
Bloomberg's ESG Governance ISS: Quality Score [GQS™]: Vetting Results of a Taxonomic Sorting Trial

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Abstract

Context For decades the *Environment, Social, and Governance* [ESG[®]]-platform offered by Bloomberg[™] Professional Services has been one of the staple-sources of contextual information for better understanding the “Stakeholder-impact” of the firm’s market activities. The ESG-platform now offers a significant enhancement provided as third-party data by Institutional Shareholder Services [ISS]—to wit, a taxonomy where firms are assigned to Governance-risk decile-groups based upon ISS: Governance Quality Scores: (GQS[®]); where firms in GQS [1] are characterized as relatively higher quality and relatively lower governance risk, and, conversely, a score in the 10th decile, GQS [10], indicates relatively lower quality and higher governance risk. Such market contexting platforms beg vetting studies to service investors in need an independent and reliable evaluation. **Study Design** We randomly selected 20 firms—ten each from the polar decile-groups [GQS [1] & GQS [10]]. These firms were profiled by the Bloomberg Analyst Recommendations [ANR[®]]. The ANR-PDF-captures were not identified as to the GQS-group to which they were assigned by ISS. These 20 ANR-profiles were given to nine-volunteers with advanced expertise in market-related discipline areas, and they were asked to: (i) sort the 20-firms into two groups of equal-size, and (ii) note their assignment logic. **Results** The inferential results are very clear. *There is no inferential evidence overall for the assignments made by the volunteers that there are sufficient numbers of triage-matches to the ISS [1] group to reject the Null of Chance of 50%. This is a valuable vetting indication that ISS-Corporate: Governance: Risk-assignments are not surrogate-holomorphs to the relative ANR-profit-profiles.*

Keywords: ISS-Vetting, Expert Triage, ANR: Bloomberg.

1. Introduction

1.1 Governance: The Universal Control Link There has been, for many decades, an interest in the quality of corporate governance. The reason is clearly expressed by [1] who note:

Since the emergence of interest in corporate governance in the 1990s, credit ratings have offered corporate governance assessment with the aim of evaluating governance risk. Empirical analyses show that shareholders give importance and value to good corporate governance. [p. 363]

They reference the key issue that is the logical support—albeit *la raison d'être*—of a system created by management to maintain adequate control over the Governance Risk-level of the firm: *Understanding the functioning of the corporate governance system of checks and balances enables stakeholders to calibrate risk in mostly all of its aspects.* However, care needs to be taken to not CONFUSE Corporate Governance Risk [CGR] with the Markowitz-version of Risk vis-à-vis Return that is a principal concept of Market Risk [2]. Due to the popularity of the Capital Asset Pricing Model [CAPM [3]], the conceptual linchpin to the Portfolio Risk & Return model of Markowitz, in the Finance and Accounting milieu Risk is linked with the particular-level of *Profit* or *Revenue* or *Return* that is needed to encourage stock acquisition. This conditioning “reflex” to hear **Risk** and think of **Return** causes a difficulty to conceptualize Risk in the Governance context.

1.2 Governance Risk Clarification As suggested above Risk is a conceptual kaleidoscope. To aid in understanding the concept of CGR, stakeholders need a longitudinal, accurate, and timely reporting service that has committed to provide reliable CGR-intel. Of the 15 or so firms that offer such services [4], we prefer *Institutional Shareholder Services*TM [ISS]. ISS is an organization that has been reporting for more than a decade on their assessment of the CGR for firms traded on active exchanges many of which are global-MNCs. ISS offers a well-expressed, articulated, and focused set of protocols to develop the richness as well as the nuances of CGR. A singular distinction for ISS is that circa 2014 they have been integrated as a third-party data provider into the renowned *Environment, Social, and Governance* [ESG[®]]-platform offered by *Bloomberg*TM *Professional Services*ⁱ that has for many decades been the preeminent source of contextual information for better understanding the “Stakeholder-impact” of the firms’ activities.

