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Integrating ESG and Corporate Social Performance

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Abstract

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This research investigates the integration of Environmental, Social, and Governance (ESG) factors into Corporate Social Performance (CSP), a subject of increasing relevance as sustainability becomes a priority for both individuals and financial service providers. Despite the growing demand for sustainable investment options, the challenge persists in accurately assessing a company's sustainability practices. The variability in ESG scores, the complexity of regulatory frameworks, and the prevalence of green hushing—where companies selectively promote their sustainability efforts—complicate the consumer's ability to evaluate corporate sustainability.
The research traces the development of ESG starting from its roots in Corporate Social Responsibility (CSR) and underscores the necessity of universal guidelines that increase the credibility and comparison of the ratings of ESG. It advocates for a nuanced, industry related view to governance considerations, recognizing that ESG is a crucial link between financial performance with environmental, social, and governance issues. The study emphasizes the importance of evaluating companies' sustainability practices through the lens of ESG, while acknowledging the challenge of creating a framework that is both inclusive of all business types and reflective of their diverse characteristics. Variations in ESG ratings are attributed to the distinct attributes of different industries, and the lack of precision in non-financial measurements is highlighted. To overcome these challenges, the thesis proposes that ESG must be tailored to industry specifics and maintain transparency to effectively direct capital towards the transition to carbon neutral and more sustainable business. The establishment of trustworthy metrics, akin to those in the ESG rating industry, is suggested as a means to foster ensuring equitable competition among businesses while prevent unwanted behaviours like greenwashing. This thesis concludes that the attention should rather be in developing specific criteria for business instead of adopting a one universal model, to ensure that ESG integration into CSP is both meaningful and effective.

Keywords: ESG, CSP, Corporate Social Responsibility, ratings

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1 Introduction

This research explores the relationship between environmental, social and governance (ESG) factors and Corporate Social Performance (CSP), offering a perspective on how these elements interact to shape corporate practices and influence stakeholder perceptions and company value. In an era where sustainability and corporate responsibility are increasingly under the spotlight, the integration of ESG criteria and CSP has become an area of interest for businesses, investors, and policymakers. However, the measuring systems of ESG are still not waterproof and there is no universal standardisation. A significant fact is that the Systemic impact of ESG rated companies is biggest at the extremes of the rating spectrum, so the best and worst rated ESG companies have the biggest systemic impact in society (Bax et al 2022). This highlights the importance of standardised ESG measurements. The Boohoo Scandal in 2020 was a particularly conspicuous example of the problems of ESG, when the fast fashion brand Boohoo Group PLC had high ESG ratings from multiple rating agencies but later it was found to underpay their employees in an unsafe working environment. This was uncovered at the height of the coronavirus pandemic, due to the concentration of infections found in a particular area of the city of Leicester, England (Mooney and Nilsson 2020).

Research has attempted to define and explain the concept of Corporate Social Responsibility (CSR). The history of CSR shows how it has evolved significantly over the decades, transitioning from a purely philanthropic activity to a complex, strategic framework that integrates social, environmental, and economic considerations. The emergence of ESG as a critical component of corporate evaluation further underscores this shift, highlighting the need for companies to address a broader spectrum of non-financial factors that affect their operational and financial performance. Additionally, Stakeholders in corporate environment are explained and their main motives are the subject of continuous discussion, theorisation and analysis.

The research issue for the thesis is: “Integrating ESG and Corporate Social Performance”. The writer understands the complexity of the topic and will focus on the

qualities in ESG but also its problems and possible improvements. The research is based on academic articles using secondary research by comparing and observing the data and evaluating the results accumulated within the literature on this topic. This thesis aims to explore the integration of ESG into CSP, examining the theoretical underpinnings, practical applications, and the challenges faced by corporations in aligning their CSR strategies with ESG criteria. It seeks to answer important questions about the productiveness of ESG measures, the reliability of ESG ratings, and the actual impact of these practices on a company's social and environmental footprint.

The thesis is divided into a literature review and discussion part. In the literature review CSP, ESG and CSR are explained and analysed. The explanation goes through the history of each topic, and how each has evolved. In ESG the writer explains all the elements of ESG—Environmental, Social and Governance—and, as a combination of these, its purpose and importance in wealth management strategies. The governance part of ESG has been questioned on grounds of should it be part of the ESG framework at all, since Governance tends to have a bigger impact in the short term because it reflects immediate risks like fraud, while environmental and social issues have a longer-term effect (Friede et al., 2020). In addition, what constitutes good governance might be contrary to responsible practice relating to environmental and social factors, if “good governance” is defined as shareholder value maximisation, as indeed it is in standard finance textbooks. As a result, grouping together environmental, social and governance factors in one single measure of performance might be the corporate responsibility equivalent of an oxymoron.

The primary objectives of this research are: (1) defining CSP; (2) evaluating the Impact of ESG on CSP, by assessing how ESG practices influence CSP, particularly looking at the dimensions of environmental management, social responsibility, and corporate governance. Also, (3) to analyse the Integration of ESG into CSR Practices, including examining how companies incorporate ESG factors into their CSR strategies and the implications of this integration for corporate governance and stakeholder engagement. Ultimately, the thesis attempts to identify challenges to measuring and reporting both ESG and CSP by linking them more explicitly, and to propose solutions to these challenges and obstacles such as to enhance the accuracy, reliability, and effectiveness of these measures.

