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# ESG Indices, Sustainable Practices and Strategic Competitiveness within the Modern Business Landscape

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## Abstract

This paper undertakes the arduous task of examining the accuracy and relevance of a statement lacking clear benchmarks. The assertion posits that Environmental, Social and Governance (ESG) indices is indispensable not just for assessing a company's sustainability efforts, but also enhancing its competitive edge. Through analysis of existing literature, frameworks, and empirical evidence, this article elucidates the nuances inherent in the link between ESG indices, sustainable practices, and strategic competitiveness within the modern business landscape. To accomplish this, the paper adopts a structured approach, dissecting the statement into its constituent components to discern the key points concerning ESG. It intends to challenge the notion of ESG as an indispensable tool in measuring sustainability, while also evaluating relevant initiatives and potential impacts. Furthermore, the article explores the extent to which indices truly function as significant tools, addressing societal and environmental issues while offering pathways for corporate success beyond conventional business performance metrics.

## Keywords

Environmental, Social and Governance (ESG), Sustainability, ESG Indices, Strategic Competitiveness

## 1.0 Introduction

The term "ESG" made its debut in a report titled "Who Cares Wins," published by the UN Global Compact (2004). Clearly, the title itself hints at the competitive nature of these efforts, insinuating that those who prioritise sustainability stand to gain markedly advantages in the market. This report signaled a step forward in the push for sustainable investing as it was born from a joint initiative involving multiple financial institutions, setting out to embed ESG principles into financial research and asset management. One of the firms that contributed to the report, Goldman Sachs, not only faced charges for breaching its policies concerning ESG investments (Singh, 2022) but was also found embroiled in the 1MDB fraud scandal (Goldstein, 2023). This company has been mired in controversies, notably for its questionable

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ethical practices that have stirred up considerable debate (Hall, 2012). When a financial firm endorses eco-consciousness guidelines yet fails to uphold ethical standards in sustainability practices, its credibility is cast into doubt. From a critical standpoint, entrusting the development of a sustainability framework to a team with pertinent expertise, rather than solely relying on a financial institution, is paramount for fostering a more holistic and impactful approach to sustainable practices.

The question lacks specific comparative data to evaluate the relevance of the statement, particularly regarding which companies or industries are being referenced. Additionally, the statement employs terms like "ESG indices", which may not be universally understood without precise definitions. For clarity, it is important to specify the particular ESG indices being references, such as the MSCI USA Extended ESG Index, S&P 500 ESG Index, Dow Jones Sustainability Index or FTSE4Good Index. This clarification enhances a clear understanding of the context and enables a more insightful analysis of the statement's implications.

## 2.0 Literature Review

### 2.1 When Money-Driven Teams Embrace the Sustainability Movement

"ESG indices", as a type of stock market index (Tamplin, 2023), are predominantly associated with investment approaches, as evident from Google search results primarily linking them to financial institutions and investment products. The prevalence of ESG indices has surged significantly, with hundreds now in existence, and this number is expected to grow further. The expansion is attributed to the escalating demand for financial products and services revolving around ESG ratings and funds (OECD, 2020). Presently, ESG is seen as a reporting framework, but without uniformity (Deloitte, 2024). Demands for ESG transparency are at an all-time high. It is not just activist investors anymore; investors of all kinds are now requesting ESG reports from a wide range of companies. Effectively addressing ESG concerns is no longer confined to environmental and social realms, it now directly impacts the financial success of companies (Nelson, 2022). G&A's 2023 research reveals a near- universal adoption of sustainability reporting among S&P 500 companies in 2022. Mid-cap companies notably saw a substantial increase, jumping from 68% to 82% in reporting from 2021 to 2022. Various corporate stakeholders, including executives, investors and analysts, have agreed upon a set of ESG indicators to assess and compare business performance (Eccles et. al., 2020; Karginova-Gubinova, 2022). Is ESG simply a tool for measuring sustainability? Not quite. Rather, it serves as a mechanism driving a profit-oriented regulatory system.

### 2.2 Deciphering ESG's Role as a Sustainable Competitive Advantage

Historically, Barney (1991) defines a competitive advantage that competitors cannot replicate is termed sustained competitive advantage. Yet, this resource-based view is incomplete. Besides serving shareholders, companies can generate value by considering the concerns of all stakeholders, including communities and the environment, in formulating corporate strategy (Freeman et.al., 2021). In the last few years, numerous researchers in strategic management have explored various perspectives to uncover the role of ESG in generating a lasting competitive advantage. As per Mohammad et. al., (2021), companies disclosing ESG-related information tend to perform better financially, socially, and environmentally, regardless of other competitive advantages they may have. High company ESG performance enhances market performance through the moderating influence of competitive advantage (Dkhili, 2024). Even today, financial consulting firms still believe that ESG factors are crucial for a company to maintain a competitive advantage over the long term (Heugh & Fox, 2017; Henisz et. al., 2019; Viertel, 2022; Gordon, 2023). Research revealed that sustainable funds experienced an unprecedented influx of investment in 2020, reaching a staggering $51.1 billion in the United States alone (Hale, 2021). ESG has emerged as a financial tool. It is a magnet for investors.

