The Transition of Corporate Social Responsibility to Environmental, Social, and Governance

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Please cite this paper as:
Gole, I., Francu, L.G., Balu, O. and Balu, P.E., 2021. The Transition of Corporate Social Responsibility to Environmental, Social, and Governance. In: R. Pamfilie, V. Dinu, L. Tăchiciu, D. Pleșea, C. Vasiliu eds. 2021. *7th BASIQ International Conference on New Trends in Sustainable Business and Consumption.* Foggia, Italy, 3-5 June 2021. Bucharest: ASE, pp. 52-58 DOI: 10.24818/BASIQ/2021/07/006

Abstract

From a certain time, the concept of Environmental, Social and Governance - ESG is frequently used, a situation that somehow put in shadow the existence of Corporate Social Responsibility (CSR). The purpose of this paper is to see what are the differences and similarities between these two concepts. Using comparative analysis and different databases we showed that CSR is rather a tool of reporting long time used to express publicly that companies ethically conduct their business. Basically, it means how companies are taking into consideration their social, economic, and environmental impact and human rights. In the last years, investors became more and more attentive to environmental aspects and they want to place their money in companies that share the same values. That is why ESG arrived on the market as a new instrument for investors and in this paper we want also to see what is different and what the amplitude of this concept is. We demonstrated that providing capital for ESG founds is today perceived as being primarily conditioned by understanding a company's purpose, strategy, and management quality. The originality but also the practical value is coming from the comparative analyses of the two tools that allow investors, from international institutions to simple individuals, to pursue their investment goals but not at any costs; they want to evaluate corporate behavior and to determine the future financial performance of companies. Nothing is for granted, all financial investments embedded an element of risk and consequently, the value of the investment and the benefit from it will vary.

Keywords

CSR, ESG, sustainable investments, responsibility.

DOI: 10.24818/BASIQ/2021/07/006

Introduction and status of knowledge in the field

The first signs of CSR appeared in the U.S. in the 1970s, when first the concept of the "social contract" between business and society was used by a governmental committee. This social contract was built under the idea that business functions because of public acceptance and so, somehow the business leaders have a moral obligation to constructively serve the needs of society. During the time the idea was transformed into a duty from the producer side, to bring more benefits to society than just offering its products for selling.

In the beginning, the so-called "social contract" included three main obligations:

1) Running well a business will succeed in providing jobs and economic growth;

2) Managing always fairly a business by thinking to employees and customers;

3) Be positively and honestly involved in improving the conditions of the community and environment in which it operates.

By the end of 2000, CSR had become an important strategic tool for many companies and they incorporated the concept into the business process, from the low level till multi-million dollar companies, such as Pepsi, Coca-Cola, Walt Disney, and Pfizer. There are many interpretations about if CSR is improving company performance or a better CSR is helping a business to maintain on the market (Crifo and Forget, 2015).

Since then, many of the big companies adapted the CSR mechanism to their own business and therefore each CSR chart may look different from one enterprise to another. Generally speaking, a basic CSR representation includes at least three P areas (planet, profit, people) where Profit represents the economy and all the other indicators related to business, Planet represents the efforts that the company is doing in term of environment, ecology, and sustainability and People stands for social activities, human rights, welfare, etc.

Of course, these areas are intertwined, many activities being attributed to two Ps or even to all three. As we said, other companies decided to put more weight into different areas. Newman and all explained that western markets are inclined to do more business with companies engaged in CSR activities.

The problem with the CSR approach is that letting the liberty of companies to decide which type of CSR wants to present and what areas, letting the enterprise to decide what corporate responsibility is. The problem consists also in the difference between CSR reporting and commitment (del Mar Miras-Rodríguez, et al., 2020).

This is also happening because, at the end of the day, it was never established in a set of clear principles what it means to be a responsible business and what are the indicators to report or the goals to overcome in order to be publicly accepted as being a real CSR company. Corporate social responsibility is whatever companies want it to be or how they want to be perceived by external people. We will not be going into details but there are plenty of companies which are presenting themselves as being champions of CSR but in the reality, they were largely different or even the opposite.

Still, some researcher (Hill, 2020) found out that there are valuable theories and empirical evidences that prove the effectiveness of ESG especially in investment by various vehicles.

