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## ESG RATES DIVERGENCE ON THE EMERGING MARKETS IN THE EUROPEAN UNION

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### **Abstract:**

*The growing emphasis on sustainability has led to a rise of ESG rating providers, but this expansion has brought challenges. ESG ratings are complex and can vary significantly between agencies, due to different scoring methods and non-standardized disclosures, making accurate assessments difficult. Moreover, investors and companies express limited confidence in the accuracy of these ratings. Regulatory developments aim to improve ESG disclosure and comparability, however, discrepancies in assessment criteria and rating methodologies persist. These aspects have led to the increasing concern of researchers from the academic field and professionals from the financial markets to identify how divergent are the ESG rates provided by various suppliers, what are the causes of this divergence, how do these influence the performance of companies and above all, how the negative effects of divergent ESG rates mitigated. Most researchers focused their attention on the aforementioned aspects on the developed financial markets from the USA or Europe, on the top companies or on the companies listed on the BRIC emerging markets. This article analyzes the divergence of ESG rates provided by three well-known rate-providers, for companies listed on emerging markets in Europe, contributing to increasing knowledge in this field.*

**Key words:** ESG score divergence, ESG investing, ESG ratings divergence, Rating uncertainty, Emerging EU Markets

### **1. Introduction**

As the impact of sustainability criteria on investment decisions in capital markets has increased, the number of ESG rating and scoring providers has also grown significantly. The ESG dimensions cover a wide range of diverse topics, such as climate change, human rights, cybersecurity, and diversity, this complexity making accurate assessment challenging. At the same time, some critics accuse ESG efforts of greenwashing and ESG rating providers are criticized for their lack of transparency and consistency in their data and methodologies. Even if certain agents set out to ensure perfect transparency, as is the Refinitive case, the very large amount of data underlying the ESG scores provided makes replication rather complex and time-consuming (Dell'Erba and Doronzo, 2023).

While ESG ratings are often produced through human analysts who evaluate a company's sustainability performance based on qualitative and quantitative factors, which

can introduce subjectivity and potential biases, ESG scores use a systematic, data-driven approach, involving more computing technology and algorithms to provide a standardized, objective assessment of ESG metrics, minimizing human biases and ensuring greater consistency and transparency.

Furthermore, investors and companies shows only moderate confidence in the accuracy and usefulness of ESG ratings, while individual agencies' ESG ratings can vary dramatically, aspects visible both in the research of academics and professionals in the field of capital markets.

ESG rating agencies employ unique scoring methods that assess various non-financial metrics, often leading to disagreements on ESG components. Unlike traditional financial metrics, selecting ESG topics and metrics is complex. Moreover, ESG ratings providers agencies typically do not fully disclose the indicators they assess or their impact, resulting in non-standardized disclosures that reduce the effectiveness of ESG ratings for institutional investors. ESG ratings also fail to fully represent the global market, as private or state-owned companies are often excluded due to a lack of critical non-financial data. Comparing ESG ratings across different regions is challenging, with notable differences observed between regions like Europe and North America.

Disclosure requirements vary significantly by country and region, with divergent regulations being introduced to encourage corporate ESG information disclosure, which is the primary source for ESG research and ratings.

In this context, as Dell'Erba (Dell'Erba & Doronzo, 2023) highlights the lack of standardization and transparency in ESG assessments, sustainable finance still lacks effective gatekeepers, contributing to investor protection and systemic risk mitigation.

The absence of standardization in ESG metrics, scores and ratings could prevent the development of sustainable practices and pose risks to the financial system and investors. But regulators in Europe, the U.S., and other regions are also enhancing ESG disclosure requirements, with new, comprehensive rules being finalized. Upcoming ESG disclosure regulations in the EU, U.S., and other regions are likely to significantly transform the ESG investing landscape. The EU Corporate Sustainability Reporting Directive (CSRD), which will come into force starting with 2025, requires all large companies and listed companies (except listed micro-enterprises) to disclose information on risks and opportunities arising from social and environmental issues. The Companies subject to the CSRD will have to report according to European Sustainability Reporting Standards (ESRS), developed by the EFRAG, previously known as the European Financial Reporting Advisory Group. This will provide a new perspective for rating providers, particularly regarding improved comparability. However, differences in assessing and selected sustainability criteria to be included in a specific ESG rate, the weighting of various criteria in the total score, and the significance of each sustainability element within each pillar will continue to contribute to divergent rating values.

In a continuous effort to provide investors with quality and reliable information on sustainability suppliers, SustainAbility Institute by ERM publish since May 2010 the annually report „Rate the Raters“, aiming to improve the quality and transparency of corporate sustainability ratings. The research and interviews that form the basis of the

report place for the year 2022 CDP, S&P Global ESG, Sustainalytics, MSCI, and ISS-ESG as leaders in terms of quality and usefulness of ESG provided rates.

