QUOTED COMPANIES ALLIANCE

Research Report

Asking the Earth?: Investor Attitudes to ESG

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Introduction from the QCA

When one of the first ESG indices, FTSE4Good, was created in 2001, the supermarket group Sainsbury's was included but its closest rival Tesco was not.

Their performance was not particularly dissimilar, except Sainsbury's published an environmental report setting out its achievements while Tesco, which recycled 155,000 tonnes of card that year, did not. Tesco's redoubtable leader, Sir Terry Leahy, was quick to give FTSE managers the hairdryer treatment for what he saw as a glaring omission.

Fast forward a generation, and appropriate disclosure remains at the heart of good ESG reporting. But the simple choice to publish or not to publish has been replaced by a multiplicity of data points that companies may be asked to satisfy, as well as the construction of a multi-year narrative so investors can understand the stock's direction of travel. And, unlike Sir Terry, directors at smaller companies cannot easily remonstrate with the indices over the way they are categorised.

The ESG conversation was once an awkward bolt-on in board meetings but now risks dominating the debate. That should be a good thing, if it involves directors thinking hard about improving performance to meet the demands of their owners, staff, suppliers and the planet.

But the concern must be that ESG requirements can unfairly stem the flow of funds because of miscommunications. Those that stand to suffer the most are the growth companies with limited resources for whom attracting fresh capital is most pressing.

For this reason, this report into small and mid-cap investor attitudes to ESG is exceedingly timely. Following an earlier survey of company views, it offers a detailed picture of what investors want – a question we know is never far from members' minds.

Most worrying, the findings do confirm our fears that companies are missing out through lack of disclosure.

Proportionality - that small companies simply cannot be held to the same standards as large - is a key tenet of the QCA. Ironically, ESG, which is supposed to be steadfastly future-focused, appears less enlightened in this area.

We hope this work shines a light on these failings, and we are grateful to CMS and Inspired PLC for supporting the project as well as YouGov for carrying out the research.

We want investors to make appropriate demands and companies to be able to respond to them quickly and easily.

If ESG encourages better behaviours, fosters better understanding of the underlying investment and channels funds into positive solutions, it's a win-win. But we aren't there yet.

James Ashton

Chief Executive, QCA

CMS foreword

When corporate governance first burst to the fore with the Cadbury Report in 1992, the focus was almost exclusively on executive pay. Over the following 10 years or so, the importance of the audit committee started increasing in recognition. Fast forward to today and the UK Corporate Governance Code and QCA Corporate Governance Code have expanded greatly to focus on inducting new independent directors, workforce engagement and regularly reviewing the functioning of the board.

The "G" in ESG has taken over 30 years to reach the stage where companies understand what it is that is required of them and to be able to report accordingly. Contrast that to the "E" and the "S" which started gaining mainstream attention some 10 or so years ago and have seen their importance to investors and customers rise exponentially over the past 5 years. Companies have had to adapt to the full panoply of ESG reporting more than three times faster than they did with corporate governance alone. Arguably, investors are also having to adapt at the same speed.

One of the biggest challenges with ESG reporting today is understanding what information is required; what investors themselves want to know; what it is that the companies they invest in need to measure; what mandatory requirements apply now; and what mandatory requirements are on the horizon.

This timely report highlights the importance of ESG reporting to investors in making their decisions – something which companies cannot afford to ignore. However, there is often a huge gap between the expectations and requirements of investors and the information that can be readily collected and processed, particularly by smaller businesses that may not have dedicated sustainability-focused teams.

The fast changing and developing nature of ESG reporting poses particular problems for companies for whom the reporting requirements may only become obvious well into the reporting period and may require information from a number of different countries. Time and again, companies are playing catch-up, having to gather data in respect of historic periods or work out how to measure data after the fact.

Given the importance of ESG reporting to investors demonstrated in this report, it will be important for investors to recognise the challenges for companies in identifying and gathering the data to provide the reports they want. The challenge for companies is keeping up with, and preferably ahead of, those needs.

For companies who get it right, they have an opportunity to "stand out from the crowd" in the eyes of investors and reap the rewards. For investors who are clear on what they want and allow their investee companies to deliver what they need, it is equally clear that they too can reap the rewards of better returns.

Alasdair Steele

Partner, CMS

INSPIRED PLC

Inspired PLC foreword

The exponential growth in ESG regulation will only increase with the upcoming EU and USA legislation. Unsurprisingly, investors and regulators are the primary drivers for improved ESG disclosures for Main Market, AIM and AQSE companies, although we note that ESG is becoming a revenue critical item for any B2B business with such regulated companies. This study provides valuable insights into the emerging expectations of the investor community and the expected direction of travel for small and mid-cap companies on ESG disclosures.

This report succinctly highlights the business case for ESG, with most investors believing that ESG positively impacts the small and mid-cap market. This finding aligns with our experience working in partnership with our small and mid-cap clients. By providing robust ESG disclosures, they protect their revenue line (both new and renewal) and communicate their current ESG position and planned future impacts with their investors. ESG disclosures enable investors to assess their ESG risk and opportunities exposure within their investment portfolio.

Conversely, the report identifies the missed ESG investment opportunity for many small and mid-cap companies. We agree with this finding; many companies fail to properly disclose their ESG credentials, which can impact client retention rates and new business growth opportunities. Further, ESG rating agencies were identified as the best source of information on companies' ESG disclosure by investors. However, the rating agencies will scrape the public domain data, and can make mistakes, emphasising the importance of each company making robust data-driven ESG disclosures to a recognised standard.

Established frameworks like the Taskforce on Climate-Related Financial Disclosures (TCFD) and Global Reporting Initiative (GRI) allow companies to make comparable disclosures for investors. However, as the report has stated, this is not feasible for many small and mid-cap companies, especially those who don't meet the minimum threshold for carbon reporting for UK companies. This is somewhere where Inspired and the QCA could help make a difference over the coming years.

Dr Michelle de Jongh

Director ESG Services, Inspired PLC

Executive summary

In its simplest form, Environmental, Social and Governance (ESG) can be defined as a set of standards used to measure a business's impact on the world around it, and how robust and accountable it is. ESG measures how a business incorporates these issues into its operations and sustainability practices.

Its importance has grown exponentially. It has caused investors, and the companies they invest in, to rethink traditional business models and place much greater emphasis on achieving sustainable growth and value creation in the future.

This study of investor attitudes towards ESG in small and mid-cap companies is, as far as we are aware, the first of its kind.

Key findings

1. The level of investor expectation around ESG disclosure and management within small and mid-caps continues to grow. Compared to three years ago, **nine in ten investors** believe there has been an increase in expectations. When driving change on ESG, investors and regulators stand out as the stakeholders with the greatest influence.
2. This increase in expectation has seen a corresponding perception that ESG disclosure among smaller companies has got better, with **four-fifths observing an improvement**, as well as some investors noting the positive impact on this area of the market.
3. Despite these improvements, expectations are set to increase over the next few years, with three-quarters anticipating that ESG expectations of smaller companies will continue to grow.
4. Two in five investors believe that smaller companies are missing out on ESG-related investment, and a third say that the greater level of ESG-related reporting requirements means they are **more likely to invest in Main Market companies** over other small and mid-caps traded on AIM or AQSE.
5. The biggest challenge for investors in assessing the ESG credentials of small and mid-caps is the inability to compare data between companies and incomplete data.
6. The role of ESG in investment decisions continues to grow. Compared to three years ago, four-fifths report greater focus on strong ESG credentials in their small and mid-cap investment strategy, and just under two-thirds of investors have seen a corresponding positive effect on their returns.
7. Nine in ten investors believe it is important to understand how a company defines its ESG issues or provides a materiality assessment and that quantitative data on their ESG KPIs is disclosed.
8. When quantitative data is not available to be disclosed, almost half of investors value qualitative disclosures, but the other half of investors say it depends on the company.
9. Regarding timeframes, almost half of investors expect detail for the past five years or more when thinking about historic performance, and looking forward two-thirds expect projections for ESG plans over a similar three-to-five-year timescale.
10. Over two-thirds of investors say that companies should look to provide **a clearly-tailored sustainability strategy** alongside their focus on each pillar of ESG.

