

Witnessing an ESG revolution

– seeking a common language for investors and companies

A report on investor
targeted sustainability
communications
and reporting

INFORMATION REGARDING THE REPORT

Miltton examined what kind of corporate sustainability information is important from the investors' perspective, and whether the current sustainability communication and reporting meet the needs of investors. This report is a qualitative overview of the current state of investor directed sustainability communication and reporting in the New Nordics region.

The report was produced by interviewing 16 publicly traded companies and institutional investors in Finland, Sweden and Estonia during the summer and early autumn of 2019. Most of the interviews, 12 to be exact, were conducted in Finland. In Sweden and Estonia, Miltton interviewed one publicly traded company and one institutional investor.

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CONTENTS

Foreword – Questions of sustainability carry increasing weight in the investor’s portfolio.....	4
The tidal wave of responsible investing	5
There is no universal model for responsible investing.....	7
Where do investors find the information they need?.....	8
Sustainability reporting that meets investors’ needs.....	12
The wild west of reporting frameworks	16
Challenges and solutions on the ESG horizon	21
Perspectives on the future	26
Conclusion	28
Miltton’s recommendations for better ESG communication	30
Terminology.....	31

FOREWORD – QUESTIONS OF SUSTAINABILITY CARRY INCREASING WEIGHT IN THE INVESTOR’S PORTFOLIO

Responsible investing or ESG investing (Environmental, Social and Governance), in which environmental, social and governance issues are factored in investment decisions, has increased its popularity during the past years. Many new responsible investment products have appeared in the market and investors are increasingly integrating ESG issues into their investment decisions.

As the ESG trend is increasingly popular, we here at Miltton, as well as many of our clients, have begun to wonder if responsible investing is really becoming mainstream or will the status quo prevail. In other words, is there a permanent change happening with the way investors think and make decisions or is responsible investing just value charged tinkering among a small group that is accomplished outside of real business activities.

On the corporate side, the growing popularity of responsible investing is visible in the increasing need for information among investors and raters, which demands an overwhelming amount of reporting and investor targeted communication. At the same time, the requirements for corporate reporting are increasing, both in terms of regulation and the expectations of interest groups. Thus, the number of frameworks for reporting is ever growing. However, the devotion to reporting and responsible communication by companies does not seem to satisfy the investors’ needs. There is a great disparity between the increase in reporting and the investors’ growing need for information.

For the time being, ESG communication seems more like a form of art than science. Therefore, we decided to take action and investigate where this lack of common language stems from and

what could be done about it. We asked a group of leading Nordic investors and companies what kind of information both sides really need from each other, in what format and through which information channels. In our conversations, we aimed to map out the issues that are of importance from the investor’s point of view, and what are the challenges companies face when seeking to answer the information needs of the investors.

Behind the emphasis on corporate sustainability and the ESG trend, there is the demand of consumers, reputation management and other risks, and the benefits created by new business opportunities. Along with the UN’s 2030 Agenda as well as the Paris Agreement, the international community is strongly committed to activities promoting sustainable development. However, achieving these ambitious goals requires even further inclusion of the investor community in order to finance sustainable development. Along with EU legislation on sustainable financing that is underway, the investors’ demand for green labelled investments will grow, which then increases the significance of sustainability communication and the reporting of companies.

Because of these reasons, among other factors, we believe that finding a common language between investors and companies is even more important than before. We hope that this report will be a fruitful beginning in building a dialogue and increasing understanding, but there is certainly more work to be done.

We want to thank all our interviewees for their time and valuable insight as well as all the experts at Miltton who have contributed to making this report. We would like to extend our thanks to you all and hope that the readers of this report find it rewarding.

”Along with EU legislation on sustainable financing that is underway, the investors’ demand for green labelled investment objects will grow”



JOHANNA TALVELA

*Senior Advisor,
Sustainability & Communications*



VISA MANNINEN

*Director,
Miltton Markets*

THE TIDAL WAVE OF RESPONSIBLE INVESTING

Companies began to cover issues of sustainability in their reports long before the first investors started to show interest in the topic. A big push happened in the investment sector in 2006, when the UN established their Principles for Responsible Investment. After 2006, major institutional investors began to increasingly invest based on sustainability, although, back then, such course of action was based on a small group voluntarily doing so.

During the past few years, responsible investing has quickly risen to be an integral part of operations of the investor community. The investors we interviewed considered the causes for this increase to be, in particular, the Paris Agreement and the adoption of the UN's Sustainable Development Goals, as well as the widely publicised IPCC reports, which all require major societal actions in order to secure a sustainable future.

“Even though barely anything happened among investors in terms of sustainability for the first five years of the past decade, for the past two or three years, all investors have agreed on the importance of the issue. When something creates the force that drives the tide, then change can come quickly. Particularly in the case of climate issues, there is no time to be wasted.”

- Ira van der Pals, The Church Pension Fund

Investors have carried out responsible investing as part of risk management even before the external pressures increased. The better the investor knows the companies in their investment portfolio regarding ESG aspects, the better they can assess the risks related to the companies. Sustainability for revenue is a central part of responsible investing and nowadays companies are increasingly being measured through the profits that have been enabled by ESG.

