Responsible Leadership and Sustainable Management

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Implementing Environmental, Social and Governance (ESG) Principles for Sustainable Businesses

A Practical Guide in Sustainability Management

Springer

Responsible Leadership and Sustainable Management

This series aims to transform organizations into a more future-fit version by bringing forth latest perspectives from cross cultural and interdisciplinary learning, management and administrative paradigm. It will not only showcase systemic outlooks on how new institutions (public and private), organizations, and/or businesses look like, but also foray into specific key areas to comprehensively reveal their challenges and propose solutions.

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Preface

In recent decades, the world has undergone significant transformations, including increased globalization of economies, widespread adoption of digital technologies and the rising influence of social media. Those changes have led to a fast-increasing demand for effective and transparent communication of responsible business practices in context of environmental, social and governance (ESG) performance.

As a result, companies are confronted with critical ESG-related risks, such as climate change impact, fair labour practices, and data protection. Neglecting stakeholder expectations can trigger public backlashes that can damage the corporate reputation and financial performance in the long term. Due to the growing demand on ESG reporting, the complexity and costs for adequate processes of data collection, analysis, reporting in accordance with third-party ESG reporting frameworks and stakeholder communication, the comprehensive tasks are often a challenge in business practice, especially for small- and medium-sized enterprises (SMEs) with limited financial resources.

The book *How to ESG: Implementation of Environmental, Social and Governance (ESG) Principle in Business Practice - A Practical Guide in Sustainability Management* offers a unique blend of theoretical research and real-world business practice for ethical management. This approach makes this book valuable for both teaching professionals and students in higher educational institutions, and the business practitioners.

The book delves into key theories, providing a thorough understanding of various perspectives of business ethics, including Environmental Social Governance (ESG) principles, Corporate Social Responsibility (CSR), the concept of Sustainability and the operationalization of sustainability management. It illustrates how ethical management can be integrated into overall business strategies and explores the relationship between value creation and ethical management, supported by presentation of pertinent theoretical frameworks and numerous examples from business practices that aid comprehension and encourage practical application.

Written by a diverse team comprising experienced academics, business executives and a young activist, the book aims to help the readers to grasp the fundamental theories of ethical management and guide business practitioners in establishing long-term, sustainable value chains with national or international partners.

Finally, the authors would like to thank the Springer team for the friendly and competent assistance for the publication of this book.

Berlin, Germany
September, 2023

Tracy Dathe
René Dathe
Isabel Dathe
Marc Helmold

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List of Acronyms and Abbreviations

AMWG	Asset Management Working Group
AWS	Alliance for Water Stewardship
BG Verkehr	Berufsgenossenschaft für Transport und Verkehrswirtschaft, the Employers’ Liability Insurance Association for Transport and Traffic in Germany
BIPOC	Black, indigenous and people of colours
BSC	Balanced Scorecard
BSI	British Standards Institution
CAPA	Corrective and Preventive Action
CC	Corporate Citizenship
CDP	Carbon Disclosure Project
GRI	Global Reporting Initiative
CDSB	Climate Disclosure Standards Board
COE	Centre of Excellence
COP	Conference of the Parties
CRA	Credit Rating Agency
CRM	cause-related marketing
CSR	Corporate Social Responsibility
CSRC	China Securities and Regulatory Committee
CSRD	Corporate Sustainability Reporting Directive by the European Union
CSV	creating shared value
D&I	Diversity and Inclusion
DEI	Diversity, Equity and Inclusion
EC	European Commission
EFRAG	European Financial Reporting Advisory Group
EPA	Environmental Protection Agency
ERG	Employee Resource Groups
ERP	Enterprise Resource Planning
ESG	Environmental, Social and Governance
ESRS	European Sustainability Reporting Standards
ETF	exchange-traded fund
ETS	emissions trading systems
EU	European Union

EV	electrical vehicles
FSB	Financial Stability Board
FT	Fair Trade
FTSE	Fair Trade Social Enterprise
GDPR	European Union's General Data Protection Regulation
GHG	greenhouse gases
GRESB	Global Real Estate Sustainability Benchmark
GRI	Global Reporting Initiative
HR	human resources
IASB	International Accounting Standards Board
IASCF	International Accounting Standards Committee Foundation
IFRS	International Financial Reporting Standards
IFRSF	International Financial Reporting Standards Foundation
IIRC	International Integrated Reporting Council
IISD	International Institute for Sustainable Development
IOSCO	International Organization of Securities Commission
IPE	China's Institute of Public and Environmental Affairs
ISSB	International Sustainability Standards Board
KPI	key performance indicator
KQI	key quality indicator
LCA	lifecycle assessment
LCM	life cycle management
LTI	long-term incentives
M&A	merger and acquisition
MD&A	management discussion and analysis (also known as management commentary)
MDGs	Millennium Development Goals
MIS	management information system
MNC	multi-national corporation
NFRD	the EU Non-Financial Reporting Directive
NGO	non-governmental organization
NYSE	the New York Stock Exchange
PoW	proof-of-work
PRI	Principles for Responsible Investment
QCD	quality, costs and delivery performance
QCD plus alpha	quality, costs, delivery performance and additional significant factors
QMS	quality of management systems
R&D	research and development
REIT	Real Estate Investment Trust
ROI	return on investment
SAC	Sustainable Apparel Coalition
SAF	sustainable aviation fuel
SASB	Sustainable Accounting Standards Board
SBTi	Science Based Targets initiative

SDGs	Sustainable Development Goals
SEC	the US Securities and Exchange Commission
SME	small- and medium-sized enterprise
SRM	Stakeholder Relationship Management
SSC	shared service centre
STI	short-term incentive
TCFD	Task Force for Climate-Related Financial Disclosures
TCO	Total Cost of Ownership
TNFD	Task Force on Nature-related Financial Disclosures
UN	the United Nations
UNCTAD	United Nations Conference on Trade and Development
UNFCCC	the United Nations Framework Convention on Climate change
UNEP	the United Nations Environment Programme
UNEP FI	the United Nations Environment Programme Finance Initiative
US SEC	the U.S. Securities and Exchange Commission
VRF	Value Reporting Foundation
WFTO	World Fair Trade Organization
WRI	World Resources Institute
WWF	World Wild Fund for Nation

About the Authors

Tracy Dathe is professor for business management at Macromedia University on Campus Berlin, Germany.In addition to her academic expertise, she is also an experienced finance professional. Served as CFO for a multinational medium-sized automotive supplier, she held a key role in overseeing commercial management across multiple legal entities in Germany, China, France, Italy, Sweden, the Czech Republic, Turkey and the USA.

René Dathe, (MBA, MSc in Chemistry) is an esteemed business executive in the global research-based pharmaceutical industry, with a strong focus on project management, medical technology and quality management. His leadership extends to global development projects and alliances across Asia, Europe and North America with constantly expanding areas of responsibility.Dedicated to responsible business operations, especially in diversity and inclusion, he actively supports his employer's global talent management efforts in identifying new talents from China, Japan and other Asian countries, nurturing them into future global leaders. Moreover, he generously shares his experience and knowledge of business culture in China at seminars conducted by prominent global business organizations.Dr. René Dathe started his career in the realm of digital research on organic semiconductor materials. He holds an MSc degree in Chemistry from the Technical University of Chemnitz, followed by an MBA acquired in Frankfurt am Main. For his remarkable research in the field of group psychological processes based on SYMLOG and TRIZ (Inventive Problem Solving) theories, he was awarded a doctorate degree in business administration at the University of Gloucestershire, UK.

Isabel Dathe decided to pursue a study in sustainable management at the Technical University Berlin after a 3-year excursion into the Berlin media industry. Ever since her early youth, she passionately advocated for sustainability through her active involvement in the student union during high school. Today, as a young academic, she is determined to make a substantial contribution to activism in interest of the upcoming generation.

Marc Helmold, MBA is full-time professor of general business administration, business ethics, performance management and international negotiations at the IU International University of Applied Sciences at the Berlin campus. Before that, he held various managerial positions and was managing director of leading manufacturers in the automotive and rail industries. With this in mind, he was able to sustainably expand CSR activities. In industry in particular, he was able to transfer sustainability concepts to the entire value chain. He spent several years in Japan and China.

1 Introduction: ESG and Corporate Accountability

The world has witnessed significant transformations in various aspects of society and the economy, including social movements advocating for environmental and societal causes, the global integration of economies through globalization, the rapid adoption of digital technologies in industrial processes and the pervasive impact of social media, which have all contributed to a dynamic and interconnected world.

As a result, there is an exponential growth in the demand for responsible business practices in the private sector and transparent communication on their performance in environmental, social and governance (ESG) perspectives (Dathe et al., 2022). The specific aspects of demand for ESG performance and communication are driven by a plethora of factors, such as the following (Dathe et al., 2022; Deloitte, 2023):

- *Investor interest*: Institutional investors, asset managers and individual investors have come to realize that environmental, social and governance (ESG) factors can significantly impact a company's long-term performance and risk profile. It has become a common practice that investors incorporate ESG criteria into their investment decisions to align their portfolios with ethical and sustainability considerations.
- *Stakeholder expectations*: Various individuals, groups and organizations, including shareholders, customers, suppliers, employees, communities and regulators, are becoming increasingly conscious of the impact of business operations on society and the environment. They expect therefore greater transparency and accountability from companies in addressing environmental, social and governance (ESG) issues.
- *Risk mitigation*: Companies are increasingly confronted with a range of critical ESG-related risks, such as climate change impact and impact on biodiversity resulting from business operations, human resource policies regarding fair pay, working conditions, diversity, equity and inclusion and data protection concerns in adherence to ethical standards. Neglecting these issues could trigger a public

T. Dathe et al., *Implementing Environmental, Social and Governance (ESG) Principles for Sustainable Businesses*, Responsible Leadership and Sustainable Management, https://doi.org/10.1007/978-3-031-52734-0_1

backlash, which ultimately would undermine the company's social acceptance to operate and its long-term financial performance.

- *Regulatory compliance*: Governments and regulatory bodies worldwide have introduced ESG reporting requirements and guidelines. Compliance with such regulations is necessary for companies to avoid potential legal and financial penalties.

In general, public perception of a company's environmental, social and governance (ESG) performance can significantly impact its corporate reputation and brand image. Positive ESG performance enhances trust and credibility among stakeholders, while poor ESG performance can lead to reputational damage and loss of trust and ultimately, financial damage.

Emphasizing ESG performance fosters the long-term value creation. By integrating sustainability considerations into their overall business strategies, organizations can better adapt to changing market dynamics, attract and retain talents and build strong relationships with stakeholders. Organizations that proactively address ESG issues are often preferred by socially conscious customers and investors. Therefore, effective ESG strategy and ESG communication can serve as a differentiator for companies, particularly industries where sustainability practices have become a crucial success factor.

Globalization has further magnified the importance of ESG reporting as more and more businesses operate across borders, engaging with markets of diverse cultures. When operating in multiple countries, companies sometimes face varying regulatory frameworks and societal expectations in the context of ESG issues. This necessitates comprehensive and standardized ESG reporting procedures to effectively communicate the companies' commitments and performance worldwide.

Worldwide, stakeholders including investors, customers, suppliers, employees, communities and regulators have become more conscious of the impact of business operations on civil society. As a result, they increasingly demand companies to be transparent, accountable and proactive in addressing ESG issues throughout their business activities.

The digital revolution has also played a significant role in the growing ESG reporting landscape. With the advent of digital technologies, data collection, analysis and dissemination have become faster and more accessible. In addition, social media platforms have become a powerful channel for stakeholders to voice their opinions and influence corporate behaviours. Such circumstances put stronger pressure on companies to navigate the challenges of managing the corporate reputation in the digital age and respond to social media-driven narratives on ESG-related matters.

To meet the growing expectations and demand for ESG reporting, companies nowadays need to invest in robust systems, processes and talent. This may involve implementing new technologies for data collection and analysis, engaging with third-party ESG reporting frameworks and standards, conducting thorough audits of operations and supply chains and enhancing stakeholder efforts.

Along with the increasing demand for ESG reporting, there comes a corresponding rise in complexity and costs. The ESG reporting needs to be multifaceted, encompassing a wide range of topics such as environmental impact, employee well-being, diversity and inclusion, supply chain ethics, corporate governance and more. Periodic gathering, analysing and reporting on this diverse set of data require significant resources and expertise and often pose a challenge for medium-sized companies with more financial constraints.

The primary objective of this book is to support ESG activities in the private sector by exploring pertinent theories and practical solutions, in order to strike a balance between social contributions and economic sustainability. To accomplish this ambitious goal, the authors delve into several research terrains that are vital for understanding and implementing effective ESG strategies, including:

- The emergence of environmental, social and governance (ESG) principles (Chap. 2)
- An introduction of pertinent concepts in social movements, public policy and academic research such as corporate social responsibility (CSR), environmental, social and governance (ESG) principles, concept of sustainability and sustainable development goals (SDGs) proposed by the United Nations (UN). Subsequently, the book will provide a comprehensive comparison of these concepts and unravel their interrelationships and implications for ESG practices (Chap. 3)
- The role of public policies in guiding the environmental, social and governance (ESG) practice in a society (Chap. 4)
- The process of strategic management, including the development of strategic concept, strategy selection and strategy implementation, with a focus on various aspects of practical management approach to building a holistic social accountability strategy aligned with the overall business strategy (Chaps. 5, 6, and 7)
- How to determine the right level of ESG efforts based on the strategic purpose of ESG initiatives in specific business settings (Chap. 8)
- The design of effective stakeholder engagement and communication to obtain and maintain the license to operate (Chaps. 9 and 13)
- The critical aspects of ESG risks and suitable risk management concepts (Chap. 10)
- The existing and emerging regulatory requirements on ESG performance and reporting (Chap. 11)
- The choice of appropriate ESG metrics for monitoring and communicating ESG performance (Chap. 12)
- How to implement ESG concepts in the entire supply chain to create value (Chaps. 14 and 15)

This book offers in-depth and critical discussions on both theoretical frameworks and practical solutions for environmental, social and governance (ESG) challenges, allowing corporate organizations to navigate the complex landscape of social accountability requirements in a globalized economy with cultural and political differences and conflicts.

To equip readers with tailored strategies to address ESG issues relevant to their specific business domain, this book offers insights from current real-world best practices in social accountability, with a special focus on ESG strategy and implementation in various industry sectors. Readers can gain an understanding of how to create new business models by integrating innovative social accountability solutions. This fosters creativity and adaptability which are essential in a rapidly changing business world.

One of the valuable benefits of this book is the guidance on developing a reporting concept compliant with regulatory requirements. It assists organizations in choosing suitable global reporting standards and understanding key principles for creating a cost-efficient reporting framework, ensuring transparency and accountability, especially in capital market and public communication.

Finally, the authors anticipate some future trends in ESG requirements and solutions, in order to equip organizations with the insights needed to proactively address evolving economic and political dynamics.

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2 Emergence of ESG Principles

2.1 The First Initiative

ESG is the abbreviation of Environmental (E), Social (S) and Governance (G). The storyline of ESG began in early 2004 as Kofi Annan, the secretary-general of the United Nations (UN), invited more than 50 executives of major financial institutions to join a UN task force with the aim of enhancing common understanding for sustainability as a major aspect of corporate social responsibility (CSR). The results of this joint initiative were subsequently to be implemented in worldwide major capital markets to guide corporate behaviours (Kell, 2018).

One of the earliest outcomes of Kofi Annan's above initiative was the report "Who Cares Wins" by the Swiss consultant Ivo Knoepfel which provided an overall framework for the integration of environmental, social and governance (ESG) goals in asset management and brokerage investments strategies (United Nations, 2004; Kell, 2018). Initially, many of the most influential credit institutes and investment banks around the globe claimed their commitment to the principles proposed by the "Who Cares Wins" report, including (United Nations, 2004; Dathe et al., 2022):

- ABN Amro
- Aviva
- AXA Group
- Banco do Brasil
- Bank Sarasin
- BNP Paribas
- Calvert Group
- CNP Assurances
- Credit Suisse Group
- Deutsche Bank
- Goldman Sachs

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- Henderson Global Investors
- HSBC
- IFC
- Innovest
- ISIS Asset Management
- KLP Insurance
- Mitsui Sumitomo Insurance
- Morgan Stanley
- RCM (a member of Allianz Dresdner Asset Management)
- UBS
- Westpac
- World Bank Group

It is interesting to observe that the three then successful large investment banks Lehman Brothers, Merrill Lynch and Bear Stearns did not participate in the environmental, social and governance (ESG) project and later on suffered extraordinary losses during the Financial Crisis in 2008. As a result, Lehmann Brothers filed for bankruptcy (Wiggins et al., 2014), Merrill Lynch was taken over by Bank of America (Campbell, 2013) and Bear Sterns was bailed out by the US Federal Reserve ("the FED") and subsequently sold to JPMorgan Chase (White, 2008). The distinctively better performance of the Swiss banks such as UBS and Credit Swiss, and the US-based financial service providers Morgan Stanley and Goldman Sachs suggest that the organizations that actively addressed the ESG objectives might have outperformed others in risk management (Dathe et al., 2022).

In recent years, many financial institutions including banks, asset management providers and pension funds have started to integrate the environmental, social and governance (ESG) principles into their investment processes and strategies. In January 2020, Larry Finks, co-founder and CEO of BlackRock, Inc., announced in his annual letter to CEOs the reshaping of the investment strategy by placing a significant emphasis on ESG factors in the internal decision-making process. Initially, BlackRock refused to discharge 53 supervisory boards or supervisory board members of some multinational companies, including (Köhler & Landgraf, 2020):

- Daimler
- Lufthansa
- Uniper
- Heidelberger Zement
- Exxon
- Volvo

Subsequently, BlackRock launched a suite of ESG-centred exchange-traded funds (ETFs) to enhance the focus on ESG performance with the intention of risk mitigation in its asset management. Altogether, the dominating financial power of the financial service providers has played a significant role in turning ESG principles from a niche concern to a mainstream consideration in the capital markets. In addition, they called on both public and private companies in their portfolio for more detailed and standardized disclosure on their sustainability performance (Köhler & Landgraf, 2020).

As a result of the growing demand for sustainable investment, leading financial service providers and rating agencies such as MSCI and Standard & Poor have developed a range of ESG-related consulting and rating services to provide investors with standardized assessment and analysis based on a range of factors. The ESG ratings have become an integral part of the market capitalization process for major stock exchanges such as Dow Jones, MSCI, DAX and so on (QONTIGOX, 2021). The impact of ESG factors on shareholder value has systematically increased the preference of companies and business executives for environment-friendly investment alternatives (Dathe et al., 2022).

At the same time, social media pressure has emerged as another powerful instrument that encourages companies to proactively take steps in addressing the environmental, social and governance (ESG) issues in their business activities. Social media platforms such as Twitter, Facebook and YouTube are widely used by worldwide users for sharing information and opinions, making them a significant influence factor on public opinions. The possibility of social media campaigns and petitions enables public scrutiny of corporate performance in major ESG issues such as environmental protection and emission control, human rights and adequate labour conditions. In today's world of globalization and digitalization, business organizations are motivated to develop concrete ESG strategies, in order to avoid the potential legal and financial consequences of reputational damage and to maintain their social license to operate. An effective ESG policy potentially increases customer satisfaction and customer loyalty and protects the brand reputation (see Fig. 2.1) (Dathe et al., 2022).

As a result of the intensifying pressure of public opinion and increasing information transparency due to advancing digital techniques, a global trend of climate concerns and green thinking has emerged. Initially, the environmental, social and governance (ESG) efforts of business organizations are conducted on a voluntary basis in line with the corporate strategy in the context of ethical management and

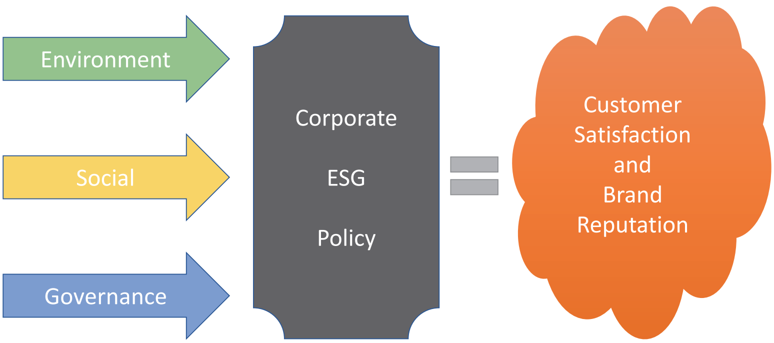

Fig. 2.1 Effect of ESG policy. (Source: Dathe et al. (2022) (modified))

not driven by specific laws and regulations. In public opinions, corporate ESG performance is often considered measurable fulfilment of corporate social responsibility (CSR), typically in the following aspects (Euramco, 2021):

- Ecological concept of products and services, e.g. electric vehicles (e-mobility) and photovoltaic products
- Environment-friendly manufacturing technologies, e.g. use of renewable energy, reduced carbon footprint, reduced energy consumption and so on
- Safe products and quality products
- Equal and fair payment for employees
- Anti-discrimination efforts: inclusion and diversity
- Anti-corruption efforts and prevention of bribe and money laundry

2.2 ESG: "Who Cares Wins" Concept and Freshfield Report

The report "Who Cares Wins" comprised by the Swiss consultant Ivo Knoepfel and published by the United Nations Environment Programme (UNEP) Finance Initiative is the initial outcome of the collaboration of the United Nations with key financial institutions with the aim of promoting sustainable and responsible investing by implementing the environmental, social and governance (ESG) objectives into capital markets (United Nations, 2004).

The concept depicted in the "Who Cares Wins" report reflects the idea that companies committed to environmental, social and governance (ESG) principles are likely to be more resilient to environmental challenges such as climate change, social inequality and economic instability. As a result, companies that prioritize ESG principles would create higher long-term value for their shareholders and other stakeholders, including customers, suppliers, employees and the broader society. Overall, the "Who Cares Wins" concept highlights the intended rising impact of ESG factors in investment strategies for financial service providers due to the potential of sustainable and responsible investment opportunities to create higher long-term value for investors and the society as a whole. In practice, the popularization of the "Who Cares Wins" concept has led to an increased demand for ESG-relevant financial products and services on a voluntary basis, such as ESG-focused exchange-traded funds (ETFs), index funds as well as ESG consultancy and ESG ratings (Kell, 2018).

In 2005, the United Nations Environment Programme (UNEP) published a further document that became another significant impulse for global ESG development: the so-called Freshfield Report. In this report titled "a legal framework for the integration of environmental, social and governance issues into institutional investment", the British law firm Freshfields Bruckhaus Deringer conducted a comprehensive analysis on the legal restriction for the implementation of environmental, social and governance (ESG) principles in protection of the investors' financial interest, as well as the impact of ESG strategy on the equity pricing process. For the above purpose, the legal experts of Freshfields Bruckhaus Deringer explored the jurisdictions in international laws, the European Union, as well as in national laws in selected countries covering various continents (United Nations, 2005):

- *Asia-Pacific*: Australia and Japan
- *Europe*: France, Germany, Italy, Spain and the United Kingdom
- *North America*: Canada and the United States

The 2005 Freshfield report depicted the investment industry as a significant player on the global economic stage. As of 2002, the estimated total volume of global invested funds exceeded US$ 42 trillion, of which the United States accounted for over US$ 19 trillion, Japan for over US$ 3.6 trillion and France, Germany, Spain and Italy altogether for over US$ 4.5 trillion. The majority of the said funds were held by institutional investors such as insurance companies and pension funds, who in the past primarily invested in equity and debt securities, however, with increasing diversification into real estate, hedge funds, private equity and other alternatives. Given the size of financial resources held by institutional investors, a change in their investment strategy in favour of environmental, social and governance (ESG) goals would have a significant impact on corporate behaviours and society as a whole (United Nations, 2005).

According to a survey by Mercer Investment Consulting in 2005, 70% of the 195 worldwide fund managers approached by the empirical study predicted that the positive screening of environmental, social and ethical performance of the target companies would become mainstream as an integral process of investment strategy among institutional investors. The follow-up on environmental, social and governance (ESG) goals was thus expected to reduce future liabilities and losses and create improved financial performance in the long term. The increasing integration of ESG concerns in the investment strategy was justified by a number of influence factors such as (United Nations, 2005):

- Positive correlation between performance on ESG issues and financial performance
- Stakeholder activism
- Corporate reputational concerns
- Consumer activism and public opinions
- Investor activism and pressure from non-governmental organizations (NGOs) and research
- Pressure from institutional investors
- Introduction of corporate environmental reporting obligations
- The rise of the global company
- Adoption of investment guidelines by development banks such as the World Bank, IFC and other intergovernmental lenders
- Rising corporate transparency
- The progress and revolution of information technology
- Regulation requiring disclosure of investment policies related to environmental, social and governance (ESG) issues.

It is commonly believed that incorporating ESG considerations into investment strategies can enhance long-term economic performance. However, as most investors evaluate investment options on short- to medium-term horizons, there is a consensus among many asset managers that ESG screening should only be implemented if it does not compromise the principle of profit maximation (United Nations, 2005).

The Freshfield Report suggested that, for effective guidance of corporate behaviours in investment and commercial sectors, legal enforcement should be implemented by both national governments and intergovernmental organizations.

Figure 2.2 illustrates the main focus of the key publications "Who Cares Wins" and the Freshfield Report by the United Nations Environment Programme Finance Initiative (UNEP FI). The main objective of those two documents is the voluntary or legally mandated integration of environmental, social and governance (ESG) factors in the decision-making process of asset management and private sectors. While the "Who Cares Wins" paper attended on voluntary initiative by institutional investors such as investment banks, pension fund managers and insurance companies, the Freshfield Report primarily explored the legal environment instruments to enhance ESG performance in society as a whole (United Nations, 2005; Kell, 2018).

The United Nations Environment Programme Finance Initiative (UNEP FI) has taken on the challenging task of clarifying to the business community what is expected of them in terms of their environmental, social and governance (ESG) performance, especially in the aspects of (United Nations, 2005):

- The development of guidelines for the implementation of responsible investment by means of an international legal framework
- The development of sustainability reporting guidelines in collaboration with global reporting initiatives

Today, the ESG principles have become mainstream thanks to the driving forces of institutional investors and rating agencies such as Blackrock, MSCI and Standard

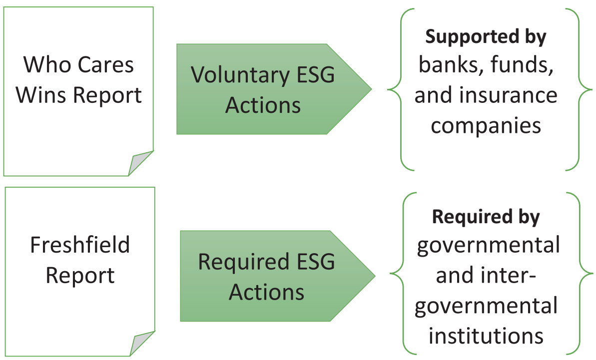

Fig. 2.2 Who Cares Wins Report versus Freshfield Report. (Source: Dathe et al. (2022) based on United Nations (2004, 2005) (modified))

& Poor's, with increasing regulatory support by the governmental institutions and political organizations (Dathe et al., 2022).

2.3 Main ESG Stakeholder Groups

Initially, the ESG recommendations by the United Nations Environment Programme Finance Initiative (UNEP FI) primarily tackled nine key stakeholder groups for the implementation of ESG objectives (Dathe et al., 2022; United Nations, 2004) (see Fig. 2.3):

- *Analysts*
  There is an increasing demand for ESG analysts due to the growing popularity of the ESG principles. There is a common understanding that companies prioritizing ESG factors tend to have more effective risk management and achieve higher financial returns over the long term. As a result, investors increasingly seek out companies that have integrated ESG factors into their business model.

  The implementation of ESG principles requires a thorough understanding of the opportunities and risks associated with the ESG issues in daily operations, for example the control of resource consumption and carbon footprint, labour protection standards and community relations and how the ESG factors might impact the company's financial performance.

  The ESG practice is not a one-time event, but an ongoing process that requires continuous monitoring and evaluation of new trends and developments.

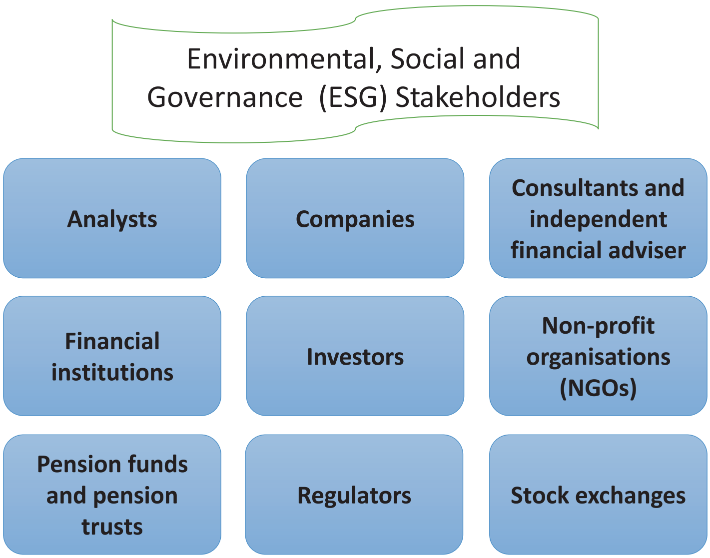

Fig. 2.3 Main ESG stakeholder groups according to UNEP FI guidelines. (Source: Dathe et al. (2022) based on United Nations (2004) (modified))

Furthermore, the globalization process further adds to the complexity of ESG issues due to the differences in cultural values and political systems.

- *Private Sector*
  As the world becomes more conscious of the impact of businesses on the environment and society, the global focus on the ESG model has been continuously growing. That means a company is judged not solely by financial performance but also by the impact on the environment, the treatment of its own employees and other stakeholders as well as by its governance practices. In today's corporate landscape, the implementation of ESG principles in business models has long become mainstream. The ESG practice is expected to improve not only the ethical standards but also the long-term business sustainability.

  Public communication is a key element in the ESG strategy for the private sector, with the main objective of informing the public of the ESG performance and progress through the communication channels. The information is usually provided in the form of quarterly and annual reports according to the standards and conventions of the business sectors. The daily operations of business organizations are driven by information systems.

  The standardization of reporting allows investors to make informed decisions. The companies need to establish an effective information system to gather, analyze and disseminate ESG data, in order to track the integration of ESG principles and measure and communicate the progress in performance effectively to investors and other stakeholders.

  In summary, ESG is a crucial aspect of business sustainability. To drive ESG performance and secure business sustainability, companies need to not only develop a suitable ESG concept to enhance ethical performance but also build a robust information system that communicates the business performance with clarity and precision.
- *Consultants and Independent Financial Advisers*
  To deal with special ESG-related topics such as the global trends and strategies in dealing with conflicts and complexity in the globalization process, the conventional industry practice and the external perspective, the business sector often relies on the support of specialized consultants and independent financial advisers. Among the most prominent service providers in this area, are the so-called big four consulting companies PwC, Deloitte, Ernst & Young and KPMG and the financial service providers Goldman Sachs and JP Morgan.

  The consultants not only provide special knowledge but also act as a catalyst for change management and moderation of transformation within corporate organizations.
- *Financial Institutions*
  Investment institutions such as asset managers, equity and debt securities play a key role in fostering sustainable investing and ESG research. The investment strategies of financial institutions provide a significant impact on global corporate behaviours in improving the long-term performance and business sustainability by incorporating ESG factors in their business concepts. In consideration

of ESG risks and opportunities, the companies take steps to become more resilient in the long term.

In addition, investment institutions also provide support to standard setters, intergovernmental institutions and national governments in developing judicial guidelines and reporting standards to promote the global ESG trends. They may engage in policy discussions of industry associations and advocate for regulatory changes to promote sustainability and ESG practices.

Investment institutions often conduct their own ESG research based on rigorous analysis. By engaging with companies and making informed investment decisions, those institutes help the companies improve their ESG performance and long-term financial returns.

- *Private Investors*

  The emergence of ESG standards and the investment strategies of financial institutions have led to a significant shift in the investment strategies of private investors. They come to realize that investing in ESG-relevant investment options would benefit investors with financial returns in the long term. As a result, more investors tend to seek out companies that prioritize ESG objectives in their business practise.

  To make informed decisions, investors often engage in ESG key performance indicators (KPIs) and key quality indicators (KQIs) to measure the performance and progress of the companies they are considering for investment. Those models are working models developed based on academic research and industry practice that are customized to the individual purposes of the investors. By analysing a company's performance across a range of ESG factors, investors can gain a deeper understanding of its overall sustainability and potential impact on the environment and society and the quality of excellence in achieving its own ESG objectives.

  By integrating ESG considerations in their investment decisions, the investors help to drive change in business practice by directing investments towards companies that prioritize ESG goals. The growing attention to ESG factors has led to an increase in ESG reporting by companies and a greater focus on improving their ESG performance. The trend of sustainable investing is believed to promote a more sustainable and equitable future in the global community.

- *Non-profit Organizations (NGOs)*

  As another important stakeholder group of the global economy, non-governmental organizations (NGOs) are invited to play a role in promoting and accelerating the adoption of the ESG model. NGOs usually practice their influence by holding companies accountable for their impact on the environment and society, as well as pushing for greater transparency and disclosure around ESG practices.

  NGOs can monitor corporate behaviours by monitoring and analyzing the ESG practice and progress of business organizations and industry sectors. They can help to identify the problem areas and set goals for improvements. They can also support the companies to better ESG performance by providing guidance and information on best practices.

- *Pension Funds and Pension Trusts*
  Pension funds and pension trusts have a significant responsibility when it comes to investing their clients' money. As a trustee, they are required to establish reliable decision-making models and risk-based approaches that will protect the interests of their clients.

  The use of ESG criteria in pension funds and pension trusts helps to align investment decisions with the values of the clients, as more and more individuals are becoming increasingly aware of the importance of sustainability and social responsibility in their investment decisions.

  By taking a proactive investing approach according to ESG principles, pension funds and pension trusts help to mitigate risks associated with climate change, resource scarcity and social instability. By prioritizing investment in companies that have good governance practices in place, they can also help to reduce risks associated with poor management and oversight.
- *Regulators*
  A key duty of the regulators is to shape the financial system by rules and regulations, ensuring that it operates in a safe and responsible manner. As the importance of the ESG factors in investment decisions continues to grow, regulators are being called upon to reinforce the initially voluntary ESG approach of the banks, institutional investors, brokers and analysts.

  Many regulators worldwide, including the US Federal Reserve and the European Central Bank, have taken steps to develop guidelines or regulations to support the ESG practice and guide financial institutions to more considerations of the long-term impact of their investments on society and the environment. As a result, financial institutions have shifted their investment strategies to promoting sustainable economic growth and social progress and strengthening the risk management strategy in the mitigation of possible negative effects of environmental harm and human rights violations.
- *Stock Exchanges*
  Stock exchanges are marketplaces for the trade of stocks, bonds and other securities. As a result of the global ESG trend, many stock exchanges around the world are also increasingly incorporating ESG factors in their offerings and trade operations. For example, the New York Stock Exchange (NYSE) and Nasdaq have both introduced ESG reporting standards as voluntary initiatives for their listed companies.

  In particular, while the NYSE requires listed companies to disclose their ESG practices and policies in addition to the financial reporting (NYSE, 2023), Nasdaq launched a sustainability reporting framework for its listed companies in 2019 (Nasdaq, 2023). Similarly, the pan-European stock exchange Euronext which operates in seven European countries including the Netherlands, Belgium, Portugal, Ireland, Italy, Norway and France introduced a range of ESG indices, including the Euronext Vigeo Eiris World 120 which tracks the ESG ratings of the listed companies (Euronext, 2023).

  Euronext. Furthermore, those institutions create more well-known indices, for example Wall Street icon Dow Jones and S&P 500, German DAX or Shanghai

Composite and others. In the ESG aspect, the companies are invited to issue ESG indices like DAX 50 ESG (QONTIGOX, 2021). The start was of course with actively communicating ESG behaviours of their listed company and working with rating agencies such as Standard &Poor's, Moddy's and Fitch which are also well-known as the Big Three in the rating world to include not just financial figures but more often also ESG aspects into their rating KPIs. MSCI is also playing an important role with its MSCI indices, for example MSCI World or ESG derivatives nowadays. Shanghai Stock Exchange has launched green securities to promote technical innovation and environmental protection and requests the disclosure on the assumption of social responsibility, contribution to sustainable development and environmental protection in line with the guidance released by the China Securities and Regulatory Committee (CSRC) (Sustainable Stock Exchange Initiative (SSE), 2019). The National Stock Exchange of India has also raised disclosure requests for business responsibility reporting by its listed companies (NSE, 2023).

Overall, the incorporation of ESG considerations into stock exchanges reflects the growing importance of ESG issues in society and drives the demand from investors for sustainable and socially responsible investment options. Under the influence of stock exchanges, ESG indices have emerged, for example the DAX 50 ESG index by QONTIGO (Qontigo, 2023) and the MSCI ESG indices by MSCI (MSCI, 2023). In addition, special ESG ratings have been developed to facilitate the tracking of the companies' ESG performance. The most influential ESG ratings are provided by rating agencies such as Standard & Poor's, Moody's and Fitch ("the Big Three") and the stock exchanges (e.g. the MSCI ESG Score).

2.4 Conferences of the Parties (COPs)

The United Nations (UN) places significant emphasis on climate change, global warming and greenhouse effects (United Nations, 2023). Global temperature patterns have shifted over the long term, and human activities have amplified this phenomenon by utilizing fossil fuels such as coal, gas and oil, which release greenhouse gases into the atmosphere (United Nations, 2023). Typical greenhouse gases include (Bodansky, 1993):

- Water vapour: H_2O
- Carbon dioxide CO_2
- Methane CH_4
- Nitrous oxide N_2O
- Ozone O_3
- Others …

According to mainstream climate researchers, the greenhouse effect has led to the continuous warming of our blue planet Earth, leading to rising global temperatures, melting polar ice caps and sea-level rise. These changes increasingly impact

Fig. 2.4 The “Beach Movie” Ko Phi Phi Le Island Maya Bay in Thailand. (Source: Authors)

the climate in various ways, such as altered weather patterns, ecological imbalances and more frequent and intensive natural disasters (United Nations, 2023).

And with this effect, our blue planet Earth is heating up (United Nations, 2023; Bodansky, 1993; Houghton, 2005) and the sea level is increasing and endangering beautiful islands like the “Beach Movie” Ko Phi Phi Le Island Maya bay in Thailand (Fig. 2.4).

In order to develop effective solutions to the pressing problems caused by climate change with joint efforts, the United Nations formed the global forums for multilateral discussions – the United Nations Climate Change Conferences. As founding members of the United Nations Climate Change Conferences, 154 states signed the environmental treaty “the United Nations Framework Convention on Climate Change (UNFCCC)” at the United Nations Conference on Environment and Development (UNCED, known as the “Earth Summit”) in 1992 in Rio de Janeiro, Brazil. As of 2022, UNFCCC has 198 parties, with its central decision-making body Conference of the Parties (COP) meeting annually to review the progress and update the climate protection measures (United Nations, n.d.-a, n.d.-b). In general, the COP takes the responsibility for the coordination of national policies on climate change control measures and supports the communication between different

Table 2.1 Overview of UNFCCC Conferences of Parties (COPs)

Name	Year	Location	Region
COP 1	1995	Berlin	Europe
COP 2	1996	Geneva	Europe
COP 3	1997	Kyoto	Asia
COP 4	1998	Buenos Aires	South America
COP 5	1999	Bonn	Europe
COP 6	2000	The Hague	Europe
COP 6	2001	Bonn	Europe
COP 7	2001	Marrakech	Africa
COP 8	2002	New Delhi	Asia
COP 9	2003	Milan	Europe
COP 10	2004	Buenos Aires	South America
COP 11	2005	Montreal	North America
COP 12	2006	Nairobi	Africa
COP 13	2007	Bali	Asia
COP 14	2008	Poznań	Europe
COP 15	2009	Copenhagen	Europe
COP 16	2010	Cancún	North America
COP 17	2011	Durban	Africa
COP 18	2012	Doha	Middle East
COP 19	2013	Warsaw	Europe
COP 20	2014	Lima	South America
COP 21	2015	Paris	Europe
COP 22	2016	Marrakech	Africa
COP 23	2017	Bonn	Europe
COP 24	2018	Katowice	Europe
COP 25	2019	Madrid	Europe
COP 26	2021	Glasgow	Europe
COP 27	2022	Sharm El Sheikh	Africa
COP 28	2023	Dubai	Middle East
COP 29	2024	To be confirmed	To be confirmed
COP 30	2025	To be confirmed	To be confirmed

Source: United Nations (n.d.-a, n.d.-b, n.d.-c, n.d.-d), IISD (2023)

countries, also known as parties (United Nations, n.d.-a, n.d.-b, n.d.-c, n.d.-d). By 2023, 28 COPs have been conducted (see Table 2.1).

The inaugural Conference of the Parties (COP) was held in Berlin, Germany, in 1995, with the Secretary's seat based in Bonn. After the reunification of Germany, Bonn became a collaborative city with 20 UN representative facilities at the Bonn UN Campus, including the Secretariat of the United Nations Framework Convention on Climate Change (UNFCCC), as part of the Berlin/Bonn Act in 1994 (UN Bonn, 2023).

The COP presidency rotates among the following United Nations regions (United Nations, n.d.-a, n.d.-b, n.d.-c, n.d.-d):

- Africa
- Asia
- Latin America and the Caribbean
- Central and Eastern Europe
- Western Europe
- Others

UNFCCC foresees three categories of responsibilities for the member states (United Nations, n.d.-a, n.d.-b):

- Developed countries: to limit their own anthropogenic greenhouse gas emissions (developed countries are also known as “Annex 1 countries”, see Table 2.2)
- Developed countries with special financial responsibilities: to provide financial resources for costs incurred by developing countries in complying with their emission control obligations
- Developing countries

The efforts of the Conferences of the Parties (COPs) have resulted in significant outcomes such as the international treaty Kyoto Protocol in 1997 which defines the ambitious goals for the reduction of greenhouse emissions based on the scientific consensus and the succeeding Paris Agreement (Robbins, 2016; Aykut et al., 2017; United Nations, n.d.-a, n.d.-b, n.d.-c; Dathe et al., 2022; Robbins, 2016; Aykut et al., 2017).

The Paris Agreement, also known as the Paris Accords or the Paris Climate Accords, was negotiated at the 15th Conference of Parties (COP 15). This agreement aims to limit the long-term global temperature rise to below 2 °C (3.6 °F) in terms of pre-industrial basis and the overall global temperature rise to below 1.5 °C (2.7 °F) (see Fig. 2.5). It was open for signature on “Earth Day” at a ceremony in New York in 2016. After the ratification by the European Union, a total of 174 countries have ratified the agreement (United Nations, n.d.-a, n.d.-b, n.d.-c, n.d.-d; Dathe et al., 2022; Robbins, 2016; Aykut et al., 2017).

During the COVID-19 pandemic from 2020 to 2022, all scheduled COPs were held without postponement, indicating the dedicated importance of all member countries to the goals set by the United Nations Framework Convention on Climate Change (UNFCCC) to protect our blue planet Earth. On the 27th Conference of Parties (COP 27) held in Sharm El Sheikh, Egypt in 2022, for the first time, an agreement was drawn to introduce a loss and demand fund which is to be provided to the countries with significant impacts of climate change such as sea level rise. This agreement is considered a breakthrough in providing support to the development countries that are most vulnerable and affected by climate change (Warner & van der Geest, 2013; Atwoli et al., 2022; Pflieger, 2023).

Table 2.2 Kyoto Protocol Annex I: member countries with status by 25 October 2022

Annex I member countries	Australia
	Austria
	Belarus
	Belgium
	Bulgaria
	Canada
	Croatia
	Cyprus
	Czechia
	Denmark
	Estonia
	European Union
	Finland
	France
	Germany
	Greece
	Hungary
	Iceland
	Ireland
	Italy
	Japan
	Latvia
	Liechtenstein
	Lithuania
	Luxembourg
	Malta
	Monaco
	Netherlands
	New Zealand
	Norway
	Poland
	Portugal
	Romania
	Russian Federation
	Slovakia
	Slovenia
	Spain
	Sweden
	Switzerland
	Türkiye
	Ukraine
	United Kingdom of Great Britain and Northern Ireland
	United States of America

Source: United Nations (n.d.-c)

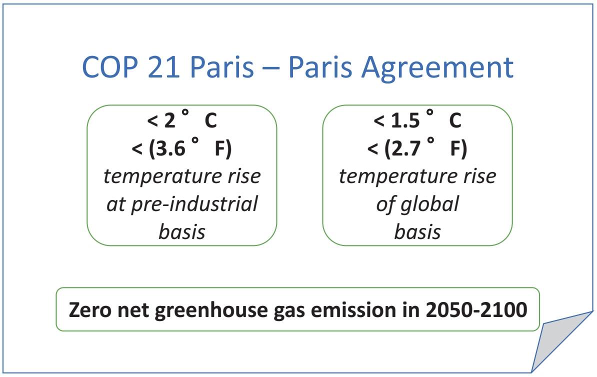

Fig. 2.5 Outcome of COP 21: Paris Agreement. (Data source: United Nations (n.d.-a, n.d.-b, n.d.-c, n.d.-d), Dathe et al. (2022), Robbins (2016), Aykut et al. (2017))

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3 ESG-Related Theoretical Frameworks

3.1 Concept of Sustainability: The Three-Pillar Model

The concept of sustainability is closely related to the environmental, social and governance (ESG) framework. For decades, there has been an intensifying demand by society for sustainable business practices. According to the Brundtland report "Our common future" of the World Commission on Environment and Development (WCED), sustainability can be defined as a "strategy of social development that meets the needs of the present without compromising the ability of future generations to meet their own needs" (United Nations, 1987).

The three-pillar model coined by Elkington, also known as the triple bottom line, is a widely accepted framework for the understanding of sustainable development objectives and the assessment of sustainable performances. This framework consists of three pillars: environmental, economic and social (Elkington, 1998):

- The environmental pillar represents the preservation of national resources (e.g. water and air) and reducing pollution (e.g. greenhouse gas emissions), especially by minimizing waste, as well as promoting renewable energy sources and biodiversity.
- The social pillar represents the promotion of social well-being, social equity and social justice, for example by improving the working conditions of the employees, providing them with access to healthcare and education or supporting local communities.
- The economic pillar represents the financial stability and positive development of the financial position.

The three-pillar model illustrates the interdependence of the three dimensions of sustainability. For example, the improvement of environmental performance by enhancing renewable energies may require massive investments that could

T. Dathe et al., *Implementing Environmental, Social and Governance (ESG) Principles for Sustainable Businesses*, Responsible Leadership and Sustainable Management, https://doi.org/10.1007/978-3-031-52734-0_3

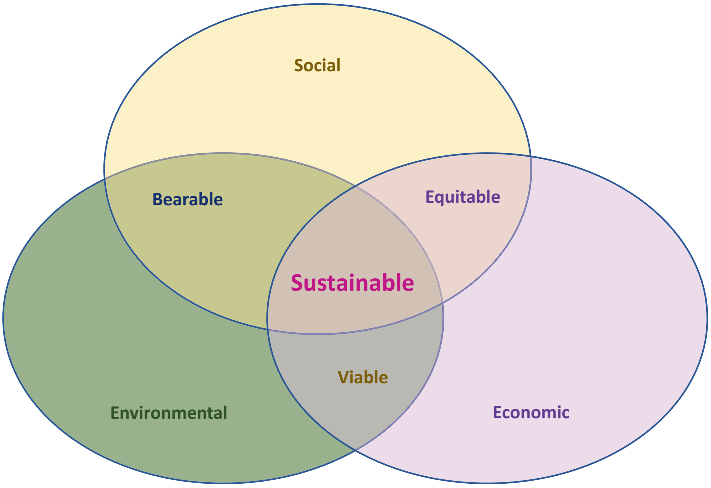

Fig. 3.1 Three-pillar model of sustainability. (Source: Based on Elkington (1998))

potentially have negative impacts on economic performance. Thus, an optimal sustainability approach must be a healthy balance between environmental, economic and social goals (Elkington, 1998). In practice, business strategies may be classified into seven categories based on their focus on the three constituent aspects (see Fig. 3.1).

Today, sustainability issues have become an integral part of the overall business strategy for most business organizations, often publicly presented in a "Sustainability Statement" and/or a comprehensive "Sustainability Report" (see Table 3.1).

3.2 Corporate Social Responsibility (CSR)

3.2.1 Fundamental Concept

Although the concerns about the negative impacts of business activities are not new, it was not until the mid-twentieth century that this concept drew intensive societal attention. The term corporate social responsibility was mentioned by Howard R. Bowen in his book "Social Responsibilities of the Businessman" in 1953, in which Bowen advocated for greater contribution to civil society by large corporations in the United States, given their significant economic power and the massive impacts of their business activities on ordinary people. The fundamental concept of Corporate Social Responsibility (CSR) is based on the thoughts that business organizations, both large multinational corporations (MNCs) and small- to medium-sized enterprises (SMEs), have the responsibility to ensure that their business operations have no negative impacts on society and the environment (Bowen, 1953, S. xi).

Table 3.1 Examples of sustainability statements

Company	Sustainability statement	Focus
Volkswagen	"For Volkswagen, sustainability means pursuing economic, social, and ecological objectives simultaneously and with equal energy. It is our aim to create lasting values, offer good working conditions, and conserve resources and the environment. With our sustainability concept we want to ensure that opportunities and risks associated with our environmental, social and governance activities are identified as early as possible at every stage of the value creation process. In keeping with this aim, we are determined that our corporate social responsibility (CSR) activities will have a lasting, positive impact on the Company's value and reputation".	Economic, social and environmental
Deutsche Bahn	"Sustainability at Deutsche Bahn Climate protection: We are going climate neutral. Nature conservation: We protect species. Resource protection: We conserve raw materials. Noise reduction: We are making railway quieter. Social responsibility: We live values".	Environmental and social
Siemens	"Our DEGREE framework sets clear and measurable ambitions: Decarbonization Ethics Governance Resource Efficiency Equity Employability".	Environmental, social and economic

Sources: Volkswagen (2023), Deutsche Bahn (2023), Siemens (2023)

The concept of corporate social responsibility (CSR) has evolved over time. In the 1960s and 1970s, social movements such as the civil rights movement, the consumer movement, the environmental movement and the women's movements all played an important role in shaping the development of societal expectations towards the corporates. Since then, businesses are no longer seen as solely responsible for maximizing profits for their shareholders but also for the impacts on a wider range of stakeholders, including their employees, customers, communities and the environment (Carroll, 2016). As a result of the external pressures, businesses increasingly adopt CSR activities, such as improving the working conditions of their employees, applying environment-friendly technologies and supporting social causes (Carroll, 2016; Dathe et al., 2022).

Today, the corporate social responsibility (CSR) concept is commonly viewed as an integral element of corporate strategy. There is a global consensus that prioritizing the CSR goals and balancing the social, environmental and economic objectives can improve the long-term value creation, for example by promoting corporate reputation, improving employee satisfaction and retention and enhancing the relationship with shareholders, customers, suppliers and other stakeholders. Besides, the shared CSR understanding increases dialogues and collaborations between businesses, governments and civil society. As a result of the systematic changes, new business models have emerged to drive innovation and build trust with stakeholders based on modern, integrated CSR strategies to guide sustainable business practices (Dathe et al., 2022).

However, despite the global attention and intensive research over the last decades, there is no universally accepted definition for the term corporate social responsibility (CSR). In the following sections, we will introduce a few major CSR-relevant theoretical frameworks that are helpful in developing effective overall CSR strategies in real-world business practice.

The concept of corporate social responsibility (CSR) shares numerous similarities with the framework of environmental, social and governance (ESG). Both concepts have gained prominence in business practice in shaping corporate behaviours in conformity with societal expectations (Euramco, 2021). On the contrary, there are also distinct differences between those two concepts. While the CSR theories primarily focus on the ethical management structure within a corporation, ESG places greater emphasis on developing suitable metrics to guide and assess ethical performance with more focus on the governance practice (Gupta, 2021). Table 3.2 entails some differences between both concepts. In general, having a thorough understanding of CSR frameworks can be beneficial in the comprehension and compliance of ESG standards (Dathe et al., 2022).

3.2.2 Carroll's CSR Pyramid

The four-step CSR pyramid model developed by A. Carroll in 1979 is a well-known Corporate Social Responsibility (CSR) model that has been widely used in the business world and in academic research. A major benefit of this model is its clear structure that enables discussions on CSR strategies and performances within and between organizations with a common language. By using Carroll's CSR Pyramid as a reference model for communication with the stakeholders including employees, investors, customers, suppliers and the broader public, companies could present their CSR initiatives and ethical management strategies in a comprehensive manner.

Table 3.2 Comparison of CSR and ESG

	Corporate social responsibility (CSR)	Environmental, social and governance (ESG)
Main purpose	Communication of contribution to the sustainable development of society	Sustainable investment strategy
Focus	Environmental, social and economic sustainability	Environmental and social sustainability and governance process
Main audience	Consumers, employees and other stakeholders	Investors, financial institutions and rating agencies
Performance assessment	Subjective, based on internal standards	Objective, based on external ESG assessment standards
Reporting data	Primarily qualitative	Primarily quantitative

Fig. 3.2 Carroll's four-step CSR pyramid. (Source: Dathe et al. (2022) based on Carroll (1979))

However, in practice, it is often not easy to find clear-cut boundaries between the different levels of the pyramid (Dathe et al., 2022).

In the four-step pyramid of CSR, Carrol determines four hierarchical levels of corporate social responsibility that can be used to provide structure to the companies' efforts in fulfilling their corporate social responsibility (CSR) (Dathe et al., 2022) (see Fig. 3.2):

1. *Economic responsibility*
2. *Legal responsibility*
3. *Ethical responsibility*
4. *Philanthropical responsibility*

Economic Responsibility

Economic responsibility is the first level of the CSR pyramid. It emphasizes a company's fundamental purpose of creating profits and providing a return to its shareholders over time while considering the interest of a broader group of stakeholders. Only when a company fulfils its economic responsibility and stays financially stable will it be able to offer useful products and services to the market, provide secure jobs and contribute to the society through tax payments. Under consideration of its economic responsibility, a company would prioritize financial viability, profitability and economic sustainability by taking actions to strive for growth and innovations. Economic responsibility forms the basis for corporate social responsibility.

Legal Responsibility

Legal responsibility is the second level of social responsibility. It refers to a company's obligation to operate within the bounds of the law and in conformity with all applicable legal and regulatory requirements in their pursuit of value creation for shareholders, including laws and regulations associated with labour practice, health and safety standards and environmental protection.

To ensure adherence to laws and regulations and avoid any harm to individuals, communities and the environment, companies can establish robust compliance programmes, including guidelines and procedures, such as the implementation of an effective reporting system to increase information transparency, and providing employee trainings and stakeholder engagement to align their business practices with the legal requirements.