This thesis is particularly relevant in the current business environment, where sustainability and ethical considerations are recognised as critical to corporate success and even survival. By providing a deeper understanding of how ESG integration affects CSP, the study aims to contribute to the ongoing discussions on sustainable business practices and offer valuable insights for companies, investors, and regulators aiming to enhance corporate accountability and societal welfare.

1 Literature review

1.1 Corporate Social Responsibility (CSR)

As a concept Corporate Social Responsibility (CSR) is a topic that has been widely discussed and debated in the academic and business communities. The definition of CSR has evolved over time, and various scholars have proposed different definitions to capture its essence. As per Carroll (1999), Corporate Social Responsibility (CSR) entails a management philosophy focused on addressing external impacts, encompassing the responsible handling of a company's operational effects on stakeholders, society, and the environment.

The concept of CSR has a rich and intricate history. The idea of CSR emerged as a response to the increasing concerns related to the social and environmental impacts of business activities, and when economist Howard Bowen stated that businesses should consider the impact of their operations on local towns and environment as a way of just focusing making profit in short term. In the 1950s and 1960s, companies began to recognize the importance of social responsibility, and the concept of CSR started to take shape (Carroll, 1999). The 1970s saw the application of traditional management functions to CSR issues, while the 1980s saw a closer alignment of business and social interests, with firms becoming more responsive to their stakeholders (Porter & Kramer, 2006). Bowen’s original idea was recreated by Edward Freeman, who wrote a book called *Strategic Management: A Stakeholder Approach*. In the book he stated that business executives should do more than just focus on the local towns and environment since it effects their long-term business and profits. Freeman stated that businesses should actually focus creating value for multiple “stakeholder” groups instead of only profitability for stakeholders. This opened the door for different activist groups who had

strong views about what they thought the companies should do, which led them to take up the title of a “stakeholder” (Mueller, 2023).

In the 1990s there was a significant shift in the way companies approached CSR and the concept of sustainability in general, by adding to consideration of environmental, and social dimensions also governance (ESG) factors, with the latter becoming increasingly important due to various corporate scandals that began to unfold at the beginning of the 1990s (Eccles, Ioannou & Serafeim, 2014). Meanwhile, growing concerns about climate change, environmental degradation, and social inequality added to concerns over corporations’ social and environmental impact, as reflected in the emergence of concepts like the Triple Bottom Line, developed by John Elkington. Companies began to recognize the importance of integrating ESG considerations into their business strategies, and CSR became a critical component of this approach (Kotler & Lee, 2005).

The 2000s saw a further evolution of CSR, with the concept becoming more mainstream and widely accepted (Eccles, Ioannou & Serafeim, 2014). Companies began to report on their CSR performance, and the concept of CSR became more formalized (Kotler & Lee, 2005). The 2010s saw a significant increase in the adoption of CSR practices, with companies recognizing the importance of ESG considerations in their business strategies (Eccles, Ioannou & Serafeim, 2014). In 2006 ESG was first discussed when United Nations published its report about principles for responsible investing (PRI). The report itself included so called “who cares wins” theory and the Freshfield Report. This was first time that ESG criteria was linked to the financial evaluation of a company. After this the significance around ESG has been growing rapidly since investors want to see commitment from corporations to ESG principles (Atkins, 2020).

According to Stobierski (2021) Corporate Social Responsibility has four types: environmental, ethical, philanthropic, and economic responsibility. Environmental responsibility is highlighting organizations behaving in environmentally friendly ways, often referred to as CSR. Some use the term "environmental stewardship" for these initiatives. Companies can achieve this by reducing harmful practices like pollution and waste, regulating energy consumption, and offsetting environmental impact through actions like tree planting and funding research. The ethical part focuses on organizations responsibility operate fairly and ethically, treating all stakeholders justly. This includes leadership, investors, employees, suppliers, and customers. In practice companies can adopt ethical responsibility through setting higher minimum wages than mandated by law

and source products according to free trade standards to avoid supporting slavery or child labour. Philanthropic responsibility is a business's commitment to improving the world and society. Beyond ethical and environmental practices, such companies allocate a portion of their earnings to charitable endeavours. Some donate to causes aligned with their mission, while others support diverse initiatives or establish their own charitable organizations to make a positive societal impact. Economic responsibility involves firms aligning financial decisions with a commitment to social good. The aim extends beyond profit maximization to ensuring positive impacts on the environment, people, and society (Stobierski, 2021).

At its core CSR is about how corporations are managing their business processes in order to produce a positive impact on society overall. It is rooted in corporate ethical responsibility, emphasizing the moral obligations of companies towards their stakeholders, meaning communities, employees, and the environment. CSR extends beyond voluntary acts of charity and encompasses mandatory practices that align with broader societal goals, such as ethical business practices and sustainable development (Lucia et al, 2019). Unlike ESG criteria, which serve as a certain set of standards for firms' operations that socially active investors use to evaluate promising investments, CSR is more about a company's holistic approach to ensuring its operations enhance societal goals (Genedy & Sakr, 2017). Thus, CSR is not just an idea but a strategic framework that integrates social, ethical, and environmental concerns into business operations.

1.1.1 Stakeholders in corporate environment

There are numerous definitions of CSR, each with its own nuances, often acknowledging the inherent asymmetry in stakeholder relationships, wherein certain groups may hold more influence or power than others. For example, "*all those who are affected significantly by the company's actions''* (Carson 1993) or *''directly affected by the operations of the firm''* (Lea, 2004). These definitions presented lack any assertion or capability to exert influence.

