The CERA Project Presents:

ALIGNING BUSINESS STRATEGY WITH ESG PRINCIPLES

Leaders International

Kingdom of the Netherlands

This paper comes as part of a series of whitepaper conducted under the Corporate Entrepreneurship Responsibility Alliance (CERA) project, that are meant to raise awareness and spread knowledge on related topics under the project's mandate. The CERA project is funded by the Embassy of Netherlands to Jordan and implemented by Leaders International. The project addresses the national imperative of promoting a transition in the enterprise ecosystem that would contribute to realizing the growth potential of SMEs. It is focused on tackling one of the key constraints that face Jordanian enterprises, namely the availability and quality of local supply chains. The project will rely on supply chain requirements and internal procurement needs of larger enterprises and will build on the concept of Corporate Entrepreneurship Responsibility as an entry point to create an alliance committed to supporting the growth of the local industry in underserved regions of Jordan.

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Introduction

In light of globalization and open markets, worldwide approaches continuously change, and additional requirements are constantly developed. Today, more than ever before, companies are required to disclose all kinds of non-financial information and become highly transparent with the public.[1] This has encouraged corporations to follow through and support global sustainable development goals and build their strategies around the concept of environmental, social and governance (ESG) performance indicators.[2] This approach encompasses increasing the range of CSR activities and initiatives implemented by firms.[3]

The principles of ESG are becoming more and more essential with the climate crisis, the increase in inequalities across the globe and cases of inefficiency across multiple governments.[4] That is why with the UN Agenda for Sustainable Development 2030 a great importance is given to the role of the private sector in achieving sustainable goals and working alongside a multitude of stakeholders.[5] Thus, many companies today are considering ESG as a highly integrated part of their activities and strategies, while others have started integrating it at a slower pace.[6] This also means that we see different trends within the private sector of focusing more on non-financial issues highlighted by social and environmental impact, and encompassing a more comprehensive approach in their operations.[7]

1 AlAmosh and Khatib 2021
2 AlAmosh, Alkurdi, and Khatib 2022
3 ibid
4 Shapsugova 2023
5 Ahmad, Moens, and Pirzada 2023
6 AlAmosh, Alkurdi, and Khatib 2022
7 Ql-Oquili and Kouhy 2006

What are Environmental, Social, and Governance Principles?

So, what exactly are Environmental, Social, and Governance (ESG) principles. They are a set of guidelines that encourage sustainable and ethical approaches by companies.[8] These principles work with a set of larger standards and frameworks and are integrated in multiple agreements. They are part of the United Nations Global Compact, which includes a set of ten principles in important areas of human rights, environment, anti-corruption and labour, and encourages organizations to adopt socially responsible practices, and report them.[9] ESGs are also part of the Principles for Responsible Investment (PRI), these principles are supported by the UN, and incorporate methods of responsible investment.[10] They are also part of the Paris Agreement, which aims at a greener and more environmentally friendly planet.[11] All of which together are said to formulate what is also known as CSER, which is the Corporate Social and Environmental Responsibility, as a corporate response to global issues today. [12]

The Importance of these Principles

The ESG principles have been accelerating in value and importance. Originally, they have been part of international laws and different agreements, but with the world's challenges magnifying, they become more essential in day-to-day activities.[13] This also means that new and upcoming businesses need to have the specific skill sets required to carry forth these activities in a sustainable manner.[14]

[8] Eccles and Serafeim 2013
[9] UNGC 2000
[10] ibid
[11] UNFCCC 2016
[12] Khalid et al. 2017
[13] Shapsugova 2023
[14] Ahmad, Moens, and Pirzada 2023

These trends are becoming more urgent for companies with the vast globalization occurring, as customers today value ESG principles and can easily switch products and suppliers.[15] Therefore, it is in the interest of companies to disclose such activities in their reports and become pioneers in manners related to ESG.[16] The more socially acceptable the business activities, the better its credibility profile and acceptance in the community; which means they are presumed to hold better relationships with stakeholders in the long run. This means that more and more companies are following a holistic approach that is more sustainable and includes green initiatives.[17] Finally, this is in turn is creating higher customer value, and has been visible in the financial reports of companies, as the trust established is increasing their sales[18]