Compliance with legal responsibility not only helps companies avoid legal penalties and reputational damages but also contributes to building trust with stakeholders, maintaining good relationships with regulators in demonstrating their commitment to responsible business practices. Subsequently, this improves the overall stability and integrity of the business environment.

Ethical Responsibility

While compliance with laws and regulations is crucial, companies should also strive to go beyond the minimum legal requirements and adopt higher ethical standards in adherence to societal expectations. Fulfilling ethical responsibility involves consideration of the broader impact of business decisions and actions on various stakeholders, including employees, customers, suppliers and communities. Ethical responsibility entails engaging behaviours in accordance with principles of fairness, honesty, integrity and respect of human rights, for example in promoting ethical behaviours throughout the organization in terms of recognition and respect of dignity, diversity and rights of individuals.

In practice, a strong ethical framework is helpful for the implementation of organizational ethical standards, often guided by the code of conduct. A code of conduct is a document that provides guidance for the behaviours of employees and other stakeholders, for example by promoting a culture of integrity and fairness, ensuring non-discrimination and equal opportunities among employees and in relationships with suppliers and customers and ensuring decent working conditions and environmental impact throughout the supply chain.

Philanthropical Responsibility

Philanthropic responsibility is the highest level of corporate social responsibility. It refers to a company's voluntary efforts and contribution to the improvement of life quality of their employees and the society as a whole which are beyond legal and ethical responsibilities.

A company can assume its philanthropic responsibility by, for example providing family-friendly flexible working hours or offering on-site childcare facilities to improve employee well-being, promote work-life balance and enhance employee satisfaction and retention, donating funds to charitable organizations, supporting community development projects, investing in educational and healthcare initiatives and contributing to environmental conservation efforts. Such measures can take the form of financial donations, in-kind donations, employee volunteer programmes, pro bono services or partnerships with non-profit organizations. Philanthropic initiatives can help to foster positive relationships with local communities, improve the company's reputation and help it to maintain the social license to operate.

Effective philanthropic responsibility involves aligning corporate social contribution and social investments with the company's core values, expertise and the needs of society and the communities it serves by focusing on areas where the company has the best potential to make a significant impact.

Despite the popularity of Carroll's model, the pyramid framework does have some limitations. The major criticism is that the hierarchical structure suggests a linear progression of the four levels of corporate social responsibility (CSR). For example, a company has to fulfil its economic responsibility before it can address the higher levels of social responsibility. In reality, however, most companies would address several multiple domains of social responsibility at the same time, for example by aiming at philanthropic targets while trying to generate profits. Thus, some practitioners and academics find the hierarchical structure confusing because the integration of CSR strategy into the core business strategies is not a step-by-step process, but rather a holistic and integrated approach. Philanthropy should not be understood as superficial acts, and the lower levels of responsibility domains are not of less importance to society (Schwartz & Carroll, 2003; Dathe et al., 2022).

Furthermore, the pyramid framework oversimplifies the complexity of reality and fails to reflect the interconnection of the four CSR levels. For example, ethical behaviours can lead to higher costs but improve the trust relationship with stakeholders, which in turn may impact the turnover and profit positively. The pyramid structure may cause the wrong impression that the four main domains are distinct and can be addressed sequentially (Schwartz & Carroll, 2003; Dathe et al., 2022).

Similarly, some critics argue that Carroll's pyramid model fails to address the varying contexts and specific industry dynamics in which the business operates. In fact, different industries have different social and environmental impacts, so CSR initiatives must be tailored to address individual specificities. Carroll's pyramid framework does not provide the flexibility to accommodate such variations to adequately capture the nuances of CSR demands across industries (Schwartz & Carroll, 2003; Dathe et al., 2022).

Furthermore, the framework does not explicitly incorporate the perspectives and voices of various stakeholder groups. For instance, the globalization process has led to the relocation of production sites to low-wage countries, resulting in the benefits of job creation and tax revenues, but, at the same time, it has also caused job losses and deteriorating social division in home countries, such as the conflicts of interest of different stakeholder groups (Schwartz & Carroll, 2003; Dathe et al., 2022).

Another limitation of the pyramid model is the absence of a practical approach to differentiate the four levels of corporate social responsibility, for example there seems to be a large overlapping area between ethical responsibility and philanthropy in practical applications (Schwartz & Carroll, 2003).

In summary, Carroll's four-step pyramid CSR model provides a clear and simple framework that can be effectively used for the understanding and communication of corporate social responsibility both in business practice and in academic research.

The hierarchical structure emphasizes the prioritization of economic responsibility of the overall CSR strategy. This helps companies to communicate the importance of economic sustainability, as this is the foundation for the other domains of corporate social responsibilities. Overall, this model facilitates a holistic view of multiple aspects of how the companies can make adequate contributions towards society.

However, this model also has limitations such as not addressing the interconnections of the various levels of responsibility and the conflict among interest groups. As a result, the weaknesses of the model can lead to confusion and problems in real-world implementations. To counteract on some of those weaknesses, some researchers have made modifications to this basic model. One example of such modified CSR frameworks is the three-domain model by Carroll and Schwartz (see Sect. 3.2.4).

3.2.3 Two-Dimensional Model of Quazi and O'Brien

The two-dimensional CSR model by Quazi and O'Brien provides a comprehensive framework for the classification of corporate social responsibility (CSR) strategies. The major strength of this model lies in the clear definition of the characteristics of the CSR strategies by two key factors: the understanding of CSR concept and the benefits versus costs of CSR activities.

The first factor, the understanding of CSR concept, is defined based on a broad versus narrow scope of responsibility. A narrow understanding of CSR concept would limit the scope of responsibility towards shareholders and focus primarily on economic outcomes, for example in terms of profitability and market value. A broad definition of responsibility would extend the scope of responsibility to include further stakeholders of the business such as employees, customers, suppliers and social communities. The broad definition of corporate social responsibility would prioritize the long-term financial performance of the company and its impact on the society.

The second factor, the benefit versus costs of CSR activities, is critical for the evaluation of CSR measures in the decision-making process. The benefit of CSR activities could be, for example increase in customer loyalty, improvement of brand reputation and enhancement of employee morale. The costs of CSR activities could include additional expenses, potential risks and opportunity costs.

The two-dimensional CSR model by Quazi and O'Brien provides a framework that can be used as an effective instrument for the development of CSR strategies in business practice, regardless of the cultural environment or the market constellation, by dividing all possible strategies into four categories according to the above two key factors (Dathe et al., 2022; Quazi & O'Brien, 2000) (see Fig. 3.3):

- *Classic view*. The classic view of CSR activities involves a narrow understanding of social responsibility and an overemphasis on the costs rather than the benefits of CSR activities during the strategic assessment. This approach would lead to a defensive CSR strategy that prioritizes short-term economic considerations. This

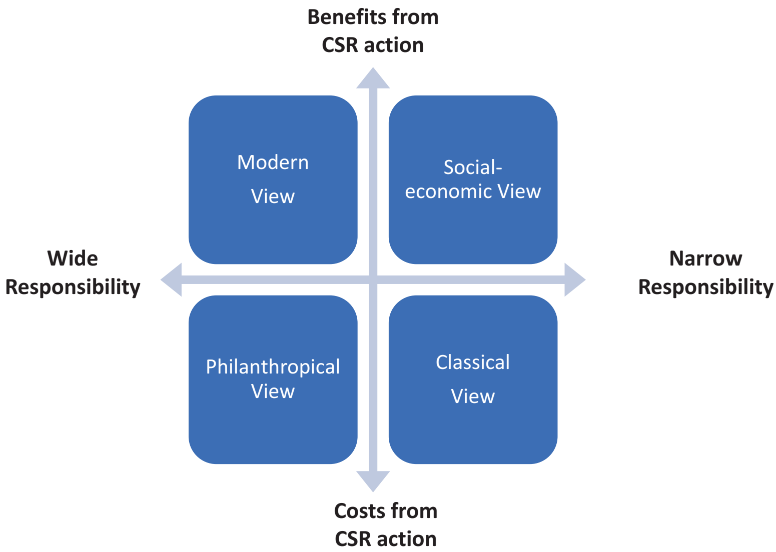

Fig. 3.3 Two-dimensional model of Quazi and O'Brien. (Source: Dathe et al. (2022) based on Quazi and O'Brien (2000))

type of strategy is characterized by the primary focus on risk mitigation in terms of the negative impacts of reputational damages and legal penalties. Companies that adopt this type of CSR strategy typically confine CSR activities to low-cost options, such as compliance with environmental regulations, workplace safety and consumer protection laws.

- *Socio-economic view*. The combination of a narrow understanding of corporate social responsibility and the recognition of the potential benefits of CSR activities would typically lead to a CSR strategy based on cost-and-benefit considerations. Companies that adopt this strategy would choose CSR activities that are expected to provide higher tangible benefits than the relevant costs, such as energy conservation, waste reduction and employee training programs.
- *Modern view*. The modern view on CSR activities emphasizes a comprehensive perception of corporate social responsibility, as well as the benefits of CSR activities rather than the costs in the strategic assessment. From this contemporary perspective, CSR activities are primarily seen as an opportunity to create value for both the company and society. The CSR strategy based on a modern view on CSR activities is shaped by the impact of such activities on shareholder value. The companies that adopt this type of CSR strategy would typically consider the long-term contribution of CSR activities to the financial performance of the company, for instance by investing in renewable energy sources that would enhance the company's reputation by benefiting the environment and reduce energy costs in the short or long term.
- *Philanthropic view*. The term philanthropy means to give away financial means to promote the well-being of others (Cambridge Dictionary, 2023). The philan-

thropic view of CSR activities involves the comprehensive perception of corporate social responsibility and the acceptance of higher costs than the economic benefits of charitable activities. That means the main criterion for the assessment of the CSR strategy is the support of social causes and not the positive return on investment. However, this type of CSR strategy can only be implemented in a company that is capable of maintaining its own financial stability and justifying the use of financial resources for altruistic purposes to its shareholders.

In summary, the two-dimensional CSR model by Quazi and O'Brien is an effective instrument for the development and implementation of corporate social responsibility (CSR) strategies in business practice. However, while this framework helps to align the CSR activities with a company's overall business objectives, it does not provide an operational systematic approach that connects the strategy with individual CSR activities. Therefore, for the application in business practice, after the determination of CSR goals and priorities based on this framework, the companies develop additional approaches to connect the overall strategy with the individual CSR activities, for example by creating a detailed roadmap for the supporting activities.

3.2.4 Three-Domain Model by Carroll and Schwartz

The three-domain model of CSR by Carrol and Schwartz is an extension of the four-step CSR pyramid model developed by Archie Carroll. This model was developed with the intention to overcome some of the limitations of the pyramid model which classifies corporate social responsibility (CSR) in a hierarchical manner as economic, legal, ethical and philanthropic responsibility (see Sect. 3.2).

A major weakness of the original four-step CSR pyramid model is that the hierarchical structure of the model leaves the misleading impression that the top levels of the responsibility pyramid are of higher importance. Besides, the pure form of the four levels of corporate social responsibility can be rarely found in business practice. To overcome the above limitations of Carroll's CSR pyramid model, the three-domain model expands on the hierarchical levels and offers several additional mixed forms of strategic orientations for the implementation of CSR activities (Schwartz & Carroll, 2003).

Altogether, the three-domain model defines three domains (economic, social and environmental) as core areas of the companie's CSR objectives. The three domains are also integral components of Carroll's four-step pyramid model; however, in this three-domain model, the definition of those fundamental domains has been refined. In addition, the model provides seven categories of CSR contributions that contain the mixed forms of the three domains (Dathe et al., 2022; Schwartz & Carroll, 2003) (see Fig. 3.4):

- *Economic Domain*
  In the CSR pyramid model, economic responsibility is the most fundamental category of corporate social responsibility (CSR) required by society (compared with Carroll's CSR pyramid in Sect. 3.2). The primary economic responsibility

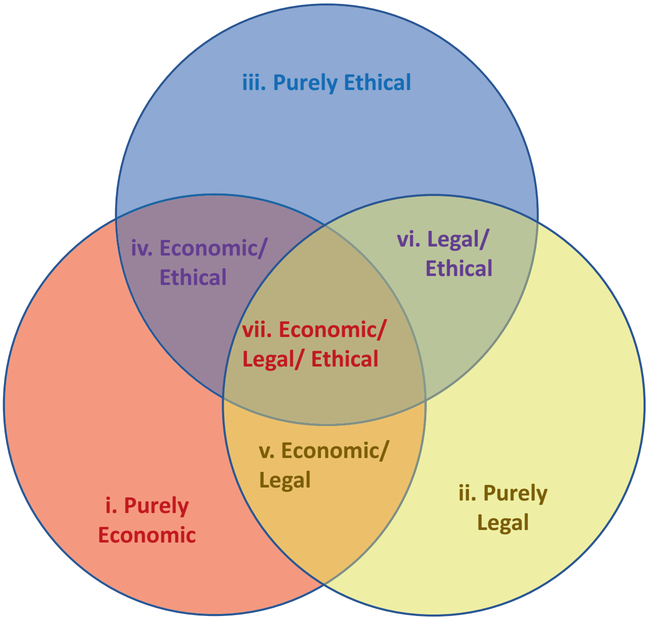

Fig. 3.4 Three-domain model by Carroll and Schwartz. (Source: Dathe et al. (2022) based on (Schwartz and Carroll (2003))

of a company is to create value for its shareholders. Only when a company maintains its long-term profitability and financial stability, will it be able to contribute to society by providing safe, reliable and affordable products or services required by the customers, creating secure job opportunities for its employees and making tax contributions to finance other social projects and purposes.

In the three-domain model, the definition of economic domain is refined to differentiate direct and indirect economic actions based on the intended positive economic impacts. A direct positive economic impact can be recognized based on two interdependent criteria: (a) the maximation of profits and/or (b) the maximation of the value per share. The direct impact can be achieved typically by actions that directly increase sales revenues and reduce costs, for example for potential legal disputes. Indirect economic actions typically aim at improving employee morale or enhancing the corporate reputation, which subsequently would drive forth the maximation of profits and/or the maximation of the value per share.

In general, most corporate actions are economic in nature. Only exceptional activities fall outside the economic domain when the maximation of profit and/or shareholder values are not intended, or if cost factors are not a part of the management considerations.

- *Legal Domain*

  It is a fundamental demand on the companies that they, like all other members of the society, comply with all applicable laws and regulations, such as labour laws, workplace safety regulations, consumer protection laws and environmental protection regulations. Breaches of laws and regulations would result in legal sanctions and reputational damages, which in turn would lead to financial losses. A company may improve its performance in the legal domain by educating its employees and implementing suitable governance processes.

The three-domain model classifies legality into three main categories based on the motive of actions (see Table 3.3):

(a) *Compliance*: This is further divided into three sub-groups: passive or accidental compliance, restrictive compliance and opportunistic compliance.
(b) *Avoidance of civil litigation.*
(c) *Anticipation of the law*.

- *Ethical Domain*
  In the CSR pyramid model, ethical responsibility represents corporate behaviours expected by the public according to moral values, including both domestic and international ethical imperatives.
  The three-domain model broadens the definition in Carroll's pyramid model and subdivides the ethical standards into three groups: conventional standards, consequentialist standards and deontological standards (see Table 3.4).

Table 3.3 Legal motives according to the three-domain CRS model by Schwartz and Carroll

Type of legal motive	Description	Example
Passive/accidental compliance (outside legal domain)	Unintentional/unconscious compliance of laws and regulations	Driving a car under the speed limit due to poor street conditions, not because of traffic rules
Restrictive compliance	Intentional compliance of restrictive laws and regulations	Compliance of emission control standards in the production process
Opportunistic compliance	Seeking out most profitable option in the legal system	Choosing business locations with weaker control standards or lower tax rate obligations
Avoidance of civil litigation	Mainly aiming to avoid possible civil litigation for negligence of law	Voluntary recall of products with qualitative defects
Anticipation of law	Acting according to anticipated changes to legislation, e.g. based on laws in other legislative regions	Engaging production technology with higher environmental protection standards that are not yet applicable, but widely accepted in the international community

Information source: Schwartz and Carroll (2003)

Table 3.4 Ethical Standards according to the three-domain CRS model by Schwartz and Carroll

Type of ethical standards	Description	Characteristics
Conventional standards	Ethical standards of conventions widely accepted by the stakeholders with a focus on the context/situation	Standards or norms of an organization, an industry section, a profession or a society
Consequentialist standards	Ethical standards with a primary focus on consequences	Actions intended to benefit the society or lead to the greatest net benefit to the society compared with other options
Deontological standards	Ethical standards with a primary focus on the concept of duty or obligation	Widely accepted moral rights or justice in the society

Information source: Schwartz and Carroll (2003)

Based on the above three pure forms of domains of CSR actions, the three-domain model creates seven CSR domains, including four overlapping domains as follows (see the Venn diagram in Fig. 3.4):

(i) *Purely economic*
(ii) *Purely economic*
(iii) *Purely legal*
(iv) *Purely ethical*
(v) *Economic/ethical*
(vi) *Economic/legal*
(vii) *Legal/ethical*
(viii) *Economic/legal/ethical*

The three-domain model can be used for the classification of real-world CSR strategies. Compared with Carroll's four-step pyramid model, it shows strength in reflecting the complexity of business situations. It also provides an interesting possibility for the graphical illustration of a company's profile in terms of its CSR strategy (see Fig. 3.5).

However, there are also some serious limitations in the application of the three-domain model. For example, it is often difficult to assign specific business situations to the defined CSR categories with absolute clarity due to the interdependence of the domains (Schwartz & Carroll, 2003).

In light of intensive public concerns over the environmental impact of business activities, some researchers proposed that an additional domain for environmental actions should be added to the three-domain CSR model (Welzel, 2008, S. 262).

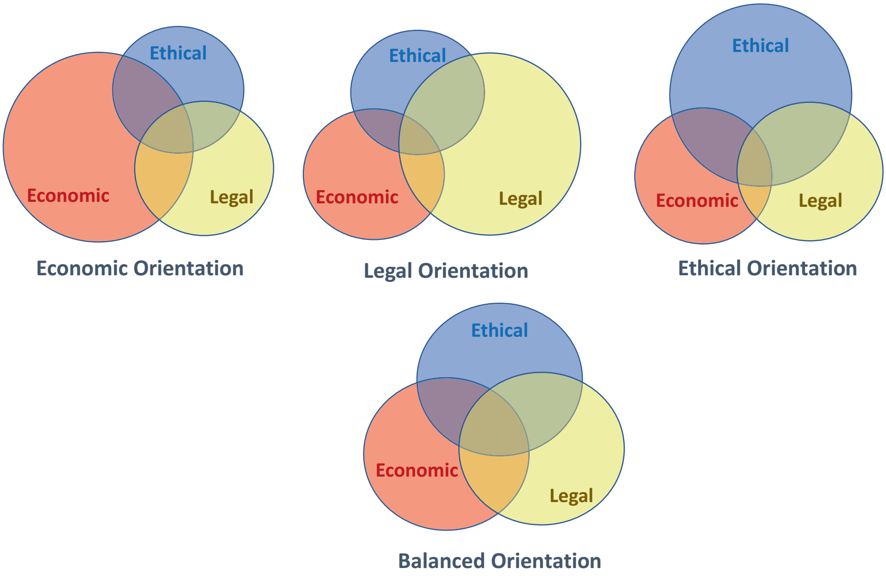

Fig. 3.5 Corporate social responsibility (CSR) profile in the three-domain CSR model. (Source: Dathe et al. (2022) based on Schwartz and Carroll (2003))

3.2.5 Corporate Citizenship (CC)

"Corporate Citizenship (CC)" is another term widely used to describe the social role of companies. However, this term has been used in different ways in the literature that fill this expression with various nuances of content (Crane & Matten, 2016, S. 69):

- In the interpretation of Corporate Citizenship (CC) in the narrow sense, this term means philanthropy in corporate social responsibility, for example engagement in charitable projects and donations to social causes.
- In the interpretation of Corporate Citizenship (CC) in the equivalent sense, the term Corporate Citizenship (CC) is used synonymously with "Corporate Social Responsibility (CSR)".
- The third interpretation of Corporate Citizenship (CC) in the broader sense contains both corporation social responsibility (CSR) and an additional political domain – that means, especially large multinational corporations (MNCs) should not confine their activities to the core business practice but actively use their dominant economic power to take political influences and shape public policies. This political domain is mainly discussed in three aspects (see Fig. 3.6):
  - *Social rights* entail the entitlement of individuals to participate in society, which includes access to education, medical care and other forms of social welfare.

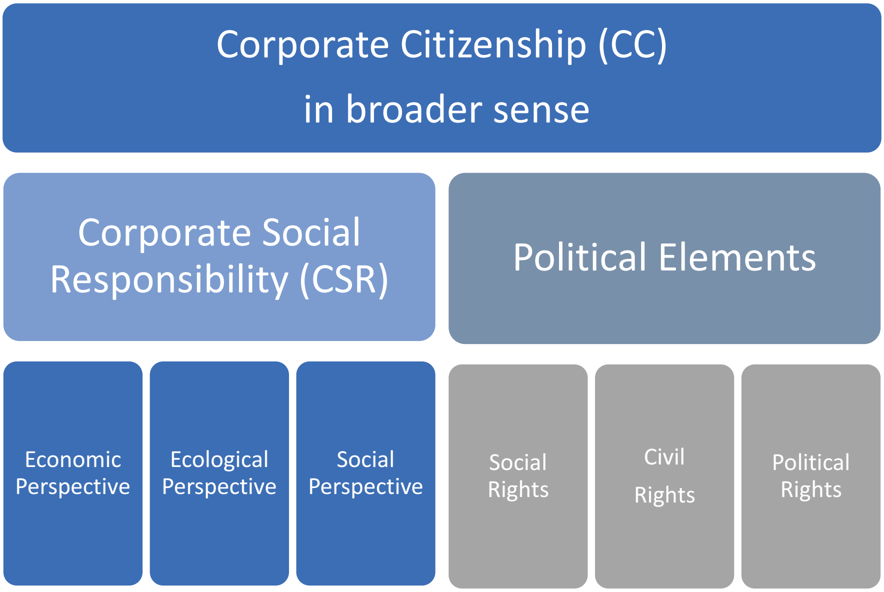

Fig. 3.6 The concept of corporate citizenship in a broader sense. (Source: Dathe et al. (2022) based on Crane and Matten (2016))

– *Civic rights* denote freedom from abuse and interference, particularly by the government, and encompass liberties such as freedom of speech and the right to property.
– *Political rights* entail the right of individuals to vote, the right to hold public office or, in general, the right to participate in the civil political process.

For decades, multinational corporations (MNCs) from industrialized countries were encouraged to use their economic power to actively influence public policies in developing countries. However, with the rise of emerging economies such as China and India and the growing complexity of cultural conflicts and geopolitics, this approach is being increasingly criticized. Many critics argue that political responsibility rests solely with the sovereign states and the NMCs should not interfere with the internal affairs of other countries with different cultural norms, political systems and economic structures. In the past, MNCs have sometimes been accused of misusing their power to push their own interests and agenda, often at the expense of the local population.

In summary, the role of MNCs in shaping politics in developing countries is being challenged with increasing complexity and criticism. While the MNCs have the economic means to gain influence, they also have a duty to respect the sovereignty and cultural norms in the hosting countries they operate. MNCs are advised to navigate the complexity of the globalized world with sensitivity and respect for local customs and legislation.

3.3 Sustainable Development Goals (SDGs)

In 2015, the United Nations announced 17 Sustainable Development Goals (SDGs) as a universal roadmap for governments, business organizations, civil society and individuals to tackle global challenges and work together towards a more sustainable and equitable future (see Fig. 3.7).

In order to common goals with wide consensus and effectively mobilize global efforts, the United Nations first established the Millennium Development Goals (MDGs) in 2000, emphasizing poverty reduction, education, health issues, gender equality and environmental sustainability. To overcome some limitations of MDGs, the United Nations General Assembly called for the development of a set of universal goals to succeed the MDGs at the United Nations Conference on Sustainable Development held in Rio de Janeiro, Brazil, in 2012. Subsequently, a process was initiated involving extensive consultations and engagement with various stakeholders, including governments, organizations of civil society, academia and the private sector, to ensure the design of a more comprehensive and universally accepted framework under consideration of diverse perspectives and interests. As a result, the SDGs adopted a multi-dimensional approach, encompassing a wide range of interconnected goals based on practical experience and scientific research. The Sustainable Development Goals (SDGs) were formally adopted by the United Nations General Assembly in September 2015 as announced in the document titled "Transforming Our World; The 2030 Agenda for Sustainable Development" (UNDP, 2023).

Fig. 3.7 Sustainable Development Goals: 17 goals to transform our world. (Source: United Nations (2015))

While SDGs and ESG are two distinct frameworks, they are closely related with shared common goals. In practice, ESG considerations can be aligned with the broader principles and objectives of sustainable development encapsulated by the SDGs. Companies can determine their ESG metrics by addressing environmental and social issues and adopting sound governance practices by integrating sustainability into their business operations, supply chains and stakeholder engagements in line with the SDG agenda. In turn, the ESG metrics and reporting frameworks can also provide indicators to measure progress towards the SDGs and enhance accountability and transparency (Dathe et al., 2022).

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4 Public Policies

4.1 The Role of Government

Being the highest political institution of a state, the government plays a crucial role in regulating the market and shaping the economic environment for individuals and business operations. Depending on the political system and cultural context, the role of government varies across countries. However, there are several fundamental functions and responsibilities commonly associated with governments, such as (Benz et al., 2007; Dathe et al., 2022):

- *Legislative function*: Governments have the authority to create laws and regulations that govern over the society. That is, they establish a legal framework that sets rules for individuals, businesses and organizations to protect public safety, ensure order and promote social cohesion.
- *Executive function*: Governments have the executive power to enforce laws and regulations, implement policies, administer public services and manage government agencies to ensure the effective functioning of society.
- *Judicial function*: Governments provide a judicial system to interpret and apply laws, including courts and judicial processes to settle disputes, uphold justice and protect the rights of individuals and businesses.
- *Protection and security*: One of the primary roles of governments is to protect their citizens and maintain national security by maintaining military forces, law enforcement agencies and intelligence services to defend the country from external threats and ensure internal security.
- *Economic stewardship*: Governments play a crucial role in regulating the national economy by establishing policies, fiscal measures and monetary systems to promote economic growth, stability and equitable distribution of wealth. In particular, governments implement public policies to regulate industries and oversee trade and commerce transactions.

T. Dathe et al., *Implementing Environmental, Social and Governance (ESG) Principles for Sustainable Businesses*, Responsible Leadership and Sustainable Management, https://doi.org/10.1007/978-3-031-52734-0_4

- *Public goods and services*: Governments provide essential public goods and services that are essential for the well-being of society, including infrastructure development (such as streets, railways, telecommunication systems, etc.), healthcare, education and public transportation.
- *Social justice and welfare*: Governments also have the responsibility to ensure social justice and welfare by promoting inclusivity, reducing poverty and providing social assistance.
- *International relations*: Governments engage in diplomatic relations with other nations on international issues such as national and international security, foreign trade and climate change by negotiating trade agreements and other treaties, participating in global governance and cooperating with other governments and international organizations.

4.2 Economic Public Policies

In the economic context, the objectives of governmental regulations for the market are typically addressed in the following fields (Benz et al., 2007; Dathe et al., 2022):

- *Natural monopoly*: In certain business sectors, competition is limited due to high market entry barriers, for example, due to large investment requirements and significant economies of scale, etc. Those sectors may be subject to governmental supervision to ensure accessibility and affordability for the public by preventing monopolistic practices.
- *Negative externality*: Business activities of the company cause economic, ecological or social impacts on third parties. This effect is known as the externality of business activities. The externality can be both positive (e.g. creation of new job offers) and negative (e.g. air or water pollution). Government supervision aims to internalize the costs of negative externality in order to guide business practices in desired manners, for instance by providing subsidies to promote environment-friendly technical systems, imposing taxes or implementing regulations to reduce hazardous emissions.
- *Information asymmetry*: Information asymmetry occurs when one party in a transaction possesses more information than the other, leading to imbalances and potential exploitation (known as the classical principal-agent problem). In the context of information asymmetry, governments often focus on consumer protection and may introduce regulations to ensure information transparency, fair practices and guarantee mechanisms for consumers. Particularly in the financial sector, governments have implemented special regulations to restrict market entry and protect investor interests.

In addition, private regulations initiated by private companies, business associations or civil law organizations ("non-governmental organizations", NGOs) have merged as means to harmonize ethical standards in business practices. Such private regulations are typically enforced through market mechanisms. In the financial industry, private institutions such as the Financial Conduct Authority (FCA), Prudential Regulation Authority (PRA) in the United Kingdom and the Securities and Exchange Commission (SEC) in the United States shape significant regulatory provisions. In general, NGOs play a crucial role in the development of regulations for responsible business practices by advocating for special economic, social and environmental contributions to the society through their political activities (Götz, 2008; Dathe et al., 2022).

Moreover, business organizations are also interested in self-regulation on a voluntary basis. In practice, regulations play an important role in corporate CSR performance and can be shaped by the state, NGOs or private businesses. There are different constellations of co-operations of the above actors as designers of regulations (see Fig. 4.1):

Private businesses may find voluntary self-regulation appealing due to a range of motivations, for example (van Calster & Deketelaere, 2001; Dathe et al., 2022):

- *Pre-empting external regulations*: By proactively implementing self-regulatory measures, businesses may influence the direction of future regulatory frameworks or avoid the need for additional government intervention. This can potentially pre-empt more stringent and costly external regulations.
- *Flexibility and adaptability*: Self-regulation allows businesses to tailor the rules and standards to match their business operations and adopt approaches that are most suitable for their own business models, products and services. By doing so, companies can adapt to changing market conditions and emerging challenges more quickly than formal regulations might allow.
- *Industry leadership and collaboration*: Engaging in self-regulation allows businesses to demonstrate industry leadership by taking proactive steps to address environmental, social and economic issues. By collaborating with other industry players, companies can work together to develop shared standards and best practices, fostering collective efforts towards sustainable and responsibility and business conduct.

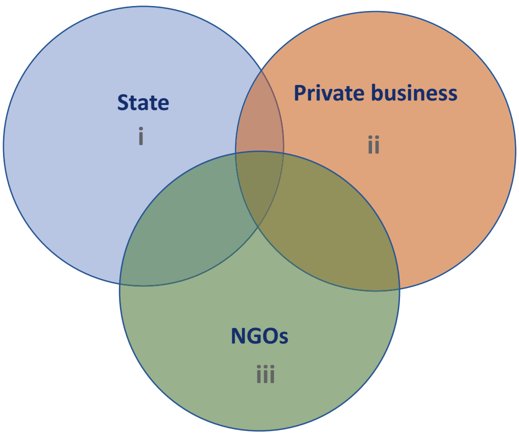

Fig. 4.1 Designers of regulations. (Source: Dathe et al. (2022) based on Crane and Matten (2016))

- *Cost-efficiency*: Voluntary self-regulation can potentially reduce administrative and compliance costs compared to mandatory regulatory frameworks. There is less time pressure for the implementation since voluntary regulations are usually not bound to timely obligations. Businesses have the freedom to choose the most efficient and effective approach to meet their sustainability goals. The flexibility, for example to have the free choice of technology for emissions certificates, may encourage innovative solutions, promote cost-saving measures and ultimately benefit the bottom line.
- *Market access and stakeholder confidence*: Self-regulation can help business demonstrate their commitment to sustainability and responsible practices, making them more attractive to socially conscious consumers and investors. This in turn can enhance the companies' reputation and build trust among stakeholders including customers, suppliers, employees, investors and the public. Demonstrating a commitment to responsible business behaviours can help attract and retain customers, differentiate the business from competitors and improve the overall brand image.

In summary, the government plays a complex role between private business and civil society. The relationship between the government, civil society and private businesses is characterized by interdependence and a delicate balance of roles (see Fig. 4.2).

First, the government assumes the crucial responsibility of safeguarding the interests of the general public through regulatory mechanisms. It acts as a natural representative of the citizens, aiming to protect their rights, ensure public safety and promote the overall welfare of society. The civil society relies on the government's

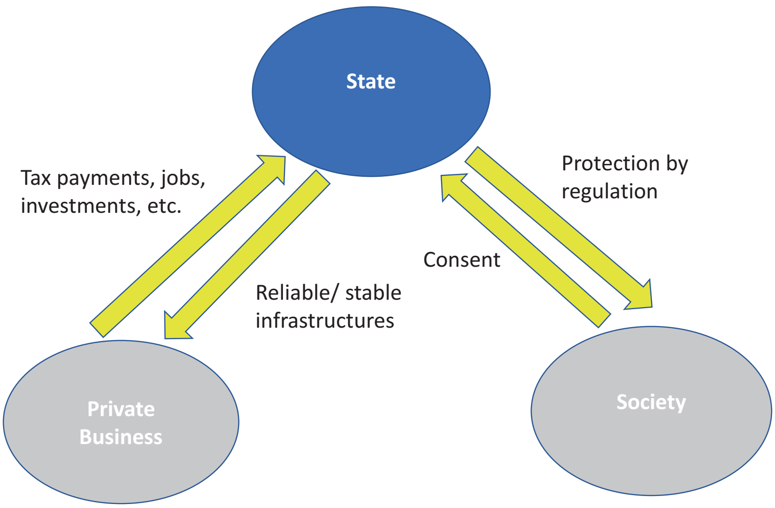

Fig. 4.2 The government's role between the private sector and the civil society. (Source: Dathe et al. (2022) based on Mitchell (1990))

protective function and looks to it for the formulation and enforcement of laws and regulations that uphold societal values and standards.

Second, the government relies on the consent and support of society to maintain its legitimacy and self-preservation. It must garner the trust and approval of the public by acting in their interests and addressing their concerns.

Furthermore, to meet the economic requirements of the civil society, such as achieving a high employment rate and stable improvement of income levels, the government relies on the contribution of private companies in the forms of tax payments, job offers, investments and so on. The private sector, in turn, relies on a conducive environment provided by the government, including infrastructure development, legal frameworks and public services relevant to their business operations. The relationship between the government and the private sector is one of mutual dependence.

In summary, the government must navigate its seemingly paradoxical roles. On one hand, it acts as a representative of citizens' interest, protecting their rights and welfare. On the other hand, the government is an actor with its own self-interest in the market and need to create a level playing field for fair competition. The harmonization of these roles is essential for the government to effectively serve the public, promote economic prosperity and ensure a stable and sustainable society (see Fig. 4.3).

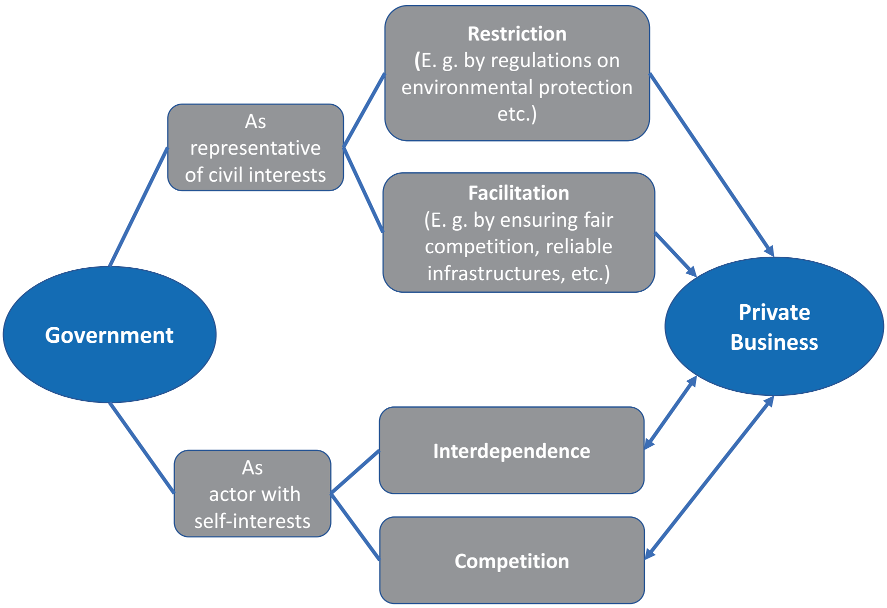

Fig. 4.3 The government's functions for the private business. (Source: Dathe et al. (2022) based on Crane and Matten (2016))

4.3 Political Power of Private Business

The government often faces criticism for allegedly prioritizing the political interests of the private sector over the public interests. Private businesses often exert influence on the political landscape and decision-making process within a society in three dimensions (Getz, 1997):

- *Access to the decision-maker*: Companies seek various means to gain direct access to decision-makers in the government. Personal contact with policymakers, such as through personal meetings, lobbying activities or participation in industry events, provides direct access for companies to present their viewpoints, concerns and policy preferences. Additionally, companies may employ indirect methods, such as advertising, campaigns or media initiatives, to shape public opinion and influence political decisions indirectly.
- *Public access to information*: The level of transparency regarding the influence of companies on the government can vary. Under circumstances, companies may disclose their engagement with policymakers to the public, allowing the general to be aware of their involvement. This transparency enables public scrutiny and an informed dialogue on the potential interest conflict of the private sector in their participation in political decision-making. Alternatively, companies may also choose to engage with politicians behind closed doors without public knowledge and transparency. Such undisclosed interactions generally raise concerns about hidden agendas and political biases in decision-making processes.
- *Type of arguments*. In practice, companies employ different strategies when attempting to influence political decision-making. They may try to convince the decision-makers through factual arguments, presenting evidence such as data or research to support their positions. In those cases, companies rely on the strength of their arguments for reasoned discourse. Alternatively, companies may put pressure on policymakers in the foreground by using their economic power in terms of market influence, or potential impact on employment and investment, to align policies with their interests. This approach relies more on the economic leverage and the potential consequences of the political decisions.

It is important to critically evaluate the influence of the private sector on governments, as this raises questions about the integrity of decision-making processes and the extent to which public interests are adequately represented. Ethical problem cases occur more frequently when private businesses exert their influence through direct access to politics. The level of political influence exerted by companies can be categorized in several grades, each with its own implications and ethical considerations (see Fig. 4.4):

Lobbying Lobbying is a form of direct influence where companies seek to access lawmakers by presenting convincing arguments rather than exerting explicit pressure. While lobbying is considered the weakest form of direct influence of the private sector on the government, it can still be problematic when politicians are

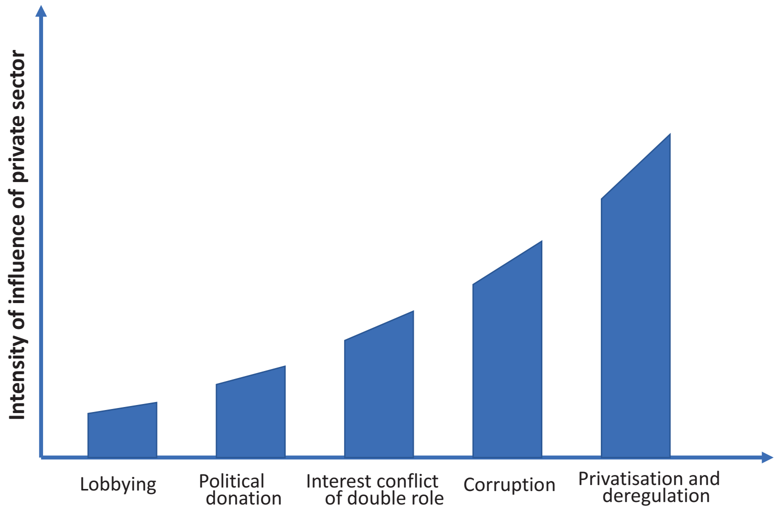

Fig. 4.4 Forms of the political influence of the private sector. (Source Dathe et al. (2022) based on Crane and Matten (2016))

subjected to one-sided information or undue influence. In modern times, lobbying has become a professionalized activity carried out by specialized individuals, managers or internal departments for government relations or public affairs, consulting firms and industry and trade associations. Their aim is to shape legislation and policies in favour of the business interests they represent (McGrath, 2005).

Political Donations Political parties in democratic systems often rely on financial contributions from various sources, including donations by private businesses. While the parties have legitimate needs for donations, they are also accountable to the public as a representative of the interests of civil society. Therefore, they are expected to disclose the information about the donations they receive. In general, donations from the private sector are viewed critically by the public, as they can be perceived as a means to influence political decisions in exchange of financial support. Some NGOs are also suspected of financially supporting political parties to advance their own strategic goals (Harris & Lock, 2002).

Conflict of Interest Due to Dual Roles Conflict of interest arises when individuals hold positions both in the private sector and in the government simultaneously, leading to potential conflicts between their personal or corporate interests and the public good. There are many examples of political leaders who have significant business ties or ownership, influential media moguls with political ambitions or former politicians who transition into high-ranking positions in the private sector, such as:

- Donald Trump: During his presidency in the United States, Donald Trump faced scrutiny for maintaining ownership of his business empire, which raised concerns about potential conflicts of interest. Critics argued that his personal business interests could shape his policy decisions to benefit his own companies. He was also criticized for hiring close family members with a strong economic background to be his important political advisors.
- Silvio Berlusconi: The former Italian Prime Minister Silvio Berlusconi dominated the nationwide media landscape through his ownership of three influential television stations and a large publishing house. This raised public concerns about the concentration of media power and potential conflicts of interest.
- Gerhard Schröder: After his tenure as the Chancellor of Germany, Gerhard Schröder took on various high-ranking positions in the private sector, including serving as chairman of the supervisory board of Nord Stream AG, a company involved in pipeline operation for the transport of natural gas from Russia to Germany. This transition raised major concerns about the revolving door between politics and business among the Europeans.
- Rupert Murdoch: The founder of News Corporation Rupert Murdoch is known for his media empire which includes Fox News, The Wall Street Journal and numerous other outlets. Murdoch's media influence is seen by many as a potential tool to shape public opinion and advance his own political interests.
- Michael Bloomberg: The founder of Bloomberg LP, a global financial data and media company has made several bids for political offices, including running for mayor of the New York City and seeking the democratic nomination for the U.S. presidency. His media platform Bloomberg News has been instrumental in promoting his political agenda.
- Tony Blair: After serving as the Prime Minister of the United Kingdom, Tony Blair established various business ventures and consultancy firms to advise governments and multinational corporations (MNCs).
- José Manuel Barroso: The former President of the European Commission, after leaving his political post, joined Goldman Sachs as an advisor and chairman of the international division. This move sparked criticism and accusations of a revolving door between politics and the private finance sector.

The above examples illustrate the potential for conflicts of interest and the blurring of lines between politics and business. Those situations raise concerns about impartiality and the potential misuse of power to favour private business interests over public welfare. While some argue that such connections can lead to optimal economic results of political decision-making, others express doubts on the fairness and integrity of the decision-making process. Overall, there is a need for transparency and appropriate regulations to protect public interests.

Corruption Corruption involves the abuse of power for personal advantages and is viewed as a violation of public interest (Rogow & Lasswell, 1963, S. 132–133). While the previously mentioned forms of attempts by private firms to exert political influences arouse ethical concerns, the act of corruption is a clear breach of legal and ethical standards. Corruption is particularly pervasive in cultures and regions where it is widespread and interpreted as a "service of friendship". Under such circumstances, companies that do not engage in corruption may face challenges in competing or even gaining a foothold in such environments.

Privatization and Deregulation Privatization involves the formal transfer of public assets into private ownership. Deregulation entails the removal of government-imposed restrictive regulations. As a result of those processes, the private business replaces the government in a partial function. Examples of privatization and deregulation include:

- Telecom industry privatization: Many countries around the world have privatized their telecommunication sectors. For instance, in the United Kingdom, British Telecom (BT) was private in 1984, transitioning from a state-owned monopoly to a private company. This led to increased competition, innovation and investment in the telecommunication industry (Durant et al., 1998).
- Airline deregulation: In the United States, the Airline Deregulation Act of 1978 removed government control over fares, routes and market entry for airlines. This led to increased competition, lower fares and more choices for consumers. Subsequently, it also resulted in the emergence of low-cost carriers such as JetBlue (Bailey, 1985).
- Energy sector privatization: Various countries have undergone privatization of the energy sector. For example, in the 1990s, Argentina privatized its energy industries including oil, gas and electricity sectors. The initial objective of the privatization was to attract private investment, introduce market competition and enhance efficiency (Preston, 1996).
- Postal service privatization: In the Netherlands, PostNL (formerly known as TNT Post) was partially privatized in 1994. The policymaker believes that the privatization would allow for greater flexibility and cost efficiency to adapt to the changing postal market (National Association of Letter Carriers, 2013).
- Banking deregulation: The repeal of the Glass-Steagall Act in the United States in 1999 deregulated the banking industry by removing the separation between commercial banking and investment banking. This had significant implications for the financial sector, leading to increased consolidation and complex financial products. Retrospectively, this was believed to be one of the key factors that induced the global financial crisis in 2008 (McDonald, 2016)

The above examples illustrate how privatization and deregulation can bring both benefits and challenges. While such policy changes can boost competition and innovation and subsequently lead to increased cost efficiency, they also require thorough considerations of public interest, consumer protection and other potential negative consequences.

Despite the concerns raised about the increasing political power of private businesses, it is worth noting that companies also have the potential to make positive contributions to society with their political power. For example, multinational enterprises (MNEs) have successfully leveraged their global influence to promote environmental sustainability, socio-political development and human rights standards for individual citizens across different political and cultural environments (Dathe et al., 2022).

4.4 Non-governmental Organization (NGO)

NGO is the abbreviation for non-governmental organization. A non-governmental organization operates independently from the government and is not driven by profit motives. Instead, NGOs work to represent the interest of civil society through their dedication to various causes, particularly in environmental and socio-political issues (Bundeszentrale für politische Bildung, 2017). Prominent examples of influential NGOs include Greenpeace and World Wide Fund for Nature (WWF) (Dathe et al., 2022).

Many NGOs are internationally active and focus on addressing critical issues such as environmental protection, human rights, poverty alleviation and combating social equality. Although the private sector primarily operates with profit-driven objectives, with the increasing importance of addressing social and environmental concerns, a growing trend of collaboration between NGOs and the private sector has been observed in recent years (Crane & Matten, 2016, S. 451).

Depending on the nature of the projects and the objectives involved, the collaborations between NGOs and the private sector take various forms, ranging from simple projects to long-term partnerships, in particular for the management of environmental and social projects, as well as economic projects.

There is a plethora of benefits to such collaborations. NGOs gain access to resources, expertise and financial sector, enabling them to amplify their impact and reach a broader audience. Furthermore, the business sector's networks and influence can help the NGOs in advocating for policy changes or mobilizing support for their causes.

As for the private sector, collaborating with NGOs offers them opportunities to demonstrate their commitment to social responsibility, sustainability and other ethical contributions to the public. It provides them with a platform to address societal concerns and improve their public image.

In summary, the increasing collaboration between NGOs and the private sector with shared values and shared responsibility provides opportunities for the collaboration partners to leverage their individual strengths and resources to drive positive changes, promote sustainable development and contribute to a more inclusive and equitable society. However, it should also be noted that collaborations between NGOs and the private sector are not without challenges. Conflicting priorities and conflicts of interest can arise during the collaboration process. For the best interests of the communities and causes they aim to support, it is important to establish appropriate governance processes to ensure the independence of NGOs and maintain transparency and clear accountability in partnerships with the private sector.

NGOs excel at promoting their causes by effectively capturing public attention and generating awareness around important issues. To advance their causes and promote desired social changes, NGOs employ a variety of tactics, both direct and indirect, which are not always undisputable from an ethical standpoint. In Fig. 4.5, we can explore some common strategies used by NGOs to advance their objectives.

NGOs employ different tactics to achieve their objectives in promoting social changes and preserving the environment. Their activities can be categorized into direct and indirect actions.

Direct Action: Without the Use of Force

NGO direct actions serve as a vital tool for raising awareness, challenging power structures and advocating for social, environmental and political changes. These actions play an important role in amplifying the voices of marginalized communities, promoting social justice and working towards a more equitable and sustainable world. The NGO direct actions are usually peaceful and aligned with their organizational values. However, the effectiveness and ethical implications of some actions are subject to debate, as they may involve confrontational tactics, disrupt public order and lead to tensions with authorities or other stakeholders. Here are some examples of NGO direct actions (Dathe et al., 2022; Crane & Matten, 2016):

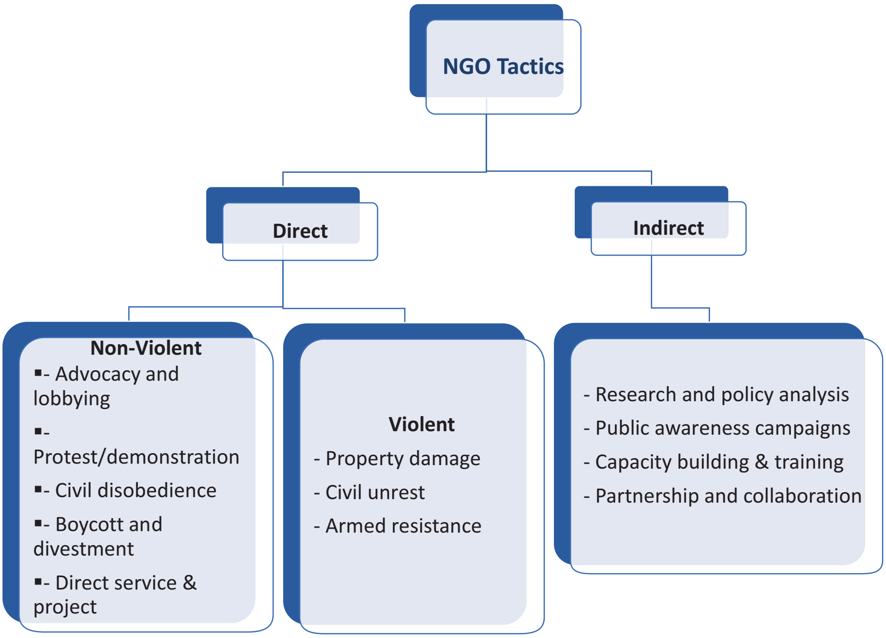

Fig. 4.5 Tactics of NGOs. (Source Dathe et al. (2022) based on Crane and Matten (2016) with modifications)

- Direct lobbying: NGOs engage in advocacy efforts to influence policymakers. They use various channels to voice their concerns, propose policy recommendations and lobby for legislative changes.
- Protest and demonstration: NGOs often organize and participate in public protests and demonstrations to bring attention to their causes by mobilizing supporters and generating media coverage. These events can include marches, rallies and gatherings where activists express their concerns, demands and grievances, as well as written protests and online protests.
- Civil disobedience: Civil disobedience is aimed at generating media coverage, provoking dialogues and highlighting the urgency of addressing the underlying issues. In some cases, NGOs resort to civil disobedience as a means of drawing attention to their cause. This can involve acts of non-violent resistance such as sit-ins, blockades, occupations or other forms of direct actions that disrupt normal public operations.
- Boycotts and divestment: NGOs sometimes initiate or support boycott campaigns to put economic pressure on companies or industries allegedly associated with unethical practices. By encouraging consumers to refrain from purchasing certain products or services, NGOs aim to force the targeted organizations to change their behaviours or policies. Similarly, divestment campaigns aim at the withdrawal of financial investments from companies involved in objectionable activities.
- Direct services and projects: NGOs also undertake direct service provision and community projects to create positive social changes at the grassroots level, especially in improving the well-being of marginalized communities in society. These activities can include healthcare services, education programmes, disaster relief, sustainable development projects and capacity-building initiatives.

Direct Action with the Use of Force

While the majority of NGOs intend to uphold the non-violent principle, however, when peaceful tactics fail to achieve their objectives, those who advocate for major changes sometimes turn to the use of force. Demonstrations, occupations, sit-ins and blockages can easily end up in violent confrontations with law enforcement or other stakeholder groups. Such aggressive actions include (Chenoweth, 2011; Crane & Matten, 2016, S. 451) the following:

- Property damage: Property damage ranges from vandalism (e.g. graffiti) and sabotage to more severe actions like destruction of property associated with the target of protest or infrastructure.
- Civil unrest: This includes especially violent demonstrations turning into riots and street clashes with law enforcement.
- Armed resistance: In extreme cases, certain activist groups may resort to the use of firearms or other weapons to challenge the existing regimes and social orders.

Direct actions with the use of force for a good cause are highly controversial and can have legal consequences, such as arrest, charge of assaults or other criminal offenses. Although direction actions with the use of force may be driven by a sense of urgency or frustration, resorting to violence can have ethical implications, diminish public support and undermine the credibility of the cause.

Indirect Action: Topic-Related Research in Advance

Compared with private companies, NGOs generally enjoy a higher level of trust in civil society due to the perception of NGOs as representatives of public interest. NGOs are often viewed as independent entities that advocate for marginalized communities, protect human rights and promote sustainable development. However, it must be acknowledged that the trust in NGOs can vary depending on the context and the background of the specific organizations. Some NGOs may face scepticism or criticism, particularly when their activities are believed to be politically motivated, or they are perceived as lacking transparency or accountability. Recognizing the importance of credibility and trust, NGOs have increasingly focused on conducting rigorous and evidence-based research to support their claims by means of (Dathe et al., 2022; Whawell, 1998):

- Research and policy analysis: Many NGOs conduct research and policy analysis to gather evidence, generate knowledge and provide informed recommendations to policymakers and/or the public on social, environmental or economic challenges. Their reports and studies contribute to the understanding of complex issues and decision-making processes.
- Public awareness campaigns: NGOs invest in public awareness campaigns to inform and educate the public about social, environmental or other humanitarian issues. They employ various mediums such as social media, media outreach, community events, workshops and educational programmes to raise awareness, change attitudes and inspire actions among the general population.
- Capacity building and training: NGOs offer capacity-building programmes and training initiatives to engage individuals, communities and local organizations. These programmes aim to enhance skills, knowledge and capacity to address specific challenges and foster self-reliance within communities.
- Partnership and collaboration: By forming alliances with other organizations including governments, businesses, academia and other NGOs, collaborations can help NGOs to effectively amplify their impact through collective actions on shared goals and coordinated efforts based on shared resources and expertise.

Due to the fast growth of NGOs worldwide, there is an increasing competition for limited funding sources. NGOs often need to employ effective fundraising strategies to secure financial support by demonstrating the impact of their work and cultivating relationships with the donors. They typically rely on various sources of funding to maintain their own financial sustainability, including (Dathe et al., 2022):

- Donations from private individuals or companies: Private individuals who are passionate about specific NGO causes, as well as private companies that view the NGO initiatives as part of their own Corporate Social Responsibility (CSR) strategy, may provide financial aid in the form of monetary contributions or in-kind support.
- Public funds: Governments at various levels (national, regional and local) may provide funds to support NGO projects that are in line with governmental policies.
- Remuneration for social services: Some NGOs that offer social services such as healthcare, education or community development receive remuneration from public or private organizations for their efforts.
- Memberships: NGOs may require individuals or organizations to pay regular fees to become members. Membership is not only a means to improve financial stability but also fosters a sense of belonging among the community.
- Business activities: In recent decades, there has been a rise in the number of "social enterprises" that raise financial means for desired social goals through their own business operations. The social enterprise model provides a solution to the funding problem for non-profit undertakings (see Sect. 4.5).