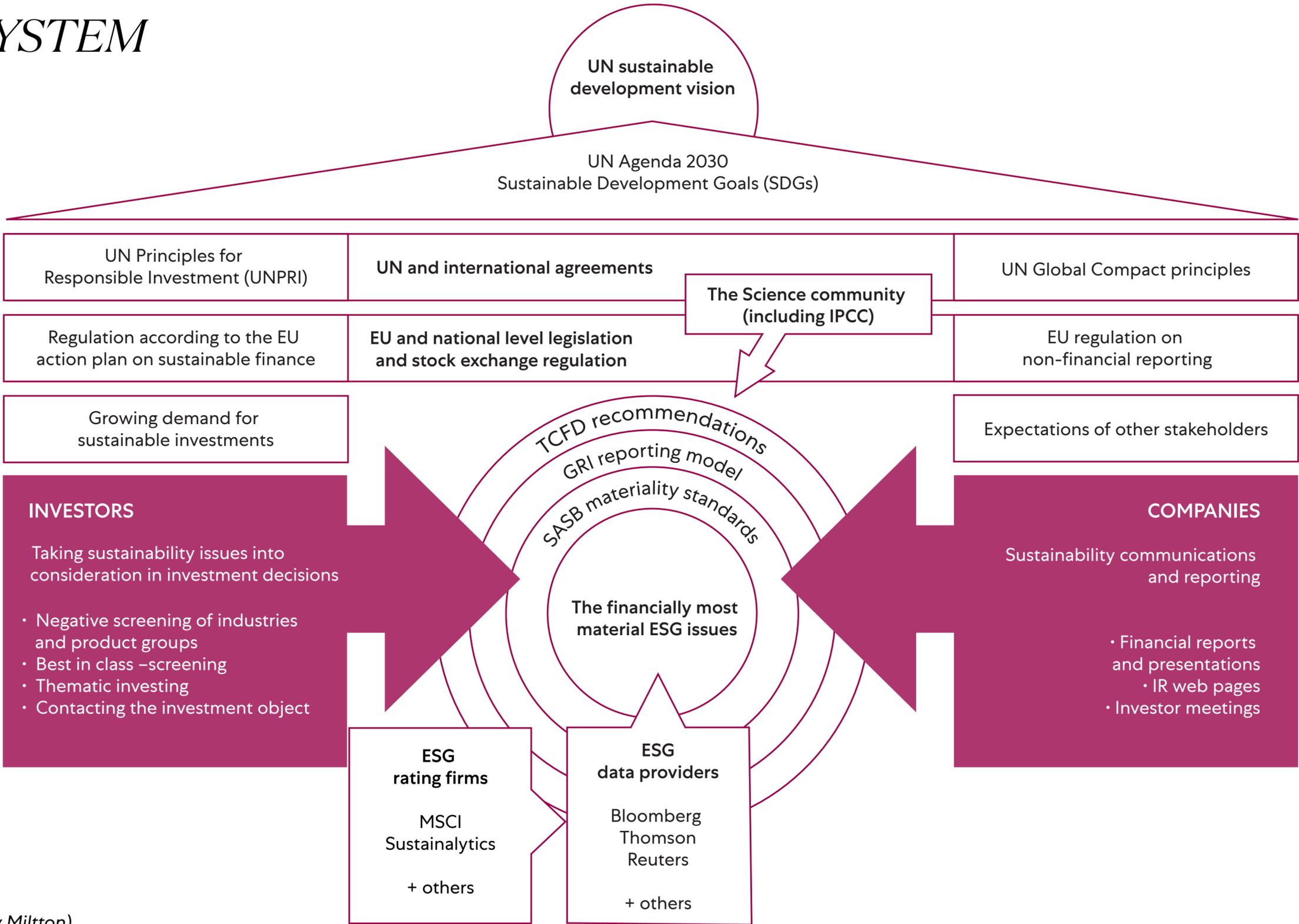
The rest of the investment field, including private investors, have also begun to follow the example of major institutional investors and started to take ESG aspects into consideration more seriously. An indicator of the importance of ESG issues on investors' agendas is how widely publicly traded companies bring the issues to the table at investor meetings.

“Of around the one hundred or so annual general meetings that Ilmarinen has taken part in this spring, only a couple did not bring up sustainability issues either in the opening speech of the chairman of the board or the CEO's review. In all the other meetings, references to sustainability were made either in one of these statements, or more often, even in both”

- ANNA HYRSKE, ILMARINEN



ESG ECOSYSTEM



Source: Tracefi (Adapted by Milton)

THERE IS NO UNIVERSAL MODEL FOR RESPONSIBLE INVESTING

Just like companies, investors too are different from each other. Thus, the approach to responsible investing depends, for example, on whether one invests directly into a company or through funds. The quantity of invested assets, the level of knowledge on responsible investing as well as the resources influence which approach will be chosen. Most investors do not have only one strategy for responsible investing, instead they use different approaches depending on the situation.

The most common and earliest approach to responsible investing is to exclude companies based on the specifications of sustainability criteria (negative screening). Typically arms, tobacco and fossil fuel industries are examples of businesses that many investors refrain from having in their portfolios. Positive screening, in which the investor favours those corporations that have committed to responsible business activities, can be seen as an opposite to the exclusion-based approach. A more ambitious approach is the best-in-class strategy, in which the investor chooses companies that have the best ESG grades compared to other actors in the same field.

The kind of investing that is purely exclusion based is becoming rarer due to the further development of investment tools, as well as the development of companies' sustainability reporting. Based on our investor interviews, the common view seems to be that a radically exclusive approach, or on the other hand, an overly favouring approach are neither necessarily seen as responsible investing at all, nor will these approaches generate the best revenue.

"The issue at stake is how the current climate change transition will be handled. For example, leaving out all oil investments will not resolve all the necessary reductions of carbon emissions. On the contrary, we could lose opportunities to have an impact as well as lose good investment returns during the interval. Those companies that are aware of the need for transition and have begun to modify their own strategies are the winners, and they will also be able to offer returns for the investment operations, which is what we as investors need right now."

- Anna Hyske, Ilmarinen

Nowadays, an important part of responsible investing is so-called active ownership, in which the investor aims to improve the company's sustainability through their rights as an owner. Active communication between the company and its management as well as voting in shareholders' meetings are examples of ways in which investors can indirectly impact the sustainability policies of companies as active owners.

"Contrary to common belief, the most substantial ways of influencing do not take place in the shareholders' meetings but rather in nomination committees before the meetings. Major investors in nomination committees can, if they so wish, have great power as well as sustainability in ensuring that there is sustainability competence among the company's board of directors."

- NIINA BERGRING, VERITAS

For the time being only a marginal, yet clearly an increasing form of responsible investing, is so-called impact investing. Green bonds are an example of an investment instrument through which investors can aim to achieve positive impacts on the environment and the climate alongside returns. Many of the companies we interviewed said that investors have viewed this form of investment positively.

"Our first Green Bond was issued in February and it was immediately oversubscribed fourfold. This is a good indicator of the fact that there is an interest for these kinds of products. One can really do good things with money and not only minimise the bad."

- Satu Kuoppamäki, OP

Where do investors find the information they need?

The investor's view on sustainability is based on many different factors, and it cannot be said that any one source of information is more important than another when making investment decisions. Direct communication between investors and target companies alongside meetings and conversations are important, but both traditional and social media have a place as sources of information on sustainability. ESG raters, as in the actors who sell sustainability analyses and reference materials to companies, have a major role in the markets of responsible investing. Without raters, sustainability analysis on major investors' investment portfolios that consist of extensive numbers of companies would not be possible.

DIRECT CONTACTS TO COMPANIES

The investors we interviewed shared with us that the most important source for sustainability information, particularly for Finnish companies, are the direct contacts that portfolio managers have with the companies that are invested in. During regular meetings and other forms of communication between the investor and the company, information concerning the company's sustainability issues are discussed in addition to other current issues.

