Stakeholder Capitalism and ESG: Achieving Climate Finance Goals

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Abstract

The paradigm of corporate governance is experiencing a pivotal shift from shareholder primacy to stakeholder capitalism. This evolution is underpinned by the definition of sustainable development outlined in the Brundtland Report of 1987. Traditionally, businesses focused exclusively on maximizing shareholder returns, but growing Environmental, Social, and Governance (ESG) concerns are demanding a more holistic approach to value creation. Focusing on long-term value creation by considering the needs of all stakeholders and integrating ESG practices, stakeholder capitalism reduces environmental risks, promotes social equity, and ensures robust governance. The World Economic Forum's stakeholder capitalism metrics provide a framework to measure and report ESG performance, encouraging transparency and accountability. The financial implications of unaddressed climate change, projected to reach USD 44 trillion in GDP lost by 2060, underscore the urgency for climate action. Short-term investor pressures, turbulent socio-political situations, an 'alphabet soup' of ESG reporting frameworks, and regulatory gaps hinder progress on consensus and climate action, but disclosures from pioneering companies demonstrate the financial advantage of stakeholder capitalism. The conclusion underscores the positive correlation between ESG and financial performance, and the importance of material ESG issues in stakeholder engagement. Recommendations highlight the need of quantitative studies for stakeholder capitalism and green finance impact measurement over geographies.

Keywords

Stakeholder Capitalism, Material ESG Issues, Climate Finance, Triple Bottom Line, Corporate Governance, Long-Term Value Creation.

Introduction

The World Economic Forum, 2020 at Davos boldly revolutionised the future with this statement about the purpose of business, 'the purpose of business is to solve the problems of people and planet profitably, and not profit from causing problems' (World Economic Forum, 2020). With this, the business world adapted the Triple Bottomline approach, of People, Planet and Profit, as the path to sustainable development as defined in the Brundtland Report of 1987. Historically, business purposes were centred around maximizing shareholder returns, a concept famously articulated by economist Milton Friedman, who asserted that 'the social responsibility of a company is to make profits for its shareholders' (Friedman, M. 1970) — a notion first articulated in the 1919 Michigan Supreme Court decision (Dodge v. Ford Motor Co., 1919). The stakeholder approach, born in 1950s, has challenged the traditional approach of 'The bottomline', with evidence from the post war decades, that an entity or person could only do well if the entire community and economy was functional. Klaus Schwab defines Stakeholder Capitalism as 'a form of capitalism in which companies do not only optimize short-term profits for shareholders, but seek long term value creation, by taking into account the needs of all their stakeholders, and society at large' (Schwab. K, 2022).

In response to the traditional short-term profit over long-term value creation, Stakeholder Capitalism is emerging as a new paradigm, emphasizing a broader purpose beyond shareholder profits. This shift acknowledges the interconnectedness of businesses and their stakeholders – employees, customers, communities and the environment. By focusing on stakeholder needs and creating shared value, companies can ensure long-term success while contributing positively to society and the environment.

The term 'ESG' that stands for Environmental, Social and Corporate Governance, was popularized by the study titled 'Who Cares Wins - Connecting Financial Markets to a Changing World' published by UNGC in 2004 (United Nations, The Global Compact, 2004). ESG is a framework designed to be integrated into an organization's strategy to create enterprise value by expanding the organizational objectives to include the identification, assessment and management of sustainability-related risks and opportunities in respect to all organizational stakeholders and environment. It is an apt framework for integrating stakeholders' interests into corporate decision making thereby assisting in achieving the goals of climate finance. This idea is explored in the sections hereunder.

Current Scenario: From Shareholder Primacy Towards Stakeholder Capitalism

The notion of Shareholder Primacy has dominated corporate governance for decades. This approach prioritizes maximizing shareholder returns, often at the expense of other subaltern stakeholders. However, growing concerns about environmental degradation, social inequalities and rising stakeholder expectations are strongly rejecting this model in favour of a more holistic one. The financial impact of unaddressed Climate Change is acknowledged by the business world and is expected to be in tunes of USD 44 trillion of GDP lost by 2060. Interestingly, for a +2 0C global temperature rise scenario, the implied ROI of mitigation costs is expected between 3 and 10 per cent by 2035 in avoided costs (Mercer, 2017). Such studies indicate the financial advantage of taking prompt action for Climate Change mitigation. The COVID-19 pandemic further exposed the inadequacy of Shareholder Primacy as a policy of choice for businesses. Companies that prioritized employee well-being and social responsibility during the crisis were better positioned to navigate disruptions and maintain long-term stability (Pillai, 2021).Stakeholder Capitalism offers a more holistic approach, recognizing the interconnectedness of corporations and their stakeholders (Schwab, 2021). This perspective posits that companies create long-term value by addressing the needs not only of shareholders but also of employees, customers, communities, and the environment.

