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How to Move from CSR to ESG Reporting

Adopting standards to report **ESG FACTORS**

Most companies still stop short of reporting the impact of ESG issues on their financial performance

The notion of CSR has been around for years, its history going back to environmental reporting. These reports were purely voluntary and boards paid little attention to them beyond the 'good for you' attitude. Most certainly, none of this information was a meaningful part of regulatory documents filed with the SEC, such as S1 and 10K forms.

Despite the concept of sustainable investment having been around for decades, it has grown in significance, popularity and scale only in the last couple of years. Why has such an evolution taken place? And what can companies do to clearly communicate their ESG practices, which now increasingly contribute to their market capitalization?

Shift From 'Good to Have' to 'Must Have'

Things are rapidly changing. CSR has evolved into ESG reporting and is now almost mandatory (and only a matter of time before it actually becomes required). The focus around ESG-conscious companies is increasing within the private and public investment community. Global sustainable investment now tops $30 tn – up 1,000 percent since 2004 and 68 percent from only five years ago.

While there is no right way to deliver ESG reporting to the target audience, there remains much room for improvement to items that are lost in translation, such as what information is communicated by issuers, and how, as well as what information is sought by investors, and why. Most of the ESG reports we have reviewed, even from large-cap companies, carry amazing graphics and tons of great information but they still look like good old CSR reports, albeit with a new cover titled 'ESG report'.

There is a lot going on in these publications, certainly enough for a 'Wow, great job!' comment, but not enough to make a pension fund t write a check. Why? Because most reports, having gone to the trouble of collecting lots of useful info, stop short of explaining the bottom-line impact on their financial performance.

What Investors are Looking for Today

Over the past decades numerous studies have shown that besides the simple do-good notions of sustainability, companies that care about ESG do better operationally. They also tend to monitor and mitigate the risks that usually scare the hell out of investors in SEC filings.

Knowing that management and the board of directors are proactively monitoring key risk factors and have mitigation strategies warrants a valuation premium for added peace of mind to investors. A recent McKinsey article illustrating the results of more than 2,000 studies on the impact of ESG on equity returns shows a 63 percent positive correlation.

Therefore, investors that pursue ESG-focused strategies are enhancing their returns on the same financial fundamentals by simply selecting the companies that keep their ship tight and tidy, with all other financial metrics being equal among their peers at a given moment in time.

Most investors, even if not specifically focused on sustainability in their mandates, assign some weight to ESG and ask, 'So what?' while examining reporting components in sustainability reports.

Ensure Visibility on Investors' Radar

While portfolio managers know how to find companies with good investment metrics through their experience and numerous smart software programs, scanning for companies with the magic ESG touch is not as easy. Ratings agencies are not the answer for many portfolio managers. Why? Because most of the companies (even publicly traded ones) have not yet jumped on the reporting train.

Of 41,000 listed companies in the world, according to the latest OECD data from October 2019, only around 120 firms are delivering ESG reporting according to the standards of the Sustainability Accounting Standards Board (SASB), 5,000 have used the Global Reporting Initiative (GRI) for their reporting at least once, and a total of 785 organizations support the reporting guidelines of the Task Force on Climate-related Financial Disclosures (TCFD).

It is safe to conclude that this is still a very much uncharted, informal and unstructured practice for most public and private companies. But while many issuers are still grappling with the ABCs of ESG, investors are grading them at the post-college level. In order to compete for investors' dollars, companies are required to meet a high bar of ESG compliance.

There are three steps we recommend to those starting their ESG journey that should generate impactful results after reporting even minimal amounts to the capital markets audience.

Moving to Quantifiable Metrics

These steps are achievable in a short amount of time, delivering a high-quality, steep learning curve, so any issuer can secure its place on investors' radar even while its internal team is still getting up to speed in its ESG practices.

- Understanding reporting standards: There are more than half a dozen reporting standards: TCFD, GRI, Climate Disclosure Standards Board, CDP, SASB, UN Sustainable Development Goals, EU guidelines, and so on. Learning the difference between those and selecting one or two frameworks to follow should be the first step
- Understanding material concepts: Determine what subjects are most material and most impactful for the core business and the industry. SASB has an easy-to-follow materiality map that each corporate can rely on and answer detailed questions that SASB put together with a great deal of help from prominent buy-side institutions. As issuers build out their ESG practices, they should add items of lower materiality to their reporting as well as other standards into their framework
- Clearly answer the 'So what?' questions: The quickest and probably the most important remedy we suggest, regardless of the reporting subject, is to relate each particular topic to a financial statement item or a risk factor, and quantify the impact, if possible. This simple step will generate more eureka moments from investors, which currently have to spend time and extract meanings from lengthy ESG reports, converting them into quantitative elements for their financial models.

The bottom line is: move away from good yet sometimes inconsequential CSR to an impactful ESG mindset. Regardless of the reporting maturity of corporate ESG practices, all capital markets participants, public and private, will appreciate corporations' ability to effectively connect the dots and demonstrate the additional value their business model brings through the power of internal ESG practices.

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This article was adapted from a longer report.

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Environmental, Social & Governance (ESG) metrics are rapidly ascending in importance for all capital market participants. Companies monitoring ESG factors tend to be more vigilant on improving overall corporate governance, while increasing profitability and mitigating risk.

Focusing on risk oversight and mitigation strategies, advocating for cultural diversity and inclusion, and being a responsible corporate citizen creates a positive environment for employees and aligns the interests of all stakeholders.

Combining MZ Group's consulting expertise with proprietary software capabilities helps crystallize each of these important components into one complete ESG solution that enables issuers to report ESG metrics in ways that resonate with capital markets participants.

ESG iQ is a user-friendly and interactive software platform designed specifically to customize ESG reporting for private and public companies, as well as ESG focused funds. ESG iQ is the only solution that generates a cross-sectional analysis incorporating Environmental, Social & Governance protocols, with the flexibility to adopt multiple standards.

ESG Consult empowers private and public clients to obtain greater insight into ESG best practices,while preparing them to track, monitor and properly report their material ESG factors to various stakeholders, rating agencies and financial media.

Please visit www.mzgroup.us/esg-iq-platform or email esg@mzgroup.us to learn more or to schedule a demo today

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