The Corporate Finance Institute provides an example about the different stakeholders that include customers, shareholders, employees, communities, governments, and suppliers. They have divided stakeholders in 6 different groups with a suggestion of a main interest of each stakeholder group (Corporate Finance Institute 2024).

Customers

Many believe that businesses exist to serve their customers since customers are stakeholders affected by the quality and value of products/services. More fundamentally, without customers, there would be no business. As Peter Drucker stated already in 1954 in *The Practice of Management*, the purpose of a business is to create a customer. This was later augmented by keeping the customer (Vohra and Muhul 2009: 2). As an example of the lengths to which companies must go to do this, airline passengers entrust their lives to the company when flying, underscoring the significant impact businesses have on their customers. This suggests that the main interest of the stakeholder group "customers" is product/service quality and value (Corporate Finance Institute 2024).

Employees

Employees hold a direct stake in the company as they earn income and receive various benefits, both monetary and non-monetary, to support themselves. Additionally, depending on the business type, employees may have a particularly strong interest in health and safety, especially in industries like transportation, mining, oil and gas, construction, etc. Therefore, we can make a conclusion that for the stakeholder group "employees" the main interest towards the company is employment income & benefits and safety (Corporate Finance Institute 2024).

Investors

Investors comprise shareholders and debtholders, with shareholders investing capital and anticipating a specific rate of return. The overarching concern for investors is often the concept of shareholder value. This group also includes other capital providers like lenders and potential acquirers. While all shareholders are stakeholders, it is important to note that stakeholders are not necessarily shareholders. For this stakeholder group "investors" we can make the conclusion that their main interest is financial returns (Corporate Finance Institute 2024). Nevertheless, it is important to note that the timing of these returns is not the same for all investors, making the concept of profit maximisation or shareholder value maximisation practically impossible to apply in practice.

Suppliers and Vendors

Suppliers and vendors play an important role by selling goods and services to the business, depending on it for revenue and ongoing income. In various industries, suppliers may also have their health and safety at stake, particularly if they are directly involved in the company's operations. Therefore, for this stakeholder group—“suppliers and vendors”—the main interests towards the company are revenues and safety (Corporate Finance Institute 2024).

Communities

This stakeholder group is probably the hardest one to define since it can basically be anyone (individual or community) that is affected by the company. Communities serve as significant stakeholders for large businesses situated within them, being affected by various factors, such as job creation, health and safety considerations and economic development. The entrance or exit of a major company can swiftly and substantially impact employment, incomes, and local spending in a community (Corporate Finance Institute 2024).

As an example, one of the biggest steel factories in Finland SSAB Raahe is employing 2.500 people in the city of Raahe and additionally hundreds of sub-contractors (SSAB 2024). Therefore, it has a huge impact on the people and community of Raahe since it brings a lot of taxes, jobs and influence on the communities around it. If something would happen or they would decide to run down the factory it would have a big impact on the people living in Raahe. Additionally, in certain industries, there's a potential health impact as companies may modify the environment. In this stakeholder group we can define that their main interests as a stakeholders are health, safety, and economic development (Corporate Finance Institute 2024).

Governments

Governments are significant stakeholders in businesses, collecting corporate income taxes, payroll taxes from employees, and sales taxes from company spending. They benefit from the overall Gross Domestic Product (GDP) contribution made by companies. For government point of view this article suggests that the main interests for the stakeholder group “governments” are taxes and Gross Domestic Product (GDP). But since, the research is focusing on ESG additional research would have to be done regarding the other interests that governments might have towards companies

from ESG perspective like pollution, social impact, and good governance (Corporate Finance Institute 2024).

It is rather easy to see that stakeholders have different interests; this makes companies often face challenges trying to balance and satisfy them all. As stated above different stakeholders have different interests.

1.2 ESG

ESG stands for Environmental, Social, and Governance, and describes the principles of sustainability within business practices. Sustainability, often treated as synonymous with ESG, concerns how a company's services and products are contributing to sustainable development and how it manages its operations to minimize negative impacts. It encompasses aspects such as environmental conservation, social responsibility, and effective governance. In the area of financial entities, ESG plays a crucial role in wealth management strategies. This involves integrating ESG considerations into investment decisions, assessing companies based on their impact for the environmental, social responsibility initiatives, and governance practices. By prioritizing ESG factors, financial entities aim to promote sustainable growth while mitigating risks associated with environmental degradation, social inequality, and poor governance. Understanding ESG and its significance in business decisions is crucial for fostering responsible and sustainable business practices that benefit both companies and society as a whole (Nordea 2023).

1.2.1 Environmental

The “E” is the environmental aspect of ESG (Environmental, Social, Governance), placing a focus on evaluating the environmental impact of a company's operations. This assessment takes into account various factors, including the company's carbon footprint, energy efficiency measures, and its approach to waste management (Nordnet 2024). Another component of this evaluation involves ensuring that the company refrains from using toxic chemicals in its manufacturing processes and other operations. Furthermore, a commitment to sustainability throughout the supply chain is measured to this aspect of ESG. This entails a strategic approach that goes beyond the company's immediate operations, extending to its broader network of suppliers and partners. By addressing

these environmental considerations, a company demonstrates its commitment to responsible business practices and contributes to a more sustainable and eco-friendly business ecosystem (Napoletano 2024).

