

White Paper

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# Seeking Return on ESG

## Advancing the Reporting Ecosystem to Unlock Impact for Business and Society

Produced in collaboration with Allianz SE and Boston Consulting Group

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# Foreword



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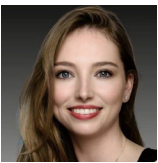
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The role of the private sector in society is evolving. As the global community aims to deliver on the United Nations' Sustainable Development Goals for 2030, citizens, governments and investors are looking increasingly to companies to take a leading role in addressing critical societal challenges.

Fortunately, companies committed to tackling such issues need not sacrifice financial performance. The evidence continues to mount that integrating environmental, social and governance (ESG) considerations into investment and company management helps deliver superior performance and long-term financial returns. In short, the creation of societal value and the creation of financial value are linked.

Today, stakeholders in public and private sectors are focusing on company ESG performance for various purposes, with differences in the ESG items of greatest interest. Yet despite the increased focus on ESG performance, a significant amount of work remains to be done by stakeholders across all communities—including investors, companies, standard setters, data providers and regulators—to advance ESG management practices and unlock the inherent value of ESG for business and society.

The World Economic Forum, as the International Organization for Public-Private Cooperation, is well positioned to bring together public, private, and civil society actors to address some of the complex challenges within the ESG reporting ecosystem. To this end, the Forum has begun to explore this theme—through its System Initiative on Long Term Investing, Infrastructure and Development and its Centre for New Economy and Society—in an effort titled 'Building an Effective Ecosystem for ESG'.

The effort is a collaboration with a coalition of members and partners from numerous stakeholder groups, industries and geographies. The group utilises the Forum's unique strengths in developing perspectives on system-level and cross-sectoral issues to advance the dialogue on the future of ESG. It will work closely with the community to accelerate and amplify much of the work already under way, highlight areas where further attention may be needed and support shared action on key items.

Since its launch in September 2018, the effort has prompted an inspiring uptake in community engagement. This paper, capturing findings from the first phase of this collaboration, increases attention on the role of the ESG reporting ecosystem in enabling effective ESG management, and sheds light on how we can advance the system for the benefit of society.

We are grateful for the support and guidance of the Project Steering Committee and Project Advisory Group, who have dedicated their time, expertise and insight to this work, and in particular to Allianz SE and Boston Consulting Group for taking a leading role in facilitating this dialogue.

# Executive Summary

Increasingly, the evidence demonstrates that a focus on strong environmental, social and governance (ESG) performance can deliver both business and societal impact.

The ESG reporting ecosystem is the fundamental enabler to management of ESG performance. The past few decades have seen significant progress in the disclosure of company ESG information. However, meaningful limitations remain in how end-users of ESG data can leverage that information.

The 'Building an Effective Ecosystem for ESG' effort of the World Economic Forum is a collaboration with members and partners of the Forum, and looks to support other initiatives and the wider community to advance the state of ESG management.

This paper summarises the initial findings of an extensive consultation process under that collective effort. The consultation process set out to uncover, in a landscape of often divergent views, opportunities for collective action to strengthen key foundations of ESG management. It included numerous interviews with industry experts and practitioners from across a range of stakeholder groups, research and analysis on published non-financial company reporting, and a review of existing external work, consultations and research literature. The undertaking investigated several important questions:

- Which challenges within the ESG reporting ecosystem draw the strongest consensus for action between all communities?
- Building on the work of existing initiatives, where is additional attention needed to accelerate the development of a more effective reporting ecosystem?
- Looking ahead, what other opportunities could this effort explore to further advance a global dialogue on ESG performance?

The initial phase of this effort found a wide range of views across the various communities of stakeholders. Despite those differences, the consultation identified a number of common issues that all groups recognise and are keen to resolve, indicating significant cross-community backing for change in the following areas:

- **The complexity and burden of ESG reporting:** Companies face hurdles in navigating reporting standards, understanding how to report well on 'S' or 'social' measures and are overburdened with data requests.
- **The incomparability of company ESG data:** Companies report different metrics based on the specifics of their industry, their location and other factors. Yet even when they report on the same topics, the application of company-specific classifications and the use of company-specific denominators to calculate certain metrics (for example, 'water consumed per unit of product manufactured') regularly render data incomparable.
- **Poor understanding of and interaction with ESG ratings agencies:** Investors and companies note a distinct lack of transparency—and difficulty in obtaining clarity—on what ESG ratings assess.

Left unaddressed, these issues discourage meaningful ESG disclosure using reporting standards, reduce the ability of companies to focus on ESG performance, and send misleading signals to the market. Perhaps most critically, they hinder the effective use of ESG data to maximise business performance and drive societal impact.

A number of initiatives that help address some of these issues and aim to drive real advances in ESG reporting are under way. However, the overall drive to improve ESG reporting suffers from a troubling lack of coordination and alignment—a gap that can limit the impact of even the best-designed reforms. Three key areas demand greater attention in order to accelerate significant system-level progress:

### 1. Improve transparency across the

**ecosystem:** Action is necessary to reduce duplication and unintentional conflict between initiatives, better inform the market of current activities and available ESG information, and clarify where convergence of efforts could be of greatest benefit.

### 2. Enable effective, active cross-system

**dialogue:** It is essential to take end-users' needs into account as the reporting ecosystem evolves. More collective, consistent messages from community to community on key ESG-related topics—including from investors to company management—is a critical need.

### 3. Tighten and align methodologies for

**metric measurement:** Effort must be made to reduce issues of non-comparability in disclosed ESG metrics and enable more effective use of ESG data—including in investment decisions and in tracking progress toward societal targets—through more consistent application of methodologies in metric measurement.

On the basis of these findings, the 'Building an Effective Ecosystem for ESG' effort will collaborate with existing initiatives and the wider community to facilitate action in all three of these critical areas. Actions for 2019 include developing an interactive ecosystem map to increase the transparency of existing activity; using the World Economic Forum platform to drive fresh, constructive dialogue between stakeholder groups; and channeling community insights on how to improve metric comparability to other initiatives.

At the conclusion of this first phase, in addition to providing continued support on these three action areas, the effort will begin exploring additional avenues with the community to further advance the dialogue on ESG management. Potential topics include the following:

- The extent to which ESG reporting should mirror the norms and practices of financial reporting, including how it is regulated
- How funding flows—including membership fees, grants and donations—affect ecosystem activity
- The ways in which new technologies, including artificial intelligence, can improve ESG reporting
- How companies and boards should be organized to drive greater focus on ESG
- Ways to improve the measurement and reporting of social issues (the 'S' in ESG), and continue the evolution of wider metric reporting

As the effort moves forward, its participants welcome further engagement from the community in identifying and leading opportunities for shared action.

# Unlocking Impact

Strong environmental, social and governance (ESG) performance has the power to unlock significant positive impact for investors, companies and wider society. The reporting ecosystem is the foundational enabler—the mechanism that makes this possible. Significant progress has occurred in ESG disclosure over recent decades, but the reporting environment must evolve further to deliver data that better supports the potential benefits of an ESG focus.

