to total managed assets



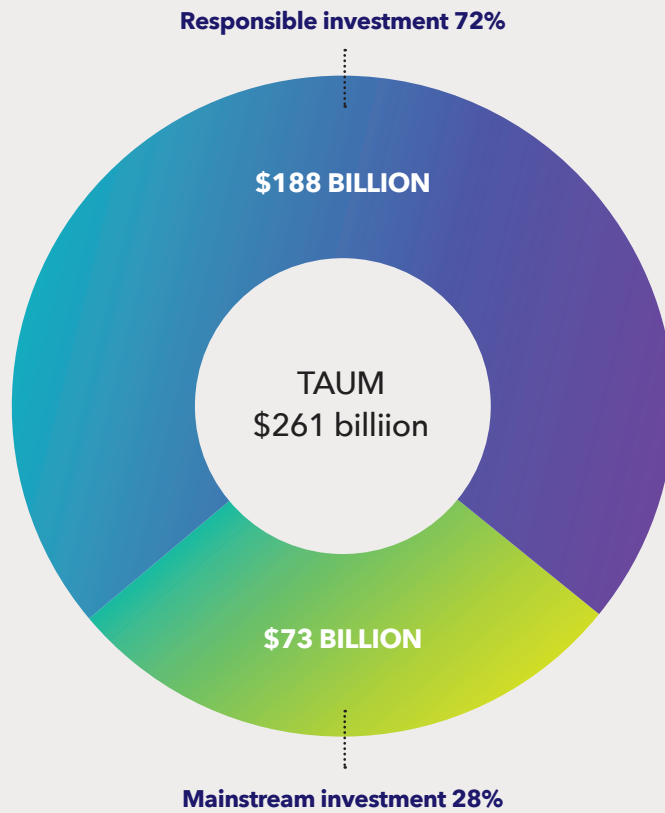
Investor snapshot

Responsible investment is now the foundation of good investment practice.

The Responsible Investment Benchmark Report New Zealand 2019 reinforces that a responsible approach to investing - one that systematically considers environmental, social and corporate governance (ESG) and/or ethical factors across the entire portfolio - spans the majority of the New Zealand finance sector and has become the minimum standard of good investment practice in New Zealand.

The responsible investment market is continuing its upward trajectory with associated assets under management growing 3% in 2018 to \$188 billion. This represents 72% of total professionally managed Assets Under Management (AUM), Total Assets Under Management (TAUM), now sitting at \$261 billion, and is a threefold increase on the \$58 billion invested in responsible funds only five years ago.

Responsible investment AUM as a proportion of TAUM



Source: Responsible Investment Association Australasia

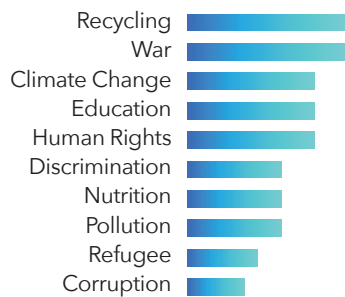


Search...

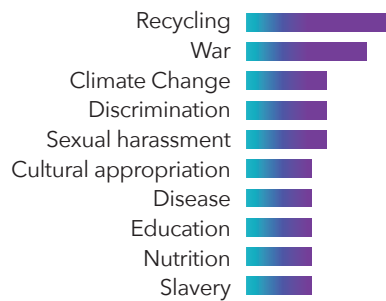


Per-capita keyword search volume on sustainability terms

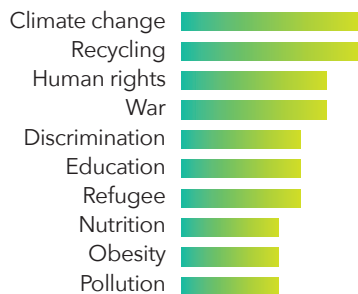
New Zealand



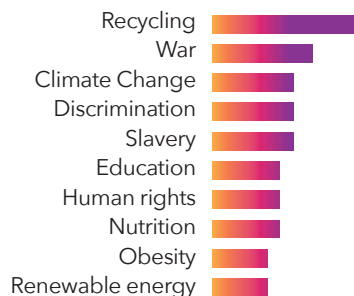
United States of America



Australia



United Kingdom



Source: Google 2018

Who Cares? About What?

Although the general population may not have a conscious awareness of ESG or be actively seeking investment in this space, they do appear have a conscious interest in the individual sub topics of ESG.

The table above shows the average monthly volume of key word Google searches that relate to ESG sub-topics over the past year looking at the 10 most investigated sub-topics (out of 64 potential ESG sub topics).