## **2. Literature review**

Environmental, Social, and Governance (ESG) considerations have become a key factor in investment decision-making, which led to the increase of the interest in research related to sustainable investment. Investors are increasingly relying on various third-party providers of reports and ratings to assess and measure the evolution of companies' ESG performance over time and to compare it with that of their peers. This inevitably led to the increase of the numbers of ESG rating providers and their assessment methodologies, while report and ratings methodology, scope and coverage vary greatly among providers (Huber and Comstock, 2017). Simultaneously, the rapid growth in the availability of ESG data and rates providers raise concerns about the quality of the data, while different regions around the world are proceeding at different speeds on ESG regulation (Matos et al., 2020).

These aspects concern both the academic research and the capital markets professionals, who questioned these ratings, noting the high degree of disagreement among data providers. In the last years, significant attention has been focused on divergence of ratings issued by different ESG rating providers for the same company. (Doyle 2018, Gibson 2019, Matos 2020.), aiming to explain why ESG ratings disagree (e.g., Berg, Koelbel, and Rigobon 2020; Christensen, Serafeim, and Sikochi, 2021), to find whether ESG rating affects stock returns (Gibson et al., 2019; Tan and Pan, 2023; Wang et al., Vyletelka 2024) or the value added to companies' market capitalization (Şerban et al., 2022).

The 2018 Technical report of American Council for Capital Formation. „Ratings that don't rate – the subjective view of ESG rating agencies” reveals that major ESG rating agencies have significant disparities in ratings due to disclosure limitations and lack of standardization, company size bias, geographic bias, industry sector bias, inconsistencies between rating agencies and failure to identify risk (Doyle, 2018).

Gibson (Gibson et al., 2019) used ESG ratings from seven different data providers (Refinitiv ESG, Sustainalytics, Inrate, Bloomberg, FTSE, MSCI, and MSCI IVA ) for a sample of S&P 500 firms, between 2010 and 2017, to study the relation between ESG rating disagreement and stock returns, analyzing the level of disagreement about a firm's ESG and examining if stock returns are related to ESG rating disagreement. The research results show that stock returns are positively related to ESG rating disagreement and in particular to the environmental rating disagreement, suggesting a risk premium for firms with higher ESG rating disagreement. Furthermore, ESG rating disagreement varies across industries.

More recently, a complex analysis performed by Michal Vyletelka (Vyletelka, 2024) explores the relationship between divergence in ESG scores and excess stock returns on European Stock Market on a sample of 851 European stocks during January 2015 to May 2022. The results of the study do not confirm previous findings on the US stock market: although stocks with the highest and lowest divergence in ESG scores exhibit excess

returns, this effect dissipates once control variables from the Fama-French factor models are incorporated. The effect is neither industry-specific nor dependent on the ESG awareness level of the issuer's country.

Investigating Divergent ESG Ratings, Dimson (Dimson et al., 2020) concluded that when evaluations intended to measure the same variable, they should produce positively correlated scores. The score should correlate with related variables, while showing no correlation with unrelated ones. For exemplification, the analysis was performed on the ESG ratings provided by three providers (FTSE Russell, Sustainalytics, and MSCI) for some well-known companies: Facebook, JP Morgan Chase, Johnson & Johnson, Wells Fargo, Walmart and Pfizer. The values obtained for the pairwise correlations between the three different raters, calculated for their environmental, social and governance scores and their overall ESG ratings, were found to be extremely low. Data discrepancies, benchmark choice, missing data at the company level, and information overload are several identified factors that explain the discrepancies.

Christensen (Christensen et al., 2021) considering the significant disagreement among rating agencies on the scores assigned to individual firms, investigate whether a firm's ESG disclosure helps account for some of this disparity. The study analyzed data from three of the largest providers of ESG ratings: MSCI, Thomson Reuters, and Sustainalytics, using 30.700 firm-year observations across 5.637 unique companies during 2004 and 2016. The findings showed that findings highlight that ESG disclosure generally exacerbates ESG rating disagreement rather than resolving it.

Berg (Berg et al., 2022) investigates the divergence of ESG ratings based on data from six prominent ESG rating agencies: KLD, Sustainalytics, Moody's, S&P Global, Refinitiv and MSCI, finding correlations between ESG ratings range from 0.38 to 0.71. This leads to the difficulty of evaluating the ESG performance of companies, funds and portfolios, contributing at the same time to the reduction of companies' efforts to improve their ESG performance. The paper identified three distinct sources of divergence: "Measurement divergence", which is the main driver of rating divergence, contributing 56%, "Scope divergence", contributing 38% and "weight divergence", contributes 6% of the divergence, where scope and weight reflect what an ESG rating intends to measure, whereas measurement reflects how it is measured.

Abhayawansa (Abhayawansa et al., 2021) examine the causes of the differences in the ratings and ranking produced by different agencies, founding that the divergences between raters can be attributed to differences in defining ESG constructs and methodological differences.

