Study on the Impact of the Emergence of ESG Concept on Corporate Strategy

Ruizi Tang[1,2], Guangyu Liu[1,2,*], Yiyang Liu[3], Jingyu Yang[4], Ziyi Huang[5]

[1]Economics, Dalian University of Foreign Languages, Liaoning, China
[2]Financial management, Jilin University of Finance and Economics, Changchun, Jilin, China
[3]Business Administration, Xiamen University, Xiamen, Fujian, China
[4]E-commerce, Xiamen University, Xiamen, Fujian, China
[5]Financial Management, Xiamen University, Xiamen, Fujian, China

*Corresponding author e-mail: 3146231338@qq.com

Abstract. The concept of ESG has been proposed in 2007 and has become a hot topic in the past two years. The concept of ESG investment refers to that in addition to paying attention to traditional corporate profits and financial status, investors should also consider the corporate and social value reflected in environmental, social and corporate governance factors in the decision-making process. The contribution of this paper is to analyze in detail and derive the influence mechanism of ESG concept on how companies set their corporate strategic goals and corporate strategic planning.

Keywords: ESG; corporate strategy; strategic objectives

1 Introduction

ESG stands for corporate environmental, social and internal governance, and is one of the concepts of sustainable development. The publication of ESG ratings represents the current level of implementation of sustainable behaviors and the trend of future sustainability potential. From an environmental (E) perspective, ESG investments focus on climate change, resource consumption, waste, pollution and deforestation; From a social (S) perspective, ESG investments focus on human rights, modern slavery, child Labour, working conditions and employee relations; From a corporate governance (G) perspective, ESG investments focus on bribery and corruption, executive compensation, board diversity and structure, political lobbying and contributions, and tax strategies [1][2]. The ESG performance of an enterprise reflects its environmental awareness, commitment to social responsibility and governance level, and can convey the enterprise value orientation that traditional financial information cannot express[3].Subsequently, numerous studies have shown that there is a significant positive relationship between good corporate social practices and corporate social value [13], i.e., a high ESG score not only increases corporate value, but also contributes to the reduction of financial risk and the alleviation of corporate financing constraints [4][5].

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Current academic research in ESG is limited to ESG on corporate value, corporate financing constraints, corporate share price collapse risk, and corporate finance, but there is still a gap in China on how the generation of specific ESG concepts affects the formulation of corporate strategic goals and planning. The contribution of this paper is to analyze and derive the influence mechanism of ESG concept on how to formulate corporate strategic objectives and corporate strategic planning in detail, which provides certain reference contents and paths for subsequent researchers to study the formulation of corporate strategic objectives and planning or ESG.

2 Literature Review

In the study of the impact of corporate strategy on intra-firm aspects, Geng, Xin and Wang, Xianglu (2021) studied the impact of independent directors' network embedding on corporate strategy based on the moderating effects of redundant resources and environmental uncertainty, and the empirical results showed that the richness of both the centrality and structural holes of the embedded independent directors' network was positively related to corporate diversity strategy; both redundant resources and environmental uncertainty positively moderated the location and diversity strategy, while the combined effect of redundant resources and environmental uncertainty negatively moderates the relationship between network location and diversity strategy [6]. Based on the industry competition perspective, Zhang Junling (2023) studied the impact of corporate strategy differences on the level of risk-taking based on A-share listed companies in China from 2010 to 2020, and the results showed that the higher the degree of corporate strategy differences, the higher the level of corporate risk-taking, in addition, the impact mechanism test surface that the degree of corporate strategy differences improved the corporate agency problem while promoting the level of risk-taking [7]. In the study of the influence of the external environment on corporate strategy, Lian Yanling et al. (2022) studied the impact of negative media coverage on corporate strategy based on a social performance feedback perspective, and the results of the study indicated that negative media coverage as a negative social performance feedback can promote the adoption of substantial additional social responsibility response behavior [8].

