The ESG Code: The “Open Sesame” for Dummies

by Davide Colombo

Have you ever been intrigued by mysteries? I have been for many years, from the very beginning. I’d liked to explore every place; every door was an explicit challenge for me. I had to open it and look inside. These are my memories from the time I was not so good with books. Then I started reading, and the world changed. Now the doors were the books’ covers, and the keys were the words. In my juvenile years, I remember an old tale. It makes me smile because it is about a door and a hideout. In this ancient time, there was a desert and some palm trees around a dry and scorched limb of sand and rocks. The night was quiet, and the inhabitants of the desert were about to start their routines. The scarabs were returning to their nest, and the snakes started to hide under the sand to collect some of the heath, just in time for not being caught disarmed by the cold night. The mice start to run like maniacs in search of something to eat, trying to avoid being eaten by foxes and feral cats. There was one inhabitant who was not searching for food or looking for sleep; he was satisfied with laying down beside the short bushes. He responded with the name Ali Baba and has been sent by his wife to collect some firewood, but he preferred to sit and lay there to calm his nerves and take some rest, when he happened to overhear a group of 40 thieves visiting their stored treasure. “*For sure, they must be thieves to galop overnight in the open desert”*, he thought. He was poor but smart, and he sniffed the opportunity to know the precise place where the treasure had been hidden. “Their treasure is in a cave, the mouth of which is sealed by a huge rock. It opens on the magic words *Open Sesame* and seals itself on the words *Close Sesame*”, he said to himself after spying on the thieves from behind the vegetation. When the thieves were gone, Ali Baba entered the cave himself and took a single bag of gold coins home. This is one of my favorite episodes from old tales from the book “One thousand and one nights”. Imagine myself as a boy going from door to door and screaming “Open Sesame!”. In a short time, I understood the most important morale of this story: knowing the right word may open the right doors. This is true for the job, for human relations, and for the economy. Our society has been built on words and language, but with time, the language changes to align with needs and human nature. The speed with which society is forging new terms helps us take a step forward with this change. So “I’m fine” becomes “I’m ok," and the old uncle Sam becomes the “boomer” Sam, and you must speak *the language* to understand the situation you are in. Speaking of changes, the world of environmental, social, and governance (ESG) investing is a labyrinth of acronyms. From SDG to SASB, these intricate combinations of letters can leave even the most brilliant student feeling disoriented. However, navigating this sea of terms and words is essential for understanding the intricate panorama of Sustainability. Like smart Ali we must be open to this new puzzle and be focused. For example, why don’t we start with the wider general term of ESG? ESG itself stands for environmental, social, and governance factors. Environmental factors consider a company's impact on the planet, including its carbon footprint, pollution levels, and sustainability commitment. Social factors assess a company's relationship with its stakeholders, such employees, but in general the whole society. Finally, governance factors analyze how a company is run, focusing on its leadership structure, and response to environmental situations. Beyond this initial term, a forest of acronyms delves deeper into specific ESG aspects, like SDGs, GRI, PRI, II, GHG. Directly under the ESG I’s like to introduce you the SDGs. The Sustainable Development Goals (SDGs), a set of 17 global goals established by the United Nations, provides a framework for measuring progress towards a sustainable future. Readers might also encounter acronyms like GRI (Global Reporting Initiative), a prominent sustainability reporting standard, and PRI (Principles for Responsible Investment), a set of guidelines for incorporating ESG factors into investment decisions. Understanding these acronyms is crucial, but it's not enough. Good analysts need to delve deeper under the matter beneath each abbreviation. For instance, there's a difference between ESG integration, which involves considering ESG factors alongside traditional financial analysis, and II (Impact Investing), which is more focused on investments that generate positive social and environmental outcomes.

The initial steps into ESG world highlight the need for foundational knowledge which every curious reader must possess to navigate the field. But true understanding lies in appreciating the shades these acronyms represent. Someone can master these new skills by moving forward the comprehension of three different aspects:

* Metrics: Acronyms like GHG (Greenhouse Gas Emissions) or WEEE (Waste Electrical and Electronic Equipment) represent specific, measurable information used to assess a company's environmental footprint. These metrics, often reported in a company's CSR (Corporate Social Responsibility) report, provide an important pow about a business impact on society.
* Frameworks: On the other hand, acronyms like SASB (Sustainability Accounting Standards Board) or TCFD (Task Force on Climate-Related Financial Disclosures) establish standardized techniques for companies to report on ESG factors. These frameworks go beyond basic needs, requiring companies to show their approach to managing ESG risks and opportunities. Understanding the framework being used gives a crucial vision to understand the reported data, and in the end the result on the environment.

Acronyms are used for describing legal entities like the ESG Rating Agencies. MSCI ESG or ISS ESG represent companies that analyze and score companies on their ESG performance. These ratings provide a relative comparison of a company's ESG performance within its industry. However, a good reader will soon understand that different rating agencies use different acronyms, so a high rating from one agency might not translate directly to another.

Remember: Acronyms are just starting points. The first step is to understand the concepts behind the acronyms and how they interrelate, and then gain a richer understanding of a company's ESG commitment. For example, look for evidence-based reporting that goes beyond simply listing metrics, and analyze how a company integrates ESG factors into its strategy and how it manages related risks. This can easily show us the importance of learning this way to communicate. So, how can you navigate this sea of acronyms? Here are some practical tips:

* Start from the ground: Familiarize yourself with the core ESG factors and the most common acronyms associated with them. Resources like the Global Sustainable Investment Alliance's (GSIA) website of SDG official website offer valuable glossaries.
* Understand the wider scenario: don't assume you know an acronym's meaning based on the letters alone. The context in which the acronym is used will often provide clues to its definition.
* Don’t be too shy to ask for explanations: Don't be afraid to ask questions. Investment professionals, research reports, and industry publications should all be able to provide definitions for unfamiliar awkward words.
* Stay focused and ready to learn: the ESG landscape is constantly evolving, with new acronyms emerging all the time. Regularly remember to refresh your basis knowledge about the previous three points.

By mastering the language of ESG acronyms, you can unlock a deeper understanding of this complex yet critical environment. Remember, informed decisions are key to navigating the ever-changing world of ESG investing. There is no “Open Sesame” this time, but consistency in study and curiosity in mastering the knowledge, but this will be worth more than a bag of gold!