

## ESG RATINGS AND INDEXES: BENEFITS AND LIMITATIONS

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### Abstract

*In recent years, environmental, social and governance (ESG) ratings and indices have gained increasing importance as tools for assessing corporate sustainability and guiding responsible investment. However, along with their popularity, debates about their reliability, comparability and real impact have intensified. The purpose of this paper is to critically examine the main advantages and disadvantages of ESG ratings and indices. It explores their nature, function and application in modern business and investment practice by applying comparative approach.*

*The analysis is based on a systematic review of leading scientific publications, focusing on methodological differences between ESG ratings, issues with transparency and comparability of assessments, as well as on the specifics of ESG indices as a basis for sustainable investing. The paper presents the key characteristics of ESG ratings and indices, distinguishes their roles and analyses the challenges associated with their application, including the risk of ESG-washing and shortcomings in considering sector specifics. The need for increased transparency, harmonisation of methodologies and strengthening regulatory oversight is emphasized, for ESG ratings and indices to effectively fulfil their role in the process of promoting sustainability and good corporate governance.*

**Keywords:** ESG ratings, ESG indices, corporate sustainability, transparency, regulatory oversight, methodology comparability

### 1. INTRODUCTION

In recent years, environmental, social and governance (ESG) issues have emerged as an important element in the concept of sustainable development and responsible corporate behaviour. Their impact on the capital market was assessed through the ESG performance of companies. Its inclusion in investment decisions is referred to as ESG investing. The PwC Global Investor Survey 2022 shows that similar to financial information, which has increased the list of information sources used, more than 60% of investors surveyed use corporate sustainability disclosures to assess how firms manage risks and opportunities and about 50% of respondents use ESG ratings and scores (PwC 2022).

ESG principles underpin many public policies, governance strategies and investment practices, particularly in the global context of climate change, social justice and corporate ethics. Many investors consider company's ESG performance when making investment decisions (Winegarden 2019). In 2020, the value of professionally managed portfolios with integrated ESG assessments exceeded US\$17.5 trillion worldwide (OECD 2020).

ESG ratings and indices are essential in this process, designed to measure and evaluate company's performance across the three pillars of sustainability. Since 1999, Dow Jones & Company offers a sustainability index. FTSE4 Good Index has been provided since 2001 by the Financial Times (Unruh et al. 2016). According to Fish et al. (2019) more than 600 ESG ratings were published in 2018.

ESG ratings are complex assessments provided by specialised rating agencies that collect, analyse and summarise non-financial information about the environmental, social and governance practices of companies. Investors, banks, insurers, regulators and other stakeholders use these assessments to guide their financial, investment, social and risk assessment decisions. On the other hand, ESG indices aggregate companies with high ESG scores and serve as a benchmark and basis for the development of sustainable investment products such as exchange-traded funds (ETFs). Despite their popularity and

widespread use in the fields of finance and corporate behavior, ESG ratings and indices are still highly controversial.

The main challenges identified in the literature are the numerous measurement criteria applied and the lack of standardized methodologies (Cornell 2020; Rusu 2020), poor compatibility of ratings across agencies. Moreover, they use self-reported data, which lacks accuracy (Unruh et al. 2016) and might manipulate or overestimate the real results of companies. This problem has also been addressed in the publications of Berg et al. (2022) and Gibson et al. (2021), Feifei and Polychronopoulos (2020) and Serafeim and Yoon (2023) and is referred to as “ESG-washing”. Hence, companies’ ESG ratings or indices might send wrong signals to investors thus affecting their investment choice.

These debates question the extent to which ESG ratings accurately reflect a company’s sustainable performance and how they can be used as tools for investment decision-making. Furthermore, ESG indices are controversial – both in terms of the criteria for including companies and the fact that the activities of some of the companies included provoke contradictory public debate. This problem is further amplified by the fact that there is no standard way to constructing indices, making them difficult to compare and potentially confusing for investors.

In light of the ongoing discussion, the purpose of this paper is to critically examine the main advantages and disadvantages of ESG ratings and indices. It explores their nature, function and application in modern business and investment practice by applying comparative approach. An emphasis is placed on the use of these tools in the areas of sustainable management, non-financial reporting and responsible investment. Considering the main benefits and limitations, this study aims to draw a conclusion about their real usefulness, potential implications, and future challenges.

## **2. HYPOTHESIS**

ESG ratings and indices are tools with potential to promote sustainable corporate governance, responsible investment and non-financial accountability. They can support redirection of capital towards more sustainable business models and guide investors and other stakeholders in their decisions. However, their reliability and effectiveness are limited due to some current limitations such as lack of unified assessment methodologies, low comparability between scores developed by different agencies, insufficient transparency of measurement processes, the use of self-reported data and ESG-washing practices. Therefore, it is suggested that to play their assigned role, ESG ratings and indices need to be improved through standardisation, more efficient control over the data used and consideration of sector and regional specifics.

