

ESG Data Production

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Foreword



By:

Nicholas Christou

Head of ESG Practice / Financial Services Consultant

ESG is steadily ascending to the forefront of the global business agenda. Business leaders, investors, stakeholders, and regulators within the wider financial ecosystem are now commonly demanding transparency from organisations on matters pertaining to ESG and sustainability, in order to assess any potential long-term value therein.

Embedding and integrating sustainability principles into the contemporary operating model is, therefore, not only a moral imperative, but also a compelling business case for growth.

Concurrently, it is vital to bear in mind that the ESG journey is an iterative process that requires a consolidated approach across the organisation. Nevertheless, and despite the hurdles that one may face during the journey of embedding an ESG mindset within an organisation, it has been proven that this process can act as a catalyst for initiating transformational shifts, which in turn lead to operational and strategic change.

To that end, we at TORI Global are committed to managing our organisation in a way which is both socially and environmentally aware and responsible, while empowering our local communities, contributing to the betterment of our planet, and driving transformative, value-add, sustainable change for our clients.

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1. Introduction

Are we talking about data… again?

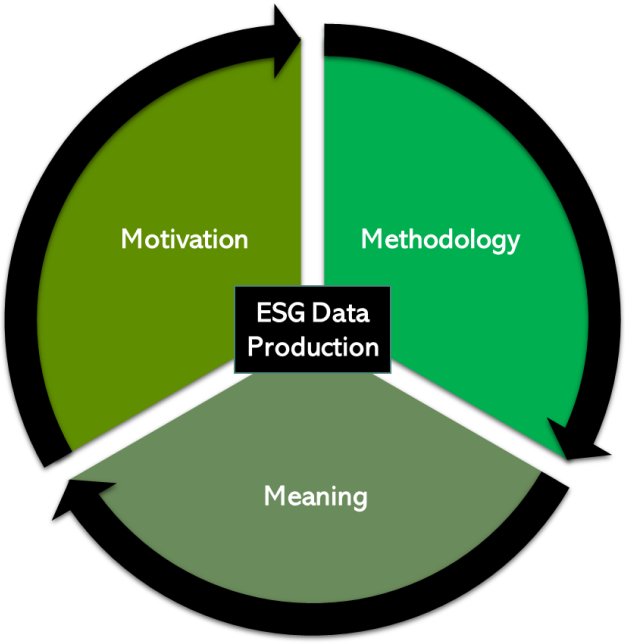
Environmental, Social, and Governance (ESG) related topics have gradually been coming to the forefront of the global business agenda since the early 2010s. However, over the last years, there has been a massive boost in interest pertaining to ESG considerations, with many organisations having ESG issues at the top of their risk register.

Companies, investors, and regulators are focusing more on ESG topics; and as it is usually the case, when numerous stakeholders show interest in an area, the need for data arises! However, whilst the use of ESG data is of increasing importance to internal and external stakeholders, according to the Financial Reporting Council (FRC), "the systems to produce, distribute, and consume ESG data are significantly less mature than those for financial information".

To that end, the FRC has published a report (dated August 2022) with the aim of outlining best-practice standards relating to the production of ESG data for both internal and external reporting purposes. In this report, we summarise the pertinent points of the FRC report and present a structured approach on how to best produce high-quality ESG data (and subsequently KPIs) to ensure your organisation remains sustainable and within the bounds of their ESG targets and/or commitments.

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2. ESG Data Production Best-Practice Methodology – The 3 Ms



Motivation

Exam Question – What is the overarching purpose for collecting ESG data and how does your company identify what is required?

Methodology

Exam Question – Is there a structured approach to ESG Data Collection?

Meaning

Exam Question – How will this data be used within your company and what impact will it have on decision-making?

A. Motivation

What is the overarching purpose for collecting ESG data and how does your company identify what is required?

This question aims to urge companies identify what type of data they need for internal and external purposes. The FRC has identified 3 main motivators for ESG data production. These are:

- Business and Strategy needs –
    - Operationally driven, e.g., energy consumption linked with overall business costs
    - Purpose driven, e.g., sustainability aligned to culture, values, credibility etc.
    - Commitment driven, e.g., meeting net-zero targets
- Investor and Stakeholder requests –
    - New investment strategies, including corporate stewardship, mean that there is more investor interest in ESG issues, resulting in a need to be able to showcase to the market any progress made within this space (you need to be seen to doing it!)
    - A wider stakeholder ecosystem, incorporating both existing and new customers, and suppliers, enables exposure to stakeholders who may themselves have preferences in interacting with ESG compliant organisations as part of their CSR strategies
- Regulatory and Framework requirements –

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- They can either be enacted mandatorily or voluntarily, to adhere to a particular regulation/ standard
- These can span far and wide, with the UK and EU being the leading jurisdictions for introducing climate risk and ESG mandatory reporting requirements

It is important to note that these drivers will vary in terms of importance and significance depending on company-specific characteristics (mission, vision, size, industry, legal jurisdiction(s) etc.). It is also important to note that these are not "clear-cut" categories, and there is bound to be some overlap between them. Other challenges can include nuance between different but similar requests for data, the sheer volume of data requests, and the pace of changes in legislation which impact what type/ selection of data is required to evidence attestation.

