ESG REPORTING IN THE SPOTLIGHT: DOES IT REALLY MOVE THE NEEDLE ON GLOBAL SUSTAINABILITY?

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BY THARA TK, Founder, ESG Minds

Climate Change is Science, Not an Opinion

Last month, the scientific community unveiled two pivotal discoveries that carry significant implications.

> ***"Seven of eight safe and just Earth System Boundaries (ESB) have been breached, critically risking the planet's health and the survival of its species." – Earth Commission***

> ***"Global warming is now more likely to hit the 1.5oC threshold set by the Paris Agreement, by 2027." – World Meteorological Organization***

Earlier in the year, IPCC (Intergovernmental Panel on Climate Change) reports summarized:

- Human-caused climate change has led to widespread adverse impacts and related losses and damages to nature and people globally.
- Approximately 3.3 to 3.6 billion people live in contexts that are highly vulnerable to climate change. Vulnerable communities who have historically contributed the least to current climate change are disproportionately affected.
- Increasing weather and climate extreme events have exposed millions of people to acute food insecurity and reduced water security.

Consensus on the Converging Global Risks

As per the findings of the World Economic Forum's Global Risk Report, the presence of economic risks among the top 5 concerns for humanity was last observed in 2015. Since then, there has been a notable shift in the perceived risks, with a predominant convergence on social and environmental aspects. However, it is from 2020 onward that this convergence has become even more pronounced, aligning purely with social and environmental concerns. These established risks of humanity are:

- Failure to mitigate climate change
- Failure of climate adaptation
- Natural disasters and extreme weather events
- Biodiversity loss and ecosystem collapse
- Large-scale involuntary migration
- Social cohesion erosion
- Livelihood crisis

Climate Denial: An Increasingly Challenging Task - Inevitable Calls for Response

Climate denial has thus become progressively more difficult in recent times due to the persistent dissemination of information, rigorous quantification efforts, and mounting scientific evidence. However, it is imperative to emphasize that the current state of climate action falls significantly short of the critical pace and unwavering determination required to address this pressing global issue.

Governments, investors, and global organizations consistently engage in a cyclical pattern of understanding, initially underestimating, subsequently acknowledging or facing pressure, and eventually responding to the challenges of climate change at their own pace. This response may not always align with the best interests of humanity as a whole. While the absence of globally coordinated action and binding commitments exacts a significant toll, there are noteworthy endeavors that act as catalysts for change. These endeavors assume the role of change leaders, even as they operate within the context of diverse approaches and priorities.

Several examples highlight this dynamic:

- The G7 nations reached an agreement to accelerate the phasing-out of unabated fossil fuel usage, albeit without finalizing a consensus on a specific timeline for phasing out coal.
- Despite the European Union (EU) demonstrating exceptional leadership in climate action through proactive policy development, instances of climate denial persist among global leadership.
- While France implemented a ban on short-haul flights, global sales of private jets reached an all-time high this year.

- In the face of global textile waste reaching 92 million tons annually, the EU has taken a praiseworthy step by prohibiting the destruction of unsold textiles, thereby preventing approximately 6 million tonnes of waste from being discarded.
- A lawsuit filed by 25 states against the Biden administration regarding "socially conscious" investing, prompted President Biden's first veto to protect the ESG rule related to pension funds.
- India, with nearly 17% of the global population, ranks as the third largest emitter of greenhouse gases and has made a commitment to achieve Net Zero by 2070. Although this target deviates significantly from the commitments of other major emitters, India maintains the lowest per capita emission among G20 countries. Furthermore, India's endeavors in decarbonization place it among the top 5 nations exhibiting commendable climate action, as indicated by a study.

These examples reflect the ongoing complexity of addressing climate change and the varying approaches taken by different entities. While they may not represent a unified and comprehensive global response, they contribute to the broader narrative of change and can serve as drivers for transformation.

ESG Reporting – Spearheading Corporate Climate Action

As per a survey conducted by KPMG last year, sustainability reporting was undertaken by 96% of the world's top 250 companies and approximately 80% of the leading 100 companies in each of the 58 participating countries. A notable percentage of these companies recognize climate change as a risk that poses a threat to their business operations.

There are several compelling factors that contributed to this notable shift in mindset and subsequent response in the past couple of years

- Regulators and non-profit standard-setters across the globe have taken significant steps to streamline policies and unify sustainability reporting frameworks. Approximately 50% of the top 100 companies in the Middle East, Africa, and Asia Pacific regions adhered to the guidelines set by their respective domestic stock exchanges, while a vast majority of companies in other regions followed the Global Reporting Initiative (GRI) standards.
- The establishment of the International Sustainability Standards Board (ISSB) in 2021 received support from the G20, the International Organization of Securities Commissions (IOSCO), as well as Finance Ministers and Central Bank Governors

from over 40 jurisdictions. The ISSB's primary aim is to develop standards for a universal framework of sustainability disclosures and provide vital sustainability information to global capital markets. The ISSB integrates key frameworks such as TCFD, SASB, CDSB, WEF IBC, and the Integrated Reporting Framework into its own framework. Its inaugural two sets of reporting standards are anticipated to come into effect in January 2024.

- When it comes to investors, giants like Blackrock, have strongly expressed their vocal advocacy of ESG investing. However, some of them, have also faced scrutiny for potential greenwashing and navigating the complex realm of politics. Conversely, figures like Warren Buffet have not hesitated to express their disapproval of ESG and stakeholder capitalism. Nevertheless, when examining the broader trends and statistics, there is a clear indication of a substantial increase in investor awareness and action within the ESG sphere and their interest in ESG reporting.