1

Survey findings and analysis

1 – How the ESG landscape is evolving in the small and mid-cap space

ESG has catapulted to the forefront of everyone's minds in recent years. Both nationally and globally, governments, regulators, investors, industry bodies and wider society continue to push this agenda forward. This has contributed to a complex web of ever-evolving and ever-expanding initiatives, frameworks and disclosure expectations, which even larger companies with comparatively boundless resources can struggle to navigate.

In the UK, the last few years have borne witness to several government-led initiatives and the implementation of multiple regulatory requirements. In July 2019, the government published its Green Finance Strategy[i], which was subsequently updated in 2023[ii]. The Financial Conduct Authority (FCA) imposed, within their Listing Rules, reporting requirements consistent with the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD) for companies on the Premium listing segment[iii] and Standard listing segment[iv] of the London Stock Exchange (LSE) in 2020 and 2021, respectively. The Department for Business, Energy and Industrial Strategy (BEIS) (now the Department for Business and Trade (DBT)) implemented mandatory climate-related financial disclosure requirements in the Companies Act 2006 for AIM-quoted companies with over 500 employees in 2022[v].

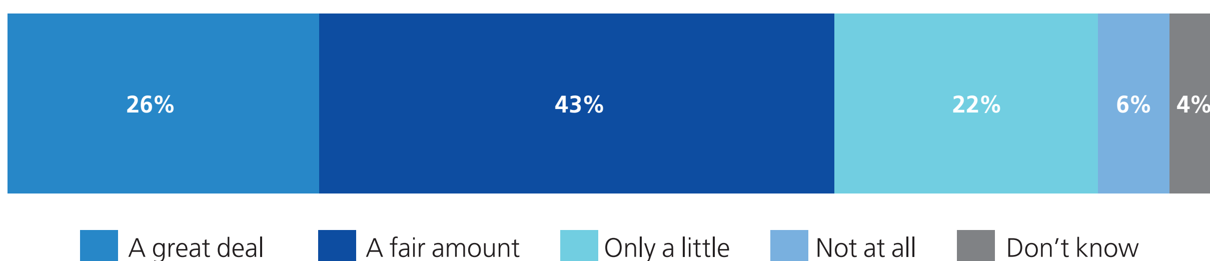
In addition to these climate-related matters, additions to the Listing Rules have also been made for both Premium and Standard listed companies to make disclosures around diversity and inclusion[vi].

As a result of all these measures, there is growing pressure for private enterprise to not only take note, but to act, or risk being left behind.

So, what about small and mid-caps? How are these companies tackling their ESG-related risks and opportunities, particularly given that many of these companies fall outside of the regulatory requirements mentioned above? What is the view of investors towards their ESG practices? Who are the stakeholders with the most influence in driving change in small and mid-caps? Are levels of expectations changing, and will they continue to do so?

Figure 1

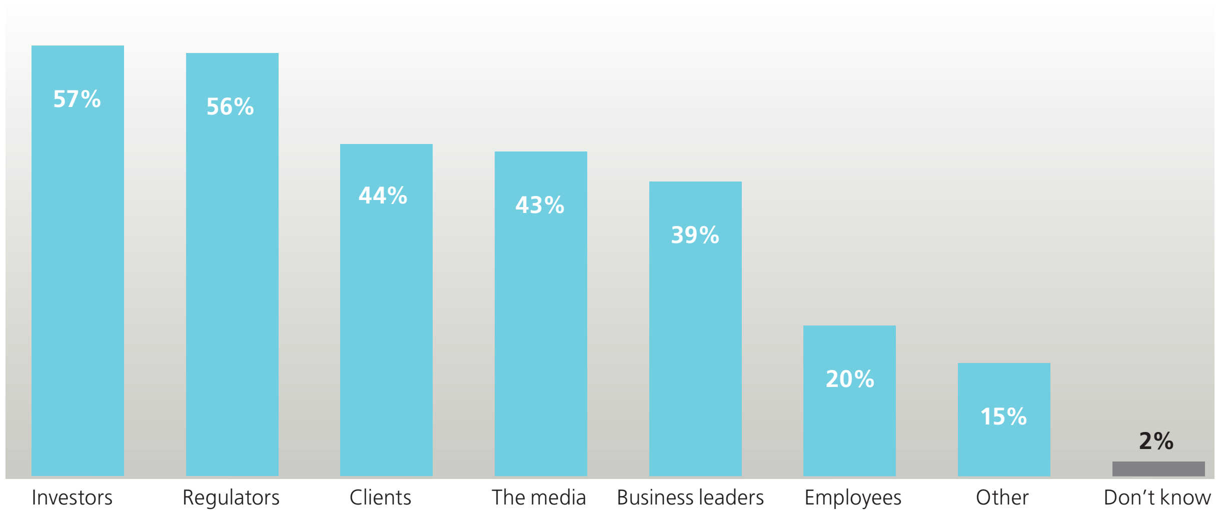
Compared to 3 years ago, to what extent do you believe the expectation of ESG disclosure and management has increased for smaller quoted companies (typically those outside of regulatory requirements such as those on AIM below certain thresholds)?



Overall, the vast majority of investors consider that the expectation of ESG disclosure and management for smaller quoted companies has increased in the last three years, with approximately 91% indicating that there has been at least a small increase in expectations. This is a reflection of increasing pressures from stakeholders for companies of all sizes to assess their social and environmental impact in the long-term. In short, maximising short-term value and profits are giving way at an increasing pace to a focus on sustainability, stakeholder value, and longer-term stability. It is also, potentially, an indication of some regulatory creep from the requirements for larger quoted companies. The implementation of regulatory or legislative requirements, even when not applicable to all companies, normalises and socialises certain levels of expectations, compelling all companies to up their game, or risk being ignored by investors and other stakeholders.

Figure 2

Who do you believe are the most influential stakeholders in driving change on ESG? Please select all that apply.

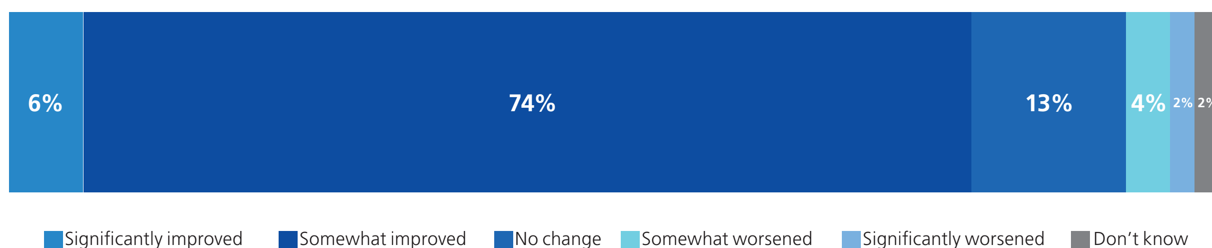


Given the consensus of higher levels of ESG expectations amongst investors it is important to establish who the key stakeholders are in driving change on ESG. Figure 2 highlights that investors believe that they themselves are the most influential stakeholders. While this is not the case for all investors, many have begun to change their business models to ensure their investee companies are placing greater focus on ESG-related risks and opportunities. This could involve divesting in certain companies who do not address certain areas of environmental or social risk, or engaging more closely in long-term dialogue to encourage companies to improve their practices. Much like the companies themselves, the investor community is also compelled to think about these issues with their own set of regulatory requirements to follow. UK asset owners and asset managers of a certain size now also have to make disclosures consistent with the TCFD's recommendations at both the entity level and the product/portfolio level[vii].

