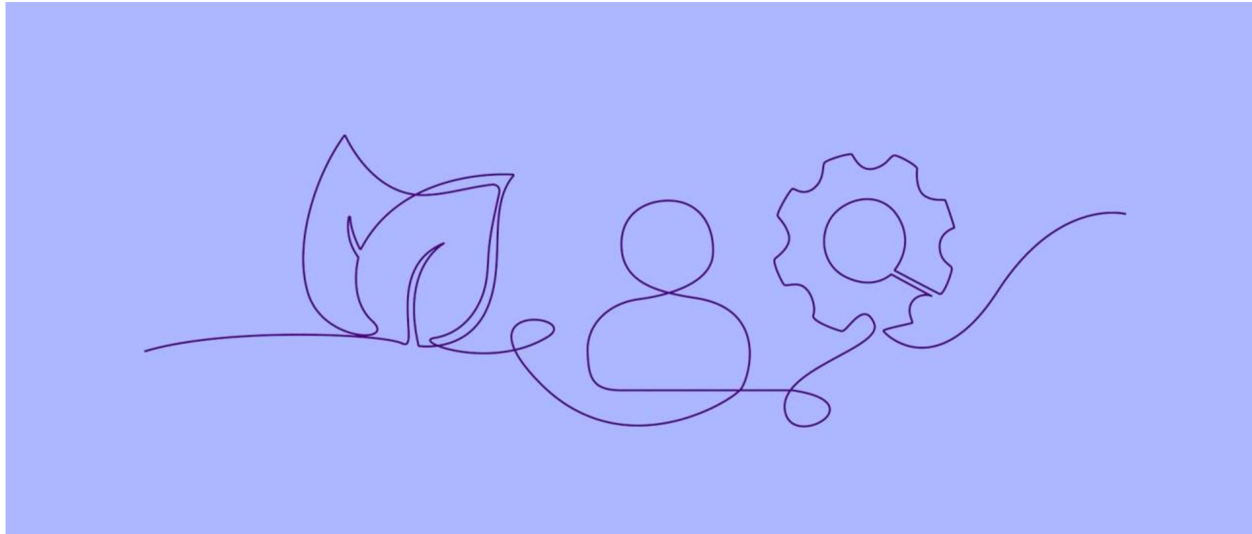
Beyond ESG: Why We Need A Novel Approach



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Standardised sustainability metrics will drive real progress.

Sustainability is no longer just a buzzword – it has become critical for life on our planet. It will also be a key actor in shaping corporate strategy and success. The shift towards sustainability has been increasingly embraced, and the common way companies do this is through the ESG (environmental, social and governance) framework.

But even though corporate impact on the environment and society is huge, the ESG methodology is increasingly being questioned – particularly in the United States – for its effectiveness and accuracy in measuring a corporation's true impact on sustainability.

To address these concerns, it's essential to replace ESG ratings with actionable metrics that drive long-term success in our quest towards sustainability. Greater understanding of the economic trade-offs being made is urgently needed to filter out the noise. This will also allow us to obtain greater clarity and awareness of the costs that economic performance imposes on the quality and sustainability of human life on the planet.

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The rise and flaws of ESG

ESG has grown rapidly over the last two decades. It has served as an **innovative tool** for investors and longer-term asset managers to assess risks – and also opportunities – beyond traditional financial metrics. ESG was created to help companies manage their environmental, social and governance vulnerabilities. Over time, it became equated with sustainability.

However, the assumption that the three elements can be evaluated using a single compound rating system is flawed. This is simply not feasible, and persisting to do so only generates confusion. A single-rating ESG measurement underplays the fact that the three components are each systemic, very different and interdependent.

One core challenge is the fact that “G” (governance) concerns a corporation’s supervisory process, while “E” (environmental) and “S” (social) focus on corporate impact. Ratings of one or several of the ESG components are invariably biased or partial, leading companies that follow them on a path of possible value destruction. Building sustainability on a flawed concept, or on flawed measurement, is simply not sustainable.

The “G” in ESG is not impact, it’s process

Governance plays a different role than environmental or social metrics. It is fundamentally about processes and accountability. A well-governed company makes certain that its shareholders, board of directors and executives align – along with as many stakeholders as possible.

The governance framework should ensure that decision-making balances the diverse interests of stakeholders while staying aligned with the company’s core purpose, which should guide all actions. The best boards promote transparency around that purpose and how it’s pursued, ensure that executives act in the company's best interest, and set policies that drive long-term value creation, not just short-term profits.

The importance of standardisation and transparency

A lack of clarity and standardisation in current ESG measurements only exacerbates these issues. What is needed – and what companies and investors are calling for – is a set of easy-to-understand metrics that can be applied uniformly across the board. This would make it easier to measure progress in sustainability and separate the companies making real impact

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from ESG-washers.

The “triple bottom line” (TBL) from 1998, attributed to John Elkington, is conceptually cleaner and intellectually more satisfactory. It proposes an “ESE”-type accounting, the second “E” referring to economic impact in replacement of “G”, which is too different in nature from “E”, “S” and economic measurement.

Elkington intended the TBL lens for spotlighting the responsibility of corporations to contribute to greater sustainability, and to the regeneration of our governance systems. Not seeing this happen led Elkington to issue his **product recall** in 2018. However, we argue in our **new paper** that greater standardisation was the crucial missing piece from Elkington’s TBL proposal.

