AMERICAN JOURNALS
Open Access, Peer Reviewed Journals

American Journal of Business Management, Economics and Banking
ISSN (E): 2832-8078 Volume 27, | August - 2024

INVESTING BASED ON ESG FACTORS: METHODOLOGICAL APPROACH

Nasirov Egamkul
PhD, Head of the Department "Valuation and Investments"
Tashkent State University of Economics
egamqul74@mail.ru

A B S T R A C T	K E Y W O R D S
The article describes the role and significance of the "ESG" approach in ensuring the implementation of the objectives set by the UN sustainable development goals. The methodological foundations for regulating ESG activities at the international level and the methodology for assessing ESG factors of companies have been studied. Here, recommendations are given for the application of the ESG approach in the national economy.	ESG factors, green economy, financial instruments, green investments, responsible investments, socially responsible investments, green financing, green projects.

Introduction

In recent years, participants in international financial relations have increasingly attached importance to the Sustainable Development Goals (SDGs). Governments of various countries, regulatory institutions, development institutions, large companies, stock exchanges and financial market participants are actively involved in the implementation of the tasks included in the BRM. In particular, the principles of responsible investment (PRI, UN Principles for Responsible Investment) were developed based on the initiative of the United Nations in this regard, which contain necessary recommendations for including the analysis of ESG factors in investment activities. Most of the world's largest companies support this initiative. Companies are also trying to ensure that their core goals are aligned with the wishes and desires of community members by considering ESG factors when making investment decisions.

For example, in January 2020, Microsoft announced plans to transition to negative carbon emissions by 2030. From its foundation in 1975 to the present day, the company has undertaken to eliminate the consequences of the company's carbon emissions. It also announced that it will invest $1 billion in the Climate Innovation Fund [1].

Unlike developed countries, in our country investment practice taking into account ESG principles is at the initial stage of the process of formation. Furthermore, the regulatory and methodological foundations for investing in the national economy based on ESG principles have not been developed. Furthermore, many local economic entities lack sufficient understanding of investment decision-making based on ESG principles. In most cases, economic entities with an understanding of this issue do not pay serious attention to the implementation of ESG principles.

Review of literature on the topic

Today, new financial instruments are emerging as a result of global efforts towards sustainable development goals. This approach is confirmed by the following sources.

Currently, changes in all aspects of the financial sector are being implemented by introducing sustainable development tools into them. Today, sustainable development is not only noted as a concept, but has become a practically oriented mainstream in the world of business and investment. This, in turn, requires the effective formation and development of the responsible investment (ESG) market [2].

The application of ESG approaches in companies is influenced by external factors, while the increasing interest of foreign investors and public policy in this area is of decisive importance [3].

Responsible investing, or ESG investing, relies on environmental, social and governance factors in the investment decision-making process. At the stage of transition to an information society and improvement of people's lifestyle, investors do not look at economic efficiency as the main factor in assessing the feasibility of making investments, but at the same time, they consider criteria such as moral values and spiritual development of the individual as a priority. When making investment decisions, economic agents rely not only on the stable growth of the company's financial indicators, but also on information not related to the company's financial indicators, in particular, on the principles of environmental protection and social responsibility of these companies [4].

As a type of institutional innovation, the application of "green" financing policies leads to increased financial constraints for companies that pollute the environment more. This can change the actions of companies in terms of environmental pollution in a positive way. Encouraging financial institutions and enterprises to assume more environmental and social responsibility through "green" financing policies can be an effective way to allocate resources and increase the efficiency of "green" development [5].

Research methodology

The methodological basis of the research includes the theoretical rules related to the application of ESG factors in the financing of projects and investment decisions aimed at achieving "green" economic development provided for in the concept of sustainable development. Graphic methods, grouping and comparison, analysis and synthesis methods were used in the research process as a systematic approach to the object of research.

Analysis and results

In recent years, representatives of the international community have increasingly put forward the idea that income from any business should correspond to generally accepted norms and rules related to environmental protection, social justice and responsibility, as well as the protection of human rights. This concept is directly related to the practical application of ESG principles.