1.3 The ISS-screening Pillars Following are details from the ISS Methodology Guide (2020)ⁱⁱ regarding their **four** screening or evaluation **pillars**: [**Bolding Added**]:

*ISS ESG Governance Quality Score (GQS) is a data-driven scoring and screening solution designed to help institutional investors monitor portfolio company governance. At both an overall company level and along topical classifications covering **Board Structure, Compensation, Shareholder Rights, and Audit & Risk Oversight**, scores indicate relative governance quality supported by factor-level data. That data, in turn, is critical to the scoring assessment, while historical scores*

and underlying reasons prompting scoring changes provide greater context and trending analysis to understand a company's approach to governance over time.

[p.4]

As noted by [4:Appendix A: p.11] these four evaluation-pillars provide the focus of the collection of information re: firm evaluation and related temporal changes so as to provide up-dates over the year the intention of which is to maintain currency in the veracity of the ISS-firm assessments. See ISS: Methodology Guide {2020. Appendix 1; p.95) where the critical *data verification* and *updating* protocols are detailed.

With this introduction of the varied nature of Risk, the discussion of the specific nature of CGR, and the selection of ISS as a reliable service offering evaluation profiles of the CGR for firms traded on active exchanges, we are able to detail our research agenda.

1.4 Research Plan In this endeavor, we will:

- 1.) Offer, as an elaboration, selected sections of the ISS EGS Governance Quality Score: Methodology Guide (2020) to focus our research protocol,
- 2.) Discuss the nature of the Market Profile information that is presented to the individuals that have volunteered to create firm assignment of 20 ISS-classified firms into two equal-sized groups,
- 3.) Present the Summary Details of the Bloomberg Analyst Recommendations ANR[®], that were presented to the volunteers,
- 4.) Detail the research design, inferential-context, and sample-size accrual,
- 5.) Examine the inferences generated by the results, and
- 6.) Offer an *en brief* take-away summary and suggest follow-up research-elaborations.

2. ISS: GQS: CGR CONTEXT

2.1 ISS: GQS: CGR-Platform: Essential Details the most efficient delivery of the essential details of the BBT [ESG [ISS [GQS]]]-platform, hereafter GQS, is to abstract information from their: Methodology Guide: ISS [2020[p10/11] **Bolding Added**]:

Page[98] Much of the information included in Governance Quality Score comes from the **annual filing of companies' proxies, annual reports, 10-Ks, circulars, meeting notices**, and other meeting related materials [- -]

Page [10/11] Governance Quality Score rests on a scoring methodology built and tested by ISS' global team of governance experts and focuses on quantitative and qualitative aspects of regional governance best practices as well as the analysis undergirding ISS voting policies and voting recommendations. A score in **the 1st decile indicates relatively higher quality and relatively lower governance risk, and, conversely, a score in the 10th decile indicates relatively lower quality and higher governance risk.** [- -].

2.2 *Additional Critical Information* in the Methodology Guide: ISS [2020] nowhere is the word “profit” mentioned as it relates to the ISS-scoring system. We searched the ISS Guide and Profit was mentioned three times—none of which related to a ***Firm’s Market Profit Profile***. In addition, recently it was reported that the ISS polar-decile groups did not exhibit inferential evidence that associated them directionally with market-profitability *per se*. simply, the ISS-assignment protocols are not likely homographic to profitability [5].

3. Research Question and Testing Design

3.1 *Question of Interest* With the above as a baseline, a question of research interest is:

Would a group of trained, experienced, and interested individuals using the Bloomberg™ [ANalyst Recommendations: ANR™]-platform arrive at “approximately” the same polar decile-groups: GQS [1] & GQS [10]?

If this—a *proffered Un-Likely-condition*—were to be the case, this would suggest that a firm’s Market Profile would be a likely surrogate for the intellectual property that are the ISS-Governance-taxonomic-drivers; this would cast doubt on the quality of the ISS-assignment taxonomy. If not, this would provide an indication that Governance-Scoring and taxonomic-Assignment is *not principally factor associated with the usual Market-Drivers* and also thus be a vetting of the indication that ***Profit*** was the principal ISS-driver[5].

