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Chapter 3: Current themes under analysis

The ESG and the SDGs in debate: where they intersect and where they differ

The present chapter 3: "Current themes under Analysis" is introduced in Year 2 of the project to bringup for debate an issue whose discussion and clarification can benefit different audiences working on sustainability issues in the corporate environment. This chapter aims to investigate, through a non-exhaustive review of academic and practical literature, the relationship, differences, and complementarity between the concepts of ESG (Environment, Social, and Governance) and SDG (Sustainable Development Goals). The aim is to initiate a healthy discussion that will allow us to share and enrich knowledge on the subject.

Given the importance and topicality of this issue, this chapter seeks to answer the following questions:

- What is the origin of the ESG concept vs. the Sustainable Development Goals (SDGs) concept?
- What are the ESG criteria?
- ESG and SDGs: main differences and implications?
- General conclusions on the topic
- What considerations can we make to open the subject to debate?

As a result of the issues being discussed, this chapter is both descriptive and reflective. Its aim is to essentially enlighten company managers and generate a discussion among interested parties and the academic community.

3.1.
What is the origin of the ESG concept vs. the Sustainable Development concept?

The origin of the ESG concept, like the concept of Sustainable Development, is linked to the United Nations (UN). In the 1990s, the UN began to work more actively with the business sector. At this time, Kofi Annan, then the Secretary-General of the United Nations, stated: "There is great potential for the goals of the United Nations - promoting peace and development - and the goals of business – to create wealth and prosperity - to be mutually supportive" (UN, 1998).

It was in the 1990s that Kofi Annan proposed the creation of the Global Compact in his speech at the World Economic Forum in Davos in 1999. Kofi Annan called on business leaders to join the UN's objectives of promoting a sustainable global economy, after a period of strong globalization, and to correct imbalances in certain issues such as working conditions, human rights, and environmental protection, among others (Pollman, 2022).

The UN Global Compact began operating in 2000. Thismarked the formal and definitive entry of the business sector into the Sustainable Development, so dear to the United Nations. Today, the UN Global Compact continues to operate based on 10 principles for the protection of human rights, decent working conditions, the environment, and clear anti-corruption principles.

Following on from his work, in 2004, Kofi Annan invited 55 CEOs from the world's leading financial institutions to join a new initiative called Who Cares Wins. It was in the Who Cares Wins report that the term ESG was formally mentioned for the first time. This report advocates for the incorporation of environmental, social, and governance criteria into investment decisions, explaining its business case. The report argues that investment and business decisions based on ESG criteria would lead to "more resilient investment markets, as well as contribute to the sustainable development of societies" (Who Cares Wins, 2004, p. 11). Following this report, the term ESG was used in various United Nations initiatives, which contributed to its adoption and dissemination.

The term ESG is, therefore, originally associated with the financial and investment markets in an attempt to incorporate new criteria into the risk and return analysis. The main purpose of this effort is to focus on creating value for society and all stakeholders (not just shareholders), and creating value in the long term, not just the short term. This effort intends to contribute to the sustainable development of societies.There is, thus, a clear link between the concept of ESG and Sustainable Development.
The concept of Sustainable Development is a predecessor of ESG and was first formally coined in the Brundtland Report as the ability to make development sustainable to ensure that it "meets the needs of the present without compromising the ability of future generations to meet their own needs" (WCED, 1987, p. 16). It aims to reconcile economic development with the protection of social and environmental balances.

However, the concept of sustainable development began to be shaped in 1972 at the Stockholm Conference. It is a concept that has evolved over the years with various UN conferences dedicated to the subject. The evolution of the concept (which appeared to be closely linked only to the environment), was stabilized by the 1987 definition, and is now embodied in the UN's Sustainable Development Goals. These are governed by the five principles of Prosperity (economic), Planet, People, Peace, and Partnerships. There are 17 universal and cross-cutting goals that guide humanity and all sectors of activity towards a single common goal: Sustainable Development.

With this brief analysis, the common and differentiating points of these concepts begin to emerge. ESG was born and has been developed as a narrower concept focused on the peculiarities of the investment markets. In turn, the concept of Sustainable Development is broader (encompassing humanity and the planet) and aims to safeguard the continuity of the species and the planetary balance.

3.2. What are ESG criteria?

As mentioned, the English acronym ESG stands for Environmental, Social, and Governance. The term, originally associated with investment markets, is now used as a framework for both investment and reporting. The reason why ESG has become not only an investment but also a reporting tool, is very consequential. Since investors demand that companies comply with these criteria when making investment decisions, it is only natural that these same companies need to report the results demanded by the market. Nowadays, this type of reporting has increasingly been defined as a legal obligation.

ESG in the investment market

Li et al. (2021) consider that "ESG is usually a strategy and practice used by investors to evaluate corporate behavior and future financial performance" (Li et al., 2021, p. 1) through their environmental, social, and governance practices. To enable investors to make informed investment decisions, various ESG ratings have been developed over the years by different investment funds. These ratings are currently the dominant metrics that guide investors in their investment decisions (van Zanten & Huij, 2022).