Yan (Yan et al., 2022) investigates the influence of ESG rating confusion on bond spreads considering China emerging markets. The findings shows that most ESG ratings are positively correlated, but correlation coefficients are less than 0.4, and their absolute values vary significantly, thus, being reasonable to assume that there is confusion regarding ESG ratings. The study provides that the greater confusing the ESG rating, the higher the spread of corporate bonds, particularly in the secondary market. Environmental and weighting inconsistencies have been identified as crucial sources of ESG rating confusion.

### **3. Methodology**

As previously presented in the literature review, the focus of academic researchers and business professionals was directed in terms of the divergence of rates, especially towards developed markets and top companies, which are part of the relevant indices in the ESG field, and when it was about the emerging markets, the BRIC markets, especially China were preferred. The present paper comes to complement these studies with a perspective on the emerging markets in Europe Union, taking into account the specific present and above reporting criteria of this segment of the capital markets.

Unlike developed markets, characterized by strong economic growth, high income per capita, liquidity, easy access of foreign investors, efficient and reliable regulations, emerging markets, promise high returns, based on faster economic growth, being extremely attractive to investors, also associated with greater exposure and risk, that can include potential political instability, domestic infrastructure problems, lack of dependable information, currency fluctuations, and illiquid equity (Vasiu, 2024). At the same time, the size of the listed companies is smaller, and, even if the regulations and disclosure and reporting obligations are more relaxed, they are under permanent pressure to improve their performance and to get closer to developed markets. For these reasons, emerging markets and implicitly, listed companies, represent an interesting and promising subject for study.

In order to select the countries whose financial markets are to be analyzed, we took into account the latest classifications regarding Emerging Markets (EM) of The World Economic Outlook Database (IMF 2024), the last (April 2024) FTSE Classification of Equity Markets, the components of MSCI Emerging Markets Index and Refinitiv Business Classification.

Considering FTSE Classification of Equity Markets – FTSE Equity Country Classification scheme, as at March 2024, developed countries are considered: Australia, Austria, Belgium/Luxembourg, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Netherlands, Norway, Poland, Portugal, Spain, Sweden, Switzerland and UK. The list of Advanced Emerging Countries contain Czech Republic, Greece and Hungary, while the list of Secondary Emerging contain Iceland and Romania. Bulgaria, Croatia, Cyprus, Estonia, Latvia, Lithuania, Malta, Republic of North Macedonia, Serbia, Slovak Republic, Slovenia were classified as Frontier Markets.

According to IMF's "Regional economic outlook" Europe : soft landing in crosswinds for a lasting recovery", published in April 2024, European Emerging Market Economies comprise Central Europe (Hungary and Poland), Eastern Europe (Belarus, Moldova, Russia, Ukraine) and Southeastern European EU Member States (Bulgaria and Romania)

Considering Refinitiv Business Classification, Emerging Europe markets comprise Albania, Andorra, Azerbaijan, Belarus, Bermuda, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus, Czech Republic, Estonia, Faroe Islands, Georgia, Gibraltar, Greenland, Guernsey, Hungary, Isle of Man, Jersey, Latvia, Lithuania, North Macedonia, Moldova, Malta, Monaco, Montenegro, Poland, Romania, Russia, San Marino, Serbia, Slovak Republic, Slovenia, Turkey and Ukraine.

For EU markets, once that the Corporate Sustainability Reporting Directive (CSRD) entered into force on 5 January 2023, EU rules require large companies and listed

companies to disclose information on the social and environmental risks they face, and on how their activities impact people and the environment, starting with the 2024 financial year, for reports published in 2025.

Considering the inclusion in the emerging markets and the additional reporting criteria in terms of ESG that apply to the countries of the European Union, the list of countries meeting all abovementioned criteria includes: Bulgaria, Croatia, Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, and Slovenia. Among the companies listed on these markets, aiming to compare ESG rates, the companies for which ESG scores provided by Thomson Reuters Refinitiv Eikon (LSEG - London Stock Exchange Group), Sustainalytics ESG Risk Ratings and S&P Global ESG Scores were available for the fiscal year 2024 have been selected. The selection led to a number of 46 companies from 6 countries, presented in Table no.1, the companies being analyzed according to the industry in which they operate, as defined by Refinitiv Business Classification scheme: Energy, Basic Materials, Industrials, Financials, Consumer Cyclical, Consumer Non-Cyclical, Healthcare, Technology, Utilities, Real Estate.

