THE INTEGRATION OF ESG FACTORS IN BUSINESS STRATEGIES – COMPETITIVE ADVANTAGE

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Abstract

Uncertainty, increasingly higher and diverse risks but also the opportunities generated by the environmental, social and corporate governance factors' actions, have led to a change of approach in the business environment - these factors are no longer treated randomly and punctually in business strategies but, in an integrated approach, in the form of ESG factors. Consequently, starting with 2005, responsible investments (ESG investments) gradually increased, becoming a decisive criterion in investment decisions, both at individual and institutional level, especially on the financial markets. It was also facilitated by their regulation and the introduction of general principles and criteria for analysis and degree of implementation measurement at the organizations' level.

Given the positive externalities generated, the purpose of the paper is to popularize and promote this type of investment and, implicitly, the sustainable behavior in business, based on the principles of sustainable growth. In this sense, we used open documentation sources of international specialized institutions, the research method having both theoretical character by presenting the conceptual evolution of ESG investments and empirical character by revealing the dynamics, advantages and limits of integrating ESG criteria in business strategies.

Keywords: *competitiveness, investment analysis, ESG factors, responsible investments, sustainability*.

1. Introduction

Awareness of the climate change impact, growing demonstrations to promote and support equity and social justice, the effects of the COVID pandemic have led to a change in perspective in society, including in business. In this context, there is an increase in the interest of investors, both institutional and individual[1], in order to obtain sustainable results and, consequently, a reconsideration of business strategies.

Thus, if initially, the responsible investments were considered niche investments, recently there has been an acceleration of the implementation rate and the degree of spread of this investment paradigm, the impact of non-financial factors such as environment, social and corporate governance (ESG factors) being integrated more often, along with the financial impact, in the analysis and decision-making in business. But while the use of this perspective is on the rise, it still remains a competitive advantage of organizations that implement and advocate for ESG investments, increasing their financial value and long-term resilience.

Therefore, the boundaries of business performance analysis have been extended by including, alongside traditional economic and financial indicators, of ESG criteria.

Table no.1 Examples of ESG factors

ENVIRONMENTAL	SOCIAL	GOVERNANCE
Resource use rationality	Modern slavery	Board of directors and employees diversity
Climate change	Supply chain	Elimination of corruption
Recycling	Exploitation of minors	Lobby policy
Pollution	Labor conditions	Donation policy
Deforestation	Inclusion	The relationship between employees - manager - shareholders (fair remuneration, support for innovative ideas)
Natural resources depletion (water)	Human capital management	Transparency
Circular economy	Health and safety (including data	Organizational culture
Gas emissions and the greenhouse effect	Social conflicts	Fiscal strategy

Source: personal adaptation after "An introduction to responsible investment", available online at

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[1] Banks, insurance companies, pension funds, hedge funds.

https://www.unpri.org/an-introduction-to-responsible-investment/what-is-responsible-investment/4780.article and https: //www.bwfa.com, accessed on 15.03.2021

2. ESG investments – dashboard

2.1. Short history

The history of ESG indicators is relatively recent and has emerged at the initiative of the UN in order to accelerate the inclusion of the financial sector, business in general, on the path of the principles of sustainable development. Thus, it began in 2004 when, at the initiative of the UN Global Compact and supported by the International Finance Corporation (IFC) and the Swiss Government, international discussions were started with representatives of the largest financial institutions in order to identify means to include ESG indicators in the capital markets[2]. The conclusions of these debates were included in 2005 in a reference paper in the field of sustainable investments, the report "Who Cares Wins", on which occasion it was used for the first time officially, in a specialized paper, the concept of factors ESG and the idea that the integration of environmental, social and governance factors in investment processes produces positive effects on their financial performance was promoted. The idea of the relevance of ESG factors in the financial evaluation of a business was reiterated in the "Freshfield" report, also prepared under the auspices of the UN, by the United Nations Environment Program Finance Initiative (UNEP FI)[3].

These two reports can be considered the cornerstone in the direction of integration and interconnection of the three categories of factors for the development and implementation of sustainable investments, consolidated on ESG factors.

The next step in promoting this approach in business strategies was the launch of the Principles for Responsible Investment (PRI) in 2006. Evidence of the growing interest in this type of investment is the continuous annual increase in the number of those who have adhered to these principles. Thus, from 100 signatories at the time of launch[4], on March 31, 2020, the total number of signatories was 3,222, which means an increase of 29% over the previous year in the number of investor signatories (from 2092 to 2701), and of 21% of the number of signatories owning the assets, meaning 521[5].

