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**“The Effects of Environmental, Social and  
Governance (ESG) Reporting on Tax Avoidance”**


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## **Abstract**

This thesis examines the relationship between tax avoidance and ESG performance in order to assess the possible effects of Environmental, Social, and Governance (ESG) on a company's tax practices. Although as a tactic, tax avoidance strategies are implemented to support immediate financial gain and profitability, this study examines the growing body of evidence indicating that businesses that prioritize tax transparency are more likely to obtain funding at a lower costs, accomplish long-term financial stability, and strengthen stakeholders trust. According to the study, abandoning aggressive tax avoidance tactics results in a number of positive ESG implications, including lower capital expenses, higher stock performance, and improved operational efficiency. These conclusions are supported by an in-depth review of the literature as well as a careful inspection of case studies from real-world situations.

## **Introduction**

Two of the most important issues in contemporary business behaviour are ESG reporting framework and tax avoidance tactics. CSR (corporate social responsibility) necessitate a company's reporting to ethical practices, economic development, environmental effects, and social stewardship. It goes beyond the narrow focus of profit maximization (Carroll, 1991). Conversely, the topic of tax avoidance entails strategically manipulating by corporations and companies to minimize the tax burden liabilities. The latter can raise social and ethical concerns, although it is a legal strategy, due to its consequences on states, public revenues, and social welfare (Hanlon & Heitzman, 2010). In the past few decades, the interplay between ESG and tax avoidance has gained crucial attention from scholars, policymakers, and business practitioners trying to identify the type of relationship between both aspects as also media reports highlighting the minimal tax contributions of various multinational corporations. This study aims to explore the relationship between ESG and tax avoidance providing comprehensive reviews of existing empirical studies and researches done on this topic.

The concept of CSR has undergone significant changes and transformations over the past years. Initially, it was perceived as philanthropy and community engagement (Bowen, 1953). However, the rise of globalization, sustainable investing, legislative requirements, consumer awareness and market differentiation increased the awareness of social and environmental issues have elevated CSR to a strategic imperative for businesses worldwide. Globalization has put pressure on businesses to follow international standards and responsibly handle their social and environmental effects. It has also demanded greater transparency and ethical practices across large supply chains. Furthermore, with institutional investors giving priority to sustainable practices and responsible governance, sustainable investing has placed an additional layer of obligation on businesses to incorporate ESG aspects into their operations. Legislative requirements have further imposed on business to follow corporate accountability, requiring compliance with regulations aimed at protecting the environment and society. Furthermore, a number of factors, such as consumer awareness, have increased demand for sustainable and ethical products, therefore in order for businesses to remain competitive, they must match with customer values. Together, these elements have transformed corporate social responsibility (CSR) from an afterthought to a vital strategic element for companies, one that is necessary to preserve their legitimacy and competitiveness in the global marketplace. Collectively, these factors have elevated CSR from a peripheral concern to a core strategic component for businesses, essential for maintaining competitiveness and legitimacy in the global market. ESG reporting has expanded to encompass social and governmental aspects reflecting where the

company stands with its operations and performance. ESG reporting offers a transparent image for both investors and stakeholders.

Several drivers have caused the rise of ESG reporting, one of the primary drivers is growing demand from investors' perspective to understand and monitor a corporation practices. Investors are increasingly recognizing that ESG reports can significantly impact a company's review, sustainability, investments and financial performance. Research has shown that companies with robust ESG practices often exhibit lower risk, better operational performance, and higher profitability (Friede, Busch, & Bassen, 2015). Additionally, governments and regulatory bodies are demanding ESG disclosures, for instance the European Union's Non-Financial Reporting Directive (NFRD) requires companies especially the high public interest companies to disclose, share and report information on how they operate. Stakeholders through demanding to see commitment from the business play a crucial role and impact on ESG. Since failing to meet this can result sometimes for a company, especially the well known reputable companies, a reputational damage or loss, or change in employees morals. ESG is an important factor for both internal and external stakeholders. ESG also helps companies identify certain risks related to environmental, social and governance issues. Consequently, ESG can be also considered as a proactive approach to cease or reduce risks and enhance risk management capabilities which by its role can improve also operational efficiency, and cost savings. ESG reporting also gives a company competitive advantage in the marketplace. Researches should that companies with high ESG ratings tend to have an easy capital access.

Tax avoidance has also become a crucial issue in recent years involving multinational corporations. These companies have been accused of steering tax planning strategies, like transfer pricing and the use of tax havens to reduce their tax liabilities (OECD 2013). While it is considered as a legal action, tax avoidance involves strategies that sometimes can be at the expense of social or governmental aspects, such as affecting the ability of governments to fund essential public services and infrastructure (Gravelle, J. G., 2009). The implications of tax avoidance are profound. Some searches argue that tax avoidance is incompatible with ESG especially with social responsibility of the company (Murphy 2008). However, in the opposite side, some researches agree that tax avoidance is a strategy aimed to maximize shareholder's value (Desai & Dharmapala, 2009). Another definition of tax avoidance can be more broadly, tax avoidance is often defined as "any activity that reduces the firm's tax relative to pretax income" (Dyreng et al., 2008). Dyreng et al.'s (2008) definition includes every action that can be taken by a firm legally or illegally. Thus, "tax avoidance" serves as an umbrella term that includes all related behaviours. So, Dyreng's et al.'s (2008) definition and explanation of tax

avoidance is used to mix all forms of tax behaviours with neither ethical nor legal judgments. Unlike terms such as "tax planning" and "tax management," which have positive connotations, or "tax sheltering" and "tax aggressiveness," which have negative ones, "tax avoidance" is often used without moral judgment. While according to Hanlon and Heitzman (2010), as tax avoidance become more aggressive, it may exceed and cross by its actions into illegal boundaries. Also the level of aggressiveness may vary as included in the study mentioned above.

The relationship between tax avoidance and ESG is a complex paradox. Several empirical studies and researches has yielded to a mix of results. Some studies suggest a negative relationship between CSR and tax avoidance, stating that firms that are actively engaged in CSR practices are less likely to partake in tax avoidance strategies (Kovermann, Jost Hendrik, and Velte, Patrick, 2021). Other research indicates that firms might use CSR as a smokescreen to divert attention from their tax avoidance activities, effectively engaging in "greenwashing" (Hoi et al., 2013). Furthermore, research by Müller and Kolk (2015) argue that without a strong and strict regulatory oversight, companies might continue to engage in aggressive tax planning strategies while using a CSR as a cover.

Understanding the relationship between tax avoidance and ESG reporting is paramount for several reasons, affecting various types of stakeholders, regulators, capital providers, society and reputation. As companies strive to reach the growing demands and grow its market share, the alignment and commitments to tax practices with ESG reporting is significant and essential. Because this relationship include complex factors that not only can affect investors and shareholders' decisions making, but also shapes societal outcomes. This thesis aims to delve deeply into the relationship between ESG and tax avoidance focusing on multifaceted consequences of social, economical, and environmental disclosure on corporate tax avoidance strategies.

In this thesis, the complex relationship between tax avoidance and Environmental, Social, and Governance (ESG) performance is investigated, with a focus on how avoiding aggressive tax methods can enhance and positively affect a company's ESG reporting. The study concludes that while tax avoidance may have some short-term financial gains, these are far outweighed by the long-term benefits of maintaining tax transparency. Reducing regulatory concerns, improving stock performance, increasing access to capital, and enhancing stakeholder trust are just a few of the many benefits that companies may reap from implementing proper tax policies. By analyzing various case studies, this thesis offers insights into the strategic financial and non-

financial advantages that emerge from integrating responsible tax policies within a sustainable ESG framework.

## **1.1 Historical Context**

In this section, we provide a brief historical context of ESG and tax avoidance.

### **1.1.1 ESG Historical Context**

The evolution of environmental, social and governance reporting and principles has been shaped by several developments over the past years. The roots of ESG goes back to early 20<sup>th</sup> century. The early foundations of ESG and the idea for a corporation to go beyond profit generation were laid by industrialists such as Andrew Carnegie and John D. Rockefeller. Carnegie's "The Gospel of Wealth" (1889) tackled about the moral duties and obligations of the wealthy, setting the stepping stone of ESG specifically the social component. Highlighting that a company's goal and objective must go beyond generating profit or maximizing financial figures.

The environmental movement and aspect has gained attention and more focus in 1960s and 1970s. Rachel Carson's "Silent Spring" (1962) was significant by its role in bringing public consciousness into more focused attention about environmental impacts and the level of harmful effects of pesticides. Additionally, U.S. Environmental Protection Agency (EPA) in 1970 sets a definition of environmental protection and responsibility. Collectively, this period has established the principles of environmental protection and regulations.

The third pillar of ESG is governance. The latter came into existence during the 20<sup>th</sup> century and particularly as a response of financial crises since in that period corporate scandals were marked and finding to a governance framework was indeed. 2008 global financial crises is a prominent example because unethical practices in the financial sector leading to increased scrutiny of corporate behaviours. Penn Central bankruptcy and the Lockheed bribery scandals highlighted the need of a strong corporate governance framework. So, these scandals were a leading step for defining the necessity of ethical and strong governance. The introduction of the Foreign Corrupt Practices Act (FCPA) in 1977 and the role of some institutions mainly Organisation for Economics Co-operation and Development (OCED) was significant in crafting corporate governance guidelines.

The Paris Agreement of 2015 and the adoption of the United Nations Sustainable Development Goals (SDGs) have highlighted the role of businesses and corporations in addressing and

dealing with global challenges, and these factors provided the importance to have ESG that is linked to corporate strategies and operations of a company.

ESG evolution was affected by several factors including technology. The rise of artificial intelligence, technological advancements and the presence of big data have enhance a company's ability to generate and disclose ESG reports giving the investors an opportunity for a better decision.

In recent years there have been more concentration on ESG reporting from a corporate level as they impact long term corporate performance. Studies show that companies tend to impact society, environment and governance in a positive way, tend to also experience stronger performance, high reputations, and lower risks. As the time is passing, ESG is more evolving and getting more obligatory and mandatory reports disclose by public firms like the financial and performance report. It means that also ESG reports are being shown to public, investors and stakeholders. Concluding that the ongoing and evolving ESG frameworks will continue in the future to shape and support sustainable business practices.

### **1.1.2 Evolution of Tax Avoidance**

To understand the current trend of tax avoidance, it is crucial to explore first its historical context, strategies used by corporations, legal and ethical dimensions and consequences. The concept of tax avoidance started to get more visible in the post-World War II era, where multinational corporations (MNCs) were involved in manipulating tax avoidance strategies to exploit the differences in international tax law. Significant attention also related to this topic appeared when it got driven by high profiles cases like Enron and WorldCam. In the late 90s, governments began to implement countermeasures for tax avoidance. The US for instance introduced various regulations to curb abusive transfer pricing and other avoidance techniques. OECD began to set some international tax rules for preventing base erosion and profit shifting (OCED 1977). Additionally, Base Erosion and Profit Shifting (BEPS) project also aimed to address tax avoidance issue by providing guidelines in a corporate level.

The historical context of tax avoidance at the corporate level, combined with the rise of ESG reporting, illustrates the dynamic and evolving nature of corporate responsibility.

## **Chapter 1: Tax Avoidance**

Tax avoidance is defined differently by scholars. For example, tax avoidance is defined as the reduction of explicit taxes per dollar of pre-tax accounting earnings by Hanlon and Heitzman (2010), Desai and Dharmapala (2009) define tax avoidance activity as a transfer of value from the state to shareholders. Others define it as representative a continuum of tax planning strategies, encompassing activities that are perfectly legal and more aggressive transactions that fall into the grey area (e.g., abusive tax shelters) (Wang, 2010). According to Pasternak and Rico (2008) it is defined as "Tax avoidance is the legal utilization of the tax regime to one's own advantage, to reduce the amount of tax that is payable by means that are within the law". Joel Slemrod and Marsha Blumenthal Ch.22 "Conceptually distinct from real substitution responses are efforts to reduce one's tax liability without altering one's consumption basket, which we will refer to as avoidance. These are actions taken in response to the tax system that do not involve shifts along a given budget set." Through this quote, Joel and Marsha the authors of the article "Tax Avoidance, Tax Evasion, and Tax sheltering" define tax avoidance as strategies implied by corporations or individuals for the main purpose which is reduction of tax liability, but without changing the actual economic behaviour or consumption patterns of the tax payer. However, there is no universally accepted definition of tax avoidance in the accounting literature. In some researches tax avoidance can be defined as a lawful set of actions aim to reduce the amount of tax obligations and liabilities to be paid by corporations and firms; its been a common use and widespread practice done by famous and well known entities. Tax avoidance had created ethical questions and debates, as well as it draws an enhancement track for a firm from a profitability perspective.

### **2.1 Methods of Tax Avoidance**

#### **2.1.1 The Use of Tax Heavens and Income Deferrals**

Desai, Foley, and Hines (2006) in their study about the demand tax heaven operations, elaborate in some strategies that can be used to avoid taxes. They study how American firms used to avoid taxes as well. The article emphasizes that firms use tax haven operations to reallocate taxable income from high tax jurisdictions to low tax jurisdiction, this is one of the methods to reduce tax liability. "Tax haven operations facilitate tax avoidance both by permitting firms to allocate taxable income away from high-tax jurisdictions and by reducing the burden of home country taxation of foreign income." Another significant method is discussed is the deferral income. Firms sometimes hold profits offshore just to defer taxes and in this study its been a strategy used for the deferral of U.S taxation on foreign income. Moving or holding the profits offshore

allows the firm to avoid immediate taxes that can be risen, and reinvest profits in low tax environments. "The evidence suggests that the primary use of affiliates in larger tax haven countries is to reallocate taxable income, whereas the primary use of affiliates in smaller tax haven countries is to facilitate deferral of U.S. taxation of foreign income." Inside the article itself, there is a differentiation between the larger and smaller tax haven, where larger havens are used mainly for income reallocation while smaller are used as mentioned before for deferring the U.S taxes. Other studies also show other methods can be used to avoid taxes, such as use of intellectual property. The article, " The Role of Tax Havens In International Trade With Services" by Hebous and Johannesen (2021) tackles about how multinational firms avoid taxes through the use of intellectual property. The article states that many multinational corporations establish entities in tax haven countries that hold intellectual property like trademarks or patent, or they establish entity for services like administration and management in tax haven also. These entities established by the mother company, charge significant fees to affiliates in higher tax jurisdictions allowing these firms to move and shift their profits to lower tax jurisdictions which is similar to profit shifting. "In these service categories, trade with affiliates in tax havens is skewed towards imports and the internal service providers in tax havens earn significant excess profits that vary strongly with the value of their internal service sales." Hebous and Johannesen (2021). These firms usually use such intellectual property or financial services because they are so difficult to accurately value them. This allows the firms to justify their transfer pricing (a price done for transaction between a company and its subsidiary) that facilitates the shifting of the profits from one entity into another, hence avoiding taxes.

### **2.1.2 Tax Arbitrage**

Slemrod and Blumenthal argue in their study also about one of the method to engage in tax avoidance is tax arbitrage; which is in definition similar to tax haven, with slight differences. Tax arbitrage represents the advantage that can be taken of inconsistency in tax laws or rates across different jurisdictions or financial instruments. It involves engaging in tax-deductible borrowing to fund investments in tax-exempt securities which is considered as an example of tax arbitrage.

### **2.1.3 Income Classification**

Another significant tool of tax avoidance could be income classification; by definition means taking advantage of tax treatments depending in how their income and expenses are categorized. This is due to the fact that different types of income are often taxed at different forms of taxes

and different rates. By reclassifying income or expenses, taxpayers can significantly reduce their overall tax liability without altering the actual substance of their economic activities. But how income classification works? An example can be converting an ordinary income into a capital gain; involves recharacterizing income that would typically be highly taxed at a higher ordinary income tax rates into income that is taxed at a lower capital gain rates. An example of ordinary income could be earned through employment like salaries, commissions or bonuses, or also could be a rental income, basically its an income coming from businesses. Ordinary income is subject to highest marginal tax rate and sometimes it is taxed progressively meaning an increase in income also increases the taxation. However, capital gains can be defined as profits realized from a sale of a capital asset example can be bonds, stocks or real estates. Usually, the capital gains are less taxed compared to ordinary income. Many tax systems distinguish between short-term and long-term capital gains, with long-term gains enjoying a reduced tax rate to incentivize investment. How the conversion works? The conversion process involves structuring transactions in a way that the income that must be taxed as an ordinary income should be taxed as a capital gains. An Irish subsidiary for a U.S parent company can license this intellectual property to other subsidiaries in US allowing them to use the technology and branding. Subsidiaries in high tax jurisdictions like the U.S will pay royalties to the Irish company because these royalties would be classified as ordinary income in high tax jurisdiction countries. By classifying these royalties payment to Ireland, the payment will be lower since the tax rate in Ireland is much lower the US itself. The income is thus classified not as ordinary income in a high-tax country but as income subject to a lower tax rate in Ireland. So, this company would pay the Ireland's corporate tax which is 12.5% instead of paying 35%.

#### **2.1.4 Transfer Pricing**

Amazon, one of the biggest e-commerce corporations in the world, and been also along as an example for several researchers for their tax avoidance strategies they implemented. Amazon engaged in transfer pricing to lower down its tax liabilities which primarily revolves around its European operations where the company has several subsidiaries all over Europe and designed to shift profits through countries with lower tax rates. The central element of this strategy is Amazon's European headquarters in Luxembourg, a country known for its favourable tax treaties and low effective tax rates on corporate profits. Amazon's European headquarters in Luxembourg plays a central role in its tax avoidance strategy. Luxembourg provided a measure to Amazon by which Amazon could exempt the vast majority of its European profit from taxation in return for investments in Luxembourg, thus affecting intra-EU trade and distorting competition. Amazon European subsidiaries pay royalties to Amazon EU S.a.r.l for the rights

to use its intellectual property, and once they are paid in Luxembourg which already have a more favourable tax rates, this will reduce the taxable income reported in those low tax jurisdictions. So, the usage of a subsidiary even within the European Union is beneficial for Amazon and facilitate more the tax reductions.

## **2.2 Tax Avoidance Impacts**

Tax avoidance is a complex topic that has both positive and negative effects.

### **2.2.1 Tax Avoidance and Firm's Value**

A more sophisticated view of this difficult topic is provided by Desai and Dharmapala (2009) study, which examines the complex relationship between corporate tax avoidance and firm value. The paper investigates the degree to which corporate tax avoidance activity is valued by investors in a large sample of US firms. The relative merits of these two views of tax avoidance are evaluated using a dataset with 4,492 observations on 862 firms over the period 1993-2001. Tax avoidance in this paper is measured by inferring the difference between income reported to capital markets and tax authorities, the book-tax gap, and controlling for accruals and other measures of earnings management. The analysis demonstrates that, for a given firm, this measure takes on higher values in years when the firm is involved in litigation relating to aggressive tax sheltering activity than in other years. The basic result that higher quality firm governance leads to a larger effect of tax avoidance on firm value. One of the immediate benefits of tax avoidance from a firm's perspective is straightforward cost reductions which means a deduction in tax debts and liabilities. By utilizing methods of tax avoidance, through legal strategies, a company can save more profits and retain more of its earnings. These savings of earnings can be hugely important for a firm's success, especially with a firm that witness high sales, since these savings can be used in new investments, penetrating markets, executing new projects, or it can be used to pay down and settle the outstanding debt for a company, distribute them to the shareholders and owners in a shape of dividends, etc. "One Percent greater sales and investment growth in nearby non-haven countries is associated with a 1.5 to 2% greater likelihood of establishing a tax haven operation" The Demand for Tax Haven Operations" Desai, Foley, and Hines (2006). The data shows a firm with 10% greater R & D / sales ratio increases its shares of affiliates in tax havens by 4%. All of these actions can enhance the company's market value and strengthen its reputation among new investors or interested stakeholders.