The data are based on over approximately 40 million individual Google searches across the four countries. The table reveals the level of interest and engagement the general population have with these ESG sub-topics.

Analysis of the 10 most searched for ESG topics for each country revealed that, of the 64 ESG sub-topics:

- › Climate change and recycling are in the top three for all four countries
- › Human rights is within the top five for Australia and New Zealand
- › Discrimination is in the top six for all countries
- › War is in all countries' top four

Credit: Dr Jay Whitehead - Sustainability Expert

CASE STUDY

Estimating the hidden costs of unsustainable use of natural resources



Richard Mattison
Chief Executive Officer

Trucost
ESG Analysis

S&P Global

Trucost, an S&P Global-owned company, estimates the hidden costs of unsustainable use of natural resources by companies. It was co-founded by Richard Mattinson, who has a PhD in neuroscience and worked as a management consultant before starting Trucost 18 years ago.

Richard and his co-founder saw an opportunity in creating data sets that went beyond the 'usual financials' with the desire to drive economic efficiency. Although business ethics were a consideration they knew that ethics can only get you so far when businesses need to get returns. They wanted to show the opportunity of getting the right returns through changing business behavior.

It was an pleasure to get a chance to chat with Richard and better understand his thoughts on ESG and the potential opportunities for the future.

Starting out

Starting an ESG journey 18 years ago, long before it was mainstream or 'on trend' ensured market engagement was not an easy task.

The initial work included recruiting a heavy hitting advisory group of people which included Robert Repetto, an Economics Professor from Yale. The founding team also worked with Professor Robert Costanza, a trail blazer on applying economic terms to natural capital and working a way of quantifying externalities such as air pollution that are paid for by society rather than individual companies.

The first business model was an accounting system, however when externalities are included most companies wouldn't make a profit. So rather than having an accounting model they changed the business model to one that created quantitative alternative data sets mostly focused on the environmental impact to help assess the contribution and future financial risks of the externalities for the investor market.

Their thinking and methodology were not immediately embraced by the market. Trucost even faced accusations of industrial espionage due to the accuracy of its estimation model, which is applied in situations where companies do not disclose their environmental impact. Progress was understandably slow. However with perseverance and constant adaptation to the way Trucost engaged the market, they started to see progress.

An example of this was a study Trucost completed on China's air pollution which was costing the Chinese Government 7 - 10 % of GDP of growth. Although China didn't immediately embrace the Trucost thinking given it was on a growth mission, Trucost presented evidence that you can grow faster if you fixed the problem at a cost of only 1%, enabling China to grow at a faster rate by addressing the externalities associated with air pollution.

The cost of fixing the problem can often be cheaper than the significant cost of the impacts which hit society rather than the individual companies. This has continued to evolve in China where ESG methodologies have been introduced. It is also going to be mandatory in 2020 for larger companies in China to report on key ESG factors.

The real power of Trucost was they could speak the 'business language'. This wasn't an idealistic theory, this was hard metrics accompanied by strong business rationale.

Keeping focused on the vision

Visionary investors and a strong focus on the end goal kept Trucost focused on the future even when things got really tough.

Richard's vision and reasoning was based around it having strong business rationale. He might consider a part of himself being an 'underground greenie' but to him the strongest driver is saving humanity. One might consider humans intellectually arrogant to always think we have the right answer to fix everything. We might have the answers but future technology solutions are likely to be a little too late to really solve the damage of the problem.

A key consequence of climate change is likely to be the geopolitical issues when people can't live in certain countries. The socioeconomic risks are enormous. He says these problems need to be solved today with current technology in order to prevent a climate disaster with huge economic and social consequences.

Richard says ethics and a desire to save humanity will only get us so far when business still need to make returns.

Although the context is to shift behaviours that have a high cost to society it's important to help businesses understand how this can practically apply to provide them with beneficial financial gains.

The first place to start is disclosure and it's important to be careful to not over-complicate with a sophisticated narrative but then completely miss the basics. This makes genuine risk analysis difficult for passive funds who use rules-based systems.

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ESG will become the normal for companies, they will become more transparent from both a consumer and investment perspective. It's important to remember however that it's a very wide ranging as each of the environmental, social and governance areas encompass a wide range of topics.

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As technology evolves, some methodology will evolve and investor expectation will evolve so what ESG will capture will need to be continually evolving.

