

The Future of ESG

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A range of factors leads to persistent confusion among investors and corporates, underlining the need for ESG reporting to be more targeted and specific.

Regulation is supporting this transition, but there are questions around how best to harness value creation, and how to fill the “vacuum” between corporates (sustainability) and investors (ESG).

Key takeaways

Corporate sustainability meets investors and ESG

- Businesses “know they won’t survive if they don’t balance the three Ps” (people, planet, profit). Sustainability has been a feature of corporate strategy for decades, by contrast, ESG, which was “invented” by the financial sector, has become firmly embedded through the Taskforce for Climate-related Financial Disclosures (TCFD) in 2018-19.
- TCFD has urged investors to think about which businesses will thrive or struggle in a warming planet, and enabled companies to “really think about their climate risks”.



- 2019-20: ESG as a “very broad genre of information” becomes mainstream. “You need to look at all ESG factors, all of it is material, all of it is important”. As a result, investors on aggregate re-orientate their priorities — “there are so many investors who won't even come to the table unless you've got a really clear ESG policy”.
- Where next? The logical trajectory is for ESG/sustainability to become more specific: What is your objective? How do you aim to achieve it? What are the trade-offs? Are you going to be an “active” owner — i.e. investor stewardship?

Challenges and confusions

- Greenwashing: “ESG has gone from being an easy policy or PR win to being a nightmarish minefield”.
- “Where we've all overstepped is the idea that you can just stick an ESG label on products, and have it mean the same thing to everyone”. The resulting confusion has “prompted a lot of backlash” and “pushback”, hence the need for ESG to become more specific and focused on objectives.
- Investment timelines differ wildly leading to different attitudes and commentary: The average holding is three to four years, ESG factors will be less material over this period, but they will be highly significant for pension funds with investment horizons lasting three to four decades.
- “There's so much coming out of the financial sector and so much confusion around what to measure and how”, leading to a “vacuum” between the two.

The APPG on ESG published its 2023 report, ‘**Defining ESG**’ to counter confusion around ESG.

Regulation, legal action and stakeholder expectations

- ESG has been “woolly in the past, but we are now moving to far greater regulation with disclosures,” marking a continued trend. “ESG has to be part of our business as usual, because there is no way out of it”. EU regulations are a major factor because they apply to countries outside the bloc.
- Once companies define their materiality, shareholders, investors, and government have a reference point that’s “set in stone”. These stakeholders expect sustainability strategies to move forward.
- “It’s a pincer movement everywhere”. Companies are faced with regulation (UK, EU, now SEC), legal action from NGOs, and rising consumer awareness — “if you don't adapt as a business, someone else will take your place”.
- Meanwhile, companies actively call for regulation because they want clarity and certainty — e.g. the UK Bribery Act.

- “Policymakers are not rewarded for bringing in regulation, apropos nothing”. Voters, consumers, businesses, and investors are the impetus, but once a regulatory mandate is established there’s no going back.
- Harmonising regulations and disclosure frameworks is essential.

Issues raised

Value creation

The economy is decarbonising. Companies that commit to net zero using ESG tools, “will make money for shareholders”. The correlation with commercial benefit is less obvious across other aspects of ESG. From a value creation perspective, factors like productivity, innovation, and culture (PIO) should be considered alongside ESG considerations.

Focusing on the specifics

“We want to disaggregate ESG, and identify what’s material”. Every business will have a cluster of UN SDGs that it will need to address. What the SDGs are and how many will vary from one company to the next.

“US capitalism is not like any other kind of capitalism”

ESG is understood differently depending on the “model of capitalism” — e.g. US-style free-market vs. the German social market model which already takes environmental and social considerations into account. In the US “you have to be so clear at the outset: Are you talking about non-financial goals, financial goals, most of one or the other, or neither?”. This is less of an imperative in the UK where we see public policy and consumer/voter preferences correlate more strongly with corporate and investor attitudes towards risk across a range of ESG parameters (net zero, waste, modern slavery, DE&I). Nevertheless, the politicisation of ESG in the US, fuelled by confusion and misunderstanding, shows the need for ESG strategies to be communicated clearly.

Delivering higher ESG standards outside of regulation

“Companies are just desperate for clarity above and beyond regulation”, meanwhile many “CEOs feel that being more environmentally and socially sustainable is the right thing to do”. How to move forward, bearing in mind that “you can’t regulate good behaviour”? Companies will too easily focus on the targets, not the outcomes. The Basel Committee, which has no legal power, offers an example for sustainability/ESG to follow. Basel rules transmit information about the condition of the balance sheet and “get banks to behave differently”. GFANZ — led by Mark Carney, who spearheaded TCFD — could potentially follow the Basel example.-

The boardroom

Increasingly, ESG strategy is being run within the wider business strategy with board-level oversight, not separately, which was typically the case. Consensus is lacking on whether a single board member should be nominated to lead ESG strategy or whether responsibility should be shared. Larger companies should establish ESG committees, reporting to the board and meeting regularly.

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