### **2.2.2 Tax Avoidance and Cash Flow**

Firms that effectively reduced their tax obligations through various strategies including financial derivatives, often experience increased cash flows, which can be directed towards productive investments or returned to shareholders in the form of dividends and share repurchases.

### **2.2.3 Tax Avoidance and Competitiveness and ROI**

Tax avoidance allow companies to lower their overall cost structure, which enable them to improve their competitive position. Businesses can offer goods and services at more competitive prices without losing or compromising their profit margins when effective tax rates are lower. Firms can witness an increase in their return on investments due to the reduced costs. The additional profits saved from reduced tax payments can be reinvested back into the business. Companies might use these funds to finance new projects, expand operations, improve infrastructure, or invest in research and development (R&D). Reinvestments have the potential to generate a positive feedback loop of value creation by increasing revenues and profitability.

### **2.2.4 Tax Avoidance and Cost of Equity**

Tax avoidance can help firms to raise capital at a lower costs. Investors may view a corporation as reduced risk when it performs well financially, even if this financial performance was partially connected to tax avoidance. Therefore, Investors may reduce the needed rate of return as a result of this perceived reduction in risk. Hence leading to a lower cost of capital. A reduced cost of capital also means that firms can finance their operations and growth initiatives more affordably which can further enhance a firm's profitability. Furthermore, a reduced equity capital cost can raise the company's weighted average cost of capital (WACC), enabling more investment initiatives to be funded and fostering additional value development.

### **2.2.5 Tax Avoidance and Governance Structure**

Corporate governance plays a crucial role in understanding the impacts of tax avoidance since the tax avoidance strategies rely heavily on the corporate structure and governance inside the firm itself. To define first what is a corporate governance; it refers to the mechanism and relations by which a firm or a legal entity is controlled. It can also refer to a hierarchy including levels and sub levels of internal control of a company. It also requires and involves balancing the interests of both stakeholders (like shareholders, management or customers, or any party that are concerned about the company or have an interest in it directly or indirectly, suppliers, and community.) a good and successful ensures that management acts what is best interest for

all what is mentioned above. Governance and tax avoidance relationship can be a double-edged-sword, it means that it can show double consequences (positive and negative). In well-governed firms, tax avoidance can enhance the firm's value. On the other hand, in non-governed companies, tax avoidance can give a sign of managerial opportunism where tax avoidance can be used for personal gains rather than overall corporation's benefits. Broadly speaking about governments, also good and well-governance structure for a nation proof to exhibit high levels of accountability, transparency, stability, control of corruption and efficient tax administrations. Dharmapala and Hines' study examines the relationship between the power of governance, tax avoidance and investment decisions. The study's findings are as follow:

For Well-Governed Countries: the research shows that the countries that have a strong governance structure; meaning they have an efficient oversight and accountability have a positive correlation with tax avoidance leading to better firm's value operating in that country. "Better-governed countries are much more likely than others to become tax havens. Controlling for other relevant factors, governance quality has a statistically significant and quantitatively large association with the probability of being a tax haven. For a typical country with a population under one million, the likelihood of a becoming a tax haven rises from 26% to 61% as governance quality improves from the level of Brazil to that of Portugal." Dharmapala and Hines (2009)

For Poorly-Governed Governments: "Poorly-governed countries are not otherwise known for their conformity, and international tax norms are in any case not very well established. Instead, the most likely explanation is that tax havens are unsuccessful in the absence of high-quality governance" Dharmapala and Hines (2009).

Better-governed tax havens provide insights about stable and predictable legal environment, which companies prefer since it reduces uncertainty and risk. Well-governed tax havens typically offer robust legal protections for businesses, including intellectual property rights and investor protections. This legal infrastructure ensures that firms can structure their tax affairs efficiently while minimizing legal risks. In addition to being financial centers and tax havens, nations like Luxembourg and Switzerland offer businesses the infrastructure they need to efficiently handle their global operations. In summary, effective corporate and governmental governance structures are critical determinants of whether tax avoidance will enhance or detract from a corporation's market valuation since it magnifies the beneficial benefits of tax avoidance on firm value.

## 2.2.6 Tax Avoidance and Market Valuation

According to Hanlon and Heitzman (2010), tax avoidance has a major positive impacts and consequences on a company's worth value. The journal considers also the after-tax cash flows as a crucial component of firm model in the financial markets, such as the discounted cash flows model (DCF). Reduced tax liabilities increase net income, which raises the company's cash flow for shareholders. As a result, investors will pay more for companies with higher net profits, which will improve the company's valuation among stakeholders and in the market. The journal also shed the lights on how firm's earnings are less variable and more stable when taxes are predictable or considered modest, or low. Operational income is an essential indicator for assessing whether a business is profitable before subtracting net financial income and taxes. Due to fluctuating tax rates, this indicator may lose value, which could ultimately result in uncertainty and instability in the financial system of the company. Therefore, taxes are one of the factors that can affect the stability and instability of a firm's earnings, savings, dividends, and the portion of net profits for the company and its shareholders. Valuation multiples such as the Price-to-Earnings (P/E) ratio are crucial to analyze while understanding the impact of tax avoidance on firm's value. P/E ratio is a common valuation multiple that compares a firm's current stock price to its earnings per share (EPS). A lot of empirical studies link tax avoidance to P/E ratio suggesting that one standard-deviation increase in tax avoidance is associated with an increase in the P/E ratio. This result is significant, suggesting that firms with higher tax avoidance are valued more favourably by the market because tactics used to avoid taxes also avoid extra-costs incurred to the company, hence increasing earnings. The numerator of the ratio is the price of a traded stock which often has a positive correlation with the earnings, since a profitable firm tend to be seen more favourable in the market, and stocks are often fast to adjust and reflect the increase in earnings resulting in high P/E ratio. It means tax avoidance can affect investors valuation and interests in the company including investment decisions, public information, stock prices, and investment opportunities since stakeholders may perceive financial ratios as a sign to maximize their values.

Market to book ratio is another crucial indicator to mention. It is calculated by dividing the market value of equity (price shares multiplied by number of outstanding shares) over the book value of equity (difference between total assets and total liabilities). Firms with higher tax avoidance strategies tend to have higher market to book ratios since they exhibit stronger and more stable financial performance due to reduced tax liabilities, they tend to save more capital, seen less risky, attract investment opportunities, and expect higher future growth.

Desai, & Dharmapala investigate the relationship between tax avoidance and Tobin's Q ratio. The latter is a ratio that measures the market value of a firm's assets relative to their replacement costs. It is calculated as market value of assets divided over the replacement costs of assets; it represents the cost to replace the firm's assets at current prices. When a company's Q ratio is higher than 1, it means that the marketplaces and suggests a higher value on its assets than their replacement cost. This suggests that the company has good growth potential and can produce returns higher than the cost of its assets and higher than replacing its assets. If the firm's assets are valued by the market at less than their replacement cost a sign of possible undervaluation or slower growth prospects the Q ratio should be less than 1. According to the study, a successful use of tax avoidance techniques can improve both internal financial performance and investor perceptions on the outside. This is because the more complex tax avoidance strategies used by multinational firms have the potential to bring in investors and increase the attraction of capital. The findings demonstrate a favourable correlation between tax avoidance and Tobin's Q ratio.

Collins, Mills, and Morris (2012) study examines the relationship between corporate tax avoidance and firm performance, offering an examination of the effects of tax avoidance on enterprises at various performance levels using a quantile regression technique. The quantile regression model enables us to investigate the consequences of tax avoidance at different quantiles of firm performance, in contrast to conventional approaches that concentrate on average and theoretical consequences. Quantile regression is a statistical technique that extends traditional regression models by estimating the relationship between variables at different quantiles (or percentiles) of the outcome distribution, rather than just the mean (as in ordinary least squares regression). A quantile for performance is a specific portion of the overall firm performance distribution. By classifying companies according to their performance levels using company performance quantiles, researchers can investigate how tax avoidance affects businesses differently depending on where they are in the performance range. A dataset can be divided into equal-sized, ordered segments using statistical metrics called quantiles. For instance, the 25<sup>th</sup> percentile or what is called in other words as the 1<sup>ST</sup> quantile includes the bottom 25% of firms based on their performance, while the 75<sup>th</sup> percentile or what is called also the 3<sup>rd</sup> quantile includes the top 25% of firms. However, the median or the 50<sup>th</sup> percentile is shown as a middle point, dividing the firms into 2 equal halves.

- Lower quantiles: include the firms and companies in the 10<sup>th</sup> and 25<sup>th</sup> percentiles, such as those businesses with lower performance levels. These firms often witness lower return on assets percentages (ROA). These companies are also less profitable and could be exposed to great financial difficulties and challenges.

- Median quantile: Is represented as the median, or in another word 50th percentile, represents the midpoint of the distribution, it divides the firms into two equal halves of performance. Firms in this quantile have average performance metrics.
- High quantile: These quantiles include firms with higher levels of performance, such as those in the 75th or 90th percentiles. These firms are generally more profitable, have higher ROA, and are financially better.

Firms are usually divided into quantiles based on several criteria including financial metrics, profitability, ratios and other key performance indicators. ROA is not enough to provide overall performance of a corporation, but it gives a comprehensive image of a firm's operational efficiency. For quantile regressions, ROA may be suitable for a number of reasons, such as: ROA measures and provides insight into how well the company uses its resources and activities to generate a profit. As you can see from the calculation's fraction, ROA is a critical measure of a company's efficiency because it divides net income by total assets. Alternatively, companies may calculate ROA by dividing profit before taxes and income (EBIT) over total assets. This method provides a precise picture of a company's operational efficiency because it accounts for both monetary and non-monetary costs and places more emphasis on the profits from the company's core activities. ROA and tax avoidance can be linked by a common factor, which is the net income. Tax avoidance strategies are tactics aim to reduce a firm's tax liability, hence increasing the net income without necessarily requiring a consistent increase in the revenues, sales or a change in the asset base of the company. When a firm successfully engages in tax avoidance, it saves more of its pre-tax earnings which by its role boosts net income up. Given this relationship between the two factors, any successful tax avoidance plan will lead to a higher net income, concluding to a higher performance metrics assuming the same asset base is still constant for a company. To sum up this study, Collins, Mills, and Morris (2012) journal starts by showing how the tax avoidance has varying impacts depending on a firm's performance quantiles. Their analysis reveals that tax avoidance has a more pronounced benefits for firms in the lower performance quantiles compared to those in higher quantiles. While tax avoidance helps less efficient firms improve their return on assets (ROA), Collins, Mills, and Morris note that it may also exacerbate inequality in the business landscape by allowing underperforming firms to survive without addressing underlying inefficiencies. These findings have implications for policy. They question the long-term viability of such strategies by citing instances in which companies with consistently poor ROA rely on tax avoidance year after year also suggesting another topic that ROA may struggle to sustain performance if tax laws change or if they fail to improve operational efficiency.

## **2.3 Tax Avoidance Negative Consequences**

Tax avoidance could also generate negative consequences for a company.

### **2.3.1 Higher Cost of Debt**

Avoiding taxes, can signal potential risks to creditors. Among these risks they include regulatory scrutiny, potential future tax problems, and financial opacity. Consequently, companies that engage in substantial tax avoidance may be viewed by creditors as riskier, and as a result, they may demand higher interest rates to offset this perceived increase in risk. This thesis shows that there is a positive correlation between tax avoidance and cost of debt, and any slight increase in tax avoidance aggressiveness strategies or the more the firm avoid taxes the more is the cost of debt. Empirical studies that a one-standard-deviation increase in tax avoidance is associated with an average of 0,20% increase in the cost of debt. This increase, while seemingly small, can have substantial financial implications for large firms borrowing significant amounts of capital. However, the effects of a higher costs of debt is not associated only with tax avoidance but also it is more pronounced in firms with weaker corporate governance and lower levels of transparency. This implies that creditors are seeing that companies that are engage in more tax avoidance strategies, or tax avoidance as a concept is a warning sign suggesting possible underlying concerns that are not entirely apparent to stakeholders, when businesses are less transparent or have weak governance.

In this sense, transparency often refers to how much a company disclose with creditors, investors, and other stakeholders its financial and operational details, including its tax policies. Firms categorized as having below-median transparency are those that rank in the lower half of the transparency distribution. These firms are less transparent with information, which could make it harder for external parties (like creditors) to fully assess their financial health and the risks associated with their operations, including their tax avoidance strategies. Tax avoidance strategies may differ also between moderate level, aggressive depending on the level of the firm's engagement. To understand more about the relation, its important to know each one aside. Aggressive tax avoidance means the strategies done that exceed the boundaries of a legal tax avoidance strategy. To minimize tax liabilities, these tactics frequently entail complex financial arrangements of tax regulations.

- Complex and more detailed financial structure: Aggressive tax avoidance often involves setting up complex financial structures, such as offshore accounts, shell companies, or inter-company transactions, which are designed to create subsidiaries or complicated networks and usually located in different and multiple jurisdiction where each could also be with

different tax rates and laws. By strategically shifting profits, costs, and assets among these entities, a firm can significantly reduce its overall tax liability.

- Use of tax heavens could be also a sign for an aggressive tax avoidance strategy. They are jurisdictions characterized by low level or sometimes zero level of corporate taxes to pay. These jurisdictions are usually adopted by multinational corporations aiming to reduce their overall tax. These multinational companies own multiple subsidiaries around many countries. It can be implemented through many strategies including: profit shifting; this is often adopted when the multinational corporations assign profits and earnings to their subsidiaries located in the countries that have tax havens or lower tax rates. This is done often through transfer pricing which is by definition is setting of price of services or goods provided or any transaction established between the multinational company and its subsidiary. Some critics can argue that these can be done only for tangible items, while other studies shows that also intellectual property holding is a method of a tax heaven also and prove that it is common strategy involves holding intellectual property (such as patents, trademarks, or software) in a subsidiary located in a tax haven. The parent company in a high-tax country pays royalties or licensing fees to the subsidiary for the use of the IP. These payments are tax-deductible for the parent company, reducing its taxable income in the high-tax jurisdiction, while the subsidiary in the tax haven pays little or no tax on the royalty income it receives. Businesses may employ thin capitalisation techniques, in which a tax haven subsidiary is primarily financed by debt as opposed to equity. In the higher-tax jurisdiction, the interest paid on the debt is tax deductible, which lowers the total tax obligation. The tax haven subsidiary receives the interest income, which is either fully or partially taxed there. In some cases, some firms can be engaged in round tripping where funds are collected or saved by tax heaven and then reinvested back into the home country. This can allow investors to benefit from tax treaties or exemptions.

Graham, J. R., & Tucker, A. L. (2006) investigate how the use of tax shelters can impact a corporate debt policy, cost of debt, and credit ratings. The study' population sample includes 110 firms listed in the main board of Malaysia comprising 10 main industry spheres of national economy. During the beginning of the financial crisis in 1997 some companies went bankrupt in Malaysia. Moreover, in Malaysia, attempts to contain further devaluation caused higher level of interest rate and credit contraction. This created severe contractions in output and corporate profitability which was reflected in massive fall of equity prices. The Kuala Lumpur Composite Index declined by 72% during the period from end-June 1997 to end-August 1998 (Zulkaflī et al., 2009). Real estate markets declined sharply due to high interest rates and in crisis

environment. This event caused debtholders to suffer from bankruptcy or experience a debt-equity swap, thereby causing them to become vulnerable to managerial malfeasance or diversions. Furthermore, because of the weak governance in Malaysia, which controlling shareholders used to exploit outside investors, debtholders became interested in mitigating agency conflicts between controlling shareholders and debtholders through the implementation of good corporate governance practices in Malaysia. Thus, tax avoidance could reduce the transparency of Malaysian firms, which enables controlling shareholders with the opportunity to extract rents from debtholders, thereby resulting in a higher cost of debt.

### **2.3.2 Lower Credit Ratings**

Standard & Poor's, Moody's, and Fitch Ratings and other rating companies suggest a credit ratings which are crucial to determine a firm's creditworthiness. The interest rates a corporation will pay on its debt, and the level and capacity of money it can borrow are influenced and affected by the credit rating evaluated by such companies. For instance, higher credit rating means lower perceived risk, which can facilitate the borrowing for a firm at a lower interest rate. On the other hand, lower credit rating implies higher risk, reflecting a higher costs of borrowing. Credit ratings are essential for getting into the debt markets as well as for affecting stock prices, investor confidence, and the health of the financial system. The relationship between credit rating and tax avoidance is highly associated with the increased risks of aggressive tax strategies adopted, which can create financial instability and uncertainty regarding the firm's future tax obligations and cash flows. When tax authorities disallow or discourage these strategies, the firm can face substantial fines or penalties. Credit agencies, when assessing the overall financial health, creditworthiness, and stability of a corporation usually take these risks into its consideration and its one of the key indicators and effective factor in determining a credit rating for an organization. The firm's credit rating may be downgraded if it is determined that there is a considerable risk of future tax problems. Credit rating agencies typically favour transparency and smoothness in a firm's financial reporting. Credit ratings also affect a firm's reputation and market perception and its relationship with stakeholders including customers, suppliers, shareholders, and investors. Taking part in aggressive tax avoidance, particularly when the public is aware of the circumstances, can occasionally damage the company's reputation. Additionally, fluctuations in stock prices may result from a lower credit rating, unstable market perception, or a negative reputation. From a cash flow point of view, if a firm relies heavily on tax shelters or financial income more than its operations, that's would make from its cash flows unstable and unpredictable. Stable and more predictable and operative cash flows can give an insight for a company that's its able to

meet its debt obligation, depending on what is the source of financing, which can also increase the credit rating. The relationship between tax avoidance and credit rating is closely tied to how strong the corporate governance is. Evidence suggests that firms engaging more in tax avoidance often experience decline in credit rating on average by 0.10-0.15 points as they are seen to be more risky by credit rating agencies. Additionally, these firms also face a significant increase in their borrowing costs by approximately 0.20% to 0.30%.

Blouin, J., & Tuna, A. I. (2007); article examining the relationship between the tax avoidance, earnings management, corporate governance, firm's value and relationship between firm's value and tax avoidance. The study provides a detailed analysis and interpretation showing that aggressive tax avoidance strategies especially those who are involved in tax shelters can lead to an increased in earnings' volatility. An increase in the engagement in tax avoidance strategies leads to a 20% variability of a firm's earnings in their reported or published earnings compared to that firm's who less got engaged in tax avoidance strategies. The average decline is 0.05-0.10 points in credit ratings to every 10% increase in earnings' volatility.

### **2.3.3 Government's Revenues Loss**

Tax avoidance may lead to a government's revenues loss. Estimates suggest that Germany loses less than €1 billion per year due to profit shifting through mispriced service imports from tax havens. The use of profit shifting through tax haven can lead to an erosion of the government's tax base and a significant financial loss. This erosion could affect or limit the ability of a government to provide or fund public services and infrastructure. Erosion of tax base usually occurs when the taxable income that would be earned and reported in high tax jurisdictions governments or countries is shifted to low tax jurisdictions governments and countries through various tax avoidance strategies implemented by multinational corporations or firms. First significant impact to be shown is the level of reduction in government's revenues, since one of the government's duties are the public ones, and tax avoidance may limit these services towards the citizens. Tax base erosion is estimated to cost governments globally a range between \$100 and \$240 billion each year, accounting for roughly 4-10% of global corporate income tax revenues. This loss matters a lot for a well developing government and countries that rely heavily on taxes as it is one of the main revenue sources to the state. Hence, governments can be forced to spend less on these services, which it cuts the longer term benefits for citizens particularly on lower income groups who are most reliant on public services like healthcare services or education. A study by Zucman (2014) highlighted that tax base erosion through profit shifting results in significant losses for governments. The study estimated that the U.S.

alone loses about \$60 billion annually due to profit shifting, which could otherwise be used to fund essential public services.