The rise of responsible investment was favored by three conditions[6]:

- the growing recognition and popularization, both in the business and in the academic environment, of the positive contribution that the integration of ESG factors has on the financial results;
- the emergence of national and international regulatory institutions (reference United Nations Environment Program Finance Initiative - UNEP FI, Principles for Responsible Investing in the New York Stock Exchange -PRI, SSEI Sustainable Stock Market Initiative) which through involvement and creation of instruments and guidance promoted the idea of ESG factors as part of the fiduciary obligation of investors;
- manifesting the clients' interest for the transparency of the information regarding the placed investments.

For example, in the US at the beginning of 2020, $ 17.1 trillion was actively invested in ESG investments, an increase of 42% over 2018[7].

We should not lose sight of the fact that specific concerns for the three problems analyzed by ESG factors have existed before. Thus, topics such as socially responsible investment, corporate governance, environmental protection and reducing the effects of climate change, human rights, gender diversity, labor exploitation of minors, sustainable development have gradually become, since the 1970s, issues of interest for the academic environment, for investors but also for institutional decision makers at national and international level. Notable in this regard are a number of positions on current economic issues, such as: The establishment in 1971 in the USA of the first socially responsible mutual fund, the massive withdrawal in the 80s of South African investments in protest against apartheid, the publication of the first corporate governance code in the United Kingdom, the issuance of green bonds by the World Bank, the involvement of over 570 large investors in reducing greenhouse gas emissions (Climate Action 100+), the UN concern for promoting sustainable development among member countries (the 2030 Agenda for Sustainable Development is the ongoing initiative), the spread of social enterprises at international level since 1978 (although in different forms and names). Under these conditions, the added value generated by the

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[2] Georg Kell (11 July 2018), *The Remarkable Rise Of ESG Investing,* available article at http://www.georgkell.com/opinions/https/wwwforbescom/sites/georgkell/2018/07/11/the-remarkable-rise-of-esg/3dd3f3501695, accessed online on 18.04.2021.

[3] UNEP FI is a partnership between The United Nations Environment Programme and the global financial sector to mobilize private sector finance for sustainable development.

[4] https://www.unpri.org/pri/about-the-pri, accessed online on 18.04.2021.

[5] https://www.unpri.org/annual-report-2020/how-we-work/building-our-effectiveness/enhance-our-global-footprint, accessed online on 18.04.2021.

[6] https://www.unpri.org/an-introduction-to-responsible-investment/what-is-responsible-investment/4780.article, accessed online on 10.04.2021.

[7] https://www.forbes.com/sites/joanmichelson2/2021/03/16/esg-investing-is-a-star-women-are-why/?sh=24ed98104bde#16163357088804&{"sender":"offer-0-Pd0MW","displayMode":"inline","recipient":"opener","event":"resize","params":{"height":293,"iframeId":"offer-0-Pd0MW"}}, accessed online on 18.04.2021.

implementation of the principles of responsible investments is the integrated approach of the three dimensions, their merging and their inclusion in a clear and organized manner within business strategies, thus increasing the premises for more efficient risk management and increasing long-term financial returns.

2.2. Opportunities and limitations in adopting ESG criteria

Although the integration of environmental, social and governance indicators in the analysis and implementation of business is still mitigated by the primary desire of investors, namely profit maximization, along with awareness and popularization of positive effects in the business environment that has adhered to sustainable investment values (a short selection is presented in table No. 2), we can gradually note, an acceptance of them as part of the fiduciary debt[8].

Table no. 2 Benefits of implementing ESG factors versus ignoring costs

ESG factors	Superior implementation	Low implementation
Employees (factor G)	involvement, superior training, diversity, innovation => positive impact on labor productivity	poorly trained and uninvolved staff, high staff turnover, inadequate working conditions => negative impact on labor productivity
Clients (factor S)	dissatisfaction mediation, flexibility, accessibility => customer loyalty	lack of a mediation policy in case of disputes (e.g. return conditions), non-compliance with the rules on labeling, over-invoicing => dissatisfied customers and thus reduced sales
Suppliers (factor S)	optimal supply chain logistics, payment on time => optimization of the supply process	supply problems, poor control quality => selected reputational risk industry
Environment (factor E)	control of carbon emissions, use of renewable energy => supply, production distribution on sustainable principles =>long-term economic benefits	pollution, irrational consumption of natural resources => short-term economic benefits
Social projects (factor S)	promotes and implements the principles of social justice => visibility and direct contribution to the improvement of the factors belonging to the macro-environment (factors included in any business plan through the analysis of FISH)	lack of social involvement => they do not contribute to the creation of economic, political and social opportunities, they only pursue short-term profitability

Source: personal adaptation based on information from RBC Global Asset Management (2019), What ESG is, and isn't. Breaking down responsible investing, Canada, p. 2, article available at https://www.rbcgam.com/documents/en/articles/what-esg-is-and-isnt.pdf, accessed online on 1.03.2021

As a result, the sphere of ESG indicators is gaining ground on the financial markets, evolving and developing as a complementary segment of the classic financial information.