Some of the most recognized ESG ratings used by investors include MSCI, Sustainalytics, Bloomberg, Refinitiv (formerly Thomson Reuters), ISS Ratings, FTSE Russell's, Moody's, S&P (RobecoSAM), and Fitch ESG Relevance Scores.

There are, however, some problems associated with the use of ESG ratings in the investment market (van Zanten & Huij, 2022):

1. ESG ratings do not measure companies' contribution to a more sustainable world, but only their exposure to environmental, social, and governance risks and their financial impact on company accounts. Although the original concept presented in the Who Cares Wins report treats ESG as criteria that should guide investments towards "the sustainable development of the societies" (Who Cares Wins, 2004, p. 2), nowadays, ESG ratings only assess the impact of ESG risks on companies' financial performance.

2. There is a huge variety of ESG ratings that are very poorly correlated with each other. This reality generates what Van Zanten and Huij (2022) call "aggregate confusion". In other words, if all the ratings use different methodologies and criteria to assess companies, there will be a clear lack of transparency, making it difficult to identify which ratings can really be trusted. Different companies can receive different assessments depending on the rating chosen, which creates additional complexity for investors and other stakeholders analyze the companies.

3. The different ability of companies to report their results means that companies with fewer resources, and which cannot report, tend to have fewer positive evaluations. This discrepancy generates a negative evaluation bias for smaller companies located in less developed countries.

Taking these three factors into account, it can be concluded that ESG is not the same as Sustainability or Sustainable Development

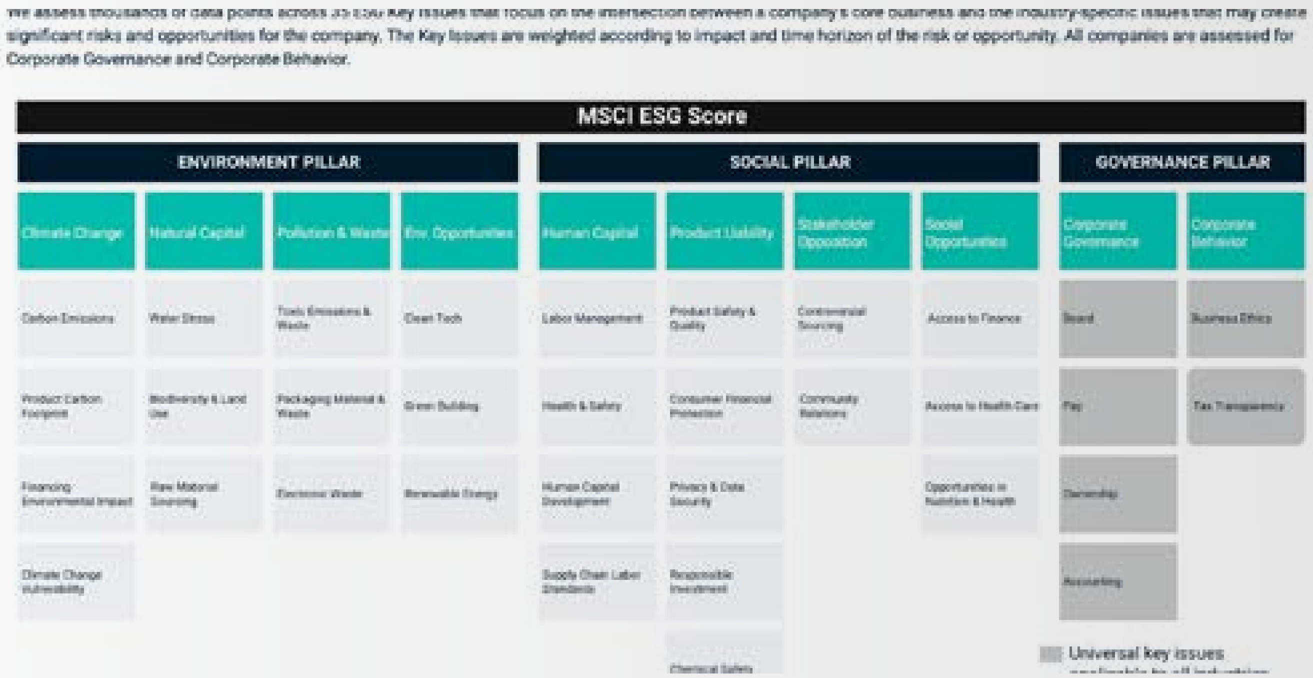
For this reason, a company can have an excellent ESG rating (because it manages environmental and social risks and their financial impacts very well) but still be a major polluter or have very negative impacts on society. The positive rating refers to its ability to to mitigate the financial impact of its risks. This is why companies like British American Tobacco or Royal Dutch Shell PLC can have good ESG ratings, despite their negative impact and net contribution to the world (van Zanten & Huij, 2022). Figures 3.2.1, 3.2.2, and 3.2.3 show examples of how some ESG rating agencies, academia, and consultancy firms measure ESG criteria (in different ways).

