

Sustainable Financial Performance Session 2

IÉSEG SCHOOL OF MANAGEMENT

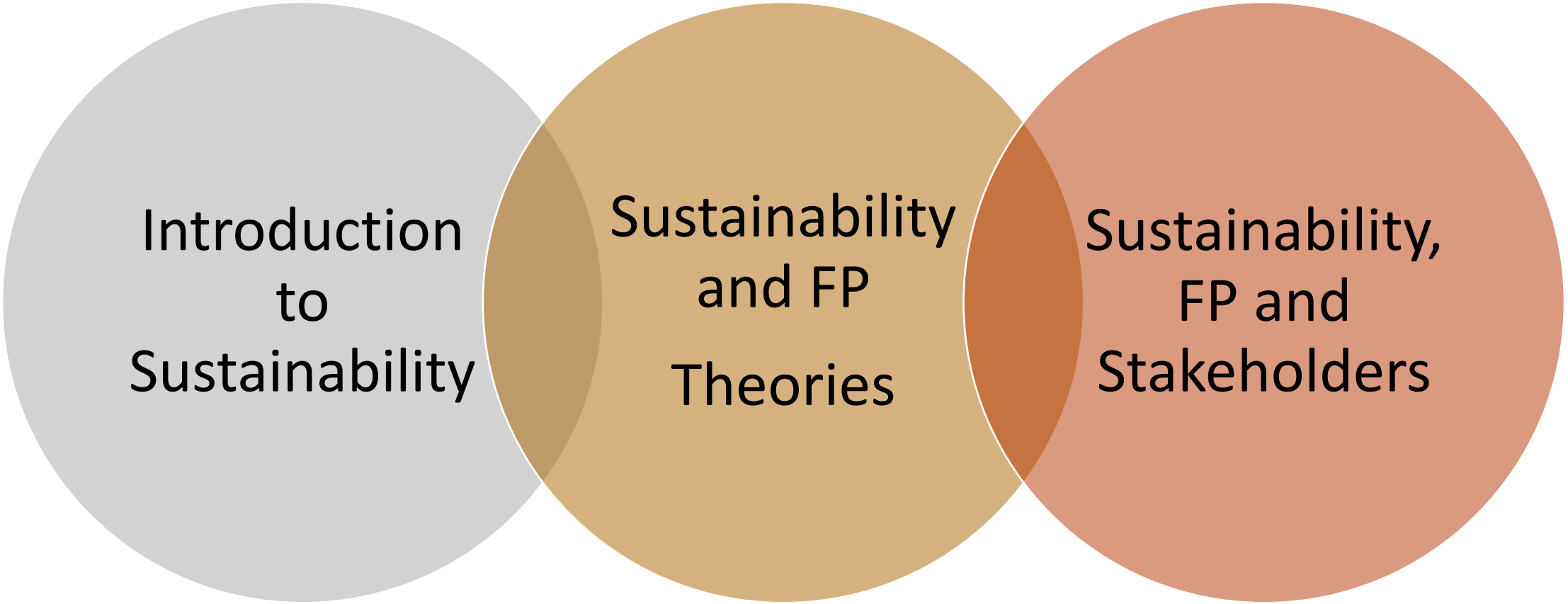
EMPOWERING CHANGEMAKERS FOR A BETTER SOCIETY

Icebreaker of the day

Share a sustainable action that you have carried out /come across since this morning



Recap of last session



Overview of Session 2

- Getting started with the Final Group Project
- Sustainability and Value Creation
- Integrating sustainability in Finance Valuation
- Sustainability Data and Rating
- Green and social washing

Overview of Session 2

- Getting started with the Final Group Project
- Sustainability and Value Creation
- Integrating sustainability in Finance Valuation
- Sustainability Data and Rating
- Green and social washing

Getting started with the Final Group Project

✓ Please refer to the group list on IESEG online and sit in your team for the project.

✓Open the group project requirements, we will browse through it together.

✓You will have multiple opportunities during classes to work on different parts of the project.

Let’s get started with the group project

- Sit within your team and introduce yourselves ☺
- Identify a company that you would like to analyse for the group project. Provide a rationale for choosing the company and the sector.
- Gather the data for past 5 years for the company (that include annual reports, sustainability reports and more).
- Establish and discuss your way of working.
- **Kindly complete this task in the next 20mins**



IÉSEG
SCHOOL OF MANAGEMENT

Overview of Session 2

- Getting started with the Final Group Project
- Sustainability and Value Creation
- Integrating sustainability in Finance Valuation
- Sustainability Data and Rating
- Green and social washing



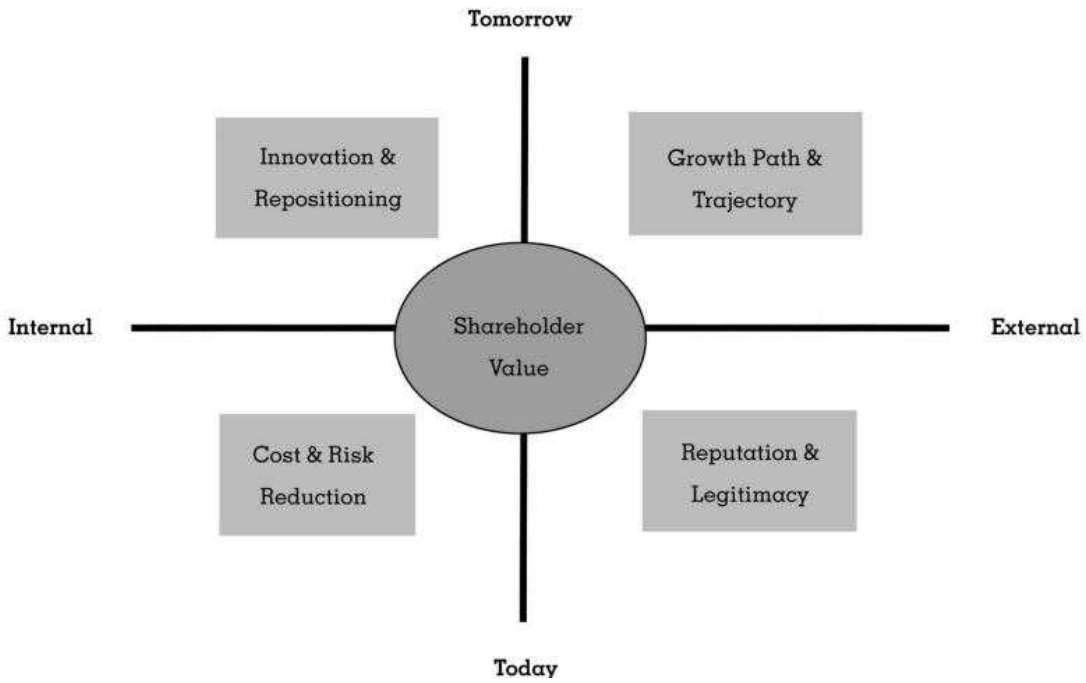
Sustainability and Value Creation

IÉSEG
SCHOOL OF MANAGEMENT

Key Dimensions of Shareholder Value

The vertical axis in the model reflects the firm's need to manage today's business while simultaneously creating tomorrow's technology and markets.

The horizontal axis reflects the firm's need to grow and protect internal organizational skills and capabilities while simultaneously infusing the firm with new perspectives and knowledge from the outside.

