2 Theoretical Background

2.1 What is ESG? Revolution or Repetition?

"Environmental, social and governance (ESG) investing is a strategy you can use to put your money to work with companies that strive to make the world a better place." (Napoletano & Curry, 2022)

"Environment, Social and Governance (ESG)—incorporates financial considerations such as investment returns, fees, risk and tax matters alongside environmental impact and matters related to workers' well-being, the diversity of corporate leadership and corporate social responsibility more generally." (Mottola, Valdes & Ganem; 2022)

"Environmental, social, and governance (ESG) investing refers to a set of standards for a company's behavior used by socially conscious investors to screen potential investments.“ (Investopedia, 2023)

"ESG means 'environmental, social and governance,' and represents a more stakeholder-centric approach to doing business. ESG is set on the principle that the environment is only one factor in determining an organization's commitment to sustainability." (Diligent, 2023).

"ESG overall, gauges the risk the world poses to a company, not the other way around. (…) I would even say many portfolio managers don't totally grasp that. Remember, they get paid. They're fiduciaries, you know. They're not as concerned about the risk to the world." (Fernandez as cited in Simpson, Rathi & Kishan, 2021).

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"ESG isn't 'sustainable', 'green' or making an 'impact'." (Samuelrich as cited in Kishan & Schwartzkopff, 2022).

What these definitions unanimously show is that there is currently no clear definition regarding ESG. Consequently, neither academics, nor professionals can agree on the purpose and mission of ESG. At least in that regard there is agreement: Larcker, Tayan and Watts state that indeed one of the biggest myths in ESG is that *"we agree on the purpose of ESG"*[7] (2022a, p. 870). Similarly, Martin Lipton – professor of Law at Harvard University – argues that *"uncertainty also abounds as to what ESG truly means"* (2022).

Evidently, ESG is surrounded by acute ambiguity. Apart from the philological questions this poses, it implies a multitude of business challenges. However, one uniting aspect of ESG is the persistent attention from society's major leadership groups[8], such as political elites, business elites (finance and corporate side) and academic elites, despite distracting affairs such as the war in Ukraine or the (now-fading) energy crisis of 2022 (Agnew, Klasa & Mundy, 2022). Particularly, the European Union can be regarded as an exemplary driver of the 'ESG Revolution' (Christ & Gassmann, 2022), as it has launched and implemented various regulations that make ESG integration mandatory for thousands of businesses. One reason for both the ambiguity and sustained attention is the historical development of the term ESG. Chapter 2.1.2 delves further into the origination of ESG and thereby examines how the terminological vagueness arose and when and why ESG gained serious momentum.

Before the history of ESG is examined though, it is important to note that considerations of the relationships a business enterprise has with the environment, stakeholders, communities and society at

7 This thesis defines the purpose of something (e.g. business enterprises, governance agencies or movements) as its raison d'être, the reason for which something is done, made or allowed to happen (Cambridge Dictionary, 2023). The mission of something is hence defined as the actions and tasks necessary to achieve this purpose.

8 Drucker would call them *"those with ressources"*, *"the business elite"* or one of *"society's major leadership groups"*.

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large have a long history (Lykkesfeldt & Kjaergaard, 2022, p. 245). For instance, in 1915, the Harvard Business School already offered a class titled 'Social Factors in Business Enterprise' (Salmans, 1987). Similarly, in 1917, Walther Rathenau expressed his skepticism about the power of speculative shareholders in Germany (Brandt & Konstantinos, 2016, p. 9) and their influence on the national economy (ibid., p. 13). Naturally, these early efforts were heavily disrupted by the two world wars, yet as early as 1953, the term 'Corporate Social Responsibility' was coined by Howard Bowen (Lee, 2008, p. 57)[9]. Since the questions regarding the role of corporations in society and their accountability for the impacts they create have surfaced, the discussion has encountered numerous twists and turns[10]. One prominent example of the past century is the 'Triple Bottom Line', coined by John Elkington in 1994. Yet, in 2018, Elkington himself writes in the Harvard Business Review that the once highly applauded idea of *"balancing people, planet & profit"* has become either completely forgotten or reduced to a mere accounting tool, instead of actually doing things differently (Elkington, 2018). As history shows, this is not a rare case when it comes to rethinking capitalism. In a collection of essays by the Fraser Institute called 'ESG: Myths & Realities', Steven Globerman explains:

> *"The call for a new set of guiding principles for private sector organizations has taken various identities over time, including socially responsible business behavior, stakeholder capitalism, sustainable capitalism, socially responsible investing, sustainable investing and, most recently, ESG. While there are differences across the varied calls for reforming capitalism, for example whether the main focus is on managers of operating companies or on wealth managers, they all call for a new form of capitalism."* (Globerman, 2022, p. 1)

9 For a comprehensive overview of the development of CSR see Agudelo et al. (2019).

10 Throughout his books and articles, Peter Drucker was continually concerned with this question too (Drucker, 1993, p. 71). Starting from Chapter 2.5, this thesis will more closely integrate Drucker's perspective.

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Now, the question that arises is if ESG will be any different in this regard? This thesis makes an argument that it most likely will be, due to a multitude of factors, which are subsequently explained throughout the theory part of this thesis. These factors entail the initial emergence of ESG, the co-development of ESG by the political and business elite, sustained momentum in times of crises (partly because of them) and the generational demand for change that continues to grow louder. However, at the same time, enthusiasm for ESG is at an infliction point. To turn it into a real change bringer, instead of merely another repetition of an attempt to change capitalism, ESG's purpose and mission must be re-examined.

2.1.2 The Emergence and Development of the Term ESG

For the initial upcoming of the term 'ESG', the United Nations (UN) and its former Secretary General Kofi Annan[11] played a critical role. The fall of the iron curtain in November 1989 paved the way for a new wave of globalization. However, during the 1980s, economists were already concerned with unchecked globalization increasingly causing poverty and inequalities in some regions of the world, while leading to great wealth in others (Dollar, 2005).

In 1998, Annan stated that *"there is a great potential for the goals of the United Nations – promoting peace and development – and the goals of business – creating wealth and prosperity – to be mutually supportive."* (United Nations, 1998). Subsequently, the UN started to set up a myriad of public-private partnerships during this period, reflecting a shift toward understanding business as part of the solution for advancing its goals (Pollman, 2022).

Notably, Annan co-founded the 'Global Compact', a voluntary initiative between the UN and nongovernmental financial bodies to advance human rights, labor rights, anti-corruption efforts, corporate governance and environmental practices across the world or in short

11 Kofi Annan was the 7th General Secretary of the UN from 1997 to 2006.

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to promote actions globally that are in line with their declared ten principles (see Appendix 1). Within its first years of existence, the Global Compact attracted more than 1,000 members to join. Particularly, the Enron scandal in 2001 and WorldCom scandal in 2002 greatly fueled the rapid growth of the initiative (Agnew et al., 2022). Today, the Global Compact consists of over 22,000 signatories and, according to its' website, is now *"the world's biggest corporate sustainability initiative"* (Global Compact, 2023). In 2004, the Global Compact published its landmark report 'Who Cares Wins', which is broadly acknowledged to be the originator of the acronym ESG (Pollman, 2022; Billio et al., 2020, p. 1427; Larcker et al., 2022b, p. 8). 'Who Cares Wins' was co-written by the UN and 18 major financial institutions, including some of the world's biggest banks and insurances[12] (Global Compact, 2004).

According to Pollman (2022), the wording of the 'Who Cares Wins' report was purposefully chosen to be open-ended, and therefore crucial for the parallel development of multiple understandings of ESG.

For instance, the report explicitly states that the endorsing organizations are convinced that a better consideration of environmental, social and governance factors will not only lead to stronger and more resilient investment markets, but contribute to the **sustainable development of societies** [author's emphasis] as well (Global Compact, 2004). Moreover, for the first time, the contributors argued that in a more globalized and interconnected world, a company's competitiveness is increasingly dependent on the management quality of ESG issues, especially because these issues can have a strong impact on the reputation and brand of a company, which are factors likely to represent two-thirds of the value of a listed company (ibid., p. 9)[13].

12 The 'Who Cares Wins' report is publicly available. Complete list of contributors: ABN Armo, Aviva, AXA Group, Banco do Brasil, BNP Parisbas, Calvert Group, CNP Assurances, Credit Suisse Group, Deutsche Bank, Goldman Sachs, Henderson Global Investors, HSBC, ISIS Assest Management, KLP Insurance, Morgan Stanley, RCM, UBS, Westpac.

13 In recent years, numerous instances have highlighted the detrimental consequences of inadequate ESG management on the valuation of publicly listed companies. Notable examples include BP (2010), Volkswagen (2015), and Facebook (2016). Recognizing ESG issues as critical factors influencing a company's reputation and

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Pollman (2022, p. 12ff.) meticulously describes three aspects that stand out most about the language used in the report. All of these aspects below have considerably sparked discussions in the ESG sphere.

Firstly, the report tried to contrast the use of the term ESG deliberately to existing terms. In the introduction of the report it reads:

> *"Throughout this report we have refrained from using terms such as sustainability, corporate citizenship, etc., in order to avoid misunderstandings deriving from different interpretations of these terms. We have preferred to spell out the environmental, social and governance issues which are the topic of this report."* (Global Compact, 2004, p. 1f).

Secondly, in 'Who Cares Wins', the authors shed light on the rationale behind including 'G' in the ESG framework, a notion that remains contested today (Larcker et al., 2022a, p. 875). The report states:

> *"Sound corporate governance and risk management systems are crucial prerequisites to successfully implementing policies and measures to address environmental and social challenges. This is why we have chosen to use the term 'environmental, social and governance issues' throughout this report, as a way of highlighting the fact that these three areas are closely interlinked."* (Global Compact, 2004, p. 2)

Thirdly, and most importantly, the report describes how ESG factors are financially material and therefore should be in embedded into every financial analyst's normal work (ibid., 38):

> *"This report focuses on issues which have or could have a material impact on investment value. It uses a broader definition of materiality than commonly used — one that includes longer time- horizons (10 years and beyond) and intangible aspects impacting company value. Using this broader definition of materiality, aspects relating to generally accepted principles and ethical guidelines (e.g. the universal*

brand is intricately linked to the concept of social legitimacy/social license, which will be explored further in the subsequent section of this thesis.

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principles underlying the Global Compact) can have a material impact on investment value." (Global Compact, 2004, p. 2)

Throughout the report, these three aspects framed the term ESG with an 'investment rationale', but one that was not constricting itself to traditional or narrow notions of (financial) materiality.

The institutions responsible for the report declared a firm commitment to actively pursue the implementation of the recommendations presented therein. Their dedication extended further as they expressed their intentions to foster a comprehensive understanding of ESG. They aimed to achieve this through the engagement with relevant accounting standard-setting bodies, professional organizations, investors, consultancies, stock exchanges, NGOs and government bodies (Global Compact, 2004, p. 40). Lastly, they pleaded to more extensively integrate ESG issues in both their investment research and offerings and to share recommendations and best practices in order to increase knowledge and implementation amongst each other (ibid., 2004).

So, the term ESG was officially brought into existence. In the following years, the UN made several strategic efforts to further develop ESG, the essence of the 'Who Cares Wins' report (Pollman, 2022, p. 14–18). One notable example is yet another initiative, namely the 'Principles for Responsible Investment' (PRI) that blue stamped ESG as an umbrella term to enhance Corporate Social Responsibility encompassing various frameworks (Lykkesfeldt & Kjaergaard, 2022, p. 48).

Still, ESG had not really caught on in broader circles until three critical milestones happened, causing a 'Ketchup-Effect'[14] that catapulted ESG from a position of a niche technical term into the midst of business, politics, academia and media (ibid.).

Firstly, in 2015, both the Paris Agreement and the UN Sustainable Developments Goals (SDGs) were signed by almost all members of the United Nations, which lifted the consideration of ESG issues to a new level of public exposure. In the following years, the European Union

14 Ketchup effect: First nothing happens – but after some shaking – everything spills out at once.

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emerged as the leader regarding ESG integration. Particularly, the Corporate Sustainability Reporting Directive (CSRD) can be viewed as **the** landmark ESG legislation. Since January 5th, 2023, over 50,000 companies in the EU must report their ESG performance according to the European Sustainability Reporting Standards (ESRS), for which ironically only drafts exist thus far [State: June 2023] (European Commission, 2023a).

Secondly, Larry Fink[15], CEO of BlackRock, the largest asset management firm in the world, addressed ESG for the first time in his annual letter to shareholders in 2017. He stated that BlackRock views ESG factors as *"essential insights into management effectiveness and thus a company's long-term prospects"* (Fink, 2017 as cited in Pollman, 2022, p. 18). Considering BlackRock's massive holdings (with voting rights) in most of the world's big publicly-listed corporations, Fink's letter was a gateway to mainstream ESG.

The third milestone for the 'meteoric' rise of ESG is not one singular moment, but an array of impactful political, social and economic events. Next to a cascade of crises such as the Euro-crisis in 2012, the refugee-crisis in 2015, the ongoing climate crisis and the Covid-19 pandemic, the developed world has also been disrupted by powerful social movements like #MeToo, Black Lives Matter and Friday's for Future (as well as similar movements throughout countries around the globe).

Today, numerous elite business schools are majorly updating their curricula to include ESG, which can be viewed as a testimony to ESG's establishment. In her New York Times article 'Have the Anticapitalists Reached Harvard Business School?', Emma Goldberg (2022) states that:

> *"Top-ranked business schools are stepping into the political arena. Harvard started its Institute for the Study of Business in Global Society last month. Nearly half of the Yale School of Management's*

15 Larry Fink is a ubiquitous personality within the ESG debate, who often tied numerous buzzwords such as 'coporate purpose', 'sustainability' and 'stakeholder capitalism' to ESG.

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> *core curriculum is devoted to E.S.G. Next fall, the Wharton School of the University of Pennsylvania will start offering M.B.A. majors in diversity, equity and inclusion and in environmental, social and governance factors for business"* (Goldberg, 2022)

While these implementations appear somewhat hasty as ESG is still in the field phase of corporate realities (Samans & Nelson, 2022, p. 6), they are unlikely to be reversed (Keegan, 2022).

Naturally, the financial industry knew how to respond to ESG's rise as well. Next to BlackRock, other big asset management firms such as Vanguard or State Street followed suit and, despite ambiguity about the real meaning of ESG, it quickly became a standard practice to offer ESG investing products (ibid.). Clearly, the market was here for it. In 2015, there were only around 500 billion USD of ESG labeled assets under management (AUM) globally (European Central Bank, 2020), as opposed to the staggering number of 18.4 trillion USD of ESG AUM in 2021 (PwC, 2022). Similarly, MSCI reports that between 2015 and 2020 the global ESG ETF AUM has multiplied by the factor of 25 (MSCI, 2020, p. 2). At the same time, the supply of consulting or asset management services regarding the trendy acronym are skyrocketing. Although the demand is there, the sincerity and qualification of the respective professionals are often questionable (Tricks, 2022; Mance, 2023). With so much money on the table, one question must be asked: How is it possible that there is still no common definition of ESG? And why, despite this, did people 'buy into' the idea of ESG?

