

The Strategic Case for ESG: Risk Management and Long-Term Sustainability

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Abstract. Environmental, social, and governance (ESG) practices are becoming essential components in modern corporate strategy and investor decision-making. This paper explores the strategic value of integrating ESG policies into business operations to promote long-term sustainability and mitigate environmental, regulatory, and reputational risks. Drawing from a comprehensive review of existing literature and industry case studies, the study argues that ESG implementation can enhance operational efficiency, attract sustainable investment, and build stakeholder trust. Companies such as IKEA and H&M are used as real-world examples to illustrate the potential benefits and challenges associated with ESG transformation. Although some researchers question the short-term financial returns of ESG adoption, the long-term strategic advantages, including improved brand resilience and access to green capital, are significant. The paper emphasizes that ESG programs are most effective when they align with a company's core capabilities and market positioning. In an era of heightened stakeholder expectations and evolving regulatory environments, ESG integration is not only a moral imperative but a business necessity. The study concludes that firms adopting ESG proactively are better positioned to achieve sustainable growth and competitive differentiation.

Keywords: ESG, sustainability, risk mitigation, corporate strategy, stakeholder value

1. Introduction

Environmental, social, and governance (ESG) refers to the non-financial factors that investors consider when making capital allocation decisions. ESG issues range from climate change policies and carbon neutrality to labor rights, corporate ethics, and board diversity. In recent years, ESG adoption has become a central concern in both academic and corporate circles. However, the impact of ESG policies on corporate financial performance remains widely debated. Some studies suggest that ESG strengths improve profitability, enhance brand reputation, and reduce operational risks. Conversely, other researchers argue that ESG initiatives may distract firms from their core business functions and result in increased operational costs.

Recent literature also reveals both consensus and divergence on ESG's implications. While a growing number of scholars support ESG as a long-term value driver, inconsistency in ESG rating systems complicates performance evaluation. For example, as shown in [1], ESG scores assigned by major agencies often diverge due to different methodologies, raising concerns about measurement

reliability. Similarly, some researchers emphasize that the lack of standardized disclosure frameworks allows for selective reporting and potential greenwashing [2]. These challenges underscore the need for more transparent and harmonized ESG evaluation systems, even as ESG continues to gain momentum.

Despite these complexities, this paper argues that companies should integrate ESG policies not only for reputational benefits but as a proactive risk mitigation strategy and a foundation for long-term sustainability. First, studies demonstrating a positive ESG-performance link will be presented. Second, research on the potential downsides and implementation risks of ESG will be discussed. Third, the essay will argue that ESG integration helps businesses identify and reduce sustainability-related risks, including those driven by regulation and shifting social expectations. Finally, ESG strategies by two major retail brands, IKEA and H&M, will illustrate how theoretical principles are being applied in practice.

2. Advantages of ESG integration

2.1. Attracting investment

Adopting strong environmental, social and governance (ESG) practices can help attract investor interest and capital flows, providing a potential financial benefit. As shown in [3], the percentage of capital being allocated using ESG considerations rose substantially from 17% in 2017 to 25% in 2019 among institutional investors globally. This indicates a rapidly growing demand for companies with strong ESG profiles. Well-known corporations perceived as ESG leaders, like Apple with its commitment to 100% renewable energy and advanced recycling initiatives, have seen increasing inflows of patient capital from sustainable investment funds that support business expansion, innovation, and growth. For example, Apple issued multiple green bonds targeted at ESG investors to finance its clean energy projects, which were oversubscribed, demonstrating that initiatives aligned with business strategy can improve access to financing and lower the cost of capital. While ESG proponents argue that sustainability leads to long-term value creation, some critics believe a strong focus on ESG could potentially reduce short-term financial returns for investors. Certain academic studies, such as [4], have found no direct statistical correlation between higher ESG ratings and superior stock performance over fixed periods of time. The investments required to transition business operations and value chains to be more sustainable, such as retrofitting facilities to use renewable energy, adopting greener chemistry and manufacturing processes, or shifting to electric vehicle fleets, often entail sizable upfront costs. The payback periods for these investments can range from 5 to over 10 years in some cases, introducing financial risk for companies without a clear path to revenue growth or cost savings within standard quarterly or annual reporting cycles. To help address this concern around the risk of over-investment without sufficient returns, experts argue that companies need to take a targeted, strategic approach to ESG integration. This involves selectively identifying and prioritizing initiatives that can create operational efficiencies through reduced waste or energy usage, appeal to expanding consumer segments demanding more sustainable products, or open new markets and revenue streams. For instance, IKEA has made far-reaching commitments to phasing out all non-essential single-use plastics and powering its operations with 100% renewable electricity [5]. While redesigning many thousands of products to remove plastic raises costs in the near term, IKEA's comprehensive sustainability focus aligns tightly with its brand identity among young, environmentally-conscious consumers, supporting continued growth. H&M has invested heavily in supply chain transparency programs and responsible sourcing initiatives like fair living wages. This focus helps strengthen brand resilience

