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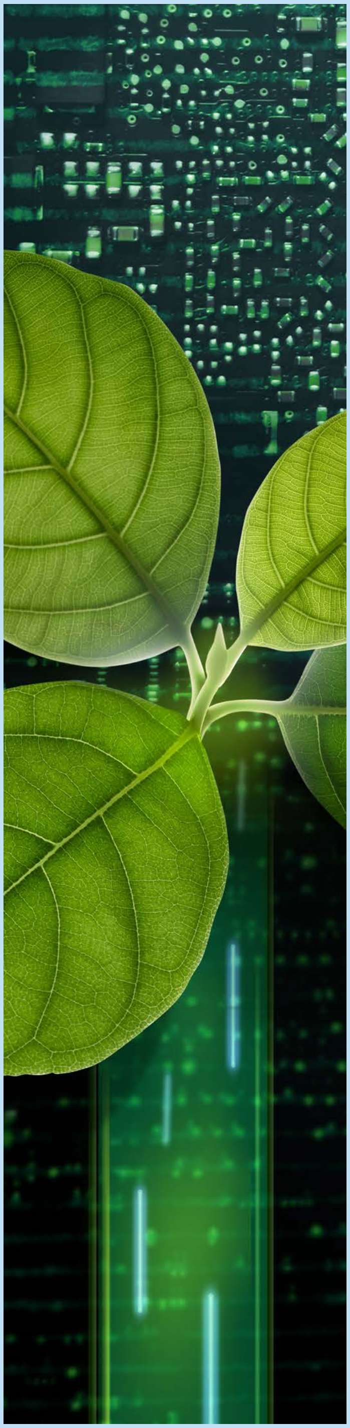

ESG: THE NEW LENS FOR BUSINESS DECISION-MAKING

Abstract

Environmental, Social, and Governance (ESG) reporting is undergoing a profound transformation. It is becoming more organised, and businesses face stricter regulations. This transformation demands innovation in data collection, reporting, and substantiating information, as this data will need rigorous auditing. To navigate this transition successfully, both a comprehensive redesign of affected processes and the integration of crucial technological advancements become indispensable prerequisites. This paper provides a comprehensive overview of the evolution of ESG reporting and its impact on businesses.

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Introduction

ESG stands for environmental, social and governance. Although policymakers, companies and investors have a long history of considering these factors in their decisions, the development in the sustainability area accelerated in recent years.

To give a brief background, back in 1987, the Brundtland Commission of the United Nations defined sustainable development as a "development that meets the need of the present without compromising the ability of future generations to meet their own needs". The next milestone was at the Earth Summit in Rio de Janeiro in 1992, where countries agreed on Agenda 21 calling for new strategies to achieve sustainable development in the 21st century. Together with political concepts and the rise in green consumerism, sustainability made its way to the corporate world in the early nineties with the development of concepts such as the triple bottom line, referring to the financial, environmental, and social factors to be included in the determination of a company's value. The United Nations advocated for the Sustainable Development Goals (SDGs) formulated in 2015, further supporting the development of ESG reporting.

Turning these environmental concepts into actions required translating them into measurable indicators such as greenhouse gas emissions, water usage, etc. To organise this data, guidelines and reporting frameworks were developed. Europe is at the forefront, leading the charge with the Non-Financial Reporting Directive (NFRD) (European Commission, 2014) requiring selected large companies to report their ESG performance in the form of a non-financial statement. The Corporate Sustainability Reporting Directive (CSRD) (Official Journal of the European Union, 2022) broadened the number of companies required to report and imposed limited assurance of disclosed data. In July 2023, the European Commission adopted the European Sustainability Reporting Standards (ESRS) (Directorate-General for Financial Stability, Financial Services and Capital Markets Union, 2023) to ensure transparency and consistent ESG reporting. Other countries and regions are following suit with their own ESG reporting regulations.

The 3-dimensional ESG reporting

The ESG reporting has three main overarching pillars - environmental, social, and governance – which encompasses a wide range of subtopics, including greenhouse gas emissions, human rights, and employee relations, to name a few. Companies must have a robust system in place to collect and disclose relevant data, set goals, and share progress and information with stakeholders.

ESG reporting is not only part of corporate-level financial reporting, but organisations are required to report on ESG subtopics at various other levels.

The first level consists of different reporting provided on the entity level based on country regulations, which depending on the company's legal structure is aggregated on the country or regional level.