The concept of "ESG", which combines environmental, social, and corporate governance factors, was first used in a report prepared in 2004 based on the materials of the conference "Who Cares Wins", held on the basis of a joint initiative of the UN and major financial institutions [6].

Subsequently, on the basis of the UN initiative, in cooperation with institutional investors, 6 principles of responsible investment for economic entities were developed (Fig. 1).

1. Consideration of ESG factors in investment;
2. Considering ESG factors in company management;
3. Require disclosure of information related to ESG factors;
4. Facilitating the implementation of ESG factors;
5. Cooperation with enterprises and organizations working on the basis of ESG principles;
6. Sharing with others the work done based on ESG principles.

Figure 1. Principles of responsible investment, developed on the basis of the UN initiative [7]

In the context of responsible investment, voluntary principles such as taking ESG factors into account when investing by economic entities, taking ESG factors into account when managing a company, requiring disclosure of information related to ESG factors, assisting in the implementation of ESG factors, interaction with enterprises and organizations operating on ESG principles, and sharing work carried out on ESG principles with others should be considered.

Methodological approaches to the regulation of ESG factors are mainly related to the establishment of rules for disclosure of non-financial reports. In international practice, a number of legal frameworks and initiatives related to the regulation and coordination of ESG activities have been formed. Such legal bases and initiatives have the following form (Fig. 2).

1. Legal bases and initiatives related to the regulation of ESG activities in international practice

- international regulation of political or economic associations established between countries on the basis of international agreements;
- corporate management codes;
- national regulation of corporate law, environmental and social issues;
- voluntary initiatives by market participants to disclose information on ESG principles.

2. Legal foundations of international regulation of ESG activities

- Paris agreement on climate change;
- UN Sustainable Development Goals (SDGs) until 2030;);
- Corporate governance principles of G20 and Organization for Economic Cooperation and Development (OECD);
- OECD principles of management for multinational companies;
- Corporate governance principles of OECD for state-owned enterprises
- UN and World Bank road map for transition to a stable financial system;
- 10 principles of the UN Global Compact on human rights, labor relations, environmental protection and fighting corruption
- A practical guide on incorporating ESG factors into investment processes developed by the Principles for Responsible Investment (PRI) organization at the UN.

Figure 2. Legal frameworks and initiatives related to the regulation of ESG activities at the international level [1]

[1] It was compiled by the researcher based on the reports of international organizations.

As part of the global call on climate change, many countries of the world have joined the Paris Agreement on Climate Change. More than 190 countries of the world, which have signed this agreement, have undertaken obligations to achieve the BRM. On the basis of such changes, until recent years, a number of companies abandoned the voluntary practice of disclosing information that was not institutionally accepted to combat climate change. In its place, a robust ESG ecosystem has been established.

Guidelines are published and regularly updated by the developers of international ESG standards to help understand the requirements for corporate ESG practices and what ESG-related topics should be disclosed. In this way, ESG standards have an impact on decisions regarding the direction of the company's ESG strategy.

We now turn our attention to a review of a number of international standards related to ESG (see Table 1). Most of the international standards for sustainable development presented in the table are non-binding. That is, disclosure of non-financial information by companies is based on discretion. However, it is mandatory to present non-financial statements based on the IFRS S1 and IFRS S2 standards provided by the International Sustainability Standards Board (ISSB) and the European Union's Corporate Reporting Guidelines on Sustainable Development (CSRD).

International practice, in addition to presenting reports based on ESG and Sustainable Development standards, there is a practice of determining ESG ratings and ESG rankings of companies. ESG ratings of companies can be determined by international agencies as well as national rating agencies.

Today, there are about 160 entities operating in the global market that determine ESG ratings or offer analytical information packages using ESG data. There are a number of commercial and non-commercial organizations that offer comprehensive or specialized ESG rating data sets.

The following companies can be included in the list of leading companies in the international ESG ranking market:

- ISS (Institutional Shareholder Services) ESG;
- Sustainalytics ESG Risk Rating;
- Moody's, MSCI and S&P Global companies' ESG ratings;
- Bloomberg ESG scores;
- Fitch Climate Vulnerability Scores (Fitch Ratings);
- FTSE Russell's ESG Ratings;
- Thompson Reuters ESG Scores.

