Problems of integration of ESG standards into the practice of Russian corporate governance

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Abstract. Over the past decade and a half, interest in sustainable development topics and the principles of ESG has been consistently at a high level. A large number of foreign academic researchers and representatives of the business community consider these issues as the central theme of management science and practice in the current socio-economic realities. In general, it can be stated that in the paradigm of globalism, actively promoted by the United States and a number of its allies over the past two decades, the concepts of green transition, zero hydrocarbon footprint, gender, and racial diversity, specific requirements for CSR and other incarnations of ESG approaches were perceived as key to business success and competitiveness. To date, the globalist track of the development of the world economy is no longer considered as the only possible one and corresponding to the needs of the development of national economies. At the same time, it should not be denied that a number of provisions used in the ESG concepts are extremely rational and universal and, if applied correctly, can show an undoubted positive result. This work is devoted to the issues of effective integration of ESG standards in the current socio-economic conditions and the objective issues that accompany this process.

Keywords: sustainable development, globalism, competitive advantages, ESG standards, corporate governance, sovereign economy, circular economy, CSR.

1 Introduction

Issues of corporate governance, namely, improving its efficiency and effectiveness, have been central to the agenda of both academic science and management practitioners. It is no secret that the corporation as an organization is the most efficient structure capable of accumulating significant financial, resource, and competence potential, which, in turn, can be used to solve the most ambitious challenges facing the national economy.

It is known that after the outbreak of hostilities in Ukraine, our country found itself under unprecedented pressure of sanctions and restrictions by the United States and its satellites. However, despite all the efforts of unfriendly countries, Russia’s national...
economy shows sufficient resilience and tolerance to such challenges. However, this does not mean that the current situation does not require sufficient and prompt action to bring a number of economic and enterprise management systems into line with the current reality.

It is quite clear that one of the areas where the mobilization and transformation of management concepts is required should be the methodology of corporate governance. The analysis of the main trends and directions of development of this methodology shows that there is a certain lag in the level of development of the national paradigm of corporate governance in matters of ecology and interaction with society. In addition, the transparency of corporate activities and the overall effectiveness of corporate governance raises certain concerns.

It seems likely that the study of ESG-management practices, foreign and domestic companies with a further adaptation of the most universal and vital of them will give the necessary impetus for the development of the Russian school of corporate governance.

ESG standards are a kind of alter-ego of the concept of sustainable development, which became world famous thanks to the report of Gro Harlem Brundtland (Chairman of the International Commission on Environment and Development) “Our Common Future” in 1987. In this case, unlike sustainable development, which is perceived by many as a philosophy and a theoretical basis for responsible business, ESG serves as a practical tool to assess the commitment to sustainable development ideology and provides a clear metric on the ranking and rating of businesses in this area. Making a comparison between the concept of sustainable development and ESG, we can see the following differences (Table 1).

**Table 1.** Comparison of sustainability and ESG paradigms.

<table>
<thead>
<tr>
<th>Categories</th>
<th>Sustainable development</th>
<th>ESG</th>
</tr>
</thead>
<tbody>
<tr>
<td>Research objects</td>
<td>global, philosophical issues of human development</td>
<td>business development methodology</td>
</tr>
<tr>
<td>Measurability</td>
<td>unmeasurable</td>
<td>there are metrics, quantitative comparison scales, ratings</td>
</tr>
<tr>
<td>Scale</td>
<td>all areas of human activity</td>
<td>financial and industrial sectors</td>
</tr>
<tr>
<td>Components</td>
<td>social sphere, ecology, economy</td>
<td>ecology, society, management</td>
</tr>
</tbody>
</table>

Source: [1].

2 Materials and methods

The phenomenon of ESG investing, which has experienced a meteoric rise in the last five to seven years, is being actively discussed among researchers. This acceleration has been driven by increased scrutiny by society, government institutions, and consumers of the increasing influence of corporations, as well as by investors and business leaders who recognize that a strong ESG offering can ensure a company’s long-term success. In [2], it is shown that higher ESG efficiency also corresponds to lower downside risk for stock prices, as evidenced by, among other things, lower spreads on credit and default swaps, and higher credit ratings.