**Table 1 : The Analysed Companies, Grouped by Country and Sector.**

| <b>Sector</b>         | <b>Country</b> |          |           |          |                 |          | <b>Total</b> |
|-----------------------|----------------|----------|-----------|----------|-----------------|----------|--------------|
|                       | Czech Republic | Hungary  | Poland    | Romania  | Slovak Republic | Slovenia |              |
| Basic Materials       | 0              | 0        | 3         | 0        | 0               | 0        | <b>3</b>     |
| Consumer Cyclical     | 0              | 0        | 2         | 0        | 0               | 0        | <b>2</b>     |
| Consumer Non-Cyclical | 0              | 1        | 2         | 0        | 0               | 0        | <b>3</b>     |
| Energy                | 0              | 1        | 3         | 0        | 0               | 0        | <b>4</b>     |
| Financials            | 2              | 1        | 11        | 1        | 2               | 1        | <b>18</b>    |
| Health                | 0              | 1        | 1         | 0        | 0               | 1        | <b>3</b>     |
| Industrials           | 0              | 0        | 2         | 0        | 0               | 0        | <b>2</b>     |
| Technology            | 0              | 0        | 5         | 0        | 0               | 0        | <b>5</b>     |
| Utilities             | 1              | 0        | 4         | 1        | 0               | 0        | <b>6</b>     |
| <b>Total</b>          | <b>3</b>       | <b>4</b> | <b>33</b> | <b>2</b> | <b>2</b>        | <b>2</b> | <b>46</b>    |

*Source: Author, using Refinitiv website*

LSEG (London Stock Exchange Group) ESG scores, formerly known as Refinitiv ESG ratings ESG (ESG Combined Score, ESG Controversies Score, Environmental Pillar Score, Social Pillar Score, and Governance Pillar Score) are expressed numerically, on a scale from 0 (worst) to 100 (best), existing also a letter grade correspondence, from A to D, where A+ represents the highest score, over 96 and D- the weakest ESG performance, below 8. Companies with higher scores demonstrate strong ESG performance and lower exposure to ESG risks.

S&P Global ESG Scores calculated from S&P Global Corporate Sustainability Assessment (CSA) captures Material Risks and Opportunities within criteria weights by industry, on a scale of 0 – 100, where 100 represents the maximum score. More than 30 criteria scores evaluate a company's performance across key sustainability themes within each ESG dimension. General criteria, applicable to all industries - such as Corporate Governance (G), Climate Strategy (E) and Human Rights (S) — are supplemented by industry-specific criteria. Scores calculated from the CSA are a primary or secondary methodological component of over 200 indices produced by S&P Global, including the Dow Jones Sustainability Indices (DJSI), S&P ESG Indices and the Paris-Aligned & Climate Transition (PACT) Indices.

Morningstar Sustainalytics' ESG Risk Ratings offer a comprehensive evaluation of a company's exposure to industry-specific material ESG risks and its ability to manage those risks, by assessing both the exposure to and management of key ESG issues. The ratings condense the total unmanaged risk into a single score that reflects the company's overall ESG risk profile. The ESG Risk Ratings are categorized across five risk levels from negligible to severe. These risks are also presented on a value scale: negligible (0-10), low (10-20), medium (20-30), high (30-40) and severe (over 40)

Given the varying assessment methodologies and rating scales, such as Sustainalytics' ESG risk score, which assigns higher ratings to companies with greater exposure to ESG risks, it was necessary to standardize these metrics. Thus, the Sustainalytics' ESG risk score scores were recalculated as the difference between 100 p and the Sustainalytics' ESG risk scores, so that the highest score is assigned to the company that presents the lowest risk.

At the same time, only LSEG and S&P Global ESG Scores offers detailed scores divided into three pillars of sustainability – Environmental, Social and Corporate Governance, so that comparisons on each component are only possible for these two companies.

IBM-SPSS Pearson correlation have been applied to test the divergence of the ESG rates provides by the by the three suppliers.

#### **4. Results/findings**

First, the average ESG total scores calculated by the three providers were compared. Thus, the highest average value of the ESG scores, of 75,09 was obtained for the ESG rates provided by Sustainalytics' ESG Risk Ratings. The differences between the three ESG rates are significant, considering that the average value of the S&P Global ESG Scores represents half of that of the average Sustainalytics' ESG Risk Ratings.

A limitation of this analysis is the fact that for almost 40% of the companies analyzed, S&P Global ESG Scores are not available.

It should be mentioned that the variation between the analyzed companies is minimal, with coefficients of variation falling between 14% and 27%. Therefore, the average ESG scores can be considered representative of the studied companies.

Table 2 : Descriptive Statistics of ESG Total Scores

|                                | N  | Range | Minimum | Maximum | Mean  | Std. Deviation |
|--------------------------------|----|-------|---------|---------|-------|----------------|
| S&P Global ESG Scores          | 28 | 38,00 | 22,00   | 60,00   | 38,36 | 10,15          |
| LSEG ESG Scores                | 46 | 57,23 | 21,21   | 78,44   | 56,15 | 15,40          |
| Sustainalytic ESG Risk Ratings | 46 | 50,20 | 49,80   | 100,00  | 75,09 | 10,36          |

Source: Author's calculation

At country level, the highest average value of the ESG scores was registered for Sustainalytic ESG Risk Ratings for all countries, respectively the highest ESG score being recorded in the case of Slovenia. For each country there are differences between the 3 ESG scores. The closest values of the three scores rates were recorded in case of Hungary, while the highest values were recorded in the case of Slovenia, considering that for Romania and Slovak Republic only Sustainalytic ESG Risk Ratings and LSEG Scores could be compared.