2.1.3 More Definitions Than Letters: Flexibility, Ambiguity and Confusion Around ESG

As far back as 2004, attempts were made to be particular about the meaning of ESG and to simultaneously to be distinct from other related terms. However, without great success. As mentioned above, to this day we have no absolute certainty about what ESG truly means. The table below presents an overview of various ESG definitions provided by

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multiple researchers who have explicitly addressed the diverse meanings associated with ESG[16].

Table 1: The Different Definitions of ESG

ESG can be viewed as...	As evidenced by...	Summarizing Narrative
Factors of Investment Analysis	Pollman (2022, p. 21); Larcker et al. (2022a, p. 870); Clément et al. (2023, p. 11)	"The business case of ESG for long-term shareholder value"; "ESG is protection against society"
Risk Management Tool	Pollman (2022, p. 23); Clément et al. (2023, p. 11)	"ESG is an attempt by companies to self-regulate their conduct."
Operationalization of CSR	Pollman (2022, p. 24); Larcker et al. (2022a, p. 871); Clément et al. (2023, p. 9)	"ESG as a measurement of the actual implementation of CSR strategies"
Factors to Implement Stakeholder Capitalism	Samans & Nelson (2022, p. 3), Larcker et al. (2022a, p. 871)	"ESG as a tool to avoid catastrophic impacts on people and planet"; "ESG is doing good."
Ideological Preference	Pollman (2022, p. 25); Larcker et al. (2022a, p. 871)	"ESG as tool for expressing a preference or virtue signaling"

Although none of the authors explicitly express that ESG is indeed a value-laden concept, their tone leads towards such an interpretation. Again, Pollman (2022, p. 18) describes that especially in the early years following the 'Who Cares Wins' report, a purposeful attempt was made to shift the conversation away from personal ethics and more towards material issues, that the investment and financial industry understood (ibid.), inter alia to "*protect*" ESG from "*lobbyists uncomfortable with anything which challenged the Milton Friedman doctrine*" (ibid.).

Euphemistically speaking, the presented flexibility of the term ESG spurs discussion and vibrant thinking amongst business, political and

16 This table shall not be seen as an extensive meta-analysis, but rather as a mean to provide anecdotal insights that the scientific community has put in efforts to decipher the true definition of ESG.

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academic leaders. On the other hand, it is also the root cause of a phenomenon that Peter Paschek would probably describe as followed:

> "*Vague terms unsettle both mind and emotion and are a major obstacle to civilized and responsible public discourse.*" (Paschek, 2020, p. 88[17] [direct translation german-english])

Chapter 2.2 extensively shows how this unsettling of mind and emotion spurred heated debates between ESG's proponents and opponents, while it simultaneously enabled an army of white-collar workers to work in the 'ESG Ecosystem' and thereby not only make a living, but turn a profit around an acronym that could not be more ambiguous. But how can ESG be interpreted in so many, and partly contradicting, ways?

Pollman (2022, p. 29) makes the convincing argument that the chosen language used in the 'Who Cares Win' report and thereby the coining of ESG remained open from the very beginning due to the absence of a specific definition and clear conceptual foundation. Although ESG was initially instated to broaden the issues that the financial industry should consider in investment analysis, it became linked to the idea of proactive involvement in addressing environmental and social concerns and generate sustainable long-term value. Additionally, it became associated with the goals of the United Nations and the principles of the 'Global Compact', which aimed to promote social benefits, security, and sustainable development on a wider scale and longer time horizons than those usually focused on by proponents of the shareholder primacy. As the term gained popularity over the next decade, it turned into a "*big tent*" that acquired diverse connotations (see table above) and interpretations from a broad variety of market actors that hold significantly different views about the purpose and mission of ESG. However, while the explosive diffusion of ESG has attracted trillions of investment dollars and fueled regulatory reform,

17 "*Vage Begriffe verstören Verstand wie Gefühl und sind ein großes Hindernis für einen zivilisierten und verantwortlich geführten öffentlichen Diskurs.*"

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it also is heavily critiqued due to its lack of common theorization and publicized ambiguity.

George Serafeim – a highly regarded ESG researcher from Harvard Business School – states that although the rise of ESG was necessary, the term has rapidly “*become a household name leading to both confusion about what it means and creating unrealistic expectations about its effects*” (Serafeim, 2021, p. 1).

In accordance to the meta-analyses by Clément et al. (2023), Dathe et al. (2022, p. 117) or Mayor (2019), this thesis cautiously adopts the definition that ESG is the operationalization of Corporate Social Responsibility. Caution is warranted however as CSR – one of the preceding acronyms to ESG – suffered from a potentially even broader range of various understandings accompanied by a colorful selection of buzzwords such as Socially Responsible Investing, Corporate Citizenship or the aforementioned Triple Bottom Line that ultimately rendered it (almost) ineffective apart from select philanthropic donations and countless whitepapers by big corporations. All of these concepts found their place of relevance, but none have significantly changed the world for the better, nor have they made the quality of life the business of business. As Chapter 2.2 will show, some voices project a similar journey for ESG as well.

2.1.4 The Different ‘Kinds of ESG’

After an extensive analysis of ESG’s origin and how it fueled both the broad acceptance by a variety of market actors and the multiple understandings of its purpose, the question arises what are commonly agreed upon ESG criteria? The following table provides a brief overview:

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Table 2: Overview ESG criteria

Environmental	**Social**	**Governance**
Addresses impact on the physical environment and the risk of a company and its suppliers/partners from climate events	Addresses social impact and associated risk from societal actions, employees, customers and the communities where it operates	Assesses timing and quality of decision making, governance structure and the rights and responsibilities of different stakeholders, in service of positive societal impact and risk mitigation
Examples: – Greenhouse gas emissions – Raw material sourcing – **Waste and pollution management** – Land use, biodiversity and ecosystems; rehabilitation – Environmental opportunities (green building, clean tech & renewable energy)	Examples: – Labor management, (health and safety, supply chain standards) – **Human capital development** – Community engagement (diversity and inclusion, local economic contribution – Customer engagement – Product and service attributes (customer engagement, product safety)	Examples: – Business ethics – Data security – Capital allocations (e.g. executive pay) – Tax transparency and financial reporting – **Position and advocacy** – Structure and oversight (Board, Ownership & Control Rights)

This table is built on suggested ESG factors from MSCI, S&P and McKinsey & Company. (MSCI, 2022; S&P Global Ratings, 2022; Perez, et al., 2022). While it is not exhaustive, it provides an overview of the ESG criteria that can be agreed upon to be relevant for most companies in most industries.

Although the methodological nuances of ESG ratings are not deeply analyzed in the presented thesis[18], it is imperative to mention that different ESG issues do not carry the same materiality weight for all companies and thus influence ESG scores differently. For instance, for an oil company, almost the entire environmental pillar is of utmost importance, while the social pillar – which includes aspects such as

18 For a rigorous analysis see 'Aggregate Confusion: The Divergence of ESG Ratings' (Berg et al., 2022).

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customer engagement or human capital development may play a less significant role. Deep water horizon could have hardly been avoided by the implementation of a Diversity, Equity and Inclusion (DEI) initiative or market research about the amenities at gas stations. On the other hand, for professional services companies, particularly within the financial industry, the governance pillar carries greater relevance. While banks typically do not – at least not directly – affect biodiversity, they can be put under scrutiny for mismanaging their governance pillar. Unquestionably, it is financially material when a bank has to pay a two billion USD fine due to money laundering, as was the case for the Danske Bank in 2014 (Reuters, 2022). Although all of the above criteria are important to get a holistic view of environmental, social and governance factors of a company, only the highlighted aspects (in bold above) will be discussed more extensively in later parts of this thesis in order to stay within a reasonable scope.

Lastly, it is critical to mention that ratings from different providers diverge significantly. For instance, Berg, Kölbel & Rigobon (2022) found that while the credit ratings of household agencies like MSCI, S&P Global and Moody's correlate 99%, their ESG ratings only show a very moderate correlation of 0.54 on average.

2.1.5 The ESG Ecosystem

ESG ratings and their respective agencies represent only a small share of the ESG cottage industry (Edmans, 2023) which has grown so big over the past decade, that it has now a self-sustaining power, commonly referred to as the ESG ecosystem (Clements & Cunningham, 2023). Generally, every market participant in the ESG ecosystem is, in some way, concerned with, and would probably consider themselves to be drivers of, the 'ESG Revolution' (Christ & Gassmann, 2022).

Or less hyperbolically speaking, they are working towards the broad integration of ESG aspects in business and investing.

However, the extent to which they are genuinely concerned with the development of sustainable societies, as originally intended by the

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'Who Cares Wins' report from 2004, is questionable in some cases. The ESG integration is a vast field that can be structured in ESG reporting, ESG investing and ESG strategy. These three 'kinds of ESG' are closely intertwined and co-developed by the actors in the ESG ecosystem. The descriptions below depict the most relevant market activities in the ecosystem.

ESG reporting refers to the practice of disclosing transparent and standardized non-financial information and data on a company's environmental, social, and governance performance. It aims at assessing the company's impact along the three pillars. Here, it is key to note that although the Global Reporting Initiative (GRI) or Sustainability Accounting Standards Board (SASB) already provide such reporting standards (Letta, 2022), they are not completely finalized or accepted by a majority of market participants. The lack of broadly adhered to ESG reporting standards is viewed by many as the greatest hindrance to ESG integration, as current practices are highly incongruent and therefore inefficient (Christensen et al., 2020; Eccles & Mirchandani, 2022; McDaniel et al., 2022). As a result, current efforts in ESG reporting are focused on improving transparency and comparability.

Given the diverse interpretations of ESG, **ESG investing** encompasses a broad spectrum of seemingly contradictory investment strategies. At least an outsider might get the impression. For instance, JP Morgen (2022) lists six and MSCI (2023) ten different approaches to ESG Investing, of which some are openly induced with normative values, while others are not. True for all ESG investment strategies is that they are investment approaches that consider environmental, social, and governance factors alongside typical financial considerations. Therewith, all approaches recognize that ESG issues have financial materiality and hence should at least be integrated into the investment analysis. The baseline approach of ESG investing is limited to merely accepting the financial materiality and is called 'Bottom-up ESG integration'. A common approach, located in the middle of the ESG investing spectrum, is 'blacklisting' or the exclusion of certain industries, e.g. big oil. The most value-laden ESG investment approach is

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impact investing, which pursues measurable and positive social and environmental benefits as its primary goal, potentially with suboptimal financial returns at sake.

ESG strategy refers to a company's plan and approach to integrating environmental, social, and governance considerations into its overall business operations and decision-making. An ESG strategy outlines the company's goals, policies, and initiatives related to topics as sustainability, responsible business practices, and stakeholder engagement. It involves identifying and managing ESG risks and opportunities, setting targets and metrics for ESG performance, and aligning the organization's long-term strategy with sustainable development goals. Many companies are currently struggling to find their ESG strategy, despite their urgent need for one (Whelan, 2022).

Figure 1: ESG Convergence (own illustration)

Clearly, the 'ESG Revolution' is a complex and dynamic field. But thankfully, this earth – unlike with other resources – has no shortage of consultants, advisors and experts.

In an **ideal world**, the market participants of the ESG ecosystem would collaborate as outlined below in the joint pursuit to maximize the Convergence of ESG ('C') in the illustration above. The following abstract briefly explains the (ideal) role of every participant in the ESG ecosystem and highlights their respective demand and supply side as well as their core activities for ESG integration.

1) **Companies**: Companies are at the center of the ESG ecosystem as they are responsible to implement an ESG strategy, due to regulatory changes and societal demand. This is (as of now) particularly true for companies within the European Union.

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Supply: Companies report on their ESG performance and thereby demonstrate transparency and accountability towards their investors, governments, consumers and society.
Demand: Companies demand ESG frameworks, guidelines and transparent ESG data from rating agencies for benchmarking purposes. Moreover, they often demand support from consultants and advisors to implement their ESG strategy.
Core activities: ESG strategy, ESG reporting

2) **Investors:** Investors consider ESG factors in their investment decision, for one of the narratives outlined in Table 1. Institutional investors may engage with companies on ESG issues and exercise voting rights.
Supply: Allocate capital (based on ESG performance).
Demand: Accurate and reliable ESG data from both companies and ESG rating agencies.
Core Activities: ESG investing, ESG strategy

3) **ESG Rating Agencies:** ESG rating agencies assess companies' ESG performance based on unique methodologies and along various criteria, depending on the company and industry.
Supply: ESG ratings or ESG scores and further analysis for investors and companies.
Demand: Rating agencies demand comprehensive and accurate ESG data from companies to generate reliable ratings.
Core Activities: ESG investing, ESG reporting

4) **Stock Exchanges:** Stock exchanges are increasingly encouraging ESG considerations for their listed companies, e.g. Nasdaq or Deutsche Börse.
Supply: Trading platform for ESG-focused products, next to other financial products.
Demand: ESG disclosure, transparency and compliance from listed companies to meet investors' expectations. However, this is (still) often on a voluntary basis for companies.
Core Activities: ESG investing, ESG reporting

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5) **Regulatory/Standard Setting Bodies:** Regulatory bodies, such as the International Sustainability Standards Board (ISSB), Global Reporting Initative (GRI) and Sustainability Accounting Standards Board (SASB), establish standards and guidelines for ESG reporting. They collaborate with companies, investors, and other stakeholders to develop consistent frameworks, ensuring meaningful and comparable ESG disclosures.
Supply: Regulatory bodies supply ESG regulations, standards, and reporting frameworks to companies, investors, and society. They aim at ensuring consistency and accountability.
Demand: Regulatory bodies demand ESG reporting, compliance, and disclosure from companies and support from industry associations, NGOs and/or governments.
Core Activities: ESG reporting

6) **NGOs and Activist Groups:** Non-governmental organizations (NGOs) and activist groups advocate for sustainable practices and hold companies accountable for their environmental and social impacts. They raise awareness, conduct research, and engage in dialogues with companies, governments, and other stakeholders to drive positive change.
Supply: Advocacy and influence of public opinion regarding practices and transparency of all market participants regarding ESG issues.
Demand: NGOs and activist groups demand transparency, accountability, and responsible practices from companies, governments, and industry associations.
Core Activities: ESG strategy, ESG reporting

7) **Governments:** Governments play a crucial role in shaping the ESG landscape. They enforce regulations and policies to address societal and environmental challenges. Furthermore, governments may mandate ESG reporting, introduce tax incentives for sustainable investments, or set emissions reduction targets. Governments also collaborate with international bodies to develop global sustainability frameworks.