The World Economic Forum's Stakeholder Capitalism Metrics, 2020 provides a framework for companies to measure and report on ESG performance. The framework consists of 21 core and 34 expanded matrices divided into four themes of People, Planet, Prosperity and Governance (World Economic Forum, 2020). The WEF framework is also inline with the requirements of UNSDG 17- Partnership for Goals and the measuring and reporting requirements are drawn from GRI and IR frameworks. This concurrence to existing reporting frameworks signifies the increasing recognition of ESG as a crucial driver for Stakeholder Capitalism.

ESG and Stakeholder Capitalism

ESG practices are a vital tool for operationalizing Stakeholder Capitalism. ESG considerations encompass environmental practices that address climate related risks and resource depletion. They also include social aspects like employee and worker welfare, diversity and inclusion, and ethical labour practices. Good Governance ensures transparency, accountability, and responsible decision-making on part of the management and leadership. Furthermore, Stakeholder Management is an integral process of any ESG management system to identify and address ESG concerns from stakeholders.

Transition to a Low Carbon Economy being an important goal of Climate Finance for addressing Climate Change impacts on business (UNFCC) has been in focus, especially since the Paris Agreement. Meta-studies of over 2000 academic studies published since 1970 indicate that integration of sustainable business practices, based on ESG frameworks can enhance Corporate Financial Performance (Mercer, 2017). The study also identifies the effectiveness of ESG in emerging markets and greater benefit of application of individual Environmental, Social and Corporate Governance focus components to business rather than a general ESG framework. This emphasises the importance and need for sector specific and thematic ESG standards and frameworks.

By integrating ESG principles, companies can build trust and enhance their long-term value proposition to stakeholders. ESG investments that address environmental and social challenges can generate financial returns by improving efficiency, reducing risk, and attracting environmentally and socially conscious investors.

Challenges and Opportunities

Despite the growing momentum, implementing Stakeholder Capitalism faces certain challenges. Short-term investor pressures may create resistance to investments with long-term sustainability goals. Unstable socio-political climates may deter sustainable climate finance and promote opportunism. Measuring and reporting on ESG performance can be complex and require robust unified frameworks. Integrating stakeholder interests into decision-making processes requires a cultural shift within organizations (Pillai, 2021).

Inspite of the World Economic Forum introducing the Stakeholder Capitalism Matrices in 2020, there is no universally accepted legal framework for Stakeholder Capitalism but, a shift towards stakeholder-centric governance is evident. Regulatory initiatives such as the EU's Corporate Sustainability Reporting Directive (CSRD) mandate reporting on sustainability factors, including ESG metrics (EU CSRD Directive, 2022). Other notable regulatory initiatives are TCFD in the UK, SEBI's BRSR in India and ISSB aligned upcoming standards in other Asian countries. This trend indicates a growing focus on corporate responsibility, stakeholder engagement and transparency in reporting.

Despite the challenges, Stakeholder Capitalism presents compelling opportunities for corporations. By prioritizing ESG, companies can create a more sustainable business model, reducing environmental impact and building resilience against climate change. Furthermore, a strong focus on employee well-being and social responsibility can improve talent attraction and retention (Sharma et al., 2024).

Strong ESG practices lead to enhanced brand reputation and consumer loyalty. Studies have shown that the consumers are increasingly willing to pay a premium for products and services from companies committed to sustainability and social responsibility (Puriwat W. et al. 2024). The demand for sustainable goods and services is evident from the rise of Sustainable Cotton and Coffee, Cruelty free cosmetics, Farm fed meat, Organic foods, Recyclable packing etc.