A large and growing body of evidence links company performance on particular ESG dimensions to its ability to deliver financial value for investors and to outperform the market over the long term.<sup>i</sup>

Not surprisingly, more and more investors are integrating company ESG performance into their investment management processes. They see this as a way not only to improve returns but also to respond to client demand for investments that align with their values. In 2016, \$22.9 trillion of assets were professionally managed under responsible investment strategies, up 25% from the 2014 figure, representing around a quarter of all professionally managed assets worldwide.<sup>ii</sup> The wave of ESG-related investment practice continues to grow, and there are no indications that it will abate.

This shift has contributed to an increased focus by companies on ESG performance. Many companies have seen evidence of the value of factoring ESG considerations into forward-looking business decisions. This includes an enhanced risk management capability, improved employee engagement, and the opportunity to tap into new growth opportunities. These tangible benefits frequently translate into improved long-term financial performance, including in the form of premium margins and valuations.

Strong company performance on ESG issues also benefits society. Increasingly, regulators and consumers are looking for companies to take a leading role in achieving national targets and public items of interest, including the United Nations' Sustainable Development Goals (SDGs). ESG performance is an important barometer of company commitment and progress toward those goals.



**Companies that place social and environmental impact at the heart of their strategies have the highest potential to be rewarded by the market.**

Rich Lesser, CEO, Boston Consulting Group



## Reporting Ecosystem as Key

Underpinning the ability to understand and manage ESG-related issues is the ESG reporting ecosystem, which forms the primary focus of this paper.

Today, more ESG data is available than ever before. In 2017, 78% of the world's largest companies integrated non-financial information in their annual reports, up from 44% in 2011.<sup>iii</sup> The demand for ESG information, aided by the development of relevant reporting standards and frameworks, has supported the proliferation of ESG information in the public sphere. End-users of company ESG data include investors, companies themselves, regulators and segments of wider society—including consumers.

However, studies highlight that issues of quality in the available ESG data today act as significant impediments to ESG integration into investment decisions.<sup>iv</sup> End-users of the data often note that the information available to them does not deliver a clear picture of performance and practice, either on an individual basis or when comparing companies with one another.

The system for reporting on company ESG performance must evolve further.



# Community Movement

‘Building an Effective Ecosystem for ESG’ is a collaborative effort with a coalition of members of the Forum. It aims to use the platform of the Forum to accelerate the movement to more effective management of ESG issues.

The importance of having a system that enables end-users to employ ESG data effectively is not lost on the business community. A significant talking point at the World Economic Forum’s Annual Meeting 2018 was the role of business in society, and ESG-related sessions at the Annual Meeting emphasised the demand by investors and companies for change in the ESG reporting environment. This momentum is only building within the agenda for the Annual Meeting 2019.

Recognising the presence of an existing body of activity looking to improve ESG management, and aware of the importance of such a movement, this effort seeks to collaborate with ongoing initiatives and the wider community to accelerate and amplify work that advances the state of ESG management. It also aims to identify, research and highlight activities that require greater focus and which may further unlock the business and societal impact that comes from an elevated focus on ESG issues.

The findings summarised in this paper draw on the results of an extensive consultation that the ‘Building an Effective Ecosystem for ESG’ effort conducted. That process captured a spectrum of leading voices across key stakeholder groups—including investors, companies, data providers, standard setters, framework developers and regulators—as well as existing initiatives in the ESG reporting environment.

The perspectives shared in this paper do not necessarily correspond to each and every of those expressed during the consultation process, but aim to reflect a balance of views captured through this effort.

The consultation included:

- More than 60 one-on-one interviews with senior representatives in investment, investor relations, treasury, sustainability strategy and the reporting functions of organizations
- Two public workshops and associated feedback from approximately 100 attendees, including significant C-suite representation<sup>v</sup>
- Regular project steering group discussions, including input from more than 35 organizations<sup>vi</sup>
- Collaboration and discussion with other bodies representing more than 1,000 organizations from more than 150 countries

Bringing so many voices together has created a powerful mechanism for identifying where collective action may strengthen the foundations of ESG management.



**The World Economic Forum as a convening body has an important role to play in ensuring collaboration towards the common goal of “meaningful disclosure”, as the ESG landscape continues to evolve. There are a lot of groups with strong efforts and differing expertise, and by bringing them together for insightful and structured discussions, the Forum is contributing to an evolving consensus that could be quite impactful.**

Jeff McDermott, Managing Partner, Greentech Capital Advisors



## An Introduction to the Reporting Ecosystem

ESG refers to the environmental, social and governance aspects of organizations. Many organizations now report ESG-related information to reflect their non-financial story and the sustainability or responsibility of their actions. This reporting often attempts to clarify an organization's risks, opportunities and impacts in relation to ESG factors.

Companies capture and track ESG performance and practices through metrics such as 'total water consumption', 'number of incidents of discrimination' and 'percentage of employees that have received training on anti-corruption'. Behind each metric is a methodology for measurement.

A number of stakeholder groups exert significant influence on the types of ESG information reported by companies, the way it is communicated and the way it is used. Key groups include the following:

**Companies** across public and private markets, ranging from large conglomerates to small and medium-size enterprises (SMEs), generate ESG data based on their practices and performance. They are responsible for the content and manner of its disclosure to the public sphere. They may also provide information on request directly to other organizations—for example, to data providers and investors.

**Standard setters** publish detailed guidelines that support companies in understanding what ESG-related information they should disclose, by topic. Through their standards, they influence a company's decisions about which ESG metrics to report on and methodologies used to measure those metrics. Well-known examples in this space include CDP (formerly the Carbon Disclosure Project), the Climate Disclosure Standards Board (CDSB), the Global Reporting Initiative (GRI) and the Sustainability Accounting Standards Board (SASB). A wide array of industry association bodies also publish guidelines on ESG-related reporting for companies.

**Framework developers** also influence the ESG-related information a company publishes, but they have a greater focus on principle-based concepts for how a report is structured. They help

companies to understand the best manner of developing and presenting their disclosures, how to consider reporting practice through the lens of long-term value creation, and the position and importance of ESG in and alongside traditional annual reporting practice. Examples include the International Integrated Reporting Council (IIRC), the GRI 10 Reporting Principles and the Task Force for Climate Related Disclosure (TCFD).

**Assurance providers** offer professional advice to companies on how to publicly disclose data, and they offer assurance on publicly disclosed non-financial information. Examples include Deloitte, EY, PwC and KPMG.

**Data providers** play an important role in the ESG information chain by aggregating the ESG information that is available on companies—often through public reports, private research and company requests—and making that information available to audiences. Users of such services include investors looking for information to aid in their investment decision-making and, frequently, companies themselves. Data providers can present ESG information to users in different forms, including individual ESG metrics or rankings and indices.

