

ESG

How ESG will change the culture of construction

An exclusive report by AMA Research for UK Construction Week

MAY 2022

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MAY 2022

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- What is ESG?
- Why has ESG emerged as a force in business?
- What does this mean for construction?
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 *Have a question?*
Ask an expert about ESG

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UK Construction Week

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Introduction

The rise of ESG reporting looks set to transform the culture of the construction sector. Little noticed a decade ago, the past two years saw ESG spread rapidly across businesses globally. Now it is becoming embedded in the decision-making processes of leading investors, developers, major construction clients, house builders, and main contractors. ESG stands for Environmental, Social, and Governance. It is an approach used to gauge and compare the social and environmental impact of businesses. To embrace it means companies collect and publish verifiable non-financial metrics that can be used to judge performance over a wide range of environmental, social, and governance factors. The metrics cover factors as diverse as diversity and corruption and as widespread as the environment and human rights. Making these metrics open to scrutiny encourages firms to raise their level of corporate social responsibility.

While it clearly has appeal for social and environmental lobbyists, the big push is coming from the financial sector. Investors increasingly believe ESG helps firms identify and manage risk better and enhances their financial performance. If ESG becomes as embedded in corporate culture as many expect, it will fundamentally shift the culture of business and with that the culture of the construction sector.

As this report will highlight, while it is relatively new to many major contracting firms and house builders, it has been an issue on the radar of developers and property investors for some time.

Critically it has huge implications for the supply chain. As it develops firms will be judged not just on their performance in isolation, but on the performances of those they deal and partner with.

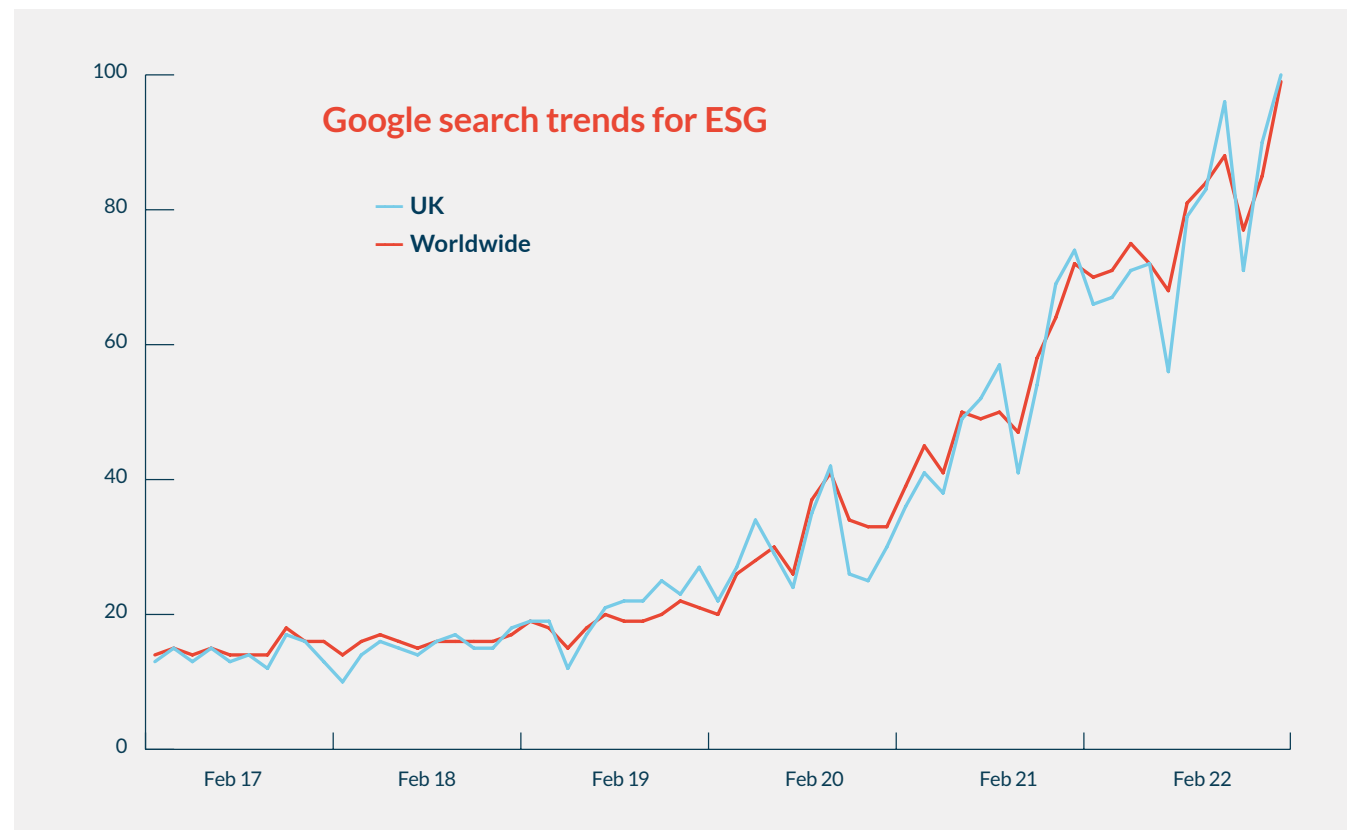


Figure 1 : Using Google trends, shows how interest both in the UK and worldwide has rocketed in recent years, particularly since the pandemic

Source: Google trends, trends.google.com

It comes at a critical time. Construction faces huge challenges. To name just three: it must find ways to radically reduce its environmental impact; it must adopt a whole new attitude to building safety and quality, and it must attract talent from a shrinking pool of available youngsters.

