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JOURNAL
OF FINANCIAL TRANSFORMATION

GOVERNANCE

Insights into successful ESG
implementation in organizations
ARMANDO CASTRO | MARIA GRADILLAS

ESG

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DEAR READER,

Welcome to edition 56 of the Capco Institute Journal of Financial Transformation, produced in partnership with King's Business School and dedicated to the theme of ESG – environmental, social and governance.

We all recognize that transformation towards a green economic system via sustainable finance is needed, welcome and inevitable. Our clients have a crucial role to play here. Acknowledging the scope and complexity of the evolving ESG landscape, we are perfectly positioned to prepare them for the ESG era.

With climate change accelerating and generating physical events on an unprecedented scale, governments and societies are considering measures to mitigate carbon emissions via net zero initiatives. The focus is firmly on greater sustainability and more equitable policies in response to shifting public attitudes. ESG considerations are reshaping investment risks on the one hand, and opening the way for green financing and sustainable technologies and innovations on the other.

This edition of the Journal examines all three pillars – environmental, social, and governance, highlighting efforts by regulators and practitioners to create a unified approach.

Moving forward, compliance with emerging ESG standards will be a critical differentiator for long-term business success. Data will also play a critical role in delivering the transparency and

insights required to validate the ESG credentials of businesses, and investment strategies. Advances in areas such as machine learning, artificial intelligence and cloud technologies will be key to establishing a future model of sustainable finance.

This edition draws upon the knowledge and experience of world-class experts from both industry and academia, covering a host of ESG topics and innovations including the value of tracking Return on Sustainability Investment (ROSI) and the importance of moving away from purely external risks to addressing issues that can have positive commercial and societal impacts.

I hope that that the research and analysis within this edition will prove valuable for you as you shape your own ESG strategies, policies, and innovation.

Thank you to all our contributors and thank you for reading.

A handwritten signature in black ink, appearing to read 'Lance Levy', with a stylized, flowing script.

Lance Levy, Capco CEO

INSIGHTS INTO SUCCESSFUL ESG IMPLEMENTATION IN ORGANIZATIONS

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ABSTRACT

In a world where organizations are increasingly held accountable for the impact of their operations on the environment and society, ESG reporting and metrics have emerged as the primary paradigm for assessing an organization's sustainability efforts. Yet, it is an area with competing concepts, an ever-expanding set of measures and requirements, and a growing ratings and standards industry. In this article, we discuss how ESG initiatives and measurements can help organizations create value rather than merely being a compliance exercise. First, we emphasize the importance of ESG reporting and ratings for organizations, notwithstanding their limitations. Second, we highlight the need for transparency of the ESG metrics and activities being implemented by organizations and the priority of avoiding greenwashing. Finally, we stress the requirement of senior management involvement and accountability in ESG initiatives that create long-term value.

1. INTRODUCTION

The popularity of the topic “environmental, social, and corporate governance” (ESG) has increased dramatically in the past few years, not just among investors but also among the general public (Figure 1). This trend reflects current societal expectations that organizations need to be held accountable for the environmental and social impact of their business activities and has resulted in the emergence of ESG as the main paradigm through which a company's efforts towards sustainable development are evaluated [MacNeil and Esser (2022)]. Investors particularly, are demanding that organizations disclose specific, measurable, and transparent non-financial ESG metrics that they systematically incorporate into their decision-making [Taylor (2017)]. Moreover, by March 2022, over 4,390 investors managing around U.S.\$121 trillion had adopted the Principles for Responsible Investment (PRI), a United Nations-supported network of investors and financial institutions that work together to implement ESG-related factors in their investment decisions [PRI (2022)].

The growing relevance of ESG-related information for investors is largely due to the recognition that ESG factors present material risks that affect an organization's ability to create long-term value [Edmans (2022)]. Indeed, empirical research supports that organizations with environmental and social policies in place achieve better financial and stock market performance than their counterparts [Eccles et al. (2012)]. What this means for organizations is twofold, first; increasingly, companies are expected to develop ESG strategies to stay competitive, and second; the supply of financial capital is becoming tied to their ESG performance, which investors evaluate both qualitatively and quantitative through ESG reports, metrics, and scores.

