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The ESG Paradigm: The Journey, the benefits and the pitfalls of Sustainable Business

N. Archana[1], Dr. D. Ramesh Kumar[2]

1Research Scholar, Department of B. Com CA, Sri Ramakrishna College of Arts and Science, Coimbatore, Tamil Nadu

2Assistant Professor, Department of B. Com CA, Sri Ramakrishna College of Arts and Science, Coimbatore, Tamil Nadu

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ABSTRACT

ESG is a framework that aids stakeholders in comprehending how a company is handling possibilities and hazards associated with environmental, social, and governance criteria. ESG adopts the comprehensive perspective that sustainability encompasses more than just environmental concerns. The objective of this study is to systematically examine the conceptual framework of ESG, evaluating its core advantages and disadvantages alongside a comprehensive historical evolution of the paradigm. The study is based on secondary data collected from various scholarly articles, policy reports, websites, newspapers and magazines. According to the historical perspective, ESG developed from its early roots in ethical investing to become a widely accepted business need. Additionally, research shows that although the key benefits of ESG include improved long-term risk reduction and increased investor trust, it is still limited by serious drawbacks such data fragmentation and a lack of internationally standardised measurements. In the end, this study offers a comprehensive summary that aids researchers and corporate managers in navigating the challenges of sustainable value development.

I. Introduction:

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The term "ESG" (Environmental, Social, and Corporate Governance) was created to describe particular information intended to be used by investors to assess the significant risk that a company is taking on based on the externalities it is producing. An organization can use the generated data as measurements for management and strategic objectives. In their assessment of enterprise value, investors may also use ESG data for purposes other than evaluating material risks to the company. Specifically, they may do this by creating models that are predicated on the idea that identifying, evaluating, and managing sustainability-related risks and opportunities with regard to all organisational stakeholders results in a higher long-term risk-adjusted return. Customers, suppliers, workers, leadership, and the environment are examples of organisational stakeholders.

As the public becomes more aware of ESG's underlying problems, the issue is becoming more urgent. Businesses are reacting to market, stakeholder, and regulatory pressures to maintain sound governance practices, reduce their environmental effect, and support the communities in which they operate. As a result, ESG considerations are becoming more important to businesses and investors, and businesses should make an effort to make sure that their operations are in line with their basic principles and objectives. Businesses who implement sound ESG practices now have a long-term, sustainable business strategy that helps them stay competitive as the market and sector change.

Investors can gain a thorough understanding of a company's risks and possibilities by evaluating its ESG performance, which gives them valuable information into the company's long-term worth. Additionally, ESG performance aids businesses in improved operational management and regulatory compliance. A company's competitive position can be ascertained by measuring and benchmarking ESG performance data against rivals. Additionally, as there is a growing need for investment in businesses that have a complete understanding of their operational risks, including intangible assets, top ESG performers are better positioned to draw in new clients and investors. Equipped with additional ESG data, investors can construct ESG-aligned portfolios. Under this paradigm, businesses are challenged to improve across all ESG criteria and held responsible for their activities.

Strong ESG performance is typically associated with superior risk management procedures, easier access to financing, enhanced customer interactions, increased employee involvement, and favourable brand awareness.

Environmental Strategy:

- **Mitigation of Climate Change**: For organisations to dedicate themselves to their ESG strategy and sustainability purpose, the environmental pillar is crucial. Businesses must create a strategy to lessen their environmental impact, which includes investing in renewable energy sources and alternative fuels as well as establishing science-based carbon neutrality targets. In order to conform with India's net zero ambitions, Indian enterprises are advised to develop a sustainability strategy with precise carbon emission reduction targets and renewable energy integration pledges between 2030 and 2045.
- **Efficiency of Resources:** Companies must increase organisational accountability for the environmental parameter in order to address climate change and its severe effects. execution of programs aimed at lowering carbon emissions, increasing energy efficiency, conserving water, and managing waste throughout all operations.
- **Ecological Procurement:** A sustainable supply chain is essential to a company's sustainability as well as to its business strategy and objectives. It is essential to make sure that products and raw materials are sourced ethically, reduce the impact on the environment, and promote sustainability across the supply chain.
- **Ecosystems and Biodiversity:** Businesses that are located in or near natural areas must devise plans to preserve and replenish biodiversity, natural habitats, and ecosystems that are impacted by their operations. This will guarantee that they care about the environment, which will assist indigenous tribes and other stakeholders regain their trust.