#### **2.3.4 Economic Inequality**

Several researches suggest that tax avoidance could lead to an economic inequality. When large size multinational corporations got engaged in tax avoidance strategies, the tax burden will shift to smaller businesses and firms that maybe are unable to engage as much as the large corporations. This shift fuels the gap of inequality between the large and small entities, as well as in individual levels also, it widens also the inequality between high income and low income individuals. Some governments might find that imposing higher VAT, or income taxes is a solution to compensate for revenues shortfall caused by corporate tax avoidance. Economic Inequality depends heavily on government's-imposed decisions. Regressive taxation for example, where tax rate decreases as income increase. Opposite to progressive where the tax rate increases as the taxpayer's income increase. So, this will also be a significant factor of increasing the inequality inside the economy itself between the levels and layers of citizens depending on their income. According to a study by Saez, Slemrod, and Giertz (2012), aggressive tax avoidance by corporations can contribute to the erosion of progressive taxation, increasing income inequality and reducing the redistributive impact of the tax system

#### **2.3.5 Market Distortion**

In certain cases, tax avoidance has also been shown to contribute to market distortion, which is the abnormal way the market functions because of a variety of variables, including the employment of tax avoidance methods by some firms operating in the same or other industries. This may lead to inequalities in allocation of resources and inefficiency. Market distortion and tax avoidance are positively correlated. Market distortion occurs when certain businesses operate in high-tax jurisdictions without owning any subsidiaries abroad or in a tax haven, making no chances for legal tax avoidance. Meanwhile, other multinational businesses that engage in tax avoidance can take the advantage and retain more gains becoming more competitive in the market by using aggressive tax avoidance strategies that give them the ability to reduce their tax burden and liabilities through their subsidiaries. As a result, they can save money on taxes, acquire special power, and become market leaders. This may lead for a monopolized market, less competition, or different pricing strategies. In response of the usage of tax avoidance, The OECD's Base Erosion and Profit Shifting (BEPS) has introduced new reporting requirement, and compliance rules to implement stricter regulations in order to limit and discourage tax avoidance strategies. While these measures are aimed to discourage tax

avoidance, they also increase the compliance burden on businesses leading a higher costs on companies for applying complex administrative requirements. For smaller firms, these costs can be also expensive to hold and financially critical.

### **2.3.6 Ethical Implications**

While tax avoidance can be considered to be a legal action done from different perspectives, but its implications especially ethically are questioned and debatable with governments, policy makers, stakeholders, tax lawyers, and the general public. Companies should move beyond financial ratios, focus on profits or sales, and take responsibility for their environmental and social reflection in the market and society they operate in. Nowadays, businesses are disclosing these environmental and social concerns for the public, which can enhance stakeholders' trust from a side, and from another side build better reputation and being as an effective corporate citizen rather than a profitable company. Corporations inside a manufacturing and non-manufacturing economies are the main players in this game as they contribute to the states with high taxes income due to their share of sales in the economy. So, when corporations pay fair taxes and comply to these rules, they fulfil their legal obligations and fund more the public services indirectly. What is the role of tax avoidance here? Tax avoidance can create a contradiction and conflict with the principle of social responsibilities, since the tension will increase with the legal compliance and ethical responsibility, and more moral questions will be stated. Because of profit shifting back in 2012, Starbucks faced a major public backlash in the United Kingdom when it was revealed that the company had paid a small and uncountable amount of corporate taxes and significantly smaller than it should be. The engagement of tax avoidance is described in Musgrave (2000) study as it is a free riding, since the companies are considered to be free riders on the public services that are funded by taxes, and the effects are doubled for individuals and smaller businesses are high on both. When tax avoidance becomes widespread, it undermines public trust in the tax system. Citizens begin to perceive the system as unfair, where the wealthy can manipulate the rules to their advantage while everyone else pays their fair share. In response, Starbucks voluntarily paid millions of pounds in back taxes to restore its reputation and regain consumer trust. This part will delve more in economical and social impacts on individual levels. When governments spend less on public services caused by corporate tax avoidance, public healthcare or education quality may be diminished. Individuals may be forced to turn into private services, provided by the private sector, which are reasonably expensive since they don't depend on taxes as a source of funding, and they are owned by normal individuals or investors and not governments. The private healthcare is way expensive leading to a higher personal costs and expenditures to be spend. Education is another

level also of social responsibility and type of public services that are supported by governments to its citizens. Education and public schools or universities also depend heavily in taxes, and budget cuts may lead to larger class size, or unpaid teachers. The main source of teachers' salaries are taxes also. Corporate tax avoidance may lead to a fluctuations or a cut in these salaries for the teachers and instructors. Nevertheless, disparities in education quality can widen, with wealthier families able to afford private schooling, while poorer families are left with underfunded public options. Social welfare programs can be also negatively impacted by the tax avoidance strategies. Social welfare programs include unemployment benefits like insurance or pension, food assistance, housing support or subsidies, etc. Reductions in funding these programs may feed inequality and erase some economical layers in the society and may push a lot of middle economical situations people into the bottom. As safety nets are weakened, the gap between the wealthy and the poor widens, leading to increased social tensions and instability. Public infrastructure is another significant topic funded mainly by taxes. Infrastructure projects include roads, bridges, public transportation, and utilities are all types of governments' public services. Shortfalls in governments budgets, will delay maintenance and new development projects. Individuals may face increased vehicle maintenance costs due to poor road conditions or higher transportation costs due to inadequate public transit options. Additionally, public safety can also be threaten when corporations avoid more taxes. Public safety projects include law enforcement, fire departments, and emergency services which are essential public services funded by the government. Budget cuts can lead to understaffing, outdated equipment, and slower response times. Tax avoidance can feeds unfairness of the tax system, widens inequality, and weakens the social connection or image between citizens and the state. When governments are forced to reduce spending on public services due to diminished revenues, the effects on individuals can be severe, particularly for those who rely on public healthcare, education, social welfare, infrastructure, and safety services.

So, the use of tax avoidance although in the some studies and researches can allow the firms and multinational corporations to shift profits, reduce taxable income, retain earnings and implement new investments, but it is also considered to be a critical issue and significant what it comes to regulatory, governmental and reputational speaking, especially as it represents to be an ongoing debate over corporate tax, international tax policy, and a long debate that opens questions about the social responsibility for firms in which are more engaged to tax avoidance.

## **Chapter 2: ESG Reporting Framework**

### **3.1 Introduction**

What is ESG and what does it stand for? ESG stands for environmental, social and governance reporting framework used to assess a corporation's operations in terms of sustainability and its impact environmentally, socially and ethically. ESG, as discussed by Clark, Feiner, Viehs, (2015) refers to the three key dimensions of sustainability that businesses must engage with to ensure long-term success. ESG reporting in the last recent years gained a huge and significant attention from investors, policymakers, and stakeholders as they are all recognizing how much impact an organization could have added or affected the society by. So, ESG covers the environmental, social, and governance dimensions of a firm's activities and performance. ESG has also emerged because it's been considered to be crucial criterion for investors, companies, and stakeholders to go beyond the scope of normal core business operations or activities of a company, reporting about sales and financial performance, but instead, ESG highlights non-financial performances of the firms that are operating within the society, reflecting their commitments and certain defined obligations towards their society. ESG factors are interdependent, and when well-managed, can lead to superior financial outcomes for businesses. This chapter explores the distinctions among these three pillars: Environmental, Social, and Governance, and how they impact corporate sustainability and financial performance. ESG reporting can be also defined as a framework to socially responsible investors and managers who aimed to align their investment decisions with their ethical values. In recent years, ESG becomes an essential set of metrics for assessing long term risk management, and that gives insight about the governance structure of a company and processes ensuring transparency, accountability, and ethical behaviour. ESG has become a more important component of investment strategies and corporate governance in the twenty-first century. Environmental concerns, especially those related to climate change, are becoming crucial to corporate operations and decision-making. The 2015 Paris Agreement pushed business action on environmental challenges by highlighting the significance of cutting carbon emissions and investing in sustainable energy sources. Additionally, social issues like inclusion, equity, and diversity have drawn more attention. The social component of ESG has become more prominent due to recent global campaigns for labour rights, racial justice, and gender equality. As a result, both investors and businesses are prioritising it. Particularly in reaction to scandals such as the Wells Fargo phoney accounts scam (2016) and the Volkswagen emissions crisis (2015), governance has continued to change. These episodes made clear how crucial transparent internal controls, moral leadership, and open communication are to preserving stakeholder trust.

## 3.2 Environmental Factors

Environmental, social, and governance (ESG) factors are all essential elements of modern corporate responsibility, sustainability frameworks, and public reporting. Among all these factors, environmental aspect has gained an increasingly prominent attention because of the need for sustainable business operations, resource depletion, and the increased awareness of the climate change effects. Environmental aspects are crucial to how businesses engage with the environment as they work to raise their sustainability credentials. These variables, which include things like energy use, waste reduction, water management, and carbon emissions, are increasingly important for regulators, investors, and other stakeholders to take into account. Cheng, Ioannou, and Serafeim (2014) highlighted in their article that environmental factors are important indicators to a company's financial and operational performance. By managing environmental risks effectively, companies not only reduce their negative impact on the environment they operate in, but also position themselves as attractive investments by demonstrating their long-term sustainability and being environmentally friendly. Environmental factors refer to the method that the company manages its operations needed for its business to run in relationship with the natural world. These can include several actions that a company can do which can impact the nature and public health as well positively like reducing pollution, minimizing waste, efficiently use of natural resources, using renewable sources to operate, addressing climate change, etc. Environmental factors usually differ from one company into another depending on the industry that this firm operates in. For example, strategies used to mitigate environmental challenges can differ between manufacturing and non-manufacturing firms. Manufacturing industries are typically more exposed to environmental risks than non-manufacturing firms since they directly interacted with natural resources during their core business activities or production process. These companies may face big challenges related to their high usage of energy, waste, consumption, and emissions. For that reason, their environmental impact is examined more closely than that of other industries, and they have to adhere to strict rules and sustainability requirements. Manufacturing companies use a range of environmental management strategies to solve these issues. These strategies reduce pollution and increase efficiency and obtain cost-effectiveness while also generate long-term commercial value. One of the key environmental factor for manufacturing companies could be carbon emissions and energy consumption; naturally, manufacturing firms are the most consumable and biggest contributors to carbon emissions because they rely on this energy during their process of production and manufacturing. Reducing the carbon emissions has become as serious issue and critical strategy often now implemented and applied by number of manufacturing

corporations due to the obligation they have towards the environment of the society and the market they operate in, and this is one of the ESG reporting objective that large the compass to cover non financial results and achieve a safe environment for the society. A key focus for many manufacturing firms is to transition from fossil fuel-based energy sources to renewable energy or increase the energy efficiency of their production processes General Motors (GM); American multinational corporation that designs, manufactures, and sells vehicles and vehicle parts, implement sustainable strategies to reduce its environmental impacts by focusing on reducing greenhouse gas (GHG) emissions through its manufacturing sites. General Motors has acknowledged the need to change its operations to comply with the regulatory and environmental standards as the industry of automotive is moving towards more sustainable practices through the last decades. ESG has imposed pressures to such companies during the last years, alongside with stakeholders increased concerns about environmental impacts of the firm, to take these issues seriously into an immediate consideration and move towards more clean technologies instead of relying on carbon usage. According to the Carbon Disclosure Project (CDP), the transportation sector accounts for approximately 15% of global CO2 emissions, making it a focal point for climate action. GM's carbon reduction plan include the transition into electrical vehicles. GM has committed to selling solely light-duty, zero-emission vehicles by 2035, coordinating its product line with international initiatives to lessen the use of fossil fuels. GM has made significant investments in electric vehicle (EV) technology, creating new battery technologies and growing its line of electric vehicles, trucks and SUVs. Consumers who care about the environment are becoming more and more interested in electric vehicles, which is driving this change in addition to legislative pressure. Nevertheless, GM also turned its operations into a manufacturing process that depends on 100% renewable energy to power its U.S facilities by 6 years from now. This was also one of the strategies implemented by GM in order not to rely on fossil fuels. By transitioning into renewable energy, natural energy as well like solar wind, this will cut down the bad emissions raised by these manufacturing companies especially for a global leader in manufacturing like General Motors. These strategies correlate positively with a strong governance structure of the firm. The presence of a strong structural governance inside manufacturing companies like General Motors can take decisions that could lead to an efficiency in operations and production. General Motors strategies implemented to reduce the carbon consumption and the use of renewable energy instead, GM is not mitigating its environmental risks and impact, instead, through ESG reporting and publishing Infront of public, such strategies used can enhance the reputation as a first level from a stakeholder perspective which can by its turn is able to affect investment decisions since companies that adopt strong environmental practices are seen as lower-risk investments by

financial markets. GM's proactive approach to sustainability helps the company attract ESG-conscious investors, improve access to capital, and reduce its cost of capital by mitigating long-term environmental risks. While the primary aim and goal is GM to focus on environmental aspects, but this can also has a broader effects like social and governance ones. By reducing fossil fuel, carbon consumption, and greenhouse gas and transitioning into new renewable energy, GM created a positive social image and outcomes by contributing to more clean environment, from clean air, to reducing global warming, reducing pollution, and enhancing generally speaking public health. From a governance standpoint, executive responsibility and strong oversight procedures underpin GM's environmental policy. The company's corporate governance structure now includes sustainability goals, and senior executives are in charge of monitoring the company's progress towards environmental goals including carbon neutrality. Another strategy can be is waste management and pollution prevention. Manufacturing firms can produce a lot of wastes and can cause a lot of pollution, essential strategies to prevent pollution and reduce wastes are crucial not only complying with the evolving regulations but also to maintain a company's reputation. Pollution control technologies and recycling initiatives help manufacturers minimize their environmental impact and reduce costs associated with waste disposal. A manufacturing company of French fries can be a good example as it produces a lot of wastes due to the soil or the coverage skin of potatoes. If these wastes are managed well, in correlation with good and strong decisions originated by a strong company's governance, it could benefit also the environment. These waste can be used to enrich the planting landscapes for other farmers. Another example could be Toyota Motor Corporation, Toyota's zero-waste-to-landfill initiative not only reduced the company's environmental impact but also contributed to significant cost savings by recycling and reusing materials. ESG reporting has also pushed companies to prioritize environmental impacts and disclose the strategies implemented in ESG report, where it can be viewed by the public including stakeholders, and this can affect investment decisions or reputation. Toyota's waste management efforts have positioned it as an industry leader in environmental sustainability, contributing to its strong corporate reputation and ability to attract environmentally conscious investors. Friede, Busch, & Bassen, 2015 tackled also about another solution or strategy that can be implemented especially by manufacturing corporations from ESG perspective and more especially targeting the environmental factor. The study done by the mentioned authors have suggested Unilever as a case of study. Manufacturing companies witnessed the highest consumption proportion of natural resources, including water, energy, raw materials, etc. so, a strategy can be called here could be resource efficiency correlated with a sustainable sourcing of the production process. Unilever was mentioned by the article as it is noted to be a company that is well known by its

leadership in sustainability of raw materials. The firm have implemented a sustainable living plan which mainly states and focuses on reducing the company's environmental impacts and focusing more on social aspects which can also be more effective and important from a stakeholder perspective. The company's sustainability efforts have primarily focused on sustainable sourcing, resource efficiency, and reducing carbon emissions across its operations and supply chains. The company has pledged to source 100% of its agricultural raw materials sustainably. This includes essential ingredients like palm oil, soy, tea, and cocoa, which are often associated with deforestation, biodiversity loss, and labour rights issues. Going back to ESG perspective, Unilever, through the sustainability living plan which focus on sustainable sourcing, the company addresses the environmental pillar or factor of ESG factors by reducing the negative consequences on ecosystems and resulting a long-term environmental sustainability. By ensuring that its suppliers adhere to the environmental standards, Unilever also mitigates environmental risks in its supply chain, which aligns with the company's broader ESG goals of minimizing its environmental consequences. ESG factors are now becoming crucial considerations and highly important aspects that give insights in how businesses are evaluated by their investors, consumers, regulators, and other stakeholders. From a customer perspective, customers that care about the environment are more likely to support businesses that practise good environmental stewardship. Companies that put an emphasis on cutting pollution, preserving resources, and lowering their carbon footprint frequently see increases in customer loyalty. Companies that disregard environmental considerations run the risk of losing market share to rivals that are perceived as more sustainable in a market where consumer preferences are evolving towards ethical purchase. Many workers, particularly those on the production line, would rather work for an organization that practices environmental responsibility and friendliness. Companies that demonstrate leadership in ESG often find it simpler to attract and retain talent, particularly when it comes to addressing environmental challenges like climate change. Excellent ESG performance is crucial because it increases employee engagement and motivation when an employer contributes positively to society and the environment. However, regulators are now stricter about environmental aspects and any company (manufacturing or non-manufacturing) that fail to comply and adapt with the evolving environmental regulations could be faced to substantial risks including legal fees, penalties, legal challenges, courts, and operational disruptions. Firms that proactively address environmental issues, such as reducing emissions or adopting renewable energy, are better positioned to meet regulatory requirements and avoid costly penalties. The environmental factor has a direct impact and immediate reflection in both companies and stakeholders as it impacted and changed the way the company interacts with nature, consume natural resources, and

impacts the public health. Since climate change is becoming a serious issue and critical topic that requires immediate solution by regulators additionally to the reporting standards that are exposing companies to report about their non-financial performance, businesses are highly required now to integrate the climate change risks mitigation and take it more seriously into their account and consideration during their operations, manufacturing, trading, or any type of service or goods a company may serve to the public. In fact, the environmental pillar of environmental, social, and governance reporting (ESG) helps companies and public firms to disclose additional non-financial information and efforts done by these companies to address the climate risks, both in terms of strategies that the company implement to mitigate this risk, and evolving with the updated environmental regulations. Additionally, any failure in the strategies used to mitigate climate change risks could lead any company to face some issues from legal point of view, environment, social and reputationally especially for well known public companies that could also be affected through their level of sales or customer proportions in the market.

### **3.2.1 The importance of Environmental factors in ESG**

The first advantage could result from the fact that this kind of ESG reporting aims to disclose to the public the company's interactions with non-financial aspects. This makes the reports highly attractive to stakeholders and sensitive to the interests of the investors, who are paying close attention to these reports because they are aware of the consequences of breaking these reporting standards. Businesses that excel in managing environmental risks, particularly those associated with climate change, are better positioned to avoid regulatory penalties, adapt to changing market conditions, and attract long-term investment. Evidence shows proactive climate change risk management not only reduces operational disruptions but also enhances corporate resilience and investor confidence. Another effect of complying with environmental regulations could be emerging more market opportunities. Being a company which can be best described as environmentally friendly is mitigating risks and positioning itself for long-term success. It's always been important to view also the topic from regulators point of view, and ESG is a method and way of reporting used to force the companies to stay ahead and in compliance with the regulations and changes in rules along with reducing risks of legal penalties and fines. Environmental regulations, particularly those targeting carbon emissions and energy efficiency, are becoming more stringent across the globe, and companies that fail to comply with these evolving regulations face significant risks. ESG reporting, particularly on environmental factors, enables companies to anticipate regulatory shifts and align their strategies with global efforts to combat climate change, ensuring both compliance and

competitiveness. A crucial framework for reporting climate risk is the Task Force on Climate-related Financial Disclosures (TCFD), which was founded by the Financial Stability Board. The TCFD advises businesses to clearly and consistently report all of their climate-related risks and opportunities, including their exposure to carbon pricing and the financial effects of climate change on their operations. Firms that disclose their carbon emissions and provide detailed strategies for reducing their climate impact are seen as more resilient and forward-looking by investors, who are increasingly concerned about the financial risks posed by climate change. Environmental disclosures can allow companies to identify areas related to operations, where the company can improve or succeed in implementing some strategies to its operations to ensure efficiency, minimize costs and expenses, attract more customers and interests from stakeholders, and also maintain and achieve longer-term competitiveness among the company's rivals. For example, companies that invest in renewable energy or energy-efficient technologies can reduce their dependence on fossil fuels and lower their exposure to fluctuate energy prices. One of the most important results behind complying to environmental changes and reducing the natural risk is to avoid the financial implications that could instead happen. As a result of increasing exposure to climate-related hazards, these effects may include decreased overall valuations, decreased profitability, restricted access to financing, and greater operational costs. Introducing carbon pricing mechanisms, including carbon taxes and emissions trading systems (ETS), is one of the biggest financial issues businesses faces. As discussed in a study done by Friede, Busch, and Bassen (2015), the collected data is done through an empirical study for over 2,000 empirical research papers and they came up with the following "Companies that manage their climate risks effectively, particularly through the reduction of carbon emissions, are better able to mitigate the financial impacts of carbon pricing and energy market volatility." This finding has explained how much important the environmental factors are and disclosing of such information, and the strategies to manage and mitigate climate risks as the environmental factor plays as a safeguard against financial and non-financial performance of the firm. Carbon emissions can be harmful, financially speaking, into more than a financial metric or performance indicator, as companies that don't manage to reduce their carbon emissions are exposed to carbon mechanisms, which is considered as additional costs and obligation to be paid by these companies, as they will have to either pay higher taxes or purchase more emissions allowances in trading systems. These costs can eat into profit margins and affect overall competitiveness. Considering firms and businesses who operate in heavy manufacturing segments and sectors, like the firms operating in oil, gas, cement or others are especially susceptible to growing carbon expenses. These businesses may show investors and stakeholders that they are actively managing these financial risks by revealing their carbon emissions and

reduction plans in ESG reports. Being a friend of the environment, with ESG transparency reporting may lead to operational costs cut and improve in a company's financial resilience.