Some providers also offer ESG ratings on companies, to serve as assessments of a company's ESG performance. Today, investors and companies alike commonly use this tool to support business decisions.

Players in this space offer different combinations of the information services above. Among these companies are Bloomberg, DJSI (formerly Dow Jones Sustainability Index), FTSE4Good, MSCI, Sustainalytics and Refinitiv (formerly Thomson Reuters).

**Investment banks** assess market trends and company performance—including the assessment of ESG information—to make buy, hold and sell recommendations to investors. Examples include Bank of America Merrill Lynch, Citigroup, Goldman Sachs, JPMorgan Chase and Morgan Stanley.

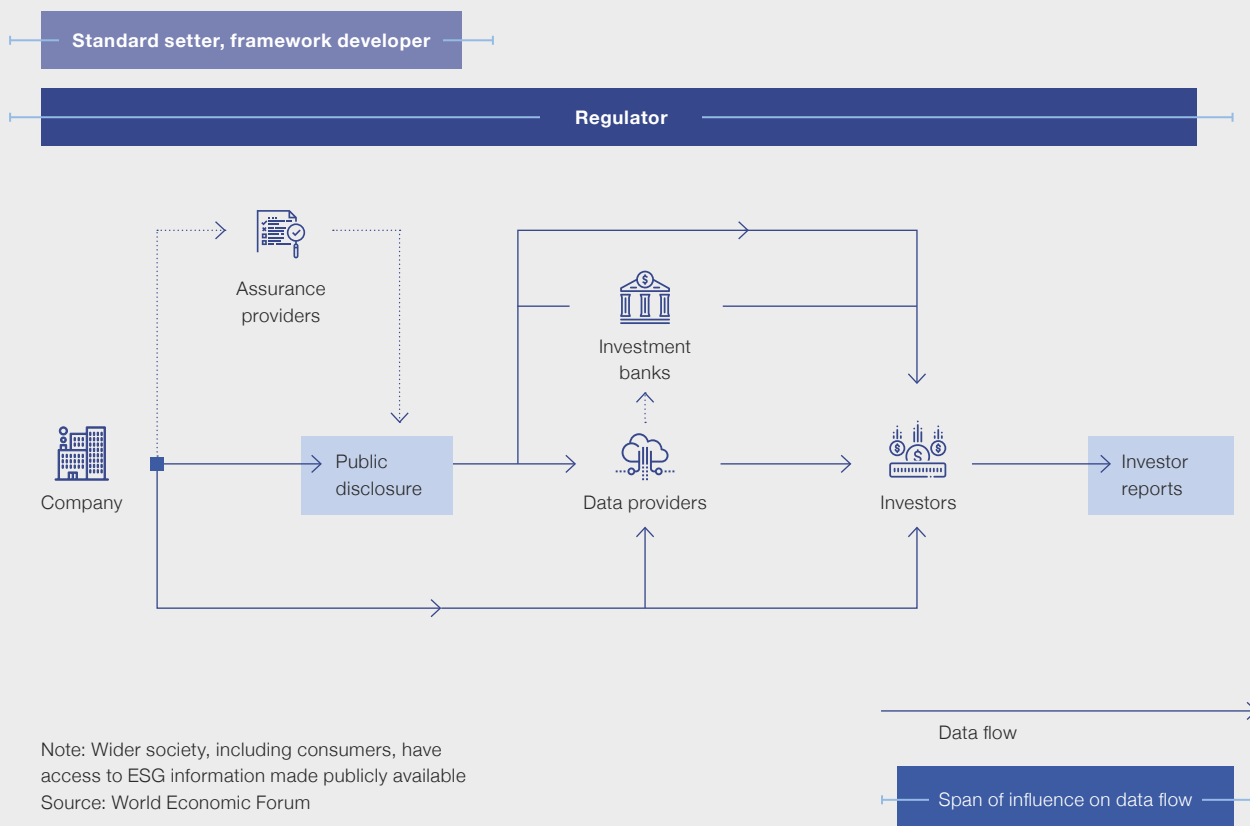
**Investors**—a broad segment that includes asset owners, asset managers and private equity firms—leverage available ESG information to inform their decisions on capital allocation, engage with company boards on ESG-related issues and aggregate ESG information on their portfolio companies into their investment reporting practices.

The breadth and depth of ESG information analysed varies by investor, for example, depending on whether they are looking only to issues of greatest perceived financial importance or company contribution to wider societal causes, and running ESG ‘screening’ or ‘integrated’ investment strategies.

**Regulators** represent a multitude of bodies that can demand ESG-related disclosure from companies under their jurisdiction. They can include local, national and supranational governments, financial regulators, and stock exchanges for companies listed on the market. Equivalent regulators may stipulate very different requirements in different markets.

**Additional key players** include a range of ESG-focused organizations that offer various operations and services to help companies understand how to better measure, benchmark, improve or report important aspects of their ESG performance. They also encourage a heightened ESG focus in organizations. A few well-known examples include Ceres, Science Based Targets, World Business Council for Sustainable Development (WBCSD) and World Benchmarking Alliance.

**Figure 1: Illustration of primary flow of company ESG data**



Note: Wider society, including consumers, have access to ESG information made publicly available  
 Source: World Economic Forum

# Issues in Common

Today, the network of organizations that influence company ESG reporting is large and complex, and so are the issues. As a result, different stakeholders often have very different views about how to solve these problems. Despite that landscape, however, the consultation revealed a cross-community consensus for action in a number of areas.

The consultation process yielded intense debate and heated discussions. Yet despite the range of views, it was notable that stakeholders from across all communities agreed on the need for change regarding three key issues:

- The complexity and burden of ESG reporting
- Incomparability of company ESG data
- Poor understanding of and interaction with ESG ratings agencies

## The Complexity and Burden of ESG Reporting

Deciding what ESG information to disclose, how to disclose it and to whom is a regular problem for companies.

Companies new to ESG or sustainability-related reporting often find it difficult to understand which reporting standards they should use to support their disclosures. In particular, they frequently struggle with the different concepts of materiality<sup>viii</sup> proposed by different standards—which help companies decide which issues should be deemed significant enough for reporting ('material' issues)—and how those concepts relate to a company's particular context

and reporting philosophy. Companies also wrestle with identifying the appropriate breadth and depth of ESG topic coverage for their reporting.

This complexity can limit firms' eagerness to report in accordance with established standards, particularly in the case of smaller or privately held companies. That, in turn, can limit the volume of ESG data that is both useful and available to the market.

Even many larger companies that are well versed in ESG reporting encounter difficulty in dealing with 'S' or 'social' measures. Social issues are particularly context dependent, varying significantly across industries and geographies. That variability makes it challenging for companies to understand which issues are most important to report, how to best measure them, and what good performance looks like. Others note difficulty in understanding how their reporting can best reflect the company's contribution toward achieving the United Nations' Sustainable Development Goals.