1.2.2 Social

The “S” is the social cluster within the ESG framework and involves a comprehensive evaluation of the company's interactions not only with its employees and customers but also the broader societal impact it generates. This entails an examination of various aspects, including working conditions, diversity initiatives, and the company's adherence to human rights standards (Nordnet 2024). Beyond the internal dynamics, the assessment extends to how the company contributes to social impact within its immediate workplace and in the larger communities it operates in. Social factors, critical to this evaluation, encompass areas such as racial diversity, LGBTQ equality, in both staff and executive positions, as well as the effectiveness of hiring practices and inclusion programs. Furthermore, the assessment delves into how the company extends its influence for social good on a global scale, transcending its immediate business operations and contributing to broader societal welfare (Napoletano, 2024). By thoroughly examining these social factors, a company demonstrates a commitment to fostering an inclusive, diverse, and socially responsible environment both within and beyond its organizational boundaries.

1.2.3 Governance

In the ESG framework, the "G" represents governance. This is essentially about how a company makes its strategic and financial decisions, and runs its operations. Governance takes a close look at the company's internal structures, rules, and overall management. This involves checking various aspects like the composition of the board, how much the top executives get paid, how clear and honest the company is about its operations, and whether it adheres to ethical business practices (Nordnet 2024).

But governance is not just about following rules; it is also about how the company's leaders contribute to making things better. It checks whether there is diversity in the leadership team, ensuring that different perspectives are considered. Additionally, governance evaluates how well these leaders respond to and work with the shareholders (Napoletano 2024). So, in essence, governance goes beyond the rulebook; it is about

how leaders drive positive changes, encourage diversity in decision-making, and interact with the individuals who have a stake in the company's success.

However, its inclusion and significance within the ESG framework have been questioned. While governance considers factors such as board composition, bribery and corruption, and executive compensation, which are crucial to corporate responsibility and risk management, some question if they should be grouped together with environmental and social issues. Studies have highlighted the differences in ESG ratings, with governance indicators being a primary driver, raising questions about the standardization and transparency of ESG measurements (Fiori et al., 2021). Furthermore, governance tends to have a bigger impact in the short term because it reflects immediate risks like fraud, while environmental and social issues have a longer-term effect (Friede et al., 2020). This conflict suggests a potential misalignment in the weighting of governance factors relative to environmental and social concerns, which may undermine the whole idea of looking at ESG as a whole. The ongoing debate calls for a re-evaluation of the G pillar's role within ESG frameworks, emphasizing the need for a more nuanced understanding of its contribution to corporate sustainability and performance (Bush et al., 2021).

1.2.4 Systemic impact of ESG rated companies

Bax et al. (2022) conducted an empirical study that questioned “Do lower ESG rated companies have higher systemic impact?” They compared hundreds of ESG rated companies in the US and in Europe between 2007-2022. Companies were divided to 4 groups based on their ESG rating, A, B, C and D, where those rated A have the highest ESG rating and D the poorest. Analysing the relationship between systemic risk and ESG scores, they found that the relationship between the companies in the study and the overall system is becoming more relevant when they are both in distress; these distress periods are for example COVID-19, the US sub-prime crisis and EU sovereign debt crisis.

The result was that when the economy is in stressed state the most sensitive companies belonged to the extremes A and D class because they receive more attention from the market. The study suggests that still the A rated companies likely are more flexible and have less systemic impact because they are overall more durable and therefore don’t have as much systemic impact due to the evaluation they record with respect to non-

financial information, as seen in the ESG scores. Meanwhile D rated companies were found having more systemic impact due their idiosyncratic risk (Bax et al 2022).

The European Banking Authority states that the Environmental or “E-pillar” of ESG could significantly affect the whole financial system and cause the biggest systemic impacts due to the scale and complexity of the environmental risks. This indicates that the E-pillar of ESG could be the most important when looking from the systemic impact perspective (Bax et al 2022).

The study also pointed out that that the results are not always consistent. For example, evidence was found when analysing the data during the COVID-19 pandemic. They noticed that high G-pillar score in the US data actually might lead to higher systemic risk impact than low G-pillar data, but they also mention that more research is needed to study the impact of single pillars, to generate more trustworthy results (Bax et al 2022).

1.2.5 Differences between US and Europe

The European Union (EU) has been known to be the trendsetter in sustainable finance and ESG integration. The EU’s ambitious sustainability goals and regulatory framework have set high expectations for sustainable finance standards, creating a lot of initiatives for promoting ESG and sustainable finance. The EU has for example created a holistic classification system, the EU Taxonomy, which indicates clear criteria for identifying sustainable financial activities. Regulations have also been made about Sustainable Finance Disclosure that mandate corporations to disclose ESG-related information. The EU has also committed to become carbon neutral by 2050 (Vonner 2023). In the EU the largest gap between the ESG rated companies was in the D-class which are the poorest performers in the ESG ranking. This means that in Europe the biggest differences in the Environmental pillar of ESG are in the weakest ESG performers, so some of them score low but some score even more significantly lower. In other pillars like Social and Governance there was no significant differences between the compared company groups (Bax et al 2022).