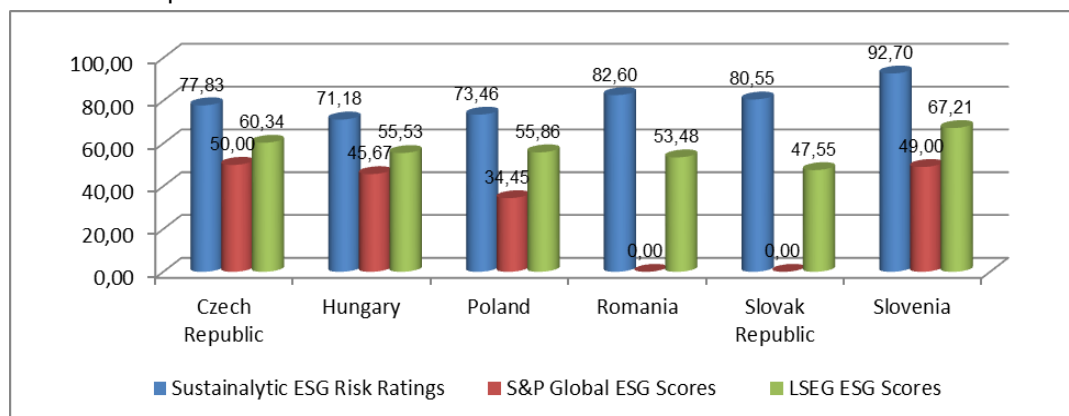


Figure 1: The distribution of the analysed companies by country, based on the average value of each ESG total score.

Source: Author

At industry sectors level the closest values of the three ESG scores rates were recorded in case of Utilities, while the highest difference were recorded in the case of Consumer Non-Cyclicals, while the the closest values meet in the case of Energy domain. Likewise at country level, the highest average value of the ESG scores was registered for Sustainalytic ESG Risk Ratings for all sectors.



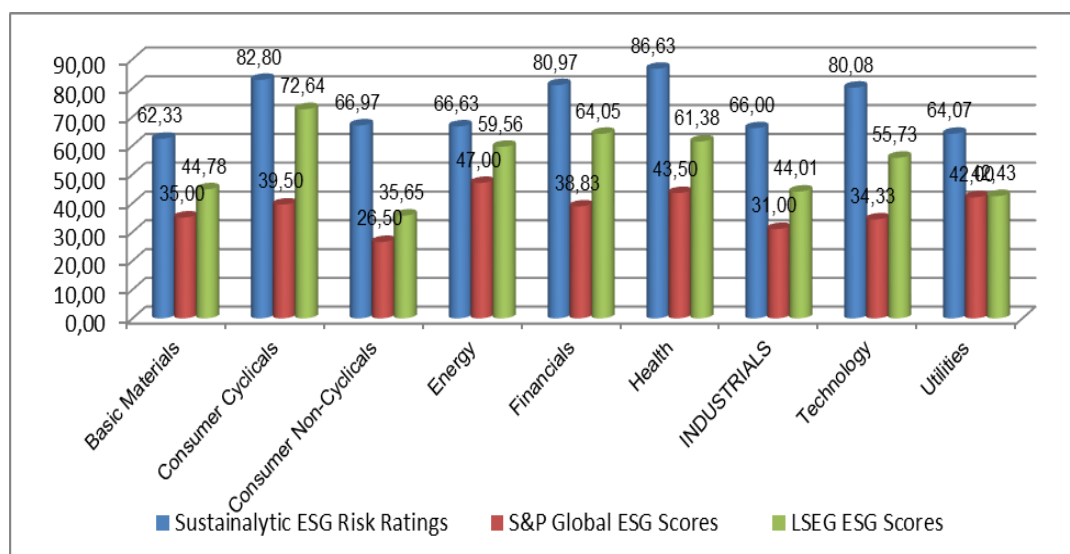


Figure 2: The distribution of the analysed companies by sector, based on the average value of each ESG total score.

Source: Author

Analyzing the differences between the average values of the three ESG total scores, the difference between each average ESG total score was determined, computing the arithmetic mean of these differences.

Further, average values of ESG Pillar Scores were compared in the case of LSEG Scores and S&P Global ESG Scores, for each of the three pillars of sustainability – Environmental, Social and Corporate Governance.

