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Complementary or Competing: Examining the Relationships Between ESG Factors, SDGs, and Circular Economy

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Abstract: The article analyses the content of the concepts of sustainable development, circular economy and ESG principles in business activities. It identifies how management practices based on ESG principles relate to the UN Sustainable Development Goals and the circular economy. The role of the ESG paradigm in the activities of Ukrainian enterprises under war conditions is determined. The expediency of combining elements of circularity in an enterprise's business model and ESG principles to achieve sustainable development goals is substantiated.

Keywords: business management, corporate governance, ESG principles, sustainable development, circular economy

The ESG (Environmental, Social, Governance) paradigm is becoming increasingly important in the economic activities of enterprises, as stakeholders prefer companies with sustainable and ethical business practices. Businesses are undergoing ESG transformation to meet consumer demand, reduce risks associated with climate change and social issues, and comply with more stringent environmental, labour, financial and tax laws in different countries. Institutional investors are paying increasing attention to ESG factors, which makes adherence to these standards essential for attracting investment. Focusing on building sustainable supply chains, engaging employees and maintaining a positive brand reputation motivates companies to implement ESG practices. In addition, aligning ESG principles with innovation and efficiency goals contributes to long-term cost savings and improved operational performance of enterprises and companies. Thus, integrating ESG standards into the work of domestic enterprises is a strategic response to the changing market dynamics, regulatory pressure, and recognition of business benefits associated with sustainable development.

This paper aims to study the relationship between ESG principles, UN Sustainable Development Goals, and the concept of a circular economy.

ESG stands for "Environmental, Social and Corporate Governance" and is a system of non-financial indicators for assessing a company's impact on the environment and the social and industrial communities of which it is a part [1].

In its development, the ESG principles have gone from a desirable element in the activities of economic entities to a business imperative, the importance of which will only grow - today, tomorrow and in the future.

The acronym ESG, as we know it today, was formed after the UN published the "Principles for Responsible Investment" (PRI) program in 2005, where banks, companies and researchers dealing with sustainable development issues were offered a way to mutually reconcile actions in the field of corporate governance of companies while balancing stakeholder interests.

The "E" in ESG stands for environmental issues, especially those that have a financial impact on companies, and their investors are aware of them and are very attentive to their investment portfolio. Investors are paying increasing attention to climate change, pollution, energy efficiency, conscious water use, resource shortages, and potential environmental risks to raise awareness of relevant issues and influence information disclosure.

The negative consequences for companies that do not manage environmental risks include

— increased costs (e.g. having to clean up collapsing dams or contain oil spills),
— reputational damage from pollution incidents,
— legal costs that can lead to paralysis of activities and damage the brand's reputation.

Incorporating environmental factors into a company's strategy ensures efficient use of resources and cost reduction while deploying innovative solutions creates competitive advantages. The environmental aspect involves measuring the company's impact on living and non-living natural systems, including air, water, land

and ecosystems. These factors also indicate how the company applies best management practices to avoid environmental risks and maximise shareholder value-generating opportunities.

The "S" in ESG stands for the social factor. Although attention to ESG principles has grown in recent years, researchers and practitioners are still trying to reach a consensus on how the "S" factor should affect company valuation and investment decisions. Companies have made significant progress in disclosing their environmental impact and governance standards, while their social impact and performance measurement could be more robust. The urgency of climate change issues and improved corporate governance control even before the 2008 financial crisis explain this situation, as they overshadowed factor "S".

However, in the context of COVID-19, the social aspect has come into focus and is now attracting much more attention from investors than before. The configuration of the crisis caused by the pandemic is unprecedented, and the factors associated with "S" are among the most pressing issues for companies worldwide in the post-pandemic period. The uncertain future will affect the company's reputation depending on how it interacts with its stakeholders and how it will be clear and transparent in fulfilling its social functions.

Investors believe "S" is the most difficult to analyse, measure, and integrate into investment strategies. The qualitative nature of social performance and the wide range of related issues make achieving consensus in the field complex. Therefore, people often see it as an intermediate link between "E" and "G". The lack of data and inconsistency in companies' social reporting creates uncertainty.

The letter "G" stands for corporate governance and primarily describes a company's systems to align the competing demands of stakeholders, including employees, customers, suppliers, shareholders, financial institutions and the public.

This process provides the foundation for achieving the company's goals, covering all aspects of organisational behaviour, such as performance measurement, planning, risk management, and corporate disclosure. Overall, it provides proper oversight to ensure long-term value creation in a sustainable manner with due consideration of the interests of all stakeholders.

Corporate governance has always been an important topic, even before it gained additional significance in the broader context of ESG. Therefore, among the factors "E", "S", and "G", it can be considered the most important in terms of performance since it determines the overall purpose and strategy of the company, as well as how risks are mitigated. Identifying and managing other issues can be challenging if a company does not prioritise the "G" factor, especially during a crisis.

Therefore, "G" in ESG is considered an essential element of any due diligence process, and some investors are paying more attention to it as a core component of their investment decision-making approach. In addition, governance data, unlike environmental or social data, has accumulated longer. Standards and norms regarding proper governance have been widely discussed, and there is a broad consensus on them in academic and business circles. During times of crisis, strong leadership is essential to effective governance.

The term "sustainable development" was introduced into scientific circulation and practical use by the International Commission on Environment and Development (Brundtland Commission) in 1987. Sustainable development meets the needs of the present without compromising the ability of future generations to meet their own needs.

In September 2015, the UN Summit on Sustainable Development was held in New York, during which the 17 Sustainable Development Goals (SDGs) were approved in the document "Transforming our World: An Agenda for Sustainable Development up to 2030" [2].