Table 1 Characteristics of international ESG standards[2]

№	Naming of international standards	Characteristics of international standards
1.	Global Reporting Initiative (GRI)	GRI is one of the most widely used standards in global ESG practice. The GRI includes comprehensive reporting requirements for the governance, economic, environmental and social aspects of a company's operations. This standard was developed by Exxon Valdez in 2000, based on the impact of damage to the environment caused by oil spill during oil extraction. According to the Sustainable Development Report of 2020, which was reviewed by KPMG, 96% of the world's 250 largest

[2] It was compiled by the researcher based on the information obtained from the official websites of international organizations and associations.

		companies reported on their sustainable development activities. 73 percent of companies reporting in this area are based on the GRI system.
2.	The Sustainability Accounting Standards Board (SASB)	The Sustainable Development Reporting Standards include 77 industries. For each industry, a minimum set for reporting topics and a set of indicators for quantitative evaluation and comparative analysis of efficiency are provided. Since August 2022, the International Standards Board for Sustainable Development (ISSB) of the International Financial Reporting Standards Fund (IFRS) has assumed responsibility for SASB standards. ISSB, in turn, has undertaken to support, improve and develop SASB standards.
3.	Integrated reporting (IR)	The concept of IR was originally announced by the International Integrated Reporting Council (IIRC). The IIRC was established in August 2010 with the aim of creating a globally recognized reporting system for companies to create specific value over time. IR is based on 3 fundamental concepts. These are: creating, maintaining or reducing value for the company and others; financial, production, human, health capital and social relations; the process of creating, storing or destroying value. In June 2021, the International Integrated Reporting Council (IIRC) merged with the Sustainable Development Accounting Standards Board (SASB). As a result of the merger, the Value Reporting Foundation (VRF) was established. The goal of the merger is to provide investors and corporations with a comprehensive system of corporate reporting. In this case, the value of the enterprise is determined according to the necessary standards.
4.	Recommendations of the Working Group on Disclosure of Climate-related Financial Information (Task Force on Climate-related Financial Disclosure, TCFD)	The working group examines the health risks associated with climate change, the risks associated with liability, and the risks associated with transitions to a low-carbon economy. It also analyzes the effectiveness of information disclosure in various sectors of the economy. In this direction, the main attention is paid to the risks associated with climate changes and their financial aspects. Also, recommendations are based on a scenario approach. Recommendations, in turn, apply to financial institutions and non-profit organizations. The TCFD recommendations were introduced in 2017 to help investors, lenders and insurers obtain the information they need to assess the risks and opportunities associated with climate change. Implementation of the working group's recommendations is voluntary. However, in countries such as Brazil, Japan, Singapore, Switzerland, Great Britain, the application of the recommendations of the working group is becoming a mandatory condition. According to TCFD's 2022 report, as of October 2022, more than 3,800 companies have submitted reports based on TCFD's recommendations.
5.	Non-financial disclosure standards for greenhouse gas emissions (Carbon Disclosure Project, CDP)	CDP Worldwide is a non-profit organization founded in 2000. This organization manages a global system for disclosure of information on the environmental impact management of investors, companies, cities, regions and regions. More than 20,000 companies from around the world complete the survey on climate change, water resources and forestry provided by CDP. The CDP questionnaire is mutually agreed with the TCFD.
6.	International Council of Standards for Sustainable Development	ISSB has released two global standards for corporate disclosure of information on sustainable development. These are the International Standards of Financial Reporting IFRS S1 "General Requirements for

	(International Sustainability Standards Board, ISSB)	Disclosure of Financial Information Related to Sustainable Development" and IFRS S2 "Disclosure of Information Related to Climate Change". It is noteworthy that these standards came into force on January 1, 2024.
7.	The European Union's Corporate Reporting Instruction on Sustainable Development (Corporate Sustainability Reporting Directive, CSRD)	From January 5, 2023, the European Union's Corporate Sustainability Reporting Directive (CSRD) came into force. This directive affects more than 50,000 companies in Europe and more than 10,000 companies outside Europe. The standards cover all aspects of environmental, social and governance issues, including climate change, biodiversity and human rights. These standards help investors to understand how the companies in which they invest are making a sustainable development impact.

