JOURNAL OF BUSINESS AND SOCIAL SCIENCES
Vol.2024:23

The ESG Shift: Role of ESG in Modern Business Strategies

Aminath Iba Naseer [1*], Syriac Nellikunnel[2]

[1]Faculty of Business and Communications, INTI International University, Malaysia
[2]Faculty of Business, Perdana University, Malaysia

***Email:** i24027073@student.newinti.edu.my

Abstract

This paper undertakes the arduous task of examining the accuracy and relevance of a statement lacking clear benchmarks. The assertion posits that Environmental, Social and Governance (ESG) indices is indispensable not just for assessing a company's sustainability efforts, but also enhancing its competitive edge. Through analysis of existing literature, frameworks, and empirical evidence, this article elucidates the nuances inherent in the link between ESG indices, sustainable practices, and strategic competitiveness within the modern business landscape. To accomplish this, the paper adopts a structured approach, dissecting the statement into its constituent components to discern the key points concerning ESG. It intends to challenge the notion of ESG as an indispensable tool in measuring sustainability, while also evaluating relevant initiatives and potential impacts. Furthermore, the article explores the extent to which indices truly function as significant tools, addressing societal and environmental issues while offering pathways for corporate success beyond conventional business performance metrics. This paper will further de-construct the statement above with the analysis of existing literature and frameworks that are evident that ESG has reached its peak and will continue towards a downward slope of decline in measuring a corporates responsibility towards society.

Keywords

ESG indices, corporation sustainability, exchange traded funds, European Securities and Markets Authority

1.0 Introduction

The stature of ESG indices as a "perfect", "transparent" and "truthful" can be argued by a single highlight made by (DasGupta, 2022) which quotes "To recover public image, sensitive industries specifically disclose more information than other sectors in their sustainability reports and achiever higher ESG performance". This negates the statement above implicating that ESG is the future in creating a sustainable generation, and therefore can be argued that it is far from truth. Anti-ESG regulations are emerging with the belief that ESG investments can cause more harm, with the argument that companies who earn more, can invest more, thus debating whether the existing regulations exists to fulfil political objectives, rather than mitigate economic implications (Tang,

Submission: 20 November 2024; **Acceptance:** 4 December 2024

Shi, and Jiu, 2024).

ESG was first unveiled and came to prominence when the "Who Cares Wins" report was published in 2004 by the UN Global Compact as a joint initiative with multiple notable companies such as Deutsche Bank, Goldman Sachs, HSBC and World Bank Group, amongst others (UN Global Compact, 2004). This report set out to conjoin environmental, social and governance (ESG) in financial decision making while advocating a shift towards more sustainable business practices that can extend its benefits towards the economy as well as the society. Despite the initiative being launched to establish transparency, accountability and sustainability, there are many underlying factors which can stamp it as illusory and multifaceted, seen on as early as the executive summary on page 3 of the report stating:

> *Companies that perform better with regard to these issues can increase shareholder value by, for example, properly managing risks, anticipating regulatory action or accessing new markets, while at the same time contributing to the sustainable development of the societies in which they operate (UN Global Compact, 2004)*

To the naked eye, the above statement provides an insight to what ESG can do whereas if looked through a magnified view, illustrates how ESG is a front put up by companies to elevate their own interests rather than the giving back to society. This alone can challenge that the statement provided in this assignment as tenuous and poorly grounded.

2.0 Literature Review

Looking at the role of ESG in modern business, it has been said that a company's value significantly rises with proper implementation of ESG (Henisz, Koller and Nuttal, 2019). A study carried out by Tarmuji, Maelah and Tarmuji (2016) concludes that in today's world of business, ESG indices are a crucial element for long-term sustainability and to enhance performance. Serafeim (2020) believes that behaving in "prosocial" ways is obligatory for all humans, whether it be in a corporate or social setting and is one of the key reasons ESG performances should be elevate. The author asserts that ESG practices must be incorporated in a company's long-term plan given the fact that it contributes to the reduction of capital costs and give a push towards the rise of their valuation.

Though ESG practice was considered useful, it is disputed by Linz and Meckenstock (2023) on the grounds that ESG practices are major contributors for both stakeholder and shareholder value without consideration towards actual implementation, therefore labelling the company as just a "regulation follower". This is supported by highlighting the "ESG Entrepreneurs" who are known to deviate from the sustainable approach and embody an "entrepreneur approach" towards ESG which leads to tailored reports with no focus on the change driven by ESG indices.