More and more companies are considering the SDGs when developing business strategies. Even though they are not legally obligated to implement them, businesses are beginning to realize the long-term benefits of striving for these goals. The motivation for adopting these goals is that companies impact the environment, society, and the state but also experience the reverse, which is not always a constructive influence. It means that global sustainability also meets their interests, and companies that do not adhere to sustainable development goals risk their corporate image and loss of customers, investors, and other stakeholders.

While the SDGs and ESG standards may seem similar in their objective of promoting sustainable growth, it is essential to note that there are distinct differences between the two. Understanding these differences is crucial for individuals and organizations seeking to positively impact and contribute towards a more sustainable future (Table 1).

Thus, the critical difference between ESG and sustainability lies in the fact that ESG is a specific tool used to measure a company's performance, while sustainability is a concept that encompasses a wide range of responsible business practices. ESG metrics are commonly employed to evaluate a company's performance in crucial areas like carbon emissions, biodiversity preservation, inclusiveness, and executive compensation. In contrast, sustainability encompasses various topics such as supply chain management, stakeholder engagement, and community development.

Table 1. Sustainable Development Goals vs ESG Principles

UN Sustainable Development Goals	ESG Principles
- Broader in scope and consist of 17 goals aimed at solving global issues such as poverty, inequality and climate change by 2030;	- Focus on the environmental, social and governance impact of business on the environment, social issues and governance;
- Apply to everyone, including government and non-government actors;	- Apply primarily to the business sector, companies and investors;
- An globally adopted system of goals.	- Do not have a standardized general system of indicators; - Can be seen as one of the methods for achieving SDS.

It is essential to understand that the definition of ESG varies between the US and Europe. In the US, the ESG concept is primarily concerned with finance-related activities. On the other hand, in Europe, ESG is more commonly integrated with sustainable development. ESG is about meeting financial market participants and other stakeholders' data and reporting needs and achieving sustainable development goals.

In a PwC survey [4], global investors named effective corporate governance and greenhouse gas emission reductions among the top five priorities for businesses concerning ESG-related outcomes. However, 81% said they would only accept a 1% or less reduction in profits to achieve ESG goals - both business-related and socially beneficial. About 50% of this group's investors did not allow profit reduction.

This mismatch with investors creates a dilemma for corporate leaders and board directors: Can their company deliver the desired ESG outcome for investors while adhering to a clear ESG strategy? According to [4], companies must balance short-term productivity demands and the investments needed to achieve long-term ESG goals. When companies invest in ESG initiatives (for example, in the technologies and systems needed to support future regulatory requirements and any carbon neutrality commitments they have made), they may encounter resistance and short-term fluctuations in stock prices in financial markets.

However, as climate change increasingly affects value preservation and the ability to generate sustainable profits in the long run, the overall benefit of not investing in ESG will be much lower than a successful ESG approach. The key is defining a compelling long-term ESG development path to create value within short-term key performance indicators that meet investor expectations. In this case, the circular economy can help balance the interests of the company's stakeholders. This economic model involves the most efficient use of resources and waste minimisation by encouraging recycling, reuse and recovery practices. The circular economy aims to create a closed-loop system where products, materials, and resources are continuously reused, restored, and recycled. It differs from the traditional linear economy that operates on a "take, make, dispose" basis. The goal is to reduce environmental impact, conserve resources, and create a more sustainable and renewable economic system.

In the context of ESG transformation, a circular business model helps increase economic value by reducing raw material costs, freeing up working capital, generating new income streams, diversifying sources of profit, and retaining customers by meeting their demands for the sustainability of the economic development of society.

Generally, the ESG paradigm for enterprise development is based on five pillars: environmental management, safety management, occupational health management, social responsibility and environmental responsibility of economic entities.

In 2022, the war unleashed by Russia against Ukraine became a factor that raised ESG to a new level of priorities. The humanitarian catastrophe caused by the invasion focused attention on the social aspect (S). Martial law forced businesses to rethink their management approaches and pay attention to ethical aspects (G). The environmental damage caused by the conflict highlighted the environmental aspect of the war (E). It is important to note that the war did not lead to the relegation of ESG to the background; on the contrary - it stimulated the mandatory consideration of ESG guidelines in the management decisions of businesses and the country as a whole. These aspects of ESG also influenced Ukraine's national post-war recovery plan.

At the same time, there are currently no legally enshrined requirements in Ukraine to determine the ESG compliance of projects implemented by business entities.

The following criteria and standards developed by international organisations are used for this purpose:

1) UN Principles for Responsible Investment: set out requirements for investors to consider environmental, social and governance factors.

2) Global Reporting Initiative (GRI) Standards: provide guidance on enterprise reporting requirements regarding social responsibility, environmental sustainability, and governance.

3) United Nations Global Compact (UNGC) Standards: establish principles for anti-corruption.

4) OECD Standards: aim to improve standards of governance, transparency and accountability in the corporate sector.

5) Leadership in Energy and Environmental Design (LEED) Standards for buildings

The ESG principles, UN Sustainable Development Goals, and circular economy aim to support sustainable development and responsible corporate governance. ESG criteria and principles of the circular economy often overlap with specific sustainable development goals. For example, ESG factors such as responsible consumption and production correlate with Sustainable Development Goal 12 (Responsible Consumption and Production). Circular economy practices contribute to achieving many Sustainable Development Goals, particularly Goals 9 (Industry, Innovation and Infrastructure) and 13 (Climate Action). Thus, ESG, sustainable development goals, and circular economy principles are complementary frameworks aimed at introducing responsible and sustainable practices into enterprises' economic activities to address global challenges. Integrating these concepts into the business strategies of enterprises and companies will increase their economic viability.

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