and loyalty despite controversies and has helped attract institutional investors increasingly concerned about ESG risks. The most effective approach is to tie ESG programs directly to core business capabilities, resources, and market positioning for maximum strategic benefit. Leading companies leverage sustainability to enhance their reputation among both consumers and investors while finding ways to balance necessary ESG investments with continued profitability through synergies with core operations and value propositions. Empirical studies further support this strategic logic. A comprehensive meta-analysis by Friede, Busch, and Bassen reviewed more than 2,000 empirical studies and found that around 90% reported a non-negative relationship between ESG performance and corporate financial performance, while 63% indicated a positive correlation [6]. These results suggest that although ESG investments may require significant upfront capital, they often yield long-term financial and reputational benefits that align with investor expectations and market trends.

2.2. Risk mitigation

Adopting strong ESG practices can help companies identify and mitigate key risks from social, environmental, and regulatory changes. As shown in [7], analyzing material ESG factors allows businesses to reduce policy and transition risks. For example, Volkswagen and Daimler's early investments in research and development for electric vehicle production technologies gave them a meaningful competitive advantage when Europe's governments and regulators began tightening automobile emissions and fuel efficiency standards in the late 2000s. By proactively transitioning their product lines and production capacities to electric vehicles ahead of the regulatory curve, these automakers faced relatively lower compliance costs compared to their lagging competitors. However, automakers that did not adequately assess and prepare for increasingly strict low-carbon transportation policies ended up facing major financial burdens to retrofit older gas-powered vehicle platforms or invest in electric vehicle manufacturing capabilities in a catch-up manner to meet the new emissions regulations. In addition, proactive ESG disclosures and transparency help reduce uncertainty for investors, according to [8]. Banks like BNP Paribas that provide detailed reporting on portfolio climate risks and reduction targets are better positioned to maintain access to capital from environmentally-conscious institutions. On the other hand, opaque ESG policies raise questions and alienate stakeholders. Moreover, demonstrating social responsibility through ethical supply chains, living wages, and diversity initiatives helps build consumer trust and resilience against controversies, as Nike's experience shows. Although incidents still occur, Nike's supplier audits and labor protections have reduced reputational impacts and share price volatility following negative media reports. However, some argue a focus on ESG could distract from core business activities and objectives. Some argue that companies pursuing ESG may take resources away from core operations [9]. However such risks can be minimized by directly linking ESG programs to business goals, capabilities, and operational efficiency. For example, Visa's financial literacy initiatives aim to expand its addressable market by improving access to digital payments. Leading retailers like H&M have invested heavily in supply chain transparency, tracing suppliers down to the raw materials level [10]. While this mapping is resource-intensive, it has strengthened brand trust and helped attract conscientious investors concerned about human rights risks. IKEA's phase-out of single-use plastics required extensive product redesigns but created reputational benefits and reduced potential regulatory exposure. The optimal strategy is to make ESG analysis integral to business decisions, allowing companies to get ahead of emerging social and environmental shifts. Overall, evidence indicates ESG adoption reduces blind spots, aids risk management and develops resilience over the long term.

3. Conclusion

In conclusion, the impact of ESG adoption on corporate financial performance remains debated. Studies demonstrate that ESG can reduce costs, attract investment, and build intangible value through reputation. However, other research questions the magnitude of these benefits and argues that ESG can raise costs without boosting revenue. The empirical evidence on both the positive and negative impacts of ESG is still developing.

Nonetheless, companies across sectors should proactively integrate ESG policies as a long-term risk mitigation strategy. ESG integration allows firms to identify and respond to emerging sustainability-related risks driven by regulation, climate change, and shifting societal expectations. The retail examples of IKEA and H&M show that ESG adoption is becoming a strategic imperative as stakeholders demand transparency and social responsibility. While the direct financial returns are unclear, early movers on ESG can gain a first-mover advantage in their industry. As ESG-related risks grow, managing sustainability issues will only become more crucial for maintaining access to capital, managing reputational threats, and ensuring the long-term viability of business models.

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