[1] ESG investment is defined as any investment that incorporates environmental, social, and governance factors into its evaluation criteria.

As Figures 3.2.1, 3.2.2 e 3.2.3 apresentam exemplos de como algumas agências de *rating* ESG, a Academia e empresas de consultoria medem os critérios ESG (de formas diversas).

Figure 3.2.1

Critérios MSCI ESG para o ESG score



Source: https://www.msci.com/our-solutions/esg-investing/esg-ratings/esg-ratings-key-issue-framework

Figure 3.2.2

Dimension	Factors	Definition
Environmental (E)	• GHG emissions • Energy consumption and efficiency • Air pollutants • Water usage and recycling • Waste production and management (water, solid, hazardous) • Impact and dependence on biodiversity • Impact and dependence on ecosystems • Innovation in environmentally friendly products and services	Environmental matters that may have a positive or negative impact on the financial performance or solvency of an entity, sovereign, or individual.
Social (S)	• Workforce freedom of association • Child labor • Forced and compulsory labor • Workplace health and safety • Customer health and safety • Discrimination, diversity, and equal • Opportunity • Poverty and community impact • Supply chain management • Training and education • Customer privacy • Community impacts	Social matters that may have a positive or negative impact on the financial performance or solvency of an entity, sovereign, or individual.
Governance (G)	• Codes of conduct and business principles • Accountability • Transparency and disclosure • Executive pay • Board diversity and structure • Bribery and corruption • Stakeholder engagement • Shareholder rights	Governance matters that may have a positive or negative impact on the financial performance or solvency of an entity, sovereign, or individual.

ESG framework da European Banking Authority, apresentado po rLi et al. (2021, p. 2)

Figure 3.2.3

Environmental
Your impact on the world

- Climate change
- Emission of greenhouse emission (GHG)
- Depletion of natural resources - Waste and pollution
- Deforestation
- Hazardous materials
- Biodiversity

Social
Your contribution to your communities

- Working conditions, including slavery and child labor
- Impact on local communities
- Regions in crisis and conflict
- Health and safety
- Employment relations and diversity
- Mis-selling
- Data protection

Governance
How you conduct yourself

- Renumbering of exclusives
- Bribery and corruption
- Public lobbying and donations
- Board diversity and structure
- Tax strategy
- Data breaches

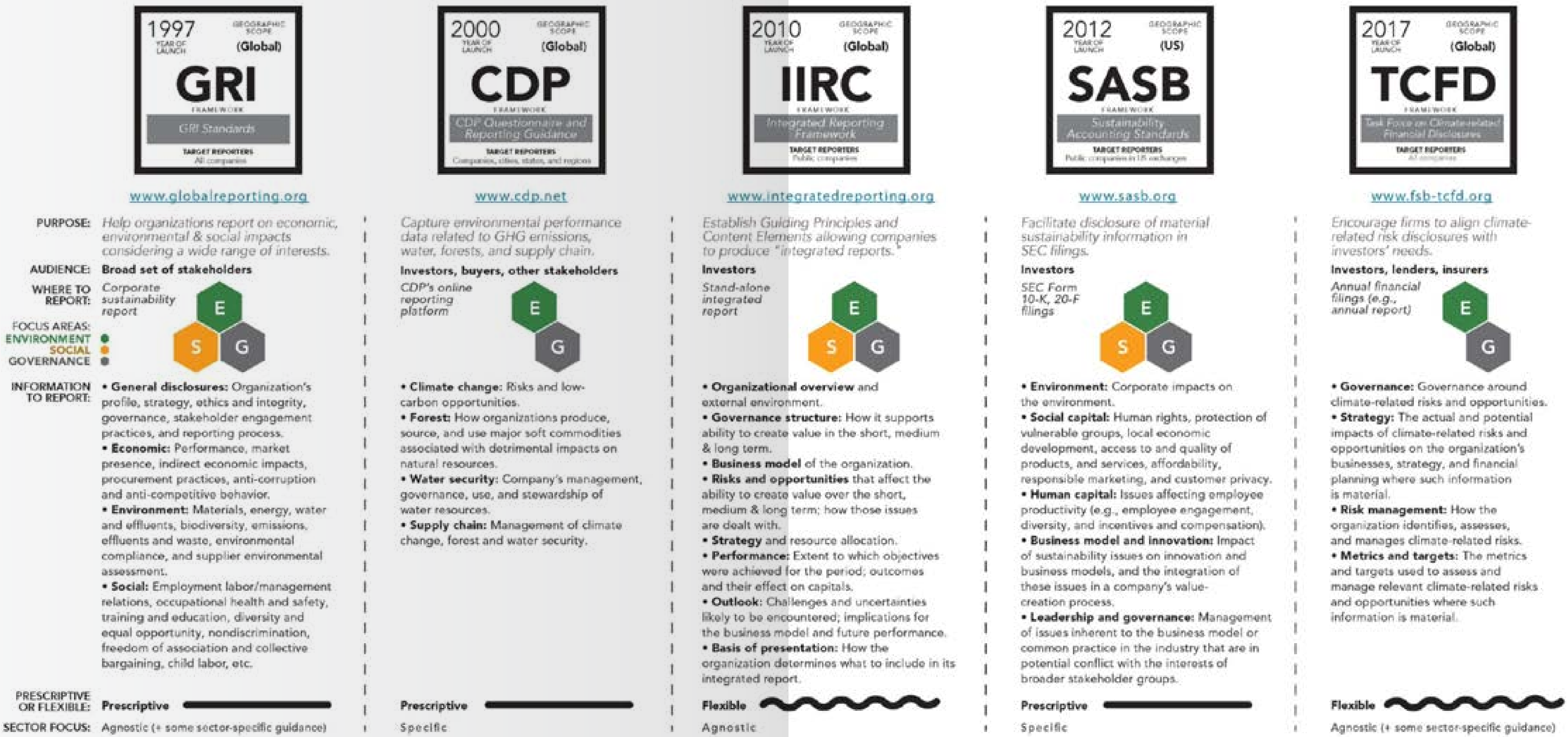
ESG framework presented by KPMG (2022)