In many ways ESG provides a platform for addressing these issues at a time when the industry and its leadership is scratching around for guiding lights to lead plot a path away from failings that have dogged construction repeatedly over decades.

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What is ESG?

Put in simple terms ESG is an iteration of the idea of corporate social responsibility (CSR). What makes it different is that it backs up actions with data.

CSR as an idea has battled around in corporate and policy circles for decades, at least since the 1960s. It fell out of favour in the 1980s as the political tide changed and the corporate world turned to shareholder value as its beacon. But the tide has again turned as multiple concerns have built up over years across a range of issues – climate change, environmental degradation, discrimination based on race, gender, and sexual orientation and unethical business to name some.

There was a resurgence of CSR in the late 1990s and early 2000s. But this became increasingly discredited as public relations “greenwash”. There were too few hard facts to back up the claims being made and no overarching way to scrutinise and compare corporate behaviour.

Into this gulf steps ESG. Three things make it different: who is pushing it; why they are pushing it; and the rigour that can be applied in rating firms on ESG measures. Today investors globally increasingly see ESG as a must have. They demand hard metrics from the firms they invest in. These are used by major credit rating agencies and other financial organisations to rank firms on ESG.

The metrics used to assess ESG are wide ranging and there are multiple frameworks used to provide ESG scores. Figure 2 gives an overview of one framework derived by ESG Book. It shows the various categories of metrics being collected and evaluated. ESG Book was launched in December 2021 with backing from multiple major global financial institutions and the United Nations.

What metrics are considered with ESG?

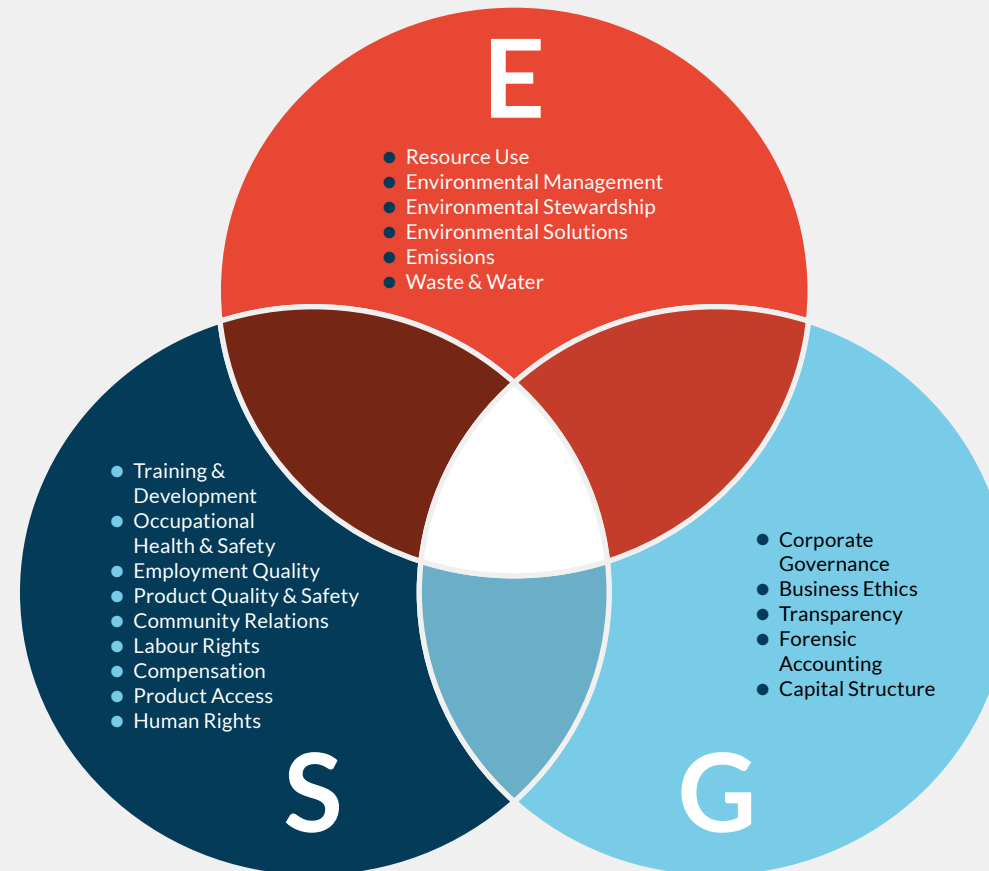


Figure 2 : Shows the main categories for the ESG Book Arabesque S-Ray (Sustainability Framework). This framework has 65 categories which cover 339 questions.

