

In life, death and taxes are certain. In ESG, it's standardisation and audit

To figure out what to do about ESG, start with the regulations that you have to report on – and then work out what's material to your business or your portfolio. Not the other way round.

Many founders and investors are awash in spreadsheets trying to answer a growing list of questions, having to fit the same data into a myriad of frameworks, principles and guidelines. If it seems never ending, the bad news is it's likely to get a lot worse.

Naturally, everyone is more interested in what's material to the business than they are in complying with regulations. VCs are building their own reporting and are beginning to work out how to tell their ESG story to their LPs, as well as the startups and SMEs they're investing in. The temptation is to head straight to 'hot topics' like CO2 emissions and diversity. Unsurprisingly new suppliers of specialist data, particularly on CO2 (scope 1, 2 and 3) emissions, are rushing to meet this demand.

New regulation requires investors to report in line with frameworks like TCFD and SFDR which uses the EU Taxonomy. And because of scope 3 they also have to report on their portfolio companies. This means yet more spreadsheets for SMEs and VCs... and even more resources to field the growing flow of questions. But there is an upside.

Because everyone has to report in the same way, regulation will become the driving force in standardisation. Cherry-picking ESG measures and data suppliers today can ultimately only lead to multiple suppliers, more expense and more confusion when it comes to reporting 2-3 years from now. The measures regulators require become the reality of what needs to be reported. De facto.

In addition to standardisation, the other thing that's certain in ESG is the requirement for data to be audited (or 'assured' to be technically accurate). A UN Report in 2004 introduced two key ideas for investors to consider: ESG issues are material to company value, as is a 5-10 year time horizon. So it's hardly surprising that ESG has been adopted by companies and investors of all sizes since and has skyrocketed in the last 2-3 years.

Just like your financials, ESG accounts and the decisions you make are only as good as the data they are based on.

Already the International Federation of Accountants (IFAC) have consulted on a principles framework for non-financial reporting. It answers calls for an ESG equivalent of the international financial reporting standards (IFRS) or GAAP i.e. generally accepted accounting principles, standards, and procedures. The introduction of an 'ESGAPP' is in the making.

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Right now, most regulation and accounting principles are focused on public companies and larger, private SMEs. But it won't be long before the rules filter down to the SMEs and startups who make up the other 50% of the world's economy.

One set of rules for only the top half of the economy isn't going to fly.

In much the same way as the standards for financial reporting are reduced for small businesses, a lite-version of ESG reporting for SMEs (and their VCs and PE funds) is on the horizon.

Whether you're a founder or VC, building sustainability data into your brand story appeals to customers and investors demanding sustainable products and services, employees looking to join companies who share their values and LPs under pressure from regulators.

To ease the burden and to future-proof your ESG reporting, don't be tempted to cherry-pick 'hot' data and suppliers.

Instead, align your metrics and data suppliers with the regulation that's on the table now. And if you get your ESG reports independently audited by Chartered Accountants/CPAs (who are also qualified in ESG), you'll be giving everyone the confidence that you're not greenwashing. Otherwise, what seems like a stitch now is likely to cost nine later.

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