Regarding the ESG investment, it is also important to mention its exponential growth in recent years, which has been increasing at an average rate of 27% per year over the last 6 years (KPMG, 2022). By 2025, assets invested in ESG are expected to represent a third of the global investment market, worth 50$ trillion US dollars, according to Bloomberg Intelligence (Bloomberg, 2021). This growth demonstrates the growing importance that investors attach to sustainable investments but also the importance that underlies the need for increasingly rigorous ESG criteria.

ESG in company reporting

Following and responding the growth in the use of ESG criteria in the investment markets, there has also been an increase in 'companies' ESG reporting. This increase is accompanied by a spread of reporting criteria. Some of these stand out as standards of international reputation. Among the most commonly adopted criteria by companies (such as the GRI - Global Reporting Initiative), some have a long history and existed even before ESG was mentioned. However, most have emerged more recently to respond to the needs of the investment market and the social and environmental challenges facing the world, which force companies to act (such as the CDP, IIRC, SASB, and the TCFD.). The CDP and TCFDonly present environmental and governance criteria. Figure 3.2.4 illustrates these main reporting criteria that have been guiding companies' actions.

Figure 3.2.4



Critérios de reporte ESG segundo o ESG Navigator (2023)

However **ESG reporting standards have not yet been standardized**. As such, they suffer from the same limitations as the investment ratings mentioned above: 1) they face the risk of not measuring the real impact (positive or negative) of the companies, 2) they follow multiple and different standards which are not comparable and generate great informational confusion and, finally, 3) they favor larger companies or those with more resources and more capacity to report.

With these problems, come three other relevant ones. The first, and potentially most worrying, is the problem of **greenwashing**. This problem occurs when companies that are more skilled at reporting use the reporting criteria to show something positive that they don't really incorporate into their operations. Another potential problem is that companies with very good practices **don't have the resources to report what they do**. The third potential problem is **cherry-picking**, in which companies report only the positive things they do or use the criteria that are most favorable to them, hiding the negative effects they may have on society and the environment.

The need to standardize ESG reporting has been widely discussed in recent years by different entities working on these issues. Several efforts have been made to ensure that the reporting of ESG criteria becomes increasingly standardized. These efforts have culminated in good news for regional and global integration of what we hope will be future standardized reports.. Reports that can inform all stakeholders (investors, customers, partners, suppliers, etc.) in a reliable, transparent, systematize and comparable way.

Examples of this standardization are the efforts made by the European Union with the new CSRD directive (at the European level), by the IFRS (at the global level), and by the SEC (in the USA), which are explored below.

CSRD Directive - European Union

In 2018, with the aim of developing a strategy for sustainable financing in the EU, the European Commission approved the Action Plan for financing sustainable growth. The sustainable financing framework established in this Plan includes a classification system, or taxonomy, for sustainable activities, and a framework for disclosing information applicable to companies. It is in this context, that the new CSRD (Corporate Sustainability Reporting Directive) emerges. .

This Directive has some noteworthy features:

- **Objective:** The CSRD aims to enable all stakeholders to assess companies' sustainability performance through transparent and comparable reporting.

- **Application:** Aims to standardize ESG reporting rules for large companies and listed companies (including SMEs) operating in the European Union market, also applying (from 2028) to non-European companies, provided they have a turnover of more than €150 million in the EU. The CSRD does not apply directly to unlisted SMEs; however, they will be indirectly impacted by the new reporting rules, as they are part of the value chains of companies covered by the Directive, and it is expected that these companies will ask them for information on sustainability . [2]

- **Differentiating elements:**

1. It is based on a **dual materiality** analysis, i.e., companies will have to report both the financial risks and opportunities for the company arising from environmental, social, and governance factors (financial materiality), as well as the positive or negative impact of their activity on people and the environment (impact materiality).