## **3. LITERATURE REVIEW**

### *3.1 Sustainability reporting regulations*

Currently, 96% of G250 companies report on sustainability or ESG matters (KPMG 2022). The growing tendency has been accelerated by the recent developments of the regulatory landscape and the expanding standardisation of sustainability reporting being a prerequisite for the improvement of disclosures on companies’ ESG performance.

At the international level, one of the most significant events was the establishment of the Global Reporting Initiative (GRI) in 1997. This independent, international organisation was committed to improving sustainability reporting worldwide. A few years later, the first GRI’s Sustainability Reporting Guidelines were published. They were considered the first global framework for sustainability reporting, aiming to enhance comparability and consistency of company’s sustainability performance (Gray 2010; Dhaliwal et al. 2011; Van Bommel 2014) and investors’ confidence in the capital markets (Munshia & Dutt 2016; Haidar et al. 2021). Another notable event was the launch of the International Integrated Reporting Council (IIRC) in 2010. In December 2013 IIRC published its first Integrated Reporting framework, one of its targets being to improve the quality of information available to providers of financial capital and to increase the efficiency and productivity of capital allocation. Two years later,

the Taskforce for Climate-Related Financial Disclosures was created by the Financial Stability Board to provide guidance on companies' disclosure of financial implications of climate-related risks and opportunities and support investors in their decisions. In the same year, the fourth revised version of GRI's Sustainability Reporting Guidelines was transitioned into GRI Standards thus becoming the first globally accepted and world's most widely used sustainability reporting standards. They are supported by the newly established standardisation body - the Global Sustainability Standards Board (Stancheva-Todorova 2022). Comparability and consistency of the companies' ESG reporting was further enhanced for the benefit of all capital markets participants with the metrics, introduced by the World Economic Forum in 2020 (2020). The International Sustainability Standards Board (ISSB) of IFRS Foundation was launched on 3 November 2021 and paved the way towards the international standardisation of investor-focused sustainability disclosures across capital markets.

In the United States (U.S.), all started with the Dodd-Frank act passed by the Congress in 2010. Considered as one of the most significant regulatory reforms in the country since the Great Depression (Berman 2023), its primary goal was to reduce risk in the banking system, but this act also introduced few environmental disclosure requirements. The sustainability landscape in the country was significantly changed by the foundation of the Sustainability Accounting Standards Board in 2011 as a non-profit organisation. Its main purpose was the development of industry-specific sustainability disclosure standards for listed companies in the U.S. These companies' disclosures on material sustainability issues should complement financial data presented to investors and become mandatory 10-K or 20-F filings of the Securities and Exchange Commission (Lydenberg et al. 2010). In March 2022, US SEC announced its climate disclosure proposal (KPMG 2022).

At European Union (EU) level, the new Corporate Sustainability Reporting Directive 2022/2464 (CSRD), adopted by the European Parliament on 14 December 2022 (Directive 2022/2464), expanded the scope of liable companies, the reporting requirements and their complexity compared to the old Non-Financial Reporting Directive 2014/95/EU, which was applicable since 2018. It introduces the European Sustainability Reporting Standards, developed by the European Financial Reporting Advisory Group. The new directive requires more than 6000 large companies to report annually on their ESG performance. They need to disclose non-financial information on how they meet social and environmental challenges related to the treatment of employees, human rights, anti-corruption and bribery, gender, and age diversity on company's board members and their educational and professional background. Under the new rules, companies should report the impact they create on people and the environment (impact materiality) alongside the financial risks associated with the effect of sustainability issues on their performance (financial materiality) (Stancheva-Todorova & Nikolova 2023). In addition, the presented information through sustainability reporting should be material from financial perspective to stakeholders (Baumüller & Sopp 2022). The liable mandatory report audit with limited assurance imposed by CSRD is expected to improve the transparency and reliability of companies' sustainability data and as a result, boost investor confidence (ACCA 2023).

### *3.2 ESG investing*

ESG investing is synonymously described as sustainable investing and could be traced back to the early 1950s when Howard Bowen initiated the first profound debate focused on business ethics and social responsibility. The father of corporate social responsibility argued that businesses should not only strive for higher profits but also need to give back to society, which is their moral obligation (Bowen 2013). Socially responsible investing rapidly developed as a practice. In the 1960s it was associated with the exclusion of certain businesses, considered "harmful" to society, from the investors' portfolio. However, the field is evolving and today it encompasses the integration of analysis of financially relevant ESG factors into the investment decisions parallel to traditional technical and financial analysis.

Since the turn of the century, a huge body of research has been focused on the impact of a variety of ESG factors on company's performance and the use of non-financial ESG data in investment decision-making. According to a global survey conducted in 2016 (Unruh et al 2016), there is a growing trend for investors to use sustainability-related data as a rationale for their decisions as they see a strong link between company's financial performance and ESG performance (Whelan et al. 2020). This is in line with the widely spread belief that disclosed ESG information has a positive impact on stock return

volatility, which reduces the risk of an investment portfolio (Bollen 2007). Companies with higher ESG ratings are associated with higher profitability, lower tail risk and lower systematic risk. The excellent ESG performance leads to financial outperformance compared to industry benchmark and greater market valuation (Ademi & Klungseth 2022). The empirical findings provided by Rounok et al. (2023) also confirm that ESG data is important for investment decisions. This view is also supported by the works of Sultana et al. (2018) and other researchers (Nakamura 2013; Crifo et al. 2015; Zwaan et al. 2015). Information about the companies' ESG performance provides investors with transparency, which impacts their choice on how to allocate their investments (Gompers et al. 2003; Khemir et al. 2019).