Regulators follow closely behind investors in terms of those with the most influence, but interestingly, other stakeholders, such as clients, the media, and business leaders also ranked highly, with employees also being deemed to have an influence (albeit to a lesser extent). This shows the recognition of the breadth of stakeholders that have an influence on driving change on ESG. It is now recognised as a means of improving relationships and improving trust between companies and their clients and workforce.

Figure 3

How, if at all, have the ESG disclosures and practices changed among smaller quoted companies (those typically outside of regulatory requirements e.g. the TCFD-aligned disclosures) over the last 3 years?

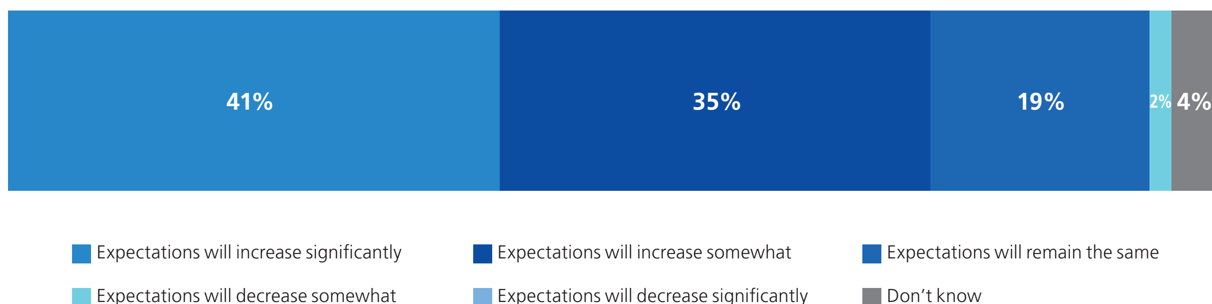


Most investors believe that ESG disclosures and practices among smaller quoted companies have improved over the course of the last three years. This is a positive development given that levels of expectations have increased. However, the analysis of ESG credentials has historically been more difficult in smaller companies, due, in part, to the lower levels of information disclosure, both from a quantity and quality perspective. This is supported by a study conducted by Federated Hermes in 2019[viii], which also found that the high rates of growth within these companies meant a rapidly changing outlook in terms of the relevance of metrics and the applicability of materiality assessments.

Nevertheless, a lot has changed in the four years since the publication of this report, and there has been an improvement in the ESG practices amongst smaller businesses that is recognised by investors. Companies are increasingly acknowledging the importance and value of communicating their ESG policies effectively. It has very much become an extension of the improved corporate governance practices of smaller quoted companies on the UK's markets in recent years.

Figure 4

How, if at all, do you see the level of ESG expectations on smaller quoted companies changing in the next 3 to 5 years?



Despite the recognition within the investment community of the improvements in the practices of smaller quoted companies, over three-quarters of investors surveyed think that expectations will continue to rise over the next three to five years, with two-fifths indicating they believe expectations will increase significantly. Some investors hold strong views around the level of expectations they have of small and mid-caps in relation to ESG:

> ***"I see no reason why smaller companies cannot comply with the TCFD framework - with the exception of scenario planning there is nothing within TCFD that is not readily deliverable."***

> ***"For most smaller companies I do not buy the argument that there are capacity constraints to their provision of data. There are numerous good examples among small cap companies."***

The level of expectation between investors does invariably differ, but the general belief is that the expectations of companies will continue to increase.

2

2 – The influence of ESG practices on investment decision-making

Obtaining investment is vital for businesses, and in particular for small and mid-sized quoted companies. The provision of investment enables businesses to acquire the necessary resources to innovate, develop product and/or service lines, and maintain and expand operations. Access to finance is essential for a business to grow and succeed.

However, in an increasingly competitive marketplace, the fight for finance continues to get fiercer. Investors' mandates change, and as highlighted earlier in this report, expectations on the practices of companies grow. This can often mean that smaller companies, who might not necessarily have the requisite level of resources or capabilities to meet expectation demands, miss out on financing opportunities, particularly in comparison with larger companies.

Studies completed in the past have looked at disparities between the preferences of investors and the practices of companies in relation to ESG. A 2020 report produced by PwC[ix], for instance, found that investors were looking for standardised, rigorous data in order to support their investment decision-making, but companies were releasing information in an inconsistent manner which investors might find difficult to understand.

Given the findings of this study, as well as others, we set out to determine how ESG practices impact investment decision-making, with a specific focus on small and mid-cap investors. We sought to uncover whether small and mid-caps were missing out on investment due to their ESG practices, whether there is a stronger preference for investing in Main Market companies due to higher ESG-related regulatory requirements, and the importance of ESG disclosures and companies with good ESG credentials in investors' decision-making.

Figure 5

Do you believe that smaller quoted companies are missing out on ESG investment? If yes, why?

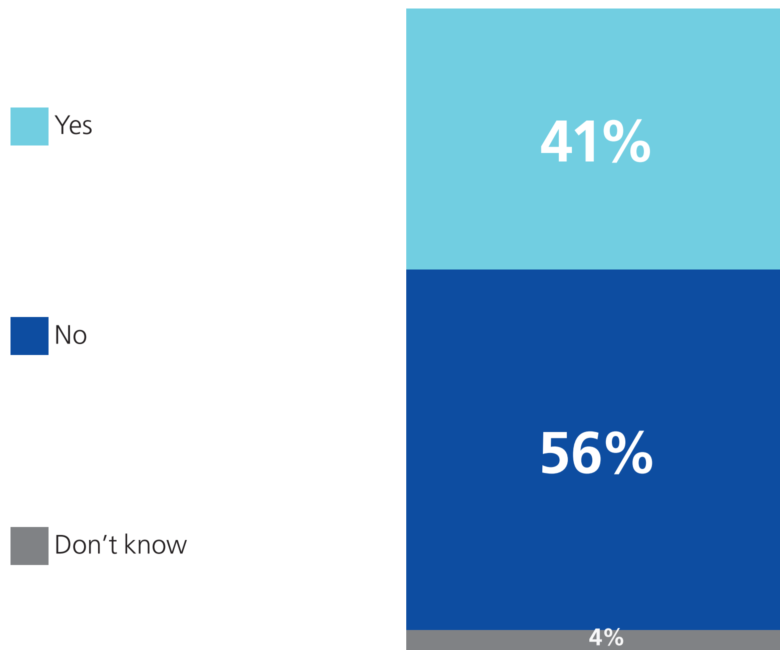


Figure 5 shows that over two-fifths of investors believe that smaller quoted companies are missing out on ESG investment. More and more institutional investors view ESG issues as essential in determining the full risk profile of a company and how well it will be able to manage their risks in the future. To do this, investors are looking for companies to clearly set out and articulate a long-term, sustainable strategy that ensures value creation by not only outlining growth opportunities, but also their related social and environmental risks.

