Bridging the ESG Disclosure Gap

by Visvesh Sridharan and Anuj Saush

Demand for increased disclosure has contributed to the emergence of several sustainability reporting frameworks, environmental, social, and governance (ESG) rating agencies, and nonfinancial reporting regulatory frameworks in different parts of the world. However, despite the uptick in the level of sustainability reporting, there continues to be a disparity between what is being reported and the information that investors need while making investment decisions.

This Sustainability Matters publication provides an overview of the current state of sustainability reporting and insights into investor expectations on ESG reporting. It also presents some tips for companies to evolve their ESG disclosure for investors.

This report is based on “Bridging the Disclosure Gap: Investor Perspectives on Environmental, Social, & Governance (ESG) Disclosures” by Visvesh Sridharan. The opinions expressed are those of the authors only and do not necessarily reflect the views of The Conference Board.
State of corporate sustainability reporting

Corporate sustainability reporting has evolved tremendously over the last two decades. According to The Conference Board’s research, disclosure across a wide spectrum of sustainability issues is on the rise, driven by stakeholder pressure and a combination of soft and hard regulation in various jurisdictions. These drivers are shifting sustainability reporting from a largely voluntary practice to one increasingly expected—and in some cases required—of companies.\(^1\) Further, reporting trends suggest that sustainability reporting is standard practice for large companies around the world. For example, 86 percent of the S&P 500 companies published a sustainability report in 2018, up from 53 percent in 2012.\(^2\) Alongside an increase in the number of reports, the nature of sustainability reporting has evolved, as summarized in Figure 1.\(^3\) The practice of seeking assurance has been growing. The Conference Board’s most recent analysis of corporate sustainability disclosure reveals a significant increase in the number of companies using external assurance. For example, among the S&P Global 1200, the share of companies using external assurance for their sustainability information grew from 30 percent in 2015 to 51 percent in 2019. However, it must be acknowledged that the assurance is often for just a subset of data.


\(^3\) *Mapping the Sustainability Reporting Landscape*, ACCA, 2016.
Sustainability reporting frameworks and standards

As sustainability reporting has gradually increased through the years, global standards and guidelines for disclosing this information have been developed as well by various organizations. Previous research from The Conference Board indicates that Global Reporting Initiative (GRI) standards remains the most popular framework for sustainability reporting worldwide.4

The GRI standards provide a framework for companies to guide the sustainability reporting process and disclose performance metrics by taking a multistakeholder approach and enabling full disclosure of an organization’s environmental and social impacts. The Sustainability Accounting Standards Board (SASB) has developed industry-based standards to help companies disclose financially material ESG information. CDP (formerly known as the Carbon Disclosure Project) is another disclosure system that enables companies to provide data on climate change, water, and forests based on a questionnaire format. Another framework that has been gaining investor interest is integrated reporting (IR). Initially put forth by the International Integrated Reporting Council (IIRC) in 2010, IR calls for corporations to disclose financial and nonfinancial information in a combined annual integrated report, thereby preventing the need for a stand-alone sustainability report. This would in turn provide a holistic view of the factors that affect value creation for companies in the short, medium, and long term.

In 2017, the Financial Stability Board’s Task Force on Climate-Related Financial Disclosures (TCFD), released a framework that companies can apply to help identify the information relevant for investors, lenders, and insurance underwriters to appropriately assess and price material climate-related risks and opportunities. The mission of the TCFD is to encourage companies to integrate climate change risks and opportunities into financial analysis and disclose them in their annual financial filings. As of February 2020, a total of 1,027 organizations are now supporters of the TCFD, including the world’s largest banks, asset managers, and pension funds, representing a market capitalization of over USD 12 trillion.

Additionally, the TCFD guidelines have caught the attention of national regulators, with France and Sweden already committing to incorporating them into national law.5 The UK is also considering making reporting on climate-related risks and opportunities in line with the TCFD recommendations mandatory for all listed companies and large asset owners in the UK.6 With increasing regulation and a growing need for climate change-related reporting, pressure is growing on organizations to disclose on these issues in a comprehensive and timely manner.

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While each of these reporting frameworks is used widely, the absence of an internationally agreed standard methodology for reporting material ESG aspects has added complexity to sustainability reporting. This has become a pain point for both the companies and the intended users of the reports. A comparison table of some of the leading sustainability reporting frameworks is available on The Conference Board website.

