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ESG Investing and the Bioeconomy: Understanding ESG Investing Frameworks, Reporting, and Stakeholders

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ESG reporting seeks to create a standard way for a range of investors to understand a company's (or a fund's or an asset's) financial and non-financial impacts, as well as the strategy, approach, and performance of the company as it seeks to make those impacts. In this series of articles we are exploring how bioeconomy companies can tap into opportunities created by the growth of ESG investing, and more broadly how ESG reporting can help bioeconomy companies improve and de-risk their operations.

ESG investing has evolved organically and competitively over the last few years. In truth, the rapid increase in ESG participants, standards, frameworks, and nomenclature has created a jumbled and confusing landscape. Numerous stakeholders and service providers are creating an ESG ecosystem that consists of:

- Reporting Frameworks
- Databases
- Data Aggregators
- Corporate Rating Agencies
- Fund Rating Agencies
- External Assurance Providers (i.e. Auditors)

In this installment of our four-part series we explore the evolving ESG ecosystem with an emphasis on understanding how ESG reporting applies to bioeconomy companies, including how to decide which ESG reporting framework to use.

Unpacking ESG Reporting

ESG reporting has grown confusing. According to Mike Wallace, formerly of the Global Reporting Initiative, "It is a confusing space for new entrants when one considers the various options, requests and suggestions for how to address the growing demand for ESG information [with] at least a half-dozen disclosure options." ESG reporting has become a catch-all term for communicating quantitative and qualitative corporate impacts, even though there are several distinct audiences for this information. Stakeholders as varied as customers, employees, industry peers, environmental NGOs, investors, and ESG ratings agencies will be interested in a company’s disclosures, but they are interested for different reasons. The key to disaggregating these audiences is financial materiality.

Many stakeholders will be interested in a company’s behavior and ESG impacts. These stakeholders might be issue driven. Is a company effectively combatting climate change? Is it reducing de-forestation? Is it compensating workers ethically? ESG reporting can inform these customers, peers, community members, and issue-driven investors.

ESG reporting can also be considered quantitative branding. From that perspective, ESG reporting is a type of sustainability branding and marketing. Although branding and stakeholder engagement are significant corporate activities and certainly can impact a company’s value, these are not the investor stakeholders of primary concern to us in these articles. We believe that bioeconomy companies should provide 1) ESG reporting and for investors that are examining a company’s financially material “management discussions and analysis” (MD&A) and 2) ongoing reporting for investors and the public.

Financially Material ESG Reporting

We are interested in helping bioeconomy companies understand ESG reporting so as to drive three positive financial outcomes:

- Recruit diverse ESG and/or impact investors.
- Support investor relations *over time* by providing financially material ESG data.
- Improve and de-risk operations by aggregating and analyzing one’s own ESG data.

Given the (many) existing requirements that biofuels and bio-based products have in order to be certified sustainable, bioeconomy companies may be surprised to hear that they need to learn another reporting language. There is certainly considerable overlap between the data requirements for sustainability certification and ESG reporting, particularly for metrics of climate and (E)nvironmental impact. However, bioeconomy companies can benefit from expanding their reporting beyond environmental sustainability (e.g. water quality and use, air quality, and carbon scoring) to include their (S)ocial impacts and approaches to (G)overnance.

Two of the leading reporting frameworks are the Global Reporting Initiative (GRI) and the Sustainable Accounting Standards Board (SASB). Their different approaches highlight the split between reporting to a general sustainability audience versus an MD&A audience.

GRI is to sustainability reporting what the IEA is to the energy sector: a significant and independent international body that works with governments and companies around the world. GRI is a non-profit focused on making ESG reporting more informative, more impactful, and more beneficial to society. In their own words, “The GRI Sustainability Reporting Standards are developed with true multi-stakeholder contributions and rooted in the public interest.” GRI standards are freely available, comprehensive and widely use. GRI standards are relevant to any bioeconomy company seeking to advertise or assure stakeholders of its good corporate citizenship.

The Sustainable Accounting Standards Board seeks to be for sustainability what that Financial Accounting Standards Board is for financial reporting. Like FASB (and GRI), SASB is a non-profit that develops standards with considerable stakeholder input. Unlike GRI, SASB is most interested in financially material sustainability disclosure. SASB (and others) recognize that there are many challenges to ESG reporting. How does one compare businesses across sectors? How does one compare start-ups versus more established firms? How does one discriminate which aspects of sustainability are financially material? How does one accommodate industries, like the energy sector, that are in transition?