Source: ESG Book, Arabesque S-Ray Methodology, November 2021, www.esgbook.com

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Why has ESG emerged as a force in business?

Investment drives business and investors are increasingly seeing value in ESG.

A big driver is risk. Poor corporate behaviour presents increasing amount of reputational risk. Poor governance, unethical behaviour, poor labour relations, or creating environmental damage all create risks of huge fines and hefty legal bills. On top of this investors are receiving evidence that firms ranking well on ESG perform better than those ranked lower.

Meanwhile, investment funds are also seeing a change in individual investors. Younger investors appear more driven towards ethical investment. The public is increasingly taking an interest and judging behaviour of businesses, especially on issues of climate change and pollution.

Figure 3 shows the monthly high and low scores in the Ipsos Issues Index, where respondents are asked to pick from a list of issues what they see as the important issues facing Britain today. Concern peaked in the late 1980s when global warming came to the public attention in a big way and the Intergovernmental Panel on Climate Change (IPCC) was established, endorsed by UN General Assembly. After almost three decades of sporadic interest, public concern has returned with a bang. Public opinion inevitably swings the political dial. In the eyes of investors, this raises further risks to businesses that fall short on ESG.

So, from the point of view of an investor, what's not to like about ESG? Fortunately, the timing is good in terms of getting the data to back up claims of social responsibility made by individual businesses. Digital technologies facilitate the measurement and comparison of ESG. It makes gathering and comparing data easier. This encourages investors to use it and firms to produce it in ever more depth and complexity.

This coalition of factors has created a surge in ESG-related investment. For any business to get access to the funds they need, it is becoming ever more essential that they have good ESG scores. This is how big businesses are seeing the future and this view is gradually working its way down the pecking order and deeper into supply chains.

The key point is that ESG is rapidly becoming embedded into the fabric of corporate life and the investment community. The metrics are increasingly being used as ways to inform investment decisions. Research suggests that more than a third of investments under management are now linked to environmental, social and governance (ESG) factors and the share is growing.