**Toward standardizing ESG reporting frameworks**

Efforts are being made to streamline and standardize ESG reporting frameworks. For example, Better Alignment Project—an initiative managed by the Corporate Reporting Dialogue—is focused on driving better alignment in the corporate reporting landscape. Another initiative aimed at helping companies consistently report sustainable value creation was proposed by the World Economic Forum in January 2020. The proposed metrics have been organized into four pillars—Principles of Governance, Planet, People, and Prosperity—and are grounded in the sustainable development goals (SDGs). While the intent is right, it is too early to know the impact of these initiatives.
Responsible investing is driving investor interest in ESG data

Globally responsible investment—an investment approach that incorporates ESG factors in investment decisions and management—grew by 34 percent to USD 30.7 trillion over the past two years, up from USD 23 trillion in 2017. Collectively, the majority of assets were allocated to public equities, followed by fixed income. Sustainable investments can also be found in real estate/property, private equity/venture capital, hedge funds, cash or depository vehicles, commodities, and infrastructure. This growth is fueled by a combination of factors: growing recognition that including ESG factors in investment analysis and decisions can help manage risks and improve returns; client demand (i.e., beneficiaries are becoming more demanding about how and where their money is invested); and an increase in the number of regulations (i.e., policy tools and market led-initiatives) in relation to responsible investing and fiduciary duties of the investors. And while not all investors have begun to embrace responsible investing, there is a wide belief it will become more significant in the future.

Strategies for pursuing ESG investing

Responsible investment involves an approach to managing assets where investors include ESG factors in their decision making about what to invest in and the role they play as owners and creditors. Figure 3 provides a simple overview of key strategies adopted by investors for pursuing ESG objectives.

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**Figure 3**

**Responsible investment approaches**

**ESG incorporation** (considering ESG issues when building a portfolio)

ESG issues can be incorporated using a combination of approaches:

<table>
<thead>
<tr>
<th>SCREENING</th>
<th>INTEGRATION</th>
<th>THEMATIC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Apply filters to exclude specific companies or industries, based on investors’ preferences or values.</td>
<td>Explicitly and systemically include ESG issues in investment analysis and decisions, to increase exposure to best-in-class companies.</td>
<td>Seek to combine attractive risk-return profiles with an intention to achieve specific environment or social outcome.</td>
</tr>
</tbody>
</table>

**Active ownership/stewardship** (improving investees’ ESG performance)

Encouraging companies they are already invested in to improve or develop more sustainable practices:

<table>
<thead>
<tr>
<th>ENGAGEMENT</th>
<th>PROXY VOTING</th>
</tr>
</thead>
<tbody>
<tr>
<td>Discuss ESG issues with companies to catalyze action on specific issues. This can be done individually or in collaboration with other investors.</td>
<td>Formally express approval or disapproval through voting on resolutions and proposing shareholder resolutions on specific ESG issues.</td>
</tr>
</tbody>
</table>

Source: The Conference Board (based on UN Principles of Responsible Investment)

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7  Global Sustainable Investment Review, Global Sustainable Investment Alliance, 2018.

8  Principles of Responsible Investment, UN.
A growing investor interest has in turn contributed to the demand for high-quality ESG data. Investors need reliable and comparable ESG data to identify companies that may be best positioned to succeed and to avoid those that are likely to underperform or fail. However, as mentioned earlier, the absence of a “go to” reporting standard for ESG data makes it difficult for investors to compare ESG issues consistently. Further, this has also contributed to the rise of many ESG ratings and rankings. Hundreds of them in fact.

A project by SustainAbility, called “Rate the Raters,” finds about 108 different ones. This number rises to more than 200 when adding research agencies, awards, and rankings. What makes matters complicated, according to SustainAbility, is that about 60 percent rely completely or partially on information submitted by companies. This information can be in the form of verification requests, questionnaires, interviews, or on-site visits. With so many different yet similar requests coming in, it is not surprising that companies suffer from ESG reporting fatigue.9

While companies are on the receiving end of multiple requests, the world of ESG ratings is far from perfect. A report from the American Council for Capital Formation—a nonprofit, nonpartisan economic policy organization—finds that the major rating agencies have significant disparities in the accuracy, value, and importance of their individual ratings to investors, and arguably undermine the validity of ESG investment strategies.10

Another aspect relates to the lack of transparency about the methodologies. Most data providers treat their methodologies as proprietary information. By relying on an ESG data provider’s score, asset owners are taking on the perspectives of that provider without a full understanding of how the provider arrived at those conclusions.11

**Search for ESG data and information**

Although investors rely on the ESG information provided by rating agencies, they are aware of the shortcomings and realize that the proxy can be noisy and that it consists of soft data. This begs the question of where and how investors get the ESG data for investment decisions or stewardship. There are several studies—based on surveys and interviews with investors—that shed light on this topic. In brief, investors do not solely rely on ESG rating agencies and typically gather ESG information from a combination of sources to guide their investment decisions and engagement approach.

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10 Ratings that Don’t Rate: The Subjective World of ESG Ratings Agencies, American Council for Capital Formation, 2018.

