ESG strategy: pivotal in cultivating stakeholder trust and ensuring customer loyalty

Ivelina Kulova1* and Valentina Nikolova-Alexieva1

1University of Food Technologies – Plovdiv, Faculty of Economics, 26 Maritsa blvd., 4000 Plovdiv, Bulgaria

Abstract. In today's business landscape, Environmental, Social, and Governance (ESG) considerations have emerged as key drivers of sustainable growth and long-term success for organizations. This article explores the significance of implementing an ESG strategy in cultivating stakeholder trust and ensuring customer loyalty. It delves into the various dimensions of ESG, highlighting their impact on corporate reputation, brand perception, and customer behaviour. Furthermore, it discusses the steps organizations can take to develop and integrate a comprehensive ESG strategy into their operations, emphasizing the need for transparency, accountability, and proactive engagement with stakeholders. The findings underscore the benefits of prioritizing ESG initiatives, ranging from enhanced stakeholder relationships and investor confidence to improved customer loyalty and market competitiveness. Through an in-depth analysis of relevant literature and secondary data, this article seeks to provide valuable insights and practical recommendations for organizations looking to use ESG as a strategic tool for sustainable growth. Keywords: sustainability, ESG, responsible investment, consumer buying decisions

1 Introduction

The dynamic nature of the ESG (Environmental, Social, and Governance) environment calls for an elevated focus on the execution of an ESG strategy. The recent advancements in ESG have far-reaching consequences on our global landscape, necessitating heightened awareness and proactive measures.

The urgency to address climate change and the escalating demand for enhanced workplace fairness and inclusivity underscore the criticality of ESG concerns, both within the corporate realm and in broader society.

Companies that neglect to prioritize their ESG strategy face the potential repercussions of brand deterioration, waning investor engagement, and difficulties in adjusting to an era where sustainable business models are indispensable.

The aim of this article is to explore the significance of implementing an ESG strategy in cultivating stakeholder trust and ensuring customer loyalty. By exploring the intersection of ESG practices, stakeholder engagement and customer preferences, the paper seeks to provide insight into the importance of ESG as a driver of organizational success.

* Corresponding author: i.kulova@abv.bg
2 Literature review

ESG (Environmental, Social, and Governance) pertains to the ecological, societal, and managerial elements that investors evaluate when scrutinizing a company's endeavors towards sustainability from a comprehensive perspective. It is a term used to describe a set of criteria and standards that investors, organizations, and stakeholders use to evaluate a company's performance and sustainability practices. [1]

The principles guiding ESG investing are as follows [2]:

- Environmental: The environmental aspect of ESG focuses on a company's impact on the natural environment. It includes factors such as carbon emissions, waste management, pollution, resource usage, climate change mitigation, and biodiversity conservation.
- Social: The social aspect of ESG pertains to a company's relationships and impacts on its employees, customers, communities, and other stakeholders. It includes aspects such as labor rights, human rights, diversity and inclusion, health and safety, product quality and safety, community engagement, and philanthropy.
- Governance: The governance aspect of ESG refers to the systems, processes, and structures through which a company is directed and controlled. It encompasses factors such as board composition, executive compensation, transparency, accountability, risk management, anti-corruption measures, shareholder rights, and ethical business practices.

ESG aims to assess and measure a company's sustainability performance beyond just financial metrics. It takes into account environmental and social impacts, as well as the quality of corporate governance. By considering these factors, ESG helps investors and stakeholders evaluate a company's long-term viability, risk management practices, and ethical conduct. [3]

ESG, derived from the concept of sustainable business practices, has increasingly made its way into the corporate landscape in recent years. ESG serves as a framework for promoting corporate sustainability and establishes criteria for defining and evaluating it. [4] Sustainable consumption entails utilizing essential resources in a manner that ensures continuous functioning of systems indefinitely. However, due to a lack of specificity and clear benchmarks, this definition can be subject to varied interpretations, such as greenwashing. [5]

The ESG framework encompasses three pillars: environmental stewardship, social responsibility, and transparent and sustainable governance. These pillars provide a clear structure for the otherwise broad and ambiguous concept of sustainability. [6]

An ESG assessment of a company offers valuable insights into the impact of its operations, including [7]:

- Transparency of policies, such as taxation, risk management, anti-corruption measures, lobbying practices, board composition, and more.
- Accountability towards employees and customers, covering areas like labor standards, human rights, social diversity, health risks, data protection, privacy, and other related factors.
- Environmental impact, including considerations for biodiversity, pollution, resource management, energy efficiency, climate change, and more.
- Supply chain practices.