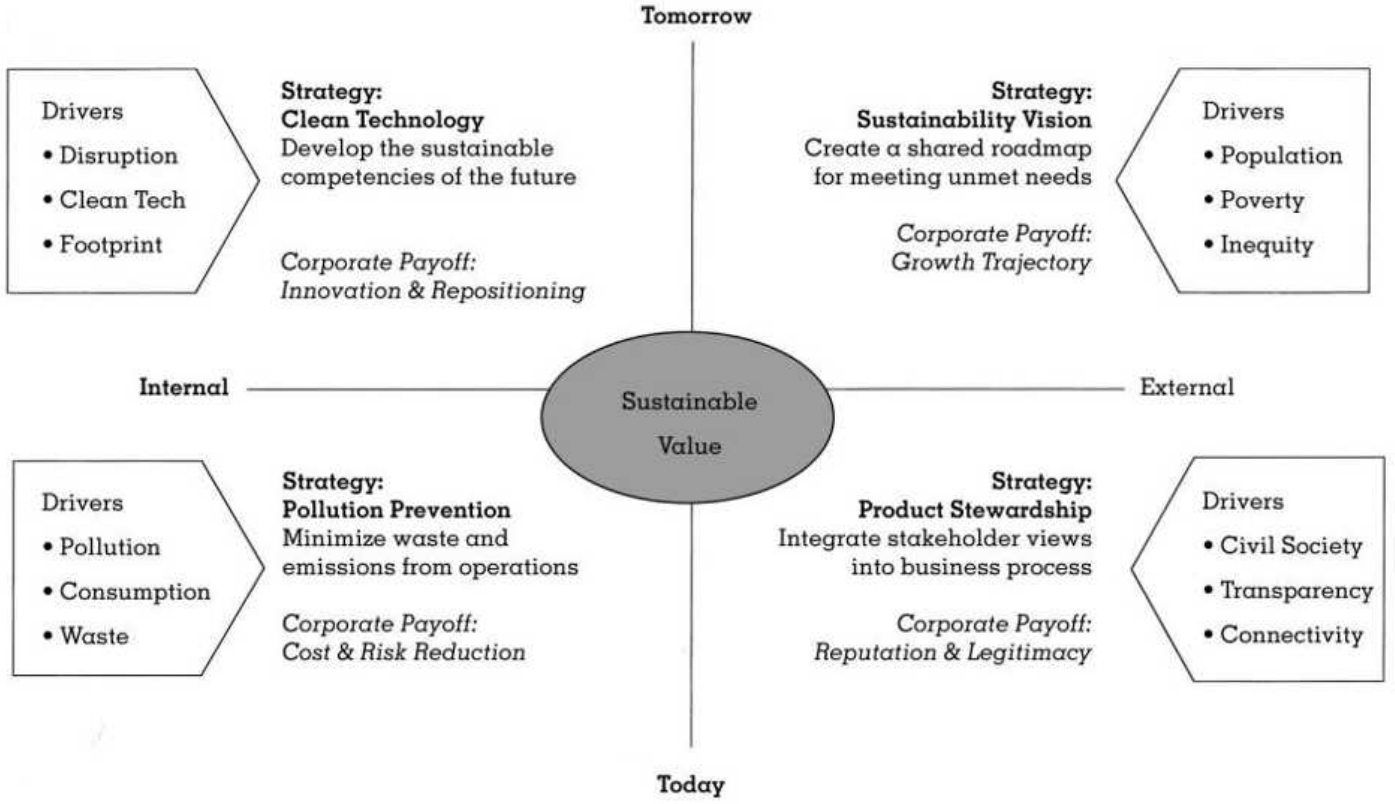


IÉSEG SCHOOL OF MANAGEMENT

The Sustainable Value Framework

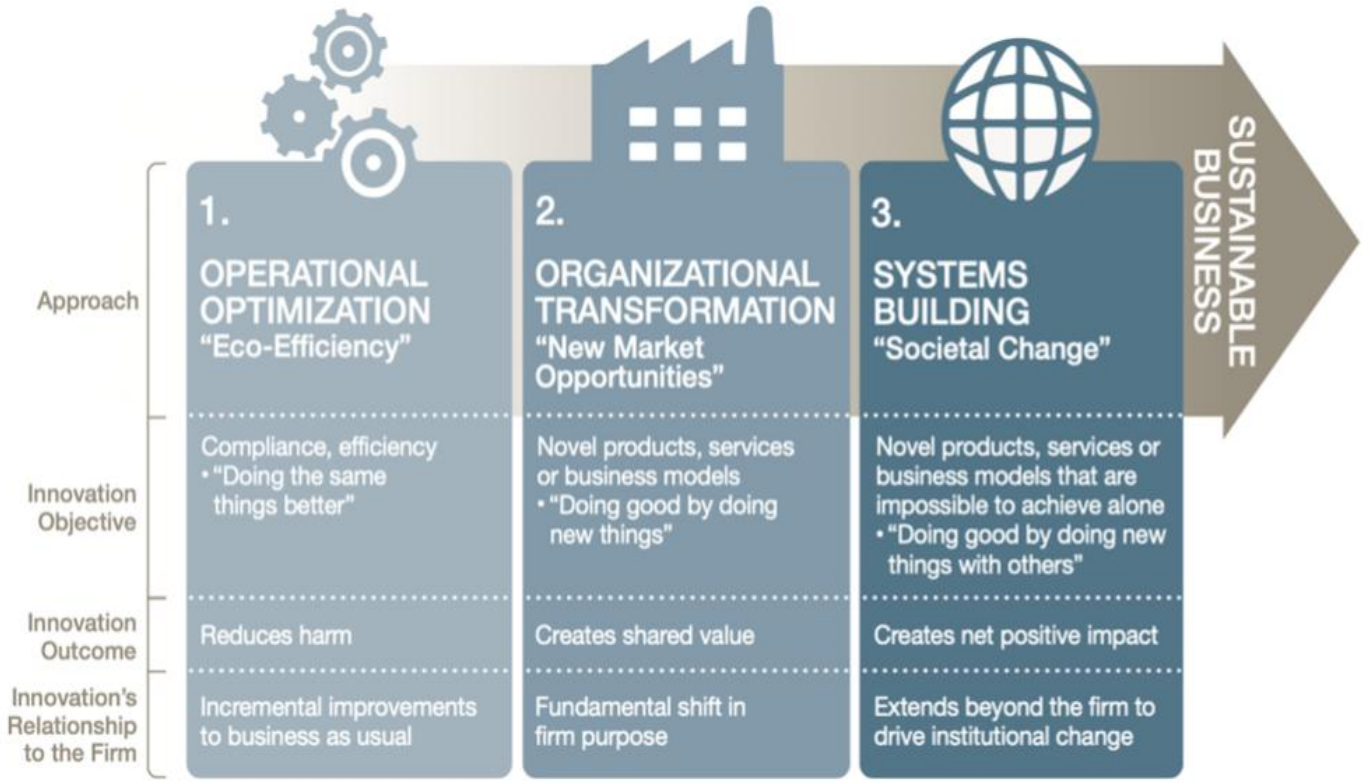
The idea of sustainable value, therefore, is ***to show how "the multiple challenges associated with global sustainability, seen through the appropriate business lenses, can help to identify strategies and practices which improve performance in all four quadrants of the shareholder-value framework***.

The sustainable-value framework can be used as a simple but important diagnostic tool. By assessing a company's (or SBU's) activity in each of the four quadrants of the framework, managers can assess the degree of portfolio balance. Extreme portfolio imbalance suggests missed opportunities and vulnerability



Source: Hart.S 1997, 'Beyond Greening :Strategies for a sustainable world', Harvard Business Review.

Sustainability and Innovation



Firms can engage in three types of sustainable innovation; Source: Adams et al. (2015)

1. **Operational optimization**

Firms can improve their operational processes without fundamentally changing their business model. They can find ways to "*do the same things better*," and reduce their negative environmental and social impacts (e.g., using renewable energy and reducing packaging). This can be done relatively easily by adding environmental and social criteria to existing quality or profit criteria.

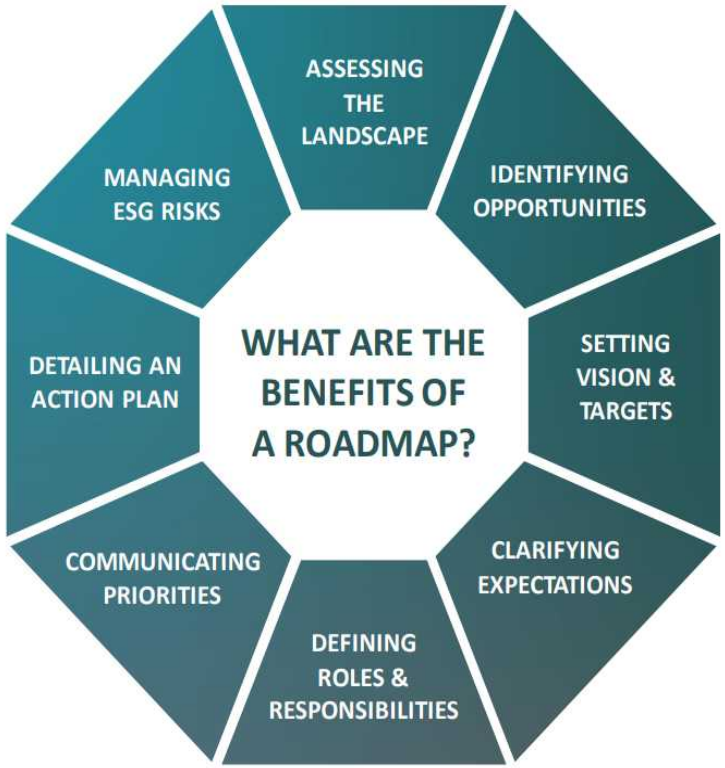
2. Organizational transformation

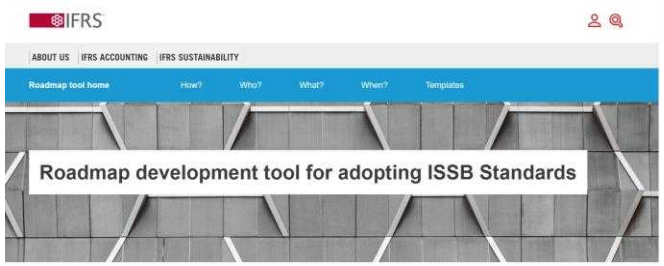
For a greater change, companies can create disruptive new products and services that serve societal needs and/or benefit the environment. This step goes beyond "doing less harm" and focuses on "*doing good by doing new things*." These companies also see sustainability as a business opportunity.

3. Systems building

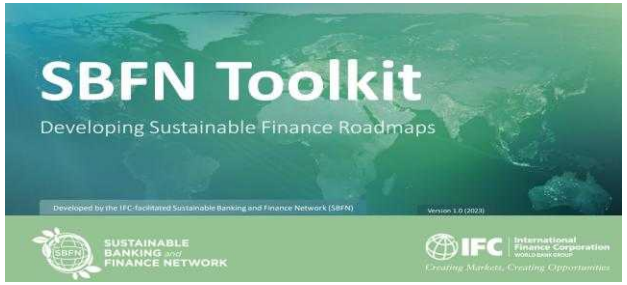
The most advanced form of sustainable innovation involves collaborating with others to create positive impacts on people and the planet. Companies here see themselves as part of an ecosystem and recognize that sustainability can't be achieved by any single organization. They aim to "*do good by doing new things with others*." These system builders extend their thinking beyond the boundaries of the organization to include partners in previously unrelated industries as well as marginalized actors.