2.1 Profit Over Planet? Sustainable Future Pursuit Led by Profit-Seeking Companies

An article published by Economist (2022) highlights the decline of ESG investments stating that it does not align with the financial motivations of companies while making an example of BlackRock, a company that claims to be "one of the world's leading providers of investment, advisory and risk management solutions" who came short of their extensive pledges due misuse of their power in the market to boycott fossil-fuel firms. This unethical practice of ESG was a shortcoming that not only strained their public image, but also gained them a spot on a state watch list by the efforts of the Indiana Treasurer, Daniel Elliot (Muñiz, 2024).

The significance of ESG indices is further contested by Hubbis (2024) with the claim that ESG is used by companies as a "smokescreen" for "lackluster performance". Similarly, Tucker, Brakman Reiser and Xia (2024)'s preliminary data indicates that ESG investments revolve around a "political bullseye" that investors lately deem too costly to pursue.

2.2 ESG Challenges and Backlash: Navigating the Storm

In the wake of anti-ESG movements, financial companies are now weaving the movement as a risk in their annual reports (Birch, 2024). As this movement has hit the throttle, it is concurrently labelled as "loosely defined" (Harvard Business Review, cited in Birch, 2024). The author further explores the multi-million dollar campaigned launched by Unlocking America's Future, a non-profit who is in defiance of the recently adopted anti-ESG legislations as they see it as "weaponizing" and damaging to the economy. On the contrary, Brown (2023), validates the call for anti-ESG movements through legislation and policies, with the dilemmas of companies highlighted in page 2:

> *"Investors and businesses increasingly face a choice between complying with these new state laws and achieving the ESG goals promised to their investors and stakeholders. New anti-ESG laws in 2023 present significant uncertainty for an increasing range of businesses." (Brown, 2023)*

While these policies may be perceived as an agenda to reinforce traditional business practices (Pollman, 2022), it is however necessary to an extent to address the impending need to mitigate greenwashing practices. This is followed by "greenhushing" gaining traction to stay afloat amidst the high tide of ESG backlash leading to adopting legal measures (Brown, 2024). The decline of company mentions of the terms 'sustainability' and 'ESG' in their financial reports are illustrated in Table 1 below:

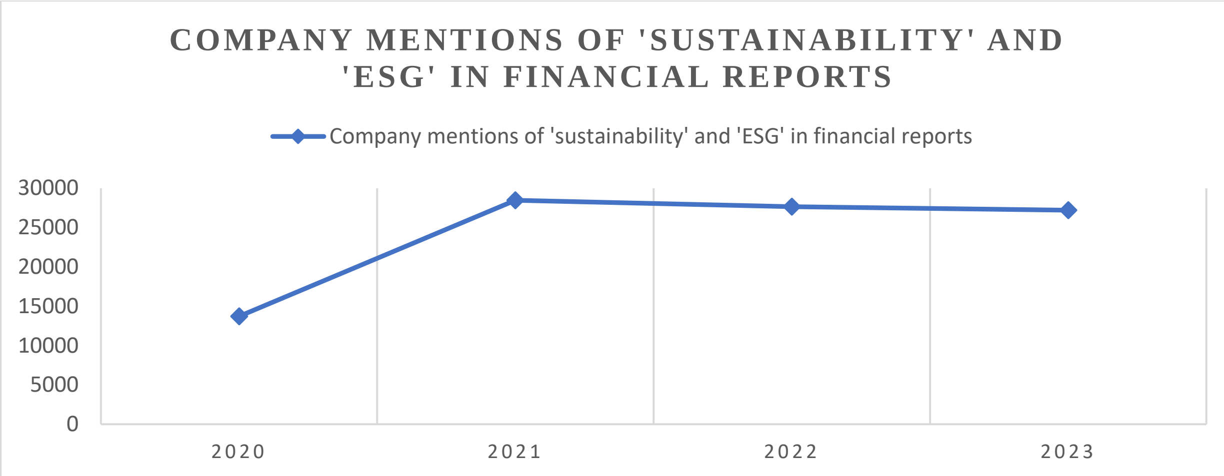

Table 1 (Factiva, cited by Brown, 2024)

