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ENVIRONMENTAL AND SOCIAL REPORTING IN CRISIS: LESSONS FROM ESG CONTROVERSIES AND SCANDALS

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ABSTRACT

Issues such as the economic crisis, global warming, ideas of sustainability, and governance have seen strong growth and improvement in the industry. The ESG (environmental, social, governance) index has attracted investors' attention to sustainable investment practices and measures the performance of companies' sustainability reports. Despite growing attention to environmental, social, and governance (ESG) practices, little is known about the financial impact of poor social performance. Therefore, this study aims to highlight cases related to ESG controversies that occur in companies around the world. The results of the study reveal that it is important to mitigate and avoid phenomena related to controversy, and the role of business ethics is needed.
Keywords: Environmental Social Disclosure, ESG Controversies, Scandal

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INTRODUCTION

In recent years, environmental, social and governance performance, or what is known as ESG (Enviroment, Social, and Governance) has become a benchmark for evaluating corporate social responsibility throughout the world. Where issues such as the economic crisis, global warming, sustainability ideas, and governance have experienced strong growth and improvement in the industry (Brinette *et al.,* 2024).

The ESG (Enviroment, Social, and Governace) index has attracted investors' attention to sustainable investment practices and measures the performance of companies' sustainability reports. The increasing trend of sustainable investment has an impact on assessing company performance not only based on financial aspects, but also through non-financial aspects, namely ESG-related information (Dorfleitner *et al.*, 2020; Nirino *et al.*, 2021)

Issues related to ESG have begun to receive attention since they were proposed in the United Nation Principles of Responsible Investment report which encourages the integration of ESG aspects into sustainable investment practices (Amalia and Kusuma, 2023). Organizations that incorporate ESG principles into their investing decisions have the potential to have a beneficial impact on sustainability. Scholars contend that by taking a proactive stance, organizations might also strengthen their ability to withstand dangers and catastrophes in the future, such climate change (Chen *et al.*, 2022).

As they demonstrate a desire to optimize the value of their shares by supporting social development, investors are also assessing ESG criteria more and more. Companies can improve their ratings using ESG (Environmental, Social, and Governance) standards, which will make them more appealing to investors and make it simpler for them to get funding and investment capital (Passas *et al.*, 2022).

According to La Rosa and Bernini, (2022) companies that perform poorly on environmental, social, and governance (ESG) issues are likely to face greater litigation costs, be forced to comply with demands from activist shareholders, and be much more volatile and prone to highly negative outcomes than those that are rated as ESG at its best. business executives therefore need to pay attention to these crucial issues and can no longer overlook ESG measures and business reputation threats (Bruna and Nicolò, 2020).

Assessing an organization's environmental, social, and governance (ESG) performance is a positive first step in understanding non-financial data. On the other hand, the business can be concealing bad, private information. A scandal occurs if unfavorable, private internal information is disclosed to the press. (Wouter and Visser, 2021). Examples of scandalous behavior might be understood, according to Utz, (2019), as providing details about unethical business practices such fraud, unfavorable working conditions, mass layoffs, corruption, falsifying financial records, and ecological disasters brought on by businesses.

ESG scandals frequently result in reputational harm and plunge share values (Nirino *et al.*, 2021; Gao *et al.*, 2022). For instance, the Volkswagen emissions scandal in 2014 cost the company roughly 15 billion euros in market value. The Volkswagen controversy commenced in early 2014 following the publication of the inquiry report by the International Council for Clean Transportation (ICCT). According to ICCT test results, Volkswagen diesel vehicles exhibit significant variations in their pollutant emissions, particularly nitrogen oxides, when tested in a lab and on a road (Siano *et al.*, 2017). Volkswagen shares experienced a 20%+ decline in value in just a few days following the announcement of this information (Aurand *et al.*, 2018). The third fiscal quarter of 2015 had a reported net profit loss of 1.73 billion euros, indicating that the impact is still present. Volkswagen's investment returns and business worth were considerably lowered as a result of the losses resulting from this global recall (Xue *et al.*, 2023).

ESG scandals have a significant negative financial and economic impact on other businesses. For instance, a disastrous dam collapse in Brazil in November 2015 caused a devastating mudflow that leaked almost 40 million cubic meters of poisonous mud into the Rio Doce River and the Atlantic Ocean, resulting in the deaths of 19 people (Carmo *et al.*, 2017). The mining behemoth Vale and BHP Billiton are funding the dam project together. It is regrettable to hear that neither company was sufficiently deterred by this episode. In January 2019, a comparable occurrence took place in Brumadinho, Brazil (Rotta *et al.*, 2020). The Brazilian government's requests for compensation from Vale and BHP Billiton following these two occurrences resulted in a considerable decrease in both firms' investment returns in the mineral business (Xue *et al.*, 2023).

As seen by the aforementioned example, ESG scandals can have a significant negative influence on an organization's investment performance and negatively affect the efficiency of such investments (Aust *et al.,* 2020). Consequently, corporations that have been associated with sustainability-related or continuing controversies, as well as companies exhibiting detrimental behavior, are undesirable to both investors and consumers (Passas *et al.*, 2022).

Investors view the ESG topic as the perfect vehicle for exposing harmful business behavior. ESG controversies are characterized as "corporate ESG news, such as product defect scandals and suspicious social behavior, that place a company under the media spotlight and, furthermore, attract investors' attention" (Aouadi and Marsat, 2018; La Rosa and Bernini, 2022).