Table 2 : Descriptive Statistics of ESG Pillar Scores

| Descriptive Statistics- Environmental Pillar Score- average values |       |
|--------------------------------------------------------------------|-------|
| S&P Global ESG Scores - Environmental Pillar Score                 | 35,50 |
| LSEG ESG Scores - Environmental Pillar Score                       | 54,71 |
| Descriptive Statistics - Social Pillar Score- average values       |       |
| S&P Global ESG Scores - Social Pillar Score                        | 36,50 |
| LSEG ESG Scores- Social Pillar Score                               | 59,56 |
| Descriptive Statistics - Governance Pillar Score- average values   |       |
| S&P Global ESG Scores - Governance Pillar Score                    | 37,82 |
| LSEG ESG Scores - Governance Pillar Score                          | 53,45 |

Source: Author's calculation

The closest values of the ESG Pillar Score were found in case of the Governance Pillar Score. The differences between ESG Pillar Scores result from different category scores calculation methodology, category weights and weight method, as presented on each rate-provider scores guide.

| ESG Score             | Environmental Criteria                                                                                                                                                     | Social Criteria                                                                                                                                                | Governance Criteria                                                                                                                                                                 |
|-----------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| S&P Global ESG Scores | <ul style="list-style-type: none"> <li>✓ Environmental Policy &amp; Management Systems</li> <li>✓ Environmental Reporting</li> <li>✓ Operational Eco-Efficiency</li> </ul> | <ul style="list-style-type: none"> <li>✓ Corporate Citizenship and Philanthropy</li> <li>✓ Human Rights</li> <li>✓ Occupational Health &amp; Safety</li> </ul> | <ul style="list-style-type: none"> <li>✓ Corporate Governance</li> <li>✓ Information Security/Cybersecurity &amp; System Availability</li> <li>✓ Supply Chain Management</li> </ul> |
| LSEG ESG Scores       | <ul style="list-style-type: none"> <li>✓ Resource use</li> <li>✓ Emissions</li> <li>✓ Innovation</li> </ul>                                                                | <ul style="list-style-type: none"> <li>✓ Workforce</li> <li>✓ Human rights</li> <li>✓ Community</li> <li>✓ Product responsibility</li> </ul>                   | <ul style="list-style-type: none"> <li>✓ Management</li> <li>✓ Shareholders</li> <li>✓ CSR strategy</li> </ul>                                                                      |

*Source: Data centralized by author using information from S&P and LSEG websites*

The fact that there are differences between the ESG scores provided by various agencies is a certainty, as previously has been highlighted in the literature review by numerous researchers. Further, we wanted to analyze which of the three analyzed ESG scores are the closest, both at the level of total scores and at the level of the Pillar Scores.

To test this, Pearson correlation using IBM-SPSS have been applied. Pearson's correlation coefficients values were interpreted according to Evans (Evans, 1996). The results are presented in table No. 3. below, leading to the conclusion that there are only moderate (0.40–0.59) or weak (0.20–0.39) correlation between the three ESG scores. The strongest correlation was found between Sustainability ESG Risk Ratings and LSEG ESG Scores, of 56,7%.

**Table 3 : Pearson Correlation Coefficients of ESG Total Scores**

|                                                              | Sustainability ESG Risk Ratings | S&P Global ESG Scores | LSEG ESG Scores |
|--------------------------------------------------------------|---------------------------------|-----------------------|-----------------|
| Pearson Correlation                                          |                                 |                       |                 |
| Sustainability ESG Risk Ratings                              | 1                               | ,252                  | <b>,567**</b>   |
| S&P Global ESG Scores                                        | ,252                            | 1                     | <b>,494**</b>   |
| LSEG ESG Scores                                              | <b>,567**</b>                   | <b>,494**</b>         | 1               |
| **. Correlation is significant at the 0.01 level (2-tailed). |                                 |                       |                 |

*Source: Author's calculation*

Figure 3 illustrates the companies distribution considering the three ESG rates.

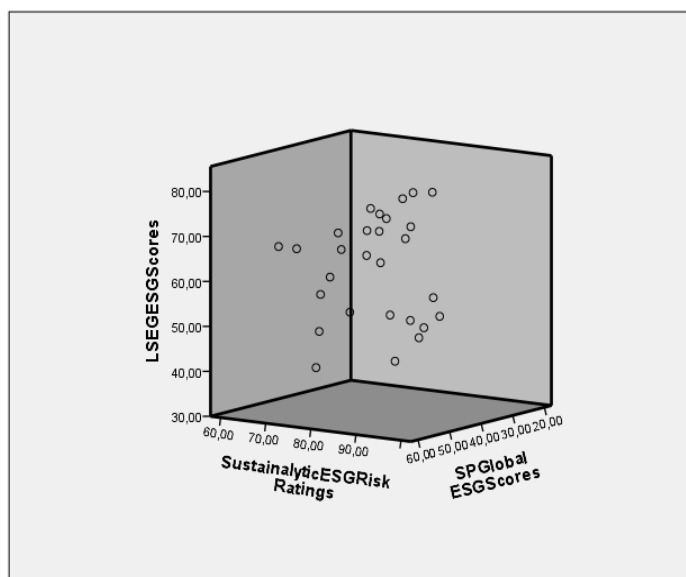


Figure 3: Companies distribution considering ESG rates  
Source: Author

For the analysis of the correlation between the three pillars of sustainability, only the paired correlations for the same type of pillars were analyzed. The highest correlation coefficient was found in the case of the Social Pillar Score, although it still indicates a moderate correlation of 48,7%. Environmental Pillar Scores provide by S&P and LSEG registered the weakest correlation of only 19%.

