Understanding Environmental, Social, and Governance (ESG) Metrics: A Basic Primer

By Jack McPherrin & Justin Haskins

"The world must act jointly and swiftly to revamp all aspects of our societies and economies, from education to social contracts and working conditions. Every country, from the United States to China, must participate, and every industry, from oil and gas to tech, must be transformed. In short, we need a 'Great Reset' of capitalism."[1]

– Klaus Schwab, founder and executive chairman of the World Economic Forum.

Key Terms and Issues

Klaus Schwab and a growing list of powerful global economic and political elites, including BlackRock CEO Larry Fink[2] and President Joe Biden,[3] have recently committed to a global "reset" of the prevailing school of economic thought. They seek to supplant the entrenched "shareholder doctrine" of capitalism, which—as Milton Friedman famously espoused over 50 years ago—holds that the only purpose of a corporate executive is to maximize profits on behalf of company shareholders.[4]

To replace shareholder capitalism, Schwab, Fink, Biden, and a legion of their peers have promulgated a nouveau "stakeholder doctrine," commonly referred to as "stakeholder capitalism." This approach, which aims to harness the growing clamor for more socially conscious corporate decision-making, authorizes, incentivizes, and even coerces corporate executives and directors to work on behalf of social objectives deemed by elites to be desirable for all corporate stakeholders—including communities, workers, executives, and suppliers.[5]

Environmental, social, and governance (ESG) scores—a social credit framework for sustainability reporting—are being used as the primary mechanism to achieve the shift to a stakeholder model. They measure both financial and non-financial impacts of investments and companies and serve to formally institutionalize corporate social responsibility in global economic infrastructure.[6]

Environment, social, and governance scores are theoretically supposed to incentivize "responsible investing" by "screening out" companies that do not possess high ESG scores while favorably rating those companies and funds that make positive contributions to ESG's three overarching categories. A company's ESG score has become a primary component of its risk profile.[7]

Who Are the Agents Responsible for this Shift, and What Have They Done to Bring It About?

Although there have been many ESG frameworks developed over the past decade, in the past three years alone, three major documents and compacts have been signed by a coalition of corporate governors, political elites, central bank directors, international organization representatives, and other powerful individuals. Together, they have had a substantial impact on the global economy and the shift to ESG.

In August 2019, The Business Roundtable (TBR)—comprised of 181 of the most powerful corporate executives in the United States—officially revised its conception of a corporation's purpose to "promote an economy that serves all Americans."[8] The companies these CEOs represent hail from nearly all sectors of the U.S. economy, including major financial institutions, media conglomerates, technology firms, defense contractors, pharmaceutical companies, and myriad others. Some of the signatories are listed in a chart on page 2.[9]

The international community quickly followed suit; the December 2019 summit of the World Economic Forum (WEF) in Davos formally announced that the new purpose of a corporation would be to "engage all of its stakeholders in shared and sustained value creation. … The best way to understand and harmonize the divergent interests of all stakeholders is through a shared commitment to policies and decisions."[10] Members of the WEF's leadership team include its founder and CEO Klaus Schwab, Blackrock CEO Larry Fink, International Monetary Fund Director Kristalina Georgieva, former IMF

Director and current European Central Bank Director Christine Lagard, former U.S. Vice President Al Gore, European Commission President Ursula von der Leyen, and Alibaba CEO Jack Ma, among many others.[11]

The third effort—the United Nations Global Compact—officially incorporates ESG scores into all firm-level investment and decision-making processes. As of January 25, 2022, the Principles of Responsible Investment (PRI), a group supported and promoted by the United Nations, reported 4,721 signatories from more than 135 countries had signed PRI. Collectively, these businesses, investors, and investment management firms control more than **$100 trillion in assets**.[12] The PRI pact emphasizes the importance of ESG disclosures and sponsors pressuring companies into ESG implementation.[13]

How Widespread Have ESG Disclosures Become?

To put it mildly, ESG scores have spread like wildfire.

In the United States, 98 percent of the country's top financial companies now disclose ESG scores, and 82 percent include the information in their annual reports, as of the end of 2020. As one analyst remarks, "Investors and regulators are increasingly demanding information on the non-financial performance of all investments. … For companies, the stakes are real. ESG reporting can impact access to capital and the ability to attract new investors."[14]

Internationally, more than 15,000 companies have signed on to the U.N. Global Compact, which uses ESG to track a company's progress toward its determined Sustainable Development Goals (SDGs).[15]

How Are ESG Scores Determined?

There is no uniform approach to specific benchmarks, measurements, or ratings; instead, there are multiple overlapping systems, each sponsored by different international governmental organizations and financial institutions.