CASE STUDY

ESG behaviour in NZ – NZ Superannuation fund



Katie Beith
Senior Investment Strategist
Responsible Investment



In recent years, many investors around the world have begun to place higher emphasis on responsible investment and the effective management of environmental, social and governance (ESG) risks and opportunities. To maintain a global best practice approach requires constant improvement and the NZ Super Fund (NZSF) team is working hard to ensure this.



(NZSF) shares responsible investment resources and activities with two other Crown Financial Institutions (CFIs), the Government Superannuation Fund Authority and the Accident Compensation Corporation. NZSF has an investment belief that responsible investors must have concern for ESG factors because they are material to long-term investment returns. For this reason, in order to achieve their legally mandated goal of maximising returns without undue risk, best practice portfolio management and avoiding prejudice to New Zealand's reputation as a responsible member of the world community, it takes an active approach to integrating ESG into investment decisions and ownership practices.

We had the opportunity to meet with NZSF's Senior Investment Strategist, Responsible Investment, Katie Beith to talk about ESG and the New Zealand investment market. Katie previously held responsible investment roles for several UK-based investors, including The Pensions Trust and Newton Investment Management. Amongst other roles, she was also Head of Implementation Support at the global standard-bearer for responsible investing, the United Nations backed Principles for Responsible Investment (UNPRI).

NZSF are strongly engaged in responsible investment, how would you describe the responsible investment practices of NZSF?

We implement responsible investment practices in a range of ways across the different opportunities and access points of the Fund. From excluding companies due to certain products they create, for example, tobacco manufacturers, to undertaking detailed due diligence of ESG risks in potential new investments or investment managers, to actively searching for investments that support the transition to a low carbon economy. We also have a strong commitment to engagement: using our influence as a shareholder to encourage companies to manage and report on their ESG risks. In addition, we exercise our voting rights globally across the Fund's listed equities portfolios.



What do you see as the main purpose for ESG within the investor community?

ESG issues can be systemic in nature affecting many companies across the globe, for example, climate change or corporate governance practices. Or they can be company and industry specific. If not managed appropriately, ESG issues can be very value destructive and costly with significant impact on management time, reputation and operational risks. On the other hand, when managed well, they can be revenue enhancing, help brand value, retention of employees and new business revenue streams, being a responsible investor is about managing investment risk and generating sustainable returns over the long-term.

There is an emerging debate, playing out with many investors across the globe, that investors have a role to play in supporting the UN Sustainable Development Goals by allocating capital to companies that are helping meet the goals.

In addition, by being an active share owner, engagement is a tool that can be used to signal to the business community that investors expect them to adapt to a future world with many sustainability-oriented challenges. This was demonstrated by NZSF, along with other crown-owned investors, leading a group of 85 global and domestic investors with assets of greater than \$13 trillion (NZD) to convince Facebook, Google and Twitter to strengthen controls around the live streaming and distribution of objectionable content such as the Christchurch terrorist attacks. It was an opportunity for the investor community to come together and, as a single voice, let the companies know that they had breached their duty of care and put their social license to operate in jeopardy. A very clear example of engaging on a topic that is about protecting the community we live in and protecting long-term shareholder returns.

When assessing ESG what are you looking for?

Multiple ESG service providers help NZSF to understand ESG risks and opportunities. We use a mix of outsourced aggregated ESG ratings as well as raw ESG data to help inform our views ESG / Sustainability reports of individual companies are also useful in active investment decisions. When looking at ESG / Sustainability reports the key things we look for are:

- › **Materiality maps so we know companies are aware of the most important issues to stakeholders;**
- › **ESG / Sustainability commentary as part of business strategy;**
- › **Measurements / charts showing performance (including targets and peer comparisons);**
- › **Adherence to management systems e.g. ISO140001, SA8000, Six Sigma;**
- › **Board accountability for sustainability;**
- › **3rd party verification;**
- › **Climate change commentary - especially given the signals from regulators and the need for adaption by companies;**
- › **Areas for improvement - work-ons for coming years.**



ESG reporting is not new but is currently evolving rapidly and becoming more and more relevant, important and useful to investors.

Where is the opportunity for the wider NZ business community within ESG reporting?

The current NZX voluntary ESG disclosure guidelines have encouraged the market to be open and to evolve in this area. Improved ESG disclosure for many New Zealand companies provides an opportunity to showcase excellent leadership in the sustainability field, create strong, future-focused brands that benefit from changing consumer attitudes

We have an opportunity as a smaller market, with NZ Inc. at the forefront of our minds, to lead the world on best practice ESG disclosure. It's important however that we don't reinvent the wheel. There are plenty of great standards out there already. For companies, it's about understanding which is the right standard for them.