1 The CSRD will apply to companies in 4 stages:
• 2024 for listed companies with more than 500 employees (1st report in 2025);
• 2025 (with the first report due in 2026) for the remaining Large Companies - i.e. companies that meet at least two of the following criteria: (i) 2 turnover of more than 40M€, (ii) balance sheet of more than 20M€, (iii) more than 250employees;
• 2026 for listed SMEs (with an opt-out option until 2028);
• 2028 for non-European companies with a turnover of more than 150M€ in the EU (1st report to be presented in 2029).

2. In order to implement the new obligations laid down in the CSRD, **European sustainability reporting standards** (ESRS being proposed by EFRAG) are being defined. The first set of ESRS was adopted by the European Commission on July 31, 2023, and is expected to come into force on January 1, 2024. These standards guarantee the uniformity, comparability, and transparency of the information required of companies . Company reporting will now be contained in a single report, which places both financial information and sustainability information (environmental and social) at the same level.

There are 12 ESRS. Two of them (ESRS 1 and 2) are transversal and mandatory for any company with a reporting obligation (cross-cutting). The remaining 10 (topical standards) are only reported if the company considers them to be material to its business, according to the dual materiality analysis[4] .

Table 3.2.1.

The 12 ESRS

Cross-cutting standards	Environment	Social	Governance
ESRS 1 – *General requirements*	**ESRS E1 *Climate change***	**ESRS S1 *Own workforce***	**ESRS G1 *Business conduct***
ESRS 2 – *General disclosures*	**ESRS E2 *Pollution***	**ESRS S2 *Workers in the value chain***	
	ESRS E3 *Water and marine resources*	**ESRS S3 *Affected communities***	
	ESRS E4 *Biodiversity and ecosystems*	**ESRS S4 Consumers and end-users**	
	ESRS E5 *Resource use and circular economy*		

3 In order to speed up and avoid duplicate reporting by companies, the ESRS was prepared taking into account other standards under development, such as ISSB and GRI.
4 In addition to these first 12, EFRAG will be presenting other standards applicable to specific sectors and listed SMEs in the future. EFRAG is also developing simpler, voluntary reporting standards for the remaining unlisted SMEs, which will report on a voluntary basis. In the future, specific ESRS will also be approved for non-European companies to which the CSRD applies.

3. Companies will have to report in detail on their sustainability governance model, their business and strategy, their sustainability policy, impacts, risks and opportunities and their sustainability targets *(with deadlines for achieving them).*

4. There is an obligation to report the existence (or not) of aincentive **schemes** associated with sustainability **matters**, which allows **financial remuneration** according to the sustainability targets the company sets.

5. Companies must describe the sustainability due diligence process implemented throughout their value chain.

6. The report produced by the companies must be audited **by a third party**, produced in machine-readable format, and made available on the portal indicated for this purpose by the EU (ESAP - European Single Access Point).

Regarding the intersection of the CSRD Directive and its reporting standards (the ESRS) with the SDGs, it should be noted that the European standardswere developed in alignment with the principles and agreements defined in the Paris Agreement, the European Green Deal and the Sustainable Development Goals, in accordance with the mandate given by the European Commission to EFRAG:

"The Task Force shall consider the full sustainability spectrum of environmental, social and governance factors in line with the overall aim of the European Green Deal and Agenda 2030. This would also bring the work in line with the broader scope of the six environmental objectives of the Taxonomy regulation as well as other relevant work streams aimed at strengthening corporate sustainability." (European Commission, 2020, p. 2)

(European Commission, 2020, p. 2)

Therefore, it can be concluded that there is an alignment between ESG and the SDGs in the European Union. This is because the ESRS reporting standards draw precisely from the principles of the 2030 Agenda

The language of corporate reporting defined at the European level will follow the principles and objectives of the SDGs, which suggests that, in the near future, Europe will witnessa re-approximation of these concepts. As Europe (a leading region, considered the most advwanced in the world in these areas), intends to extend its reporting requirements to companies based outside of Europe, it is to be expected that its obligations will extend positively to the world to comply with more demanding ESG criteria, which will in turn lead to a clear contribution to the SDGs.

An example of this alignment are the European standards defined for the topic of the company's own employees, ESRS S1 - Own Workforce, in which the SDGs are associated with the reporting standards in a very clear and direct way:

AR 41. The undertaking may explain whether any such initiatives are designed also to support the achievement of one or more Sustainable Development Goals. For example, an undertaking committing to SDG 8 to "promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all" may be actively working towards eliminating ***forced labour*** or compulsory labour or supporting higher levels of productivity on activitiesin developing countries through technological upgrades and ***training*** of local labour, which canbenefit both the specific people in its ***own workforce*** targeted by the ***actions***, and also their local communities.