Social Strategy:

- **Diversity, Equity, and Inclusion (DEI), Human Rights, and Labour Practices:** Respectful, inclusive workplaces are fostered by advancing DEI, fair labour standards, and human rights. In addition to fostering innovation and fostering stakeholder trust, businesses guarantee equal opportunities, safeguard employee welfare, and construct diverse teams, all of which advance society.

Governance Strategy:

- **Ethical Business Conduct:** The tone at the top must guarantee that the organization is accountable, transparent, and compliant with all local regulations. They are successful in gaining the trust of stakeholders, reducing any ESG risks, aligning their operations with long-term sustainability and corporate ESG strategy, and drawing in investors because they prioritise integrity in decision-

making, prevent corruption, implement strict codes of ethics, and establish strong governance frameworks.

- **Risk management, corporate governance, and compliance**: Maintaining fairness and transparency is the cornerstone of good company governance. It guarantees that businesses follow the law, take calculated risks, and maintain accountability. Businesses may develop trust, draw in potential investors, and maintain their competitive edge by concentrating on compliance and taking proactive measures to address risks.
- **ESG Reporting and Performance Metrics:** The need for organisations to meet stakeholder expectations in terms of having an ESG roadmap and goals is expanding along with the ESG atmosphere. Therefore, in order to monitor how well they are doing on their environmental goals, social effect, and governance, the organisations must use unambiguous metrics to assess their performance on a number of ESG aspects. Understanding actual progress is more important than just showing numbers, and doing so requires adhering to a precise framework and checklist. Frequent reporting establishes the organization's commitment to long-term goals and fosters trust among all stakeholders, including employees, communities, and the supply chain, as well as investors.

II. Objectives of the Study

- To trace the ESG paradigm's historical development.
- To assess the strategic advantages of implementing ESG
- To evaluate the challenges of ESG frameworks

III. Research Methodology

This study is conceptual in nature and is based on secondary data. The data were collected from scholarly journal articles, books, research reports, policy documents, sustainability frameworks, newspapers, magazines, and relevant websites related to Environmental, Social, and Governance (ESG). The sources were selected based on their relevance to ESG components, sustainable development, corporate governance, social responsibility, and stakeholder welfare. The study reviews and analyses existing literature to understand the historical concepts, advantages, and challenges of ESG in modern industries.

IV. Historical Development of ESG Paradigm

Pre-ESG: The mid-2000s saw the emergence of the ESG that people are familiar with today. But ESG and its tenets have a long history. The "S" and "G" categories might theoretically be used to categorise attempts to enhance basic working conditions during the Industrial Revolution. Many efforts during the 20th century compelled businesses to implement more equitable and sustainable business practices. Although opinions on how well they functioned differ, there is no denying their existence. Examples include the removal of labour exploitation, the financing of authoritarian governments such as apartheid, and the formation of corporate governance rules, which are legal rulebooks that teach firms on how to operate their operations.

The Origins and Early Days of ESG Investing:

The Pax World Fund was the first mutual fund in the United States to be made public and to consider social and environmental considerations in its investing decisions. It was started in 1971 by two United Methodist preachers who opposed the Vietnam War. Hence, the early days can be traced back to the 1960s or 1970s, when SRI, or socially responsible investing, became popular. It entailed making investments depending on an organization's influence on society and the environment. In 1980, CSR, or corporate social responsibility, was established.

CSR holds corporations accountable for their influence on the environment and society. However, the development of ESG began around 2000, particularly in the investment realm. In the early days of the field, ESG aspects were measured and assessed inconsistently.