Reporting departments also complain of an overload of unique data requests from external data providers. These requests come on top of the information-producing efforts that companies perform in adhering to ESG reporting standards—data that companies typically make publicly available. The requests are often for similar sets of data, but come in slightly different forms, requiring reporting departments to dedicate additional time and effort to respond to each. Besides the natural frustration that this causes, the need to focus on responding to requests reduces employee capacity to work on improving the company's actual ESG performance.

As a result, many organizations have to prioritise the data providers they respond to. This can be challenging, as meeting numerous data requests can be a drain on resources, but failing to respond may result in a poor rating or ranking, or complete exclusion from an index, even if the company has superior ESG practices. Ultimately this situation puts the accuracy of market signals at risk.



**Materiality in the context of reporting is a fundamental concept, intended to generate information that is useful for decision-making. But it can be a difficult concept to apply in practice, due to the range of ESG issues to be considered, the range of stakeholders whose views contribute to materiality assessments, multiple definitions of materiality, its legal implications and the time frames over which the materiality of ESG matters might become evident.**

Rodney Irwin, Managing Director, World Business Council for Sustainable Development



## **Incomparability of Company ESG Data**

The depth of ESG disclosures has steadily increased over the years, supported by developments in reporting standards and their application. Nevertheless, intercompany comparability remains elusive.

Companies rightly attempt to reflect in their reporting the material topics specific to their industry and context, so the metrics reported by different firms vary significantly.

However, even when companies report on the same topics and adhere to the same reporting standards, the data they report may not be comparable. That's because guideline methodologies for metric measurement are often too high-level to ensure comparability in reported company information. Companies have considerable latitude, for example, to use their own classification approaches when reporting metrics. In addition, the use of company-specific

denominators to calculate certain metrics (for example, 'water consumed per unit of product manufactured') makes comparisons more difficult. These realities mean it is impossible today to easily answer the simple question: "Is Company X better than Company Y?" on a given metric.

Consequently, data users cannot compare company ESG performance on an apples-to-apples basis, even within the same industry. They must either expend additional resources in attempting to make the data comparable, or draw on results that are not comparable between companies.

Without the ability to compare ESG performance, investors find it more difficult to meaningfully integrate ESG data into investment decisions and management processes. In fact, a recent CFA Institute survey of investors ranked "lack of comparability across firms" as the number one impediment to integration.<sup>viii</sup>

Companies cannot benchmark themselves against their peers, and regulators and wider society face challenges in trying to understand a company's contribution to national or local targets of public interest.



**Having simplified, reliable, consistent, and comparable data is key for the financial institutions, governments, and the public to channel more capital into sustainable investment and consumption.**

Axel Weber, Chairman of the Board of Directors, UBS



## Data on Diversity and Other Topics Is Not Comparable

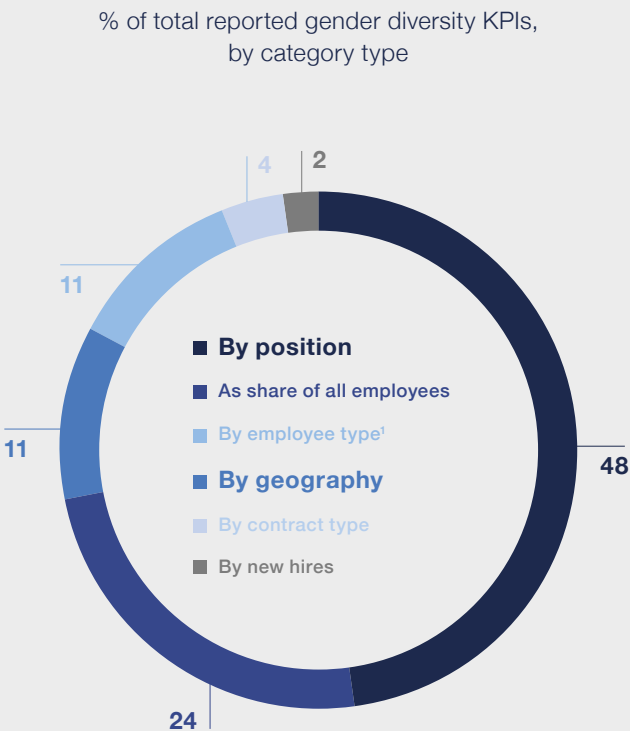
Many people would assume that data comparability on the topic of gender diversity is relatively straightforward. But an analysis of 15 peers in the fast-moving consumer goods (FMCG) industry indicates that even when companies within a single industry and with similar business models adhere to the same reporting standards, non-comparability of published data remains a problem.

The graphic below shows the percentage share, by category, of gender diversity metrics reported by the assessed FMCG peer group.

Reporting on metrics for women as a percentage ‘share of all employees’ enabled broad comparability across companies. However, standards-compliant reporting on women ‘by position’ or ‘by geography’ regularly used different company-specific classifications, leading to low comparability across companies.

Further comparisons across other social metrics showed similar outcomes, including those for health and safety. On environmental topics, the use of productivity and output-related denominators, while useful for intra-company tracking across multiple years, renders inter-company comparability difficult.

**Figure 2: Analysis of gender diversity disclosure, from companies in the fast moving consumer goods industry**



### By position

Peer group of 15 firms used 22 different employee classifications. Of these, 16 were for equivalents of ‘senior management’

### By geography

Peer group used 7 regional classifications—all of which were structured differently. Even similar regions had unique country mixes

1. i.e. full-time vs part-time

15 firms studied, 13 of which referenced GRI reporting standards

Source: World Economic Forum; Procter & Gamble

## Poor Understanding of and Interaction with ESG Ratings Agencies

Difficulty in understanding the assessments that ESG ratings agencies perform and the inputs that they use to do so hurts companies, investors and the ratings agencies themselves.

ESG ratings agencies play an important role in aggregating and processing ESG information to provide perspectives on companies' non-financial performance. No single correct methodology exists to assess the ESG performance of a company, and today dozens of ratings agencies exist, each using its own approach to determine and process the ESG data it receives from companies and organizations.

However, many organizations report that it can be difficult to obtain clarity on what ESG information each agency is looking at and how it analyses that data to produce its perspectives. Consequently, when different ratings agencies produce divergent scores for a given company—as often happens—it can be difficult to understand why. The result is confusion in the market as to what reality the scores reflect.

Given the lack of understanding in the market about how ratings agencies assess companies, the end-users of ratings—in many cases, investors and companies themselves—find it harder to trust the information they receive. They find it challenging to determine whether the ratings reflect an assessment of the relevant aspects of companies in which they are interested. As a result, those who rely on the ratings to make capital allocation or management decisions are at risk of making sub-optimal decisions.

If left unaddressed, low transparency and confusion reduces users' trust in ESG information, and lessens faith in the ability of ESG ratings to support meaningful decision-making.