Commission Delegated Act, C (2023) 5303 final, Annex 1, ESRS-S1 Own Workforce, p. 178

IFRS – World

The second initiative to standardize sustainability reporting standards which is also worth mentioning, given its global nature, is the one being promoted in the context of the IFRS (International Financial Reporting Standards). This initiative is being embodied by the ISSB (International Sustainability Standards Board), which was created following COP 26, in November 2021. .

The ISSB has set itself the objectives of (i) developing standards that are the global basis for sustainability reporting, (ii) meeting the information needs of investors, (iii) enabling companies to provide comprehensive information to the global capital markets, and (iv) facilitating the interoperability of its standards with others developed by specific jurisdictions or aimed at a wider range of stakeholders.

The first IFRS sustainability standards were published in June 2023 and will come into force in January 2024:

- IFRS S1 — Defines a set of reporting obligations that enable companies to communicate to investors the risks and opportunities they face in the short, medium, and long term in terms of sustainability;
- IFRS S2 — Defines reporting obligations relating specifically to climate matters and is designed to be used in conjunction with IFRS S1.

Unlike the ESRS, the standards issued by the ISSB still focus only on climate matters. However, with the intention of establishing the topics to be prioritized over the next two years, the IFRS launched a stakeholder consultation and indicated the following as potential topics to be addressed: (i) biodiversity, ecosystems, and ecosystem services, (ii) human capital, (iii) human rights, and (iv) further integration of reporting. Prioritization refers not only to the specific topics to be addressed, but also to the specific industries and activities to be tackled.

In terms of materiality, the IFRS standards take an approach focused on the risks and opportunities that social and environmental factors generate for the company (financial materiality). This is because these standards are intended to inform investors,, and no other types of stakeholders, unlike the ESRS. These standards will be applied in the jurisdictions that formally adopt them . [6]

SEC – USA

In March 2022, the Securities and Exchange Commission (SEC) presented a proposal for reporting standards for US companies. The final version of these standards is currently being prepared. The SEC's standards focus on reporting the risks and possible financial impacts that the climate issue[7] may represent for listed companies - in other words, they are based on a materiality analysis that is essentially financial and centered on the risk for investors (Ho, 2023).

The SEC's reporting standards (essentially environmental) would apply from 2023 (in the report to be presented in 2024); however the final version is still awaiting approval, which is expected to happen by the end of 2023.[8]

[5] 26th Conference of the Parties to the United Nations Framework Convention on Climate Change.
[6] It should be noted that it has already been reported that the UK is planning to create its own reporting standards (the UK Sustainability Disclosure Standards (SDS)), which will be based on the IFRS climate standards (https://www.esgtoday.com/uk-to-create-ifrs-based-sustainability-disclosure-standards/).
[7] The climate aspects that are expected to be considered include, among others, (i) climate risks and their actual or probable impacts on the company's activity and strategy, (ii) the governance implemented by the company about climate risk and the existing processes for managing it, (iii) the company's greenhouse gas emissions, and (iv) information about the climate objectives and targets that the company has set, and the respective transition plan, if any.
[8] The State of California recently passed rules that are even stricter than the standards proposed by the SEC: California Lawmakers Pass Bill Requiring Companies to Disclose Full Value Chain Emissions - ESG Today.
Upon entry into force.

Table 3.2.2

CSRD Directive and other reporting standards

	CSRD Directive	IFRS	SEC
Scope	Europe	World	USA
Standard	ESRS	ISSB	SEC
Addressed topics	All ESG factors	Focus on climate issues	Focus on climate issues
Companies	European and non-European companies	Aims to be adopted by companies in adhering jurisdictions globally	North American listed companies
Focus	*Multi-stakeholder: includes investors and all stakeholders*	Investors	Investors
Timeline	Phased. Presentation of the 1st report in 2025 (referring to 2024)	Approved. Entering into force on January 1 2024, subject to adoption by different jurisdictions	Presentation of the 1st report in 2024 (referring to 2023)
Materiality analysis	Double materiality	Financial materiality analysis	Financial materiality analysis
Direct alignment with the SDGs	Yes	No	No

In summary, the European Sustainability Reporting Standards (ESRS) stand out for their comprehensive approach, their aim to share information to all stakeholders, and for addressing a broad range of ESG factors,including climate.

Additionally, the ESRS are progressive in nature, applying to SMEs and even companies not based in Europe, and therefore have a global reach. The ESRS also demand greater responsibility from companies, focusing on a dual materiality approach and alignment with the SDGs, while the other standards focus only on the financial materiality.

The analysis of European standards obliges companies to report their real impacts (positive and negative) on society, thus recognizing the role that CSRD and ESRS have in pursuing social, environmental, and governance objectives in line with the goals of the 2030 Agenda and the European Green Deal, which is also inspired by the SDGs. These characteristics place the ESRS at the forefront of more complete and holistic sustainability reporting, with the aim of promoting progress in Sustainable Development through the monitoring and reporting of business operations.