The US is lagging behind when it comes to regulations within ESG, even though Securities and Exchange Commission (SEC) has shown interest in standardizing the reporting for investors. According to the article the US is also very divided and there is also so called “Anti-ESG movement” who wants to take distance from the sustainable-

related themes. This causes difficulties and challenges to investors and asset managers because they have to think whether to apply the sustainable strategies or take the risk of falling behind (Vonner 2023). Unlike in EU the United States (US) has a strong private sector leadership where big corporations lead the way with their own example by setting ambitious goals about their ESG performance while some want just to look “green”. This might explain why unlike in the EU in United States the biggest gap in the Environmental pillar of ESG rated companies is in the best performing group A instead of D. Like in the EU there were no significant differences in Social and Governance pillars. (Bax et al 2022)

In conclusion, we can see that in European Union they trust more on regulations and standardised frameworks, whereas the US trusts more on the market driven model where the private sector would solve the problem with the financial leverage and new technologies. Both have their problems. The EU’s strict regulations might bring challenges to following the regulations whereas in the US trusting on the market might lead to unstable progress in different industries (Vonner 2023).

If we could combine the best practices from both markets, it could bring synergies that could accelerate ESG. The International Sustainability Standards Board (ISSB) proposed in 2023 Global disclosure standards that allow companies and investors to standardise the regulations based on a single, worldwide baseline of sustainability regulations for the capital markets, with any additional jurisdictional requirements being built on top of this global baseline. Having aligned reporting standards like ISSB combined to joint green investment projects would be a good start to developing ESG (IFRS, 2023).

1.3 ESG Ratings

Socially Responsible (SR) investments typically undergo a screening process, which generally falls into two main categories: negative and positive approaches. In the negative approach, certain industries deemed undesirable, such as gambling, tobacco, alcohol, or weapons, are excluded from consideration by raters. Conversely, the positive approach evaluates companies based on their Corporate Social Performance (CSP) measures, which assess their Corporate Social Responsibility (CSR) decisions. This screening method involves in-depth research, often conducted by specialized "raters" or

institutions, who provide Environmental, Social, and Governance (ESG) ratings. These ratings gauge a company's commitment and effectiveness in addressing environmental, social, and governance issues (Dorfleitner et al. 2015).

ESG scores are developed and provided by various rating providers, and they are intended to evaluate companies' ESG performance through a range of criteria, measurements, using both quantitative and qualitative methods. These scores usually are evaluated in a scale between 0 and 100. Higher ESG scores signify more responsible ESG practices. Additionally, ESG scores are often linked to a rating class (such as A, B, C, or D) based on thresholds or quartiles of the ESG score values. There are many different raters and institutions measuring ESG performance. Their purpose is to provide data which would help investors to better understand their portfolios and investments. The biggest ESG rating providers according to Lovas (2023) are Bloomberg ESG Disclosures Scores, MSCI ESG Ratings, Sustainalytics' ESG Risk Ratings and S&P Global ESG Score.

Quantive highlights an important fact about the ESG ratings; there is no universally applied set of ESG metrics, and the regulations and definitions are chancing constantly. This makes ESG or socially responsible investing (SRI) hard to measure in a good way. At the moment the most common ESG metrics according to Quantive are Greenhouse gas emissions, Diversity, and inclusion percentages, living wages and tax paid (Quantive, 2024).

1.3.1 Difficulties in measuring ESG

As mentioned above, measuring Environmental, Social, and Governance (ESG) performance has become a critical aspect when evaluating company's sustainability and social impact. However, several challenges still exist in accurately assessing ESG metrics, leading to complexities and limitations in the measurement process. Measuring ESG poses challenges due to the multidimensional nature of ESG factors, for example the lack of standardized reporting frameworks, and the diversity of data sources available (Eccles, Ioannou & Serafeim, 2014). ESG encompasses a wide range of criteria, making it challenging to quantify and compare across companies and industries. Additionally, the absence of universal reporting standards results in inconsistencies in data collection and reporting practices, hindering the ability to make meaningful comparisons.

A study conducted in 2015 examined the different methods of rating CSR through the lens of ESG criteria. This research involved prominent ESG rating providers and uncovered a deficiency in standardized policies regarding ESG metrics. The evaluation of these rating agencies and methodologies revealed discrepancies not only in their scoring systems and definitions of Corporate Social Responsibility (CSR) but also in their levels of transparency. This was seen particularly in the social pillar, where significant contrasts were observed in indicators between agencies. Descriptive statistics also highlighted major differences and variations among three different providers of ESG ratings. The analysis found major positive correlations between environmental, social, and governance scores. Additionally, ESG risk analysis pointed out that the expected losses were dependent on the available and unutilized dataset, with minimal correlation observed between different sets of data. In conclusion the findings didn't indicate significant correlation between expected losses between the different data providers (Dorfleitner et al. 2015).

Also, the rating of different raters provides may vary even when measuring the same company. A study conducted in 2020 indicates that the generation of ESG scores by agencies can exhibit significant subjectivity and non-correlativeness. Which is resulting in significant diversity in scores for the exactly same corporation across different raters. In a study by the MIT Sloan School of Management, analysing the ratings provided by six different ESG ratings agencies, an average correlation of only 0.54 was observed in their scoring of the same companies. Correlations spanned from 0.38 to 0.71, highlighting significant disparities in their assessments. The study attributed these differences to the specific metrics and qualities chosen by each agency, as not all agencies use the same factors to assess ESG risks, and there is no universal standard for ESG measurement. Additionally, variations in valuating of the factors employed by the rating agencies can further influence the scores. The report also brought attention to an inherent ratings bias, wherein scores for a single company remained consistent regardless of the specific ESG risk being assessed (Berg et al 2022).

Another significant difficulty in measuring ESG is the lack of direct correlation between ESG practices and financial performance. Companies may be successful in ESG metrics, this may not always translate into good financial returns (Aguinis & Glavas, 2012). For instance, a company with high ESG ratings may still face financial challenges or underperform in the market, in discussion part Danone provides a real-world example about this and the Boohoo scandal serves an example, where the company had a strong

ESG rating despite facing allegations of poor labour practices and human rights abuses in its supply chain (Anner, 2020).