A recent paper aggregating evidence from more than 1,000 studies on ESG performance found "studies use different scores for different companies by different data providers."[16]

The Business Roundtable Signatories

Jeff Bezos – Founder and former CEO of Amazon

Doug Parker – CEO of American Airlines

Tim Cook – CEO of Apple

Brian Moynihan – CEO of Bank of America

Larry Fink – Chairman and CEO of Blackrock

James Quincey – Chairman and CEO of Coca-Cola

Ed Bastian – CEO of Delta

Jim Fitterling – Chairman and CEO of Dow

Jim Farley – President and CEO of Ford Motor Company

Lachlan Murdoch – Executive Chairman and CEO of Fox

David Solomon – Chairman and CEO of Goldman Sachs

Alex Gorsky – Chairman and CEO of Johnson & Johnson

Jaime Dimon – Chairman and CEO of JP Morgan Chase

Marillyn Hewson – Chairman, President, and CEO of Lockheed Martin

James Gordman – Chairman and CEO of Morgan Stanley

Adena Friedman – President and CEO of Nasdaq

Kathy Warden – Chairman, CEO, and President of Northrop Grumman

Safra Catz – CEO of Oracle

Albert Bourla – CEO of Pfizer

Kevin Johnson – President and CEO of Starbucks

Doug McMillon – President and CEO of Walmart[9]

One study analyzing six prominent ESG ratings agencies noted that each of the six companies employs different category scopes, different measurement of those categories, and different assigned weights to those categories. Additionally, a rater's overall subjective view of a firm was found to influence the rater's assessment.[17]

The system promoted by the International Business Council (IBC), which incorporates 45 metrics, combine completely different types of data. The IBC's method mixes quantitatively determined metrics such as "Total R&D Expenses" and "Total Social Investment" with qualitative metrics such as "Purpose-Led Management." These metrics are then subjectively weighted according to the preferences of corporate directors, and then aggregated into a number that is supposed to resemble a risk profile.[18]

There truly is no objective, uniform ESG model. ESG scores are often subjectively determined and typically depend on potentially biased self-reporting from large corporations.

A stakeholder capitalism model, which relies on ESG, is designed to ignore consumers and put corporations, banks, and investors in the driver's seat.

What Are Some of the Most Important Concerns with ESG Models?

1. Corporations, Banks, and Financial Institutions Are in Control

Under a free-market economic model, businesses respond to the demands and preferences of customers, who effectively vote with their dollars for the products and services they want businesses to provide.

A stakeholder capitalism model, which relies on ESG, is *designed* to ignore consumers and put corporations, banks, and investors in the driver's seat. In fact, this is primary purpose of ESG. According to advocates of stakeholder capitalism, their proposed shift is needed to tackle the biggest problems of today and tomorrow, including climate change and economic inequality. But, in reality, ESG models do very little to address these issues. They do, however, make some investors and corporations exceptionally wealthy, often at the expense of others.

ESG systems also limit opportunities and, in some cases, the rights of individuals. And because in the United States ESG frameworks are not operated by government agencies, individuals and families have no constitutional protections guarding against such actions.

For example, an ESG model targeting "misinformation" online coerces social media companies to ban speech they might otherwise allow. Similarly, a consumer who wants to purchase a gasoline-powered car will, under most ESG models, eventually be forced to purchase an electric vehicle instead. Likewise, future ESG frameworks could include mandates for restaurants to provide or restrict certain kinds of foods, or even encourage vaccine requirements for employees and customers.

Because ESG systems can be adjusted at virtually any time, and without any public input, there are no limits to the impacts ESG could have on society, raising serious ethical questions about the power ESG models give to a relatively small number of corporate, banking, and investment leaders.

As one article published by the Global Financial Markets Center at Duke University's School of Law rightly questions, "Is it appropriate for company executives, who have been neither elected nor empowered to make social decisions, to decide that the prices set in the economy are not appropriate indicators for making corporate decisions. … are corporate executives qualified to evaluate these social policies? More importantly, what gives them the right to evaluate such policies on behalf of their shareholders and other stakeholders such as employees?"[19]

2. ESG's Tenuous Links to Financial Welfare

Though many studies show a slight positive relationship between ESG activities and financial performance, this relationship is weak, at best, and levels off over the long-term.[20,21,22] This leveling occurs because firm value receives an initial spike when corporate leaders publicly come out in support of ESG principles, such as what occurred with many PRI signatories.[23]

Firm value can also be jeopardized when engagement in ESG issues is forced. For example, if unqualified candidates are chosen to sit on a board simply because they fulfill an ESG diversity quota, or if unqualified managers are chosen to meet similar ESG benchmarks, this will result in non-optimal firm performance eventually.[24] Additionally, many companies that have been coerced into adopting

ESG have abandoned proven business practices and profitable products and services to ensure they meet ESG guidelines, even though these decisions might have a remarkably negative long-term effect on a company's ability to earn a profit.

