

Prerequisites and prospects for improving the quality of ESG assessment as a tool for responsible investment

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Abstract. The purpose of this article is to examine comprehensively the issues of information and methodological support for the ESG assessment of companies as a tool for responsible investment, to identify the prerequisites for the development of approaches to ESG assessment, and to identify areas for improving the quality of ESG assessment in order to make investment decisions that are comprehensively justified, ESG-conscious, and strategically valuable. The research examines the prerequisites for enhancing the quality of the ESG assessment, with a focus on the lack of information and methodological support for the analysis of sustainable development, and identifies the principal means for its enhancement. This article argues that the most important factor in guaranteeing the high quality of the ESG assessment is to increase the transparency, validity, and objectivity of methodological approaches to the ESG assessment, as well as the utilization of reliable tools for assessing uncertainty and sensitivity. The author proposes a method for a comprehensive evaluation of a company's sustainable development, utilizing modern digital technologies for the analytical processing of ESG data.

Keywords: responsible investment, ESG integration, ESG data, sustainability report, ESG rating, comprehensive ESG assessment

1 Introduction

In the modern business environment, the assessment of a company's sustainable development is the most important area of business analytics, which provides a holistic description of environmental responsibility, social responsibility, and business management efficiency, forms the basis for making long-term business decisions, and meets the interests of management, the company's owners, and its investors as key stakeholders.

ESG valuation received a boost in the early 2000s in connection with the increased attention on the part of international organizations to sustainable development issues at the global level, the adoption of the 2030 Agenda for Sustainable Development by the UN

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Member States in 2015, and the implementation of international projects in the field of responsible investment, giving priority to the role of institutional investors in stimulating the solution of environmental, social, and corporate governance issues. Of particular note is the 2006 UN Principles for Responsible Investment (PRI), which define responsible investment as "an approach to investment that aims to integrate environmental, social, and governance (ESG) factors into investment decisions in order to better manage risks and generate sustainable, long-term returns" [1]. According to the first PRI principle, institutional investors should consider ESG issues in their investment analysis and decision-making processes. At the same time, in practice, for a long time, the importance of the principle of responsible investing has been acknowledged, which prescribes the requirement for maximum openness in the corporate reporting of the investment object by ESG elements. This has led to the currently existing asymmetry of the components of information and analytical support for sustainable development, which is manifested in the outstripping of the development of approaches to information disclosure in comparison with the tools for assessing and verifying ESG data.

According to a number of authors [2], "not enough is known about how investors use ESG information," and moreover, there are problems with the quality of the ESG data itself [3, 4]. The literature on using ESG data for investment decision-making has traditionally focused on the impact of company ESG performance data on financial performance and market valuations [5-9].

At the same time, the ESG analysis algorithm has not yet been fully developed to provide a holistic approach to assessing the sustainable development of an organization. Many investors face difficulties in interpreting and evaluating numerous private ESG indicators, as well as incorporating them into the investment decision-making process. Existing approaches to ESG estimation are imperfect, and often give conflicting results. The discrepancy in ESG ratings is considered in a number of publications by modern economists [10-12].

Currently, ESG assessment is essential for companies and investors and has evolved into a full-fledged responsible investment tool used by investment decision-makers to enhance the validity and effectiveness of their investments. To ensure the objectivity of the ESG assessment, the level of development of its methodological apparatus remains insufficient, necessitating the development of traditional approaches that take into account modern trends in corporate reporting, business intelligence, and digitalization opportunities.

2 Materials and Methods

This study is aimed at a comprehensive review of the problems of information and methodological support for the ESG assessment of companies as a responsible investment tool, identifying the prerequisites for the development of approaches to ESG assessment as well as ways to improve the quality of ESG performance assessment in order to adopt comprehensively justified, ESG-conscious, and strategically valuable investment decisions.

Methods of analysis and synthesis, generalization and specificity, comparison, abstraction, analogy, systemic, strategic, and risk-oriented approaches were utilized to carry out the study.