”When portfolio managers began to present ESG related questions at our company meetings a couple of years ago, they were at first “embarrassed” to raise the topic. Now the situation is completely different and companies themselves talk about these issues and understand their significance”

- NIINA BERGRING, VERITAS

Traditionally, the investor relations of companies have been managed through dedicated Investor Relations departments, but as sustainability issues have become more clearly part of investor contacts, the role of corporate sustainability departments has increased. The companies we interviewed note that conversations on investor needs take place more broadly within companies. Direct contacts for gaining sustainability information work well only when the size of the investment portfolio is manageable.

Generally, the investment portfolios of major investors, such as pension companies, are comprised of thousands of different companies around the world. In such cases, having active direct contacts to all investment companies is not possible, and analysis needs to be supported, for example, by information provided in reports.



ALL COMMUNICATION IS INVESTOR COMMUNICATION

Nowadays, the investor communications of companies involve a broad range of different communication channels, from reporting personal meetings to websites and newsletters. Likewise, media is an important source of sustainability information for companies.

”Gathering sustainability information for companies is constant in one form or another. If changes due to, for example, corporate acquisitions come to our knowledge, we will react to those changes and often meet up with the company. We also ask for the company's position on smaller issues that are brought up in the media, and do not rely solely on information available from the media. We allow the corporation to discuss the issues in their own voice”

- Teemu Salonen, OP Varainhoito

Recent information on the sustainability and rising trends of companies is available for investors also in social media. For example, the way a company reacts on social media during a media crisis can be rather telling about the company's abilities to handle unexpected situations. It communicates to the investors how well the management model of the company functions.

”In my view, all communication will serve also investors in the long run. Especially crisis and reputation management are strong indicators for the investors on how well the company operates and whether crises are quickly controlled. This is especially visible in the fast-paced environment of Twitter.”

- Eeva Taimisto, Stora Enso

ESG RATING SUPPORTS INVESTOR ANALYSIS

From the investor's perspective, the reporting by companies themselves is often poorly comparable as there are no universally binding sustainability standards. Thus, it is challenging for investors to carry out comprehensive ESG analysis to support their investing decisions. This is where ESG raters come into the picture, offering the investor more advanced and commensurate information on the sustainability of the targeted investment companies. Some of the major ESG rating operators are MSCI, Sustainalytics, CDP and RobecoSAM.

Using data bought from ESG raters is common especially when big investors are concerned, as the investing is always done at least partly passively. On the other hand, the investors we interviewed emphasised that data provided by ESG raters is used as a base for personal analysis on the companies.

”You do not consider MSCI’s score as a given but rather it works as a first indicator on where to focus one’s own analysis. It is very important that the portfolio manager understands the scoring model behind MSCI, and the things emphasised by that model. In the end, the portfolio manager makes the decision on their own, based on the information gathered from different sources”

- OUTI HELENIUS, EVLI BANK

Based on our interviews, it is clear that ESG rating invokes strong opinions both in the investors and companies. The lack of transparency concerning the methods of analysis for the targeted companies is seen as particularly problematic. ESG companies often justify this by referring to trade secrets. According to our interviews, there is more information on the methods of analysis available for investors.

Investors also mention the inadequate sustainability reporting of smaller companies as a rating challenge, creating a distortion when compared to companies that operate with more extensive resources for reporting. In these cases, the ESG rating of these companies is either missing completely or it can be incorrect when compared to the actual level of sustainability work done by the company. Likewise, regarding the ratings of larger companies, further interpretation is necessary due to the lack of certain information, which lowers the reliability of the rating.

The varied group of ESG raters

From the perspective of companies, the biggest challenge for ESG rating is related to how often the ESG operators contact the companies, which then increases the use of the already limited resources of investor communications and sustainability experts. The ESG rating operators are quite varied, which causes frustration and confusion among the companies we interviewed.

ESG rating is based mainly on the corporate sustainability reports of companies. In addition, the companies being analysed may be asked to answer separate questions concerning certain topics. The methods of collecting data between the different rating operators can vary quite considerably, which is visible to the companies in the quality of ESG questionnaires.

”Raters too should indicate that they have done their homework before sending out the questionnaires. If raters could show that they have researched what we do and familiarised themselves with our integral subjects, it would make our work a lot easier.”

- Pia Hildén, Neste

Another confusing issue for the companies we interviewed was the fact that ESG raters collect information for different purposes, of which only a proportion is later available for the companies themselves.

” If a company has a crisis, that information is typically kept in the rater’s database for around five years. The rater looks for information on how the company has handled the crisis. In these types of case studies, the rater’s recommendation, or rather the condemnation, is only visible to the paying client. I would hope that these recommendations would be visible also to the company that is being evaluated. Then the raters could claim to be truly implementing the principle of transparency.”

- Ulla Paajanen, Stora Enso

Prioritising ESG enquiries pays off

Based on our interviews, ESG ratings were seen mainly as a good thing despite their shortcomings, since due to the ratings, understanding the significance of sustainability has increased within companies. Many of the investors we interviewed noted that many of the tools, including rating, must be utilised so that the indicators of responsible investing can be developed.

“As someone who has followed responsible investing for a long time, I have noticed that big leaps have been taken forward as well. Even as recently as five years ago, the importance of rating enquiries was not understood in companies and sometimes they were left unanswered. Now, companies understand that if they leave the enquiries unanswered, it can cause a poor result and the company might then not be chosen as an investment target.”
- Ira van der Pals, The Church Pension Fund

Companies say that they use rating enquiries for improving their own sustainability reporting

“When the work for annual reporting begins, it is good to recap what issues have been brought forward in the enquiries. Of course, there are all sorts of questionnaires, but they also indicate how we can better respond to the needs of investors and rising trends.”
- Pia Hildén, Neste

As the number of ESG enquiries is constantly increasing, both investors and companies think it is best to focus on those raters and their information needs, which are most vital for one's own investor group. When answering the enquiries, companies can prioritise the actors that are most relevant to their operations by finding out the investors behind each rating company.

“We have asked our investors directly about which raters they follow. After this, it was easy to decide which rater's enquiries to respond to.”

- TIMO KOLEHMAINEN, NOKIA

As the number of ESG ratings and enquiries related to them has increased, the value of information provided by companies themselves has not decreased, quite the contrary. Regardless of where the investor gets their information on a company's sustainability, it is important that it is based on information provided by the companies themselves, and that it is up-to-date and relevant. Consequently, the investor has the best capabilities to evaluate companies when making investment decisions.