The Evolution of ESG and the Rise of ESG Investing:

ESG has grown in popularity over time, with investors, stakeholders, and customers demanding that enterprises adhere to ESG standards. More restrictions are being imposed, and compliance mechanisms are in place to ensure fewer deviations. Followings are the changes over the years using the ESG history timeline:

- **1990: Domini 400 Social Index:** Amy Domini developed the Domini 400 Social Index to encourage firms to prioritise their social and environmental responsibilities. Investors were not very familiar with this element at the time. The next year, she established the Domini Social Impact Equity Fund, which raised $1.3 billion in 2001 and returned 15.08%, compared to 15.25% for the S&P 500.
- **1992: UN Framework Convention on Climate Change:** At the Earth Summit in Rio de Janeiro, 154 countries signed an agreement to reduce "dangerous human interference with the climate

system." It also established an annual meeting of participants, known as the Conference of the Parties (COP), to hammer out details and adjust objectives.

- **1995: The United States' First Sustainable Investment Inventory:** The Social Investment Forum Foundation, located in Washington, D.C. and now known as the U.S. SIF Foundation, performed the first comprehensive inventory of the amount of all sustainable investments.
- **1997: Kyoto Protocol and launch of Global reporting initiative:** This was adopted in 1997 but came into existence in 2005. 192 countries agreed to a specific greenhouse gas reduction target, 36 of which signed for the first commitment period. And on the other hand, Global Reporting Initiative, was established to address environmental concerns. It then expanded to touch social and global issues as well.
- **2000: Global Compact of the United Nations and Carbon Disclosure Project:** The UN's Global Compact unit develops standards for human rights, anti-corruption, the environment, and labour. More than 13000 agencies and organisations from 170 countries take part in it and the Carbon Disclosure Project (CDP) was founded by Paul Dickinson and granted large investors the ability to request that firms reveal their climate performance and risk mitigation initiatives.
- **In 2004: T**he "Who Cares Wins" report, which included the term "ESG," gained popularity during a UN summit. The paper summarised major concerns faced by banks and investment corporations.

- **2005: Freshfields Report**: Freshfields Bruckhaus Deringer, a London-based firm, has produced A Legal Framework for Impact: Sustainability Impact in Investor Decision Making.

- **2006: Principles for Responsible Investment:** Environmental and investing specialists published six guidelines outlining how institutional investors should consider ESG trends in their decisions.

- **2011: Sustainable Accounting Standards Board:** Jean Rogers founded the Sustainability Accounting rules Board to provide appropriate accounting rules that address how ESG concerns affect the financial performance of industrial firms.

- **2015: United Nations Sustainable Development Goals and Climate-related Financial Disclosures:** The United Nations General Assembly established 17 Sustainable Development Goals (SDGs) and Financial Stability Board established the Task Force on Climate-related Financial Disclosures, which is an industry cooperation that makes recommendations on a variety of hazards.

- **2016: Initiative for Workforce Disclosure:** The Workforce Disclosure Initiative was founded by Share Action, a charitable organization that promotes ethical investing. The effort aims to increase the reliability and usefulness of worker health, safety, and risk management data.

- **2017. The Responsive and Responsible Leadership Compact along with Difficulties in Board Diversity at State Street Global Advisors:** The Compact for Responsive and Responsible Leadership was signed by over 140 CEOs at the World Economic Forum (WEF) in Davos, Switzerland and at the same time, State Street Global Advisors, an asset management firm, has told 600 firms in the United States, United Kingdom, and Australia that it will vote against the chairs of boards that do not include any female candidates or directors.

- **2019: Davos Manifesto for 2020:** The WEF announces the Davos Manifesto 2020, a set of moral rules to help businesses manage the Fourth Industrial Revolution.

- **2020: COVID-19 Pandemic and Related Events and Standardised Metrics for Stakeholder Capitalism:** The COVID-19 pandemic forced millions of workers to work from home. It highlights how an invisible threat can radically destabilise both the global economy and people's quality of life. On the other hand, the Big Four accounting firms and the WEF published a whitepaper on standardised metrics for businesses reporting on their ESG progress.

- **2022: Tesla Excluded from S&P Sustainability Index and Consolidation of Sustainability Standards:** Tesla was removed from the S&P 500 ESG Index one month after Musk initiated talks to acquire Twitter. This was due to a "rebalance" and the company's "decline in criteria level scores" and on the other hand, the Value Reporting Foundation (VRF) oversaw the Sustainable Accounting Standards Board standards, which were thereafter integrated within the IFRS to form the International Sustainability Standards Board.

