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Why ESG Matters (Sixth of a Series)

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So far in this special series we've outlined the history of the ESG movement, its complexities and challenges, and current themes in climate and social change, and governance.

It's clear that compelling dynamics are behind ESG in all its aspects. It's also evident that defining, let alone organizing or regulating, such a multi-dimensional entity goes beyond borders and jurisdictions. Yet the attempt to do so was there from the start.

The impetus for environmental disclosure has perhaps the longest history. The result has been the development of many "standard-setters:" the Carbon Disclosure Project, the Global Reporting Initiative, the International Integrated Reporting Council, the Sustainability Accounting Standards Board, and the Task-Force on Climate Related Financial Disclosures (the widely recognized standard on climate risk reporting).

To simplify this regulatory maze and help create common frameworks, several agencies have merged while others have formed partnerships.

The urgency to create manageable disclosure and reporting systems has grown with concerns around "greenwashing." Deceptive ESG representation is drawing scrutiny from government and regulatory agencies. That plus investor demand for transparency is leading to higher disclosure standards for portfolio companies and managers.

Sketchy reporting is also fueling general ESG skepticism. There's precedent for hope around data legitimacy. Nutrition labels are a given today, but in the 1960's the idea of listing calories and serving sizes was far-fetched. With better technology, food could be more precisely analyzed. FDA regulation in 1973 finally forced manufacturers to allow consumers to make informed decisions about fat and sodium content.

In the same way claims of food being called "organic" also attracted regulatory attention, the SEC is today focusing on funds calling themselves "green." In a proposed rule in March, the agency recommended "certain climate-related disclosures…including information about climate-related risks…[and] also would include disclosure of a registrant's greenhouse gas emissions."

Disclosure and reporting go hand-in-hand, but what about the challenge of collecting and measuring ESG-related data itself? The head of sustainability for a major private equity firm reported in a recent WSJ article, "In the absence of clarity on what information to collect and how, we get a lot of mishmash of information that's not…decision-useful."

How does one measure social factors? Some items that can be assessed include turnover, recruitment, productivity, and workplace safety. As one study suggested, whatever metrics are eventually developed, it's not just inputs but the impact of that data that matters.

Next week: We look at ESG evolution by asset class.