In 2004, Kofi Annan, the then Secretary-General of the United Nations, urged major financial institutions to collaborate with the UN and the International Finance Corporation (IFC). The objective of this partnership was to explore ways to integrate environmental, social, and governance concerns into capital markets. [8]

ESG's emergence can be traced back to the publication of the study "Who Cares Wins" [9] in 2005, which marked its first official usage.
As financial institutions recognized the need to protect the environment and uphold high social standards for sustainable financial success, ESG gained prominence in business development. Ethical and responsible business practices contribute to long-term economic progress, leading to the gradual integration of ESG standards into corporate practices, offering a fresh perspective on fair governance. [10]

ESG-related issues were first addressed in the United Nations' Principles for Responsible Investment (PRI) report [11] in 2006, which introduced the requirement for companies to include ESG criteria in their financial reports. This step enables further advancements in sustainable investments. Corporate sustainability guided by ESG principles generates long-term value for shareholders and all stakeholders involved.

ESG criteria are used by investors to make informed decisions about allocating their capital to companies that align with their values and sustainability objectives. It also serves as a framework for organizations to improve their sustainability practices, enhance their reputation, and attract responsible investors. [12]

The terms sustainability and ESG may appear synonymous, but they are distinct. Sustainability encompasses a wide range of concepts but primarily centers around safeguarding the environment and human well-being. On the other hand, ESG concentrates on the tangible concerns such as emissions, water consumption, diversity, equity, and inclusion that present immediate financial threats to a company due to its industry, operational procedures, and business conduct. [4]

It's important to note that ESG is not a standardized or universally defined framework, and different organizations may have varying interpretations and methodologies for assessing ESG factors. However, the overall goal is to promote sustainable and responsible business practices that benefit both companies and society as a whole.

3 Research methodology

To investigate the pivotal role of ESG strategy in cultivating stakeholder trust and ensuring customer loyalty, a thorough review of existing relevant literature, scholarly articles, research papers, and secondary data was conducted. The collected data underwent a rigorous analysis process. Quantitative and qualitative findings were integrated to provide a comprehensive interpretation of the data. Triangulation of results strengthened the overall validity and reliability of the study findings.

4 Analysis and results

The expansion of financial investments is a clear manifestation of the flourishing endeavors in the realm of ESG (Environmental, Social, and Governance). For instance, the influx of funds into sustainable investment vehicles witnessed a remarkable surge, escalating from five billion dollars in 2018 to surpass fifty billion dollars in 2020, and further soaring close to seventy billion dollars in 2021. [13] This substantial growth in ESG is predominantly attributed to the ecological dimension and the response to the pressing issue of climate change.

When assessing a company, its standing and performance in terms of reputation and ESG carry significant weight, particularly in the current landscape where intangible assets constitute a substantial ninety percent of a company's market valuation. [14]
In the contemporary landscape of business, strategic deliberations pertaining to ESG assume paramount significance for corporations. This arises from the escalating importance accorded to sustainability and ethical conventions by investors and stakeholders.

To prosper within this milieu, enterprises must assimilate ESG principles into their strategies, remain well-informed about the latest developments, and evaluate their impact on the public and investors. Disregarding the prioritization of ESG can yield severe ramifications, including reputational harm and an augmented risk profile, ultimately leading to financial setbacks and erosion of trust.

The pervasiveness of social media and digital platforms amplifies the rapid propagation of negative narratives surrounding ESG matters, underscoring the indispensability of proactive management of ESG perception monitoring.

An impactful ESG strategy assumes immense significance owing to diverse factors. The burgeoning influence of stakeholders propels the momentum of ESG on a global scale. In 2021, forty-two percent of investors [15] proclaimed that their adoption of ESG practices chiefly stems from client expectations and apprehensions regarding reputation.

At present, an expanding cohort of investors relies on ESG rankings to appraise the feasibility of investing in a company. Additionally, governments across the globe have also commenced employing these scores to ascertain which enterprises will be granted authorization to operate within their jurisdictions, further accentuating the import of an effective ESG strategy.