Domestic corporations also strive to meet the world’s best practices in matters of ESG compliance. This trend is largely led by organizations interested in attracting investment
funds from foreign sources [3]. However, the concept of responsible investing, albeit not as significant as in several countries, is also beginning to play a significant role in the corporate securities market in our country [4].

Today there is a relatively well-established system of values and priorities that, generally speaking, form the basis of the ESG architecture and around which all the constructs designed to justify both the economic rationality and the social significance of ESG practices are built. As an example of this system structure, Table 2 shows a set of aspects that are most common to the vast majority of enterprises representing the real sector of the economy.

**Table 2. Main aspects of the ESG agenda.**

<table>
<thead>
<tr>
<th>ENVIRONMENTAL (Environmental)</th>
<th>SOCIAL (Social)</th>
<th>GOVERNANCE (Governance)</th>
</tr>
</thead>
<tbody>
<tr>
<td>▪ combating climate change (greenhouse gas emissions, carbon footprint, other industrial factors)</td>
<td>▪ interaction with the state and local communities, participation in social programs;</td>
<td>▪ reasonable and open remuneration of top management</td>
</tr>
<tr>
<td>▪ natural resources conservation (soil, water, air)</td>
<td>▪ ensuring employee health and maintaining high occupational safety standards</td>
<td>▪ zero tolerance for bribery and corruption</td>
</tr>
<tr>
<td>▪ reducing the level of industrial waste and anthropogenic pollution of nature</td>
<td>▪ employee training and development</td>
<td>▪ abandoning political lobbies</td>
</tr>
<tr>
<td>▪ preventing deforestation and desertification of areas</td>
<td>▪ product quality certification</td>
<td>▪ disclaiming key business metrics;</td>
</tr>
<tr>
<td></td>
<td>▪ combating discrimination on racial, religious, and sexual grounds</td>
<td>▪ maintaining a balance in the structure and gender composition of the board of directors</td>
</tr>
<tr>
<td></td>
<td>▪ responsible and transparent business conduct</td>
<td>▪ open and transparent tax strategy</td>
</tr>
</tbody>
</table>

*Source: Compiled by the authors.*

Given the above, we can outline the main actions that an organization (depending on the industry of its activities) seeking to work following ESG practices should take. It is interesting to consider the experience of domestic companies that are already implementing the ESG concept in their daily operations.

For example, the M.Video-Eldorado Group’s ESG strategy is based on activities to achieve the UN Sustainable Development Goals (SDGs). For e-commerce businesses, the priorities could be good health and well-being (SDG #3), decent work and economic growth (SDG #8), reducing inequality (SDG #10), responsible consumption and production (SDG #12), combating climate change (SDG #13), and partnerships for sustainable development (SDG #17).

M.Video-Eldorado Group has defined three areas of activity to implement the ESG strategy:

- *One planet* – optimization and greening of own operations.
- **Uniform standards** – responsible business conduct, risk management, and corporate governance.
- **One community** – implementation of sustainability principles into team and community relationships.

Table 3 summarizes the actions of the group in the implementation of the above areas:

<table>
<thead>
<tr>
<th>ESG agenda direction</th>
<th>Activities and actions</th>
<th>Key KPIs</th>
</tr>
</thead>
<tbody>
<tr>
<td>One planet</td>
<td>Support for carbon neutrality principles.</td>
<td>recycling 85% of own waste;</td>
</tr>
<tr>
<td></td>
<td>Commitment to the principles of circular economy.</td>
<td>100% coverage of the regions by the household appliance recycling program;</td>
</tr>
<tr>
<td>Uniform standards</td>
<td>Development of corporate culture in the ESG paradigm.</td>
<td>20% of revenue from products complementary to eco-friendly lifestyles;</td>
</tr>
<tr>
<td></td>
<td>Formation of a transparent risk management system.</td>
<td>reduction of own carbon dioxide emissions by 30%</td>
</tr>
<tr>
<td>One community</td>
<td>Fighting inequality, ensuring inclusion.</td>
<td>80% of employees involved in the EPS concept;</td>
</tr>
<tr>
<td></td>
<td>Charity projects.</td>
<td>100% protection of personal data of employees and customers</td>
</tr>
<tr>
<td></td>
<td>Staff training and development.</td>
<td>100% disclosure of non-financial information to increase transparency</td>
</tr>
<tr>
<td></td>
<td>Employee health protection and injury prevention.</td>
<td>100% of offline stores have accessibility equipment for people with disabilities;</td>
</tr>
<tr>
<td></td>
<td></td>
<td>100% of staff have equal access to educational programs;</td>
</tr>
<tr>
<td></td>
<td></td>
<td>60% of vacancies are filled by internal candidates;</td>
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<td></td>
<td></td>
<td>15% of the staff is involved in volunteer work;</td>
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<tr>
<td></td>
<td></td>
<td>2 million people receive direct or indirect charitable assistance.</td>
</tr>
</tbody>
</table>