The evolution of ESG factors has created more value for sustainable investment, which is affirmed in a series of publications (Berry & Junkus 2013; Crifo et al. 2015; Mehwish et al. 2022). They are now routinely integrated into the investment process (Morgan Stanley Institute for Sustainable Investing & Morgan Stanley Investment Management 2020). Long-term profitability could only be achieved when addressing sustainability risks (Fink 2020).

Parallel to the mainstream research, a host of publications focus on the challenging areas for ESG investing and reveal some controversial empirical results. Derwall et al. (2011) claim that the ESG shares have only short-term profit generating potential. This view is also supported by Borgers et al. (2015), who argue that no excessive return should be expected from investing in ESG equities. The empirical findings of Rusu (2020) indicate that embedding sustainability into the corporate strategy does not significantly affect investors' stock price valuation or allocation of funds. Furthermore, the researcher advocates that there is no firm conclusion on how companies' ESG engagement affects their financial performance and investors' behavior. Based on the extant literature, she claims that there is no clear quantitative evidence for the outperformance of sustainable and responsible investment. This view is also supported by Chen and Xie (2022), who argue that there are discrepancies in investors' attitude towards integrating ESG consideration into their decisions. Therefore, supplementary empirical research is needed to add value on the impact of company's ESG performance on investment decisions.

A separate research strand emerged to address the challenges of implementing ESG in investment. Despite the increasing volume of the disclosed ESG data by companies, the published information is irrelevant and immaterial for investment decisions (Khan et al. 2016; Amir & Serafeim 2018; Jonsdottir et al. 2022). Sustainability information needs to be financially material (Abhyankar et al. 2019). A group of researchers provides evidence that when sustainability investments address material issues, they raise the shareholder value (Unruh et al. 2016).

Another impediment for improving ESG integration in the investment decisions is the quality of ESG reporting by companies and the lack of transparency (Eccles et al. 2017). The quality of consistent and comparable ESG information is still a challenge despite the evolving regulatory landscape worldwide and the enhancing standardisation of sustainability reporting practices (Abhyankar et al. 2019; Jonsdottir et al. 2022). In the middle to long run these trends will have a positive effect on the capital markets returns mediated by the decreased information asymmetry, the growing investors' confidence in companies' ESG performance and the expected decline of the greenwashing practices.

### *3.3 ESG ratings and ESG indices*

The academic literature on ESG ratings and indices has increased significantly over the past decade. The growing number of scientific publications indexed in Scopus and Web of Science provide evidence for their high importance for academia and practice. Key research areas include methodological differences between ratings, the relationship between ESG and company performance, the reliability and transparency of ESG data, the role of ESG indices, and challenges to regulation and standardisation.

A substantial body of research identifies the weak correlation between ratings provided by different agencies as a major problem. Another research strand is focused on the analysis of the impact of ESG ratings on the financial performance of companies. Most empirical studies, including those by Li et al. (2018) and Khan (2022) find a positive relationship between good ESG performance and firm value, especially in the context of strong leadership and transparency. Fatemi et al. (2018) highlight the role of ESG disclosures as a moderating factor in this relationship – the effect is stronger when companies actively communicate their sustainable practices.

Some literature analyses the role of ESG data as signals sent to financial markets (Spence 1973; Marie et al. 2024). Signalling theory is widely used in interpreting ESG ratings as an indicator of reducing information asymmetry between companies and their stakeholders. In parallel, stakeholder theory (Freeman, 1984) serves as a basis for research focused on the relationship between ESG practices and corporate social responsibility (Lagasio & Cucari 2019; Gillan et al. 2021). Marie et al. (2024) argue that after COVID-19, interest in ESG indices has increased significantly, but the need for clarity and reliability directs the scientific and regulatory debate.

Comparative studies, such as those by Shen et al. (2023) show that differences between national regulations and standardization of ESG practices lead to unclear interpretation of the data. Despite the efforts of institutions such as the European Commission ISSB, there is still no fully unified global standard for ESG ratings. Galletta et al. (2022) emphasize that in sectors such as banking, ESG assessments are already starting to affect access to finance, which reinforces the need for more objective and standardized approaches.