When ESG considerations intersect with sustainability and profitability, it sparks a crucial question: Can ESG be a way to achieve greater social and environmental impact while maintaining financial profitability, or does it compromise both objectives? Some people who follow the Friedman (1970) doctrine, which says that businesses should mainly focus on maximizing profits for shareholders, might see eye to eye with ESG investing (Authers, 2022). Indeed, ESG has be a potent investment strategy (Pino, 2022). ESG, in its early days, often leaned on qualitative methods. Yet, with the exponential growth in available ESG data, this has paved the way for a more quantitative approach for factor analysis (Orsagh, 2019).

Over the past couple of years, ESG investment is like a powerful trend that has swept through the financial and corporate sectors. However, this is not without contention. In recent years, there has been a growing backlash against ESG initiatives, posing significant challenges for many influential corporate leaders (Tett, 2023). Moreover, ESG-focused investing has become a contentious political issue (Doyle & Snyderman, 2024). For example, the Texas comptroller has enforced a law mandating state pension and school funds to divest shares in listed financial institutions that, according to the government's view, are actively boycotting energy companies (Masters & Patrick, 2022). European ESG funds are encountering a critical situation regarding their investment in fossil fuels following a ruling in France (Johnson, 2023). A few years back, Wall Street eagerly adopted sustainable investing. However, now it is discreetly shuttering funds or rebranding them after yielding unsatisfactory returns, leading investors to withdraw billions of dollars (Shifflett, 2023). One major supporter of ESG, who is the CEO of BlackRock, the globe's largest asset management firm, shared that he now avoids using the term "ESG" due to its politicisation and weaponisation (Worland, 2023). With this kind of momentum, ESG factors are losing prominence in importance in the modern business world (Unwala, 2023).

### 2.3 ESG Conundrum: A Social Catalyst or Corporate Distraction?

Once the "value-enhancing" and "investor-friendly" justifications are stripped away from ESG considerations, the only remaining argument is its benefit to society. However, even in this aspect ESG is perceived as destined for failure (Damodaran, 2023). Binder (2023) emphasises that ESG indices are not crafted to gauge a company's positive impact on the environment and society. Porter et al. (2019) warn that overly positive ESG reports might provide short-term satisfaction to investors and consumers, but they could also result in companies prioritising appearances over genuine social impact. This focus on image could detract from addressing critical social issues directly tied to the company's core activities. In today's dynamic business landscape, some are authentically committed to sustainability and social impact, while others indulge in "greenwashing" tactics or surface-level ESG initiatives to polish their image without backing it up with real action. Recently, the European Parliament (2024) ratified a new law targeting unfair corporate practices that obstruct consumers from making sustainable choices.

The ESG rating system is not perfect. Industries that are inherently unsustainable often exploit it as a chance to divert attention from the environmental and societal harm they cause (STOP, 2022). The WHO report (2022) highlights that the tobacco industry claims at least 8 million lives annually, while leaching 7,000 toxic chemicals into the environment. Surprisingly, these “lung blackeners” outperformed the world's largest electric vehicle manufacturer in ESG ratings (Glover, 2023). ESG ratings can be a risky strategy (Logan, 2022). Tobacco companies hide the detrimental effects of their operations by presenting themselves as a responsible corporate citizen through various CSR activities (Marshman et. al., 2023).

ESG data is riddled with numerous shortcomings. First, ESG scoring method often prioritise companies' internal procedures over the real-world effects of their products and services (Logan, 2022). Take, for instance, PepsiCo has consistently been recognised for its exemplary ESG reporting, earning the title for three consecutive years (Maiden, 2023). According to their most recent annual report, this food and beverage powerhouse has leveraged on its innovative roadmap, pep+, to enhance transparency regarding its health and safety protocols, achievements in reducing saturated fats, and climate objectives. While these accomplishments are noteworthy, they still leave us pondering the pivotal question if PepsiCo's products truly foster a healthier and more sustainable world. Second, ESG ratings can be quite diverse (Toplensky, 2023). It resembles a constellation without a fixed star (Tayan, 2022). For example, Marathon Petroleum was rated “A” by MCSI but “B” by S&P Global.

### 2.4 ESG Pursuit: A Double-Edged Sword for Sustainability and Eco-innovation

When delving into ESG practices, it is vital to examine how these frameworks integrate the concepts of eco-efficiency and eco-effectiveness. Eco-efficiency revolves around generating greater value with reduced negative impact (WBCSD, 2006), whereas eco-effectiveness optimizes positive outcomes (Hauschild, 2015). Relying solely on capitalism's drive for efficiency to address climate change and resource scarcity is overly optimistic and unrealistic (Jackson, 2009). In a 2023 CNBC interview, the CEO of Chevron faced scrutiny regarding the acquisition of Hess, a natural gas producer, and its potential impact on overall carbon emissions from production. He emphasised efficiency improvements, including a 25% reduction in carbon emissions within scope 1 and 2. Viewed through an environmental lens, the goal is not merely to be "better," but rather to achieve net zero emissions.