### 3 Results

As can be seen from the data presented above, M.Video-Eldorado Group implements the ESG strategy quite extensively and systematically. Given that the group is the clear leader in the e-retail industry, legitimate questions are: To what extent can ESG practices maintain and strengthen this leadership? And is a commitment to the ESG agenda a guaranteed means to improve a company’s competitiveness and efficiency? It is no secret that the implementation of ESG programs involves both financial costs and an increase in non-core
activities, staffing, and management resources for business processes that in no way can be relegated to the core. In what case would an ESG transition be reasonable and effective? Below is an algorithm consisting of the necessary actions to initialize and start the transformation mechanism.

Stage 1: Deciding on an ESG transformation. The implementation of the ESG transition strategy cannot be done successfully without some prior preparation.

The practice of Russian business shows that the initiator of ESG transformation is most often executives having a background of work in foreign companies, or seeking to develop collaborations with Western partners. It falls on the shoulders of the “ambassadors” to educate colleagues about what the ESG agenda is and what the differences are in this management system. One of the significant difficulties that await the process of initializing the transition can be considered skeptics who do not consider it worthwhile to spend resources for the sake of new regulations. Particularly painful are the costs required to participate in the rankings.

Stage 2: Creating a team of integrators. If the BOD has conducted activities to analyze the need for ESG transition, the results of which with a sufficient level of expertise give an affirmative answer to the demand for this transformation, and assessed the resource base for launching an ESG strategy, it is reasonable to proceed to the new stage. It will be about staffing the so-called “assault team”, which will take on the most ungrateful work – preparing draft documents. It is recommended to strengthen the composition of the external expertise, especially if any of the areas has problems with the effectiveness of direct professional activities. It will also be complementary to involve representatives of production to exchange ideas and vision for the transformation of basic business processes of the company in the track of improving environmental friendliness, lean use of resources, and industrial safety.

At later stages, it is advisable to involve corporate lawyers and financiers – this often allows to filter ideas in terms of financial and legal feasibility.

Step 3: Conflict Management. Since ESG practices are just beginning to be introduced in Russian management (at least, this statement is true in most cases) there is no clear division of control areas, areas of responsibility, and performance-based remuneration. The main problem is that the components of the ESG strategy (E – ecology, S – social block, G – corporate governance), in the practice of Russian corporate management referred to separate and often unrelated to each other units. In this regard, we can take a cue from Western experience, where in national and multinational companies, for the past fifteen years, ESG issues are most often handled by a specially created committee or service.

In addition, in several cases there is confusion between the ESG agenda and the term “corporate social responsibility” (CSR), which is already quite tightly integrated into the practices of Russian companies. Some researchers generally believe that the foundation of the idea of ESG is concentrated in the equitable distribution of top management compensation and an effective set of social programs.

Such a misconception seems very dangerous from the point of view of the development of ESG vision in the Russian corporate field. It is important to understand that the idea of ESG is most accurately conveyed by the combination of “corporate responsibility to society”, where there is a place for ecology, responsibility to the consumer, and fair wages. The famous ENRON case, the oil spill in the Gulf of Mexico in 2010, and the Volkswagen Dieselgate are all ESG crises. That is, the companies did not justify the trust of society. Summing up, we can say that a confrontation about “who’s in charge at ESG” cannot only bury the ESG transition at the very start but also generally disassociate the management staff and reduce the competitiveness of the company.