Though the "crackdowns" on inflated greenwashing publishments by companies has made it risk-bound for them continue this agenda, 2022 statistics show that close to 60% are continuing the unethical practice of overstating its sustainability efforts (Toplensky, 2023). The latest data on ESG investing suggests that it is simply "falling away" with the indices being suffering a hostile landscape in the USA market but is merely a fluctuation and not a permanent threat (Byrne, 2024). This statement is intriguingly backed up by a forecast report published by Bloomberg Intelligence (2024) with the prediction that ESG assets are on track to exceeding $40 trillion in the next 6-year stretch, with Europe being the main hub for this growth. However, this assertion can be contested when the discrepancies between sustainability reports of companies and the actuality of their operations are put to trial. Let's put Toyota's 2022 sustainability report to scrutiny by looking at two of their aims stated on page 6:

> *"Contributing to the creation of a prosperous society through our business activities based on the Guiding Principles at Toyota while continuing to uphold the spirit of the Toyoda Principles, which we have inherited since our foundation. Aiming to be the "best company in town" that is both loved and trusted by local people to achieve the mission of "Producing Happiness for All" under the Toyota Philosophy compiled in 2020." (Toyota Motor Corporation, 2022).*

The convincing tone of these aims were undeniable, though the delivery failed to materialize. Toyota caught in yet again another scandal involving falsifying data for safety certification tests led to a raid by the Japanese Transport Ministry followed by an apology by the company (Liang, 2024). Additionally, the author highlighted the closing of all factories of 'Daihatsu', a carmaker owned by Toyota after conceding that safety tests were falsified. Reflecting to the staunchly stated aim inclusive of "trusted by local people" and "uphold the spirit of the Toyoda Principles" is annulled due to the Safety scandal caused by their negligence, which provokes the thought that "Toyoda Principles" is about causing more harm to the customers and society.

2.3 Unveiling ESG as a Smokescreen in Greenwashing Practices

The standards and systems revolving sustainability reporting and monitoring has barely gained momentum, despite the ramped-up attention revolving corporate sustainability (In and Schumacher, 2021). Let's look at why ESG has become a smokescreen below:

> *"The existing challenges on firms' disclosure on ESG data are manifold: unaudited ESG data, no global governing body, various behavioural issues at firm level, and no specific regulatory guidelines to ensure the accuracy of reported ESG data" (PRI, 2015; Khan et al., 2016; PRI, 2017; State Street Global Advisors, 2017; Schroders, 2017; Fride, 2019, cited in Yu, Van Luu and Chen, 2020)*

This perplexing nature of ESG data disclosure provides latitude for companies to continue their greenwashing practices. Volkswagen's Dieselgate Scandal is a quintessential example of greenwashing complicity and unethical corporate leadership (Mujkic and Klingner, 2019). In 2015, Volkswagen was issued a notice of violation following the uncovering of their "defeat device", used to falsify the emission of their diesel vehicles, in which emission rates were 40 times more than what's legally allowed. The charges against them were irrefutable and damages irreversible. Some intriguing takeaways from their first sustainability report published in 2017, two years following the industry-wide scandal are highlighted in page 12:

> *"In truth, our company faces a dual challenge. We have not yet surmounted the diesel crisis for which we ourselves are responsible; its consequences will continue to weigh on us for the foreseeable future. We have taken significant steps to strengthens our internal processes and control mechanism, and to refocus on compliance and integrity – by revising our code of conduct, for example, and extending our whistleblower system……" (Volkswagen Group, 2017)*

The report attempts to present an image of corporate remorse and responsibility, aiming to regain public trust. However, it ultimately serves as a smokescreen, masking the company's continued obfuscation of its past wrongdoings. Instead of offering genuine accountability, the report perpetuates a narrative of redemption that distracts from the ongoing issues at hand.

The company Shell is a great illustration of this phenomenon. High ESG scores were awarded to Shell in 2018, even as the company still invested in the extraction of fossil fuels. Many people praised Shell for its pledge to reach net-zero emissions by 2050, but others noted that the firm's greenhouse gas emissions were still increasing, and its capex was predominantly on oil and gas projects (Boffey, 2020). This malaise resulted in allegations that Shell was trumpeting its ESG ratings to justify its actions overrunning with unsustainable practices.

