

ESG UNCOVERED

Using Available Data—and Filling the Gaps That Remain



EXECUTIVE SUMMARY

Meeting investment objectives isn't so much a matter of making the right choices as it is of making choices right. Decisions made in informational vacuums are no more accurate than shots in the dark. That's why investors, who provide financial capital, have increasingly called on corporations to return the favor by supplying useful performance data on financially material sustainability matters.

Although companies today report more sustainability information—also known as environmental, social, and governance (ESG) information—than ever before, much of this disclosure is aimed at a broader set of stakeholders, thus limiting its utility to investors. Shareholders, for example, are interested in only a small subset of sustainability issues—namely, those that represent key business drivers of long-term value creation, such as the industry-specific factors identified by the Sustainability Accounting Standards Board (SASB). However, on these issues, today's market participants are challenged by highly inconsistent “data coverage”—in other words, the share of issues for which meaningful performance information is readily accessible.

This paper explores how good “data coverage” is a function of two variables:

- **Data availability:** the ESG information that companies report; and
- **Data collection:** the ESG information that data providers aggregate.

Making this distinction helps clarify key obstacles and opportunities on the road ahead for ESG integration, which has become a core activity for a rapidly growing segment of the mainstream investing community.

- 1. Start using SASB-aligned data now.** First, a significant amount of data is already being reported that is well-aligned with the SASB standards and is available for use by investors today. For example, our analysis of one widely used third-party provider indicates that data collection mechanisms are already in place for information aligned with more than half of the SASB metrics. Investors need not wait to integrate these data into their analyses, products, and decision making.
- 2. Exercise your influence—on both parties.** Secondly, investors have a dual opportunity for improving ESG data coverage by engaging two key agents of change. As the paper notes, by identifying which ESG issues are characterized by which types of reporting and aggregation practices, “investors can more efficiently and effectively shape their strategies for engagement with companies (on issues with a lack of available data), with data providers (on issues that lack coverage), or with both.” The key to improving ESG data sets is understanding which type of improvement is needed on which issues and in which industries.

Investors have plenty of reasons to be optimistic. With the recent codification of the SASB standards, markets have established important infrastructure to support improvements in both of the key variables that sway the data coverage equation. Armed with this understanding, investors will be better prepared to exert their influence on key market mechanisms to improve the effectiveness of their ESG integration, drive competition, and enhance the stability, resiliency, and efficiency of capital markets.

INTRODUCTION

An “educated guess” may be imperfect, but an uninformed decision is little more than gambling. For investors who aren’t playing with the house’s money but rather their own, useful information is the lifeblood of effective decision making.

Increasingly, mainstream investors have begun to look beyond traditional financial statements to gain additional insight into whether and how a company’s past results are likely to be indicative of its future performance. Much of these data fall under the banner of sustainability—or environmental, social, and governance (ESG) information.

Today, globally, more than one out of every four dollars under professional management is invested using sustainable strategies. (See Figure 1.) Nevertheless, only 12 percent of global institutional investors surveyed agreed that “companies adequately disclose their ESG risks that could affect their current business models.” (See Figure 2.)

This perspective—that corporate sustainability disclosure is insufficient for investment decision making—has dominated the conversation about ESG integration and its progress. However, a closer look at data coverage—in other words, the portion of material sustainability issues for which meaningful performance information is readily accessible—reveals that the reality of the situation may be more nuanced. First, companies are already reporting a larger amount of potentially useful sustainability information than they are often given credit for. Secondly, the perception of limited data availability, while rooted in truth, may be driven as much by imperfections in how third-party data providers collect ESG performance information as it is by how companies report it.

The good news is that both variables can be addressed directly by investors, in part by leveraging the standardized ESG performance metrics recently issued by the Sustainability Accounting Standards Board (SASB). As markets continue to align on materiality as a guiding principle for sustainability-related management and reporting, opportunities arise for investors to drive improvements in both data availability and collection, thus enhancing data coverage.