3.2 *Research Task and Volunteers* We contacted ten colleagues and described the assignment task. There are two random samples of ten firms each taken from ESG [GQS [ISS {QGS [1s & 10s]]]. The trading tickers were randomly selected from the BICS™-platform on Bloomberg; they are presented in Appendix A. For each firm a Screenshot of the ANR are saved as PDFs. All 20 of these ANR: PDFs were given in random-order to each of the volunteers.

3.3 Instructions

- (i) Thank you for agreeing to assist in this research-protocol. You have received, as a download, 20-PDF-ANR:Screen Shots,
- (ii) For the 20 Firms profiled in these BBT [ANRs], you are asked to assign them into two groups of equal size of YOUR choosing. If this is not possible, then please return the information set. No explanation is necessary,

One volunteer declined the offer to participate. The profile of the volunteer-group is: All of the individuals have advanced education degrees: Eight PhDs & One Master’s Degree. Their discipline areas are: Accounting, Finance, Economics, Auditing, and Programming & Data Analytics. Seven individuals have used and have access to the Bloomberg Market Terminals in the John and Diana Conner’s Finance Trading Lab at the State University of New York College at Plattsburgh, NY USA. For the other two, one used *Reuters*™ and the other used various internet sources. These nine volunteers produced 13-different assignments of the 20-firms. Therefore,

there were 130 [13×10] data-points; thus, the inferential context discussed above is approximately as scriptedⁱⁱⁱ.

4. The Bloomberg Analyst Recommendations [ANR]

The ANRs offer a cornucopia of Market-Intel. For this reason, it is not possible to list and discuss the complete Intel-set offered in the ANR-Tab. However, following are some selected aspects; the actual categories in the ANR is scripted in *italics*. As an illustration, we selected the ANR of Plantronics Inc.: [PLT US Equity]:

4.1 Basic Information for: 12 Feb 2021 [PLT [USD]]: Volume [359,419], High [44.39 YtD], Low [41.9583 YtD] & Val [Market Cap: 15.549M]

4.2 12 M Tgt Px is: The 12 Month Consensus Target Price: PLT [45.00] [Information: For all the analysts who have rendered an opinion. Indication: \$45. Computationally, there are six 12 M Tgt Pxs noted on the PLT-ANR: {31; 45; 46; 53; 55 & 40} = Average = 45.00.

4.3 The Consensus Rating is: Current average rating of all analysts who updated within the last 12 months [1 is Sell, 2, 3, 4 and 5 is Buy]. For PLT, 4.00 was the consensus: Means Buy but not a Strong Buy.

4.4 LTM Return is: Last 12Months return of the security

4.5 Return Potential is: the expected future return potential based upon

: [(Best Target Price less Last Price) / Last Price] $\times 100$. For example [(54.5 – 49.58)/49.58] $\times 100$ = 9.9%

4.6 Price Spread Graphic is: (Target Price less Current Price) this is a Rolling Spread—i.e., indexed each Trading Day over varying time periods that can be selected by the user.

5. Hypothesis & Results

5.1 Inferential Specifics The Inferential FPE-test Null is:

H_1^{Null} *The assignment made using the ANR-Market Sensitive return profiles by the set of qualified volunteers will not differ from a random assignment when profiled against the ISS:GQS[1] group.*

5.2 Discussion of H_1^{Null} The inferential test is very simple. The ISS (2020) manual indicates that ISS creates ten-decile groups: GQS [1] indicates relatively higher quality and relatively lower CGR. The set of volunteers are evaluating firms that are profiled by the Market performance indications as presented by the BBT [ANRs]. The Null simply indicates that the assignment made by volunteers will be in sync with a random selection vis-à-vis the ISS-assignment to GQS [1]. The volunteer group never was given any ISS-information, nor did we ever mention Governance or Risk, and nor did we specifically indicate that they should address *Market-risk* or *Market–return*. Thus, failing to reject H_1^{Null} offers as the likely state of nature:

Corporate Governance Risk [CGR] as detailed in the ISS: Guide [2020] and a Firm's Market Performance as detailed in the BBT [ANRs] are not functionally linked such that the Driver of the ISS-assignment is the firm's Market Profile.