Examples of Developing Sustainability Roadmaps





https://www.ifrs.org/ifrs-sustainability-disclosure-standards-around-the-world/roadmap-development-tool/



https://www.sbfnetwork.org/sites/default/files/2025/Mar/SBFN_Sustainable_Finance_Roadmap-Toolkit_Guide_0.pdf



Roadmap for Integrated Sustainability

https://unglobalcompact.org/take-action/leadership/integrate-sustainability/roadmap

Sustainability & Value Creation Examples

	Strong sustainability proposition (examples)	Weak sustainability proposition (examples)
Top-line growth	Attract B2B and B2C customers with more sustainable products Achieve better access to resources through stronger community and government relations	Lose customers through poor sustainability practices (eg, human rights, supply chain) or a perception of unsustainable/unsafe products Lose access to resources (including from operational shutdowns) as a result of poor community and labor relations
Cost reductions	Lower energy consumption Reduce water intake	Generate unnecessary waste and pay correspondingly higher waste-disposal costs Expend more in packaging costs
Regulatory and legal interventions	Achieve greater strategic freedom through regulation Earn subsidies and government support	Suffer restrictions on advertising and point of sale Incur fines, penalties, and enforcement actions



Sustainability & Value Creation Examples

	Strong sustainability proposition (examples)	Weak sustainability proposition (examples)
Productivity uplift	Boost employee motivation Attract talent through greater social credibility	Deal with “social stigma,” which restricts talent pool Lose talent as a result of weak purpose
Investment and asset optimization	Enhance investment returns by better allocating capital for the long term (eg, more sustainable plant and equipment) Avoid investments that may not pay off because of longer-term environmental issues	Stranded assets as a result of premature write-downs Fall behind competitors that have invested to be less “energy hungry”

IÉSEG SCHOOL OF MANAGEMENT


TIME
FOR A
BREAK!

Overview of Session 2

- Getting started with the Final Group Project
- Sustainability and Value Creation
- Integrating sustainability in Finance Valuation
- Sustainability Data and Rating
- Green and social washing

Integrating Sustainability into Finance Valuation



IÉSEG
SCHOOL OF MANAGEMENT

The Market Approach

To account for sustainability factors a valuer will be required to:

1) Identify and assess the **relevant ESG/sustainability criteria** for the comparable companies and industry, then

2) **Assess the performance** of the subject company for such criteria, and

3) **Calibrate the market inputs** (e.g., net profit) to the subject entity to take into account the relevant performance as compared to the comparable companies.

Scenario Analysis

A common approach used by investors to understand the impact of ESG factors on the fair value of a company is to conduct a scenario analysis, where an **ESG-integrated company valuation is calculated and compared to a baseline valuation.** The differences between the two scenarios very clearly depict the materiality and magnitude of ESG factors affecting a company.

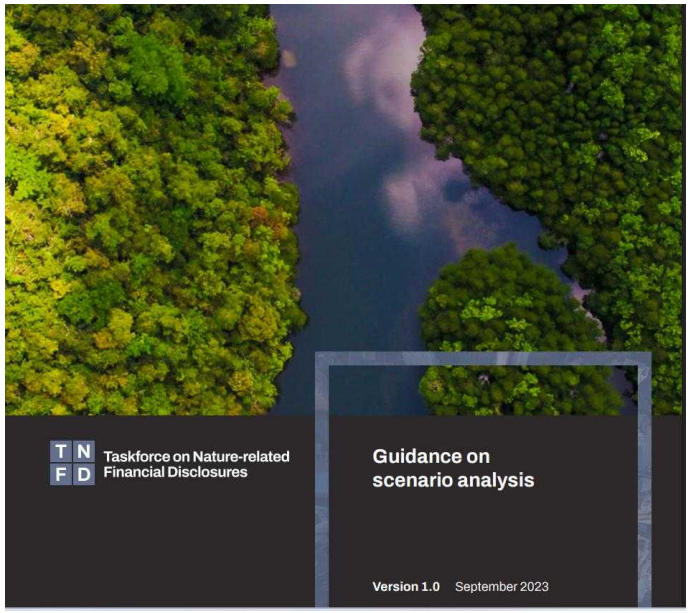


Case study by UN PRI on Scenario Analysis https://www.unpri.org/listed-equity/material-esg-issue-scenario-analysis/160.article

Examples of Scenario Analysis



https://www.tcfdhub.org/scenario-analysis/



https://tnfd.global/wp-content/uploads/2023/09/Guidance_on_scenario_analysis_V1.pdf?v=1695138235



https://www.msci-institute.com/themes/climate/climate-scenario-analysis-101/?utm_source=google&utm_medium=cpc&utm_campaign=sustainb_institute_institute_pp_consid&utm_content=sustainb_institute_institute_pp_consid_plfm_invstr_global_theme-climate-scenario-analysis&utm_term=what%20is%20climate%20scenario%20analysis&creative=763935509227&gad_source=1&gad_campaignid=22796524724&gbraid=0AAAADv1QH2yqi9FRMvjbKD-TZARf3iRK&gclid=CjwKCAjw_fnFBhB0EiwAH_MfZlvS_iG84O4-8A9ISydX5v4BYQl_z10oW9YAKpkoSbioZeEIMdYSJxoCoNgQAvD_BwE

Sustainability and Finance Valuation (contd…)

Beta

- Reliable output from the CAPM requires the identification of sufficiently comparable public companies. As with the market approach, ESG characteristics may need to be added to the current framework for comparable company screening and identification.

Long term Growth

- A core concept of sustainable investing is to acknowledge that not all companies have the same structures in place to drive long term sustainable growth. As such, a blanket reliance on standard long-term growth rates, with only minor consideration of industry and/or geographic growth rates, is likely to be insufficient.

IÉSEG SCHOOL OF MANAGEMENT

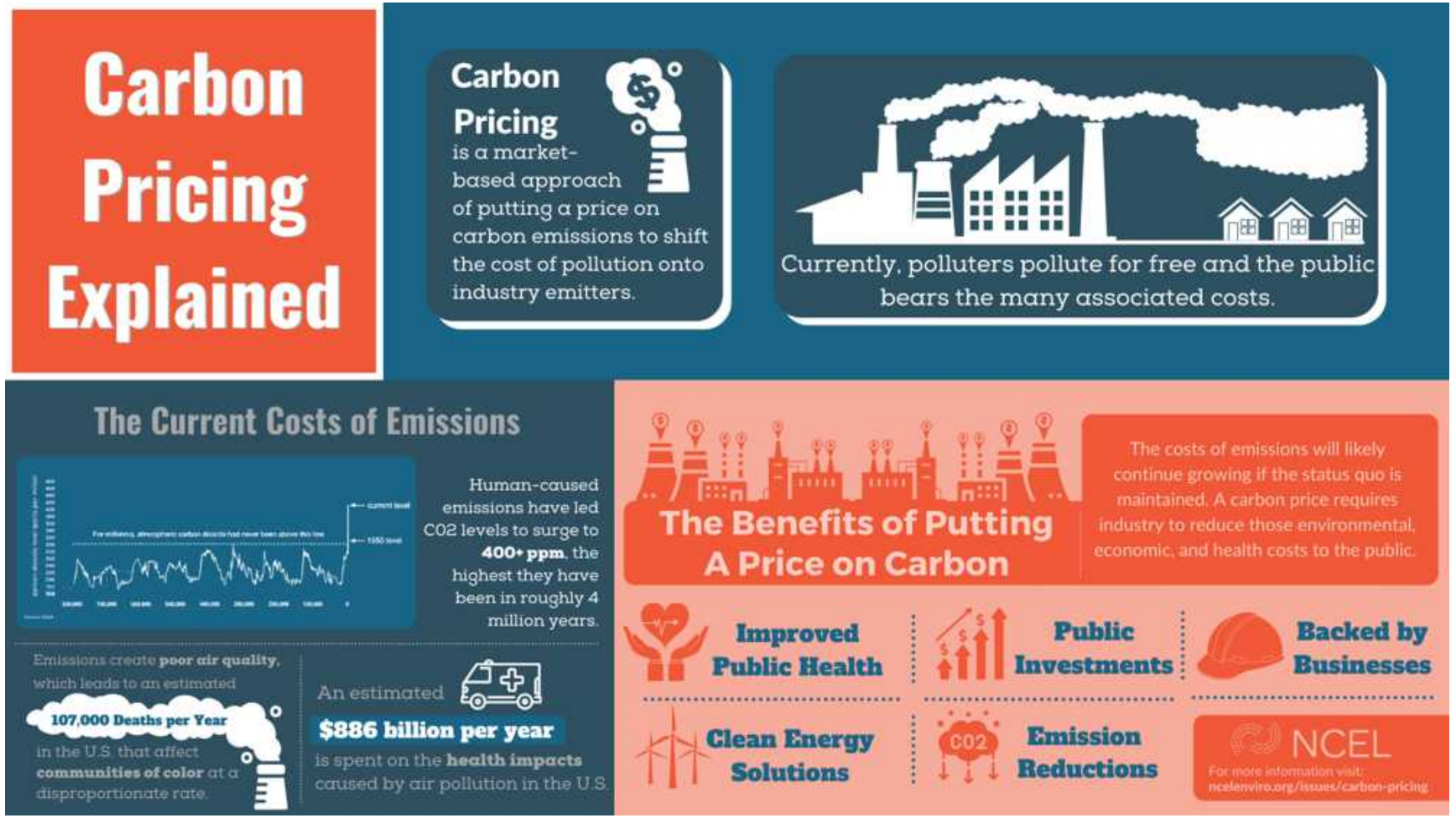
Beta Calculation

$$\beta_a = \left[\frac{V_e}{(V_e + V_d(1-T))} \beta_e \right]$$

β_a = asset beta
β_e = equity beta
V_e = market value of company's shares
V_d = market value of company's debt
$((V_e + V_d(1 - T))$ = after tax market value of company
T = company profit tax rate