Using clear and transparent impact measures for the TBL approach provides a uniform system to assess and compare corporate sustainability efforts. This is vital to producing credible cumulative scores and benchmarks across companies and sectors, offering a much clearer picture of how we are doing in tackling sustainability and the climate emergency.

The need for impact-focused metrics

The environmental and social dimensions of ESG are where impact measurement becomes crucial. For too long, companies have relied on indirect proxy measures, such as board diversity or process certifications, which do not necessarily reflect the real outcomes of their sustainability efforts. Although diversity or supplier policies are important, they do not equate to reducing a company’s carbon footprint or ensuring fair labour practices in the supply chain.

What we need are standardised, transparent measures of corporate impact in three key areas. We believe these indicators, while not perfect, will significantly account for these impacts. A major step forward in addressing climate change would be made if the negative impacts of economic activity would largely disappear. The following proxy measures would enable this aim:

1. Greenhouse gas (GHG) emissions: With climate change intensifying, a company’s contribution to global warming is a critical metric. Increasingly, organisations are reporting their GHG emissions across three scopes: direct emissions (Scope 1), emissions from purchased energy (Scope 2) and

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emissions from their value chain (Scope 3). As the cost of carbon rises globally, reducing emissions will not just be a sustainable move – it will become an economic imperative.

2. Living wage: Social impact can be measured through a company's commitment to providing **a living wage** across its value chain. This would allow employees to meet their basic needs and maintain a decent standard of living. Standardising living wage metrics provide a tangible and comparable way to assess how well a company provides for the workers in its value network. Companies that promote living wages benefit from improved employee productivity and loyalty, while reducing risks associated with social unrest and labour shortages.

3. Biodiversity: Environmental and social measures must be complemented by a third crucial metric: biodiversity. Biodiversity loss is intricately linked with the climate crisis. As species disappear and ecosystems degrade, the risk to human survival increases. Although biodiversity measurement is less developed than measuring GHG emissions or living wages, it is a critical metric for companies aiming to minimise their negative impact on the planet. There is more work to do to create standardised ways to measure corporate impacts on biodiversity, but **progress is being made** and this measurement should gain widespread recognition.

Why corporations should care

Corporations may wonder why they should adopt this new framework. After all, isn't managing short-term economic performance difficult enough? In reality, measuring and improving sustainability is not at odds with financial success. Companies that invest in reducing their environmental and social impact will benefit from:

1. Risk mitigation: By addressing climate-related risks and ensuring fair treatment of workers, companies can avoid costly lawsuits, regulatory fines and reputational damage.

2. Investor confidence: As institutional investors increasingly prioritise sustainability, companies with strong, transparent impact metrics will attract more capital and reduce their cost of financing.

3. Long-term value creation: Sustainability is no longer a "nice-to-have". It is increasingly a competitive advantage. Companies that successfully

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integrate sustainability into their business models are better positioned to thrive in the low-carbon economy of the future.

Additionally, measuring sustainability impact using standardised, transparent metrics makes it easier to align corporate incentive structures with long-term goals. Executives can be rewarded for real progress in sustainability rather than be incentivised based on ESG ratings that don't reflect **true impact**.

A novel approach to sustainability governance

The proposed framework should change how boards govern corporations. By committing to clear sustainability goals, companies benefit from enhanced governance practices. Rather than relying on external ESG raters with insufficient insight into internal governance, it is more transparent to judge boards' performance using common measurable environmental, social and economic impact data. If the data is good, one can only conclude that their governance performance is good.

Standardised sustainability metrics will enable stakeholders – shareholders, employees, governments and customers – to track a company's progress in meaningful ways. Fairer comparisons across sectors will also be possible. This transparency will push companies towards continuous economic and sustainability improvement.

The path forward for corporations

The sustainability landscape is rapidly evolving. Companies that fail to accept environmental and social targets risk being left behind. Current ESG practices, while well-intentioned, are insufficient to promote the change needed. By embracing the shift to impact metrics in the areas of GHG emissions, living wages and biodiversity, leaders will ensure everyone – including their shareholders and stakeholders – knows where they and their firms stand.

Here is a six-step implementation process that leaders can adopt:

1. Establish baseline data for GHG emissions, living wages and biodiversity, supported by stakeholder assessments and targets decided on **by the board**.

2. Define long-term corporate ambitions for these areas, balancing short- and long-term economic performance.

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3. Set short-term sustainability targets that align with medium- and longer-term goals. Create a road map to achieve these goals.

4. Analyse risks associated with reaching longer-term goals, evaluate fallback options and commit to mitigating actions.

5. Publish environmental and social corporate plans alongside economic plans, ensuring transparency.

6. Ensure accountability by holding independent audits of results. Stakeholders can evaluate a company's performance annually and raise red flags if it falls short of targets.

Moving beyond ESG and adopting a clear measurement system that enhances the TBL concept offers an holistic and effective way to balance economic performance with social and environmental responsibility. By committing to standardised and transparent impact metrics, corporations can focus on real-world impact and drive meaningful change. This will allow them to secure long-term success in an increasingly unsustainable world.

Find article at

https://knowledge.insead.edu/responsibility/beyond-esg-why-we-need-novel-approach

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About the research

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"**The Need for Impact Transparency and Standardization in Sustainability Measurement**" is published as an INSEAD Working Paper.

About the series

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