Sustainability reporting that meets investors' needs

The official reporting carried out by companies is an essential source of ESG information for investors and it affects the investment decisions as much as traditional financial reporting. In Finland, public companies report on sustainability in their annual reports without exception and sustainability issues are often brought up in quarterly reports too. However, the question is whether the sustainability information reported by companies is relevant and easily accessible to the investors or not.

WHAT IS RELEVANT SUSTAINABILITY INFORMATION?

The investors we interviewed state that the main issue with sustainability reporting, from the perspective of investors, concerns relevant sustainability information, which is seen differently by investors and corporations. For a company, sustainability reporting is a way to inform all the important interest groups, such as consumers, employees and officials. However, the all-encompassing information flow can bury the sustainability data that interests investors.

Another difference in perspectives mentioned by the investors relates to the effects of business operations. The sustainability reports of companies are often based on materiality assessment, which are carried out in collaboration with interest groups. The analysis examines the effects on surrounding society as well as the effects on those interest groups that are most relevant to the company's business operations. For the investor, choosing relevant corporate sustainability topics is based on those risks and opportunities created by the surrounding society, which are most likely to affect the operations of the company.

Differences in perspectives and the overall undefined nature of sustainability reporting leads to the fact that companies that report on largely different issues are not, from the investors' perspective, comparable with each other regarding ESG issues.

PAYING ATTENTION TO THE FINANCIALLY MOST MATERIAL ESG ISSUES

The increase in responsible investing indicates that ESG issues are being recognised as important factors affecting companies' financial earning power. Thus, from the sustainability reports, investors expect to get information on those sustainability issues that are financially most material for companies.

One of the investors we interviewed notes that alongside perspective differences concerning the relevancy of certain issues, the reason why sustainability reporting has not been focused on investors is because sustainability and financial departments have traditionally been clearly separated from each other. Communication departments are usually responsible for sustainability reporting, in which case the focus of ESG issues is centred around marketing, instead of the raw data that would interest investors more.

From the investors' point of view, it would be important that the information on a company's most central ESG issues could be found in the same place where all the other relevant information is located – as part of the annual report.

”Whereas a separate sustainability report can serve other interest groups, for investors this is only nice-to-know information. Financially material sustainability issues should be included in all reporting – not as a separate part of all other reporting.”

- ANNA HYRSKE, ILMARINEN



NUMBERS ARE NEEDED, WITHOUT FORGETTING THE STORY

Traditionally, sustainability reporting is centred around qualitative information. The investors we interviewed emphasise, that the tools used by investors when analysing companies are mainly based on number-based data. Thus, ESG perspectives should be available in a numerical form as much as possible, much like financial information.

Although numerical sustainability data is, in itself, most useful for investors' purposes, the investors we interviewed reminded that qualitative information also has an important role in certain sustainability subjects. For example, describing the operational culture of companies and management approach of corporate sustainability are particularly interesting information for investors. The management approach reveals, for example, which operator's relevant questions are answered and what instructions steer the company's operations.

"Qualitative information is, of course, harder to compare, but some kind of description on risks and opportunities should exist. Both are nonetheless needed, numbers and description."

- Outi Helenius, Evli Bank

Many of the issues that belong to the sphere of social sustainability are often such that the companies we interviewed hesitate to transform them simply into numbers, because consequently, important perspectives can easily be ignored or not understood. Such topics as the wellbeing of employees, realisation of human rights, local communities, and ensuring the client's information security also belong to the sphere of social sustainability.

"Investors do not always understand the company's challenge of answering questions concerning equality and human rights. The terminology related to these issues is often ambiguous and even though inappropriate behaviour or harassment cases are easily reportable in numbers, they do not tell the whole story of the company."

- Kati Ihamäki, OP

The investors we interviewed thought that as the tools develop, there will be an increasing amount of Excel-based data on corporate sustainability issues that can be brought into portfolio management systems. Thus, alongside traditional financial numbers, one can monitor the numerical trajectory of corporate sustainability and make better predictions.

THE MANAGEMENT'S PERSPECTIVE ON THE FUTURE INTERESTS INVESTORS

A substantial part of investing is the intention to predict the cash flow of companies that one is investing in. Thus, the information needs of investors regarding sustainability are very much future-oriented. It is important for the investor to hear the company's own perception on the future risks and opportunities regarding the company's sustainability issues.

The investors we interviewed said that they also needed information on how the strategically most significant corporate sustainability issues are being managed, what kinds of goals have been set for them and how those goals are monitored. From the perspective of investors, it is important that the significant sustainability issues of the reporting company have been recognised from the top down.

”As investors we cannot always know about the strategic courses or structural changes of certain fields, which may become essential with regards to business operations in the next five years. Therefore, it is crucial to get information on the material sustainability issues earnings-wise according to the knowledge and understanding of the company's management.”

- NIINA BERGRING, VERITAS

ASSURANCE INCREASES THE RELIABILITY OF THE INFORMATION

As the significance of ESG as part of investment decision-making increases, investors expect companies to increasingly verify relevant information in their reporting. The investors we interviewed emphasise that in an ideal situation, ESG data would go through the same verification process as the company's financial information. Also companies advocate for verification processes, as they see it would increase the reliability of reported information.

”Stora Enso has used a verification process in its sustainability reports since 1998. Since 2015, we have verified our CO₂-numbers on the Reasonable Assurance level. This has significantly increased the credibility of our report.”

- Eeva Taimisto, Stora Enso

Since the obligation to report non-financial information, part of sustainability reporting has already moved under the obligatory verification sphere, since such information is audited as part of the board of director's report alongside financial reporting.

The wild west of reporting frameworks

There are very few legally binding requirements for the sustainability reporting of companies. For most parts, sustainability reporting is based on voluntariness and companies themselves can decide which framework to use when reporting on sustainability issues. There is an enormous amount of different types of frameworks concerning sustainability reporting and the number is not likely to decrease as the significance of corporate sustainability itself is increasing. Next, we will discuss those frameworks and their roles in reporting that are most significant to companies and investors.



THE REPORTING OF NON-FINANCIAL INFORMATION – CONTRADICTIONS AND OVERLAP

The EU's non-financial reporting (NFI) directive that took effect in 2016 brought such issues as environment, social responsibility and good governance as part of mandatory annual reporting. So far, the reporting requirement has involved only large companies that are significant in terms of public interest.

The companies we interviewed saw NFI based reporting as somewhat contradictory. Its benefits were questioned regarding companies that have already been reporting on sustainability for a long time or that operate globally, since information becomes scattered in the report and doesn't allow investors to form a cohesive view on sustainability.