Today, the number of organizations that determine ESG ratings in the global market is increasing year by year. In turn, each organization providing such services has its own methodology for determining ESG ratings and they differ from each other. In addition, some organizations determine the ESG rating based on open data without sending a formal request to the company. Therefore, when ESG indicators of the same company are evaluated by different organizations, its results differ significantly from each other.

For example, studies conducted by Florian Berg, a researcher at the "MIT Sloan School of Management", show that six out of ten different ESG ratings match. A comparison of the MSCI and Sustainalytics ratings for S&P Global 1200 companies by CSRHub revealed a weak correlation (0.32) between the two ratings. This indicator differs several times from the indicators used to determine credit ratings. Usually, credit scores match in 99% of cases. For example, Moody's and S&P credit ratings have a very strong positive correlation (0.90) [8].

Therefore, the ESG rating system based on different standards is an obstacle for market participants to make informed decisions when investing capital taking into account ESG. This situation, in turn, means that different ESG standards and rating methodologies need to be reviewed in terms of integration.

Conclusion

1. In our country, the practice of making investments based on ESG factors is at the initial stage of the formation process. In our opinion, the state should be the leader in the development of such activities. For this, it is necessary to include ESG-related provisions and frameworks for regulating and promoting ESG activities in legislative documents.
2. The lack of a single set of standards and evaluation methodology for evaluating the ESG indicators of companies, the lack of clear definition of entities that regulate ESG activities in the segment of economic entities, and the absence of organizations for determining ESG ratings are an obstacle to the development of ESG investment practices in Uzbekistan. Therefore, in our country, based on foreign experiences, a single set of ESG standards, their evaluation methodology, the establishment of entities regulating ESG activities, and the introduction of the procedure for determining ESG rating serve to fill the "gaps" in this regard.
3. In order to develop ESG activities in Uzbekistan, it is recommended to accelerate the issuance of "green" and "social" bonds and the granting of "green" loans by commercial banks, the creation of new types of "green" energy and their active use, as well as the use of ecological labels.
4. In Uzbekistan, it is necessary to make it mandatory to apply ESG requirements in the following types of activities and directions:

- at the initial stage, large and medium-sized business entities, and at the next stage, all small business entities submit an ESG report;
- reflection of ESG factors in the feasibility study (business plan) of medium and large investment projects;
- to study the compliance of projects with ESG standards when allocating loans to medium and large investment projects by commercial banks;

inclusion of ESG principles in the requirements of investment portfolio formation by commercial banks, insurance companies and investment funds.

References

1. https://blogs.microsoft.com/blog/2020/01/16/microsoft-will-be-carbon-negative-by-2030/?Culture=ru-ru&country=ru
2. Ivanitsky V.P., Petrenko L.D. Development of responsible investments in accordance with the concept of sustainable finance. Journal of New Economy. 2020, Vol. 21, No. 4, -P. 63.
3. Galazova S. S. The influence of ESG factors on the sustainable development of companies and the financial performance of the corporate sector // Bulletin of the RSUE RINH. 2018. No. 4 (64). P. 81–86.
4. Ivanitsky V. P., Gabyshev D. N., Zubkova L. D. Individual income tax management: new opportunities// Manager. 2019. Vol. 10, No. 5. P. 41–51. DOI: 10.29141/22185003-2019-10-5-5.
5. Shuitu Qian, Wenzhe Yu, Green finance and environmental, social, and governance performance, International Review of Economics & Finance, Volume 89, Part A, 2024, Pages 1185-1202, ISSN 1059-0560, https://www.sciencedirect.com/science/article/pii/S1059056023003386
6. https://www.unepfi.org/fileadmin/events/2004/stocks/who_cares_wins_global_compact_2004.pdf
7. https://www.unpri.org/about-us/what-are-the-principles-for-responsible-investment
8. Berg F., Koelbel J.F., Rigobon R. Aggregate confusion: The divergence of ESG ratings. 2019. https://www.eticanews.it/wp-content/uploads/2019/09/20190819MITdivergenceESGratings.pdf