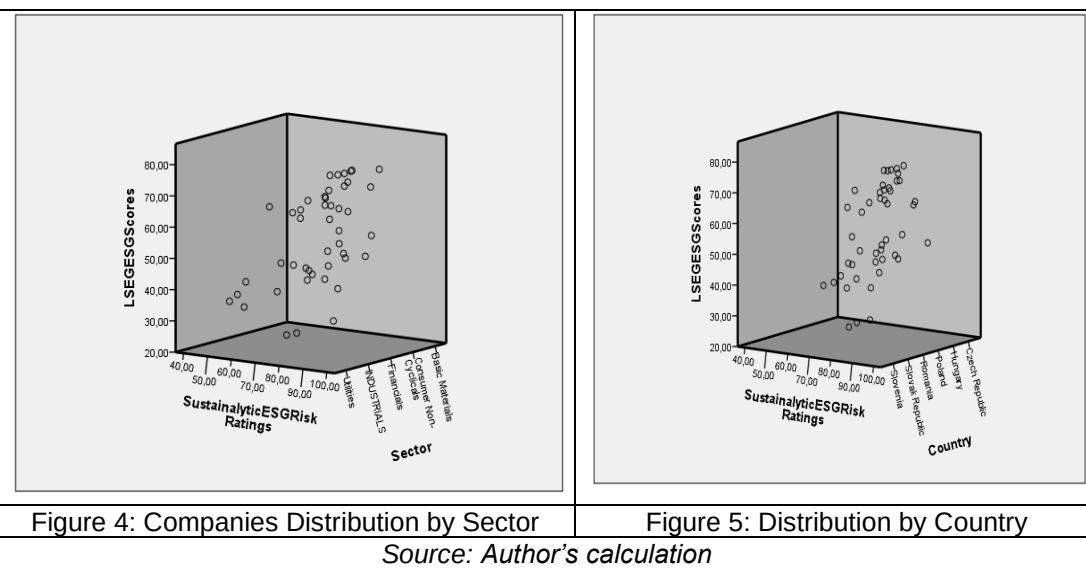
Table 4 : Pearson Correlation Coefficients of ESG Pillar Scores

| Pearson Correlation                                          | S&P Environmental Pillar Score | S&P Social Pillar Score | S&P Governance Pillar Score | LSEG ESG Environmental Pillar Score | LSEG ESG Social Pillar Score | LSEG ESG Governance Pillar Score |
|--------------------------------------------------------------|--------------------------------|-------------------------|-----------------------------|-------------------------------------|------------------------------|----------------------------------|
| S&P Environmental Pillar Score                               |                                |                         |                             | ,190                                |                              |                                  |
| S&P Social Pillar Score                                      |                                |                         |                             |                                     | ,487**                       |                                  |
| S&P Governance Pillar Score                                  |                                |                         |                             |                                     |                              | ,248                             |
| **. Correlation is significant at the 0.01 level (2-tailed). |                                |                         |                             |                                     |                              |                                  |
| *. Correlation is significant at the 0.05 level (2-tailed).  |                                |                         |                             |                                     |                              |                                  |

Source: Author's calculation

Given a stronger correlation, identified between the LSEG ESG Scores and Sustainalytic ESG Risk Ratings, the following figures depict the clustering of analyzed

companies based on these two sustainability rates providers , illustrating their distribution by country and by sector.



## 5. Discussions

For European emerging markets, the lack of mandatory non-financial sustainability reporting makes it difficult to evaluate the discrepancies in ESG ratings. However, despite the relatively small number of companies involved, it is clear that in case of companies listed on emerging markets from the European Union, different rating agencies provide inconsistent scores, a trend increasingly recognized by global researchers (Vyletelka 2024; Berg et al., 2022; Avramov et al., 2022; Clement et al. 2022; Wang et al., 2024).

Literature suggests that one of the causes of divergence can be the size of companies (Drempetic et al., 2020). On developed financial markets, larger companies often use more resources for providing ESG data, compared to smaller companies listed on emerging markets. This doesn't necessarily imply that larger firms are more sustainable than smaller ones; it could simply mean that larger firms have more robust sustainability reporting, which in turn leads to higher ESG scores.