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Supply: Governments supply regulations, policies, and incentives to drive sustainable development and enforce ESG reporting requirements, ultimately to protect society.
Demand: Governments demand ESG reporting, compliance, and transparency from companies, support from NGOs, and responsible behavior from investors in order to develop policies, address societal and environmental challenges, while also protecting investor interests.
Core Activities: ESG reporting

8) **Industry Associations:** Industry Associations (e.g. Global Compact or PRI), bring together companies, investors, and other stakeholders depending on the sector. They promote ESG best practices, facilitate knowledge sharing, and encourage collaboration to advance sustainability goals (such as the UN SDGs) within industries.
Supply: Industry associations supply guidance, best practices, and collaboration platforms to companies, standard setting bodies and governments.
Demand: Willingness to collaborate and truthful sharing of shortcomings in ESG practices to further develop best practices.
Core Activities: ESG reporting, ESG strategy

9) **Consultants and Advisers:** Consultants and advisers specialize in providing ESG-related services to companies and investors. They help companies develop ESG strategies, conduct assessments, improve ESG performance, and advise investors on sustainable investment options. Examples of such firms are: PwC, KPMG, McKinsey & Company, Deloitte and many more.
Supply: Expertise to navigate the complex ESG landscape. They help to integrate ESG and optimize ESG practices.
Demand: Money for their expertise.
Core Activities: ESG strategy, ESG reporting

10) **Consumer & Society:** Consumers and society shape the ESG ecosystem only indirectly by driving companies to adopt sustainability practices through their preferences, demands, and concerns.

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They increasingly support sustainable products and services, while advocating for responsible business conduct to influence companies, investors, and governments to prioritize ESG.
Supply: Market force, ability to shape and influence trends.
Demand: Consumers and society demand sustainable products/services, transparency, and ethical behavior from companies, influencing their business decisions and practices.
Core Activities: ESG Investing, ESG Strategy

Evidently, the ESG ecosystem consists of a multitude of stakeholders. Explaining all of the nuanced interrelations of the presented stakeholders would go beyond the scope of this thesis, even for a hypothetical ideal world[19]. It is sufficient to conclude that they generally all aim to work towards increasing the convergence of ESG in the business world. However, the world is not ideal and there are two major issues with the assumption of such a world:

Once again, there is no clear definition of what ESG truly means. Hence, it is hard to find common ground for participants in the ESG ecosystem to increase the convergence of ESG, especially as ESG is not only politicized, but increasingly polarized (Edmans, 2023).

Secondly, the ecosystem consists of a mix of for-profit (e.g. rating agencies), non-profit (e.g. industry associations) and passive actors (consumer & society). This poses the question of who truly benefits from the 'ESG Revolution', especially in a moment in time, where ambiguity about ESG persists?

2.1.6 Who Is in the Business of ESG?

Aswath Damodaran, professor at NYU's Stern Business School, expresses a dire response to the questions above, as he calls ESG the latest "*new and revolutionary*", yet elusive idea, marketed as the solution to all of the problems in business decision making (Damodaran,

19 Apart from the ten market actors outlined here, one could argue that academia and media also play a significant role in shaping the ESG landscape.

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2022, p. 2). He states that similar to concepts decades before, ESG is characterized by a healthy dose of marketing and selling, usually by consultants and bankers and predicts that the appeal for ESG will quickly fade, once its limitations broadly surface (ibid.). Next to other accusations of how ESG is merely a marketing tactic, Damodaran makes the convincing argument that ESG services (such as rating agencies or consultancies) *"seem to have little sense of what exactly they are measuring with ESG, swerving from goodness to risk, when it suits them"* (ibid., p. 5). Indeed, it has been documented that the financial incentive for an ESG rating (e.g. collecting money from investors) is often enough for a company to adopt it, without regard to its quality (Larcker et al., 2022b, p. 7). As it seems, professional service companies embrace the definitional flexibility of the term ESG.

However, this comes at a two-fold cost for investors, especially retail investors, who often purchase ESG funds in order to ensure their investments reflect certain societal values or environmental standards (Larcker et al., 2022b, p. 8) and essentially embrace the view that ESG is *"doing good"* (ibid., p. 2). Firstly, investors swayed by 'better world'-marketing often incur opportunity costs as ESG rating providers predominately adopt an opposing view about the meaning of ESG. For instance, in the case of MSCI, Simpson et al. (2021) state in their Bloomberg article:

> *"There's virtually no connection between MSCI's 'better world' marketing and its methodology. That's because the ratings don't measure a company's impact on the Earth and society. In fact, they gauge the opposite: the potential impact of the world on the company and its shareholders."* (ibid.)

Secondly, Kessler (2022) argues in his article in the Wall Street Journal that *"slapping"* an ESG tag onto an ETF enables asset managers to charge 5–15 times more compared to standard index funds, despite the fact that their different weightings are neglectable and often perform worse than the regular index funds.

So, if ESG (in its current state) does not necessarily serve the consumer, society nor the socially conscious investor, who does it serve?

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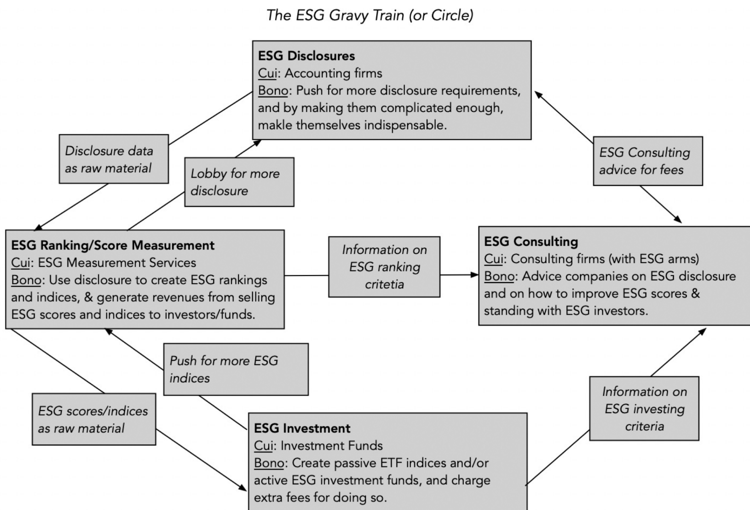
Damodaran argues that next to big asset management companies, three key players of the previously described ESG ecosystem – namely ESG measurement service companies (rating agencies and data providers), consulting firms and accounting firms – benefit substantially from the 'ESG revolution'. For the sake of completeness of the list of beneficiaries, one should include big law firms as well (see Runyon, 2022). The illustration below explains the question why ESG is still being sold by answering the most necessary question in business: Cui Bono?

Figure 2: The ESG Gravy Train (or Circle) (Damodaran, 2022).



The notion that mostly the for-profit actors in the ESG ecosystem benefit (at least so far) is not a rare one. Quinson (2021) outlines how banks, and Ferazzi and Tueske (2022, p. 4) describe how 'Big 4' accounting firms, *"cash in"* on ESG. Both articles insinuate that the line between turning a societal need into a business opportunity and simply using one's brand or title to make a profit is thin.

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Damodaran, concludes his lecture that the ESG movement has done a great disservice by fostering the belief that individuals caught between morality and money can have both simultaneously (Damodaran, 2022, p. 33). Deceitfully, this notion suggests to companies that embracing ethical practices will automatically increase their value, convinces investors that incorporating moral considerations into their investments will yield higher returns, and leads young job seekers to believe they can receive lucrative compensation while engaging in humanitarian work, akin to being paid as bankers. Such notions, however, are delusional (Mackintosh, 2022). At last, Damodaran (2022, p. 33) predicts that an attempt to resist the true nature of this delusion, *"will breed cynicism in everyone involved"* (ibid.).

Acknowledging the sentiment connected to 'ESG's Gravy Train' with the backdrop of the acronym's overall vagueness is a critical prerequisite to better understand the current dynamics of ESG.

2.2 Current Dynamics of ESG: Between 'Better World' and Deceptive Greenwashing

It has been discussed extensively now that the term ESG has seen a rapid rise over the past decade. Overall, ESG has already had significant impact on the work of important decision makers in business enterprises, investment firms and law makers. At the same time, regardless of the view one ultimately assumes about the purpose and mission of ESG, there is a looming notion that some of the players in the ESG ecosystem are using it for profits rather than progress. That is why ESG has recently experienced somewhat of a *"stall"* as it is increasingly politically polarized (Clements & Cunningham, 2023). While this is exponentially truer for the United States, where billionaire founder Elon Musk called ESG a scam, that *"has been weaponized by phony social justice warriors"* (Barry, 2022) or where 15 states effectively introduced anti-ESG laws (Gombar, 2023) it can also be observed in the EU. An inflection point that led to the bursting of the ESG hype was

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the forthcoming of Desiree Fixler[20] about the malpractices at Deutsche Bank's asset management arm, DWS. In an interview with Lorenz Honegger from the Neue Züricher Zeitung in 2022 she states [quote directly translated from German to English]:

> *"We have watered down ESG to a meaningless concept. I hope recent criticism of ESG and resurgent climate activism, along with calls for more regulation and more reporting standards, will get us back on track."* (ibid.)

Coupled with geo-political uncertainty in Ukraine as a "*caesura of the ESG transformation*" (Betz, 2022), inflows into ESG investments have been declining starkly since mid 2022 and were the lowest in the beginning of 2023 (Foster, 2023).

Interestingly though, the same is true for the few anti-ESG funds in the United States. While they attracted some money in late 2022, they now see fewer new capital as most investors believe that investing against ESG principles is also too restrictive (Kerber, 2023). Moreover, it has been proven that although the supporters of the anti-ESG movement receive plenty of media coverage, they don't get a lot of "*big wins*" (Goth, 2023).

On the one hand, as Peter Drucker might have described it, the anti-ESG movement resembles a minority of single-minded "*true believers*" that is concerned only with nullifying (Drucker, 2011, p. 215f., first published in 1980). But on the other hand, contrary to Drucker's respective idea from 1980[21], the great majority of moderates is shrinking across the globe as political polarization – towards both ends of the spectrum – is increasing worldwide (Schedler, 2023, p. 14). Furthermore, especially the younger generations of today's nations are

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20 Desiree Fixler gained prominence in the ESG arena, because she spoke out about the greenwashing of financial ESG products at her former employer DWS (by Deutsche Bank). First, it cost her the position at the company, but less than a year later DWS was raided by German police and the CEO resigned.

21 Drucker describes that the single-minded minority has the power to block issues and ideas, mostly because of "*the lethargy of the great majority of 'moderate', who do not show up at meetings, do not vote, and do not greatly care.*" (Drucker, 2011, p. 216).

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not characterized by lethargy, but instead they are participating in various forms of (often digital) engagement. Needless to say, globally, the range of such engagement is fairly wide as it entails inter alia the dissemination of propaganda, conspiracy theories and environmental activism at the same time. All of the developments above, characterize and perpetuate the current discourse around ESG.

Overall, despite advances, ESG remains hardly defined and inadequately regulated, which makes it confusing for both investors and companies to understand (Kishan & Schwartzkopff, 2022). This poses a multitude of challenges for both private and public sector organizations as there must be – and there are – quite a few charlatans, and many more who preach ESG only because it is the fashionable thing to do[22]. As Peter Paschek described it for the "*mega-trendy*" term of sustainability and Corporate Social Responsibility, ESG is under threat to be used inflationary and thereby to be undermined and degenerated to an empty shell of a word (Paschek, 2019). Right now, as ESG remains definitionally vague and is simultaneously accompanied by great attention from a multitude of ideologically diverse members of society's major leadership groups, it is unsurprising that the current perception of the acronym is multi-faceted. Therefore, the following part of this thesis is concerned with analyzing the views of both, opponents and proponents of ESG, before it delves into the demands of young people and their relation to ESG issues.

2.2.1 The Opponents of ESG

Criticism towards ESG is not new. In fact, research articles as early as 2005 (Derwall et al.) or 2008 (Kempf & Osthof) show, that the academic community has been discussing ESG controversially for a long time. To stay within a reasonable scope, the following passage provides

22 This statement is an adaptation of Peter Drucker's statement, who wrote in 1986 the following: "*There must be—and there are—quite a few charlatans, and many more who preach management development only because it is the fashionable thing to do.*"

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an overview of the main arguments against ESG that are brought up today.

ESG is Distraction

The most prominent criticism is that ESG is a distraction for both investors and companies. Since the coining of the term ESG, critics have claimed that considering ESG issues for investments is a distraction for investors because it violates their fiduciary duty towards their clients. As Pollman (2022) explains, this critique has been invalidated by the 'Freshfields Report'[23] in 2005. However, it is still brought up in recent debates regarding ESG (McGowan, 2022; Rubenfeld & Barr, 2022). For companies, opponents state, ESG is a distraction because it gets in the way of what businesses are supposed to do: *"make as much money as possible while conforming to the basic rules of the society,"* as the infamous Friedman Doctrine stated in 1970. From this vantage point, ESG assumes the guise of a mere diversion—a public relations maneuver or a cunning exploitation of customers', investors', or employees' loftier aspirations. ESG becomes an instrument to bolster the brand's image rather than an integral component of corporate strategy. It is viewed as supplemental and sporadic in nature. Given this perspective, some argue that ESG is a virtue signal and merely a marketing tool *"that lends itself to greenwashing"* (Pollman, 2022, p. 26), without adding any real value. This notion has primarily led to the political polarization of ESG, deepening the *"culture wars"* in the United States (Winston, 2023), where (republican) critics claims that ESG threatens the economic freedom of people by putting social causes before their will (Kishan & Schwartzkopff, 2022) or where former Vice President Mike Pence accuses ESG to be a pernicious strategy that *"allows the left to accomplish what it could never hope to achieve at the ballot box or through competition in the free market."* (Pence, 2022 as cited in Pollman, 2022, p. 27). At the most basic level, this point of

23 The Freshfields report is seen as the leading resource, stating that integrating ESG into investment analysis is permissible and potentially required globally.

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view denounces ESG to being 'woke', which has become a trigger word, weaponized by the right (Rose, 2020), to signal abnormalisation for the proper development of our societies (Cammaerts, 2022).

ESG is Impossible

A second argument against ESG is that it is intrinsically too difficult to be feasible (Perez et al., 2022). Finding the right balance to implement ESG in a way that satisfies various stakeholders is extremely challenging for companies. While pursuing (only) financial returns has the straightforward and highly influential objective of "*maximizing shareholder value*" (Jensen & Murphy, 1990), a broader ESG focus introduces greater complexity in order to identify and measure the best-balanced interest of various stakeholders. Addressing the needs of multiple stakeholders involves making difficult trade-offs and may even seem impossible (Perez et al., 2022). When allocating additional resources towards ESG initiatives, who should a manager prioritize? Should it be directed towards customers through lower prices? Should it benefit employees with improved benefits or higher wages? Should it go towards suppliers? Or should it be dedicated to environmental concerns, such as implementing an internal carbon tax? Determining the optimal choice is often unclear. As a result, companies often act hesitantly (ibid.).

ESG is Box-Ticking

This hesitation of companies however is juxtaposed to the vast spread of ESG ratings and ESG investment products, which are both characterized by – as has been examined above – a stark disconnect between their marketing and their methodologies for ESG scoring or their inclusion criteria for financial products. Generally speaking, the

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supply side of ESG products[24] radiates around the 'protecting against society'-narrative, while the demand side of ESG products, willingly (or unwillingly due to marketing) is looking for something within ESG that follows the 'doing good'-narrative.

This leads to an important caveat: for many, ESG ratings elicit the impression that companies are given false credit for meeting criteria that one would expect to be met anyway. A simplified example: the fact that a company does not pollute scarce drinking water, ensures that their products are safe and is transparent towards the public where it pays taxes and how much revenue it generated does not warrant the impression that it makes our world better or improves our quality of life – it simply does not make it worse. At the very best, from this perspective, ESG scores can be viewed as a box-ticking exercise, where metrics protect against ESG-risk, but not as scores that indicate that a company contributes something meaningful towards the betterment of our today's social and environmental problems. This very notion perpetuates and eventually breeds the first argument that ESG is a grossly inflated 'buzz' with not much behind it but deceptive (and for investors even costly) 'woke-washing'.