This demand on organizations to focus on their ESG performance is an opportunity to move away from a short-term profit-maximization perspective towards a broader, longer-term understanding of value that considers not just economic value but also social and environmental value. However, too much investor pressure and an over-reliance on metrics can

also result in ESG initiatives that are worthless and become a box-ticking exercise [Taylor (2017)]. There are numerous examples of organizations that use their ESG practices as a PR and marketing tool, but there are also encouraging examples of organizations that have embraced this opportunity to integrate ESG challenges into their daily decision-making and operations, creating a unique competitive advantage [Serafeim (2020)].

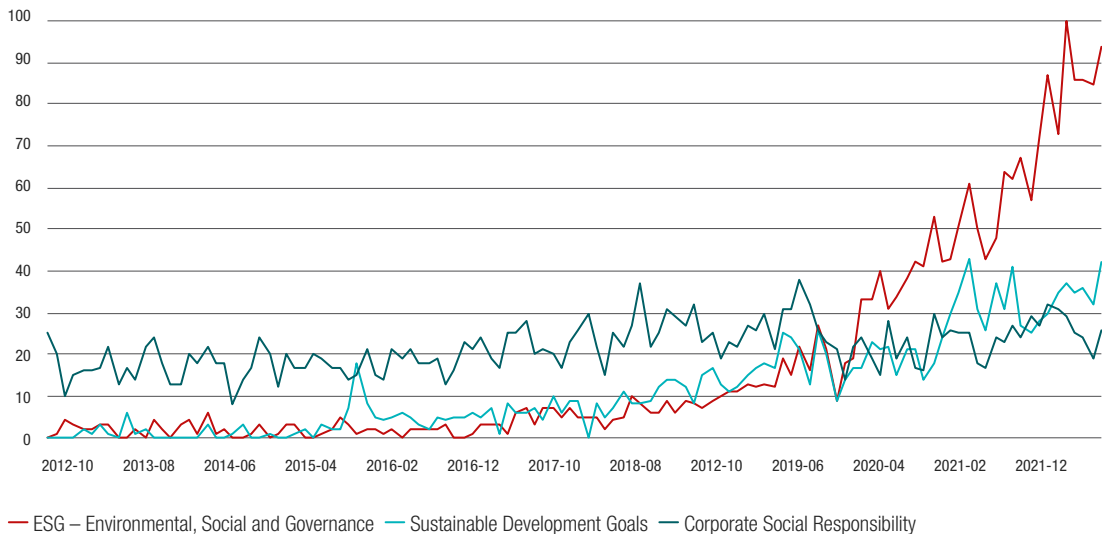
In this article, we start by briefly reviewing the emergence and development of the ESG concept, which is distinct yet related to “corporate social responsibility” (CSR) and sustainable development. Second, we review some of the key measurements and ESG ratings and their providers. This is an increasingly competitive and developing market where many providers have created their own indexes and methodologies to assess the ESG performance of organizations. Finally, we share our thoughts on how ESG can become a value-creation tool for organizations and not just a set of meaningless metrics. In this sense, we highlight the importance of ESG reporting and metrics despite their imperfections, the priority of transparency and staying away from greenwashing, and the need for senior management commitment to implement value creating ESG initiatives that are core to the organization’s activities.

2. EMERGENCE OF ESG

Historically, the social responsibility of organizations has been mostly connected to creating better living conditions for their employees and communities through, for example, funding hospitals, care homes, or orphanages [Chaffee (2017)]. Nonetheless, it was not until the mid-nineteenth century that the obligations of organizations towards society were explicitly defined, leading to the emergence of the concept of corporate social responsibility (CSR), understood as a decision-making process that could be implemented through models and frameworks, and which allowed organizations to consider the impact of their business operations on society [Latapí Agudelo et al. (2019)]. Although the concept of CSR has evolved to incorporate both social and environmental concerns, it has maintained this original connection to social accountability and is ultimately about organizations behaving ethically as they pursue their business goals [MacNeil and Esser (2022)].

Recently, however, and to a great extent driven by the rise in climate change concerns, organizations, governments, and other stakeholders are turning their attention to ESG initiatives and strategies as a more focused and “tangible” alternative to CSR, to evaluate an organization’s contribution to sustainable development¹ and the United Nations Sustainable Development Goals (SDGs) (Figure 2).

