ESG Integration into the Business Model

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The integration of environmental, social, and governance (ESG) into the business model means considering ESG issues in the existing business model, which is defined by four factors: value proposition, value creation, value delivery, and value capture.

ESG integration | business model | socially responsible investment | ESG | sustainability | sustainable development

1. Introduction

Since its introduction by the United Nations in 2004 [1], environmental, social, and governance (ESG) integration has been considered one of the latest and most widely adopted sustainability yardsticks worldwide [2]. The pressure from official regulations, investors, and stakeholders on firms to disclose their ESG performance has impacted company attitudes toward sustainability. This has led to issues such as the manipulation of firms' ESG performance and the emergence of notions such as greenwashing, value washing, and blue washing, aimed to attract funds and satisfy stakeholders. Greenwashing refers to the manipulation of sustainability reporting [3], value washing relates to the misrepresentation of value outcomes [4], and blue washing alludes to unethical behaviors in using the United Nations Compact for gaining legitimacy [5].

Two views of ESG integration exist in the literature. The first view is that of socially responsible investment (SRI), which discusses ESG from the perspective of investment; and the second view has evolved from sustainable development (SD) and considers ESG from the perspective of firms' operations. However, to date, while the literature has focused extensively on examining ESG integration from the viewpoint of SRI, there has been little discussion of the integration of ESG factors into core business operations.

Thus, while an increasing number of firms are adopting ESG compliance, there remains a paucity of knowledge regarding the impact of ESG on the business model, which is required to address the sustainability of firms and society.

This entry presents two critical views of the literature, conceptualizing the relationship between ESG and the business model. The researchers examined the impact of ESG on business model outcomes and on the process of integration.

The results show the need for more research on the integration process to explain how it occurs in different contexts and provide guidelines on how to integrate it into the present business model. This should also address integration issues, such as the lack of ESG standardization [6].

The main practical implication is that unless the world gives serious consideration to the integration of ESG into the business model, the current promotion of ESG may turn out to have been unfounded.

2. Environmental, Social, and Governance (ESG) Integration: Socially Responsible Investment

Concerns about the environment have raised global awareness of sustainability issues, thereby shifting traditional investments directed toward profit maximization to those that support sustainability. The current tendency of the integration of sustainability and ESG in the financial market is termed SRI [7][8]. SRI refers to ESG integration based on an explicit and systematic consideration of environmental, social, and governance factors in the investment decision-making process [2]. The definition of ESG can be broken down in terms of three factors. Environmental factors consider how a company performs as a steward of the natural environment. Social factors examine how a company manages its relationships with its employees, suppliers, customers, and the communities in which it operates. Governance factors include a company’s leadership, executive pay, internal controls, audits, and shareholder rights. These factors are used as a set of standards to assess a company’s operations when screening for investments [9].

Empirical research shows that the effects of ESG on financial markets, as represented in firms’ financial performance and value, are being debated in terms of both positive and negative impacts. A study of more than 2000 empirical findings revealed that most ESG research findings indicate a positive impact of ESG on firms’ corporate financial performance [10]. In addition, a positive relationship was found between ESG disclosure and profitability in European firms [11]. A survey of empirical research in accounting and finance literature spanning 45 years also found a positive link between ESG and financial performance [12]. However, other findings indicate a negative impact of ESG on financial performance [13][14].

Most of the literature provides mixed signals regarding the positive and negative market values of ESG reporting. One author argues that a socially responsible market leads to an increased number of stakeholders [15]. Others find a negative impact on market value and recommend improving report quality to mitigate this [16]. Investors play an essential role in supporting ESG and ethical practices, which is reflected in the literature in terms of the investor-based integration of ESG in decision-making [17], the process of investing in managing risks [18], and improvements to the investment process [19]. However, research has also identified negative effects of investor integration of ESG, such as lack of consideration of the core issues that drive business models and finance [20], the lack of a business case, poor quality of data, and the absence of clear standards and definitions [21].

There are references to the manager-based integration of ESG into investment strategies at different levels, ranging from full integration to low integration [22], and using ESG reporting for reducing risk rather than for maximizing value [23].