While reporting is typically seen as a concluding step, for many companies, their sustainability journey commences with reporting. By engaging in reporting, they establish a basis for measurement, and through measurement, they drive improvement. Undeniably, ESG reporting has garnered substantial attention, instigated actions, and is establishing a robust foundation for corporate sustainability.

However, in terms of its effectiveness and outcomes, ESG Reporting is still an early-stage endeavour marked by imperfections.

As an emerging initiative, ESG reporting is grappling with its formative challenges.

- As we face a code red situation for humanity, the politics surrounding single or double materiality reporting appears to downplay the urgency and cater to specific stakeholder interests. The inability of ISSB and GRI to reach a consensus on actions that serve a greater purpose undermines the gravity of the situation emphasized by scientists.

- As per a global investor survey conducted by PWC last year, 87% of investors believe that corporate reporting includes unsubstantiated sustainability claims, commonly referred to as greenwashing.

- Investors and companies heavily depend on a range of rating agencies to assess and streamline business ESG performance. Nevertheless, the absence of adequate regulations and a standardized consistent scoring framework across different agencies result in minimal correlations among these systems.

- Currently, the ecosystems offer minimal assurance and tools to validate the disclosures made by businesses. It will require time to establish the trustworthiness of data and enhance transparency in processes.

Just like traditional financial accounting, which has taken a century to evolve, ESG accounting is also expected to face similar challenges before it can establish a strong foundation of trust and credibility.

Can Mature ESG Reporting Propel Global Sustainability?

ESG Reporting with its current objectives and anticipated outcomes, can be compared to a "shotgun approach" when it comes to tackling broader global sustainability challenges. This is mainly because it does not directly contribute to achieving specific global targets such as the Sustainable Development Goals (SDGs) or Net Zero by 2050. Additionally, the commitments made through ESG reporting are non-binding, further emphasizing the scattered nature of its impact.

Delving into diverse aspects of the discussion:

- Planetary boundaries delineate the boundaries of Earth's ecological systems, setting the limits within which humanity can safely operate to prevent surpassing critical thresholds and causing irreversible harm to the environment. By respecting these boundaries, we aim to maintain a stable and habitable planet for all. Our social, economic, and scientific systems are yet to achieve the level of maturity where the impact of every economic activity can be readily linked to its effects on planetary boundaries. As a result, making safe and equitable decisions at the community, industry, global, and sub-global levels is challenging at this point in time.

- The Earth Overshoot Day of 2023, falling on August 2nd, represents the point in the year when our consumption exceeds Earth's capacity to regenerate resources in a year. If the global consumption rate is matched to that of the USA and UAE, it would require approximately 5.5 Earths to sustain us for a year. Addressing this will require our economic systems to be restructured for equitable global consumption governance and reflecting the same onto the corporate landscape. This necessitates embracing the principle that "limited resources cannot deliver unlimited growth" and implementing measures to optimize resource utilization. In such a context, businesses will need to pay to procure their social and environmental license to operate.

- The transformation will occur when (as surreal as it may sound):
  - The primary objective of larger corporations shift from generating wealth for a select few to positively influencing the lives of millions.
  - We find effective ways to decouple economic growth from its detrimental environmental consequences.
  - The developed economies embrace the concept of Degrowth, the theory of shrinking rather than expanding economies, prioritizing the efficient use of global resources, and placing well-being ahead of profit
  - Developing economies grow sustainably and establish Universal Basic Income and Services for all citizens

Hence, for ESG Reporting to truly shape global sustainability, the transformation must occur at deeper levels. This includes reforming economic systems, establishing equitable geopolitical governance, accurately linking Earth system indicators to economic activities, and decoupling the economy from its environmental impacts. When these changes are integrated into ESG reporting frameworks guided by regulations, ESG reporting will emerge as a significant catalyst for global sustainability, truly revolutionizing the way we approach environmental, social, and governance concerns.

That does not imply that the ongoing efforts invested in ESG reporting are in vain. Geopolitics, economics, social justice, science, technology, and solutions are advancing in parallel. They are being incorporated into ESG reporting as they unfold. Time is of the essence. Our capacity to solve this intricate puzzle, which requires us to rethink the fundamental principles we operate on, within the remaining time, will ultimately shape our destiny.

In Conclusion

The urgency and magnitude of the global sustainability challenge demand swift and transformative action. While ESG reporting has emerged as a significant catalyst for change, it is still in its early stages and faces challenges and imperfections. To truly propel global sustainability, deeper transformations are required, including economic system reform, equitable geopolitical governance, accurate linking of Earth system indicators to economic activities, and decoupling the economy from environmental impacts. As we integrate these changes into ESG reporting frameworks guided by regulations, we can harness its potential to revolutionize our approach to environmental, social, and governance concerns. Time is of the essence, and our ability to solve this intricate puzzle will shape our destiny.

In the pursuit of a sustainable future, the path ahead demands our unwavering commitment. We must choose our leaders wisely, for they hold the power to shape our world; be ready for changes, for their arrival will be swift and transformative; and believe in the vision of an equitable world and let that belief fuel our actions. A sustainable future signifies a world of greater well-being for the majority of the planet’s inhabitants. It is both meaningful and imperative to work towards that.