The Determinants of these Principles

Today, companies are facing higher and higher pressure on being held socially accountable, which has motivated them to pursue and announce more ESG related activities.[19] These principles have also become more popular as they were incorporated in various international agreements and global guidelines for the integration between the private sector and the community.[20] Thus, companies are reporting against various different criteria including but not limited to environmental impact (such as energy use, waste, and pollution), social responsibility (including labor practices, data protection, and community development), and governance (covering issues like corporate structure, executive compensation, and shareholder rights).[21]

[15] ibid
[16] Adams 2002
[17] Ahmad, Moens, and Pirzada 2023
[18] Khalid et al. 2017
[19] Patten & Shin, 2019
[20] Richardson 2008
[21] Eccles and Serafeim 2013

Here, studies have revealed that there are various determinants for the degree of ESG principles and activities undertaken by a firm, and these are directly related to the board of directors, the management of the companies, and the type of sector.[22] From these elements, it has been reflected that top management has the highest influence on ESG activities implemented.[23] All in all though, the most important determinant remains the valuation of stakeholders to the firm, and their satisfaction of the activities carried out, as they directly reflect an overall positive image of the company and encourage further investment;[24] which leads to higher profitability.[25] The more powerful the stakeholder, the higher the pressure on companies to pursue ESG related activities.[26]

It was also found that ESG is affected by the company's size and age, and they both play an essential role on the quantity and kind of activities implemented.[27] The larger the firm, the more it must disclose information, and thus by extension, the more ESG activities it carries out.[28] Furthermore, younger companies have been found to follow ESG principles on a volunteer basis, as they have just gotten started, and have not been able to initiate specific strategies as per older companies that have been operating for many years.[29] In some cases that has also been extended to the size of the board of directors, as the larger it is, the more influence there was to implement such activities, and a higher urge to be transparent. [30]

[22] AlAmosh, Alkurdi, and Khatib 2022
[23] AlAmosh and Khatib 2021
[24] Yoon & Chung, 2018
[25] Khalid et al. 2017
[26] ibid
[27] Mudiyanselage 2018
[28] Khalid et al. 2017
[29] Parsa and Kouhy 2008
[30] Dias et al. 2017

Method of ESG Adoption

There are some general parameters that have encouraged and eased the adoption of ESG principles by the private sector. One important notion is the global reporting initiative (GRI). The GRI is a full-fledged organization that was founded in the USA, in cooperation with Nations Environment Programme (UNEP) and the Coalition for Environmentally Responsible Economies. These entities have been working closely for almost thirty years and established a specific framework for preparing sustainability reports and assisting organizations to disclose ESG related indicators.[31] Standardizing methods of reporting has made it easier for firms to report and compare their accomplishments with one another. It has also made it easier for stakeholder to assess more widely the sustainability approaches adopted by firms.[32]

The success of adopting ESG principles has been affected by certain factors. The frequency of board meetings and the harmony between members has been said to encourage further the adoption and implementation of ESG related activities.[33] It has also greatly depended on the strategies prepared and adopted in relation to ESG and similar initiatives, such as the sustainable development goals.[34] The more focused the approach, the better the anticipated results. Finally, the type and frequency of company audits is also presumed to play a role in achieving ESG.[35] Whether, positive or negative, that a firm needs to be monitored to pursue development and sustainable activities remains an open question, yet the type of the audit firm and the frequency has led to better ESG results at times.