The important take-away from this is to ensure that there is a clear understanding across the business of why ESG data is being produced, as that helps to subsequently formulate the relevant KPIs and MI to assist and/or enhance the decision-making process of the company.

This process can also include the involvement of a wide range of internal and external stakeholders to identify the data required to best meet both the company's and stakeholders' requirements, thereby increasing collaboration, communication, and collective efforts across the organisation. Finally, the commencement of industry standardisation around ESG reporting means that there is opportunity to engage with industry peers through industry bodies or trade associations, which itself encourages efficiencies and fosters consistency.

According to the FCR Report, some pertinent questions for your Board include –

i. Does the organisation understand the benefits derived from ESG data?

ii. What ESG data is required to monitor and assess risks?

iii. What information do you already have? Is it suitable and robust?

iv. What framework(s) do your stakeholders use to assess and compare companies?

v. How can your organisation assess the views of your stakeholders and integrate them into necessary data collection for decision-making?



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B. Methodology

Is there a structured approach to ESG Data Collection?

This essentially refers to:

1. Who is involved in the data collection activity, i.e., role definition e.g.,: producers, owners, coordinators, and reporters
2. How is the data sourced, i.e., internal, or external data
3. What systems are used, i.e., manual, or automated process – processing data using master spreadsheets, Business Intelligence (BI) platforms, Specialised ESG platforms, ERP system etc.
4. Which method is employed to validate the data, i.e., variance analysis, internal audit, external assurance etc.



There are challenges to be addressed within this area, too. Firstly, when requesting external data from say third party suppliers, it can sometimes be the case that there are difficulties in obtaining it, especially when many relatively smaller suppliers are involved in the process. Secondly, human error associated with the manual collection and input of data onto your platforms is an additional risk to consider. Finally, with different regulations applying to different jurisdictions, which may also be operating under different data systems and technology infrastructure, it becomes inevitable that a centralised, group-wide approach for ESG data collection is harder to achieve (this is particularly true for multinational corporations).

The FCR report points out that "*Where companies are considering this data* [i.e., ESG data] *to be core to strategic management, and the sustainability team has joined up with other teams including finance, they have been more advanced in applying controls over the data. The added rigour is also enabling […] using this data more frequently, akin to financial data*". This signifies that having a clear methodology behind collecting ESG data can add operational value to your organisation, over and above advances within the ESG space. The process of identifying and allocating the different roles and responsibilities for the production process, encourages cross-functional cooperation across the organisation and can help instil a working culture that breaks away from siloed thinking. Additionally, if this is executed holistically, then the company would have undertaken a comprehensive data mapping exercise of internal and external data sources, identifying data maturity, reliability, validity, and gaps across multiple areas as a result.

According to the FCR Report, some pertinent questions for your Board include –

i. Who collects the information and is that the appropriate team? Is the information collected top-down or bottom-up?

ii. What processes and controls are in place to collect and manage ESG data?

iii. Does your organisation have the right systems and tools for analysis and reporting ESG data? If not, what is the process for identifying how systems and controls need to be introduced or strengthened?

iv. What is the process in place to periodically review the quality and accuracy of data?

v. Is there a consistent level of data maturity and systems across the group?

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C. Meaning

How will this data be used within your company and what impact will it have on decision-making?

Data is just random numbers / points, unless meaning is attached to it. 'Meaning' explores how the C-suite and/or executives can utilise ESG data for decision making, oversight, forecasting, and risk management.

ESG data can be useful from a reputational point of view (i.e., strengthening the brand name), as it is the case that the market is becoming more and more conscious and concerned with matters of sustainability, equality, and equity. Concurrently, ESG data is used because organisations with sustainability embedded in the core of their operations, are looking for other companies that have a compatible ethos, evidenced through quantitative metrics and KPIs.

Numerous companies, and in particular those with publicised environmental and social commitments, utilise ESG data from both an operational and a sustainability point of view. This means that ESG data can be analysed during cost-cutting initiatives (e.g., energy consumption) in addition to implications pertaining to environmental impact. It is indeed the case that companies with sustainability as a core pillar of their business strategy have developed a set of KPIs which are frequently reviewed to ensure that they are on track to achieve their sustainability objectives. These same KPIs can also help shape and direct, albeit to an extent, their overall business strategy and operating models. These companies are also pioneering the introduction of ESG metrics in renumeration decisions, creating initiatives to boost interest, accountability, and action (usually a top-down approach).