#### **4. ESG RATINGS AND INDICES – AN OVERVIEW AND COMPARATIVE ANALYSIS**

##### *4.1 Definition and key characteristics of ESG ratings and ESG indices*

ESG ratings are assessments that calculate how a company performs in terms of sustainability factors: E (Environment), S (Social) and G (Governance). Environmental factors include climate change, greenhouse gas emissions, biodiversity, resource management, deforestation, and pollution. Social factors, on the other hand, encompass human rights, equality, health and safety, impact on communities, product responsibility and stakeholder relations. Governance factors imply board structure, business ethics, transparency, internal controls, corruption, and compliance with laws and regulations. ESG ratings measure company's exposure to ESG risks, which are financially material and the way they are managed. Some rating agencies also consider in their scoring model the ESG-related opportunities. They apply specific methodology to transform qualitative and quantitative disclosures and other relevant and reliable data into standardised indicators and scores aimed at supporting mainly investment and credit decisions. Some ESG rating providers are focused on the unmeasured ESG risks across sectors, while others imply industry-relative benchmarks and compare a company to other companies, experiencing comparable material challenges. In any case, their target is to convert complex sustainability information into useful signal for decision-making. (Feifei & Polychronopoulos 2020)

ESG rating are built on the principle of materiality, considering which ESG issues will probably affect company's value, referred to as financial materiality. Under certain methodologies, the impacts on environment and society are also reflected in the computation, which is an application of the double materiality concept. Many models break down each ESG issue to exposure and management. The former reflects the extent to which the firm is at risk, considering its business model, geographical location and operations. The latter implies the company's risk mitigation policies, programmes and performance. Many methodological frameworks also reflect any controversies or incident data, functioning as a dynamic layer. (Gibson et al. 2021)

Most of the ESG ratings use publicly accessible information such as company annual reports, sustainability reports, compliance documents, company websites, expanded by trustworthy third-party data and structured monitoring for controversies by media or stakeholders. Based on these sources, the providers calculate indicators, apply weights to reflect industry specifics through development and application of materiality maps, and summarise an overall rating based on individual pillar scores. The output indicators vary by rating agencies. Some use letters while others apply numeric scales. (Serafeim & Yoon 2022)

ESG ratings might integrate dynamic elements, for instance controversies and real-time events, which impact the scores through structured incident analysis. We need to highlight that due to the variety of data sources used, the ratings should be interpreted and applied with an understanding of their underlying assumptions and scope, though their coverage implies thousands of companies worldwide. Application

in practice may vary from investment screening, through risk management and regulatory compliance, to evaluation of company performance.

ESG indices, on the other hand, are stock market indices composed of companies selected based on their ESG performance. They reflect it by incorporating non-financial information rather than financial data if compared to traditional indices. The latter rank companies based on their financial indicators, such as market capitalisation, return on equity, etc. ESG indices are used both as benchmarks for sustainability performance and as a basis for developing sustainable investment products – for instance ETFs, mutual funds, etc.

ESG indices are usually aligned with a parent index, for example S&P 500 or MSCI World, but applies ESG-related filters and scoring methodology. The selection criteria vary but usually implies one or a combination of three approaches. The first is referred to as negative screening and implies excluding companies which violate the global ESG norms or perform controversial activities. In contrast, the so called ‘positive screening’ includes only top companies with the best ESG metrics. Under ESG integration, being the third approach, companies are weighted based on their ESG scores and financial indicators. Some indices include only the highest-rated companies within the industry (best-in class), while others follow the industry structure of their parent index but imply ESG scores to adjust the weights.

The construction of ESG indices relies on a variety of data sources, both provided by internal ESG research teams and third parties. These data sources include a large number of quantitative and qualitative metrics, including greenhouse gas emissions, board diversity, supply chain management, etc. These indices account for changes in company performance, controversies, or major shifts in market dynamics. Serious ESG controversies may cause immediate exclusion, which indicates the index’s key role in risk management.

ESG indices might be used both as financial tools and as an instrument to direct or redirect company’s performance. On one hand, they help investors to align their financial market portfolios with sustainability performance thus reflecting sustainable investment demand. On the other hand, these indices are drivers of corporate behaviour transformation as the inclusion and exclusion criteria stimulate companies to improve their ESG performance and reputation. Due to the expanded sustainability disclosures and increased climate-related financial risks analysis, the relevance of ESG indices has grown significantly over the last few years.

#### *4.2 ESG ratings vs. ESG indices*

Table 1 provides a comparative overview of the key characteristics of ESG ratings and indices. Both share the objectives of promoting responsible business practices and transparency and might be considered as tools for investors and other stakeholders to assess company’s sustainability performance. Despite their common features, they differ in some respects as summarized and presented below.

**Table 1.** Comparative overview of ESG ratings and ESG indices

| <b>Characteristics</b> | <b>ESG ratings</b>                                                        | <b>ESG indices</b>                                                        |
|------------------------|---------------------------------------------------------------------------|---------------------------------------------------------------------------|
| <b>Aim</b>             | Assessment of company’s non-financial performance                         | Creating sustainable investment portfolios and benchmarks                 |
| <b>Source</b>          | ESG rating agencies such as MSCI, S&P, Sustainalytics, FTSE Russell, etc. | ESG index providers such as MSCI, FTSE Russell and S&P Global             |
| <b>Methodology</b>     | Diverse, partial transparency for some ratings methodology                | Usually public, simpler and formalised                                    |
| <b>Users</b>           | Investors, analysts, regulators                                           | Investors, ETFs managers, funds                                           |
| <b>Data update</b>     | Most often annually or semi-annually                                      | Usually quarterly                                                         |
| <b>Main Criticisms</b> | Low consistency, reliance on self-reported data                           | Inclusion of controversial companies, marketing effect without real value |