ESG Can't Be Measured

Moreover, critics justifiably argue that ESG performance is not measurable, at least not to a practical degree (Perez et al., 2022). Larcker et al. (2022a, p. 877) conclude their argument that ESG ratings do not accurately measure ESG quality with the following statement:

> *"The number of input variables is daunting. Rigorous measurement of each dimension constitutes a significant research challenge. Measuring all of them accurately and combining them into an overall*

24 This thesis defines ESG products as ESG Data, ESG Ratings, ESG Consulting and ESG Investment Products. Hence, in this context ESG products are revenue-generating activities by for-profit organizations.

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composite ESG score that is predictive of outcomes is likely not possible." (ibid.)

As outlined above, the lack of broadly adhered to ESG reporting standards, is a recognized obstacle for the 'ESG revolution'. Hereby, it is essential to acknowledge that standard setting organizations like the GRI and SASB have distinct approaches to measuring the same aspects. Consequently, it is unsurprising that different rating and scoring providers, who, on top of standards, incorporate their own analyses and weighting methodologies, would yield contrasting scores. As Berg et al. (2022) have shown this is currently the case, as the ESG ratings of major rating agencies hardly corelate with each other. However, for some, this diversity of 'perspectives' on ESG is currently a great hindrance to fully unlock its potential, as different agencies may rank the same company very differently on the ESG spectrum, with the result of limited comparability (Christensen, et al., 2020; Berg et al., 2022). For a few examples of rating divergence see Appendix 2.

Additionally, major investors have developed their own exclusive approaches to assess the ESG performance of a company that rely on a range of factors, including – but not limited to – ESG scores from external providers. These methodologies have been refined and perfected by investors over time, however with a lack of external transparency. Lastly, as every company (that commenced its ESG journey) goes through thorough ESG materiality assessments, often with the help of consultants or advisors, ESG performance of companies becomes even less comparable, especially between industries. For instance, only for ESG insiders, it can appear rational that the consumer goods behemoth Unilever receives an 'AAA-rating' from MSCI, signaling ESG excellence and at the same time is assessed with 'Medium Risk' by Sustainalytics. Conversely, MSCI rates Exxon Mobil with 'BBB', indicating ESG midfield within the industry, while Sustainalytics's rating for Exxon Mobil indicates 'Severe Risk'.

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There Is No ESG Alpha

At last, opponents of ESG investing in particular state that even if ESG could be measured and reported correctly, there is no connection to financial performance (Perez et al., 2022; Billio et al., 2020). This argument is highly debated. Some authors claim that ESG funds overperform (e.g. Paulman & Winston, 2022), while other claim that they underperform (e.g. Johnson, 2021).

Notes on the Opposing Views

It is imperative to mention that all of the arguments above are focused on the fact that ESG criteria are almost entirely intangibles (Christensen et al., 2020; Polman & Winston, 2022). Here, one negative and intuitive conclusion comes to mind: *"If you can't measure it, you can't manage it"*. Although Peter Drucker is commonly associated with this quote, he never actually said it (Zak, 2013)[25]. His approach to measurement was more nuanced and explicitly included the case of intangibles. Drucker wrote (1986, p. 102):

> *"But the starting point for effective work is a definition of the purpose and mission of the institution, which is almost always intangible."*

Drucker further explains that in subsequence the manager has to define explicit, clearly defined targets from which in turn priorities, deadlines and accountabilities can be derived (ibid., p. 102). Although in the realm of ESG there are no crystal-clear targets yet, it can be argued that the industry will inevitably get there. While it might still take some time, it surely will be quicker than the formation of our initial corporate accounting customs, which took decades after the Great Depression to standardize (Eccles & Mirchandani, 2022).

25 In fact, this quote originates from Dr. W. Edwards Deming, but is also a misleading reduction of his original quote with quite the opposite meaning: *"It is wrong to suppose that if you can't measure it, you can't manage it – a costly myth."*

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Therefore, this thesis postulates that, instead of focusing on finding the right KPIs and measurement methods, the primary focus should be on ESG's *purpose* and *mission*. This intangible term of *mission* and *purpose* for ESG has to be rethought. Urgently, it needs to be re-directed from its course to a 'watered-down' concept, towards a course of a change bringer. Furthermore, the thesis defines the purpose of ESG as its the raison d'être, which is argued to be the actualization of environmentally and socially responsible business practices, or as Clément et al. (2023) describe it, the operationalization of Corporate Social Responsibility. The mission of ESG is hence defined as the actions and tasks to achieve this purpose.

However, the current rendering of ESG will by no means help to cure environmental or social ills, but at best not increase them. If one only focuses on the standardization of ESG, one outcome is likely to be produced: ESG will hit target, but miss the point.

2.2.2 The Proponents of ESG

Done Is Better Than Perfect – Also in ESG

Admittedly, the favorable voices of ESG may prematurely state that "*ESG has completely changed the game*" (Kishan & Schwartzkopff). But even with an imperfect system, ESG has already achieved substantial change. Proponents therefore argue, that despite imperfections it is worth to pursue ESG (Larcker et al., 2022a, p. 878). Of course, depending on the nature of the endorsers within the ESG Ecosystem (for-profit vs. non-profit) and their respective understanding of the mission and purpose of ESG, the motivations for driving the 'ESG Revolution' may be different. However, even with opposing definitions of what ESG truly means, supporters of ESG are in it for the following common denominators.

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Climate Crisis Demands the Shift to Long-Term Thinking

Firstly, amongst ESG supporters, it is universally agreed upon that 1) the human-made climate crisis requires increasingly urgent action (e.g. Climate change and human behavior, 2022; Prabhakar, 2023)[26], and that 2) social cohesion is an important prerequisite for a functioning society (e.g. Bourdier, et al., 2021; PRI, 2017). Thereby, being anti-ESG is intrinsically illogical for any investor or manager, who wants to achieve sustainable long-term value.

> *"(…) it seems crazy to title an article "The end of ESG." But this title intends not to signal ESG's death, but ESG's evolution from a niche subfield into a mainstream practice. The biggest driver of this ascent is the recognition that ESG factors are critical to a company's long-term (financial) value. But then all executives and investors should take them seriously, not just those with "sustainability" in their job title."* (Edmans, 2022, p. 2)

This statement hints at the fact that the global business world may have finally eclipsed shareholder primacy, especially for the short term (LoPucki, 2022). This is in line with both, Drucker's understanding from 1993 that maximizing shareholder value would lead to suboptimal outcomes as *"long-term results cannot be achieved by piling short-term results on short-term results"* (p. 72) and the 'Who Cares Wins' report that clearly states that when considering ESG factors, the new time horizon should be ten years or longer (Global Compact, p. 2). To put it pungently: while being on the ESG sideline may still be practical (today) from a business perspective, being against ESG appears nonsensical if one truly aims at developing sustainable societies (Global Compact, 2004).

26 The cited articles stem from *Science* and *Nature*, the world's most renowned scientific journals. It's worth to highlighting, just in case this thesis ever falls into the hands of a denier of climate change.

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Accounting Profit for the "Cost of What"

Secondly, the aforementioned argument is perpetuated by the fact that in our interconnected world, the actions undertaken by big companies often bear significant impact for individuals who may not have direct involvement with the company itself. This impact manifests as externalities, encompassing various aspects such as the greenhouse gas emissions generated by the company, its impact on labor markets, and the implications for supplier health and safety. For a long time, hidden behind and legitimized by the well-known Coase Theorem (1960), companies were able to operate with no real regard to their externalities whatsoever (Johnston, Amaeshi & Adegbite, 2021). In short, the theorem suggests that the solution to negative externalities from the creator (companies) is either instrumental regulation (through a governor) or bargaining between the creator and the victim (uninvolved individuals) of the externalities (ibid., p. 39). The latter is called Coasian bargaining and represents the approach that has been opted for in the past by regulators across the globe – especially for the case of social (ibid.) and environmental externalities (Gills, 2015) – as long as the creators of externalities *"stayed within the rules of the game"* in Friedman's manner.

However, as pressure regarding the ineffectiveness of holding big corporations accountable for externalities piled up in the second decade of the 21st century, a lasting shift away from the traditional understanding of the business enterprise's role in society began to emerge. For instance, in 2019, the Business Roundtable redefined the purpose of corporations, placing corporate responsibility and stakeholder capitalism at the center of this redefinition. Regulatory bodies have also taken notice of this development, although with varying degrees of urgency and assertiveness across different countries, local governments, and agencies. Many ESG advocates argue that, for the first time, ESG offers a structured approach to internalizing such externalities across a (potentially too) broad spectrum of applicable metrics (Samans & Nelson, 2022; Perez et al., 2022).

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Diversified Standardization Is Valuable for ESG

The third common denominator of ESG supporters is that there is a great potential for standardization in ESG reporting. As discussed extensively above, many participants in the ESG ecosystem are concerned with proposing, discussing and implementing such standards. Again, especially for the for-profit participants in the ecosystem, this may be a win-win situation, as the current state of ESG allows them to not only significantly benefit from it financially but they can also call themselves drivers of the 'revolution' at the same time. Many researchers agree that the standardization of metrics will come eventually (Eccles & Mirchandani, 2022), probably within this decade (Lykkesfeldt & Kjaergaard, 2022). Lykkesfeldt & Kjaergaard (2022) argue that the 2020s *"will likely be remembered for implementing the regulatory framework and harmonizing ESG data."* (p. 247).[27] It is important to consider that financial accounting, similar to ESG reporting, developed over time in response to stakeholder demands rather than spontaneous regulatory initiatives. Although ESG measurements are still in progress, there have been notable advancements in this area. ESG measurements are continuously improving and undergoing changes, including a constant effort towards the consolidation of reporting and disclosure frameworks. For instance, on June 26th the ISSB released their inaugural global sustainability disclosure standards, which have received adamant feedback from participants in the ESG ecosystem (IFRS, 2023)

The 'Big Tent Approach' Covers Many Interest Groups

Eccles[28] and colleagues from BCG state that although the bare acronym has suffered a reputational loss, there is great potential for ESG ahead, especially when it is driven by the top of the business elite (Eccles et al.,

27 Most recently, on June 26th 2023, the ISSB released their inaugural global sustainability disclosure standards, which have received adamant feedback from participants in the ESG ecosystem.

28 Robert Eccles received his PhD from Harvard University and is currently a chairman of KKR & Co. Inc. Arguably, he is part of *"society's major leadership group"*. He

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2022). Pollman (2022) concludes her essay that while the "*big tent approach*" of ESG's history has led to great challenges, critiques and disagreements, it was also uniquely successful as it facilitated vast buy-in from a wide range of stakeholders, diverse in their views about more things that just the definition of ESG. Perez et al. (2022) argue that the differences in ESG, highlight the significance of these matters to stakeholders and do not at all weaken the case for rigorous reporting: if anything, they underscore its importance. Similarly, Edmans (2022) states that another word for disagreement is diversity, when it comes to ESG. He further explains that many of the controversies surrounding ESG become "*moot*" when viewing ESG as a set of long-term factors (ibid.)

> "*We don't need to get into angry fights between ESG believers and deniers, because reasonable people can disagree on how relevant a characteristic is for a company's long-term success.*" (Edmans, 2022, p. 3)

It is worth mentioning one set of investors, who (claim to) know best what characteristics are relevant for a company's success: private equity companies.

Private equity (PE) companies globally have over 11.7 trillion USD in AUM (McKinsey & Company, 2023a) and their business model[29] gives them an advantageous position to push an ESG agenda in their portfolio companies. While the increasing importance of 'E' is accompanied by many new signatories to the PRI[30], PE must actively increase diversity within their holdings and their own companies ('S') and spread the wealth generated by the PE industry more evenly ('G').

is also a leading expert on the integration of ESG factors, particularly for the private equity industry. For more insights see Harvard Business Review, 100(4).

29 PE companies commonly have one their employees on the board of directors of their portfolio companies.

30 The number of PRI signatories has quadrupled over to past 5 years. However, as Gibson et al. (2021) show the new signatories in the USA do not follow through on their responsible investment commitment.

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Eccles et al. (2022) summarize their article in the Harvard Business Review cautiously (p. 92):

> "*To be successful in the future, PE leaders must speak openly and often about the importance of sustainable value creation. They must recruit people who care about it in the broadest sense and aren't joining the industry just because it can be very lucrative. We foresee three consequences if the industry fails to fully embrace ESG: Its* ***social legitimacy*** [author's emphasis] *will increasingly come under attack. It will no longer be able to deliver its historically high returns. And it will fail to fulfill its potential to help solve, rather than exacerbate, environmental, social, and governance problems.*"

Social License is Corporate Oxygen

This leads to the last and all-encompassing argument in favor of ESG: "*Social license is corporate oxygen*" (Perez et al., 2022, p. 8), for all business enterprises, not only for private equity companies. It is impossible for any business enterprise to survive without it. Consequently, it should not be taken for granted.

A wait-and-see approach is unlikely to be sufficient. Rather, companies are advised to demonstrate that they *"benefit multiple stakeholders and the broader public"* (ibid.). As Chapter 2.5 will show, this again, has been advocated for by Peter Drucker a long time ago.

To sum up: what this chapter showed is that ESG is controversial. While the business interest seems unstoppable, skepticism (even from activists) is also on the rise. What makes ESG's current state unique is its simultaneous criticism from conservatives and climate or social justice activists. The former accuse it of being 'woke', while the latter view it as a dangerous placebo that merely delays real action (Honegger, 2023). Today, ESG is somewhere in the middle between being the bridge to a 'better world' and deceptive greenwashing. Defining the best-fitting metrics for measurement is critical, but primarily the intangibles – the *purpose* and *mission* – of ESG must be re-considered.

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The presented thesis is not alone with this perspective as some financial institutions are already pitching 'ESG 2.0', which should help to realign capitalism for the benefit of broader society (UBS, 2023) or more meticulously integrate the concept of double materiality[31] (Fidelity, 2023). At the same time, other ESG advocates propose to scrape the acronym ESG altogether as it has become overly polarized (Edmans, 2023; Fink, 2023 as cited in Binnie, 2023; Eccles, 2022 as cited in Kishan & Schwartzkopff, 2022).

Henceforth, one forgone conclusion can be presented here: if executives ignore that ESG is not yet ripe but still take any ESG-seal they can get, they could soon be faced with the social legitimacy question of their own business, even if they have received a pleasant score in regard to the discussed acronym.

2.2.3 Long-Term Value for Who?

When combining the social license argument with the true merit of sustainable long-term value creation of ESG, one thing becomes evident: social license needs to be gained and retained from those who are increasingly questioning it: young(er) people. Within the next two decades, the '20-somethings' of today (and tomorrow) will move into positions of greater power and wealth and therewith drastically shape the (business) world from all of its angles. Unquestionably, there will still be some confident shareholder value maximizers or exploiters of social inequalities. However, the vast majority of younger people, especially those who experience the privilege of higher education are increasingly demanding change and ask tough questions about what a given institution does for the planet or society (Hunt et al., 2022; Goldberg, 2022). As professionals from Oliver Wyman Forum and The News Movement (TNM) explain, after gathering insights from over

31 Double materiality states that a company's financial success is influenced by its effects on the environment and society, and these effects can also affect its long-term financial viability.