In ESG-related studies, Zhang Maohuan and Zhao Zhiyu (2023) sorted out the current situation of ESG information disclosure in China and empirically analyzed the impact of ESG information disclosure on Chinese enterprises. They concluded that the higher the batch quality of ESG information, the higher the value of enterprises and the lower the financing cost of enterprises have a significant promoting effect. For enterprises of different nature and scale, the promotion effect is obviously different. For non-state-owned enterprises, improving the quality of ESG disclosure can improve their enterprise value and reduce their financing costs, but for state-owned enterprises, higher quality of ESG disclosure will reduce their enterprise value and have no significant impact on their financing costs. For polluting enterprises or enterprises of different sizes, better quality of ESG information disclosure is conducive to the improvement of enterprise value, but in terms of financing cost, it is more conducive to the reduction of financing cost for polluting enterprises and large enterprises [9].Tang Kaitao et al. (2023) studied the ESG rating and audit report decision of listed companies from the perspective of information generation and information disclosure behavior. The research results showed that the higher the ESG rating of listed companies, the greater the probability of auditors issuing positive audit reports. Mechanism test shows that ESG rating can affect auditors' behavior decisions on audit report by influencing information generation behavior (improving enterprise operation and management) and information disclosure behavior (reducing information asymmetry). Heterogeneity analysis shows that the positive impact of ESG rating on audit reporting behavior is more obvious when the regional institutional regulation intensity is greater, the enterprise is non-state-owned and non-polluting, and the internal control is more effective[10].Wei Xiuli (2023) deeply analyzes the motivation, process and results of ESG management in enterprises based on behavior-based analysis framework. According to her analysis, it can be seen that for enterprises, ESG behavior based on external motivation is completely to follow external rules "Compelled" actions to satisfy external requirements of legality or compliance; Driven by the acceptance motivation, The implementation of ESG by enterprises is still subject to external control, mainly to avoid losses. Therefore, in order to better meet social requirements and reduce losses, enterprises have to start to implement ESG, so as to show the side of sustainable development of enterprises[11].

3 Impact of ESG concept on corporate strategy

Under the current comprehensive background, the government, the public, investment institutions in the capital market and partners of the industrial chain begin to pay more attention to the social value and corporate governance practices of enterprises, and pay more attention to the long-term value of companies. Sustainable consumption is moving from a vision to a reality, and changing consumers and communities are influencing innovations in business models and marketing. The latest global research shows that sustainability has gone from niche to mass, with sustainable brands growing five to six times faster than non-sustainable brands across a wide range of product categories. ESG is the path guide of sustainable development and an important framework for enterprises to understand the risks and opportunities they will face in the future. Effective transformation supported by ESG can help enterprises build sustainable competitive advantages. There are multiple interests involved in ESG goals, and sometimes difficult negotiations are needed to balance conflicting demands.

From the perspective of society, the original economic development model has been unable to solve the severe environmental and social challenges faced by the current society. ESG is the fundamental means for the whole society to promote the transformation of enterprises from the producer to the solver of environmental and social problems. At the enterprise level, ESG is a tool and framework to effectively assess and manage the major risks and opportunities caused by changes in the external macro environment.

The core purpose of an enterprise is to create value. The role of corporate strategy is to maximize value by choosing the path, balancing priorities and sequencing. Then, what is the relationship between ESG - corporate environmental, social and governance responsibility - generally known as "corporate social responsibility" in China, and corporate strategy? From a financial perspective, the value of a business comes from the return on investment and the growth in the size of that investment. Therefore, the most important source of corporate value is a high and sustainable return on investment. Growth works by scaling proven business models to larger and more application scenarios. The value of a business must be long-term value, from long-term sustainable ROI, and its volatility in the short term is often a small percentage of the overall value of the business. If we switch out of the financial perspective and look at the enterprise from the perspective of society. We find that the long-term interests of business and society are highly aligned.

In addition, as the basis of socially responsible investment, ESGs are an important part of the green finance system. The carbon emission and other indicators included in the environmental dimension of ESGs can effectively measure the practice of enterprises in helping to achieve the "two-carbon" strategic goals[12]. From the CSR reports of many domestic listed companies, it is found that at present, domestic enterprises still pay more attention to the production optimization of products, the improvement of manufacturing process, social welfare donation, etc., and the systematic construction and the cultivation of relevant capabilities need to be improved.Business is a part of society, and in the short term it is possible for business to be good but society to be bad, or for society to be good but business to be bad. But this difference is unsustainable in the long run - without a good business, society has no economic base; without a good society, the business loses stable, quality customers, and therefore has no value to survive. So from the perspective of society, the enterprise creates value by first creating social value, and then a portion of it stays in the enterprise. Creating social value is a prerequisite; what percentage is left to the enterprise is determined by the industrial structure and competition pattern of the enterprise.