Figure 1.
Global Sustainable Investment Assets (in billions)

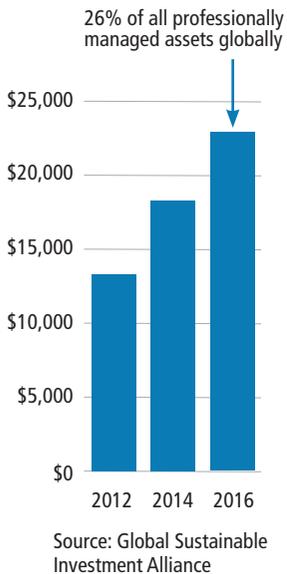
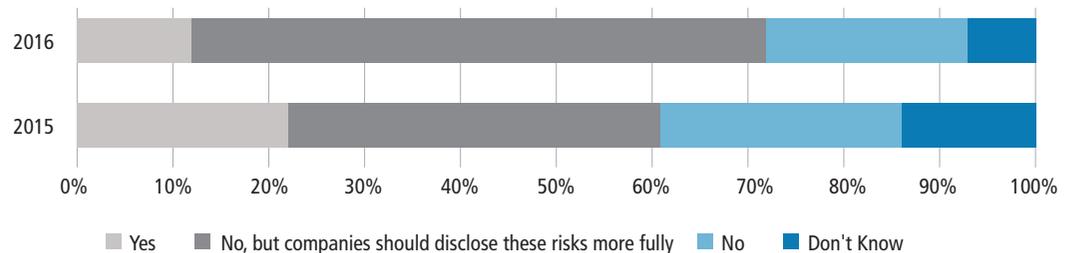


Figure 2. Survey of Global Institutional Investors

Do companies adequately disclose their ESG risks that could affect their current business models?



Source: EY, *Is your nonfinancial performance revealing the true value of your business to investors?* (2017)

DECONSTRUCTING DATA COVERAGE

The communication that occurs between the users and providers of financial capital does not always follow a short, straight line. This is particularly true of information that—like much sustainability data—is not always mandatory, is not often standardized, or both. Although companies have begun to report a large amount of sustainability-related data—including some that is material to investors—it is typically filtered through an informational “supply chain” before it is incorporated into investment and voting decisions. This dynamic raises the potential for communication breakdowns between investors and their portfolio companies regarding financially material ESG factors.

For example, in pursuing ESG integration, investors rely heavily on third-party data providers for information on corporate sustainability performance. In a survey, approximately half of U.S. asset managers (49 percent) indicated they use such services, which are provided by Bloomberg, Thomson Reuters, Sustainalytics, and others.¹ These services are especially popular among large institutional investors. For example, according to MSCI, 46 of the world’s top 50 asset managers—and more than 1,200 investors globally—use its ESG research and ratings.

These third-party providers collect data from a wide variety of sources, including company financial filings, annual reports, and sustainability reports; government databases; and macroeconomic information from academic, government, and nongovernmental organization (NGO) databases. However, what’s important to note for investors is that, due to the lack of a standardized approach to reporting financially material ESG data, the information that companies disclose and the information that data providers aggregate do not always match.

TWO KEY VARIABLES

Therefore, because of the differences between what companies report and what data providers gather, data coverage is a function of two variables:

