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MANUFACTURING A SUSTAINABLE FUTURE

**A PRACTICAL GUIDE TO DEVELOPING
AND ENHANCING YOUR ESG STRATEGY**

ACCOUNTANCY | BUSINESS | FINANCE

UNLOCKING THE BENEFITS OF ESG

Manufacturers across the UK are being tasked with developing robust ESG (Environmental, Social, and Governance) strategies to demonstrate their commitment to sustainable and ethical business practices.

By prioritising environmental responsibility, social equity, and strong governance, these companies can not only reduce their carbon footprint but also build trust with stakeholders and consumers.

But how can manufacturers develop their ESG strategies?

Awareness is becoming significant, although attitudes are split:

57% of smaller businesses are aware of the government's commitment to reach net zero emissions by 2050

47% of smaller businesses state carbon reduction is a high or very high priority

53% are not yet ready to prioritise decarbonisation

<https://www.british-business-bank.co.uk/about/research-and-publications/small-businesses-and-transition-net-zero/infographic>

Businesses are having to upskill in order to respond to downward supply chain pressure around ESG in both their own production and that of their supply chain. The [Carbon Border Adjustment Model](#) is sure to provide even more pressure where manufacturers are competing in the global market.

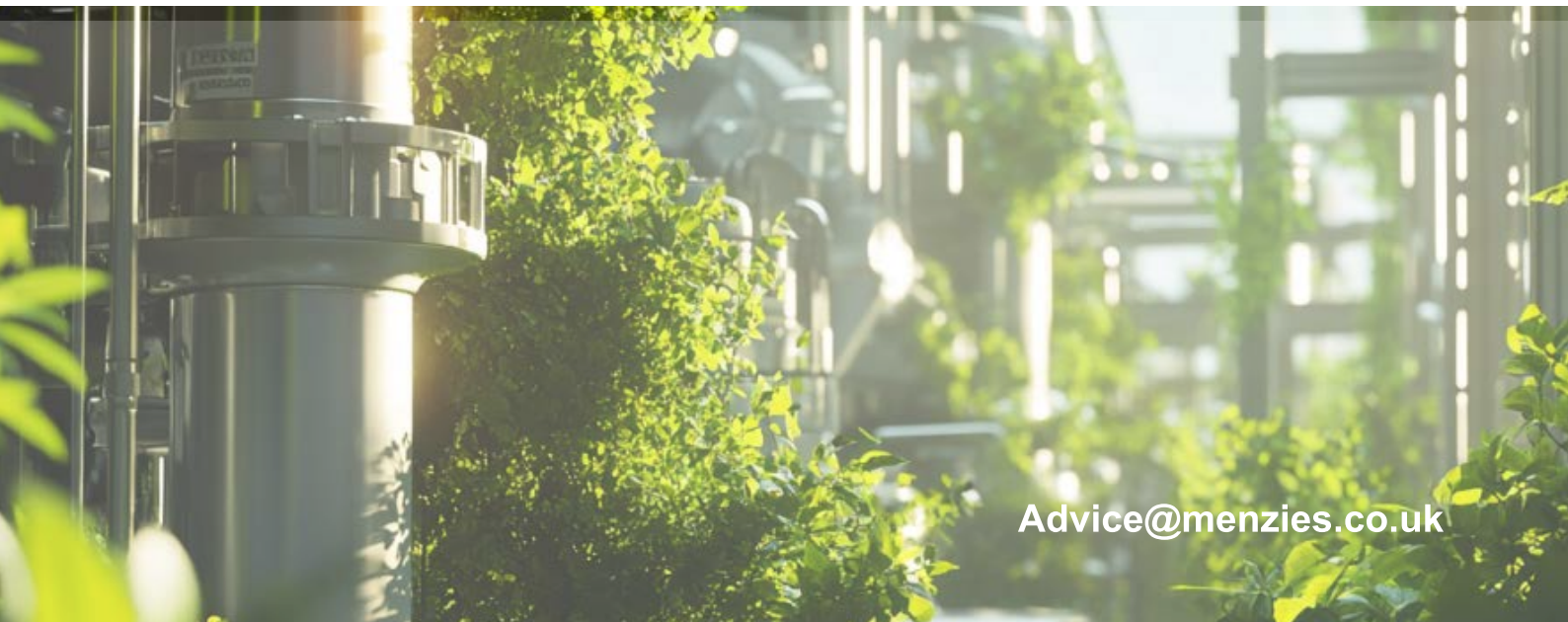
In terms of strategies around decarbonisation, some businesses are leading the way, having already implemented strategies to minimise waste, invested in reviewing their products and supply chain, and created energy efficient initiatives. Others, however, are just beginning, with many finding there is little support or guidance available to them.