There is also plenty of opportunity for NZX to support improved ESG disclosure. Many companies are overwhelmed at the volume of choice and information out there and are struggling to work out what is appropriate for them given their size and industry. NZX could help by being a source of research and resources, highlighting the costs and benefits of ESG disclosure, linking in to academic research and other resources to help issuers looking for guidance.

Beith's advice for issuers is to get started by doing a gap analysis on what ESG risks and opportunities you are already aware of and managing. Be open about what areas you haven't yet tackled. In the early days, it's about showing your awareness and desire to plan, measure and manage. Currently, the External Reporting Board (XRB) has some great resources to help New Zealand companies navigate their way through the decisions needed.

For those mature in their ESG reporting journey, it's about keeping the reporting balanced, understanding what your various stakeholder's value and a constant evolution as expectations from investors and other stakeholder change.

CASE STUDY

Passive ESG investment



Thom Bentley
Client Director



Smartshares offers access to a comprehensive selection of global and domestic ETFs (exchange traded funds) across the main investment asset classes of Cash, Bonds, Shares and Property.

Smartshares makes investing really accessible to everyone, allowing both the larger institutional investors and smaller retail investor to enjoy the benefits of passive funds.

In June this year Smartshares launched a range of new environmentally and socially responsible equity ETFs, covering Global Equities, Japan, US, Europe and Emerging Markets. Each fund offers New Zealand regulated and cost-effective access to underlying BlackRock iShares ETFs.

To understand more about their experience with ESG investing we spoke with Thom Bentley Client Director - Institutional at Smartshares Ltd.

What made Smartshares want to include ESG within its investment portfolios?

There has been a significant increase in demand for ESG funds from NZ investors and we wanted to offer customers access to a range of passive responsible ESG funds through Smartshares.

Importantly, our ESG ETFs are priced at the same level as our non-ESG options, so there is no additional cost to investors who want to invest in a responsible way.

You said above there has been a significant shift in demand. Are you seeing this more from retail investors?

The immediate demand was driven by institutional investors, and by Kiwisaver investors keen to make sure their money is invested in a responsible way.



We also see demand from charities and community trusts, which have a keen interest in making sure their investments are socially and environmentally responsible. It's important to remember however that one size doesn't fit all. Investors whether institutional or retail have specific aspects ESG that they are attracted to, so it's important to have a mix of funds that have a variety of attributes to meet different needs.

What attracted you to Blackrock/iShares?

Blackrock is the largest investment manager in the world and has a large global team that engages with listed company boards to fully understand the behaviours of the organisation and provide an extra level of assurance that companies are meeting the desired attributes of investors.

iShares' ESG funds are screened by index provider MSCI, which excludes companies which do not meet ESG requirements. Examples include companies involved in tobacco, nuclear weapons, controversial weapons, civilian firearms, thermal coal and oil sands. In addition, BlackRock's engagement team actively engages with companies to raise concerns

about their culture, governance and behaviour with the aim of driving improvement in these areas.

Are we likely to see ESG only investing?

ESG has become mainstream over the last couple of years, but it's about choice, so many investment managers will continue to offer both ESG and non-ESG options. However, companies that want to raise capital (including debt) in the listed markets need to think very carefully about their policies across the business to capture the capital in this space, otherwise they may be forced to seek capital from more expensive avenues.

.....

Ultimately, investors in ESG funds believe that companies that act in an environmentally and socially responsible manner and have strong governance will outperform the wider market.

.....

If this proves to be true, it makes sense that ESG investing will become the default option for most investors.

Are we likely to see increased growth in ESG funds?

A recent article quoted a poll that Morningstar investments had taken with Australian financial advisors showing that more than 60% of financial advisers (that responded) think it is part of their fiduciary duty to ask clients about their ESG values and preferences. Most NZ fund managers (if not all have an ESG policy, and many have also signed up for the UN PRI (United Nations Principles for Responsible Investment) and undergo regular audits on their ESG process and approach. Given all of this I expect ESG investing will continue to grow strongly in NZ.

Please download product disclosure statement for the funds here: <https://smartshares.co.nz/legal-documents>

What does this mean for your ESG reporting?