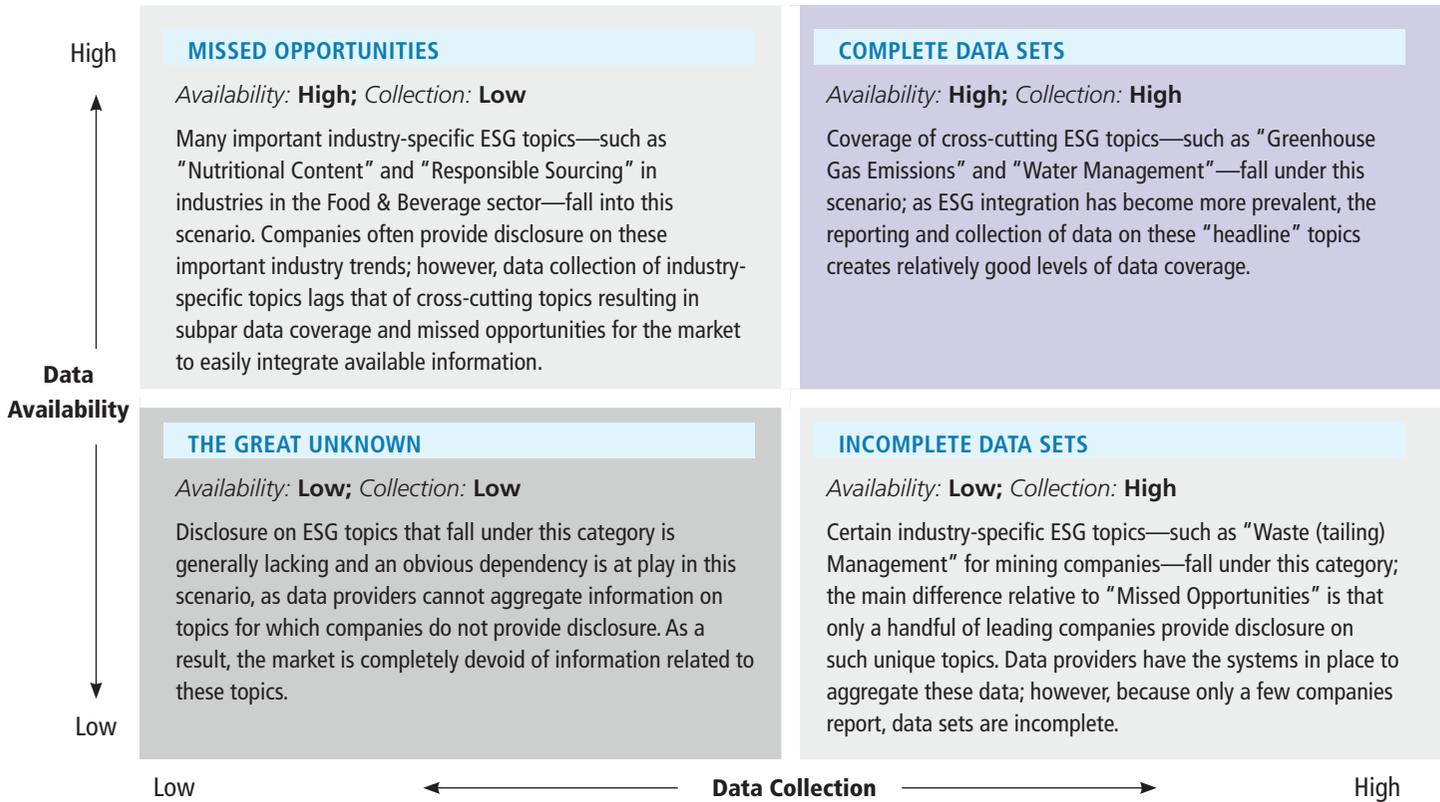
- **Data availability:** the ESG information that companies report; and
- **Data collection:** the ESG information that data providers aggregate.

The interactions between these two variables create four different scenarios that may characterize the data coverage available to the market for any given sustainability factor: (1) complete data sets, (2) missed opportunities, (3) incomplete data sets, and (4) “the great unknown,” a data frontier, marked by low amounts of reporting and low amounts of collection. These scenarios are described in more detail in the quadrants of Figure 3.

Making these distinctions can help investors achieve their primary ESG objective—improved coverage of financially material sustainability data—because the issues that fall under each scenario are likely to involve unique levers of change. Therefore, by identifying which ESG issues fall into each quadrant, investors can more efficiently and effectively shape their strategies for engagement with companies (on issues that lack availability), with data providers (on issues that lack coverage), or with both.

¹ Morgan Stanley Institute for Sustainable Investing, *Sustainable Signals: The Asset Manager Perspective* (2016).

Figure 3. ESG Data Coverage as a Function of Availability and Collection



DATA COLLECTION ANALYSIS

Because much of the prevailing sustainability reporting narrative has focused primarily on issues of data availability (which is to say, what information companies disclose) a brief overview of data collection (in other words, what information is gathered) can help paint a clearer picture of the road ahead for ESG integration.

An analysis of the Bloomberg Professional Service, which has more than 12,200 ESG users, helps illustrate the current state of data availability, collection, and therefore coverage. For this analysis, SASB mapped each of the 2,511 industry-specific sub-metrics in its 79 provisional standards to Bloomberg ESG codes. This exercise revealed that a Bloomberg-equivalent code—either as an exact match or a proxy—exists for 52 percent of the SASB provisional sub-metrics.² In other words, the provider’s system is designed to aggregate data for more than half of

² Of the 1,299 SASB sub-metrics for which a Bloomberg ESG code exists, 60% are proxies, and 40% are one-to-one matches.