The performance of the business and external factors might also have an impact on a company's ability to access funds. ESG investors, or environmentally conscious investors, are selective about where their capital are invested; they prefer companies that actively manage climate risk and make contributions toward environmentally good practices. Studies also reveal that investors are choosing their investments more carefully because of growing concerns over the financial implications associated with climate change. So the ability to attract funds and liquidity highly depends on how effectively these companies manage their operations and their impacts on climate change especially with companies in which energy sources are essentials in their operations. ESG reporting could be a bridge of communication between investors and non-financial results and environmental performance, since ESG reports can give an insight to any stakeholder to know and have a better image about a company's operations and impact in various fields. The Financial Stability Board introduced the Task Force on Climate-related Financial Disclosures (TCFD) framework, which is now widely acknowledged as the industry standard for disclosing financial risks associated to climate change. The main goal of the TCFD guidelines is to make sure businesses disclose information about climate risks in a clear and consistent manner, especially when it comes to their energy use, carbon emissions, and plans to move to a low-carbon economy. TCFD-compliant ESG reports not only improve and enhance transparency but also increase a company's ability to manage climate risks, which is critical for attracting long-term capital. Companies give investors the information they need to evaluate the financial effects of climate change, including possible costs associated with carbon pricing, energy market volatility, and regulatory compliance, by exposing their climate risks through frameworks like the Triple Bottom Line (TCFD). Mitigation and management of climate change risks can lead to long term financial resilience. Grewatsch and Kleindienst (2017) found in another study that businesses that make long-term environmental sustainability investments are better prepared to face challenges because they have already established the systems and procedures required to control environmental risks. So, investing in sustainable energy and renewable sources for a purpose of mitigating climate risk changes not only reduces the risk of financial shocks from the climate change but also it positions the company as good figure in sustainability, which can improve and give highly importance insights about their market valuation and investor confidence. In an era where sustainability is a key driver of consumer preferences and investor decisions, companies that proactively report on their environmental impact and climate change strategies are more likely to gain a competitive advantage over those

that lag. One of ESG reporting factors, and more specifically environmental one, can lead a company and rive it into an innovation track and more competitiveness inside the market it operates in. In a world in general, and a market more in specific, demanding for sustainable sources are becoming more common and increasingly demanding, companies that are implementing such strategies can develop eco-friendly products in which it they can be differentiated from other rivals or competitors' products they offer. When it comes to changing the pattern of production, manufacturing, business model, or business operations into more sustainable one, innovations in this sense not only help companies to address and mitigate risks but it also land for it a competitive position in the market through the ability of surveying the ESG conscious customers. Therefore, this can provide businesses a competitive advantage by cutting expenses, building brand loyalty, and drawing in eco-aware investors. Empirical studies evidences showed that designed environmental standards can trigger innovations that lower the total cost of a product or improve its value. That means that investing in such sustainable and environmentally friendly technologies can improve efficiency in operations, reduce costs and expenses, and at the end deliver high-quality products to the final customer. Tesla is one of the famous examples recently that relies on environmental innovations to gain advantage in the market, mainly competitive one, not necessary in terms of the price, while in terms of luxury, high quality, models, environmentally friendly products, and other factors that could play a role here in determining its competitiveness among other rivals. Tesla's main aim and operation is focused on producing electric vehicles as a solution to the environmental challenges and risks, and making itself an alternative of the normal cars and vehicles that produce emissions and rely on fuels which in fact can harmfully impact the environment. By pioneering advances in battery technology, renewable energy, and autonomous driving systems, Tesla has been able to position itself as an effective and affective leader in the automotive industry's transition to sustainability. By utilising renewable energy in its Gigafactories, Tesla has significantly reduced costs while simultaneously gaining a larger market share in the electric vehicle (EV) business. This is the result of the company's innovation-focused approach. Tesla has shown its dedication to innovation in a variety of industries by developing energy storage devices like the Powerwall and Powerpack in addition to its EV manufacturing. Tesla's ESG reporting and environmental role have been both highly significant for many types of stakeholders expressing and meeting their environmental goals also within the operations of the business that Tesla services. Certain consumers have a preference in contributing positively to the environment through driving ecologically friendly cars. IKEA could be another example that represents innovation from an ESG perspective. IKEA its becoming a circular business, and by 2030 as stated, it will be fully circular operative business, meaning that all of its products will be designed to be reused, or

recycled. This shift represents a significant departure from traditional linear production models, where products are made, used, and then disposed of. IKEA has been able recently to reduce its environment impacts and use more efficient materials. This strategy has differentiated IKEA among its competitors, and landed IKEA to be defined as a high place in the competitive edge list in the industry it operates in which is furniture market, where specifically in these markets, sustainability is becoming a key differentiator. General Electric is another example where the company addresses environmental issues through creating energy-efficient products through Ecomagination, including fuel-efficient jet engines, wind turbines, and power generating technologies that lower emissions and fuel consumption. As a result, GE was able to fulfil its clients sustainable needs, witness costs reductions and gain a competitive position. Nestle has committed for an environmental innovation especially to its packaging as a part of complying to ESG reporting as a response of growing the questions about plastic waster and environment pollution, Nestle will be 100% and fully packaging recyclable by 2025. The company has invested heavily in biodegradable and compostable packaging solutions, which have helped reduce its environmental impact while also meeting consumer demand for more sustainable packaging. Such a type of industries and sectors that Nestle is operating in, like food and beverage industry, its highly important to comply to environmental regulations and ESG reporting to be as a main priority to disclose. Food and beverage industry can impact easily and directly the public health of people, and various types of stakeholders are conscious and interested in better knowing from what business they are buying or investing, and what is health implication of this business's products, and how the environment would be affected. By providing sustainable packaging solutions, Nestle has been able to appeal to environmentally conscious consumers and enhance its brand reputation. We conclude that innovation can be seen as an effective way that helps the companies to reduce their environmental impacts, and create more long-term financial effects, better business valuation, attribute to stronger reputation, and competitive advantages. ESG reporting help companies to communicate to the public their environmental innovations, demonstrating to the stakeholders their commitment and interest to sustainability through disclosing this information in ESG reports. This transparency can attract capital investments, as previously mentioned. Well-known companies like Tesla, Nestle, and IKEA have achieved strong market positions, due to the high-quality products they offer. These products are the result of significant investments in environmentally friendly technologies. Reputation is a broad topic and significantly important especially for listed companies and well known ones, since some companies rely on their customers' reputation in order to continue and resume their operations, which can lead also into better and longer term financial results. The environmental pillar of ESG reporting plays a crucial role in enhancing corporate reputation

and fostering long-term brand loyalty. As consumers are being more aware in the recent years about environmental implications that a company can have with a help of ESG reporting, stakeholders by their various types are getting more knowledgeable and more selective in their decisions about where they invest, what to buy, and how a single individual could be affecting others. Patagonia: a company specializing in outdoor apparel products, has strongly achieved a better connections with its customers, and shredded brand loyalty through its strategies adopted against environment. Beginning with waste reduction in its supply chain and continuing with the production of long-lasting, environmentally friendly apparel manufactured from recycled materials, Patagonia has continuously placed a high priority on environmental challenges in its business operations. The firm has introduced the “Worn Wear Program”, aiming to cut down its environmental negative implications, which encourages users to fix and repurpose existing items. The focus on Patagonia’s environmental stewardship has improved its brand loyalty and approached its clients emotionally. In addition to the previous examples provided, Starbucks serves another strong case on how sustainability efforts and investments towards environment can positively impact firm’s value from trust and reputation sides. Through its commitment to sustainability, Starbucks has improved its emotional bond with consumers, who now view the company as more than just a coffee shop or brand, but also as one dedicated to ethical business practices and standards. Starbucks has introduced a number of tactics as part of its ESG reporting, including sourcing coffee ethically and decreasing waste through programs that promote the use of reusable cups and recyclable packaging. Businesses such as Starbucks may effectively and honestly express their commitment and their effects to stakeholders, investors, and customers by disclosing their efforts in ESG reports. Such companies are highly effective in the market especially nowadays with the presence of social media platforms, well-known companies are able to entail widen customer base. Any strategy implemented by such companies can be widely distributed among stakeholders and could affect the public opinion. In addition to attracting socially conscious stakeholders, these reports have greatly increased business value, competitive advantage, brand recognition, trust, and investment attractiveness.

Businesses that are more considering environmental factors in ESG framework reporting are meeting firstly regulatory requirement, reducing long-term financial implications, reducing costs, mitigating climate risks, positioning themselves strongly in the market, and gaining more advantages of growth prospects. Prioritizing these variables helps businesses show their dedication to cutting carbon emissions, preserving resources, and implementing sustainable practices, all of which enhance their operational effectiveness and financial viability. Apart from adhering to regulations, a company's reputation and brand loyalty are greatly improved by

robust environmental policies and transparent ESG reporting. This leads to a higher and a well shredded relationship connecting both customers and companies' operations. These strategies also put firms in a position In ESG aware investors, get a competitive advantage and stand out in the markets that are increasingly driven by sustainability where the latter is becoming more and more crucial and important. Real-world examples such as Patagonia's eco-friendly initiatives and Tesla's pioneering role in clean technology highlight the importance of environmental innovation in creating new market opportunities and securing long-term business resilience. n the end, businesses that incorporate strong environmental practices into their ESG strategy not only reduce risk but also future proof their operations, create long-term value, and make sure they can compete in a global market that is changing quickly and where sustainability is crucial.

### **3.3 Social Factors**

The social pillar of the ESG framework is the second pillar or factor of ESG reporting framework. The social factor refers to the interrelationship between the company itself and various types of stakeholders including employees, suppliers, customers, communities in which the companies operate, etc. This pillar, through ESG reporting is crucial since it showcase through the report how a company can is addressing social challenges and mitigating the risk that could be raised in the society. So, it is a pillar in which is linked directly to the high social responsibility the company hold. The social component is essential for ensuring ethical practices, fostering strong relationships with stakeholders, and creating long-term value by integrating responsible behaviour into business operations. The social factor can be decomposed into several parts and components including labour practice, employees' relations, Diversity, equity, inclusion (DEI), human rights, supply chain management, health or in other words safety, community engagement and product responsibility.

#### **Components of the Social Pillar**

##### **3.3.1 Labour Practices and Employees Relations**

Is one of the key elements of the ESG reporting framework that gives insight into how companies manage their workforce and illustrate the company's relationship with its employees and labours. This pillar addresses important topics like career development, diversity and inclusion, fair labour standards, remuneration, working environment, health and safety, and employee well-being. Incorporating labour practices in ESG reporting is highly important as a strong labour practices have proven to enhance the relation between the company and its employees, hence enhance productivity levels, establish for the company long term success,

and better positioning from a competitive advantage perspective. Businesses with great labour and employee relations scores typically have better reputations, less turnovers, and higher productivity. The International Labour Organization (ILO) emphasizes that companies complying to fair labour practices and standards tend to have a healthier work environment, promote equity, and enhance employee morals, which ultimately leads to increased productivity and corporate success. Other researches called this strategy as company's brain investment. Eccles, Ioannou, and Serafeim (2014) highlighted that companies that retain with its employees in a positive relation, tend to be better positioned, retained top talented hands, and in which it contributes better long-term performance, and higher profits are attributed to the company. How this strong labour practices can be established? To establish such practices and enhance more the relation with employees, companies and businesses must implement strategies that goes side to side with the corporate responsibility. These methods can start for example by fair wages and benefits to the employees. Companies like Costco, put a high priority on fair wages and employee benefits are more likely to see long-term performance, gains, and build stronger relationships with their workforce. The business increased their minimum wage to \$17 per hour as of 2021, which is significantly more than the government minimum wage of \$7.25 per hour. Depending on their role and longevity, Costco employees typically make \$25 per hour. In addition to offering competitive pay, Costco offers full-time and part-time workers a comprehensive benefits package that includes health insurance (after 180 consecutive days of employment with at least 23 hours per week). In the retail industry, this degree of coverage is uncommon. A worker's entire compensation package, including healthcare and retirement contributions, makes up about 32% of their benefits (Mashed). In such cases, companies are recommended to make periodically studies about the emerging and evolving salaries in the market, and must be fair enough to let the employees earn an income of average or above average wages according to the industry that this business operates in. Although these methods could be costly and expensive on company's financials, they aim to foster a better relationship between businesses and employees leading to more productivity and higher efficiency. Through "Zero-Harm" safety that Unilever introduced, it allows the employees to have training sessions about the workplace safety with detailed explanations about the tools and safety conditions to avoid any accident that can happen. Unilever have announced before that well-being for its employees is not determined only by safety equipment and regulations, but its also focusing on mentally and emotionally aspects. To guarantee that safety procedures are followed across its supply chain, Unilever extends its health and safety policies to its suppliers. Unilever reduces risks and fosters a culture of safety across its whole value chain by enforcing stringent safety standards from its suppliers. Another method could be crucial is career development and

employees intensive training. Providing mentorship opportunities, leadership development programs, and on-the-job training. encouraging staff members to get certified and take online courses to improve their skills. Internal promotions are another powerful tool for increasing employee loyalty. Employers who provide chances for ongoing education encourage staff members to advance within the company. Google's "Career Guru" or "Guru plus" program, launched in 2010, offering one-on-one coaching, enhancing career development, fostering personal well-being and team dynamics through allowing employees to receive mentorship from senior leaders across the organization. In the modern corporate environment, especially after COVID 19, employees and especially office workers, are being more flexible regarding their work time and shifts to cover at work. Work shifts have become also more flexible since some companies are mixing between remotely and in site work, while some companies have allowed their employees to stay hybrid or 100% remotely. Deloitte (2020). Global Human Capital Trends 2020 states that "flexible working arrangements improve employee retention by 89% and increase productivity by 22%". Khan, Serafeim, and Yoon (2016) also through their study proves that a flexibility of working hours can provide a balance for the employees between their work and their personal life. Remotely work can provide employees with more flexible time to solve and accomplish personal stuffs while working at the same time. It balances work and lifetime especially for married employees. Some companies like Patagonia has approached the social pillar differently also through extending their employees' parental leave and implementing family-friendly policies. Such companies are trying to prioritize employees-well-being and consider the challenges that an employee may face outside work, with a great understanding of family issues. Extending and paying parental leave and maternity leave maybe supportive strategies towards employees' family's needs. Companies that prioritize employee's well-being are more likely to experience higher levels of productivity, stronger reputation, more engagement, stronger loyalty and lower turnover. Through the integration of robust labour practices into ESG reporting, corporations exhibit their dedication to moral business conduct, reduce potential hazards, and guarantee the generation of long-term value for all parties involved. Examples like Unilever and Patagonia are companies in which employee's well-being is a priority for them, and they became better positioned to navigate the complexities of modern business models, flexible in working days and vacations, address physical, mental, and psychological risks for employees, and able to build better connections between the employees and their families.

### **3.3.2 Diversity, Equity and Inclusion**

Diversity, equity and inclusion is the second aspect of the social pillar of ESG reporting framework. Diversity represents a wide range of certain aspects or characteristics within the same entity or organization. Diversity can include several factors including gender, demographics, age, disability, ethnicity and etc. Deloitte (2020): "Diverse teams are 87% better at making decisions, and companies with diverse leadership are 1.4 times more likely to see innovation-driven growth". Another definition was mentioned by Khan, Serafeim, and Yoon study, that diversity represents the good difference and positive meaning of difference within a given setting. It represents the different backgrounds that people come from, carrying different perspectives and experiences with them to the workplace. Equity could be summarized by fairness or fair treatment. Actually, some can mix between equality and equity and view them as one thing but in reality they are different. Diversity and equality here correlate with each other's since equality can be defined as seeing the various and different individual characteristics with no barriers or obstacles. Equity requires recognizing and addressing systemic barriers that prevent certain groups from having equal access to opportunities. So, equality means on personal levels like seeing no difference, while equity goes beyond into and providing employees with a fair distribution of resources in the workplace regardless their background. These resources are helpful for the employees regardless of their gender, sex, ethnicity, or any other variable or characteristic to achieve their full potential. The meaning of inclusion differs from that of diversity and equity. One way to define inclusion would be as a feeling of inner belonging that is more deeply rooted in the emotions of the workers themselves. While inclusion refers to the actions or behaviours that the business does to guarantee that every individual, without exception, feels valued, accepted, appreciated, important, and a member of the organization itself, it also promotes respect. It also can be defined as the active engagement of diverse and different individuals in all areas, departments and work of the organization ensuring that they have respected voices, perspective, and point of view to be ensured that is heard and respected. Deloitte (2020): "Inclusion is the key to unlocking the potential of diversity. Without inclusive practices, diverse workforces cannot thrive, and companies will not benefit from the full range of perspectives and experiences". Microsoft is one of the well-known companies that has set a target of achieving diversity, equity and inclusion inside the workplace frame. As of 2021, Black and African American employees represented 5.7% of Microsoft's U.S. workforce, with this number growing steadily due to focused recruitment efforts. In ESG report of Microsoft, the company represented its commitment to ensure all the employees feel included and supported and not left over. Salesforce is another example in which the company

pay annually to equity audits to ensure that employees are paid fairly. Women occupy 47.7% of Salesforce's worldwide leadership positions as of 2021, demonstrating the company's deliberate efforts to advance gender diversity at the highest levels of management. The long-term objective of Citi company is to attain wage parity for all workers worldwide, irrespective of their gender or race. The company's objective is to have at least 40% of women in senior positions by 2023. It has also concentrated on expanding the participation of women and people of colour in leadership roles. Integrating DEI into ESG frameworks puts businesses in a better position to attract socially conscious investors, create innovative and inclusive work environments, and lower legal and reputational concerns. Evidence from companies like Microsoft and Salesforce suggests that DEI is not only a social obligation but also a vital component of long-term sustainability and company success.