Figure 1: Interest in ESG topics over time



Note: The graph shows the great growth of interest in the topic of ESG in Google trends, particularly in the last five years.
Source: <https://bit.ly/3CNbD6W>

¹ We follow the “Brundtland Report” and define sustainable development as “development that meets the needs of the present without compromising the ability of future generations to meet their own needs” [U.N. (1987)].

The concept of ESG emerged in the 1990s as a response to investor pressures to understand the exposure of their portfolios to material risks related to environmental (e.g., carbon emissions), social (e.g., workforce diversity), or governance (e.g., transparency) issues and has a clear finance focus, in contrast to the ethics focus of CSR. The ESG approach or paradigm involves identifying, assessing, and reporting, both qualitatively and quantitatively, risks to an organization’s ability to generate long-term financial returns, which derive from their exposure to environmental, social, and governance issues [MacNeil and Esser (2022)].

Although ESG has a very different focus to CSR, the two concepts are related, as they are both tools or frameworks that organizations can implement to understand how they can contribute to sustainable development. While the implementation of CSR reflects an organization’s commitment to considering and addressing social and environmental challenges, ESG initiatives enable this effort and commitment to be measured and communicated so that external audiences, such as investors, consumers, or regulators, can evaluate them [Daugaard and Ding (2022)]. A key difference between the two approaches is that the ESG model, in which ESG factors are incorporated into investors’ capital allocation decisions, presents a major shift of responsibility from the board of directors to investors in driving organizations’ efforts in addressing major environmental and social challenges [PRI (2016)].

The growing societal concerns around environmental and social issues, and the increased urgency in tackling the SDGs and “grand challenges”, have resulted in the need to measure our progress towards specific environmental and social goals, such as carbon reductions, board diversity, etc. This trend has favored the financial ESG model, which has emerged as the dominant approach worldwide and is reflected in the current plethora of ESG reporting initiatives, metrics, ratings, and regulatory rules [MacNeil and Esser (2022)].

3. ESG REPORTING, METRICS, AND STANDARDS

When organizations start to think about ESG, a central concern is often how to communicate their ESG initiatives and their impact to stakeholders. In this sense, it is important to understand the main ESG reporting initiatives, ratings, and metrics, as well as what is exactly being measured and how. In this section, we analyze some of the current key actors, rating providers, and what they capture.

3.1 Key actors

3.1.1 PRIVATE RATING AGENCIES

Since the ESG market is not yet fully mature, there is no market concentration and a wide variety of ESG indices and measures are being provided by different organizations. Large and well-known ESG providers include companies such as

Figure 2: U.N. Sustainable Development Goals (SDGs)



Source: <https://bit.ly/3MjHIAI>

Sustainalytics and MSCI. Data and media conglomerates such as Thomson Reuters and Bloomberg have also developed their own methodology to calculate ESG ratings. In addition, traditional ratings and index providers such as Fitch, Moody's, and S&P now also provide ESG ratings and indices. This has happened via the expansion of current teams or the acquisition of specialized companies such as RobescoSAM by S&P in November 2019. Finally, although these large companies have moved in, there are still successful specialized ESG ratings companies such asGRESB, which is the most well-known ESG rating provider in the real estate and infrastructure industries.

3.1.2 INTERNATIONAL ORGANIZATIONS AND ESG REPORTING INITIATIVES

Companies interested in adopting more sustainable practices and ESG initiatives do not only rely on ESG rating agencies, "international organizations" have also had a preeminent role in setting standards, frameworks, and guidelines regarding sustainability reporting.

For example, there has been growing relevance and visibility of international events such as the U.N. Climate Change Conference (COP) where governments and companies have actively participated and signed major climate pacts (COP26 – Glasgow Climate Pact). One of the world's largest voluntary corporate sustainability initiatives, Principles for Responsible Investment (PRI), is also supported by the United Nations. Founded in 2005, this initiative is now internationally recognized and has over 7000 corporate signatories in over 135 countries. The Organization for Economic Cooperation and Development (OECD) has also released numerous in-depth assessments and reports on ESG, focusing on themes such as investment practices [Boffo and Patalano (2020)] and metrics [OECD (2022)].