4.5 Social Enterprise

Social enterprise is a hybrid organizational model that combines charitable social and/or environmental objectives with traditional market activities. The European Commission defines "social enterprise" as: "… an actor in the social economy whose main objective is to create social impact rather than make a profit for its owners or shareholders" (European Commission, 2011).

Although social enterprises, like classic business organizations, aim to earn a profit by providing goods and services for the market in an entrepreneurial and innovative manner, their primary objective is to create social impact rather than maximizing return on investment for their owners or shareholders. Compared to classic business organizations, social enterprises are characterized by transparency and responsible practices in their business operations, as well as intensive engagement with their employees, consumers and other stakeholders.

Collaborations between social enterprises in the private sector and non-profit NGOs can lead to mutual benefits. While businesses benefit from enhancing their brand reputation through market-effective publicity on their partnerships with NGOs with positive social images, they also provide financial means to solve the funding problems for the non-profit activities of the NGOs. Optimally, social enterprises can secure the sustainable pursuit of social goals with their economic success.

However, the close collaboration between NGOs and private businesses is sometimes met with criticism. One major concern is that private businesses may have a dominant influence in joint activities, leading to significant financial gains for businesses, while the targeted social objectives are only inadequately addressed. As a result, it is feared that businesses benefit disproportionately compared with the intended recipients of the social benefits. A further concern is the potential "contamination" or "co-opting" of NGOs with economic thinking due to their close interactions with the private sector. Critics argue that NGOs may adopt the perspectives and priorities of private businesses. In order to maintain their independence and credibility, it is advisable for NGOs to keep a healthy distance from the private.

In summary, social enterprises as an organizational model combine social objectives with self-containing financial sustainability. They contribute to counteracting on the funding challenges faced by non-profit organizations aiming to create positive social impact. While collaborations between NGOs and the private sector can bring mutual benefits, there is also a need for the preservation of the NGOs' independence and credibility (See Dathe et al., 2022; Crane & Matten, 2016, S. 471 ff).

4.6 Case Study: WFTO (World Fair Trade Organization)

In recent decades, the concept of Fair Trade (FT) has gained global significance as an alternative to mainstream business models. Businesses based on fair trade principles prioritize social equity and environmental sustainability in global trade and seek to empower marginalized producers, particularly in developing countries, by providing them with better trading conditions, promoting local social and ecological sustainability as well as enhancing long-term trust relationships between producers and buyers (Huybrechts, 2012).

The World Fair Trade Organization (WFTO) is not a social enterprise itself, but an international network of social enterprises engaged in fair trade. WFTO plays an important role in supporting and promoting fair trade principles among social enterprises around the world (currently across 76 countries) by providing a platform for organizations to connect, collaborate and learn from each other. It also brings together farmers, producers, businesses and artisans to create equitable opportunities and sustainable trade relationships among the member organizations including over 1000 social enterprises and 1500 shops (WFTO, 2023).

The World Fair Trade Organization (WFTO) provides a Guarantee System as an international verification model for social enterprises that fulfils the requirements for the protection of workers, farmers and artisans, covering various aspects such as fair wages, safe working conditions, gender equality, respect for cultural identity and environmental preservation along the supply chains. WFTO engages in advocacy and campaigns to raise awareness about fair trade among consumers and support market access of member organizations. WFTO also provides training programmes for the auditing process (WFTO, 2023).

In summary, the corporate strategy of the World Fair Trade Organization (WFTO) is based on the concept of fair trade. It provides a support system and network for fair trade enterprises, farmers, producers and artisans, helping members to connect and collaborate, and facilitates their market opportunity by promoting global fair-trade education and the auditing process for the WFTO Guarantee System (WFTO, 2023).

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Corporate Strategy

5

5.1 Corporate Strategy and Strategy Pyramid

Corporate strategy plays a critical role in shaping overall decisions such as business purposes and directions for business development endeavours. As a result, all other strategic choices are to be aligned with the corporate strategy. The process of developing a corporate strategy can vary depending on the size and nation of the business organizations (Dathe et al., 2022; Stibbe, 2019):

- Smaller and newer organizations that operate within a specific niche market or offer a limited set of unique products or services often have a simpler task in developing their corporate strategy with fewer variables to consider such as value proposition, target market and price strategy.
- On the contrary, larger and more established business organizations face a more complex task in developing the corporate strategy, due to the comprehensive portfolio of products and services, and market structure. As they seek growth and new opportunities, larger companies need to carefully analyse market trends, competitive forces and internal capacities and capabilities.

Corporate strategy can be described in three layers (Dathe et al., 2022; Johnson et al., 2007) (see Fig. 5.1):

- *Corporate strategy (strategic level)*: This level of strategy focuses on the overall direction and courses of the business. Corporate strategy outlines the general directions for market selection, procurement, production, distribution and logistics, aiming to optimize the flow of goods and services, minimize costs and ensure efficient operations throughout the supply chain.

  Corporate strategy is primarily defined by top-level executives such as managing directors and executive boards. This strategic framework sets the tone for

T. Dathe et al., *Implementing Environmental, Social and Governance (ESG) Principles for Sustainable Businesses*, Responsible Leadership and Sustainable Management, https://doi.org/10.1007/978-3-031-52734-0_5

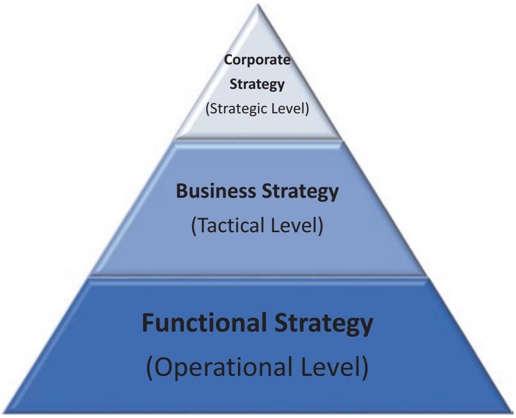

Fig. 5.1 Strategy pyramid. (Source: Based on Johnson et al. (2007) and Dathe et al. (2022))

the organization, guiding decision-making processes and determining the fundamental principles for the allocation of resources. It compasses various aspects such as market positioning, supply chain management, market entry strategies, risk mitigation and other overarching organizational activities.

- *Business strategy (tactical level)*: Business strategy derives from the overarching corporate strategy and involves the determination of more specific objectives for individual business units or subdivisions within the organization. Business strategy can serve as a roadmap for achieving the objectives defined in the corporate strategy. In particular, business strategy includes:

  (a) Market-specific tactics
  (b) Business unit alignment

  While business strategies are more common in larger firms with diverse activities, smaller organizations can also benefit from defining strategies for different subdivisions, so as to allow them to effectively allocate their resources to achieve those objectives. Overall, business strategy serves as a crucial link between the corporate strategy and the specific business operations.

- *Functional strategy (operational level)*: The functional strategy focuses on the day-to-day operation, ensuring efficient business functions in line with business strategies. While an overarching corporate strategy provides a guideline of direction, it is the functional strategy that determines how everyday operations should be conducted. Leaders should define how different departments and functions work together towards higher goals at the lowest level of strategic development. Without a well-developed plan for operational excellence, organizations may struggle to make progress even with a clear corporate strategy.

  Functional strategies address specific aspects and operations of departments, teams, groups and activities within the organization, in particular:

  - Day-to-day actions aligned with broader goals and objectives of corporate and business strategies
  - Interdepartmental relationships, promoting coordination and cooperation to achieve common goals

- Setting targets and monitoring process, for example by defining key performance indicators (KPIs) and other metrics to assess progress

In summary, each level contributes to the overall performance of the organization. Successful strategies align the organization with the corporate mission including ethical considerations, such as corporate social responsibility (CSR) and environmental, social and governance (ESG) concepts, and introduce appropriate measures to monitor progress. While corporate strategy often receives all of the attention, its success is finally achieved at the bottom of the hierarchy through day-to-day operations.

It is crucial to synchronize strategies from top to bottom, as well as horizontally across the organization, with feedback flowing between corporate and functional levels bridging the gap between high-level strategies and the specific actions taken by individual departments and teams, ensuring the smooth functioning and progress of the organization (Dathe et al., 2022; Khojasteh, 2018). Effective communication among stakeholders, especially among employees, is essential for the implementation of strategies (Wagner, 2019). While strategy alone does not guarantee organizational success, it provides a solid foundation for progress (Dathe et al., 2022).

5.2 Strategic Management and Strategy Triangle

The process of the strategic management cycle consists of elements: strategy analysis, strategy choice and strategy implementation (Johnson et al., 2017) (see Fig. 5.2). The strategy triangle, also known as the strategic triangle or strategic cycle, aims to answer the following questions in terms of corporate strategy and market positioning (Dathe et al., 2022):

- Who are we?
- Where are we?
- Where do we want to go?
- How do we achieve this?

Strategy Analysis This step involves evaluating the organization's current strategic position. The key objectives of this step are as follows:

- *Factor analysis*: To identify internal and external factors that impact the organization's performance, such as technological development, market trends and internal competitive advantages
- *Defining strategy options*: To determine strategic options based on the identified impact factors

Strategy Choice After the strategic analysis, the best strategic options are to be implemented based on the corporate decision-making processes and assessment methods.

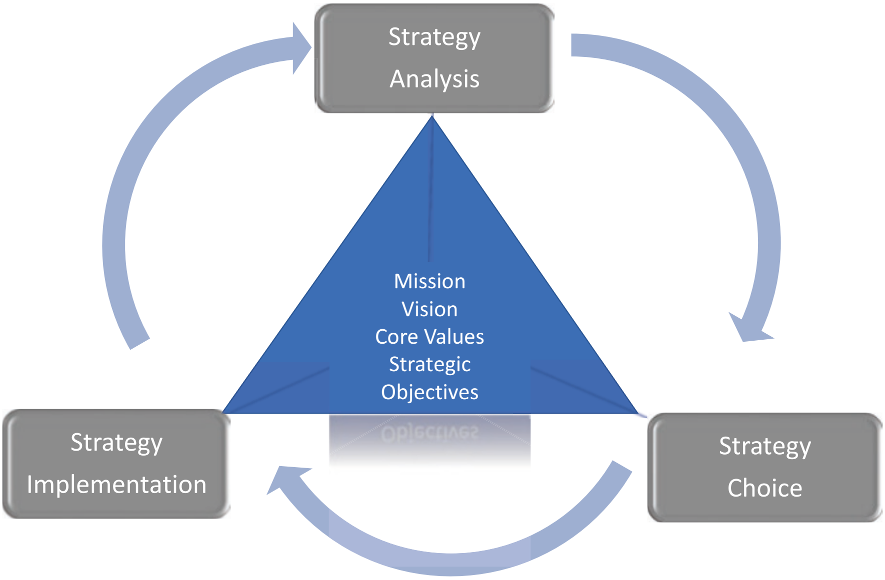

Fig. 5.2 Strategic core values and strategic triangle. (Source: Based on Dathe et al. (2022) and Johnson et al. (2017))

Strategy Implementation The final step is to execute the chosen strategy and to determine the approach to achieve strategic objectives. This involves:

- Translating the strategy choices into strategic objectives
- Developing tactical strategy and action plans
- Setting performance targets
- Establishing monitoring procedures
- Allocating resources

The strategy triangle provides a framework for guiding the strategic management cycle that helps organizations to systematically analyse their current situation, making informed decisions on development plans, effectively implementing the chosen strategies and, subsequently, improving future decision-making processes with the gained experiences (Johnson et al., 2017).

5.3 Strategy Analysis

5.3.1 Internal and External Factors

The strategy analysis of an organization is a crucial stage that involves understanding the current strategic position (Johnson et al., 2017). There is a plethora of internal and external factors that have a significant influence on the business success.

Table 5.1 Corporate strategy: examples of internal and external factors

Internal factors	External factors
Organizational culture: Shared values, beliefs and behavioural norms that shape the attitudes and behaviours of employees within the organization Management capacity: Skills, competencies and leadership styles of managers Human resources: Skills, knowledge and motivation of employees, as well as internal processes for recruitment, training and employee development Organization structure: Formal arrangement of roles, responsibilities and responsibilities between employees, as well as decision-making processes and communication channels Operational excellence: Effectiveness, efficiency and quality of internal processes Technology and infrastructure: Technological capabilities and physical infrastructure (especially information systems) that support the business operations	Economic environment: Overall economic conditions, such as economic growth, inflation rates and exchange rates, that impact business operations and consumer behaviours Legal and regulatory environment: Laws, regulations and government policies that impact the organization's operations, including environment protection regulations, labour laws, consumer protection laws and so on Market conditions: Dynamics of the industry sector at the relevant market where the organization operates, such as market trends, customer preferences and competition Political factors: Political stability, political ideologies and governmental policies that impact the organization's operations and financial performance

Internal factors are those that can be controlled and directly influenced by the management. On the contrary, external factors originate from the external business environment outside the organization's control. Some important internal and external factors are depicted in Table 5.1.

Strategy analysis involves a comprehensive assessment of internal and external factors that significantly impact the organization's chance of success. For the strategy formulation, various analysis methods are often used to create valuable insights for informed strategic decisions, such as (Dathe et al., 2022):

- *PESTEL analysis*: PESTEL stands for political, economic, social, technological, environmental and Legal factors. This method focuses on the external macro-environmental influence factors for a business model and is helpful in identifying the major opportunities and threats associated with the above factors in the environment where the organization operates.
- *Porter's Five Forces analysis*: The analysis framework helps to assess the attractiveness and profitability of an industry sector, including the bargaining power of suppliers and customers, threat of new entrants and substitute products or services as well as the competitive rivalry.
- *SWOT analysis*: SWOT stands for strengths, weaknesses, opportunities and threats. SWOT analysis helps to build a comprehensive understanding of the

Table 5.2 Common strategy analysis methods

Analysis method	Focus	Findings
PESTEL	Macro-environmental influence factors, including political, economic, social, technological, environmental and legal factors	Major opportunities and threats of the relevant business environment
Porter's Five Forces	Bargaining power of suppliers and customers, threat of new entrants and substitute products or services and competitive rivalry	Attractiveness and profitability of an industry sector
SWOT	Strengths, weaknesses, opportunities and threats	Understanding of the organization's competitive position
Core competencies	An organization's unique capabilities and resources	Competitive advantage
Benchmarking	Performance and processes with those of industry leaders or competitors based on performance metrics	Best practices
Stakeholder analysis	Interests, concerns and potential impacts of key stakeholders	Interests, expectations and potential impacts of key stakeholders
Cultural analysis	Organizational culture in terms of norms, beliefs, attitudes, behaviour rules and communication patterns	Cultural strengths and weaknesses of an organization and inter-organizational cultural fit

organization's competitive position which can be used as the foundation for the strategy formulation.

- *Core competencies analysis*: The core competencies of an organization are its unique capabilities and resources that lead to a competitive advantage.
- *Benchmarking analysis*: This involves comparing an organization's performance and processes with those of industry leaders or competitors based on performance metrics. Benchmarking is a cost-efficient approach for strategy analysis and strategy development. The knowledge of best practices can help to identify areas for improvement and opportunities for innovations or expansion.
- *Stakeholder analysis*: The focus of stakeholder analysis is the identification of interests, concerns and potential impacts of key stakeholders, including employees, customers, suppliers, shareholders, local communities, government agencies and non-governmental organizations. The results of stakeholder analysis can help organizations manage stakeholder relationships by addressing their interests and expectations in corporate strategy.
- *Cultural analysis*: Cultural analysis focuses on norms, beliefs, attitudes, behaviour rules and communication patterns that shape the organizational culture. The results are helpful for the identification of the cultural strengths and weaknesses of an organization, as well as the cultural fit between organizations in the context of potential mergers or acquisitions (Table 5.2).

Strategic analysis is crucial for the understanding of an organization's strategic position in terms of value chain management. This requires a thorough assessment of its competencies, resources, strengths, potentials, opportunities and risks. Overall, strategic analysis aims to define possible future directions and opportunities for growth.

In the following sections, some strategic analysis methods will be explained in more detail.

5.3.2 PESTEL Analysis

PESTEL analysis, also known as PESTLE analysis, is a framework used to assess the macro-environmental factors that have a profound impact on an organization's chance of success and strategic decisions. This framework is especially helpful for new businesses and existing businesses trying to enter a foreign market.

PESTEL is an acronym that stands for its components including political, economic, social, technological, environmental and legal factors (see Fig. 5.3).

- *Political factors*: Government policies, political ideologies and political stability are of enormous importance for business operations and strategies, as they shape the legal and regulatory framework in which organizations operate.
- *Economic factors*: The broader economic conditions, such as economic growth, inflation rates, unemployment level, interest rates and exchange rates, have a strong impact on market demand, consumers' purchasing power, cost of resources and thus the overall business profitability.
- *Social factors*: The societal and cultural influences include factors such as cultural norms, social attitudes, lifestyle preferences, consumer behaviour patterns as well as population growth and demographic development.
- *Technological factors*: Technological progress includes technological innovations such as automation and digitalization, as well as the adoption of new technologies. Technological progress can create new opportunities or disrupt existing business models and processes.
- *Environmental factors*: There is an increasing requirement for the integration of ecological considerations in the overall business strategy and business practices, including environment-friendly technologies, emission control, waste management, energy efficiency and so on.
- *Legal factors*: Business organizations have to operate within the framework of legal and regulatory requirements, including labour laws, consumer protection laws, intellectual property rights and industry-specific regulations.

In practice, PESTEL analysis is often used in collaboration with other business analytical frameworks such as SWOT analysis and Porter's Five Forces analysis, so as to provide a more comprehensive presentation of a business situation based on its internal and external factors (Dathe et al., 2022).

Fig. 5.3 PESTEL analysis. (Source: The Authors)

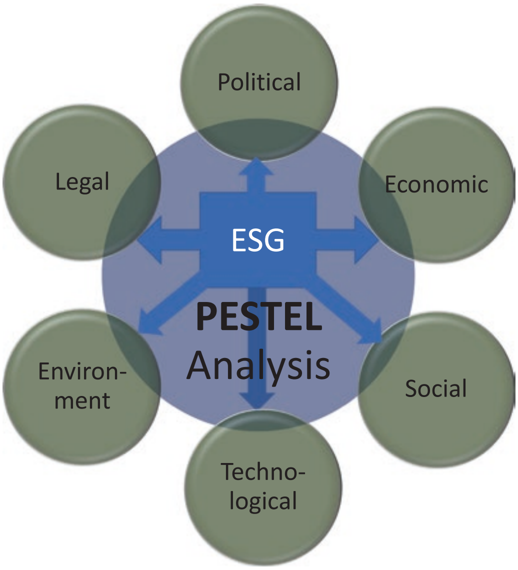

Fig. 5.4 Porter's Five Forces. (Source: Author based on Porter (1980))

5.3.3 Porter's Five Forces

Porter's Five Forces is a strategic framework developed by Michael Porter that is commonly used to analyse the competitive dynamics of an industry and the attractiveness of the market. The framework consists of five key forces that shape competition (Porter, 1980) (Fig. 5.4):

- *Rivalry amongst competitors*: This force refers to the level of competition among existing competitors in the industry. Rivalry among competitors can be described

with metrics such as the number of competitors and market shares of competitors. Higher competition potentially leads to lower profitability.
- *Bargaining power of suppliers*: This force describes the supplier's standing at the market in terms of their ability to raise prices or reduce the quality of deliveries for comparable prices. The higher bargaining power of suppliers can reduce the profitability of the industry. The bargaining power of suppliers can be measured by, for example the number of available suppliers and their market shares.
- *Bargaining power of customers*: Buyers can use their power to put pressure on companies to reduce prices and, subsequently, reduce the profitability of the industry. The bargaining power of customers can be measured, especially by the concentration of buyers and their price sensitivity.
- *Threat of market entrants*: This force describes the level of market entry barriers. Higher market entry barriers result in more difficulties for new entrants, so it is easier for existing providers to maintain their market share. Threat of new entrants can be measured by, for example investment demand for new entry, economies of scale, brand loyalty and other entry barriers such as official permits.
- *Threat of substitutes*: This force focuses on the availability of alternative products or services that can fulfil the same needs as the industry's offerings. The existence of substitutes strengthens the bargaining power of customers.

Porter's Five Forces analysis is helpful for the understanding of the competitive landscape by identifying strategic opportunities and risks. The higher the pressure posed by these five forces, the more difficult it is to achieve a sustainable competitive advantage, and the less attractive the industry is.

Under certain circumstances, it is possible for organizations to manipulate the market with their strategic influences, for instance by introducing innovative technologies to add competitive advantages to their products and services or centralizing procurement to enlarge their own bargaining power against the suppliers.

5.3.4 SWOT Analysis

SWOT analysis is a strategic planning tool based on a comprehensive assessment of the internal and external factors that can impact the organization's performance and success. Subsequently, these influence factors are categorized as:

- *Strengths* = internal factors that lead to a competitive advantage of the organization, such as brand reputation, innovative technologies, unique expertise, efficient processes and qualified and motivated workforce.
- *Weaknesses* = internal factors that cause a disadvantage compared to the organization's competitors, such as outdated technologies, limited resources, lack of market presence and poor leadership.
- *Opportunities* = external factors in the business environment that help the organization amplify its advantages, such as favourable regulatory changes, market trends, emerging technologies and strategic partnerships.

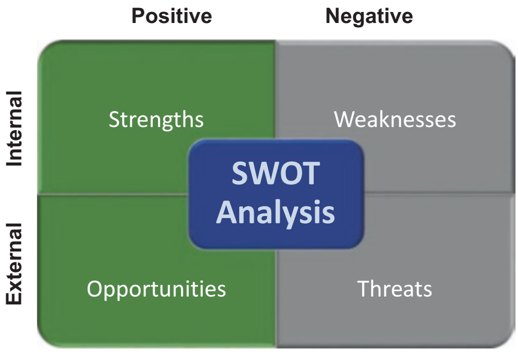

Fig. 5.5 SWOT analysis. (Source: Authors)

- *Threats* = external factors that pose challenges or risks to the business model, such as intense competition, economic downturns, regulatory hurdles and disruptive technologies that lead to competitive product or service substitutes.

By conducting a SWOT analysis, organizations can gain valuable insights into their current performance and future success potentials. By capitalizing strengths, addressing weaknesses, seizing opportunities and mitigating threats, they improve sustainable performance thanks to informed decisions on effective strategies and efficient resource allocation (Fig. 5.5).

SWOT analysis is a systematic approach to strategic analysis. In practice, by involving representatives from different divisions throughout the organization, key factors and their impacts can be identified and visualized. Opportunities can lead to growth and competitive advantages, while addressing and mitigating threats is vital to safeguard the organization's performance and market position. Visualizing the findings further improves the effectiveness of strategy development and communication.

5.3.5 Core Competencies Analysis

Core competencies are an organization's unique strengths and capabilities that contribute to its competitive advantages. Core competencies analysis involves identifying and understanding the key areas where the organization excels, such as product features, internal processes, brand reputation or special skills, technologies or resources. An organization's core competencies typically consist of a combination of tangible and intangible assets.

Once identified, the core competencies should be further evaluated in terms of their relevance and importance in the industry or market, for example how well those competencies help to create value for customers and enable the organization to outperform its competitors, in order to maintain a competitive edge in the marketplace.

Furthermore, core competencies analysis helps organizations recognize the potential further developments and how core competencies should be enhanced in the future to stay in long term ahead in the market (Dathe et al., 2022).

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Strategy Selection

6

6.1 Mintzberg's Strategy Definition (5Ps Model)

Strategy serves as the guiding principle for decision-making processes that shape the direction of an organization. To effectively define strategy options, it is necessary to establish a clear understanding of what strategy entails. By clarifying the concept of strategy, a framework for analysing and evaluating optional courses of action can be developed that allows organizations to align their efforts and resources towards achieving their determined objectives.

A well-defined concept of strategy enables a systematic approach to strategy analysis and a consistent structure in describing strategy options. This facilitates the comparison of strategy options, as well as more productive discussions among decision-makers based on a coherent understanding of the strategic intent. Subsequently, a clear definition of strategy also promotes effective communication and collaboration among stakeholders involved in strategy choice and strategy implementation processes.

Mintzberg provides a multi-dimensional framework that depicts the diverse interpretations and complexities associated with the multiple facets of the concept of strategy. According to Mintzberg, a strategy can be described in five distinctive dimensions (Mintzberg et al., 1995) (see Fig. 6.1).

- *Plan*: Strategy can be understood as a plan – a premeditated guideline to deal with a particular situation, including a purposeful course of action as an approach to achieving intended outcomes. Strategy as a plan emphasizes the forward-thinking and the purposefulness of actions.
- *Ploy*: When viewing strategy as a ploy, the focus lies in the realm of tactical manoeuvres to gain a competitive advantage. Aligned with the long-term goals, a ploy-driven strategy provides more specific guidelines on short-term tactics aiming to outwit competitors and opponents and, ultimately, obtain a more

T. Dathe et al., *Implementing Environmental, Social and Governance (ESG) Principles for Sustainable Businesses*, Responsible Leadership and Sustainable Management, https://doi.org/10.1007/978-3-031-52734-0_6

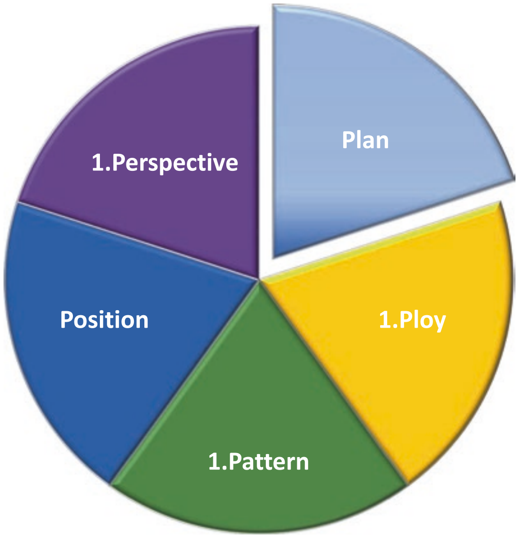

Fig. 6.1 Mintzberg's strategy definition (5Ps model). (Source: Based on the concept of Mintzberg et al. (1995))

favourable market position for the organization. A ploy is not a standalone strategy, but rather a tactical move within a broader strategic framework.

- *Pattern*: A strategy as a pattern refers to the observable and recurring behaviours that emerge in a stream of actions, regardless of whether they were originally intended or not. While strategy as a plan may fail to be implemented, strategy as a pattern may be implemented without preconception.

  By distinguishing the predetermination of intentions, strategies can be differentiated as deliberate strategies or emergent strategies. Deliberate strategies are characterized by intentions that are previously conceived and to be subsequently realized through actions aligned with the original strategic plans or ploys. Emergent strategies are those with patterns that arise organically from collective behaviours as a response to unforeseen circumstances or market dynamics, despite or in the absence of specific intentions.
- *Position*: Viewing strategy as a position emphasizes the importance of aligning the organization with its environment. The environment can be described with various external factors such as market conditions, competition, technological advancement, regulatory requirements and sociocultural trends that impact the organization's ability to attain a competitive advantage. A strategic position, on the contrary, entails the organization's standing in its environment in terms of its strengths, weaknesses, opportunities and threats. By effectively positioning itself, an organization needs to align its internal capabilities and resources with the external context to create sustainable competitive advantages.
- *Perspective*: The concept of strategy as a perspective acknowledges that strategy goes beyond mere plans or positions but encompasses the collective mindset with the shared perception of the organization and the world in which it operates. Cultivating a shared strategic perspective allows organizations to foster unity, collaboration and alignment among their stakeholders, enabling them to navigate the challenges of the business environment and achieve their strategic goals.

By considering the multiple dimensions of strategy, decision-makers can develop a comprehensive and holistic understanding of this concept, allowing them to make more informed and effective decisions that enhance the organization's ability to navigate the complex and fast-changing business landscape to achieve long-term success (Mintzberg et al., 1995; Dathe et al., 2022).

6.2 Selection Criteria

Strategy choice is the process of selecting a particular option from a range of alternatives as identified through strategy analysis. The selection of an overall strategic approach could be conducted based on the following three criteria (Dathe et al., 2022; Johnson et al., 2017):

- *Suitability*: This criterion assesses the degree to which the strategic options can be deemed suitable for the organizations' current position as identified through self-assessment in strategy analysis. The following questions are helpful in identifying the suitability of strategic options:
  – Does the strategy leverage the company's strengths, such as specialized employees, expertise in a niche market or existing distribution channels to enhance market growth?
  – Does the strategy help to mitigate the risks and challenges identified in strategy analysis, such as the strong bargaining power of suppliers or customers and unsolved financing issues?
  – Does the Strategy align with the organization's objectives, such as profit targets, or expected growth rate?
- *Acceptability*: This criterion assesses the likely consequences of the strategic options with regard to the risks and potential benefits, closely tied to stakeholders' expectations. Some relevant questions to ask include:
  – How will the strategy impact shareholder value?
  – How will the strategy impact the organization's performance?
  – Which additional risks are involved?
  – Will the strategy significantly impact the organizational structure and/or the activities of any departments, groups or individual employees of the organization?
  – will the strategy change the organization's relationship with external stakeholders such as suppliers, customers, government entities or local communities?
- *Feasibility*: This criterion evaluates whether the organization possesses sufficient resources to carry out the strategy. Considerations for feasibility can be examined with the following questions:
  – *Markets*. What market share is necessary for success, and how quickly can this be achieved?
  – *Machinery*. Is the existing production capacity sufficient for the demands imposed by the strategy?

– *Materials*. How will the strategy impact the sourcing activities? Are changes in quality and quantity necessary?
– *Manpower*. How many employees with what skills are needed, and when will they be needed? Are there talent gaps, and if so, can they be filled through recruiting or training?
– *Management*. Does the existing management possess the necessary knowledge and skills to execute the strategy effectively?
– *Money*. How much financial investment is required, when will it be required and can financial sources be secured?

Strategic choice is a comprehensive process that involves narrowing down the strategic options after thorough consideration of the possible impacts of the most influential internal and external factors.

6.3 Strategic Management Tools

6.3.1 Porter's Generic Strategies

Porter's generic strategies provide a valuable framework that helps organizations select their fundamental strategic approaches, in order to position themselves effectively in the market and outperform their competitors. This framework consists of three main generic strategies (Porter, 1985) (see Fig. 6.2):

Fig. 6.2 Porter's generic strategies. (Source: Authors based on Porter (1985) and Dathe et al. (2022))

- *Cost Leadership*: The cost leadership strategy aims to achieve a competitive advantage by offering products and services at the lowest cost level while maintaining acceptable quality. In order to achieve cost leadership, organizations need to minimize their costs throughout the value chaining, including sourcing, production and distribution, by achieving operation excellence, economies of scale and effective cost management. Cost leadership helps organizations attract price-sensitive customers and increase market share.
- *Differentiation*: The differentiation strategy aims to create unique and distinctive products or services that are perceived as superior by customers, for example by offering unique features, superior quality, exceptional customer service or innovative design. Organizations following a differentiation strategy usually invest large amounts in research and development, innovative product design, branding and so on. The target customers are those who value and are willing to pay a premium for the unique attributes offered.
- *Focus*: The focus strategy involves targeting a specific market segment, such as a market niche, a geographic area or a special customer group. By focusing on a narrow market segment, organizations can make the best use of their resources by tailoring products or services to meet the distinct requirements of their target customers. This strategy requires profound market knowledge and specialization and the ability to deliver unique value to the target market more effectively than broad-based competitors.

Porter's generic strategies provide a framework for organizations to define their unique value proposition and competitive advantage. By aligning their resources and activities with the chosen strategy, organizations can optimize their operations, in order to deliver superior value to customers and outperform competitors in the marketplace. Failing to establish a distinctive strategy can lead to a lack of clarity and direction in the organization. The "stuck in the middle" scenario can result in competitive disadvantages due to the diluted focus and inefficient resource allocation.

In summary, it is essential for organizations to make unambiguous strategic choices and commit to a specific path that aligns with their capabilities, resources and market opportunities. By doing so, they can navigate the dynamic and competitive business landscape more effectively to achieve sustainable profitability (Porter, 1985; Dathe et al., 2022).

6.3.2 Ansoff Matrix

The Ansoff Matrix developed by Harry Igor Ansoff is a strategic planning tool that helps managers determine their growth strategies by analysing potential growth opportunities in a framework with two key factors: products/services and markets. The Ansoff Matrix is also known as the Product-Market Matrix or Z-Matrix.

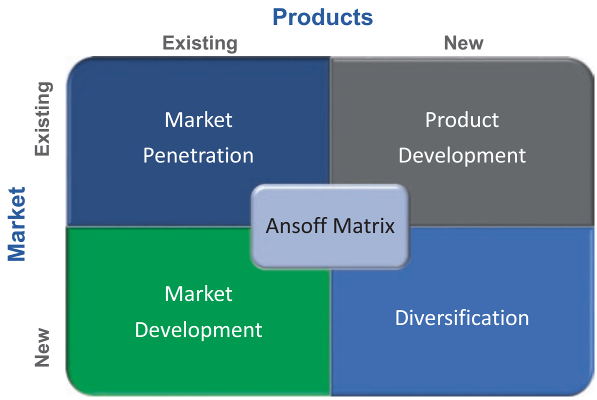

Fig. 6.3 Ansoff Matrix. (Source: Authors)

The Ansoff Matrix consists of four quadrants, each representing a distinctive growth strategy (see Fig. 6.3). These are:

- Market penetration
- Product development
- Market development
- Diversification

- *Market penetration*: This strategy is recommended for existing products/services in the current market, aiming at increasing market share by attracting more customers or encouraging existing customers to make additional purchases. To implement this strategy, organizations typically employ tactics such as aggressive marketing campaigns, aggressive price strategies and other marketing instruments to improve customer loyalty or optimize and enhance distribution channels.
- *Product development*: This strategy seeks to introduce new products/services to an existing market, for example by updating products/services based on customer feedback and market trends with additional features or improved quality to enhance the customer value proposition. The goal is to capitalize on the existing customer base and distribution channels by offering additional value to customers.
- *Market development*: This strategy aims to introduce existing products/services to new markets, in order to expand the customer base, for example by targeting other geographic regions, demographic segments or new distribution channels (e.g. e-commerce). Applying a market development strategy may involve adapting the products/services to match the needs of the new markets and developing new marketing strategies to attract new customers in unfamiliar territories.

  By implementing a market development strategy, organizations aim to expand their customer base and revenue streams. However, targeting new market segments or geographic regions usually requires considerable initial investment. It is therefore essential to carefully assess the market potentials, risks and resource requirements to ensure the successful implementation of this strategy. This could involve:

- *Market research*: Thorough market research helps organizations to enhance their understanding of customer needs and preferences, as well as their purchase behaviours in new markets, so as to identify untapped market segments with potential demand for the existing products/services. The findings of a comprehensive market research could enable the development of effective marketing plans to reach the new target groups, such as new branding, promotional activities and public communication that matches the demand of the customers of the new market segment.
- *Competitive landscape analysis*: Prior to entry into new markets, it is important to get to know the offerings and marketing strategies of the competitors. This knowledge helps organizations determine their unique value proposition such as additional product features, after-sales services or price advantage.
- *Distribution channel analysis*: To effectively reach new markets, it is often helpful to establish partnerships with local distributors or new distribution channels such as online marketplace.

Regular monitoring and evaluation of the market development efforts will allow organizations to make necessary adjustments to the existing measures and effectively capitalize on the growth opportunities.

• *Diversification*: This strategy involves entering new markets with products/services that are new to the organization's current offerings. The aim of this strategy is to reduce dependence on a single product/service or market.
The diversification strategy can be further divided into three types: horizontal, vertical and lateral diversification. The choice of diversification strategy mainly depends on the organization's risk tolerance level (Dathe et al., 2022).

 - *Horizontal diversification*: The key characteristic of horizontal diversification is that the new products or services are directly related to the organization's current production range. This means that the organization can usually leverage its existing resources and knowledge to develop and market the new offerings with only minimal adjustment to its value chain. By engaging in horizontal diversification, organizations aim to capitalize on their existing brand reputation and operational excellence.
 An example of horizontal diversification is the implementation of ChatGPT technology into the search engine Bing. By doing so, the web browser provider Microsoft aims to enlarge its customer base and enhance customer loyalty by introducing the revolutionary artificial intelligence (AI) technology by the research institute OpenAI (UCToday, 2023).
 - *Vertical diversification*: Vertical diversification is a growth strategy in which an organization expands its operation or control over the value chain by integrating the current downstream distribution activities (forward integration) and /or the current upstream production and supply processes (backward integration).
 In the case of <u>forward integration</u>, organizations take more control of the sales and distribution of their own products or services, for example by

opening producer-owned retail stores or establishing online shops. Forward integration can potentially increase the organization's market share and enhance customer experience, thus capturing more value from its offerings.

In case of backward integration, organizations take over some production or sourcing activities of their current suppliers, in order to reduce their dependency on external suppliers, secure raw material resources, ensure quality standards and eventually achieve cost savings.

Successful implementation of a vertical diversification strategy can reduce reliance on external partners, gain greater control over critical steps in the value chain and subsequently achieve higher profitability. However, the requirement for necessary investment in additional production capacities, know-how and infrastructure imposes significant financial risks on the organization. Additionally, there may be further potential risks associated with taking on new responsibilities, such as increased operational complexity and potential conflicts with existing partners.

– *Lateral diversification*: Unlike horizontal or vertical diversification, lateral diversification strategy involves venturing into completely new markets that have less connection with the existing business or industry. The purpose of lateral diversification is to explore new business opportunities by capitalizing on the organization's core competencies, such as operational capabilities, technical know-how or management expertise, in new markets or industries. In practice, the lateral diversification strategy is often driven by multiple factors, such as saturation of the current market, or the identification of emerging market trends and opportunities.

The Ansoff Matrix is a valuable strategic planning tool with a clear structure. It facilitates the understanding of appropriate strategic approaches for an organization by visualizing its strategic growth options and potentials based on the dimensions of market and product development (Dathe et al., 2022).

6.3.3 BCG Matrix

The BCG matrix, also known as the product portfolio matrix, is a strategic management tool developed by Boston Consulting Group (BCG) in 1970. The framework visualizes different products in a company's portfolio in a grid with two axes: the market growth rate (vertical axis) and the relative market share (horizontal axis). The results aim to help managers make informed decisions on strategic priorities and resource allocation (Dathe et al., 2022).

The BCG matrix categorizes products in the portfolio into four quadrants (see Fig. 6.4):

- *Cash cows*: Cash cows are products that have a relatively high market share in a mature market. At present, they generate substantial cashflows and profits for the company and serve as a source of funds that can be used to finance products with

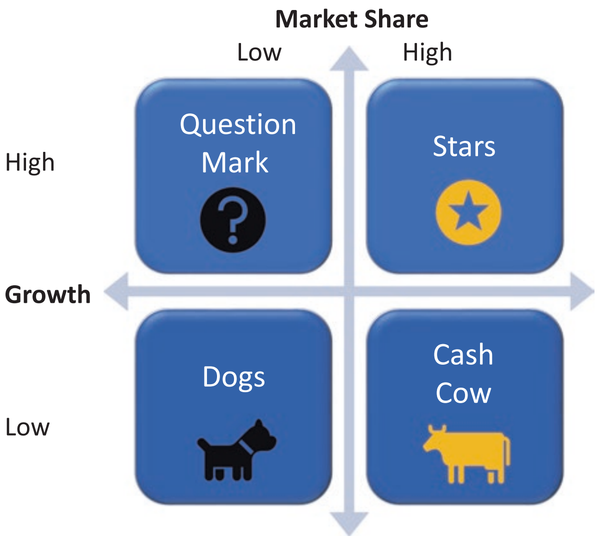

Fig. 6.4 BCG strategies. (Source: Author's Source)

growth potential. As the market is mature, however, there is limited room for significant growth. As a result, it is unnecessary to make large investments to maintain their competitive position. The recommended strategy for cash cows is to capitalize on their existing market share and optimize their profitability.

- *Stars*: These are products that have a high market share in a rapidly growing market. Stars have the potential for substantial growth and profitability. They require significant investment to enhance their competitive position, in order to capture the growth opportunity in the market.
- *Question marks*: Question marks are products that have a low market share in a rapidly growing market. These products have the potential for growth; however, they also require significant investment to improve their market position. Question mark products require careful analysis to determine their profitability prospects. They can be transformed into stars through additional investments, or alternatively, they may be divested if the growth prospects are deemed not favourable.

  The selection decision on question marks is typically based on a thorough evaluation of market trends, the competitive landscape and the organization's capacities. By making informed decisions on question marks, organizations can allocate their resources effectively, so as to position themselves for future growth and success.
- *Dogs*: Dogs are products that have a low market share in a slow or declining market. These products tend to generate low or negative returns and have limited growth potential. Since dogs consume resources to maintain their operations without delivering substantial benefits, it is advisable to divest dogs if they cannot be turned around to become profitable. By relocating resources from dogs to

more promising products or ventures, the organization can focus on products with high growth and profitability potentials to improve its overall financial performance.

The BCG matrix visualizes the product lifecycle in a portfolio that typically progresses from question mark to star, then cash cows and, eventually, dog. In practice, scatter or bubble diagrams are often used to indicate the sales volume of the products. With relative market share and market growth rate as key drivers for investment decisions, the matrix considers both organizations' competitiveness and the market's attractiveness. The presence of question mark is essential to enhance the organization's position in the future marketplace.

Overall, the BCG matrix is a valuable management tool to support strategic choices, optimizing the product portfolio and resource allocation for sustainable profitability and growth. However, when using the BCG matrix to make product portfolio decisions, it should be noted that not all products follow the ideal path of product lifecycle. For example, some products may fail to reach the star stage or skip the question mark phase in their development.

In addition to evaluating individual products, it is essential for companies to take a holistic view of their entire portfolio when making strategic decisions on the entire portfolio. This helps companies identify any gaps or imbalances in their product offerings. A well-diversified portfolio encompasses products at different stages of the lifecycle, so as to reduce dependence on a single product or market and achieve a competitive advantage in the long term.

The holistic view of the product portfolio can also ensure a balanced allocation of resources and minimize risks through financial equilibrium. That is, products at different stages in the lifecycle can support and finance each other. For example, cash cows that generate stable cashflows can provide the necessary financial means for investment in question marks and stars to fuel their growth. This interplay between products helps to create a financially sustainable portfolio (Dathe et al., 2022).

6.3.4 McKinsey 7-S Model

The McKinsey 7-S model developed by the management consulting firm McKinsey & Company is a framework that views an organization as a system composed of seven interdependent components, often referred to as the 7-S's (Odeh, 2021) (see Fig. 6.5):

- *Strategy*. The strategy represents the organization's plan of action to achieve its long-term goals and objectives. The strategy provides guidance on how the organization intends to create value and differentiate itself in the market to gain a competitive advantage.
- *Structure*. The organizational structure is its formal hierarchical arrangement, reporting lines and division of responsibilities. The structure defines how deci-

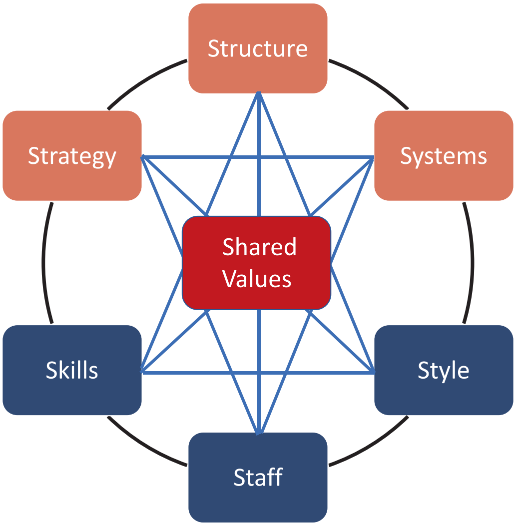

Fig. 6.5 McKinsey 7-S change model. (Source: Based on Odeh (2021))

sions are made and how resources are allocated within the organization. The structure should be designed to support the strategy by facilitating effective communication, coordination and decision-making process.

- *Systems*. The systems include processes, procedures and routines that guide the organization's operations, such as information systems, performance measurement systems, financial systems and other formal processes. Effective systems ensure efficient and consistent performances throughout the organization.
- *Shared values*. The shared values are the organization's core beliefs and overarching principles of a corporate culture. Share values shape the organization's identity and the organizational behaviour norms.
- *Skills*. The skills are capacities and competencies of the employees, including both technical and soft skills such as leadership, teamwork and problem-solving abilities. The right skills of the employees are important for strategic success.
- *Staff*. The staff encompasses an organization's workforce. Recruitment, development and retention of employees, so as to have the right staff in the right roles are crucial for the organization to achieve its strategic objectives.
- *Style*. The style represents the behaviours exhibited by senior management (leadership style). The leadership style should be aligned with the shared values to create a supportive and effective working environment.

The McKinsey 7-S model provides a holistic view of the organization and helps leaders understand the interdependence and alignment of these seven elements and identify gaps or misalignment among the elements, so as to improve the overall effectiveness of business operations.

6.3.5 Blue Ocean Versus Red Ocean Strategy

Blue Ocean Strategy is a strategic management approach developed by W. Chan Kim and Renée Mauborgne at the INSEAD Business School. The term "blue ocean" refers to untapped markets or industry branches with less or no competition. The focus of this approach is value innovation – an organization's ability to deliver exceptional value to customers. By offering novel products or services, the organization creates a market without competition and is therefore to best exploit the market potential (Kim & Mauborgne, 2015).

The classical competition-based strategy is described by Kim and Mauborgne as Red Ocean Strategy. The term "red" symbolizes blood and stands for the fierce competition in existing markets. In order to outperform the competitors and earn a larger market share, organizations are forced to choose between differentiation or cost leadership strategies by constantly addressing the trade-offs between value (customer utility) and cost. As the market becomes saturated, companies engage in intense competition, often in the manner of a zero-sum game where one company's gain is at the expense of another's loss. As a result, organizations are forced to exploit their growth potentials within fixed boundaries (Blueoceanstrategy.com, 2023a).

While the Red Ocean Strategy places the focus on competition in existing markets, Blue Ocean Strategy aims at creating new demand and uncontested market opportunities. Due to the unique value proposition of innovative products and services, organizations are able to break through the limitations of the Red Ocean and unlock new growth opportunities. Organizations that successfully apply Blue Ocean Strategy can simultaneously pursue differentiation and low cost of their products and service, in order to attract more customers and expand the market size. Table 6.1 indicates the fundamental differences between Read Ocean Strategy and Blue Ocean Strategy (Blueoceanstrategy.com, 2023a).

The advantage of Blue Ocean Strategy lies in its ability to generate significant growth by creating new market space. By focusing on value innovation and exploring untapped customer needs, companies are rewarded with higher profit margins and sustainable growth. In the absence of a zero-sum game, different companies can thrive simultaneously in their own markets (Kim & Mauborgne, 2015; Blueoceanstrategy.com, 2023a).

Table 6.1 Blue Ocean vs. Red Ocean Strategy

Red Ocean Strategy	Blue Ocean Strategy
Compete in existing market space	Create uncontested market space
Beat the competition	Make the competition irrelevant
Exploit existing demand	Create and capture new demand
Make the value-cost trade-off	Break the value-cost trade-off
Align the whole system of a firm's activities with its strategic choice of differentiation or cost leadership	Align the whole system of a firm's activities in pursuit of differentiation and low cost

Source: Kim and Mauborgne (2015), Blueoceanstrategy.com (2023a)

In summary, Blue Ocean Strategy offers a new approach to strategic thinking by encouraging organizations to explore the potentials of untouched markets and create novel demand, which in turn will be rewarded by sustainable growth and higher profitability. However, this also comes with challenges. In order to identify new opportunities for untouched markets, organizations need to have a visionary mindset and a deep understanding of customer needs and market dynamics. In addition, the implementation of Blue Ocean Strategy also requires effective planning, execution, monitoring and continuous adaption to changing market conditions. Figure 6.6 shows the major steps for the development of a Blue Ocean Strategy.

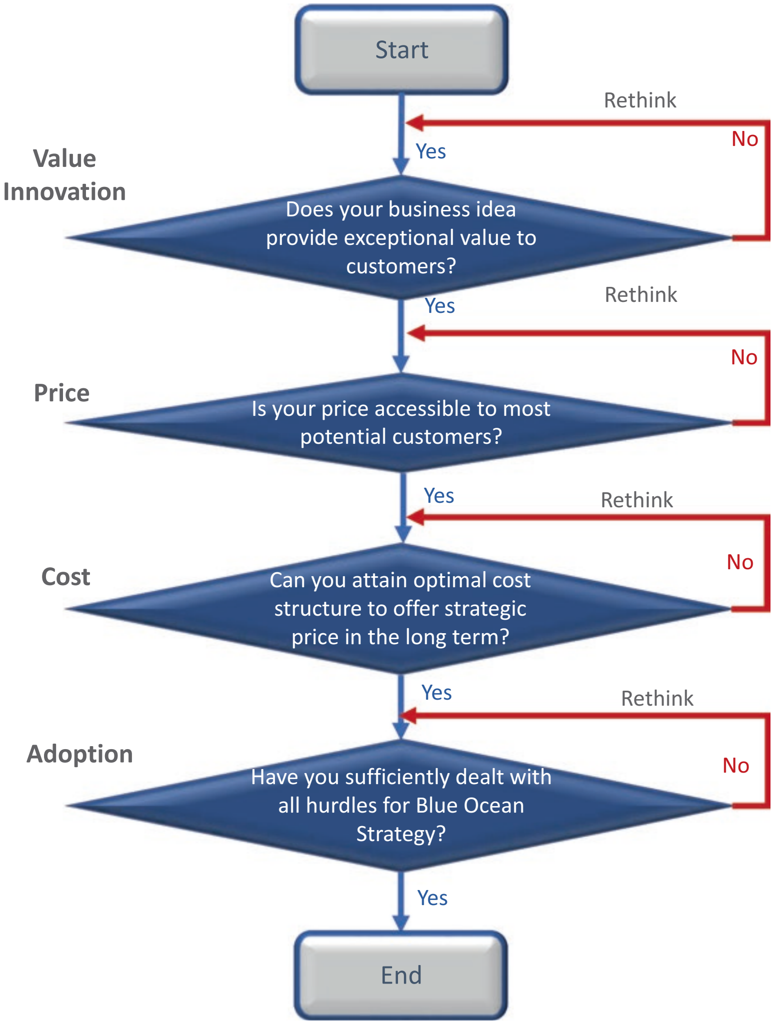

Fig. 6.6 Planning process for a Blue Ocean Strategy. (Source: Adapted from Blueoceanstrategy.com (2023b))

6.4 Case Study: Marvels Strategy Transformation

Marvel Comic was founded in 1939 in the United States as a comic book company. In the next decades, the company struggled to gain traction in the children's comic book market as their superhero figures had fallen out of fashion. In the 1960s, however, visionary creators such as Stan Lee, Jack Kirby and Steve Ditko invented a series of superheroes with human-centric characteristics and vulnerabilities, such as Spider-Man, Iron Man, the Hulk and the X-Men for adult readers. The innovative storytelling shifted the marketing focus from children, the traditional comic readers, to adults, especially college students. As a result, Marvel created a novel market and disrupted the entire comic industry. Subsequently, the company entered a thriving phase of its history later known as "the Marvel Age of Comics".

During the 1980s, Marvel experienced a significant downturn when more competitors emerged in the comic book industry and the new owners concentrated on short-term benefits rather than long-term strategic growth. Despite hundreds of millions of dollars in earnings in the beginning, the Red Ocean Strategy resulted in a continuous loss of market share due to declining quality and lack of innovation. The deteriorated financial position finally drove Marvel into bankruptcy.

In 1999, the arrival of the renowned turnaround expert Peter Cuneo as CEO marked a turning point for Marvel. In his opinion, Marvel needed to take a radical shift by exploring an untapped market with significant growth potential, in order to revive its fortune. Cuneo and his team soon recognized the motion picture industry as a prime opportunity to create a blue ocean.

Marvel's strategic move into the movie industry was a gamechanger that completely transformed the dynamics of the entire entertainment landscape. Instead of confining the business activities to capitalizing on individual character franchises in the portfolio, Marvel took a visionary step by introducing a shared cinematic universe. This approach allowed characters and storylines to seamlessly interconnect across multiple movies and TV shows, providing audiences with a unique and immersive experience and enabling fans to engage with a broader narrative and follow the development of their favourite characters beyond standalone movies. Besides, the utilization of cutting-edge visual effects and the carefully crafted narratives that blended humour, action and emotion resonated with audiences on a deeper personal level.

As a result of the new blue ocean strategy, Marvel movies generated unprecedented revenues and fostered a dedicated fan base of millions worldwide. Through the strategic move by restoring the Blue Ocean strategy, Marvel became the most profitable move franchise in history (Statista, 2023).

Marvel's journey from the brink of bankruptcy to becoming a cultural phenomenon illustrates the immense reward potentials that can be achieved by embracing a blue ocean strategy and venturing into unexplored territory (Blueoceanstrategy.com, 2023c).

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7 Strategy Implementation

7.1 Process of Strategy Implementation

Strategy implementation refers to the process of translating a chosen strategy into action to achieve the desired outcomes (Miller, 2020). In order to put the strategic plans into practice, organizations need to allocate available resources, coordinate activities and manage necessary changes in organizational structure and processes. Strategy implementation is a critical phase for the success of a corporate strategy and requires careful planning, effective communication and strong leadership (Dathe et al., 2022).

The following are the key elements of strategy implementation (Dathe et al., 2022; see Fig. 7.1):

- *Goals and objectives*. The first step in strategy implementation is to clearly define the goals and objectives that the organization aims to achieve.
- *Action plans*. Based on the determined goals and objectives, action plans are to be developed to outline the specific activities, timelines and resources required to achieve those. Action plans break down the strategic goals and objectives into operational tasks, assign responsibilities to individual employees or teams and define milestones with deadlines.
- *Resource allocation*. The implementation of action plans requires adequate resources, including financial resources, human resources as well as technological and other physical resources. Effective resource allocation involves the processes of budgeting, staffing and the allocation of supporting technological and infrastructural factors.
- *Change management*. Strategy implementation often involves changes to organizational structures, internal processes and employee behaviours.
    - *Organizational alignment*. The organization must ensure that all departments, teams and individual employees understand the corporate strategic goals and

T. Dathe et al., *Implementing Environmental, Social and Governance (ESG) Principles for Sustainable Businesses*, Responsible Leadership and Sustainable Management, https://doi.org/10.1007/978-3-031-52734-0_7

Fig. 7.1 Key elements of strategy implementation. (Source: Authors)

objectives and their own roles and responsibilities in achieving them. Effective communication collaborations across different levels and functions of the organization are crucial to the success of the strategy.