### **3.3.3 Human Rights and Supply Chain Management**

Human rights and supply chain management are both critical components of the ESG framework and most specifically of the social pillar of ESG. These two domain components guarantee that organizations maintain and retain ethical standards not only inside the company's operations but encompass outside it, until it reaches across their international supply networks. This includes certain actions and strategies including making certain vendors and suppliers respect fundamental human rights, like fair wages, secure working atmosphere, and the prohibition of forced labour or child labour. Building sustainable and socially conscious enterprises requires organisations to incorporate human rights into their supply chain management processes. Human rights in business can be viewed as the obligation and social responsibility of the organization to respect the rights and dignity of the individuals across their operations, ensuring there is no discrimination is applied, ensuring also fair labour practices against all individuals without any exception. Human rights are concerned with how companies engage with their employees, workforce, communities, and other stakeholders, ensuring that their actions have no effects on violations of human rights. Within the social pillar of Environmental, Social, and Governance (ESG), supply chain management refers to the tactics that a business has chosen to address social and ethical issues along the supply chain. Ensuring that suppliers comply to the ethical criteria and business principles is necessary, particularly with regard to labour practices, environmental sustainability, and human rights. Having effective supply chain management involves auditing and monitoring of regulations to ensure compliance of the company and its suppliers with the ethical standards including labour rights, environmental sustainability, and overall social responsibility. Linking both together, the supply chain management and human rights, are both concepts of the social pillar in ESG framework

reporting. While human rights focus more on ensuring that humans and individuals within the workplace are treated equally regardless their characteristics or backgrounds, supply chain management also ensure the same standards are applied across the company's suppliers and from outdoor perspective. So, both being linked together ensure that these standards are applied in and out of the company's zone. Different studies proved that companies that address both external and internal practices for employee's well-being tend to experience sustainable business goals, better reputation, less social criticism, interest from stakeholders, lower turnover and efficient productivity. As a result of the implementation of supply chain management and human rights protection, a company's relationships with stakeholders and employees are typically stronger. This is because these initiatives show the company's willingness to adapt ethical standards, work with employees on an emotional level, and demonstrate high social responsibility. Investors are becoming more knowledgeable about the factors that contribute to a company's financial performance, whether it be their own or one they would like to invest in, with the advent of ESG reporting and the firms that disclose it.

### **3.3.4 Community Engagement**

Community engagement is one of the aspects of the social pillar of ESG reporting framework, it involves the actions and the strategies taken from businesses side to interact and react with the communities they operate in. In the context of ESG reporting, community engagement means a company's commitment initiatives as if being a good corporate citizen who is performing the social responsibility at a best practice phase. By actively being an effective company with the community can impacted different slices of the society including employees, citizens, customers, governments, reputation and overall social morals. Different strategies can be implemented to attain community engagement, such as corporate social responsibility programs. To begin with, let's define corporate social responsibility (CSR): it refers to the tactics employed by businesses to demonstrate how they both positively and negatively impact the societies in which they operate. Additionally, CSR communicates with the public using ESG disclosure reports, ensuring to convert their efforts into information that is helpful to the public and share it with them so that they can see the company in a different perspective and see beyond the concept of core business operations alone. For instance, many companies communicate with the public through charitable giving, it means engaging in philanthropic activities through donations to charity for example or funding healthcare or funding school educations, etc. These contributions have both socio-economic effects. Microsoft believe in empowering the society and individual well-being as investments to foster economic development and social enhancement in the communities they operate in. Employee volunteer

programs are another approach that may be suggested; they are optional, subjective initiatives that the company often offers to its employees as a way for them to become involved in and support the community and benefit the local society. Many businesses have requested the help of their staff members in green planting initiatives by setting aside a day to plant in agricultural areas. Others could be interested also in cleaning the public place and reducing pollution like beaches and gardens. All these strategies can be done through offering training courses and development trainings aiming to enhance more the efficiency workplace and the productivity in the workforce, hence affecting the whole society. By means of its Networking Academy, Cisco has made investments in workforce development, offering individuals worldwide training in networking and IT skills. Many students now have the potential to increase their technical skills, compatibility, and get better-paying offers. The implementation of effective corporate social responsibility programs in the local community can lead to various benefits such as increased employee engagement, improved socio-economic conditions, satisfaction, sense of belonging, retention of expertise, stakeholder trust, and improved reputation. The company can also view itself as a good contributor and corporate citizen that is benefiting not only the economy but also society and the environment. The impacts are broad and wider when seen from both an individual and a societal perspectives. Participating in volunteer programs can improve social skills and communication with the community on an individual basis, whether or not one is an employee. It can also increase an employee's sense of participation, job satisfaction, motivation, and commitment because motivated employees tend to feel more comfortable in environments that align with their values and way of life. Therefore, a sense of satisfaction is achieved here if they were good contributors to their society before becoming employees and found that their employers followed pattern. Also speaking about individual stage, companies with stronger social responsibility programs and engagements are more attractive to talent acquisitions especially from socio-economic conscious employees who are particularly young and talented. Businesses that share the same values as their employees, especially when it comes to social responsibility, tend to draw top talent and have reduced employee turnover, according to Deloitte (2020). From a societal viewpoint, businesses that adopt these tactics have the potential to gain a better reputation and lose the trust of their stakeholders. By strongly adhering to social responsibility, a company can increase its social license to operate, manage risks, and create confidence. CSR initiatives are an essential part of ESG reporting's Social pillar. Stakeholder requests for social responsibility are more likely to be met by companies that demonstrate a commitment to community involvement through CSR programs. A company's CSR activities, such as staff volunteering, charitable giving, or sustainable development projects, are typically highlighted in ESG reports as evidence of its

social responsibility. Additionally, to what mentioned, partnerships with local organizations can be a crucial aspect of community engagement is forming and creating partnerships with local authorities, non-governmental organisations (NGOs), and other community groups. Through cooperation and partnerships, these collaborations enable corporations to meet regional issues and have a lasting social effect. Proven social leadership, ethical behavior, and responsible governance are considered to be signs of a business's ability to carry out corporate social responsibility initiatives across its overall business strategy.

### **3.3.5 Customer and Product Responsibilities**

One of the key components of the social pillar in ESG reporting is customer and product responsibility. The company's degree of responsibility towards its consumer base is determined by several aspects, including customer satisfaction, safety conditions, and high-quality products. Through definition, it also refers to the moral measures taken by the business to guarantee the fulfilment and well-being of its clients. It is a key component in establishing a solid reputation for the company and its offerings, a marketing tool, a measure of profitability, and from a legal perspective, it certifies adherence to changing social and economic laws. Product responsibility is a broader concept that covers all aspects of a product's lifecycle, including design, lifespan, expiration and manufacture, and consumption, whereas customer responsibility relates to the ethical approach towards customers. It encompasses every product offering level made by the company up to the very end, when the product is disposed. Customer and product responsibilities are closely related to and have a significant effect on all other elements of the social pillar of ESG. This is because they are correlated to the company's core business operations, sales volume, suppliers, customers, stakeholders, and governance, as all production products are authorized for use by a hierarchy of managers and employees within the same organization. Studies indicate that organizations that proactively participate in fair labor standards and corporate social responsibility (CSR) build deeper employee relationships. Because motivated staff members are more willing to demonstrate pride in their work, higher quality output results from this. On the other hand, employees who feel underappreciated or unsupported are less motivated and productive, and they make more mistakes and would also increase the level of errors. All these factors are linked also to the product safety and quality as the production process depends heavily on the first levels of employees. In industries like food and beverage, pharmaceuticals, or electronics, lack of training or less motivations can result in safety risks, unsafe work environments, or low-quality products. The quality of labour practices across the supply chain directly affects the integrity of the finished product. Businesses that make investments in fair labour practices are more likely to provide products that live up to

consumer expectations in terms of both ethical standards and quality. Johnson & Johnson has placed a higher priority in being accountable and responsible for product safety and customer responsibility. This dedication was put to the test in 1982 during the Tylenol crisis, when the business acted to recall millions of bottles and prioritized product safety over profits generation. Companies involved in pharmaceutical industry are more exposed to stricter regulations, as they are directly linked to human well-being and public health. ESG reporting helps these companies to be more transparent in showing their tactics and practices implemented for their customers. Strict safety regulations are enforced in the pharmaceutical sector by regulatory agencies such as the European Medicines Agency (EMA) and the U.S. Food and Drug Administration (FDA). In order to minimize risk and show accountability, pharmaceutical corporations such as Pfizer are required to report on these requirements in their ESG disclosures in addition to complying with them. During the development of the COVID-19 vaccine, Pfizer demonstrated a strong dedication to product safety by prioritizing safety processes along with increased production volume to meet worldwide demand. Transparent communication from Pfizer towards patients and hospitals, with a focus on product description and benefits played a crucial role among other vaccines in building public trust. In sectors like customer care, healthcare, public health, food and beverage, pharmaceuticals, manufacturing and non-manufacturing firms, social pillar and transparency in product's safety are essentials to the public, regulators, and health institutions. Companies like Nestle and Pfizer show their commitment to social responsibility by emphasising ethical sourcing, product safety, and open communication. This builds consumer trust and complies with legal requirements. In today's world, where social media plays a crucial role in communication, platforms like Facebook, Instagram, and Twitter have changed how businesses approach product and customer responsibilities. The transparency and accountability these platforms bring have pushed firms to adapt in key areas such as product safety, ethical marketing, data privacy, and customer satisfaction since such platforms provide users with an easy access to freely express their opinions hence affecting public. Social media has empowered consumers to quickly and publicly voice concerns about product safety or quality, which can have significant reputational impacts if businesses fail to address them. If a business ignores concerns about the safety of its products, a single post share or comments can negatively impact a company's reputation. Businesses now include real-time social media monitoring in their ESG frameworks to proactively handle any issues related to the safety of their products. Online surveys, for instance, are significant for companies to identify risks associated with the product offered. New customers depend heavily on reviews and online ratings of the products or services provided by businesses. These platforms help companies to mitigate risks and minimize losses. On social

media, H&M was criticized after customers drew attention to differences between the clothing brand's stated and real sustainability policies. Businesses can no longer avoid or ignore customer complaints. Feedbacks are nowadays public and visible to wide audience, making it essential for companies to keep an eye on their online pages, websites and customer satisfaction to maintain and foster customer's trust and build better reputation. These strategies differ from one company to another, some can employ strategies to address customer concerns through refunds, others through gift cards, or better services. All these efforts are considered to be investments towards the consumer base in order to increase market share and enhance the public image. These strategies could be also costly on firms, firms may be required to employ social media specialists or marketing team specialized for customer's requests and addressing their concerns. Businesses are finding it more and more crucial to include product responsibility, safety, and customer pleasure in the social pillar of ESG reporting. Furthermore, social media also helps businesses to show greater standards and social approaches for people who may not read their ESG reports, particularly when it comes to matters like product safety, ethical marketing, and data privacy. Businesses show a sincere commitment to social responsibility by incorporating these values into their ESG reporting. This, in turn, generates long-term value for investors and clients.

### **3.3.6 Social Impacts of Products and Services**

This is the most important component of the social pillar of ESG reporting for a company since it summarizes why social pillar is important and combine all the social components with their societal challenges and effects on the society. ESG reporting highlights companies' contributions to societal well-being through their products especially through areas such as public health improvement, inequality reduction, and achievement of sustainable consumption.

- Health improvement: Products that promote health have a particularly important social influence in sectors including consumer goods, healthcare, medicines, pharmaceuticals, and food and beverage. Corporations that produce goods aimed at enhancing public health outcomes can lower the cost of illness, lengthen life expectancy, and provide easier access to necessary medications. With its Access to Medicine Strategy, multinational pharmaceutical corporation Novartis has made notable progress in enhancing public health. This strategy is focused on the low-income nations, and low income countries since Novartis has focused and concentrated on creating and supplying reasonably priced medications. Moreover, Novartis funds research to develop medicines for chronic illnesses that disproportionately impact underprivileged communities as well as neglected tropical diseases (NTDs).

- **Inequality Reduction:** Through giving access and offering affordable high quality goods whether it's in education, financial services or housing can reduce the inequality between marginalized or underserved people. Citigroup (Citi) has made significant contributions to the reduction of housing inequality by means of its Citi Community Capital (CCC) initiative. Citi facilitates the availability of safe and reasonably priced housing for low-income families by providing funding for affordable housing initiatives in underdeveloped areas. This program addresses housing inequities and promotes economic growth, especially in places where cheap housing is hard to come by.
  
- **Sustainable Consumption:** This aspect is a socio-economic factor where it combine both environmental and social pillar approaches. The goal of sustainable consumption is to create and promote goods and services that have the least negative effects on the environment, generate less waste, and promote resource conservation. Businesses that appeal to socially conscious customers and encourage sustainable consumption through their product lines both protect the environment and benefit society. Unilever's Sustainable Living Brands. Companies like Dove, Lifebuoy, and Ben & Jerry's concentrate on reducing their environmental harmful effects while supporting social objectives like promoting good hygiene and decreasing the effects of climate change. Unilever has established challenging targets to decrease plastic waste, enhance water conservation, and source raw materials responsibly.

The social pillar of ESG reporting is supremely significant since it coordinates business core operations and relates it with the society impacts and the need or objectives of global sustainability. Companies may greatly enhance public health, lessen inequality, and encourage sustainable consumption by developing goods and services responsibly. Not only does this social impact improve community well-being, but it also improves labour practices and employee relations because workers are more engaged and devoted when they see their effort going towards a greater benefit in society. Businesses are trying to generate long-term positive social effects, whether through supplying basic services like healthcare and affordable housing, making sure ethical considerations are considered throughout product development, or promoting an inclusive work environment. In the end, the social pillar fortifies the link between corporate activities and societal advancement, which is becoming more and more important for ESG reporting and drawing in socially conscious investors and customers.

### **3.4 Governance Factor**

Governance is the third and the last pillar of the ESG reporting frameworks which represents generally and tackles about how companies are controlled and directed. It refers usually to the internal system and hierarchy of control, implementing practices, and procedure that ensure that the company is transparently complying to the ethical regulations. Strong governance is often viewed as a foundational element for successful ESG integration. Governance is composed by various factors:

#### **3.4.1 Board Structure and Independence**

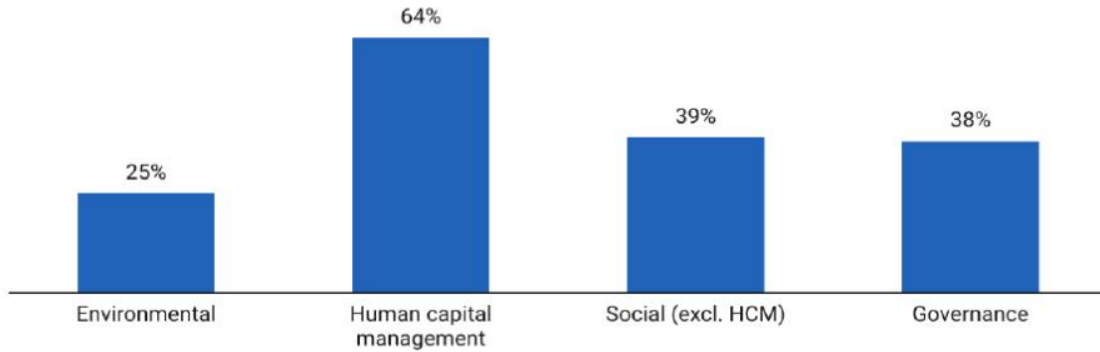
It represents the board of directors which is considered as a vital component and factor of governance. An independent board ensures that executive management is held responsible and accountable that decisions are made in the best interests of shareholders and stakeholders. The board structure includes a mix of executive management and non-executive directors. Independent non-executive directors they are not involved or concerned within day-to-day business operations of the company and can provide just a general view about the organizational management's performance. Boards that are mostly composed of independent directors are better able to adapt and align to corporate strategies with the long-term interests of shareholders, particularly in areas related to sustainability. However, executive directors are usually part of senior management, including the CEO. Independent directors are able to take unbiased judgments since they have no material or financial connection or interest to the business or its management. Independent boards members consist of committees such as risk, nomination, audit and compensation committees. These committees focus on specific governance areas, ensuring detailed oversight and risk management. Board independence brings several advantages. Independent directors ensure that management is held responsible for its decisions, especially for the ones related to ESG factors. These directors can better assess the company's ESG initiatives and ensure they serve both stakeholders and shareholders since they are unbiased. Their independence helps prevent external pressures from prioritizing short-term profits over long-term sustainability, ensuring that decisions are more balanced. For instance, compensation committee are the ones who ensure that executive pay aligns with the organization's ESG objectives, instead of short-term decision making. Alphabet board; Google's parent company, includes highly experienced board in technology and ESG aspects. Its committees, which include an independent audit committee, are in charge of monitoring sustainability risk management procedures and making sure that comprehensive financial disclosures are made. Additionally, companies having independent boards typically witness better reputation for governance and ethically more transparent since they are more likely to

provide fair oversight and opinion of management. Independent boards are also better equipped to anticipate environmental challenges and address regulatory changes. After Deepwater Horizon oil spill, BP's governance is one of the examples since it hired additional independent directors with expertise regarding environmental fields in order to detect and mitigate environmental risks. This strategy taken by the company has strengthened its reputation and rebuild its governance structure or framework. Independent directors also ensure transparency since they are not influenced by any mean of internal interest with the internal management. So, their decisions or opinion are purely transparent and not linked or pressured by any body inside the organization. Evidence shows that they are more trustworthy by stakeholders including investors and regulators. Because of the function independent boards play in the business, which includes undertaking decisions that are transparent and fair, the governance and independence structure is essential to ESG reporting. Companies like BP have demonstrated that effective board supervision can enhance ESG performance, contribute to better corporate reputation, and create long-term value for shareholders. As investors prioritize governance in ESG evaluations, companies with independent boards are likely to gain from enhanced financial resilience, stronger stakeholder trust, and easier access to financing.

### **3.4.2 Executive Compensation**

Is the most paramount component of governance in ESG reporting since it refers to the additional package (mostly financial package) offered to senior managers and executives, including bonuses, incentives, commissions, or even stock options. In terms of governance and the ESG framework, this compensation plays a crucial role that can have both positive and adverse impacts. Executives are rewarded for achieving targets, hitting budgets, achieving short-term goals, and receiving other types of pay. The latter can be quarterly, monthly, upon achievement, yearly or during any specified and pre-determined period. Empirical results have found that companies in which they link the compensation into ESG performance tend to experience sustainable business practices, and great improvements as the leaders are being highly incentivized to consider both social and environmental impacts of their company. Figure 1 below illustrates that executive compensation plans generally include human capital management (HCM) performance goals the most frequently 64 % of S&P 500 businesses have them. This is understandable given that stakeholders and investors are highly involved on a variety of HCM issues. Governance, social (other than HCM), and environmental goals come after HCM (found in 39%, 38%, and 25% of S&P 500 businesses, respectively).

ESG goals, prevalence by area

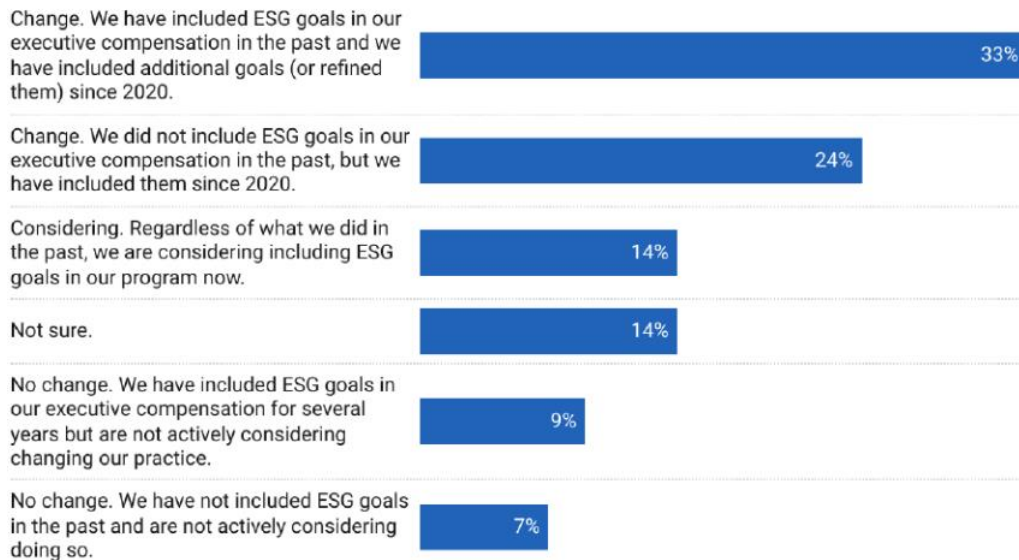


Note: Based on disclosures made by 455 S&P 500 companies between January 1 and September 7, 2022  
 Source: The Conference Board/ESGAUGE, 2022 • Created with Datawrapper

Figure 1: What factors are executive compensation tied to? (Harvard Law School Forum on Corporate Governance)

Incentives that include ESG targets and hold leaders accountable for meeting them can both drive a company's ESG performance and overall business performance, as well as show how important ESG is to the organization.