Step 4: Evaluate materiality. This is the first practical stage of strategy preparation. In today’s corporate governance practice, there is a wide variety of ESG transition topics.
Each of them has its undeniable advantages and equally weighty problems in implementation. The important thing is that they are at least not the same priority for a particular business. The role of stakeholders and their expectations from the implementation of the ESG strategy looks crucial.

One of the results of the described work stage should be a “materiality matrix”, where all the factors are ordered and ranked. Having such a tool allows for visualizing the problem pool and building a hierarchy of actions. Also, during this stage, it will be extremely useful to analyze the best practices and the subsequent application of the benchmarking tool.

**Step 5: Formalize your starting point (Baseline Study).**

It is important to understand that deciding to implement an ESG transformation program is clearly a risk. With some coarsening, we can list the main risk components of the ESG transition:

- lack of a unified methodology of corporate governance on ESG transformation;
- financial, personnel, and time costs required to launch ESG programs can be substantial for a business;
- lack of sustained demand in the investment community for informed investing and promotion of ESG ideas;
- business culture regarding a number of ESG provisions on business transparency has not been formed at the necessary level;
- presence of a significant time lag between the costs of implementing ESG practices and the economic results of its implementation;
- non-obviousness of the goals of ESG strategies, the lack of a methodological framework for managing ESG practices by objectives;
- attempts to directly copy the provisions of ESG used by foreign companies, which can cause rejection of the very idea of ESG;
- certain retardation of the corporate culture of domestic enterprises on issues of ecology and careful use of natural resources;
- cost of an error in the design and implementation of an ESG strategy is extremely high: correcting strategic errors is incredibly difficult and expensive;
- insufficient development of state institutions responsible for supporting ESG initiatives at the enterprise level.

Before going on to further detail the steps for starting ESG processes, let us consider the mentioned risk from a mathematical point of view.

It is known that risks are largely stochastic. In this regard, the process of risk management can be accurately described by the theory of random processes, which is a well-developed scientific methodology, with the necessary conceptual and instrumental apparatus. In [5] an algorithm that can be adapted to the task of ESG-transition risk analyses is given. In fact, with some assumption, transformation problems similar to ESG can be approximated by the problem of detecting a useful component (in our case – transition benefits) on the background of additive noise (in the investigated problem – costs and administrative risks):
\[ \xi(t) = \left[ 1 - \theta(t - \lambda_0) \right] v_1(t) + \theta(t - \lambda_0) v_2(t), \quad \theta(t) = \begin{cases} 1, & t \geq 0, \\ 0, & t < 0, \end{cases} \]

where \( v_i(t), \ i = 1, 2 \) – stationary random process (SRP) with normal distribution, having the property of statistical independence with the expectation \( a \) and spectral density (SD), having the form:

\[
G_i(\omega) = \frac{d}{2} \left\{ 1, \ |\omega| \leq \frac{\Omega_{\omega}}{2}, 0, \ |\omega| > \frac{\Omega_{\omega}}{2} \right\}.
\]

Here \( \Omega_{\omega} \) – the bandwidth and \( d \) – the intensity (spectral density value) of the process \( v_i(t) \), determining its dispersion \( D_i = \frac{d\Omega_{\omega}}{4\pi} \), with \( \Omega_{01} \neq \Omega_{02} \).

Let this process be realized on the background of white noise \( n(t) \), which also has a normal distribution (under the influence of many factors, their probability-density function (PDF) can be approximated by a normal law). In this case, the analyst making the decision will observe the mixture having a given shape:

\[
x(t) = \xi(t) + n(t), \quad t \in [0, T].
\]