The short answer is it depends on what your business is trying to strategically achieve. The long answer is, this will raise more questions than answers to genuinely work it out:

- › **Who are your stakeholders?**
- › **Are you monitoring current and developing non-financial risks which could spill into financial risks that will impact shareholder returns in the future?**
- › **What do you want your stakeholders to be saying about you?**
- › **Who cares about what?**

Your organisation and your stakeholders are the only ones who can answer these questions so utilizing IR or GRI frameworks will go a long way to helping you navigate this process with sound structure helping to save time, energy and money. These frameworks also help you align intention with impact, ensuring your investment focuses on the areas that will provide you the biggest bang for your buck and that are well suited to your scale and industry focus. Some organisations may not be sufficiently progressed to formally adopt a framework, but it's advisable to at least use aspects of a framework when you are starting out.

Do not confuse ESG reporting with flashy storytelling. Your history, your people, your kindness and generosity are all extremely important but they are only part of the ESG puzzle. It's easy to fall into the trap of becoming expert story-tellers or "mission marketers" while missing out the bits that really matter to your stakeholders. If we don't have a clear objective, and a clear understanding of the audience, the outcome and desired impact, you risk over-selling things that don't matter and under-selling the things that will matter the most.

It's important to remember that a single ESG report will not be a silver bullet, you need to constantly work at it, review your stakeholder expectations, review your materiality mapping and ensure that you adapt your business behaviour and report this accurately. It is a significant investment but one that can identify future commercial opportunities. It's also good to consider some areas that may not impact your business today but could be emerging risks. Starting your ESG journey sooner rather than later could help you uncover future commercial opportunities through better understanding of customers and enable innovation.



So what?

Your business is part of a supply chain

If your customer starts to strategically focus on ESG reporting then this could eventually filter down to those who provide services or products to them (such as yourself) in the form of supply chain conduct agreements. As they mature into their ESG journey, their expectations of you in regards to reporting and audit could significantly shift. If you complete ESG reporting you will engage them as a stakeholder and have early insight into future changes, giving you time to adapt.



You wish to source capital

This might be a current or future requirement. It could be banking or through issuing shares; either way ESG reporting is filtering into the capital sourcing space disguised as either a carrot or a stick. Although it's in the early stages some banks in the institutional banking space such as ANZ will provide discounted capital for those who can provide ESG reporting metrics and as this entire report outlines if you are an issuer it's sensible business risk management.

You just want to sit under the radar

Regardless of your ESG reporting behaviour as an issuer your company is being ESG-rated by multiple rating agencies all the time. They assess publicly available data, they extrapolate data to complete risk models, and they may even approach you directly. Regardless of which method is used, they will be making judgement calls on your potential future business risks and the value of including your shares in an index, an asset management portfolio, an Exchange traded fund (ETF).



The proof is in the investing

Different businesses are at different stages depending on scale and business maturity when it comes to ESG reporting. We are not implying all businesses should rush into ESG reporting 'perfection'. Far from it. There is no such thing. Starting the journey however, gives them the ability to connect with a growing number of investors looking for responsible/ impact/ ESG investment opportunities. This has been demonstrated by ASB recently releasing a positive impact fund that they describe as "hand-picked investments in businesses that are actively building a better future for the world." Hatch Investment released the findings to their investment landscape survey completed in June. They wanted to better understand where and how New Zealanders currently invest and what their attitudes and perspectives are around different types of investing. They found that 37 percent of Kiwis prefer to put their money into companies that support sustainable practices and exhibit good governance. The survey also found social investing is more of a consideration for women and millennials.

As the world continues to magnify its focus on sustainability, ESG reporting will continue to become more important for assessing business risk, meeting fiduciary responsibility and helping investors match their values to returns.

ESG reporting considerations

1

Understand what the most important issues are to your stakeholders

This will channel your focus to areas that will give you the biggest desired impact. Validate all assumptions and don't underestimate the valuable business opportunities you will uncover in this process.

2

Use a recognized framework to guide your reporting

It will save you a lot of time, energy and money but most importantly it will improve the effectiveness of your reporting and ensure you don't miss areas that are of most importance to your stakeholders.

3

Authenticity versus perfection

There is more value in highlighting imperfections than trying to distract attention away from them by focusing on only telling 'good stories'. Stories don't build trust, telling the truth does.

4

No contracting out of responsibility

ESG is most effective when it's integrated through the business, it should be the golden thread that weaves strategy, governance, operations, and stakeholders together.

5

All journeys start with a single step

It might feel overwhelming to start your ESG journey, remember it's a process and it takes time to build up to your desired end point, but you need to start. Take a strategic, structured approach, talk with organisations you see doing it well, use the huge amount of resources freely available to you and draw on the expertise of consulting organisations committed to the ESG space.

Talk to us about your ESG reporting requirements

NZX



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