EVALUESERVE

Inside the data, outside the (black) box: Using Insights to Inform Your ESG Journey

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Three runners, Ava, Benjamin, and Cameron, ran a 100 meters race. If Ava beats Benjamin by 10 meters, and Benjamin beats Cameron by 10 meters, then by how many meters does Ava beat Cameron? Here's a hint – it's not 20. To answer this question, one must go beyond what seems evident and conduct a deeper analysis of the information presented. Likewise, when it comes to understanding companies' ESG performance, the obvious answers often leave one wanting for correct explanations and require deeper analysis to take away useful insights.

Knowing where a company stands in the ESG landscape vis-à-vis its peers is essential business intelligence. Benchmarking is crucial for companies to inform their ESG and sustainability strategy and how to communicate performance. Done right, the findings identify how performance stacks up against a peer group and *why*.

The current default practice of using broad ESG scores and rankings offers only superficial snapshots of where one stands. Reliance on ESG scores and rankings is fraught with downsides. At Evalueserve, we believe the right approach is better insights, not more scores. Better insights drive better strategy, while scores only drive more scores.

Even though this certainly sounds like common sense, it is easier said than done. Occupied with various reporting requirements, corporate ESG teams often lack the time and resources to conduct the necessary deep-dive analysis for comprehensive benchmarking. Drawing ESG insights to drive higher-level strategic decisions requires a combination of deep ESG know-how and industry experience.

Too Many Ratings = Too much noise. In 2010, the first *Rate the Raters* report concluded, "Ratings beget Ratings."[1] It found that "a growing number of ratings are built upon other, often more established, ratings," creating more complexity and confusion.[2] Fast forward to 2023, there are estimated to be more than 600+ ESG ratings and rankings in the marketplace. This proliferation of ESG data providers has meant growing confusion in understating corporate ESG performance as scoring methodologies differ substantially, resulting in considerably different outcomes.

The problems with ESG ratings are well documented (Figure 1). Nevertheless, ESG scores and companies' desires to improve their scores have real-world business impacts, from the ability to lower the cost of capital to consumer and brand appeal.

Figure 1. The Challenges of Relying on ESG Scores

Recognized shortcomings of ESG ratings and scores include:[3]

- *Lack of standardization/methodology*
- *Focus on larger, publicly traded companies*
- *Lack of transparency (e.g., "black box" problem)*
- *Industry bias*
- *Country/geographical bias*
- *Data availability bias*

A 2021 study examining several major ESG rating providers found weak correlations across their reported scores (figure 2).[4] The findings revealed little consensus among providers, which starkly contrasted with the high correlation found when looking at more traditional credit ratings. The widely differing interpretations and weighting of similarly reported data expose the diminished usefulness of scores in drawing valuable comparisons.

Figure 2. Correlations Across ESG Ratings

S&P Global	Sustainalytics	CDP	ISS	Bloomberg	
35.7%	35.1%	16.3%	33.0%	37.4%	**MSCI**
	64.5%	35.0%	13.9%	74.4%	**S&P Global**
		29.3%	21.7%	58.4%	**Sustainalytics**
			7.0%	44.1%	**CDP**
				21.3%	**ISS**

Source: Prall (2021)

More disclosures ≠ better scores (or impact). For many companies, a quick solution for improving their ESG scores is to report more data. However, this quick fix may backfire, as a recent study suggests that increased ESG disclosures have resulted in greater scoring disagreements across ESG rating providers.[5] The subjectivity inherent in the differing methodologies means that the outputs (i.e., scores) vary even when assessing the same input. While finding disagreement across all three dimensions, the most outstanding disagreements were found in the environmental and social pillars.[6]