In management, it is usually necessary to make a binary choice: to launch a project or not, to fire an employee – or keep it, to accept the risk, or avoid it. In the connotation of risk management, this means choosing some alternative, based on the availability of a priori information about the state of the object of management, as well as the nature and level of the risk component. The reviewed setting can also be illustrated by a binary model: start an ESG-transition campaign, or not. Of course, ESG transformation is a rather complex process, where the basic bifurcation point will not be isolated from many preceding and succeeding alternatives. At the same time, the algorithm discussed below can be slightly adapted for use in such combined tasks as well. The basis of the proposed algorithm is the maximum likelihood method. In analytical form, it looks like the following: the decisive statistic – the logarithm of the likelihood ratio functional (LRF) is formed as a function of the current values of all the unknown parameters:

\[
L(\lambda, \Omega) = \frac{d}{N_0(N_0 + d)} \left[ \int_0^\lambda y(t, \Omega) dt + \int_T^\lambda y(t, \Omega) dt \right] +
\]

\[
\left[ \int_0^\lambda \left( \frac{a + \lambda \Omega + \Omega \Omega}{4\pi} \right) x(t) dt - \frac{a + \lambda \Omega + \Omega \Omega}{4\pi} \right] +
\]

\[
\frac{2a}{N_0 + d} \int_0^\lambda x(t) dt - \frac{a + \lambda \Omega + \Omega \Omega}{4\pi} \left( 1 + \frac{d}{N_0} \right)
\]

The maximum likelihood estimates (MLE) \( \lambda_m, \Omega_m \) of the measured quantities \( \lambda, \Omega \) is defined as the position of the greatest maximum of the decisive statistic (3):

\[
\left( \lambda_m, \Omega_m \right) = \arg \max_{\lambda \in [\lambda_1, \lambda_2], \Omega \in [\Omega_1, \Omega_2]} L(\lambda, \Omega).
\]

The parameters necessary for the implementation of the described method can usually be selected by experts, or by computer statistical modeling.

4 Discussion
Stage 6: Goal setting. At this stage, there is already an understanding of ranking the elements of the ESG agenda: a list of urgent and important, there is a list of auxiliary and complementary. The status of ESG is generally clear at this point. And the team implementing the ESG strategy proceeds to classify ESG topics. As a rule, it is reasonable to do it using the principle of “three baskets”:

- develop: strengthen and support the projects and programs that the company is already doing in ESG at the top level.
- adapt/tune: often, there were initiatives in company practices that were not directly related to the ESG transition, but have potential in this area. Perhaps the level of information should be changed, or the people in charge should be replaced with more interested management.
- improve: use a benchmarking tool and best-practice, relying on the collection of analytics and the dense processing of all information relating to the ESG agenda of competitor companies.

It is very likely that at this stage it will be necessary to discuss the details of the ESG strategy with the shareholders or business owners [6].

Stage 7: GAP analysis. The development of an ESG strategy involves appropriate resource support. At this step, it is necessary to understand: how much the real position differs from the given parameters. The ESG strategy at this point already has a formalized form, and it allows building metrics to match the current development of ESG processes to the desired formats and results. Most often the key positions are determined by the level of funding, the development of corporate culture, the availability of competencies, and the provision of business processes.

Stage 8: Road mapping ESG goals: identifying key achievements. This stage must necessarily be formalized in the form of a document. Such a document fixes the sequence of movement and timing to achieve the result.

Stage 9: Prepare action plans and set KPIs. The presence of key indicators in the implementation process seems to be a necessary detail. Any program involving transformation requires the necessary detailing and set of bonuses and premiums for achievements (as well as penalties and punishments for failures!). The performance indicators must be consistent with the SMART ideology. And the status of their implementation and progress in achieving KPIs is best monitored through the company’s internal planning and reporting systems.

Stage 10: Monitor implementation. The main problem at this stage is not to turn the execution of tasks into a pure protocol practice. Many of the elements of the agenda require a creative and informal approach. However, it should not be forgotten that many reports and execution protocols relate to the external environment of the organization. That is, it is very likely that any ESG data (reports on this topic are a priori open to the public) will be examined extremely carefully, and any errors could have a devastating effect on the progress of the ESG strategy.

5 Conclusion

ESG strategy is becoming an increasingly popular element of the corporate strategy of a modern company. However, there is still no clear hierarchy of values, priorities, and areas of responsibility. Is it possible to measure ESG-transformation risks and formalize the ESG-transition algorithm? We hope that this article can answer the questions raised.
It is important to understand that ESG-strategy forms the track of business development for years to come, but any error, an attempt to postpone something, or an individual defect is guaranteed to lead the company to multimillion losses.

References