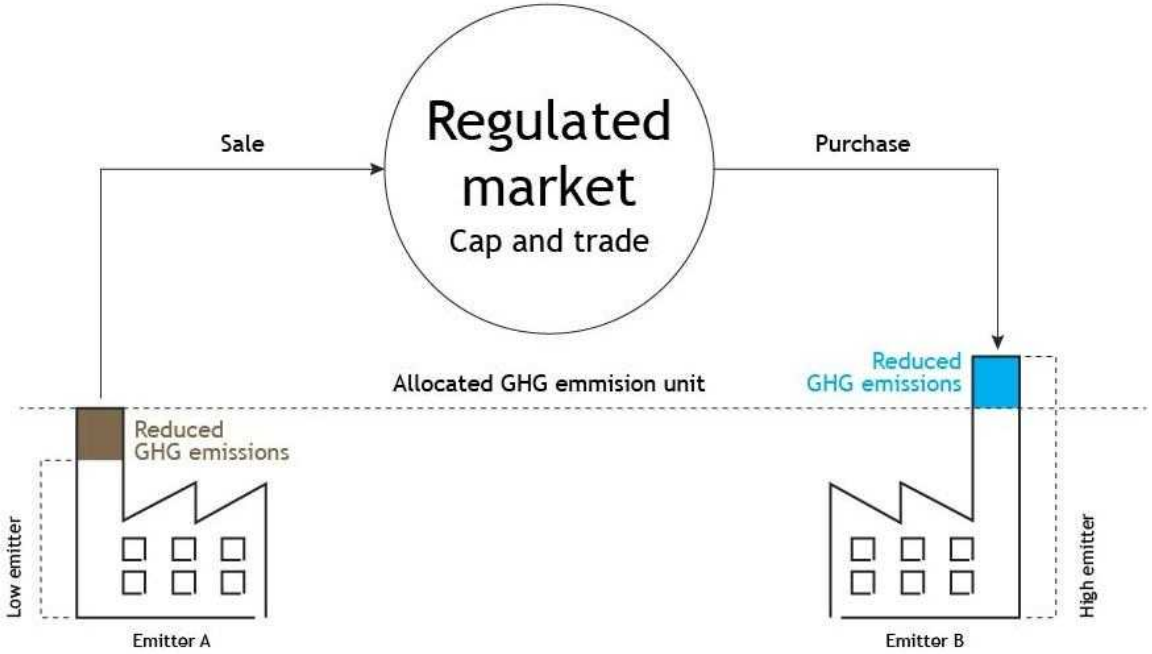
https://www.youtube.com/watch?app=desktop&v=nt8Q9lrdFMw

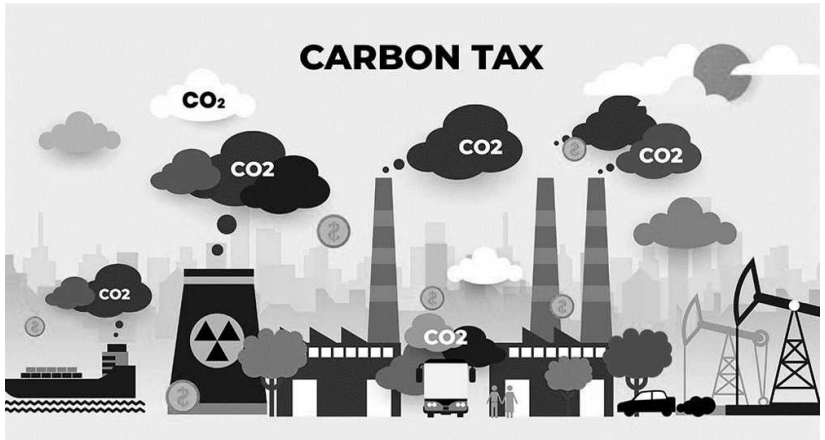
Example carbon pricing to recalibrate market inputs



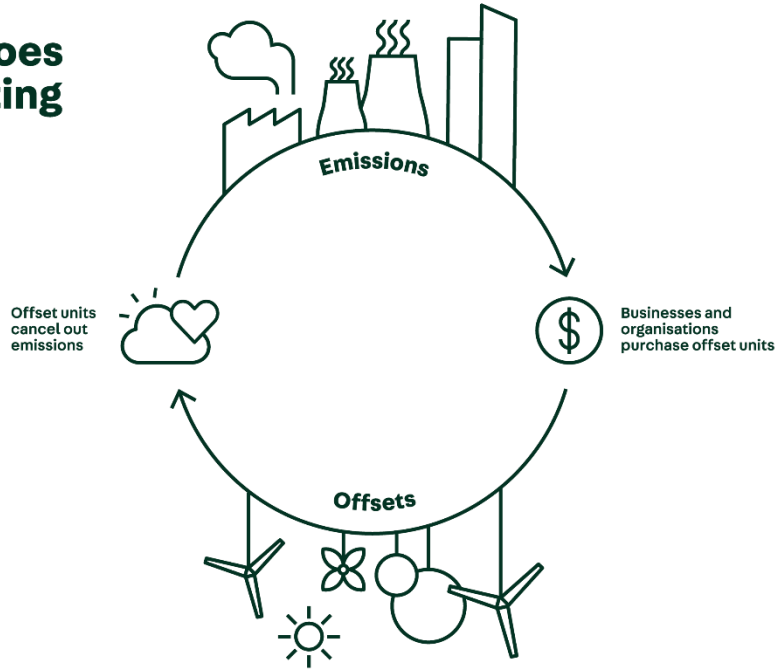
https://www.youtube.com/watch?v=UpSskXWJyS0

Types of Carbon Pricing





How does offsetting work?





https://www.worldbank.org/en/publication/state-and-trends-of-carbon-pricing

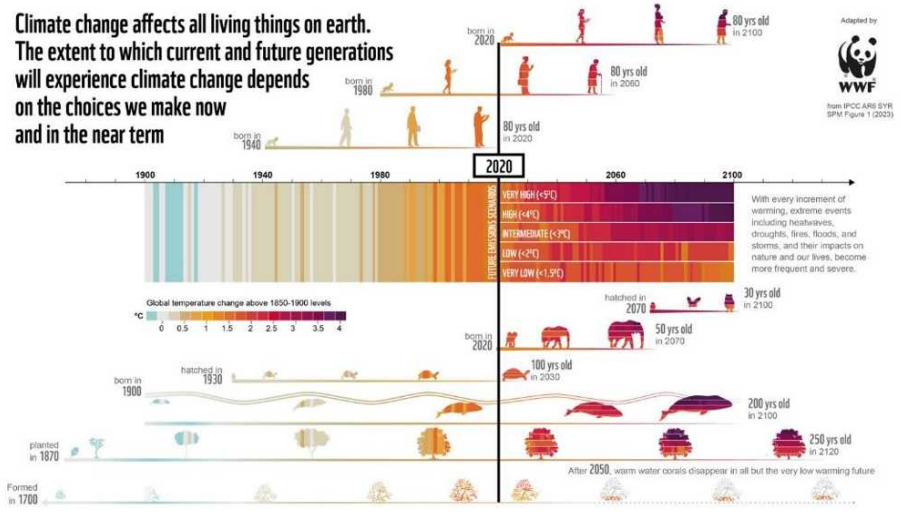
Discount Rate Adjustment

- The general expectation is that a future benefit or cost is valued less than the same benefit or cost in the present—i.e., $1 today is preferred to $1 tomorrow. Such preference for the present is typically captured through discount rates, where a discount is assigned to future benefits or costs to express them in comparable “present-value” terms.
- Policymakers evaluating public projects use the **social discount rate (SDR) to weigh outcomes over long time horizons**. This process could involve certain **philosophical and ethical judgments** such as in relation to intergenerational equity.

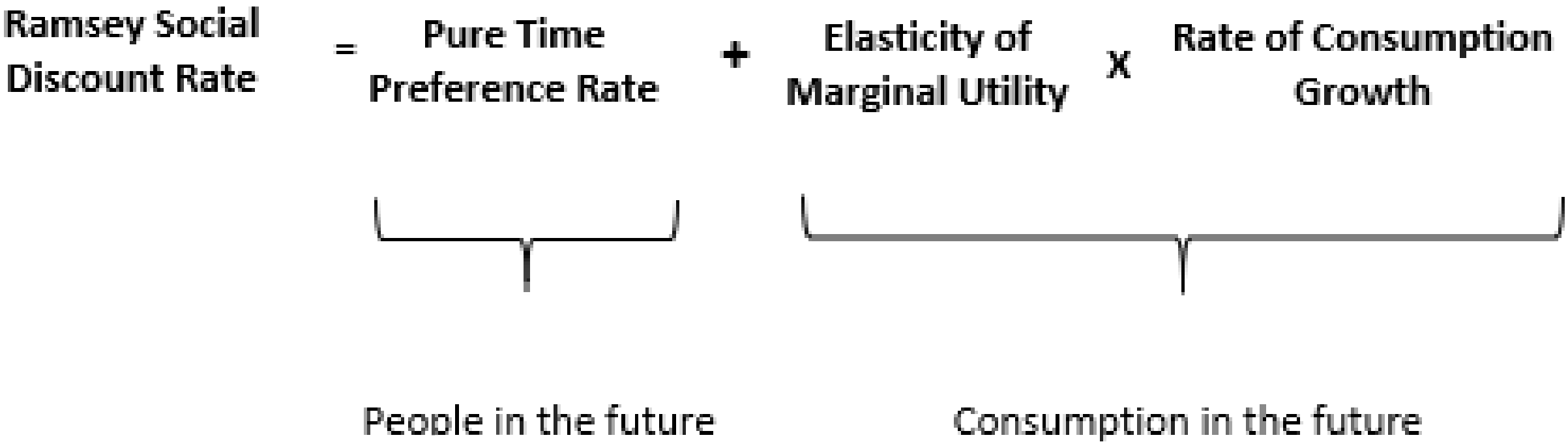
IESEG SCHOOL OF MANAGEMENT

Discount Rate Adjustment

- Discounting highlights **intergenerational equity** issues, but there are also concerns about **intragenerational equity**. A majority of countries with data to allow analysis have seen rising inequality in income and wealth over the past several decades , and there are very large gaps in income and wealth between high-income and low-income countries.
- Requiring sacrifice from the current poor to improve outcomes for future generations who may be better off may not be desirable on equity grounds.



Reminder on the first slides on intergenerational equity in session 1.