Figure 4. SASB’s “Universe” of Sustainability Issues

ENVIRONMENT	SOCIAL CAPITAL	BUSINESS MODEL AND INNOVATION
<ul style="list-style-type: none"> › GHG emissions › Air quality › Energy management › Water and wastewater management › Waste and hazardous materials management › Ecological impacts 	<ul style="list-style-type: none"> › Human rights and community relations › Customer privacy › Data security › Access and affordability › Product quality and safety › Customer welfare › Selling practices and product labeling 	<ul style="list-style-type: none"> › Product design and lifecycle management › Business model resilience › Supply chain management › Materials sourcing and efficiency › Physical impacts of climate change
	HUMAN CAPITAL	LEADERSHIP AND GOVERNANCE
	<ul style="list-style-type: none"> › Labor practices › Employee health and safety › Employee engagement, diversity and inclusion 	<ul style="list-style-type: none"> › Business ethics › Competitive behavior › Management of legal and regulatory environment › Critical incident risk management › Systemic risk management

the SASB standards. (Of course, this does not necessarily imply data availability—even when mechanisms are in place to collect information, many companies may not report it.)

The SASB standards address issues related to five broad dimensions: environment, social capital, human capital, business model and innovation, and leadership and governance. (See Figure 4.) As the following examples will show, the rate of data collection varies considerably depending on the type of sustainability issue. Bloomberg’s data collection systems are designed to gather more information on SASB sub-metrics related to the environment and human capital than for other dimensions. (See Figure 5.) This is likely a reflection of the fact that environmental and human capital factors tend to be more generic in nature—cutting across a variety of industries—and that the market’s traditional lack of focus on material, industry-specific issues has thus incentivized the collection of information related to broader, “cross-cutting” topics.

Figure 5. Data Collection Levels by Sustainability Dimension

	No. of SASB sub-metrics	No. collected	No. not collected	% data collection
Environment	759	532	227	70%
Human Capital	386	226	160	59%
Leadership & Governance	621	328	293	53%
Business Model & Innovation	240	107	133	45%
Social Capital	505	106	399	21%

Furthermore, these differences among sustainability dimensions can impact the level of data collection among sectors and industries, whose unique sustainability profiles typically emphasize one or more dimensions over others. Therefore, sectors and industries heavily influenced by environmental and human capital factors have better data collection percentages than those with more socially oriented—or even mixed—sustainability profiles. (See Figure 6.) As a result, depending on a sector or industry’s sustainability profile, opportunities may exist today for investors to integrate the SASB framework into their analyses and decision making where both data availability and collection are high (i.e., “complete data sets”).

Figure 6. Data Collection Levels by Provisional SICs Sectors

	No. of SASB sub-metrics	No. collected	No. not collected	% data collection
Renewable Energy & Alternative Energy	122	96	26	79%
Transportation	158	104	54	66%
Resource Transformation	145	94	51	65%
Non-Renewable Resources	328	199	129	61%
Consumption	424	245	179	58%
Technology and Communications	205	110	95	54%
Health Care	200	98	102	49%
Services	237	102	135	43%
Infrastructure	254	107	147	42%
Financials	438	144	294	33%

However, given that “complete data sets” are not always available, challenges remain for investors, as illustrated by the following examples. The dimension- and sector-based distinctions above can help ESG-minded investors identify the most effective path forward on an issue or within an industry.

Missed Opportunities

In a number of instances, information on certain industry-specific topics is available, but aggregated data is tough to find. For example, SASB’s standard for the Education industry includes a disclosure topic called “Quality of Education and Gainful Employment.” One of the associated performance metrics is “program cohort default rates,” a measure that provides information on student defaults.³ Cohort default rates are commonly reported by participants in the industry, according to SASB’s most recent *State of Disclosure* analysis.⁴ However, this uniquely industry-specific metric is not currently collected by the Bloomberg service, pointing towards an opportunity for investors to perform more robust ESG integration.