An additional instance relates to Nestlé, who also had been accused of greenwashing in terms of their environmental initiatives. Although Nestlé reported advancing plans on palm oil sustainable sourcing and plastic waste reduction, the firm was still a massive polluter, mostly due to its use of single-use plastic bottles (Macdonald, 2019). In light of these concerns, however, Nestle was able to hold firm disabling ESG investment indices pointing out the concerns on the efficacy of NESI in eradicating poor sovereign outlays environmentally and socially.These cases can paint a clear picture on how ESG indices can inadvertently praise corporations for their ambitious, yet unrealistic plans without allowing any real change, which therefore encourages more greenwashing practices.

eISSN:2805-5187

3.0 Discussion

3.1 The Mirage of Transparency: ESG Indices and Their Lack of Standardization

The central claim in this essay is that that ESG indices are “transparent”, “truthful” and “unambigious”. This is however brought into question due to the variation in ESG reporting frameworks across jurisdictions. Kotsantonis and Serafeim (2019) have pointed out that different rating agencies, including MSCI and Sustainalytics and RobecoSAM, assess companies along different metrics and have different processes of assessment resulting in significant rating gaps for the same company. For instance, in the year 2020 oil corporation ExxonMobil was rated highly for its governance and environmental policies by handful of agencies while some agencies took it very low because of its continued funding of fossil-based energy (Berg et al, 2019).

Since there is no harmony in the measurement or the rating systems, this implies that the investors and other stakeholders can always be in the wrong direction as ESG scores are unable to reflect on a single standard of ethical practices which is globally accepted. Such lack of transparency can also enable the companies to cherry pick the good metrics at the same time avoiding the negative metrics, as was the case with regard to the ESG ratings of Tesla. Although Tesla received good scores for environmental expectations, its labor practices and aspects of governance focusing on worker safety and diversity, have been of concern to some of the ESG raters (Berg et al, 2019).

The European Securities and Markets Authority (ESMA) has cited that over 80% of large publicly listed companies in EU have some kind of ESG reporting but ‘quality and detail’ of this reporting differs drastically (ESMA, 2021). Consequently, most stakeholders are frequently misinformed about a firm’s real effect on the ecosystem and community. This can be illustrated by BP during its reinvention on green energy. Despite the company trying to position as a green energy innovator, BP’s reports concerning scope 3 emissions (which are emissions produced by end users who utilize BP’s products) were frequently deficient and deceptive. So, while BP strategically released components of its energy transition strategy to account for a large proportion of its reported ESG performance, the lack of detailed and aggregate data on the environmental footprint of its operational and fossil fuel sectors businesses raised serious questions regarding the company's sustainability inclination (Wright, 2020). Such deficient reporting not only undermines the ability of ESG indices to provide meaningful ratings but also furthers the causes of greenwashing by concealing the behavioural aspects of the corporations that are more difficult to observe.

3.2 ESG: When Ethics Become a Marketable Asset

Another emerging concern in relation to ESG would be the fully developed financialization of ESG in towards filters whereby ESG ratings are mostly employed as a tool for investment rather than as genuine measures of a firm’s sustainable performance. As its culture grows, so does the chance that a firm’s ESG strategy will be evaluated as an investment strategy, concentrating on how its ESG ratings may enhance financial returns rather than the social or environmental responsibilities (Grewal et al., 2021). Such perverse market-based approach to ESG data reduces sustainability into an investment portfolio rather than an ethical theme.

The proliferation of ESG exchange traded funds (ETFs) is one example of this trend. Many ESG indexes include as a selection criteria companies which are rated on their ESG rating system; however, these funds have been accused of incorporating companies like Chevron and Bristol-Myers Squibb, who have a bad Environmental and Social reputation but are included for having a high financial or governance scoring. In 2020, an ETF focusing on ESG by BlackRock was outed for having stakes in companies which were known for their unethical human rights practices, which included a company responsible for the deforestation in the Amazon (Griffiths, 2020)

3.3 SDGs: The Blueprint for Meaningful Business Transformation

Amid growing criticism of ESG indices' short comings, more and more voices have been heard suggesting a transition toward the United Nations' Sustainable Development Goals (SDGs). The SDGs, which are in themselves multiple, including alleviation of poverty and inequalities, advancement of climate action and protection of the environment, are regarded as more holistic constituents to measure a corporation's sustainability (Kolk and Van Tulder, 2020). In contrast to the rather narrow vision of ESG benchmarks, wherein financial performance and selective environmental or social concern are the emphasis of focus- the SDGs define a more expansive view of societal development.

To illustrate, Unilever has received plaudits for its attention in merging its business purposes and goals with those of the SDGs, specifically gender equality, responsible consumption and climate change (Dahl, 2021). It is apparent that Unilever, due to its emphasis on SDGs, has been able to showcase its commitment to sustainability in a way that, in a much deeper sense, goes beyond seeing sustainability as an ESG issue. It is expected that firms that operate within the framework of the SDGs will be able to impact global issues in a positive way while at the same time improving their reputation and business continuity.