Some manufacturing businesses may be concerned about the costs associated with carbon reduction strategies, but there are many opportunities to add value too. Alongside some valuable tax reliefs and other incentives, investing in an ESG strategy can make a business more appealing to investors, customers and employees.

“The number of firms setting ESG targets for their business has increased by 48%, with around two thirds (62%) of manufacturers now doing so since 2021, according to a new report by Make UK and Lloyds Bank – ESG in Manufacturing: Growth, Supply Chain Cooperation and the Future of Sustainability in the Industry.”

MAKE UK, February 2024

In this report, we focus on the benefits and advantages of developing an ESG strategy for your business, alongside acknowledging the challenges. We provide some practical tips to help design or develop an ESG strategy for your business.



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WHAT IS ESG?

ESG stands for **Environmental, Social, and Governance** – for each of these pillars, a set of criteria is used to evaluate a company’s operations and resulting impact in these three areas.

Implementing an ESG strategy helps to guide responsible business practices. It focuses on sustainability, ethical behaviour, and effective management to create long-term value and mitigate risks.



Environmental

The impact on nature: air quality, water and waste management, energy management, ecological and climate impact



Social

Improving equity and lives: e.g. diversity and inclusion, human rights, living wage, gender pay, staff welfare, community



Governance

Ethical and corporate governance: e.g. risk management, disclosure and transparency, performance management, reporting and taxation

THE BENEFITS OF EMBRACING ESG PRINCIPLES

There are several key benefits for manufacturing SMEs (small and medium-sized enterprises) who embrace ESG principles:

COMPETITIVE ADVANTAGE:

Meeting Customer Demands: As mentioned earlier, consumers are increasingly demanding sustainable products and services. By embracing ESG, SMEs can differentiate themselves from competitors and gain a competitive edge.

Resilient Supply Chains: Integrating ESG principles into supplier selection can create more resilient and sustainable supply chains, reducing risks of disruptions.

Future-Proofing the Business: The manufacturing sector is undergoing a significant shift towards sustainability. By being proactive in adapting, SMEs can ensure they are well-positioned for the future.

More than eight in 10 SMEs (83%) say that sustainability is important to them – up from 76% last year – and 58% are already making statements and commitments to key stakeholders about their performance. [1]

Accreditations are always an option. For example, you could empower your manufacturing business with BCorp certification and lead the way in social and environmental responsibility while driving profit.

OPERATIONAL IMPROVEMENTS:

Resource Efficiency: Focusing on reducing waste and using resources more efficiently can streamline production processes and minimise material costs.

Improved Risk Management: Climate change regulations and resource scarcity are future risks. By adopting sustainable practices, SMEs can mitigate these risks and future-proof their businesses.

Enhanced Employee Engagement: Employees are increasingly motivated by working for companies with strong ESG values. This can lead to higher employee morale, engagement, and productivity.

FINANCIAL ADVANTAGES:

Tax Relief and Incentives: Governments are increasingly offering tax breaks and financial incentives to businesses that demonstrate a commitment to sustainability. This can directly reduce costs for SMEs.

Enhanced Brand Reputation: Consumers are becoming more environmentally and socially conscious. By demonstrating strong ESG practices, SMEs can build a positive brand image, attracting more customers and potentially commanding premium prices.