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150,000 participants in ten countries, young people are unlikely to "*become their parents*" (and adopt their values) as they move through life because of their unique upbringing, which has been riddled by economic and social turbulences (Oliver Wyman Forum & TNM, 2023, p. 7[32]). While their extensive report, reveals many insights about the notorious Gen Z (born between 1996–2010), this is not news. In fact, throughout modern human history, young people have always shaped their distinct attitudes, beliefs and values based on shared formative events, that have in subsequence largely influenced social and political change. This phenomenon was firstly coined "*Das Problem der Generationen*" by Karl Mannheim in 1928 and is one of the few canonical theories of sociology (Caballerro & Baigorri, p. 337). In this context, one summarizing thought by Peter Drucker from the prologue of his book 'A Functioning Society' comes to mind:

> "*Finally, it should be understood that legitimacy is a purely functional concept. There is no absolute legitimacy. Legitimate is a power when it is justified by an ethical or metaphysical principle that has been accepted by the society. Whether this principle is good or bad ethically, true or false metaphysically, has nothing to do with legitimacy, which is as indifferent ethically and metaphysically as any other formal criterion.*" (Drucker, 2003, p. xxii).

Was it ethical for past generations to exploit the planet to such an extensive degree that we are now fighting for humanity's survival? Probably not. But – amongst other things – the Friedman Doctrine and shareholder primacy legitimized it. Will these paradigms still function as convincing arguments for sustainable long-term value today? Again, probably not. The following pages will therefore more closely elaborate how this generational demand manifests with regard to ESG and thereby give testimony to Drucker's statement from 2003 that "*In the next society the biggest challenge for the large company, especially for*

32 The report of Oliver Wyman Forum and TNM focuses on the cohort of young people that was between 18 to 25 years old in 2022 and is thereby greatly aligned with the age group most closely examined in the survey of this study.

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the multinational, may be its social legitimacy." (Drucker, 2003, p. 230). One critical insight should be presented as a primer: value will be increasingly generated through values.

2.3 Young Generations and ESG: Legitimacy Under Threat

While the generational gap in attitudes is not new, the size of Gen Z is. For the last century, there was not a single generation as big as Gen Z is (Oliver Wyman Forum & TNM, 2023, p. 5). This alone is reason enough to study their opinions and could fill many theses. It is imperative to mention that studying generations in fixed cohorts (such as Gen Z or Baby Boomer) can obscure individual motivations and has recently become questioned by academics in the field (Elliot, 2021). Generational theory always comes with this caveat. Hence for this thesis, the classification of generational cohorts is used as a tool of thinking about society rather than an assertion of absolute truths for a certain age group. For the given research, it is of special interest to examine what young people (roughly aged between 18–30 years)[33] think about the role of the business enterprise in our society and how this is connected to ESG respectively. Of course, Gen Z did not invent the movements, ideas or demands outlined below. Yet, researchers agree that opposed to their predecessors – Millennials – they are keener to take real action and thereby turn theoretical idealism of previous generations into practical activism (Oliver Wyman Forum & TNM, 2023). Accordingly, there will be a brief discussion on how they are expected to shape society through their various societal roles as consumers, voters, and employees. Finally, the hypotheses for the given thesis are presented in Chapter 2.4, which are analyzed along the collected data in Chapter 4.1.

33 The terms 'Gen Z' and 'young people' are used interchangeably in this thesis.

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2.3.1 Consumer Demands

From a consumer standpoint, sustainability emerges as a paramount concern for young individuals. Numerous recent reports affirm that the purchasing decisions of young people consistently revolve around the environmental impacts of products and services. To the extent that they are willing to pay a premium for items or offerings, provided they are assured of their minimal detrimental effects on the planet (Deloitte, 2023, p. 30; PwC, 2020, p. 17). One other consequence is the emergence of upcycling, re-use and do-it-yourself approaches which all aim at reducing overall consumption whatsoever or contributing to the circular economy (Euromonitor International, 2023, p. 20–24).

Gen Z has real 'climate anxiety', which can be described as the heightened sense of urgency to turn climate change around. According to McKinsey & Company, Gen Z widely report to think about the fate of the planet on a daily basis (2023b, p. 3). They feel a strong sense of responsibility to mitigate the damage caused to our earth and show a clear preference for companies that proactively prioritize their environmental impact. Accordingly, Gen Z exhibits a positive inclination towards businesses that demonstrate a genuine societal purpose that transcends mere business operations and profit-making. In their view, the business of business should not only be business, but the quality of life. They hold the belief that it is the responsibility of big institutions to act with regard to today's problems. They think that businesses need to "*raise their game*" and they "*back it up with their wallets*" (Oliver Wyman Forum & TNM, 2023, p. 5; McKinsey & Company, 2023b). This holds to be true for their capital allocations as well: 82 % of Gen Z investors have exposure to ESG investments (Versace & Abssy, 2022). More notably, according to a Stanford survey more than 80% of Gen Z and Millennial investors think that their investment firm should influence companies' environmental, social, or governance policies or practices even if doing so decreases the value of their investment (Gelfand, 2022). Hence, many believe ESG can and should truly serve their values.

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Yet, their tech-savviness equips them well to sniff out green-or purpose-washing (Oliver Wyman Forum & TNM, 2023, p. 5). Companies that merely talk the talk, but don't walk the walk are quickly 'shit-stormed' or 'buycotted'[34]. Commonly, these uproars go beyond environmental accusations and companies are put in the pillory for nontransparent corporate behavior, the lack of diversity and inclusion efforts or simply unethical business practices, as young people no longer form their opinion of a company solely based on the quality of their products or services but now on their ethics, practices and social impact (Deloitte, 2018). Such upheavals quickly gain a respectable momentum thanks to modern technology and Gen Z's tendency to be *"always on"* (McKinsey & Company, 2023b, p. 2). Following this overall notion, Georg Kell, founder of the Global Compact that produced the repeatedly mentioned 'Who Cares Wins' report denies the question if ESG will fade away again with three "*irreversible structure altering forces*". Firstly, he states, the constantly emerging technology will only lead to more opportunities for measurements and transparency in ESG and will hence be sought after. Secondly, there is no doubt that earth is heating up and that companies must *"get a grip"* on their externalities. And thirdly, the intergenerational factor will be the single most important driving force behind ESG. According to Kell, "*younger people are – rightfully – pushing for answers. If one disregards their shift in preferences and does not offer sustainable products and services, one has no chance*" (Kell, 2022 as cited in Christ & Gassmann, 2022, p. 96f. [quote directly translated from German to English])

The Shakespeare-inspired proverb that heavy is the head that wears the crown can be related to Gen Z. From social injustices to climate change, they could be the generation that has the last word on the future of society and humankind (Oliver Wyman Forum & TNM, 2023, p. 4).

34 'Buycotting' is a form of negative purchasing behavior characterized as a type of protest aimed at a company with dubious ethical standards in which consumers purposefully buy the products of another company (Collins, 2023).

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2.3.2 (Corporate) Political Demands

In line with the consumer demands, it is unsurprising to observe that the political demands of young people are comparably drastic. They are upset about the slow pace of climate policies and are not afraid to speak up. In fact, currently, the most famous climate advocate is a member of Gen Z herself – Greta Thunberg. Her 'Fridays for Future' movement has disseminated across borders rapidly. Within just 5 years, it grew into a truly global movement with protests being organized in more than 7.500 cities on all continents (Fridays For Future, 2023). Evidently, young people's perceived obligation to do something about our climate transcends the one of a 'keyboard warrior' and is instead backed by real world activism. According to Jean Guerrero, columnist at the LA Times, this is what sets them apart from Millennials, their preceding generational cohort (2023). All around the world, Gen Z is on the streets and at the forefront of climate protests. Next to Greta Thunberg's organization, many young people rally for activism, such as die 'Letzte Generation' in Germany, 'Extinction Rebellion' in the UK or the 'Sunrise Movement' in the United States, all of which are sizable climate organizations spearheaded by young people. While it is debatable if these protests have a tendency towards radicalism or not, they certainly achieve one thing: the climate crisis is on the agenda for every member of society – for better or worse[35].

Overall, Gen Z does not feel heard by politics, but at the same time is characterized by a coherent self-image of a generation that will bring change (Vodafone Stiftung Deutschland, 2022, p. 2). They are strong advocates for social justice and demand clear efforts to reduce inequalities within our modern societies (Carnegie, 2022). This includes efforts against racism, affordable education for everyone and a narrowing of the wealth gap. More and more young people, cannot

35 Potentially, this could be even 'worse' or rather divisive, as some of their methods are highly polarizing compared to climate scientists' recommendations. The 'Klima-Kleber' in Germany, who protest by blocking major roads in cities, face critique from a diverse range of socio-economic groups in the country.

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shake the feeling of being behind in life despite their willingness to work hard and attempts to succeed. College graduates in the US are increasingly living paycheck to paycheck (Cachero, 2022) and owning their own apartment/house one day appears totally out of reach for most young professionals in both Germany and America (Lembke, 2019; Huddleston, 2022). It is an undeniable fact that if they don't come from money, they are much less likely to achieve considerable wealth in comparison to prior generations. Even traditionally well-situated Gen Z-ers from typical middle-class families are falling victim to the ever-growing global wealth-gap. Here one statement from Peter Drucker comes to mind that relates to their frustration during a phase of what some call *"late-stage capitalism"*[36] (Espinoza, 2022).

> *"In particular, the poverty that is most offensive to us today, that is, poverty in the midst of affluence, was then taken for granted."* (Drucker, 1986, p. 221).

Contrary to the context of Drucker's statement, the current working generation did not take poverty for granted, but wealth and (relative) stability. While the post-world war II time was surely anything but easy, it was yet characterized by a) stable economic growth (for the developed societies at least) and b) a time where democracies won the peace. But as Homer-Dixon and Rockström state, things have gone fundamentally awry in the past ten years (2022). Rising global hunger, accelerating climate crisis, increasing level of political authoritarianism and a frequent occurrence of violent demonstrations and ongoing conflicts are the topics that flood news agencies nowadays (ibid.). Homer-Dixon and Rockström describe *"today's mess"* as a *"polycrisis"*, where the risks of individual crises are causally interlinked, though these links

36 Late-stage capitalism refers to a critical view of the advanced phase of capitalist economic systems, characterized by increased wealth inequality, corporate influence in politics, and a focus on profit maximization, often at the expense of social and environmental concerns.

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have not been extensively explored due to deeply specialized and siloed knowledge of the risk-evaluating experts[37].

> *"So, for example, while specialists in climate change's economic impacts know something about how climate heating aggravates economic inequality within and between societies, they know very little about how it impacts ideological extremism. And they give virtually no attention to the possibility that causation might operate in the reverse direction, too — that inequality and extremism might worsen climate heating."* (Homer-Dixon & Röckstrom, 2022)

We can already observe this becoming our reality, as >30 % of Americans believe that climate change is not real (The Economist, 2021) and the German right-leaning party 'Alternative für Deutschland' (AfD) has reached a staggering 20% in national polls, despite their negating statements regarding climate change (Berliner Zeitung, 2023).

Therefore, Gen Z's fight for our planet is also concerned with the fostering of social cohesion. Next to climate change this is often strongly linked to the demand of fair pay (Edelman, 2023, p. 68; Oliver Wyman Forum & TNM, 2023, p. 9) and stronger support for underrepresented groups in our societies (ibid.). While the disenchantment with governments is high globally (Edelman, 2023, p. 9), people nowadays, believe that businesses have to take a more central role in tackling our today's most pressing environmental and social challenges (ibid., p. 29). Young people in particular want companies that contribute to the greater good, and therefore closely tie the legitimacy of a business enterprise to such efforts. For Gen Z (and Millennials) Corporate Social Responsibility plays a critical role and it is important to them that the company they buy from or work for makes a meaningful difference in their community (European Commission, 2023b). Gen Z demands a contribution from companies towards the 'better world' and

37 *"There is no Queen of Knowledges"* (Drucker, 1993, p. 198). For more background on the importance of interdisciplinary work and how Peter Drucker called for it, again, decades ago see: Optimizing for The Health of the Planet and the Well-Being of People (Schwarzer, 2023) – available upon request.

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believe that governments have the obligation to provide the appropriate regulatory nudges (Hernandez et al., 2022). They want to see their true values represented in politics and in the workplace.

2.3.3 Employee Demands

Consequently, young people are not shy to evaluate potential or current employers according their values. 75 out of 100 Gen Z-ers state that they would not work for a company that misaligns with their personal beliefs (Oliver Wyman Forum & TNM, 2023, p. 49). This is drastically different from previous generations, where most emphasis was put on career outlook, compensation and benefits, perceived prestige or to do whatever it takes to "*climb the corporate ladder*" (ibid., p. 10). While young individuals still desire a career and fair compensation, their aspiration is to cultivate a purpose-driven path. Such purpose entails clear growth opportunities, continuous learning opportunities, corporate transparency, and most importantly, a job that fulfills them in the sense that it produces tangible positive outcomes for society and/or the environment. In other words, a job that has a greater purpose than paying the bills (Merriman, 2022, p. 22). All of this, of course, with a constant backdrop of mental health awareness (Oliver Wyman Forum & TNM, 2023). Young people do not want to jeopardize their well-being and "*tough it out*" for a generation of mid-fifties or older bosses, who exploited the planet for economic growth. These demands are often spitefully commented by older cohorts of the workforce, who accuse Gen Z to be a bunch of "*snowflakes*", who demand a lot, but deliver little (Jewell, 2022). While it is hard to ultimately assess whose arguments are more valid, one thing is certain: young people are not lethargic bystanders. As extensively outlined above, many Gen Z individuals are passionate about social and environmental issues. Thus, they seek out employers who demonstrate not only a commitment, but real action towards sustainability, Corporate Social Responsibility, and ethical practices (Deloitte, 2023, p. 7). Companies that traditionally do not serve either, are increasingly struggling to attain an retain talent

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(Alexander, 2023). Christ & Gassmann state that any employee value proposition directed at young people must include Corporate Social Responsibility.

> *"Unlike previous generations, college graduates and apprentices today demand that not only they apply for a job, but also that companies explicitly state why one should join them and how they fulfill their social responsibility."* (Christ & Gassmann, 2022, p. 12)

2.4 Legitimacy Under Threat – Survey Hypotheses

In summary to this short elaboration on young people and their relation to ESG topics, it can be stated that most Gen Z individuals are very aware of their calling to meaningfully contribute to a better – or at least bearable – world. Environmental anxiety, persisting social injustices and a new outlook on what their job should do and be for them, transforms them into prospective change-bringers, that should be taken seriously by society's major leadership groups. Social legitimacy is always a contemporary concept. And as younger people inevitably acquire more wealth and decision-making power within their multiple societal roles as consumers, voters and employees, business leaders and politicians alike would be well-advised to consider the preferences of this generational cohort today. This is because – apart from a moral obligation to help tackle today's ills – young people are likely to continue to re-interpret the notion of long-term value creation and the role of the corporation in our society, that many professionals or politicians hold today. Additionally, they are unlikely to change their perspective, even as they grow older (Oliver Wyman Forum & TNM, 2023, p. 7). True long-term value creation is ultimately tied to the support of people. And for young people, value is created through values. Hence, derived from the contents of Chapter 2.3, this thesis postulates the following hypotheses[38]:

38 For the presented hypotheses, one note is necessary: the formulation and testing of these hypotheses is not intended to reveal novel ideas, but rather to further empiri-

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H1: Young people **do not** agree that the only social responsibility of the business enterprise is to generate profits.