Measuring ESG holds crucial significance for the following reasons:
- Meeting Public Expectations: The evolving landscape necessitates that companies meet the public's expectations of upholding ethical, sustainable, and responsible conduct, which have transformed into demands rather than mere preferences. A striking seventy-six percent of consumers [16] assert their intention to sever ties with companies that exhibit insufficient regard for the environment, employees, or the communities they impact.
Through diligent monitoring of their ESG score, companies can pinpoint areas of scrutiny, gauge their strides towards attaining sustainable and ethical transformation, and proficiently convey their progress to all relevant parties.

- **Potential for Profitability:** Recent research [17] indicates that companies exhibiting exceptional ESG ratings have, on the whole, delivered superior returns to shareholders over the last 10 years.

  Developing a strong and comprehensive ESG framework empowers companies to explore untapped markets and deepen their presence in established ones. The presence of trust in corporate practices amplifies the prospects of obtaining governmental authorizations, licenses, and market entry approvals.

- **Shaping Perceptions:** Companies that demonstrate excellence in ESG measures are regarded as being highly skilled in anticipating forthcoming challenges and prospects. They display a forward-thinking approach and endeavor to establish enduring value.

  Furthermore, a company's ESG endeavors have a substantial impact on how customers shape their perceptions of the brand. Hence, it is crucial for these endeavors to align with the company's mission and desired reputation.

  Through proactive efforts to enhance ESG ratings, companies can fortify their connections with stakeholders, attract augmented investments, secure access to more affordable capital, and cultivate trust.

  To enhance the ESG score, the following steps can be taken by the companies:
  
  — Obtain management commitment: Prior to embarking on an ESG strategy, it is essential to obtain assurance that the management team is committed to allocating resources towards accomplishing ESG objectives. This process may involve various departments and could be time-consuming and costly, depending on the company's culture, size, and age.
  
  — Perform an in-depth analysis of the significance and relevance of ESG factors: Prioritize ESG subjects that hold relevance for the organization and industry. Assess the potential impact on business and brand, as well as the importance of these issues to key stakeholders and society. A comprehensive materiality assessment aids in prioritizing initiatives and building business cases for previously dismissed actions.
  
  — Incorporate and make ESG an integral part of the company's strategic approach: ESG strategies have become indispensable as the public demands transparency in environmental,
social, and corporate policies. Investors closely monitor companies' responses to ESG risks, opportunities, and environmental concerns. Emphasizing ESG factors is crucial for maintaining competitiveness and establishing a reputation as a responsible and sustainable organization.

— Develop a strategic roadmap and ensure its diligent execution: Define the initiatives necessary to achieve ESG goals, outline key steps, assign responsibilities, set timelines, and establish success criteria. To avoid straining resources, focus on a limited number of ESG strategies at a time. Engage stakeholders by initiating low-effort initiatives to build confidence and choose effective communication channels.

— Establish a robust communication strategy: Consistent communication about ESG performance fosters trust, enhances reputation, and attracts investors, customers, and talent. Transparent communication of ESG strategies demonstrates accountability, ethical practices, and a commitment to stakeholders' interests. Align internal practices with external communications to ensure authenticity and familiarity with stakeholders. Reporting on ESG metrics is vital, and utilizing well-known frameworks for progress communication is recommended.

Enhancing the ESG rating necessitates a long-term commitment, aligning with investor interests and the growing influence of ESG considerations, particularly with the emergence of Gen Z as a significant consumer segment. The benefits extend beyond societal impact, as a higher ESG score can lead to stronger financial outcomes in the future.

Companies should place greater emphasis on how the public perception of their ESG efforts for several reasons:

- Reputation Management: A commendable evaluation of ESG performance coupled with favorable viewpoints serve as an indication that the endeavors of the organization are being acknowledged and acknowledged by the appropriate target groups. In the present fiercely competitive landscape, where each brand strives assiduously to earn the faith of its stakeholders, the metrics of perception play a pivotal role in assessing the influence of the brand's ESG initiatives. Managing reputation becomes essential for maintaining stakeholder trust and loyalty.