Thus, all the more so, the analysis of empirical data revealed a positive financial impact, reflected by increased profitability, reduced risks, reduced capital costs, improved operational performance and, implicitly, a better return on stock prices over the medium term and long in the case of companies where the ESG criteria have been implemented.

Reference in this direction is the study conducted in 2012 "The impact of corporate sustainability on organizational processes and performance" for which the authors George Serafeim, Bob Eccles and Ioannis Ioannou compared the results recorded in 1993-2009 by 180 American companies, divided into two categories: companies that have adopted and implemented sustainable development policies (High Sustainability companies) and companies not interested in their sustainable development (Low Sustainability companies).

Similar results have been reflected in numerous subsequent scientific studies, such as "Industrial changes in corporate sustainability performance - an empirical overview using data envelopement analysis[9]" or "Foundations of ESG Investing: How ESG Affects Equity Valuation, Risk, and Performance[10]", but also within studies and recommendations of some globally prestigious companies activating in the investments evaluations and consulting field - MSCI, Morgan Stanley Institute for Sustainable Investing, Moody's, BlackRock, etc.

For example, BlackRock, Inc., an American multinational investment management corporation, one of the world's largest asset managers, states that between January 1 and April 30, 2020, 88% of the sustainable funds in their analysis exceeded unsustainable counterparts.

Also, for 2020, the Morgan Stanley Institute for Sustainable Investing reported a higher performance of sustainable investments compared to traditional ones

[8] Georg Kell (11 July 2018), *The Remarkable Rise Of ESG Investing*, available article at http://www.georgkell.com/opinions/https/wwwforbescom/sites/georgkell/2018/07/11/the-remarkable-rise-of-esg/3dd3f3501695, accessed online on 18.04.2021.

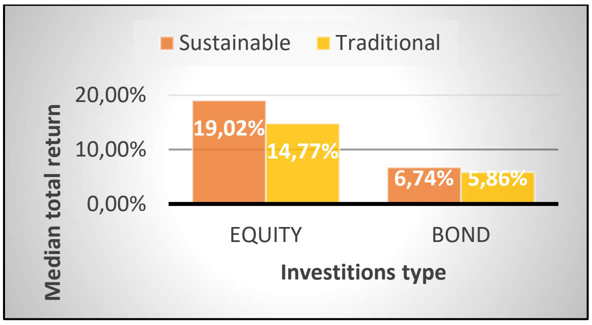
[9] Chang Dong-Shang, Kuo Li-Chin Regina, Chen Yi-Tui (2013), *Industrial changes in corporate sustainability performance – an empirical overview using data envelopment analysis*, Journal of Cleaner Production, Volume 56, pp.147-155.

[10] Guido Giese, Linda-Eling Lee, Dimitris Melas, Zoltán Nagy, Laura Nishikawa (2019), *Foundations of ESG Investing: How ESG Affects Equity Valuation, Risk, and Performance*, The Journal of Portfolio Management, volume 45, number 5, pp 1-14.

from a median total return perspective (chart no. 1), and Moody's stated in February 2021 that “2020 marked a year for the performance of ESG investments” and that “Thematic investments in environment, social and governance (ESG) have become one of the best performing categories of investment in recent years, paving the way for the continued growth of this strategy.”.[11]

Therefore, the evolution of the financial results in the context of the COVID pandemic brought an additional proof of the superior resilience of the investments built on the principles of sustainable development.

Chart no.1. Sustainable vs traditional investments - median total return in 2020



Source: personal adaptation based on information available at https://www.morganstanley.com/ideas/esg-funds-outperform-peers-coronavirus, accessed online on 12.03.2021

All these results support the importance of integrating the ESG criteria together with the financial evaluations, within the reference criteria for designing the business strategies and to analyze businesses, respectively investment opportunities, regardless of the activity sector.

2.3. Reporting the degree of implementation of ESG indicators

Given that ESG factors play an important role in a company's ability to create value by identifying and correcting non-financial issues that may impact the organization's financial results, there has been a growing interest in gaining access to such information by default, the ESG reporting request. The diversity of reporting models and tools, the difficult access to the information presented subjectively and fragmented revealed the need to develop and apply standardized ESG reports.