H2: Young people **do** agree that every organization must assume full responsibility for whomever and whatever it touches.

H3: Young people's understanding of social legitimacy for the business enterprise is deeply value-driven.

H4a: Young people care about how companies handle environmental issues.
H4b: Young people care about how companies handle social issues.
H4c: Young people care about how companies handle (corporate) governance issues.

H5: Young people simultaneously care about how companies handle, environmental, social and governance issues.

Of course, not only the young generation is affected by the turbulent times of today. But they are the most important to consider from the 'long-term value' perspective of ESG, as they will for the long-term a) live with the consequences of the political, economic, social and environmental developments of today and b) shape the political, economic, social and (to the best of their ability) environmental sphere of tomorrow. Overall, (young) people today, pressure for what Peter Drucker predicted to be an important requirement in order to maintain its social license as a business enterprise in the 1970s: to be a socially responsible organization. Therefore, his notion of the social responsibility of a business enterprise will be the topic of the following chapter, before the conditions of a bearable society are briefly discussed.

cally examine the perceptions of young people and their relation to ESG topics, as outlined in Chapter 2.3. The hypotheses will be tested in a descriptive fashion and are not aimed at the discovery of causal links (see Chapter 2.4). Conversely, while the semi-structured interviews are developed based on the theoretical background of this thesis, their goal was to produce new insights, through an exploratory approach (see Chapter 3.3).

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2.5 Peter Drucker's Understanding of Social Responsibility

The 50-Year-Old New Responsibility of Businesses

Globally, the disenchantment with politics and simultaneously the pillarization between governments and business enterprises is unprecedently advanced (Edelman, 2023). With ongoing wars, constant natural disasters, historically high inflation and political polarization, humanity undoubtedly finds itself in turbulent times and society becomes increasingly less bearable. For instance, the World Economic Forum (WEF, 2023) lists erosion of social cohesion and societal polarization alongside various environmental aspects[39] as some of the most pressing global risks for both the short term (2 years) and long term (10 years). At the same time, Edelman's extensive global study shows that people trust business enterprises much more than governments (2023, p. 8f.). In fact, businesses are perceived as the only organization which can be ethical and effective simultaneously (ibid., p. 26). Hence, the call for more societal engagement of business enterprises is steadily increasing, not only from the young generation (ibid., p. 29). Peter Drucker, foresaw decades ago, that the more our society transforms, the higher the demand for socially responsible business organizations will be well. Why?

> *"The most popular and most obvious explanation is the wrong one. It is not hostility to business that explains the surge of demands for social responsibility. On the contrary, it is the success of the business system which leads to new and, in many cases, exaggerated expectations. The demand for social responsibility is, in large measure, the price of success."* (Drucker, 1986, p. 221)

Alongside the rise of ESG, the demand for societal engagement is generally on the upswing. However, so are the exaggerated expectations regarding the abilities and competencies of business enterprises to drive

39 Such environmental aspects include e.g.: failure to mitigate climate change, failure of climate-change adaptation, natural disasters and extreme weather events & biodiversity loss and ecosystem collapse. For more see WEF Report (2023).

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such transformative change (Serafeim, 2021). Nevertheless, it can be inferred that due to the continuous momentum of ESG (despite its current ambiguity), the acceptance of Milton Friedman's understanding of social responsibility is becoming brittle. In 1970, Friedman wrote in the New York Times:

> *"(…) there is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception fraud."* (Friedman, 1970).

Today, only focusing on shareholders by maximizing profits within the rules of the game, is increasingly perceived as corporate ignorance (Merrick, 2021; Williamson, 2022).

Then again, the end of shareholder primacy has been announced for years now (some examples: Freeman, 1994; Stout, 2013 or Spence, 2019). In fact, the idea that Friedman's argument may be too narrow and simple is not at all a modern development. Friedman's contemporary, the also–highly–influential management thinker, Peter Drucker, wrote as a response in his 1973 book 'Management: Tasks, Responsibilities, Practices.' that a manager's first duty is, indeed, to fulfill the purpose of the corporation—making money:

> *"Performance of its function is the institution's first social responsibility. Unless it discharges its performance responsibly, it cannot discharge anything else."* (Drucker, 1986, p. 239).

But, according to Drucker's idea of social responsibility, economic performance (or profitability) is only the primary, yet imperative, responsibility of a business, but it is not enough…

> *"(…) because no organ can survive the body of which it serves; and the enterprise is an organ of society and community. Therefore, mismanaging social impacts and social problems eventually will destroy society's support for the enterprise and with it the enterprise as well.* (ibid., p. 34).

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> *"The social dimension is a survival dimension. The enterprise exists in society and economy. Within an institution one always tends to assume that the institution exists by itself in a vacuum. And managers inevitably look at their business from the inside. But the business enterprise is a creature of society and economy. Society or the economy can put any business out of existence overnight."* (ibid., p. 83)

Ignoring the threat of fragile social legitimacy was always dangerous according to Drucker. While it is questionable if society could have truly put any business out of existence overnight in the 1970s (ibid.), it is certainly true today[40]. In his self-curated collection of insights of writing on community, society and polity, Peter Drucker concisely expresses his understanding of the social responsibility of a business enterprise and what limits it[41]:

> *"It is futile to argue, as Milton Friedman, the American economist and Nobel laureate does, that a business has only one responsibility: economic performance. Economic performance is the first responsibility of a business. Indeed, a business that does not show a profit at least equal to its cost of capital is irresponsible; it wastes society's resources. Economic performance is the base without which a business cannot discharge any other responsibilities, cannot be a good employee, a good citizen, a good neighbor. But economic performance is not the only responsibility of a business any more than educational performance is the only responsibility of a school or health care the only responsibility of a hospital.*
> *Unless power is balanced by responsibility, it becomes tyranny. Furthermore, without responsibility, power always degenerates into nonperformance, and organizations must perform. So, the demand for socially responsible organizations will not go away; rather, it will widen.*

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40 A recent example, is the popular beer brand 'Bud Light'. Due to a series of poorly coordinated missteps revolving around the endorsement of the beer by a transgender person, both liberals and conservatives felt betrayed by the brand. This led to its dethroning as America's most popular beer (Manager Magazin, 2023).

41 For his central elaboration on this topic see Drucker, 1986, p. 219–244.

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Fortunately, we also know, if only in rough outline, how to answer the problem of social responsibility. Every organization must assume full responsibility for its impact on employees, the environment, customers, and whomever and whatever it touches. That is its social responsibility. But we also know that society will increasingly look to major organizations, for-profit and nonprofit alike, to tackle major social ills. And there we had better be watchful, because good intentions are not always socially responsible. It is irresponsible for an organization to accept—let alone to pursue—responsibilities that would impede its capacity to perform its main task and mission or to act where it has no competence." (Drucker, 2003, p. 117)

Application to ESG

As Chapter 2.1 showed, the conventional wisdom that good intentions are rarely predictive for positive outcomes holds true for ESG as well. So how should businesses, investors or any other organization act in the nebulous ESG landscape? Of course, complying with the ESG regulations, which are coming into force slowly, is the first step – but is it enough?

The Drucker Institute writes that ESG factors are essentially built on his body of thought (Drucker Institute, 2023). Similarly, S&P Global states that Peter Drucker's philosophy is foundational to ESG considerations (S&P Global, 2019). Consequently, it is fitting to consider his perspective to re-examine ESG's purpose and mission.

In essence, Peter Drucker's forward-thinking stance on corporate responsibility lays the groundwork for the principles that underpin ESG's purpose and mission as intended by the 'Who Cares Wins' report. As illustrated by the statements above, Drucker anticipated the evolving role of businesses in society, including the extension of responsibility beyond mere financial performance. His call for organizations to consider their impacts on employees, society, and the environment resonates deeply with the pillars of ESG: Environmental, Social, and Governance. Throughout the following pages, this section

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briefly discusses three Druckerian aspects of social responsibility and how they relate to current ESG renderings.

First of all, according to Drucker, the first principle of social responsibility is to limit impacts on people as much as possible (Drucker, 2003, p. 103). For Drucker, *"not knowingly do harm"* was the basic rule of professional ethics, and thereby the basic rule of any ethics of public responsibility, applicable to both individuals and organizations (Drucker, 1986, p. 256).

The 'E' dimension of ESG encapsulates the environmental consciousness that Drucker urged businesses to adopt. His warning about the consequences of ignoring impacts aligns with ESG's focus on sustainable practices, resource efficiency, and responsible resource management. Overall, ESG acknowledges that businesses must consider their ecological footprint, echoing Drucker's sentiment about organizations as integral components of the broader societal ecosystem.

Moreover, according to Drucker, next to not knowingly do harm, each institution or individual **should** [author's emphasis] also look out for the common good, while focusing on their primary task (Maciariello, 2005, p. 30).

> *"Free enterprise is defensible only to the extent that it is good for society."* (ibid.)

Of course, as we know now, voluntary limitations, though often praised by public relations, were not effective. And under the broadly shared impression that focusing on maximizing shareholder value is genuinely good for society, even the most ruthless business strategies became defensible. As discussed above, legitimacy has little to do with good or bad ethics, but rather with broad acceptance. Here again, Drucker's stance on governance reflects the 'G' aspect of ESG. He cautioned against power without responsibility, emphasizing the need for effective governance structures. ESG's (theoretical) emphasis on transparent governance, business ethics, and accountability in decision processes mirrors Drucker's call for organizations to maintain a balance between private power and public responsibility.

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In this regard, ESG, in all of its varying definitions, can already be viewed as an achievement. The heightened emphasis and thereby acceptance of the importance of ESG has forced virtually all companies to deal with the originally unpopular and in some cases even risky disclosure of environmental, social and governance aspects of their business operations. As we are on the brink of extensive mandatory disclosures of ESG aspects, no one has to wait for voluntarily action and even the *“stupid, greedy and shortsighted”* (Drucker, 2003, p. 105) market participants will be forced to take – to some degree – responsibility for whomever and whatever they touch. The caveat here is that regulations are (still) imperfect. Fortunately, as discussed above, improvements are likely. However, the problem of hitting target but missing the point remains.

The second principle of social responsibility, which is more significant in Drucker's view, is the obligation to foresee the societal ramifications resulting from an organization's actions (Drucker, 2003, p. 104).

> *“It is the job of the organization to look ahead and to think through which of its impacts are likely to become social problems. And then it is the duty of the organization to try to prevent these undesirable side results”* (ibid.)

Through this lens, defining ESG as the operationalization of Corporate Social Responsibility, appears suitable, because it entails the analysis of corporate actions not only in terms of financial materiality, but also social materiality, without necessarily limiting itself to actions that only ‘do good’. Here, the ‘S’ component of ESG closely aligns with Drucker's vision of businesses as societal actors responsible for fostering well-being. Drucker's emphasis on organizations' obligations to address societal challenges and collaborate with stakeholders is – in theory – reflected in ESG's ambition on tackling social issues such as fostering diversity and inclusion engaging in community development, improve labor conditions along the value chain and ensure high product safety standards.

The importance of this can be exemplified by the case of the Swiss food and drink behemoth Nestle. Their production and *“rampant ma-*

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nipulative" marketing of breastmilk substitutes – commonly referred to as formula – has had tangible adverse effects on infants across the globe, particularly in poorer countries (Boyd, 2012, p. 285). There is no scientific doubt that breastmilk from mothers is better suited to feed infants (Soguel, 2023), especially if its substitute – which is often the case in poorer countries – is prepared with contaminated water or too little powder. Formula (willingly distributed in such a way) is a product that cannot be characterized as anything other than blind and greedy profit seeking. It is not a 'Genussmittel' (a German euphemism for 'pleasure product') like alcohol, candy, or tobacco, which have all been subject to severe marketing restrictions due to their detrimental health effects. Although Nestle's breastmilk imitates have been controversially discussed for over 50 years now[42] and were accompanied by serious accusations from regulatory bodies such as the WHO (ibid.), their practices have had limited legal repercussions and clearly turned out positive from a financial materiality point of view, as they still market formula in developing countries and as their share price rose by 8,460% from 1974 till today[43] (Nestle, 2023). Nonetheless, damaging the health of infants can hardly be understood as anything but a social problem. In this lieu "*the rhetoric of profit maximization and profit motive are not only antisocial. They are immoral.*" (Drucker, 1986, p. 546).

Therefore, the definition of ESG as factors of investment analysis (see Table 1) is not sufficient, as this view would allow the legitimization of corporate behavior that is good only for the business and bad for the rest of us.

On the other hand, for instance, the production of medicine, which is beneficial for us but potentially harmful to the environment, leads to one last principle in Drucker's understanding of social responsibility: whenever possible, turn social needs and wants into a profitable busi-

42 In 1974, the NGO 'War on Want' publicized the report 'The Baby Killer', which started the formula debate.

43 Of course, Nestle is a highly diversified company, whose growth does not only stem from selling formula. However, opposed to other corporate scandals such as Volkswagen's 'Dieselgate', the controversy around Nestle's formula has not (yet) led to the termination of the respective criticized corporate actions.

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ness opportunity (Drucker, 2003, p. 105), especially if those needs and wants arise from one's own impacts.

> *"Organizations, to sum up, do not act 'socially responsible' when they concern themselves with 'social problems' outside of their own sphere of competence and action. They act 'socially responsible' when they satisfy society's needs through concentration on their own specific job. They act the most responsibly when they convert public need into their own achievements."* (ibid., p. 106)

The unprecedently fast development, testing and mass production of Covid-19 vaccines are the most recent prime-example that public need can be turned into a profitable business that has incredible positive societal effects. Naturally, in this case, the positive societal effect of a functioning vaccine outweighed the approximately 8.4 million tons of plastic waste (consisting of e.g. gloves, masks, test kits, etc.) that has been generated to tackle the global pandemic (Laville, 2021).

If it is urgent, it is important. In the case of the deadly pandemic, that was crystal clear. This, however, does not always work the other way around. Too often, importance follows urgency. The most central crises in today's developed societies: the climate crisis and the corrosion of liberal democracy and therewith social cohesion are steadily worsening. Unfortunately, for the longest time, they were characterized by a lack of urgency and made our society's increasingly less bearable (Homer-Dixon & Röckstrom, 2022). In the summer of 2023, Europe experiences the detrimental consequences of this negligence, grappling with political populism in France, Germany, Italy, and Spain, coupled with devastating wildfires in Greece and floods in Italy, all linked to the climate crisis and resulting in loss of lives.