3. Stakeholder Interests, Power Concentration, and Wealth Accumulation

Though the effect of ESG scores upon a company's overall financial health is indeterminate, there is no doubt that investment in ESG funds has soared. In 2020, investment into "sustainable funds" surpassed $50 billion, 10 times that of 2018.[25]

Cui bono?

ESG funds have been tremendously lucrative to the financial institutions and their corporate stakeholders at the heart of this radical shift in corporate governance. ESG's novelty has justified higher management fees, and the system "gives a pass to a large number of harmful actors, driving large fund flows to them and lowering their cost of capital, while CEOs and Wall Street executives celebrate a lucrative movement that they hope will improve their public image."[26]

And it is BlackRock, the world's largest private asset manager, that has stood to gain the most. BlackRock holds a stake in almost every public company with its $7.4 trillion in assets under management, and it has leveraged its size and diversification to fully reap the benefits of ESG investment.[27] BlackRock's iShares Global Clean Energy ETF is one of the largest ESG funds in the world.[28]

Is it a coincidence that BlackRock is run by Larry Fink, who has largely spearheaded the stakeholder takeover and is a board member of the World Economic Forum, one of the leading advocates of ESG?

Fink and his fellow corporate executives at other firms are more protected from accountability than ever under this new paradigm.[29] BlackRock, which has become a top-five shareholder in the vast majority of important global companies, is perfectly situated to influence ESG decisions via its considerable voting blocs, giving this one financial firm a massive amount of power to shape society.[30] When combined with other large investment firms, such as State Street Global Advisors, the demands of the wealthiest Wall Street investors become virtually impossible to ignore for corporations and the small businesses they often lend to and work with.

About the Authors

Jack McPherrin works as the research editor for the Editorial Department of The Heartland Institute, where he also contributes to the mission of the Socialism Research Center as a research fellow.

Additionally, he is the managing editor of 1818 Magazine. Jack is in the final stages of completing his Master's Degree in International Affairs from Loyola University-Chicago, where his myriad research interests primarily encompass domestic and international economic policy, global institutions, authoritarian regimes, and foreign affairs - with a particular emphasis upon Russia and China. Prior to his graduate pursuits, Jack spent six years in the private sector after graduating from Boston College with a dual Bachelor's Degree in Economics and History. He currently resides in the Lincoln Park neighborhood of Chicago, a few short miles from where he was raised.

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Haskins is a widely published writer and political commentator and the editorial director and research fellow at The Heartland Institute, a national free-market think tank. Haskins is the editor-in-chief of StoppingSocialism.com, one of the world's largest and most influential publications devoted to challenging socialism, and Justin serves as the director of the Henry Dearborn Institute for Human Rights, a nonprofit association of scholars and professionals.

Haskins writes frequently for FoxNews.com and works as a contributor for *The Hill*, *Newsweek*, *Washington Examiner*, and *Townhall*. He has appeared on television and radio more than 200 times, on shows like *Tucker Carlson Tonight, Fox & Friends*, and the *Glenn Beck Program*.

Haskins is the author of the Amazon best-selling book *Socialism Is Evil: The Moral Case Against Marx's Radical Dream* (2018), and he served as the first contributor to Glenn Beck's *Arguing with Socialists* (2020), a New York Times best-selling book. Haskins is also the co-author, with Beck, of *The Great Reset: Joe Biden and the Rise of Twenty-First Century Fascism* (2022).

Haskins has been published more than 800 times in major digital and print publications, including *The Wall Street Journal, New York Post, Forbes, Newsweek*, and *National Review*, among many others. His writing has also been featured or discussed by *The Rush Limbaugh Show, Glenn Beck Radio Program, The New York Times, Drudge Report*, The Heritage Foundation, the White House, and Newsmax, which named Haskins one of "Top 30 Republicans Under 30" in 2017. In 2016, Haskins was named to MediaDC's "30 Under 30" list of young and influential leaders on the right.

Haskins is author or co-author of three Heartland *Policy Briefs*, all of which received significant media attention: "The American Health Care Plan" (2021), "Estimating the Income Tax Hikes Required to Pay for Bernie Sanders' Medicare-for-All Plan" (2019) and "Debunking the Scandinavian Socialism Myth: An Evaluation of Denmark, Norway, and Sweden" (2019).

Haskins has also co-authored several national surveys conducted by Rasmussen Reports, one of America's leading pollsters.

Haskins graduated from the University of Richmond (Richmond, VA) in 2010. In 2011, Justin earned his M.A. in government with specializations in international relations and American government from Regent University (Virginia Beach, VA), and he earned a second M.A., this time in journalism, from Regent in 2015. Haskins was inducted into the Philadelphia Society in 2018.

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