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EDITORIAL EJAFB
WHAT ARE ESG INDICATORS AND SRI INVESTMENTS

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The sustainability report is a narrative document that includes non-financial information, i.e. information in addition to the mandatory reporting. This information provides details on the economic, environmental and social impact of the reporting entity. Although not mandatory for all companies, the Sustainability Report is a selection criterion by investors, banks and large companies. Thus, on 10 November 2022, the European Parliament adopted the final text of the Corporate Sustainability Reporting Directive (CSRD), which will require companies operating in the European Union (EU) to disclose information and data on environmental, governance and social issues.[1] Clearly the vast majority of companies, even if they do not currently use this type of reporting, will face situations where other competitors interested in sustainability reporting will have a significant advantage in terms of improving corporate reputation, accessing mortgages and loans in order to invest and strengthen their corporate image by demonstrating an optimal level of environmental and community responsibility.

In this respect, to meet the requirements of stakeholders, sustainability reporting is structured around indicators that include environmental, social and governance information. ESG stands for *Environmental, Social and Governance* and refers to three factors central to measuring the sustainability of an investment. This approach derives from the concept of the "Triple Bottom Line", also known as "People, Planet and Profits" (PPP), introduced in the 1990s, according to which companies should focus not only on "Profit" but also on each of the other two "P's", which are equally important for the sustainability of any business. This concept has evolved into ESG factors, which today are the cornerstone of Sustainable and Responsible Investment (SRI). Each pillar refers to a specific set of criteria, such as environmental commitment, respect for corporate values and whether or not a company acts with accuracy and transparency. Typically, ESG criteria take the form of a kind of social credit score in which all three categories are used to illustrate how much risk a company is taking for investors. The ESG rating is usually calculated based on data and values related to an organisation's intangible assets. As a result, the decision to invest is based not only on an organisation's economic performance, but also on values such as environmental friendliness and effective governance.

In recent years, environmental issues and the growing political will to act, have seen ESG issues evolve from a corporate buzzword to a critical aspect of a company's operations. As well as playing an important role in mergers, acquisitions and investment decisions, research has shown a positive link between ESG issues and financial performance or value creation. ESG factors have become increasingly critical to investors and corporate social responsibility scores have helped them avoid organisations with high financial risk or questionable business practices.

ESG principles are extra-financial metrics that are added to traditional economic metrics, thus increasing the information available to form an opinion on the company. For investors, ESG criteria - or rather ESG scores and ratings - also serve to assess their investment soundness. In fact, we speak of sustainable finance when, in addition to economic objectives, environmental and social objectives are also taken into account.

A sustainable and responsible company must be focused on the environmental factor, in the sense that it is necessary to introduce clear policies to reduce greenhouse gas emissions, to use energy and natural resources as efficiently as possible: water, air, soil, raw materials, vegetation, fauna, practice sound anti-pollution policies, etc. The value placed on the social factor includes information on how the reporting company pays attention to the quality of the working environment and supply chain, to the human resource development, gender equality, diversity and inclusion. The third ESG factor - corporate governance - refers to ethics and transparency, control policies and procedures, shareholders' rights, composition, independence and remuneration of the board of directors, etc. in the case of joint-stock companies.

ESG therefore indicates a real rating, also known as a sustainability rating, which refers to the environmental, social and decision-making impact of a company operating in the marketplace. There are a number of criteria for measuring an organisation's environmental, social and governance activities that take the form of a set of operating standards that should underlie the company's policies in order to ensure the achievement of certain sustainability outcomes.

Analysing the acronym, "E" can refer to all the activities of a company that have an impact on the natural environment; "S" indicates the social aspect, the related criteria of this pillar examining the impact of an organisation in the context of the community in which it operates; finally, "G" refers to business management issues, which should be inspired by best practices and ethical principles.

ESG investing is therefore seen as a sustainable way of investing, which takes into account environmental and human welfare as well as purely financial aspects. Investing in ESG activities means directing capital to companies that, for example, respect the environment, encourage women in governance and are attentive to employee inclusion and well-being. In other words, it is important for stakeholders to understand that socially responsible investment is the practice of investing money in companies and funds that have a positive social impact. In these cases, the aim is to create value and generate returns through a strategy that integrates financial analysis with attention to the environment, social balance and good governance.

ESG ratings are developed by agencies specialised in collecting and analysing data on sustainability aspects of business activities gathered from various internal and external sources: public information, company documents, data from supervisory authorities, trade associations, trade unions, NGOs. Company inspections and management meetings may also be carried out. An investment is defined as sustainable and responsible if it creates value for the investor and for society as a whole through a medium to long-term strategy that integrates financial and ESG analysis in assessing companies and institutions.

Although ESG and SRI investments are similar, they differ in concept. The former take into account the potential of the entities involved to improve indicators of inclusiveness and circularity in the use of resources. The latter put ethics above all other values and assess the actions companies have already taken (not those they will implement) to improve the parameters of environmental sustainability and social equity. While the ultimate goal remains profit generation, the moral categories and positive impact areas of corporate activities are even more stringent for SRI investments.

[1] Directive on Corporate Sustainability Reporting, CSRD (COM/2021/189), which fundamentally changes the current sustainability reporting regime. The Directive will enter into force 20 days after publication. The rules will start to apply between 2024 and 2028. Member States are obliged to transpose the Directive into local law so that it applies from 1 January 2024 for financial years starting on that date for Article 4 (audit fee capping provisions and audit committee approval of sustainability reporting) and within 18 months for Articles 1-3 (all others). The requirements for subsidiaries of companies domiciled in third countries will have to be transposed by 1 January 2028, after the publication of EU guidelines.