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A sustainable ESG strategy to avoid unsustainable consequences

Financial markets do love heterogeneity. Corporate Governance last decade's debate has been centred on the idea of cultural and gender diversity. Modern finance theory itself is grounded on the principle of diversification: Markowitz's portfolio selection framework is based on the research of uncorrelated assets.

In order to valorise heterogeneity (of contents), however, we need homogeneity (of forms).

A single shared language must be spoken within a boardroom; agreed measures of risk/returns must drive every portfolio selection.

The same holds for corporate information: specificity of context must be conveyed through standardized and comparable languages. This is particularly true with regards to the emerging wave of ESG information.

The biggest challenge for our generation, with Covid-19, is climate change and, attached to this, the related social inequality and human rights violations. We decided to tackle these issues requiring companies to be to be sustainable in order to receive funding. This is a **strategy** that puts a heavy responsibility on us. EU has a very strong commitment and our job is to enforce EU ESG regulations but also to put in place, in my view, a surveillance on any unintended side effect that has to be reported back to EU to fine tune the framework.

Much more is needed. **Transparency** and **standardization** must be the core of our strategy, i.e. data. Data published **by** companies, and lately, as remarked by ESMA, ratings published **on** companies. Beneath this needs there is also the need of **consistency** and **comparability** in sustainability reporting drawn up with different standards. It's so impelling that this is the way on which are working the standard setters of the non-financial information, (CDP), Climate Disclosure Standards Board (CDSB), Global Reporting Initiative (GRI), International Integrated Reporting Council (IIRC) e Sustainability Accounting Standards Board (SASB) and on which both IFRS Foundation and EU, by means of EFRAG and ESMA, are moving.

The priority now must be a clever **proportional** regime for disclosing non-financial information. Disclosure has a cost; so many companies simply do not disclose their ESG situation. If investors and lenders became more demanding on 'green' and 'sustainability', a side effect could quickly arise: a company that does not disclose ESG information can be cut off by financial market or, at least, by cheap funding. Obviously **this is the aim of the strategy** in the background, but the size of the company 'matters'; while big companies can afford big investments in transition **and** in reporting, SMEs have to decide whether to invest in transition in sustainability **or** in disclosure or in which mix of these, because the cost of disclosure could be not light. This need of proportionality becomes more urgent the more we approach standardization and ratings and reports are issued. Moreover, poor, or lack of, non-financial information could also have an impact on the supply chain entities in case the top-chain company requests all the suppliers to disclose their ESG data. Not providing this could lead a cut off even here.

Related to this, if we think about production district, whose typical feature is to be built up on many specialized micro and small companies, then we can have – and in Italy we do have many textile, mechanics, furniture districts – wide regions where the success of the general strategy, if not accompanied by deemed disclosure, can be potentially disruptive due to the effect either on the funding (being cut off by cheap one) and on the revenues (being cut off by supply chain).

We need to manage the possible unintended consequences that ESG strategy may have more negative immediate effects on people and communities than positive future effects on the environment.