Increased Access to Capital: Investors are increasingly prioritising ESG factors when making investment decisions. A strong ESG commitment can make SMEs more attractive to investors, providing easier access to funding for growth.

Cost Savings: Implementing ESG practices often leads to operational efficiencies. Reducing waste, using less energy, and adopting cleaner technologies can all lead to significant cost savings in the long run.

[1] <https://www.icaew.com/insights/viewpoints-on-the-news/2023/dec-2023/just-8-of-smes-reporting-on-sustainability-issues>

THE CHALLENGES OF IMPLEMENTING AN ESG STRATEGY

While implementing ESG offers numerous benefits such as enhanced reputation, increased investor and customer appeal, and long-term sustainability, it also presents several challenges, particularly for SMEs. These challenges include the initial costs and resources required for ESG integration, which can be significant for smaller businesses with limited budgets. Additionally, SMEs may lack the expertise and knowledge needed to effectively implement and measure ESG initiatives, leading to potential compliance and reporting difficulties. There is also the risk of greenwashing, where efforts to promote ESG can be perceived as insincere if not executed transparently and authentically. Furthermore, balancing short-term financial pressures with long-term ESG goals can be particularly daunting for SMEs striving to maintain profitability while adopting sustainable practices.

Uneven starting points

While some larger manufacturers have begun implementing sustainable practices, many SMEs are further behind on their journey. Research suggests a significant portion haven't assigned responsibility for developing an environmental strategy or begun measuring their sustainability impact.

Financial concerns

Transitioning to cleaner technologies or energy sources can involve significant upfront costs, which might deter some businesses, particularly SMEs with tighter budgets.

Knowledge and resource gaps

SMEs might feel overwhelmed by the lack of clear and accessible guidance on decarbonisation strategies, and are unlikely to have the time to commit to the research required. Implementing new technologies or processes might require specialised technical knowledge and resources that some SMEs might lack.

Infrastructure constraints

Many manufacturers operate in geographically dispersed locations, making it challenging to extend new infrastructure to all areas.

Standardisation and measurement

The lack of standardised metrics for measuring environmental performance makes it difficult for businesses to accurately track progress and compare themselves to others.

Balancing sustainability and competitiveness

Concerns exist that focusing on carbon reduction might make UK manufacturers less competitive in a global market where regulations might be less stringent.

Barriers are multiple, complex, and business specific:

35%

cited costs as a barrier for reducing carbon emissions including upfront costs, with smaller businesses identifying more than 20 barriers preventing actions on net zero

32%

cited feasibility, such as a lack of control due to tenancy agreements or lack of an appropriate technology

12%

cited lack of information

<https://www.british-business-bank.co.uk/about/research-and-publications/small-businesses-and-transition-net-zero/infographic>

ENVIRONMENTAL IMPACT

[Centre for Sustainable Finance]



Significant emissions

While manufacturing strengthens the UK economy, it also has an environmental impact. The sector contributes roughly 12% of the UK's total greenhouse gas emissions.



Key culprits

The biggest emitters within manufacturing are chemicals, iron and steel, and cement industries, which account for nearly half of the sector's emissions.



Room for improvement

There have been positive strides though. Manufacturing emissions have declined by 57% since 1990.

GREENWASHING

Greenwashing, where companies mislead consumers about the environmental benefits of their product, service, or actions, is making it harder to compare businesses on a like for like measure, along with everyone using different metrics to measure themselves against.

Greenwashing poses a double threat to UK manufacturing:

1. Unfair competition:

Companies that greenwash can create a misleading perception of being environmentally friendly without actually investing in sustainable practices. This gives them an unfair advantage over genuinely eco-conscious manufacturers who prioritise responsible production but might have higher costs.

When greenwashing is prevalent, it can discourage manufacturers from making genuine efforts towards sustainability. If consumers can't easily differentiate true eco-friendly practices from mere marketing claims, companies might be hesitant to invest in real change.

2. Reputational damage:

When greenwashing scandals are exposed, it erodes consumer trust in the entire manufacturing sector. This can lead to decreased demand for British-made goods, especially if consumers perceive a lack of transparency or commitment to sustainability.