We also asked investors how their investment strategies and decisions in the small and mid-cap market have changed in recent years. Over two-thirds of investors say that ESG disclosures are important in their investment decisions and four-fifths indicate that they now have a greater focus on companies with positive ESG credentials compared to three years ago, hinting as to why some companies are missing out on investment.

Some respondents also mentioned the importance of ESG and how companies are missing out on more investment and that a greater focus could lead to growth:

"Smaller quoted companies have failed to change their behaviours and are missing out on [a] sea of investments."

"[The] future is all about ESG and it could lead us to greater chances towards growth."

The reasons why investors believe smaller companies are missing out on this investment vary, but predominantly relate to their reporting and size limitations:

"They don't provide the same level of info as large cap."

"It's difficult for smaller quoted companies to implement."

"It is more difficult for smaller companies to score highly on ESG."

"Under resourced management teams [are] distracted, being pulled in different directions by inconsistent approaches to ESG reporting expectations."

Figure 6

What is the biggest challenge you face when asking for ESG-related information in small and mid-caps?

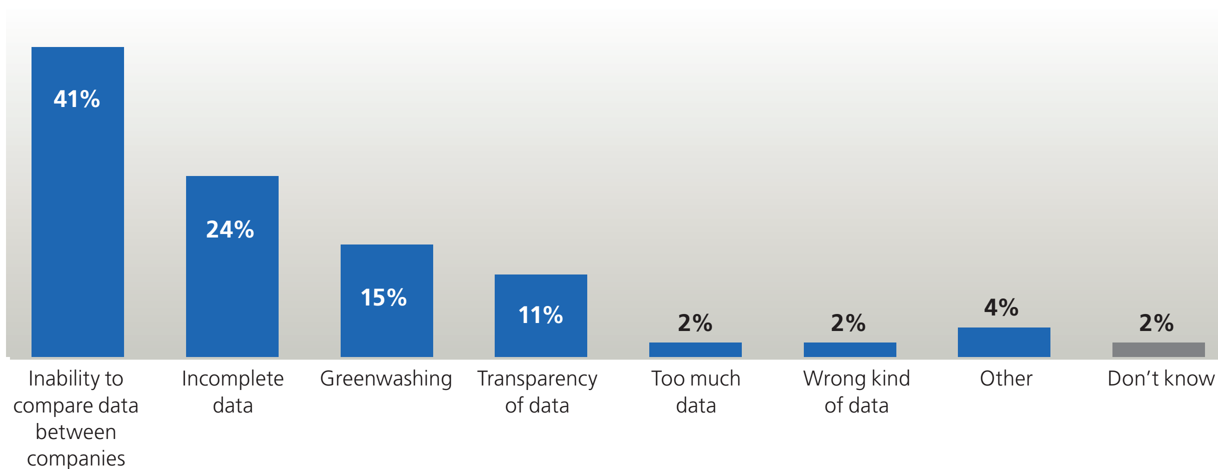


Figure 6 also reflects these viewpoints, with the inability to compare data between companies and incomplete data sets ranking as the key issues investors encounter when retrieving ESG information from small and mid-caps. This shows a strong desire amongst the small and mid-cap investor community for companies to provide robust quantitative data so that they can assess a company and compare it with others.

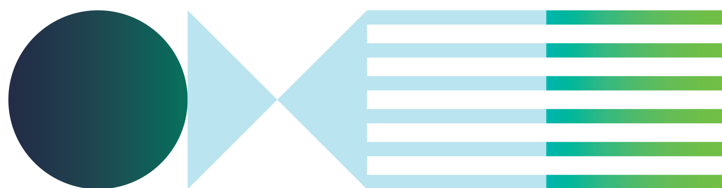
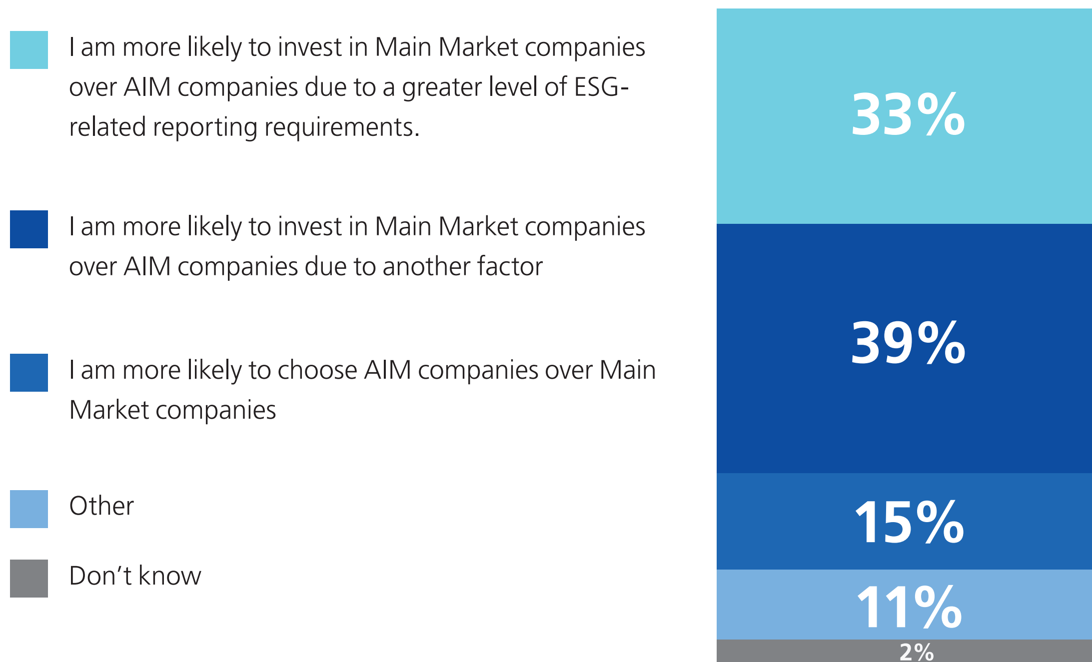


Figure 7

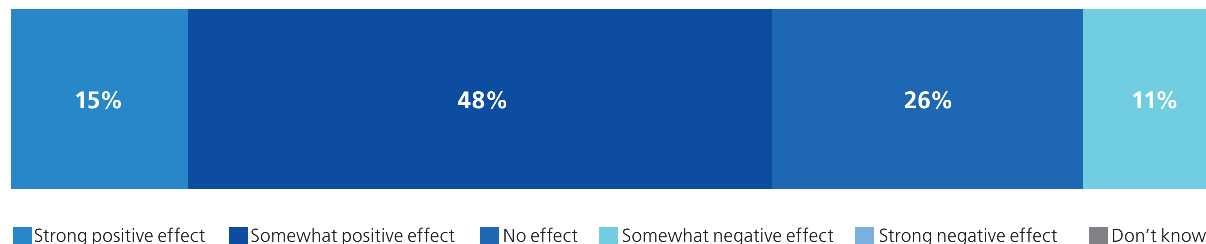
Are you more likely to invest in Main Market companies over AIM companies due to a greater level of ESG-related reporting requirements on the Main Market?