The study is based on the analysis of the development and assessment of the content of ESG reporting standards as a conceptual basis for ESG assessment of organizations. The conclusions and results of the study are based on the generalization of foreign practice in ESG data disclosure as well as their reflection in the corporate statements of Russian corporations placed in the National Register of the Russian Union of Industrialists and

Entrepreneurs (RSPP). A large sample size (over 30 organizations) and a lengthy observation period (over 5 years) ensure the validity of the findings. The study used data from information and analytical systems as well as the world's leading ESG rating agencies to carry out a comparative analysis of approaches to ESG rating methodologies.

3 Results

The assessment of a company's sustainable development is in the best interests of all stakeholders, especially investors, and is a complex problem whose effective resolution is contingent on several conditions. They are specifically related to the information support of the ESG assessment, as presented by sustainability reporting, as well as methodological support, which includes assessment tools and methodological approaches to the analysis of ESG indicators, the development of ESG ratings, and the ranking of organizations based on the degree of sustainable development.

There are currently several dozen standards for disclosure of information on sustainable development in corporate reporting and several hundred rating systems used for ESG assessment of companies to determine their commitment to the green economy, social responsibility, and corporate governance efficiency. In essence, this indicates the absence of a reliable basis for the ESG assessment of organizations, given that numerous ESG reporting standards, each of which is characterized by certain shortcomings, a variety of ESG indicators defined by standards, and the ambiguity and opaqueness of approaches to developing ESG ratings inevitably lead to subjective ESG assessments of the company's activities.

At the same time, ISO Standards (14000, 26000, etc.) with global acceptance and widespread practical use are not sufficiently developed in terms of specific recommendations on information disclosure and reporting evaluation criteria.

The Carbon Disclosure Project standards have also been promoted globally and are easy to apply, but their focus on environmental metrics such as carbon footprint, water and energy consumption, and targeting the largest corporations for public disclosure significantly limits their scope.

GRI Standards hold a unique position due to their extensive distribution in various countries and economic sectors, relative usability, availability of detailed recommendations, and regular updates.

KPMG's Sustainability Reporting Review, published since 1993, reflects the rapid growth in ESG reporting around the world. The 2022 study examined the disclosure practices of the world's 250 largest companies by revenue (G250), as well as the 100 largest companies in each of the 58 sample countries (N100) [13].

The 2022 KPMG Sustainability Reporting Review showed:

96% of G250 (no change since 2020) and 79% of N100 (compared to 77% in 2020) prepare ESG reports;

78% of G250 reports are guided by GRI standards (up from 73% in 2020);

68% of the 5,800 N100 companies use GRI standards (up from 67% in 2020);

GRI standards are used by the majority of surveyed companies in all regions (75% in the Americas, 68% in Asia-Pacific and Europe, and 62% in the Middle East and Africa).

Thus, the use of GRI standards in the preparation of ESG reporting is a global trend. At the same time, it should be noted that the continued voluntary nature of the application of the GRI Standards allows organizations to customize the information disclosed, that is, to adapt to the requests of interested users, and creates conditions for impact-washing—false positive information to investors and other stakeholders regarding ESG efficiency, which

has recently received time wide scope. The flexible approach to selecting criteria proposed by the GRI standards leads to overestimation or underestimation of reporting indicators; consequently, the GRI SRS does not completely ensure the objectivity and impartiality of the evaluation.

Against the backdrop of current trends in the steady growth of reporting on sustainable development, the expansion of reporting on risks associated with climate and biodiversity, the problems of evaluating ESG reporting are clearly manifested, due to the preference for quantitative criteria for disclosing ESG information over qualitative ones, as well as the insufficient development of industry-specific GRI Standards.