- *Behavioural alignment*. It is important to minimize resistance among employees to ensure a smooth transition. Enhancing communication, training and involvement of employees in the change process can facilitate acceptance and adoption of the new strategies.

- *Monitoring and evaluation*. Continuous monitoring and evaluation of the implementation progress are helpful for tracking performance, identifying deviations from the plan and making necessary adjustments. Regular review meetings and reporting mechanisms on key performance indicators (KPIs) enable the management to assess the impact of the strategy implementation and make informed decisions. The retrospective review of strategy implementation will contribute to the development of future strategies.

Overall, strategy implementation requires a systematic and coordinated approach to translate strategy plans into action. By effectively implementing the chosen strategy, organizations aim to achieve their objectives and gain a competitive advantage in the marketplace.

Strong leadership is a critical success factor for successful strategy implementation. A good management should provide clear guidelines and motivate and inspire employees to align themselves with the corporate strategy. The most important aspects of leadership include the establishment of accountability, that is, to clearly define the responsibilities of individual employees and teams and the assessment process of their performance and to ensure the allocation of necessary resources, as well as other crucial support for them to achieve the desired outcomes.

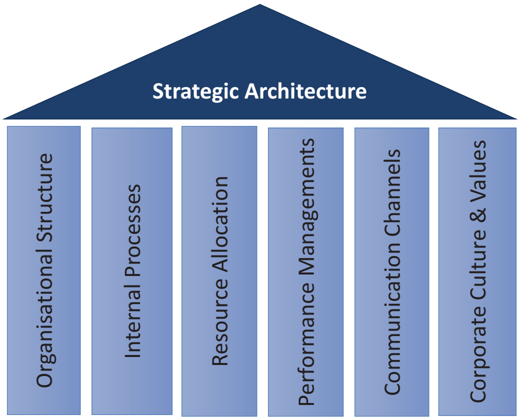
In practice, organizations often use a strategic architecture framework as an effective instrument to ensure that all important aspects of strategy implementation are aligned with the execution of the chosen strategy (see Sect. 7.2).

7.2 Strategic Architecture

The term "strategic architecture" refers to a decision-making framework that guides the strategy implementation in an organization by providing a blueprint for its alignment with the overall strategic objectives. It encompasses a plethora of key components such as (Dathe et al., 2022; see Fig. 7.2):

- *Organizational structure*. The organizational structure outlines the organization's hierarchical levels, the authorities, responsibilities and reporting relationships within and across various departments and functional units. The organizational structure should be aligned with the strategic goals and objectives to promote effective decision-making and collaboration. This includes the accountability structure for the governance mechanisms within the organization.
- *Internation processes*. The processes include formalized procedures, workflows and information systems that support the organization's operations. Well-designed processes facilitate the smooth and efficient execution of tasks, as well as the timely and accurate flow of information across various functions and hierarchical levels of the organization. This includes especially the internal governance processes such as decision-making processes and risk management procedures that provide oversight and ensure that the organization operates ethically and in compliance with all relevant laws and regulations.
- *Resource allocation*. Strategic architecture involves the allocation of resources in alignment with strategic priorities, including the allocation of financial resources, human resources, technological resources and other physical resources. Effective resource allocation ensures that the necessary resources are made available in a

Fig. 7.2 Strategic architecture and key components. (Source: Authors)



timely manner to support the internal processes, in order to achieve the overall desired outcomes.

- *Performance measurements*. A set of key performance indicators (KPIs) should be determined to track the progress of strategy implementation and monitor the achievement of strategic objectives. Performance measures can be defined through the steps of setting targets, data collection, data analysis and making action recommendations. Performance measurements help the organization identify the strengths and weaknesses in strategy implementation and ensure accountability of individual departments, teams and employees.
- *Communication channels*. Effective communication is essential for strategy alignment. It fosters the understanding of strategic objectives, progress and changes among employees and encourages knowledge-sharing during internal and cross-functional operations.
- *Corporate culture and values*. The strategic architecture also encompasses the organization's culture and values, which, to a large extent, shapes the behaviours, attitudes and decisions within the organization. Corporate culture entails shared beliefs, values, behaviourial norms and underlying assumptions that characterize the organization's identity. A supportive corporate culture aligned with the strategic objectives can promote employee engagement, innovation and adaptability of the organization.

7.3 Balanced Scorecard (BSC)

7.3.1 Fundamental Concept of Balanced Scorecard (BSC)

The Balanced Scorecard (BSC) is a strategic management framework developed by Dr. Robert Kaplan, a professor at Harvard Business School, and Dr. David Norton, a consultant and business strategist. The concept of the BSC emerged as a response to the limitations of traditional financial performance measurement systems that primarily focused on short-term financial outcomes and failed to capture the full range of key factors that drive organizational success in the long term.

The core idea behind the fundamental concept of Balanced Scorecard (BSC) was to translate an organization's strategy into a set of objectives measurable with both financial and non-financial key performance indicators (KPIs) across four distinct perspectives (Kaplan & Norton, 1992, 1996; see Fig. 7.3):

- *Customer perspective*. The customer perspective focuses on understanding and meeting the expectations of the target customers. The performance in customer perspective can be measured with metrics such as customer satisfaction, customer loyalty, market share and customer retention. Those metrics can provide insights into how well the organization is delivering value to its customers and building strong relationships customer relationships.

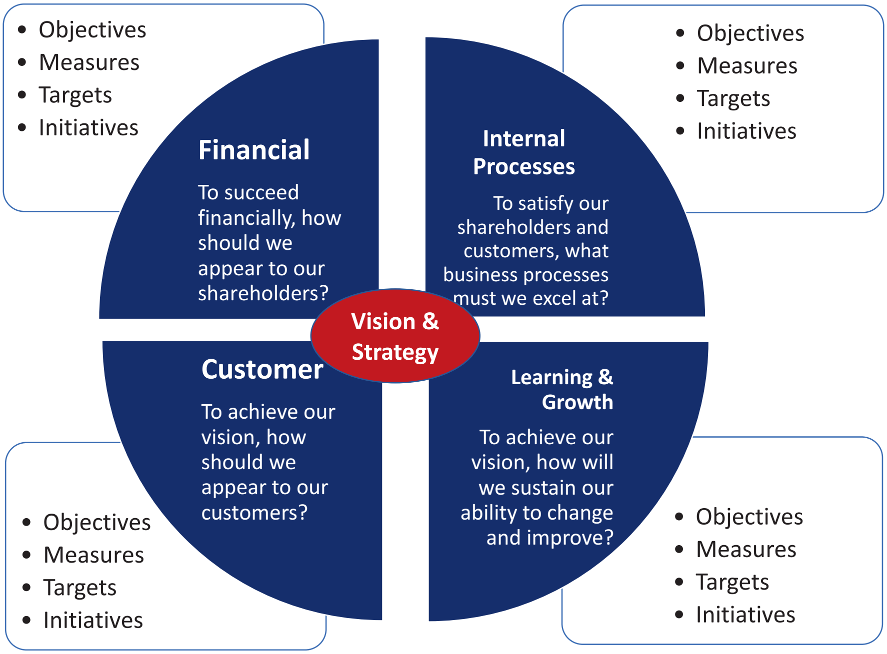


Fig. 7.3 Balanced Scorecard (BSC). (Source: Based on Kaplan & Norton, 1992, 1996)

- *Internal processes*. The internal process perspective examines the critical internal processes that drive the organization's performance and value creation. The performance in the internal process perspective can be measured with metrics such as process efficiency, quality, innovation and operational effectiveness that help identify areas where improvements can enhance the overall performance.
- *Learning and growth*. The learning and growth perspective focuses on the organization's ability to adapt to change through learning and development. It encompasses the development of employees' skills, knowledge and capabilities and fosters a corporate culture of innovation, continuous learning and employee engagement. The performance in this perspective can be measured with, for example employee training, employee satisfaction, employee retention and implementation of new technologies.
- *Financial perspective*. The financial perspective captures the financial outcomes of the corporate strategy. The financial perspective can be monitored with financial metrics, such as revenue growth, profitability growth, return on investment (ROI), return on equity (ROE) and cost efficiency, that reflect the organization's financial health and achievement in delivering value to shareholders.

Each of the above four perspectives of Balanced Scorecard (BSC) contributes to a comprehensive and balanced view of the organization's progress towards its vision and strategy.

7.3.2 Vision, Strategy and Performance Management

In the Balanced Scorecard (BSC) framework, vision and strategy play a central role in guiding the development of performance management and measurement systems (see Fig. 7.3). They serve as the foundation for defining the objectives and measures in each of the four BSC perspectives (see Sect. 7.3.1).

In the context of the Balanced Scorecard (BSC), the vision represents an overall direction that aligns stakeholders towards common objectives, while strategy refers to the general approach to achieving the vision and fulfilling the long-term goals. The determination of strategy involves making choices and setting priorities for resource allocation, in order to obtain market advantages. The vision and strategy provide a guideline for the selection of objectives for performance management and performance assessment (Kaplan & Norton, 1992, 1996).

Performance management in each perspective consists of four levels of elements (objectives, measures, targets and initiatives) that provide a systematic approach to defining and implementing strategies, defining action tasks, allocating necessary resources and monitoring performance progress throughout the organization. Those four elements of the BSC perspectives can be described as follows:

– *Objectives*: Objectives are the desired outcomes that an organization intends to achieve. The objectives should be aligned with the organization's overall vision and strategy.
– *Measures*: Measures are also known as key performance indicators (KPIs). They are quantitative or qualitative metrics used to track performance in each BSC perspective by assessing progress towards achieving the objectives. Measures should be carefully selected to reflect the development of the critical success factors of the organization.
– *Targets*: Targets are desired levels of performance that an organization sets for each measure within a certain timeframe. Targets are helpful in evaluating performance against predefined expectations and providing a clear focus for improvement efforts.
– *Initiatives*: Initiatives are also referred to as action plans. They are specific projects, actions or activities designed to address gaps between the initial situation and the targets. Initiatives should outline the specific steps, allocated resources and timelines involved in implementing the strategic changes and achieving desired outcomes.

In the Balanced Scorecard (BSC) framework, the vision and strategy serve as the foundation for defining the objectives and measures in each of the perspectives: financial, customer, internal processes and learning and growth. The vision and strategy guide the selection of objectives that are aligned with the long-term goals and in turn the choice of appropriate measures to track performance resulting from management efforts. By linking the perspectives to the vision and strategy, organizations can ensure that measures and targets are directly tied to the strategic priorities. This alignment facilitates a cause-and-effect relationship, that is, achieving objectives in the various perspectives contributes to the overall realization of the organization's vision and strategic success. Additionally, the Balanced Scorecard (BSC) framework translates the vision and strategy into actionable initiatives. This provides a structured approach for aligning the organization's resources and activities according to the strategic priorities.

Importantly, the Balanced Scorecard (BSC) framework facilitates effective communication of strategic priorities to align the entire organization. Regular communication channels, such as strategy meetings, performance reviews, scorecard reports and dashboards, provide internal platforms to inform all stakeholders about the strategic objectives and targets and update performance progress. The BSC concept encourages dialogue and collaboration among different hierarchical levels and functions across the organization. By involving employees in the processes of strategy development and strategy implementation, a shared understanding of the strategic priorities and a sense of ownership and engagement are fostered, motivating teams and individuals to work towards common goals. Besides, clear performance measures and targets enable continuous tracking of performance improvement, which helps align the efforts of teams and individual employees with the desired strategic outcomes (Kaplan & Norton, 1992; Dathe et al., 2022).

7.4 Change Management

7.4.1 Change Management Strategy

Strategy implementation implies changes that can lead to resistance among employees. Resistance to change is a natural reaction to fear, uncertainty or a lack of understanding. Change management is a management concept that engages employees in the change efforts which enhances their commitment, reduces resistance and increases the likelihood of successful implementation. Change managers should identify potential sources of resistance and develop effective strategies to address them (Phillips & Klein, 2023).

Change management strategy is an integral part of the overall strategy and can include the following key components (Phillips & Klein, 2023):

- *Vision*. A clear and convincing vision is crucial to motivating employees to embrace the change. A well-formulated vision should articulate the benefits of desired outcomes of the change and provide compelling reasons for employees to support the change.
- *Change Plan*. The plan should entail the scope of change, including objectives, timeline, resource allocation as well as the communication and education processes for the change initiative. Effective communication is vital for successful change management. Transparent and regular communication can keep employees informed about the rationale and progress of the change initiatives. Focused education and training programs can help employees develop the necessary skills and knowledge to adapt to the new situation.

– *Stakeholders*: The key stakeholders should be determined, including their roles and communication channels that keep them informed throughout the change process. Stakeholder engagement helps create a sense of ownership and active support of teams and individuals. Successful stakeholder engagement should address the concerns and expectations of the stakeholders, as well as involve them in the decision-making process.
– *Change Management Team/Agents*: A dedicated change management team or change agents should be established to lead the change initiative. The team members should have the necessary skills and expertise to guide the employees throughout the change process, coordinate the execution of the change management plan and provide support to address any issues or obstacles that may arise.
– *Monitoring Instrument*: Change management is an ongoing process that requires monitoring and adjustment. Regular assessment and review of the change initiatives' progress should be conducted to identify needs for improvement or potential risks. Feedback from employees should be sought to determine necessary refinements. Sustaining change involves embedding processes to evaluate changes in the organizational culture and ensuring long-term employee commitment to the new rules.

An effective change management can navigate the organization through transitions, minimize disruptions and achieve the desired outcomes by engaging key stakeholders and coordinating activities of different hierarchical levels and functions. In business practice, some change management models are often used to guide strategy implementation.

The following sections will introduce a few prominent change management models which find wide applications in business practice and academic studies in this prolific research field.

7.4.2 Lewin's Change Management Model

Lewin's change management model developed by the organization psychologist Kurt Lewin emphasizes the importance of addressing both the technical aspects of change (such as new processes and systems) and the human aspects (such as attitudes and behaviours of stakeholders and corporate culture) simultaneously. Lewin's model provides a valuable framework that facilitates the understanding and management of organizational change by analyzing the often complex and iterative change process in three phases (Hussain et al., 2018; see Fig. 7.4):

1. *Unfreezing*. The first phase of change involves creating a readiness for change by building awareness of the need for change and establishing a sense of urgency. In this phase, existing behaviours, attitudes and beliefs within the organization are analysed to accommodate individual emotions and perceptions to increase the readiness for change and ultimately the chance of successful adoption and implementation of new strategies.

Fig. 7.4 Lewin's change management model. (Source: Based on Hussain et al., 2018)

2. *Moving*. The focus of the second phase of change lies in the management of transition. This involves the introduction of new organizational structures, systems and processes that are designed to induce the desired outcomes. The moving phase often engages stakeholder training programs on new technologies, revised policies and procedures or other interventions that aim to facilitate the change. During this stage, communication plays a crucial role in ensuring the stakeholders' understanding of the change, its benefits and their own roles in the change process.
3. *Refreezing*. The final stage of Lewin's change management model refers to reinforcing and stabilizing the change as the new norm in the organization. The reinforcement intends to prevent a return of the old ways of doing things and drives forth the establishment of a new organizational structure, processes and culture in the long term.

Overall, Lewin's change management model is a straightforward framework that can be used to guide organizational changes in business practice. By addressing both the technical and human aspects of change, it helps organizations navigate complex changes and increases the likelihood of successful strategy implementation. In practical applications, various factors in change management such as stakeholder engagement, leadership support and continuous learning can be incorporated into the model to effectively manage the change process (Hussain et al., 2018).

7.4.3 Kotter's Eight-Step Change Model

Kotter's eight-step change model developed by Harvard professor John Kotter is another widely used framework for the implementation of organizational change. This model consists of eight sequential steps that guide organizations through the change process (Kotter International, 2018; see Fig. 7.5):

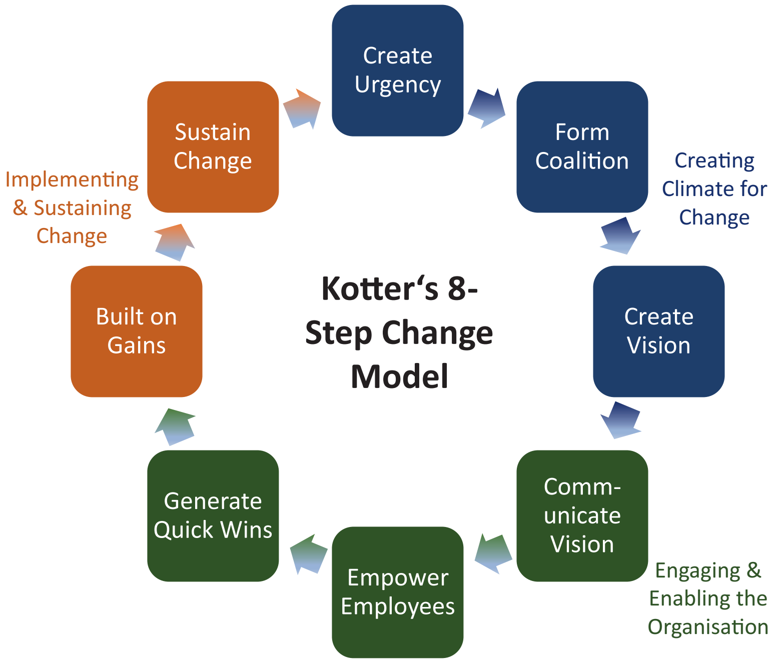


Fig. 7.5 Kotter's eight-step change model. (Source: Based on Kotter International, 2018)

1. *Create a sense of urgency*. The first step of the change process is to establish a compelling reason for change. By fostering a shared understanding of the need for change and highlighting the risks of maintaining the status quo, leaders can increase the support among employees for upcoming change initiatives.
2. *Form a powerful coalition*. It is helpful to assemble a strong team of change agents from various hierarchical levels and functions with diverse skills and expertise across the organization. The change management team can provide active guidance and support for the change initiatives.
3. *Create a vision for change*. Leaders of change management should articulate a comprehensive vision for the desired future state and the benefits of change. The vision serves as a beacon that motivates and aligns employees towards a common goal by facilitating the understanding of the purpose of change.
4. *Communicate the vision*. Effective communication is crucial to gaining support from employees. Leaders should use various channels to communicate strategies, address concerns and expectations of employees and ensure a consistent common understanding of the change vision.
5. *Empower employees*. The empowerment of employees fosters ownership and accountability and contributes to the success of the change process. Leaders should ensure that the key stakeholders receive trainings and development opportunities to acquire relevant skills and knowledge, are provided with necessary resources and have the authority to participate in the decision-making process.

6. *Generate short-term wins*. By setting achievable short-term goals (milestones) and delivering visible progress, leaders can build confidence in the change process and motivate and engage employees.
7. *Consolidate gains and produce more change*. Once initial successes are achieved, it is crucial to build on them to drive further change. Leaders should continue to identify and address obstacles to change, reinforce new behaviours and practices and prevent the organization from slipping back into the previous ways of operating.
8. *Anchor the changes in corporate culture*. The final step involves incorporating the changes into the corporate culture and making them the new norm to ensure the long-term sustainability of change.

Kotter's eight-step change model facilitates a structured approach for change management which focuses on employee engagement, building momentum and sustaining the change over time. By following these steps, organizations can minimize resistance within the organization and increase the chances of successful change (Kotter International, 2018).

7.5 Case Study: Volkswagen Group's Vision Statement and Sustainability Strategy

Volkswagen Group, commonly known as VW Group, is one the world's largest automotive manufacturers with a long history. The multinational company maintains its headquarters in Wolfsburg, Germany. Today, it operates with a large product portfolio under many automotive brands, including Volkswagen, Audi, Scania, ŠKODA, SEAT, CUPRA, Audi, Lamborghini, Bentley, Porsche and Ducati. In 2015, the company suffered a major setback during the emission scandal after manipulating emissions tests for its diesel vehicles. To restore its corporate image, Volkswagen Group subsequently launched a large change process, aiming to become a global leader for sustainable mobility (Volkswagen, 2023a, b, c).

The vision statement describes the long-term aspirations of an organization and describes the ultimate goals the organization aims to achieve or its core values. The management of Volkswagen Group communicates the corporate strategy publicly as "NEW AUTO", i.e. providing electric vehicles with a high level of digitalization and automation and enhancing profitability growth. The change plan across the brand groups is summarized in twelve Group Initiatives, consisting of five tech initiatives with a focus on the multidisciplinary Volkswagen technology platforms for mechatronics, software, battery and charging and mobility solutions and seven base initiatives for strategy alignment including ESG, Decarbonization and Integrity, Business Model 2.0, North America Region (NAR), China Region, Group Steering Model, People and Transformation and Financing the Transformation (Volkswagen, 2023a, b, c).

To align the stakeholders with the corporate strategy, Volkswagen Group determines a set of values for interactions with customers, shareholders, business partners and internal employees as the foundation of its corporate culture (Volkswagen, 2023a, b, c):

I. *Responsibility*: "We are part of society. We take on social responsibility. We pay attention to the environmental compatibility of our products and processes, and improve them, every day".
II. *Honesty*: "We do the right thing out of inner conviction, even if no one is watching. We are not afraid of hierarchies and say openly what we think. We listen to one another and find the best solution together".
III. *Bravery*: "We are bold. Innovative. Inventors. Movers. We let go and think afresh. We shape the mobility of tomorrow".
IV. *Diversity*: "We are multi-coloured. Different. Unique. Part of the greater whole. We are open to other ways of thinking, to new experiences and solutions. We approach one another with respect, as equals".
V. *Pride*: "We stand for sustainable products and quality. We make an important contribution to the company's success, with passion, with conviction, effectively. We are proud of what we do and how we do it".
VI. *Solidarity*. "We work together, without hesitation or complications, worldwide. We are bridge builders not gatekeepers. Together unbeatable. We stand united, we are a team".
VII. *Reliability*. "We can be counted on. We do what we say and say what we do, candidly, honestly. We keep our promises. We regain lost trust".

Effective change management requires strong leadership commitment and support. Volkswagen's top management plays an essential role in driving the progress of the 12 Group Initiatives by allocating resources and creating a culture of sustainability throughout the organization. To monitor the change initiatives' progress, Volkswagen Group has established a plethora of metrics and tracking systems. The ESG Performance Reporting enables the organization to identify areas for improvement and adjustment on a regular basis. By applying effective change management principles, Volkswagen successively transformed its business strategy, contributing to a more environmentally conscious and socially responsible automotive industry (Volkswagen, 2023a, b, c).

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8 Approach to ESG Policy

8.1 Challenges in Business Practice

The growing public interest in environmental, social and governance (ESG) performance of organizations across various sectors and industries is evident. As a result, financial institutions, foundations, hedge funds, governmental agencies, industrial companies, rating agencies and educational institutions increasingly integrate ESG considerations in the decision-making process. The widespread adoption of ESG activities is driven by a plethora of factors, including the desire of seizing ESG-related business opportunities, meeting stakeholder expectations, risk management and enhancing long-term value creation (Dathe et al., 2022).

An effective ESG policy requires alignment with the organization's overall strategy, as well as cross-functional collaborations within the organization, while breaking down the policy into processes in the core business operations and fostering a corporate culture of sustainability. In practice, the development of an ESG policy can be a complex task, which encompasses a wide range of aspects such as emission control, resource management, human resources management, investor communication, community engagement and more (see Fig. 8.1). Where should we start in order to address the requirements of various dimensions simultaneously?

8.2 McKinsey ESG Approach

McKinsey, one of the leading global management consulting firms, outlined a framework based on a forward-looking mindset to guide the development of ESG strategy development in business practice. That means companies need to recognize that dealing with ESG considerations is not merely a compliance exercise, but a strategic imperative to obtain and maintain the license to operate and enhance their

T. Dathe et al., *Implementing Environmental, Social and Governance (ESG) Principles for Sustainable Businesses*, Responsible Leadership and Sustainable Management, https://doi.org/10.1007/978-3-031-52734-0_8

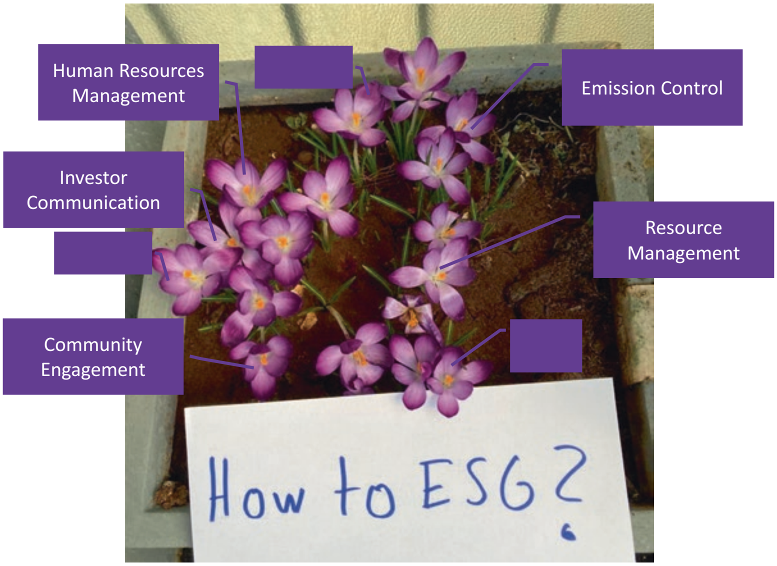

Fig. 8.1 Complexity in developing an ESG policy. (Source: Authors)

market position for long-term success (McKinsey., 2022). This approach will be explained in more detail in the following sections.

8.2.1 The Start Point: ESG Purpose and Level of Ambition

McKinsey encourages a holistic approach to ESG, considering the interconnectedness of environmental, social and governance aspects. Companies need to address ESG issues across their value chain, from sourcing and production to distribution and end-of-life considerations. Business organizations that approach ESG rigorously by defining, implementing and continuously refining a well-designed portfolio of ESG initiatives that align with their core business activities are referred to as "forward-looking companies".

The starting point of a successful ESG strategy is a comprehensive understanding of the purpose of ESG, including the risks and opportunities that impact the organization's operations, reputations and long-term sustainability. Not all ESG factors are equally relevant to the specific business context, and companies cannot excel in all areas simultaneously. Therefore, they need to prioritize the planned initiatives for resource allocation and analyse the trade-offs among different ESG dimensions, in order to determine the specific objectives.

McKinsey suggests three levels of ambition to categorize ESG policies in business practice (see Fig. 8.2):

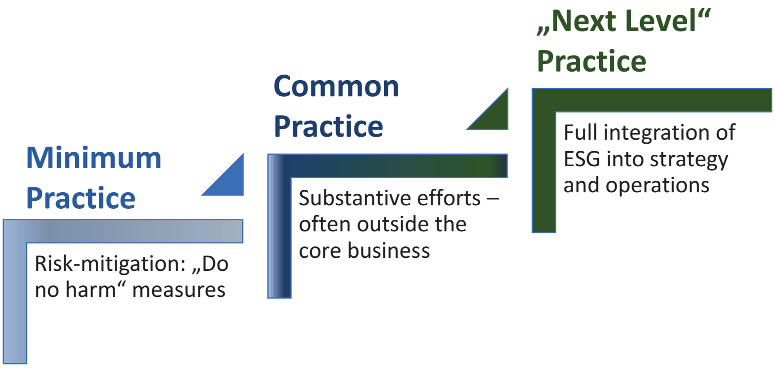

Fig. 8.2 McKinsey ESG process: three levels of ambitions. (Source: based on McKinsey., 2022)

- Minimum ESG policy: This is a basic level of ESG practice with low impact but high risks if not addressed properly. The main focus of minimum ESG policy is the compliance with regulatory requirements and mitigation of significant ESG risks.
- Common ESG policy: At this intermediate level of ESG practice, companies go beyond compliance with substantial efforts, but mostly outside the core business operations.
- Next-level ESG policy: At this level, companies embrace ESG as a part of the core business, adopt innovative approaches, establish ambitious targets and actively seek opportunities to create maximal positive impact while minimizing risks.

8.2.1.1 Minimum ESG Policy

A minimum ESG policy takes a risk-based approach to ensure the overall compliance of regulatory and moral requirements across the organization. Companies adopting the minimum ESG practices prioritize measures that help identify and mitigate risk factors that may cause harm to the environment, communities and stakeholders. This includes implementing processes that aim to promote ESG-conform practices and minimize possible negative impacts throughout the value chain, in particular (McKinsey., 2022):

- Reacting to trends affecting industry and business: By staying attentive and responsive to emerging changes in the relevant business landscape, companies can adapt to evolving stakeholder expectations and demands by adjusting the business strategy.
- Addressing external vulnerabilities: Some external factors such as climate change, resource scarcity, regulatory changes or social unrest may have a significant impact on the business outcomes. Understanding these vulnerabilities could help companies take proactive measures to enhance resilience and long-term viability.

- Donating resources: Companies may demonstrate their commitment to the well-being of the community and corporate citizenship by making donations and supporting philanthropic activities. This includes financial contributions, in-kind donations as well as volunteer efforts.
- Meeting and reporting baseline standards: The baseline standards for ESG performance include laws and regulations, industry standards and guidelines and internationally recognized reporting frameworks such as the Global Reporting Initiative (GRI) or the Sustainability Accounting Standards Board (SASB) Standards. Conformity with those standards ensures transparency and accountability in reporting ESG performance to the public.
- Pledging to minimal commitment levels: This demonstrates a baseline commitment of the companies to ESG principles, typically involving a minimum level of ESG performance, disclosure and stakeholder engagement.

The main focus of a minimum ESG policy lies in risk management. Although it represents a minimal level of effort, companies applying a minimum ESG policy are encouraged to continually update and improve their ESG practices to achieve positive impacts and long-term sustainability (McKinsey., 2022).

8.2.1.2 Common ESG Policy

Common ESG practice involves a range of actions aimed at delivering ESG performance beyond the minimum requirements. Those actions, however, remain mostly outside the core business activities. The key elements of common ESG practice include (McKinsey., 2022):

- Tracking major trends and contingency planning: Companies closely monitor major trends that could impact their business sustainability. In addition, they proactively develop contingency plans to effectively respond to potential risks and capitalize on emerging opportunities. This proactive approach enables companies to effectively adapt to changes in the ESG landscape.
- Leveraging strengths to deliver increased value: After identifying their own core strengths such as unique resources, expertise or market position, companies align those with the strategic ESG priorities, so as to create value for the organization, as well as for the stakeholders.
- Compliance with voluntary industry standards: Companies actively participate in industry initiatives to establish and maintain best practices that are beyond ESG regulatory requirements. This could help the companies to obtain leadership in the industry sector and gain a competitive edge, as many customers and investors prefer to engage with companies with excellent ESG performance.
- Comprehensive sustainability policy: The sustainability policy serves as a guiding framework for the integration of sustainable practices into all aspects of business operations. A comprehensive sustainability policy outlines a company's commitment, goals and strategies for addressing environmental, social and governance issues and provides a roadmap for the implementation of action plans.

- Inclusive HR practices: Companies foster a diverse, inclusive and equitable work environment to promote employee well-being and work–life balance. These practices contribute to a positive corporate culture that helps to attract and retain top talents and, as a result, enhance overall organizational performance.
- Strategic philanthropic programs: Companies engage in high-impact philanthropic programmes that align with their core values and ESG priorities, for example in terms of initiatives that address pressing societal challenges, support communities and promote overall sustainable development. By leveraging their resources and expertise, companies can effectively generate positive social and environmental outcomes through carefully selected programmes.
- Stakeholder engagement: Companies seek inputs from various stakeholder groups such as customers, employees, communities, investors and NGOs. This engagement helps companies gain valuable insights, build trust and make informed decisions with consideration of expectations and concerns regarding ESG issues from the stakeholders' perspectives.

Compared with minimum practice, common practice represents a significant step towards addressing environmental, social and governance issues and complying with voluntary industry standards by making substantive efforts to drive changes and create sustainable values for both the business organization and society as a whole. However, at the stage of common practice, the ESG efforts stay outside the core business operations.

On the contrary, companies can take one step further to fully embed ESG measures into their strategy and operations. This level of ESG ambition is described by McKinsey as "Next Level Practice" (McKinsey., 2022).

8.2.1.3 Next-Level ESG Policy

Next-level ESG practice represents the most advanced level of ambition of an ESG policy. At this stage, companies embed ESG initiatives into their overall strategy and business operations and integrate ESG considerations into decision-making processes across the organization. This mainly includes the following aspects (McKinsey., 2022):

- Leveraging "superpowers" to drive forth sector standards: Companies proactively engage with their peers in the industry sector and participate in initiatives that drive collective progress in ESG performance that allow them to turn their unique strengths and capabilities into a competitive advantage.
- Increase social impact by innovation, market and customer choices: To enhance their influence, companies seek ways to address societal challenges through production and service innovations, promoting sustainable production and consumption patterns and aligning their business models with ESG goals.
- ESG as a differentiator in core strategy: Next-level ESG practitioners view ESG as a source of competitive advantage. As a differentiator, ESG principles become an integral part of the brand identity and value proposition that attract customers, investors and talents who prioritize sustainable practices.

- Clear articulation of leadership areas: Companies identify areas where they can make the most significant impact on specific ESG issues aligned with their purpose and core competencies and subsequently communicate these leadership areas publicly, along with ambitious targets, as well as roadmaps for the implementation of the strategic plans.
- Embed ESG in capital and resource allocation: ESG criteria are used to evaluate projects and guide investment decisions so that financial resources are allocated to support sustainable potentials such as research and development of green technologies, and initiatives that drive positive environmental and social outcomes.
- Employee incentives: Employee performance objectives and compensation structures can be aligned with the company's ESG targets, promoting a culture of accountability and responsibility for sustainability outcomes that encourage employees to actively contribute to the implementation of the overall ESG strategy.
- Permanent internal and external improvements: Next-level practitioners strive for continuous improvement in sustainability outcomes, both internally and externally, by setting ambitious targets and developing action plans for reducing environmental damages, improving resource efficiency, enhancing diversity and inclusion and fostering positive community relationships.
- ESG disclosures: Transparent reporting that covers the company's full operations is crucial for monitoring and driving progress in ESG performance.

Next-level ESG practices encompass a comprehensive approach where ESG considerations are fully integrated into corporate strategy and core business operations. The commitment of next-level ESG practices goes beyond compliance and embraces ESG as a strategic imperative. Overall, implementing a next-level ESG policy offers a range of new business opportunities by means of access to new markets, innovation of products and services or attraction of new investors. By applying the maximal level of ESG ambitions, companies can drive positive changes and unlock potential economic value (McKinsey., 2022).

8.2.2 ESG Process Cycle

According to the determined level of ESG ambitions, organizations can set out to develop and implement the ESG strategy. McKinsey describes the development and implementation of ESG principles in business practice as a cyclical process with four main integral steps (McKinsey., 2022) (see Fig. 8.3):

- Mapping
- Defining
- Embedding
- Engaging

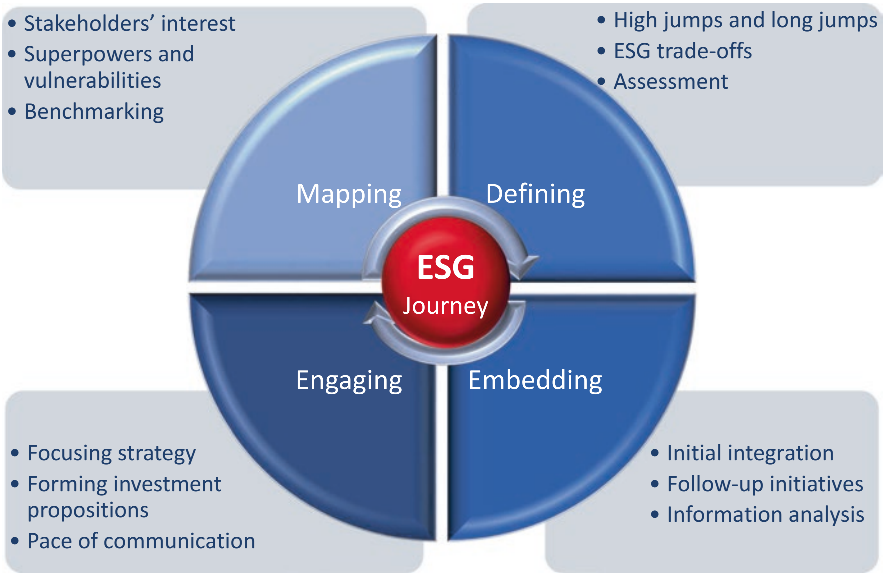

Fig. 8.3 McKinsey's four-step ESG process. (Source: based on McKinsey., 2022)

8.2.2.1 Mapping Business Model with ESG Dimensions

The term "mapping" in the realm of ESG strategy development and implementation refers to the matching of a specific business model with the individual ESG dimensions based on a critical analysis. This includes the following essential aspects (McKinsey., 2022):

- Stakeholders' interest: Comprehensive ESG mapping involves a thorough examination of the major stakeholder groups and their respective interests. Understanding stakeholder expectations and concerns is vital for developing effective ESG strategies. Involving stakeholders in discussions around ESG helps companies understand the thoughts of their stakeholders, so as to leverage their support.

  Forward-looking companies beyond normal shareholder engagement. In considering the perspectives and interests of a broad range of stakeholders such as employees, customers, investors and communities, companies can align their ESG efforts with their expectations, in order to strengthen the stakeholder relationships, enhance corporate reputation and capitalize on new opportunities for sustainable growth.
- Superpowers and vulnerabilities: Superpowers refer to the unique capabilities that a company possesses which allow it to have a distinct impact. Vulnerabilities, on the contrary, refer to specific aspects of a business model that need to be addressed seriously in the fundamental expectations of the critical stakeholders.

  Forward-looking companies carefully assess the operations where they can excel and maintain a competitive advantage based on their specific strengths.

- Benchmarking: This involves comparing an organization's processes, products or performance metrics against those of its competitors and industry peers (under circumstances those of other business sectors), in order to develop strategies, set performance targets and adopt best practices to enhance overall efficiency and effectiveness.

  Forward-looking companies take a creative approach to defining appropriate performance metrics and peer sets to measure sector-specific effects and stakeholder engagement, in order to navigate the dynamic ESG landscape and drive sustainable value creation.

The mapping process helps organizations focus on initiatives that align with their business models, strengths and weaknesses. Over the last decades, ESG has become increasingly an essential strategic concern in most industry sectors. The findings of the mapping process lay the foundation for defining ESG targets and monitoring tools.

8.2.2.2 Defining ESG Targets and Monitoring Tools

Forward-looking companies set purposeful ESG targets to align their ESG initiatives with the organization's core values, business models and long-term strategic objectives. This involves mainly the following aspects (McKinsey., 2022):

- High jumps and long jumps: Initially, companies face two sets of crucial decisions to set courses of action based on their superpowers and vulnerabilities.

  First, they need to determine the levels of performance, deciding how far they aim to go beyond regulatory requirements ("high jumps"). For example, companies can choose to apply higher disclosure standards and production processes with net-zero emissions, offer higher wages and family-friendly working conditions or enhance the principle of diversity within the organization.

  Second, companies should identify the ESG area(s) where they intend to take a leadership role ("long jumps"). Long jumps leverage the companies' superpowers and enable them to influence other players in their ecosystem and beyond. For example, the Danish shipping and logistics company Maersk established the Mærsk Mc-Kinney Møller Center for Zero Carbon Shipping with 18 strategic partners to drive carbon-neutral solutions across the shipping industry.
- ESG trade-offs: Companies assess trade-offs of different ESG aspects based on the benefits and costs, including costs of inaction, in their unique business models. In order to allocate the limited resources to the best ESG initiatives, they need to assess the value at risk of various scenarios. For example, offering employees higher wages will cause additional expenses; however, this will likely improve productivity and, as a result, overall profitability.
- Measuring and assessing: Forward-looking companies align shorter-term metrics with long-term strategic objectives, using carefully defined milestones and key performance indicators (KPIs) that are suitable for their business models. Measuring ESG performance is not mere data collection but measuring influence factors that truly matter. For example, a poultry farming company may measure

the removal of antibiotics from fresh produce and replacement of controversial battery cages by free-range methods. Effective measuring enables swift updates of internal and external changes.

In the next step, business executives may make informed decisions and navigate the dynamic ESG landscape by quickly responding to reality shifts based on regular and robust data analytics.

In summary, forward-looking companies thrive in the ESG realm by recognizing and strategically focusing on the most relevant influence factors and initiatives, considering trade-offs and choose appropriate metrics to monitor and analyse what truly matters to achieve sustainable success (McKinsey., 2022).

8.2.2.3 Embedding ESG in Business Strategy

By aligning the ESG policy with their core business functions, companies can implement ESG throughout their organizations. The process of embedding ESG into the daily operations and corporate culture can be described in the following steps (McKinsey., 2022):

- Initial integration: While some companies consider ESG initiatives as an add-on after addressing the main business purpose, forward-looking companies recognize ESG initiatives as an integral part of regular business operations, a holistic and integrated effort, instead of a sequential process. The initial integration of ESG into the core strategic plans involves a plethora of dimensions, including:
  - Portfolio strategy and products – the products and services the company offers at the market, as well as the markets it chooses to operate in.
  - People and culture – the talent management approach that fosters a culture of sustainability and corporate social responsibility.
  - Processes and systems – operational processes aiming at ESG-related targets such as optimizing resource usage, reducing waste or adopting environment-friendly practices.
  - Performance metrics – appropriate metrics to measure the progress and success of ESG initiatives.
  - Positions and engagements – the approach a company takes to align its external positions and affiliations with its ESG priorities, for example by engaging with key stakeholders such as regulators, government agencies and community representatives.
- Follow-up initiatives: To ensure effective impact, companies need to translate their ESG commitments into specific initiatives, such as:
  - Offering incentives for driving ESG impact, recognizing and celebrating ESG contributions of employees, teams and other stakeholder groups.
  - Supporting ESG performance of stakeholders by leveraging insights from behavioural sciences.
  - Implementing transparent reporting to enhance accountability.

- Continuous information analysis: To embrace ESG principles, forward-looking companies ensure permanent comprehensive insights into the sustainability performance of their organizations. This involves especially the following aspects:
  - Continuous improvement of ESG metrics.
  - Selecting appropriate external ESG agencies.
  - Avoiding overemphasis on high scores.
  - Adapting to changing regulatory environment.
  - Preparing for impact-weighted accounting.

8.2.2.4 Engaging ESG Stakeholders to Maintain Social License

Unlike mapping and measuring ESG initiatives for an existing business model that are relatively straightforward, maintaining the social license requires continuous efforts for open communication and a commitment to addressing stakeholder concerns. Engaging ESG stakeholders to maintain social license involves the following main aspects (McKinsey., 2022):

- Focusing strategy: In order to obtain and maintain a social license to operate, it is critical for companies to sharpen the overall strategy to meet the needs of the key stakeholders. Stakeholder communication is not mere one-way announcements but involves continuous improvements by accommodating the evolving demands of investors, trade partners, employees and other stakeholders through a rigorous and iterative process.
- Forming investment propositions: As ESG considerations have gained prominence in the investment community, investors are increasingly interested in understanding how a company's ESG policy aligns with its overall strategic plan and contributes to its long-term value creation. To demonstrate their ESG business propositions to investors, companies can articulate how their sustainability efforts integrated into the business model help to enhance operational efficiency, mitigate risks and drive long-term value creation, preferably by transparent reporting based on selected metrics and key performance indicators (KPIs).
- Pace of communication: Not only the quality of interactions with stakeholders and the content of information shared with them but also the pace of communication is essential. At present, ESG reporting has commonly become part of the ordinary course of doing business worldwide. With well-designed processes in place, companies can optimize stakeholder communication by quickly providing information on their ESG performance, as well as the alignment with the strategic plans.

8.3 Case Study: Lufthansa's ESG Strategy

In the aviation sector, airline activities deal with various specific expectations related to their ESG performance by the stakeholders including passengers, employees, investors, regulations, local communicates and environmental activists (see Fig. 8.4).

Fig. 8.4 Stakeholder perspective of ESG for aviation service providers (Berlin-Brandenburg Airport). (Source: The author)

The main stakeholder concerns are viewed from many different perspectives, including:

1. **Environmental (E)**.
   (a) *Climate change*: Stakeholders are increasingly concerned about the aviation industry's impact on greenhouse gas emissions and climate change. They expect airlines to take measures to reduce their carbon footprint, for example by investing in fuel-efficient aircrafts, adopting sustainable aviation fuels and participating in carbon offset programmes.
   (b) *Air quality and noise pollution*: Local communities around airports are concerned about the air quality and noise pollution caused by commercial flights. They expect airlines to take measures to minimize noise and air pollution, especially during take-offs and landings.

2. **Social (S).**
   (a) *Customer service*: Passengers expect high-quality customer service, including on-time flights, responsiveness to inquiries and prompt communication during disruptions.
   (b) *Passenger safety and security*: Passengers also prioritize safety and security when choosing airlines. They expect service providers to maintain rigorous safety standards, implement effective security procedures and continuously invest in training for pilots and crew members.
   (c) *Accessibility and inclusivity*: Airlines are also required to accommodate passengers with disabilities, limited mobility or other diverse needs and to

attend to the needs of passengers without prejudice based on age, gender, racial, ethnical and cultural backgrounds.

(d) *Labour practice*: As employers, airlines are expected to prioritize employee well-being and maintain positive labour relations. Employees and labour unions demand fair wages, safe working conditions and individual opportunities for professional development in the aviation industry.

3. **Governance (G).**
   (a) *Ethical business practices*: Stakeholders, especially investors and regulators, require airlines to uphold high standards of ethical behaviours and corporate governance to ensure transparency, accountability and integrity in decision-making and reporting.
   (b) *Board diversity and independence*: Airlines are expected to improve gender equality and diversity and ensure the independence of members of boards of directors representing a broad range of perspectives and expertise.
   (c) *Executive compensation*: Stakeholders, especially investors, expect responsible executive remuneration practices that align with long-term sustainability performance.

The German airline Lufthansa determines ESG as a key component of their overall business strategy and aims to maintain the leadership in sustainability performance in the aviation service sector. Accordingly, the company's ESG policy is defined based on the highest level of ESG ambition ("next level ESG policy", see Sect. 8.2.1.3).

Initially, Lufthansa Group maps the business purpose of being the leading European airline service provider that connects people, cultures and economies in a sustainable manner with the main ESG dimensions:

- Climate and environmental protection.
- Fair treatment of employees.
- Engagement in activities that address social concerns.
- Transparency of governance processes.

As a result of continuous benchmark analysis of the operational processes, Lufthansa recognizes the organization's superpowers of the organization in the dimension of climate and environment protection. The objectives in this ESG dimension have evolved over time in consideration of the technological progress and the changing circumstances of the industry sector. The following are a few examples of the specific objectives in this ESG dimension:

– Noise reduction.
– Use of sustainable aviation fuel (SAF).
– Technical aerodynamic elements for fuel reduction, such as sharkskin or sharklets.
– Other measures for environmental protection, such as offering railway option as an alternative for short-haul flights and tree-planting compensation programme for passengers as an optional item on the booking platform.

At present, the climate protection performance is mainly measured by the progress of emission control, aiming at a neutral CO_2 balance by 2050. To achieve the set goals, Lufthansa has invested in modern and fuel-efficient aircrafts, as well as in partnerships for the development of Biofuels. The efforts for effective climate protection have been integrated into the business model by means of extended product offerings and selected partnerships.

In the dimension of fair treatment of employees, the challenge of price pressure at the market has caused diverse disputes with the works council in the past which subsequently led to strikes. However, Lufthansa intends to establish itself as an ethical ESG employer by offering fair pay, qualification and trainings, health management and occupational safety programmes, as well as working conditions that enable a positive work–life balance to its employees. In 2021, Lufthansa recorded 3.7 work-related injuries per 1 million working hours which is significantly less than the industry benchmark of 12.1 set by the Employers' Liability Insurance Association for Transport and Traffic (Berufsgenossenschaft für Transport und Verkehrswirtschaft, BG Verkehr).

In addition, diversity and inclusion goals in talent management are set to enable equal opportunities for employees from various cultures and genders of different health conditions. At present, there are employees of 172 nationalities in the Lufthansa Group workforce, while 40% of Supervisory Board members, 16.7% of Executive Board members and 18.7% of managers are female.

From a Governance point of view, it is an interesting feature in the airline industry that the majority of shareholders need to come from the home country in this case Germany to avoid losing flight rights and starting slots according to German law: Luftverkehrsnachweissicherungsgesetz (LuftNaSiG) (Lufthansa group, 2023). Furthermore, cyber security is an important aspect as many data from suppliers but also from customers need to be managed over the flight journey.

To ensure transparent governance processes and safeguard the trust relationship with the stakeholders, Lufthansa introduced an ESG reporting system to disclose its ESG performance on a regular basis. The reports entail the information on the ESG strategy, the targets and the current performance, as well as the composition of the compliance system and its control instances.

To verify the validity of the disclosed information, Lufthansa publishes its ESG rating results by several ESG rating agencies (see Fig. 8.5). Especially with focus on its performance in climate and environment protection, as the first European airline group and the second airline group worldwide, Lufthansa obtained validation for its emission reduction targets from Science-Based Targets initiative (SBTi), a collaboration between the standard setter Carbon Disclosure Project (CDP), the United Nations Global Compact, World Resources Institute (WRI) and the World Wild Fund for Nation (WWF) (SBTi, n.d.).

The aviation industry faces growing pressure from stakeholders, including customers, investors, regulatory bodies and civil society, to address environmental, social and governance (ESG) concerns. Lufthansa's commitment to sustainability and ESG practices positions it as a leader in the aviation industry's transformation

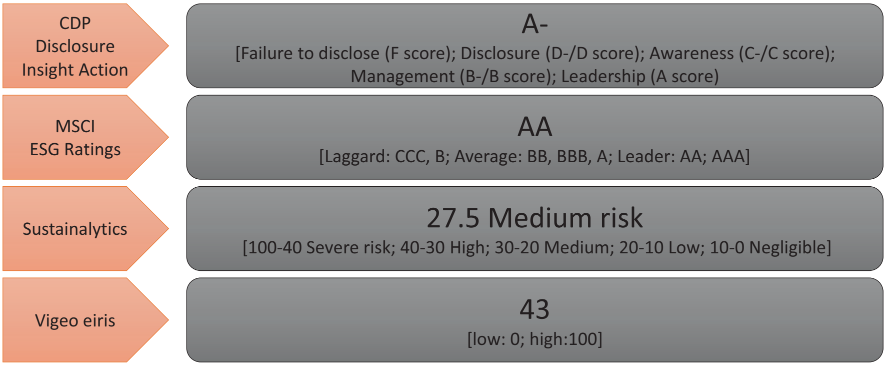

Fig. 8.5 Lufthansa Group's ESG ratings. (Source: Lufthansa, 2023)

towards more environmentally conscious and socially responsible operations. By integrating ESG principles into its business strategy, Lufthansa enhances its competitive advantage through continuous innovative sustainability solutions (Lufthansa, 2023).

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ESG Stakeholders

9

9.1 The Concept of Stakeholder

9.1.1 Classic Stakeholder Theory

The concept of stakeholder in the context of economic theories emerged in the early 1960s and has since then become an important aspect of business management. The term "stakeholder" was first used in an internal memo of the Stanford Research Institute (SRI) in 1963, where it was defined as "those groups without whose support the organization would cease to exist" (Freeman, 2010). This initial definition laid the foundation for what would later evolve into stakeholder theory.

Stakeholder theory suggests that a business organization has a responsibility to consider the interests and needs of various groups or individuals who are directly or indirectly affected by its activities and decisions. These stakeholders play a crucial role in the sustainable success of the business. In the classic form of stakeholder theory, the typical stakeholders in a business organization are identified as (Freeman et al., 2007, S. 3; see Fig. 9.1):

- *Financiers*: These include shareholders, institutional investors and lenders who provide financial resources to the company and expect a return on their investment.
- *Customers*: Individuals or entities that purchase goods and/or services from the company and contribute therefore to its revenues and growth.
- *Suppliers*: Individuals or entities that provide goods and/or services to the company that are necessary for the company's business operations.
- *Employees*: The workforce of the organization whose skills, dedication and performance contribute to the company's success.
- *Society*: The broader community, local residents and the general public who may be impacted by the company's business operations, products and/or services.

T. Dathe et al., *Implementing Environmental, Social and Governance (ESG) Principles for Sustainable Businesses*, Responsible Leadership and Sustainable Management, https://doi.org/10.1007/978-3-031-52734-0_9

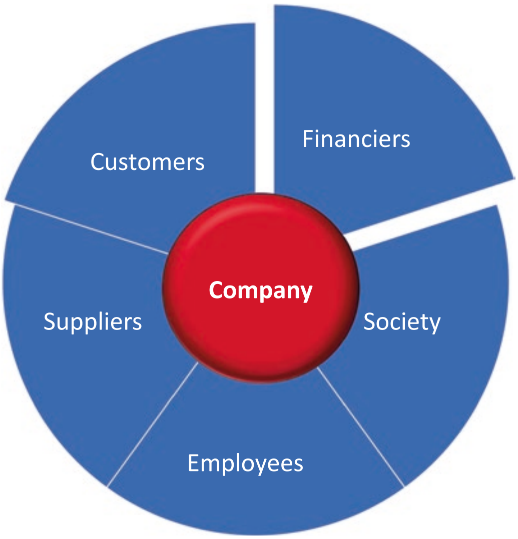

Fig. 9.1 Stakeholders in classic stakeholder theory. (Source: Based on Dathe et al., 2022 and Freeman et al., 2007, S. 3)

The stakeholder theory recognizes that decisions and actions taken by the company can have far-reaching consequences that are not confined to financial impacts, affecting various stakeholders and the broader society. By acknowledging and addressing the interests of these stakeholders, companies can create value, contribute to society and achieve in turn economic success.

Effective stakeholder management involves engaging with these groups, understanding their concerns and incorporating their interests into the company's decision-making processes. By taking a holistic approach that considers the interests of stakeholders beyond just shareholders, companies can build trust relationships and enhance corporate reputation by contributing positively to the well-being of the communities they operate in (Dathe et al., 2022).

9.1.2 Freeman's Stakeholder Model

Over time, stakeholder theory has evolved and expanded to include further groups. Edward Freeman, a prominent management researcher, provided a broader definition of stakeholder as "any group or individual who can affect or is affected by the achievement of the firm's objectives" (Freeman et al., 2007, S. 3). In contrast to the classic stakeholder theory, Freeman's approach comprises a more comprehensive list of stakeholders in consideration of the dynamic and interconnected relationships between the company and various stakeholder groups. Along with the traditional stakeholders, such as financiers, customers, suppliers, employees and society, Freeman's stakeholder model includes the following additional groups (Freeman et al., 2007, S. 7):

- *Government*: Government bodies and agencies at various levels can have a significant influence on a company's operations, especially by means of laws and regulations, public policies and other legal frameworks.
- *Competitors*: Rival entities within the same industry sector or market can influence a company's competitive position and market dynamics.
- *Consumer advocates*: The organizations or individuals representing consumer interests may impact market demand for product offerings.
- *Media*: Media outlets and journalists can shape public perceptions and affect a company's reputation through their reporting and coverage.