To address these issues SASB applies a divide and conquer approach. SASB starts from a collection of ESG metrics that cover financially material impacts on the Environment, Human Capital, Social Capital, Corporate Leadership & Governance, and the company's Business Model & Innovation (see accompanying figure). Working with stakeholders SASB has now refined the overall metrics into 77 distinct, industry-targeted subsets. There is even an SASB framework for biofuel producers, but it is disappointingly minimal, not even covering as many sustainability issues as most sustainability standards. We anticipate engaging with SASB and assisting them to upgrade their standard for biofuels companies, and creating relevant standards for other companies of the bioeconomy. That said, the overarching list of metrics is complete and does capture the material that a diverse array of investors is interested in knowing about a company. But more importantly the formatting of the SASB standards permits apples-to-apples comparisons within a sector and even facilitate apples-to-oranges comparisons across sectors. One could imagine using standards to convince diverse investors to consider investing in the bioeconomy over other green technologies or even traditional sources of energy, but that is a topic for another day.

Attracting a Range of Investors

ESG reporting and investing certainly began with publicly traded companies providing data and being ranked on various ESG Indexes, such as the MSCI Indexes. However, the expansion of impact investing by private equity and venture capital means that companies at all stages of development could benefit from ESG reporting. Some high-flying examples of ESG-minded VC funds include Obvious Ventures that funded Beyond Meat in its early days back in 2014 and Base10 Partners that is IT-oriented.

A big reason that VC funds are starting to take ESG seriously is the growing perception (and track-record) that ESG transparent companies outperform. Marija Kramer, who is the head of ESG at the ISS ratings agency, explained that companies are "seeing the value in sustainability and putting their own programs in place internally, because they, too, think that it's an important variable to their own viability in the long term."

Another reason for a company to monitor and/or report ESG data is to be able to demonstrate progress to itself and others. Investors respond to operational improvements, particularly those that are quantified. The collection and analysis of these data over time can help a company diagnose and troubleshoot problems before they are financially damaging. In this way, internal ESG reporting can help de-risk operations, and all investor classes will welcome the commitment to de-risking.

Climate Change Disclosure and ESG

The elephant in the ESG room is Climate-related Financial Disclosure. And like an elephant in a watering hole, it has a tendency to muddy things up. Specifically, people tend to conflate the concepts of climate-related reporting with environmental reporting, while we in the bioeconomy know that environmental reporting is multi-faceted and so much more than climate reporting. As with other ESG reporting there are two sides to the coin: 1) reporting on your company's impact on climate change, i.e. emissions, and 2) reporting on the impact of climate change on your company, i.e. risks and risk mitigations for your business.

Climate-related disclosure has a lot of momentum and some strong backers. The Task-Force on Climate Related Financial Disclosure (TCFD) is a well-funded and ambitious effort that is driving wide spread change among publicly traded companies. There is tremendous pressure on institutional investors to participate in the TCFD. As reported in the Financial Times, the investor-led Climate Action 100+ campaign is driving big companies to set targets on reducing emissions and reporting on their progress. For example, this year, Shell did an about face and agreed to set hard targets, whereas before it was less ambitious.

We believe that bioeconomy companies, many of which are focused on emissions reducing products across the spectrum of fuels, chemicals, and materials, are well positioned to benefit from investor appetite for climate-related investment opportunities. If a company is producing a product with a low CI score, then it should benefit from both policy and investor appetite. However, we don't support the idea of climate-related reporting as somehow distinct. It is a cornerstone of good ESG reporting, but not the entire story.

Conclusion

In summary, despite being a bit convoluted, ESG investing by a diverse set of investors is creating as of yet unrealized opportunities for bioeconomy companies. ESG reporting, including climate-related disclosure, can help to attract ESG-minded investors and to support post-investment communications and relations. The potential for de-risking operations through expanded data collection and analysis is key. In our next two articles we will address the nuts-and-bolts of ESG reporting by answering the following questions:

- How can I create an ESG risk mitigation plan and also incorporate all of my other risks to present a well-rounded risk mitigation plan to investors?
- How should I properly plan for sufficient time and resources to manage and monitor ESG risks, now and in the future?

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