- **2023: The EU's Corporate Sustainability Reporting Directives:** According to a new European Union legislation, organisations based in the EU, as well as non-EU enterprises doing business there, will soon be required to audit sustainability data and provide corporate sustainability information on how they align with an EU ESG-related taxonomy.

- ESG Today: Present Practices and Trends:
  - Companies will prioritise explicit, quantifiable, and executable plans to achieve net zero.
  - Transition towards renewable energy.
  - Geopolitical priorities will shape ESG.
  - Businesses will employ artificial intelligence and circularity to cut waste.
  - Working along with environmental standards.
  - New Carbon Pricing Regime
  - The supply chain aims to achieve net zero.

V. Advantages of Implementing ESG

- **Boosting reputation and trust:** Companies that incorporate ESG into their strategy show a strong commitment to ethics, environmental sustainability, and community well-being. This strategy builds customer trust and improves the company's reputation with investors, regulators, and other stakeholders.
- **Attracting and keeping talent:** Today's workforce, particularly younger generations, prefer organisations that combine financial success with positive social and environmental impacts. According to studies, many professionals prefer employers who are strongly committed to ESG. Diversity, inclusion, and employee well-being programs increase morale, productivity, and talent acquisition, transforming ESG practices into a competitive differentiator in the job market.
- **Access to cash and investment opportunities:** ESG policies can open up new funding options. Today, many institutional investors include ESG measures in their investment decisions. Similarly, banks and lenders are providing preferential terms to companies with excellent ESG practices since they are viewed as lower-risk and more sustainable in the long run. ESG policies are becoming a more valuable asset for businesses seeking finance.
- **Risk mitigation and regulatory compliance**: Focusing on ethical governance and risk management enables firms to predict and reduce financial, operational, and reputational risks associated with environmental and social noncompliance. Meeting ESG standards decreases the risk of fines and regulatory penalties, protects corporate reputation, and fosters consumer trust and brand loyalty. Companies that operate honestly and ethically are better able to negotiate an increasingly complicated and competitive regulatory environment.

- **Driving innovation and competitive advantage:** Implementing ESG rules frequently causes businesses to reconsider established processes and take more innovative ways. ESG-focused businesses can generate new revenue and cut expenses by developing sustainable goods and optimising resource efficiency. ESG-driven innovation benefits not only the environment, but also financial performance.

VI. Challenges of ESG Frameworks

- **Lack of awareness and understanding:** Many businesses, particularly small and medium-sized enterprises, still have a poor knowledge of ESG. This impedes the successful implementation of sustainability solutions.

- **High implementation costs:** ESG adoption is frequently linked to large investments, such as employing renewable energy or developing more ecologically friendly waste management systems. Various factors which cause high cost on ESG such as, Investment in infrastructure and technology, employee training and development, lack of consistent data and Metrix and unfavourable business culture etc.

- **Inconsistent regulations:** ESG requirements vary by country and are continually changing, making it challenging for businesses to comply with applicable standards.

- **Difficulties with Measuring and Reporting ESG:** Because of the lack of standardised standards, companies frequently struggle to measure and report on their Environmental, Social, and Governance (ESG) impact. Furthermore, ESG data gathering is frequently dispersed among departments or manually entered into spreadsheets, making it impossible to provide a comprehensive picture of the company's ESG performance. There is a lack of precise methodology for analysing the impact of sustainability activities on a company's profitability, making it difficult to understand the link between ESG and financial success.

VII. Conclusion

To summarise, the ESG paradigm has transitioned from a historic voluntary gesture into a modern strategic necessity. Incorporating ESG principles is a critical strategic imperative that reduces organisational risks and encourages long-term innovation, acting as the decisive differentiator for future-proof business success.

Integrating ESG policies is no longer a luxury but a requirement for businesses aiming to remain competitive and relevant in an evolving world. By adopting ESG framework, companies not only contribute to a more sustainable and equitable future but also generate tangible benefits for their reputation, workforce, investors, and financial performance. However, navigating this journey successfully necessitates overcoming considerable pitfalls, such as high implementation costs, fragmented data reporting metrics, and an inconsistent worldwide regulatory framework.

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