**Investors need to be clear about what the methodology they choose is actually measuring, and why. Otherwise ESG scoring risks creating a false sense of confidence among investors who don't really understand what lies behind the numbers—and therefore don't really understand what they're buying.**

Financial Times, “Lies, Damned Lies and ESG Ratings Methodologies”, 6 December 2018



# Advancing the Ecosystem

A number of existing initiatives are driving advances in the ESG reporting environment, including attempts to address the three issues outlined above. However, better system-level collaboration, communication and alignment are required to maximise the positive impact of those initiatives. The first phase of this effort identified three critical areas in which action must be taken to accelerate system-level progress.

## Action Under Way

The buzz of activity in ESG reporting provides hope for progress. Several leading organizations and initiatives—representing different stakeholder groups and working through various mechanisms—are already under way. These efforts take aim at the causes or consequences of one or more of the three problem areas that consultation participants identified.

From a reporting standards lens, the Corporate Reporting Dialogue has the potential to deliver widespread benefits to the ecosystem as it seeks to create more coherence between leading frameworks and standards.

Other notable efforts attempting to advance ESG reporting standards include the Impact Management Project, the United Nations' Principles for Responsible Investment (PRI) work on corporate reporting, the United Nations Development Program's SDG Impact initiative, and the work of the United Nations Conference on Trade and Development's (UNCTAD) ISAR group.

One key aspect of the ecosystem that observers regularly note is the relative difficulty of understanding what good social performance looks like and how best to capture it. It is encouraging that a number of initiatives—including ShareAction's Workforce Disclosure Initiative, the Corporate Human Rights Benchmark, and the Gender Equality and Empowerment Benchmark of Equileap and the World Benchmarking Alliance—are working to advance the discussion of social performance and measurement.

Nasdaq Nordic recently announced an ESG data portal that provides 'transparent, comparable and actionable' ESG data through standardised reporting, in an effort to meet investor demand in the region.

From a regulatory standpoint, recent and impending changes mandate disclosure of key items of interest, increasing the availability of ESG information to the market. These include the 2015 'transparency in supply chains' provision of the UK's Modern Slavery Act, recent 'comply-or-explain' ESG disclosure requirements imposed by the Hong Kong Stock Exchange on its listed companies, and the European Commission's Action Plan for Financing Sustainable Growth.

Making use of the Forum's network and platform, the 'Building an Effective Ecosystem for ESG' effort will look to support some promising initiatives and raise awareness of emerging efforts.



## The Corporate Reporting Dialogue

The International Integrated Reporting Council (IIRC) convened the Corporate Reporting Dialogue (CRD) to enable major standard setters and framework developers to work together to deliver greater coherence, consistency and comparability between their respective corporate reporting frameworks and standards.

In addition to the IIRC, participants include CDP (formerly the Carbon Disclosure Project), the Climate Disclosure Standards Board (CDSB), the Financial Accounting Standards Board (FASB), the Global Reporting Initiative (GRI), the International Accounting Standards Board (IASB), the International Organization for Standardization (ISO) and the Sustainability Accounting Standards Board (SASB).

Announced in 2018, the CRD's 'Better Alignment Project'—a two-year project—seeks to align a substantial number of metrics between the different standards, where differences are not required for the standards organizations' respective objectives. The project intends to "give more confidence to

businesses to start the journey towards better, more effective reporting, irrespective of which reporting framework they choose initially."<sup>ix</sup>

If successful, the project will reduce the confusion of those new to reporting standards about where and how to start, and will encourage increased reporting of material ESG information through use of established standards. For those reporting to multiple standards, it will shorten the time needed for metric calculation and reporting, as increased alignment will lead to fewer unique metric requests between the standards bodies.

The dialogue has also helped to clarify reporting concepts based on market demand, including the definitions of and approaches to materiality supported by standard setters and framework developers within the group.<sup>x</sup> Increased clarity over the nature and scope of the various frameworks and standards also helps companies understand how to navigate them in order to deliver the breadth and depth of ESG reporting that companies consider most appropriate.

## European Commission: Action Plan on Sustainable Finance

The European Commission's recent Action Plan on Sustainable Finance<sup>xi</sup> adopts four legislative proposals. One includes work on clarifying and unifying definitions related to sustainability, the goal of which is to ensure consistently applied market taxonomies—an essential first step in helping to channel investments towards sustainable activities.

Another proposal will introduce obligations for institutional investors and asset managers to disclose how they integrate ESG factors into their investment decision-making. This package of legislation is likely to have two tangible effects.

First, it will increase ESG-related disclosures from investors. Second, it will sharpen the focus on the sustainability and ESG-related performance of companies looking to meet new "sustainable" guidelines.

The increased focus on the ESG activities of portfolio companies and potential investees will concurrently drive greater demand for company ESG disclosure. Such disclosures are also likely to be more transparent because of their alignment with the aforementioned proposed EU taxonomies.

## System-Wide Change

The wave of emerging initiatives is creating significant momentum in the drive to build a more effective global reporting ecosystem. However, the complexity and interdependence of the stakeholder groups through which ESG data flows—from companies to end-users—means that isolated activity risks forfeiting the ability to support ecosystem gains. Players must work together in a spirit of constructive collaboration if they are to solve the problems that hinder the reporting ecosystem today.

The consultation revealed the need for additional action, steps that help maximise the impact of existing and emerging efforts to accelerate progress in the ESG reporting ecosystem. As a first priority, greater action in three critical areas is required to accelerate system-level progress:

1. Improve transparency across the ecosystem
2. Enable effective, active cross-system dialogue
3. Tighten and align methodologies for metric measurement

This collective effort of the Forum and its members encourages existing initiatives in this space to adopt these aims and to work with the wider community in delivering on these objectives.

### 1. Improve transparency across the ecosystem

A wide range of organizations and initiatives are looking to make an impact in ESG reporting, but many efforts are neither transparent nor well communicated. Without an accurate view of the system, there is a high risk—and evidence of this danger exists today—that even the most well-intentioned efforts might find themselves unknowingly in conflict with or duplicating others. In addition, as highlighted earlier, the confusion surrounding ESG ratings contributes to limited awareness of available ESG information. Ultimately, the lack of transparency on activity across the ecosystem risks undermining the system-wide benefits many efforts intend to deliver.

There is action in some quarters to address transparency problems. The work of organizations such as the WBCSD in developing ‘The Reporting Exchange’<sup>xiii</sup> helps increase awareness of efforts to improve ESG reporting, providing a high-level overview of many of the players in this space. Further development of open-reference repositories such as these can help provide actors with the knowledge base they need to shape a more cohesive environment in the future.

Non-profit organizations, governments and development agencies are a crucial force in funding much of the work in the reporting ecosystem. Ensuring that they clearly understand where their money is going, in the context of the wider activities of the system, should be considered a duty of the ESG community.