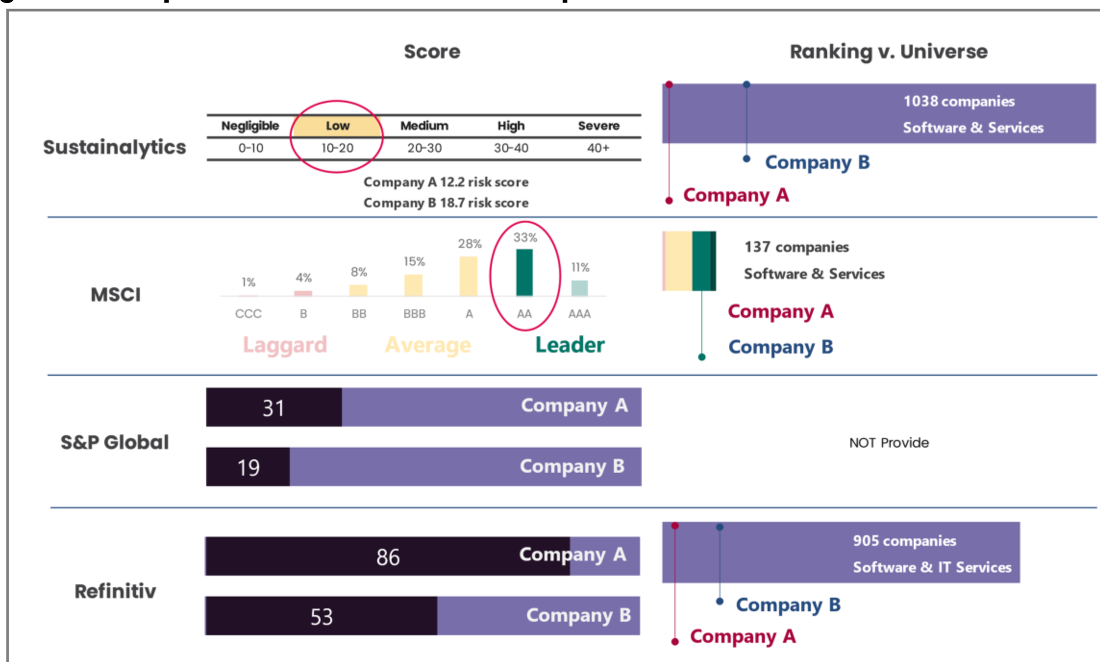
Further, more disclosures do not mean better sustainability performance or outcomes. Too often, the increased disclosures cover implementation of corporate ESG policies and procedures, offering little to no quantification of actual ESG impact. These

disclosures note efforts, but not effects, offering little more than "cheap talk."[7] At the end of the day, these additional disclosures cloud the substantive evaluation of performance and progress and increase greenwashing concerns.

Too much subjectivity in KPIs and peer grouping. Even for specific KPIs, many are not offering apples-to-apples comparisons. Items like "employee health and safety" have over 20 different metrics used in companies' reporting.[8] Moreover, using ratings to understand one's standing among industry peers is a tricky task. Peer group definitions vary greatly across rating providers, creating marked inconsistencies and undermining reliability for meaningful benchmarking.

The treatment of two software companies offers a striking example of the inconsistency across major rating providers regarding ESG ratings and peer group designation. Figure 3 shows the discrepancies in even these most fundamental questions. The size of the relevant sector grouping varies tremendously, ranging from 137 to over 1,000. As for scores, Company A generally scores better than Company B. However, note the inconsistencies here as well. The difference between the two companies ranges from small, large, or none, depending on the provider. Especially for Company B, we observe it is classified as an industry leader by one provider but only reaching the top third or quarter by others. What is the correct takeaway? Which company is doing better? Scores may not be the answer.

Figure 3. Comparison of Two Software Companies



The Solution: More Insights to Power the ESG Narrative

So, what was the distance between Ava and Cameron? The correct answer is 19[*]

More insights, not more scores. Scores and ratings too often provide an incomplete picture of the totality of a company's ESG and sustainability efforts. Evalueserve's insights-based approach goes beyond restating reported KPIs to provide detailed ESG assessments tapping into a full range of relevant criteria, not just a single data point (Figure 4). This approach offers a comprehensive understanding of companies' overall ESG strategy, covering activities from reporting to supply chain to consumer and investor outreach.