[9] upon entry into force.

ESG in reporting as a legislative instrument

The regulatory initiatives for sustainability reporting described above aim to define and stabilize - through the law or voluntary adoption - how and which ESG criteria will be considered for this reporting (worldwide). It can be concluded that the European initiative is the most ambitious in terms of sustainability reporting standards and their application, considering the scope of the ESRS. In addition, the ESRS have the potential for global application since Europe has made provision for its sustainability reporting to benefit from a principle of extra-territoriality. In other words, with the new ESG reporting legislation, the European Union intends to disseminate its sustainability reporting requirements as a inspiring example to the world. Thus, the more the EU's sustainability reporting is aligned with the SDGs, the more it can indirectly serve as a driving force for promoting the 2030 Agendaworldwide.

The politicization of the ESG **USA vs Europe**

In the US, the ESG issue has been politicized, which hinders scientific discussion and aggravates the ideological debate on the subject. Although public discussion of the issue is fruitful, there has been a setback in the adoption of sustainability agendas by companies and investors since the ESG is seen in a very antagonistic way by Democrats and Republicans. This discussion has been accompanied by the denial of climate science and the realization that economic benefit does not always accompany more sustainable business practices.

The denial of scientific evidence follows by the argument that only economic return should guide companies' activities (going back five decades ago to Milton Friedman's statementsthat the only social responsibility of companies was to generate profit (Friedman, 1970)). The immediate consequence of these discussions is the instability of the sustainable investment markets and the increased risk of investing in companies with a clear alignment with sustainability. Evidence of this is the recent revelation by Larry Fink (an American CEO of the world's largest asset management fund - BlackRock - and a great ambassador for sustainability issues), who publicly declared that he would never use the term "ESG" again, given its recent politicization and misuse (Worland, 2023).

The result of this fragmentation of agendas in the US could lead to a retraction of investment and sustainability strategies by companies in the country. This retraction could have a significant impact on the world, given the size of the American economy and companies. It is also evidence of the marked fragmentation associated with the ESG concept (particularly in this geography).

3.3. ESG and SDGs: main differences and implications

As explained in the analysis, it is clear that, nowadays, **there is a difference between the ESG criteria and the SDGs** (Sustainable Development Goals). These are agendas with different ambitions and scopes. However, considering the analysis that follows, it can be concluded that there are many advantages to be achieved from bringing these two agendas closer together, as is the case in the European Union. .

Therefore, in addition to understanding what ESG is, its origins, and its application by the business sector, it is also important to understand the difference between ESG and the SDGs. Since ESG and SDGs differ in their objectives and scope, the following table briefly explains how they intersect, differ, and how they can possibly converge.

Table 3.3.1

Main similarities and differences between ESG and SDG

ESG	SDG
There is no universal definition or framework (yet)..	*Globally accepted and recognized framework.*
There are no standardized metrics for calculating or presenting ESG metrics at a global level..	It has 17 Goals, 169 targets, and 231 universally accepted indicators.
Focused on specific management issues, such as the investment market and company reporting (from a voluntary perspective, but increasingly in transition to mandatory reporting).	They are universal and aimed at all stakeholders and sectors of activity. Voluntary.
Corporate language	A universal language, but with little corporate adaptation.
Focused on company management processes - how activities are carried out and how they should be carried out. There is very little focus (yet) on the company's impact abroad.	Focused on promoting the (positive) impacts and objectives defined in the 2030 Agenda. They seek to monitor negative impacts to turn them into positive ones.
Focused on environmental metrics, social issues, and governance, which exclude the economic issue of Sustainable Development.	They make the concept of sustainability and sustainable development tangible in its economic, environmental, and social aspects, with clear metrics.
It does not have a systemic character, but only a micro one, in the vision of Sustainable Development.	A systemic vision of sustainable development.
Serve to enable companies to report on what they do and manage their risk (in change with the CSRD).	Serve as an action guide to align corporate strategies with the real development needs of the world, humanity, and communities.

While the SDGs represent a globally accepted framework for progress, aimed at all sectors, with tangible, universal, and measurable targets, focusing on Sustainable Development in its different aspects, the ESG criteria are more specific. The latter is geared towards business management, essentially serving the purposes of investment, reporting, and management of organizations.

Despite the differences, both (ESG and SDGs) intersect in their basic objective of pursuing sustainability. The SDGs provide a systemic and basic vision for aligning corporate strategies with global needs. They are a strategic and inspirational agenda that serves to guide companies toward a desirable future for all. On the other hand, the ESG criteria, by focusing on management practices, enable companies to report their actions transparently and to manage the risks associated with the business as well as increasingly report (in the case of the CSRD and European legislation in the pipeline), potentially negative or positive impacts on the surrounding communities.