It is a common viewpoint that the ESG community will witness a consolidation of some of the many reporting initiatives over the coming years, and that this could support greater coherence in the ecosystem’s activities. By first shining a spotlight on exactly what is happening in this space, stakeholders can take an important step towards clarifying where any potential convergence of efforts could be most beneficial.

## 2. Enable effective, active cross-system dialogue

An effective reporting ecosystem must serve the needs of a broad spectrum of ESG data users and providers. It cannot function optimally if each stakeholder group seeks solely to service its own immediate needs, as the actions of each group affect the wider data value chain.

The community must work together to ensure that data produced helps end-users better meet their requirements, and that the process of reporting is less burdensome on companies. Open-minded, effective dialogue between stakeholder groups is important to build an understanding of each group's individual needs and frustrations, thereby ensuring that decisions reflect the priorities of a wide range of organizations that are important to the ecosystem's health.

The historical absence of dialogue in the ESG community has contributed significantly to the system-level ineffectiveness of the current reporting ecosystem.

In particular, effective dialogue between investors and companies is essential. The investor community has a growing number of active voices on ESG, but companies still note that what investors want to see from their ESG reporting and performance is often unclear. Communication from the investor community in a more collective and cohesive voice would help address this, and support a more proactive culture on ESG engagement, particularly if delivered by asset owners.

In addition, there is more work to do—particularly within many emerging markets—in communicating the business benefits that companies can reap from high-quality disclosure, especially for companies that are issuers on listed markets. Clear communication of the connection between improved disclosure and investment flows, led by influential market bodies, is important to accelerate the development of a more effective global reporting environment.

A recent paper by the Global Investor Organizations Committee, which represents the voice of a wide array of major investors, also endorsed the call for cross-system dialogue.<sup>xiii</sup> Published in 2018, the paper's stated objective was to provide an "investor perspective to the global Corporate Reporting Dialogue and its members". This is critical because the CRD's work influences corporate reporting standards that largely determine publicly available ESG information in the market. It is encouraging to see that the Corporate Reporting Dialogue's 'Better Alignment Project' is now consulting with the UN PRI.



**Key global investment players [...] are now calling for greater ESG transparency in emerging markets. They are bringing their influential voices into the debate, and indicating they are ready to invest as ESG reporting conditions improve. They agree that ESG data can create levels of trust that build deep and liquid local capital markets. And that is vital for a thriving private sector.**

Ethiopsis Tafara, Vice President for Legal, Compliance Risk and Sustainability and General Counsel, International Finance Corporation



### 3. Tighten and align methodologies for metric measurement

For ESG data to truly inform decision-making—including integration in investment, company management or the tracking of societal targets—greater comparability of reported data is a necessity. This requires tighter and more rigorous methodologies for metric measurement.

Today, many methodologies proposed by standards bodies to calculate metrics offer companies a certain degree of flexibility. This includes the ability to draw on organization-specific definitions of scope, and the use in reporting of denominators related to output or productivity. The consequent divergences in reporting practices on even the same metric make comparisons across companies difficult.

There are ongoing efforts to align the overlapping metrics of different reporting standards, including through the work of the Corporate Reporting Dialogue. It is also important for the standard setters to coordinate on developing tighter methodologies for metric measurement, leaving less room for the application of company-specific classifications or denominators.

Because of the inherent value of more useable ESG data and its importance in helping solve pressing societal problems, this topic demands swift attention. However, standards development has not always been a quick process, and the universe of metrics is large—expanded by topics that are material only to specific industries.

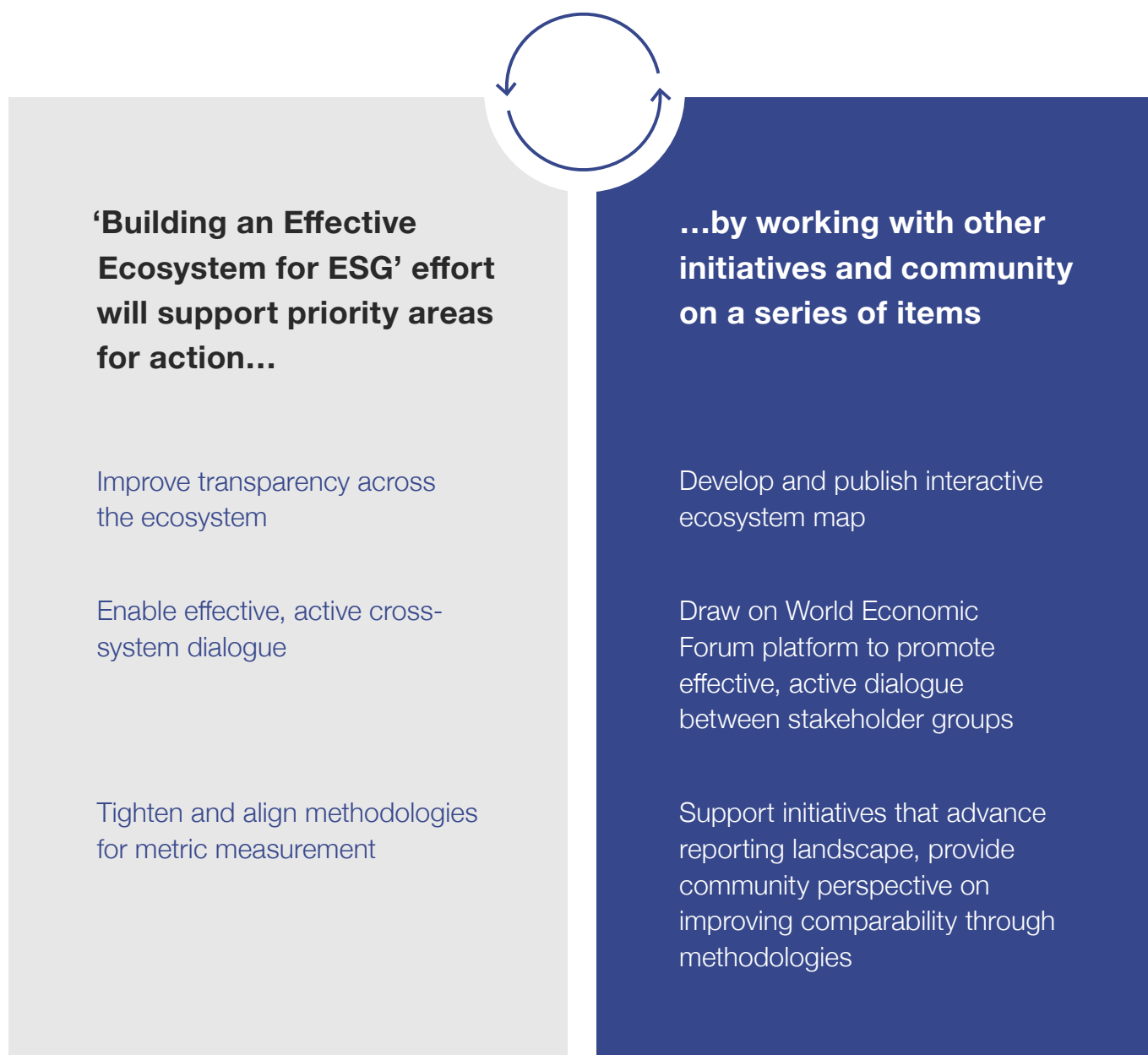
A practical starting point would be agreement by the coalition of standard setters to align on a set of metrics, compatible with their respective guidelines, for shared methodology review and adoption. This process could begin with metrics that are most broadly applicable across industries and deemed of high value to end-users.