Figure 4. Advantages of an Insights-based approach to ESG

More than just a score, ESG insights provide:

- ***Transparency*** – the ability to see the data behind the analysis
- ***Context Specific*** – industry materiality awareness of critical ESG issues
- ***360° perspective*** – from reporting to supply chain to shareholder engagement
- ***Adaptability*** – User control over peer groups and material issues

The Narrative is Imperative. An *Insightsfirst* approach includes understanding materiality and relevancy concerns for specific industry sectors. The metrics, issues, and initiatives of importance when assessing ESG and sustainability efforts vary across industries. Simultaneously, individual companies' ESG actions must be evaluated according to sector-specific context. The ESG landscape is multi-dimensional. Every company's ESG story exists within the bounds of sector baselines, expectations, and best practices, which are emphasized by an insight-grounded method.

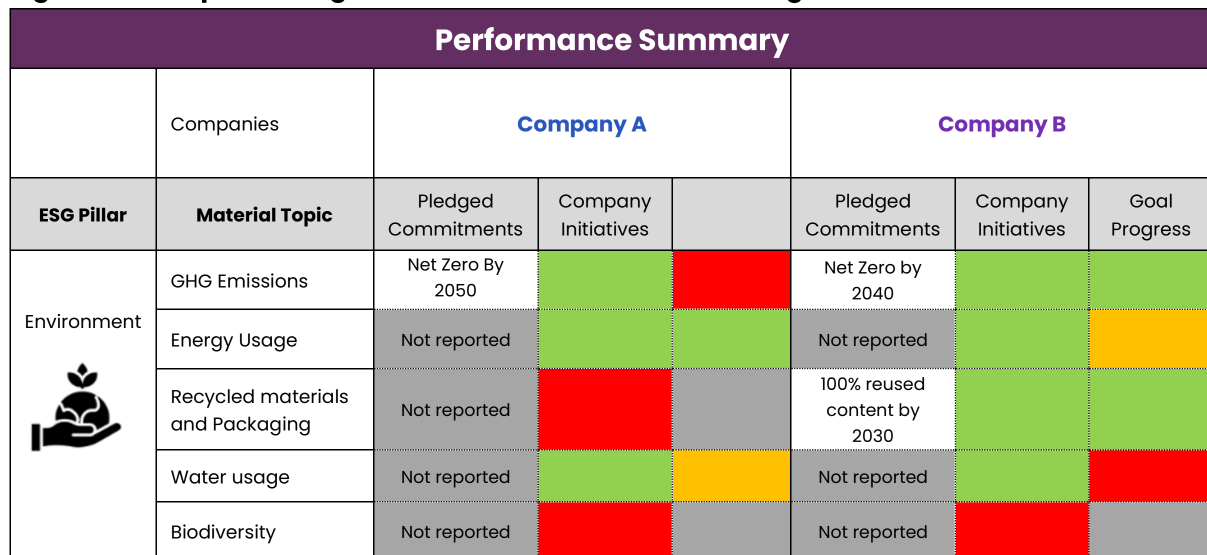
Better Benchmarking, Better Decisions. Evalueserve leverages its wide-ranging experience working with clients across industries with an extensive understanding of ESG data mining, controversies, business involvement research, and ESG competitive

* Assuming running at a constant speed, the ratio of distance covered by A and B is 10:9 and B and C is 10:9, A:B:C = 10x10; 9x10; 9x9 =100:90:81 meaning when A was at 100 meters C was at 81 meters.

intelligence. With over two decades of experience, we have something to say about how best to produce insights.

With its comprehensive focus, *Insightsfirst* offers superior results when conducting ESG and sustainability benchmarking. First, sector-specific context is front and center in defining the topics of material importance against which to evaluate a company against its peers. Companies often define the issues they view as most material to their business; however, what they see as material can be at odds with peers and investors. The totality of these perspectives is needed to identify gaps that help or hinder a company's ESG standing vis-à-vis its peer group.