”New legislations do not necessarily ease the burden of reporting as it seems that it is not always possible to present as holistic a message as the company itself would want to in the reports. The rather broad terms of reference set by legislation still determine how information is represented, organised and placed within the report, causing overlap between different reports.”

- MARI REPONEN, FINNAIR



WAITING FOR A BETTER REPORTING FRAMEWORK

A traditional, and by far the most popular framework of corporate responsibility reporting is the Global Reporting Initiative (GRI), which was originally in use already in the year 2000. GRI based reporting has established itself as a reporting format that takes all of the company's interest groups into account. It has become the generally accepted reporting practice in many fields.

The investors that we interviewed agreed that the current GRI directions have expanded to such extent that the framework has lost its user-friendliness in examining the most relevant sustainability issues within companies. In terms of comparability, investors do not see GRI as the best possible framework.

Some of the companies interviewed also state that the level of precision demanded by GRI does not always serve the company's own needs or the most relevant issues in the correct way. However, so far GRI has been viewed as a relatively concise way to report otherwise very complex corporate sustainability issues to different interest groups.

”GRI is a good first step towards coherent reporting, even though it does not yet allow making comparisons between different companies. We plan to keep to GRI while waiting for a better one.”

- Satu Kuoppamäki, OP

SDGs

JUST NICE SYMBOLS OR A VALID TOOL FOR REPORTING ON IMPACTS?

The UN's Sustainable Development Goals (SDGs) are important background forces behind responsible investing, visible in the investment principles and direction of most major investors. The interviewed investors commented that when comparing companies they mostly prefer such actors that have positive impacts on the surrounding society.

The information on companies' impacts is also important due to the fact that the investors themselves are expected to report more extensively to their own interest groups about the impact of their investment portfolios. From the perspective of companies, the commensurability or reliability of the sustainability data is not yet on such a level that it could be used to support investment decisions on a large scale. Yet, the companies' reporting on the impacts of their business operations is still increasing and tools to measure different impacts are starting to appear on the market.

SASB

A CONTENDER FROM THE UNITED STATES

SASB (Sustainability Accounting Standards Board) is a framework that is increasing in popularity particularly among investors.

Originally from the United States, the standards of SASB, published in 2018, are based on years of preparation work that included participants representing various fields and, for example, experts on financial and environmental legislation.

The reason for the popularity of SASB among investors is the fact that the framework is based on key sustainability issues on each commercial sector and industry group, that are most material from a financial perspective. SASB aims to improve the comparison between different analysed companies from an investment perspective.

Although SASB is still characterised by its reputation as an American financial reporting framework, the possibilities of its appliance beyond the United States have begun to be recognised. Some of the companies we interviewed have started to consider the benefits of SASB as a reporting framework.

"Concerning airlines, SASB could offer added clarity and comparability between the American and European companies operating in the airline sector. It would, however, require a detailed analysis and estimate on what would be the best way to report according to SASB in Europe, and how SASB could be used as part of mandatory non-financial reporting in order to ensure a coherent reporting entity."

- Mari Reponen, Finnair

TCFD

TOWARDS THE MODELLING OF CLIMATE SCENARIOS

Although the central sustainability issues are always specific to the company or the line of business, after the Paris Agreement and IPCC reports, environmental issues have emerged as an integral part of the reporting of companies. The effects of climate change have already been recognised as an essential factor affecting the returns of investors. This is proven by the various investor-driven initiatives that seek to increase investments against climate change.

TCFD (Task Force on Climate-related Financial Disclosures), which released its first guidelines in 2017, is perhaps the most widely noted and accepted climate reporting framework among both investors and lawmakers. Like SASB, TCFD is also developed based on the needs of investors. Its central issues are the financial risks and opportunities for the company.

The interviewed investors saw TCFD as a good tool particularly because it is future oriented. Examining the effects of climate change through TCFD frameworks is considered to benefit not just investors but also the reporting company, as it forces it to

consider the effects of different scenarios on their own business operations as well as the durability of their strategy.

The challenge in TCFD reporting from the perspective of the investor is that only a small number of companies use the framework for their reporting. The investors we interviewed said that there is still a lot of variability in reporting, which once again makes comparison between different companies difficult. Thus, investors themselves are not able to fully utilise the TCFD framework in assessing the effects climate change can have on their own investment companies.

Both companies as well as the investing front is preparing for broader reporting on the effects of climate change, because the EU has indicated that it will base its future regulation on TCFD's recommendations. In the future, other than emission intensive companies will also have to report more broadly on their climate effects. Thus, by now all organisations should begin familiarising themselves with the principles of TCFD reporting.



A CLOSER LOOK AT SWEDEN

Swedish investors focus on climate issues

The major Swedish pension funds have gained extensive experience in responsible investing, and their best practices have provided the basis for creating responsible courses of action also for Finnish pension investors. Currently, on a broad front, responsible investments are focused on climate issues. In this case as well, the major Swedish investors are ahead of the game.

Rebecca Rehn, ESG analyst at the Swedish pension fund Alecta, comments on climate risks and how it has become more important during the past years, and that investors are considering their investment portfolios in relation to these risks

“Alecta has a strong focus on climate issues. We recently joined the UN-convened initiative Net-Zero Asset Owner Alliance, where we commit to reduce the carbon emissions of our investment portfolio to net-zero by 2050. We are also interested in measuring climate effects especially since we have 37 billion SEK in green bonds and 10 billion SEK in impact investments,” Rehn says.

For Alecta, TCFD is an important framework for evaluating the climate related risks of the investment portfolio. As part of Alecta’s annual ORSA (Own Risk and Solvency Assessment) reporting, the entire investment portfolio is stress tested based on various climate scenarios, applying the TCFD-framework. This entailed calculating the financial impact of various outcomes connected to the climate. For example, how the value of the portfolio would be influenced by a sharp rise in the price of carbon dioxide which, according to assessments, is required to achieve the Paris Agreement’s two-

degree target. This year, the focus will be to elaborate especially on the physical risks related to climate change.

“This year, we will seek to put more emphasis on the physical risks of climate change and how our portfolio will be affected in this perspective, for example, the companies whose factories or other facilities are located in high risk areas relative to rising sea levels. In addition to risks, we evaluate opportunities – which sectors and companies will end up as winners in relation to climate change,” - Rehn points out.

“As a consequence, we will strongly promote better climate disclosure of our portfolio companies, as our stress test has revealed a notable lack of available and good quality data, in particular Scope 3 GHG-emissions. TCFD is well known among investors, but we expect also non-financial companies to use the principles to explain the strategic impact of climate change to their business model and strategy,” Rehn continues.