Research methodology

In order to see what are the main differences but also the similarities between CSR and ESG, as research methodology we will be using as methods the comparative analysis and information from different databases and from a questionnaire-based survey.

End of CSR, beginning of ESG

From a different point of view, labels such as “bio”, “organic” or “fair-trade” for food are also common for customers but they represent something more than a CSR report because to have such a stamp on a product, is usually strictly regulated by government law. On the contrary, a large variety of definitions and CSR reports make the people skeptical, although some companies were totally honest and did all the efforts to contribute to better relations with the people, planet, and the investors. These uncertainties, combined with steady market growth in sustainable investment products triggered by the new investors’ willingness to place their money in a healthy business, had pushed the financial authorities to tighten their regulations on sustainable investing. This is the reason we are speaking today about ESG (environment, social, and governance).

It is very important that investors understood that sustainable investing is more about placing money in economic progress, and companies dealing with an environmental problem could be a challenge that

will allow them later on to grow. It is the right time to promote doing business in a different but better way and create the knowledge and energy that will inspire more people to choose how to do business in a clean environment and better future. Stakeholder engagement is probably the only way to intensify both business environmental policy and sustainable development (Campanella, et al., 2020).

That is why, by a mix of different approaches as a traditional investment, environmental, social and governance (ESG), a variety of investors coming from different global financial institutions to individuals are taking the responsibility of considering the sustainable approach a real method in achieving their objectives.

Worldwide, the amounts of assets related to sustainable investing strategies have increase in logarithmic pace, and this is only the beginning since there is no sign of slowing down. Of course, the situation after the pandemic it remains to be seen but there are signs that knighting changed.

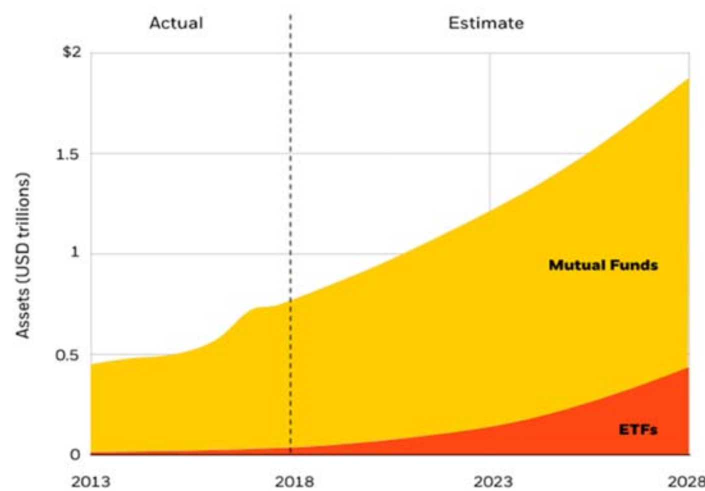

Figure no. 1. Investment value in ESG mutual funds and ETFs
Source: BlackRock, with data from Broadridge/Simfund, June 2018.

In the chart above, according to data from BlackRock with data from *Broadridge/Simfund,* we can see the total value of assets under management in ESG mutual funds (MFs) and ETF (exchange-traded funds) worldwide. From the graphic, we could realize the amplitude that ESG investing is growing.

But let’s first see what an ESG fund is. It is, first of all, a portfolio of equities or bonds (or a mix of both) that have in their ADN environment, social, and governance factors; in other words, those equities and bonds which are part of the fund have already passed serious tests concerning the sustainability of the company regarding to its ESG standards.

An ESG fund should be composed only of securities with a top sustainability classification and definitely would exclude companies that would have low classification on environment pollution, social conflicts, or management practices. The same standards should be applied by governments when they make decisions to invest money or help a company. Using this type of assessment before investing will at least lead to better analysis and ultimately to a fundamental decision.

This also may be the reason why sustainability funds are having better results than non-sustainable ones. For example, a company with low carbon emissions certified standard will be confronted with the low regulatory, environmental, or societal risks than a real and recognized polluter (e.g. a mining company). If we consider the predictability of the shares over time is clear that the low carbon footprint company will have an advantage for investors.