Relevant frameworks and reporting initiatives, including Global Reporting Initiative (GRI) and Sustainability Accounting Standards Board (SASB), have also been successful. It is important to point out that there has been an even larger array of impactful reporting and sustainable standards initiatives regarding climate crises. For example, the Taskforce on Climate-Related Financial Disclosures (TCFD) was created in 2015 and launched at COP21 in Paris focusing on climate-related risk and opportunities and is now mandatory in the U.K. for large businesses. More recently, the International Sustainability Standards Board (ISSB), established at COP26, has been discussing and consulting on global sustainability and climate-related disclosure requirement standards.

3.2 Decomposing the metrics

ESG metrics are varied and rating companies can analyze from 120 to almost 200 key metrics and sub-metrics [Boffo and Patalano (2020)]. Weights and the relative importance of each of the letters also differs, E factors tend to be close to half of the weight for many providers. Consequently, rather than only aggregating all the metrics in a final number or score it is important to understand what is being measured and included in the main ratings at a more micro level. This article will not provide an exhaustive listing of all the metrics but will show how some themes are universal among different providers and how different providers might also choose to add different measures.

3.2.1 ENVIRONMENT

Environment metrics have been developed and refined in the last decades. Several of these metrics have been part of a large movement focusing on environmental sustainability and green movements around the world.

Recently, many companies have announced ambitious plans regarding the reduction of emissions in the next decades or carbon policies for the next few years and decades. These include around a third of the U.K.'s biggest companies (30 of the U.K.'s FTSE100 companies) signing up for the United Nation's Race to Zero campaign in 2021. These campaigns have also included, paradoxically, oil companies such as BP and Shell that have announced an ambition to reduce emissions or even become net zero companies.

Yet, it is still important to try to understand how these statements and commitments are measured. Among the main ESG rating providers, environmental metrics captured include pollution, emissions, waste, and energy efficiency data. Broadly speaking, companies should think about how their activities impact, and how they can measure, air pollution (including greenhouse gas emission), biodiversity or habitat impact, contamination, energy sources/use, water use/impact, waste management procedures, resource efficiency, and materials sourcing and impact.

Even in such an established field, there will be different emphasis placed on different emissions by different agencies, such as Bloomberg's focus on carbon emissions. Ratings can also vary depending on a company's emphasis on waste (disposal/pollution), resource use and depletion, and renewable energy. Other rating agencies will also include investment and development of environmental innovation metrics (i.e., Thomson Reuters) or environmental opportunities

(i.e., MSCI). Nonetheless, nowadays most “E” ratings focus mostly on the disclosure/existence of measurement of environmental targets, objectives, and policies rather than transition frameworks or more innovative investments in climate mitigation and renewable energy [OECD (2022)].

3.2.2 SOCIAL

Social issues are a broad category to measure. Consequently, measuring social factors can lead to an even greater discrepancy among funds’ S scores. Broad topics such as human rights are taken into consideration within this category by different providers [Boffo and Patalano (2020)]. Health and safety measures can refer to the community, supply chain, customers, employees, and contracts. Discrimination and diversity in the workforce are also clear statistics that can be measured. Freedom of association/unionizing has also been included by some ESG rating companies.

Community relations in areas where the companies operate are a clear topic of interest in the measures. They can focus on stakeholder relations, community development, partnership with social enterprises, or even on stakeholder opposition (MSCI).

A broad category of customer satisfaction has been included within the social rating. Some ratings have refined it to product liability or responsibility (Thomson Reuters, MSCI), which are not only related to social issues but also consumer goods legislation.

Topics related to labor standards and working conditions are also measured. Particularly the controls and measures in place in the companies and supply chains regarding illegal practices such as modern-day slavery (compulsory/forced labor) and child labor.

There is an overlap between some of the potential social and governance measures. Many of the measures can take into consideration how companies interact with society but also internal social factors and inequalities within the company.

3.2.3 GOVERNANCE

Governance is a key feature of management. Arguably, it is one of the key sources of competitive advantage for companies and how to design and implement good governance is taught by business schools around the world. Furthermore, corporate social responsibility (CSR) departments are, or have been, included in a variety of organizational structures.

Governance is currently mainly measured by managerial and board level metrics. Board/management measures can include the composition of the board, board-chair independence, executive compensation independence and composition of the compensation committee, and audit committee independence and structure. Operation measures can relate to anticorruption measures, political contribution, data protection and cybersecurity, fiduciary duty, fraud, political contributions, and protection of whistleblowers.