Q: What best describes your company's approach to including ESG-related goals in executive compensation programs?



Note: 58 respondents  
 Source: ESG Performance Metrics in Incentive Plans Roundtable, The Conference Board, 2022 • Created with Datawrapper

Figure 2: An increase % of companies that link exec pay into ESG performance (Harvard Law School Forum on Corporate Governance)

Some companies are moving from including ESG measures as part of the individual performance section of the annual bonus plan to incorporating ESG performance as a modifier of the company's financial performance rating. This has the benefit of showing how some

investors view ESG. Others include ESG goals in a business strategy evaluation and take a data-driven, quantitative approach, but with a qualitative overlay that leaves room for compensation committee or board discretion. While this link of compensation to sustainability goals can lead into better reputation, higher company's value, revaluation of the business stock option, and other financial and non-financial positive results, it also can drive the company to be under the risk of greenwashing. Greenwashing represents a tactic used by corporations to falsely or deceptively present themselves as being an environmentally friendly or socially responsible to attract attention of the stakeholders like customers, governments, or investors without actually doing or implementing the real strategies to accomplish that mean. Delmas and Burbano (2011) define the term greenwashing as the intersection between two firms behaviours: one in which the company is performing poorly towards the environment, and the other in which have positive communication which is in other words pretending about environmental performance. When businesses is engaged in greenwashing, it reduces stakeholders' trusts and weaken its corporate social responsibility resulting in higher risks and lower ESG scores. It also raises the possibility of fines and regulatory attention. Businesses that are discovered making false environmental claims risk serious legal and financial obligations which are normally costly. Capital misallocation can result from greenwashing, since investors may be tricked into funding businesses that lack a sincere commitment to sustainability. In the future, before implementing ESG practices into executive compensation plans, businesses would want to incorporate them into their business plans for a few years. Before linking that pay. Additionally, rather than introducing any ESG indicator, organizations may wish to think about different means of achieving ESG goals if they want to positively impact social or environmental issues. Companies should consider how they may provide CEOs with incentives to drive transformation throughout the industry and company value chain. After all, environmental and social risks can't be addressed and solved by a stand-alone person.

### **3.4.3 Ethics and Anti-Corruption Policies**

These are policies used by businesses to prevent and address unethical behaviours that may rise including fraud, bribery and corruption. It is a crucial part of the governance pillar of ESG reporting. They are essential for preserving a positive company reputation, guaranteeing regulatory compliance, and establishing trust among stakeholders. Ethics and anti-corruption policies is composed of code of conduct, whistleblower protections, third-party due diligence, and training programs. To start with the code of conduct is a written document by the company that outlines and illustrates the ethical practices by the company and the business value additionally to also employee behaviour. It typically includes specific rules against bribery,

fraud, and unethical practices ensuring the increase the employees trust and ethical behaviours. Whistleblower protections allow the companies employees without fear of retaliation to report the unethical behaviour policies. JP Morgan has implemented an effective whistleblowing policy aiming to detect potential occurrence of fraud, corruption, and unethical behaviour in the organization's operations. While third-party due diligence represents the process of monitoring or evaluating the third-party sides including business partners, vendors, etc. to ensure that they comply with a company's ethical, legal, and governance standards. Supplier's auditing is one method of third-party due diligence. Companies can take prompt action by using auditing procedures to help them in detection and identification of the areas of unethical actions or non-compliance violations. Companies must ensure that their suppliers and partners are free from corruption to maintain ethical business practices and comply with global anti-corruption laws like the Foreign Corrupt Practices Act (FCPA) or the U.K. Bribery Act. Verifying that suppliers are on track with environmental laws and sustainability objectives is a crucial component of third-party due diligence in ESG reporting. Stakeholders trust increased and ESG results may improve through third-party diligence which encourages responsibility, accountability, transparency, trust, and reputation.

#### **3.4.4 Shareholder Rights and Engagement**

Shareholders rights refer to the proportion of entitlements they have to influence or to affect decision making process. Executive compensation could be one of the kinds of shareholders right, voting or major company issues are also another type of rights entitled to the shareholders. What regards voting, shareholders have the right to elect board members or vote on decisions that can influence the direction of the company or change the corporate policies. Voting can have also several aspects or forms; some shareholders have the proxy voting right which it gives the voting power to other shareholders enabling them to participate in corporate governance even if they cannot attend the meetings. Recommendations or proposals from shareholders also considered as a type of shareholders rights which is applicable or can be heard during annual general meetings (AGMs). These recommendations frequently touch on ESG topics including executive compensation, human rights, and climate change legislation. Furthermore, shareholders also have the right to access and view information highly relevant for the company, including financial information, firm's value and other financial private information. Since shareholders are increasingly demanding a transparent non-financial reporting, to have access for ESG tactics and procedures is also highly important resulting in informed decisions that may align with the sustainability objectives and long-term value creation for the company. By viewing these information, shareholders can also predict potential risks including environment,

social, and reputational. Through the effects of fostering and strengthening more accountability, transparency and sustainability objectives, shareholders' rights are significantly important since they have a widespread impacts on companies strategies, initiatives taken, and on stakeholders.

### **3.4.5 Internal Control and Risk Management**

Both internal control and risk management are critical mechanism in recognizing and managing various business's risks including financial, environmental, social and operational ones. The first step is diagnosis of the risk itself and identification of potential risks that can also affect after. Once risk is identified, companies may study the impacts of each risk individually and separately. Prioritizing risks into levels, can help companies in identifying and going through significant risks first or the most significant threats as first. In ESG context, it means understanding the risks caused by climate change as an example, that can directly be linked or influence to a company's value. The last step of the whole process is implementing the strategies that are useful to mitigate these specific kinds of risks. Risk mitigation strategies often focus on reducing environmental impacts like carbon emissions reduction, improving labour practices, and enhancing social responsibility. Internal controls are procedures that requires a compliance auditing to ensure the integrity of financial and operational processes. Internal control actions are like risk management actions as they start from the common starting point which is risk identification or assessment. The steps that are required to reduce risks are known as control activities. This could involve the division of labour, authorization procedures, and permissions. Information and communication stage is also a step in the internal control's procedure in which it ensures that the important and correct flow of information reaches accurately and timely the right people or audience. Internal control mechanisms at Microsoft ensure that the key ESG data flows without barriers and using advanced analytics and reporting rules between operations and management levels. Monitoring came to be the last process, in which the effectiveness of the internal control procedures is being studied and examined over time. To ensure that internal controls stay effective over time, the company's audit committee examines reports on internal controls on a regular basis and highlights areas for improvement. Through identifying risks, managing, auditing, controlling, and mitigating them, companies can turn from the edge of reputational risk damage or financial or non-financial conflicts into long-term sustainability and better performance.

Governance plays a vital role in overseeing the internal control and risk management processes since governance outline decision-making processes, including the roles of employees, board members and executives. Strong and well-structured governance ensure that companies remain accountable to their stakeholders and shareholders. This transparency encourages trust between

investors and the company itself. Firms with stronger governance structures are more likely to disclose their ESG performance in a transparent and accountable manner, improving investor confidence. Another benefit of a strong governance is when it links incentives and compensation to good environmental and social results avoiding greenwashing. The governance also ensure that the business is adhering to the evolving legislations all ESG aspects and environmental, social, and corporate governance importance. Long-term sustainability and resilience can be both also achieved by strong governance since it ensures that companies are able to adapt to changes in the market, regulations, or consumer preferences by promoting a proactive and forward-thinking approach to risk management and decision-making.

### **3.5 ESG Reporting and Disclosure: Standards and Challenges**

ESG reporting in the recent years has become increasingly important as different types of stakeholders are demanding more transparency on company's non-financial performance and what's behind the good financial numbers, figures and performance published including customers, investors, regulators and shareholders. Multiple reporting standards are present to help ESG reports to be published in a justifiable and transparent manner. The standards are as follows:

- Global Reporting Initiative (GRI): is one of the most widely used and common standards for sustainability and ESG reporting. It provides guidelines on what steps should this company follows in order to report about its environmental, social and governance impacts. GRI involves a multi-stakeholder process; meaning that these guidelines are made with collaboration or in hand with investors and labour organizations. To offer extra assistance to sectors including mining, financial services, and oil and gas, GRI has created sector-specific standards. These guidelines cover the particular sustainability issues that every industry faces. The GRI standards are aligned with other global sustainability frameworks, such as the United Nations Global Compact (UNGC), OECD Guidelines for Multinational Enterprises, and the Sustainable Development Goals (SDGs).
- Sustainability Accounting Standards Board (SASB): Is independent organization that's man aim is to provide to help and facilitate companies' communication and disclosure of consistent information and relevant reports and data to their investors, and these data are mainly ESG reports. SASB is specialized by focusing in its industry-specific methodologies. This strategy makes sure that every business reports on the sustainability issues. SASB also

help the investors who are looking to interpret sustainability factors into their financial analysis since SASB emphasizes financial materiality.

- Task Force on Climate-related Financial Disclosures (TCFD): The Task Force on Climate-related Financial Disclosures (TCFD) is a framework designed to direct businesses in their reporting process in how they can disclose the financial risks posed by the climate change. TCFD encourages transparency in how companies assess and manage climate-related challenges and provide a framework for dealing with these risks.

Challenges in ESG reporting: In addition to greenwashing elaborated before, data collection could be a serious issue in ESG framework. Unlike financial data, ESG metrics from environment, social to governance also are often and mostly qualitative and difficult to measure. Even within the same industry, there could be a difference between two companies and more in the method used for data collection. It is challenging to gather ESG data across geographies and suppliers because many businesses are global in scope and operate in many countries and depend on intricate supply chains. Accuracy testing could be also challenging also regarding ESG components also unlike the financial data where the reliability of financial numbers can be tested or examined. Also, additionally to qualitative data, some data of ESG are quantitative in nature. Quantitative like carbon usage and energy or emissions maybe easier to collect or to report than the qualitative data such as governance procedure, employment relationships, etc.

### **3.6 Impact of ESG on Company's Valuation: Stock Performance, Cost of Capital, and Investors Behaviour**

Impact on stock performance and cost of capital: there is a significant correlation between stock performance including the price volatility of the stock and ESG reporting. Clark, Feiner, and Viehs (2015) suggested that companies with strong sustainability practices witness a positive market performance especially in their stock performance. Companies that report ESG correctly, transparently and accurately tend to have stronger risk management processes adopted with a stronger governance structure. As the governance is also respecting and complying to environmental and social evolving rules and regulations and proactively managing these challenges. Additionally, companies with good and strong financial performance with a non-financial sustainable performance tend to experience lower cost of capital since these companies are viewed less risky from regulatory point view as they are not facing any penalties what regards to their performance against ESG components, also they tend to have strong reputation, economically and socially friendly, and alongside with financial

outcomes, these type of companies are able to access financing more easier than others, or at more favourable terms as they are able to cover their obligations in case of loans. Firms with higher ESG ratings experience a reduced cost of equity and debt, leading to better financial outcomes and, consequently, superior stock performance. Businesses that are addressing environmental challenges also are more likely to implement strategies which are efficient and lower the overall expenses and costs like a company trying to reduce the carbon or gas emissions through changing or turning into renewable energy sources. Cost-savings in this matter also could reflects in the operational profits in the financial statements disclosed by the company like the income statement (Earnings before Interest Taxes Depreciation and Amortization). Since EBITDA is a measure of the operational profits after deducting all the operational expenses used for the core operations of the business. So, it is the left over after the revenues which is the main source of money from an ordinary organization after deducting all the costs used in the operational process of the business. Reducing carbon, turning into renewable sources of energy for production, employees engagement are all can be direct and indirect effects of cost reduction which can reflect a better financial overall operational performance for a company. Profitable companies tends also to have higher stock prices. Strong ESG reports frequently improve a company's brand loyalty and corporate reputation. Sustainability and ethical practices are becoming more and more significant considerations for stakeholders including consumers and others when making financial or capital investment decisions. Therefore, businesses that actively seek to lessen their impact on the environment and to advance social equity tend to draw in a larger base of devoted clients, which can boost sales, attract investment decisions, and enhance stock performance. While other studies suggest that there is a negative correlation between ESG reports and stock performance. Scholtens and Kang (2013) point out that "in sectors with high environmental costs, the implementation of ESG practices may lead to short-term declines in stock performance, as companies incur significant costs to improve their sustainability" So, in this case, some studies show that efforts on ESG by the company can be costly and negatively impact stock performance as the strategies implemented by companies to address the challenges especially environmental one could be so costly and expensive to adapt.

MSCI, a leading provider of ESG ratings and research, developed the MSCI ESG Leaders Index, which tracks the performance of companies with high ESG ratings. MSCI performed a monthly study between the years 2015 and 2024 between ESG performance and the cost of capital comprising 4,319 unique issuers with available monthly cost-of-capital data from August 2015 through May 2024. Data collectors divided issuers into five equal-weighted quintiles based on

their industry-adjusted score (IAS) that directly underlies the MSCI ESG Rating: top ESG rating (highest-scoring companies); high, mid and low (average-scoring companies); and bottom ESG rating (lowest-scoring companies). The study conducted the cost-of-capital comparisons within peer groups based on a company’s home market, sector, credit quality and, for debt, also currency, by comparing the cost of capital and its components among MSCI ESG Rating quintiles calculated within these control groups. The results showed the following figure:

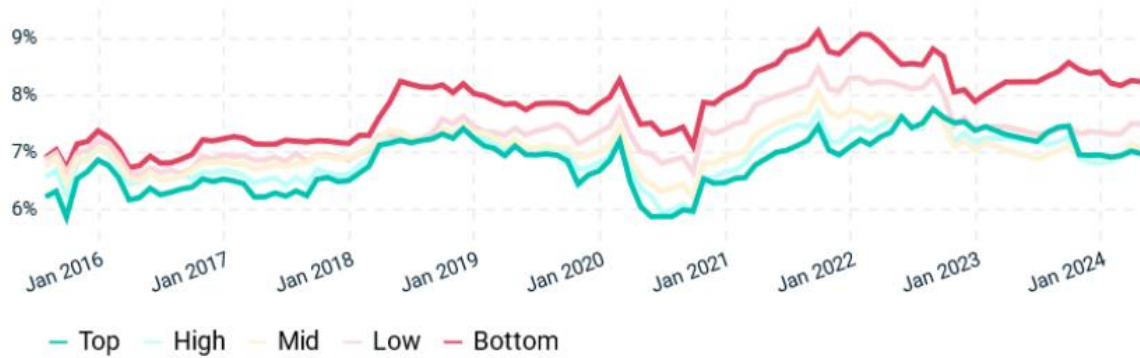


Figure 3: Cost of capital across MSCI ESG Rating quintiles (MSCI ESG Ratings and Cost of Capital July 2024)

The figure illustrates that the cost of capital is lowered to those of top-rated companies. This concludes that ESG practices and strategies implemented by firms are highly demanded by stakeholders and significantly effective factors in the market in terms of company’s access to capital ability.

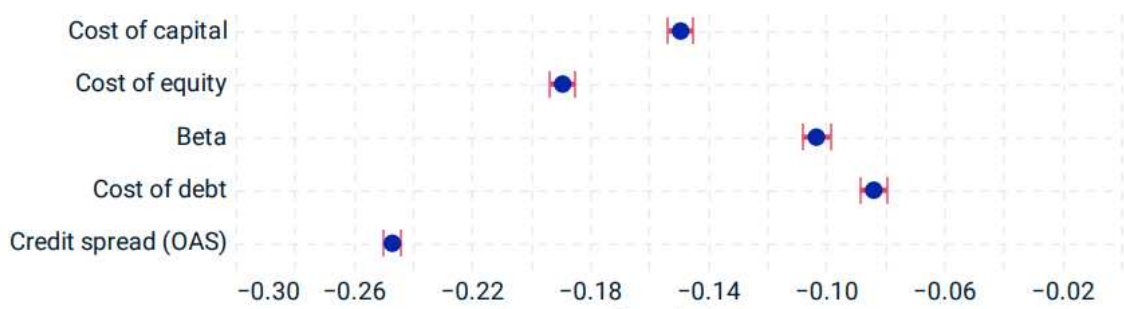
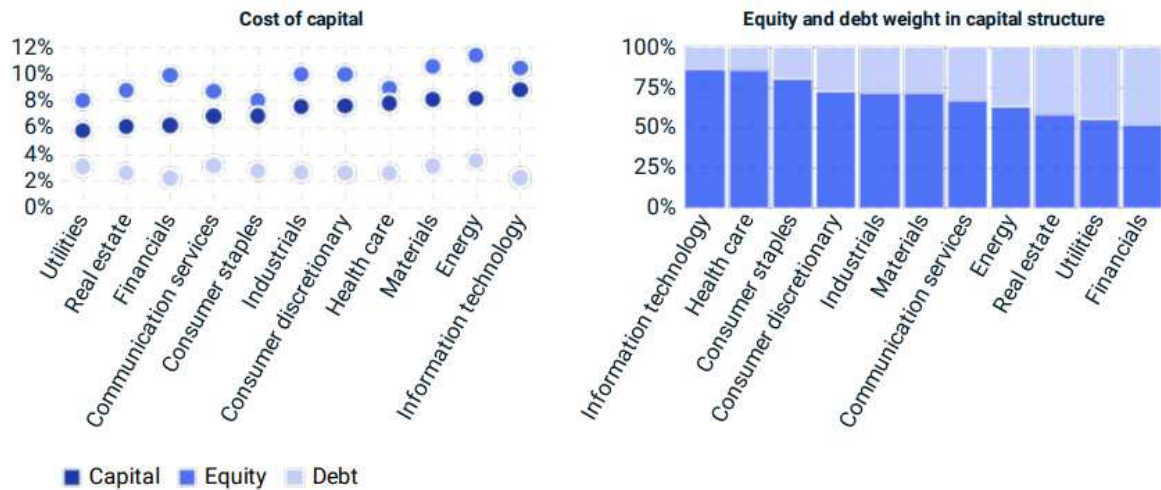


Figure 4: Historical correlation between companies’ MSCI ESG Rating and their cost of capital (MSCI ESG Ratings and Cost of Capital July 2024)

The lowest-rated companies had the highest financing costs (7.9%, on average, over the study period), while the top-rated companies, on average, financed themselves at the lowest rate (6.8%) over the study period.



Data period from August 2015 through May 2024. We show the average values over the study period. Source: MSCI ESG Research

Figure 5: Average cost of capital and funding structure by sector (MSCI ESG Ratings and Cost of Capital July 2024)

Still, companies with the highest MSCI ESG Ratings had significantly lower financing costs than lower-rated peers across sectors, except for the diverse consumer-discretionary sector.

The study found that there is a strong relationship between a company’s MSCI ESG and its cost of capital, wherein companies within higher ratings according to industries are less risky compared to the ones who are low rated. Hence, experiencing lower cost of capital during all the study period.