Sources: Authors' interpretation, based on data from: FTSE Russell 2024, 2025a, 2025b; MSCI ESG Research 2022, 2024a, 2024b, 2024c, 2025a, 2025b, 2025c; Morningstar 2024; S&P Global 2024, 2025a, 2025b; <https://www.msci.com/>; <https://www.sustainalytics.com/>; <https://www.spglobal.com/sustainable1/en/csa/methodology>; <https://www.spglobal.com/sustainable1/en/solutions/esg-scores-data>; <https://www.lseg.com/en/data-analytics/sustainable-finance/esg-scores>; <https://www.msci.com/our-solutions/esg-investing/esg-indexes>; <https://www.lseg.com/en/ftse-russell/indices/ftse4good>; <https://www.spglobal.com/sustainable1/en/csa>; <https://www.spglobal.com/spdji/en/indices/esg/>; <https://www.sustainalytics.com/esg-data>; <https://stox.com/all-indices/>; <https://www.spglobal.com/sustainable1/en/csa>

## 5. ESG RATINGS – BENEFITS AND LIMITATIONS

### 5.1 ESG rating agencies. Comparative analysis.

ESG ratings are calculated by specialised rating agencies such as MSCI, Sustainalytics, S&P Global, FTSE Russell, and Refinitiv, now part of LSEG, through the analysis of publicly available data such as financial statements, sustainability reports, and other disclosed non-financial information, media publications, Big Data, AI-based analytics such as RepRisk (<https://www.reprisk.com/>), and in some cases, additional surveys. Their main goal is to inform investors and other stakeholders about risks and opportunities related to a company's ESG practices. Comparison of leading ESG rating agencies and the ratings they provide is provided in Table 2.

**Table 2.** Comparison of leading ESG rating agencies

| Criteria            | MSCI ESG Ratings                                                                                                                                                                  | Sustainalytics (Morningstar)                                                            | S&P Global ESG Scores                                                                                                                                                              | FTSE Russell ESG Ratings (FTSE4Good)                                                               | LSEG ESG Score                                                                                                                                                      |
|---------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Methodology</b>  | Material risks assessment, which is sector based                                                                                                                                  | Measures the magnitude of a company's unmanaged ESG risks: exposure x governance        | Corporate Sustainability Assessment (CSA) – an annual rule-based assessment that converts around 1,000 data points per company into a score.<br><br>S&P applies double materiality | Rules-based model, which covers 3 pillars (E, S, G), 14 themes and more than 300 indicators        | Covers 3 pillars (E, S, G), 10 categories and more than 870 underlying ESG measures.<br><br>The score is computed on a basis of a comparable subset of 186 measures |
| <b>Rating Scale</b> | Letter scale from AAA to CCC, the former being a leader, the latter – a laggard, which is industry related.),<br><br>The letter score is mapped to a numeric 0-10 score, which is | Numeric scale 0–100 (lower is better), five risk categories (cross-industry comparable) | Numeric scale 0–100 (higher is better). Scores are relative within industry. Percentile ranks are also provided.                                                                   | 0.0–5.0 (to 1 decimal; higher is better).<br><br>Theme scores: 0–5; Pillar scores: 0–5 (1 decimal) | Numeric scale 0–100 (percentile based).<br><br>In addition, letter grades D- to A+, which are mapped from the percentile.                                           |

|                                       |                                                                                      |                                                                            |                                                                                                                                                                               |                                                                                     |                                                                                                                                            |
|---------------------------------------|--------------------------------------------------------------------------------------|----------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------|
|                                       | industry adjusted                                                                    |                                                                            |                                                                                                                                                                               |                                                                                     |                                                                                                                                            |
| <b>Company coverage</b>               | More than 17,000 public companies                                                    | More than 15,000 companies across 42 industries                            | Around 13,000 companies                                                                                                                                                       | More than 8,000 securities across 47 developed and emerging markets                 | Over 16,000 companies worldwide                                                                                                            |
| <b>Sector focus</b>                   | Yes – strong                                                                         | Yes                                                                        | Yes – strong.<br>Scores cannot be compared across industries                                                                                                                  | Yes                                                                                 | Yes                                                                                                                                        |
| <b>Type of data used</b>              | Public and company-reported                                                          | Public + media incidents and databases                                     | Company-provided information and public disclosures; modelling is applied to fill disclosure gaps for S&P Global ESG Score; modelling is not applied for S&P Global CSA Score | Public data only                                                                    | Only public and auditable sources; continuously updated database                                                                           |
| <b>Risk management assessment</b>     | Yes                                                                                  | Yes – key component                                                        | Partial                                                                                                                                                                       | Partial                                                                             | Partial                                                                                                                                    |
| <b>Investor Tools</b>                 | MSCI ESG Manager, ESG Ratings & Climate Search Tool (via MSCI ONE), ESG Fund Ratings | Global Access (web platform), Public company pages, Controversies Research | Public ESG Score Finder, Licensed data access, CSA benchmarks, ESG indices                                                                                                    | ESG Scores are available by subscription to FTSE Russell clients via LSEG platforms | Scores and full datasets are available via LSEG Workspace/Eikon, Datastream, the Refinitiv (LSEG) Excel add-in, and the LSEG Data Platform |
| <b>Sector materials (Materiality)</b> | Industry-adjusted Materiality Map                                                    | Customized materiality per industry                                        | Industry materiality matrix                                                                                                                                                   | Explicit materiality design                                                         | By category, not strongly expressed by industry. The materiality matrix is dynamic.                                                        |
| <b>Methodology Transparency</b>       | Partial                                                                              | High                                                                       | High (CSA methodology site)                                                                                                                                                   | High                                                                                | Medium                                                                                                                                     |
| <b>Regional Focus</b>                 | Global coverage                                                                      | Global coverage                                                            | Global scope                                                                                                                                                                  | Global coverage                                                                     | Global coverage                                                                                                                            |