4. DISCUSSION – ORGANIZATIONAL IMPLEMENTATION OF ESG STRATEGIES FOR VALUE CREATION

The emergence of ESG as the leading paradigm to evaluate an organization’s sustainability performance (via the exposure to risks lens) leaves managers facing the challenge of which ESG metrics to implement and how to measure them (point 1). Furthermore, the reliance of the ESG paradigm on metrics and reporting without proper transparency can result in a greenwashing exercise that does not lead to long-term value creation (point 2). Finally, managerial support is needed for a successful ESG strategy leading to value creation (point 3). It is worth mentioning that in the context of ESG, and sustainability in general, a long-term perspective on value is necessary [Flammer and Bansal (2017)] as well as a broad conceptualization of value, where not just economic value is considered but also social and environmental value.

Below, we discuss in a bit more detail what we believe are the important issues that organizations need to consider to derive value from their ESG initiatives.

4.1 ESG metrics are not perfect but necessary

The first challenge an organization will face is the lack of alignment between the different ratings, ESG standards, and ESG reporting initiatives. As explained earlier, different ESG rating agencies measure different things. This has led to some confusion about how ESG metrics are measured and what are the most determinant performance metrics, resulting in some criticisms from the press [Economist (2022)] as well as open confrontation of public business figures, such as Elon Musk questioning the logic of his electric car company, Tesla, being removed from S&P 500 index dedicated to companies excelling at ESG, while major oil companies were still included.

In any rating, there will always be room for discretionary, or ambiguous choices on what parameters should be included and how to weigh them. Hence, it is not only ESG ratings that suffer from such issues. In fact, it is important to remember that even traditional credit ratings of companies with decades of proven performance are still susceptible to error and criticism. For example, well-established traditional rating agencies (Moody's/S&P/Fitch Rating) were very criticized for the ratings they had issued in the run-up to the 2008 financial crisis and ended up paying fines to U.S. federal and state authorities [Freifeld (2017)].

Auditing companies have also not been immune from such criticisms, with Ernst & Young's Wirecard audits and KPMG's failures with Carillion audits receiving international attention [Makortoff (2022)]. However, even though there have been some controversies related to these important companies, auditing companies are still very important developers of metrics used to assess the management of companies and the likelihood of receiving investments. Consequently, it is important to remember that ESG measurements are still a work in progress.

In any case, ESG reporting, metrics, and ratings are important because they allow external audiences (investors, regulators, shareholders, etc.) to form a picture of an organization's current ESG-related practices, the extent to which its operations are exposed to environmental and social risks, and the issues they need to address to improve their ESG performance. Moreover, organizations will find value in comparing their ESG metrics and performance ratings with their peers, within the same industry as well as across industries.

Rather than focusing on one metric, a more sensible approach for organizations is to improve on a wide range of metrics within the E, S, or G framework. This can lead to a broader positive societal impact and less exposure to changes or rebalancing of specific ESG performance ratings.

Governments have been trying to catch up and regulations regarding mandatory ESG reporting and several other initiatives have been discussed in the U.K., Switzerland, the E.U., the U.S., and many other parts of the world. Consequently, there has been an evolution of the value of ESG ratings from simply voluntary standards adopted by some companies following a wide range of measurements, to the diffusion of more established and accepted metrics.

Furthermore, it is expected that ESG ratings will converge, or de facto standards will emerge, as has been the case in the real estate industry, with GRESB's real estate index now being accepted globally as the industry's sustainability standard [Gradillas et al. (2021)]. It is expected that there will be a concentration and consolidation of ESG rating providers and, hence, a clearer consensus of what are the most relevant metrics and standards within each industry, enabling comparison of sustainability performance across organizations in the same industry.

To conclude, ESG reporting initiatives and metrics are not perfect, and they will never be perfect (as any metric), but they are being refined and improved. ESG reporting and metrics are important because they convey relevant ESG information that allows better decision-making for investors, consumers, governments, and regulators. Organizations should, therefore, implement ESG reporting initiatives or standards that best fit their needs despite their limitations. As we have seen in real estate, eventually comparable metrics will emerge so that investors can assess and compare not just the extent to which companies are exposed to ESG-related risks but also the ability of organizations to create long-term value through their ESG strategy.