ESG became with the time a fashionable investment because it is good marketing to be seen as a contributor in saving the environment by fighting against global warming, contributing to human right

development in complicated countries, having guided by best governance principle; and all this by not even compromising the financial returns.

As we already said the investors consider an extremely large range of range of data to understand if a company is based on environmental, social, and governance criteria. Despite the regulatory requirements, the issue of transparency is still important (McBrayer, 2018). The first set to analyze is the environmental criteria which may include:

- Source of energy used;
- Waste and recycling;
- Pollution (air, water, land but could also be noise, heat, light or specific to plastic or radioactive materials);
- Natural resource conservation strategies, procedures, and policies;
- Treatment of animals (worthless to mention these days how many zoonotic diseases - appears because of how humans treat animals and what could be the consequences – Covid-19 being one of the viruses that passed from animals to human).

The criteria we mentioned above are undoubtedly part of an evaluation of the environmental risks of every company, but the problem is how they might deal with them and what the strategy to face them is. The analyses could go in other different areas as ownership of contaminated land, the management of hazardous waste, how to deal with toxic emissions, or what are the companies' possibilities to comply with government environmental regulations and what the lobby possibilities are (Choi, et al., 2020).

Social criteria are another set of indicators to be taken into consideration and this because it involves a company's business relationships, such as:

- Are they work downward or upward of the chain of suppliers with companies that share the same values as they pretend to defend?
- Are there a willing or facts regarding donations a part of the profit, to local charities or other social causes?
- Is the safe and health of own employees an important issue for the company?
- Are the working conditions taken seriously by the company?
- The employees are encouraged to volunteer in different activates to help the local community?
- Are the other stakeholder's interests considered from a social point of view?

In what concerns the governance area it is obvious that the investors want to know:

- if a company uses accurate, standardized, and transparent accounting methods;
- if they report real data;
- if stockholders are granted with the opportunity to vote on important issues;
- if the company avoid conflict of interest between board members;
- if use methods to gain favourable treatment (political contributions, conspiracy, etc.);
- if engage in illegal practices to gain unfair advantages (corruption).

It is very important for investors to have all data to do an in-depth analysis to decide what is most important to them, because not all the companies may correctly have answers to every question from what was mentioned.

It exists today many possibilities to assess a company's performance with ESG metrics that are comparable across thousands of enterprises. The difficulties consist not only in analysing correctly the

data but also in collecting them properly during years, to develop proprietary investment strategies. There are few important players on the market; among them we could mention MSCI, Vigeo Eiris, Sustainalytics, and RobecoSAM who are proposing methods of assessments. Unfortunately, each has its own way of seeing the business, own method of calculating, and consequently the results could vary from different reasons (Dimson and all, 2020). Even though the final conclusion cannot be completely contradictory still, the conclusion for investors could be quite unclear so their decision of investing in ESG companies might be postponed or even disrupted.

As we said, one of the ESG analysts is MSCI ESG Metric who creates a specific tool in order to assess the company results and activity, a set of specific indicators grouped in 8 branches. The main directions of assessments and few of the indicators are presented as follows:

- Climate change KPIs - geographic exposure to carbon regulation; geographic exposure to climate vulnerable region; reliance on carbon-intensive supply chain.
- Natural capital KPIs - business exposure to operations with land or ecosystem disturbance; geographic exposure to fragile ecosystems; geographic exposure to water stressed regions.
- Pollution and waste KPIs - business exposure to operations producing high levels of packaging waste; business exposure to operations producing high levels of toxic emissions and waste.
- Environmental opportunities KPIs - alternative energy products and services, energy efficiency products and services, sustainable water products and services.
- Human Capital KPIs - geographic exposure to poor workplace safety standards, reliance on highly-skilled workforce, business exposure to labour-intensive operations.
- Product liability KPIs - geographic exposure to chemical safety regulations, exposure to business prone to data breaches or handles high volumes of customer data.
- Stakeholder Opposition KPIs **-** social impacts on communities' controversies, social impacts of raw materials controversies, human rights concerns controversies.
- Corporate behaviour KPIs - geographic exposure to corruption and instability, Business exposure to operations commonly associated with corrupt practices.

Source: MSCI ESG METRICS.