- Investor Relations Enhancement: ESG ratings significantly influence investor preferences and decision-making. Investors might utilize ESG ratings to assess a company's enduring sustainability and risk mitigation strategies, thereby influencing the company's capital accessibility and capital expenses. In the absence of favorable stakeholder perceptions, investors may express concerns regarding the adequacy of the company's efforts to gain external support, leading to potential negative repercussions on the company's assessment. Research [18] shows that a substantial majority of investors, approximately eighty-nine percent, take into account ESG matters while deliberating on their investment choices.

- Meeting customer preferences and expectations: Perceptions of a company's ESG practices can sway customer preferences and purchasing decisions. Customers have a tendency to show a preference for companies that are perceived as socially responsible and sustainable, and this preference can directly influence a company's market share and revenue. Studies indicate that sixty-six percent of millennials research a company's ESG practices online before making a purchase.[16] A disconnect between a company's ESG ratings and public perceptions may indicate a reputation risk, impact investor relations, necessitate better stakeholder engagement, and put the company at a competitive disadvantage.

Hence, it is imperative for organizations to give primacy to resolving disparities or disparities between ESG assessments and the way they are perceived by the wider public. In simpler terms, the objective is to close the disparity between perception and actuality.
In the absence of a comprehensive understanding of how stakeholders view ESG accomplishments, companies might face the risk of neglecting their concerns until it becomes too late, leading to an erosion of trust from investors, customers, and employees, culminating in financial setbacks [19-20] and a compromised brand reputation.

The future projection for ESG reporting indicates that it will maintain its prominent position in the corporate realm. Although Corporate Social Responsibility (CSR) has historically served as a foundational element of ethical conduct, ESG has emerged as a focal point that significantly influences business evaluation and assessment.

In a recent survey [21], it was uncovered that eighty-two percent of chief executive officers (CEOs) recognized ESG as an essential catalyst for creating value within their enterprises.

Around half, specifically forty-nine percent, of the overall income generated by the top 1,200 global corporations originates from endeavors that contribute to the advancement of the United Nations Sustainable Development Goals (SDGs). [22]

Considering the increasing significance governments attribute to addressing the climate crisis and promoting equality, it is highly probable that this trend will gain even more momentum. In the coming years, ESG reporting may be treated on par with financial reporting, necessitating all companies to disclose their ESG performance based on universally recognized benchmarks.

There is an urgent need for businesses to prioritize sustainability, as stakeholder pressure on both companies and governments is anticipated to intensify. Seizing the opportunity to showcase leadership positions enterprises at the forefront of their respective industries. With ESG matters gaining traction with each passing day, time is of the essence and cannot be squandered.

Through the strategic utilization of media events and campaigns that align with shifting perceptions and emerging trends, coupled with the unique evaluation of purpose and ESG, brands can cultivate improved communication narratives and position themselves as ethical, responsible, and environmentally conscious entities.

5 Conclusion

In today's socially conscious landscape, an ESG strategy has become a vital tool for organizations aiming to cultivate stakeholder trust and ensure long-term customer loyalty. By embracing sustainability, addressing social responsibilities, and implementing effective governance practices, businesses can reap the benefits of enhanced reputation, increased investor interest, and lasting customer loyalty. Embracing an ESG strategy is not only an ethical imperative but also a strategic necessity in the pursuit of sustainable success in the global marketplace.

The findings and insights derived from this study contribute to the growing body of knowledge on ESG practices and offer practical implications for organizations seeking to integrate sustainability principles into their business strategies.

6 Acknowledgements

The paper was financed by a project under the "Science" Fund of the University of Food Technologies - Plovdiv, contract No. 3/22-H, subject: "TECHNOPOLIS UFT" - a center for qualitative scientific research in the field of academic entrepreneurship and green innovations to achieve high university competitiveness in the conditions of accelerated digitization".

References
1. L. Swedroe, S. Adams, Essential Guide to Sustainable Investing: How to live your values and achieve your financial goals with ESG, SRI, and Impact Investing, Harriman House, 244 (2022)
2. B. Bradley, ESG Investing, For Dummies, 1, 368 (2021)
4. C. Pagitsas, Chief Sustainability Officers At Work: How CSOs Build Successful Sustainability and ESG Strategies, Apress, 1, 356 (2022)
17. 2020 ESG trends to Watch, MSCI, https://www.msci.com/documents/10199/02f6473f-6fd8-aa8f-be72-443196478ec3 (Last accessed 11.06.2023)