Another divergence arises from the fact that we are dealing with ratings and scores, both tools designed to condense extensive sustainability data into one single number or letter (Dell'Erba & Doronzo, 2023). The difference between ESG ratings and ESG scores lies in their methodologies (Windolph, 2011; Edmans, 2023; Cheng et al., 2023). The variations in ESG ratings stem from differences in the methodologies used for calculating category scores, the weighting of these categories, and the overall weighting methods, as outlined in each rating provider's scoring guide. Not all rating agencies disclose their scoring methodologies, and when this information is made available, the weights or factors considered in the score calculation often differ (Abhayawansa et al., 2021; Berg et al., 2022; Rubino et al., 2024). For example, in case of Social ESG Pillar score, where highest correlation coefficient of 48,7% was found between S&P and LSEG

scores, S&P Global ESG Scores takes in considerations Corporate Citizenship and Philanthropy, Human Rights and Occupational Health & Safety criteria, while LSEG ESG Scores consider Workforce, Human rights, Community and Product responsibility when calculating ESG Pillar Scores. Beyond the different criteria, there are different weights of each criterion in the calculation of a pillar score and different weights of the pillars in the overall scores.

Analyzing the correlation between various rates provided by different agencies for the same company, the findings shows that most ESG ratings are positively but low correlated, and their absolute values vary significantly, generating confusion regarding ESG ratings (Yan et al., 2022; Christensen et al., 2021). The same low or moderate values between the scores provided by different agencies were also identified in the research at the level of emerging markets in Europe, both in terms of total scores and for each pillar score,

In the absence of mandatory reporting and, furthermore, imposing a certain reporting standard (Hazen, 2021), it is difficult to compare rates. Although these issues will be resolved with the implementation of the directive in the European Union, companies listed on emerging EU markets, who did not have the use of such reports, will face additional costs for preparing these reports, which may impact the performance of these companies, in terms of costs rising (Cheng et al., 2023; Dell'Erba and Doronzo, 2023).

## **6. Conclusions**

The analysis of ESG ratings provided by three different agencies (Thomson Reuters Refinitiv Eikon (LSEG - London Stock Exchange Group), Sustainalytic ESG Risk Ratings and S&P Global ESG Scores) for companies listed on the emerging markets of the European Union aligns with global research findings (Vyletelka 2024; Berg et al., 2022; Avramov et al., 2022; Clement et al. 2022; Cheng et al.; 2023, Doyle 2018; Gibson 2019; Matos 2020): significant discrepancies exist between the ratings at the company, sector, and country levels.

In this analysis, the main limiting factor is the that only a small number of companies provided non-financial sustainability reports. Given the criteria for classification emerging economies, 11 countries were selected as part of the emerging markets in Europe. Of these countries, the companies for which ESG scores provided by Thomson Reuters Refinitiv Eikon (LSEG - London Stock Exchange Group), Sustainalytic ESG Risk Ratings and S&P Global ESG Scores were available for the fiscal year 2024 have been selected. The selection led to a number of 46 companies from 6 countris. In the absence of mandatory reporting and certain reporting standards the analysis is challenging, and comparisons with relevant developed markets, as well as the research conclusions, should be approached with caution, an aspect this is expected to change significantly, starting in 2025, with reports for the fiscal year 2024. Another important limitation is due data unavailability: almost 40% of the companies analyzed, S&P Global ESG Scores are not available.

For companies listed on European Emeging Markets divergences in different ESG rates have been found at country level, at industry sectors, between ESG total scores and between Pillar Score provided by the by three different agencies.

For the comparison of total ESG scores, the average levels calculated for each sector and country were utilized. At both the country and industry levels, the highest average ESG scores were recorded by Sustainalytics' ESG Risk Ratings, which often showed values nearly double, compared to those of S&P Global's ESG Scores. At the country level, the smallest differences between scores were recorded in Hungary, while the largest were in Slovenia. At the sector level, the closest scores were in Energy domain, and the most divergent were in Consumer Non-Cyclicals sector. Given that in the Energy sector can be find some of the best performing companies and the sector has long been under sustainability pressure and former CSR reporting standards, the less divergence in ESG rates may be due the greater familiarity with sustainability reporting in this field. This familiarity contributes to the production of more accurate, appealing reports for rating agencies, which are also easier to process.

When comparing ESG Pillar Scores in the case of LSEG Scores and S&P Global ESG Scores, for each of the three pillars of sustainability – Environmental, Social and Corporate Governance, average values have been used. The results indicated that the closest values were found in case of the Governance Pillar Score.

Using Pearson correlation, it was analyzed which of the three analyzed ESG scores are the closest, both at the level of total scores and at the level of the Pillar Scores, leading to the conclusion that there are only moderate or weak correlation between the three ESG scores. The strongest correlation, of 56,7%, was found between Sustainalytic ESG Risk Ratings and LSEG ESG Scores. Between the three pillars of sustainability, the highest correlation coefficient was found in the case of the Social Pillar Score, although it still indicates a moderate correlation of 48,7%. Environmental Pillar Scores provide by S&P and LSEG registred the weakest correlation of only 19%.

These differences originate from variations in the methodologies used to calculate the ratings, including the weight assigned to each element within the pillars, as well as the differing emphasis placed on each pillar, which can be confusing for investors. A future research direction will be to explore the causes of these divergences, particularly in the context of the specific challenges that the mandatory reporting requirements will bring, starting with 2024

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