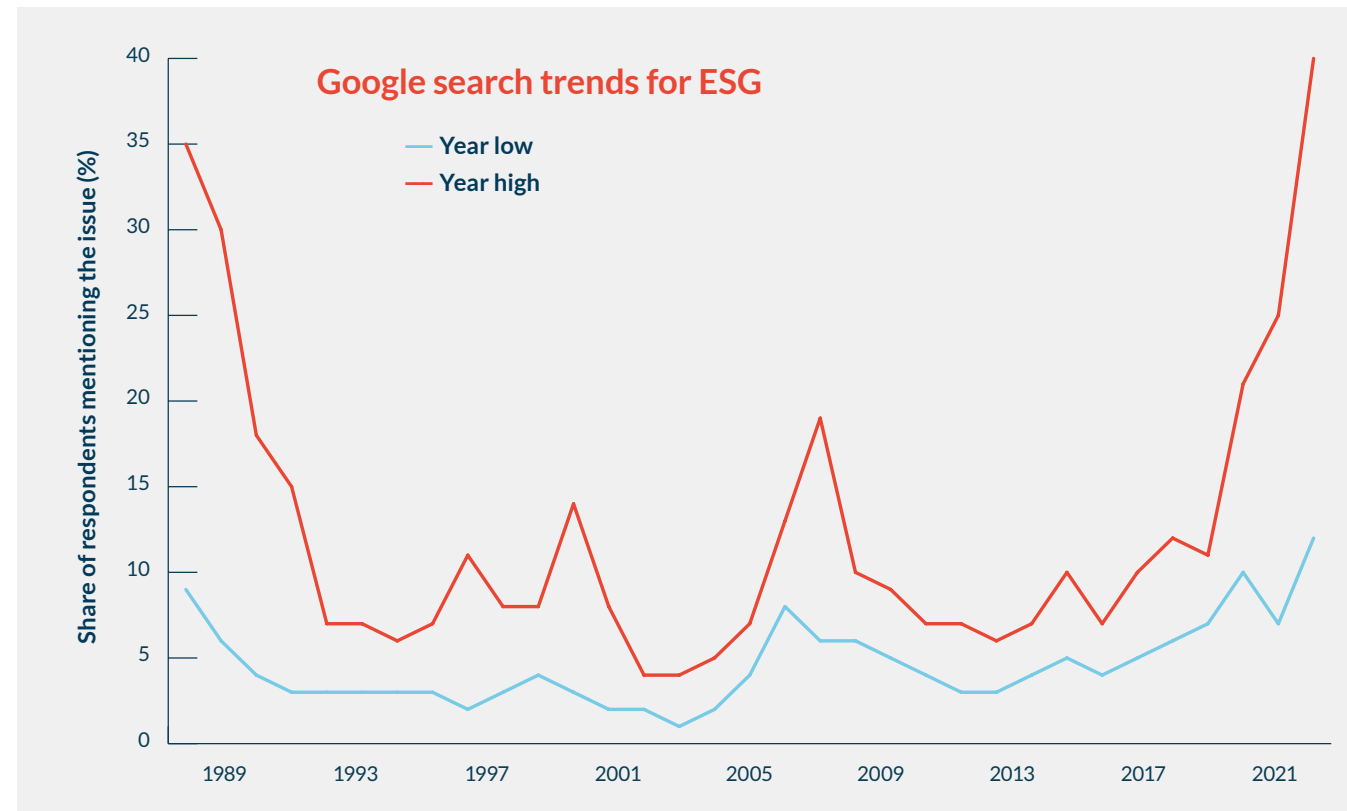


Figure 3: Highest and lowest monthly readings from the Ipsos Issues Index for pollution, environment, and climate change.

Source: www.ipsos.com/en-uk/issues-index-archive

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What does this mean for construction?

Construction more than most industries is critical to meeting the challenges the world faces over the coming decades. Its role inevitably has a huge direct impact on the environment. And in creating and reshaping the built environment, it fundamentally influences every aspect of human life – health, wealth, wellbeing, life chances, social structures, opportunities, and the aspirations of the community in which it operates.

Given that the lifeblood of construction is investment. If access to rests on good ESG scores, there can be little doubt that ESG will become a major aspect of business life in the sector.

The challenge of adapting is unlikely to be easy. There are many aspects of construction that make it harder than most industries to guard against corruption, corner cutting, poor quality, poor customer service, poor relations with communities, and a host of other undesirable attributes. And much of the industry is mobile with limited roots in the communities they serve. Furthermore, construction is not a sector noted for its transparency.

Embedding ESG in construction businesses will require huge culture change. It will fundamentally alter recruitment and labour relations. It will change the terms of trade. It will change the way firms interact. It will almost certainly promote change within the regulatory framework. That all points to a major transformation in how the industry operates and how it is structured.



As things stand the case for major construction firms to embrace ESG is huge. Developers and major clients will follow the investment community on ESG. This will mean firms on the outside face finding themselves starved of work. But ESG does not stop at the firm, it relies ultimately on the whole supply chain having credible and acceptable ESG scores.

There is clear evidence that major construction firms are beginning to react to the ESG tidal wave, as our research shows.

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How are firms engaged in the built environment responding?

The words used by companies in their annual reports reflect the thinking of the business. Using a similar approach to Google trends, we tracked the use of key terms associated with ESG across the latest 11 annual reports for 40 firms that operate in the built environment as investors, developers, house builders, infrastructure clients, and contractors.

The data shows for each term searched the percentage use of a total usage over 11 years. This was adjusted to account for differences in the overall use of words within each report, using the frequencies of financial terms “margin” and “profit” as a control.

The results were clear. As we can see in Figure 4, terms associated with ESG have risen remarkably over recent years. Interestingly the use of corporate responsibility has fallen, which fits the notion that it has been displaced by ESG.

The view that contractors have come later to ESG is also supported by comparing the overall results in Figure 4 with the results for contractors only in Figure 6. The use of ESG among contractors was very sparse until picked up by some firms two years ago and picked up heavily across the board in the latest set of account reflecting active over the past year or so.

Note: The data are adjusted using the frequency of profit and margin appearing in each report as a control. Where profit and margin appear more often the term search is reduced accordingly.

Contractors: Use of ESG related terms in annual reports over 11 years

Percentage spread of “term” used in 11 annual reports, from latest to 10 years previous