5.3 Results With this as the inference context, we present the actual results of the experience in Table 1. The codex of Table 1 is: $V_j: \{1, \dots, 13\}$ is the index for the Volunteers, in Col [1] are the ten firms **identified by ISS** as members of the GQS [1], in the Total Row there are the number and the percentage of correct matches, finally, in each of the V_j Columns, are the actual indications of the volunteers re: their assignment of that firm into "the most desirable" group according to the information that they reported. See Appendix B. These matches are bolded and the cell shaded in the case that there was a match.

TABLE 1. ASSIGNMENTS ISS [GQS [1s]

ISS[1s]	V1	V2	V3	V4	V5	V6	V7	V8	V9	V10	V11	V12	V13
CA LM	CC K	DZS I	CV X	PL T	SH YF	CR AI	MT W	MC K	DZS I	BR KS	CA LM	MT X	SH YF
CC K	KF RC	AB CB		MT X	DZS I	DZS I	KI M	CC K		TA P	MC K	AZ Z	CC K
CV X	CV X	SH YF	MC K	MC K	RIC K	RIC K	KF RC	BR KS	MT W	DZ SI		AB CB	MA TW
KF RC	MC K	CV X	TR XC	CC K	BR KS	SH YF	BR KR	BR KR	MT X	SH YF	CC K	BR KS	TR XC
KI M	CA LM	MC K	KI M	KF RC	AB CB	TR XC	SH YF	SH YF	CA LM	TR XC	MA TW	CC K	MT W
MA TW	MA TW	MA TW	CC K	AB CB	CV X		MT X	CA LM	MC K	CV X	BR KR	BR KR	PLT
MC K		MT X	BR KS	BR KS	MA TW	KF RC	MC K	AZ Z	MA TW	MC K	CV X	TA P	CA LM
MT W		CC K	BR KR	CR A	CC K	CA LM	CV X	RIC K	CV X	CA LM	KF RC	M CK	BR KR
MT X	DZS I	BR KS		DZ SI	MC K	MA TW	CC K	KF RC	AB CB	MT X	SH YF	KM B	CV X
PLT	CR AI		MA TW	SH YF	MT X		AB CB	DZ SI	CR AI	MT W	TR XC	CV X	BR KS
Total	6/60 %	6/60 %	6/60 %	5/5 0%	5/50 %	4/40 %	7/7 0%	4/40 %	6/60 %	5/50 %	6/60 %	4/4 0%	6/60 %

Table 2 reports the instances where the ten firms in ISS: GQS [1] were correctly matched over the 13-volunteers.

TABLE 2. NUMBER OF CORRECT MATCHES VOLUNTEERS VIS-À-VIS ISS: [GQS [1]

GQS[1]	CALM	CCK	CVX	KFRC	KIM	MATW	MCK	MTW	MTX	PLT
Counts	7	10	10	6	2	8	11	4	7	5

5.4 Inferential Analysis: Overview The nature of this study requires the use of the percentages in Table 1 aggregated over the number of trials. There are 70 correct matches in the 130 [10 × 13] trial-matches or as a percentage of: 52.3%. The *a priori* expectation for the Null-test is Chance—i.e., 50%. In this case, there are two standard analyses both of which use the standard error formed from the Null, $4.385\% = \sqrt{[50\% \times [1 - 50\%]]/130}$ and the *actual* percentage result of 53.8% as follows:

5.4.1 Confidence Interval

In this case, we will use the 95%CI that is:

$$95\% \text{ CI} = [50\% \pm 1.96 \times 4.385] \equiv [41.4\% \text{ to } 58.6\%].$$