Figure 5. Sample of Insightsfirst based ESG Benchmarking



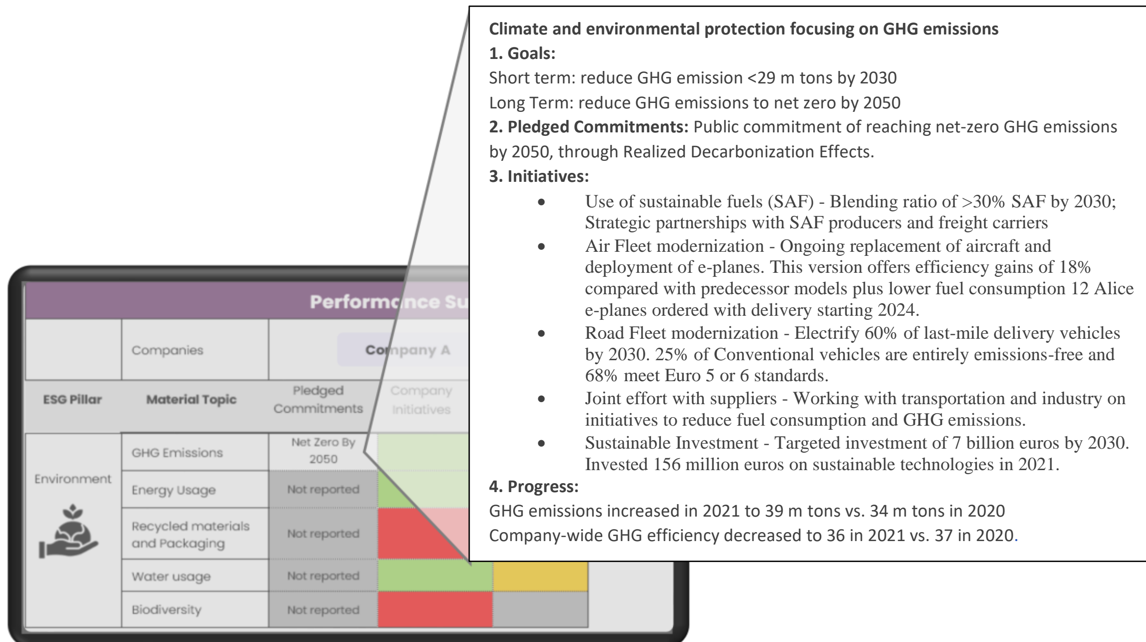
Performance Summary							
	Companies	Company A			Company B		
ESG Pillar	**Material Topic**	Pledged Commitments	Company Initiatives		Pledged Commitments	Company Initiatives	Goal Progress
Environment	GHG Emissions	Net Zero By 2050			Net Zero by 2040		
	Energy Usage	Not reported			Not reported		
	Recycled materials and Packaging	Not reported			100% reused content by 2030		
	Water usage	Not reported			Not reported		
	Biodiversity	Not reported			Not reported		

Evalueserve's ***ESG Insightsfirst*** *platform - Sample use only*

Second, instead of black-box scores, an *Insightsfirst* approach analyzes the specific nature of the commitments, pledges, initiatives, and performance across the identified material topics (Figure 5). This allows for drilling down, identifying where a company is trailing and how. Are they behind the curve in adopting policies, launching initiatives, or applying new technologies? Are they keeping up with industry best practices and emerging trends?

For example, assessing a company's commitment to reduce GHG emissions, or other publicly pledged commitments, necessitates going beyond headline goals. Policies directly linked to such activities need to be found, but so too initiatives driving action and data measuring progress (Figure 6). More meaningful comparisons versus peers are made through such deeper analysis, assessing genuine action and performance rather than aspirational goal-setting.

Figure 6. Sample of Detailed Company ESG Performance



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An Insightsfirst-driven approach to benchmarking offers immediate and actionable insights. Insights enable companies to recognize those actions (e.g., policies, programs, or technology) providing the most significant short-term impact. Over the long term, company leadership is empowered to more readily identify and align their sustainability strategy and ESG disclosures with industry best practices and trends.

To see how Evalueserve's *Insightsfirst* approach to ESG can benefit your company in its sustainability journey, contact us at ESGsolutions@evalueserve.com to schedule a demonstration of **ESG Insightsfirst.**

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For more information please contact:

ESGsolutions@evalueserve.com

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