Terms searched	Latest	-1	-2	-3	-4	-5	-6	-7	-8	-9	-10
Net zero	68%	25%	3%	1%	0%	0%	0%	0%	0%	0%	1%
ESG	55%	17%	8%	3%	2%	2%	2%	2%	2%	3%	4%
Climate	42%	25%	10%	6%	4%	3%	2%	2%	2%	2%	3%
Wellbeing	36%	26%	12%	10%	6%	4%	3%	2%	0%	1%	1%
Inclusion	32%	21%	13%	9%	7%	5%	4%	3%	3%	2%	1%
Carbon	31%	19%	9%	6%	5%	5%	5%	5%	5%	4%	5%
Equality	31%	15%	12%	11%	6%	4%	4%	5%	2%	7%	3%
Stakeholder	27%	23%	14%	9%	5%	4%	4%	3%	4%	4%	3%
LGBT	27%	27%	11%	10%	15%	7%	3%	1%	0%	0%	0%
Emissions	22%	16%	11%	9%	8%	8%	8%	9%	4%	2%	2%
Welfare	22%	16%	11%	7%	6%	8%	8%	7%	6%	5%	4%
Diversity	22%	18%	13%	11%	8%	7%	6%	6%	4%	4%	2%
Sustainab	20%	15%	10%	8%	7%	7%	7%	6%	7%	7%	5%
Social	20%	17%	12%	9%	6%	6%	6%	5%	6%	6%	6%
Embed	19%	15%	12%	11%	9%	8%	6%	5%	5%	5%	6%
Gender	19%	18%	16%	13%	7%	6%	6%	5%	5%	4%	1%
Human right	18%	18%	16%	13%	9%	9%	7%	8%	1%	1%	0%
Transparen	17%	16%	13%	10%	8%	8%	6%	6%	6%	5%	5%
Community	17%	17%	11%	9%	8%	8%	6%	6%	6%	7%	5%
Greenhouse	16%	15%	11%	10%	10%	9%	10%	11%	5%	2%	1%
Energy	16%	13%	10%	7%	7%	7%	9%	7%	8%	8%	7%
Purpose	16%	16%	10%	8%	8%	7%	7%	7%	7%	7%	6%
Reputation	15%	14%	11%	10%	9%	8%	8%	7%	7%	6%	5%
Ethic	15%	15%	12%	12%	9%	6%	6%	5%	6%	6%	6%
Satisfaction	13%	13%	12%	11%	9%	7%	8%	7%	7%	7%	5%
Risk manage	13%	13%	10%	10%	10%	9%	8%	7%	8%	7%	5%
Governance	12%	11%	10%	9%	9%	9%	9%	8%	9%	7%	6%
Water	11%	11%	10%	10%	9%	9%	8%	8%	9%	9%	6%
Corporate responsib	3%	4%	5%	5%	8%	8%	7%	11%	17%	15%	18%
All the above	16%	14%	10%	9%	8%	8%	8%	7%	7%	7%	6%

Figure 4: Comparing use of key terms across 11 years of annual reports for 40 firms with interests in the built environment.

Source: Annual reports

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How are firms engaged in the built environment responding? continued...

This suggests that the next step will be a growth of awareness within the construction supply chain, not so much major building materials producers, but subcontracting and specialist businesses.

Figure 5 ranks the various terms searched by frequency in the latest reports and those published five years earlier. Given these reports are primarily

financial, "profit" and "governance" will inevitably rank near the top. However, the change in ranking illustrates how some terms used in annual reports have risen or fallen in relative popularity over the period. Notably, "governance" rose above "profit". And "net zero", "climate", and "ESG" were the biggest risers.



All firms surveyed: Terms ranked by frequency in latest annual report and report 5 years previous

Terms searched	Latest	5 years previous	
Governance	1	2	1
Profit	2	1	-1
Sustainab	3	4	1
Water	4	3	-1
Stakeholder	5	12	7
Community	6	7	1
Social	7	11	4
Carbon	8	13	5
Energy	9	6	-3
Climate	10	23	13
Diversity	11	10	-1
Purpose	12	8	-4
Emissions	13	9	-4
Risk manage	14	5	-9
ESG	15	29	14
Wellbeing	16	24	8
Net zero	17	31	14
Gender	18	18	0
Inclusion	19	26	7
Transparen	20	16	-4
Ethic	21	20	-1
Embed	22	19	-3
Reputation	23	17	-6
Greenhouse	24	21	-3
Satisfaction	24	22	-2
Margin	26	14	-12
Equality	27	27	0
Human right	28	25	-3
Corporate responsib	29	15	-14
Welfare	30	28	-2
LGBT	31	30	-1

Figure 5: Comparing the ranking of terms searched in the latest annual reports with their rankings five years earlier across 40 firms with interests in the built environment.

Source: Annual reports

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How are firms engaged in the built environment responding? continued...

Note: The data is adjusted using the frequency of profit and margin appearing in each report as a control. Where profit and margin appear more often the term search is reduced accordingly.

All firms surveyed: Use of ESG related terms in annual reports over 11 years

Percentage spread of “term” used in 11 annual reports, from latest to 10 years previous