Examples of country or region-specific ESG reporting include reporting related to the Waste Electrical and Electronical Equipment Directive (WEEE), battery tax, the plastic tax being rolled out by EU countries such as Italy or Spain, or the contribution to the state fund for rehabilitation of disabled people in Poland.

The country and regional reporting should be in line with figures reported at the entity and/or consolidated level. Furthermore, it is important to note that in certain regions, there might be regulations stating that a subsidiary must provide consolidated ESG reporting, even if the holding company is not obligated to do so.

The ESG reporting at the consolidated level aggregates figures from all below levels. At present, ESG reporting at the consolidated level is increasingly becoming regulated with new standards and frameworks issued by the Security and Exchange Commission (SEC) Climate Disclosure Rules in the USA and the European Sustainability Reporting Standards (ESRS) in the EU.

A crucial factor for companies is that, regardless of the reporting framework they follow, they all mandate independent assurance of the data. This means that the information needs to be substantiated across all levels, ensuring complete and reliable information is presented.

How ESG is changing the way businesses operate

As of 2023, nearly thirty countries and territories require companies to disclose different elements of ESG information along with their financial statements. So far, the ESG reporting practices among companies have exhibited a spectrum of approaches depending on their industry, size and commitment to sustainability and transparency. Some engage in comprehensive voluntary reporting, while others adhere to limited reporting requirements mandated by regulators or in response to investor demands. Some companies treat their ESG reporting exclusively in compliance with country-specific regulations. With the upcoming standardisation of ESG reporting, more companies are recognising the need to incorporate sustainability into their core business, while maintaining all data points and ensuring auditability of the disclosed values.

As with any change, the development of ESG reporting has a broad impact on the company at large, particularly on:

- **Strategic planning and decision-making:** ESG reporting requires companies to assess their influence on the environment and the public and incorporate it into their strategic planning.
- **Risk management:** Companies must proactively address climate and social risks and minimise the impact in these areas through their business activities.
- **Stakeholder engagement:** ESG promotes greater transparency and accountability to a broad range of stakeholders. For example, investors take into consideration ESG reporting while making investment decisions, as under the EU Sustainable Finance Disclosure Regulation (SFDR), investors are obliged to perform ESG reporting for their investments and/ or when making investment decisions.
- **Operational changes:** ESG reporting requires implementing energy-efficient practices and adapting processes to meet more rigorous compliance standards. This often requires extending ESG reporting beyond the company to include suppliers and even suppliers of suppliers, which can require companies to redesign affected processes and adopt new technologies.

A more regulated ESG reporting at the company level will require organisations to assess what is already reported and what would need to be developed further. Moreover, companies should evaluate data governance, oversee new data points (e.g., internal audit reviews) and finally build capacity in their respective teams to perform additional work to strengthen their ESG capability.

The role of BPM providers in ESG reporting

The BPM industry is perfectly positioned to help companies implement ESG reporting by the new standards. BPM companies can assist in the following areas:

- **ESG implementation project:** The implementation project requires a cross-domain approach, including process redesign and technology intervention. The BPM providers are well suited to support companies due to their diverse experience across processes and industries. Additionally, BPM providers can deliver cross-domain automation solutions, making the project more effective.
- **Master data management:** Proper master data is essential for accurate ESG reporting. Therefore, any ESG implementation project should prioritise setting up proper data structures within existing material, product, vendor, or customer master data. BPM experts can provide support in all these areas and ensure that the changes are sustainable.
- **Sourcing and procurement:** Improved procurement can support achieving ESG goals, reduce costs imposed by regulations like plastic tax, and gain a competitive edge. BPM providers can work across countries and jurisdictions to support all aspects of sourcing and procurement.
- **Finance and accounting:** Proper financial data is required for correct reporting at all levels of the reporting pyramid presented earlier. BPM providers can not only help in the first time establishing ESG reporting, but once it is established, it becomes a transactional activity that BPM providers can perform regularly.

The changing landscape of ESG reporting, driven by increasing stakeholder engagement, evolving regulations, and the acknowledged significance of ESG in business operations, presents a set of challenges for companies to navigate. The Business Process Management industry can play a crucial role in offering invaluable support to organisations in surmounting these challenges through its wealth of expertise, innovative technology, scalability, and cost-effective solutions.

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