Like Rehn, Peter Kangert, Head of Investor Relations at Swedish property company Faberge, has found that inquiries from investors tend to emphasise risks and opportunities related to the climate.

“We are asked about the effect that a global warming of 1,5 or 2 degrees will have on our business. It’s difficult to give a good answer to such question today, because nobody really knows what will happen if it occurs.

But we are preparing for such scenario more than before. For example, when developing new properties, we will take into account that the facades can withstand stronger winds and the buildings can cope with increasing amounts of rain. In addition to figures related to energy and CO2 levels, investors are interested in the ways we benefit from our sustainability efforts,” Kangert says.

Faberge has a framework for green funding and the company’s goal is to have 100 percent green financing, in Q3 2019 it was 82 percent. Peter Kangert notes that due to the growth of demand for green bonds, the price of green funding is lower than non-green today.



Challenges and solutions on the ESG horizon

The social responsibility communication and reporting of Nordic countries is of a very good standard when compared to the international level, but in the big picture there are only a small number of forerunners inside the “sustainability bubble”. The large-scale growth of responsible investing and sustainability reporting presents challenges to those investors and companies that are already relatively developed with regards to sustainability issues, due to the pressure for finding more talent and resources. The upcoming EU legislation on responsible investing is considered to ease the work of investors when making comparisons between different companies. Yet, when considering both companies as well as investors, the workload concerning ESG is not believed to decrease.

HOW ABOUT SMALL COMPANIES AND THE REST OF THE WORLD?

The interviewed investors agree that Finnish companies mostly report on their sustainability well and broadly enough. Regarding small companies, investors, however, have a smaller number of sustainability data at their use since ESG raters are not able to offer rating information on such companies due to their limited reporting. Often, the sustainability analysis of smaller companies needs to be done by investors “manually”.

”Big companies in Finland conduct their reporting very well. But when considering the distribution of companies in Finland, about 30 from around 130 companies are worth over a billion and the remaining 100 are smaller companies. In that smaller end of the spectrum there is still room for improvement.”

- TEEMU SALONEN, OP ASSET MANAGEMENT

The reason for the limited reporting of smaller companies is, naturally, their smaller resources. The investors we interviewed seemed to understand the situation very well, but at the same time they are aware of the problem caused by the lack of reporting in the fact that bigger companies will overshadow the smaller ones in the ESG raters’ analysis. Bigger companies report broadly on their sustainability, yet smaller companies that can be very responsible may be left out of investment portfolios.

Another challenge that came up in the interviews is the focus of corporate sustainability reporting on mainly Europe and the Nordic countries. Finland and other Nordic countries are, in particular, clear frontrunners in social responsibility, which, according to the companies, is not yet well known among international investors.

”Questions of equality have recently increased among investors and raters. These questions can sometimes include peculiarities that are hard to recognise in Finland, since such issues have always been answered to. For example, questions about parental leave or feminine hygiene issues can be rather surprising.”

- Matti Kalervo, Kesko

The interviewed investors stated that the biggest challenge is how to include investors outside of Europe in efforts related to ESG. Although developing markets have also woken up to the importance of this topic, Europe and the Nordic countries alone cannot solve the global sustainability challenges.

A CLOSER LOOK AT THE BALTICS

ESG reporting in the Baltics

The differences in sustainability reporting between small and large companies are visible especially in the Baltic states, where companies, on average, are smaller than their Nordic counterparts. Startups are often funded by private equity investors, whose authority and sustainability in developing the operations of their target companies – including sustainability efforts – is much more substantial compared to other investor groups.

“As a private equity investor, our role as an owner is highly active and we are closely involved in the operations of our portfolio companies. By working responsibly, we can make sure that the companies we own act similarly. This helps us reach our objectives of creating a sustainable business in the long term and in generating a healthy profit for our investors,” says Martin Kõdar, partner at the Estonian private equity company BaltCap.

Smaller companies have very limited resources for reporting ESG data, which means that the emphasis is only on the most relevant indicators of sustainability.

“Baltic companies are too small to be able to take on employees solely for the purpose of ESG reporting. The aim is to limit our measurements simply to the issues that offer added value to us as owners and can also help the management in leading the company better in daily work. An excessive investment in measuring non-essential matters would only distract us from the main task of the company and leave too little time to attend to the needs of customers, employees and other important stakeholders,” Kõdar remarks.

In Martin Kõdar’s view, the sustainability of Baltic companies is generally on a good level, and communications related to sustainability issues often tend to be even too modest. However, the practices concerning ESG reporting are not as established in the Baltics as they are in the Nordic countries. Valdo Kalm, CEO of the recently listed Port of Tallinn, says that sustainability is an important part of the company’s operations, although related reporting does not follow any specific framework.

“The Port of Tallinn went public last year. When presenting the company to investors during a roadshow, ESG topics were included in our prospect. We received inquiries related especially to environmental requirements, which are becoming stricter in the shipping industry. Later on, our reporting has become less formal, since, as small company, we cannot offer much more ESG data to investors,” Kalm notes.

According to Kalm, the company’s ESG reporting practices have been created by listening to the needs of its investors. He does not consider increasing regulation as a positive development. Similarly, Martin Kõdar from BaltCap believes that the upcoming EU regulation on ESG reporting could have a harmful effect on the operations of small companies, since increasing demands for reporting may cause businesses owned by private equity investors to end up in an unfair situation compared to privately owned companies.



DEMAND FOR KNOW-HOW INCREASING

A major challenge in responsible investing and ESG reporting is keeping up with the rapid development of the industry. The constant change of different initiatives, legislation and frameworks keeps the investors and companies busy and overstretches already limited resources.

”The challenge is that since so much is happening it requires certain know-how from the investors about which things to concentrate on. You cannot take part in each and every initiative, instead you have to know how to choose the things that are essential to your own processes. You do not have to follow tickers by the scores but rather focus on the most relevant ones”

- SANNA PIETILÄINEN, EQ ASSET MANAGEMENT

In the midst of ESG enquiries companies feel like they would need a full army of people to answer those enquiries and to follow the developments of reporting frameworks. From the ESG perspective, a sufficiently comprehensive reporting standard would ease the situation, as in that case, answering individual rating enquiries would be a thing of the past.

Knowledge on sustainability issues is increasingly demanded from others than just experts on the subject. Thus, the workload regarding internal training, both among investors and corporate organisations, has been increasing. Likewise, connections between IR and sustainability departments have become closer and the need for learning has increased on both sides.