Terms searched	Latest	-1	-2	-3	-4	-5	-6	-7	-8	-9	-10
Net zero	81%	8%	0%	0%	0%	1%	0%	1%	3%	1%	4%
ESG	75%	10%	2%	2%	2%	2%	2%	2%	2%	3%	0%
Climate	41%	17%	6%	4%	2%	4%	4%	3%	5%	5%	7%
Wellbeing	33%	16%	13%	13%	7%	4%	3%	5%	1%	1%	4%
Carbon	33%	11%	7%	5%	5%	7%	4%	6%	7%	7%	8%
Equality	29%	11%	13%	5%	8%	4%	4%	12%	4%	6%	4%
Inclusion	29%	16%	12%	9%	8%	6%	5%	5%	4%	3%	2%
Stakeholder	25%	20%	13%	8%	6%	6%	5%	5%	5%	5%	4%
Emissions	25%	12%	10%	6%	7%	9%	8%	9%	5%	5%	3%
Diversity	21%	16%	11%	10%	8%	8%	7%	7%	5%	6%	2%
Human right	20%	17%	18%	7%	8%	6%	13%	6%	1%	3%	1%
Sustainab	16%	11%	7%	7%	8%	7%	8%	8%	8%	11%	9%
Gender	16%	19%	14%	13%	7%	6%	6%	6%	7%	4%	1%
Transparen	16%	15%	11%	8%	8%	10%	8%	8%	5%	7%	4%
Purpose	15%	14%	8%	8%	8%	8%	8%	8%	8%	8%	7%
Embed	15%	11%	11%	11%	9%	9%	6%	6%	7%	8%	9%
Social	15%	12%	8%	7%	8%	7%	9%	7%	8%	9%	9%
Greenhouse	12%	12%	7%	7%	8%	13%	14%	14%	4%	5%	3%
Satisfaction	12%	11%	13%	8%	11%	13%	8%	12%	5%	5%	3%
Risk manage	11%	11%	10%	9%	10%	11%	10%	8%	8%	7%	5%
Energy	11%	9%	7%	6%	7%	7%	7%	8%	12%	13%	13%
Community	11%	12%	8%	8%	9%	10%	8%	7%	7%	10%	9%
LGBT	11%	11%	4%	11%	33%	15%	15%	0%	0%	0%	0%
Governance	11%	12%	12%	8%	8%	10%	11%	10%	9%	6%	5%
Welfare	10%	14%	5%	2%	2%	12%	12%	22%	8%	8%	5%
Water	10%	11%	10%	7%	7%	8%	9%	10%	10%	9%	8%
Reputation	10%	9%	6%	7%	8%	11%	10%	10%	10%	12%	7%
Ethic	8%	9%	10%	7%	10%	9%	11%	9%	8%	9%	8%
Corporate responsib	5%	2%	3%	5%	5%	3%	5%	12%	34%	15%	11%
All the above	14%	11%	9%	8%	8%	9%	9%	8%	8%	8%	7%

Figure 6: Comparing use of key terms across 11 years of annual reports for seven contracting firms.

Source: Annual reports

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What do the experts think?

While the four experts may have differing views on the potential magnitude of the impact of ESG on construction, the time scale, and the depth of penetration into the industry, they all see it as a very powerful force for change. The commonality is striking.



Expert Opinion

Ann Bentley

GLOBAL BOARD
DIRECTOR, RLB, AND SITS
ON THE CONSTRUCTION
LEADERSHIP COUNCIL

Ann Bentley has seen ESG knocking about within the built environment sector for a decade or so. But, in the past three to four years, it has moved mainstream and she believes it will have profound implications for construction.

Its rise to prominence, she says, coincides with the emergence of Greta Thunberg, the school strikes, and a spreading public awareness of environmental issues. Although, she sees many reasons for its increasing influence.

Along with the interest generated by Thunberg, wider media coverage and documentaries, such as Blue Planet II, have promoted public awareness. The science is now stronger, presenting very worrying evidence. We see more climate related disasters. And the recent COP26 spotlighted the issues, concerns, and challenges.

"There's been a growing environmental movement at least since the seventies, but the public movement today is far bigger than I've ever seen before. The "E" part of ESG seems to have multiplied a hundredfold over the past three years," says Bentley.

The "S" part of ESG has been a slower burner, but she says: "In a bizarre sort of way, I think Brexit accelerated the social value agenda." Certainly, in her dealings within Westminster, she watched the EU referendum vote shock the establishment.

Inevitable post-referendum research revealed to politicians and civil servants alike a large group of what might be viewed as the ordinary population that was in employment but held a very strong sense of grievance. "That was a massive wake up call to many of the politicians in power," says Bentley. "This was a group of the electorate that they had never really focused on."

For her, Brexit brought the issues of that group to the fore. It changed the conversation within the establishment. It became less about money and taxes, more about issues such as fairness and equitability. However, she sees much of the business community as being well ahead of government in understanding changing public sentiment, not just regarding social issues, but on the environment.

For her, the acceleration of ESG is in many ways a product of the confluence of growing public concern and engagement, a recognition within the political establishment of a need to promote change through legislation, and the willingness of businesses to make changes happen.

The maintenance of this coalition of forces will determine how embedded ESG becomes she feels, drawing parallels with health and safety. As the post-war era progressed, public sentiment steadily changed, becoming less and less accepting of workers being maimed or killed.

This led to the 1974 Health & Safety at Work Act, the sentiments of which are now deeply and increasingly embedded in the fabric of the industry, which in turn have catalysed wider improvements, especially within construction.

If ESG becomes similarly institutionalised it will, she senses, profoundly alter construction and the wider community operating within the built environment community. It will, she suspects, create much tighter links between main contractors and their supply chains. This is already happening, she says, but the growing engagement with ESG is accelerating the trend.