3. ESG Integration into Firms: Sustainable Development

The integration of sustainability and ESG into firm operations is referred to as SD. SD has been defined in corporate activities as balancing current sustainability with economic, environmental, and social aspects while also addressing company systems, such as operations and production, the organizational system, governance, assessment, and communication [24].

Few empirical studies have examined the impact of ESG on firm operations. The discussion is mostly limited to the positive impact of strategies that consider ESG performance [25], as well as corporate governance and ESG reporting [26][27][28][29]. A positive impact of regulation on reporting strategies and governance practices is noted in firms becoming proactive in addressing sustainability through communication, transparency, stakeholder engagement, and the improvement of relationships with external resources [30].

However, ESG as an indicator of sustainability is criticized for not showing the position of firms with regard to the sustainability and trustworthiness of ESG data [31]. **Figure 1** illustrates ESG integration in the literature in terms of both investment and internal operations.

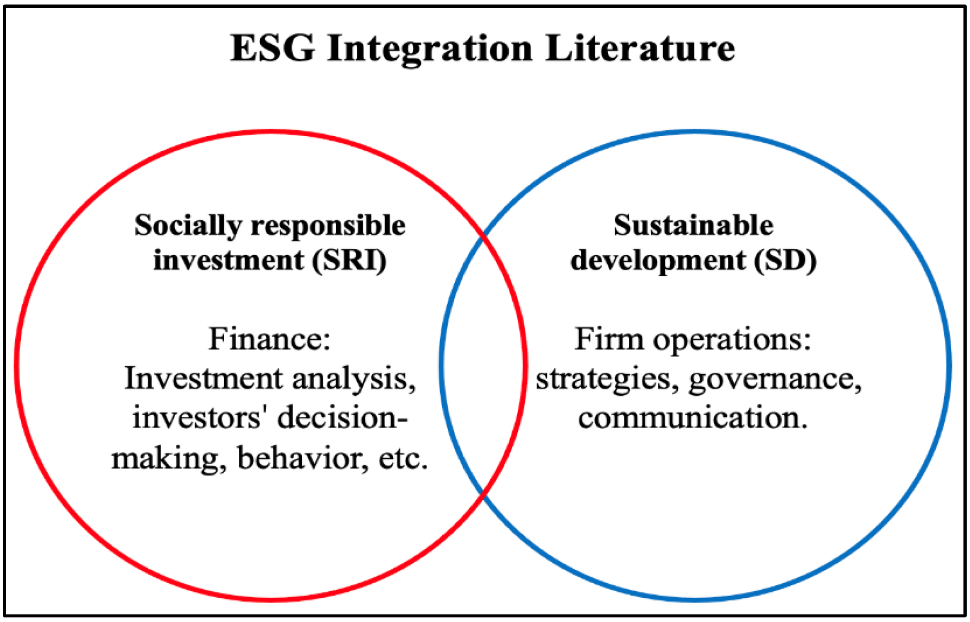

Figure 1. ESG integration literature.

4. Findings: ESG Integration into the Business Model

We found only 29 studies related to this ESG integration into the business model. Including 27 papers conceptualized ESG into the business model as an outcome; they included 10 papers along the lines of SRI, 16 papers following the view of SD, and 1 paper that addressed both SRI and SD. The papers provided only a general conception of the relationship between ESG and business models with no details of how the integration actually occurred. The researchers grouped similar integration outcomes into four dimensions: (1) integration behaviors of ESG, in which the literature discusses the impact of government regulations, investors, and banks on integration behavior; (2) the advantages of ESG integration for firms and investors; (3) ESG practices, such as an examination of current cases addressing ESG in the business model; and (4) critical views of ESG in the business model.

Of the remaining two papers, the first examined the integration process based on the SRI view, while the second paper addressed the integration in terms of SD. The latter dealt with a firm integrating the concepts of sustainability and circular economy into its business model through value proposition, value delivery, value creation, and value capture.