With the growing global focus on environmental responsibility, countries with stricter regulations against greenwashing might restrict imports from the UK if its manufacturing sector is seen as unreliable on eco-credentials.

In essence, greenwashing weakens the UK manufacturing sector by creating an uneven playing field and potentially damaging its reputation for ethical production.

Manufacturers can steer clear of the risk of 'greenwashing' by:

- **Providing transparent and verifiable information:** Ensure that all environmental claims are supported by clear, accessible, and independently verified data. This includes using credible third-party certifications and providing detailed evidence of the environmental benefits of their products or practices.
- **Being specific and honest:** Avoid vague or broad statements like "eco-friendly" or "green." Instead, provide specific details about what makes the product sustainable, such as the percentage of recycled materials used or the exact environmental impact reductions achieved.
- **Engaging in comprehensive sustainability practices:** Focus on overall sustainability rather than isolated green initiatives. This means addressing all aspects of ESG (Environmental, Social, and Governance) in the business operations, from sourcing and production to distribution and end-of-life disposal, ensuring a holistic approach to environmental responsibility.



HOW TO IMPLEMENT AN ESG STRATEGY

The process below describes a series of steps designed to integrate environmental, social, and governance principles into the core of the business – ultimately leading to the development of an ESG strategy.

01

Take a step back

- Assess the current state of your business and existing sustainability efforts
- Identify gaps and areas for improvement in your current operations

02

What are your challenges?

- List and prioritise the specific challenges your business faces in implementing ESG
- Consider financial constraints, resource limitations, and knowledge gaps

03

Understand your business

- Conduct a thorough analysis of your business operations, supply chain, and overall impact
- Identify key areas where ESG principles can be integrated effectively

04

Consider the impact at macro level

- Evaluate broader industry trends, benchmarks, and best practices in ESG
- Understand how macroeconomic factors and market demands influence your ESG strategy

05

Purpose, values, culture

- Define your company's purpose, core values, and the culture you aim to cultivate
- Ensure these align with ESG principles and communicate them clearly to your team

06

Long-term vision for the business

- Assess the current state of your business and existing sustainability efforts
- Identify gaps and areas for improvement in your current operations

07

What are your stakeholders saying?

- Engage with stakeholders, including employees, customers, suppliers, and investors
- Gather feedback and understand their expectations regarding your ESG efforts

08

Regulations

- Stay informed about relevant local, national, and international regulations
- Ensure your ESG strategy complies with current and upcoming regulatory requirements

09

Applying ESG

- Implement ESG initiatives across your business operations and regularly monitor progress, measure outcomes, and adjust your strategy as needed
- Communicate your ESG achievements transparently to stakeholders

UNLOCKING OPPORTUNITIES FOR YOUR BUSINESS

If your ESG implementation is effective, it unlocks key opportunities that will benefit the business:



Access to new markets

Some larger companies are prioritising sourcing from suppliers with strong ESG practices. By embracing ESG, SMEs can access new markets and customer segments.



Strengthened relationships

Demonstrating a commitment to ESG can build trust and stronger relationships with larger companies in the supply chain.



Innovation and collaboration

The pressure to improve ESG performance can drive innovation within supply chains. Collaboration among suppliers can help share knowledge and resources, making sustainable practices more affordable and achievable.



Future-proofing the business

As regulations and consumer demand for sustainable products grow, building a strong ESG profile now can position your business for long-term success.

TAX PLANNING OPPORTUNITIES

Timing

If a business is planning to invest in new plant and machinery, consideration should be given to the timing of the expenditure. The current full expensing regime means that qualifying expenditure will benefit from 100% capital allowances in the year of expenditure and therefore bringing forward expenditure into an earlier year could accelerate the tax saving. For any non-qualifying expenditure it is possible to take advantage of the Annual Investment Allowance which allows 100% relief on the first £1m of other plant and machinery spending.

