Does ESG Create Real Value, or Is It Just Smart Marketing?

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Environmental, Social, and Governance (aka ESG) is a term that is blowing like a gale in the scene of corporate and investment worlds. On the one hand, it’s increasingly becoming a mandatory part of company strategies and a key tool for attracting investments.

On the other hand, ESG faces significant scrutiny and criticism. In this article, I’ll try to illustrate why ESG is bringing reactions and still makes the value of its existence for investors and businesses.

The rise of ESG’s popularity

It’s hard to ignore the growing influence of ESG. For example, sustainable fund inflows jumped from $5 billion in 2018 to $87 billion in the first quarter of 2022. However, this enthusiasm cooled noticeably, with inflows dropping to $33 billion by the second quarter. Nevertheless, as of mid-2022, global sustainable assets stood at approximately $2.5 trillion.

Many factors contribute to these factors, particularly emphasizing the environmental side of ESG, which is mainly focused on climate change. Companies are striving to reduce their carbon footprint and adopt renewable energy sources. The social and governance aspects of ESG are beginning to be treated similarly.

For example, in 2021, shareholder proposals on social issues, such as pay equity, improved working conditions and diversity initiatives, increased by 37%.

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Criticism of ESG

Why, despite its apparent growth, does ESG face criticism? First, many argue that ESG detracts from businesses' primary objectives. Milton Friedman made this saying too well decades ago when he said that a company is meant to make profits. Skeptics believe ESG diverts resources from this aim.

Another common critique centers on ESG ratings. In Europe, where ESG principles have been embraced for over a decade, data has revealed inconsistencies in these ratings. Large corporations with the resources to invest in social and environmental initiatives often dominate rankings, while smaller companies struggle to compete due to limited financial capacity.

Besides, the methods of computing ESG scores lack transparency. Different agencies apply varied criteria, resulting in inconsistent evaluations. High ratings can be assigned to certain factors of a company while maintaining neglect to others.

There's also the issue of ESG's mandatory nature. Economists argue that sustainability should be voluntary. Mandating ESG metrics increases business costs, which can lead to higher product prices and reduced competitiveness, particularly in emerging markets where resources to meet international ESG standards are limited.

Moreover, some critics view ESG as a marketing ploy. Corporate social responsibility and environmental activities sometimes appear more as a reputation-building exercise than sincere

efforts toward real change. A large number of institutional investors remain skeptical about companies' ESG claims, questioning their authenticity and effectiveness. This doubt raises concerns about the long-term value of ESG initiatives and whether they genuinely contribute to meaningful change or are simply used as a marketing tactic.

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Why ESG still matters for investments

Despite the criticism, ESG still plays a significant role in all investment decisions. Surveys show that 82% of asset managers in the U.S. and almost 100% in Europe systematically incorporate ESG metrics into their strategies. This approach widens the net by creating a larger pool of data for analysis on how investors are seeing companies addressing risks associated with climate change, employee rights and corporate ethics.

From my experience working with investment funds, I've seen how a company's sustainability efforts directly impact its ability to attract capital. For instance, tech companies score high on ESG owing to their low carbon content, and therefore, they turn into attraction magnets for investors. Additionally, companies with strong social and environmental initiatives often receive backing from government funds and international organizations, creating a competitive edge.

In the long run, ESG helps mitigate risks. Generally, companies that incorporate environmental factors and those located near social factors tend to be more impenetrable during a crisis. During the COVID-19 pandemic, ESG-focused companies adapted more quickly thanks to robust corporate cultures and socially responsible practices. High ESG-rating companies report lower volatility with more steady profit

growth in tough economic times, according to studies.

Striking a balance between profit and responsibility

One of ESG's biggest challenges is balancing financial goals with stakeholder interests. Responsible companies must account for the needs of customers, employees, suppliers and environmental initiatives. However, it's impossible to satisfy everyone simultaneously.

Trade-offs are inevitable and can be perceived negatively by both investors and the public. For example, increased spending on environmental projects might reduce profits, causing shareholder dissatisfaction.

Some studies also question the direct link between high ESG ratings and financial performance. Correlations may often result from external factors like market trends or industry characteristics.

For example, a company might score high on ESG due to its commitment to sustainability, but its financial performance could be driven by factors like a booming industry or a favorable market cycle rather than the ESG initiatives themselves.

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The future of ESG

Modern challenges like the energy crisis and geopolitical instability are testing the limits of ESG. For example, enhancing energy security could lead to increased fossil fuel use, contradicting environmental goals. However, these crises also drive innovation, such as adopting renewable energy sources and developing new resource management technologies –

potentially paving the way for ESG’s evolution.

I firmly believe that ESG remains vital. While it needs refinement – ratings must become more transparent, and mandatory metrics more flexible – companies that embed sustainability into their strategies gain a competitive advantage. They better understand risks and foster stronger relationships with investors. Moreover, ESG’s development can transform corporate culture, making businesses more adaptable to future challenges.

In conclusion, ESG represents an effort to make businesses more responsible and sustainable. Although the path to an ideal model is long, investors and companies embracing ESG are laying the groundwork for a more stable and equitable future. The success of ESG depends on collaboration across the market – from regulators to investors and corporations. This collective effort could be the key to building a more sustainable global economy.

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