It is clear that the better is the score obtained after a SGE assessment the higher is probability for the business to continue its activity on long-term, to become involved in the development of research and innovation sectors, to base its decisions in strategic thinking and more important to have in mind the ultimate objective of long-term value creation and sustainability. Of course, such analyses could be used not only externally by new investors but also internally, by the management, in order to realign in accordance with stakeholders willing.

On the other side, when we look at the data regarding the performance of ESG during the last years, we cannot say that the pieces of evidences are so clear.

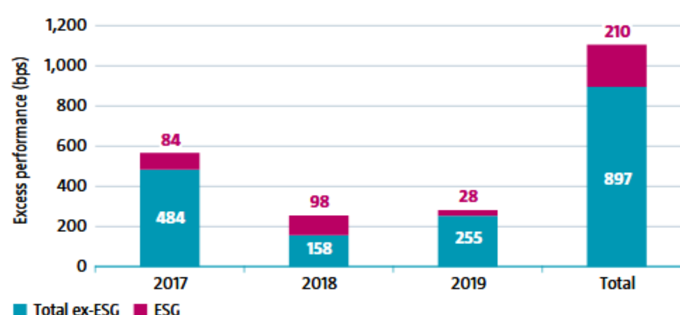

Figure no. 2 ESG performance

Source: RobecoSAM

Taking into consideration all the principles or criteria stated above, it is still difficult to measure the effect of ESG integration on the performance of a fund or portfolio. This is happening mainly because the portfolio decisions are based not only on a set of principles but rather on a completely integrated analysis. According to Sustainable Global Stars Equity, 20 % of the outperformance, during the 2017-2019 time periods, is the result of sustainability investments.

The main findings

In this paper, we tried to explain what the main differences between CSR and ESG are but the reality is, despite the divergence, that both concepts are suffering from alignment. In a way, CSR overshadows the credibility and performance of the ESG; as a consequence, even the entire transition to a sustainable business model is questionable. For example, Edelman's Trust Barometer in 2017, discovered that only 37% from the 33,000 people who answered to a survey (people coming from 28 countries, between the ages of 25–64, found in the upper quartile of household income for their age in their country), have trust in a company's CEO.

Maybe part of mistrust is justified and there is ground for it but much can be adjusted by an imposing of a clear set of indicators and an honest reporting system about the company strategy.

As a solution for the lack of synergy between CSR and ESG, during the last time, many companies (almost 85% from S & P 500) have started to publish both reports (CSR and ESG). It is appreciable that companies decided to publish more data and be transparent about their intentions and facts in sensitive areas as sustainability, social responsibility, etc. but at the same time, it is also clear that not all of them have the resources and knowledge to create valuable reports. The whole responsibility is put under the CSR team and sometimes not all data are transmitted or incorporated in the final report, a fact that may generate not only confusion but misunderstandings.

There are two main ideas from which the problems may arrive:

- CSR and ESG reports address to different stakeholders, internal and external;
- While ESG reports are created with support from the business units, based on quantitative data, with a concise style, CSR reports are rather concentrated on qualitative data, pictures and videos, storytelling style.

Conclusion

Therefore we believe that companies should work more in creating aligned reports, otherwise the general impression might be perceived as a lack of management or strategy. Although CSR and ESG have a lot in common they are quite different but necessary tools for stakeholders. Both instruments could be used together because are addressing different perspectives. We are living times when tons of information is available, from what the company is willing to share to NGOs reveals, internet, social media content (from traditional news reporting to blogs, vlogs, etc.) so there are plenty of opportunities for ESG analysts to get data and create relevant rankings. Our conviction is that with the help of machine learning technology all information should be confronted with a standard and all scores should be easily comparable. Otherwise the risk of transforming ESG into a new CSR tool is quite big.

The ESG approach represents a tool that could help companies seeking to do the right thing rather than thing right. Companies have to understand that there is a time of change that has arrived and so a reset of corporate governance is absolutely necessary.

Corporations need to restore public trust, but at the same time, they have to carry on being in line with changing economical perspectives and social expectations. If stakeholders are pushing the shift of business strategy the society is asking from companies, the Board of managers is responsible for the integration of the ESG agenda in all industry sectors and all countries. Undoubtedly, it is a sure path to create long-term sustainable value for shareholders as well as for stakeholders at the same time.

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