Besides, Freeman argues that managers and other employees within the same organization can have distinct perspectives and interests due to their different roles and responsibilities. Therefore, he often considers them as separate stakeholder groups.

Furthermore, based on the level of direct mutual impacts, Freeman divides stakeholder groups into two subgroups: (Freeman et al., 2007, S. 7; see Fig. 9.2).

– *Primary (direct) stakeholders*, who directly engage with the company and often take an immediate interest in the company's business activities and outcomes.
– *Secondary (indirect) stakeholders*, who do not directly engage with the company. They are impacted by the company's operations in a tangential manner and their interests in the company are more diffuse.

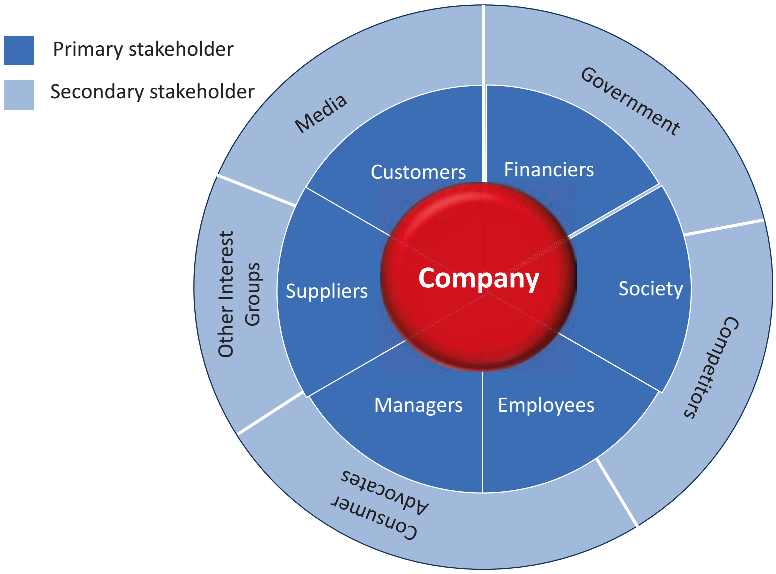

Fig. 9.2 Freeman's stakeholder model. (Source: Based on Dathe et al., 2022 and Freeman et al., 2007, S. 7)

9.1.3 Stakeholder Theory vs. Shareholder Value Approach

Edward Freeman's stakeholder model contradicts Milton Friedman's shareholder value approach. Friedman posits that the sole responsibility of managers is towards the shareholders. Therefore, managers should always prioritize shareholders' interests and do their best to maximize shareholders' wealth (Friedman, 1970).

One criticism of the shareholder value approach is that shareholders may not always have a long-term perspective on their ownership of the business. Instead, some shareholders focus on short-term profit maximization through speculation in the stock market (Crane & Matten, 2016, S. 63). Such short-term investment strategies reflect the shareholders' prioritization of immediate financial gains over sustainable growth of the business.

In contrast to the widespread shareholder value approach, Freeman's stakeholder theory emphasizes that a company's value is created through interactions and collaboration of various stakeholders. Therefore, business organizations have a social responsibility towards all relevant stakeholders, not only shareholders. According to Freeman, stakeholders including financiers, customers and consumer advocates, suppliers, employees, governmental institutions, competitors, media and others, have legitimate interests in the business processes (Freeman et al., 2007, S. 7). This broader view of stakeholders highlights the interconnectedness of the business with its external environment and the importance of consideration of interests of major stakeholder groups in decision-making processes (Dathe et al., 2022).

9.1.4 Internal vs. External Stakeholders

In practical applications, stakeholder analysis is conducted in various manners based on the individual business model and the specific purpose of the analysis. Stakeholders are often divided into internal and external stakeholder groups based on their relationship with the business organization (Dathe et al., 2022). Internal stakeholders usually include employees, managers and shareholders/owners who have a direct legal affiliation relationship with the company. Other stakeholders such as customers, suppliers, regulatory bodies and local communities who are impacted by the company's activities but without a direct legal affiliation relationship with the company are considered external stakeholders (see Fig. 9.3).

In general, stakeholder theory provides a more holistic perspective on business operations and decision-making. By adopting a stakeholder-oriented approach, businesses tend to achieve long-term value creation by considering the diverse needs and expectations of a broad range of stakeholders beyond stakeholders. Understanding and engaging with multiple stakeholder groups can enhance corporate reputation and a stronger tie with the broader community in which the company operates.

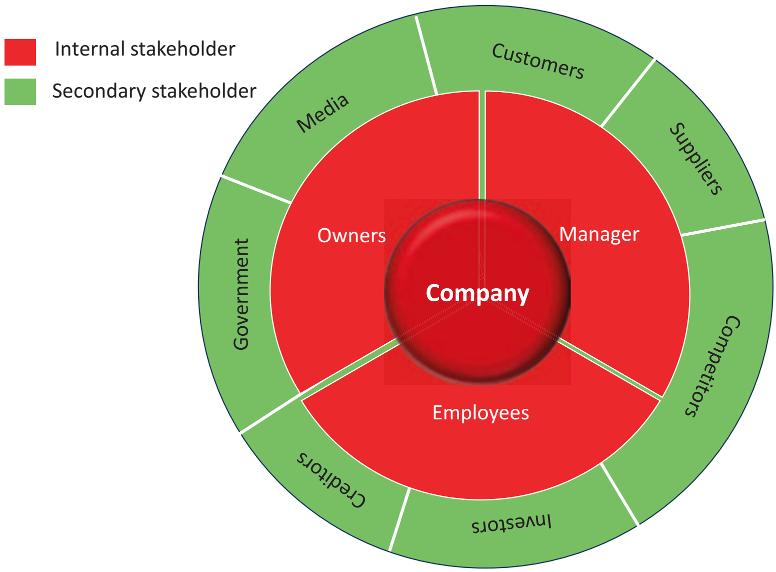

Fig. 9.3 Internal vs. external stakeholder groups. (Source: Based on Dathe et al., 2022)

9.2 Stakeholder Relationships and ESG Strategy

9.2.1 Stakeholder Relationship Management (SRM)

Stakeholder relationship management (SRM) has become a vital aspect of modern business practice. The term stakeholder relationship management (SRM) refers to the processes for identifying, engaging and maintaining relationships with various individuals, groups or organizations that have a justified interest in the company's activities and outcomes. In practice, managers increasingly recognize the importance of engaging with a wide range of relevant stakeholders. By adopting cooperative approaches, businesses can foster mutually beneficial relationships that contribute simultaneously to positive societal impact and sustainable growth of the business organization (Crane & Matten, 2016, S. 199 ff.).

In the past, stakeholder relationship management (SRM) often existed in a confrontational context, characterized by protests, boycotts and other negative impacts against breaches of environmental, animal protection or exploitation of socially disadvantaged groups of businesses. However, a shift towards more cooperative and harmonious stakeholder relationships has been observed in recent times (Dathe et al., 2022).

Companies have come to recognize the benefits of proactive engaging with stakeholders to develop mutually beneficial strategies. Collaborative efforts between stakeholders and business organizations are evident in various areas, such as cooperation with supervisory authorities or non-governmental organizations (NGOs) to promote environmental management and social projects. While marketing initiatives often involve partnerships with aid agencies, cooperation with governmental institutions predominantly addresses social, educational, health and public transportation issues. Moreover, companies increasingly collaborate with NGOs, trade unions and governmental agencies to improve working conditions and combat human rights violations in developing countries (Seitanidi & Crane, 2014, S. 201).

On the contrary, in spite of the numerous advantages of building collaborative stakeholder relationships, it is also a resource-intensive process. Such expenses can pose a challenge, particularly for medium-sized companies, due to their financial constraints (Crane & Matten, 2016, S. 203). As a result, companies need to prioritize strategically important stakeholders and focus their efforts on their needs, as it may not be possible to fully satisfy all stakeholders simultaneously (Jones & Hill, 2013).

Selecting stakeholders for engagement can be subject to several criteria. First, companies need to analyze the perceived potential power of stakeholders to actively impact business operations. This involves anticipating the influence stakeholders can exert over the company's decision-making and outcomes. Besides, companies need to evaluate the perceived legitimacy of stakeholders' influence and whether their demands align with societal expectations and norms. Stakeholders' influence is deemed desirable and appropriate if it aligns with the company's values and goals. Finally, the urgency of attending to stakeholders' demands is also a factor in selecting stakeholders for engagement. Addressing critical issues promptly is essential for maintaining positive relationships and preventing potential crises (Mitchell, 1990).

Effective stakeholder relationship management (SRM) can be described in the following key steps (Bourne, 2010; see Fig. 9.4):

- *Stakeholder identification*: The first step in SRM is to identify and categorize all stakeholders who have a justified interest in or are impacted by the company's activities. This involves conducting a thorough analysis to identify individuals, groups or organizations that could influence the company's success or be affected by the business operations. Stakeholders may include customers, employees, investors, suppliers, communities, authorities, NGOs and so on.
- *Stakeholder prioritization*: Not all stakeholders have the same level of influence or are equally important to the company. Therefore, in the second step, the company needs to prioritize its stakeholders based on their potential impact and level of significance. Stakeholders who have a higher influence or are more crucial to the company's success should be given greater attention in the engagement process.
- *Visualization (mapping) of stakeholder community*: Once the stakeholders are identified and prioritized, companies can create stakeholder maps. Such visual presentations help in understanding the relationships, interests and connections among various stakeholders. Stakeholder maps provide a comprehensive view of the stakeholder community and enable the company to identify potential interdependencies and areas of concern.
- *Stakeholder engagement*: The effect of stakeholder relationship management depends mainly on the engagement with stakeholders through effective communication strategies. Companies need to establish regular and transparent com-

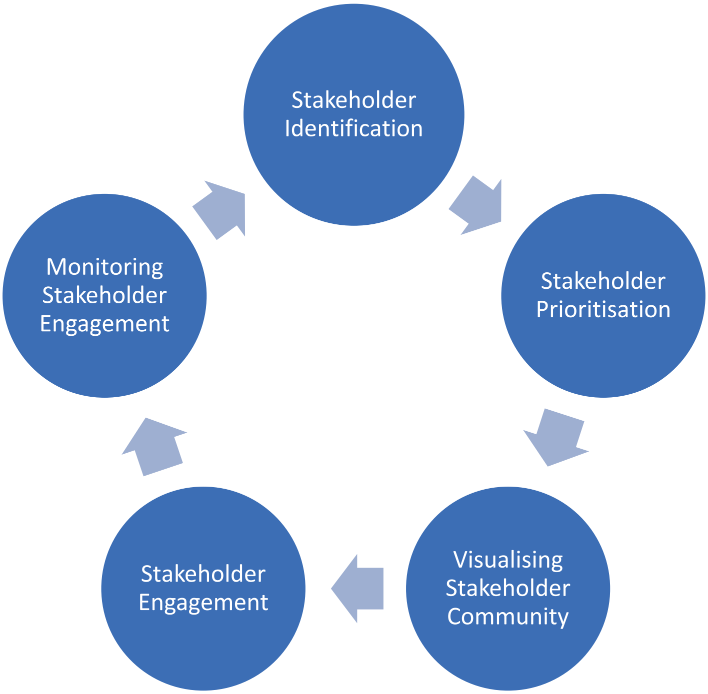

Fig. 9.4 Process of stakeholder relationship management (SRM). (Source: Based on Bourne, 2010)

munication channels to interact with stakeholders. This may involve listening to stakeholder concerns and suggestions through holding meetings, workshops, consultations, social media interactions and other forms of engagement. Open and honest communication plays a key role in building trust and fostering positive relationships.

- *Monitoring of stakeholder engagement*: The final step in the SRM cycle is to monitor and assess the impact of the engagement efforts. Monitoring the effectiveness of stakeholder engagement can involve tracking changes in stakeholder perceptions by analyzing stakeholder feedback and the overall stakeholder satisfaction. The continuous feedback loop allows companies to make necessary adjustments based on the lessons learned and improve future stakeholder relation management (SRM) processes.

9.2.2 Identifying Stakeholders

The identification of stakeholders for the environmental, social and governance (ESG) goals is a crucial step in the integration of ESG considerations into a company's overall business strategy. This step can be organized through the following activities (Bourne, 2010):

1. Developing a list of stakeholders. The first activity involves compiling a comprehensive list of individuals, groups and organizations that have a vested interest in or can be impacted by the company's operations, for example customers, suppliers, investors, employees, communities, NGOs and other relevant parties. There are various information sources for the identification of ESG stakeholders, such as reviewing ESG reporting and other relevant documents, collaboration with ESG experts, supply chain analysis as well as brainstorming and consultation with internal and external stakeholders.
2. Identifying mutuality. The mutuality between stakeholders and the company can be measured in two aspects:

   (a) Importance to business: The company needs to assess the significance of each stakeholder's impact on the business' success based on factors such as financial contributions, access to resources or the ability to otherwise influence the business outcomes, both positively and negatively.
   (b) Stakeholder expectations: Subsequently, the company needs to understand what each stakeholder expects to gain or lose in the context of the success or failure of the business operations. Stakeholder expectations may vary from financial gains to social benefits or mitigating negative impacts.

3. Developing influence categories: Stakeholders can be subsequently categorized in the following two dimensions (see Fig. 9.5):

   (a) *Strategic vs. operational stakeholders* based on the type of influence they can exert on the business operations. While strategic stakeholders impact the

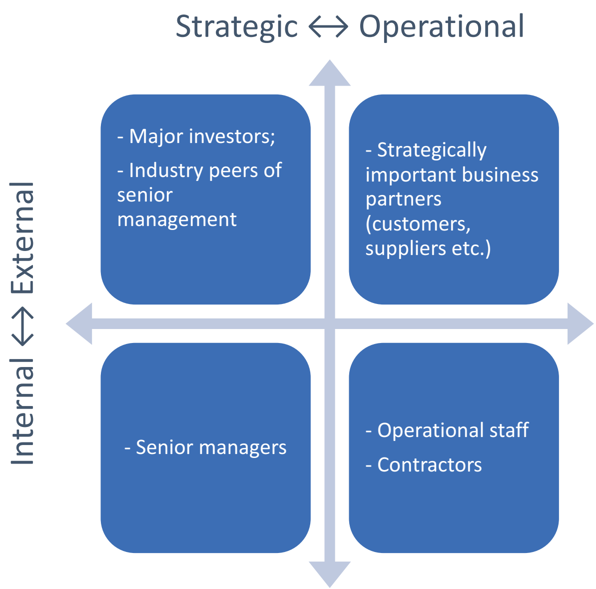

Fig. 9.5 Identifying stakeholders: stakeholder categorization with examples. (Source: Based on Bourne, 2010 (with modifications))

strategic decision-making process (e.g. senior management and peers of the senior managers or major investors), operational stakeholders have a major influence on operational processes (e.g. operational staff or contractors).

(b) *Internal vs. external stakeholders* based on their relationship with the organization (see Sect. 9.1.4). This distinguishment is helpful for the planning of communication strategies.

The output of identification of ESG stakeholders is a comprehensive list of individuals, groups and organizations, along with the understanding of their expectations, as well as their importance to the company and possible impacts on business operations. The identification of stakeholders provides a solid foundation for the subsequent steps in ESG integration in stakeholder relationship management (SRM).

9.2.3 Prioritizing Stakeholders

Once stakeholders have been identified, the next step is to prioritize them based on their importance and influence on business operations that can be assessed in three dimensions (Bourne, 2010):

- *Proximity*: Proximity refers to the degree of involvement of stakeholders with the company. It measures how closely the stakeholders are connected and how frequently they interact with the company. Close and regular interactions often lead to greater trust and more effective outcomes of collaborations.
- *Power*: Power refers to the level of influence that a stakeholder has over the business success. It is the ability of an individual, group or organization to permanently change or halt the progress of business operations.
- *Urgency*: Urgency refers to the importance and time sensitivity of stakeholder relationships. The notion of urgency can be judged by two main factors:
  - *Time sensitivity* – fixed timeliness or deadlines to be met for business operations, for example the common practice of just-in-time deliveries in the automotive industry.
  - *Criticality* – the perceived intensity by stakeholders for specific issues or outcomes based on their beliefs or values. For example, environmental activists feel strongly about climate changes.

The combination of power, proximity and urgency provides a comprehensive picture of the relative importance of stakeholders. In practice, each stakeholder's importance can be evaluated through its rating in each of the above dimensions (e.g. power can be assessed, for example on a scale of 1–4, with 4 being the highest rating implicating a significant impact on the business outcome). By applying the ratings in all attributes of stakeholder importance to each stakeholder, the company can prioritize stakeholders and determine which of those require more attention, engagement and communication efforts.

9.2.4 Visualizing Stakeholder Community

The objective of this step is to create a comprehensive presentation of the stakeholders and their key characteristics to support the design of stakeholder engagement programmes. Visualizing the complex collected data can serve multiple important purposes in processes of stakeholder relationship management (SRM), such as (Bourne, 2010):

- Delivering a useful list of current stakeholders.
- Assessing key characteristics of current stakeholders.
- Reducing subjectivity and increasing transparency in the assessment process.
- Reducing complexity for the understanding of collected stakeholder data.
- Supporting planning for stakeholder engagement activities.

One practical approach for the visualization of stakeholders is the Stakeholder Circle methodology that consists of the following key elements (Bourne, 2010):

- *Proximity (centric circles)*: The centre of the circle represents the business activity and the circles surrounding it represent the distance (*proximity*) of stakeholders from the business activity. Stakeholders directly involved or affected by the activity are portrayed closer to the centre, and those with a more peripheral or indirect relationship with the company are put in the outer circles (see Fig. 9.6).
- *Power (radical depth)*: The radical depth of the segments within the concentric circles indicates the stakeholders' degree of power. A deeper radical segment represents a stakeholder with greater power, whereas a shallow segment signals less influence of the stakeholder over the outcome of business activities (see Fig. 9.7).

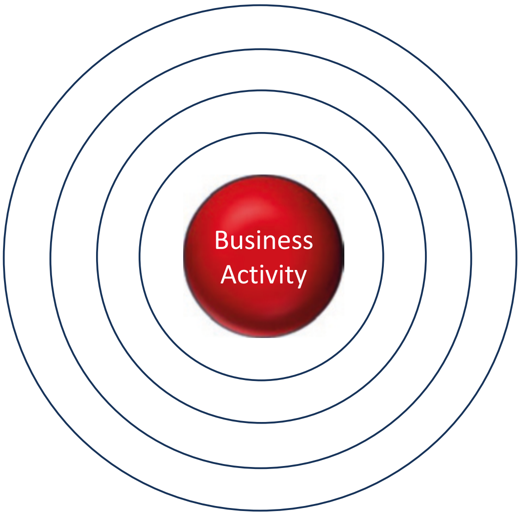

Fig. 9.6 Stakeholder Circle: visualization of stakeholder proximity. (Source: Based on Bourne, 2010)

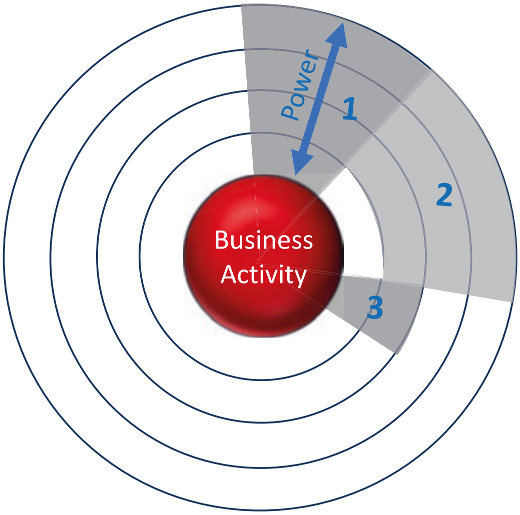

Fig. 9.7 Stakeholder Circle: plotting stakeholder power. (Source: Based on Bourne, 2010)

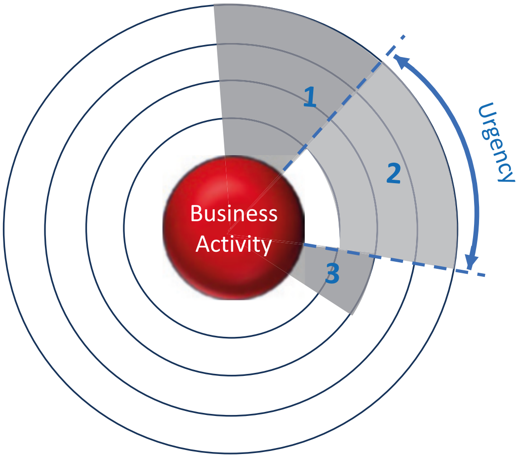

Fig. 9.8 Stakeholder Circle: plotting stakeholder urgency. (Source: Based on Bourne, 2010)

- *Urgency (size of blocks)*: The size of each block (length of the outer circumference of the segment) indicates the level of urgency of each stakeholder (see Fig. 9.8).

In this example, Stakeholders 1 and 3 are directly involved in the business activity (proximity scale of "1") and Stakeholder 2 is less close to the business activity compared with the other two stakeholders (proximity scale of "2").

Besides, Stakeholder 1 has a power scale of "4" which indicates that this stakeholder plays a decisive role in the success of the business activity. Thus, Stakeholder 1 can be easily recognized as a key stakeholder.

In spite of his high rating of proximity, Stakeholder 3 has less power over the activity (power scale of "2"). This could portray the role of an operational staff member.

Compared with the other two stakeholders, Stakeholder 2 is less close to the activity but possesses a relatively strong influence (power scale of "3"). This could depict the role of an important customer (Bourne, 2010).

The urgency of each stakeholder can be represented by the size of the segment measured on the outer circumference of the circle: the longer, the higher the level of urgency.

To keep the visualization clear and manageable, depending on the nature of the business activity, the number of portrayed stakeholders should be limited, for example to 10 or 15 in total.

It is also helpful for comprehension to put the stakeholders in a sequential order according to the overall importance (based on the proximity, power and urgency). The most important stakeholder is to be plotted at position 1 starting at 12:00 o'clock, and the second most important stakeholder is next, through to the last of the prioritized stakeholders (see Fig. 9.8).

In addition, it is possible to add further information through colours and shadings. For example:

– The colour orange can be used to indicate strategic influence and green for operational influence. Different shadings can be used to indicate multiple hierarchical levels.
– Dark colours (high intensity of colour) indicate internal stakeholders, and light colours indicate external stakeholders.
– Different patterns can be used to indicate the size of the stakeholder group, for example hues for small groups and patterns with many dots for a large size of groups (Bourne, 2010).

The Stakeholder Circle is a powerful tool for stakeholder relationship management (SRM) as it provides a holistic view of the stakeholder community and facilitates the identification of key influences, potential challenges and opportunities for collaboration. By applying this visual representation, organizations can enhance their stakeholder engagement efforts, in order to build strong ties with the stakeholders and ensure the success of the business undertakings.

9.2.5 Engaging Stakeholder: The Communication Plan

Stakeholder engagement focuses on effective and efficient communication strategies and measures. To achieve desirable results, a comprehensive and structured communication plan can be developed with consideration of the major aspects of stakeholder communication. *The Communication Plan* should first contain a list of targeted stakeholders and their characteristics, including mutuality, stakeholder category (see Sect. 9.2.2), stakeholder influence (see Sect. 9.2.3), stakeholder engagement profile and communication strategy (Bourne, 2010).

9.2.5.1 Stakeholder Engagement Profile

Successful stakeholder engagement involves a good understanding of the attitudes of stakeholders towards the business organization and its activities and finding ways to manage the expectations of the stakeholders to maintain supportive relationships and address their concerns and doubts.

Stakeholder attitudes can be influenced by a plethora of factors, such as:

- Stakeholders' level of identification with the outcome or purpose of the business activity.
- Perceived importance of the activity, including benefits and disadvantages, in both financial and emotional contexts.
- Level of investment, both financial and emotional.
- The voluntary or involuntary nature of stakeholders' involvement.
- Individual factors such as personality traits or position within the organization.
- Cultural context of both the business organization and the stakeholders.

To develop optimal engagement plans, it is rather helpful to determine stakeholders' attitude profiles. The stakeholders' actual attitudes can be captured in two dimensions:

- Levels of support, ranging from extremely positive (rated as "5"), through neutral (rated as "3"), to extremely negative (rated as "1").
- Stakeholders' receptiveness, ranging from eager to receive information (rated as "5″), through ambivalent (rated as "3"), to completed uninterested (rated as "1").

The engagement profiles are helpful for the determination of communication strategy. For example, stakeholders who are extremely unsupportive and reluctant to receive information need other communication approaches than those who are supportive and eager to receive information.

The next step is to identify the optimal outcome of stakeholder engagement as desired attitude profiles in the above two dimensions. The comparison between the actual and the target stakeholder engagement profiles can visualize the gap between the current situation and the desired outcomes.

In Fig. 9.9, Stakeholder 1 is supportive about the business activity (rated as "4" on the scale from 1 to 5), however, not interested in receiving relevant information (rated as "2" on the scale from 1 to 5). From the company's perspective, however, the target attitude of this stakeholder is supportive and ambivalent about information (not rejecting receipt of information, score "3" in receptiveness). The visualized profile indicates that there is only a small gap between the current stakeholder attitude and the desired outcome.

The assessment of Stakeholder 2 indicates that this stakeholder is less supportive, but willing to receive relevant information. The significant gap between the current and the target engagement profile suggests that considerable effort will be necessary to encourage the stakeholders to become supportive towards the business activity.

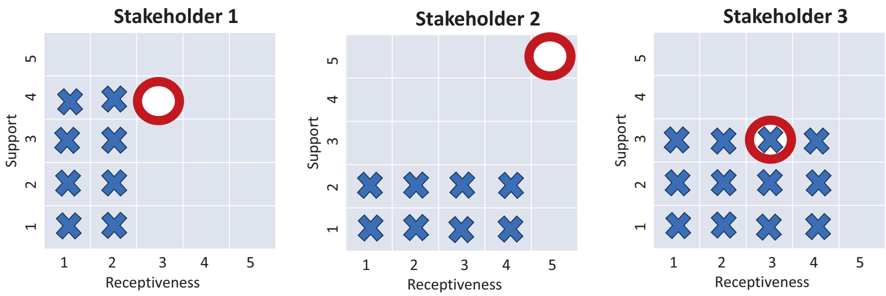

Fig. 9.9 Stakeholder engagement profile. (Source: Based on Bourne, 2010)

Stakeholder 3 is currently neutral with a supportive level of "3", however, eager to receive information with a receptiveness level of "5", surpassing the stakeholder engagement target of "3". This gap requires careful reconsideration of the communication strategy to avoid alienating the stakeholders (Bourne, 2010).

9.2.5.2 Communication Strategy

In the context of environmental, social and governance (ESG) practices, the communication strategy involves engaging stakeholders in a manner that aligns with both sustainability principles and responsible business practices. The ESG communication should be designed based on the unique needs and expectations of the identified and prioritized stakeholders which could include investors, customers, suppliers, employees, communities, regulators and non-governmental organizations (NGOs). The communication strategy can include the following key elements (Bourne, 2010):

- *Audience*: The selected key stakeholders who have a direct or indirect interest in the company's ESG initiatives, for example shareholders seeking sustainable investment, customers who value environmentally and socially responsible products, employees who are concerned about the company's social impact, communities impacted by the company's business operations or regulatory authorities overseeing the company's ESG compliance.
- *Purpose*: The purpose of ESG communication should be closely aligned with the corporate objectives in consideration of the key stakeholders' needs and expectations. The communication should aim to transparently share the company's ESG performance, progress and commitments with stakeholders and demonstrate the company's foundational dedication to ethical norms and ESG principles.
- *Message*: The message should encompass the company's ESG efforts, achievements and challenges in environmental stewardship, social impact and corporate governance, for example by highlighting specific initiatives related to reducing ecological footprint, promoting diversity and inclusion, ensuring ethics along the global supply chain and enhancing accountability. The content should be factual, credible and ideally supported by data and appropriate metrics that substantiate the claims made.

- *Channel*: Appropriate communication channels should be chosen according to the preference of the stakeholders, for email, official websites, for example social media, webinars, virtual town halls, public forums or face-to-face conversations. Both formal and informal channels can be utilized to foster dialogs and gather feedbacks to enhance stakeholder engagement.
- *Frequency*: The frequency of ESG communication should be consistent. Periodic updates on ESG initiatives, performance and progress can intensify stakeholder engagement. However, excessive communication should be avoided, as overload of information could dilute the impact of the message.
- *Owner*: To ensure accountability and consistency of interactions with stakeholders, a responsible individual or team, such as the internal ESG committee, should be designated for the ESG communication efforts.

9.2.6 Monitoring Stakeholder Relationships

Effective stakeholder relationship management (SRM) is an ongoing process that requires continuous monitoring and adjustment. Monitoring the effectiveness of communication with stakeholders ensures that the engagement efforts yield the desired outcomes. This step focuses on two main aspects (Bourne, 2010): maintaining the stakeholder community and reviewing the stakeholder engagement profile.

9.2.6.1 Maintaining Stakeholder Community

Effective stakeholder management goes beyond reacting to changes. It involves proactive engagement with stakeholders. Regular communication, open dialogue and trust-building efforts are crucial elements of maintaining positive stakeholder relationships.

The stakeholder community is not a static entity, but a dynamic network. It evolves over time due to a plethora of factors such as personnel changes, development of product offerings or shifts in stakeholders' priorities. To ensure the stakeholder community's relevance, therefore, the process of stakeholder identification, prioritization and engagement needs to be reviewed on a regular basis (e.g. every 3 months).

The company needs to be attentive to changes in stakeholders' attitudes and power dynamics, in order to incorporate such insights into decision-making. Also unplanned occurrences or events in the fast-changing environment should be taken into consideration.

By actively maintaining the stakeholder community, companies can adapt to changing circumstances, identify emerging risks and opportunities and foster collaborative relationships. This in turn will help companies to remain responsive to evolving stakeholder expectations to achieve sustainable ESG performance and economic success (Bourne, 2010).

9.2.6.2 Reviewing Stakeholder Engagement Profile

Continuous reviewing and optimizing the stakeholder engagement process is crucial to ensure that the ESG goals are met and that the company can maintain its commitment to responsible and transparent practices. The review process for assessment of the outcomes of stakeholder engagement efforts should be data-driven, relying on relevant metrics and key performance indicators (KPIs). Thus, evidence-based analysis on the effects of stakeholder communication initiatives, such as a comparison of stakeholder engagement profiles before and after the actions (see stakeholder engagement profile approach introduced in Sect. 9.2.5.1), can provide reliable insights into stakeholder sentiment and identify areas for improvement and enable informed decision-making for future stakeholder engagement strategies.

Optimizing the review of the stakeholder engagement profile requires a strategic and purposeful approach. By adopting a holistic and data-driven approach, organizations can effectively manage stakeholder relationships, align with the ESG objectives and drive positive social and environmental impact while ensuring long-term value creation for all stakeholders involved (Bourne, 2010).

9.3 Case Study: LVMH Louis Vuitton Moët Hennessy SE

LVMH (Louis Vuitton Moët Hennessy) Group is a European fashion and luxury icon with a market capitalization of more than 500 billion US Dollars. The CEO, Chairman and founder Bernard Arnault successfully transformed LVMH into the largest luxury provider worldwide (Sibony & Tochtermann, 2014; Donzé, 2018; Forbes, 2010; CNBC, 2022).

At present, LVMH's main product portfolio comprises wine and spirits, fashion and leather goods, perfumes and cosmetics, watches and jewellery, selective retailing and other activities such as hotel service including Belmond Ltd. (formerly Orient-Express Hotels) and Hôtels Cheval Blanc (LVMH, 2022).

Due to the nature of business, LVMH engages its stakeholders with great sensibility. The company's current ESG action plan entails three pillars:

- *Art and Culture*
- *Life 360*
- *2025 CSR Roadmap*

9.3.1 Art and Culture

LVMH's commitment to art and culture extends beyond its business operations and encompasses various philanthropic initiatives, reflecting its dedication to supporting and enriching society.

The Louis Vuitton Foundation (see Fig. 9.10) is a combination of art, fashion and luxury under one philanthropic umbrella. It serves as a hub for artistic and cultural endeavours and intends to make art and culture accessible to people from all walks

Fig. 9.10 Louis Vuitton Foundation in Bois de Boulogne, Paris. (Source: Author)

of life. To achieve this objective, the foundation provides multiple cultural programmes and opportunities to encourage open discussions and reflections on art, fostering a sense of cultural inclusion and appreciation. For example, the Legacy Collection Access Initiative is committed to sharing LVMH's rich legacy collection with the public.

In recognition of the importance of nurturing talent in the fashion and design industry, LVMH has established the LVMH Prize for Young Designers. This initiative is dedicated to supporting both emerging and established talents within the fashion and luxury sectors. By providing opportunities, mentorship and resources to young designers, LVMH contributes to the growth and vibrancy of the industry.

9.3.2 Life 360

LVMH's "Life 360" strategy reflects the company's comprehensive commitment to environmental sustainability and responsible business practices across its various operations and subsidiaries. This holist approach encompasses several key aspects:

- *Biodiversity*: LVMH is dedicated to reducing its overall impact on natural ecosystems to minimize habitat disruption, protecting endangered species and supporting other initiatives aimed at restoring ecosystems.
- *Climate*: Addressing climate change is a central component of LVMH's sustainability efforts. The company is committed to minimizing its carbon footprint that involves adopting energy-efficient practices, transitioning to renewable energy sources and implementing strategies to mitigate the impacts of climate change. By taking these actions, LVMH aligns itself with global efforts to combat climate change and promote environmental stewardship.

- *Creative circularity*: This approach encourages innovation in sustainable components and materials. LVMH seeks to understand and manage the entire life cycle of its products, from sourcing material to end-of-life disposal. This includes efforts to develop recycling and repair techniques, a relatively uncommon practice in the luxury goods industry. By embracing circular design principles, LVMH aims to minimize waste, extend the life of its products and reduce its environmental impact.
- *Traceability and transparency*: LVMH places a strong emphasis on transparency and transparency throughout its supply chain. The company is committed to providing customers with comprehensive information about the safety, environmental impact and overall sustainability of its products. By offering transparency, LVMH empowers consumers to make informed purchase choices and supports ethical and sustainable consumption practices.

9.3.3 2025 CSR Roadmap

The "2025 CSR Roadmap" is a comprehensive strategic action plan that comprises the following pillars:

- *Engagement for equal opportunities*. LVMH is committed to promoting equal opportunities for vulnerable groups and its workforce. This aspect of the roadmap emphasizes the importance of creating a diverse and inclusive workplace in all countries where the company operates.
- *Excellent through savoir-faire*. LVMH places a strong emphasis on its "savoir-faire" or know-how, which is a critical aspect of its luxury brands. By investing in talent and fostering a culture of continuous learning, LVMH ensures that its workforce maintains and enhances the unique skills and craftsmanship that define its luxury products.
- *Health, safety and well-being*. By focusing on creating and maintaining safe and healthy working environments, LVMH complies with safety standards and enhances social dialogues with its workforce, encouraging open communication and collaboration. By prioritizing the well-being of its employees, LVMH not only fulfils its ethical responsibilities but also promotes a positive workplace culture.
- *Individuality and non-discrimination*. Diversity, equity and inclusion (DEI) are central themes to LVMH. The company places particular emphasis on addressing issues related to race, gender and disabilities. By promoting non-discrimination and creating an inclusive working environment, LVMH seeks to enhance diversity within the group.

In general, LVMH's ESG concept goes beyond business profitability and places a strong emphasis on sustainable, responsible and ethical practices. These initiatives not only positively impact society but also preserve expertise within the organization, create safe workplaces, promote diversity and inclusion and presume environmental responsibility. In turn, they also position LVMH as a responsible and forward-thinking leader in the luxury and fashion industry, thus enhancing the company's success in the long term (LVMH, 2022).

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10 ESG in Risk Management

10.1 Fundamentals of Risk Management

The International Organization for Standardization (ISO) defines risk in the 2018 version of ISO 31000 as the "effect of uncertainty on objectives", such as reputation damages caused by poor performance in climate change effect, inadequate working conditions of employees, product quality issues, cybercrime or geopolitical development (ISO, 2018).

In the context of business management, risks can be described as influence factors that can impact the effectiveness and efficiency of the core processes of an organization. Based on the nature of risks, they are expected to lead to positive, negative or uncertain outcomes. Accordingly, risks be divided into the following categories with recommended risk management strategy (see Table 10.1; Hopkin, 2018):

The primary goal of risk management is to achieve corporate strategic objectives by minimizing potential risks and enhancing opportunities. This involves several critical processes such as (Hopkin, 2018):

- **Risk identification**: To identify all potential risks and their sources, such as financial uncertainties, operational issues, reputational concerns, regulatory changes, natural disasters and so on.
- **Risk assessment**: This involves the analysis of risk profiles, especially the impact and likelihood of their occurrence (see Fig. 10.1). To improve decision-making in risk management, it is important to obtain a good understanding of the nature of risks, especially in terms of risk magnitude and likelihood (see Fig. 10.1). In general, high-impact, high-likelihood risks need greater attention in risk management.

T. Dathe et al., *Implementing Environmental, Social and Governance (ESG) Principles for Sustainable Businesses*, Responsible Leadership and Sustainable Management, https://doi.org/10.1007/978-3-031-52734-0_10

Table 10.1 Risk categories based on expected outcomes

Type of risk	Description	Main risk management approach
Compliance risks	Risk of failing to act in accordance with laws, regulations or internal policies, for example production safety procedures	Risk minimization
Hazard risks	Risks resulting in negative outcomes, for example cybercrime	Risk mitigation
Control risks	Risks resulting in uncertain outcomes, for example actual sales volume or project duration (that can be better or worse than the budget)	Risk management
Opportunity risks	The financial loss of taking an opportunity or missing to take financial advantage of an opportunity by turning it down. For example, there are opportunity risks associated with the strategic decision to enter a new market/enlarge product offering or not	Assessing and embracing opportunities

Source: According to Hopkin (2018)

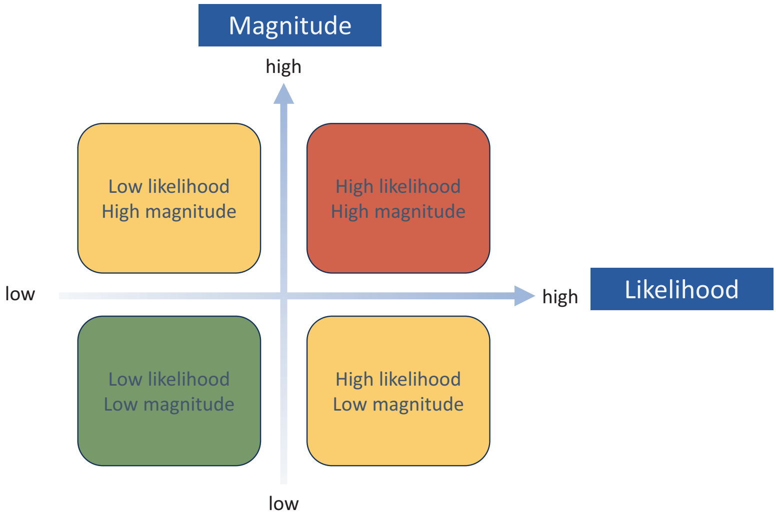

Fig. 10.1 Risk matrix based on magnitude (impact) and likelihood. (Source: According to Hopkin, 2018)

- **Risk prioritization**: To prioritize risks based on the significance of their impacts and the urgency, in order to be able to allocate resources and efforts efficiently to address the most critical risk factors.
- **Risk mitigation**: This involves developing and implementing strategies to reduce the likelihood of a risk occurring or to minimize its impact in case it does occur, for example by redundancy planning, insurance coverage, diversification or implementing safety protocols.

- **Risk monitoring**: This refers to the ongoing process of updating profiles of existing risk factors and identifying new risks, including appropriate risk mitigation measures.
- **Risk communication**: A clear and transparent communication of identified risks and mitigation strategies to relevant stakeholders, such as management, employees, investors, customers, suppliers and regulators, is essential for effective risk management.

In addition, in order to maintain effective risk management in the long term, it is important to foster a corporate culture of risk awareness, where employees are encouraged to report risk concerns without fear of retribution (Hopkin, 2018).

10.2 PWC Four-Step Framework for ESG Risk Management

Over the previous decades, ESG risk management has emerged as an indispensable aspect of responsible investment. Investors are increasingly recognizing the importance of environmental, social and governance (ESG) factors in assessing a company's long-term sustainability and financial performance. Integrating ESG risk considerations into investment decisions allows investors to identify companies with a focus on ESG objectives and robust risk management practices which are expected to lead to better risk-adjusted returns and more resilient portfolios. From the investors' perspective, ESG issues have long become an integral component of their risk concerns that essentially impact today's active or passive investment strategies in portfolio management (Bertolotti, 2020).

Mitigating the risk of damage to their public reputation is a vital aspect of ESG risk management. As companies venture on their ESG journey, safeguarding the corporate reputation becomes paramount for maintaining their social license to operate and securing a sustainable, positive cash flow. In addition, more and more companies come to realize that ESG practices are not just about risk mitigation but can offer substantial opportunities for growth. Companies can often attract more customers and expand their market shares by demonstrating their commitment to environmental and social responsibility, thereby benefiting both private business and society at the same time.

To effectively manage ESG risks, past researchers and practitioners recommend analyzing and structuring the risk portfolio based on a classical cause-effect chain framework that aligns ESG aspects with the overall business strategy. Integrating ESG risk management with traditional risk management practices empowers companies to apply sustainability principles to their overall risk management strategy, fostering a culture of responsible and informed decision-making. The holistic approach to ESG risk management concept requires a long-term and interdisciplinary understanding of short-term and immediate business impacts (Hochschule Luzern, 2023).

The leading multinational auditing and consulting service network PricewaterhouseCoopers International Limited (PWC) is one of the Big Four

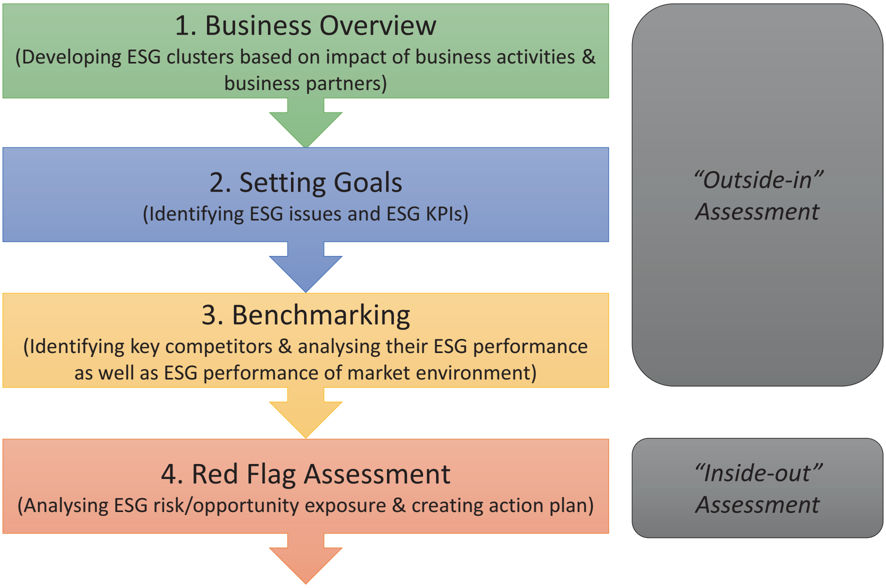

Fig. 10.2 Four-step risk management framework by PWC. (Source: According to PWC, 2023)

accounting firms worldwide (along with Deloitte, Ernst & Young also known as EY and KPMG). To effectively guide the ESG risk management in complex business practice, PWC has developed a four-step iterative process cycle that consists of four main steps (see Fig. 10.2; PWC, 2023):

- **Business overview**: This initial step lays the groundwork for the organization's ESG journey. By conducting a thorough analysis, companies can gain valuable insights into their ESG performance, strengths, weaknesses and improvement potentials. The process involves:
  - *Obtaining a business overview* by collecting relevant information on the company's operations, reviewing financial statements and other existing reports and engaging with internal key stakeholders across the organization.
  - *Preparing an As-Is analysis* based on the collected information, outlining the company's current environmental impact, social initiatives and governance structure, delving into various aspects of business operations, such as energy consumption, waste management, diversity and inclusion efforts, human rights policies and ethical and compliance standards.
  - *Conducting background research of business partners*, as the ESG practices of the external stakeholders can significantly impact the company's ESG performance and reputation.
  - *Analyzing countries of business activity* with reference to the ESG regulations, moral norms and societal expectations.

  - *Identifying ESG clusters* by grouping interconnected ESG-related issues, in order to focus on areas that require immediate attention.

- **Setting goals**: The second step aims at aligning the company's ESG objectives with its overall business strategy, in particular:

  - *Identifying the core ESG topics* for each ESG cluster based on the outcomes of the previous step "Business Overview".
  - *Identifying appropriate ESG KPIs* for each core ESG topic to measure and track the performance and progress of the ESG efforts.
  - *Determining weighting factors* to prioritizing various ESG topics according to their strategic importance based on the expected impact on financial performance, brand reputation, stakeholder expectations and regulatory compliance.
  - *Creating an ESG roadmap* with a short list of ESG topics, chosen from the core ESG topics after applying the weighting factors. The roadmap can guide further decision-making on resource allocation by determining the performance objectives measured by the chosen metrics.

- **Benchmarking**: The third step focuses on the pivotal role of benchmarking in assessing the company's ESG performance in comparison to its peers and industry competitors. This involves a comprehensive analysis of both direct competitors and the broader market environment, in order to gain valuable insights and identify areas for improvement.
- **Red flag assessment**: This final step in the iterative framework aims to identify potential warning signs (red flags) that may indicate areas of concern that need immediate attention. In addition to the findings of the previous steps, this step involves:

  - A thorough analysis of the major risk/opportunity exposure of the selected major ESG topics and determination of the warning signs (red flags).
  - Development of an action plan to close the gap between the actual and the target performance.

Overall, the PWC ESG framework offers a systematic approach to ESG risk management that helps companies assess their current ESG practices, determine appropriate metrics, set future goals, benchmark their performance with industry peers and proactively address potential risks. Implementing this framework can facilitate the alignment of ESG principles with the overall business strategy, enhance stakeholder trust and contribute to a more sustainable business environment (PWC, 2023).

10.3 ISO 31000:2018 and ESG Risk Management

Internal Organization for Standardization (ISO) is an independent, non-governmental standard-setting organization built on the membership of 168 national standards bodies. It was founded in 1947 with its headquarters in Geneva, Switzerland (ISO, 2023a, b, c).

ISO standards are a set of globally recognized guidelines and specifications developed by the Internal Organization for Standardization (ISO), aiming to facilitate international collaborations by providing a common ground for the technical specifications and requirements of products, services and industrial systems. The ISO standards are developed through a consensus-based process involving experts from various fields and countries. These standards are reviewed and updated on a regular basis to ensure their relevance and effectiveness in addressing emerging challenges and needs. At present, there are around 15,000 ISO standards, covering a wide range of technology, management and manufacturing (ISO, 2023a, b, c; Dethan et al., 2022).

ISO standards are not legally binding. However, they are voluntarily adopted by organizations worldwide due to their benefits, such as enhancing product quality, promoting safety, ensuring environmental sustainability and improving efficiency and interoperability. Compliance with ISO standards especially by means of ISO certification is often used to demonstrate conformity to necessary specific requirements in the procurement process, contractual negotiations and regulatory contexts. In practice, ISO certification can improve the credibility and reputation of the certified organizations, as well as enhance customer trust (ISO, 2023a, b, c).

In 2018, the International Organization for Standardization (ISO) also published a series of standards related to risk management, collectively known as ISO 31000:2018 (meaning Standard ISO 31000 Version 2018). ISO 31000 is complemented by some other standards addressing specific aspects of risk management, such as ISO 31010:2019 on risk assessment techniques, and ISO Guide 73:2009 which provides definitions for technical terms in risk management (ISO, 2023a, b, c).

The ISO 31000 framework is intended to provide principles and guidelines for risk management in all types of organizations by offering a systematic and structured approach to identifying, assessing, treating, monitoring and communicating risks. The standard emphasizes risk management as an integral part of an organization's overall management and decision-making process. According to ISO 31000, risk management is an iterative process that should be customized to the specific needs, context and objectives of the organization. The risk management processes should be kept transparent and inclusive to optimally involve stakeholders' engagement (ISO, 2023a, b, c).

Although ISO 31000 is not suitable for certification purposes, it can be incorporated into internal and external auditor procedures (e.g., self-inspection plans) to support the overall corporate governance. The application of ISO 31000 is considered beneficial in various aspects, such as (Dethan et al., 2022; Wiguna et al., 2017; ISO, 2023a, b, c):

- *Improving decision-making by proactively dealing with risk factors and minimizing negative impacts based on holistic considerations of risks and opportunities.*
- *Enhancing effective internal controls for risk management.*
- *Enabling efficient resource allocations to encounter risks.*
- *Strengthening resilience to cope with uncertainty and changes.*
- *Increasing stakeholder confidence and trust.*

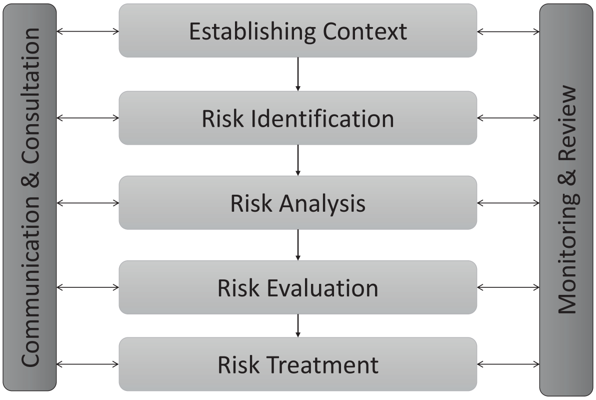

Fig. 10.3 ISO 31000: risk management process. (Source: According to Risk Engineering, 2023; ISO, 2023a, b, c)

The risk management process according to ISO 31000 is defined as a step-by-step approach. Based on ISO 31000, the overall risk management process consists of the following steps (Risk Engineering, 2023; ISO, 2023a, b, c; see Fig. 10.3):

- Establishing the context: To explore the strategic objectives, stakeholders and the internal and external influence factors for business outcomes, in order to determine the scope and boundaries of risk management activities (Risk Engineering, 2023; ISO, 2023a, b, c).
- Risk identification: To identify potential source of risks/hazards that could affect the achievement of the organization's objectives. This involves a systematic analysis of events or situations that can lead to adverse outcomes (Tchankova, 2002; Risk Engineering, 2023; ISO, 2023a, b, c).
- Risk analysis: To understand the identified risks in detail, including risk nature, probability of occurrence, potential consequences, interrelationships between risk factors and significance of risks to the organization's overall objectives (Aven, 2012; Risk Engineering, 2023; ISO, 2023a, b, c).
- Risk evaluation: To determine the tolerance level of risks identified in previous steps. This step enables prioritizing risks that require immediate attention and treatment (Vrijling et al., 1995; Risk Engineering, 2023; ISO, 2023a, b, c).
- Risk treatment: To select and implement risk management actions to address identified risks, including avoiding, transferring, mitigating or accepting the risks (BSI, 2009; Risk Engineering, 2023; ISO, 2023a, b, c).
- Monitoring and review: To continuously monitor and review the effectiveness of risk treatments and their impact on the organization's objectives, ensuring that the risk management process remains current and relevant (ISO, 2023a, b, c).
- Communication and consultation: Effective communication and consultation are essential to maintain transparency and accountability throughout the risk man-

agement process. Successful communication and consultation enhance stakeholder engagement by informing relevant stakeholders about risks, treatment plans and progress of various steps of risk management (ISO, 2023a, b, c).

In addition, ISO 31000 recommends proper documentation of risk management activities (recording and reporting) to ensure traceability and accountability of risk assessment, treatment and reviews. In general, risk management should be embedded in strategic planning, project management and day-to-day operations to ensure the incorporation of risk management in the organization's decision-making process at all hierarchical levels (ISO, 2023a, b, c).

There is a consensus among business practitioners and researchers of management science that ESG issues need to be integrated into the overall risk management to effectively identify, assess and mitigate risks. It is important to accommodate the local requirements in the ESG strategy, particularly in consideration of the portfolio theory and hedging of investments (spillovers) (Cagli et al., 2022).

A previous study on Chinese companies listed on the Shanghai Stock Exchange in a Chinese focus study revealed that companies with higher ESG rating scores tend to exhibit lower default risks. This suggests that companies that prioritize and implement sustainability principles are more likely to demonstrate financial stability and resilience. By considering ESG factors in their business strategy, these companies effectively manage risks, which in turn reduces the likelihood of defaulting in their financial obligations (Li et al., 2022).

Other studies on ESG rating and risk management observed a U-shaped correlation between corporate sustainability and risk features when investing in eco-friendly setups. This suggests that companies prioritizing environmental responsibility can experience reduced risk exposure, leading to potential long-term benefits. However, it is also crucial to strike a balance between costs and benefits and avoid overinvestment in ESG initiatives which can cause idiosyncratic risk (Korinth & Lueg, 2022).

Certain S&P 500 companies were criticized for "window dressing" practices – presenting a more favourable ESG and financial performance in their disclosures to create a more impression on investors and other stakeholders (Landi et al., 2022). The introduction of ISO 31000 could enhance transparency in stakeholder communication and reduce misleading information.

Overall, there is a consensus that integrating ESG considerations into risk management can enhance business sustainability and resilience, provide long-term benefits and reduce potentially misleading communication practices.

10.4 Case Study: Nestlé S.A.

The Swiss-based food and beverage giant Nestlé has made great efforts to integrate environmental, social and governance (ESG) considerations into its overall business strategy and risk management. Nestlé's vision statement "Good food, Good life" implies that the company's core business concept is not only to provide quality food and beverage to its customers but also a positive contribution to the society – the global population. Therefore, the ESG performance plays a decisive role in Nestlé's success.