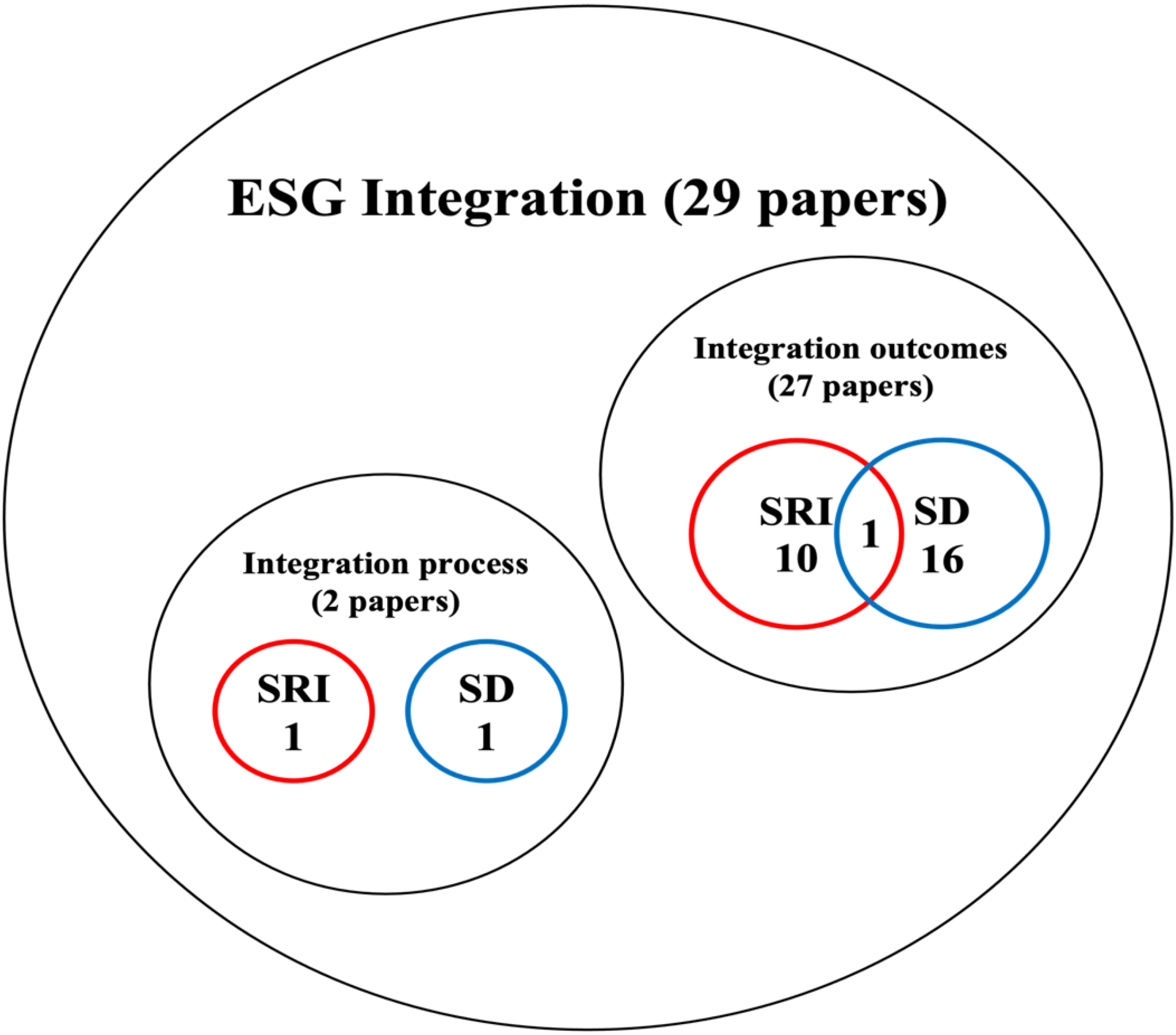

Figure 2. Paper analysis results of ESG integration process and outcomes.

5. Conclusion

The literature provides only a conceptual understanding of the relationship between ESG and business models. There is neither an actual detailed case of the integration process nor an explanation of how firms can fully integrate ESG, transform, or improve their business model to resolve trade-offs [32], and enforce profit and sustainability. Moreover, there has been no discussion of ESG integration into core business models. The results suggest that the pressure to integrate ESG leads to reluctant ESG adoption without a holistic integration of ESG into the business model. The researcher state the need for more research into the integration process to motivate firms to reform their business models, foster sustainability, and enhance financial performance.

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