An EY report revealed that investors read widely in search of valuable nonfinancial information and no single source dominates decision making. Surveyed investors reported that the most useful source of nonfinancial information for making investment decisions was the company's own integrated report, deemed “very useful” by 89 percent. This was closely followed by the company's own annual report, which investors deemed “very useful” at 82 percent. A study by Clermont Partners of 189 active investors found that annual reports and corporate sustainability reports are the primary sources of ESG information for investors, followed by direct question to the company. A different study found that investors most frequently turn to sustainability ratings for ESG information but may also rely on company reports.

Figure 4
Where do investors go for ESG information?

<table>
<thead>
<tr>
<th>Source</th>
<th>Essential</th>
<th>Very useful</th>
<th>Somewhat useful</th>
<th>Not very useful</th>
</tr>
</thead>
<tbody>
<tr>
<td>Integrated report</td>
<td>6%</td>
<td>89%</td>
<td>4%</td>
<td>1%</td>
</tr>
<tr>
<td>Annual report</td>
<td>12</td>
<td>82</td>
<td>5</td>
<td>1</td>
</tr>
<tr>
<td>CSR or sustainability report</td>
<td>2</td>
<td>51</td>
<td>43</td>
<td>4</td>
</tr>
<tr>
<td>Equity research and advice prepared by brokers-dealers</td>
<td>2</td>
<td>50</td>
<td>45</td>
<td>3</td>
</tr>
<tr>
<td>Press coverage and business commentary</td>
<td>2</td>
<td>42</td>
<td>51</td>
<td>5</td>
</tr>
<tr>
<td>ESG ratings or assessment from investment data providers</td>
<td>3</td>
<td>34</td>
<td>56</td>
<td>7</td>
</tr>
<tr>
<td>SASB indicators</td>
<td>4</td>
<td>27</td>
<td>66</td>
<td>3</td>
</tr>
<tr>
<td>Social media channels</td>
<td>4</td>
<td>25</td>
<td>64</td>
<td>7</td>
</tr>
<tr>
<td>Corporate website</td>
<td>6</td>
<td>15</td>
<td>73</td>
<td>6</td>
</tr>
<tr>
<td>Social sustainability or CSR rankings produced by a third party</td>
<td>2</td>
<td>12</td>
<td>81</td>
<td>5</td>
</tr>
</tbody>
</table>

Source: EY

It can be confidently said that when it comes to evaluating ESG performance, investors seek inputs from different sources to form their own assessment. Most investors, even those without in-house capabilities, certainly don’t rely on numerical scores. Rather, they use the analysis as a backdrop for their own broader assessment, to flag the most relevant ESG issues in an analysis that remains quite focused on financials. Some investors only use the narrative included in the ESG rating report as an input to form their own assessment.

Another trend to consider is that as ESG data becomes increasingly relevant to financial decision making, investors are beginning to build their own in-house ESG expertise that relies on a combination of data sources to complement their analysis. This is partly driven by the fact that investors have different investment philosophies and are looking to align their portfolios to specific ESG metrics based on client interest. While this will not take away the need for companies to disclose ESG data, it might have some ripple effects on the role of ESG rating agencies in the future.

ESG factors investors consider material

Several reporting frameworks discussed above, such as the GRI, IIRC, and TCFD, are establishing their own standards companies should follow, depending on stakeholder needs, to report on the materially relevant issues affecting their businesses. However, it is important to consider that investors are looking for “material” ESG information that will assist them in their investment decisions.

Poor corporate governance and environmental and human rights risks were the most likely to influence investor decisions.15 A study by CFA Institute—a global association of investment professionals—found details around board accountability and oversight as the most sought-after metric in the investment analysis.16 An earlier report by The Conference Board, Beware the 80/20 Governance Trap: Focus on the “G” in ESG, highlights that currently most of the conversation on sustainability focuses primarily on environmental and social impacts, with less attention given to governance issues. Businesses and stakeholders may be better served if companies discuss their ESG strategies within the context of materiality and governance.

A report by US SIF: The Forum for Sustainable and Responsible Investment found that investors and money managers incorporated ESG factors fairly evenly across environmental, social, and governance categories. Climate change and carbon was the most important specific environmental issue in terms of weighted terms, whereas executive pay and diversity were the most important social issues.17 It must be highlighted that the aforementioned studies looked into material ESG issues in general and didn’t explore sector-specific views.

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16 Environmental, Social and Governance (ESG) Survey, CFA Institute, 2017.
ESG factor consideration also varies by sector. For example, for companies within the information and technology sector, investors prioritize ESG issues such as data privacy and protection, whereas for the mining sector, they might also incorporate occupational health and safety and social impact on community.