Discount Rate Adjustment

- The **Ramsey discounting equation** has a built-in mechanism for addressing equity weights through the elasticity of marginal utility of consumption (*n*). As income rises, the marginal utility falls, such that groups with lower incomes have higher marginal utilities, giving their benefits greater weight. Greater concern with intra- and intergenerational justice and fairness can be accommodated by choosing a higher n.

- The larger is *n* the more that marginal utility falls with income and the larger is the relative weight given to low-income groups. With growing income, choosing a higher value of *n* will mean setting a higher social discount rate, giving less weight to future generations. However, a high value of *n* gives greater weight to current and future poor.

IÉSEG SCHOOL OF MANAGEMENT

Balance sheet adjustment – Book value and impairment charge

Sustainability can influence assets' anticipated cash flow, such as by forcing long-term or permanent closure, and therefore alter their net present value.

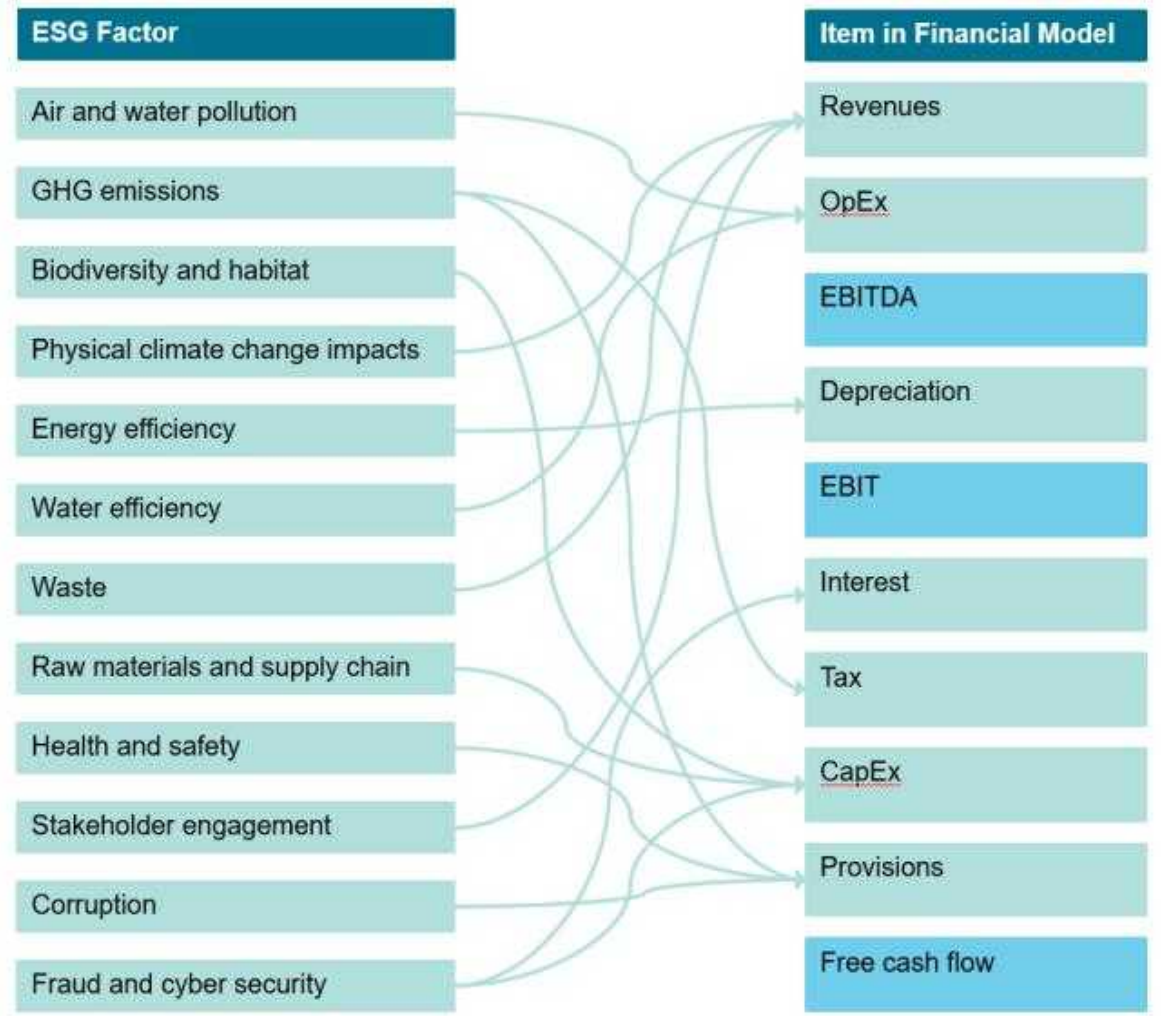
The impact is most likely to be a reduction → resulting in an impairment charge being made to bring the book value down → reduce company's earnings for the year in which the non-cash, one-off impairment charge is recorded on the income statement.

An asset revaluation can result in lower future earnings, a smaller balance sheet, additional operating/investment costs and a lower company fair value.

Example, the future cash flow from a mining company's coal assets may be significantly less than the estimated future cash flow due to insufficient demand or regulatory change, or new technology could make it possible for a miner to extract commodities that were previously economically unviable

IESEG SCHOOL OF MANAGEMENT

Impact of ESG/sustainability factors on specific elements in the financial model - examples



IÉSEG SCHOOL OF MANAGEMENT

Quantifiable Sustainability factors – rationale for financial impact of sustainable factors on infrastructure organisations – illustration of potential impact pathways

Sustainability Factor	Scenario Example	Item in Financial Model	Rationale to consider	Metrics/Financial elements
Air pollution / Water pollution	Regulatory: - Tightening of regulation regarding pollution limits	Asset write-off CapEx	- Write-offs, asset impairment or early retirement of existing assets may result from tightening of regulation - Investment in technologies/new assets to reduce pollution becomes necessary	- Write-off or impairment value - EUR invested per unit of pollutant reduced (air: e.g. particulate matter (pm2.5), NOx, SOx, volatile organic compounds, lead; water: e.g. oil
Corruption	Regulatory/ Legal: - Employees' and board members' violations of legal stipulations	Provisions	- Provisions may be made for unforeseen fines and settlements of court cases	- EUR paid historically in comparable cases based on the number of non-compliance cases of comparable projects, number of PEP (Politically Exposed Person) involved in the project, and legal action in comparable projects in the region.

Let’s explore sustainable Components in Finance Valuations

- Form a group of 4-5 students
- You are provided with 15 mins to draft one slide on integrating a sustainable component in finance valuation.
- Kindly refer to the card to identify the component allocated to you and use the same table.
- For example :refer to previous slide
- Present your results in 2 mins



IÉSEG
SCHOOL OF MANAGEMENT

Sustainability Data and Rating



IÉSEG SCHOOL OF MANAGEMENT

ESG Data and How to use it?

- https://about.datarade.ai/blog/what-is-esg-data-and-how-to-use-it

Rationale for Sustainability Data and Ratings

A sustainability rating could help the global economy in a multitude of ways:

- **Transparency and Accountability**: help companies be more transparent and subsequently hold themselves more accountable to their actions.
- **Business Improvement**: Quantity doesn't always mean quality. A sustainability rating can prove as a useful guideline to reveal to companies where they are excelling and where they can still improve.
- **Competitive Edge**: A good sustainability rating could do wonders for companies trying to work the market – as both customers and investors are increasingly interested in allocating their money towards companies that can demonstrate their commitment to the environment.
- **Improved Access to Capital**: Investors are beginning to rank sustainability as one of their most imperative criteria when choosing which companies to invest into and instead of making them investigate the sustainability of a company themselves, a sustainability rating can make investing into companies easier for them.
- **Better Risk Management:** When sustainability issues are challenged, such as when receiving a poor sustainability rating, it can encourage companies to implement better risk management

Sustainability Rating and Data Overview

Sustainability ratings try to assess a company's economic, environmental and social values and performance. How well a company manages to balance these three dimensions yields valuable information on its ability to benefit from opportunities and manage risks in the mid- to long-term.

Such information is particularly valuable for long-term investors. It is being used, for example, by genuine sustainability funds whose composition is based on the "best-of-class" principle: instead of focusing on certain industries or screening some of them out, sustainability funds strive to select the best, i.e. the most sustainable, companies within each industry for inclusion.

The methodologies adopted by sustainability rating providers are intrinsically different, but the final ratings are used by market investors for the same purpose, which is to identify companies that adopted better sustainability practices. In this regard the analysis of the methodological approaches will be beneficial to understand which factors are driving the final sustainability ratings.

Sovereign sustainability data provider

- Data may be download at the following webpage: https://datatopics.worldbank.org/esg/framework.html

- 27 variables on planet
- 22 variables on people
- 18 variables on profit

Other sovereign sustainability data providers

- ***National accounts statistics*** collected by OECD, United Nations Statistics Division (UNSD), etc.
- ***Internal departments and specialized databases of the World Bank***: World Bank Open Data, Business Enabling Environment (BEE), Climate Change Knowledge Portal (CCKP), Global Electrification Database (GEP), etc.
- ***International organizations***: Emission Database for Global Atmospheric Research (EDGAR), Food and Agriculture Organization FAO, International Energy Agency (IEA), International Labour Organization (ILO), World Health Organization (WHO), etc.
- ***NGOs***: Climate Watch, etc.;
- ***Academic resources***: International disasters database (EM-DAT) of the Centre for Research on the Epidemiology of Disasters (Université Catholique de Louvain), etc.