In terms of whether investors have a preference for the market on which their investee companies are situated, a third indicated that they would be more likely to invest in the Main Market over AIM or AQSE due to greater levels of ESG-related reporting requirements. This could be for requirements such as those related to the FCA's Listing Rules on the TCFD-aligned disclosures and diversity and inclusion disclosures. However, just over a third of investors indicated that they are more likely to invest in Main Market companies for other reasons, including lower volatility, more liquidity, and reduced risk factor.

Figure 8

Compared to 3 years ago, what effect, if any, has ESG had on your return outcomes in the small and mid-cap market?



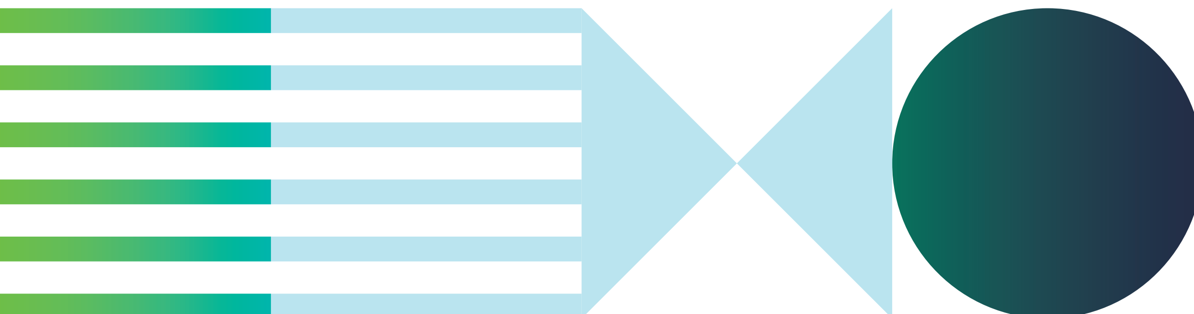
So, with investors amending their strategies and decision-making processes to place a greater focus on ESG, the question remains whether it has had a noticeable impact on their return outcomes, or whether all the increased attention has translated into any tangible benefits.

The advantages of incorporating ESG into investment processes has been the subject of debate in recent years, with some holding the view that higher levels of incorporation creates a trade-off between 'doing the right thing' and achieving lower returns.

However, this study serves to contradict this. Figure 8 shows that greater returns are the most likely result, with nearly two-thirds saying that ESG has had a positive effect on their return outcomes in the small and mid-cap market. Recent research conducted by investment company Abrdn, also supports this[x]. This study finds that the benefits of ESG are threefold and can: (1) have a positive effect on corporate financial performance; (2) influence single-stock returns; and (3) benefit portfolio risk and return.

Despite this, it is important to note that there is a sizeable portion, with just over a quarter of respondents, indicating that ESG has had no effect on their return outcomes. It is also necessary to remember that there are a number of drivers of share prices and financial returns that may not be related to ESG, and there is an important distinction to be made between correlation and causality. Moreover, it has been historically difficult to accurately determine the performance of companies around ESG, and in respect of smaller companies, it is even more difficult to judge due to information availability and inconsistencies.

Notwithstanding this, and on balance, the emerging consensus is that ESG incorporation can result in improved performance and improved returns.



3

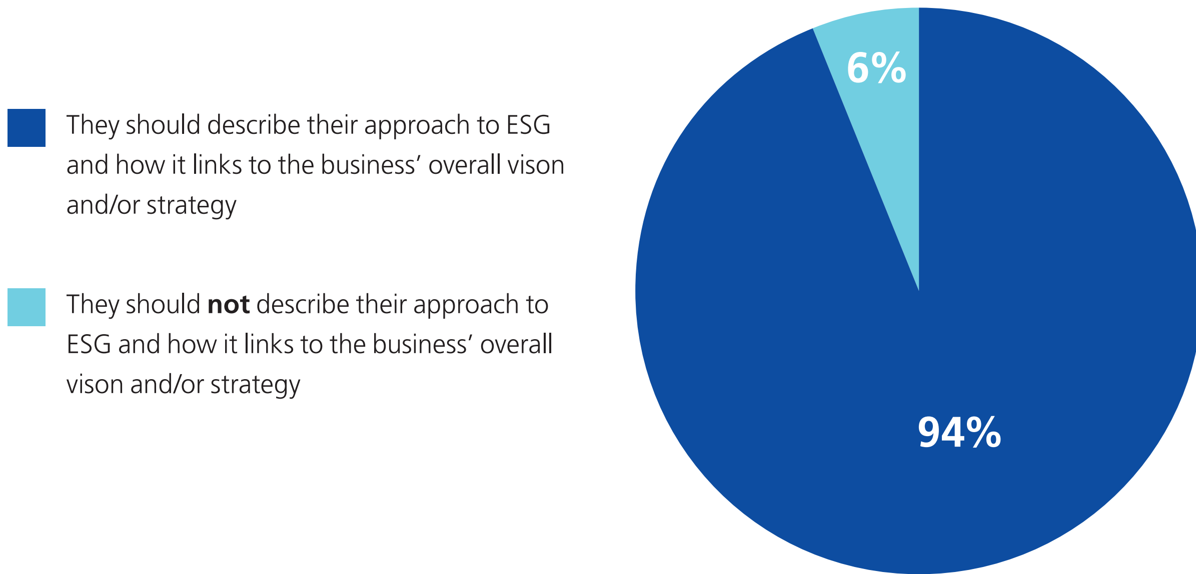
3 – What investors want to see from small and mid-cap companies

The first two parts in this section of the report have focused on the views of small and mid-cap investors on how they see the ESG landscape evolving and how it has impacted their decision-making and ultimately their returns. It is evident from the results that expectations have not only increased but are also set to continue to increase. These increasing expectations have, to an extent, triggered a response from companies, with many investors believing that small and mid-caps have improved their ESG practices. Nonetheless, it is still apparent that some small and mid-caps are missing out on investment and there is a tendency amongst some investors to favour Main Market companies over those on AIM or AQSE due to a greater level of requirements.

In light of this, it is important to determine what it is exactly that investors expect of smaller companies and what it is that is currently preventing investment into small and mid-caps or investors favouring Main Market companies as regards ESG. We explored, at a high-level, what investors wanted to see when assessing a company on its ESG credentials.

Figure 9

Should smaller companies describe their approach to ESG and how it links to the business' overall vision and/or strategy in their annual report and/or website?