Additional difficulties in ESG measurement are data quality and availability and delayed reporting. Getting proper data which is available to provide reliable and comprehensive ESG data can be challenging, as companies may not disclose all relevant information or may use different reporting formats (Chatterji et al., 2016). Incomplete or inconsistent data can explain and effect the accuracy of ESG assessments and limit the ability to make informed investment decisions. Where delayed reporting of ESG data is making it difficult to capture real-time changes in a company's ESG performance this time lag can impact the relevance and timeliness of ESG assessments, especially in fast-changing industries or during periods of rapid environmental or social change. (Bebchuk & Weisbach, 2010).

1.4 Possible Solutions for ESG measuring issues

One key approach to deal with the conceptual drawbacks in ESG measurement is the standardization of ESG metrics by establishing common reporting frameworks and measures, so the comparability and reliability of ESG data can be enhanced. For example, the development of standardized ESG reporting guidelines, such as those proposed by the Global Reporting Initiative (GRI) or the Sustainability Accounting Standards Board (SASB), these could help companies provide more relevant ESG information consistently. Standardization would promote transparency and would enable investors and stakeholders to make informed decisions based on comparable ESG data. The next step would be Improving data quality and transparency which is essential to tackle the challenge of subjectiveness in ESG ratings and ensure the accuracy of ESG assessments. Companies should disclose comprehensive and reliable ESG data, including the methodologies used for ESG measurement. Third-party verification of ESG data can also enhance credibility and reliability. For example, independent audits of ESG reports by reputable firms can validate the accuracy and completeness of ESG disclosures, reducing the risk of greenwashing and enhancing the trustworthiness of ESG ratings (Cornell, 2021).

One practical example would be including machine learning and artificial intelligence (AI) to the process and let them analyse the ESG data. AI tools can process large volumes

of ESG information, identify patterns and trends, and generate insights to support decision-making. By leveraging AI technology, companies can improve the accuracy and efficiency of ESG assessments, leading to more robust and data driven ESG strategies (Amel-Zadeh & Serafeim, 2018). Another method to address ESG measurement challenges is the implementation of stakeholder engagement initiatives. Engaging with stakeholders, including customers, employees, communities, investors and communities, that can provide valuable feedback on ESG performance and priorities. For example, conducting regular surveys, focus groups, and consultations with stakeholders can help companies identify key ESG issues, improve transparency, and enhance accountability in ESG reporting (Eccles, Ioannou & Serafeim, 2014).

It is important of course to remember that even if company will have the best ESG rating it is not sustainable if it cannot make profit. Therefore, it is important to include financial incentives or sanctions. Without appropriate financial mechanisms, companies may be less inclined to take meaningful action towards sustainability. Cornell (2021) is suggesting green bonds and sustainability-linked loans as one option to support companies' engagement to ESG. Green bonds and sustainability-linked loans are financial instruments that tie the cost of borrowing to ESG performance. Companies that meet the predefined ESG targets can benefit from lower interest rates or other financial incentives, while those failing to meet targets may face higher borrowing costs. This mechanism aligns financial incentives with sustainability goals and encourages companies to improve their ESG practices to access favourable financing. Amel-Zadeh & Serafeim (2018) also suggested the possibility to link executive compensation to ESG performance metrics. This can incentivize company leaders to prioritize sustainability in decision-making. By incorporating ESG criteria into executive pay structures, companies can ensure that leadership is accountable for driving sustainable practices and achieving ESG targets. This approach aligns financial rewards with long-term sustainability objectives and fosters a culture of responsible business conduct.

Bax et al (2022) state that investigating interactions and possible spillovers of the different clusters of ESG and companies that could potentially cause simultaneous disruptions across various sectors of the financial system would have to be high on the agenda when thinking different ways to make it better. Moreover, Bax et al. suggest extending the analysis to encompass alternative sustainability metrics and conducting industry-specific investigations could produce valuable insights. In this research AI and machine learning mentioned by Amel-Zadeh & Serafeim (2018) could be useful, and

possibly would be able to provide non-biased information. Additionally, exploring the impact of distinct regulatory frameworks, such as the Paris Agreement of 2015, and examining potential causal relationships presents an intriguing avenue for exploration. It is crucial to underscore that the current research phase remains preliminary, underscoring the imperative for further inquiry. This includes exploring alternative data sources and employing diverse modelling tools to effectively grasp systemic risk dynamics that were discussed earlier in the thesis.

1.5 Corporate Social Performance

Earlier in the 20th century, Corporate Social Performance (CSP) was initially seen as a noble act in the corporate environment. It highlighted charitable giving and community service. The 1960s and 1970s showed a significant shift, focusing on reducing negative business consequences and addressing broader social issues. As CSP evolved in the 1980s and 1990s, theoretical positions were combined, linking CSR with corporate financial performance (CFP) (Wood, 2022).

Corporate Social Performance (CSP) is a comprehensive framework that evaluates a company's stewardship of both social and environmental resources. It is described as an extension of the concept of Corporate Social Responsibility (CSR), focusing not just on the policies a company proposes but also on the effects of these policies in practice. CSP is measured through various dimensions including environmental management, community involvement, employee relations, and product responsibility. One common method for assessing CSP is through frameworks like the Global Reporting Initiative (GRI), which provides standardized criteria for reporting non-financial impacts (Thomas, 2019).