5.4.2 Probability-Value for the inferential test [p-value]

Another perspective is the non-directional p-value:

$$z_{\text{cal}} = \left[\frac{\text{Abs}[50\% - 53.8\%]}{4.385\%} \right] \text{ Is } 0.877$$

The p-value is: T.DIST.2T [0.877, 10000] = 0.381 or 38.1%

For these inferential-screens, we arrive at the same inferential result—to wit there is not sufficient evidence to reject the *a priori* expectation of chance. *Inferential justification* the *actual* percentage of current matches is IN the FPE-95% Confidence Interval $53.8\% \subseteq [41.4\% \text{ to } 58.6\%]$. This indicates that the likely state of nature is Chance—i.e., the center of the 95%CI. The p-value indicates that about 40% of the time when the *a-priori* expectation, 50%, is the state of nature one would observe a result of a difference around 50% of 3.8% by random sampling chance. Also, as this p-value percentage is relatively large or frequent in this experimental context, it would ***not be prudent to reject the a-priori expectation, 50%, as the likely state of nature.*** Thus, we fail to reject H_1^{Null} .

5.5 Discussion These inferential results provide very clear evidence that, in the aggregate, the volunteer-assignment protocols used were not in-sync or homomorphic-surrogates with the ISS:GQS:CGR protocols used by ISS to make the GQS-group assignments. ***This is strong inferential evidence that the ISS: GQS: CGR-assignment that creates the governance-sensitive polar decile-triage is not driven by protocols based principally upon market-reliable variables presented in the ANR as used by the volunteers.***

6. Summary

Overview Summary The simple take-aways from our research results are:

1. *In the BBT[ISS:GQS:CGR]-trriage model, Governance-Risk astuteness is not likely a viable-screen for teasing out market winners; and of course vise-versa, i.e., firms with Market-leading profiles are not necessarily the dominate players in the ISS:GQS[1]-group vis-à-vis for the ISS:GQS[10]-group, and*
2. *As impressive as is the ISS:CGR-assignment model, after all: (i) we have selected ISS as the Gold standard in scoring CGR for our research project, (ii) ISS was deemed worthy of inclusion in the preeminent ESG-platform offered by Bloomberg, and (iii) as detailed above, ISS is committed to temporal monitoring, evaluation and updating of their GQS-decile groups, however, as ISS does not have the Crystal Ball of Merlin™, from time to time, their GQS-profiles may not track well with reality.*

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Appendix A**TABLE A1 ACCRUAL FIRMS ROW [1]: GQS [1]-FIRMS AND ROW [2]: GQS [10]-FIRMS**

CALM	CCK	CVX	KFRC	KIM	MATW	MCK	MTW	MTX	PLT
ABCB	AZZ	BRKR	BRKS	CRAI	DZSI	RICK	SHYF	TAP	TRXC

Appendix B

There were 13-protocols $\{V_i, i: 1, \dots, 13\}$ offered by the nine volunteers. We have permission from all the volunteers to provide their un-edited comments just as we received them. These commentaries are available from the authors via a download.

ⁱ <<https://www.bloomberg.com/professional/>>

ⁱⁱ The ISS web-link that has the ISS EGS Governance QualityScore: Methodology Guide (2020) and access to other informative platforms is: <<https://www.issgovernance.com/>>

ⁱⁱⁱ In this case, we used a sample-size calculation that is conditioned by the False Positive [FPE] & False Negative [FNE] Errors. We elected to use a two-tailed test, precision of 10%, a FPE of 10%, and Power of 75% thus a FNE of 25%, and a test-against differs of 10% Using the standard formula, [6 p.306] for the sample-size [SSize] as parametrized is:

$$\sqrt{SSize} = \left[\frac{1.645\sqrt{50\% \times (1-50\%)} + 0.675\sqrt{40\% \times (1-40\%)}}{Abs[50\% - 40\%]} \right]$$

The SSize of 133 observations is in the range of the volunteer group.