Improving the quality of ESG business valuation is critical to the institution's progress in validating sustainable development reports, because investors can only make sound investment decisions if they have complete and accurate information. The analysis of cases from a diverse range of Russian companies preparing sustainability reports revealed a fairly common practice of manipulating ESG reporting indicators, manifested in the absence, incomplete disclosure, or veiling of individual indicators, setting strategic goals in a streamlined form that does not allow tracking their achievement, and inconsistency in some reporting data information from open sources. Given the prevalence of ESG risks in companies with a high level of sustainable development, as reflected in corporate non-financial reporting, institutional investors cannot fully rely on the results of company self-assessments and have confidence in ESG assessments based on unverified data [14]. The development of independent external confirmation of ESG reporting is the key to increasing confidence in the information disclosed in sustainability reporting, a necessary condition for improving the ESG assessment.

In addition to strengthening the information support for assessing firms' sustainable development, overcoming the inadequacies of existing ways of ESG rating assessment is a crucial condition for boosting its objectivity. In the absence of unified sustainability reporting standards, the ESG rating system does not allow investors to make informed decisions on capital investment in an ESG-conscious format. ESG ratings are based on a non-standardized list of various indicators of environmental responsibility, social responsibility, and corporate governance, with each rating agency using its own approach to determining the significance of an indicator in its totality. Table 1 summarizes the data on ESG indicators used for rating by the world's leading rating agencies.

Thus, ESG ratings differ significantly in the number and content of indicators taken into account, evaluate the significance of individual indicators in different ways, and have different scales and evaluation formats. In recent years, ESG rating agencies have integrated new criteria into their scoring models, such as carbon emissions, biodiversity impact, and tax transparency, to respond to new global challenges, while the old scoring criteria are also gradually changing, making the scoring process even more complex [15].

The practice of ESG rating as a responsible investment tool faces the challenge of a low correlation between ESG ratings formed by the world's leading rating agencies. According to a study by a group of scientists from the MIT Sloan School, the various ESG ratings are typically consistent six out of ten times [16]. The results of this study are consistent with the author's own findings from a survey of ESG rating practices. This is quite different from credit ratings such as Moody's and S&P, which have a strong positive correlation.

Table 1. Key features of ESG ratings of leading rating agencies

Rating agencies	Number of ESG criteria	Priority ESG risks	ESG rating score
MSCI	37	<i>Environmental responsibility.</i> Climate change. Natural resources. Pollution and waste. Management. Environmental opportunities. <i>Social responsibility.</i> Responsibility for the product. Human capital. Stakeholder concerns. Social opportunities. <i>Management efficiency.</i> Corporate behavior. Corporate governance	CCC to AAA
Refinitiv	186	<i>Environmental responsibility.</i> Resource usage. Outliers. Innovation. <i>Social responsibility.</i> Personnel. Human rights. Society. Responsible production. <i>Management efficiency.</i> Management. Shareholders. CSR (Corporate Social Responsibility) strategy.	from D- to A +, from 0 to 100
Sustainalytics	155	Industry indicators. Changing factors depending on the industry of the organization.	from 0 to 100
RobecoSAM	74	Industry indicators. Three main dimensions: economic, environmental and social	from 0 to 100
Bloomberg	120	<i>Environmental responsibility.</i> Carbon emissions. Climate change. Pollution. Waste disposal. Depletion of resources. Renewable energy. <i>Social responsibility.</i> Supply chains. Discrimination. Diversity. Human rights. Public Relations. <i>Management efficiency.</i> Independence of management. Shareholder rights. Absorption protection.	from 0 to 100
FTSE Russell	300	<i>Environmental responsibility.</i> Biodiversity. Climate change. Pollution and resources. Water safety. <i>Social responsibility.</i> Labor standards. Human Rights and Community. Health and safety. Responsibility to the client. Supply chain. <i>Management efficiency.</i> Tax transparency. Risk management. Corporate governance. Anti-corruption practice.	from 0 to 5

Source: Compiled by the author

These circumstances undermine the credibility of ESG ratings as a tool for responsible investing. For example, Tesla, the world leader in carbon-reducing technologies, has an ESG rating below all European automakers, while the German auto industry's big three companies show a high level of ESG controversy [17]. In its 2021 Impact Report, Tesla stated that "current ESG scoring methodologies are fundamentally flawed because they do not address the company's real impact on society and the environment."