FINDING A SOLUTION FROM THE EU LEGISLATION ON SUSTAINABLE FINANCE?

The need for comparability between companies on ESG issues has been recognised at the level of international legislation. The goal of Action Plan on Sustainable Finance, published by the EU Commission in 2018, is to create a system of grading, or a taxonomy, which will hopefully make the environmental impacts of companies more transparent and comparable for investors.

The legislation of sustainable finance will clarify the obligations of institutional investors and asset managers to take into account, for example, the aspect of sustainability within their investments. The legislation will also provide clarity for companies about which issues they should report in the future. The obligation for non-financial reporting that took effect in 2016 will also be clarified regarding climate risks due to the new legislation.

The investors and companies we interviewed saw the upcoming EU legislation primarily as a good thing, as it will create a standard similar to accounting legislation for corporate sustainability and responsible investing. At the same time, the investors and companies state that drafting the law is not simple and its execution will not be trouble-free.

It is also considered problematic that the new standard will dictate what sustainability issues are the most material ones for reporting companies. Although the goal of the legislation is to better serve responsible investors, both investors and companies have doubts whether the standards will be suitable for different markets and companies operating in different geographical areas. There is also worry over increasing bureaucracy and administration, which might shift the focus away from the most relevant issues for one's own business operations.

The investors and companies we interviewed point out that EU level legislation is not enough to solve the issue of reporting practices. Global problems should have global legislation. The biggest companies operate around the world as part of a global supply chain, in which case navigating in the sea of different legislation of each country can feel demanding. However, with its taxonomy EU is aiming to be a frontrunner and it is generally believed that if the taxonomy is successful, it will spread quickly on a global level.

Based on our interviews, investors and companies are cautiously optimistic about the EU legislation. And although it is not thought to act as a solution to all the problems on its own, it is still believed to steer investor-targeted sustainability reporting into the right direction. The obligation to report non-financial information that took effect in 2016 already brought ESG issues closer to the financial reporting of companies and the new legislation is believed to further strengthen this development.

Both the investors and companies also emphasised that developing a reporting system that will serve both parties in the best possible way will take time – similarly to creating the present standards of accounting, IFRS.

PERSPECTIVES ON THE FUTURE

A great deal of expectations have been placed on the year 2030. In light of the goals of the UN's 2030 Agenda and Paris Agreement, the investors and companies we interviewed agree that corporate sustainability and responsible investing will increase their significance in the future, and that by 2030 they will be common in all business areas.

"Everything should be based on the premise that ESG/sustainability are not separate, but rather a key part of companies and their business operations. In my view, this is the direction we are headed for in the future."

- Sanna Pietiläinen, eQ Asset Management

The currently popular theme of climate and environmental issues is here to stay and the risks they cause for business operations are better understood. The focus of the conversation on corporate sustainability is considered to be increasingly shifting from risk management towards the opportunities for business operations provided by climate change.

"A big part of both sustainability and investing is about capitalising on opportunities and minimising risks. Yet, many investor enquiries focus only on the negative effects and risks caused by companies, even though technology can answer many of the world's greatest challenges. Through such technology, companies like Nokia can generate positive effects for their investors and interest groups."

- Timo Kolehmainen, Nokia

The development of technology affects both responsible investing as well as sustainability reporting. As artificial intelligence and other technological solutions make sustainability data more accessible and available for use, the manual analysis work of investors and ESG raters will become easier.

"One possible scenario for the future is that sustainability reporting will become more short-sighted, in which case we will no longer talk about yearly or quarterly reporting but rather weekly reporting. Technology could then be used, for example, to calculate the weekly sales figures by using drones to count the cars that have been parked in the parking lot during Friday."

- Anna Hyske, Ilmarinen

The interviewed investors and companies strongly believe that by 2030 there will be a globally approved standard for sustainability reporting. Standardised and more quantitative reporting would offer investors much needed comparability for corporate sustainability, based on which responsible investing could be conducted even more effectively than before.

"In my view, there are three important goals for the future of sustainability reporting:

- 1. Assured, high-quality data*
- 2. A globally accepted code that will increase comparability*
- 3. Defining monetary value for sustainable development goals"*

- Ulla Paajanen, Stora Enso

As responsible investing becomes more mainstream, private investors will also begin looking for the sustainability information of companies from their reports. In that case, the ESG reporting practices that have been developed for institutional investors will have to become more comprehensible and straightforward.



OP-ED

Investors are interested in solutions of sustainable development

Investors are looking for investment targets that benefit from the goals of sustainable development. Companies, on the other hand, are considering how to communicate about their business' operational solutions that support sustainable development to investors, and thus be included in their funding. Service providers related to responsible investing and, for example, the major Dutch pension investors PGGM and APG, have defined classifications on which business operations they view as sustainable development solutions.

Despite extensive reports, recognising the companies that offer solutions for sustainable development can still be challenging. This is due to the fact that few companies report on the share of the revenue that is generated by products or services in accordance with sustainable development, let alone the size of the sustainability effects these business operations have created.

However, developments in this area are rather swift: EU legislation is currently being prepared according to which sustainable development funds will need to comply with the sustainability classifications defined by the EU. The outline concerning climate change has already been through a commenting round among interest groups and the classification is expected to take effect by the end of year 2022.

Due to the forthcoming legislation, the investment products of sustainable development, such as funds, will have to be able to report on how they follow this classification. Companies can expect that a growing number of investors will be looking for more comprehensive ESG reporting in the future and should thus already begin preparing for this

TIINA LANDAU

Sustainability expert and one of the authors of the book
"Vastuullisuudesta ylituottoa sijoituksiin"
(Alma Talent, 2019)



Conclusion

Based on the interviews we conducted for this report, it can be stated that companies in Finland, Sweden and Estonia all believe that they act responsibly and seek to actively communicate about this fact. On the investor front, it is increasingly believed that responsible companies are more profitable than others in the long run. Despite having a good starting point, the challenge is that companies do not feel confident about the kind of sustainability communications that investors expect from them. There is an increased need for dialogue between investors and companies, and so far, the flow of ESG information seems more like a form of art than science.

The management's perspective on the most material sustainability issues

According to our study, from the management's perspective, the most important discussion related to ESG communication and reporting is about the materiality of sustainability issues. Compared to international actors, Nordic companies are forerunners in communicating sustainability issues. The availability of corporate sustainability information is not the problem as such, but rather its content, which in its current state is not comparable when it comes to questions of investing. The reason for this is the aim of corporate sustainability reporting to serve different interest groups as broadly as possible. Thus, the information that is of interest to investors can get lost.