ESG Rating Agencies for Firms

Major Players

- ISS ESG (Deutsche Borse)
- MSCI ESG
- Sustainalytics (Morningstar)
- Thomson Reuters (Refinitiv)
- Vigeo-Eiris (Moody's)

Other Players

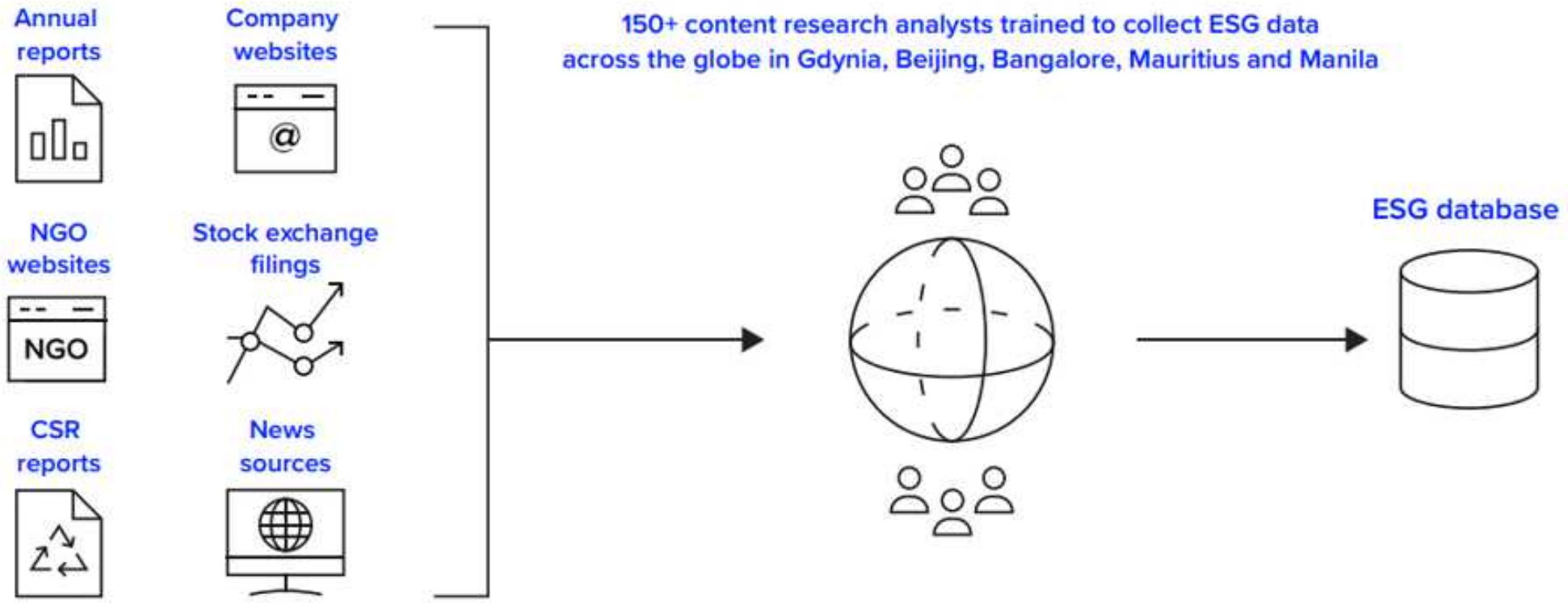
- Beyond Ratings (LSE)
- Bloomberg ESG
- FTSE Russell
- RobecoSAM (S&P)
- TrueValue Labs (Factset)

Specialised Climate Data Providers

- Carbon Disclosure Project
- Iceberg Data Lab
- Trucost (S&P)

IÉSEG SCHOOL OF MANAGEMENT

ESG Data
(Example of ESG Database compilation from Refinitiv)



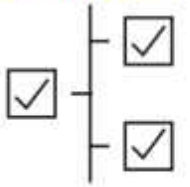
Weights allocated to ESG by Refinitiv

Pillar	Category	Indicators in Rating	Category Weights	Pillar Weights
Environmental	Resource Use	19	11%	(32.35%+35.30%+32.35%)
	Emissions	22	12%	
	Innovation	20	11%	
Social	Workforce	29	16%	(45.07%+12.68%+22.53%+19.72%)
	Human Rights	8	4.50%	
	Community	14	8%	
	Product Responsibility	12	7%	
Governance	Management	34	19%	(62.30%+22.95%+14.75%)
	Shareholders	12	7%	
	CSR Strategy	8	4.50%	
TOTAL		178	100%	

ESG Data by Refinitiv

Data quality is a key part of the collection process; that is why we use a combination of both algorithmic and human processes to make sure we achieve as close to 100% data quality as possible. Below is an overview of the various methods we use to achieve this goal.

Data entry/ pre-product



- Around 400 built-in error check logics in the collection tool for various data points
- Error checks can be tailor-made for specifi requirements

Post-production



Around 300 automated quality check screeners run on ESG collection tool:

- Relating to interrelated data points
- Negative screening
- Inconsistency or missing in quants and qualitative
- Scaling
- Variance within a year
- Raw data and comments section
- Sector-based checks (TRBC codes)
- Validating completeness of the prior year

Independent audits



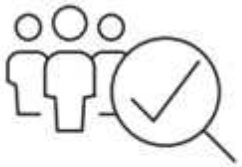
Sample audits on a daily basis:

- Detailed audits
- Critical data point checks
- Product audits

Weekly reporting and root cause analysis:

- Feedback sessions with the production teams

Management reviews



- Monthly quality – deep dives
- Heatmap analysis with top areas for concerns
- Measures to address problematic topics and data points
- New system validation checks and screeners are constantly created based on new learning, insights and feedback to continuously improve the data quality

ESG Calculation Methodology on Refinitiv

Scores Calculation Methodology

This section describes in detail the ESG scoring methodology because we believe transparency is a key component of trust and confidence in the data we provide to our customers.

Category Scores Calculation

Percentile rank scoring methodology is adopted to calculate the 10 category scores and the ESG Controversies score. It is based on three factors:

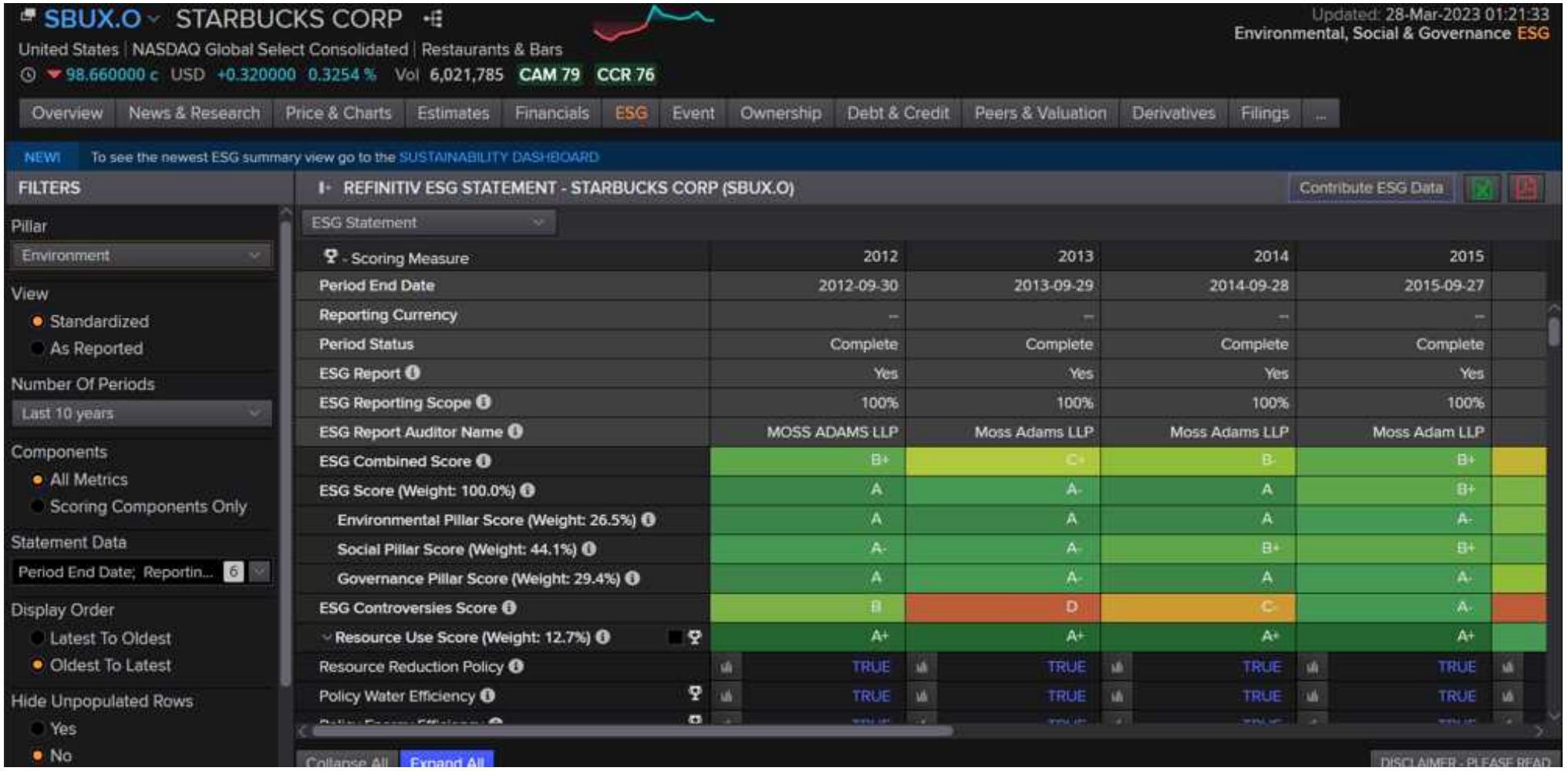
- How many companies are worse than the current one?
- How many companies have the same value?
- How many companies have a value at all?