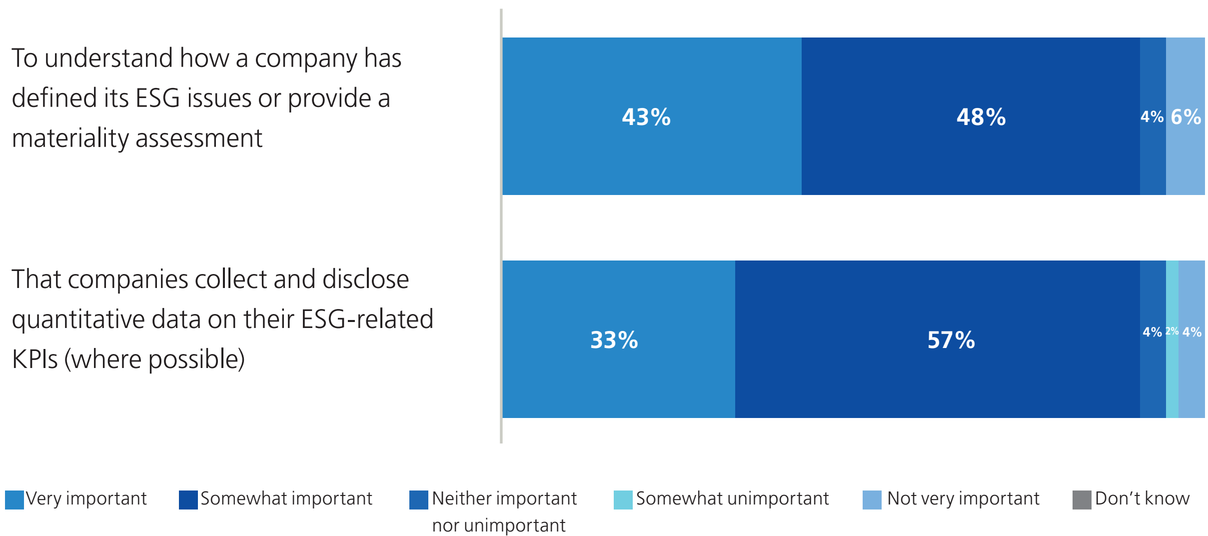


Firstly, it is imperative that a company should describe its overall approach to ESG and how it links to the business' overall vision and strategy. Over 9 in 10 investors stressed the need for companies to do this. Companies should consider their approach to ESG, identify the associated risks and opportunities and embed them into their long-term visions and strategies. Issues relating to ESG have the potential to impact a company's present and future business model and operations, and investors want to see forward-looking companies that integrate these issues into their strategies to help maximise opportunities and mitigate risk. It is also fundamentally important for a company to communicate effectively to investors on how they are doing this.

In order to achieve this, it is important for businesses, where possible, to ensure that they have the necessary structure in place to achieve this. Some companies may have a dedicated sustainability department, or an individual sustainability officer, or the responsibility may fall on an executive or someone in senior management. Whatever the company's situation, it is important that the team or individual responsible is aware of, and integrates, the company's strategy development and risk assessment processes in order to provide an accurate picture of how the company's approach to ESG links to the business' overall vision and strategy.

Figure 10

How important, if at all, do you believe each of the following are?



It has been highlighted earlier in this report how investors value data and that incomplete data and the inability to compare data between companies is the biggest challenge for investors with respect of ESG. Figure 10 above reiterates this.

Over 9 in 10 investors believe it is important to understand how a company defines its ESG issues or provides a materiality assessment and that quantitative data on its ESG KPIs is disclosed. They see that KPIs are important in their assessment of companies in helping them to determine a company's risks and performance, and that quantitative data allows them to measure these indicators most accurately.

Figure 11

Over what time period, if at all, should companies provide detail of their historic performance on ESG-related metrics?

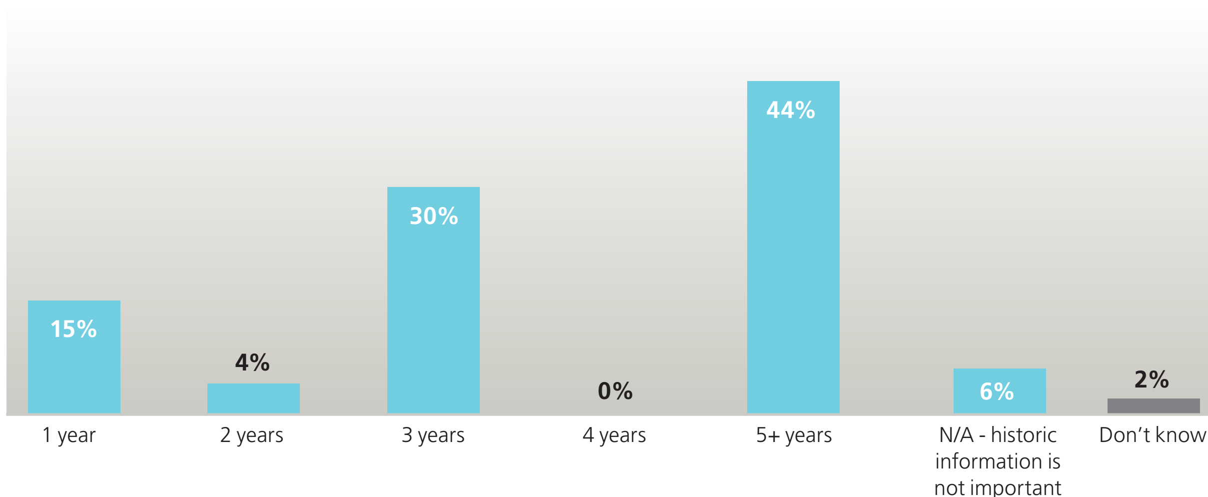
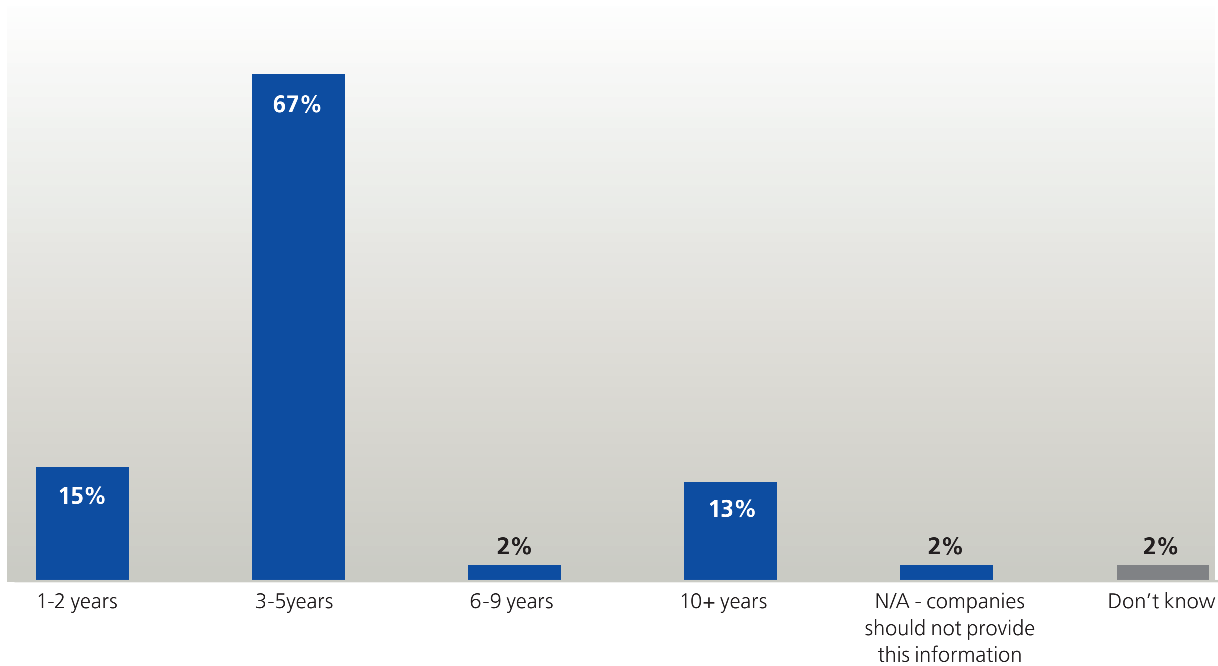


Figure 12

Over what time period, if at all, should companies provide detail on their ESG-related plans/targets for the future?



