What Is ESG? It's Complicated, But Getting Clearer

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Today, environmental, social, and governance (ESG) investing is all the rage. But as investment dollars flow into sustainable funds at record levels, it's increasingly important that we ensure those investments are based on sound data and information infrastructure.

In many respects, standardized corporate sustainability disclosure has presented a more complex challenge than did the standardized financial information that companies have long disclosed. Sustainability information must meet the needs of a range of different users – not just investors – each of whom digests and processes information in unique ways and in accordance with their own objectives. This may include a company's employees, customers, and suppliers, as well as its local communities, policymakers, regulators, civil society, and others.

In this context, there is no single disclosure framework or set of standards that can be all things to all people. As a result, a number of different initiatives have emerged, and markets have become confused. Recently, the five leading organizations in ESG disclosure – CDP, the Climate Disclosure Standards Board (CDSB), the Global Reporting Initiative (GRI), the International Integrated Reporting Council (IIRC), and the Sustainability Accounting Standards Board (SASB) – have joined forces to overcome this challenge.

In our joint paper, "Statement of Intent to Work Together Towards Comprehensive Corporate Reporting," we advanced a shared vision of the elements necessary for a coherent, comprehensive system of corporate disclosure. Collectively, our organizations believe our frameworks and standards complement Financial GAAP and provide the natural starting point for progress toward such a system. Furthermore, we're encouraged by the interest of the IFRS Foundation – which oversees the International Accounting Standards Board (IASB), whose financial accounting standards are generally accepted in more than 140 countries – to build on this work. Such an effort would improve the global consistency and comparability of sustainability disclosure.

Although sustainability information is of interest to a broad range of users, the information needs of one set of decision makers – specifically, participants in global capital markets – are unique. Investors need ESG information that is explicitly connected to the creation of enterprise value. They need a focused set of topics and related performance metrics that capture the industry-specific risks and opportunities a company faces in managing its performance.

This is precisely what SASB's 77 industry-specific standards were designed to do. Such disclosure provides companies and investors with comparable information among industry peers on how they are managing the sustainability issues most likely to impact a firm's financial condition, operating performance, or cost of capital. This focus on "financial materiality" is why SASB's industry-specific standards are supported by global investors with approximately $55 trillion in assets under management, including many of the world's largest asset managers and asset owners.

Of course, investors have always used a combination of quantitative analysis and qualitative judgments to evaluate companies and make investment or lending decisions. Importantly, SASB Standards are also designed to serve as practical tools for implementing principles-based frameworks, such as those of the IIRC and the Task Force on Climate-Related Financial Disclosures (TCFD). Qualitative disclosure provides invaluable context, particularly in cases where numeric measures have more confirmatory than predictive value. For example, qualitative information can provide important visibility into why a company is pursuing sustainability-related efforts and how it achieves, or intends to achieve, results – for instance, through information about its approach to governance, strategy, and risk management.

This synergy is one reason among many that SASB and the IIRC have announced our intention to merge into a unified organization, the Value Reporting Foundation, later this year. This important convergence responds directly to market calls to simplify the field, bringing together the leading standard setter for disclosing sustainability information to investors with the leading framework for integrating sustainability information with financial and other capitals.

Indeed, thus far, it is market forces that have driven sustainable investing to the fore. Looking ahead, as the IFRS Foundation explores next steps, and with policy developments underway in Europe and seemingly looming in the US, this trajectory is only likely to escalate. These developments are significant. However, as we build toward sustainable, long-term economic development, we must start with the foundation. Just like traditional investing, ESG investing should be established on a bedrock of consistent, comparable, reliable information.