As commensurable sustainability reporting does not exist, investors have so far been dependent on the services of ESG raters that offer corporate sustainability analyses and comparisons. This then causes an overflow of rating enquiries to companies, overstressing the resources for ESG communication.

The non-financial information of corporate reporting has become an integral part of investors' analyses on the financial prospects of companies. Thus, investors would like to see ESG issues limited to those that most effect the cash flow and risks of companies. Without forgetting other important interest groups of companies, investor-focused sustainability reporting should concentrate on the most financially material issues.

Investor-based initiatives to determine the material issues have become increasingly popular. For example, the SASB framework developed by US investors defines the financially most relevant sustainability issues according to fields of operation. A tool such as SASB can help companies choose the most relevant ESG issues based on their own business operations, helping them allocate the full report entities into a more useful form for investors.

An important observation in our report is that investors expect companies to report the most essential sustainability issues for their company from the top down. The management's perspective is particularly required when assessing which issues are the most central ESG related risks and opportunities right now and in the future, how the company manages these strategic sustainability issues, what kind of goals have been set for them, and how these goals will be achieved. Going through these questions offers the companies themselves better preconditions to prepare for the future.

Proactive and multichannel communication behind the comprehensive story of ESG

EU level legislation is on its way to ease investor-based ESG communications, and along with it, a clearer set of criteria and classifications for responsible investing and investments will be created. The forthcoming classification system on sustainable finance will provide investors and companies with a clearer direction on what ESG reporting should focus on. However, the journey towards the best possible standard for sustainability reporting is only beginning.

The need for investor-based sustainability communications will continue to increase even before the EU legislation takes effect. Our report confirms the conception that few companies or investors can afford to not take sustainability issues as part of their investor communications, strategy or investment policies. The proactive communication from companies on sustainability issues that are considered most essential is always more useful for investors than information offered by a third party.

Reporting will continue to have a strong position as an information source for investors but the comprehensive story of a company's sustainability will be formed through consistent handling of essential ESG issues in all the channels that are relevant for the investor. In the future, in addition to sustainability experts, the company management is also expected to speak about sustainability issues as a natural part of the investment story and a broader corporate strategy.

A common language is needed not only between investors and companies but also between the different departments of organisations. Sustainability and financial departments have traditionally been completely separate, but the two departments must cooperate more closely in order to answer the needs of investors. This requires mutual learning so that sustainability experts would utilise financial numbers more courageously and IR and financial communication experts would better understand the sustainability aspects of their business operations.

MILTON'S RECOMMENDATIONS FOR BETTER ESG COMMUNICATION

How can companies better respond to the ESG information needs of investors?

- » **Direct your focus on the material issues and present a perspective on the future – preferably voiced by the management.** Investors want to hear the management's perspective on financially material sustainability issues and about the risks and opportunities such issues entail. For example, how can a company adapt their operations as the environmental consciousness of consumers is increasing and the legislation is becoming stricter?
- » **Include material ESG information as part of other financial reporting.** As part of broader sustainability reporting, a company should compile a section on the financially integral ESG issues directed at investors.
- » **Provide numeric information and verify it.** Investors base their company analysis largely on numeric ESG data. Confirming the information will increase credibility.
- » **Do not forget the story.** Although investors are concerned with numbers in their everyday work, numbers do not tell the whole story. Qualitative data is needed to support the investors' decisions. Such data can appear, for example, in the accounts on operational culture or management approach.
- » **Report how climate change affects the company's business operations.** Be prepared to report on climate change impacts according to the EU's new regulations by familiarising yourself with the TCFD framework.
- » **Communicate proactively in all channels.** The investor will form their view on the sustainability of the target company based on multiple sources. Thus, companies should proactively communicate on their sustainability issues in all main channels, such as the IR website, quarterly reports and presentations, CMD events, shareholders' meetings and social media.

What do companies want from investors?

- » **Communicate your needs to companies.** If you are looking for more specifically targeted communications, take a more active role in communicating your ESG information needs to companies.
- » **Draw up a clear policy definition.** Communicate your values and expectations to your interest groups by compiling clear and transparent policies of responsible investing.
- » **Make better use of the already existing materials.** Various information requests by investors and raters can cause an immense burden on companies.

TERMINOLOGY

C

CDP = Carbon Disclosure Project. Independent non-profit organisation that collects detailed information on climate change prevention, greenhouse emissions and about adjusting to climate change.

E

ESG = Environment, Social and Governance. A term typically used by investors referring to sustainability. ESG refers to the inspection of issues related to the environment, social responsibility and good governance when making investment decisions.

G

GRI = Global Reporting Initiative. An international initiative that aims to create a generally accepted operations model for sustainability reporting. GRI has published a broad collection of standards for the sustainability reporting of companies.

I

IPCC = Intergovernmental Panel on Climate Change. The panel aims to analyse scientifically produced information to support national and international decision-making.

M

MSCI ESG Indexes = One of the major international ESG rating companies

N

NFI = Non-financial information. Legislation that took effect in 2016, which determines how major companies report their non-financial information. According to the EU directive, large companies must report on their policies and provide a short description on their business model and risk management. In addition, companies must report on their diversity policies.

P

PRI = Principles for Responsible Investment. The UN's Principles for Responsible Investment, which concern taking environmental, social and governance practices of the corporation into account when investing. Complying with the principles also requires a certain amount of annual reporting.

R

RobecoSAM = One of the major international ESG rating companies.

Reasonable Assurance = The confirmation level of the report. Reasonable Assurance refers to the fact that the information of the reporting company can be confirmed to comply with the most important criteria. Limited Assurance is a lower-level form of confirmation.

S

SASB = Sustainability Accounting Standards Board. A framework for sustainability reporting from the United States. The standards published by SASB in 2018 are based on years of preparational work, which involved a group of representatives from different operational fields, for example experts from the fields of finance and environmental legislation.

SDGs = Sustainable Development Goals. At a summit held in September 2015, the UN member countries agreed upon 17 sustainable development goals and plans of action, which are aimed at directing global development efforts until 2030.

Sustainalytics = One of the major international ESG rating companies.

T

TCFD = Task Force on Climate-Related Financial Disclosure. TCFD recommendations are a tool directed at companies to help them communicate the opportunities and risks that climate change creates for their business operations.

Miltton Group is an explorative, dynamic and constantly curious consultancy that supports their customers to succeed both globally and locally. We work beside our customers, helping them to find creative approaches, navigate among constant change, take part in effective dialogue with stakeholders and participate in societal debate.

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