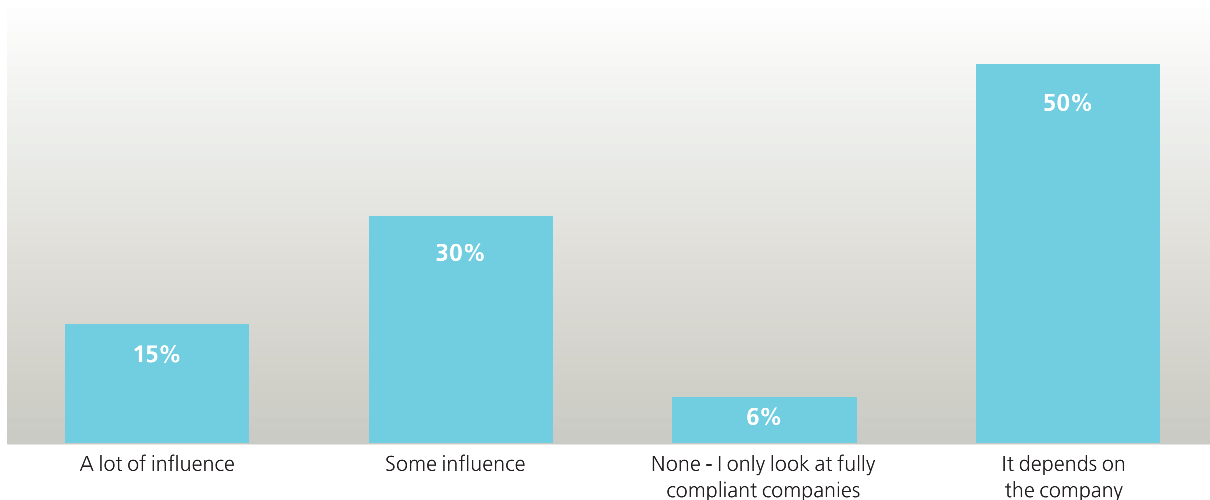
So, how should companies approach collecting their data? Of course, the specifics of what data each company should be collecting will be determined by the nature of each individual company. However, in terms of time horizons, investors show a clear preference for companies providing both historical data and information about future plans and targets.

For historical data, almost half of investors indicated a preference for companies to provide information on performance of ESG-related metrics for at least five years previous, with nearly a third indicating that it should be for three years.

For detail on future plans/targets, over two-thirds of investors indicated a preference for companies to provide forward-looking information for between three and five years.

Figure 13

Where companies are unable to comply with certain regulatory requirements or frameworks, how much influence does their approach to explaining their ESG story have on your investment in their company?



While these investors' preferences around data are clear, it is often the provision of reliable and accurate data that companies, and in particular smaller companies, struggle with the most. We have covered this in two previous reports that considered company attitudes towards ESG[xi]. In both these reports, we highlighted how companies lack confidence in the quality of ESG information disclosures, with difficulties around collecting, measuring and analysing data.

We asked the question posed in Figure 13 to determine if investors still value the narrative information companies provide to tell their story when they are unable to meet certain requirements or collect and report certain types of data.

Almost half of the investors surveyed say that their decision to invest would be influenced to some degree by companies telling their story. When companies are unable to comply with requirements and provide quantitative data, the other half of investors say that their decision to invest would be dependent on the company. This indicates that investors will determine the level of influence of narrative disclosures based on things like the sector of the company, amongst other additional factors.

We also asked investors what the solution would be to the reporting challenges of smaller companies and their ability to provide reliable and accurate quantitative disclosures. The responses vary, but many point towards the need for standardisation of reporting for this group of companies:

> ***"We need some industry standardisation from a regulator or industry bodies."***

> ***"Standardising the reporting of data, allows comparison with others."***

> ***"A standardised questionnaire which maps to compliance (or otherwise) with pre-existing frameworks. [A] standardised approach will allow for [a] consistent approach across the market, more efficient reporting and disclosure by companies, and an ability for investors to compare companies across sectors / general market."***

Other respondents highlight the need for open and honest reporting lines:

> ***"Honest disclosures even if not meeting [certain requirements] or able to provide data. Give a timeline to when you would expect disclosures to be met, or even if you don't think you will ever be able to!"***

Finally, some investors believe that smaller companies who struggle to collect data should outsource this task to third-party organisations:

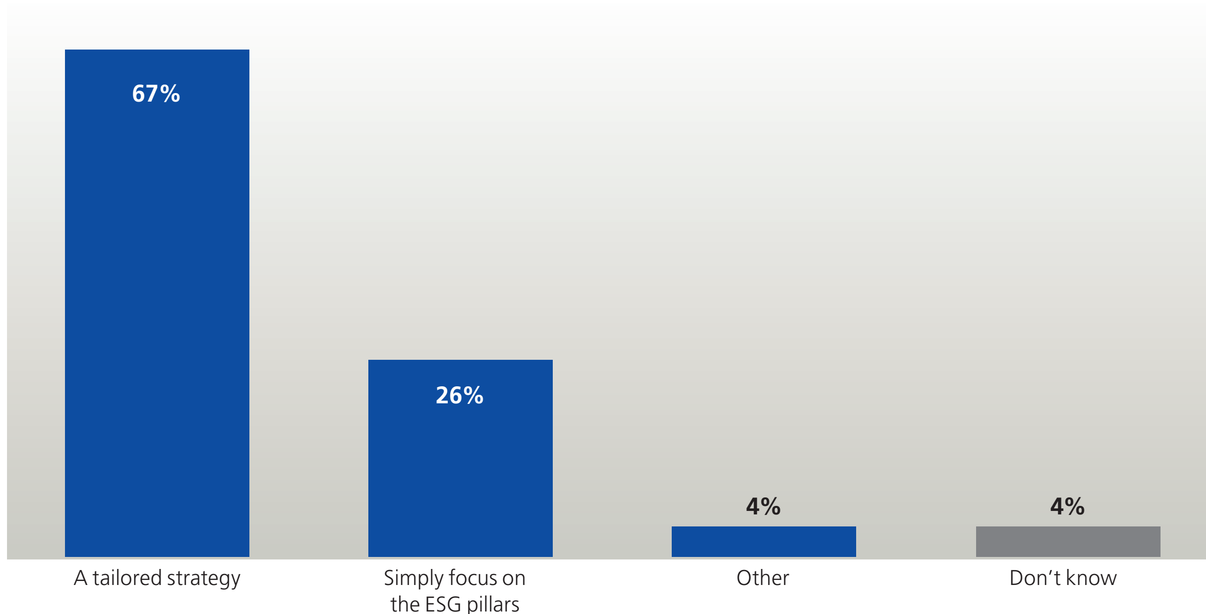
> ***"Third party provision of the analysis should be outsourced effectively."***

> ***"They do have the ability to outsource that particular element of their management, as there are very capable industries who can manage data at every level."***

However, it is important to note that many smaller companies are already stretched financially and may be unable to commit expenditure to this.

Figure 14

Should companies have a clearly tailored sustainability strategy or simply focus on the pillars E, S and G?"



The question posed in Figure 14 looks into whether investors consider an approach that only focuses on ESG to be sufficient, or whether a wider sustainability strategy is also needed. For clarity, it is first important to determine what sustainability and ESG mean.

Sustainability and ESG are two closely related but distinct concepts. Both ESG and sustainability are concerned with environmental, social and governance issues. The key difference is that ESG focuses on a set of criteria used to measure and assess a companies impact on these issues, whereas sustainability is a broader, more holistic principle that encompasses a wider range of business practices. In short, therefore, ESG is a specific tool used to measure the performance of a company against specific criteria, while sustainability is the practice of operating a business so that it meets the needs of the present without compromising the needs of others in the future.