5. TRANSPARENCY AND STAYING AWAY FROM GREENWASHING ARE A MUST

Companies are facing increased pressures to disclose ESG-related information, both qualitative and quantitative, that allows external audiences to assess their sustainability performance. These pressures are mostly driven by the understanding that ESG factors present material risks that can affect an organization's ability to generate financial returns [Sharma and Aragon-Correa (2005)]. However, as mentioned earlier, it is not just investors, but also governments, regulators, consumers, and society in general, that are demanding access to ESG information to make better decisions and choices. It is, therefore, tempting for organizations to engage in ESG initiatives as a marketing or PR exercise, and this is indeed the case for many companies. Nonetheless, investors and other stakeholders are becoming increasingly sophisticated at identifying worthless ESG activities, which are being discounted as greenwashing. For example, the efforts of McDonald's to be perceived as supporting diversity by increasing the number of women and minorities in senior roles were thwarted by a discrimination suit in the U.S. by black franchisees who claimed to have been treated less favorably than white franchise owners [Taylor (2017)].

Organizations are increasingly being scrutinized for their ESG initiatives and those perceived as greenwashing face severe credibility and reputation damage. Furthermore, greenwashing has moved from only a reputational concern to investigations and legal sanctions in certain countries (i.e., France) and in some industries (financial). Managers, particularly directors, with their fiduciary duties must be aware of these risks and engage in coherent ESG initiatives that avoid greenwashing. For instance, ESG metrics should not be regarded as balancing themselves out, so that increasing the diversity of staff, for example, does not give leeway for an organization to pollute more without impacting their overall ESG performance. The risk of being perceived as engaging in greenwashing activities can to some extent be addressed with transparency.

Transparency in ESG should truly reflect an organization's long-term commitment to considering the environmental and social impact of its business activities. In this sense, organizations should focus on not just explaining how they address the negative externalities caused by their operations, such as reducing their carbon emissions, but also on explaining their efforts to create a positive environmental or social impact; for instance, by promoting inclusiveness through designing clothes for people with disabilities. In addition, when considering disclosing ESG information, companies are also encouraged to be transparent in relation to their failures. Natura, for example, a Brazilian cosmetics company, clearly communicates its sustainability targets in its integrated annual report, as well as its progress towards those targets whether that progress has been positive or not. Natura believed that this honest, open approach was important to developing a dialogue with its stakeholders [Eccles et al. (2012)].

Beyond reputation and credibility, transparency in ESG also has obvious financial implications. First, a company's ESG disclosure and performance will impact its ability to raise capital in the financial markets as well as the price at which it is able to raise money [Clarkson et al. (2008)]. Second, the valuation of companies without adequate ESG reporting activities will be discounted as regulation in this area increases [Serafeim (2020)]. Indeed, governments have been increasing the need for mandatory ESG reporting and several initiatives have been discussed, such as the SEC's proposals on climate disclosures and the European Sustainability Reporting Standards (ESRS). ESG reporting is, therefore, moving from a simple set of voluntary initiatives adopted by companies for a different range of ethical or commercial motivations to legal

requirements to do so. Larger companies, such as those listed on stock exchanges, might already disclose their sustainability performance and strategies [Gallo and Christensen (2011)] due to shareholder and regulatory pressures, however, small and medium-sized organizations (SMEs) should also be focusing on making sure they can transparently disclose their ESG commitments, impacts, and initiatives.

To conclude, transparency in ESG information that truly reflects an organization's long-term commitment to considering the environmental and social impact of its business activities has become imperative. Cosmetic fixes can easily be considered greenwashing, which, beyond being unethical and having reputational damages, is increasingly being considered illegal. Honest ESG goals, policies, and initiatives need to be transparently shared with internal and external stakeholders, so they understand how the organization is considering and addressing their ESG challenges.

6. MEANINGFUL ESG INITIATIVES REQUIRE SENIOR MANAGEMENT COMMITMENT AND ACCOUNTABILITY

Currently, most medium and large organizations have a person or a team responsible for sustainability and ESG initiatives. Many of these positions or teams were initially created and included within the organigram of companies with the growth in the popularity of CSR in the 1970s [Latapi Agudelo et al. (2019)]. However, these teams are often isolated from the rest of the organization and have limited budgets and power, which may result in ESG initiatives that lack the relevance to provide benefits to the organization [Taylor (2017)]. For instance, they may release a sustainability report or improve the organization's ESG disclosure, both of which have limited impact. Nonetheless, achieving long-term value creation through ESG initiatives that are core to the organization's activities involves strategic decisions that cannot be made by a sustainability team and require the attention of the CEO and senior management [Serafeim (2020)]. Senior management can, therefore, lead the initial push so that sustainability becomes a horizontal function that affects the whole organization. From an initial top-down initiative from senior executives, the ESG values and initiatives can then be shared across the company at different organizational and seniority levels. This is essential to drive the organizational changes necessary to fully embed ESG values within the governance of the whole company.

