Sustainability rankings don't always identify sustainable companies

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ESG rankings and lists aren't often entirely reliable for consumers or investors wanting to make decisions on companies they buy from or invest in. Credit: Appolinary Kalashnikova/Unsplash

British American Tobacco (famous for cigarettes), Coca-Cola (world-renowned for its sugary soft drinks) and Glencore (a British/Swiss mining company) were recently ranked in the top five most environmentally and socially responsible companies on the FTSE 100, the share index of the 100 biggest companies listed on the London Stock Exchange.

As consumers and investors, we often look at environmental, social and governance (ESG) rankings to guide our purchase, investment and employment decisions. But what should we make of this list, compiled by British investment services firm Hargreaves Lansdown?

As kids, we learned that smoking kills, yet British American Tobacco has a place at the top of the list, suggesting it's a highly responsible company.

Obesity, cardiovascular disease and diabetes are life-threatening diseases, yet Coca Cola, a leading sugar purveyor, also has a top ranking.

Glencore is being investigated for alleged fraud offenses, yet it's No. 4 on the same list.

Meaningless?

A number of lists rank companies as being "most responsible" or the "best corporate citizens" or the "most green."

The Corporate Knights Global 100, for example, is an annual list that evaluates companies based on their sustainability performance. Companies are given a score based on their environmental, social, governance and economic performance and then ranked from one to 100.

Newsweek magazine's America's Most Responsible Company list also ranks U.S. companies on their sustainability performance.

Its 2021 list ranked Citigroup as the country's ninth most responsible firm. The bank was recently fined US$400 million by federal regulators for "unsafe and unsound banking practices."

Microsoft is ranked third on the same list, yet earlier this year, 250 million client records were exposed online without password protection.

Procter & Gamble, 23rd on the Newsweek list, is currently being scrutinized for its reliance on trees from Canada's northern boreal forest.

In Canada, Corporate Knights ranks Canada's Best 50 corporate citizens. Leading the pack is Mountain Equipment Co-op, which recently apologized for the lack of diversity in a marketing campaign that excluded people of color.

Hydro One, in the No. 11 position, has been taken to task for its executive compensation packages.

Consumers, investors look at rankings

Increasing numbers of investors depend on ESG information from third parties for their investment decisions. Similarly, consumers are seeking sustainable products and looking to responsible firms to inform their purchasing decisions.

There are also an increasing number of companies entering the ESG rankings field. Currently there is no regulatory oversight or consistency across ranking agencies on what factors are being assessed in the rankings and who is assessing them.

As well, there are no global or nationally accepted standards or consistent requirements on what should be reported or measured for ESG performance. Companies are evaluated based on a wide range of criteria, making it challenging for consumers and investors to make fully informed decisions.

Should investors look at ESG ratings to assess their investment choices and the associated risks?

We looked at the top five Canadian firms from Corporate Knights 2020 Global 100 list and searched the Sustainalytics ESG Risk Database to see their ESG risk. Sustainalytics, a company initially launched in Canada as Jantzi Research, measures a company's exposure to industry-specific ESG risks and how well a company is managing those risks, as well as the extent of any unmanaged ESG risk.

Three Canadian companies—the Bank of Montreal, Cascades and Canadian National Railway—were ranked as low risk, while two, Algonquin and Bombardier, which placed even higher on the Corporate Knights Global 100 list than the three aforementioned companies, are considered high risk by the Sustainalytics ESG Risk rating.

No consistency

Why would one well-known ESG ranking agency rate a company a leader while another flag it as high risk? If all the ratings and rankings are measuring ESG, we would anticipate consistency across rankings.

While rankings should help us in our quest to make better, more sustainable decisions and choose ethical companies as consumers and investors, they can be misleading and provide only a partial view of a company's ESG commitments.

When determining which rankings to trust, we suggest looking for ranking agencies that use public information to assess companies on ESG performance. Quality ranking organizations are transparent about how they analyze companies and come up with their rankings. Those reading the lists should be able to assess the information provided in the ranking quickly and with confidence about what it really says.

Look for rankings that don't accept payment from companies to participate; this reduces their power to influence their placement. Look at information from multiple rankings and ratings.

When companies in contested industries (those that do harm) score high in sustainability rankings, it should raise serious questions about the validity of the ranking.

Rather than blindly trusting rankings, understand the information provided by each list. While rankings are designed to offer compressed information, unfortunately, we still need to do our own research to evaluate companies.

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