With a growing demand for sustainable investment options, investor behaviour has dramatically switched towards ESG-focused investments. ESG-aligned portfolios are in high demand due to regulatory demands, rising social and environmental awareness, and other factors. The shift toward ESG investing has resulted in significant capital inflows into ESG-focused funds. Investors believe that companies with high score of ESG reporting are better to handle risks related to several aspects including environmental, social and governance scandals. Morningstar’s 2021 Sustainable Funds Report, ESG funds saw witnessed inflows about \$50 million in 2020, representing a sharp increase compared to previous years. ESG is important for both analysts and investors since they both are increasingly considering ESG frameworks into their company valuation models, particularly when analyzing long-term patterns. Additionally, ESG considerations are becoming more and more significant in mergers and acquisitions (M&A). Potential acquisition targets' ESG performance is now being evaluated by

buyers, and businesses with excellent ESG credentials may fetch higher premiums in M&A deals.

### **3.7 The Future of ESG: Trends and Innovations**

Technological advancements including big data, artificial intelligence and blockchain are impacting ESG framework, as they facilitate the data collection and reporting methods of ESG factors. Blockchain nature it ensures that data is recorded and unable to be altered. This is supreme when investors demand transparency in reporting since blockchain entitles a track providing a real time transparency of the subject under study. For example, Walmart, uses blockchain to track its food supply chain, through this, company can reduce misinformation and can verify its ethical sourcing practices. World Economic Forum (2020) report, "blockchain technology has the potential to eliminate greenwashing by providing a transparent, verifiable ledger for environmental data." So, blockchain implies transparency in the process, and it can be used for example in environmental strategies. A company can build a platform for managing carbon assets based on blockchain technology that will improve the tracking of carbon credits. By ensuring the accuracy of carbon offset data, this platform assists businesses in achieving their emission reduction targets in a verifiable manner. In this way, the company has detected the issue and able to mitigate it, and this issue is directly related to one of the ESG factors. Harvard Business Review (2021) article emphasizes that "blockchain could solve key issues in the carbon offset market by providing traceability and ensuring that carbon credits represent genuine, verifiable reductions in emissions." At the end, blockchain present real-time data which can improve ESG and be useful for the quality of the disclosure of the company. It also verifies the data, increasing the trust among the stakeholders and accountability. Businesses and investors can make better decisions by using AI-powered analytics tools to evaluate non-financial risks since AI can be used to collect information about a climate change from different sources including satellite imagery, weather forecasts, and energy usage patterns. This can helps company imagine or expect potential risks that could be faced environmentally. Talking about environment, AI can be significantly useful, since predictive models driven by AI can forecast the financial consequences of climate changes, such as how supply chains or operating costs may be impacted by flooding or drought. These models give businesses a better knowledge of how operations might be impacted by climate change, allowing them to plan mitigation actions. Socially speaking, also AI can track labour practices by collecting data and analyzing social media platforms, and employees feedback. AI can offer real-time labour condition insights, helping businesses in solving the risks before they become more serious problems for operations or reputation. While governance also can be impacted by AI through monitoring

internal and external reporting to ensure compliance and company's complying with corporate governance regulations and laws. Stakeholders may be informed via automated warnings of possible governance infractions, such as breaking anti-corruption rules. Increasingly, investors are looking for active ESG integration in their portfolios, going beyond simple ESG screening. Investors are pushing more for a sustainable reporting and disclosures putting them under to demonstrate quantifiable progress on ESG concerns, particularly diversity and climate change. ESG reporting and its collection of data can be influenced in the future by the new technological advancements, and new areas that are coming into the world's attention like biodiversity. ESG reporting before its era, wasn't one of the disclosures from a company's side, and now it is, so the investors expectations are more and increasingly turning their focuses into more sustainable topics. So, ESG in the future can also contain more than three factors and can expand by its definition to entitle more and more factors of the environment, society or regarding the governance part. The quality and transparency of ESG data are being improved by emerging technologies like blockchain and artificial intelligence, and investors are giving more weight to businesses who have quantifiable sustainability programs. As ESG evolves and update periodically by time, companies will need to adapt to meet these growing expectations from its shareholders and stakeholders, with the help of technology and innovation in business model as these companies, stakeholders and shareholders are being more aware about the rapid consequences that ESG has on the firm's value, performance and reputation.

## **Chapter 3: ESG and Tax Avoidance Relationship:**

### **4.1 Why Tax Avoidance and ESG Relationship is Important?**

#### **4.1.1 ESG as Marketing Tool Rather than Sustainable Change**

Some companies use ESG metrics as a marketing tool in their reports to attract external stakeholders, without necessarily being eco-friendly organization or active approaching the environment. This phenomenon is called as mentioned and defined before as greenwashing; in which it occurs when a company adopt superficial ESG practices just to get the advantage of the public image that they can gain without being actively sustainable through their operations. Exploiting ESG benefits to hide tax avoidance strategies. Emissions scandal 2015 highlighted that Volkswagen had just invested to create its marketing and sustainability image. After the scandal, Volkswagen ended up by paying \$ 3.3 billions as fines and legal costs settled despite its high ESG ratings before the scandal. Coming into fashion industry, results showed that there were still a percentage of material used in the production unchanged and unsustainable. While ESG can be used to promote transparency especially about taxes strategies for some companies, also it can be falsely used as a marketing tool, to gain a public image while continuing tax avoidance practices, focusing only on financial gains and profits maximization.

How Complex Governance Can Affect ESG and Tax Avoidance Relationship:

Other researches also argue the complexity of governance of a company having multinational subsidiaries can also lead this company to avoid more taxes. Corporate governance arrangements frequently get more complicated as they expand. Increasing complexity can occasionally result in more opacity in tax techniques, enabling businesses to evade taxes without drawing attention from the public or regulators. Adoption of Environmental, Social, and Governance (ESG) frameworks can often exacerbate this opacity by enabling companies to emphasise their social and environmental credentials while concealing aggressive tax planning activities. Complex structures, including multinational operations, subsidiaries, holding companies, and cross-border activities, provide more chances and opportunities for companies to engage in transfer pricing, profit shifting, use of tax havens, income classification and more tax avoidance strategies. The more complex a firm's organizational structure, the greater the opportunities for tax avoidance through the exploitation of jurisdictional differences. Complex organizational structure use often tax havens or transfer pricing as most strategies to avoid taxes due to the advantages they can exploit of having multinational subsidiaries. The authors argue in their findings that firms with complex governance like Apple, can reduce their

taxable income through the use of intangible assets such as intellectual property rights, held in tax-friendly jurisdictions. Apple Inc used transfer pricing and the use of intellectual property rights to pay less taxes in Ireland. So, multinational corporations with complex governance structures, such as Apple, frequently utilise this complexity to mask their tax tactics, decreasing transparency and making it more challenging for stakeholders and regulators to evaluate their tax policies and tactics used.

#### **4.2.2 Cost-Saving Justification for Tax Avoidance in ESG Firms**

Environmental Costs:

ESG frameworks require businesses to make significant investments to meet their sustainability commitments. These investments are usually costly, and some companies may prefer to avoid taxes as a cost-saving measure more than focusing on the governance factor in ESG framework. Environmental costs and investments can be made to be environmentally friendly organization can include renewable energy investments, wind or solar power, etc. Environmental factors focus on reducing carbon emissions of the companies, to get this reduction, a company should implement energy-efficient machinery or carbon credits to decrease their carbon emissions. These strategies and proactive actions are usually costly and can increase the overall capital expenditure of the company. Businesses who are dedicated to sustainable sourcing may have to pay extra when switching to vendors who adhere to ethical and environmental standards. The high costs of reducing carbon emissions, particularly in industries dependent on fossil fuels, create financial pressure that can encourage tax avoidance. Example could be Nike; operating in fashion or apparel industry, has faced significant expenses like organic cotton or recycled polyester in their production leading to higher production costs. Waste management and pollution reduction requirements such investments lower methane emissions are sources of additional expenditures for the organization, especially in areas with strict environmental standards. Walmart has made investments in energy-saving improvements, such as installing solar panels and LED lighting throughout its distribution centres and retail locations. Although these improvements have a significant up-front cost, they assist Walmart in lowering its carbon impact. Businesses that invest in energy efficiency may have substantial capital costs, which could have an impact on their short-term profitability. Businesses may employ tax avoidance tactics to manage these financial strains and costs keeping and saving more capital resources. A significant investment in environmental costs, such as renewable energy, sustainable sourcing, pollution control, and energy efficiency, is frequently necessary for the implementation of ESG policies. Particularly in the short-term run, these expenses may have greater company's profit

margins and shareholder returns. Because of this, some businesses might defend tax avoidance as a necessary compromise to preserve profitability and achieve their sustainability objectives.

#### Social Costs:

Social costs are also countable in this topic, since they are expenses related to ESG initiatives focusing on company's social responsibility towards its employees, relationships with communities, and as a general impact on the whole society. Welfare costs are a type of social costs. Companies who are committed to improving worker welfare should, for instance, pay their staff more than the industry minimum to attract and retain talent, especially in low-wage industries. Healthcare programs, which are a subset of welfare program costs, are another example of social costs. This involves offering wellness programs, complete health insurance policies, and mental health support to staff members, all of which can be expensive for the company. Training and development are a portion of costs attributable to the company that engage in ESG practices especially investments in the social pillar. As the company focuses on providing staff members chances for training and development, with a particular focus on inclusion, diversity, and additional skills training, it incurs significant operational expenditures. These costs include workshops and training sessions to educate and teach the employees about unbiased considerations, cultural sensitivity, and fair working practices. There are additional expenses associated with maintaining compliance with diversity goals, which call for continuous auditing, reporting, and monitoring, particularly for businesses that operate in various jurisdictions with disparate legal requirements. Community engagement and philanthropic efforts are components of the list of social costs. Corporate philanthropy can be seen through supporting non-profit organizations, donation for charity organizations, and engaging in community-building initiatives. Projects can include healthcare, education, and disaster relief. While engagement with community could be investing in local development projects like infrastructure, schools, or hospitals. When it comes to production, companies that prioritize social responsibility may face additional operational costs in adapting their products or services to better align with ethical standards. Production cost rise associated with ESG include ethical sourcing; businesses who commit to source their raw materials ethically, particularly in the fashion and food industries, frequently face increased production costs. To produce goods with a social impact, businesses might also need to spend on research and development (R&D) investments. This could be creating environmentally friendly substitutes, providing services to under-represented populations, and ensuring that the company's supply chain adheres to ethical labour standards. Evidence indicates that even if the company's

operational costs were significantly higher due to the investments made in ESG practices, brand distinctiveness, consumer loyalty and long-term benefits may surpass the initial expenditures.

#### Governance Costs:

Governance costs are usually represented by the expenses companies incur to ensure that their operational practices are transparent, ethical, and in compliance with the regulatory requirement. The establishment and upkeep of robust corporate governance frameworks, a crucial component of the Governance pillar in ESG frameworks, is the source of these expenses. In order to guarantee accountability, transparency, and long-term viability and sustainability in a business's activities, governance expenses are required. We will examine the many forms of governance expenses, their significance, and their effects on ESG performance in the sections that follow. Compliance and regulatory costs are a form of governance-related costs. There are many different laws and regulations that apply to businesses in the countries where they operate, particularly to multinational corporations. Anti-corruption legislation, environmental regulations, and financial reporting requirements are a few examples. External auditors, compliance officers, and legal teams may need to be hired by businesses. More costs associated with compliance arise from the need for firms to stay current with changing laws. Breaking these regulations can lead to legal issues, reputational damage, and increased regulatory attention. Walmart has incurred significant costs to ensure compliance with anti-bribery laws, such as the Foreign Corrupt Practices Act (FCPA), and has set up extensive compliance systems to monitor adherence to international anti-corruption standards. To ensure compliance, some companies also recruit experienced and independent directors who can oversee the company's management and ensure that the firm adheres to its ESG commitments. Attracting such talents and expertise involves the companies bidding competitive compensation packages, high salaries, executive compensation, etc. Additionally, board members require continuous education on ESG trends and corporate governance practices to remain effective in their oversight roles. Berrone & Mejjia (2009) illustrated in their study that companies with higher board independence perform better on governance-related metrics but incur higher expenses in attracting and compensating independent board members. Apart from compliance costs, transparency and accountability also account for high portion of governance-related expenses. Businesses require strong internal control systems that keep an eye on every facet of their operations to guarantee accountability and transparency. These systems are essential for adhering to governance rules, preventing fraud, and guaranteeing accurate financial reporting. Maintaining internal control systems necessitates large investments in staff, technology, and outside audits. To evaluate their adherence to ESG-related governance norms, including the

Sustainability Accounting norms Board (SASB) principles or the Global Reporting Initiative (GRI), many companies hire independent auditors. A significant financial commitment and funds are required for data collecting platforms, reporting systems, and outside verification services in order to collect and report governance data. The financial commitment associated with governance costs is substantial for organizations that aim to maintain high ESG standards and scores. These expenses consist of shareholder engagement, internal control systems, board and executive compensation, ESG reporting, compliance and regulatory costs.

In addition to the costs associated with the ESG framework, some researches argue that firms should be more profit-oriented and meet shareholders' expectations. It is common for investors and shareholders to anticipate consistent and risk-free returns on their capital, particularly from multinational firms. Companies may see a narrowing of their profit margins if they devote more resources to ESG activities. This could lead to decreased dividends or stagnating stock prices. Companies may resort to tax avoidance tactics and strategies in order to preserve shareholder confidence and free up money. Furthermore, businesses in fiercely competitive marketplaces could feel pressure to hit profit and environmental requirements at the same time. Companies may look for costs reduction ways as a result of this combined pressure, and tax avoidance may be one simple way to boost earnings without reducing investments in environmental, social, and governance (ESG) issues. Although the aim of ESG strategies is to encourage sustainability and to be socio-economic activist, they frequently come with a high cost associated mainly with social and environmental activities. Some businesses use tax avoidance as a cost-cutting strategy in order to preserve profitability, retain earnings, and maximize shareholders wealth. Companies may justify aggressive tax avoidance by balancing the high costs of ESG initiatives against the requirement for financial performance.

### **4.3 How ESG Can Decrease Tax Avoidance & Lead To Better Firm's Valuations?**

#### **4.3.1 Governance Role**

Governance mechanism is a fundamental factor in ESG framework, focusing on how companies are controlled, hierarchy of corporate structure, decisions process, how companies are managed, and also how transparent and accountable the corporation is to its stakeholders. Governance is effective in the way taxes are treated. To start with, the independence of board of directors. Independent board of directors are usually unbiased and most likely to enforce ethical standards and maintain their oversight overall the company's performance, including the taxes strategies used or an oversight over the relationship between the government state and

the business itself, controlling the decisions about how taxes are treated. Independent board usually value reputational aspects since it has a direct link with the long-term profitability of the firm and sustainability success. Aggressive tax avoidance can lead to a short-term reputational damage and reduce stakeholder's trust. Executives that have independent directors are less likely to act with self-interest. They also provide objectivity and monitoring. They are more likely to make sure that tax methods comply with moral principles and legal requirements, promoting more financial and tax reporting transparency. Independent board of directors can through complying with the correct and direct ethical standards, can eliminate greenwashing effects and ensure that the compensations distributed to executives are truly and accurately linked to the ESG success factors or mitigation of risks plans. Additionally, independent boards are usually more responsive and active to external stakeholders' pressure, including investors and customers especially the conscious ones regarding the ESG topics and factors affecting socially and environmentally the market they operate. Firms with more independent boards tend to focus on regulatory compliance and ethical tax reporting, avoiding strategies that could result in legal collapse or damage to the firm's public image. Independent directors tend to adopt a risk-averse approach to tax avoidance, ensuring compliance with laws and regulations. A risk-averse approach refers to the strategy where the company or individuals aim to minimize exposure to risk through cautious decision-making to avoid uncertainties or actions that could result in significant financial or reputational damage when also speaking about tax avoidance. One of the example of risk-averse approach is corporations may concentrate on adhering to international tax laws, such as the OECD's Base Erosion and Profit Shifting (BEPS) regulations, rather than employing intricate tax loopholes. Another method could be, being transparent in tax reporting and this is one of the decisions powers that an independent board can apply. Companies can steer clear of the possible negative public opinions that comes with aggressive tax avoidance tactics by implementing a risk-averse tax plan. Audit committees are essential in maintaining tax transparency and ethical tax practices. These committees are responsible in keeping an eye and attention on regulatory compliance, financial reporting, and the general integrity of an organization's accounting procedures, including tax treatment and approaches. The committee usually review that the company reflect a full and fair account of the company's tax liabilities including its use of tax incentives, deductions, and compliance with international tax laws like the OECD's BEPS (Base Erosion and Profit Shifting) framework. All these factors make from firms with more audit committees tend not to avoid taxes. Businesses that have more robust ESG governance frameworks including active audit committee oversight are more likely to adopt open tax policies and disclose their tax strategies in their ESG disclosures. A company's reputation may suffer from aggressive tax avoidance, which may also result in fines or legal

repercussions. Audit committees can lower these risks, preserving investor trust and averting expensive regulatory investigation, by guaranteeing tax transparency. Audit committees provide essential oversight in ensuring that tax strategies are not only legally compliant but also transparent and aligned with the company's ethical values. As a part of ESG reporting of a company, the audit committee as mentioned above should ensure that the tax practices are disclosed transparently. In their ESG disclosures, many businesses now provide thorough reports on their tax contributions, plans, and adherence to national and international tax rules. Investors are demanding more and more transparency from companies because they want to know how they handle their tax obligations and if their policies and practices are in line with larger social objectives. Many committees recently are referring to GRI 207 as a benchmark to ensure compliance; GRI 207 Tax 2019, a standard that offers recommendations and guidelines for tax transparency in ESG framework. This standard encourages companies to disclose their approach to tax governance and risk management, to ensure that their tax policies reflect their dedication to sustainability and ethical governance. So, audit committees in general play a crucial role in being the central role between internal and external pressures; internally from investors mainly and shareholders while externally mainly from customers or stakeholders in general, to ensure more transparency in reporting taxes. Shareholder activism has been crucial in pressuring businesses to implement more transparent disclosures of tax practices. In response to this pressure, audit committees have strengthened their supervision over tax tactics and made sure that investors are properly informed of these strategies. In conclusion, and as a part of an company's ESG structure, audit committees are especially significant in guaranteeing tax transparency. Audit committees ensure that a company's tax practices are not only legal but also in line with larger ethical and sustainability objectives by monitoring financial reporting, controlling tax disclosures, and reducing reputational risks. Audit committees may also affect the direction of tax governance as stakeholder and investor demands for transparency increase. Vodafone study case proves the importance of having an effective audit committee. One of the first significant decisions taken by the audit committee of Vodafone is to implement country-by-country tax payment reporting. This strategy complies and it is in line with international efforts to increase and ensure more tax transparency, like the Base Erosion and Profit Shifting (BEPS) framework developed by the OECD. The audit committee of Vodafone is responsible for supervising the disclosure of tax payments in all the jurisdictions in which the firm conducts business. The committee also makes sure that the reports comply with financial legislation and corporate social responsibility guidelines. By publishing detailed country-by-country reports, Vodafone has not only complied with emerging tax laws but has also built a reputation for ethical business practices. Vodafone's decision to increase tax transparency in response to public

criticism is an example of how rigorous audit committee supervision can result in more moral tax practices and increased stakeholder confidence. Vodafone has improved its standing and gained the public's, regulators', and investors' trust again. Speaking about governance, it's important to mention CEO or executive levels inside the company, linking their compensation to ESG and tax avoidance also. By aligning their compensation with non-financial performance, companies encourage executives to implement strategies that balance profit-making with social responsibility. Because the link between compensation and ESG performance creates a direct relationship between the governance strategies and sustainability and ethical objectives, the Harvard Law School Forum on Corporate Governance Conference Board Report (2022) concluded that companies in which they correctly link executives' compensation to ESG factors, avoiding greenwashing and personal benefits, had significantly higher social performance and less tax avoidance. Additional findings also conclude that firms with ESG-linked compensation had better long-term financial performance and higher stock market valuations because aggressive tactics made by the firm to avoid taxes may affect its reputation, which in turn could affect the stock performance as a result of tax avoidance. Moreover, stakeholders including customers and investors pressure recently demanding the companies for more proactive strategies to save the environment and effectively act in society, the regulatory structure of ESG's framework pressure also can decrease tax avoidance. Frameworks like the Sustainability Accounting Standards Board (SASB) and the Global Reporting Initiative (GRI) now incorporate explicit requirements on tax transparency as ESG reporting becomes more standardised. Businesses that adhere to these guidelines are unable to engage in tax avoidance since they must reveal information about their tax plans. Corporate social responsibility (CSR) is closely in meaning and alignment with ESG reporting principles, particularly focusing on ethical consequences including the social effects of tax strategies. Empirical evidence suggests that firms with high CSR scores were shown to adopt more ethical tax practices, thereby contributing more fairly to the societies where they operate. CSR-conscious businesses usually understand that aggressive tax avoidance contradicts with the idea of a fair contribution to society or to the public. These businesses are more likely to match their tax plans to the organization's overarching social responsibility objectives, guaranteeing that they make a just contribution to society. Chen, Chen, Cheng, and Shevlin, (2010) prove that businesses with a strong commitment to corporate social responsibility (CSR), especially in the areas of social fairness and community development, were found to be less likely to employ aggressive tax techniques.