Furthermore, to create value, an organization's ESG initiatives need to be part of a long-term strategy that is aligned and coherent with the company's vision, identity, and core activities. There are very few organizations that systematically incorporate environmental, social, and governance factors into their daily decision-making. For most organizations, meaningful ESG initiatives that create financial, as well as social and environmental value, involve continued organizational changes that require the power of senior management to be implemented [Eccles et al. (2020)]. For example, the outdoor clothing company Patagonia's unique approach and commitment to fighting climate change come directly from the founder's vision and leadership.

A way to align and foster ESG commitments of c-suite executives is to have members that have either had experience as sustainability officers or have this objective in parallel to their current and traditional managerial roles. These senior executives could influence the strategic decisions of the companies, without compartmentalizing them. Companies of different sectors have started trying it, such as Tyson Foods, where the executive vice president of corporate strategy was also a former chief sustainability officer and managed the company venture fund [Serafeim (2020)].

Another recent trend that has received considerable media attention recently is linking senior management pay to ESG metrics, to both incentivize and make senior management accountable for the organization's ESG goals. Theoretically, if ESG metrics are relevant for long-term value, then tying pay to long-term value should be sufficient to encourage executives to bolster them [Flammer and Bansal (2017)]. Yet, some nudging for change might still be needed since some senior executives might want to focus on traditional managerial practices and performance metrics. Hence, in recent years, a number of activist funds have pushed companies to tie senior leadership compensation to ESG metrics [Hill (2021)] as a way to speed up adoption. In fact, there have been some developments in this regard, with 58 percent of FTSE 100 companies in the U.K. having included an ESG measure within their executive incentive plans by 2021 [PWC (2021)]. This has also led to a positive public relations boost for companies that adopt this practice.

This approach, as with most things ESG, has not been free from critics [Edmans (2022)], with some suggesting that including ESG metrics within executive compensation packages might incentivize CEOs to focus only on the ESG metrics in their

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contract, and not all value drivers. However, it is important to remember that similar arguments were made when other pay metrics were included in senior executive packages, such as stock options.

To conclude, ESG should not be viewed through the compliance prism; instead, companies should focus on how ESG factors could be integrated into the core activities of the company. A long-term ESG strategy that creates value for the company is likely to require strategic choices and organizational changes that can only be achieved with the full support and commitment of senior management. In this sense, it is important to have processes and structures in place that make senior management accountable for the achievement of the organization's ESG goals.

7. CONCLUSION

Organizations are increasingly expected to disclose ESG information and metrics, and their ESG performance is being continuously evaluated through a plethora of ESG ratings that often measure different things and are not necessarily aligned. With the growth of the implementation of ESG initiatives by companies and the likelihood of more regulation in the coming years, many companies know that they cannot just stay still and wait. In fact, some managers have already been exploring how companies can gain competitive advantages from, for example, environmental policies for decades. In more strictly regulated industries, such as investment funds, the incentive to implement voluntary environmental efforts may be stronger in anticipation of more strict regulatory norms in the future.

While transparency and ESG disclosures are crucial for facilitating better decision-making by investors, consumers, governments, regulators, and other stakeholders, an over-reliance on metrics can result in organizations engaging in a superficial compliance exercise with limited impact. Some companies might be tempted to exclusively focus on achieving high ESG ratings as opposed to having a long-term ESG strategy. However, this is very risky since these ratings are in constant flux, and more importantly, ESG initiatives should not be aimed at scoring points but at becoming a more sustainable company.

Finally, organizations should develop transparent ESG reporting practices that include clear ESG goals, and their failures as well as their successes. ESG initiatives need to focus on activities that are core to the company and be integrated into a company's long-term strategy. Creating value through ESG initiatives will most likely require strategic choices and organizational changes that cannot take place without senior management commitment and accountability.

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