As she projects forward, she sees the potential split between those firms that engage with ESG and form much tighter bonds, and firms mainly in the repair, maintenance, and improvement sector that operate with perhaps less attention to ESG.

"There's been a growing environmental movement at least since the seventies, but the public movement today is far bigger than I've ever seen before. The "E" part of ESG seems to have multiplied a hundredfold over the past three years."

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Expert Opinion

Mark Callender

HEAD OF REAL ESTATE
RESEARCH, SCHRODER
REAL ESTATE

“Five years ago, the debate might have been about whether a rise in the specification would pay. Is it worth it?”

Property investors have been aware of environmental issues and climate change for a considerable time and about a decade or so ago ESG began appearing on the radar. What might have been occasional blips on the radar five years ago are now solid signs of increasing activity.

That is pretty much how Mark Callender sees the emergence of ESG as a force shaping investment decision within the property sector. Importantly, he has little doubt that this will change not just what the construction sector creates but the way it operates.

“Five years ago, the debate might have been about whether a rise in the specification would pay. Is it worth it?”, he says. “Then, it was more about an act of faith, a sense of doing the right thing. But over the past three years there has been increasing evidence that shows occupiers are prepared to pay a premium for buildings that meet higher standards, particularly over environmental standards.”

What is more, he says, the data shows that offices rated BREEAM “very good” and above are quickest to let. “Energy efficiency and many other attributes associated with these higher standards have moved from nice to have to a major priority for many occupiers.”

Moreover, he feels that the effects of Covid and working from home will strengthen the trend as occupiers trade down on space but up on quality.

That quality he thinks will increasingly include the wider provenance of the buildings as firms seek to reduce the risk of reputational damage and increase the values that resonate with their staff. So, while initial interest in ESG may have focused on the “E bit”, mainly energy and water use, Callender sees signs that that all aspects of the ESG agenda are gathering pace, not just in the commercial sector but also in industrial.

This prompts the question of what to do with existing buildings that will increasingly fail to meet the commercial cut. This concern has been brought to the fore in the property market lexicon the phrase “stranded assets” – those seeing unanticipated or premature write-downs, devaluation, or becoming liabilities. Many buildings face this fate as regulations tighten and corporate choices shift as action to tackle climate change increases.

Given the increasing awareness of embodied carbon, the ideal choice would be to retrofit or repurpose the existing building. This does however provide commercial challenges particularly in locations where property values are low. For investors with a long horizon, this is not simply a challenge for existing buildings, but one that brings to the fore future proofing of new buildings.

This points to building above current standards and seeking to raise existing standards to avoid

building in premature obsolescence. Callender sees little push back from the sector over raising regulations, which is already being priced in.

The role of investors in property does not stop with the building and increasingly they are engaging in the “S bit” of ESG. They are looking for greater transparency within the supply chain. They no longer see “that’s not my responsibility” as an acceptable response. This was a gathering mood among established investors. That mood has spread further and deeper with each revelation from Grenfell.

Investors are increasingly ensuring that the communities in which they invest share in value. This may mean insisting on providing apprentices for local people. They are seeking to be more interventionist, seeking to push positive social value.

Callender has no illusion that some of this is clearly a reputational thing. Bad behaviour is harder to hide. But his view conveys a deeper shift in attitude, an increasing and genuine desire to do the right thing. “You feel better about what you are doing. And, yes, that does add greatly to job satisfaction.”

How ESG will change the culture of construction

MAY 2022

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What do the experts think? *continued...*



Expert Opinion

James Kenny

HEAD OF GLOBAL AFFAIRS AND PR, ARUP

“It feels today that the boulder has reached the crest and looks set to gather pace as it comes down the other side.”

“The way I’d describe the progress of ESG is rolling a boulder up a hill,” says James Kenny. Indeed, for many advocates seeking over decades to embed corporate social responsibility into the fabric of business the task must at times have seemed suitable for Sisyphus.

But he says: “It feels today that the boulder has reached the crest and looks set to gather pace as it comes down the other side.”

Kenny believes that the development and use of metrics sharply distinguish ESG from earlier introductions of corporate social responsibility, while the increasing reputational and commercial risks of non-compliance help explain its growing importance across the business community. The finance sector is increasingly using measures of environmental, social, and governance performance, along with traditional financial metrics, in making investment decisions.

This trend is being accelerated by the Taskforce on Climate-Related Financial Disclosures (TCFD), established in late 2015 by the Financial Stability Board, the international body that monitors the global financial system.

TCFD will soon be mandatory. This has prompted the introduction of new reporting regulations, for example, on emissions. But many firms are looking to go further to satisfy the investment community and the accessibility, comparability, and transparency of data on ESG issues is now spreading, encouraged by the finance community. This has pushed ESG factors up the agenda in most major companies, not just in the UK, but globally.

The insurance sector is very much at the forefront, as they are seeing in their data the scale of emerging risks, particularly around climate change.