It is possible to increase confidence in SPE (Sustainability Performance Evaluation) ratings by overcoming the subjectivity of indicator selection and their aggregation and evaluation based on reliable tools for assessing uncertainty and sensitivity, specifically operations research and fuzzy logic.

The Principles for Responsible Investment (UN PRI) provide guidance on the use of ESG data, prescribing three options for including it in the process of analytical justification for investment decisions: screening, thematic investment, and ESG integration. As part of the screening process, investment options are evaluated to determine which are permissible and which are unacceptable based on the investor's standards and beliefs. ESG data are used to determine the structure of the investment portfolio in accordance with a thematic investment strategy. According to the ESG incorporation strategy, investors incorporate ESG factors into their investment models alongside other significant factors.

In this regard, the author suggests, as part of the rationale for investment decisions, that in addition to ESG ratings, which should serve as a general guideline and be evaluated through the prism of an investor's main ESG risks, an integrated approach to ESG assessment should also be utilized.

A comprehensive ESG assessment of a company involves the following stages of implementation:

- general diagnostics of ESG factors, focused on identifying environmental, social, and governance aspects of sustainable development relevant to the organization;
- assessment of the transparency and quality of ESG data disclosure;
- ESG performance analysis, including an assessment of the organization's environmental responsibility, social responsibility, and management efficiency;
- assessment of the impact of ESG factors on the organization's business model, formed as part of the study of resources, business processes, and products;
- assessment of the impact of ESG factors on the value chain, based on the analysis of suppliers, business processes, and customers;
- analysis of the impact of ESG factors on the financial performance and market valuations of the organization;
- assessment of ESG risks and their impact on the investment attractiveness of the organization.

Such an approach, implemented on the basis of modern digital technologies and information and analytical systems, is designed to ensure a sufficient level of ESG awareness among investors and will make it possible to make comprehensively informed and effective investment decisions.

4 Discussion

The problem of the reliability and validity of the ESG assessment as a responsible investment tool is of great practical importance since it determines the real ESG risks associated with companies, as well as the financial consequences of investment decisions. Although the level of disclosure of ESG data is consistently increasing due to the constant development of ESG reporting standards, the quality of information disclosure in

sustainability reporting still needs to be improved. Positive developments in this regard can be expected in connection with the implementation of the IFRS Foundation project, which was launched in 2021 to be developed by the International Sustainability Standards Board (ISSB) in conjunction with the Global Reporting Initiative for international standards focused on the needs of investors and financial markets, as well as the development of new European Sustainability Reporting Standards (ESRS), developed by the European Financial Reporting Advisory Group (EFRAG). However, given the observed trends, the plurality of standards is expected to persist in the foreseeable future, and overcoming the bottlenecks that have emerged in the methodological correctness of the ESG rating assessment will take time. This study of the current transitional conditions is important as it systematizes the problems of the theory and practice of ESG assessment, determines the main vector of promising changes, and offers an approach to a comprehensive ESG assessment in the interests of the company and investors.

5 Conclusion

The prerequisites for improving the quality of the ESG assessment as a responsible investment tool are related to the problems of information and methodological support for the analysis of sustainable development and determine the main ways to improve it. The main prospects for improving the quality of the ESG assessment are, first of all, the harmonization of sustainable development reporting standards, the consistent transition to the mandatory formation of ESG reporting, and the development of a standardized list of reporting ESG indicators, taking into account the industry affiliation of the organization, which will contribute to the formation of a unified taxonomy that provides the opportunity for comparative ESG analysis and evaluation of ESG data for compliance with the requirements. Another priority area for improving the quality of the ESG assessment is the development of an institution for independent external confirmation of ESG reporting. At the same time, it is especially important to ensure the high quality of the ESG assessment by increasing the transparency, validity, and objectivity of methodological approaches to the ESG assessment, the use of reliable tools for assessing uncertainty and sensitivity, the implementation of a holistic approach to assessing the company's sustainable development, and the widespread use of modern digital technologies for the analytical processing of ESG data.

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