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How ESG Can Be a Value Creator for Food & Beverage Companies

By Beth Johnson

Look at the shelves in grocery stores or on the menus at restaurants, and you'll notice that many product descriptions go beyond the ingredients. Certified B Corporation, Regenerative Organic Certified, Fair Trade, and other certifications or attributes are front and center on a variety goods, from beer to chocolate. Why? Environmental, social, and governance (ESG) factors have become increasingly important as businesses face mounting pressure from environmentally and socially conscious consumers, reputational risks, and increased legislation, as well as greater scrutiny from investors who recognize that a strong ESG profile can support a company's long-term success.

ESG investing has been on the rise in recent years and ESG assets surpassed $35 trillion in 2020, up from $30.6 trillion in 2018 and $22.8 trillion in 2016.[1] Global ESG assets may exceed $50 trillion by 2025, which would account for a third of all assets under management. While Europe has historically led on ESG assets, the United States is ramping up its investments and has potential to take the dominant role. The growth suggests that it isn't simply a fringe movement, but a fundamental shift as governments, investors, and consumers continue to allocate more dollars toward accelerating ESG goals.

ESG and Its Connection to Value Creation

The elements of ESG include:

- Environmental - A company's impact on the planet, such as climate change, pollution, biodiversity, waste management, and the responsible use of natural resources.
- Social - How a company manages its relationships with key stakeholders including employees, suppliers, customers, and communities where it operates.
- Governance - How a company approaches its leadership, executive pay, internal controls, and shareholder rights.

[1] ESG assets may hit $53 trillion by 2025, a third of global AUM, Bloomberg, 2022, www.bloomberg.com

A company with strong ESG principles can unlock value in several ways, including growing topline revenue; generating cost reductions; mitigating legal and regulatory interventions; and boosting productivity. Business owners should think of ESG as a verb, not as a static solution. In this article, we provide an overview of ESG in the context of the food and beverage industry, with specific examples of how it links to value creation.

Environmental

As an industry that accounts for 70% of global freshwater withdrawal and a third of all global greenhouse gas emissions, food and beverage companies face growing scrutiny to improve their environmental and sustainability practices.[2] For many businesses, ESG initiatives have often remained on the periphery in part because business leaders traditionally have viewed ESG as a cost.

However, effectively implementing ESG can help manage costs that consume a substantial amount of a company's operating expenses. Food and beverage production is incredibly energy intensive, from growing and sourcing ingredients to basic facility needs like HVAC. Conducting an energy audit and investing in energy efficiency upgrades can substantially lower a company's operating costs, in addition to boosting its profile among consumers. Craft brewing is a standout sector in the food and beverage industry when it comes to ESG and proof that smaller firms—not just corporate behemoths—can adopt ESG goals. Take, for example, Kona Brewing Company. The brewery operates in Hawaii, where energy costs are the highest in the nation, and the company is actively investing in measures to reduce its carbon footprint. Its new 30,000 square foot facility includes solar panels to power the brewery, in addition to technologies that greatly reduce water usage and enable CO2 reclamation. Since its founding in 1994, Kona Brewing Company has operated with strong environmental values, which resonates with eco-conscious consumers and sets the business apart in the competitive brewing industry.

Another case of ESG as a value creator is seen with New Belgium Brewing. The company started like many small businesses—in a home—and grew to be the fourth largest craft brewer in the U.S. with 700 employees. The craft brewer became famous for its flagship beers, like Fat Tire, as much for its sustainability and social responsibility. It was the first brewery to join 1% for the Planet and became a certified B Corporation in 2013, shortly after its transition to 100% employee ownership.

New Belgium's employee ownership was particularly salient to its core values, as founder Kim Jordan believed in providing wealth creation opportunities to employees at all levels of the company. The company's participative ownership structure included open-book management, continuous learning programs, monthly opportunities to hear updates and provide input on operations, and more.