“Environmental disasters that were once one-in-a-hundred-year events, are now happening with increasing frequency – in some areas the frequency of these hits can be every five or 10 years,” says Kenny. Insurance companies are pricing in this risk.

He feels the implications for construction are significant and widespread. For instance, in the commercial sector he expects investors will want to see buildings built to standards well in

advance of current regulations. And asks: “Why would investors want to invest in what would become a stranded asset in 10 years’ time?”

“To meet the climate goals that we’ve committed to in law, regulations have to become much tougher. If we only build to today’s standards, within a short timeframe, investors will be left with buildings that they can’t sell or will need to be heavily upgraded. What investor would want to take that risk?”

He also believes that, as ESG becomes more embedded, relationships down the supply chain will have to change, becoming much closer. This suggests firms, particularly higher up the supply chain may reduce the number of firms they deal with and concentrate less on price as they look to reduce ESG-related risks.

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What do the experts think? *continued...*



Expert Opinion

Simon Rawlinson

HEAD OF STRATEGIC RESEARCH AND INSIGHT, ARCADIS, AND SITS ON THE CONSTRUCTION LEADERSHIP COUNCIL

“Increasingly, in some sectors of the market, ESG will become, in effect, a licence to trade.”

There is little doubt in Simon Rawlinson’s mind that the industry needs to pay close attention to ESG. But he sees the speed and depth of adoption into the culture of the construction sector in coming years as unknowns.

“Just recently we had a FTSE-listed London-based developer asking us some quite detailed questions about ESG. Arcadis is some years down that road, with a particular emphasis on issues of diversity, inclusion, and transparency.

Not only had the developer made rapid progress, but they were also considering how ESG could be applied to project procurement. That suggests that the application of ESG principles could become much wider,” he says.

Indeed, from his experience, CEOs are increasingly taking notice of their company ESG scores and how they compare with competitors. And he believes the proliferation of ESG funds within the financial markets is increasing the attention senior executives are paying to ESG scores.

Rawlinson expects that in some construction markets a good ESG score may well become a prerequisite to bid for work. He points to civil engineering, characterised by large-scale

projects with big environmental and social impacts, as a likely sector. “Increasingly, in some sectors of the market, ESG will become, in effect, a licence to trade,” he says.

But, while ESG is coming, he senses the road to wider adoption within the supply chain is likely to be pitted with potholes. His view is that how fast and how deep ESG penetrates the construction sector will rest largely on the answers to two questions.

His first question is what share of the market will expect good ESG credentials? Will it be so big it forces widespread change, or too small to have a major impact? This he says will determine how far it goes down the supply chain. “We know that it will be a challenge, as the second and third tier of the construction supply chain is shallow and broad,” he says. This could suggest a two-speed market, with some supply-chain firms adopting and responding to the ESG agenda bidding for one pool of work while others operate in the market outside that pool.

His second question touches the heart of a consistent problem associated with corporate social responsibility – “greenwashing” and the challenge of reliable and accurate metrics. Can

these concerns be overcome? He points to a Financial Times article on February 20 that looked at green investment. It raises concerns about mis-selling, contradictory metrics, and deception that undermines credibility. It also notes that a recent review by US financial services firm Morningstar led to 1,200 funds with assets of \$1.4 trillion being cut from its sustainable investment list.

He feels that the array of “passive” funds, where investors put money in based on an “ethical” or “green” label, may make little difference. But where there is direct investment in, say, a building or structure, that results in changes in the project that result in improved performance, the impact of ESG could be direct and more powerful.

While the path of ESG is still uncertain, he has little doubt that it represents a potentially powerful force that could reshape the construction sector.

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Looking forward

In these chaotic times, certainty is in short supply. But the available business weathervanes currently point strongly in one direction. ESG is being adopted rapidly by investors, clients, and major contractors and it seems highly likely that it will gather pace and begin to penetrate deeper into the supply chain.

A report to be published in November will focus on the potential impacts of ESG on the supply chain and its preparedness to respond

Key points and implications are:

- Investor interest in ESG continues to grow rapidly suggesting the spread of ESG will accelerate. This increasing pace is feeding through to developers, house builders, and contracting firms.
- The focus recently has been weighted towards environment issues, but social issues are coming to the fore, particularly around community relations, welfare, diversity, and inclusion.
- ESG appears less well recognised in much of the supply chain than among their clients and main contractors. Yet the supply chain may well see the most disruption as it embeds. It has the potential to create a split between those that embrace and invest in ESG and those that don't.
- The trust and transparency implicit in ESG will prompt firms to create fewer but deeper relationships within supply chains.
- ESG is likely to find favour with industry leadership groups, as it addresses many persistent and intractable problems that have dogged construction for decades.
- Measuring the non-financial ESG metrics and the incentive to improve scores will provide managers with data that can help them better understand their business and improve performance.
- Measuring ESG factors and improving performance will help firms stay ahead of future regulatory change.
- ESG has the power to radically reshape the culture of construction for the better.

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