Percentile rank score is based on the rank, and therefore it is not very sensitive to outliers. The distribution of the scores generated with percentile rank score is almost flat; for this reason, average and standard deviation of the scores generated with percentile rank score are not overly useful.

$$score = \frac{n.\ of\ companies\ with\ a\ worst\ value + \frac{n.\ of\ companies\ with\ the\ same\ value\ included\ in\ the\ current\ one}{2}}{n.\ of\ companies\ with\ a\ value}$$

Each category score is the equally weighted sum of all relevant indicators for each industry used to create it. The normalized weights are calculated excluding quantitative indicators with no data available in the public domain, as it would be highly inaccurate to assign a default value with the exception of GHG emissions where we calculate estimated emissions when not reported by the companies.

Link to Refinitiv ESG Database Information: https://www.lseg.com/en/data-analytics/sustainable-finance/esg-scores



Example of Data provided

Example of Data provided



	2014	2015	2016	2017	2018	2019	2020	2021	2022
Earnings Quality Score	16	90	96	97	100	78	47	96	82
Period End Date	28-Sep-2014	27-Sep-2015	02-Oct-2016	01-Oct-2017	30-Sep-2018	29-Sep-2019	27-Sep-2020	03-Oct-2021	02-Oct-2022
+ Revenue	16,448	19,163	21,316	22,387	24,720	26,509	23,518	29,061	32,250
Other Revenue, Total	–	–	–	–	–	–	–	–	–
Total Revenue	16,448	19,163	21,316	22,387	24,720	26,509	23,518	29,061	32,250
+ Cost of Revenue, Total	11,497	13,199	14,575	15,532	17,368	19,021	18,399	20,626	23,865
Gross Profit	4,951	5,964	6,741	6,855	7,352	7,488	5,119	8,435	8,385
+ Selling/General/Admin. Expenses, Total	991	1,197	1,361	1,393	1,759	1,824	1,680	1,933	2,032
Research & Development	–	–	–	–	–	–	–	–	–
+ Depreciation/Amortization	710	894	861	1,011	1,247	1,377	1,431	1,442	1,448
Interest Expense, Net - Operating	–	–	–	–	–	–	–	–	–
+ Interest/Investment Income - Operating	(268)	(250)	(318)	(391)	(301)	(268)	(323)	(385)	(234)
Interest Expense(Income) - Net Operating	–	–	–	–	–	–	–	–	–
Interest Exp.(Inc.),Net-Operating, Total	(268)	(250)	(318)	(391)	(301)	(268)	(323)	(385)	(234)
+ Unusual Expense (Income)	(20)	(330)	0	154	(1,651)	(487)	338	(650)	80
+ Other Operating Expenses, Total	457	522	545	554	539	371	430	360	442
Total Operating Expense	13,367	15,232	17,144	18,252	18,961	21,808	21,956	23,324	27,633

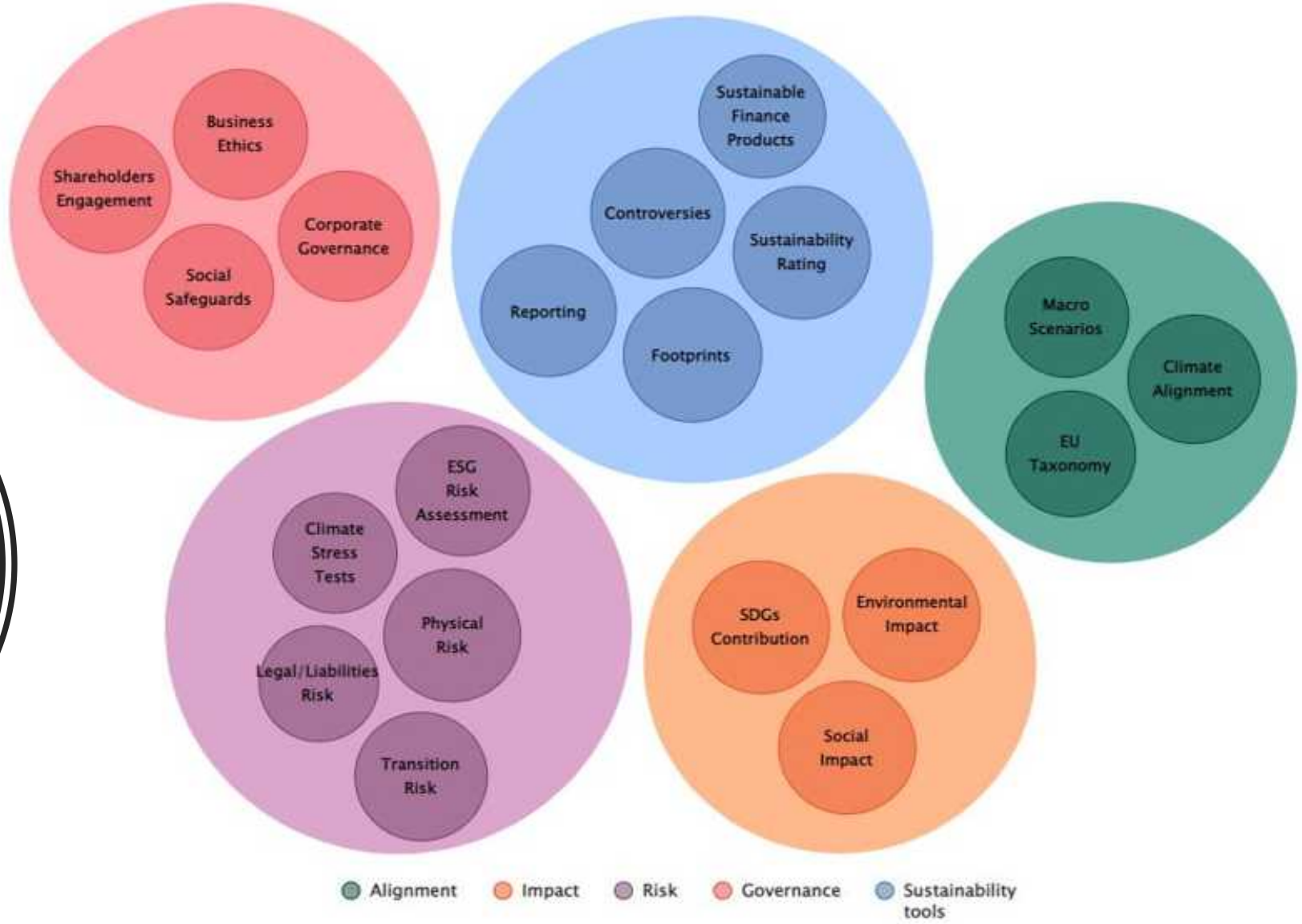
Comparison of ESG Criteria by Major Index Providers

Pillar	Thomson Reuters	MSCI	Bloomberg
Environmental	Resource Use	Climate Change	Carbon Emissions
	Emissions	Natural resources	Climate change effects
	Innovation	Pollution & waste	Pollution
		Environmental opportunities	Waste disposal
			Renewable energy
			Resource depletion
Social	Workforce	Human capital	Supply chain
	Human Rights	Product liability	Discrimination
	Community	Stakeholder opposition	Political contributions
	Product Responsibility	Social opportunities	Diversity
			Human rights
			Community relations
Governance	Management	Corporate governance	Cumulative voting
	Shareholders	Corporate behaviour	Executive compensation
	CSR strategy		Shareholders' rights
			Takeover defence
			Staggered boards
			Independent directors
Key metrics and submetrics	186	34	>120

Source: Refinitiv, MSCI, Bloomberg, FTSE; OECD assessment.

IESEG SCHOOL OF MANAGEMENT

Map of ESG Data



Source: Pladifes platform of Institut Louis Bachelier
pladifes.institutlouisbachelier.org/esg-data-cartography/

IÉSEG SCHOOL OF MANAGEMENT

Ambiguity over Sustainability Data Providers

- **Data discrepancies** – There is a significant variety of the metrics that purport to measure much the same thing. The diversity of measures gives rise to considerable dissimilarity in ratings reflecting firm-specific attributes, differing terminologies, metrics and even the units of measurement.
- **Benchmark choice** – There are differences in how raters define the benchmark for comparisons. For example, Sustainalytics compares companies to constituents of a broad market index, whereas S&P compares companies to industry peers.
- **Data imputation** – at the company level, ESG ratings are plagued by missing data. When a company does not reveal metrics, some ESG raters assume the worst and assign a score of zero. Other raters give it a score that reflects peers that do report the data.
- **Information overload** – reflecting the never-ending expansion in the volume of public information and the lack of consensus on metrics, there is greater scope for raters to disagree about the scores for particular companies.

Tesla is both the best and the worst!

One rating agency claims "It's the best" while another is putting it in last place. The discrepancy reflects the fact that MSCI judges Tesla to be almost perfect on carbon emissions because of its clean technology, while FTSE, which evaluates factory emissions, regards the firm as a serious offender.

IÉSEG SCHOOL OF MANAGEMENT


TIME
FOR A
BREAK!

Activity on Sustainability Data

- ❑ Divide into group of 3 students and take 20 mins to:
- ❑ Select two sustainability Data providers from the pladifes platform

pladifes.institutlouisbachelier.org/esg-data-cartography/

- ❑ Make a comparison between the two sustainability Data providers. Select one of the two as your ESG data provider and provide arguments to support your choice.
- ❑ Why do you think one is better than the other?
- ❑ Group pitching of 2mins each (max 2 slides of presentation)



IÉSEG
SCHOOL OF MANAGEMENT

ESG Washing and Controversies



IÉSEG SCHOOL OF MANAGEMENT

Greenwashing

Greenwashing is perhaps the oldest of all these practices as the phrase “Greenwashing” itself was coined in the 1980s. Companies in the energy sector are considered to have among the worst environmental records and not surprisingly are among the most frequent practitioners of greenwashing to polish their image.

These sorts of claims can range from a Big Oil company running ads showcasing how they help save butterflies, to a manufacturer of disposable consumer goods highlighting their use of recycled raw materials in a tiny minority of their products.