The relationship between CSR and CSP is important in understanding how proactive commitments translate into actual social and environmental outcomes. CSR motivations, like philanthropy or charity, enlightened self-interest, and normative reasons, significantly influence CSP outcomes. For instance, in the power industry in India, firms with higher philanthropic motivations achieve higher CSP levels (Acharyya & Agarwala, 2020). This suggests that the underlying motivations for CSR activities can lead to variations in CSP, with different sectors and corporate cultures influencing the strength and nature of this relationship.

ESG factors are also directly impacting CSP by encouraging companies to enhance their practices in these areas. For example, companies that perform well in ESG criteria often exhibit superior CSP as they are pressured to maintain high standards in environmental stewardship, social responsibility, and governance practices. The integration of ESG considerations into business strategies has been shown to improve CSP by aligning company operations with broader societal goals (Biswas, Manna & Pahari, 2023). So, in summary, CSP is defined as the outcome of CSR activities that further social good beyond what is legally required, and it is measured through various methods that capture the multi-dimensional nature of a company's social and environmental impact.

In the 21st century, CSP has become a dynamic and multidimensional concept that intersects various disciplines including history, philosophy, legal studies, economics, and the social sciences. This broadening of scope reflects its relevance and complexity, making it a critical area of study for both scholars and practitioners. CSP is now understood as an extension of CSR, focusing not just on the policies a company proposes but also on the actual effects of these policies in practice. It encompasses various dimensions such as environmental management, community involvement, employee relations, and product responsibility. One of the common methods for assessing CSP is through frameworks like the Global Reporting Initiative (GRI), which provides standardized criteria for reporting non-financial impacts (Wartick & Cochran, 1985).

Data Envelopment Analysis (DEA) has been used to measure CSP by creating a Social Efficiency Score (SES) for Italian Mutual Banks, it highlights the trade-offs between inputs (like bank efficiency variables) and outputs (proxied by CSP dimensions). This method adjusts the weight of each CSP dimension based on performance, thus providing a nuanced view of a company's social efficiency (Piatti & Cincinelli, 2015).

Despite its advantages, CSP has faced criticism primarily concerning its measurement and the authenticity of corporate commitments. Critics argue that CSP measurements can be inconsistent and sensitive to manipulation, as companies might engage in "greenwashing" or "social washing" to present a favourable image without making substantial changes to their operations (Ahmad & Yandra, 2020). Additionally, the relationship between CSP and financial performance is not always clear, leading to debates about the economic benefits of high CSP scores (Tulay et al., 2015).

2 Discussion

2.1 Boohoo scandal

Boohoo Group PLC, which is an online fast fashion retailer, shocked the financial world when the *Sunday Times* alleged that their subcontractor "*was paying less than half of the UK minimum wage to its employees in a sweatshop in Leicester, UK*". It was reported as modern-day slavery. After the revelation the share price dropped significantly when major ESG focused investment funds dumped their shares and big retailers cancelled orders in the following days. Boohoo Group was also included in multiple ESG investment funds which made it interesting to investigate from the ESG perspective (Leahy 2020).

The Boohoo scandal and the company itself can be critically observed from all the clusters of ESG and including it in the ESG investment funds is to be questioned. As mentioned above the environmental cluster of ESG ratings study the environmental impact of the companies like carbon footprint and waste management. Boohoo Group PLC as a fast fashion brand is already questionable. Fast fashion has been known to have significant environmental impacts because it uses a lot of water, usage of natural resources and creates waste. According to *Business Insider*, fashion in total is responsible about 10% of global carbon emissions (Johnsen 2019).

As we know, the social cluster in ESG rating evaluates the company's interactions with its employees, customers, and the broader social impact that it generates. The social cluster of ESG in its core is about human rights and equality. According to the journalistic investigation by the BBC, Boohoo was paying less than half of the UK minimum wage to their employees in their sweatshop in Leicester in unsafe working conditions. This shows that obviously Boohoo was neglecting the core of the social part of ESG especially when it comes to working conditions, diversity initiatives and human rights standards.

The Governance perspective of ESG estimates how companies run things, make decisions and what are their structures, rules and overall management including how much executives get paid and how clear and honest the company is about its operations and whether it adheres to ethical business practices (Nordnet 2024). Boohoo Group paid less than half of the minimum wage to their employees in an unsafe working environment in a sweatshop manufacturing fast fashion products which are harmful to the

environment. This indicates that Boohoo clearly wasn't employing the best practises from the Governance perspective either.

Boohoo got great ratings from multiple different ESG rating agencies. For example, CSRHub gave Boohoo a ESG rating of 70% out of a hundred, suggesting major outperformance among the other 20,000 companies that were ranked. Interestingly, Non-Governmental-Organization (NGO) Fashion Revolution, through its Fashion Transparency Index, which is an independent evaluator of the disclosure of social and environmental policies, practices, and impacts of the 250 largest fashion brands and retailers ranked Boohoo in the bottom 10%, with a score of zero on traceability. This was the very key issue that caused problems for Boohoo. (Leahy 2020)

In Boohoo's case we can see the core issue of measuring ESG. It is very subjective and open to interpretation which makes it hard to measure. Since rating agencies heavily depend on data supplied by individual companies to formulate their scores, this can result in selective disclosure by companies eager to highlight inflated ESG credentials, which are increasingly crucial for accessing specific pools of capital. Additionally, this approach tends to benefit larger companies over smaller ones, as smaller firms often lack the resources to handle the substantial data disclosure and reporting requirements associated with ratings (Leahy 2020).