Sources: Authors interpretation, based on data from: FTSE Russell 2024, 2025; MSCI ESG Research 2022, 2024a, 2024b, 2025a, 2025b, 2025c; Morningstar 2024; S&P Global Inc. 2024, 2025a, 2025b; LSEG Data & Analytics 2024; Sustainalytics 2023; <https://www.msci.com/>; <https://www.sustainalytics.com/>; <https://www.spglobal.com/sustainable1/en/csa/methodology>; <https://www.spglobal.com/sustainable1/en/solutions/esg-scores-data>; <https://www.lseg.com/en/data-analytics/sustainable-finance/esg-scores>;

### *5.2. ESG Rating – benefits and limitations*

ESG ratings provide structured and comparable information about companies' ESG performance. In this way they support institutional and individual investors in their decision-making. By facilitating sustainable investments, they contribute to the building of sustainable portfolios, and reallocation of capital to responsible business, which is one of their major advantages (Li et al. 2018; Khan 2022).

In addition, ESG ratings reduce non-financial risks, such as climate, regulatory and social, by assisting investors in their identification and management (OECD 2020). Companies with high ESG scores often have lower systemic risk, better resilience in crisis conditions and more stable long-term results (Friede et al. 2015; Marie et al. 2024). ESG ratings also serve as tools for monitoring and reducing reputational and regulatory risk (World Economic Forum 2020).

Another benefit of ESG ratings is that they promote good governance practices. Driven by their ESG assessment, companies are motivated to implement internal control systems, encourage ethical behaviour, introduce environmental standards and social norms. Therefore, ratings function as incentive for improvement and not only as ESG measurement tool (Fatemi et al. 2018).

The increased access to capital is another advantage which the companies might benefit. Those with good ESG ratings usually receive more favourable credit terms. In addition, responsible investors and banks are more interested in firms with higher ESG scores (Galletta et al. 2022; Marie et al. 2024).

An important advantage of ESG ratings is that they facilitate dialogue with stakeholders as they serve as a communication channel between companies and interested parties. The information which they provide complements financial reports and indicate firms' sustainable performance (Kotsantonis & Serafeim 2019).

Despite their advantages, ESG ratings suffer from a few limitations. One of the criticisms refers to the low comparability between companies and rating systems. Berg et al. (2022) point out that the discrepancies stem from differences in the scope, methodology and weighting of the factors used in the assessment. A similar statement is made by Kotsantonis & Serafeim (2019), who highlight the lack of standard definitions and limited transparency in the assessment processes. This creates difficulties for investors, who often face conflicting signals from different sources. The use of firms' self-reported data for assessment purposes is also pointed out as a disadvantage of ESG ratings. The agencies rely on information which is provided by companies themselves. There is no guarantee of its completeness and reliability especially when it is not verified by an independent audit (Aouadi & Marsat 2018).

Companies with greater resources can more easily develop their ESG strategy and build up more efficient communication with stakeholders about their responsible behaviour compared to smaller firms. Hence, the latter, even being sustainable might have less opportunities to demonstrate it. This is discrimination against them, which is also considered a disadvantage of ESG ratings.

Ignoring sector specifics is another limitation of the scores. Some ESG methodologies inadequately address differences between sectors. For example, greenhouse gas emissions of the energy industry cannot be directly compared to those of other sectors, such as IT. This might cause imprecise assessments and wrong conclusions (Khan et al. 2016; Christensen et al. 2022; Berg et al. 2022).

## **6. ESG INDICES – BENEFITS AND LIMITATIONS**

### *6.1 Leading ESG indices. Comparative analysis*

The leading ESG indices worldwide include MSCI ESG Indices, FTSE Russell ESG Index Series, S&P Global ESG Indices, STOXX ESG Indices, Bloomberg SASB ESG Indices, Dow Jones Sustainability Indices renamed to Dow Jones Best-in-Class Indices on 10 February 2025, and Nasdaq ESG Indices. The comparative analysis of the top 5 ESG indices is presented in Table 3, based on the following criteria: provider, regional scope, number of constituents, selection criteria and type of ESG data used.