However, as discussed above, we find ourselves at an inflection point (or past it already) as a) stricter ESG regulation is coming into place and b) a generation is coming of age that has not only a heightened sense of urgency for the environmental crisis, but also a perception of collective responsibility for our societies, as they will have to live in them. Before this thesis suggests a few expansions for ESG

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in order to become a vehicle towards a bearable society, it will briefly discuss what is central to such a society.

2.6 What Makes a Society Bearable?

Of course, this question is very broad and frankly quite philosophical. Therefore, for this thesis, only Drucker's view will be considered. For him, a functioning civil society was the indispensable part to achieve the approximation of a bearable society (Paschek, 2020, p. 189). In short, for a functioning civil society, there are three main prerequisites:

First, the individual needs both function and status in a society.

> *"For the individual without function and status, society is irrational, incalculable and shapeless. The 'rootless' individual, the outcast—for absence of social function and status casts a man from the society of his fellows—sees no society"* (Drucker, 2003, xviii).

This is becoming a serious challenge for knowledge societies worldwide, as the wealth gaps in and between nations expands steadily, thereby diluting the (economic) status of many, which was hard earned through their own work or that of the preceding generation (Piketty, 2017; Robinson, 2022). Simultaneously, the belief is still engrained into people's minds that upward mobility is potentially unlimited (Paschek, 2020, p. 135). This *"culture problem"* of the developed world (ibid.), one could argue, does not help to mitigate the collective frustration of the majority in *"late-stage capitalism"* (Espinoza, 2022), where we have fewer and fewer extraordinary financial winners and increasingly more average economic losers[44]. The fact that capitalism becomes less acceptable the more it succeeds (Drucker, 1986, p. 546) is becoming increasingly visible as a central weakness of today's society and economy.

The second prerequisite for the functioning society is the liberal democracy. Of course, the two interact with each other. One will not follow the other, but they rather are mutually dependent (Drucker, 2009, p. 288). The most important fundaments for this reciprocal rela-

44 Globally, economic prosperity of middle-classes is shrinking (Kochhar, 2021).

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tionship are the rule of law and human rights, both of which provide the necessary social and political order which effectively protects the person and the property of citizen against arbitrary interference from above (Drucker, 2009, p. 285). Moreover…

> *"The Neo-Classics are right: without the Free Market there will be no functioning modern economy and, in fact, no economic growth. But the Free Market is in turn dependent on a functioning civil society. Without it, it is impotent."* (ibid.)

Today, one may perceive the attitudes of the younger generation towards work in the 'free markets' as a sign of such impotence (Suchy, 2023). Conversely, the young generation is increasingly skeptical towards the current organization of capitalism, which will, according to Tariq Fancy, a former ESG executive at BlackRock, inevitably cause political instability (Fancy, 2021). Whether or not the free market is truly a *"hoax"*, as he calls it, shall not be discussed here, however one thing is certain: if social problems cannot be turned into profitable business opportunities, they turn into the *"degenerative diseases of society"* (Drucker, 1986, p. 237) and then regulation is required (ibid., p. 233). Because *„if one waits for voluntary action on the part of everyone, no one acts"* (Drucker, 2003, p. 105). Therefore, also when it comes to the 'ESG revolution', it is expectedly true that *"(…) the invisible hand of the market needs the visible hand of the law."* (Homan, n.d. as cited in Paschek, n.d.).

Today, we see a plethora of such degenerative diseases: income equality, poverty, corruption, climate change, prevailing racism, social fragmentation, collective mental health issues, healthcare access disparities, opioid crises, digital divide, erosion of democratic norms and many more. Of course, no business or law will solve these diseases once and for all. Yet, they can be managed, and that management could certainly be better. Delegating the management of the degenerative diseases exclusively to governments is irresponsible of the business world because, as we experience every day, the political system demonstrates limited competency in producing adequate approaches to deal with the social ills of today. Nonetheless, every healthy business, as organ

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of society, requires a healthy, or at least functioning society (Drucker, 1993, p. 337).

> *"A healthy business, a healthy university, a healthy hospital cannot exist in a sick society. Management has a self-interest in a healthy society, even though the cause of society's sickness is none of management's making."* (Drucker, 1986, p. 229)

Thus, it is of urgent time for business executives to truly become an integrating force of the general will and for the qualities of life. Again, although written more than 40 years ago, Drucker expressed it in great eloquence:

> *„The manager of institutions must establish himself as the representative of the common good, as the spokesman for the ‚general will'. He can no longer depend on the political process to be the integrating force; he himself has to become the integrator. He has to establish himself as the spokesman for the interest of society in producing, in performing, in achieving. And this means that the manager of any institution (but particularly of business) has to think through what the policy should be in the general interest and to provide social cohesion".* (Drucker, 1980, p. 208–215 as cited in Paschek, 2020, p. 150)

Here, one last note prior to the extensions of ESG, is necessary. Unquestionably, it is true that any member of society can as consumer, as employee and as voter influence our society in both constructive and destructive ways. More than we have ever seen before in human history. This is thanks to economic globalization and worldwide virtual connectivity. Believing otherwise and acting accordingly is the irresponsibility of the individual. For the masses, such irresponsibility may, hopefully, be overcome eventually due to the generational change. However, the elites or society's major leadership groups have outsize influence on the political, environmental and societal developments of our society. Thus, for Peter Drucker "*it is, therefore, only logical that they are expected to take the leadership role and take responsibility for major social problems and major issues.*" (Drucker 1993, p. 319 as cited in Paschek, 2017, p. 75). This is especially important because value-ori-

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ented actions by the elites are more likely to justify their existence than wasteful ignorance, which is often displayed on social media today[45]. Consequently, Drucker calls on these elites to act according to certain guiding principles, all of them oriented toward the ideal society to be striven for according to Peter Drucker: a society that is bearable and worth living in for almost all citizens (Paschek, 2020, p. 99). The business elites, or 'those with resources', which are often to be found in the financial sector, are ultimately co-responsible for the outcome of our world. So then, isn't it fortunate for all of us that exactly these elites are driving the 'ESG revolution'?

2.7 The Extensions of ESG

It would be naïve to postulate that ESG will single-handedly change the world for the better and provide social cohesion in its entirety. But, ESG does entail important aspects of today's most pressing challenges and has achieved great attention from society's major leadership groups. Historically, the financial industry (and its high-ranking executives) has had a great impact on the quality of people's life – though mostly the negative peaks are remembered. Social responsibility cannot be a public relations issue any longer, the stakes are too high. To approximate a bearable society, 'big money' needs to own the '50-year-old new responsibility' of the business, that Drucker outlined almost 50 years ago:

> *"This new concept of social responsibility no longer asks what the limitations on business are, or what business should be doing for those under its immediate authority. It demands that business take responsibility for social problems, social issues, social and political goals, and that it become the keeper of society's conscience and the solver of society's problems."* (Drucker, 1986, p. 220)

45 To catch a glimpse of such ignorance, one documentary of the German publicly funded journalistic collective 'STRG_F' is recommended: https://www.youtube.com/watch?v=MbJOQsK42iE&t=893s.

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Without a doubt, that is a big, and perhaps an idealistic, ask. However, only the financial elite holds immense potential to leverage both the ambiguity and the momentum of ESG into a truly new set of guiding principles for the corporate world, built on Drucker's understanding of social responsibility. The thesis postulates that through such a course-correction an approximation to the bearable society may be possible.

The ideas below are to be seen as exemplary additions to aspects of current ESG criteria. As mentioned earlier, they shall not be viewed as either exhaustive, nor as a substitution for existing ESG factors. However, they are to be seen as inspirations for how a business could be assessed and, what aspects should be more closely considered when implementing ESG. Convergence in ESG is important for the 'ESG Revolution' to be successful, but the purpose of ESG – to whatever degree measurable – is decisive. The following chapter now expands each pillar of ESG with regard to select aspects built on the current ESG renderings, the generational demand for change, and Peter Drucker's understanding of social responsibility and requirements for an approximation to a bearable society.

2.7.1 Environmental: From Primum Non Nocere to Tertium Sanare

The Latin phrase "*primum non nocere, secundum cavere, tertium sanare*" originates from a doctor called Scribonius Largus (approx. 50 Anno Domini) and means loosely translated: "*Firstly do not harm, secondly be careful, thirdly heal*" (Markwart, 2005). Peter Drucker (1986, p. 256) states that to 'not knowingly do harm' is the basic rule of professional ethics. Furthermore, Weber and Paschek (2017) argue that over the past decades, managers have made successful efforts to avoid destroying our natural environment. Unfortunately for the sake of humanity's survival, not knowingly destroying the environment is no longer sufficient. During his speech on the 27th of July 2023, current UN general secretary, António Guterres, declared the era of global warming to be over. It has now been replaced by the era of global boiling (Niranjan, 2023). Famous for his zero tolerance for greenwash-

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ing by companies or their financial enablers, he demands swift actions from all elites (UN News, 2022):

> *"The air is unbreathable, the heat is unbearable, and the level of fossil fuel profits and climate inaction is unacceptable. Leaders must lead. No more hesitancy, no more excuses, no more waiting for others to move first. There is simply no more time for that."* (Guterres, 2023 as cited in Niranjan, 2023).

Hence, actions of all institutions of society (including the business enterprise) should be measured against efforts towards 'tertium sanare' – the **healing** of our earth. If all companies were content with not (further) destroying the planet, just within the 21st century we will experience the catastrophe of rising temperatures, the disappearance of ecosystems, disastrous crop failures, more economic pain and massive loss of life (Ignatius, 2021). Actions to heal our planet commonly include, but are not limited to, technical innovation (ibid., 2021). In fact, a change in the business model can also be healing. The French car manufacturer Renault is an expectational example. At its 'Re-Factory' near Paris, Renault established a successful operation that recycles gearboxes, engines, turbos and injectors from old cars to new cars. Thereby, Renault produces significant environmental benefits. According to the Ellen McArthur Foundation typical savings from the production of a remanufactured car are 80% less energy, 88% less water, 92% less chemical products and 70% less waste. Additionally, 'Re-Factory' saves Renault €500 million Euros (Ellen McArthur Foundation, 2022). Consumers, particularly young ones, are leeching for goods and services produced in a circular economy (Euromonitor International, 2023) and its producers could, after an initial ramp-up, save money on resources and manufacturing. For instance, for the automotive industry, adapting circularity is argued to improve the profitability of each car produced by the factor 1.5 (WEF, 2022).

Back to ESG as a tool for investment assessments, proxy for corporate strategy or reporting metric: a high ESG performance does not contribute to a 'better world' if it merely represents that the company is not destroying our planet any further. Instead, it should reflect the mes-

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sage to an investor that a given company is actively doing something to heal our planet. Of course, it is not to be expected that all companies can immediately fulfil this condition, but it would be more effective to establish a tool that highlights, rather than masks such shortcomings.

For financial products overall, ESG should overcome the common approach of a disinvestment strategy from 'black sheeps' towards an investment strategy in companies that create the quality of life for the generations to come, may that be through technological innovation (e.g. green e-mobility) or a truly environmentally sustainable business model. Given the persistent presence of participants in the finance industry who vehemently resist discontinuing the funding of climate change enablers like major oil corporations, it is imperative that the regulation of reporting, and consequently the methods for attributing ESG scores, becomes exceptionally stringent. This rigor should be such that there is no room for misinterpretation regarding companies such as Shell or ExxonMobil being anything less than significantly impactful on the health of our earth.

A company with an 'AA'-rating is considered a leader in ESG, according to MSCI. Young people who want to put their money where their values lie, might easily be under the impression that they are investing in something climate-friendly. Why should they think otherwise? ESG scores could be a useful tool, but only if companies like Shell do not receive 'AA'-Ratings any longer (see Appendix 2).

Hence, the argument is made that ESG must not only serve as a signal within the ESG ecosystem but also as an expression of genuine Corporate Social Responsibility. It should go beyond merely assessing the societal risk for a given company or engaging in virtue signaling. The message, if one chooses to convey it through a score, must be easily understandable to the 'untrained eye'. Everything else, similar to "*bogus net-zero pledges*", is reprehensible (Guterres, 2022 as cited in UN News, 2022). Guterres comments the fossil fuel expansion of recent years accordingly:

> "*It is rank deception. This toxic cover-up could push our world over the climate cliff. The sham must end.*" (ibid.)

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When considering the long-term value argument, it is essential to recognize that if we don't achieve a bearable environment for most of Earth's population, developed societies will come to face less bearable conditions too. Recent years have shown that extreme heats, droughts, wildfires, and other disasters aren't exclusive to the global south. The shareholder value from Silicon Valley (or other hubs) will dwindle as more regions scorch like Death Valley – literally. In the worst-case scenario of temperature rising, a staggering 18% of the global GDP is expected to be wiped out (WEF, 2021).

To sum up: The 'E' in ESG investing, reporting, and strategy should focus on healing the planet, not just on avoiding further damage. This can be achieved through technological innovation, business model innovation, and radical honesty about environmental impact. While this honesty may have to be enforced with regulation, the long-term value argument makes it inevitable. Short-term gains from greenwashing will be outweighed by the long-term costs of financial value destruction linked to unbearable environmental conditions.

2.7.2 Social: Providing for Competence

> *"Encouraging the competence of the poor and promoting their capacity to develop themselves is clearly in the self-interest of the affluent, that is of the democracies. For their stability and social cohesion is increasingly threatened by the anomie, the degradation, the despair of the incompetent and dependent poor."* (Drucker, 2009, p. 276)

People sometimes imagine yesterday's revolutions as planned and carried out by self-conscious revolutionaries, but this has rarely, if ever, been the case. In essence, a revolution starts to form when an initially disconnected group of people experience a state of shared discontent and frustration in their life, and consequently fuse into a critical mass as a more or less stable constellation with the intention to transform the existing institutions of society (Tiruneh, 2014). Throughout history, these discontents were those that perceived themselves as unfairly treat-

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ed, unfulfilled, poor, under-privileged and ultimately disregarded by society (‘s major leadership groups).

Fortunately, the storm of the capitol on January 6th in 2021 was not successful, but it was irrefutable proof that the United States’ society (the world’s spearheading liberal democracy) is disenchanted, fragmented and abundantly (and dangerously) aware of their constitution’s 2nd amendment (Heinberg, 2022). The situation in Europe is slightly less severe, yet protests are beginning to escalate there too (Reuters, 2023). While, we currently may not be on the verge of another social revolution in the industrialized world yet, we can already observe some alarming symptoms.

For instance, looking at the social ills in the United States or in Germany paints a dire picture. Every fifth employee in Germany is working in a low-wage job (in german: *“Niedriglohnsektor”*) (Statistisches Bundesamt, 2021), in the US it is every third (Luhby, 2022). Jobs that pay their employees that little are usually those that keep the society ‘running’ (e.g. caregivers, kindergarten teachers, security personal, taxi and delivery drivers, hair dressers, garbage men, etc.). Earning less than 12 € (or 15 $) was never (morally) enough, but with today’s soaring inflation is simply too little. ‘The hard workers’ of society are falling behind and frustration is on the rise. Alcohol in Germany and prescription drugs in the US wreak havoc on the poor (Luhby, 2022; Collins, 2016). Moreover, nationalist have become increasingly popular amongst politicians in the free democracies of the western world – Donald Trump, Marine Le Pen, and recently Giorgia Meloni.