The convergence between the two concepts, as spearheaded by the European Union, is promising, as it leads to companies adopting ESG practices to contribute to the SDGs, incorporating environmental, social, and governance sustainability and promoting solid economic results.

The challenge lies in standardizing and broadening ESG metrics to align them more closely with the SDGs and the concept of Sustainable Development, bringing both "languages" closer together and enabling a holistic approach to management.

While ESG criteria are currently diffuse and generally don't measure the same things as the SDGs, this reality could change in the near future through the incorporation of concepts such as dual materiality and the reporting of holistic standards (economic, social, and environmental) linked to the core of the company's business.

If this does not occur and if the financial materiality (ISSB and SEC) continues to dominate the interest of the markets, then ESG criteria will continue to serve only the interest of investors and the purpose of informing financial decisions. In the latter case, however, the study by Van Zanten & Huij (2022) concludes that both concepts (ESG and SDGs) can be used in a complementary way, since the former measures companies' ability to manage risk (environmental and social) and the latter their effective impact on society.

In this way, the use of these two concepts depends on being used together. Either 1) an increasingly unified approach (in the case of CSRD) or 2) a complementary and informative approach for investors and potentially other stakeholders (in the case of IFRS and SEC). In any case, using them together always allows for a more complete view of the performance of organizations, which is not possible using ESG criteria alone.

3.4. General conclusions on the topic

ESG issues are extremely important in the current European business scenario especially in a regulatory context where the ESG framework is moving from a voluntary approach to a compliance logic. Neglecting these criteria could lead to serious consequences for companies, such as fines, loss of customers and investments, increased financing costs, and misalignment with other essential stakeholders to the 'companies' operations, such as talent. Moreover, it is undeniable that, in Europe, ESG is becoming a real license to operate and an obligation, making it indispensable for business sustainability.

Nonetheless, it is important to recognize that ESG criteria, mainly considered broadly and beyond the EU, have certain limitations Its scope is bounded to investment and reporting language, and corporate legislation. It can also be a politically manipulable concept. This makes the ESG criteria less comprehensive and less attractive as a sustainability tool compared to the SDGs, which are characterized as a universal, solid agenda aimed at all stakeholders.

In this context, even though not all the SDG targets may be targets to which companies can contribute directly, it is essential that ESG language is mapped in terms of the SDGs so that this is possible:

- Align the language of companies with a universal, ambitious language that truly contributes to the Sustainable Development that society needs;
- Promote the alignment of companies with other stakeholders and make their action effective, through partnerships whenever possible;
- Promoting the contribution of companies in a positive way, taking into account their positive impacts and also managing their negative effects, turning risks into opportunities;
- Leveraging the role of companies as a "piece of a much bigger puzzle" and promoting their convergence and alignment with the change needed for the world (Planet, People, and Prosperity).
- Understanding the virtues and shortcomings of both languages in order to increasingly align the contribution of companies to the necessary changes in the world.

The good news is that the new European legislation (CSRD) has opened opportunities in this regard by inspiring and aligning its ESG criteria with the SDGs and their impact ambitions. This will make it easier for companies to comply with European ESG legislation and contribute to the SDGs in an integrated way.

As this European legislation will have a strong influence on the rest of the world, relying on its global reach (as seen previously) and the EU's international trade and operations, possibly this European ESG agenda will rule the world and help businesses follow a uniform language that will directly contributes to the SDGs. At this stage, it remains to complete this legislative package in alignment with the 2030 Agenda, through a clear and explicit mapping, if necessary, of the ESRS in terms of SDGs. There is still a need to ensure that the SDGs are taken into full consideration by EFRAG, something that this project is committed to implementing.

This proposed alignment will allow the ESG criteria, which originated in the 1990s and are intrinsically linked to the concept of Sustainable Development of societies and the purposes of the UN Global Compact, to fulfill their initial purpose after more than three decades: to align business agendas not only with financial risks, but with the "sustainable development of the societies" (Who Cares Wins, 2004, p. 11). We can only hope that the ESG business case represents real value creation and not just value capture. This value creation can only be achieved when ESG business agendas are fully aligned with the Universal Agenda that we so desperately need to fulfill - the SDGs.

3.5. What considerations can we make to open the subject to debate?

Considering the challenge proposed by the Observatory and the potential benefit this debate could bring to all stakeholders, we are committed to this discussion, which can make a genuine contribution to advancing the 2030 Agenda. Therefore, we propose that this debate be launched, and, to this end, we present **some questions for reflection:**

- What steps are required to achieve clear harmonization of ESG criteria on a global scale? Will it be possible to achieve this harmonization in the next 5 years?
- Does it make sense to align the ESG criteria with the SDGs, and to what extent can we achieve this alignment in the short term?
- What are the pros and cons of this alignment? What advantages and challenges await us?

The Observatory is therefore proposing to delve deeper into this issue and promote debate on it in Year 3 of the project (2024). We believe that this initiative can provide significant advances in the role of companies towards the progress of Sustainable Development and the advancement of the 2030 Agenda.

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