Paying the Piper: A Review of ESG Scandals

"In technically complex, multidisciplinary industries like the mining industry it is impossible for ESG risk to be adequately understood unless ESG is fully embedded and integrated into decision-making processes through the inclusion of technical professionals who have an intrinsic understanding of the operations and its associated impacts. " Joshua Kilani, Managing Director, Xpotential Mining Services

How to generate profits in a socially responsible way is a critical, emerging issue, in the Management Sciences owing to the rise of stakeholder capitalism as an economic ideology. The principles of ESG are the natural manifestations, within a modern setting, of this new economic ideology dominated by disruptive technologies, social fragilities, environmental jeopardy and geopolitical uncertainty. Now, more than ever, the stewardship of an organization's intangible assets carries massive financial implications.
This reality has led to the rising importance and mainstreaming of ESG in investment decisions as investors fear being stranded with assets not suited in a low-carbon, stakeholder capitalist economy.

However, considering that complexity of ESG, and still in its infancy, with a broad range of scope in its reporting frameworks and virtually unregulated, investors will remain at risk of ESG scandals within their portfolio until the ecosystem develops, converges and consolidates.
We are well aware of the large historical scandals that could also be retrospectively attributed to ESG failures such as Bre-X, Enron and Exxon Valdez. However, there is no shortage of contemporary examples, such as the recent exposure of a toxic corporate culture at Rio Tinto, oil spills by BP, Chevron and Royal Dutch Shell in the Gulf of Mexico, Rio de Janeiro and Nigeria respectively. Volkswagen's recent "diesel gate" scandal, falsification of product safety data by Kobe Steel, the environmental catastrophe at the Fukushima Nuclear Power Plant, EOH's public sector corruption scandal, and the violent labour disputes at Lonmin which culminated in the Marikana massacre to name a few.

Even companies operating at the forefront of the green economy are at risk of scandals, this was evidenced when the S&P 500 dropped Tesla from its ESG 500 index - an action with massive repercussions considering the numerous S&P linked passive index funds. This was due to racial discrimination claims and ongoing investigations by the National Highway Traffic Safety Administration.

These scandals, and the consequent reputational damage, highlight the fact that when it comes to ESG no organization is above paying the piper his dues.
So how do stakeholders, particularly investors, mitigate the risk posed by scandals within their portfolio?
ESG investing has been a source of positive growth for the asset management industry in recent years, with total worldwide assets within sustainable funds reaching US$ 3.9 trillion in 2021. Holding green assets allows asset managers to tap into this growing pool of investors, but also puts immense pressure on them to validate such portfolios. To do this they usually rely on a mixture of 3rd party ratings, their own research and inevitably the reliability and transparency of ESG reporting. Unfortunately, the nascent ESG industry has seen the repurposing of public relations and marketing departments for the provision of ESG services resulting in vague reports with heavy rhetoric, disingenuous promises, lack of sharp clarity, inconsistencies and omissions.

ESG portfolios therefore need to ensure they invest in companies or funds that are part of the solution, not just those that have an ESG report or policy. Specialized ratings agencies are developing ever more sophisticated tools to uncover real materialities or else at least to discard companies with poorly executed ESG disclosures. From a legislative perspective, the sharp growth of ESG funds have not yet allowed regulators to establish sufficient frameworks, however there are calls for legally binding definitions around sustainability, which could potentially have huge ramifications for the reporting market.

In technically complex, multidisciplinary industries like the mining industry it is impossible for ESG risk to be adequately understood unless ESG is fully embedded and integrated into decision-making processes through the inclusion of technical professionals who have an intrinsic understanding of the operations and its associated impacts.
The stakeholder economy requires factual and quantifiable information to determine materialities which provides a perfect opportunity for the sciences to take a leading role.

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SOURCES:

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