



**CFA SINGAPORE  
INSIGHTS**

By Matt Orsagh

## ESG analysis: Is judgment more important than data?

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**O**VER the past two years, CFA Institute and the Principles for Responsible Investment (PRI) have gone around the world to better understand the current state of environmental, social, and governance (ESG) integration. One key ESG topic raised in all our discussions was the issue of ESG data – specifically, the problem of obtaining quality data that are decision-useful.

Many of the investors and financial analysts we spoke with said that the availability of meaningful and comparable ESG-related data is getting better, but still is not at a sufficient level. The availability of ESG-related data is growing and improving – just look at a Bloomberg terminal or whatever resource you use to collect ESG data. The amount of data available for ESG metrics has grown exponentially over the past decade, and for large multinational companies in developed markets, investors can find a lot of what they need. But gaps still exist. If, however, you are trying to find ESG data for small- or mid-cap companies or companies in emerging markets, it is likely that the data does not yet exist or will take a great deal of digging to uncover.

Until the availability of data catches up with the demands of financial professionals, investors and analysts will have to use more judgment than data in some of their analysis and decision-making surrounding ESG issues.

Is that so bad? Not necessarily.

### It's called analysis

After all, what we do as financial professionals is analysis. This often involves doing as much investigating and data analysis as we can so that we have a detailed, if not complete, picture of the companies in which we invest or are looking to invest.

Emily Chew, global head of ESG at Manulife Investment Management, sums up the question well: "I think it can be a false dichotomy to say that data is more important than judgment. I think that investing more generally, even outside of the ESG space, is always a combination of both. Obviously, in the active management space, which is where we are, it's a combination of both.

"But I don't think that there's ever a space where you would say that the data is somehow more important than the judgment, as they complement and enhance each other. And I think when people get so focused on the quality of data in the ESG space, what they're really saying is 'I would like to feel more confident in my judgment. I would like to feel like I had all of the information that I could have obtained and that it's high-quality and reliable, so that I can make a better judgment using my qualitative interpretation of that quality data'."

Habib Subjally, ASIP, senior portfolio manager at RBC Global Asset Management, says: "This isn't a 'data thing'; this is a 'judgment thing'. What is the right incentive scheme for management? There isn't a right or a wrong scheme because it depends on the



company, sector and country. Judgment is needed to determine what is appropriate to the profitability of the company, the industry, the state of development of the company and so forth. Climate and water have different impacts on and materiality to a bank, to advertising and to a chemical plant. We need to improve the data, but we also need to make judgments about how to best use the data and about what is relevant and material for the generation of a company's underlying business."

### Is data really a barrier?

Well, yes and no. Yes, it can be in the short term, but less so in the long term. Yes, it can be for small- and mid-cap companies, but less so for larger companies. Yes, it can be for those who want data to drive decision-making, but less so for those who are comfortable using judgment in their investment decision-making.

The challenges around data and the use of judgment are further explained by Jacob Messina, CFA, head of SI Research at RobecoSAM: "Quality and availability of ESG data have greatly improved over the past five years, but there are still many deficiencies, so you need judgment to decide if you're using data in the right way."

### Small- and mid-cap companies

As ESG disclosure standards such as SASB (Sustainability Accounting Standards Board) and TFCF (Task Force on Climate-Related Financial Disclosures) gain traction with investors and issuers, the data supporting ESG data will only improve.

Small- and mid-cap companies and companies in emerging markets will feel more comfortable gathering and disclosing ESG information, will be able to focus on the handful of ESG metrics germane to their business, and will not have to worry about hundreds of other ESG data points.

Currently, with so many ESG key performance indicators (KPIs) demanded by investors, practitioners are concerned about which ones to choose – a problem that standardisation of reporting would

help. ESG integration requires understanding the ESG issues and selecting those that are material. Including every KPI in an analysis would result in a tiny weighting of each, with the most relevant KPIs being diluted. Large companies have an advantage over small companies in reporting ESG data. Investors need comparable data and a significant data history, which are not available with small-cap firms. Because large companies have more resources in terms of personnel and budget, they also can spend more on ESG marketing, allocate more time to engaging with investors and devote more resources to tracking ESG data.

### Judgment versus data

ESG integration is just good analysis. Such analysis captures more of the risks and opportunities – including unknown risks and opportunities – that ESG integration techniques typically identify. Practitioners who fail to analyse ESG issues could miss alpha-generation opportunities, whereas investors who do analyse ESG are likely to outperform their peers over the long term simply because they are engaging in a more thorough analysis.

As Sebastien Thevoux-Chabuel, portfolio manager at Comgest, points out: "If you want to have an edge, you need to go from data to judgment to insight. Insight creates a holistic view of what truly matters for a specific company."

When complete data are not available or standardised, analysts and portfolio managers really earn their money. Knowing the industries in which they invest and the companies they analyse enables good analysts and portfolio managers to exercise judgment to fill in the gaps.

Nevertheless, judgment and data go hand in hand, as Patrick O'Hara, senior responsible investment analyst at USS Investment Management, points out: "You can't apply judgment without reliable data, if the data is unreliable then this can compromise your judgment. Equally raw data provides very little insight unless it is contextualised and judgment is applied to it."

Good analysts track down data when they aren't handed data in company filings. Analysts can do channel checking, kick the tires of a company's supply chain, or do a deep dive into regulatory data (such as health and safety data in each market) that may not be included a company's filings.

In our workshops held around the world over the past two years, we encountered more than just a few investors who admitted that ESG data needed to be improved, but they were in no hurry to see ESG data standards develop. These investors were confident that their judgment around ESG issues was a competitive advantage, and that if that data were standardised, their advantage might be taken away.

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