Additionally, the SDGs present a more uniform and clear-cut methodology that can help resolve some of the discrepancies associated with ESG rating systems (Schmidt and Cohn, 2020). As far as businesses align their plans with the SDGs, they are urged to Embark on a more integrate approach which brings for the SDGs.

4.0 Conclusion

There is no doubt that ESG indices have become popular as tools for the measurement of responsible corporate behavior. The three factors, however, raise serious issues regarding the effectiveness of the indices: a fragmented standard, some variance in the developed metrics, and greenwashing. Practical examples demonstrate the exercise in futility which Shell, Toyota and Volkswagen brought to ESG metrics: self-regulation of the companies in terms of their impact on society as well as the environment. Owing to these, place the SDGs as the best alternative, they promise a more sophisticated concept for adoption especially for corporate social responsibility. In such a context, these goals will become operational for businesses and transitions from words to actions because they have a clearly defined and in unison international standard.

References

Berg, F., Kölbel, J. F. and Rigobon, R. (2019). "Aggregate Confusion: The Divergence of ESG Ratings." *MIT Sloan Research Paper*. https://dx.doi.org/10.2139/ssrn.3438533

Birch, K., (2024) *Fightback Against Anti-ESG Agenda and Investment Bans in US. Sustainability Magazine*, [online] 20 January. Available at: https://sustainabilitymag.com/esg/fightback-against-anti-esg-agenda-and-investment-bans-in-us

BlackRock (2024) *Corporate*. [online] Available at: https://www.blackrock.com/corporate

Bloomberg Intelligence (2024) 'Global ESG assets predicted to hit $40 trillion by 2030 despite challenging environment', *Bloomberg*, 8 January. Available at: https://www.bloomberg.com/company/press/global-esg-assets-predicted-to-hit-40-trillion-by-2030-despite-challenging-environment-forecasts-bloomberg-intelligence/#:~:text=London%2C%208%20January%202024%20%E2%80%93%20Global,from%20Bloomberg%20Intelligence%20(BI).

Boffey, D. (2020). "Shell Faces Growing Backlash Over Greenwashing Allegations." *The Guardian*. Retrieved from https://www.theguardian.com

Brown, H.C., (2024) *Companies Haven't Abandoned Sustainability, They're Just Talking About It Less. The Wall Street Journal*, [online] 19 August. Available at: https://www.wsj.com/articles/companies-havent-abandoned-sustainability-theyre-just-talking-about-it-less-acd0e85f

Byrne, D. (2024) 'Is ESG investing falling away?', *The Corporate Governance Institute*, Available at: https://www.thecorporategovernanceinstitute.com/insights/news-analysis/is-esg-investing-falling-away/?srsltid=AfmBOoodCvug7p6zakFn-lKVQ1EqGyHgI3bIfbxRrHCmSsN09awzq8i3

Dahl, R. (2021). "Unilever's Strategy for Achieving SDGs: Leading the Way in Corporate Sustainability." *Sustainability Journal, 18*(2), 50-67.

DasGupta, R. (2022) Financial performance shortfall, ESG controversies, and ESG performance: Evidence from firms around the world. *Finance Research Letters*, 46, p.102487.

The Economist (2022) 'The fundamental contradiction of ESG is being laid bare', *The Economist*, 29 September. Available at: https://www.economist.com/leaders/2022/09/29/the-fundamental-contradiction-of-esg-is-being-laid-bare

ESMA (2021). *Sustainable Finance: Disclosures and ESG Data Gaps*. European Securities and Markets Authority. Available at: www.esma.europa.eu

Griffiths, L. (2020). "How ESG Investing Can Be Misleading: The Case of BlackRock's ETF." *Financial Times*. Retrieved from https://www.ft.com

Henisz, W., Koller, T. and Nuttall, R. (2019). *Five ways that ESG creates value*. McKinsey & Company. Available at: https://info.fiduciary-trust.com/hubfs/Fiduciary_Insights/McKinsey_Five_Ways_that_ESG_Creates_Value.pdf

Hubbis (2024) ESG investing: The rise, the decline, and the quest for authenticity. *Hubbis*. [online] Available at: https://www.hubbis.com/article/esg-investing-the-rise-the-decline-and-the-quest-for-authenticity

In, S. Y. and Schumacher, K. (2021). Carbonwashing: a new type of carbon data-related ESG greenwashing. *Available at SSRN 3901278*. https://sfi.stanford.edu/sites/sfi/files/media/file/carbonwashing-_a_new_type_of_carbon_data-related_esg_greenwashing_working_paper_0_0_0_0.pdf

Kolk, A. andVan Tulder, R. (2020). "The SDGs: A New Framework for Business." *Journal of Business Ethics, 169*(2), 237-250.