**Table 3.** Comparison of leading ESG indices

| ESG indices                                 | Provider                                              | Regional scope                                          | Number of constituents                                                                                    | Selection criteria                                                                                                                                                                                                                     | ESG data used                                                                                                                                                          |
|---------------------------------------------|-------------------------------------------------------|---------------------------------------------------------|-----------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>MSCI ESG Leaders Index Series</b>        | MSCI Inc.                                             | Global, regional, country                               | Around 50% of the parent index (for instance MSI World) market capitalisation per sector                  | Best-in-class within each Global Industry Classification Standard sector; excludes companies with low ESG ratings, controversies and from controversial industries                                                                     | MSCI ESG ratings, MSCI ESG controversies, business involvement screening                                                                                               |
| <b>FTSE 4Good ESG Index Series</b>          | FTSE Russell                                          | Global, developed markets, emerging markets, regional   | Varies by index. FTSE 4Good Global Index includes about 1,000 companies                                   | A company inclusion is based on FTSE ESG ratings score threshold sector exclusion (tobacco and weapon manufacturing, coal or oil extraction from tar sands) and conduct exclusion (human rights breaches, corruption, etc.)            | FTSE ESG ratings, Carbon Disclosure Project, Non-governmental organisations (Amnesty International, Greenpeace, Human Rights Watch, etc.), media publications          |
| <b>S&amp;P 500 ESG Index</b>                | S&P Dow Jones Indices                                 | U.S.                                                    | Roughly between 300 and 350 from S&P 500                                                                  | Scoring and screening applied as selection methods, companies with low ESG performance are excluded, certain sectors are excluded, violators of United Nations Global Compact principles are also excluded                             | S&P ESG scores calculated by S&P Global Sustainable <sup>1</sup> for each company in the index. The scores are based on data from CSA, Sustainalytics, Arabesque S-Ray |
| <b>STOXX Global ESG Leaders Index</b>       | Qontigo (Deutsche Börse Group)                        | Global (developed markets)                              | Between 400 and 500 companies; geographic distribution                                                    | A company must rank in the top quartile for at least one ESG category and above average in the other two categories. Norm violators and firms with controversial activities (weapons, tobacco, coal, oil and gas sectors) are excluded | Sustainalytics ESG scores, global standards screening                                                                                                                  |
| <b>Dow Jones Sustainability World Index</b> | S&P Dow Jones and S&P Global Sustainable <sup>1</sup> | Global, only companies with large market capitalisation | Top 10% of the largest 2,500 companies in the S&P Global Broad Market Index (around 300 to 325 companies) | Based on CSA scores (industry leaders), media and stakeholder analysis via RepRisk                                                                                                                                                     | S&P Global CSA, which combines company-disclosed information, public data and reputational risk monitoring via RepRisk                                                 |

Sources: Authors interpretation, based on data from: <https://www.msci.com/our-solutions/esg-investing/esg-indexes>; <https://www.lseg.com/en/ftse-russell/indices/ftse4good>; <https://www.spglobal.com/sustainable1/en/csa>; <https://www.spglobal.com/spdji/en/indices/esg/>; <https://www.sustainalytics.com/esg-data>; <https://stoxx.com/all-indices/>; <https://www.spglobal.com/sustainable1/en/csa>

## *6.2.ESG indices – benefits and limitations*

One of the key advantages of ESG indices is that they are drivers of corporate sustainability by pushing companies to improve their ESG performance. By including or excluding firms from indices, they sanction or reward them thus playing the role of informal market regulators and also stimulate the implementation of sustainable business models and practices. Moreover, as many indices use data, provided by third parties to incorporate controversies and stakeholder feedback into company assessment, firms are additionally encouraged to apply stronger corporate governance mechanisms, improve their environmental management system and be more active when addressing social risks. In this way they contribute to the improvement of sustainability performance across entire sectors and geographical areas. In addition, they serve as incentives for publicly traded companies to improve the quality and disclosure of non-financial information, which should be consistent, verifiable and comparable. Hence, ESG indices stimulate firms to improve their sustainability reporting to be included in the index or to avoid exclusion. (Ademi & Klungseth 2022; Rounok et al. 2023)

Another benefit of ESG indices is that they integrate sustainability into standard investment strategies. In particular, they facilitate the implementation of ESG into passive investments as they overcome the need for time-consuming and expensive profound analyses and assessments of companies' ESG practices. They offer institutional and private investors standardised, rule-based frameworks that apply ESG assessment of many public companies, exclusion of norm violators and firms with controversial activities. ESG indices are used as the basis for ETFs, which offer diversified, cheaper and more liquid exposure to sustainable investments if compared to traditional active investing. For instance, ETFs, which follow the MSCI World ESG Leaders Index, the S&P 500 ESG Index or the FTSE 4Good ESG Index allow investors to infuse sustainability principles into their portfolios without giving up the efficiency and simplicity of the index-based investment. In this way ESG indices significantly expand sustainable finance by making it accessible to a greater number of investors. Parallel to this, they support companies' transition to long-term value creation.

