2025 KAIVALYA RESEARCH ISSUE 1

INSIGHTS

ESG IS BROKEN

WHAT IS ESG?

The acronym ESG stands for Environmental, Social, Governance. In recent years, it has been used by investors and companies as a framework to identify and evaluate business risks that are hard to quantify with traditional financial metrics.

ESG is not one 'thing' that can be easily defined and quantified. It is really meant to be used as a lens and organizing structure to evaluate and assess qualitative factors that can impact performance.

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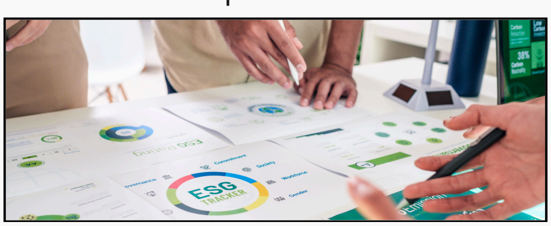
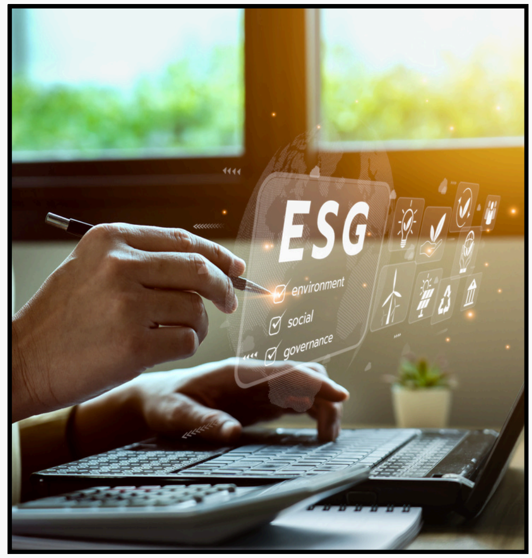
BACKGROUND - A BRIEF OVERVIEW OF ESG

While socially responsible investing has existed as a niche industry for many decades, it wasn't until 2004, with the publication of the United Nation's "Who Cares Wins" series, that Environmental, Social and Governance or 'ESG' took hold as a broader concept in the investment industry.

ESG evolved to correct a very real oversight by investors. Many investors had, and still have, a singular focus on financial metrics when allocating capital. This often results in short sighted decision making that undermines long-term performance. While many day traders can profit in this environment, the majority of institutional investors have much longer time horizons.

For example, cutting back on health and safety programs will look like cost savings and improved financial performance in the short term. That is until a major safety related incident results in material liabilities and brand damage, leading to financial underperformance.





ESG was introduced to systematically account for these types of risks. ESG provides a framework to focus on financially material risks and opportunities related to investment performance that are not easily captured in existing financial analysis. This is ESG's purpose and why it gained traction amongst investors and companies alike.

But somehow ESG became divorced from its true purpose. In so many ways it has become a checkbox exercise where the purpose of the checkboxes has been lost. Too many people are going through the motions, making glossy reports that claim to be ESG without grappling with what that actually means.

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SIMPLE STEPS TO START

Focus on practical short term actions NOT aspirational long term goals

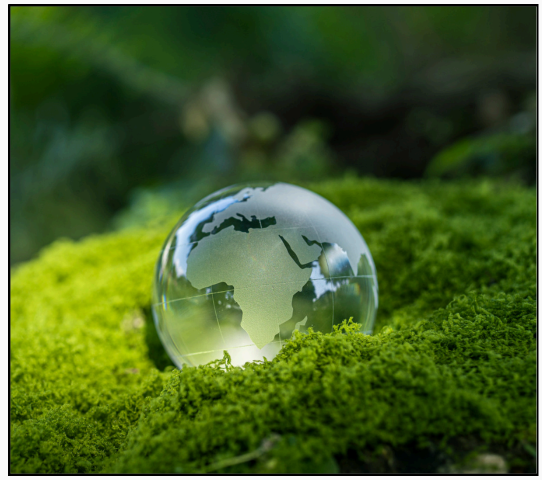
Making *a long-term commitment like net-zero by 2050 isn't bad, but it can obscure the action needed today. What is the strategy and plan to meet an ESG target that has been set? What is the on-the-ground impact?*

ANTI-ESG MOMENTUM DID IT BREAK ESG?

ESG as general areas are not fundamentally broken but what we know as ESG very much is.

There are many justifiable criticisms of ESG but I have heard few of these from the so-called anti-ESG movement. ESG's breadth makes it easy to twist into whatever argument one wants – pro or con. And the all too common checkbox approach to ESG just confirms what these skeptics believe and often does validate their concerns when practiced in this manner.

But this does provide us with an opportunity to really scrutinize the application of ESG frameworks. To bring them back into alignment with their original purpose. To really think about the critiques of ESG, especially those coming from reactionary anti-ESG forces. They are actually helping strengthen ESG, if we will only let them. We can only improve what we are willing to ruthlessly question.



HOW DO WE FIX IT?

There isn't a silver bullet that will solve it, but there are many things we can do. It is always about getting back to basics.

People want a clean environment, good jobs, healthy communities, fair and equitable institutions, and understandable processes where people's voices can be heard. For most people it isn't controversial to care about these things.

We need to redefine the how of ESG to get it back to its purpose. Focus on tangible actions and process. Implementation and execution.

Sure, set a net-zero target and commit to reporting on gender pay gaps in your organization, but targets and reports alone don't mean much anymore.

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Focus on the tangible outcomes NOT semantics and presentation

Using the 'right' language and broadly reporting in line with sustainability frameworks doesn't mean the work is credibly being done. How are these indicators driving financial decisions, including long-term capital allocation? What resources are being allocated to this work?

TURNING PRINCIPLES INTO PROGRESS

ESG currently has too many ideas, statements, and thoughts with too little actual action. We paint an idealistic world and set goals to achieve this but don't think about the how. It is the how that matters. The how is what drives progress. The how is what turns ideals into change.

ESG's potential will never be realized through reports and promises alone. Progress depends on deliberate choices, incremental actions and disciplined follow-through. With the adoption of a pragmatic practical approach, we can reclaim ESG's role as a framework to improve decision-making. A focus on implementation will help us reduce risks and capture opportunities to create long-term value that benefits investors and other stakeholders alike.

This is only the beginning. In the weeks ahead, I'll dive deeper into ESG – first its current state and foundations, then the practical steps organizations can take to turn principles into progress. As the landscape continues to evolve, this series will remain an ongoing exploration. Stay tuned.

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