Now that this has been determined, we can see that a majority of investors have a preference for companies to have a clearly tailored sustainability strategy, while a quarter of respondents believe that focusing on each pillar of ESG alone is sufficient. This reflects a desire amongst investors for companies to not only measure their environmental, social and governance impact, but also establish a sustainability strategy to support this that will help deliver long-term value creation.

4

4 - Key questions for companies to consider

In response to the previous elements of this report, and in particular Part 3 on investor preferences, we provide a list of some key questions for companies to consider:

- Have you ever had any feedback from investors about your ESG reporting, and have you adapted as a result of this?
- Do you engage with your investors to understand how they are integrating ESG into their investment decisions and what their preferences are? How could you help their decision-making?
- Are you aware of what similar companies in your sector are doing on ESG and how they are communicating with investors? Is there anything that could be learnt from them?
- Do you have a comprehensive ESG purpose statement?
- Are you communicating your ESG story and data effectively? Are you aware of the opportunities that may arise from improved communication in this area?
- Do you have the necessary organisational structure to ensure that your ESG communication is effective? Is the team or individual responsible for ESG reporting integrated with the company's strategy development?
- Have you identified your ESG-related risks and opportunities, and are these embedded into your strategy and value creation story?
- How could ESG affect your business operations and long-term financial performance?
- Does your company consider its ESG-related risks within the organisation's overall risk management framework?
- Have you established the factors that are material for your individual business, sector, and location?
- What data do you currently collect on ESG, and could this be improved? Have you quantified the potential value of tracking ESG data to your company?
- Recognising that collecting, managing and analysing ESG data might be difficult, how do you explain your current story and practices and what you aim to do in the future to meet the expectations of investors?
- Have you considered using third party service providers to help you collect and manage your ESG data?
- Do you currently have gaps in expertise that are hindering your performance in relation to ESG? Is it possible to secure additional expertise to help improve the quality of your disclosures and practices?

Summary and conclusions

The results of this study are telling. There is an evident divide between investor expectations and the practices and disclosures of small and mid-cap companies. Investors have increasing expectations for companies and a desire to understand more about a company's long-term sustainable strategy that is supported by credible, standardised, and quantitative information. This will allow them to assess small and mid-caps more accurately on their performance around ESG, as well as contrast between them.

However, despite improving their practices in recent years, many companies fall short of these expectations. They are adept at telling their story and have established processes to identify and manage ESG-related risks and opportunities, but are often unable to provide the right information and in the right manner to investors.

This creates a conflict: acquiesce to the rising demands of investors, take time and resources away from more immediate business operations and growth, or risk missing out on investment.

Meeting these expectations is no easy task, and investors must be reminded of this.

The majority of smaller companies find themselves outside of the regulatory regimes of larger companies in respect of ESG. This is not to say they should be included, with many frameworks being too onerous having adopted a one-size-fits-all approach, but it does mean that there is no standardisation. This creates difficulties for companies in understanding on what and how they should be focusing their efforts.

Moreover, different types of investors – short and long-term, passive and active, those with and without specific mandates – have different priorities and thus levels of expectation regarding ESG. On the one hand, passive and long-term investors are likely to be concerned more with a company's sustainability strategy and long-term ESG-related risks. On the other hand, short-term or active investors may only be concerned about more immediate risks to their investments, such as an ESG-related catastrophe.

As a consequence of this, the messaging from investors can be difficult to interpret for companies, it is often inconsistent. The result is a situation that is intrinsically difficult to navigate.

So, is there a simple answer to this apparent dichotomy between companies and investors? In the immediate future, it is likely to persist. However, as ESG likely comes into ever-sharper focus, perhaps the answer is in companies, investors and wider society coming together to build and agree on a common, proportionate, and standardised approach to ESG reporting and practice for small and mid-caps.

Endnotes

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Methodology

Interview sample

YouGov completed online interviews with a sample of 54 small and mid-cap investors in the UK. The fieldwork was conducted between 22 March 2023 and 19 April 2023.

Sample profile

Table 1: Size of fund

What size is/are the fund(s) you manage in terms of assets under management?

Size of fund	Percentage (%
Less than £200m	45%
£200m to £499m	21%
£500m to £999m	6%
£1bn to £2.5bn	6%
More than 2.5bn	6%

Table 2: Equity areas invested in

Which equity areas does your fund invest in?

Size of fund	Percentage (%
UK Main Market mid and small-caps	92%
Global	83%
European (including UK)	79%
UK large caps	79%
North American	73%
UK AIM	71%
Emerging markets	69%
UK Aquis Exchange	29%

Notes

Some charts indicate a total percentage over 100%, this is due to fractions being rounded up to the nearest whole number.

Where there is no corresponding colour to an answer within a chart, this indicates that the answer was not selected by any participant.

About CMS

CMS offers deep local market understanding with a global perspective. We help businesses successfully meet the demands of climate change, technological disruption, urbanisation and social concerns and advise clients – from multinationals to start ups – in all sectors and areas of ESG-related law.

At CMS, our approach is integrated and multidisciplinary. This enables us to anticipate and understand the issues in the rapidly evolving ESG landscape. With their in-depth expertise, our lawyers around the world identify risks and threats while seizing the opportunities arising from the increasing focus on ESG for our clients.

CMS is committed to its environmental and social responsibilities. We have led the legal sector by setting Science Based Targets for carbon reduction, aligning ourselves with the UN Goals for Sustainable Development and are committed to be net zero by 2050 at the latest.

About Inspired PLC

Inspired PLC is a leading B2B technology-enabled service provider delivering solutions that enable organisations to transition to net-zero carbon and manage their response to climate change in the UK and Ireland. The current climate change challenges facing UK businesses are vast, and there has never been a substantive independent solutions provider to support them. Inspired are changing that.

Inspired recognise the increasing pressure on businesses to get serious about sustainability and is emerging as a leading provider of ESG disclosure services. Inspired establish a solid foundation of ESG data collection and disclosure processes for clients, ensuring all legal requirements are met. Inspired create clear and actionable long-term plans to improve clients' ESG impact, making investment easier to obtain and carbon reductions quicker to realise.

About the QCA

The Quoted Companies Alliance champions the UK's community of 1000+ small and mid-sized publicly traded businesses and the firms that advise them.

We believe the public markets can be the best place for companies to source the funds to grow, operate transparently and distribute wealth, fairly.

The QCA seeks to inform policy in dialogue with regulators and government, showcase the latest thinking on leadership, investment, technology and governance through our events and research, and provide a forum to share good practice among our members, who are quoted on the Main Market, AIM and the Aquis Stock Exchange.

Informed by our six Expert Groups drawn from the membership, we campaign to ensure that regulation is proportionate, while maintaining the necessary protections for investors. Our QCA Corporate Governance Code is followed by the vast majority of AIM companies.

Small and mid-sized publicly traded companies represent 91% of the quoted sector. They employ around 2.1m people and contribute more than £25bn in annual taxation. Our goal is to create an environment where their potential is fulfilled, helping to ensure a healthy and resilient UK economy.

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@quotedcompanies

linkedin.com/company/the-quoted-companies-alliance

youtube.com/quotedcompanies

Quoted Companies Alliance

T +44 (0)20 7600 3745
mail@theqca.com

QUOTED COMPANIES ALLIANCE

Quoted Companies Alliance

T +44 (0)20 7600 3745
mail@theqca.com

theqca.com