Nestlé's current ESG concept comprises the following main aspects (Nestlé, 2023b, c):

- **Environmental**
  - Road to net zero: Reducing greenhouse gas emissions and achieving carbon neutrality
  - Waste-free future: Minimizing waste and adopting circular economy practices.
  - Establishment of ESG Worksteams to carry forth environmental objectives, including:
    - 2050 Net Zero
    - Communications and Advocacy
    - Sustainable Packaging
    - Sustainable Sourcing
    - Water
- **Social**
  - Nutrition: Ensuring the provision of nutritious and high-quality products to customers worldwide.
  - Diversity and Inclusion (D&I): Emphasizing diversity and inclusion in the workforce to create an equitable and collaborative environment.
  - Sustainable sourcing: Sourcing raw materials sustainably, with particular attention to the cocoa supply chain, a historically contentious area for the industry.
- **Governance**
  - Accountability of top management: Nestlé Executive Board is committed to the leadership for the company's overall sustainability strategy. Nestlé Board of Directors is responsible for developing and enforcing the ESG strategy, as well as ESG risk management.
  - Internal supporting units: A Sustainability Committee supports the Board of Directors with the development of Nestle´s long-term ESG strategy, as well as public communications with shareholders and other stakeholders along the value chain (Nestlé, 2023a).
  - Internal monitoring system: Nestlé established a comprehensive KPI system for its ESG and sustainability performance. A specialized ESG Strategy and Deployment Unit is made responsible for transparent reporting on the continuous progress of ESG performance.
  - Independent reporting: Nestlé appointed the external auditing firm E&Y to verify its internal and external disclosures on ESG and sustainability issues, including the ESG KPIs. Independent reporting can increase the trust of stakeholders and the public.

Nestlé's business success depends largely on its adequate raw materials, especially in terms of coffee, cocoa and water. The major ESG issues in its supply chain include fair treatment of small farmers, promoting equal opportunities for women and combating child labour. Based on previous scientific research on chocolate manufacturers (mainly in East Africa), Nestlé initially assessed its own sustainability performance in sourcing of cocoa by benchmarking the major competitors such as (Myers, 2020; Fair Labor Association, 2012; Lalwani et al., 2018; Obeng, 2015):

- Ferrero
- Mars
- Mondelez

According to previous studies, the price of cocoa beans in global trade has been declining at the cost of child labour (Schrage & Ewing, 2005; Lalwani et al., 2018; Wilkinson, 2018). Nestlé therefore decided to make the combat of child labour in its global supply chain a key issue in its ESG strategy. To develop effective solutions, Nestlé initially explored the root causes for child labour in West African cocoa farms (Fig. 10.4):

Based on the above findings, Nestlé developed the Sustainable Livelihood Initiative to address the ethical concerns along the global cocoa supply chain, especially the root causes of child labour (Nestlé, 2023d). The initiative intends to improve the farmers' overall living standards, comprising three main components (Nestlé, 2023e):

- **Better farming**: Helping farmers to improve farming yields and their incomes.
- **Better lives**: Promoting access to education for women and children. Better education can help them find better jobs and improve their income perspectives in the future.

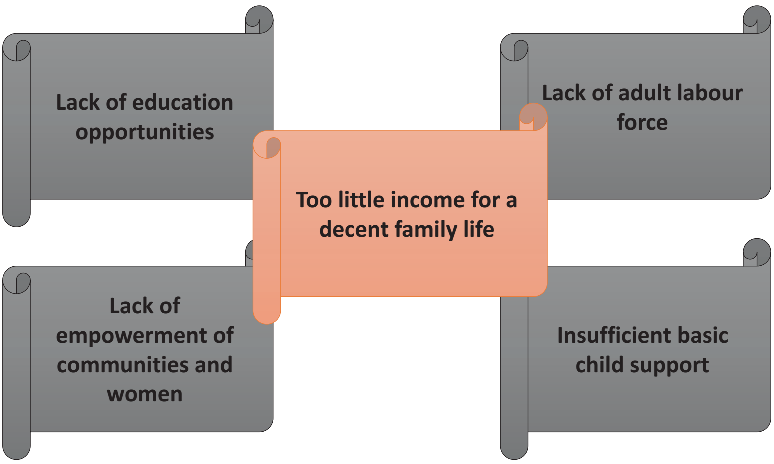

Fig. 10.4 Main root causes of child labour in West African cocoa farms. (Information source: Nestlé, 2023a)

- **Better cocoa**: Investing in cocoa beans as a key source of business to improve the quality of the global chocolate supply and satisfy the demands of customers and stakeholders.

To encourage better education, Nestlé offers farmer families 100 CHF for a school enrolment programme if they send their children to local schools. With further initiatives such as "leave no farm behind" and "empowerment of women", Nestlé helps the farmers to improve their finance through diversification and saving plans or promotes equal payment for women (Nestlé, 2023d). (Guillou et al., 2014; Beckett et al., 2017; Odijie, 2018).

As a plastic bottled water producer, Nestlé established water workstreams as a part of its overall ESG strategy, which closely monitors water use and collaborates with external stakeholders (McNeish & Neufeldt, 2023; Galli & Vousvouras, 2020). Based on the types of water used, Nestlé developed several control plans for responsible water management (Nestlé, 2023a):

- Nestlé drinking waters (Buxton, Perrier, San Pellegrino and Vittel): Supporting water regeneration cycle, targeting an Alliance for Water Stewardship (AWS) for all water operating sites (Nestlé, 2023a).
- Nestlé agricultural waters: Focusing on responsible water management in its supply chain and reducing water footprint (Nestlé, 2023a).
- Nestlé manufacturing waters: Aiming to reduce 6 million m^3 consumption of industrial water in Nestlé plants between 2021 and 2023, with a focus on water recycling and reusing. The continuous monitoring of discharged water ensures compliance with local regulations and standards (Nestlé, 2023a).
- Nestlé community waters: Ensuring sustainable consumption of drinking water and sanitation water in accordance with Nestlé's Human Rights Salient Issue Action Plan and relevant stakeholder initiatives (Nestlé, 2023a; see Figs. 10.4 and 10.5).

Fig. 10.5 Nestlé's Water Initiative memberships. (Source: According to Nestlé, 2023a)

Nespresso, a coffee capsule brand owned by Nestlé, initially had patent protection for its Nespresso capsules that used specialized devices to brew coffee. After the patent expiration, Nespresso adopted a new marketing strategy similar to luxury brands such as LVMH and Hermes by opening flagship stores to increase the sales of capsules (Brem et al., 2016; Conley et al., 2013; Anderson et al., 2012). While this approach has been successful in meeting customer demand for convenient coffee brewing, it has raised environmental concerns due to the significant amount of waste from single-use coffee capsules. In order to strike a balance between meeting customer demand and minimizing waste generation, Nestlé continuously explores possibilities for material recycling and reusing, as well as substituting end of life material to reduce their environmental footprint (Narazaki et al., 2018; Domingues et al., 2020; Beulque & Aggeri, 2016).

In the end, ESG needs to be lived by the customers as well to reduce and avoid trach such as single coffee mugs and single-use coffee capsules.

In summary, by integrating ESG principles into its overall strategy and risk management, Nestlé successfully created shared value with its stakeholders, creating value for both its business and society (Nestlé, 2023e). In 2020, the company received a Double A (AA) rating from MSCI ESG Research for its consistently positive social impact and financial performance in the previous 4 years (Nestlé, 2023e).

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11 ESG Reporting Rules

11.1 Corporate Governance

In a corporation, managers have the responsibility to protect and prioritize the interests of shareholders, especially in the following aspects (Parkinson, 1993, S. 76–100):

- *Duty to act for the benefit of the company*. Managers should make all decisions to promote the well-being of the company, considering both short-term financial performance and long-term survival of the organization.
- *Professional duty*. Managers should utilize their skills and expertise to run the company in a professional and effective manner.
- *Duty of care*. The managers are legally bound to exercise due diligence in conducting corporate affairs. This involves making well-informed and prudent decisions and considering potential risks and opportunities with the expected level of commitment.

Shareholders have the right to participate in strategic management decisions. The shareholders' control of business executives is referred to as "corporate governance". Corporate governance in a narrower sense focuses on the mechanisms and structures that allow shareholders to exercise their rights to monitor and control management decisions. In a broader sense, corporate governance encompasses the entirety of rules, processes and organizational structures through which the shareholders practice their control through participation in determining strategic goals and exercising influence on the reward or reprimand of the management. Corporate governance aims to ensure that the company's decisions are aligned with the interests of its various stakeholders, especially shareholders (Parkinson, 1993, S. 157).

In practice, however, the principal-agent dilemma arises due to the inherent conflict of interest and information between managers (agents) and shareholders (principals) (Dathe et al., 2022):

T. Dathe et al., *Implementing Environmental, Social and Governance (ESG) Principles for Sustainable Businesses*, Responsible Leadership and Sustainable Management, https://doi.org/10.1007/978-3-031-52734-0_11

- *Conflict of interest* arises when managers' personal interests diverge from those of shareholders. For example, managers are prone to seize highly risky business opportunities and prioritize short-term financial gains of the company to boost their performance-based bonuses, potentially compromising long-term business sustainability. For example, in September 2015, the US Environment Protection Agency (EPA) discovered the unlawfully manipulated emission tests by Volkswagen AG for their diesel truck production. Subsequently, this scandal led to a substantial decline in Volkswagen's share price and set off a widespread crisis within the automotive sector (Welt, 2015).
- *Information asymmetry* refers to the fact that managers possess more detailed information on business operations than shareholders, so shareholders might not fully understand the impact of the management decisions.

Effective stakeholder communication is crucial to overcoming the challenges posed by the principal-agent dilemma in complex stakeholder relationships, enhancing accountability of management decisions and maintaining active stakeholder engagement. Therefore, transparent ESG reporting plays an important role in the communication of ESG performance and commitment of the business organizations (Dathe et al., 2022).

11.2 Globalization and ESG Reporting

Globalization has further magnified the importance of ESG reporting as more and more businesses operate across borders, engaging with markets of diverse cultures. When operating in multiple countries, companies sometimes face varying regulatory frameworks and societal expectations in the context of ESG issues. This necessitates comprehensive and standardized ESG reporting procedures to effectively communicate the companies' commitments and performance worldwide.

To meet the growing expectations and demand for ESG reporting, companies nowadays need to invest in robust systems, processes and talent. This may involve implementing new technologies for data collection and analysis, engaging with third-party ESG reporting frameworks and standards, conducting thorough audits of operations and supply chains and enhancing stakeholder efforts. In addition, there is a growing need for harmonization and convergence of reporting standards to further enhance their effectiveness and impact.

ESG reporting standards are guidelines and frameworks that provide a structured and standardized approach for companies to disclose their environmental, social and governance (ESG) performance and impact. These standards are designed to promote transparency, consistency and comparability in ESG reporting, allowing companies to communicate their ESG performance in a structured and meaningful way to stakeholders including shareholders, customers, suppliers, employees, regulators and the public. Adopting ESG reporting standards not only enables investors to make informed decisions by evaluating the companies' ESG risks and opportunities in a consistent manner but also helps companies demonstrate their commitment to sustainability, engage stakeholders and enhance their reputation as responsible organizations (Dathe et al., 2022).

The corporate disclosure on sustainability practices is shaped by both legal requirements and voluntary reporting engagements. While legally binding regulations are put in place by governments or regulatory bodies so that failure to comply can lead to penalties or legal consequences, voluntary reporting activities are based on the companies' individual efforts to showcase their ethical and business practices.

11.3 Regulators of ESG Reporting

Environmental, social and governance (ESG) reporting regulators are governmental organizations and bodies that oversee and influence the reporting of non-financial information, with the aim of improving transparency, comparability and reliability of ESG-related disclosures. Compared with financial reporting, ESG reporting lacks regulatory oversight, auditing and certification, potentially leading to inaccuracies, incompleteness and greenwashing.

Recognizing the limitations of independent ESG reporting, regulatory bodies increasingly push for integrated reporting with both financial and non-financial information, aiming to provide a holistic and more accurate presentation of a company's overall performance.

The most influential regulators for ESG reporting include:

- *European Financial Reporting Advisory Group (EFRAG)*: Established in 2001 at the urging of the European Commission (EC) to serve the interests of the public, the European Financial Reporting Advisory Group (EFRAG) is a private association that plays a pivotal role in shaping financial and sustainable reporting practices in Europe. EFRAG's core activities can be described in two distinct areas: financial reporting and sustainability reporting (EFRAG, n.d.).
- *The US Securities and Exchange Commission (SEC)*: The SEC is an independent agency of the United States Federal Government to oversee federal securities laws against market manipulation (SEC, n.d.).
- *The UK Financial Reporting Council (FRC)*: The FRC is an independent regulatory body that regulates financial reporting and sets the Corporate and Stewardship Codes in the United Kingdom (FRC, n.d.).

Especially in the previous decade, the legal requirements on environmental, social and governance (ESG) reporting have undergone significant changes. Within the European Union (EU), around 49,000 large companies will experience substantial shifts in their reporting practices in the coming years. Increasingly, in addition to traditional financial metrics such as revenues and net profits, the focus of annual financial statements is broadened to include detailed information on various sustainability aspects, such as greenhouse gas emissions, harmful substance usage and workplace accidents in a certain reporting structure. The rising requirements on disclosures pose new challenges for companies due to higher reporting complexity and costs (Auditboard, 2023).

11.4 ESG Reporting Requirements in Europe

11.4.1 Applicable Rules and Regulations

In 2014, the European Commission introduced the regulatory framework EU Non-Financial Reporting Directive (NFRD), which requires large companies to disclose non-financial information in their annual reports, covering their sustainability practices, impacts and risks. The directive aims to enhance transparency, accountability and comparability of environmental, social and governance (ESG) matters (European Commission, 2014).

In December 2019, to act on the increasing demand for combating climate change, the European Union (EU) introduced a suite of goals as "the European Green Deal", which comprises several ambitious objectives (European Commission, n.d.-a) (PWC, 2021):

- *Net zero emission by 2050*: Reducing greenhouse gas emissions by at least 55% by 2030 compared with 1990 levels through the adaption of EU policies on climate, energy, transport and taxation.
- *Decoupling economic growth and resource use*: Promoting sustainable development and minimizing environmental degradation by breaking the traditional link between economic growth and resource consumption.
- *Leaving no one behind*: An integral part of the European Green Deal is its commitment to ensuring that all segments of society participate in the transition to a greener economy, regardless of their socio-economic status or geographical location.

To meet the strategic objectives of the European Green Deal and foster sustainable investments, the EU also launched the Green Deal Investment Plan to mobilize a substantial total amount of at least € 1 trillion over the next decade (PWC, 2021).

As part of the European Green Deal, the European Union implemented new rules on corporate sustainability reporting, including the EUR Taxonomy Regulation and the Corporate Sustainability Reporting Directive (CSRD) (European Commission, 2023a).

11.4.2 EU Taxonomy for Sustainable Activities

The EU Taxonomy is an integral component of the European Union's sustainable finance framework for promoting sustainable investment by providing a standardized classification system for environmentally sustainable economic activities. The criteria for environmentally sustainable economic activities are aligned with the objectives of the European Green Deal (see Sect. 11.4.2) (European Commission, 2023b).

The Taxonomy Regulation builds on a set of four overarching conditions that qualify economic activities as environmentally sustainable:

- *Making a substantial contribution*: The economic activity must significantly contribute to at least one of the environmental objectives aligned with the European Green Deal. In other words, the activity should have a notable positive impact on enhancing at least one of the following six environmental objectives:
    - *Climate change mitigation*: Activities that actively contribute to reducing greenhouse gas emissions, thereby combating the adverse impact of climate change.
    - *Climate change adaptation*: Activities designed to enhance societal and ecological resilience against the consequences of a changed climate by minimizing vulnerabilities, strengthening infrastructure and supporting communities to cope with extreme weather events and other climate-related challenges.
    - *Sustainable use and protection of water and marine resources*: Activities that ensure responsible management, conservation and protection of water bodies and marine ecosystems, by preventing pollution, over-extraction and degradation of water resources, enhancing their sustainable use for both current and future generations.
    - *Transition to a circular economy*: Activities that promote business models for minimizing waste generation and maximizing resource efficiency, for example by encouraging the reduction of resource consumption reuse and recycling of materials.
    - *Pollution prevention and control*: Activities that safeguard the environment from the adverse effects of pollution of various forms, including the pollution of air, water and soil.
    - *Protection and restoration of biodiversity and ecosystems*: Activities that encompass efforts to protect endangered species, restore degraded habitats and maintain the ecological balance of biodiversity and ecosystems.
- *Avoiding significant harm*: The economic activity must not cause any significant harm to the other five environmental objectives.
- *Complying with minimum safeguards*: The economic activity must comply with internationally accepted standards (e.g. the UN Guiding Principles on Business and Human Rights) and not have any detrimental social or ethical consequences.
- *Meeting technical screening criteria*: The economic activity must meet the specific technical screening criteria outlined in the Taxonomy Delegated Acts.

Although the EU Taxonomy imposes no mandatory benchmarks for environmental performance, it is anticipated that the classification criteria will find wide applications in decision-making for sustainable investment and foster a transition towards sustainability practices in alignment with the EU ESG objectives.

In addition, the EU platform for sustainable finance provides the EU Taxonomy User Guide tailored for individuals without specialized expertise in the field by providing a comprehensive step-by-step manual for Taxonomy implementation with 12 distinct use cases (European Commission, n.d.-b) (PWC, 2021).

11.4.3 Corporate Sustainability Reporting Directive (CSRD)

In January 2023, the Corporate Sustainability Reporting Directive (CSRD) officially came into effect, marking a significant milestone in the realm of sustainability reporting regulations of the European Union. The novel directive will replace the existing Non-Financial Reporting Directive (NFRD) framework in the future, introducing a significant expansion of sustainability disclosure obligations (European Commission, 2023a).

All companies listed on an EU-regulated market (except for micro-enterprises) are subject to the new reporting obligations of the Corporate Sustainability Reporting Directive (CSRD). In addition, also non-capital market-oriented companies are subject to CSRD if they fulfil at least two of the following three criteria (KPMG, 2023a, c):

- Total assets > € 20 million.
- Net turnover > € 40 million.
- Number of employees >250.

It is estimated that around 50,000 companies in the EU will be affected by the new regulations of the Corporate Sustainability Reporting Directive (CSRD), with 15,000 alone in Germany (KPMG, 2023c). The earliest adopters will publish their reports in accordance with CSRD rules in 2025 for the 2024 financial year (European Commission, 2023a).

The Corporate Sustainability Reporting Directive (CSRD) is based on the "Double Materiality" principle. This means, the companies are required to document both the impact of sustainability activities on their economic conditions and their operational effects on sustainability aspects. The CSRD reporting package should include the following information (KPMG, 2023a):

– Sustainability objectives.
– The Roles of the executive board and the supervisory board.
– The most important negative impacts on the company.
– Unreported intangible resources.

Under the new rules of the Corporate Sustainability Reporting Directive (CSRD), there is a significant paradigm shift for sustainability reporting. Depending on the nature of the business, the content of future financial statements is expanded to include a diverse spectrum of suitable metrics. One of the major changes is that companies will be required to integrate their sustainability reporting in the management report, instead of the conventional practice so far of presenting such information in a separate non-financial report.

In summary, the stricter regulations and broader stakeholder involvement required by the Corporate Sustainability Reporting Directive (CSRD) will contribute to more comprehensive, transparent and standardized sustainability reporting practices. The implementation of stricter rules will also improve the integration of ESG considerations in corporate decision-making, as well as overall sustainability awareness and accountability. However, the increased reporting complexity will also inevitably cause higher resource consumption and costs (KPMG, 2023a, c).

11.4.4 ESG Reporting Standards

11.4.4.1 International Sustainability Standards Board (ISSB) Standards

Headquartered in London, the International Sustainability Standards Board (ISSB) was officially announced at the United Nations Climate Change Conference (COP 26) in 2021 as a standard-setting body under the International Financial Reporting Standards Foundation (IFRSF or IFRS Foundation). The IFRS Foundation is an independent, non-profit organization, formally known as the International Accounting Standards Committee Foundation, IASCF. The main objective of the International Financial Reporting Standards Foundation (IFRSF) is to develop and promote the use of a single set of high-quality, globally accepted reporting standards. Since the emergence of the International Sustainability Standards Board (ISSB), the existing International Financial Reporting Standards (IFRS) framework developed by the International Accounting Standards Board (IASB) has been expanded into the International Integrated Reporting Framework to include the new ISSB Standards that focus on sustainability-related standards (see Fig. 11.1). The International Integrated Reporting Framework aims to optimally connect financial statements and sustainability-related financial disclosures (IFRS, 2023a).

The International Sustainability Standards Board (ISSB) was established based on the consolidation of several organizations, including (IFRS, 2023a):

- International Integrated Reporting Council (IIRC) emerged in 2010 in London which created the initial Integrated Reporting Framework (IIRC, 2023).

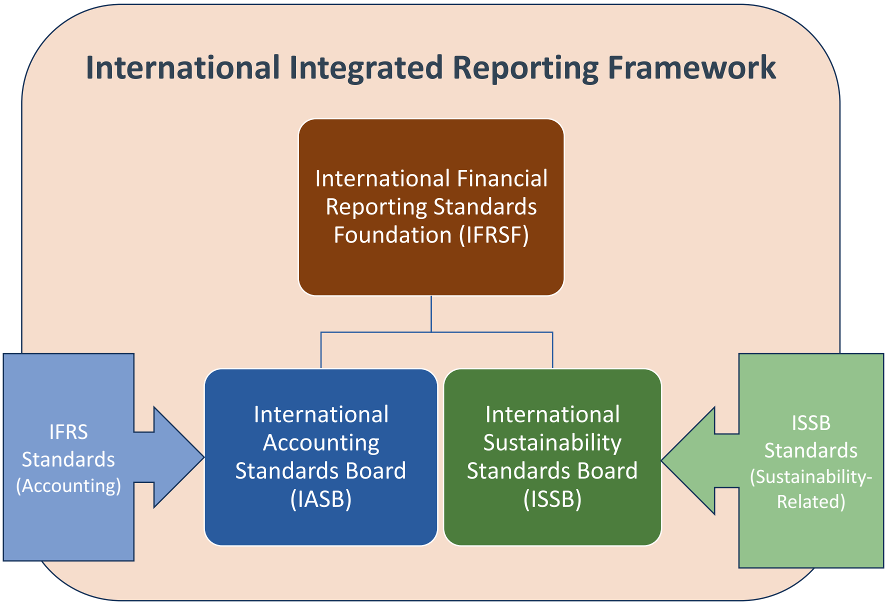

Fig. 11.1 IFRS and the standard-setting bodies of IFRSF. (Source: Author)

- Climate Disclosure Standards Board (CDSB) founded in 2007 in London, providing the CDSB Framework for climate and natural capital reporting (CDSB, 2022).
- Sustainability Accounting Standards Board (SASB) founded in 2011 in San Francisco, United States.
- Value Reporting Foundation (VRF), the combined effort of IIRC and SASB after the fusion of both organizations in 2021.

In response to calls for more consistent, comparable and reliable information for stakeholders, the International Sustainability Standards Board (ISSB) issued its inaugural standards on 26 June 2023, IFRS S1 and IFRS S2, marking a significant milestone in sustainability-related disclosures across global capital markets. While IFRS S1 focuses on disclosing requirements for sustainability-related financial information, IFRS S2 delves into specific climate-related disclosures. These standards aim to enhance trust in corporate disclosures on sustainability performance, enable informed investment decisions and create a common language for conveying the impact of ESG-related risks and opportunities. The launch of the standards was accompanied by a series of events at various major stock exchanges In Frankfurt, Johannesburg, Lagos, London, New York, Santiago de Chile and Singapore. Endorsed by the Task Force on Climate-related Financial Disclosures (TCFD), the ISSB Standards received rigorous market feedbacks (IFRS, 2023b).

The International Sustainability Standards Board (ISSB) collaborates closely with the EU and influential bodies like the G7 and G20, the Financial Stability Board and the International Organization of Securities Commissions (IOSCO) to ensure alignment. With the IFRS Accounting Standards required by more than 140 jurisdictions, the ISSB intends to create a global baseline with the ISSB Standards through continuous collaborations with jurisdictions and other standard setters like the Global Reporting Initiative (GRI) (IFRS, 2023a, b).

11.4.4.2 Global Reporting Initiative (GRI)

Established in 1997, the Global Reporting Initiative (GRI) is an independent international standard-setting organization headquartered in Amsterdam, the Netherlands, with the primary objective of fostering transparency, accountability and comparability in reporting of economic, social and governance (ESG) performance and impacts across a wide array of organizations, regardless of their size, legal status, business sector or geographical location (GRI, 2023a, b).

The GRI framework provides a framework of interconnected standards that help organizations identify relevant ESG topics, set goals, collect data on their individual ESG performance and impacts and communicate their efforts to stakeholders. The GRI standards consist of a modular system with three key elements (see Fig. 11.2):

- *GRI Universal Standards* that apply to all organizations, consisting of:
    - Foundation 2021 (GRI 1), which outlines the purpose of the GRI Standards, defines key concepts and explains procedures and requirements for the application of the Standards.
    - General Disclosure 2021 (GRI 2), which outlines the organizations profile and context of ESG impact, with a focus on the organization's structure,

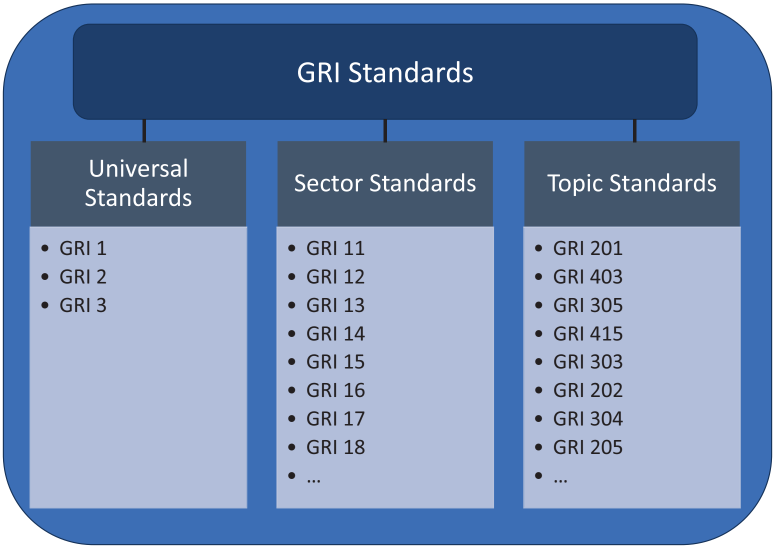

Fig. 11.2 Structure of GRI standards. (Source: According to GRI, n.d.)

reporting practices, activities and workforce, governance, strategy and policies, as well as stakeholder engagement.
- Material Topics 2021 (GRI 3), which outlines the process through which the organization identifies its most relevant ESG issues ("material topics").

- *GRI Sector Standards*, which outline topics that are likely to be material for most organizations within a specific sector. At present, the Global Reporting Initiative (GRI) has defined 40 sectors, starting with those having the most significant impact such as oil and gas, agriculture, aquaculture and fishing. The GRI Standard users are required to disclose the material topics of the applicable sector.
- *GRI Topic Standards*, which provide guidelines for reporting on specific topics, such as waste disposal, or occupational health and safety.

The implementation of GRI standards involves the following five steps (see Fig. 11.3):

Step 1: Ensure a good understanding of the key concepts, principles and requirements of the GRI Framework among stakeholders (GRI 1).

Step 2: Identify material topics through understanding the organization's context by:

– Determining the business sector (GRI 2).
– Determining the material topics of the specific sector (GRI 3).
– Identifying the organization's actual and potential impacts.
– Assessing the significance of the impacts.
– Prioritizing the most significant impacts for reporting.

Step 3: Prepare reporting that discloses the organization's performance and impact on the material topics with reference to the GRI Standards.

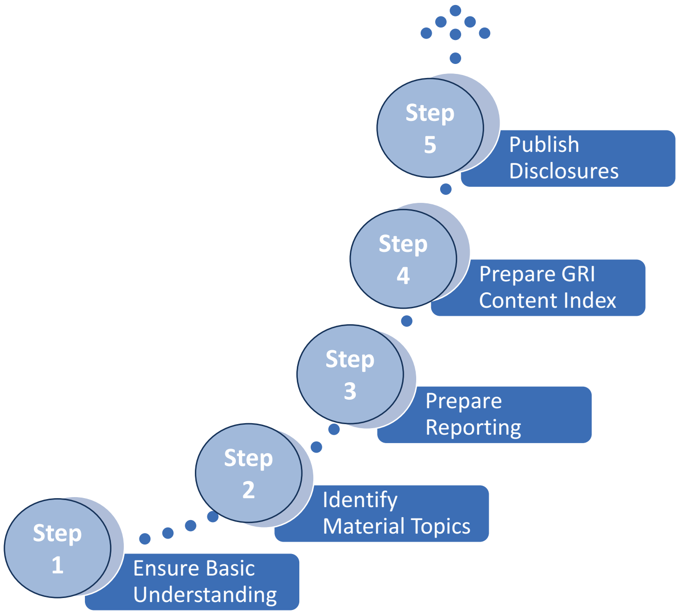

Fig. 11.3 GRI reporting process. (Source: According to GRI, n.d.)

Step 4: Prepare a GRI content index. This helps stakeholders gain a quick overview of the used and unused standards according to the GRI Framework. The disclosure should include an explanation for omissions of applicable topics according to the GRI Standards.

Step 5: Publish disclosures including both reporting and GRI content index.

Although the use of GRI Standards for ESG reporting is voluntary, there are several compelling reasons why organizations worldwide choose to adopt these standards such as (GRI, 2023a, b):

– Global recognition and network.
– Comprehensive framework.
– Alignment with global goals such as the United Nations Sustainable Development Goals (SDGs).
– Well-organized support services.

11.4.4.3 European Sustainability Reporting Standards (ESRS)

On behalf of the European Commission, the European Financial Reporting Advisory Group (EFRAG) proposed the European Sustainability Reporting Standards (ESRS) with the intention to harmonize sustainability reporting requirements across the European Union member states. These standards are meant to establish a consistent and comprehensive framework to guide the companies in disclosing their environmental, social and governance (ESG) performance and impacts in a structured and transparent manner (European Commission, 2023c).

The implementation of ESRS is mandatory for all companies subject to the Corporate Sustainability Reporting Directive (CSRD). While CSRD sets the regulatory framework that mandates certain business organizations to report on their sustainability performance and impacts, the ESRS provides specific guidelines for the development of disclosure concepts. Both initiatives are part of the EU's efforts to promote responsible business practices and transparency of accountability.

The European Sustainability Reporting Standards (ESRS) is a regulatory-driven framework of the European Union, while globally recognized reporting frameworks like GRI are implemented voluntarily by organizations around the world. As such, the European Sustainability Reporting Standards (ESRS) is not anticipated to replace GRI in the future, but the two types of sustainability reporting frameworks may coexist based on the reporting needs and regulatory requirements of individual companies.

In pursuit of harmonization with the existing global reporting frameworks, the European Financial Reporting Advisory Group (EFRAG) invited global standard-setting organizations, such as the International Sustainability Standards Board (ISSB) and the Global Reporting Initiative (GRI), to actively participate in the development of the European Sustainability Reporting Standards (ESRS). A seamless exchange of information and experience is intended to benefit businesses, investors and regulators alike. However, in the initial version of the European Sustainability Reporting Standards (ESRS), numerous definitions were found different from those by ISSB or GRI Standards. That means, for the mandatory implementation of ESRS, companies must scrutinize possible discrepancies between their existing reporting standards and the requirements of ESRS (KPMG, 2023b) (European Commission, 2023c).

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ESG Metrics

12

12.1 Types of ESG Metrics

Over recent years, due to the notable shift in business practices across all industry sectors towards integration of environmental, social and governance (ESG) considerations in the strategic concept, business executives find themselves increasingly compelled to assess and improve their organization's ESG performance on a regular basis. Amidst this trend, ESG metrics have emerged as a pivotal means to appraise organizational ESG performance across a range of sustainability criteria based on a wide array of relevant data. Today, measuring ESG performance with ESG metrics is not only an integral part of ensuring resilience and sustainable growth but also a regulatory requirement.

ESG metrics are performance indicators, predominantly of a non-financial nature, aimed at measuring an organization's adherence to sustainable and responsible practices. They can be broadly divided into quantitative and qualitative metrics. While quantitative metrics encompass numerical data that can be directly measured and compared (e.g. greenhouse gas emissions or quantity of waste caused by production processes), enabling transparent benchmarking and gauging progress over time, qualitative metrics draw from non-numerical data such as diversity, equity and inclusion (DEI) efforts. Due to the subjective nature of qualitative metrics, it is often difficult to compare performance in those aspects. However, qualitative metrics often provide valuable insights into an organization's culture and values.

Based on the subjects to be measured, ESG metrics can also be categorized into environmental metrics, social metrics and governance metrics. Some of the most common ESG metrics are (Farmer, 2023):

- *Environmental Metrics*
  - Greenhouse gas emissions: total produced quality of greenhouse gases such as carbon dioxide.

T. Dathe et al., *Implementing Environmental, Social and Governance (ESG) Principles for Sustainable Businesses*, Responsible Leadership and Sustainable Management, https://doi.org/10.1007/978-3-031-52734-0_12

  - Resource consumptions: total quantity of energies such as electricity and water consumed for operations. These metrics can help to identify opportunities for improvement.
- *Social Metrics*
  - Diversity, equity and inclusion (DEI) of workforce.
  - Labour practices such as responsible employee treatment including fair wages, fair working conditions and work safety.
  - Community engagement measures how a company contributes to the development of the communities in which it operates.
- *Governance Metrics*
  - Ethics and compliance that addresses subjects such as anti-corruption policies and business integrity, data protection and process transparency.
  - Board diversity that measures the diversity of a company's board of directors in terms of gender, race and so on.
  - Executive compensation that examines the senior executives' remuneration and alignment of financial incentives with stakeholder interests.

ESG metrics are rather helpful for clarifying ESG strategy and targets, continuously measuring and reporting on internal progress to support decision-making. An overview of the array of ESG metrics and available reporting frameworks is necessary for companies to select and employ them effectively. This encompasses a good knowledge and understanding of both regulatory requirements and industry best practices. Companies can learn from their successful peers that have successfully integrated effective ESG standards into their operations.

In some business fields, companies are facing challenges by disruptions that necessitate adjustments to ESG practices. For instance, the airline industry grapples with the need to reduce kerosene consumption per passenger per mile and transition to eco-friendly alternatives such as E-fuels or synthetic fuels. At the same time, airlines also need to find a balance between green transportation and meeting customers' mobility demands while minimizing noise pollution (Becker et al., 2019).

In addition, organizations can use ESG metrics to benchmark and communicate their ESG performance and efforts. ESG metrics are also widely used in commercial ESG ratings, ESG certifications as well as internal or third-party audits.

12.2 ESG Ratings

One significant advantage of applying ESG metrics is the reduction of investment risks stemming from corporations' violation of ethical norms. To manage the risks associated with public images, rating agencies such as MSCI, FTSE4Good, IMUG, Inrate, Oekom Research and Sustainalytics offer specialized ESG rating services to assess the ESG performance of companies, industry sectors and even entire countries.

Nowadays, more and more companies are turning to external ESG scoring and rating services for independent evaluation of their own ESG performance. These providers utilize standardized procedures based on diverse criteria which are mainly selected ESG metrics. The resulting numerical ESG scores or specific ESG ratings offer stakeholders a convenient way to compare a company's ESG performance with its peers. These ratings are essential information sources for investors and other stakeholders seeking insights into an organization's sustainability practices and ethical values (Dathe et al., 2022). The popularization of ESG ratings has also led to the creation of new job positions such as ESG analysts, who are specialized in establishing and maintaining ESG monitoring processes on a long-term basis.

ESG ratings have become an additional dimension to financial investment evaluation beyond the traditional profitability criteria. Benchmarking ESG performance offers several key benefits for facing increasing pressure to demonstrate their commitment to responsible business practice. Those who excel in ESG performance can gain a decisive competitive edge over competitors (see Fig. 12.1).

Benchmarking ESG performance is crucial in meeting customer demand. Consumers worldwide are becoming more educated about the impact of their choices and consciously use their power to gravitate towards brands and providers who reflect their values. By actively benchmarking and improving their ESG performance, companies demonstrate responsiveness to consumer preferences. As customer expectations evolve, businesses that integrate ESG principles into their operations attract more loyal customers who prioritize sustainability and ethical considerations.

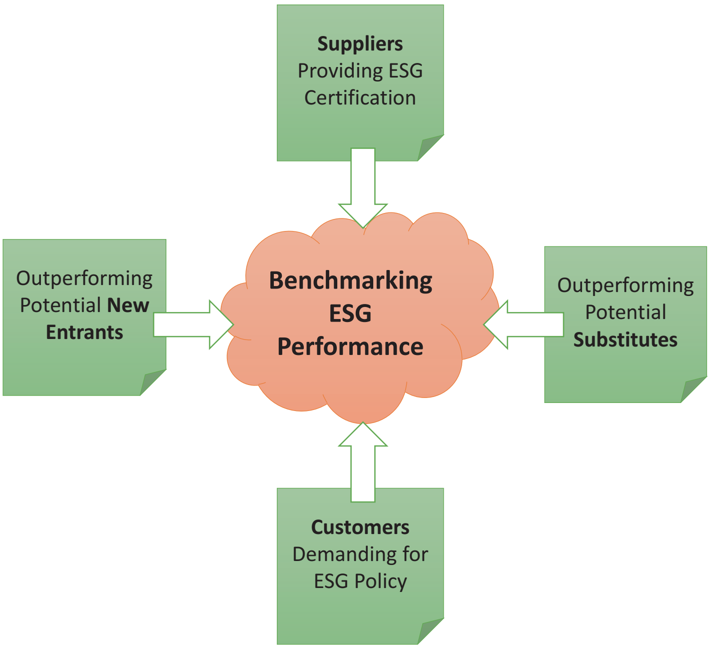

Fig. 12.1 Benchmarking ESG rating as a performance indicator for sustainable success. (Source: Based on Porter's Five Forces Framework (Porter, 2008))

Companies with established ESG policies showcase their dedication to environmental concerns, engagement with stakeholders and governance for ethical practice. A positive track record of ESG performance not only attracts environmentally conscious consumers but also appeals to investors who prioritize sustainability factors. By demonstrating superior ESG performance, existing market actors can set a high bar for potential new entrants who intend to establish themselves as credible players in the competition. Businesses that actively integrate ESG principles into their operations stand a better chance of retaining their market share and customer loyalty, even as alternative products or services emerge.

Benchmarking ESG performance also leads to more intensive collaborations with suppliers who can offer ESG certifications to enhance their credentials for sustainable and ethical practices. By partnering with certified suppliers, businesses seek to ensure that their entire supply chain adheres to high ESG standards, further reinforcing their commitment to responsible practices.

ESG ratings cover three essential aspects of sustainable investments:

1. *Environmental (E)*. The ecological performance of a business is often measured by emissions, share of renewable energy and so on in the production process. A company is considered particularly sustainable if, for example the main product uses environment-friendly technologies (e.g. electronic vehicles).
2. *Social (S)*. The social performance can be reflected by the diversity and inclusion measures, production safety and workplace design as well as human rights issues such as the prohibition of child labour.
3. *Governance (G)*. Governance stands for the inspection bodies or processes that are intended to ensure compliance with ethically sustainable standards in the company.

In a broader context, ESG ratings offer several advantages, including but not limited to (Armanino, 2023):

- Supporting Investors' Understanding of Business Risks. ESG ratings provide investors with insights into a company's exposure to environmental, social and governance (ESG) risks. This knowledge is essential for informed decision-making on investment choices and risk management issues.
- Enhancing Talent Retention. Companies that align with ESG principles create an environment that resonates with employees who share similar values. Such a positive working environment can enhance employee morale and contribute to retaining top talent.
- Strengthening Customer Loyalty and Satisfaction. As consumer consciousness about ESG issues intensifies, companies with favourable ESG ratings can attract and retain customers who prioritize ethical and sustainable practices in the long term.
- Identifying Weaknesses and Strengths. ESG ratings help companies compare their performance with that of their peers and identify areas where their achievement is above or under expectations. This insight enables them to enhance their overall ESG strategy and improve their future ratings.

However, the challenges within the ESG rating landscape are not to be overlooked. One major concern is the alleged lack of information transparency in the rating process and outcomes.

First of all, the fact that ESG ratings heavily rely on the self-declaration of corporations themselves can lead to potential biases and inaccuracies in the assessment process. When companies are entrusted with providing the data upon which their ratings are based, a potential conflict of interest arises. In order to present their ESG practices in the best possible light, companies may choose to focus their report on positive aspects of their ESG initiatives while omitting or downplaying areas where they fall short. Such selective reporting can create an imbalanced, incomplete or even misleading picture of a company's overall ESG performance (Armanino, 2023).

Unlike financial reporting which is guided by well-defined standards like IFRS, ESG reporting still lacks a globally accepted and consistent framework for reporting standards. The absence of standardization leads to variations in reporting metrics, methodologies and data interpretations. As a result, comparisons between companies and industries, especially among those from different regions, are often quite difficult, hindering investors' ability to make informed decisions.

Besides, unlike financial reporting, ESG reporting lacks comprehensive regulatory oversight. While some regions have introduced guidelines and initiatives to promote more standardized ESG reporting, there is yet no universal regulatory authoring governing the process. The lack of regulation adds to the challenges of data accuracy, consistency and reliability.

In practice, ESG consultancy firms and ESG rating agencies often stem from the same mother company, potentially giving way to biases due to conflict of interest. This may arise when an ESG rating agency offers services like mock audits by itself or through affiliated ESG consultancy firms to "boost" ESG performance. To showcase the effect of their service, the rating agencies may provide extremely negative ratings prior to the consultancy, thus distorting the perceptions of the clients' current ESG performance and undermining the integrity of the rating process (Tayan, 2022).

Moreover, as ESG ratings gain momentum, more rating agencies are entering the space. The dynamic landscape of service providers offers investors and business owners with a wider array of choices for evaluating their ESG performance and efforts. However, as each rating agency has its own methodologies and criteria, this uniformity complicates the comparability of rating outcomes across different sources, leaving stakeholders especially investors struggling to understand the differences between ratings from various agencies (Armanino, 2023).

Despite the complexities and challenges, ESG ratings serve in global business practice as an effective instrument for investors, regulators and other stakeholders alike. The increasing demand for transparent and responsible business practices has driven the growth of ESG ratings, highlighting their role in reshaping the business landscape. As regulatory bodies and standard setters have set out to refine oversight and reporting standards (see Chap. 11), the credibility and usefulness of ESG ratings will continue to increase in the future. The ESG ratings not only enable better-informed decision-making by external stakeholders but also encourage companies to improve their ESG performance, contributing to a more sustainable business environment.

The fast-growing influence of ESG ratings is underscored by the increasing recognition that successful investing is closely intertwined with ESG considerations. Many investors are convinced that companies with strong ESG performance are better positioned for sustainable growth and resilience in an evolving market (Armanino, 2023). Previous studies indicate the impact of low ESG ratings on the volatility of share prices, highlighting the tangible consequences of ESG performance on a company's financial standing (Dunn et al., 2018). Nevertheless, a definitive financial advantage of ESG-rated companies over non-ESG-rated companies is yet to be further confirmed with further scientific analyses and data (Tayan, 2022).

The rising trend of ESG ratings has also ignited a competition among businesses across various sectors. Peers and competitors are now engaged in a race to improve their rankings and benchmark their performance against industry standards. This competition extends to top executives of business organizations, who have come to realize the significance of ESG in the strategic decision-making process. Larry Fink, the co-founder and CEO of BlackRock Inc., advocated for a fundamental transformation of investment strategies, emphasizing the primacy of ESG factors in his annual letter to CEOs (Dathe et al., 2022). This influential call has prompted corporate leaders to rethink their broader business approaches, as now ESG considerations have become an indispensable component of their organizational roles and incentive structure.

Here are some of the most influential ESG rating agencies for corporate ESG rating and ESG risk assessment:

- MSCI
- Sustainalytics
- FTSE Russell
- ISS ESG (now part of Deutsche Börse Group)
- CDP (formerly Carbon Disclosure Project) that specializes in environmental contribution to environmental protection and combatting climate change

The choice of appropriate ESG ratings depends on the business sector, region and corporate policy. Figure 12.2 shows the ESG ratings chosen by the German real estate company Vonovia SE.

12.3 ISO Standards and Certifications

12.3.1 ESG-Relevant ISO Standards and Certifications

The International Organization for Standardization (ISO) is an independent, non-governmental organization based in Geneva, Switzerland, that develops and publishes globally accepted standards to ensure the safety, consistency and efficiency of products, services and systems across various industry sectors. While ISO itself does not provide ESG rating services, a wide spectrum of ISO standards in the areas including quality management, environmental management, information security

Fig. 12.2 ESG ratings of Vonovia SE for private (residential) real estate market. (Source: According to Vonovia (2023))

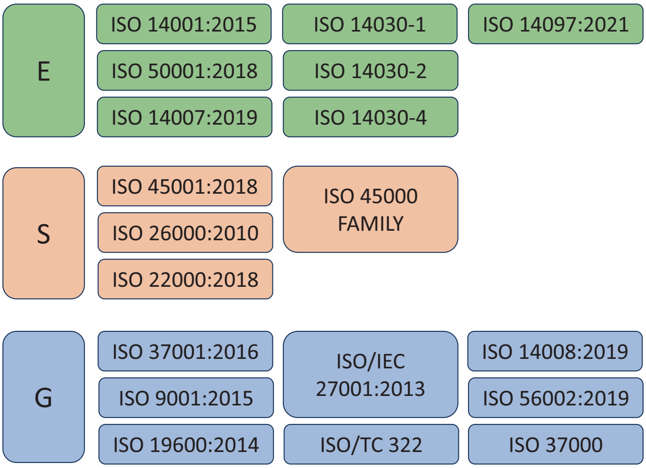

Fig. 12.3 ISO standards relevant to social, environmental and governance (ESG) goals. (Information Sources: ISO (2021), Certification Italy (2021), Connexis (2018), QMS Certification (2020))

and so on can be related to aspects of ESG performances, such as (ISO, 2021; Certification Italy, 2021; Connexis, 2018; QMS Certification, 2020) (see Fig. 12.3):

- ISO 14001:2015 Environmental management systems – Requirements with guidance for use

- ISO 50001:2018 Energy management systems – Requirements with guidance for use
- ISO 45001:2018 Occupational health and safety management systems – Requirements with guidance for use
- ISO 26000:2010 Guidance on social responsibility
- ISO 22000:2018 Food safety management systems – Requirements for any organization in the food chain
- ISO 37001:2016 Anti-bribery management systems – Requirements with guidance for use
- ISO 9001:2015 Quality management systems – Requirements
- ISO 19600:2014 Compliance management systems – Guidelines
- ISO/IEC 27001:2013 Information technology – Security techniques – Information security. management systems – Requirements
- ISO 56002:2019 Innovation management – Innovation management system – Guidance
- ISO /TC 322 Sustainable finance
- ISO 14007:2019 Environmental management – Guidelines for determining environmental costs and benefits
- ISO 14008:2019 Monetary valuation of environmental impacts and related environmental aspects
- ISO 14030-1 Environmental performance evaluation – Green debt instruments – Part 1: Process for green bonds
- ISO 14030-2 Environmental performance evaluation – Green debt instruments – Part 2: Process for green loans
- ISO 14030-4 Environmental performance evaluation – Green debt instruments – Part 4: Verification program requirements
- ISO 14097:2021 Greenhouse gas management and related activities – Framework including principles and requirements for assessing and reporting investments and financing activities related to climate change
- ISO 37000 Governance of organizations – Guidance
- ISO 45000 Family occupational health and safety (ISO 2021; Certification Italy 2021; Connexis 2018; QMS Certification 2020)

The growing number of ESG-relevant ISO standards implies the need for standardization for the assessment of ESG performance in business operations. Given the popularity of ISO standards, it can be expected that the proliferation of ISO standards is on the rise for various aspects of environmental, social and governance activities.

The International Organization for Standardization (ISO) provides ISO management certification (ISO certification) to organizations as a formal recognition for compliance with certain ISO standards. ISO certifications are a means for organizations to signal to their stakeholders including customers and the public that they meet the globally recognized standards for best practice in specific areas such as quality management, environmental management or IT service management. Such certifications are typically issued by accredited certification bodies (registrars) such as TÜV or BSI after a rigorous assessment process. The registrars serve as partners for manufacturers and service providers, as well as for industry associations and regulators. In order to retain their certifications, organizations need to maintain their adherence to ISO standards and conduct regular audits and re-assessments.

Unlike ISO management systems standards such as ISO 9001 for quality management or ISO 140001 for environmental management, there are also non-certified ISO standards, known as ISO guidelines or ISO publications that are intended to serve as valuable references to help organizations improve their performance and comply with industry standards. In spite of the absence of formal ISO certifications, compliance with those guidelines often results in improved processes, increased efficiency and greater acceptance by stakeholders including customers and the general public. The non-certified ISO guidelines include:

- ISO 26000 – Social responsibility
- ISO 31000 – Risk management
- ISO 22301 – Business continuity management
- ISO 37001 – Anti-bribery management systems
- ISO 10002 – Customer satisfaction
- ISO 50001 – Energy management
- ISO 19600 – Compliance management systems
- ISO 22375 – Crisis management
- ISO/IEC 27002 – Information security
- ISO 30301 – Records management

Alongside the ISO certifications, various non-ISO certifications have emerged to address specific ESG-related issues. These certifications focus on areas like sustainable supply chain, fair trade, renewable energy or ethical labour practices. As the ESG landscape evolves, organizations may need to seek multiple certifications for optimal demonstration of their commitment to various aspects of sustainability and responsible business practice.

12.3.2 Global Influence of ISO Standards and Certifications

The large number of worldwide ISO certifications and certification sites is a testament to the significance and influence of ISO certification across various industries (see Table 12.1). ISO certifications enjoy global recognition and enable organizations to demonstrate their commitment to quality, safety, environmental responsibility, effective governance processes and other critical aspects of their operations. ISO certifications can help organizations meet and exceed regulatory requirements and prevent legal issues and regulatory fines. Adherence to ISO guidelines for risk management and compliance standards can reduce the risk of product defects, accidents, legal issues and other incidents. Investors, customers and clients often prefer to work with or buy from organizations that hold ISO certifications. The ISO

Table 12.1 Number of certificates and sites of various ISO Certification standards per 2021

ISO standard certification	Number of certificates	Number of certification sites
ISO 9001:2015	1,077,884	1,463,153
ISO 14001:2015	420,433	618,384
ISO 45001:2018	294,420	374,292
ISO IEC 27001:2013	58,687	101,794
ISO 22000:2005&2018	36,124	42,937
ISO 13485:2016	27,229	38,503
ISO 50001:2011&2018	22,575	57,019
ISO 20000-1:2011&2018	11,769	13,998
ISO 37001:2016	2896	7982
ISO 22301:2012&2019	2559	6053
ISO 39001:2012	1285	2357
ISO 28000:2007	584	1106
ISO 55001:2014	488	1993
ISO 20121:2012	253	712
ISO 29001:2020	157	795
ISO 44001:2017	136	186

Information Source: ISO (2023)

certifications can therefore set an organization apart from its competitors as a signal of commitment to excellence.

ISO standards play a critical role in standardizing ESG practices across industries around the world. ISO supports the United Nations SDG initiative that underscores the global commitment to advancing sustainability and responsible business practices. These standards provide guidance for organizations to optimize processes in areas such as environmental management, social responsibility practices and corporate governance. The growing proliferation of ISO standards in the ESG domain signifies the need for a structured approach to manage ESG risks and opportunities.

ESG considerations are increasingly recognized as risk management tools. As stakeholders demand greater transparency on ESG issues, companies that proactively address these concerns can safeguard their reputation and access a broader investor and customer base. Organizations that effectively manage ESG risks can enhance their resilience and long-term viability (Gillan et al., 2021). At present, ESG is widely seen as a key driver of long-term business success. Companies that integrate ESG principles into their strategies are better positioned to adapt to changing market conditions, meet evolving customer expectations and contribute positively to society and the environment (Cini & Ricci, 2018).

There is a growing need for an overarching ISO certification for ESG performance and processes that streamlines ESG reporting and evaluation, similar to ISO 9001 and ISO 13485, that unify quality management standards and enhance comparability among organizations (ISO, 2021).

The development of ISO/TC322 on sustainable finance reflects the growing importance of aligning markets with ESG principles, aiming to create a single global standard that connects various ESG aspects in the capital market. By doing so, ISO seeks to reduce confusion, promote innovation in sustainable financial products and establish common ESG metrics (ISO, 2021).

12.3.3 Certification Process on Example of ISO 9001: 2015

ISO 9001 plays a crucial role in ensuring the quality of management systems (QMS) of organizations cross various industries. This standard, published and owned by the International Organization for Standardization (ISO), establishes a set of requirements and guidelines for effective QMS implementation. ISO 9001:2015 is the latest version of the ISO 9001 standard approved and published in 2015. The primary goal of ISO 9001:2015 is to provide a structured approach for companies to meet regulatory requirements while continually improving their QMS (TÜV, 2023).

ISO 9001:2015 stands out prominently among ISO certificates, firmly establishing its reputation as the world's leading certification (see Table 12.1). It has achieved remarkable global acceptance with over 1 million companies in 160 countries holding this certification. The widespread adoption underscores the importance of its importance as an instrument for achieving quality excellence. Table 12.2 shows the countries where ISO 9001:2015 has the greatest impact (ISO, 2023).

ISO 9001:2015 emphasizes the importance of continuous improvement. Companies are encouraged to regularly review their processes to boost efficiency and quality, for example by increasing resource utilization, reducing waste and enhancing productivity. The standard also places a strong focus on customer satisfaction and compliance with customer needs and requirements (TÜV, 2023).

Obtaining ISO 9001:2015 certification involves a structured process. The procedure can vary based on the organization's size, multinational status and corporate culture, including the following key steps (TÜV, 2023):

Step 1 – Identification of Notified Body
The first step of the certification process is to identify a Notified Body – the entity that acts as an auditor for the organization, subsequently issues the certification and plays a vital role in maintaining the certification throughout its lifecycle.

Step 2 – Readiness Assessment
A readiness assessment is typically carried out by one to two auditors either through an on-site visit or remote inspection. During this phase, auditors evaluate the organization's current adherence to ISO 9001:2015 and provide recommendations for improvements that are necessary to align with certification requirements.

Step 3 – Certification Audit
The certification audit is to be conducted by an audit team on-site with a focus on:

- *Documentation review*: The certification audit begins with a thorough review of the organization's documentation and processes. Auditors intend to understand the manufacturing or service procedures to assess compliance with ISO 9001:2015.