ESG compliance could demand companies focus on score improvements and short-term results, inadvertently entrapping them from nurturing the dynamic capabilities essential for long-term eco- effectiveness and innovation. Prioritizing adherence to ESG standards merely to sidestep penalties or protect reputation may cause companies to miss out on opportunities for transformative solutions that could propel them towards enduring sustainability (Kozma, 2023). Liang et.al., (2023) uncover a problematic duality in the connection between organisational resilience and ESG performance: it either superficially inflate innovation input, distorting ESG metrics, or, more concerning, fosters strategic inertia, hindering genuine progress in sustainable practices. The strategy of effectiveness is frequently overlooked (Herrmann, 2015). An eco-effective approach necessitates designing products from the beginning to be fully recyclable or biodegradable, considering the entire product life cycle (Diana, 2014). This cradle-to-cradle design (McDonough & Braungart, 2010) is like a game changer that does not settle for simply doing less harm but instead aims to unleash maximum positive impact (Toxopeus et. al., 2015). In ESG, eco-effectiveness stands as the overlooked gem in sustainability metrics.

Encouragingly, many manufacturers have started momentum through transitioning from single-use plastics to biodegradable alternatives. Take Colgate-Palmolive company, for example, they rolled out toothbrushes crafted from bamboo or wood, alongside recyclable packaging, setting a stylish trend in eco-friendly oral care (Sinclair, 2021). Plug-in vehicles, very green. But their environmental impact is not as straightforward as it seems. The way they are charged up and manufactured raises intriguing questions about their overall eco-effectiveness (Tabuchi & Plumer, 2023).

## 3.0 Discussion and Finding

### 3.1 Unlocking Sustainability Solutions: Aligning ESG with the UN SDGs

The concept of sustainability is far from novel. The core similarity between "sustainability" and "sustainable development" lies in their shared goal of conserving resources for the long term and ensuring the continuity of present systems into the future. However, the key difference between the two concepts emerges in their approach to “development” (Haas et.al., 2022). In fact, there is a wealth of literature on sustainability. Topics covered include methodologies for measuring sustainability (Bell & Morse, 2013), beyond sustainability (Edwards, 2010; Scheel, 2016; Lee et. al., 2017), case studies spotlighting sustainable practices across different industries (Nordin et. al., 2014; Khan et. al., 2021), and much more.

The notion of sustainable development was initially introduced in 1987 by the World Commission on Environment and Development (Jarvie, 2016). Fast forward to 2015, the Sustainable Development Goals (SDGs) were embraced by the United Nations as a global imperative, setting forth an ambitious agenda to eliminate poverty, safeguard the planet, and guarantee universal peace and prosperity by 2030. With the SDGs representing a global pledge encompassing 17 distinct goals, 169 targets, and 231 detailed indicators, they provide a holistic framework for evaluating a company's impact, both positive and negative. As ESG's lens narrows mainly on financial risks, vital dimensions of a company's sustainability performance remain obscured. It is essential for companies to disclose the broader impacts of their actions on both humanity and the environment (Binder, 2023). In this narrative, the SDGs emerge as a comprehensive canvas to vividly depict the complete picture.

Within the realm of ESG criteria, the SDGs serve as pivotal guideposts for companies' non-financial disclosure and reporting, injecting a dynamic dimension into corporate sustainability efforts (Berrone et al.,2023). Combining ESG principles with the SDGs opens up exciting avenues for directing capital towards specific societal and sustainability objectives (Markopoulos & Ramonda, 2022; Rowton, 2024). The SDGs serve as a nexus, consolidating various international agreements, initiatives, and spheres of activity pursued by actors at local, national, and global levels into a unified reference point (Nathalie & Schmidt, 2024). For instance, Huawei steps gracefully into the spotlight, harmonising its mission with the rhythm of SDG #9: Industry, Innovation, and Infrastructure. While Nike sets its compass needle straight for SDG #12: Responsible Consumption and Production (Strietman, 2020).

## 4.0 Conclusion

In today’s ever-shifting business panorama, ESG indices are not the indispensable tool or ultimate solution for perfectly measuring a company’s sustainability and securing a lasting competitive edge. Originally hailed as a marketing tool to connect with socially and environmentally conscious consumers, manage reputational risks, and woo investors, ESG experienced a golden decade of growth. However, it is now navigating a maze of challenges. Critics argue that ESG's environmental (E) focus often veers into greenwashing territory, offering little real impact on combating climate change. Meanwhile, the social (S) dimension of ESG has become a political battleground, overshadowing governance (G) concerns. The lack of a universal ESG rating system only exacerbates the issue of inconsistency. Furthermore, this paper has underscored the importance of moving beyond mere efficiency gains towards proactive measures that yield tangible positive outcomes for both society and the environment. Despite the recent ESG backlash in the U.S. and Europe, certain companies still soldier on with their ESG efforts, seeing it as good for business success. As the business world evolves, integrating ESG principles with SDGs will be crucial for building resilience and sustainability.

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