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THE BOTTOM LINE

Time to make ESG disclosures work

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THE last seven years have been the warmest for the planet. We see enough stories of supposedly "extremely rare" weather events becoming far too common. The Intergovernmental Panel on Climate Change (IPPC), for example, warns of dire consequences unless there are immediate, rapid and large-scale greenhouse gas reductions. Agriculture and health, for instance, would increasingly be impacted with increasing global warming.

Fortunately, many businesses and organisations have heeded the call and started looking at their own strategic, tactical and operational roles in environmental, social and corporate governance (ESG).

For example, over 3,800 signatories of the UN Principles for Responsible Investment committed to responsible investment which entails including ESG factors in investment and ownership decisions. Collectively, they represent assets under management of over US$121 trillion as of 31 Mar 2021.

The Task Force on Climate-related Financial Disclosures (TCFD) -- formed in 2015 to develop a reporting framework based on climate-related financial risk disclosure recommendations -- has been endorsed by more than 2,600 organisations around the world, including governing bodies. The G7 Finance Ministers and Central Bank Governors supported the move towards mandatory climate-financial disclosures in 2021 based on the TCFD framework. Disclosure mandates are also appearing in the European Union with the Corporate Sustainability Reporting Directive (CSRD) in 2021 and in the US for NASDAQ-listed companies.

Businesses that are still on the fence or simply see ESG as another compliance requirement should heed some recent research findings.

A review of over 2,200 empirical studies found that about 90 per cent of the cases show a positive association between ESG investing and stable corporate financial performance. Another study linked corporate sustainability efforts with improved competitiveness through stakeholder engagement, improved risk management and the fostering of innovation. Another recent review pointed to the positive link between corporate sustainability practices and the performance and competitiveness of small and medium enterprises (SMEs).

Aggregate confusion

At the recent 2022 World Economic Forum meeting in Davos, executives differed on how ESG promises and commitments can be tracked and assessed across companies. Some observers have called this "aggregate confusion" and recommended paying greater attention to how the data underlying ESG ratings is generated.

Indeed, a large study of over 400 companies across 24 industries showed that different ratings methodologies tell vastly different stories about the same company, demonstrating "the immaturity of the current ESG ratings environment and highlights the need for improvements".

Corporate moves in the ESG research and rating space are also happening in a fast and furious manner. Moody's bought into Four Twenty Seven, Vigeo Eiris and SynTao Green Finance. Meanwhile MSCI has acquired Carbon Delta, and S&P bought RobecoSAM. The acquired firms are all ESG specialists and are expected to be integrated into the various ESG rating metrics offered by Moody's, MSCI and S&P.

In a recent report, EY noted that there are more than 600 different ESG reporting systems, which are marred by inconsistencies, lack of uniformity, and weak material financial implications. Clearly that's quite a boiler pot alphabet soup of ESG standards.

Silver lining

The need for a global set of sustainability standards had a major push with the creation of the International Sustainability Standards Board (ISSB) in 2021 when four of the top five sustainability reporting standards organisations agreed to effectively merge as ISSB under the auspices of IFRS Foundation.

The ISSB has recently released two draft standards: One for general sustainability-related disclosure requirements and the other for climate-related disclosure requirements. This is expected to bring about greater comparability and clarity of corporations' ESG disclosures. ISSB hopes the two standards will kick-start a comprehensive global baseline of sustainability disclosures designed to meet the information needs of investors in assessing enterprise value.

The sooner businesses support and participate in the growing momentum of standardising ESG reporting formats and bring them to a level that is universally accepted, the sooner will businesses have a better picture of how ESG improves their financial performance and increases investors' confidence in their businesses.

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