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[31] https://www.globalreporting.org/
[32] Shapsugova 2023
[33] Dienes and Velte 2016
[34] Ahmad, Moens, and Pirzada 2023
[35] AlAmosh and Khatib 2021

Mechanisms of ESG Integration

More and More companies are not only adopting ESG practices and implementing related activities but integrating them within their strategies and corporate social responsibility initiatives early on and across all departments. The research reflects that several companies have been able to successfully merge Environmental, Social, and Governance (ESG) principles and Social Responsibility (SR) into their core business models, their strategies, and even their daily operations.[36] This early integration mechanism has been said to increase their efficiency and create a higher value in the eyes of consumers in the long run.[37]

The integration of ESG principles has in itself meant that there will be higher disclosure of CSR activities, as they become instruments for these principles to spread globally and through the adjacent communities.[38] These disclosures, nonetheless, remain closely related to the corporate industry, as there remains higher pressure on the manufacturing industry to integrate further ESG principles and by extension CSR activities within their daily routines.[39] This comes along due to the higher risks for the environment and community that are associated with these types of businesses. The integration of ESG, however, remains quite difficult, as it needs special mechanisms, skills, and investments. Yet, it will in the long run create a competitive advantage in the eyes of stakeholders and help to mitigate risk in certain cases.[40]

[36] Shapsugova 2023
[37] ibid
[38] Khalid et al. 2017
[39] ibid
[40] Shapsugova 2023

Benefits of Adopting and Integration ESG

The implementation of ESG has been said to reflect very positively on corporations, enhance their valuation, and even improve their financial performance.[41] The higher the ESG integration and reporting, the better the companies' reputation and stakeholders' satisfaction, with evidence of a direct proportionality between them.[42] These steps have reflected a better corporate image among investors, customers, and suppliers, as they are considered more community cautious and environmentally friendly. [43] Thus, it is anticipated that potential ESG will enhance brand loyalty and increase the corporations' market share.[44]

Today, it becomes more and more evidence that customers are aware of the activities of corporations, and it is incorporated in their product selection. So are investors, whereby trends have shown that they are willing to invest more with companies that have high metrics in regards to environmental and social responsibility.[45] Especially as this means higher stock valuation for them, and surely by extension higher returns.[46] In more tailored cases, research has also reflected that the integration of ESG practices has also had a positive effect on risk management, and operational efficiency, as they generally follow a more calculated and context-sensitive approach.[47]

[41] Shapsugova 2023
[42] AlAmosh, Alkurdi, and Khatib 2022
[43] ibid
[44] Fatma et. al 2015
[45] Dal Maso et al. 2017
[46] Shapsugova 2023
[47] Friede et. al 2015

These benefits re-emphasize the importance of adopting and integrating ESG approaches in company strategies and long-term planning, [48] and in yearly policies and economic goals and objectives.[49] Surely this push towards sustainable outcomes results in more durable and innovative business models and overall enhanced approaches.[50]

Hurdles and Gaps

Similar to other principles and adopted approaches, the ESG still faces some challenges to enable full integration, along with certain gaps. Essentially there is still a lack of standardization of the ESG principles, as a sole framework is yet to be developed.[51] Thus stakeholders may have different expectations on what the final results and disclosure reports would actually look like. A related component is the data quality and accessibility. Thus far several companies that are implementing ESG principles still lack the mechanisms to collect, assess and analyze data correctly, [52] therefore, an accurate assessment of their performance remains lacking. Lastly, adopting ESG principles, especially for smaller companies can be very costly, and requires high initial investment, and thus makes adoption for some more difficult.[53]

On a larger scale, some scholars still argue that the relation between ESG disclosures and better connections with external shareholders remains somewhat theoretical, and more empirical data is required.[54] In parallel, the increased need for global sustainability has surely brought more pressure to smaller firms. It has also in certain cases led to misdirection, as certain companies have used these principles as a mechanism to decrease costs and taxes, without following through on the main principles, and as means of falsely attracting further customers.[55]

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[48] AlAmosh, Alkurdi, and Khatib 2022
[49] Wasara and Ganda, 2019
[50] Bocken et. al 2014
[51] Busch et. al 2016
[52] Shapsugova 2023
[53] ibid
[54] Ahmad, Moens, and Pirzada 2023
[55] AlAmosh, Alkurdi, and Khatib 2022

The role of the government

For better ESG principal adoption, integration, and implementation, it is worth assessing whether specific regulations will be beneficial. A regulatory framework could ensure a more standardized and collective approach to undertaking ESG principles, along with a more calculated approach by businesses that are working on stargazing ESG standards.[56] Thus it is encouraged that governments should take a more proactive approach in this regard. Whereby authorities could be either nominated or created to follow through on the principles of good governances,[57] monitoring implemented projects, testing the effects of ESG on communities, and promoting more cohesive business approaches.