Similarly, many companies in the Food & Beverage sector have established—and commonly report progress against—goals on responsible sourcing practices, which is a SASB disclosure topic for most industries in the sector. This data too is difficult to find in the aggregate since it is not collected by many ESG data providers. In such cases, investors are faced with additional legwork in the near term, manually collecting the data directly from a variety of different sources. However, they are also presented with a clear path forward over the medium to long term: By engaging with data providers to emphasize the materiality of these ESG factors and the availability of decision-useful performance data, the investment community can improve data coverage on these issues.

Incomplete Data Sets

In other cases, data providers have systems in place to collect information, but only a handful of companies report on the topic, resulting in incomplete data sets. For example, the Bloomberg Professional Service has developed a process to identify and collect information on “tailing waste” generated by mining companies.⁵ The ESG field is intended to capture the

³ Program cohort default rate is measured as a percentage of student borrowers who become subject to their repayment obligation in the relevant federal fiscal year and default by the end of the second federal fiscal year following that fiscal year.

⁴ SASB, *The State of Disclosure 2017* (December 2017).

⁵ Tailing waste represents the remaining ground rock and process chemicals used to extract a product from a mining ore.

“total volume of tailings created in the preparation and extraction of a company's mineral products and discarded during the reporting year” and, according to the SASB Metals & Mining industry standard, this issue is likely to have material impacts on companies in the industry. However, an analysis of data availability for this metric shows that only 16 percent of the 268 companies in the sample reported such information.⁶

In such instances, investors are faced with significant gaps in industry-wide data sets that substantially limit their utility for comparative analysis and benchmarking. However, by using engagement opportunities to lobby “laggard” companies to follow industry best practices and begin reporting this information, investors can again enhance data coverage.

⁶ The analysis covered all mining companies that were publicly traded on global exchanges and whose market capitalization was more than \$1 billion (or equivalent) as of November 2016.

LOOKING AHEAD

Until recently, corporate sustainability reporting has lacked an investor focus. As a result, companies have primarily reported information on broad, economy-wide ESG factors—such as climate change, labor relations, employee health and safety, and the like—and data providers have therefore been incentivized to collect similar information. However, the majority of ESG risks and opportunities that investors care about are not broad, cross-cutting issues, but rather unique, industry-specific factors. Reporting of this type of data is spotty, even today, and therefore collection by data providers—who face significant costs to mine and manage information—has traditionally followed suit.

Of course, the biggest opportunities lie in the data gaps, where risks are inefficiently priced or not priced at all. However, developing a more nuanced understanding of the underlying causes of these gaps reveals a dual opportunity for improvement. Addressing existing shortcomings with data “availability” and “collection” may seem like a “chicken-or-egg” conundrum, however these two key variables—and their associated incentives—are closely intertwined and mutually supportive. By working to improve one, investors are likely to influence the other. By working to improve both, they are likely to speed up the process.

With the recent codification of the SASB standards, markets have begun to establish a global standard for the disclosure of financially material sustainability information. This market standard can therefore provide the foundation for investor engagement with reporting companies to improve the availability of data and with data providers to improve its collection. Together, these efforts are likely to result in significantly enhanced data coverage. “As most ESG data is neither audited for consistency nor mandated for disclosure, SASB provides a framework that leads both investors and companies toward a consistent and comprehensive set of metrics to measure key business risks and opportunities fundamental to valuation analysis,” said an ESG Analyst at Rockefeller Capital Management.

More immediately, however, investors have the opportunity to begin using SASB-aligned data today. During its standards-development process, SASB made efforts to align its codified metrics with those of other reporting frameworks and/or regulators; therefore, many of these metrics are already being reported by companies and consistently collected by data providers. By integrating this existing information into analyses, investment products, and decision-making processes, investors can thereby establish more fully that financially material ESG data is not just a “nice to have,” but rather a core part of a robust investment approach.

Supported by this “proof of concept,” investors will be even better prepared to catalyze improvements in the reporting and collection of key ESG information.

Long-term, institutional investors are the dominant players in today’s capital markets, and as fiduciaries they shoulder significant responsibility for shaping the future of those markets and the broader economy. By leveraging available ESG data, and by working to fill the gaps that remain, the investment community can not only improve its own ability to make informed decisions, but also drive corporate performance that will create mutually beneficial value for markets and society alike.