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NEXT LEVEL OF CORPORATE SUSTAINABILITY

Corporate sustainability, ESG and sustainable development are buzzwords which have already been well-known for some decades now. But are they really already reflected in the landscape? The momentum to integrate ESG into the strategies and operations of Slovak companies is yet to come.

WHY CORPORATES SHOULD NOT IGNORE THEIR SUSTAINABILITY PERFORMANCE

The corporate world is by far the most economically powerful and environmentally impactful bloc on the planet and short of a mass redistribution of that power and impact, voluntary corporate action will be an essential ingredient in the preservation of the biosphere. Hence, the private sector-led effort is now considered a critical ingredient in the avoidance of climate and other catastrophes.

As such, various corporate sustainability and ESG movements have been built over the past 20 years and we have come to the point where realization of long-discussed sustainability strategies is expected and businesses should start to "walk the talk".

The following non-exhaustive list of ESG purposes has often been outlined, which are to:

- Measure what matters
- Inform capital allocations
- Empower investors
- Drive innovation
- Support the transition through adaptation and mitigation

The intent of ESG – to help stakeholders understand more about an organization's broader commitments, performance and impact – is indeed very commendable.

Yet there is an urgent need for ESG to mature to the same level as financial disclosure. To inspire trust and confidence in it and create long-term value, organizations should be managing ESG and sustainability performance with the same rigor as financial performance. Unlike standards for measuring financial performance, however, there has been no set standard for measuring non-financial information and the value we create for stakeholders beyond shareholders – until now.

NON-FINANCIAL REPORTING IS GETTING REAL

European businesses will soon encounter the upcoming EU Corporate Sustainable Reporting Directive (CSRD), which will introduce new standards for non-financial disclosures including metrics and required data. The new directive will replace the current Non-Financial Reporting Directive (NFRD) with stricter requirements and a broader scope of European companies that are affected.

The integration of ESG into corporate strategy will present an obligation and increasing demand to disclose more, but more importantly, an opportunity to drive differentiation in how a company delivers long-term value across stakeholders. Leading companies are embracing a broader vision of ESG to set out their unique narrative and to drive innovation. By adding elements that positively differentiate them from others they are pushing to be more attractive to investors, employees and consumers.

> **The desire of companies to improve their sustainability ratings score has led to more disclosures rather than to more sustainable outcomes.**

THE EMERGING SUSTAINABILITY INFORMATION ECOSYSTEM

While there are increasing connections between the financial and sustainability information ecosystems (stronger connection between the "F" of financials and ESG), the latter has additional voices, including largely unregulated ESG ratings and data providers, civil society, including activist investors and employees.

The sustainability information ecosystem aims to serve two primary investor groups:

1. Those focused on financial risk – that is, those who seek material information related to the financial impacts of sustainability-related factors
2. Those focused on social impact – that is, those who seek information about the company's impact on its external surroundings (including on people, communities, the environment, and society)

To date, the sustainability information ecosystem has evolved to meet the expectations of stakeholders who are primarily interested in assessing financial risk. For example, most ESG reporting regimes, as well as all the major ESG ratings providers, do not measure a company's impact on society. They measure its relative exposure to various internal and external financial risks, as well as opportunities.

Yet, recent growth in ESG investing has been driven by investors, including millennials, who prioritize social and moral considerations.

A 2020 survey found that nearly three-quarters (71%) of individual investors, globally, want to make a positive social impact as part of their investment objectives, with the response rate for millennials even higher (75%).

So it seems, there is an opportunity for stakeholders within the ecosystem, including standard setters and ESG rating agencies, to consider how they can address the needs of all users of sustainability information.

WE DON'T SEE THE FOREST FOR THE TREES

It is equally important to understand the bigger picture of ESG and corporate sustainability. Data is, of course, hugely important in determining with certainty if a company's sustainability strategy is working or not, but the insistence that data alone will illuminate the path forward has diverted the better part of the corporate sustainability industry since its inception.

The desire of companies to improve their sustainability performance in terms of better ESG ratings has led to the problem that the vast majority of their effort is recycled back into more disclosure rather than to more sustainable outcomes – which should be the real driving force and motivation.

Furthermore, the notion of the corporation as an independent "closed loop" system has led to corporate sustainability's excessive focus on the boundaries of operational control. However, it is the whole value chain of a business that we need to put on a sustainable footing. Sustainability is a specific point at which economic activity is maintained within sustainable limits. For the individual corporation, this means knowing, with great accuracy, the environmental resources that it relies upon across its value chain.