If the choice of the enterprise and the choice of society overlap, we say that "the enterprise has fully fulfilled its corporate social responsibility". However, in the vast majority of cases, the choices of enterprises and the choices of society do not completely overlap. What companies want to do when they are alive is to stay alive, and preferably to live better. And to do that, companies must maximize revenue, reduce costs, and beat competitors through the market's pricing system. Competition in the market makes it impossible for companies to stand alone outside the laws of the market. But such a problem arises: as mentioned earlier, the value of society is multifaceted, but the market is in most cases imperfect and cannot cover all dimensions of social value; there are things for which the market is explicitly priced, and there are things for which there is no price for the time being. Businesses operating under the laws of the market naturally focus on what is explicitly priced and ignore what is not in the price system, and so there is environmental pollution, and so corporate behavior produces damage to the interests of society. Why are some things that are important to society not introduced into the price system? A major reason is the delay in human cognitive and political processes.What should companies do in this social and economic iteration? One scenario is to ignore the issue of climate change and do what they were doing and still do. This approach was not a big problem in the early and middle stages of the problem's development, but is actually very unwise, and even dangerous, today when a social consensus has emerged. Completely ignoring the climate problem will cause a major conflict between business and society in terms of fundamental interests, and in time, society will naturally issue sky-high fines to business through economic and political means.

Another situation is to be proactive, to be at the forefront of the climate change issue, to take the initiative to reduce carbon before a consensus is formed in society, and to make the enterprise's own example to solve the world's problems. This approach is morally admirable, but if put into practice it often results in companies being unable to survive due to high costs. Social problems need to be solved collectively by society, and world problems need to be solved collectively by the world; enterprises cannot solve social or world problems independently. Since neither of the above black-or-white approaches works. What should companies do? The answer is that companies should go ahead of their competitors, but they must follow the general trend of the world and society. The general trend determines the direction and speed of things, and the influence of enterprises is extremely limited, but as long as they can keep pace, they will not lag behind. As companies face ubiquitous competition, following the general trend to get ahead of competitors can bring long-term and sustainable competitive advantages to companies.In addition, as a corporate citizen in society, it is important to see not only the E and S, but also the G (Governance). Drucker, the master of management, said that the primary social responsibility of a company is to run its business first. If a company does not make money and has no healthy operation, there is no way to talk about sustainable development. From countries to companies, sustainable development in the true sense cannot be achieved without a change in governance.

In China, ESG has taken a different path. We started with S in the earliest days, but now we have proposed the construction of an ecological civilization society, and the overall economic and social governance has changed. In order for a company to develop sustainably, it must focus on harmony between people and nature, not at the expense of the environment, but also on multiple interests, including the development of employees, the well-being of consumers, the common growth of supply chain partners, the progress of the community, and so on. Whereas in the past corporate governance was based primarily on financial indicators in board decisions, today the connotation of corporate governance has changed in essence. More and more countries are mandating the inclusion of environmental and social issues in corporate strategic planning in national governance. Companies have to consider not only how to make money, but also how to avoid environmental and social risks and how to develop synergies with external stakeholders. For example, in Europe, a special emphasis is placed on the need for a certain number of seats for women in the structure of the board of directors because, in some university follow-up studies, it was found that companies with a certain percentage of women on the board performed better in terms of sustainability competitiveness and touched fewer minefields.

4 Conclusion and Implications

In general, corporate and social values overlap in the long run. Companies that neglect "social responsibility" will be punished by society and will be eliminated. However, "social responsibility" is a dynamic concept, subject to the slow process of social consensus formation and deduction; the end of the deduction process is the political process of transforming "social responsibility" into explicitly priced commodities or regulatory provisions. The responsibility for the formation of social consensus lies with society as a whole, with the government playing a decisive role. Businesses are only part of society and have the initiative, but generally do not have sufficient resources or influence to lead. Until social responsibility is transformed into a market mechanism, companies that fulfill their "social responsibility" are bound to incur higher operating costs and therefore lower their profit margins. However, this kind of action is actually laying the groundwork for the future. Socially responsible companies are actually acting in accordance with the trend and gaining a long-term competitive advantage at the expense of short-term benefits. Since the value of a company does not come from the short term, but from a sustainable return on investment in the long term, being socially responsible is also a form of corporate value creation.

Sustainable growth has become a widely accepted mission. However, implementation is much more complex, as companies must balance the needs of different stakeholders and the natural environment. At the same time, automation, digitization and digitization are accelerating the scale and pace of business transformation. Implementing an ESG program is critical for companies that want to integrate environmental, social and governance considerations into their business operations. A well-implemented ESG program can help companies reduce risk, improve brand reputation and create long-term value for stakeholders.

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