Case Studies: Leading the Way

Several companies have successfully embraced Stakeholder Capitalism and integrated ESG principles into their core business strategies. For example, Unilever has made significant strides in sustainable sourcing and reducing its environmental footprint achieving 97.5 per cent deforestation free verified status for its key commodities (Unilever Plc.). The company's commitment to social responsibility has also garnered widespread recognition. Similarly, Patagonia has built a strong brand identity around its sustainable business practices and procurement practices led by their Responsible Service Provider Principles and Preferable Purchasing Principles respectively. Patagonia purchased 7000 REC (7000MWh) in 2023 in addition to installed RE infrastructure and aims to have 100 % renewable energy for its owned and operated facilities globally by 2025 (Patagonia, Inc.).

Google intensified its public policy and advocacy efforts with becoming the official COP-27 partner in 2022 and declaring support for policies aligning with the Paris Agreement. Expanding its stakeholder engagement and governance scope, Google launched the '20 % Project' initiative for its employees enabling opportunities to work on sustainability alongside their primary role and including Environmental Stewardship in their Supplier Code of Conduct. Recognising itself as an energy intensive business, Google became a signatory for SBTi and declared its ambitious 'moonshot' target of 100 per cent carbon free energy (24/7 CFE) by 2030. Currently, 64 per cent electricity across its data centres and offices globally is CFE (Google Environmental Report 2023).

Ikea updated its climate goals in-line with 1.5^0 C target and submitted a revised SBTi Net Zero goal of 50 per cent reduction in GHG emissions by 2030 and 90 per cent by 2050. With initiatives for supporting small business and local communities, in FY23 Ikea signed 12 partnerships with 11,000 people from vulnerable and marginalised groups who are now employed in IKEA production (IKEA Sustainability Report FY23).

Other notable examples are of GE, Siemens and IBM (Research Gate, 2024). A Rockefeller-NYU meta-study aggregating the findings of 1,000 studies published between 2015 and 2020 on the relationship between ESG and Financial Performance of organisations found only 6 and 13 per cent negative outcomes for corporate and investor studies respectively. These outcomes were attributed to expense and effort on non-material ESG issues and confusion regarding ESG investment strategies (Whelan et al., n.d.).

The abovementioned case studies demonstrate the potential for long-term value creation through Stakeholder Capitalism. By integrating ESG factors into business decision-making and materiality driven stakeholder engagement, these companies are improving their climate risk resilience and market reputation.

Conclusion

- The shift from shareholder primacy to stakeholder capitalism represents a fundamental transformation in corporate purpose and an evolution in corporate governance.
- The positive correlation between ESG and Financial Performance of corporates and investors is evident from the meta-studies and public disclosures.
- Materiality and material ESG issues has emerged as the pivot for the above correlation for ill-planned and misdirected efforts could lead to negative outcomes.
- Stakeholder engagement for identification and action on material ESG issues of mutual interest has emerged as the single largest contributor to long term value generation for businesses.
- The best possible outcomes of climate action, i.e. climate change resilience, achieving Net Zero targets, circularity etc. seems to be through long-term value generation.
- Exploring the role of technology in facilitating stakeholder engagement and data collection is crucial. By understanding the dynamics of stakeholder relationships and the evolving regulatory landscape, researchers can provide valuable insights for policymakers and businesses alike.
- WEF's Stakeholder Capitalism Metrices, 2020 could be the tool for exercising Stakeholder Capitalism globally, imbibing requirements of other ESG impact and reporting standards

Future Research and Exploration

- Just like EU, USA, Singapore and many other countries, India should develop a national ESG Impact measurement and reporting standard and, a regulatory mechanism for its mandatory implementation across sectors. Adapting the WEF Stakeholder Capitalism framework in this national ESG standard would greatly improve diversity, inclusion and transparency matrices of ESG reporting from companies. On a national level, this initiative would improve social-justice and reduce the socio-economic divide in Indian society.
- To ensure effective implementation, experts and industry leaders should collaborate on creating globally accepted ESG frameworks and robust metrics to measure the long-term impact of ESG initiatives on financial performance.

- Governments and international regulatory bodies should take urgent action on finalising Regulatory Frameworks for geographies to enforce climate action and transparent reporting.
- There's a need for conducting detailed quantitative studies on the impact of stakeholder capitalism in different geographies and measure its impact on long-term value creation in the region. Also, *for climate, or green, finance as part of ESG investing there seems to exist no peer-reviewed meta-analysis to date* (Atz et al., 2020).

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