2.2 Integration of ESG into CSR Practices

The integration of the ESG factors into CSR practices represents a significant evolution in how companies approach their broader societal and environmental responsibilities. This integration is driven by the recognition that sustainable business practices are not only beneficial for the environment and society but also crucial for long-term business success (Eccles, Ioannou & Serafeim, 2014).

Companies are increasingly aligning their CSR strategies with ESG criteria to address global challenges such as climate change, social inequality, and corporate governance failures. This alignment is evident in the adoption of ESG standards and frameworks that guide companies in implementing practices that meet the expectations of stakeholders and regulatory requirements (Kotler & Lee, 2005). For instance, frameworks like the Global Reporting Initiative (GRI) and the Sustainability Accounting Standards Board

(SASB) make guidelines that help corporations to report their ESG performance in a manner that is transparent and comparable across industries.

Integrating ESG into CSR practices offers several benefits, including enhanced brand reputation, increased investor confidence, and better risk management. Companies that proactively embrace ESG criteria often experience a stronger alignment with the values of their customers, employees, and investors, which can lead to competitive advantages. However, the integration also presents challenges, such as the need for significant investments in sustainable technologies and processes, the complexity of measuring and reporting on ESG performance, and the ongoing need to balance shareholder returns with broader societal goals (Eccles, Ioannou & Serafeim, 2014).

2.3 Impact of ESG on Corporate Social Performance

Companies with strong ESG practices typically exhibit superior CSP. This is because such companies are committed to reducing their environmental footprint, enhancing social equity, and practicing transparent and ethical governance. For example, companies that excel in environmental performance often adopt practices that reduce their carbon emissions and waste, which directly improves their CSP in environmental stewardship (Napoletano, 2024). Similarly, companies that score high on social criteria usually have robust policies for employee welfare, diversity, and inclusion, which enhance their social CSP (Nordnet, 2024).

While integrating ESG into CSR and its impact on CSP is generally positive, the financial implications are less predictable. High CSP scores do not always correlate with immediate financial performance, as sustainable practices may require substantial upfront investments. However, over the long term, companies with high CSP and strong ESG integration tend to experience financial benefits through enhanced reputation, customer loyalty, and operational efficiencies (Eccles, Ioannou & Serafeim, 2014). However, one major challenge is the inconsistency in ESG reporting and ratings, which can lead to contradictions in how companies are evaluated on their social performance. Additionally, the phenomenon of "greenwashing", where companies exaggerate their environmental efforts, can mislead stakeholders about the true impact on CSP (Berg, Kölbel & Rigobon, 2022).

The integration of ESG into CSR practices and its impact on CSP represents a significant shift in corporate strategy towards sustainability and social responsibility. While this approach offers numerous benefits, including improved stakeholder trust and potential long-term financial gains, it also presents challenges such as measurement inconsistencies and the risk of greenwashing. As the corporate world continues to evolve, the integration of ESG into CSR will likely become more standardized and central to business strategies, driving further improvements in CSP across industries.

2.4 Integrating ESG and Corporate Social Performance

The biggest challenge in the effective integration of ESG into CSP is the lack of standardized measurements. Now, ESG criteria and reporting vary significantly across regions and industries, leading to inconsistencies that can hinder global sustainability efforts. To address this, there is a pressing need for a unified global framework that can provide clear, consistent, and comparable ESG and CSP metrics. One possibility to solve this problem would be the global disclosure standards proposed by the International Sustainability Standards Board (ISSB) that could serve as a baseline for sustainability regulations across capital markets. This approach would allow additional jurisdictional requirements to be built on a common foundation, facilitating better comparison, and understanding of ESG performance globally.

A global standard like the one proposed by ISSB would provide a foundation, but it is crucial to adapt ESG metrics to specific industry contexts. Different sectors have unique environmental impacts, social challenges, and governance issues that require tailored approaches to measurement and management. In industries like manufacturing, environmental metrics might focus heavily on emissions and waste management, while in the service sector, social metrics related to employee welfare and customer satisfaction might be more relevant. Tailoring ESG standards to industry specifics can enhance the relevance and effectiveness of corporate sustainability programs.

The Boohoo scandal served an important reminder of the contradictions that can exist between reported ESG performance and actual practices. It showed the need for transparent, and verifiable reporting standards. To prevent such discrepancies, it is essential to enhance the transparency of ESG reporting and introduce stringent third-

party verification processes which would help to ensure that ESG disclosures accurately reflect the company's practices and are not merely exercises in greenwashing.

3 Conclusion

While the integration of ESG into CSP is a step in the right direction for corporate accountability and sustainability, there is a clear need for improved standardization and transparency in ESG measurement. The development of global disclosure standards, such as those proposed by the International Sustainability Standards Board (ISSB), could provide a more consistent and comparable framework for ESG reporting. Furthermore, industry-specific adaptations of ESG metrics and enhanced third-party verification processes are essential to ensure that ESG disclosures accurately reflect a company's true impact on society and the environment. As companies continue to navigate the complexities of ESG integration, the pursuit of standardized, transparent, and actionable ESG metrics remains a critical goal for achieving sustainable and socially responsible business practices. The thesis concludes that the focus should be on developing business-specific criteria rather than adopting a one-size-fits-all approach, to ensure that ESG integration into CSP is both meaningful and effective.

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