Kotsantonis, S. and Serafeim, G. (2019). "The Misalignment between ESG Reporting and Performance." *Harvard Business Review*. Available at: https://hbr.org

Liang, A. (2024) 'Toyota raided as safety testing scandal grows', *BBC News*, 4 June. Available at: https://www.bbc.com/news/articles/c1wwj1p2wdyo

Linz, C. and Meckenstock, C (2023). *Is this a new dawn that will transform the impact of ESG?* World Economic Forum, 24 November. Available at: https://www.weforum.org/agenda/2023/11/is-this-a-new-dawn-that-will-transform-the-impact-of-esg/

Macdonald, S. (2019). "Nestlé's Greenwashing: The Problem with Corporate Responsibility." *The New York Times*. Retrieved from https://www.nytimes.com

Pollman, E. (2022). The making and meaning of ESG. *U of Penn, Inst for Law & Econ Research Paper*, (22-23). https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4219857

Mujkic, E. and Klingner, D. (2019). Dieselgate: How Hubris and Bad Leadership Caused the Biggest Scandal in Automotive History. *Public Integrity*, *21*(4), 365-377.

Muñiz, L.B., (2024) *Indiana Treasurer Puts BlackRock on ESG Watchlist*. Indiana Capital Chronicle. [online] 21 June. Available at: https://indianacapitalchronicle.com/2024/06/21/indiana-treasurer-puts-blackrock-on-esg-watchlist/

Schmidt, R. and Cohn, J. (2020). "The SDGs: A Better Framework for Corporate Sustainability." *Journal of Global Business, 25*(3), 54-72.

Serafeim, G., 2020. *Social-impact efforts that create real value*. Harvard Business Review, [online] September–October. Available at: https://hbr.org/2020/09/social-impact-efforts-that-create-real-value

Tang, O., Shi, X. and Jiu, L. (2024) Value creation or political trick? An event study on anti-ESG regulations. *Finance Research Letters*, 65, p.105530. https://doi.org/10.1016/j.frl.2024.105530

Tarmuji, I., Maelah, R. and Tarmuji, N. H. (2016). The impact of environmental, social and governance practices (ESG) on economic performance: Evidence from ESG score. *International Journal of Trade, Economics and Finance*, *7*(3), 67. https://www.ijtef.org/vol7/501-FR00013.pdf

Toplensky, R. (2023) 'Global executives say greenwashing remains rife', *The Wall Street Journal*, 13 April. Available at: https://www.wsj.com/articles/global-executives-say-greenwashing-remains-rife-10a0e273

Toyota Motor Corporation (2022) *Sustainability Data Book 2022*, Toyota. Available at: https://global.toyota/pages/global_toyota/sustainability/report/sdb/sdb22_en.pdf

Tucker, A., Brakman Reiser, D. and Xia, Y., (2024) Is 2024 past peak ESG? *Harvard Law School Forum on Corporate Governance*. [online] Available at: https://corpgov.law.harvard.edu/2024/09/16/is-2024-past-peak-esg/

UN Global Compact, 2004. *Who Cares Wins: Connecting Financial Markets to a Changing World*. [pdf] Available at: https://documents1.worldbank.org/curated/pt/280911488968799581/pdf/113237-WP-WhoCaresWins-2004.pdf

Volkswagen Group. (2017). *Sustainability Report 2017*. Volkswagen Group. Available at: https://www.volkswagen-group.com/en/publications/corporate/sustainability-report-2017-2355

Wright, C. (2020). "BP's Greenwash: Examining the Incomplete ESG Reporting of Big Oil." *Sustainable Business Review, 13*(4), 22-39.

Yu, E. P. Y., Van Luu, B. and Chen, C. H. (2020). Greenwashing in environmental, social and governance disclosures. *Research in International Business and Finance*, *52*, 101192. https://doi.org/10.1016/j.ribaf.2020.101192