IÉSEG SCHOOL OF MANAGEMENT

Social Washing

Social washing is quite similar to greenwashing, except the fact that corporations are wrongfully trying to market themselves as socially conscious. In reality, they don't do anything beyond lip service to support the cause espoused by them in the social washing campaigns. Labor rights, along with the human rights of employees and the broader communities, gender equality, and discrimination within corporations, have been in the spotlight for some time.

Hiding negative information: Companies often hide any negative information or reviews about their products and services by burying them in search results, deleting them from websites, or even buying out the domain of a website that hosts negative reviews.

Blue Washing

Blue washing refers to the practice of businesses to sign up for the UN global compact and use their association with the United Nations to enhance their image and shift attention from their controversial business practices. United Nations created their UN Global Compact program at the turn of the century supposedly to bring corporations onboard for the Millennial Development Goals and Sustainable Development Goals.

For example, it is misleading for a food manufacturer to claim that they are contributing to Goal #2 just because they produce food. It is virtually impossible to know the net effect of the company's production methods on world hunger – there are too many variables between the cause (firm activity) and effect (zero hunger). It may be that the company's production methods actually increase hunger.

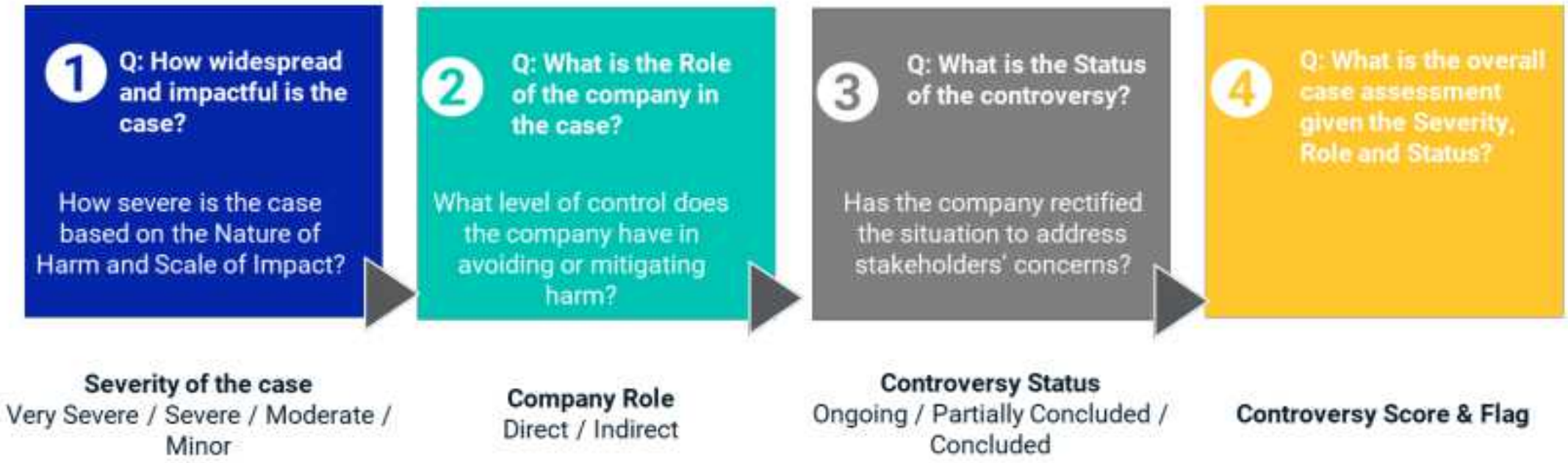


ESG Controversies

Controversies – or news items related to perceived ESG missteps are part of the ESG data and scores provided by ESG rating agencies. While due diligence on ESG ratings information can be monitored by companies, controversies are often more difficult to tackle and are also at risk of being mismanaged, either because they are overlooked, or on the contrary, because they are misunderstood.

Their influence on a company's overall ESG rating and potential impact in terms of company reputation and investability, should be carefully considered by companies.

An **ESG controversy case** is defined as either an event or an ongoing situation in which company operations and/or products allegedly have a negative environmental, social and/or governance impact.



ESG Controversies Assessment

ESG Controversies assessments measure companies' reputational/brand risk based on actual or alleged involvement in adverse impact activities as reported by the media, nongovernmental organizations (NGOs), civil society groups, academia, regulators and other stakeholders.

A case can be a single event such as a spill, accident or regulatory action, or a set of closely linked events or allegations such as health and safety fines at the same facility, multiple allegations of anticompetitive behavior related to the same product line, multiple community protests at the same company location, or multiple individual lawsuits alleging the same type of discrimination.

MSCI ESG Controversies Thematic Framework



Source: MSCI

Each ESG controversy case is assessed for the Severity of its impact on society or the environment as Very Severe, Severe, Moderate or Minor

Rating Agency	Approaches	Indicators/Factors	Case Monitoring
MSCI ESG Controversies	* Cases identified from company public documents, media sources, and NGO publications. * Score uses a 0-10 scale (0 - most severe), based on a combination of severity (Very Severe, Severe, Moderate or Minor), type (Structural or Non-Structural) and status (Ongoing, Partially Concluded, Concluded, Historical Concern and Archived).	5 Pillars: Environment, human rights & supply chain, labour rights & supply chain, customers and governance.	* Very Severe cases are reviewed on a quarterly basis, other cases are reviewed annually. * A Concluded controversy retains its final severity assessment for 1 year from the date of conclusion, at which point it is upgraded by one severity level (e.g. from severe to moderate). The following year, the case will be upgraded again or archived.
Sustainalytics	* News from reputable international and local media sources, specialized publications, and non-government organizations. * Incidents are assessed on a scale of 5 levels, 1-5 (5 severe). Controversy Rating is accompanied by a positive, neutral or negative outlook that reflects the analyst's assessment of the likeliness of possible ratings change in the next 12 to 24 months.	3 Pillars: Environment, Social & Governance. Within each pillar, there are a number of topics that are scored according to the severity of the event.	* Incidents typically inform the Controversy Rating for a period of 3 years. In exceptional cases, long-running high-impact incidents continue to inform the rating for more than 3 years until it no longer poses a risk to the company. * Controversy Rating is fully reviewed at least every 12 months.
S&P ESG MSA (Media & Stakeholder Analysis)	* News stories from the media and stakeholder groups are compiled and pre-screened by RepRisk. Assessment based on absolute severity and in context of the industry. * 3 possible impact ratings: Minor, Medium and Major.	1. Breach of company's policies and extent of management failure 2. Fines/settlements/legal costs/operational costs 3. Reputation 4. Impact on stakeholder and the environment	* MSA cases are processed and implemented in a monthly review cycle. * Companies can provide additional information and comments from their perspective on cases. * MSA cases will continue to have an impact on the score in future Corporate Sustainability Assessments (CSA). Cases no longer deemed by S&P as material get removed in future annual assessments.
ISS ESG Norm-based Research	* Controversies are identified by evaluating allegations of corporate involvement in failures to respect international norms and standards from media and stakeholder publications globally. * Controversies are categorized by various levels of severity ranging from Potential, Moderate, Severe and Very Severe.	1. Fundamental human rights & taxes 2. Labour rights 3. Environmental protection 4. Business ethics 5. Consumer protection	* Companies may receive draft reports prior to publication, to review, confirm or supplement the facts presented. * Assessments are reviewed annually, and are updated when significant developments are obtained through systematic monitoring or dialogue with company and stakeholders.
Moody's ESG – Vigeo	All controversies are systematically assessed based on Severity (Critical, High, Significant and Minor),	1. Human rights 2. Human resources 3. Business behaviour	* Time horizon: -Critical/High = 48 months max

How do investors use controversies score?

- From an investment perspective, having these items flagged are an important component of a company's ESG evaluation process as they provide useful and up-to-date context potentially underlying governance or operational flaws in a company.

- Many institutional investors, including some well-known large asset managers such as BlackRock, State Street Global Advisors and T.Rowe Price, monitor controversies collected by ESG rating agencies to assess potential risks, prioritise engagement with companies and inform their proxy voting decisions.

- If engagement is pursued, in the worst-case scenario, the outcome can potentially trigger a divestment decision by some of those investment funds, depending on their mandates, and as such, the impact of ESG controversies goes beyond a simple rating.

How should companies monitor and address these controversies?

- Given the importance of investors' access to company controversy listings, companies could benefit from having a controversies management plan in place. Companies should **first identify the most impactful ESG ratings providers among their investors and monitor their online portals and reports on a regular basis, including the controversies collected**. When a controversy has been identified by an agency, oftentimes the immediate reaction by companies may be to rush a rebuttal response. However, this is not always the best approach. Careful consideration should be given to evaluating if all the relevant facts surrounding a given event and any company press releases associated to provide investors, its clients, have been provided. Because the controversy item in the portal may already include how a company is responding to a given event, no additional feedback may be necessary.

- In other cases, **providing relevant feedback would be advisable.** Some listed controversies may contain incorrect facts or could be missing key information, in which case, should be sought to be corrected by the company through providing factual evidence where needed. In these cases, companies would do well taking some time to liaise with internal subject matter experts (such as legal or governance teams) to collect all the relevant facts and prepare a cohesive well-put-together response. Not only can this result in a descaling of the controversy severity, but it can also help to resolve a controversy and potentially have it archived.

- **Having a specific point person or team responsible for monitoring ESG rating agency accuracy**, including controversies is a useful way to help ensure consistent monitoring and communication. In terms of who should coordinate controversies' responses, having a team/individual responsible works best. In many cases, the Sustainability team, or alternatively the Corporate Communications or Investor Relations teams, are best placed to manage communication with ESG rating agencies, including ESG controversies.

Reminder

- Quiz on session 1 and session 2 will be held at the beginning of the class.
- Please be on time.