The quote at the beginning of this chapter is from Drucker’s essay called ‘Can Democracies Win the Peace?’ (Drucker, 2009), and was first published in the Atlantic Monthly in 1995. Drucker makes the convincing argument that more money is not merely the solution for the poor (ibid., 2009). While his text is more closely related to the welfare dependents[46], one could argue that there is a similarity to today’s service proletariat in the western world (Hainbach, 2020). Those stuck

46 People working in the described job are also often only ‘one step away’ from becoming dependent on the welfare system. One personal tragedy, the bankruptcy

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in the low-wage trap often experience cognitive degradation, and a strong sense of unfulfillment due to their self-perceived incompetence (Berger, 2022; Huggins, 2014). Drucker argues that in a bearable society 'man' does not need to be fulfilled to his fullest, perfection in that sense is unrealistic, but fulfilment must be adequate, because:

> *"We deal after all with the social order of men not with that of angels. But there is a point below which the efficiency of social fulfillment may not fall without making society appear despotic, arbitrary, irrational and meaningless. Where this point is we do not know."* (Drucker, 1993, p. 151 as cited in Paschek, 2008, p. 5)

As has been discussed above, it should be the social responsibility of all institutions to ensure that most people do not view their society as despotic and meaningless. As Drucker states, it is hard to identify where that breaking point of low fulfilment lies, but having a fifth of the German workforce and a third of the American workforce tangled up in (potentially) cognitively degrading jobs coupled with a salary that makes them fall behind, is not a good sign.

So how can ESG efforts of companies help? An employee-centered survey conducted by JUST Capital showed that in many cases 'S' issues are prioritized over 'E' issues (Benjamin, Heffetz & Weinstein, 2023). When considering the 'S' pillar, adequate pay instead of mere philanthropic donations, is of course a first step, but more importantly, companies should promote competence – inside or outside of a given organization.

After the *"year of efficiency"* was introduced by Mark Zuckerberg, linked to the anticipated implementation of generative AI in modern jobs, many knowledge workers expressed fearfulness of becoming obsolete in the foreseeable future (Kay, 2023). Of course, reversing the progress in technology is unlikely and not commendable, because AI *"Is Essential for Solving the Climate Crisis"* – as the Boston Consulting Group writes (Maher et al., 2022). According to Tamayo et al. (2023),

of a local business or physical illness can be triggers for the downgrade. One out of 10 transitions from a low-wage job to unemployment in Germany.

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millions of people will have to be re-skilled due to AI within the next decades. Therefore, developing one's employees and teaching them how to work with and not against AI, appears to be a suitable addition to the 'S' of ESG. This ensures that the modern knowledge worker can leverage it and therefore will not have to compete with it – a contest any human is likely to lose. Moreover, a quick adoption of AI – as one can imagine – promises all the of the wonderful things that shareholder maximizers love: automation, cost reduction & efficiency. While these things are admirable and certainly necessary to mitigate our complex environmental challenges, they should be utilized socially responsibly, helping people do their job instead of obliterating it and thereby risking the loss of status and function of thousands of individuals.

One example for providing for competence outside of the organization comes from the world's largest online retailer. In the fall of 2021, Amazon declared a landmark investment in its own people. With a funding of 1.2 billion USD, the online retailer expanded its 'Career Choice Program' and now provides the opportunity for all of its approximately 750.000 US-based operations workers (those working in the fulfillment centers) to get a college education that is fully paid for – 100% upfront (Lake, 2022). Hereby, Amazon facilitates upward social mobility for its less skilled employees, which would otherwise be unattainable without Amazon as their employer. Participants in the 'Career Choice Program' demonstrate elevated job satisfaction, substantial income growth and most notably, an enhanced feeling of self-esteem and value (ibid., 2022).

Of course, not every company can engage in such an extensive upskilling program. However, the intention behind it can be understood by every business enterprise. Again, when considering ESG as mechanism to rate 'investments towards a better world', or to operationalize true CSR in one's company, the 'S' in ESG should not merely reflect that employees of a given company work in a non-hazardous environment or that they have a racially diverse workforce. To be genuinely 'social', a company should develop its communities. That includes paying a wage that (at least) allows the maintenance of one's life and the

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opportunity to grow and develop competence. Young people demand – rightfully so – a society that is worth living in, not one that's barely possible to survive in. In the pursuit of convergence within ESG, providing for competence must be central in the social pillar to ensure adequate (not perfect) fulfillment, function and status for individuals in the modern employee society.

2.7.3 Governance: Politics and Pay

But what really is competence anyway? Merriam-Webster defines competence as "*the quality or state of having sufficient knowledge, judgement, skill, or strength (as for a particular duty or in a particular respect)*" (Merriam-Webster, 2022). Drucker argues in the Harvard Business Review from 1997 that:

> *"Knowledge constantly makes itself obsolete, with the result that today's advanced knowledge is tomorrow's ignorance."* (Drucker, 1997)

Without a doubt, this quote has implications for a business to constantly monitor its technological capabilities, understanding of the relevant target groups and general strategy within a market. Disregarding that things are changing will leave anyone inevitably behind. Chapter 2.3 discussed extensively that ignoring the changing demands of younger people will cost social license first, and profits second, as it will be perceived as corporate ignorance.

Today, one area where such ignorance can be particularly dangerous for a company's social legitimacy is political advocacy – or rather the lack thereof (Theobald & Gaiser, 2022). The 'advanced knowledge' about political communication that many business executives have is rooted in their time at colleges and universities, years or even decades ago, which most likely would steer them away from taking a political stance whatsoever. Many executives believe that commenting on political developments may cast an unfavorable light. Companies appear disengaged and careless (ibid., 2022). Yet on the other hand, they are expected to become the political integrator and provider of social cohe-

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sion. In an interview with Bethany McLean hosted by the Corporations and Society Initiative at the Stanford Graduate School of Business, Tariq Fancy[47] argues in the context of how 'business leaders can fix the government' that is has to start with the disclosure of political spending.

> *"But how could a company hide their political spending and not get an automatic zero ESG score?"* (Fancy, 2023 as to be seen in Stanford Graduate Business School, 2023, [minute 38:54]).

To foster social cohesion, it is critical to enhance the 'G' pillar in this regard. No enlightened person expects that we live in a perfect system, decades of history have proven otherwise. However, a lack of transparency is damaging to society as it further erodes trust in 'the system', especially of the lesser educated. This could result in devastating effects for today's polycrisis (see p. 42).

Because ESG is a politically polarized topic, participants of the ESG ecosystem need to become politically competent with it. The political sphere and the business sphere both exist in the same society – in the same *"body they serve"* – so why pretend it is not the case? With sincere efforts in the 'G'-pillar, the widening pillarization between business and politics could be narrowed and increased political engagement – maybe accompanied by outrage – might be one consequence. However, maintaining secrecy about a business enterprise's political connection perpetuates the narrative of 'evil elites' or other conspiracy theories, which are then distributed quickly via social media platforms as they openly promote the cultivation of 'alternative truths' and contribute to uncertainty about the relationship between fact and fiction, as well as between honesty and hypocrisy (Bubert, Drews & Krischer, 2023). An important note: this thesis does not argue that elites, by default, hurt democracy or society. In fact, it assigns them a special role in the approximation to a bearable society, as they have the necessary resources

47 Tariq Fancy is a former chief investment officer for sustainable investing at BlackRock who has criticized ESG investing and called for a more radical approach to sustainable investing.

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to drive significant change. Nonetheless, their current perception may be detrimental to a functioning society. If the 'G'-pillar in ESG reporting, ESG Investing and ESG strategy focuses on political transparency, ESG can become an enabler of social cohesion.

There is, however, another avenue for businesses to take. So-called 'brand activism' describes a new development that business enterprises (not only their CEO's) increasingly speak about socio-political topics. In well-governed cases of brand activism, companies also act upon their words. For instance, Google has not only been pro-abortion verbally, but also with their actions. After Roe v. Wade was overturned[48], Google announced to update their health insurance so that all employees would be covered for out-of-state medical procedures that are not available where an employee lives or works (Rosenblatt, 2022).

One further aspect needs to be taken into more serious consideration when assessing the ESG score of a company: executive compensation, especially the CEO-to-employee (median) ratio. Drucker argued in the Wall Street Journal in 1977 that explaining excessively large salaries with the need to pay the market price is "*nonsense*" (Drucker, 1977) and further added that a 25-to-1 ratio is desirable enough and within the range what the ordinary employee deemed acceptable. Today, the average CEO-to-employee ratio in the S&P 500 is 299-to-1. That number grew by over 1300 % since 1978 (Richter, 2022). There is no justification for such a ridiculous distribution of wealth and company revenues. Any company that really cares about ESG factors would know that capital can be allocated more effectively than by fueling the hubris of a few select executives. It could also mitigate the anger, frustration or conspiracy against the elites.

One way to improve corporate behavior is to ensure that executives are rewarded for making decisions that are good for the environment and society, and penalized for making decisions that are harmful. This

48 In June 2022, the US Supreme Court overturned Roe v. Wade, the landmark piece of legislation that made access to an abortion a federal right in the United States. The decision dismantled 50 years of legal protection and paved the way for individual states to curtail or outright ban abortion rights.

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can be done by tying executive compensation to ESG targets and having a rigid clawback mechanism in place. Overall, researchers concur that connecting executive pay to ESG goals *"makes sense"* for our future (Kiger, 2023) and has already shown to positively impact the ESG outcomes of companies that have adopted such compensation plans for their top managers (Cohen et al., 2023).

All in all, ESG reporting, investing and strategy implementation should firstly assess the transparency of political spending and the balance of brand activism of a company (responding to declining political discourse) and secondly, a reasonable C-Level executive-to-employee pay ratio, that additionally incorporates the fulfilment of ESG targets in remuneration.

2.8 Reflection and Interview Research Questions

Naturally, there are start-ups (or other companies) which are greener, fairer and more transparent than Renault, Amazon or Google. Consciously, this last chapter selected companies that are not necessarily perceived as 'green' by the general public to illustrate towards what *purpose* each pillar of ESG should develop. The examples show that even big companies can take actions that go beyond public relations and a few select philanthropic donations. Indeed, companies that are criticized for their actions with regard to one of ESG's pillars, can be leaders in the context of another pillar. Of course, any ESG score should reflect this respectively. The theoretical background can be summarized with three main conclusions.

Firstly, the main challenge for ESG is not the question: 'How can ESG be measured?' – but rather – 'What to look for in ESG?'. The currently ambiguous purpose and mission of ESG need to be sharpened, in order for ESG Investing, ESG strategy and ESG reporting to converge to a set of measurements for responsible business practices that enable changes towards a bearable society, not the protection against societal change. Otherwise, ESG is likely to turn into something that

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enables companies and investors alike to hit the target, but miss the point, all while wasting an abundance of society's resources.

Secondly, in order for ESG to become such a transformative tool towards such a world, the emphasis on 'S' and 'G' must become equivalent to 'Environmental'-pillar. Climate change is unquestionably the biggest threat to the survival of the human race. But mismanaging 'Social' and 'Governance' is arguably a bigger threat to the survival of a functioning society, to the triumph of democracies. Neglecting aspects of 'S' and 'G' could exacerbate the urgency of 'E' even further. In this context, managing one's legitimacy, a dynamic concept, is critical. As demonstrated above, both the generational demand and the general disenchantment with elites can be financially material for corporations, particularly in the long-term.

Thirdly, with an updated notion of ESG not all companies may immediately achieve high ESG performance, however it becomes evident why all companies should strive for it. More importantly, it becomes clearer for the general public. Declaring ESG a marketing fad and putting it on a shelve next to the Triple Bottom Line or any other glossy term of Corporate Social Responsibility would be unfair to its current momentum. However, more work is required to turn ESG effective. It is proposed that the finance industry as a whole or in general, 'those with resources'[49], must make a commitment to distill ESG into something that yields the qualities of life for everyone, instead of the quantities of financial returns for themselves and their accomplices on the 'gravy train'. Making ESG efficient does not guarantee its effectiveness.

In short, derived from the generational demand and Peter Drucker's thoughts on social responsibility of the business enterprise and the requirements for a bearable society, the following expansions to ESG are proposed:

'**E**' must focus on healing our planet, rather than not harming it further. How? Mainly, it should no longer be useful to cover-up climate

49 Relevant business players for the transformation of ESG are e.g. Investment Banks, Private Equity Companies, Investment Management Companies and Family Offices.

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inaction, but rather make the shortcomings visible to the 'untrained eye' in particular. Companies who indeed contribute to the healing of our planet deserve praise (e.g. through stellar ESG ratings) and accordingly, more funding. People want to invest in the creation of a better world, hence it should be made easy for them. Leaders must lead, not deceive.

In addition to ensuring livable wages to mitigate frustration and social upheaval, which is in the best interests of businesses, **'S'** in ESG should focus more on developing human capital. This is especially important as the era of generative AI begins to unfold its implications for the labor market. Providing for competence is argued to be critical to ensuring adequate (but not perfect) fulfillment, function, and status for individuals in the modern employee society.

The '**G**' pillar of ESG should reflect metrics that promote political transparency and openness, rather than merely box-ticking on compliance issues. It should also consider restrictions on absurdly high executive compensation, as this undermines the support of the majority for the elites who receive such salaries.

It is not lost on the researcher that the proposed extensions to ESG could be perceived as somewhat idealistic. After all, Drucker's teachings on social responsibility have unfortunately borne fruit only to a limited extent. This is quite obvious, otherwise we would not be where we are today. However, it is precisely today's more drastic state of affairs that could provide a promising breeding ground for his teachings, when integrated into the ESG debate. It remains questionable (and masochistically intriguing to see) if the myopia inherent to human's nature[50] can be overcome and if the business elites of our current society can navigate the ambiguity of ESG towards a vehicle that contributes to a bearable society. The semi-guided expert interviews of this study explored this question and the sub research questions in myriad ways:

50 It easy for executives – especially in the private equity industry – to declare that their company will be net-zero by 2050 when they know with all certainty that they will be retired (or dead) by then.

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Main Research Question (MRQ): Can ESG become a vehicle towards a bearable society?

Sub Research Questions (SRQs):

- SRQ 1: When considering ESG's current state, what are its' purpose and mission, perceived impact, major shortcomings and obstacles for broad adoption?
- SRQ 2: Who are the drivers and true beneficiaries of the 'ESG Revolution'? Who should they be?
- SRQ 3: What is the role of the business enterprise in our society and what is its social responsibility? Do elites have a special role to play? How is legitimacy affected?
- SRQ 4: How can the 'E' pillar be effective and is it – in this regard – recommendable to focus on healing the planet, instead of not harming it further? Is there a comprehensibility issue?
- SRQ 5: How can the 'S' pillar be effective and is it – in this regard – recommendable to focus on providing for competence, inside and outside of the organization?
- SRQ 6: How can the 'G' pillar be effective and is it – in this regard – recommendable to focus on a company's political stance and executive compensation?

Considering the extensively discussed flexibility of ESG's purpose and mission amongst different participants in the ESG ecosystem, a qualitative approach is best suited to answer these research questions. Next to the prime objects of investigation, a more general assessment of ESG and the idea of a bearable society are examined in order to yield the most comprehensive results possible from the conducted in-depth interviews.

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