[2] Water for Sustainable Food and Agriculture, Food and Agriculture Organization of the United Nations, 2017, fao.org; Food Systems Account for Over One-Third of Global Greenhouse Gas Emissions, United Nations, 2021, un.org

In 2019, New Belgium Brewing sold for an undisclosed amount to Little Lion World Beverages, the craft beer arm of Kirin. Both companies were aligned on aspirations and goals related to climate and equality, and Little Lion valued the culture and engagement rooted in New Belgium's ownership structure. The sale was a success story for employee ownership: upwards of 300 New Belgium employees received more than $100,000 in retirement money and over $190 million was paid out to hundreds of families.

Pursuing ESG Goals Through Partnerships

Companies may look to partnerships to when pursuing environmental and social goals. An example of this is the strategic partnership between Walden Local Meat Company, a direct-to-consumer company that delivers local, sustainably-produced meat, and B.GOOD, a fast-casual farm-to-table restaurant with an emphasis on sourcing local products. Both brands are New England companies and share a mission to grow local economies while providing people with nutritious, sustainable foods. The partnership provides an opportunity for Walden Local Meat to serve restaurants at scale, while also helping B.GOOD expand its regional producer network.

Clif Bar Commands Top Price, Backed by Its Strong Brand and Mission

A notable food and beverage transaction in 2022 was Mondelēz International's $2.9 billion acquisition of Clif Bar & Company, a leading manufacturer of energy bars revered for its adherence to sustainability and social responsibility. The company uses organic ingredients, diverts 90% of its waste from landfills, and is reducing its use of plastics (a move saving it hundreds of thousands of dollars annually), in addition to investing in renewable energy. The company also maintains a traceable supply chain and conducts annual visits with its farmers. Clif Bar's integration of ESG factors into its business strengthened its value proposition and provided an opportunity for Mondelēz to advance its "Snacking Made Right" strategy.

Social

Suppliers, employees, and customers are key components in the "S" of ESG, in which the element addresses a company's relationship with people and the communities where it conducts business. From a workforce perspective, running a business with a strong ESG proposition can generate several benefits. A 2022 survey by IBM showed that 70% of employees find sustainability programs make employers more appealing and 80% want to help their companies reach climate or ESG goals[3]. Engaging employees on ESG initiatives can help a business reach goals faster and boost workforce engagement, whereas a company with a weak ESG mandate may experience a drag in productivity, and in more severe cases, experience worker strikes and other labor actions.

[3] Sustainability at a Turning Point, IBM, 2022, ibm.com

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ESG and its impact on productivity extends beyond internal operations and can ripple across a company's supply chain. Ingredient sourcing is often done through large suppliers that source from subcontractors and among these subcontractors, there may be firms that operate with little oversight of workers' safety and health. A glaring example of this is the cocoa industry, which is connected to some of the worst forms of child labor, human trafficking, and slavery.[4] Dutch chocolate maker Tony's Chocolonely produces an array of unique chocolate bars, but more importantly, the company is on a mission to create a 100% slave-free chocolate industry. It approaches this through a variety of strategies, from continually examining its supplier relationships (the company cut ties with a Turkish hazelnut supplier after child labor practices surfaced) to creating a digital platform Open Chain, which provides competitors and other industry participants with information to copy the company's sourcing practices. Since its founding in 2005, Tony's Chocolonely has stood out for its commitment to equitable practices. Today, the chocolate maker is a market leader in the Netherlands and growing rapidly in other countries, demonstrating that a clear ESG mandate can significantly contribute to a company's growth.

Governance

Governance is intertwined with environmental and social elements of ESG and is the internal system of controls, practices, and procedures that enable a business to govern itself, make decisions, and maintain compliance with regulators. Financial and accounting transparency, honest financial reporting, and proper oversight are key elements of good governance. The food and beverage industry is highly regulated, and companies that operate with weak governance could face fines, penalties, and enforcement actions.