Several evaluation systems are currently used: GRI standards, Stakeholder Capitalism Metrics of the World Economic Forum, Moody’s Sustanalytics which calculates ESG ratings for both companies and countries, MSCI ESG Indexes, Standard & Poor’s ESG Evaluation.

The first steps towards building a business sustainability reporting guide were taken by GRI in 2000, but limited to environmental factors. Gradually, the GRI guide was extended, completed and improved, being included together with environmental factors and economic, social and governance factors, so that in 2016 the first global standards for sustainability reporting will be formulated. Today, over 80% of the world's major corporations use GRI standards.[12]

Given that investors' interest in ESG information is growing, the ESG information market has evolved, matured continuously, but currently, the diversity of evaluation methods and the selective and optional nature of the reported information generate disputes and difficulties in comparing scores.

As a result, companies and international institutions such as the World Economic Forum, the Global Reporting Initiative (GRI), the US Council on Sustainable Accounting Standards (SASB), the International Federation of Accountants (IFAC) aim to develop standardized sustainability reporting standards. but with ESG factors adapted to each sector of activity.

In this context, the political environment is also emerging as an important actor, with a decisive role in creating a favorable framework, built on global rules and principles that regulate, stimulate and harmonize the practices of monitoring and reporting the sustainability of organizations' activities. sustainability to go beyond formalities and become, along with financial reporting, a relevant source of information, generally accepted and a decision-making criterion for investors.

For example, the rules of the 2014/9 /EU Non-Financial Reporting Directive - NFRD (a supplement to Directive 2013/34 / EU) currently apply at EU level, and the European Commission announced in April 2021 its intention to it imposes additional reporting requirements compared to the rules in force and to extend the scope (by different standards for large companies and SMEs) so that, in the long run, sustainability reporting becomes comparable to financial reporting[13].

Today, thousands of professionals around the world hold the position of ESG analyst, and the sustainability teams of large companies and evaluation institutions also include professionals in accounting and finance[14]. Consequently, ESG reporting is gradually affecting the accounting profession as well.

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[11] https://www.forbes.com/sites/joanmichelson2/2021/03/16/esg-investing-is-a-star-women-are-why/?sh=24ed98104bde#16163357088804&{"sender":"offer-0-Pd0MW","displayMode":"inline","recipient":"opener","event":"resize","params":{"height":293,"iframeId":"offer-0-Pd0MW"}}, accessed online on 18.04.2021.

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2.4. Romania from the perspective of implementing ESG factors

Romania, as a member state of the European Union, took the first steps for harmonization with the European regulations by enforcing the Order no. 1938/2016, amended and supplemented by Order no. 3456/2018. If in the initial version only the institutions of public interest with over 500 employees were targeted, Order 3456 extends the area of applicability, eliminating the condition regarding the public interest institutions. Thus, according to Article 7, starting with the financial year 2019 "Entities which, at the balance sheet date, exceed the criterion of having an average number of 500 employees during the financial year shall include in the administrators' report a non-financial statement containing, as far as they are necessary to understand development, performance and position of the entity and the impact of its work, information on at least environmental, social and personnel issues, respect for human rights, the fight against corruption and bribery, including".

Thus, if approximately 180 entities were initially targeted, after the addition, more than 1000 entities are targeted, especially since, although not directly, the regulation on sustainability reporting also indirectly targets collaborating companies (suppliers, subcontractors) because, the wording a non-financial statement also involves non-financial data provided by them. As a result, these companies will also have to implement a process of tracking and reporting non-financial performance[15] but, although at first glance it may be perceived as an additional burden for taxpayers, previous experiences have shown a positive impact on the long-term financial results of organizations, but also on society, the environment and the national economy.

3. Conclusions

Sustainability must be the core of successful[16] investment since sustainable and responsible investment brings together traditional financial values and environmental, social and governance factors, allowing their promoters to express their own values and preferences from an ethical and moral business perspective, without negatively affecting the profitability of their investments.

Although ESG investments are currently analyzed and measured mainly from the perspective of capital markets, their expansion as a generalized business practice, regardless of the field of activity and scope, must become a desideratum for all actors of national economies. This is because the holistic tracing of ESG criteria in business strategies, through their multistakeholder approach, has proved useful and effective not only for the entities that have implemented them, but also for the evolution of financial markets, of host economies in general.

ESG investments therefore aim to optimize financial results, but also the current impact and the legacy left to future generations.

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