Table 12.2 Countries with most ISO 9001:2015 certifications in 2021

Country	Number of certificates	Number of certification sites
China	426,716	430,065
Italy	92,664	135,550
Germany	49,298	81,550
Japan	40,834	96,808
United Kingdom of Great Britain and Northern Ireland	39,682	55,622
India	36,505	45,255
Spain	31,318	61,813
United States of America	25,561	42,498
France	21,918	60,539
Brazil	16,268	25,386
Korea (Republic of)	14,339	15,089
Thailand	12,711	18,291
Romania	11,886	14,641
Malaysia	11,610	15,584
Czech Republic	11,429	12,580
Poland	10,512	16,575
Taiwan, Province of China	10,379	14,782
Colombia	10,263	15,210
Netherlands	9090	14,533
Israel	8942	9963
Australia	8307	16,109
Indonesia	7973	10,823
Mexico	7969	12,551
Turkey	7866	9394
Hungary	7856	10,886
Switzerland	7351	16,066
Greece	7024	7428
Belarus	6989	7562
Bulgaria	6402	7173
Viet Nam	6258	7771
Argentina	5965	10,032
Canada	5426	9049
Russian Federation	4313	6086
Singapore	4232	5475
Portugal	4222	6232
United Arab Emirates	4177	6168
Slovakia	3921	4276
South Africa	3796	4913
Austria	3768	5437
Philippines	3481	6269
Serbia	3461	4758
Pakistan	3254	3656

(continued)

Table 12.2 (continued)

Country	Number of certificates	Number of certification sites
Sweden	3155	9655
Finland	2916	8014
Chile	2860	4157
Croatia	2839	3175
Belgium	2799	4485
Hong Kong	2558	4546
Egypt	2321	2758
Saudi Arabia	2261	2904

Information Source: (ISO, 2023)

- *On-site inspection*: The audit team conducts an on-site inspection to evaluate the effectiveness of the quality management system (QMS). Any deviations or nonconformities identified during the inspection are to be documented and discussed in a close-out meeting. Subsequently, a Corrective and Preventive Action (CAPA) plan is to be developed to address these issues. A comprehensive report is to be issued within 30 days.

Step 4 – Certificate Award

Following the certification audit, the organization is required to address the nonconformities identified and documented in the CAPA plan. The audit team will then review and approve the corrective actions. Upon successful completion of the CAPA plan, the Notified Body will issue the ISO 9001:2015 certificate. The certification is usually published on the company's official website and incorporated into product labelling, symbolizing the organization's commitment to quality. Figure 12.4 shows the product label with integrated ISO 9001 and ISO 13485 certifications of a Chinese medical device manufactured in Beijing, China.

Recertification typically takes place every 3 years, with annual monitoring audits conducted by the Notified Body to ensure ongoing compliance.

Preparation is key to a successful ISO certification process. Organizations can best prepare themselves for the certification with effective internal processes such as (TÜV, 2023):

- *Self-inspection* involves:
  - Internal audits. Conduct regular internal audits to assess the organization's compliance with ISO standards and continuously identify areas that may require improvement and implement corrective actions.
  - Documentation review. Ensure that all documentation, including quality manuals, procedures and all relevant records, is aligned with ISO requirements.
- *External mock audit*. With the support of a consultant team or individuals with expertise in ISO standards and certification processes, for example former ISO investigators, the simulation of an external audit can be conducted. The results of

Fig. 12.4 An example of ISO 9001 and ISO 13485 certification label of a Chinese medical device. (Source: Author)

the simulation can provide valuable feedbacks and recommendations for improvement.

- *Front and Back Office Preparation*, including:
  - *Employee trainings* at all levels on ISO standards and the certification process, ensuring that the employees understand their roles and responsibilities in maintaining compliance.
  - *Documentation accessibility*, ensuring that all relevant documentation and records are easily accessible for auditors.

ISO 9001:2015 is a globally accepted standard that provides organizations with a competitive edge by enhancing stakeholder confidence and fostering a culture of quality and excellence. The certification is to many companies an investment in its own future, aligning the organization with international quality standards and facilitating growth in a competitive, globalized world.

12.4 Case Study: The DWS Case

The DWS case, involving the investment arm of Deutsche Bank and its former employee Desiree Fixler, highlighted the pressing need for clear guidelines and standards in the realm of environmental, social and governance (ESG) investments. This case drew considerable public attention and was extensively covered by reputable financial news outlets such as the Wall Street Journal, Finanzen.net. and die Zeit in 2021.

DWS Group, formerly known as Deutsche Asset Management, is a global asset management firm that provides investment solutions across various asset classes. In recent years, there has been a significant surge in interest in ESG-related investments, taking into account ESG factors alongside traditional financial metrics. ESG investments are seen as a means for investors to align their portfolios with sustainability goals and ethical considerations.

Desiree Fixler is a former employee of DWS who played a pivotal role in shedding light on the company's ESG practices. She alleged that DWS engaged in misleading marketing practices by exaggerating the ESG performance of its funds. Her revelation initially sparked a wider discussion about the accuracy, transparency and integrity of ESG investments.

One of the central issues raised in the DWS case was the lack of consistent and reliable Key Performance Indicators (KPIs) for ESG investments. ESG investments often involve complex metrics related to environmental impact, social responsibility practices and governance processes. Without common standards, these metrics can vary significantly, making it challenging for investors to assess the true sustainability impact of their investments.

The DWS Case had far-reaching implications for both DWS and the broader ESG investment industry. DWS's reputation was heavily tarnished, leading to a notable 14% drop in its share price by the end of August 2021. This case highlighted the financial risk associated with discrepancies between ESG claims and the actual performance and underscored the urgent need for standardized ESG reporting and assessment frameworks that could help investors make informed decisions on ESG investments. Clear and universally accepted ESG metrics can prevent "greenwashing" where companies exaggerate their ESG efforts to attract investors and customers, as well as enhance comparability of ESG reporting across various industries and regions.

Since then, independent organizations like the International Organization for Standardization (ISO) have intensified their efforts in establishing guidelines and standards for the choice of ESG metrics and reporting frameworks. As a result, ISO developed the ISO/TC 322 standard that provides a unified framework for ESG reporting and assessment, aiming to enhance transparency and facilitate innovation in sustainable financial products.

The DWS Case spurred discussions on the standardization of ESG metrics and reporting frameworks, so as to ensure the alignment of ESG investments with their stated goals and genuine sustainability benefits. This incident speeded up the process of robust ESG standards in the ESG investment landscape that is necessary to maintain trust in a sustainable global financial system (Frankfurter Allgemein, 2021; Finanzen.net., 2021; Zeit, 2021).

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13 Consumer Relationship and Sustainable Talent Management

13.1 Stakeholders in Public Attentions

According to the management consulting firm McKinsey & Company, a good starting point for the development of an ESG policy is the engagement with major stakeholders, in order to understand their needs and requirements and to fulfil societal expectations. Subsequently, depending on the fundamental business model and the type of market where it operates, a company can then determine the level of efforts it asserts into its ESG strategy, as well as appropriate metrics to monitor the progress of strategy implementation (McKinsey, 2022).

Among a company's key stakeholders, consumers and employees often receive more public attentions and sensibly impact the corporate image. Both groups of stakeholders have special legal rights and protections such as labour laws and consumer protection regulations. Failure to meet social expectations or legal obligations with respect to these stakeholder groups can lead to damage of brand image, regulatory scrutiny, penalties or legal consequences.

13.2 Consumer Relationship

13.2.1 Power of Consumer and Sustainable Consumption

The role of consumers is pivotal in holding organizations accountable for their environmental, social and governance (ESG) practices and shaping business strategies. Social media platforms have given consumers a powerful voice so that they can quickly mobilize and express their opinions, concerns and criticisms. A negative social media campaign, often referred to as a "shit storm", can have severe repercussion for a company's reputation and financial performance (Kühte & Rohde, 2023).

T. Dathe et al., *Implementing Environmental, Social and Governance (ESG) Principles for Sustainable Businesses*, Responsible Leadership and Sustainable Management, https://doi.org/10.1007/978-3-031-52734-0_13

Today, consumers have access to a wide array of products and services. They can make choices based not only on price and quality but also on ethical considerations. Consumers increasingly use their influence to demand ESG accountability and ethical, sustainable and responsible business operations. Companies that fail to comply with their expectations risk losing business and facing public backlash.

Companies that invest in ESG initiatives often realize that consumers are willing to pay a premium for products and services that align with their values. Thus, higher prices for sustainable and ethical products can lead to higher revenues, improved return on investment (ROI) and increased corporate value.

Due to the growing consumer awareness, ESG initiatives have long become an integral aspect of the marketing concept worldwide that largely impacts strategy development in both the private business sector and politics (Gupta, 2021; PRI Association, 2021). There is ample evidence that consumers globally reward ethical behaviours by companies, such as sustainable sourcing, fair labour practices and reduced environmental impacts (Devinney et al., 2010). This type of conscious engagement of consumer influence is often referred to as "sustainable consumption".

The popularity of sustainable consumption is still on the rise. Consumers increasingly seek products that use environment-friendly technologies, such as electric vehicles ("e-mobility"). However, there is also scrutiny for "greenwashing", where companies overstate their sustainability claims. For example, although electric vehicles reduce toxic exhaust gas in driving, the production of eCars may cause severe pollution and the later disposal of batteries may yet cause other environmental issues. To avoid negative consequences, private firms often distance themselves from business partners, including suppliers and customers, who are embroiled in ethical scandals (Dathe et al., 2022).

One approach of sustainable consumption is the trend of "refurbishing", a production approach that intends to replace the traditional linear flow of resources in the production process by reusing waste materials through product recapture, recycling and overhauling (compare Figs. 13.1 and 13.2). Companies that adopt circular economy principles, such as Apple with its iPhone dismantling robot Daisy, are considered to contribute to resource efficiency and sustainability by doing so.

Collaborative consumption, also referred to as the sharing economy or the collaborative economy, is a further approach of sustainable consumption. This socio-economic model is characterized by individuals or groups sharing access to resources, goods or services rather than owning them outright. This concept leverages technologies and online platforms to facilitate peer-to-peer transactions and resource sharing. Collaborative consumptions can take many different forms, for example ride-sharing (e.g. Uber and Lyft), shared cars or bikes, accommodation sharing (e.g. Airbnb and Vrbo that help homeowners rent out their existing housing space to travellers) or peer-to-peer lending.

However, affordability remains a crucial factor for many consumers when making purchasing decisions. Different consumers have different priorities. While some prefer eco-friendly and ethical products, even if they come at a higher cost, others may prioritize lower prices due to their own financial constraints. Therefore,

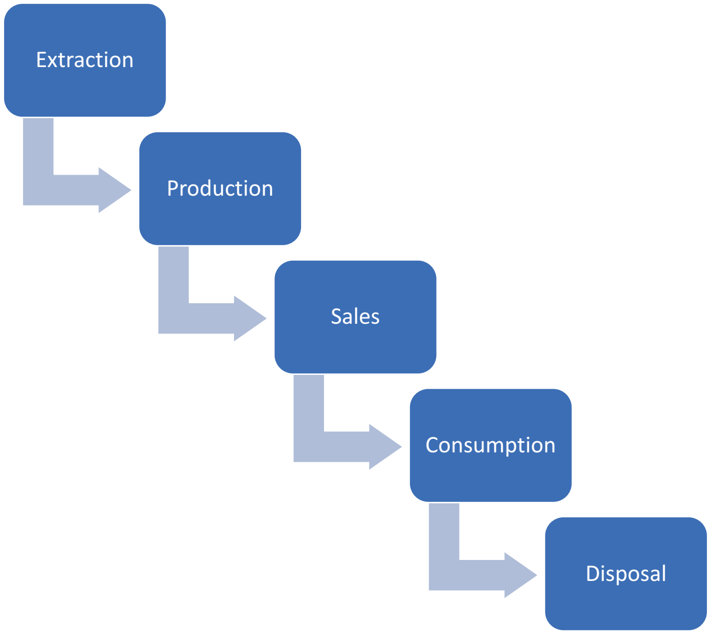

Fig. 13.1 Product life cycle: Linear flow of resources. (Source: Based on Crane and Matten (2016, S. 369 ff.))

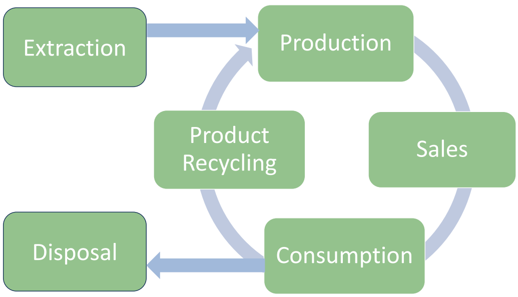

Fig. 13.2 Product life cycle: Circular flow of resources. (Based on Crane and Matten (2016, S. 369 ff.))

companies need to strike a balance between ESG standards and cost factors during product development, manufacturing, marketing and sales to cater to various consumer preferences (Gerard, 2019).

13.2.2 Consumer Protection

Customer protection refers to a set of laws, regulations, measures and practices aimed at safeguarding the rights and interests of consumers in commercial transactions. The primary objective of consumer protection is to ensure that individuals in the role consumers are treated fairly, honestly and safely in the marketplace while

Table 13.1 Objective of the United Nations Guidelines for Consumer Protection

C	Assisting countries in achieving or maintaining adequate protection for their populations as consumers
O	Assisting countries in curbing abusive business practices by all companies, nationally and internationally, that adversely affect consumers
N	Encourage the development of market conditions that allow consumers more choices at lower prices
S	Facilitating production and distribution in response to consumer needs and desires
U	Facilitating the development of independent consumer groups
M	Promote a high level of ethical behaviour among those in the Production or distribution of goods and services to consumers
E	Promotion of international cooperation in the field of consumer protection
R	Promotion of sustainable consumption

Source: UNCTAD (2016)

Table 13.2 Scope of legitimate consumer needs in the United Nations Guidelines for Consumer Protection

P	Access to sufficient information for consumers to make informed decisions based on individual wants and needs
R	Availability of effective arbitration or settlement of consumer disputes
O	Consumer access to essential goods and services
T	Consumer education, including education about the economic, social and environmental consequences of consumer choices
E	Freedom to set up consumer and other relevant groups or organizations, including the opportunity for such organizations to express their views in the decision-making processes that affect them.
C	Promotion and protection of the economic interests of consumers
T	Promotion of sustainable consumer behaviour
I	Protecting consumers from threats to their health and safety
O	Protection of consumer privacy and the free flow of information around the world
N	Protection of vulnerable or disadvantaged consumers
S	The level of security for consumers using e-commerce that is no less than for other forms of business

Source: UNCTAD (2016)

promoting consumer confidence and trust and building the foundation of the economy. Consumer protection is part of the ESG approaches (Gupta, 2021; PRI Association, 2021).

The United Nations Conference on Trade and Development (UNCTAD) established a set of principles called "United Nations Guidelines for Consumer Protection" to support legislators, law enforcement agencies and the arbitration boards of the member states in promoting consumer protection – United Nations for Consumer Protection (UNCTAD, 2016) (see Tables 13.1 and 13.2). The guideline also intends to promote collaboration of the member states and harmonization of legal standards (UNCTAD, 2016).

In economic activities, consumers often find themselves in a disadvantaged position for several reasons, for example the significantly stronger financial power or the knowledge advantage of the companies. This power of symmetry can translate into significant contractual advantages for businesses over individual consumers. However, despite these challenges, modern society places a high premium on ensuring that the most critical consumer rights are safeguarded. These rights encompass various dimensions, above all the right of access to non-dangerous products, the right to just and sustainable economic and social development and environmental protection (UNCTAD, 2016).

In accordance with the United Nations Guidelines for Consumer Protection, the European Commission has issued a series of EU consumer protection regulations under the designation Consumer Contract Law. These regulations address contractual matters in business transactions between companies and consumers. They cover important aspects such as the right of withdrawal, legal guarantee and unfair contractual conditions to regulate. These regulations are based on several binding legal provisions associated with EU consumer directives (see Table 13.3) (Europäische Kommission, 2019).

The increasing digitalization of commerce has ushered in a new era of consumer protection, bringing to light several critical aspects that require attention. Among

Table 13.3 Consumer protection guidelines by the European Commission

Legislation	Detailed content
Unfair Commercial Practice Directive	The directive has a fundamental objective: to enhance consumer confidence while simultaneously facilitating cross-border trade for businesses, particularly small- and medium-sized enterprises (SMEs). This directive empowers national enforcement authorities to effectively address a wide spectrum of unfair business practices such as: Untruthful information: where businesses provide consumers with inaccurate, misleading or deceptive information about product/service features, benefits or prices. Aggressive marketing: where businesses engage in overly aggressive or coercive marketing practices aiming to influence consumers' choices.
Consumer Rights Directive	Regulations for consumer information and other contractual questions, e.g. distance selling, or contracts conclude outside of business premises, consumer sales rights for public auctions, transfer of existing contracts between consumers, pre-contractual information, the right of withdrawal, delivery, transfer of risk and fees for the use of payment methods.
Price Indication Directive	The sales price or the price per unit of measure (unit price) for all products that retailers offer to consumers must be indicated to make it easier for consumers to compare prices. The selling price must be unambiguous, easily identifiable and clearly legible.
Unfair Contract Terms Directive	Protecting consumers from unfair standard contractual clauses imposed by traders. The policy applies to all types of contracts for the purchase of goods and services, such as online or offline purchases of consumer goods, gym subscriptions or contracts for financial services such as loans.

Source: European Commission (2021)

those are e-commerce, efforts to reduce customer and price discrimination (Png, 1991) and the assessment of product quality in both online and offline markets (Xu et al., 2021). Online shopping presents unique challenges, including issues related to data privacy, secure transactions and reliable product descriptions. These challenges should be addressed. Consumer protection laws and regulations have been adapted to encompass the digital marketplace. This includes especially the following aspects (European Commission, 2021; Xu et al., 2021):

- *Data privacy and security:* In the digital era, the protection of consumer data has become a paramount concern. Consumers provide sensitive personal information during online transactions, and they expect these data to be handled with care and safeguarded from breaches or misuse. Laws like the European Union's General Data Protection Regulation (GDPR) set strict standards for data privacy and require businesses to obtain clear consent for data collection and processing.
- *Online reviews and ratings:* Online reviews or ratings can significantly influence consumer decisions. However, these are susceptible to manipulation and fraud. More consumer protection efforts have been directed towards ensuring the authenticity and reliability of online reviews and ratings. New regulations may require platforms to implement measures to detect and prevent fake reviews.
- *Reducing customer and price discrimination*: Consumers are sometimes charged different prices based on factors such as location, browsing history or demography. Efforts are being made to reduce such discriminatory practises and ensure pricing transparency. In the future, legislation may require businesses to disclose the criteria used for pricing decisions.
- *Quality assurance in online and offline markets:* The quality of products sold online and offline is a critical aspect for consumer protection. Consumers expect that the products they purchase meet certain quality standards. Authorities and consumer protection organizations may conduct quality assessments and testing to ensure that products are safe, reliable and as advertised. This is particularly important in sectors such as food, electronics and healthcare.
- *Consumer education:* As digitalization continues to reshape consumer experiences, consumer education becomes paramount. Consumers need to be aware of their rights and responsibilities when engaging in online transactions. Consumer protection agencies and non-governmental organizations (NGOs) play a crucial role in educating the public about potential risks that come up with best practises and available remedies in the digital marketplace. For example, Stiftung Warentest, an organization under civil law in Germany, focuses on providing independent product information and public advice based on their own comparison tests (Warentest, 2021).

Consumer protection laws and regulations, as well as relevant social norms are dynamic and can vary significantly from one country to another, reflecting diverse legal frameworks, cultural norms and economic priorities. These norms are designed to safeguard the interests and rights of consumers in their transactions with businesses and service providers. They play a vital role in ensuring ethical and responsible business conduct and contribute to consumer trust, as well as to broader societal values and goals.

13.3 Sustainable Talent Management

13.3.1 David Ulrich Model and the Role of Talent Management

Talent management encompasses the entire spectrum of strategies and approaches that organizations apply to acquire, nurture and retain their workforce, including all activities from recruitment and onboarding to the development and retention of their employee.

Talent management is an investment in the most valuable asset of any organization: its people. The employees are often referred to as “human resource”, “human capital” or “talent”. Numerous studies have demonstrated a strong correlation between effective talent management and overall organizational performance. A previous McKinsey survey found that 99% of companies with reported effective talent management practices significantly outperformed their competitors. This competitive advantage arises from having a skilled, engaged and motivated workforce that can execute strategies effectively. Especially during economic turbulences, talent management can be a critical success factor.

The Dave Ulrich Model, also known as the Ulrich HR Transformation Model, is a renowned framework designed in the late 1990s to redefine the role of human resources (HR) and support the alignment of HR practices with the overall business strategy. The model illustrates the changing roles of HR to move away from a purely administrative function to become a strategic partner within the organization and different possible approaches to integrate HR into the core business functions to collaborate closely with other departments to achieve shared goals (Ulrich, 1997; Ulrich & Dulebohn, 2015; Thill et al., 2014).

The Dave Ulrich Model still finds wide applications among talent management professionals and organizations worldwide. Practitioners and researchers have also adapted the model to accommodate the integration of ESG principles in talent management concepts. Depending on the strategic settings of the organization, the role of talent management can be classified into four categories (Mercer Mettl, 2023; Ulrich, 1997; Ulrich & Dulebohn, 2015; Thill et al., 2014; HR Heute, 2023; Snapsim, 2023) (see Fig. 13.3):

1. *Strategic partner*: Talent management professionals are strategic advisors who work closely with senior management to design talent management strategies in alignment with the overall strategic objectives and the key processes across different functional areas. In this role, they need to have a good knowledge not only of their own business model but also of industry trends and the competitive landscape.
2. *Change agent*: As change agents within the organization, talent managers take on the strategic responsibility to drive forth change management initiatives, such as organizational restructuring, mergers and acquisitions (M&As) and culture transformation for ESG integration. To fulfil this role, talent management may provide guidance and trainings to leaders and employees to facilitate change.

Fig. 13.3 Adapted Dave Ulrich Model for ESG integration in talent management. (Source: Base on Ulrich (1997), Ulrich and Dulebohn (2015), Thill et al. (2014), HR Heute (2023), Snapsim (2023))

3. *Administrative expert*: In this traditional HR function, the main focus of talent management lies in streamlining processes like payroll administration, compliance with labour laws and maintaining HR systems (such as shared service centres or employ self-service functions) to support the efficient operations of other functional departments.
4. *Employee champion*: Talent managers can also serve as advocates for employees, ensuring that their needs, concerns and well-being are considered in the management decision-making. In facilitating communication between employees and management, talent management plays a crucial role in fostering a positive workplace culture and addressing workplace issues.

Employees play a pivotal role in driving corporate innovation and value creation. In today's globalized competitive landscape, a company's success hinges largely on its employees' dedication to the sustainable growth of the organization. In order to optimize the internal processes, organizations invest significant amounts in recruiting highly skilled personnel, professional trainings for the employees, as well as knowledge transfer. Upholding ethical standards in the workplace means to businesses not only fulfilment of their corporate social responsibility but also a competitive edge with highly motivated and engaged employees.

The adapted version of Ulrich's Model is an effective tool that helps organizations manage the transitional change of ESG implementation by clarifying the role of talent management in the overall strategic setups.

13.3.2 Talent Management Processes

In order to attract and retain skilled employees, an organization must take the following major steps (see Fig. 13.4):

- *Strategy and planning*: Effective talent management strategy plays a central role in successful talent management by identifying possible talent surplus or shortage and aligning talent activities and initiatives with overall business objectives, so as to close skills gaps, foster leadership development and adapt to evolving market dynamics.

  The workforce planning usually contains the components of identifying key positions and the leadership qualities required, building forward-looking skill pools to ensure the organization's readiness for future development and implementing workforce planning tools such as AI-enabled software programmes to efficiently track the development of employee skills and performance.

  In general, a company has the following alternatives to meet the talent requirements:

  – Boosting existing talent pools: Including creating opportunities for employees to acquire new skills (upskilling), reshaping their job roles (reskilling) and increasing the deployable time of the existing workforce.
  – Redeploying existing talent pools: By shifting individuals with additional skill sets to positions where they are needed.
  – Recruitment: To hire new individuals with required skill sets, if necessary, by means of mergers and acquisitions (M&As). The M&A approach has been

Fig. 13.4 Key components of talent management. (Source: Based on McKinsey (2023b))

popular, for example among established multinational rating agencies in urgent need to acquire ESG rating talent by taking over existing specialized ESG rating agencies.
  - Leveraging strategic partnerships: By outsourcing certain functions.
  - Optimizing existing workforce by offering voluntary severance packages to release less engaged employees.

- *Recruitment and selection*: Attracting and hiring the right talent is the foundation of talent management. This involves identifying job requirements, sourcing candidates, conducting interviews and selecting the candidates who best fit the organization's strategy and culture.
- *Learning and growth*: The organization can support the continuous development of employees through training programmes and workshops, mentorship and coaching to enhance skills, competencies and career progression.
- *Performance management*: It is important to align individual performance with organizational strategy by setting clear goals, conducting performance reviews, providing feedbacks and rewarding performance.
- *Improving employee experience*: A positive employee experience can significantly impact employee engagement and retention. According to a recent McKinsey survey, employees reporting a positive experience in the workplace are 16 times more engaged and eight times more likely to stay in the company.

13.3.3 Prioritizing Employee Experience

13.3.3.1 Diversity, Equity and Inclusion (DEI)

The concept of inclusion is rooted in ethical norms in many countries and is often supported by legal standards such as laws and regulations for the protection of minorities. Inclusion in workplace goes beyond simply hiring diverse employees; it encompasses the principle of equal treatment and equality opportunities for all individuals, regardless of their ethnical origins, skin colour, age, gender, sexual orientation, religion, political convictions and so on. For the integration of ESG principles in modern talent management, the inclusion principle has often been expanded to a Diversity and Inclusion (D&I) and increasingly to a Diversity, Equity and Inclusion (DEI) framework (PWC, 2023) (see Fig. 13.5).

- *Diversity* in talent management means actively recruiting, retaining and promoting employees from different backgrounds based on their gender, nationality and ethnicity, age, sexual orientation, disability status, political or religious convictions and so on. The goal of diversity is to create a workforce with a broad spectrum of perspectives and backgrounds and to foster a culture of creativity and innovation.
- *Equity* refers to fairness in talent management, ensuring that everyone has an equal professional opportunity across the organization. In order to achieve this goal, the organization needs to implement policies and processes that eliminate bias and discrimination, ensuring that all employees have equal access to

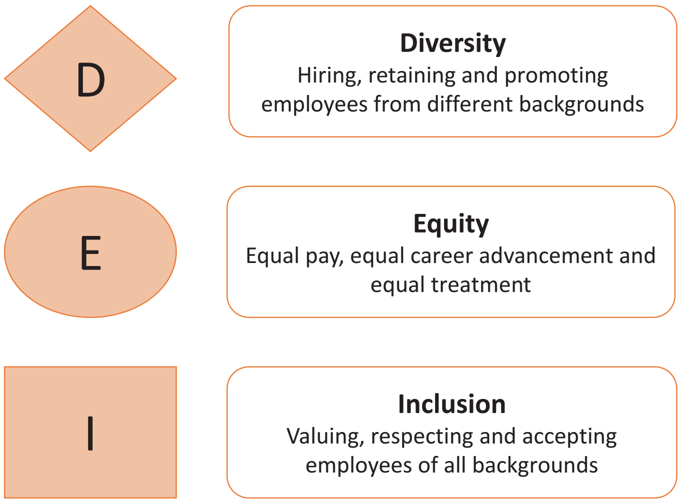

Fig. 13.5 DEI as a key element of sustainable talent management. (Source: According to PWC (2023))

resources and career advancement paths. This can involve addressing pay gaps and recruitment procedures.
- *Inclusion* in the narrow sense aims to create a working environment where all employees feel valued, respected and accepted. Inclusion helps organizations foster a sense of belonging among the employees, regardless of their backgrounds or identities. The implementation of inclusion can involve promoting open communication and addressing any bias or discrimination, especially sexual harassment, promptly. Sexual harassment is a serious offence that involves physical, verbal or emotional abuse or other forms of mistreatment. In practice, this issue needs to be addressed with sensitivity, as there is a fine line between harassment and harmless teasing.

Amidst the growing influence of Diversity, Equity and Inclusion (DEI) concept worldwide, new divisions under the name of Employee Resource Groups (ERGs) are emerging within HR (human resources) or P&O (people & organization) departments to manage DEI efforts across the organization. ERGs are voluntary groups formed by employees, each focusing on some specific aspects of the DEI concept, such as (McKinsey, 2023a, b):

- Believe and faith
- Climate change
- Cultural diversity
- Generational professionals
- Green society
- Health
- LGBTQ+

- People with disability
- Equal opportunity for women
- Work–life balance
- Working parents/single parents
- Veterans

Any employee within the organization can initiate an ERG and actively participate in its activities. ERGs serve as a catalyst for building a positive DEI momentum in the company. The core objective of ERGs is to connect the company's mission with individual employee aspiration, creating a win–win situation for corporate growth, employee satisfaction and the overall well-being of the company.

The concept of ERGs has a history dating back to the 1970s when some employees at Xerox created the first Employee Resource Groups (ERGs) to raise awareness of diversity and inclusion within the organization. Today, ERGs have gained widespread adoption, with implementation in over 90% of Fortune 500 companies in the United States, driving forth a more inclusive workplace culture (McKinsey, 2023a; Fortune, 2023).

The most common methods employed by Employee Resource Groups (ERGs) to inspire organizational change include (McKinsey, 2023a):

- *Enhance inclusion:* Promoting a non-discriminatory environment where every employee feels that they belong to the community. This can promote mutual understanding, increase the visibility of underrepresented groups and enhance the meaningfulness of their work.
- *Forster diversity:* Contributing to attracting talent, particularly when ERG members are involved in interview panels and talent retention initiatives. This can promote awareness of DEI from the initial job application through future career development.
- *Drive external impact:* Aligning with the overall business strategy and operational mindset, infusing diversity into the company's philosophy. ERGs can also serve as a marketing opportunity to engage with new customer segments and accelerate business processes. through a culture of speaking up and increased brand awareness.

13.3.3.2 New Work: Working Conditions in the Era of Digitalization

In the era of digitalization and especially through the COVID-19 pandemic, a transformation of traditional working conditions and practices has taken place in response to the challenges and opportunities brought about by the new technology and socioeconomic shifts. The broad range of changes aimed at creating more flexible, employee-centric and technologically enabled work environments is often referred to as "New Work".

In addition to the conventional employer's duty of care that includes accident prevention and work safety, protection from health hazards and overtime limit, New Work places a strong emphasis on employee well-being, safety and empowerment while leveraging technology to create more flexible and efficient working environments. For example, employers can use sensors, wearables and smart devices to monitor workplace conditions and ensure the safety of employees or apply data analytics and predictive maintenance to identify and address potential safety risks proactively.

Work–life balance is a fundamental principle in the New Work philosophy. It recognizes that employees are not only workers, but individuals with personal lives, families and interests outside of their professional roles. Achieving a healthy work–life balance is paramount for the well-being and productivity of employees. To improve the work–life balance of employees, employers increasingly make offers that can substantially raise the flexibility of working conditions in terms of when and where work is conducted. Remote work, enabled by digital tools and telecommunication technologies, has gained prominence. This flexibility allows employees to better harmonize their professional responsibilities and private lives.

However, remote work also poses a challenge on employers in protecting their employees from health hazards, both physical and mental. In practice, employers can address this issue by actively engaging in ergonomic workplace design and providing mental health support programmes and technologies such as telemedicine to promote employee well-being.

New Work encourages greater employee participation in organizational decision-making. To empower employees to make more autonomous decisions, employers need to increase transparency about business strategies and the overall performance and create channels for employees to express their opinions, especially on matters that affect their working environment.

The implementation of New Work relies heavily on the technology that enables remote collaboration and real-time data exchange for efficient decision-making, including tools for project management, remote communication and data analysis.

At the same time, implementing New Work practices also involves compliance with labour laws and ethical considerations. One great challenge of New Work is that the boundary between professional and private life can become blurred, with employees feeling the need to remain constantly available, often through smartphones. This issue has drawn public attention and sparked discussions about the right to disconnect and the importance of setting clear boundaries.

New Work practices and EGS principles are substantially interconnected. Organizations that adopt New Work practices also contribute to ESG goals, for example reducing environmental impact through remote work and improving social well-being by enabling flexible working arrangements. Embracing New Work can be a strategic move for organizations to enhance their ESG performance and create a more sustainable and responsible business environment (Helmold et al., 2023).

13.3.3.3 Fair Wage

Fair wage practices are not only a legal requirement in many jurisdictions but also a critical component of the ESG policy of thriving and sustainable organizations. They contribute to employee satisfaction, retention and performance while enhancing the organizations' reputation and aligning with social expectations of responsible business operations.

In many countries, legislators have established legal frameworks to safeguard employees from exploitation and ensure fair compensation. These regulations may include minimum wage laws that set a baseline for the lowest acceptable wage and equal pay laws that mandate that men and women receive equal pay for equal work, aiming to eliminate gender-based wage discrimination. Violating such laws can result in legal consequences, including fines and lawsuits.

In certain professions, such as sales, performance-based remuneration, often in the form of bonuses, is common. These bonuses are designed to encourage employees to excel in their role in the organization. However, determining fair and objective performance metrics can be challenging, which requires careful consideration to ensure realistic and attainable targets.

The compensation of top executives, especially in large corporations, has been a subject of considerable debate and scrutiny. Exorbitant executive bonuses that are significantly higher than the income of regular employees often generate controversy. These bonuses are typically justified based on the high level of responsibility, market value and the belief that motivated top talent can create higher value for the organization. However, critics argue that when executive bonuses are disproportionately large and not recognizable tied to performance, they can be perceived as unjust and demotivating to the rest of the workforce. In particular, when executives receive substantial bonuses despite poor company performance, it can erode the trust of employees, investors and the public.

To address concerns related to the ethical distribution of rewards within the organization, companies and stakeholders increasingly put emphasis on the transparency, fairness, accountability and ethical distribution of rewards within the organizations. Publicly traded companies are often required to disclose executive compensation details to ensure the alignment with the interests of all stakeholders, including shareholders, employees and the broader public.

Successful fair wage practices can align employee actions with organizational values and encourage employees to perform at their best and, in turn, lead to improved business outcomes and competitiveness (Dathe et al., 2022).

13.3.3.4 Dismissal Protection

Job security is a fundamental concern of employees across various industries and countries. It refers to the assurance and the stability of their employment, and the expectation that they will not face arbitrary or unjustified termination. To address this concern, many countries have established statutory regulations to serve as a framework for dismissal protection.

Dismissal protection laws, often referred to as” job security laws” or “employment protection laws”, are a set of legal provisions that restrict the circumstances under which employers can terminate the employment relationship. These laws are designed to safeguard the rights of employees and ensure that their job security is not easily compromised.

Companies that adhere to ESG principles are expected to demonstrate a commitment to their social responsibility, including offering job security to their employees above the applicable legal standard (Dathe et al., 2022).

13.3.3.5 Employee Privacy

Privacy is a multifaceted concept that encompasses multiple aspects, and it plays a crucial role in both personal and professional settings. Protecting employee privacy is essential for creating a healthy and respectful working environment. Finding the right balance between respecting privacy and addressing workplace needs is crucial for fostering trust and maintaining a positive employer–employee relationship. While there may be circumstances where employer interests necessitate limited intrusion into employee privacy, the boundaries of legal and ethical norms should always be taken into consideration at all times.

In the context of employment, privacy is of great relevance in several aspects (Dathe et al., 2022; Simms, 1994):

- *Physical privacy* refers to individuals' right to their personal space that should remain physically inaccessible to others. In the workplace, physical privacy can be a sensitive matter. For instance, employees may expect private offices or designated spaces to work without constant intrusion. In open-plan offices, finding a balance between collaboration and physical privacy can be challenging.
- *Social privacy* refers to individuals' right to make free decisions for their private life. Employers typically respect their employees' social privacy by not interfering in their personal affairs, unless the interference becomes necessary due to legal or ethical circumstances (for example, grounded suspicion of drug misuse).
- *Data protection*: Data protection is a critical aspect of privacy in the digital era. It encompasses an individual's autonomous decision on how, when and which personal data should be released to third parties. In the workplace, data protection relates to the handling of employees' personal information, such as HR records and financial or health information. Employers are generally bound by data protection laws such as the European Union's General Data Protection Regulation (GDPR) to safeguard such information.
- *Psychological privacy* refers to individuals' control over their emotional and cognitive inputs and outputs without being forced to reveal one's private thoughts and feelings. This aspect of privacy is particularly relevant in situations where employees may need to manage stress or emotional challenges. Employers should create a working environment where employees feel comfortable to discuss such issues voluntarily, without fear of discrimination or reprisal.

13.4 Case Study: Apply Inc.

Apple's journey from a technology company with little focus on corporate social responsibility (CSR) and environmental, social and governance (ESG) ambitions to becoming a global ESG role model under the leadership of Tim Cook is a remarkable transformation. In the late 1990s, when co-founder Steve Jobs returned to Apple, the concepts of CSR and ESG were not prevalent among companies, investors or customers (Deutschman, 2001; Isaacson, 2011, 2012; Bilton, 2014).

Fig. 13.6 ESG at Apple: Areas of reported improvements in 2022. (According to: Apple (2023a, b))

Tim Cook, who succeeded Steve Jobs as CEO, has played a pivotal role in shaping Apple's ESG policy. Cook emphasized that the impact of innovation should be measured by its positive effect on the users. He describes Apple's ESG approach as: "At Apple, we believe the measure of any great innovation is the positive impact it has on people's lives. It's why we work every day to make our technology an even greater force for good" (Apple, 2023a).

Apple has achieved improvements in numerous ESG aspects in recent years (see Fig. 13.6). Its ESG strategy revolves around several key pillars, including (Patil et al., 2021; Liu, 2023; Lu et al., 2023; Apple, 2023a):

- *Accessibility*. Apple is committed to making its technology accessible to all people. The company has made significant strides in designing products and services that cater to diverse needs, such as features for wheelchair users or the left-handed.
- *Education*. Apple recognized the importance of education in empowering individuals and communities. The company invests in various educational initiatives and technology to enhance the learning outcomes of stakeholders.
- *Environment*. Environmental sustainability is a core element of Apple's ESG strategy. The company has made substantial efforts to reduce its greenhouse gas emissions, adopt renewable energy sources and design products with minimal environmental impact.
- *Inclusion and diversity*. Apple places a strong emphasis on fostering an inclusive culture in workplaces and makes continuous efforts to provide additional support to underrepresented groups of employees across the organization.

- *Privacy*. Protecting user privacy is a fundamental principle for Apple.
- *Supplier responsibility*. Apple holds its suppliers to high standards of ethical products, including labour and environmental practices. The company makes continuous efforts to ensure that its global supply chain meets these criteria.

Apple's commitment to ESG is reflected in its annual ESG report and the Apple ESG Index, incorporating information according to the frameworks of the Global Reporting Initiative (GRI), the Sustainable Accounting Standards Board (SASB) and the Task Force on Climate-Related Financial Disclosures (TCFD). These reports use appropriate key performance indicators (KPIs) to link Apple's progress with multiple ESG dimensions, including the environment, people, suppliers, customers, communities and governance (Apple, 2023a, b).

One notable aspect of Apple's ESG efforts is its focus on "smarter chemistry". This approach aims to create safer materials for products and promote recycling and material recovery to produce iPhones, iPads, Macs, Apple watches, Air pods and nowadays Apple Vision Pro (Apple, 2023a, b). For the benefit of the environment, Apple has recently agreed to comply with the EU standards by implementing the USB-C interface for future iPhone models in the European market instead of using Apple's individual lightning interface design (Guardian, 2022; Meyer, 2022; Ichikawa et al., 2022).

Additionally, discussions around battery life and sustainability have led Apple to offer Battery Life Cycle Management (LCM) plans, recycling and exchange options. The company is actively working on sourcing battery minerals responsibly, conducting audits on human rights and environmental standards for materials such as lithium, cobalt, graphite, nickel and copper (Sun et al., 2019; Metri et al., 2012; Patil et al., 2021; Apple, 2023a, b).

Apple's commitment to ESG has garnered numerous awards and recognitions, including being the world's first AWS Certified Data Centre in 2020, receiving an "A-"rating in the CDP Climate Change assessment and earning the Corporate Information Transparency Index Master's Level designation from China's Institute of Public and Environmental Affairs (IPE) among others. Positive ethical management has made a significant contribution to the successful expansion of the company in the world market (Apple, 2023a, b; Sustainalytics, 2023).

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14 Sustainability Marketing

14.1 Marketing Strategy

14.1.1 Purpose of Marketing Strategy

The market is the lifeblood of any business. Companies need to generate revenues by selling their products or services to cover their own expenses and provide profit to investors. Marketing strategy is a long-term plan aiming to maximize a company's competitive advantage in the market. A well-designed marketing strategy aligns the marketing efforts with the overall business strategy and ensures that the available resources are used efficiently to attract potential customers, including the range of product offerings, target customer groups, distribution channels and means of marketing communication (Dathe et al., 2022; Schindler, 2012).

Marketing strategy primarily focuses on a company's relationship with its customers, in order to create value propositions and develop tactics to reach and engage customers. To develop a robust marketing strategy, however, the company needs to conduct a prior market analysis, for example based on the framework of Porter's Five Forces Model to gain a thorough understanding of the major competitive influences, including (see Fig. 14.1):

- *Competitive rivalry*: Analysis of rivalry among existing competitors is helpful for the identification of the unique selling point (USP) of the products. A strong USP can differentiate the brand and attract customers even in a highly competitive market.
- *Threat of new entry*: The attractiveness of the industry and barrier to market entry need to be taken into consideration for the development of a marketing strategy. An attractive market with low entry barriers implies that quick market expansion with more competitors can be expected in the near future.

T. Dathe et al., *Implementing Environmental, Social and Governance (ESG) Principles for Sustainable Businesses*, Responsible Leadership and Sustainable Management, https://doi.org/10.1007/978-3-031-52734-0_14

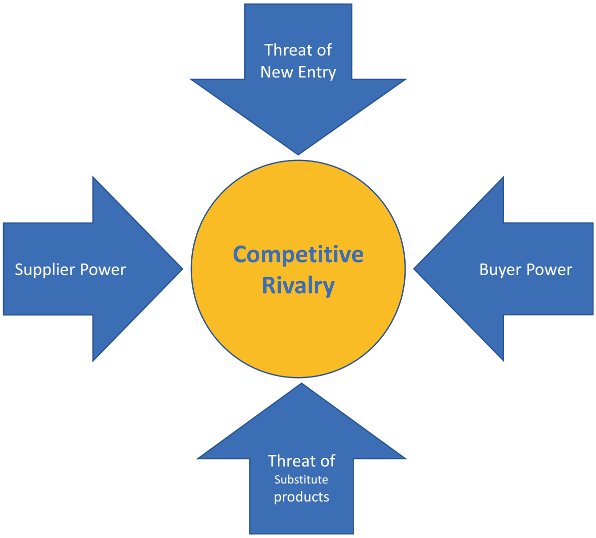

Fig. 14.1 Understanding market position with Porter's Five Forces Model. (Source: Author based on Porter (1980))

- *Buyer power*: Assessment of the bargaining power of customers can substantially shape pricing strategies and sales tactics. For example, more discounts or loyalty programmes are necessary to retain customers in a market with strong buyer power.
- *The role of suppliers*: The bargaining power of suppliers determines product quality, sourcing costs and availability of products, all of which are critical elements of the marketing strategy.
- *Threat of substitute products*: Recognizing the threat of substitute products or services highlights the urgency for innovation and product differentiation. Marketing efforts can focus on highlighting unique features and benefits to reduce the appeal of substitute products.

In order to market a product or service efficiently, marketers follow very specific strategies. The most important decisions and actions for marketing approach are often summarized in the so-called marketing mix framework to create a structured marketing concept. The marketing mix is a fundamental concept that helps businesses formulate and implement effective marketing strategies. There are two main variations of marketing mix (Kusumawati et al., 2014):

- The 4Ps Model for marketing of classical consumption goods (see Fig. 14.2).
- The 7Ps Model for marketing of the service industry (see Fig. 14.3).

Fig. 14.2 Classic marketing mix for physical products: 4Ps Model. (Source: Based on Kusumawati et al. (2014))

Fig. 14.3 Marketing mix for service industry: 7 Ps Model. (Source: Based on Kusumawati et al. (2014))

14.1.2 Marketing Mix for Physical Products: 4Ps Model

The traditional marketing mix, often referred to as the 4Ps, consists of the four key influence factors for a successful marketing strategy (Kusumawati et al., 2014) (see Fig. 14.2):

- *Product* (product policy): This refers to the tangible and intangible offering that a company provides to meet the needs and wants of customers. The most important aspects of products include product features, design, quality, variety, branding and packaging.
- *Price* (pricing policy): Price is the amount of money that customers must pay to acquire the product or service, including the initial sale price, discount, payment term and other price adjustments.
- *Place* (distribution policy): This refers to decisions related to distribution channels, such as direct sales, retail stores and e-commerce platforms, as well as decisions on logistics and inventory management.
- *Promotion* (communication policy): Promotion encompasses all activities aimed to communicate the value proposition of products and services to potential customers, including advertising, public relations, sales promotions, personal selling, social media marketing, content marketing and other promotional techniques.

14.1.3 Marketing Mix for Service Industry: 7Ps Model

The service industry has unique characteristics compared with industry sectors with physical products. Services are tangible, inseparable (produced and consumed at the same time), variable (varies in quality from one interaction to another) and perishable (cannot be stored). To deal with the challenges in service management, three additional elements are typically added to the classic marketing mix framework to address the special features of service-driven deliveries (Meffert et al., 2018) (see Fig. 14.3):

- *People*: Services usually require direct interaction between customers and service providers. In the 7Ps Model, the element "people" refers to employees, customer service representatives and other persons who interact with customers. Their appearance, knowledge, skills, behaviours and attitudes can significantly impact customers' experience and satisfaction. Staff training is essential for implementing people-related marketing strategies.
- *Process:* The processes and systems a company has in place to deliver its service have a substantial impact on the efficiency and consistency of the service. This includes service delivery processes, customer support processes and other operational procedures. Process standardization can help maintain service quality and reduce viability. Services can also benefit from ongoing process improvement efforts to enhance efficiency and effectiveness.

- *Physical evidence*: Unlike physical products, services have no tangible forms. Physical evidence refers to the tangible cues and physical environment that customers encounter when receiving a service, including service environment, equipment and any other physical elements that largely impact the customers' perception of the service quality, for example the cleanliness and ambiance of a restaurant, the facilities and professional-looking staff uniforms of a hospital or the professional website design of a service provider. Positive physical evidence can help build trust and confidence in the service.

As the above indicates, the marketing mix is a flexible framework that can be modified to meet the unique needs of different products, industries and target markets.

14.2 Marketing Strategy as Driver for ESG Implementation

14.2.1 Transformational Marketing Concept with ESG

Incorporating ESG principles into marketing strategies is not just a matter of compliance but also an opportunity for businesses to thrive in a world where sustainability and responsible business practices are becoming increasingly important to customers and investors alike.

The function marketing within a business organization aims to maintain and enhance direct and robust connections with external stakeholders. Consequently, it needs to be attuned to the shifting dynamics and forces in responsiveness to the business landscape with increasing ESG concerns. This involves a twofold transformation process in terms of both the implementation of ESG principles in the overall business strategy and the alignment of operations and activities with the strategy. The incorporation of ESG principles in marketing strategy can be summarized in the following aspects of the sustainability concept (Dathe et al., 2022):

- *Economic Sustainability*: To secure long-term competitiveness and sustainable profit targets, a company needs to continuously focus on acquiring market shares and customers.
- *Ecological Sustainability*: Careful stewardship of natural resources is at the core of this facet of sustainability to meet the evolving expectations of customers who prioritize eco-friendly practices. Companies need to address issues such as responsible raw material procurement, efficient waste management as well as the development of recycling systems.
- *Social Sustainability*: In addition to fostering social justice within society, companies are expected to treat all individual employees fairly. This involves initiatives that promote life-long learning, maintain work–life balance and ensure the well-being of the workforce. These measures resonate with modern consumers and contribute to a positive corporate image.

14.2.2 Creating Shared Value (CSV)

Creating shared value (CSV) is a business concept articulated by Porter and Kramer (Porter & Kramer, 2011), underscoring the intricate relationship between a company's competitiveness and the well-being of the society in which it operates. In other words, business operations should consistently generate value not only for the companies themselves but also for their consumers.

The creating shared value (CSV) concept guides companies to integrate social issues and challenges directly into their business strategies and processes, aiming to achieve a competitive edge by doing so. It begins with a comprehensive analysis of the points of intersection between the company and the society, including the social problems and concerns connected to them. When a company successfully identifies these junctures and reinforces them through its product offerings and communication strategies, it can create a win–win situation without any inherent contradiction between improving its competitive standing and genuinely contributing to societal improvement.

Creating shared value (CSV) is a long approach that seeks to enhance a company's competitiveness and sustainability by addressing social and environmental challenges. It is about finding innovative solutions to societal problems that can lead to a lasting competitive advantage. One of the critical insights of the creating shared value (CSV) approach is the acknowledgement that planet, people and profit are no longer isolated considerations, but interwoven into a company's core strategy that can drive innovation and achieve competitiveness.

Companies practicing creating shared value (CSV) are likely to employ cause-related marketing (CRM) strategies (see Sect. 14.2.3) (Dathe et al., 2022).

14.2.3 Cause-Related Marketing (CRM)

Cause-related marketing (CRM) is a widely employed approach to marketing strategy, especially for the incorporation of ethical management principles into short- to medium-term campaigns aimed at building brand image and driving sales, while contributing to social causes. In CRM, the promotion of a product is intertwined with supporting a charitable initiative. Typically, predetermined percentages of the sales revenue from certain products are allocated to a social project or a non-profit organization. The total amount of donations depends on the purchase frequency and volume of consumers.

A cause-related marketing (CRM) promoted product implies an added value to customers by enhancing consumer satisfaction and cultivating long-term loyalty to the product. Moreover, communicating this philanthropic aspect to consumers, highlighting that they are "doing good" to society, can lead to increased sales volume and revenues. The end consumers benefit from the cause-related marketing (CRM) strategy through the perception of contributing to a social cause while purchasing a product they desire. The elevated consumer satisfaction often leads to increased demand for the product and brand loyalty. In turn, a company that employs a cause-related marketing (CRM) strategy can improve its visibility, revenues and profitability. When executed thoughtfully and ethically, CRM can create a win–win–win for all involved parties: beneficiaries of the CRM initiative, consumers and business organizations.

However, the CRM approach is to be implemented with caution to avoid allegations of "greenwashing", where a company exaggerates its commitment to sustainability targets for financial purposes. To pre-empt negative publicity, CRM should not replace but rather complement genuine ESG initiatives. Besides, transparency and accountability are paramount to CRM success. It is crucial that the donations promised are effectively channelled to the intended beneficiaries. Mishandling donations can erode consumer trust and harm a company's reputation (Dathe et al., 2022).

14.2.4 Transformative Marketing Concept

Transformative marketing is a strategic approach that focuses on leveraging a company's marketing efforts by addressing social and environmental challenges and creating value for both the business organization and its stakeholders. Companies practicing transformative marketing align their marketing initiatives with their purposes and values. They communicate not only what they do but also the motivation for their activities, emphasizing their commitment to making a positive impact on society (Kumar, 2018).

This concept of transformative marketing recognizes that social norms, values and priorities are constantly evolving, thus companies need to adapt their marketing strategies to reflect changing societal needs and expectations. As integrating ESG principles into marketing and the overall business strategy has become imperative for modern companies, a successful ESG policy can meet changing societal expectations through transformative marketing and provide a competitive edge by addressing all dimensions of sustainability and reinforcing quality and reliability.

Next-level environmental, social and governance (ESG) policy represents the pinnacle of commitment to sustainable and responsible business practices. It signifies a comprehensive and proactive approach to integrating ESG considerations into a company's overall strategy and daily operations. Companies with next-level ESG policy are sustainability leaders in their industry, keep abreast of new trends and developments in ESG and actively engage and collaborate within their networks. As a result of their comprehensive ESG initiatives, these companies tend to achieve positive ESG ratings and higher shareholder returns. Worldwide, investors are increasingly integrating ESG performance as part of their due diligence for potential investment opportunities. Moreover, companies with next-level ESG policies can cater to the growing public demand for sustainability and enhance customer loyalty (McKinsey, 2022).

The choice of ESG policy should be aligned with the overall business strategy (see Fig. 14.4). The key is to integrate ESG seamlessly into the business model and leverage it as a tool to enhance competitiveness, meet customer expectations and

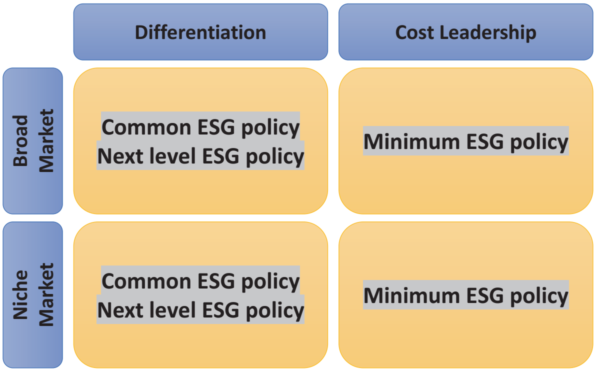

Fig. 14.4 Market, corporate strategy and choice of ESG policy. (Source: According to McKinsey (2022) based on Porter's Five Forces Framework Porter (2008))

drive long-term value creation. Companies focusing on product/service differentiation can emphasize the unique sustainability features that set themselves apart from competitors, for example by considering ESG initiatives that showcase innovation, premium quality and at the same time contribution to the environment and society. On the contrary, companies aiming at cost leadership should concentrate on resource optimization and operational cost efficiency and implement minimum ESG policies for risk mitigation.

The target market is also an important factor for the choice of ESG strategy. In a broad market, ESG policies need to resonate with a wide range of consumers, so ESG priorities should be given to universal sustainability concerns, such as reducing greenhouse gas emissions, promoting diversity and inclusion (D&I) or ensuring ethical sourcing. In niche markets, companies need to cater to a specific group of customers. The ESG policy should be tailored to the unique needs and values of the target group and highlight the sustainability features that align with their preferences and passions, for example fair treatment of international trade partners and fair labour treatment along the global supply chain.

In practice, the influence of ESG performance on executive remuneration is a powerful instrument for leadership behaviours. Incorporating ESG objectives into executive compensation packages not only holds leaders accountable for ESG performance, but also serves as a motivator. The direct personal financial stake in achieving these goals can drive managers to a deeper commitment to ESG initiatives.

The German pharmaceutical BioNTech SE successfully developed the urgently needed vaccination products during the COVID-19 pandemic. As a listed company of the Nasdaq Biotechnology Index, BioNTech is obliged to fulfil the Nasdaq ESG listing criteria (Nastaq, 2023). To align the decision-makers with the broader ESG goals, the company has integrated ESG criteria into the executive short- and long-term incentives (STI and LTI) programmes with assessment criteria such as (BioNTech, 2023):

- Targets for environment protection and energy reduction
- Target for workforce diversity
- Targets for corporate Governance criteria
- Other sustainability goals proposed by external agencies, e.g. Institutional Shareholder Services Inc.