### **4.3.2 Ethical Commitment**

Businesses that engage in ESG transparent reporting seek to affect positively the society as well as their shareholders. One of the most immediate ways a business supports the social infrastructure, which includes public safety, healthcare, education, and environmental protection, is through paying taxes. Taxes is considered a great portion of revenues sources for a government. A business that has demonstrated a strong ethical commitment through its ESG framework is more likely to see taxes as an essential component of societal well-being rather than as a burden that should be minimized. According to a 2020 report by KPMG, 45% of firms that actively engage in corporate social responsibility and ESG initiatives have significantly reduced aggressive tax avoidance tactics to align with their ethical commitments. This shows a clear trend in companies associating tax transparency with social responsibility. Justice and fairness are prioritized by an ethical commitment to a company's governance. Businesses that include ethics into their governance frameworks guarantee legal compliance and equitable contributions to the economies in which they operate. These businesses show justice in sharing the financial load by refraining from using aggressive tax avoidance, which advances social equality.

### **4.3.3 Long-Term Stakeholder Trust and Reputation Management**

Companies that commit to ethical representation of its ESG standards aim to strengthen the relationship with its stakeholders, gain their trust, increase its reputation with its stakeholders including customers, investors, and regulators. This trust leads to enhanced corporate public image and, consequently, better financial performance. Investors are becoming more selective and highly interested about the allocation of their capital. Sustainable investing, which considers ESG factors, has gained momentum in recent years. Due to Unilever's solid reputation of ethical business practices and tax transparency, investors have continued to have faith in the company. Company's sustainable bonds increased by 15% as a result of their dedication to ESG, which includes ethical tax reporting. Another study also done by PwC in 2020 that highlighted 79% of institutional investors are more likely to divest from companies engaging in tax avoidance, considering it a governance risk.

Companies that adopt ESG strategies usually adopt proactive approaches to risk management. Businesses that adopt proactive ESG tactics usually identify potential risks associated with environmental, social and governance risks earlier and implement certain policies in order to mitigate them. These proactive strategies are significantly important from investors' perspective. Companies that also report transparently their ESG frameworks and adopt transparent tax

practices are better positioned to access capital since investors recently perceive such companies as more responsible and aligned with long-term value creation, rather than short-term profit maximization through tax avoidance. Firms with low tax avoidance are often seen as low risk firms by investors and lenders, which can also translate into a lower and more affordable cost of capital. ESG-focused firms are seen less risky to several reasons including that companies that avoid aggressive tax avoidance tactics are less exposed to financial costs like fines, penalties or any legal actions towards them from the government or state. This reduces their exposure to regulatory risks, which can have a significant impact on financial performance. As stated before, to comply with the regulatory rules, and ESG reporting requirements, companies have to be stronger in its governance structure including internal and external controls, from auditors and executives. These companies proactively address both financial and non-financial risks (such as environmental or social risks), which leads to overall stability. Turning to customer point of view, consumers are increasingly preferring to support companies that can reflect their morals or contribution to both society and environment and companies who are transparent and ethically responsible. Firms that maintain transparency and fairness in their tax strategies tend to attract sustainable investors and loyal customers also who are concerned about both financial returns and corporate responsibility. Edelman's 2021 Trust Barometer stated that 76% of consumers trust companies more when they demonstrate tax transparency as part of their ESG practices. This trust translates into brand loyalty and customer retention, which enhances long-term profitability.

#### **4.3.4 Better Stock Performance, and Higher Cashflows to Shareholders**

ESG-focused companies have better risk management practices which can help in mitigating several potential risks earlier including environmental, social and financial risks and costs. These companies are more likely to comply with all ESG standards and report about their environmental approaches, labour and employees relationships, and governance standards. By managing risks effectively, ESG companies are viewed as safer and less risky investments. Investors reward this lower risk by assigning a lower risk premium, which results in higher stock valuations and better performance. Companies that adopt ESG reporting are focusing on sustainable practises that promote long-term profitability. For instance, reducing waste, boosting energy efficiency, turning into renewable energy sources, and encouraging innovation will eventually reduce expenses and boost operational effectiveness, which will increase profitability. Harvard Business Review (2019) found that companies with strong ESG scores outperformed their non-ESG peers by 4.8% annually in stock returns, highlighting the long-term financial benefits of ESG integration. Although implementing ESG practices at the

beginning could be costly, but looking at the long-term firm's value, companies with high ESG ratings often attract more investments, more capital from funds dedicated to long-term sustainable performance, and higher returns. Bank of America (2020) reported that ESG stocks outperformed non-ESG stocks by 5% during the COVID-19 pandemic. This was attributed to the resilience of ESG companies in maintaining business continuity and navigating the crisis more effectively. Strong ESG profiles make a company more valuable to investors since they are seen as less risky and more likely to produce steady, long-term returns. Higher stock prices, improved returns on equity (ROE), and total shareholder value are all influenced by this premium.

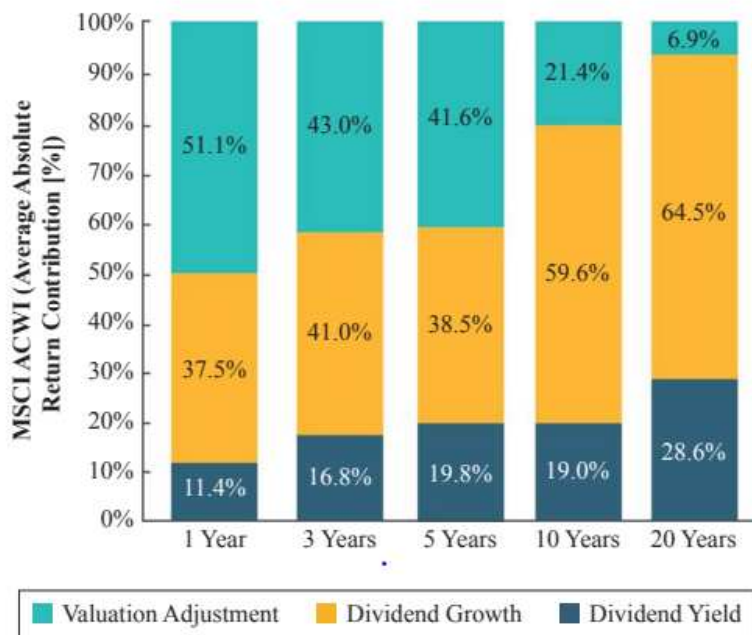


Source: MSCI. Data from 31 December 2012 till 31 May 2023. The chart shows the cumulative performance of MSCI ESG factor (defined as the z-score of MSCI ESG Industry-adjusted ESG score) in the MSCI Global Equity Factor Model + ESG (GEMLTESG) model.  
<https://www.msci.com/www/blog-posts/factoring-in-esg/02343304664>

*Figure 6: Cumulative factor return (%) per unit of factor exposure of MSCI ESG z-scores (MSCI ESG Ratings in Global Equity Markets: A Long-Term Performance Review March 2024)*

This chart shows the performance of investments based purely on ESG factors in MSCI risk models over time. The fluctuations in returns highlight the varying impact that ESG factors can have on investment performance. As shown in the graph, investments returns have been significantly rising throughout the years as ESG being more important and significant factors for different stakeholders preferences. Looking beyond returns, the exhibit below presents a statistical summary for the period January 2007 to December 2018 and, separately, for the last two years. In the latter period, ESG became more important in explaining performance. While this recent increase in ESG explanatory power is beyond the scope of this blog, prior MSCI research has noted that there has been: increased investment by companies in sustainability-related technology, growing awareness of ESG and sustainability by investors and greater regulatory scrutiny around ESG and sustainability. Companies with higher ESG scores had more consistent and predictable dividend policies, according to a Deloitte (2020) study. This was because the companies' governance structures encouraged better financial discipline.

## In the Long Run, Cash Flows to Shareholders Drive Most of the Portfolio Return



Notes: The graph presents a decomposition of the total return of the MSCI ACWI Index for the time period from December 1994 to September 2015. Total return is decomposed into dividend yield and price return components, and price return is further decomposed into dividend per share (company fundamental) growth and price-to-dividend (valuation ratio) growth.

Figure 7: Total return for the MSCI ACWI Index into stock price increases, dividends, and dividend growth (How ESG Affects Equity Valuation, Risk, and Performance 2019)

The graph illustrates the relationship between ESG and cashflows attributed to the shareholders. Companies with a strong ESG profile are more competitive than their peers and competitors operating in the same industry. This competitive advantage can be due to the more efficient use of resources, better human capital development, or better innovation management. In addition to this, high ESG-rated companies are typically better at developing long-term business plans and long-term incentive plans for senior management. High ESG-rated companies use their competitive advantage to generate abnormal returns, which ultimately leads to higher profitability. Hence, higher profitability results in higher dividends. These results are all associated with transparent ESG reporting, and avoiding tax avoidance which can affect investment decisions, access to capital, firm's valuation, stock performance, firm's reputation, and shareholders' returns.

### **4.3.5 Lower Borrowing Costs Associated with Lower Risk Perception**

ESG -focused firms are viewed as more prepared for regulatory changes, environmental and social risks, and less risky as investments than other companies since by avoiding taxes also they are able to avoid penalties or governmental issues. These firms have been also encouraged by the banking sector for a favourable and affordable access of capital linked to ESG performance. Dutch multinational bank ING Group has been offering loans with a sustainability component to businesses that fulfil specific ESG requirements. ING makes a connection between the loan interest rate and the sustainability performance of the business. The company can lower the interest rate on the loan if it raises its ESG score (as determined by organizations such as Sustainalytics or MSCI). If the borrowing firm accomplishes its ESG performance goals, ING will typically reduce interest rates by 5 to 10 basis points (0.05% to 0.10%). The conditions of the loan are designed to incentivise businesses that improve their social and environmental consequences, such as reducing carbon emissions or enhancing labour standards. Global food and agribusiness Olam International has obtained a \$500 million loan from ING that is tied to sustainability. Improvements in areas like cutting water use, social factors, with a transparent taxation reporting lead to a lower and favourable cost of debt. HSBC Bank has also provided green loans and loans associated with sustainability to businesses that prioritise eco-friendly initiatives or show advances in environmental, social, and governance (ESG) elements. Companies who fulfil or surpass their ESG-related criteria are eligible for borrowing rate reductions of 10 to 20 basis points (0.10% to 0.20%), according to HSBC. Cheng, Ioannou, and Serafeim (2014) found that "firms with better ESG performance enjoy a significantly lower cost of capital," as investors value the long-term sustainability and reduced risks of these firms.

### **4.3.6 Operational Efficiency**

Businesses that include environmental sustainability at the top of their ESG strategy concentrate on cutting back on energy use, reducing waste, and making the best use of available resources including renewable ones. Significant cost reductions and improved operational effectiveness are the results of these efforts. Siemens's ESG commitment includes investments in smart manufacturing and energy-efficient technologies. Siemens has opted for sustained expansion through innovation over aggressive tax avoidance, resulting in increased productivity and decreased operational costs. Higher employee engagement is frequently the result of the company's ethical practices or commitments including transparent tax processes coupled with a strong commitment to ESG factors. Employers who follow ethical business tactics, such as paying their fair share of taxes, focus on their relationship with their employees, encourage diversity, inclusion and equity typically have more satisfied employees. Employees that are

engaged are more creative, productive, more efficient, and dedicated to the long-term objectives of the organization.

To conclude our findings, we can see that the integration of transparent tax policies with the adoption of Environmental, Social, and Governance (ESG) frameworks has the potential to greatly improve a company's overall financial performance and valuation. Businesses that put an emphasis and focus on ESG and avoid aggressive tax avoidance tactics not only build trust with authorities, consumers, and investors, but also develop a more robust and sustainable business model. The combination of ESG and moral taxation behaviour improves stock performance, raises market values, and draws long-term capital from ethical and sustainable investors. Businesses that implement both tax transparency and ESG measures enjoy cheaper borrowing and capital costs since the financial markets perceive them as less risky. Strong governance is a key component of ESG, which guarantees that businesses make wise financial decisions that increase their long-term profitability. In addition, a company not engaging in tax avoidance lowers the danger of fines and reputational damage, which helps to maintain a stable financial performance and frees up businesses to concentrate on technological expansion and innovation. Companies that focus on the combination between ethical business practices and tax behaviour should anticipate better financial and non-financial results, such as increased investor confidence and better profit margins. This shows that ethical business practices are not only a social responsibility but also a major factor in achieving financial success. For all parties involved, including several kinds of stakeholders, this all-encompassing strategy promotes long-term growth, stability, and wealth generation.

#### **4.4 Factors that Influence the ESG-Tax Avoidance Relationship**

- **Industry-Specific Trends:** Certain industries are fallen under this category and may affect the relationship between tax avoidance and ESG reporting frameworks especially those with substantial multinational operations or who heavily depend on their intangible assets to operate. Example can be technological and pharmaceutical firms may still be engaged in tax avoidance while maintain at the same time strong ESG commitments or high ESG scores since these firms and the industries they operate in, rely on intangible assets like intellectual property, which can easily be shifted across various tax jurisdictions across multiple countries to minimize the tax burden. Multinational firms, especially in the technology and pharmaceutical industries, demonstrate a propensity for tax avoidance, facilitated by their reliance on intellectual property and intangible assets, which are more mobile across jurisdictions.

- **Geographic Differences:** Even if a company is committed to ESG in other areas, it may nevertheless take advantage of tax avoidance or engage in aggressive tax strategies in nations with weaker tax laws or less robust ESG enforcement procedures. There are potential for tax avoidance in various areas due to a lack of regulatory scrutiny. In countries where tax laws are loosely enforced or ESG standards are not as rigorously applied, firms may find opportunities to engage in aggressive tax strategies while maintaining a positive ESG reputation.
- **Stakeholder Pressure:** Assessing a company's tax policies as part of a larger ESG assessment has become more important to investors, especially those engaged in sustainable investing. Companies are more likely to match their tax strategies with their ESG objectives in response to pressure from institutional investors that prioritise ESG issues in order to protect their brand and win back investor trust. Some other investors maybe more profit-oriented than being focused on sustainability goals and can pressure for maintaining higher financial performance, maximizing their own wealth and cost saving by avoiding taxes. So, the degree of the pressure adopted by stakeholders like investors, regulators, or consumers can shape what tax policies should the company report.

## Conclusion

This thesis concludes that in order to study ESG standards and corporate practices it is crucial to consider taxes as a relevant metric. “While it is premature to predict how ESG standards in this regard will evolve, a key area of focus is tax arbitrage, including profit-shifting among jurisdictions.” Harvard Law School Forum on Corporate Governance, Tax and ESG (2020). Looking at tax reporting from an ESG perspective has the potential to tell a relevant story about a business’s purpose, thereby building and creating trust. A corporation’s tax footprint is defined as how much tax is paid and to whom, which is something stakeholders are increasingly requiring a company to report on now, in contrast to, for example, a promise to net-zero emissions, which might take years to prove and achieve. These companies are increasingly monitoring other companies’ tax practices as a crucial indicator of how they might manage other aspects of ESG. Building trust on tax reporting can mean also building trust in other areas. Tax reporting these days should be addressed to a broader audience including different types of stakeholders. The Global Reporting Initiative (GRI) standards are being used by over 10,000 organizations across 100 countries, and one of their uses is tax reporting. The International Business Council of the World Economic Forum, which has over 120 members, included tax disclosures as a fundamental element of its ESG reporting criteria, which the WEF published in 2020. Mining company Anglo-American, for example, has been publishing its Tax and Economic Contribution Report. Furthermore, businesses are under pressure year after year to disclose about their tax practices from public, government, regulators, investors, civil society and the media. In 2015, the Organisation for Economic Co-operation and Development (OECD) and 20 countries formally adopted a form of country-by-country reporting as part of the OECD’s base erosion and profit shifting (BEPS) initiative. From an ESG reporting perspective, there are three ways to enhance transparency of taxes. First, through businesses increasing the reporting to non-financial performance, significant examples can be carbon emissions or diversity in a workplace. Second, companies highlighting the link between governance and transparency, which is the key element of stakeholders’ trust. And third, an ESG-based approach; is about having a clear and narrative strategy to be exposed to the public. This can conclude that transparent tax practices foster stakeholders’ confidence, improve corporate reputation, and contribute to long-term financial and non-financial stability and performance. Furthermore, this study highlights the possible advantages of ESG-driven tax transparency based on actual world case studies, specifically with regard to lower borrowing and capital costs, better stock performance, and increased investor trust. The thesis ultimately sought to shed light on how ESG might be used strategically to strike a balance between moral leadership and long-term financial prosperity.

Businesses that use ESG-aligned tax practices experience a decrease in regulatory risk, which reduces the possibility of penalties and reputational damage. By positioning companies as low-risk assets and facilitating easier access to capital at reduced costs or favourable offerings from lenders especially banks, this strategy also improves the credit rating of the company. To further increase profitability, adopting tax transparency within ESG initiatives can promote operational efficiency and enable businesses to reinvest in sustainability projects mainly through environmental factor by turning more into renewable and efficient energy sources. Although this thesis offers significant and insightful information about the relationship and correlation between tax avoidance and ESG performance, there are a number of difficulties and restrictions that must be taken into consideration. Firstly, data consistency and availability is considered one aspect behind limiting or complicating this correlation, especially when comparing businesses in various industries and geographical areas. The findings' predictability is restricted by the differences in tax transparency and ESG disclosure requirements among different nations, particularly in those with weaker regulatory environments. Secondly, there can be a delay in monitoring the complete influence of ESG practices on financial performance and tax avoidance. It may take years for the advantages of implementing ethical tax practices as part of an ESG framework to become apparent and quantified, making it more difficult to measure the results immediately within the parameters of this study. Lastly, complex governance inside multinational firms having subsidiaries in multiple countries can be also a complicated aspect affecting the correlation between tax avoidance and ESG performance.

From Regulators and government perspective, the long-term sustainability of a state's revenue will depend on sustainable taxation as taxes are the main revenue source for a state. A social perspective on corporate social responsibility (CSR) demands that businesses to pay their fair share of taxes to fund public infrastructure, welfare, and societal development programs. CSR is closely related to the social component of ESG. Environmentally speaking, Companies that adopt environmentally-friendly policies may receive tax credits or benefits for investing in sustainable practices. Going to investors lens, a company's overall risk management and governance framework include transparent tax behaviours. Investments in companies with transparent tax policies are thought to carry less risk. Ultimately, from business's point of view, they can lower reputational risk and gain a competitive edge in the market by combining ESG with tax transparency. Businesses can preserve public trust, access more capital, and improve operational efficiency by coordinating their tax policies with sound governance.

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