Furthermore, ESG data can also be used to influence capital allocation and procurement choices. There is a progressively frequent trend that during merger and acquisition activities, some companies will review and scrutinise the acquiree's ESG performance. This is also true on the operational expenditure side, as companies are factoring ESG credentials into the choice of their preferred supplier(s).

As one would expect, ESG data also plays a vital role during scenario analysis and risk modelling. However, the majority of ESG measures tend to be backward-looking (historical data) rather than forward looking (preventive) with the aim of shaping future business strategy (e.g., diversity metrics). Moreover, other indicators tend to have little, relevant historical data associated with them, and the trends tend to be non-linear in nature (e.g., climate-change related metrics). On a positive note, many contemporary organisations are now developing leading indicators (and relying less and less on lagging ones), with the aim of using those in order to adopt a more proactive stance to risk manifestation relating to ESG issues.

According to the FCR Report, some pertinent questions for your Board include –

i. How can your organisation establish a data-centric decision culture?

ii. How is ESG data being embedded into the organisation?

iii. Does your organisation have a balance of lagging and leading data sets that help monitor performance on both operational strategic needs?

iv. How does your organisation build a continuous improvement culture on ESG?

v. How does your organisation monitor developments and changes across the market?

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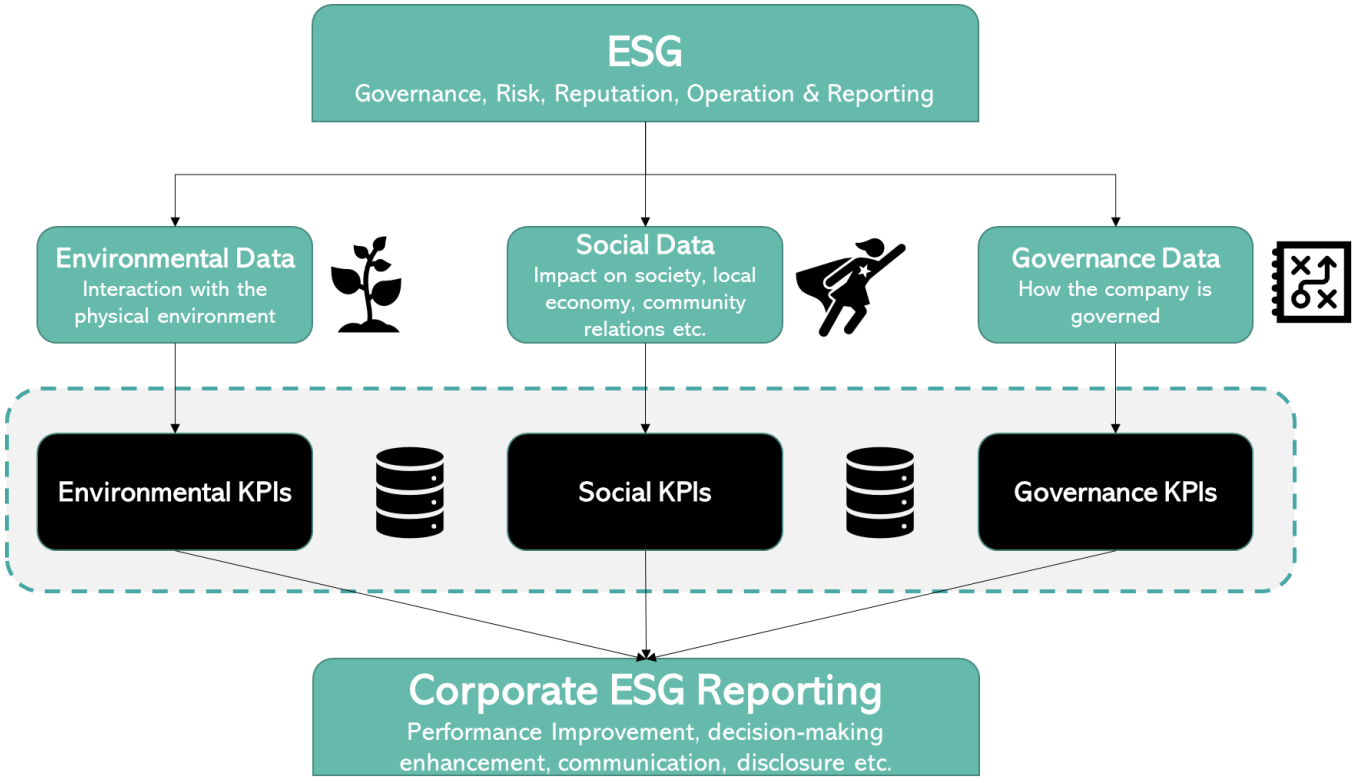
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3. Utilising ESG data to formulate ESG KPIs

"You cannot improve what you cannot measure!"