Plastic packaging tax

The plastic packaging tax increases in line with CPI. Since April 2024, the rate is £217.85 per metric tonne for UK businesses that manufacture or import 10 tonnes of plastic packaging per year. The tax applies to packaging that contains more plastic by weight than any other single material and the definition of plastic includes biodegradable and compostable plastics. On the other hand, packaging that contains at least 30% recycled plastic is exempt. Manufacturers should consider the impact this tax could have on their business model and make adjustments where needed and should also be aware that other jurisdictions have also introduced similar regimes and therefore it is important to understand whether any overseas obligations arise.

Have you taken advantage of tax relief schemes?

The definition of R&D is much broader than many businesses imagine. The scope of the R&D tax relief has been expanded to include spending on cloud computing and data costs. Innovative manufacturers can obtain an enhanced deduction of up to 86%, that equates to tax relief of up to c.46.5% of the qualifying expenditure for profitable companies and where the investment leads to a loss there is scope to reclaim a cash repayment of circa 18.6% of the R&D spend (26.97% for companies who meet the R&D intensity threshold). Even if the business is innovating in collaboration with a third party, such as a customer or supplier, it may still be possible to qualify for relief. Seeking advice at an early stage can help businesses to leverage optimum value from the scheme and early identification is particularly important as new claimants must notify HMRC within 6 months of the year end in order to be entitled to claim.

FURTHER OPPORTUNITIES

Other areas to consider:

Financial modelling

Having an accurate financial model is the most reliable way to work out the payback period of any planned investment in carbon reduction, waste minimisation or other sustainability initiatives. The 'cost of capital' and resources, such as employee time spent on initiatives, should be taken into account. With a model in place, the business will have a much clearer idea of how a planned investment will impact cashflow and the value of the business over the short, medium and long term. Once an accurate financial model has been produced, it should be kept under review and updated as necessary.

People management

Responding to the net zero emissions challenge is an opportunity for producers and manufacturers to strengthen their employer brand. Businesses with a strong sustainability story to tell are more attractive to employees who often prefer to work for companies that are aiming to have a positive impact on the environment and society. People management strategies to boost employer brands include building employee involvement, expanding communication, both internally and externally – to give workers a wider sense of purpose.

Revenue generation

With any investment strategy, securing some financial quick wins at an early stage can help to secure Board-level buy in and demonstrate that a healthy return on investment is achievable. When planning a waste minimisation strategy for example, a good place to start might be to explore opportunities to monetise waste by selling unwanted by-products to another business. There are many examples of such ingenuity within the manufacturing sector.

Grant funding

Grant funding is available to support manufacturers in making specific sustainability investments. These tend to be focused geographically. Manufacturers should seek advice on the options available to their business through industry and funding organisations.

Diversification and new product development

During the pandemic, many manufacturing businesses learned that adapting to change can bring opportunities to boost revenues and profit. Staying responsive to market changes in recovery can open up opportunities to diversify. For example, a number of meat producers have capitalised on vegan and health trends by producing meat-free and plant-based alternatives alongside their standard ranges. Manufacturers could consider what alternative products they could bring to market that fit an ESG brief, accessing new customers and markets in the process.

Improving efficiency by reducing costs

With any business investment strategy, it is important to look for opportunities to trim costs to ensure processes are operating efficiently from the start. When devising a net zero or sustainability plan, manufacturers should seek the help of employees in identifying cost reduction opportunities that can reap significant rewards, particularly if implemented at an early stage.



MEET THE MANUFACTURING TEAM

At Menzies, we assist businesses in building an ESG strategy from scratch or enhancing existing sustainability plans by providing tailored support and strategic advice. Our services include offering expert guidance on tax incentives and relevant credits as a result of sustainable operations. We conduct strategic reviews of businesses to identify areas for improvement and align ESG goals with overall objectives. By addressing these key areas, we help to empower businesses to effectively integrate ESG principles, drive sustainable growth and achieve long-term success.

If you would like to discuss any of the topics raised in this report, or other areas of advice you may wish to explore, please contact one of the team below, or at advice@menzies.co.uk.



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