## Next Steps

Taking its cue from these findings, the ‘Building an Effective Ecosystem for ESG’ effort aims to catalyse delivery on the three action areas identified as critical to maximising system-level progress. To achieve this, the effort, in collaboration with the community, will advance on a number of fronts in 2019:

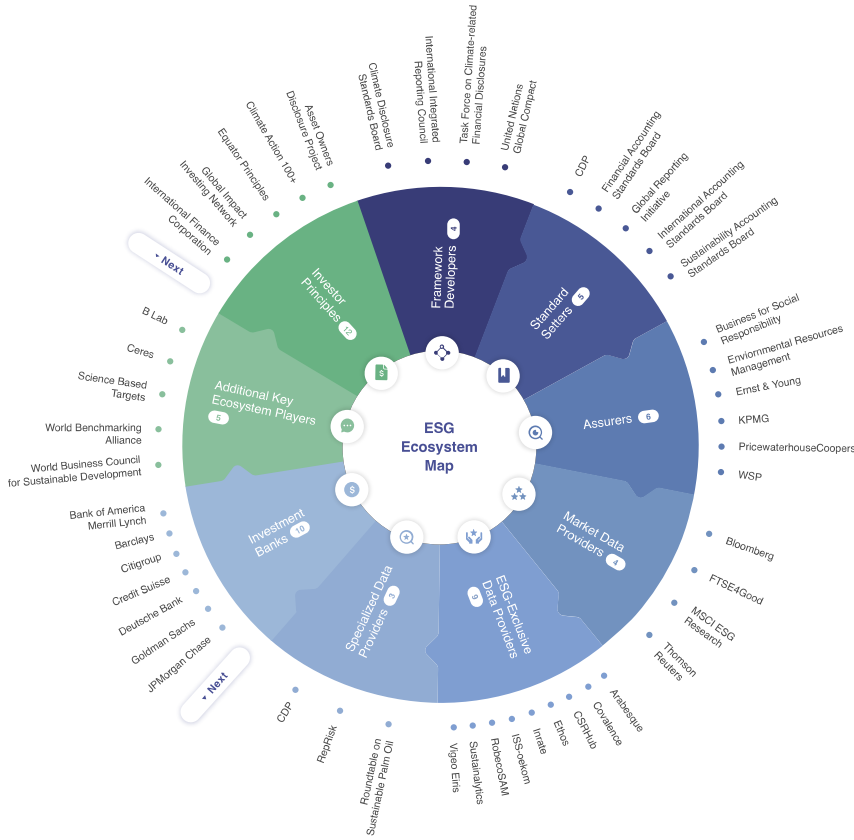
1. Develop and publish an interactive ecosystem map highlighting vital stakeholder groups in the reporting ecosystem and the activities of organizations within those groups. The map should help the community better understand the complex global system of players influencing ESG disclosure—including those from non-OECD countries—and enable players to act in a more coherent, cohesive manner.
2. Draw on the World Economic Forum’s platform to promote effective, active cross-system dialogue between different stakeholder groups within the reporting ecosystem. This endeavour can help inspire action towards shared goals, and better support the community in addressing the fundamental ESG data needs of investors, companies and other data end-users.
3. Support actors and initiatives in the field of ESG reporting that seek to advance the reporting landscape. This will include providing a community perspective on how to better improve comparability of reported data through tightened and aligned methodologies for metric measurement.

**Figure 3: 'Building an Effective Ecosystem for ESG' support for community action in identified priority action areas**

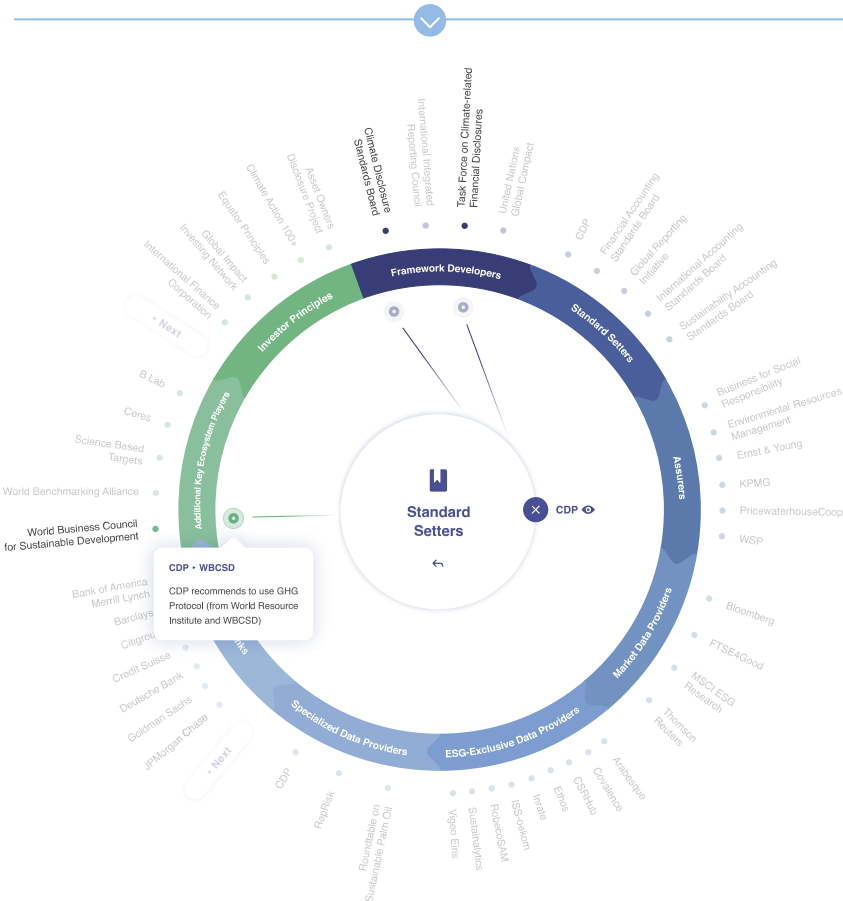


Source: World Economic Forum

**Figure 4: Illustrative images of ecosystem map**



The ecosystem map is currently in development. It intends to capture key players from across stakeholder groups important to the ESG reporting ecosystem, globally



The map functionality will allow users to click through for more details on individual organizations, including their purpose, services, funding sources, and direct links with other organizations captured on the map

Source: World Economic Forum

## Avenues for Further Exploration

The 'Building an Effective Ecosystem for ESG' effort is just beginning, and many opportunities exist for improvement in the landscape of ESG management beyond those outlined above. Over the coming months, this collective effort will look to explore some of these. The effort invites further community engagement in taking these areas forward, and welcomes proposals for new areas of exploration.