**Challenges to achieving full ESG integration**

Sustainability reporting is becoming mainstream for companies, and investors are expecting transparent disclosure of information. However, despite greater availability of ESG data, investors don’t have a complete understanding of how companies are performing along different dimensions of sustainability. It is not surprising to see that although 80 percent of institutional investors include an ESG component in their investment strategy, only 27 percent fully integrate ESG criteria into long-term decision making.18

A PwC report observed that the main reason for this misalignment is that corporates and investors see different value in disclosing data; corporates focus on growth while investors focus on risk.19 Further, investors and corporates also speak different languages when it comes to ESG issues, a challenge exacerbated by competing frameworks and standards that are designed for different audiences.

ESG disclosures are largely voluntary, which gives companies the flexibility to choose among different frameworks for reporting, resulting in information that is not necessarily comparable from company to company. Investors believe that ESG reporting should be relevant to operational and financial performance and that the ways companies manage it to achieve long-term financial sustainability should offset long-term risks. But, until a common regulated framework with a set of standards is established, inconsistent disclosure will undoubtedly affect the usefulness of ESG data. While it is hoped that standardization may be a good thing, it remains to be seen whether a single framework or a combination of a few will be better than any of the individual frameworks we have now.

The scope and depth of ESG disclosures differ considerably as a result of the subjective choices companies make about their approaches to sustainability reporting: which frameworks and standards to follow, which stakeholders to address, and which information to make public. Companies most often report performance based on backward-looking ESG data with limited forward projections of value. Another critical challenge faced by investors is the availability of quantifiable ESG data to check cross-company comparability.

Investors apply different sustainable investing strategies, and this spectrum of investors generates highly divergent views as to what the appropriate list of sustainability issues would be and, consequently, what ESG metrics are relevant on an individual level.

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Recommendations

As companies are increasingly urged to adopt more sustainable practices, investor interest in ESG will continue to rise, and we are likely to witness investors adopting several engagement strategies with companies. Investors are interested in understanding a company’s exposure to material ESG risks and want companies to disclose the measures implemented to manage these risks, as well as provide a more forward-looking ESG performance outlook.

• **Focus on value creation** Companies need to refine their sustainability reporting in a way that tells their value creation story and focus on disclosing material ESG issues. Companies can do so by including a visual representation of their business model (i.e., how the company creates value). Keep the report concise by focusing on material ESG issues so it provides information with context that doesn’t overburden readers.

• **Disclose ESG governance systems** Information on governance for sustainability is important to investors as it allows them to understand how companies proactively identify, assess, and respond to ESG risks. Companies need to ensure they communicate how ESG is integrated into overall strategy, governed, and managed in their organization. They need to go beyond describing governance systems and disclose how they are used to guide ESG strategy.

• **Adopt a framework and standards specific to your company** Determine the reporting framework that is appropriate given your company’s industry and business. This can help you identify the recognized standards and measures needed to support the reporting framework, as well as internal and external reporting. No matter what, the framework should take into account financial materiality, and the report should be written in plain language. Some of the reporting frameworks that we have discussed provide companies a foundational starting point to improve disclosure. For example, the TCFD specifically offers a logical framework that encompasses governance, strategy, risk management, metrics, and targets for disclosure of climate-related material issues. Adopting integrated reporting practices also helps companies to better meet the needs of investors by disclosing materially financial and nonfinancial information in a single report.

• **Ensure data is reliable** Treat financial and nonfinancial data disclosures with equal rigor. Obtaining external assurance for material ESG information can help build credibility and trust with stakeholders.

• **Engage investors to understand their expectations** Companies also need to proactively engage and seek dialogue with investors to understand what they really expect in relation to ESG reporting so that organizations can select the right initiative or methodology.
Related reports


Disclosure across a wide spectrum of sustainability issues is on the rise, driven by stakeholder pressure and a combination of soft and hard regulation in various jurisdictions. These drivers are shifting sustainability reporting from a largely voluntary practice to one increasingly expected—and in some cases required—of companies. In this edition we analyzed data on sustainability disclosure and performance on 90+ environmental and social practices for nearly 6,000 companies in 26 markets, spanning Asia-Pacific, Europe, and North America.

Emergence of Integrated Reporting

Over the last 30 years, intangible assets have moved from 20 percent to over 80 percent of the value of public companies, yet decision making within companies has failed to keep pace. Financial reporting has made even less progress in addressing these changes. As they take ESG impacts ever more seriously, US investors are urging management and the board to adopt a reporting method that accounts for both tangible and intangible assets. “Integrated reporting” is such a method: It provides a framework that highlights all the ways a company creates and will continue to create value.

Sustainability Assurance Practices

The practice of obtaining third-party assurance on sustainability reporting is a response to the increase in the number of companies disclosing their nonfinancial impacts, and expectations from rating agencies and stakeholders that this disclosure be reliable, consistent, and of high quality. This report examines findings from a survey of the sustainability reporting and assurance practices of 57 large US and European companies.
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