The ESG agenda is interdisciplinary. Pertinent themes relate to macroeconomic, environmental, and cultural issues that could affect a company's operational, financial, and sustainability performance, as well as their risk profiles, brand value, and corporate accountability.

To that end, organisations need clear, relevant, material, and trackable KPIs to establish or improve their performance as it relates to ESG considerations. In other words, ESG implementation needs to have quantitative elements underpinned by a data-driven approach.



A six-step approach to design and measure ESG KPIs is depicted below –



ESG KPI creation, measurement and reporting are an integral part of the "contemporary" business, providing transparency, openness and clarity to shareholders, stakeholders and potential customers and investors. Through a thorough selection of KPIs, business can gain invaluable understanding on areas where there are untapped opportunities, areas where remediation actions are required, and areas where initiatives need to be eliminated altogether.

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Different ESG KPIs are better suited for different organisational types. The set of chosen ESG KPIs should take into consideration and reflect, inter alia, on the following:

- Business and Operating Model
- Medium- and Long-term Business Strategy
- Value and Supply Chain
- Revenue Contributors
- Corporate Brand
- Corporate Values and Ethos
- Customer Preferences
- Local / Regional Characteristics
- Industry Standards
- Growth / Improvement Opportunities
- Regulatory Agenda

Examples of some frequently used KPIs include –

Environmental KPIs	Societal KPIs	Governance KPIs
1. Energy usage / location	1. Employee diversity (age, gender, sexuality, race, ethnicity etc.)	1. Operational and financial performance
2. Energy intensity & efficiency	2. Management / Board diversity	2. Executive compensation levels
3. Excepted energy saved to actual usage ratio (ISO50001 Standard)	3. Consumer responsiveness (to product or service)	3. CEO pay ratios (ideally linked to the company's ESG performance)
4. % of energy from renewables	4. Employee training	4. ESG compliance incidents, penalties, and remediation
5. Water usage / location	5. Pay equality	5. Cybersecurity incidents, risk management and remediation
6. Waste management (operational waste, consumer waste etc.)	6. Average and liveable wage comparisons	6. Risk exposure associated to ESG
7. Unit intensity economics (per location, per product, per service etc.)	7. Rate of employment (turnover rate)	7. Protected Ethics and Reporting (disclosure and tracing of ethics programs)
8. Supplier sustainability	8. Economic development and external contribution (on local, regional, and government economies)	8. Anti-corruption (e.g., % of senior management with anti-corruption training, total number of corruption incidents etc.)



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4. Conclusion

To sum up the key points of this report –

a. Similar to every other area of business, data plays a crucial and vital role in the success of your ESG journey. It helps to provide a snapshot of the 'As-Is' state of your organisation, while at the same time enhancing, enriching, and informing the decision-making process in order to achieve the desired 'To-Be' state.

b. However, the maturity of the processes underpinning ESG data collection, production, reporting, and communication are significantly less matured when compared to those for financial data.

c. Data collection, production, and communication is not a simple process. It requires clear allocation of roles and responsibilities, continuous measurement, reporting, communication, and quality assurance to guarantee a truthful representation of the 'on-the-ground' reality. According to the FCR, this can be achieved by ensuring that –
    i. There is clear motivation behind ESG data collection;
    ii. There is a comprehensive, structured methodology; and
    iii. Relevant meaning is applied.

d. ESG raw data can subsequently be formulated into a set of KPIs to track progress over time. Companies should choose from a wide range of KPIs across all three elements constituting ESG (Environmental KPIs, Societal KPIs, and Governance KPIs) depending on, inter alia, their –
    i. Intrinsic business characteristics;
    ii. Operating models;
    iii. Regional economics and demographics;
    iv. Industry standards; and
    v. Corporate values.

All in all, the use of ESG data is still an evolving practice. However, most companies expect that its usage will increase in both volume and frequency over the next few years. To that end, it is important for businesses to consider instituting training programmes pertaining to ESG matters, and explore potential investment in tools required to incorporate ESG data within organisational reporting to enhance their overall decision-making capabilities.



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Meet the TORI ESG TEAM –



Costas Liassides
Joint-CEO

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Nicholas Christou
Head of ESG Practice / Financial Services Consultant

j 7!, 55!)1*8985: 87426

Bj ^fi7Ojdi prbt/Di sjt upv Aupsjhnpcbr/dpn



Vicky Stavrinides
ESG Practice Lead / Financial Services Consultant

j 7!, 55!)1*85: 15: 7694

Bj ^fi7Wkdl z/Tubwsjojef t Aupsjhnpcbr/dpn



Aliza Ayaz
ESG Junior Consultant

j 7!, 55!)1*8616559746

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https://w/ww.toriglobal.com

London - 125 Old Broad Street | EC2N 1AR | United Kingdom

New York - 14 Wall Street | New York, NY 10005 | United States

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