In addition to continued work with the community on the items highlighted earlier in this paper, potential topics that this effort may explore further include the following:

### **In what respects should the world of ESG reporting look more like financial reporting?**

Today, ESG information is treated differently from financial information, and the markets that serve the flow of data behave differently. Major differences exist in regulations governing standardised disclosure. The operating models of ESG ratings agencies and credit agencies vary significantly, from payment arrangements to data collection. The use of audit and assurance on ESG information is far less regular, and the timeliness of ESG reporting lags behind that of the mainstream financial world.

What elements and practices of the financial reporting system should ESG look to adopt or avoid? Is coordinated regulation necessary to mandate company disclosure on a minimum set of ESG information? Is a longer-term mindset in investment and company management critical to supporting effective ESG management? How should ESG and financial information be understood in a context of wider value creation?



**Keeping financial and ESG reporting separate comes at a risk of speaking in two tongues and underappreciation of company performance. We need a lingua franca for 'FESG' and decision-useful metrics**

Susanne Stormer, Vice President, Corporate Sustainability, Novo Nordisk A/S



### **How do funding flows affect ecosystem activity?**

Many organizations exist in the ESG ecosystem, supported by significant contributions from membership fees, grants and donations. But today there are regular complaints that some of their activities are duplicative or conflicting.

Are funders aware of the work their money goes to support, in the context of wider ecosystem activity? Where can increased coordination or consolidation of funding from key bodies best support ecosystem advancement?

### **How can new technologies be utilised?**

Digitalisation of data is regularly mentioned as a tool that could support the reporting process, as are open platforms for publication of standardized ESG data.

What is the role of digitalisation and artificial intelligence in the ESG reporting ecosystem? How can it be used effectively to reduce the reporting burden and increase the quality of published ESG data?

## How can companies organize for success?

Organizational and governance structures, and board management practices, play an important role in determining an organization's focus on ESG issues, as well as the influence that ESG information has on company practices.

How can boards best engage with companies on ESG issues? What ESG-linked board remuneration practices have been effective, and in what context? How can a company think about where to house ESG expertise within the organization?



**Systematically integrating environmental, social and governance (ESG) considerations and objectives across all business activities is not just a matter of operational excellence, it helps businesses to succeed in a sustainable way and to address the world's pressing problems**

Prince Max von und zu Liechtenstein,  
CEO, LGT Group



## How can the measurement of 'S' be improved, and how can wider metric reporting continue to evolve?

The 'S' or 'social' issues that are material to a company vary significantly by geography, industry and context, especially between mature and emerging markets. Societal values, science and the growing desire to understand an organization's impact will continue to shape what are deemed material issues for companies.

How can the understanding of 'S' be improved, and what can be done to measure it more effectively? How should the reporting ecosystem incorporate new metrics to enable appropriate measurement in an evolving global context, while ensuring consistency, developing comparability and supplying the breadth and depth of information sought by various stakeholder groups?

## GrowInclusive

Other efforts of the Forum are already looking to support companies in capturing the value of the 'S' in ESG. The Forum's GrowInclusive platform<sup>xiv</sup>—an initiative launched in 2018 in collaboration with the International Development Research Centre and the World Bank Group—aims to help organizations better understand how to derive business benefits from more socially inclusive business practices.



## Conclusion

The dialogue that this effort has sparked in just a few months is very promising, with participants from across stakeholder groups working past traditional barriers of engagement and trying to identify core elements of consensus across communities with often divergent views.

The findings of the first phase highlight a significant shared desire to collaborate in resolving multiple issues. The effort, working in close collaboration with the community, will look to catalyse action in areas that support system-level progress.

Additional avenues remain to be explored beyond the issues highlighted in this first paper, to better unlock the impact that an ESG focus enables, building on the burgeoning work at the World Economic Forum on sustainable investment and the new economy.

The Sustainable Development Impact Summit 2019 in New York, held during the United Nations' General Assembly Week, along with other regional conferences, will provide updates on and interactions with the group's work, leading up to the Annual Meeting 2020.

As this collective effort continues, its participants welcome further engagement from the community in identifying and leading opportunities for shared action, and in advancing this important dialogue on ESG management.

# Contributors

'Building an Effective Ecosystem for ESG' is a collaboration between the Forum and a coalition of its members and partners, guided by a Project Steering Committee and supported by a wider Project Advisory Group, dedicated to capturing leading insights and perspectives from across industries and geographies.

The World Economic Forum would like to thank the members of the Project Steering Committee and the Project Advisory Group to this effort for their time, expertise and support.

In addition, the Forum would like to thank the wider members of the community who have contributed their insight in the development of this effort—including experts and practitioners across investor, company, data provider, assurance provider, standard setter, framework developer, and regulator stakeholder groups.

The perspectives shared in this paper do not necessarily correspond with each of those expressed by the contributors noted below, but seek to reflect a balance of views captured through this effort.

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'Seeking Return on ESG: Advancing the Reporting Ecosystem to Unlock Impact for Business and Society' is a white paper published jointly by the World Economic Forum's System Initiative on Long Term Investing, Infrastructure and Development, and the Centre for New Economy and Society. It was written in collaboration with Allianz SE and Boston Consulting Group, with leading support from a constellation of individuals.

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# Endnotes

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<sup>iv</sup> See, for example, Amel-Zadeh, Amir and George Serafeim, “Why and How Investors Use ESG Information: Evidence from a Global Survey”, *Financial Analysts Journal*, vol. 74, no. 3, 2018, pp. 87-103;

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<sup>vi</sup> See paper section ‘Contributors’ for a list of Project Steering Committee and Project Advisory Group members who were involved in the initial phase of this effort.

<sup>vii</sup> For an introduction to the concept of materiality as applied to the environment of ESG reporting, and a short summary of the definitions of materiality proposed by various standard setters and framework developers, see: “Statement of Common Principles of Materiality of the Corporate Reporting Dialogue”, *Corporate Reporting Dialogue*, March 2016, <https://corporatereportingdialogue.com/wp-content/uploads/2016/03/Statement-of-Common-Principles-of-Materiality1.pdf>.

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<sup>ix</sup> “Better Alignment Project”, Corporate Reporting Dialogue, November 2018, <http://corporatereportingdialogue.com/wp-content/uploads/2018/11/Corporate-Reporting-Dialogue-Better-Alignment-Project.pdf>.

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<sup>xi</sup> “Sustainable Finance”, European Commission, December 2018, [https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance\\_en#commission-action-plan-on-sustainable-finance](https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance_en#commission-action-plan-on-sustainable-finance).

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