ESG may impact the regulatory landscape and business leaders would be wise to follow the evolving regulatory environment. In March 2022, the U.S. Securities and Exchange Commission put forth a proposal that would require publicly listed companies to disclose information on climate risks. While the proposal has not been finalized, food and beverage companies should follow the developing ESG regulation to avoid noncompliance risk. And, while companies that are not publicly traded do not have to file with the SEC, ESG factors are often material to securing contracts with publicly traded companies and/or government agencies.

4 2020 Findings on the Worst Forms of Child Labor, Department of Labor, 2020, www.dol.org

A Food Distributor's Equitable Sourcing Strategy Benefits Farmers, Drives Growth with Key Customers

Institutions such as universities are publicly committing to ESG initiatives and using procurement as a tool to reach their goals. Increasing sourcing of local products is a goal of many organizations, but institutional buyers want a streamlined process when purchasing from small producers.

A growing fresh foods distributor leveraged its equitable sourcing strategy to connect historically marginalized farmers with a university food service provider. The connection was pivotal for the farmers, who faced limited access to high-volume accounts like those with universities. The distributor's deep trust with its producer network, commitment to building a more just and equitable food system, and transparent and efficient sourcing model was compelling for the university – the university could partner with the company to pursue ESG goals and streamline its local sourcing process. What began with a few orders grew into weekly standing orders, boosting the recurring revenue for the company and increasing the university's spend with local farmers. Demand, and impact on the local farming community, continues to grow: the partnership proved so successful that the food service provider expanded the model to other universities and the distributor remains the preferred local foods supplier.

Across Different Scenarios, ESG Provides Opportunities to Create Value

As environmental, social, and governance concerns become more pressing, companies that prioritize ESG can unlock greater value and enjoy a strong position for the long-term. From an M&A perspective, buyers are incorporating an ESG mindset as they make decisions around deal selection, valuation, and risk allocation. A PwC survey revealed that 72% of private equity respondents always screen target companies for ESG risks and opportunities at the pre-acquisition stage, and a report by Bain & Company stated that 93% of limited partners would walk away from an investment if it posed an ESG concern. [5]

Business leaders should assess which ESG factors align with their organizations and develop a plan that plays to their strengths. For some businesses, it may be expanding employee benefits or providing professional development opportunities that support promotion from within an organization, both of which are attractive offerings in a tight labor market. For other businesses, it may be implementing energy efficiency measures (which can reduce overhead costs) or increasing sourcing from regional producers (which can mitigate supply chain risks).

As the focus on ESG builds, driven by decarbonization and social transformation, private equity firms, strategic acquirers, consumers, and other stakeholders will increasingly incorporate ESG factors into their decision-making. Food and beverage businesses that continue business as usual risk being unable to adapt to social and environmental change. Companies that embrace ESG can enhance and sustain their value, create a more resilient business, and enjoy long-term success.

[5] Private Equity's Journey: From Compliance to Value Creation, PwC, 2021, pwc.com; Limited Partners and Private Equity Firms Embrace ESG, Bain & Company, 2022, bain.com

Rustic Crust: A Leader in its Commitment to Workers and Local Community

In 2014, Rustic Crust, an all-natural pizza product company based in New Hampshire, suffered a devastating fire that burned its facility to the ground. The company was on a strong growth trajectory and on track for record monthly sales. While grappling with the catastrophic damage, the company's leadership prioritized taking care of its workforce. Production halted, but the CEO, Brad Sterl, continued paying the company's 100 employees.

The community and employees rallied around Rustic Crust and the company's 28 products were back in production in just 30 days. The company lost $4 million in revenue during the downtime. Thirty employees were added, and the team worked seven days a week to make up for lost time. Sterl's active engagement in the community benefited the company as well. Permits were secured faster, and bankers stepped up to provide funding for construction. Employees even used the downtime to train and plan for future growth. Despite the fire, the company grew revenue by 25% from 2013 to 2014. Today, Rustic Crust is the number on U.S. national brand of natural, ready-made pizza crusts.

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