Academic Paper Summary

Assessing the business case for environmental, social and corporate governance practices in South Africa

This is a review of an academic paper. To read the original paper, click here.

*Source: Johnson, R., Mans-Kemp, N. & Erasmus, P.D., 2019, '**Assessing the business case for environmental, social and corporate governance practices in South Africa**', South African Journal of Economic and Management Sciences 22(1), a2727. https:// doi.org/10.4102/sajems. v22i1.2727*

As the corporate world continues its gradual move from the traditional 'shareholderism' approach towards 'stakeholderism', a broader view of what is considered value creation and how it can benefit the business and society must be considered. This academic paper investigates the business case for using environmental, social and corporate governance (ESG) metrics when measuring company performance. This paper explores the relationship between ESG and corporate financial performance (CFP) measures as we traditionally know them. William Ford Junior stated that "creating a strong business and building a better world are not conflicting goals; they are both essential ingredients for long-term success". Traditionally, corporate financial measures have formed the bulk of measures used to measure corporate performance against. This is backed up by the vast number of academic papers that explore corporate performance as a function of financial measures. This paper takes an alternative approach and analyses the ESG performance (dependent variable) data from 66 JSE-listed firms (for 6 years) against eight corporate financial performance measures. In the past, ESG measures have typically been a composite index of the three elements (environmental, social and governance); this paper investigates the impact of each of these in isolation as the combination of these factors conceals the intensity with which each factor is pursued. The ESG scores for each company are based on the Bloomberg ESG disclosure score. The aspects considered under each section of ESG are:

Environmental Aspects	Social Aspects	Corporate Governance Aspects
Risk created by operational decisions	Risks arising from human resource policies and practices	Risk stemming from flaws in corporate governance policies
Carbon emissions	Supply chain	Voting practices
Climate change	Discrimination	Executive compensation
Pollution	Political contributions	Shareholder's rights
Waste disposal	Diversity	Takeover defences
Renewable energy	Human rights	Staggered boards
Resource depletion	Community relations	Independent directors

The relationship between the environmental, social and corporate governance aspects and the corporate financial performance measures were tested at both an aggregate (ESG) and individual (environmental, social and corporate governance separately) level. There are 8 corporate financial measures used as the independent variables and these are grouped under three types of measures as listed below:

Accounting-based CFP Measures	Market-based CFP Measures	Value-based CFP Measures
Return on Assets	Earnings Yield	Return on Invested Capital (ROIC)
Earnings per Share	Total Shareholder Return	Spread (ROIC - WACC)
		Market Value Add
		Cash Return on Invested Capital

The sample data indicated that over the 6-year period, although the average composite ESG score increased, this was driven primarily by increases within the social aspects of the ESG measures. Given South Africa's history of inequality, it is not surprising that this area is receiving specific attention. The average score for each of the individual ESG aspects are significantly different from each other which supports the view that the impact of the ESG aspects should be viewed in isolation so that their true relationship is clearer (rather than being viewed as a composite ESG index).

The accounting-based CFP measures had no significant relationship with the composite ESG measures; however, it did have a significant relationship individually with the environmental and social aspects. In fact, within this analysis, the composite ESG index did not have any significant relationships with the CFP measures. This illustrates the impact of each individual ESG factor on financial performance is not evenly distributed across the factors and that they each have their own unique relationships.

Similarly, the relationship between the individual ESG factors and the CFP measures were investigated within individual sectors to investigate whether the sector influences these relationships. The consumer goods, consumer services and industrials sectors were explored in this research. The findings are such that it can be concluded that the sector does play a significant role in determining the relationship between each individual ESG factor and the CFP measures. This would seem logical as it is more likely that a mine would focus on land rehabilitation than a tech company due to the mine's obligations in terms of its mining license, as an example. This means that organisations pursue the ESG factors that have the most impact / present the most risk to them and these are largely determined by the environment within which they operate. Therefore, ESG factors are not pursued with equal vigour across all industries.

This paper indicates that businesses that target ESG factors as performance metrics will select the most appropriate factors relative to their business environment. The evidence indicates that pursuing each of the ESG factors with equal vigour is not taking place and intuitively this makes sense (as illustrated in the mining example earlier in the text). Although these factors need not be pursued with equal vigour, it is imperative that each ESG factor is considered as the purpose of targeting ESG factors is to improve long-term sustainability rather than focussing largely on financial factors as has been the case in the past.