Benchmarking share prices against relevant stock market indices is a common practice in the financial world that provides investors, analysts and business executives with a valuable point of reference to assess a company's performance in comparison with its industry peers. Benchmarking against the Nasdaq Biotechnology Index allows BioNTech to evaluate how its stock price compares to other biotechnology firms listed on the Nasdaq. Previous empirical research implies increased commitment to ESG principles as a long-term effect of the incorporation of ESG criteria in executive remuneration programmes (Hu & Loh, 2018; BioNTech, 2023).

Also the German real estate company Deutsche Wohnen integrates ESG elements into the long-term incentives (LTI) of its leading workforce, in order to reinforce its long-term success with ESG principles and sustainable value creation. By incorporating ESG metrics into LTI measurables, the company provides incentives to its leadership teams to prioritize sustainability objectives that extend beyond short-term financial goals (Deutsche Wohnen, 2023).

In 2021, Deutsche Wohnen was taken over by the German-based multinational real estate company Vonovia, creating the largest publicly traded real estate company in Germany. This acquisition deal was driven by several factors, including regulatory pressures related to Berlin's rent control measures (known as "Mietendeckel") (Dathe et al., 2021). The ESG principles were integrated throughout various stages of this merger and acquisition (M&A) process, including (Deloitte, 2023):

- *Due diligence*: Assessing the ESG performance and risks of the target company Deutsche Wohnen. This evaluation helps the acquiring company Vonovia understand the potential ESG-related impacts on the transaction.
- *Day 0 (deal closure)*: Implementing ESG integration strategies and aligning corporate cultures to ensure a smooth transition.
- *Day 1 and day 100*: Continuing to monitor and integrate ESG practices into the new entity's operations and culture.
- *Day X (long-term integration)*: Maintaining a consistent and proactive approach to ESG alignment and communications.

With a specific emphasis on sector-specific elements, Deutsche Wohnen demonstrates its commitment to sustainable and responsible real estate management, especially in the following aspects (Deutsche Wohnen, 2023):

- *Customer satisfaction*: Ensuring a high level of satisfaction among residential real estate customers by providing quality living conditions and addressing tenant needs.

- *Employee satisfaction*: Creating a positive working environment, fostering employee well-being and promoting sustainable labour practices.
- *Reducing carbon footprint*: Addressing environmental concerns by actively reducing carbon emissions of real estate projects in alignment with global efforts to combat climate change and promote sustainable resource management.

Deutsche Wohnen also employs ESG metrics as part of the Long-Term Incentives (LTI) measurables to align its leaders with sustainability goals that extend beyond short-term financial gains. During the merger and acquisition (M&A) process, Deutsche Wohnen's short-term and long-term incentive (STI and LTI) programmes were reviewed, positively approved by Vonovia and subsequently communicated to the public (Deloitte, 2023).

In spin-off scenarios, such as Johnson & Johnson's spin-off of its consumer healthcare business or Alibaba's plan to split into six independent companies, retaining the bonus system with ESG aspects is often treated with high priority. This ensures that the new entities continue to build on sustainability and stay attractive to consumers and investors who value ESG considerations. Successful IPOs and marketing strategies increasingly depend on companies' ESG commitments and performance (Reuters, 2022; CNBC, 2023).

Many societal changes are complex and cannot be dealt with by one organization alone. Therefore, transformative marketing often involves collaborations with other companies, governmental institutions, communities and non-profit organizations to work towards shared goals.

Moreover, transparent and authentic communication are vital for successful transformative marketing. Companies practicing transformative marketing need to share openly their progress, challenges and setbacks in the ESG initiatives.

Transformative marketing is not a short-term endeavour. Companies committed to this approach should judge their sustainability impact in the long term, rather than engaging in short-lived, opportunistic campaigns.

14.3 Case Study: Tesla and Disruption of the Automotive Industry

The rise of environmental, social and governance (ESG) principles and the global shift towards sustainability have created unique challenges and opportunities in various industries. The increasing consumer consciousness of the environmental impact of their purchase choices is reshaping consumer preferences towards more sustainable options.

In the automotive sector, while traditional automakers initially focused their ESG efforts on the improvement of their manufacturing processes by employing renewable energies or reducing resource consumption and greenhouse gas emissions, the company Tesla, led by Elon Musk, revolutionized the automotive market. Tesla's business model with offerings of electric vehicles (EVs) and carbon certificates trading has not only led to financial achievements but also created a new market segment.

Moreover, governments worldwide have introduced regulations and initiatives to combat climate change and reduce greenhouse gas emissions. Increasingly, regulators are phasing out petrol and diesel cars. For example, the European Union has set ambitious targets to become climate-neutral by 2050, including banning new international combustion engine vehicles by 2035 to accelerate automakers' transition to electric vehicles (EVs) (Forbes, 2023).

The technological innovation of electric vehicles (EVs) is still facing some serious ESG concerns, for example the pollution caused by the production of batteries and the subsequent disposal. Decarbonization of battery production remains a focus of current research and development (R&D) efforts of carmakers (Kader, 2022; Zhang, 2022).

14.4 Case Study: The Walt Disney Company's ESG Concept

The Walt Disney Company, commonly referred to as Disney, is one of the most well-known mass media and entertainment companies in the world. At present, the conglomerate operates in five segments of the entertainment industry (Walt Disney, n.d.):

- Media networks
- Parks and resorts
- Studio entertainment
- Consumer products
- Interactive media

Bob Iger is widely regarded as one of the most competent CEOs in Disney's history. Under his leadership, Disney made several key acquisitions, including Pixar, Marvel, Lucasfild and 21st-Century Fox. He also oversaw the successful launch of Disney+, the company's streaming service. Iger's legacy at Disney was one of expansion, diversification and strong financial performance (Havard, 2020; Calandro, 2010; Calandro Jr, 2019; Sergi et al., 2019; Brookey et al., 2023; Martínez-Sánchez et al., 2021; Pitre, 2022).

In February 2020, Bob Iger handpicked Bob Chapek to become his successor and planned to transition himself into a more creative role within the organization. However, as Disney faced critical challenges including the impact of the COVID-19 pandemic on its theme parks and theatrical businesses, and Chapek being criticized by disappointed investors for missing financial objectives and stock market expectations, Iger turned in November 2022 as Disney's CEO to stabilize the financial performance and restore market confidence with an effective ESG concept (CNBC, 2022; The Guardian, 2022).

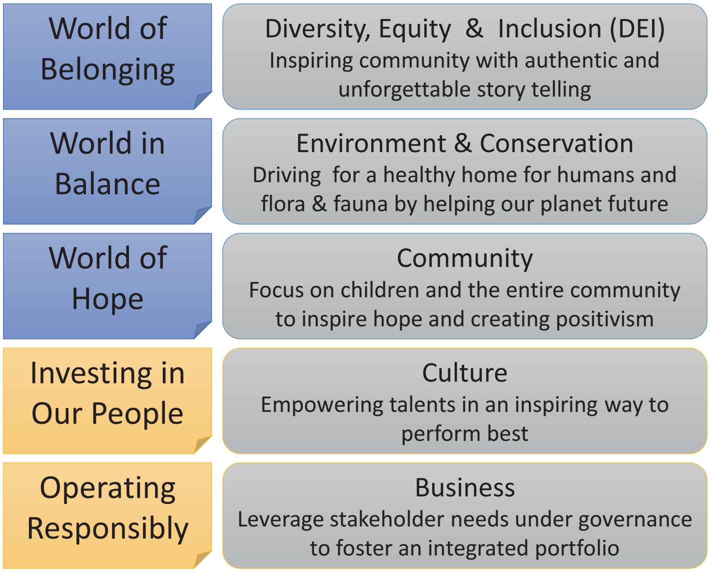

Fig. 14.5 Disney's ESG strategy: CSR priorities. (Information Source: Disney (2023))

Disney's ESG concept is depicted in the company's annual CSR report. This concept consists of five components defined as CSR priorities, including (Disney, 2023) (see Fig. 14.5):

- *Three Focus Areas of ESG Strategy*
  - *World of belonging*: Focusing on the commitment to fostering a sense of belonging and inclusivity, this involves initiatives aimed at creating a diverse and inclusive workforce, promoting diversity in content creation and representation both on-screen and behind the scenes, ensuring that Disney's brands and products resonate with a broad and global audience.
  - *World of balance*: Centred around the company's responsibility to protect the environment and conserve natural resources.
  - *World of hope*: This includes Disney's philanthropic efforts including charitable giving and community engagement as a contribution to society, such as supporting programmes for education, children's hospitals and disaster relief efforts.
- *Two Foundational Pillars*
  - *Investing in our people*: This pillar emphasizes Disney's determination to provide its employees with a safe and inclusive work environment where they can thrive and contribute to Disney's mission through trainings, development and opportunities for growth.
  - *Operating responsibly*: This encompasses Disney's initiatives and operational designs to ensure ethical business practices, transparency and accountability.

Disney's commitment to environmental sustainability is evident in its 2030 Environmental Goals White Paper (Disney, 2022) which outlines specific objectives aimed at reducing environmental impact, including emissions reduction, transition to zero-carbon electricity by 2023 to combat climate change and sustainable investment in climate solution (Disney, 2023).

By 2023, facilities involved in Disney's product manufacturing need to attain sustainable manufacturing certification and achieve an appropriate Higg Index Rating. The Higg Index developed by the Sustainable Apparel Coalition (SAC) measures sustainable practices in consumer habits and supply chains (Radhakrishnan, 2014; Yudina, 2017; Chun et al., 2021).

The sustainability of a material depends on factors such as its manufacturing process, resource consumption and disposal. The sustainability ratings can help consumers make informed decisions. While the Higg Index is a valuable tool, there is a debate, as noted by The New York Times, regarding its bias towards synthetic (vegan-like leather) versus natural fibres in ESG sustainability ratings (New York Times, 2022). Disney might consider using multiple sustainability ratings to reduce such biases (Jiang, 2022).

Disney's ESG strategy is not merely a moral act, but it is also a strategic decision aimed at securing competitive advantages that navigate the organization in an increasingly value-driven marketplace. By aligning its business practices with ESG principles, Disney not only contributes to a greener future but also strengthens its brands, enhances customer loyalty and mitigates risks associated with environmental regulations and changing customer preferences.

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15 Sustainable Supply Chain

15.1 The German Supply Chain Act

Leading corporations such as Tesla, Inc. have long recognized the importance of ESG conformity. They voluntarily take action to enhance their brand image and ensure accountability for sustainability performance throughout the global supply chain. By doing so, they have successfully achieved a competitive edge by establishing innovative sustainable business models and attracting worldwide consumers who are growingly conscious about the power of their purchase choices (Lu et al., 2023).

On the contrary, the introduction of stricter supply chain regulations can increase risks for violation of ESG principles, thus leading to greater pressure on companies to intensify their investment in ESG-relevant programmes and products.

In 2021, the German government introduced the new Supply Chain Act (Lieferkettengesetz) that came into effect as of 1 January 2023. This marks a milestone in the legislation that aimed at safeguarding the rights of individuals involved in the global supply chain for the delivery of goods and services intended for the German market. As German companies often benefit from products manufactured in other parts of the world, they are expected to share the responsibility for ensuring that human rights are upheld along the entire length of their supply chains (Federal Government of Germany, 2021; Dathe et al., 2022).

The German Supply Chain Act emphasizes the importance of third-party risk management, in particular in terms of environmental standards and human rights protection. With the new Supply Chain Act, the legislator established a framework for corporate due diligence in global supply chains, compelling German companies to take effective control of ethical practices not only for their own operations but also among their suppliers. In case of reliable reports of human rights violations by suppliers (such as child labour, exploitation, discrimination and inadequate working

T. Dathe et al., *Implementing Environmental, Social and Governance (ESG) Principles for Sustainable Businesses*, Responsible Leadership and Sustainable Management, https://doi.org/10.1007/978-3-031-52734-0_15

conditions and environmental protection), German companies are expected to take action (Federal Government of Germany, 2021).

The German Supply Chain Act extends accountability not only to immediate suppliers but also to the broader supply chain, including indirect suppliers. This comprehensive approach of the German Federal Government is in line with the growing awareness of sustainable and responsible supply chain practices. The observation of the Supply Chain Act is not only essential for compliance purposes but also expected to help German companies earn a competitive advantage in an increasingly value-driven global marketplace. Companies that prioritize ESG considerations and demonstrate a commitment to sustainable supply chain management are more likely to attract consumers and enhance long-term customer loyalty.

Similar regulations and standards as the German Supply Chain Act are emerging in other parts of the world. For instance, in the United Kingdom, the Modern Slavery Act 2015 mandates that companies with an annual turnover above a certain threshold disclose their efforts to combat modern slavery within their supply chain (Legislation.gov.uk, 2023). The Act requires companies to outline the steps they have taken in an annual statement, including measures taken to identify and prevent human trafficking and slavery, in order to increase transparency and accountability of labour practices throughout the entire supply chain. In the United States, the U.S. Securities and Exchange Commission) (SEC) requires companies, under Regulation S-K, to inform customers about potential supplier risks. This regulation is mainly aimed at helping investors and customers make more informed decisions by enhancing the transparency of the companies' sustainability practices including environmental, social and governance (ESG) factors (Che et al., 2023).

The emerging regulatory changes in sustainability reporting extend the corporate accountability to actions and practices of their suppliers, inducing an important shift in the corporate landscape in the context of supply chain management. To enhance corporate accountability and transparency, the regulators obligate companies to report on their activities related to human rights, environmental protection and risk management including a comprehensive third-party risk management on the conduct of their suppliers throughout the global supply chain. As a result, there is increasing pressure on companies, especially those with limited ESG efforts, to enhance their ESG awareness and practices. This development not only aligns with societal and environmental goals but also offers opportunities for companies to build trust with consumers and investors to secure their long-term competitive advantage in an increasingly value-driven global market.

15.2 Supply Chain Network

15.2.1 Procurement and Supply Chain Management

The concept of procurement, especially in the context of modern supply chain management, plays a vital role in ensuring the efficiency and resilience of the business organization. In general, procurement serves as a bridge between the external

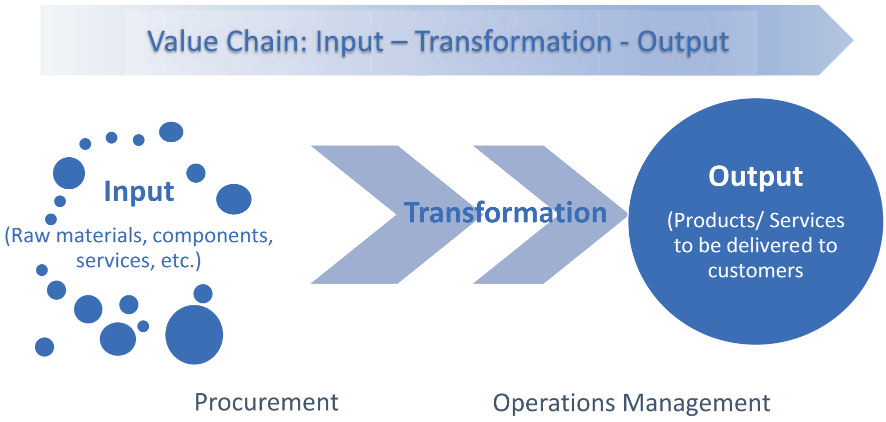

Fig. 15.1 Procurement managing the input and supplies. (Source: According to Dathe et al. (2022))

suppliers and an organization's internal operations. Its primary responsibility is to ensure that the necessary inputs, which can range from simple products and services to complex production equipment with training programmes or consulting projects, fuel the transformation process, which is designed to add value to the inputs and ultimately deliver products or services to customers.

Procurement serves as the bridge between the external suppliers and an organization's internal operations (see Fig. 15.1). Its primary responsibility is to ensure that the necessary inputs are readily available for the transformation process that adds value to the inputs through business operations.

The traditional understanding of procurement as purely purchasing activities has evolved into a broader concept of a key value-adding enterprise function, as, for example illustrated by Porter's value chain model (see Fig. 15.2). The value chain is a stream of activities that a company performs to add value to the products or services it delivers to the market (Porter, 1985).

The globalization process in recent decades has witnessed significant changes in supply chain dynamics. Many companies in industrial countries have outsourced a substantial part of their production and services to external suppliers, resulting in increased complexity and a higher degree of internalization of supply chains. The globalization of supply chains has also increased the number of supply chain layers (tiers). Consequently, supply chains have become more vulnerable to disruptions and risks.

The part of the supply chain dealing with the flow of inputs into the preproduction stage in the organization is referred to as the upstream supply chain. The upstream supply chain usually involves interactions with suppliers who provide the essential inputs such as raw materials, components or services required for the production or providing services to customers. For example, upstream activities in the automotive industry can include the procurement of steel, electronics and built-in components such as car seats, car glasses and sensor systems. The partial supply

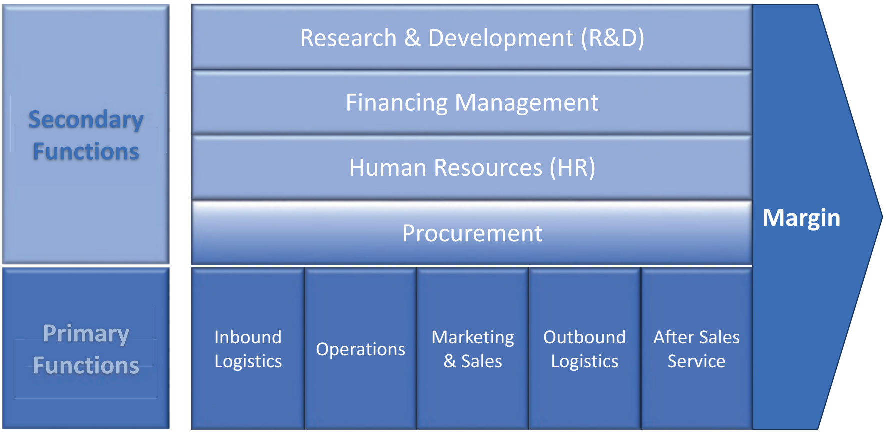

Fig. 15.2 Porter's value chain model (with modifications). (Source: Based on Dathe et al. (2022))

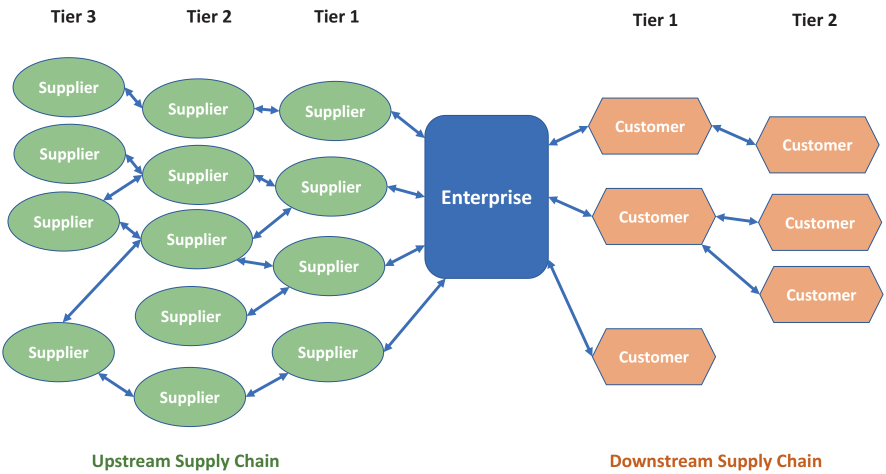

Fig. 15.3 A supply chain network. (Source: According to Helmold et al. (2022))

chain focusing on the distribution of products and services to customers is referred to as the downstream supply chain.

In supply chain management, supply chains are often divided into multiple layers based on the proximity of suppliers and customers. For example, the immediate suppliers who directly provide inputs to the company are referred to as tier 1 suppliers. Those that provide inputs to tier 1 suppliers are referred to as tier 2 suppliers, and the suppliers of tier 2 suppliers are referred to as tier 3 suppliers (see Fig. 15.3).

Supply chain disruptions, often stemming from disturbed upstream procurement processes, can have severe consequences on sales, stock prices, brand image and financial stability of a company. Recent incidents such as the COVID-19 pandemic have highlighted the need for a proactive and sustainable approach to procurement that can tackle supply chain disruptions effectively.

To address the growing complexity and vulnerability in supply chains, procurement has gained prominence in both core and peripheral business areas. It now plays a critical role in building a resilient supply chain as an integral component of enterprise risk management. Resilience in the context of supply chain management refers to a company's ability to anticipate, prevent and quickly respond to supply chain disruptions. This involves strategies such as flexible contingency planning and forecasting to minimize the impact of disruptions, whether they are caused by supplier inefficiency, natural disasters or other unforeseen events.

While procurement risks have traditionally been studied at the tier 1 level of direct supplier relationships, the emerging regulatory requirements and modern procurement concepts seek to expand supply chain risk assessment to include sub-suppliers across the entire supply chain (see Sect. 15.1) (Dathe et al., 2022; Helmold et al., 2022).

15.2.2 Objectives of Supply Chain Management

15.2.2.1 Seven Rights (7Rs) of Logistics

In classic supply chain management, the main objectives of supply chain management are often described as the seven rights (7Rs) of logistics (see Fig. 15.4). Achieving these objectives is essential for efficient and effective supply chain management. This requires not only that customers receive the products they desire which contribute to cost-effectiveness, quality and overall competitiveness in the marketplace but also that the products are produced and delivered in alignment with ESG standards throughout the entire supply chain.

Fig. 15.4 Seven rights (7Rs) of logistics

1. *Right products*: The products sourced by procurement should perfectly match the specifications and requirements set by the customers, including dimensions, materials, colours and other specific features.
2. *Right quality*: All quality requirements should be met. In practice, metrics such as non-conformities, field rejects or defects at the point of receipt are often used to measure and continuously improve quality standards.
3. *Right time*: Products must reach the specified location at the specified time, neither too late nor too early. An effective procurement management requires a thorough understanding of supplier lead time, which is the time it takes for the supplier to deliver the ordered product from the order placement till the physical receipt at the specified location (usually the buyer's facility).
4. *Right quantity*: Procurement needs to translate the demands of internal and external customers into actionable orders within the supply chain network. Ordering too much or too little can lead to inefficiencies and increased costs and, in worst cases, supply chain disruptions.
5. *Right location*: Location is the place where the ordered products are needed. The location is essential information for logistics and distribution planning. It is closely linked to lead times, for example when products need to be shipped over long distances.
6. *Right people*: In the modern global market, people play a crucial role in supply chain management. To satisfy customer needs, the supplier needs to ensure that the relevant personnel such as salespeople, project managers and supply chain operators have the right skills and knowledge, such as adequate language skills, or expertise in import and export procedures.
7. *Right cost*: Procurement should aim to strike the right balance between cost and quality to ensure that the end products are both qualitatively competitive and profitable (Dathe et al., 2022; Helmold et al., 2022).

15.2.2.2 Triple Constraint Model: Cost-Time-Quality

The triple constraint model, also known as the value triangle, was originally developed for project management. However, this model can be used to explain the fundamental trade-offs in supply chain management. This model consists of three interconnected key components: cost, time and quality. Changing one of them will often affect the other two factors (see Fig. 15.5).

- *Cost*: In the value triangle, cost is often seen as the baseline constraint. There is a limit to the availability of financial resources that cannot be exceeded. Cost advantage is an important competitive edge in the global marketplace. Cost control is a crucial aspect of supply chain management that involves minimizing expenses related to procurement, production, transportation and inventory management. Optimal cost management can involve finding more affordable resources, continuous process improvement and internal education on cost consciousness. A total cost of ownership (TCO) analysis that considers all major cost elements in the entire product lifecycle, including purchase price and costs

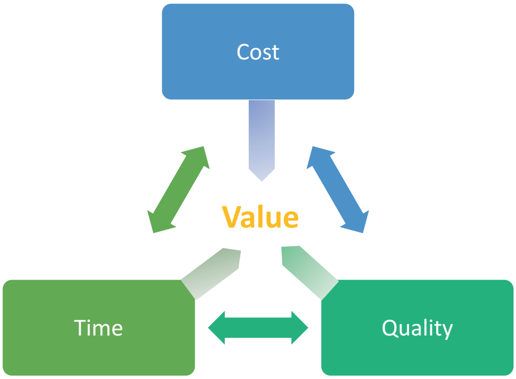

Fig. 15.5 Triple constraint model for supply chain management

for maintenance, transportation, disposal and so on, can help supply chain managers make more informed sourcing decisions.

- *Time*: Lead time stands for the time it takes for products to move from the initial order to delivery to the end customer. Longer lead time often requires larger inventories to buffer against delays. Shortening lead time enables leaner inventories that can reduce carrying costs and the risk of obsolescence. In addition, minimizing lead time helps supply chains respond quickly to changing business environments and customer demands. Thus, shortening lead time can substantially increase agility and customer satisfaction, especially in industry sectors where demand can be highly variable.
- *Quality*: High product quality is essential for meeting customer expectations and maintaining a positive brand reputation. Poor production quality can lead to costly recalls, warranty claims and reputational damage. Supply chain managers need to implement quality control measures, in order to identify and rectify quality issues during the early stages of the process. Depending on the industry sector, companies may be subject to stringent quality and safety regulations. Ensuring compliance through the supply chain is vital to avoid legal and reputational risks. To ensure reliable product quality, supply chain managers should engage in supplier audits and assessments, aligning suppliers with required quality standards to deliver reliable product quality.

There are trade-offs among the above three factors in the value triangle. For example, reducing lead time can require more resources and therefore increase costs. Alternatively, reducing costs may lead to compromises in product quality. One important task of supply chain management is to strike an optimal balance of cost, time and quality and determine the priorities for the organization, for example if a shorter lead time/ time to market is necessary at the expense of higher costs or less exclusive product quality. This can be the case for the launch of an innovative product in a competitive market (Dathe et al., 2022; Helmold et al., 2022).

15.3 Special Decisions in Supplier Management

Supplier management is a pivotal component of global supply chain management. It compasses various critical aspects, including quality assurance, supplier relationship management and ethical considerations. In times of globalization, modern supply chain managers not only seek cost advantages within the organization but also collaborate with business partners worldwide to share knowledge, optimize processes and continuously improve overall supply chain efficiency. To benefit from global cross-company potential, they set a series of strategic goals for supplier management, such as (Dathe et al., 2022; Helmold et al., 2022):

- *Supplier identification*: One of the first steps in supplier management involves identifying suppliers who can consistently provide products and services of desired quality. This includes the assessment of their manufacturing processes, quality control measures and the analysis of their contribution to added value including product development and innovation, as well as overall supply chain efficiency.
- *Supplier segmentation*: Classifying suppliers into appropriate categories such as preferred suppliers, alternative suppliers, benchmark suppliers, market suppliers and other suppliers. Preferred suppliers should have a track record of excellence, while alternative suppliers offer backup options. Market suppliers add flexibility to procurement decisions when needed.
- *Supplier selection*: Carefully choosing suppliers that align with the organization's values and needs for the relevant material groups. The selection criteria can be quality, reliability, cost and sustainability.
- *Utilization of effective tools*: Implementing advanced supplier management tools and software that can streamline communication, track performance metrics and facilitate data-driven decision-making. Especially a digitalization strategy that aligns with the organization's goals and capacities can substantially improve the supply chain's effectiveness and efficiency, including adopting digital procurement platforms, implementing IoT devices for supply chain monitoring, as well as enhancing data analytics solutions.
- *Internationalization*: To benefit from international supply chains, supply chain management needs to establish effective processes for stable cross-border transactions and, at the same time, implement comprehensive risk assessments to prevent supply bottlenecks. The COVID-19 pandemic underscores the importance of resilient supply chains. Shortages of critical products such as masks due to supply chain disruptions can lead to crisis in particular industry sectors, such as healthcare, or even to the entire society.
- *ESG policy*: Ensuring sustainability across the entire value chain.

In contrast to a confrontational approach focused on cost reduction, many companies today aim to build long-term, collaborative and trustful supplier relationships. This can create a win–win situation, where both business partners work together to achieve mutual benefits such as cost savings, innovation and risk mitigation. Successful supplier relationship management depends largely on effective communication on mutual expectations, opportunities and challenges through open channels.

15.4 ESG Issues in Supplier Management

15.4.1 The Role of ESG in Supplier Management

Classic supplier management plays a crucial role in establishing value-added supply chains that are guided by well-defined criteria and strategies. This management task revolves around various critical aspects, including quality, costs, delivery performance and additional significant factors, often encapsulated under the acronym QCD plus alpha. However, the contemporary landscape of global commerce has introduced a multitude of challenges, necessitating an expansion of the traditional role of supplier management.

Governments and regulatory bodies in various countries are introducing laws and regulations that hold companies responsible not only for their own ethical behaviours but also for the actions of their suppliers throughout the entire global supply chain. This emerging trend increases pressure on companies to conduct due diligence on their suppliers to identify and mitigate ethical risks (see Sect. 15.1).

However, supplier relationships often give rise to ethical dilemmas and the complexity of modern global supply chains makes it challenging to monitor and regulate ethical practices throughout the entire supply chain, as most companies source materials, components and services from suppliers located in different countries and regions with different legal and cultural backgrounds.

In an era marked by political turbulence, international trade complexities, climate change concerns and stringent environmental regulations, soaring energy prices and an increasingly conscientious consumer base, supplier management has undergone a profound transformation in response to the changing global landscape. It has evolved into a multifaceted discipline that embraces sustainability as a cornerstone of success. Companies that effectively integrate ESG principles into their supplier management strategies are not only better positioned to mitigate risks but also thrive in a marketplace where responsible and ethical practices are increasingly highly valued (Dathe et al., 2022).

15.4.2 Human Rights

Human rights in supply chains are a critical and complex aspect of modern supplier management. International conventions and legislation such as the German Supply Chain Act highlight the importance of upholding human rights across global supply chain networks (see Sect. 15.1). Companies can use their influence, for example by conducting regular supplier audits and assessments, to press their suppliers to comply with the human rights standards, including (Federal Government of Germany, 2021):

- *Prohibition of child labour*: Companies must ensure that their suppliers do not employ underaged workers and violate their rights to education, health and a safe environment. The prohibition measures can include verifying the age of workers and providing opportunities for education and personal development to young people in the communities.
- *Protection against slavery and forced labour*: Modern slavery and forced labour are grave human rights violations. Companies need to identify and rectify any situations throughout their supply chain where workers are coerced or held against their will.
- *Occupational health and safety*: Companies must urge their suppliers to minimize workplace hazards and provide proper training and protective equipment to their employees.
- *Adequate living wage*: Suppliers should pay reasonable wages that allow employees to live with dignity and provide for their families, including food, shelter and healthcare.
- *Freedom from discrimination*: Companies must insist that their suppliers provide equal opportunities and fair treatment to all employees, irrespective of their background in terms of race, gender, religion, ethnicity or other factors.

Companies can implement various measures that can help them fulfil due diligence obligations in the context of human rights in supply chains, such as supplier audits and assessments, systems that facilitate traceability of the origin of products and materials or trainings on human rights standards and adequate working conditions.

15.4.3 Environmental Protection

Suppliers are expected to comply with local and international environmental regulations. Companies can encourage their suppliers worldwide to contribute to environmental protection by conducting regular environmental audits and selecting suppliers who adhere to sustainable practices. This typically involves the evaluation of suppliers in the following aspects:

- *Sustainable sourcing*: Seeking suppliers who use environment-friendly methods for their production processes, for example sourcing from suppliers who employ organic pharming methods to reduce the environmental impact.
- *Reducing carbon footprint*: Optimizing transportation routes, utilizing cleaner transportation options such as electric vehicles or sea transport to reduce emissions.
- *Energy efficiency*: Encouraging suppliers to adopt renewable energy sources and implement energy-efficient technologies.

- *Waste reduction:* Encouraging suppliers to implement processes that reduce, reuse and recycle materials, for example by redesigning packaging to be more eco-friendly, using recycled materials or developing closed-loop systems to recover and reuse resources.
- *Water management:* Requiring suppliers to implement water-saving technologies, reduce water pollution and manage water consumption effectively, especially in areas prone to water scarcity or pollution concerns.
- *Lifecycle assessment:* Demanding suppliers to conduct lifecycle assessments (LCAs) to understand their environmental impact from production to disposal. This helps in identifying areas where improvements can be made.

Companies that prioritize environmental protection in their supply chains not only contribute to a more sustainable world but also often benefit from improved reputation and reduced risks.

15.4.4 Fair Trade and Ethical Trading

The distribution of profits in business interactions is closely tied to the relative power positions of companies in a supply chain (Porter, 2008). The constant pressure to lower costs and meet the demands of powerful buyers can be detrimental to smaller suppliers. Smaller companies often struggle to survive as they are forced to cut development costs, potentially compromising product quality or financial outcomes. Intensive competition between suppliers, driven by the demand of powerful buyers, can reshape the entire industry. For example, when supermarkets in Germany started to offer fresh baked goods and entered into direct competition with traditional bakeries, the number of traditional bakeries soon dropped by half (Dierig, 2019).

Companies practicing ESG principles are expected to treat their less powerful suppliers fairly by adopting approaches such as fair trade and ethical trading (Gupta, 2021; PRI Association, 2021). Fair trade initiatives ensure that producers, especially those from developing countries, receive fair compensation for their products. The fair prices contribute to the regional economic and social development of the suppliers, as well as to environmental sustainability (fairtrade.de, n.d.). Ethical trading refers to the corporate strategy of not only considering economic aspects, but also how potential business partners can be engaged to fulfil their social responsibilities. This can involve implementing ethical codes of conduct to ensure employees well-being, environmental preservation and so on (Dathe et al., 2022).

15.4.5 Fair Competition

Companies have a social responsibility to treat competitors fairly. Unethical actions, such as unfair competition or collusion in the form of shopping cartels, can distort market functions and subsequently harm consumers. For example, large companies sometimes engage in ruinous competition by undercutting competitors' prices with their financial strength. After smaller competitors exit the market, the surviving companies often raise prices significantly, benefiting from a quasi-monopoly position. The action of a few competing companies secretly agreeing on higher sales prices to take advantage of the customers is referred to as a shopping cartel or a buyers' cartel. In Germany, like in many other countries, price-fixing agreements are prohibited and can lead to heavy fines and legal consequences (Federal Cartel Office, n.d.).

Unfair competition includes actions such as negative advertising against competitors, bribery, industrial espionage and brand theft. These actions can violate both ethical and legal norms. In Germany, specific acts related to unfair competition such as disparagement, bribery and misleading advertisement are outlined in federal laws (Bundesamt für Justiz, n.d., S. §§ 4–7).

15.5 Case study: Aroundtown's ESG Concept for Housing Market

The real estate industry is a major driver of economic growth. It contributes significantly to the gross domestic product (GDP) of most countries, creating jobs in construction, property management, real estate agencies and other related service industries. Especially residential properties provide essential shelter and housing for individuals and families, contributing to the overall well-being and quality of life and fulfilling one of the basic human rights (Dathe et al., 2021).

To understand the circumstances and requirements of different segments of the real estate industry, it is helpful to classify the real estate market into different categories. This can be done by using various criteria (see Table 15.1).

Real estate objects, whether residential or commercial, are also highly favoured investment objects for many investors due to their potential for long-term returns and diversification benefits. However, compared with the stock market, the real estate market operates with some distinct characteristics and challenges, making it less transparent and subject to various influence factors, such as:

- Location of the property.
- Age and condition of the building.
- Renovation needs and opportunities: Properties with eco-friendly heating systems, energy-efficient features and modern amenities may attract higher demand and offer better investment prospects.
- Applicable regulations by governments and policymakers, such as zoning laws, building codes and tax incentives, can impact property values and development opportunities.
- Demographic trends: Population growth or decline can have a significant impact on housing demand and property prices. Also changes in the age, income levels and lifestyle preferences of the population can shape the types of properties in demand and affect market dynamics.

Table 15.1 Examples of real estate market classification

Classification criteria	Real estate market segments
Intended use	Residential Properties: Properties intended for living purposes of individuals and families, such as houses, apartments, condominiums, townhouses and residential land. Commercial Properties: Properties used business activities, for example: Office real estate Retail properties including shopping centres, standalone stores and mixed-use retail complexes Hospitality real estate such as hotels and restaurants Industrial properties used for manufacturing, production and distribution activities, including factories, distribution centres and logistics parks Agricultural properties
Ownership	Publicly owned Privately owned
Change of ownership	Primary real estate market dealing with properties that have not been previously owned Secondary real estate market dealing with pre-owned homes and commercial properties
Location	Domestic market International market
Relationship between owner and resident	Objects for self-use Renting objects
Purpose of trade	Buying and selling Rental

- Interest rates: The interest rates set by central banks can significantly impact borrowing costs for real estate investors and homebuyers, affecting affordability and demand.
- Economic cycle and market sentiment: Real estate markets are often sensitive to economic cycles, especially periods of expansion and contraction can greatly impact property prices and rental yields. Investor sentiment, consumer confidence and prevailing market trends can create fluctuations in property prices.
- New construction rates: The availability of new properties can influence competition and pricing dynamics for both new and existing properties.
- External factors: Global economic trends and geopolitical events can also impact real estate markets.

Over the previous decades, the increasing global attention to environmental, social and governance (ESG) considerations also had a significant impact on the real estate market, influencing how properties are developed, managed and valued.

Aroundtown S.A., a Luxembourg-based commercial real estate company, is a prominent player in the European real estate market, boasting a diverse portfolio encompassing office buildings, residential homes, hotels, logistics centre, wholesale and retail spaces. With such a broad scope of properties, the company recognizes the importance of integrating ESG into their overall business strategy (Aroundtown SA, 2023a, b).

In order to develop the ESG strategy, Aroundtown initially identified their key stakeholder groups. The major stakeholders of the real estate industry include (Dathe et al., 2021):

- Investors including real estate fund managers, real estate investment trusts (REIT), institutional investors and banks
- Real estate advisors and real estate agents
- Employees, including property management and service teams
- Tenants
- Buyers
- Sellers
- Policymakers and regulators

Aroundtown recognizes that tenant satisfaction is a key factor for its success. Satisfied tenants are more likely to maintain long-lasting relationships with the company, resulting in higher retention rates and reduced vacancy risks. To achieve tenant satisfaction, Aroundtown focuses on providing high-quality and well-managed properties with the support of competent employees, ensuring that the needs of tenants are met promptly. Thus, Aroundtown identifies two primary stakeholder groups: employees and tenants. These groups are central to their business strategy, and their satisfaction is a top priority (Aroundtown SA, 2023b).

Recognizing the importance of ESG principles in today's business landscape, Aroundtown places a strong emphasis on meeting or exceeding ESG performance expectations, especially from its commercial tenants. They aim to support their tenants' sustainability goals and build mutually beneficial relationships by incorporating ESG considerations into their operations (Aroundtown SA, 2023a, b):

- *Environmental perspective*: Aroundtown implements sustainable property management practices and energy-efficient technologies, contributing to a greener and more sustainable future while reducing consumption expenses.
- *Social perspective*: They engage in community and neighbourhood development, prioritizing diversity and inclusion policies, offer health and safety training and provide career development opportunities to enhance employee satisfaction.
- *Governance perspective*: Aroundtown emphasizes business and compliance solutions to ensure that good governance practices are in place.

In today's real estate landscape, ESG factors are no longer just a matter of corporate social responsibility; they are fundamental to business success and resilience. In order to track and anticipate the ESG expectations of its stakeholders, Aroundtowns chooses to employ the Global Real Estate Sustainability Benchmark (GRESB) and the Task Force for Climate Finacial Disclosures (TCFD) as vital yardsticks for evaluating and improving its ESG efforts (Newell et al., 2023).

The Global Real Estate Sustainability Benchmark (GRESB) is a widely recognized global benchmark that assesses the ESG performance of real assets. It provides a comprehensive framework for measuring and reporting on ESG-related risks and opportunities. By aligning with GRESB standards, Arondtown aims to enhance its transparency and credibility in ESG matters.

The Task Force for Climate Finacial Disclosures (TCFD) focuses on the financial implications of climate change. TCFD's recommendations help companies like Aroundtown disclose the financial impact of climate risks and opportunities, enabling better decision-making and risk management.

Incorporating the above benchmarks into the business processes allows Aroundtown to systematically track and improve its ESG performance, demonstrating a commitment to sustainability and resilience in the face of environmental and social challenges.

Climate change plays an important role in housing markets due to multiple factors, including:

- *Construction emissions*: The construction industry is a major emitter of greenhouse gases. Implementing sustainable construction practices and materials can help reduce emissions associated with building and renovating properties.
- *Heating systems*: Traditional heating systems in buildings often rely on fossil fuels such as coal, gas and oil. Transitioning to more energy-efficient and sustainable heating solutions is essential for reducing carbon footprints.
- *Energy efficiency*: Buildings with low energy efficiency cause high energy consumption and greenhouse gas emissions.
- *Water management*: Water management practices in construction and property management can affect natural water recycling processes. Sustainable water management is key to reducing water-related environmental issues.

In the commercial housing market, the regulatory landscape is evolving rapidly. Aroundtown has observed a shift from voluntary ESG practices to more stringent regulations imposed by investment companies, rating agencies and government policies (Robinson & McIntosh, 2022). International standards such as ISO standards, in particular ISO 14000 norm family for environmental management, play a significant role in ensuring compliance and accountability (Robinson, 2023; ISO, 2023).

Effective waste management is a critical aspect of ESG issues in real estate. With the certification of ISO 14001:2015, Aroundtown demonstrates its commitment to robust waste management systems to comply with regulatory requirements and responsible operations (ISO, 2023).

Overall, Aroundtown's ESG approach goes beyond its own operations; it extends to its commercial customers and partners, helping them achieve sustainability goals within their own supply chain networks. By doing so, Aroundtown fosters long-lasting partnerships based on trust and shared values that ensure sustainable success for all parties.

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16 Outlook to ESG Future Trends

16.1 Climate Litigation

The trend of increasing legal pressure on business organizations regarding their contributions to climate change and their response to its impact is a global phenomenon that reflects the growing recognition of climate change as a global critical issue. Governments and international bodies are establishing more comprehensive regulatory frameworks, including emissions reduction targets, reporting requirements and penalties for non-conformities, to align companies within their jurisdictions.

Courts in various countries have entertained the framing of climate change as a violation of human rights. Lawsuits argue that the impacts of climate change, such as displacement due to rising sea levels or extreme weather events, infringe on individuals' right to life, health and a clean environment (United Nations, 2023). Some of the most high-profile climate-related lawsuits target fossil companies and seek compensation for their historical emissions, hinging on allegations of concealing knowledge about the risks of climate impacts (The Guardian, 2023).

In addition, shareholders, consumers and advocacy groups are holding corporations accountable for their environmental practices. They use legal means, such as shareholder resolutions and class-action lawsuits, to demand more transparency and action on climate-related issues. Regulatory bodies and investors are pushing for better climate risk disclosure by businesses, for example by the implementation of the TCFD (Task Force on Climate-Related Financial Disclosures) guidelines for climate risk reporting. This trend is particularly prevalent in industries with significant footprints. Businesses are increasingly required to conduct environmental impact assessments that evaluate the potential environmental consequences of their projects. Failure to deliver the required assessments or to address identified risks can result in project delays, reputational damage or legal repercussions.

T. Dathe et al., *Implementing Environmental, Social and Governance (ESG) Principles for Sustainable Businesses*, Responsible Leadership and Sustainable Management, https://doi.org/10.1007/978-3-031-52734-0_16

Climate litigation increasingly transcends national borders. Lawsuits against multinational corporations and governments usually involve complex jurisdictional issues, drawing attention to the global nature of climate change and its impacts. Some lawsuits have resulted in landmark decisions that set legal precedents. For example, the Urgenda case in the Netherlands established that governments have a legal duty to protect citizens from climate change (Urgenda, 2019). Such decisions can influence future legal actions and government policies.

As the impacts of climate change intensify, it is likely that legal pressure on businesses will continue to increase. Therefore, companies will need to proactively address climate risks, reduce their carbon footprint and adapt to changing regulations to minimize legal exposure.

16.2 Green Financing

Green financing is a multifaceted approach with the primary goal to facilitate the allocation of capital to initiatives and projects that not only promise a reasonable rate of return but also deliver tangible environmental and social benefits. These financial resources come from a wide range of sources, including the public sector, the private sector and non-profit organizations.

The public sector plays a pivotal role in promoting green financing by shaping regulatory frameworks to incentivize sustainable practices. Governments can introduce tax incentives, subsidies or penalties that encourage environmentally responsible financial decisions. The public sector can also align its own financing decisions with the environmental dimension of the Sustainable Development Goals (SDGs) to direct financial flows to projects that contribute to environmental protection, climate preservation and social well-being. This alignment ensures that government policies are consistent in promoting sustainability goals (United Nations, n.d.).

One of the fundamental aspects of green financing is the prudent management of environmental and social risks. Financial institutions, including banks, investment companies, micro-credit providers and insurance companies, are encouraged to assess the environmental and social impacts of their investments and loans. By doing so, they can, on one hand, identify and mitigate potential risks that could harm ecosystems or communities, while, on the other hand, identify and capitalize on opportunities that offer both financial returns and environmental or social advantages. This entails that green financing is not solely motivated by altruism or ethics; they can be financially viable and even profitable.

A key objective of green financing is to increase investments in clean and green technologies, including renewable energy projects, energy-efficient technologies, sustainable agricultural practices and eco-friendly manufacturing processes, for example by increasing the use of green bonds.

Green bonds are also known as climate bonds. Like traditional bonds, they are fixed-income securities that allow issuers to raise capital by borrowing money from investors for a defined length of time (“maturity period”). However, green bonds are distinct from regular bonds due to their specific label, indicating a commitment to use the raised funds exclusively for financing or refinancing of projects, assets or business activities with environmental benefits. Issuers of green bonds typically provide detailed information on how the bond proceeds are to be allocated to specific green projects. The purpose of the bonds is usually subject to third-party verification (OECD, 2015).

Green financing is intended to bridge the gap between finance and sustainability. It leverages various strategies and mechanisms to steer financial resources towards sustainability by shaping the future production, consumption and ecosystem dynamics. Companies can benefit from green financial in multiple ways, for example by accessing additional capital to undertake sustainability initiatives without tapping into their core operating budgets, cost savings through energy efficiency improvements, enhancing the corporate reputation and mitigating ESG-related risks.

16.3 Carbon Pricing

Carbon pricing is an economic instrument that assigns a cost to carbon emissions, so as to effectively internalize the environmental and social costs associated with greenhouse gas pollution and encourage low-carbon business processes. Various emissions trading systems (ETS) establish a cap or limit on total emissions and distribute allowances equivalent to this cap among participating companies ("Cap-and -trade"). These allowances can be traded in a carbon market. Companies that reduce emissions can sell their surplus allowances to those exceeding their caps, creating a financial reward for emission reductions.

Carbon price has gained significant global traction. The Paris Agreement, a landmark international climate accord, encourages countries to introduce carbon pricing as a means to achieve emission reduction targets. Some regions, like the European Union, have already established well-functioning carbon markets, while others, including China and the United States, are still exploring alternative carbon pricing systems (Standard & Poor, 2023; rff.org, 2022). However, implementing carbon pricing can face political and economic resistance due to concerns about the competitiveness of national manufacturing industries and potential job losses.

Altogether, carbon pricing is a dynamic and evolving strategy that aligns economic activities with ecological goals. By fostering the preference of businesses, investors and consumers to low-carbon technologies and practices, it can accelerate the transition to a sustainable, decarbonized economy.

16.4 Consolidation of ESG Reporting Standards

Historically, there has been a proliferation of ESG reporting standards and frameworks worldwide with each region and industry often having its own set of guidelines and disclosure requirements. For example, the Global Reporting Initiative (GRI) developed the GRI Framework as one of the earliest sustainable reporting standards. Later, the United Nations launched the Principles for Responsible

Investment (PRI) to encourage investors to integrate ESG considerations into their investment decisions and drive forth a more standardized ESG reporting on performance and progress. Moreover, the Task Force on Climate-Related Financial Disclosures (TCFD) established by the Financial Stability Board (FSB) released its recommendations for voluntary climate-related financial disclosures which were used in various industry sectors as templates for consistent and transparent reporting of climate-related risks and opportunities.

The European Union (EU) demonstrated regulatory efforts to standardize ESG reporting, for example by releasing the Sustainable Finance Disclosure Regulation (SFDR) that SFDR outlines specific disclosure requirements for financial market participants, such as asset managers, investment funds and financial advisors with a focus on transparency regarding the environmental and social impacts of investments. SFDR is closely related to the Taxonomy Regulation – a framework for the classification of sustainability-related terms which largely increases the transparency of the reporting disclosures according to the Sustainable Finance Disclosure Regulation (SFDR) or the Corporate Sustainability Reporting Directive (CSRD) by the EU (European Commission, 2023) (see Sect. 11.4).

This diversity led to complexity and confusion for both companies and investors when comparing ESG performance across organizations or regions due to the lack of standardized metrics and reporting formats. Consequently, investors, regulators and other stakeholders increasingly called for a globally standardized and consistent approach to ESG reporting to enable evidence-based reliable sustainability performance and risk profile of companies.

In recent years, a trend of consolidation of ESG reporting standards has been observed. The IFRS Foundation proposed the International Sustainability Standards Board (ISSB) Standards to bring ESG reporting into the mainstream of financial reporting. Organizations such as the International Reporting Council (IIRC) and the Climate Disclosure Standards Board (CDSB) have intensified their collaboration to harmonize reporting frameworks and promote integration between financial and non-financial reporting. It can be expected that standard-setting organizations, governments and industry leaders will keep working together to create a unified global ESG reporting standard.

The consolidation of ESG reporting standards will facilitate investors' assessment and comparison of ESG performance across different industries and regions to support informed investment decision-making. From the corporate point of view, adopting a globally recognized and standardized ESG reporting framework can enhance their credibility and trust relationships with stakeholders including investors and consumers. Besides, streamlining ESG reporting processes can avoid duplicative efforts and thus lead to cost savings. A standardized reporting framework can also help companies identify and manage ESG-related risks in areas such as climate change, human rights and governance, more effectively.

There are also new challenges associated with this trend. The increased regulatory requirements will demand higher proficiency of companies in dealing with ESG reporting. As a result, companies may have to allocate significant resources to ESG reporting and compliance efforts that can divert financial means and attention from core business activities. In addition, collecting and reporting ESG data may involve sensitive information, so robust data security measures will be required to avoid breaches, reputational harm and legal consequences. To mitigate these new risks, companies should stay informed about evolving regulations, invest in data security, develop strategic resource allocation and engage with stakeholders proactively.

16.5 The Challenge of Disruptive Innovations

Disruptive innovation presents both challenges and opportunities for organizations in the context of ESG considerations. Disruptive innovations are typically innovations that create new markets or significantly alter existing ones, often displacing established products, services or even business models (Helmold et al., 2023).

Companies can leverage disruptive innovations to earn a decisive competitive edge. For example, AI tools and data analytics can be used to optimize energy use, reduce waste, improve the overall efficiency of business operations and enhance supply chain resilience. Early adopters of disruptive technologies that align with ESG values can establish themselves as leaders in sustainable practices, attracting socially responsible investors and customers. Organizations can foster collaborations with innovative startups and other technology providers to benefit from their fresh perspectives and solutions to sustainability issues. However, the introduction of disruptive technologies into ESG practices often faces serious challenges.

Bitcoin, introduced in 2008 through a whitepaper titled "Bitcoin: A Peer-to-Peer Electronic Cash System" by the mysterious Satoshi Nakamoto, marked the birth of cryptocurrencies. Its initial appeal lay in offering financial sovereignty through a decentralized payment system, garnering attention from tech enthusiasts and early adopters. The decentralized payment system eliminates the need for a trusted intermediary for payment transactions. This is achieved through a vast network of participants (nodes) that collectively maintain a record of all Bitcoin transactions in a blockchain. Transactions are validated using the energy-intensive proof-of-work (PoW) consensus mechanism.

Over time, Bitcoin evolved into a recognized asset class and a store of value. By reducing dependence on traditional financial systems, it provides an alternative for nearly 1.4 billion people around the world without bank accounts. Bitcoin's advocates argue that it offers protection against failures in the traditional banking system and has the potential to revolutionize cross-border payments (U.S. News, 2023).

However, Bitcoin also faces criticism and challenges. Its pseudonymous nature makes it attractive for illegal transactions and money laundering. Additionally, the significant energy consumption associated with Bitcoin mining has raised environmental concerns. While some financial institutions consider cryptocurrencies ESG-compliant (KPMG, 2023; PwC, 2023), there is an ongoing debate about whether their energy consumption outweighs their positive impacts, thus potentially challenging their quality as green investments (Ye et al., 2023). This uncertainty has contributed to the price volatility of cryptocurrencies in the capital market (U.S. News, 2023).

The example of Bitcoin exemplifies the challenges and complexities involved in the introduction of disruptive innovations into ESG practices. While it offers certain advantages, such as financial inclusion, it also causes significant environmental, ethical and regulatory challenges that ESG-conscious companies and investors must carefully navigate when considering cryptocurrency investments.

The artificial intelligence (AI) product ChatGPT introduced by OpenAI in November 2022 quickly gained popularity and found wide applications in various business settings. However, this innovation soon raised concerns, including the limitation and quality of its outputs, for example, the AI system can inherit biases, i.e. biases in the training data can lead to discriminatory outcomes. Such biases can have significant social consequences, such as reinforcing existing inequalities and perpetuating discrimination in areas such as hiring, lending and criminal justice. There are also legal concerns regarding data safety and privacy, with the Federal Trade Commission (FTC) investigating potential deceptive practices and data privacy standards. The fast-paced advancement of AI technology has also outpaced existing laws and regulations on image and likeness rights and copyright ownership of AI-generated content (Forbes, 2023).

AS artificial intelligence (AI) systems become increasingly capable of handling complex tasks, it raises the concern that AI may take over tasks and roles traditionally performed by humans, thus leading to displacement and job losses of human workers, particularly in routing and repetitive jobs.

Companies need to make a strategic choice to increase transparency and reassurance to stakeholders in terms of ethical and responsible AI usage. To address the social concerns, stakeholders including businesses, governments and educational institutions need to take proactive measures to offer training programmes to equip individuals with the skills needed to work alongside AI systems and minimize financial disparities resulting from AI adoption.

In the ever-evolving landscape of business and technology, the integration of disruptive innovations into daily operations offers significant benefits and opportunities. However, it also triggers the demand for regulatory development in the pertinent areas. The above two examples underscore the need for continuous evaluation and adaption of ESG frameworks in response to emerging technologies and innovations. This adaptability ensures that ESG reporting remains a valuable tool for addressing the broader disruptive innovations on businesses, society and the environment. As new challenges arise, ESG frameworks must evolve to provide adequate insights into a company's overall sustainability and ethical performance.

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