ESG in the Jordanian Context

In developing countries, ESG disclosures and awareness in regards to social and environmental components is still falling behind, and further governmental initiatives and regulations need to be put forth.[58] Accordingly, and as part of improving the country's economic outlook and increasing sustainability, the Jordanian government has launched the "*initiative for sustainable development based on social, economic and environmental goals*", whereby it aims to improve its sustainability matrices by 2025. [59]

Today, a quick assessment reflects that although many Jordanian companies have launched social related initiatives in the past few years, ESG performance levels are still quite low in comparison to world averages. A recent study has revealed that the disclosure of information related to ESG performance - of a select group of companies registered on the Amman stock exchange - shows a low level of reporting and a weakness within this component.[60] Although there have been some visible improvements based on further pressure by stakeholders.

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[56] Gond et. al 2011
[57] Ahmad, Moens, and Pirzada 2023
[58] Khalid et al. 2017
[59] Al Amosh 2022
[60] AlAmosh and Khatib 2021

Studies have also revealed that there are various factors that affect the level of ESG related activities and reporting in Jordan. The main factor that led to improvements was the size of the board of directors, and the frequency of board meetings, both reflecting a direct proportionality with the level of ESG reporting. Furthermore, a main incentive of the implementation and reporting of such activities in the country has been tax exemptions where possible;[61] which once again ensures the importance of the role of the government in relation to ESG.

In other regards, the previous studies also revealed that unlike other countries, the audit committees in Jordan, had no effect on prompting higher implementation and disclosure of ESG related activities. Yet, the company size had a positive effect, where larger companies have pursued and disclosed ESG related activities more regularly.[62] The reasons can be attributed to the higher availability of resources and qualifications to better strategize and explore various opportunities.

Overall, when attesting to the effect of different variables on ESG principles integration and disclosure, the previous studies have additionally reflected that all ESG principles and sustainable measures that were carried forth by Jordanian companies have actually had a positive effect on their market valuation and prompted further customer acquisition.[63] The only negative perception that resulted, is the pressure on smaller companies to follow through with ESG principles, especially in their early years of operations, as they lack the capacity and skills to do so, and this may affect their valuation on an unfair basis. [64] Yet this is a worldwide program that requires higher governmental involvement and initiatives.

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[61] ibid
[62] ibid
[63] ibid
[64] Khalid et al. 2017

Country-Based Hurdles

There are specific hurdles pertaining to Jordan, that are worth investigating to highlight certain gaps, and find mitigation measures. An essential point to keep in mind is that overall, there remains a lack of sufficient initiatives related to economic, social, and environmental practices and development. Especially, as the country has one of the most alarming scarcities of water resources worldwide, which puts a huge strain on sustainability, coupled with a lack of capacity to integrate renewable energy practices in the economy. [65] This means that specific governmental initiatives and global partnerships remain essential to upgrade the environmental and social standards and pursue a more sustainable approach to guarantee a more prosperous economy.

Country-Based Initiatives

The Jordanian government is fully aware of these hurdles and has been working on more sustainable measures for over two decades. In the early 2000s some measures were implemented to improve the social and environmental responsibility of Jordanian businesses. In 2003 the Ministry of Environment was established to conserve natural resources, work on sustainable development initiatives, and improve and maintain green practices in the Kingdom. Later in 2006, the Environment Protection Law No. 52 was introduced to protect the environment, local communities, and way of life through official legal means.[66]

In 2015, the Jordanian government launched its comprehensive development plan- referred to earlier in this section- under the name Jordan 2025 with economic, social, and environmental goals to achieve sustainable development. This was paralleled with certain legislations that encouraged Jordanian companies to contribute to sustainable development initiatives. These have included Income Tax Law exemptions and deductions, especially when the initiatives have served important causes for the country and community. [67]

[65] AlAmosh and Khatib 2021
[66] Khalid et al. 2017
[67] AlAmosh and Khatib 2021

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