ESG indices might be also considered as signals for good corporate behaviour regarding sustainability. Inclusion in a distinguished index such as Dow Jones Sustainability World Index or STOXX Global ESG Leaders Index impacts company's reputation and is a strong incentive for implementing stronger and more efficient ESG strategies and align with international standards such as United Nations Global Compact principles or the OECD Guidelines for Multinational Enterprises. The threat of exclusion, on the other hand, reduces unsustainable or unethical business practices. Hence, ESG indices not only assess the responsible performance of firms but also shape it by functioning as both benchmarks and driver for change.

ESG indices promote sustainable finance and responsible investment as their alignment with national and international regulatory frameworks expands over time. For example, they play a key role in the implementation of the Sustainable Finance Disclosure Regulation and EU Taxonomy for Sustainable Activities. These indices promote compliance and standardisation of financial reporting and investment practices. They also support broader policies with global impact such as United Nations Sustainable Development Goals and European Green Deal by redirecting capital towards companies with stronger positive environmental and social impact. Therefore, ESG indices serve as stimulator for transition towards green and more inclusive economy. (Winegarden 2019; Rusu 2020)

Despite their unquestionable advantages, ESG indices suffer from some limitations. Their reliance on ESG ratings is considered as a fundamental weakness as they are characterised with low consistency across providers and lack of standardisation. Due to different assessment methodologies, weighting and data sources used, there are significant deviations between ratings measured for one and the same

company but by different ESG agencies (Kotsantonis & Serafeim 2019; Berg et al. 2022). This inconsistency spoils their comparability and the objectivity of ESG assessment which causes inclusion or exclusion of companies based on private evaluation models rather than globally accepted standards. As a result, investors following different ESG indices, might have different financial market exposures despite sticking to the same ESG principles. The lack of unified global framework for both ESG ratings and indices challenges reliability and transparency in sustainable investment.

Like ESG ratings, a key disadvantage of ESG indices is that larger companies with greater resources are better presented. One reason offered is that these firms can produce detailed sustainability disclosures which are better aligned with the relevant regulations and ESG expectations (FTSE Russel 2025a, b). In contrast, smaller firms, including those in emerging markets, might lack the capacity needed to respond fully to ESG requirements and provide comprehensive information on ESG issues even in cases where they have solid sustainability performance. As a result, smaller companies are continuously underrepresented in ESG indices thus distorting the presentation of corporate sustainability and even excluding well performing firms in ESG terms that suffer from reporting limitations due to resource shortages.

Another limitation of ESG indices stems from the fact that they fail to consider sector specific materiality in full because very often they apply common criteria across all industries. This approach might lead to unfair assessments and discourage companies from sectors with high sustainability impact to be involved in ESG initiatives and to loosen their ESG focus. For example, greenhouse gas emissions are higher in energy and transportation sectors compared to finance and IT. Therefore, their similar treatment in ESG assessment could limit the effectiveness of ESG integration in leading transformation in the sectors with high climate and social impacts.

The risk of ESG-washing is another concern related to ESG indices (OECD 2022). Some companies may overestimate their sustainability performance and impacts striving for index inclusion. Moreover, they could even report high ESG outcomes but without real transformation of their business models and practices. In addition, the exclusion criteria applied by some indices are minimal – for instance, only weapons or tobacco are considered controversial activities and remain outside the index scope. As a result, investors might be misled with a false sense of sustainability and their trust in ESG products can be eroded. ESG indices need to be audited and monitored in real time to serve as tools for shifting towards sustainable finance.

## **7. CONCLUSION**

ESG ratings and indices will continue to gain discussions of academics and practitioners due to their key role in the sustainable corporate governance, responsible investment and non-financial accountability. The performed critical review highlights that these tools promote greater transparency, accountability and a focus on long-term value creation. They support investors to make informed decisions, guide external stakeholders and are used to redirect capital towards sustainable businesses.

Despite their advantages, ESG ratings and indices suffer from significant limitations and criticisms. The most discussed are the lack of unified methodology, low comparison between ratings from different agencies, insufficient transparency of the assessment process, the use of self-reported data and the risks associated with ESG-washing. ESG indices in particular might include companies with questionable practices and be used for marketing purposes only without having a real transformational effect on companies.

The conducted analysis underlines that ESG ratings and indices need significant improvements in order to fully perform their assigned role. The applied criteria require wider standardisation, increased transparency of the applied methodology as well as independent control over the data used. In addition, ESG assessment should be aligned with sector specifics and regional contexts to reflect actual sustainability, not just marketing targets and effects.

The future of ESG assessment depends to a greater extent on closer collaboration and synchronisation between rating agencies, regulators and academics. Moreover, the gathering and analysis of ESG data

needs to be automated and transparent which requires implementation of new technologies. ESG ratings and indices have the potential to become a reliable and effective mechanism supporting the sustainability-driven transformation of the global economy. A prerequisite for this to be achieved is a well-balanced combination of properly defined targets and analytical accuracy, institutional control, and real commitment to sustainability.

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