Environmental issues, workplace fraud and harassment, and monopolistic behavior can all be highlighted by scores. Investors retaliate against companies that exhibit social irresponsibility and become embroiled in environmental and social problems. The value of the business may be impacted if these kinds of unethical or illegal practices are disclosed since they put the company's reputation and shareholder trust at risk (Aouadi and Marsat, 2018; Amalia and Kusuma, 2023).

Engagement in controversial activities can negatively impact stakeholder perceptions and threaten a company's legitimacy. Therefore, it is important to understand the impact of controversies on companies and how damage to reputation and legitimacy can be repaired. This research contributes to exploring a series of indicators that are considered ESG controversy, which can help explain to company stakeholders the mechanisms for building strategies to deal with controversy. This research aims to highlight cases related to ESG controversies that occur in companies throughout the world.

METHOD

The examination, synthesis, and assessment of literature or written materials pertinent to the research issue are the main objectives of the literature review research process (Nightingale, 2009; Paré and Kitsiou, 2017; Snyder, 2019), particularly ESG. This approach concentrates on evaluating data that already exists in the scientific literature rather than gathering primary data through surveys or interviews. The general steps in the literature review research process are as follows: [1] Choosing a study topic in accordance with the goals of the investigation. [2] Gather readings that are pertinent to the subject. Books, journal articles, theses, dissertations, and other relevant papers can all be included in this literature repository. [3] Choosing literature that is most pertinent to the area of study. This entails selecting the literature to include in the review as well as reading and evaluating the literature's quality. [4] Arranging the literature according to particular subjects, ideas, or themes. This aids in the creation of a structured review, [5] conducting critical and literature analyses, and [6] summarizing the results of the literature by highlighting the connections and patterns that appear in each work of literature. The literature review research method is a highly valuable tool for comprehending the advancement of knowledge and scholarly discourse surrounding a specific subject (Nightingale, 2009; Paré and Kitsiou, 2017; Snyder, 2019). This can also assist in formulating future research plans or pinpointing unexplored study areas.

RESULTS AND DISCUSSION

What is ESG?

ESG is a framework of three criteria that firms can use to measure their sustainability and social impact. A synopsis of each of the three ESG components is given below:

Environmental – Among the environmental factors that the company measures and policies address are carbon emissions, energy and raw material waste, and climate change, all of which are aimed at improving the business's overall environmental sustainability.

Social – The ESG criteria framework's social elements center on a company's degree of social responsibility and its adherence to workplace safety, diversity and inclusion, human rights, community relations, consumer protection, and personal data protection.

Governance – Governance is the term used to describe the internal policies, guidelines, and precautions taken to ensure an organization's correct and lawful operations. Examples of these include risk management, AML, audits, and statutory reporting.

ESG Controversies

Acts that uphold the values of preserving both the environment and people are influencing contemporary society more and more and bringing about social transformation. (Surana, Singh and Sagar, 2020). In order to adapt to the changes in society, businesses are now responding to the pressure from stakeholders and the general public to reconsider their operations in a more moral and sustainable manner (Bogers *et al.*, 2020).

Issues like plastic pollution and global warming force businesses to adapt their business practices and confront these phenomena (Tardivo *et al.*, 2017). This prompts them to reconsider their governance procedures, reevaluate their value chain architectures, and develop new business models (Centobelli *et al.*, 2020; Santoro *et al.*, 2020). As a result, in recent years, business strategy and scientific debate have included environmental, social, and governance (ESG) factors more and more (Raimo *et al.*, 2020).

The consideration of ESG factors by financial institutions and institutional investors is growing in relation to corporate governance, environmental, and social performance of businesses (Cole *et al.*, 2021). Before funding or investing in a firm, stakeholders can assess its viability and reliability by comparing its performance to that of its rivals and understanding its performance thanks to ESG considerations. Accordingly, revealing a business's ESG performance will improve sustainability practices' transparency and assist financial institutions and investors in making more informed choices (Chen *et al.*, 2022).

Yet, despite the apparent sense in which businesses should take steps to safeguard the environment and society, they frequently flout legal requirements or allocate insufficient funds to corporate social responsibility (CSR) projects. In this instance, managers' decisions and behaviors that are inconsistent with sustainability principles may give rise to conflicts and harm their reputation (Janney and Gove, 2011).

This scandal is called a controversy that can put the business's reputation in danger and thus hurt its performance (Walsh *et al.*, 2009). However, what are the ESG controversies? This term is associated with harmful practices that may be carried out by businesses and the spread of negative ESG information in the media about companies, such as their involvement in scandals. This results in the company experiencing negative news, resulting in losses such as a decrease in market share. In addition, a company's participation in illegal practices can affect financial performance and damage the company's reputation, thereby reducing market value and increasing market risk (Damette and Kouki, 2022; DasGupta, 2022).

ESG scandals frequently result in reputational harm and plunge share values (Walsh *et al.*, 2009; Nirino *et al.*, 2021; Gao *et al.*, 2022). ESG scandals also have the impact of causing large economic and financial losses. The following are examples of ESG scandals that have affected companies:

Table 1. Examples of ESG Scandals

Time	Incident	Impact
April 2010	Because of the explosion of the Deepwater Horizon oil rig, there was the greatest maritime oil leak in history.	Tens of billions of dollars were lost by BP as a result of the shares losing half of their value.
April 2011	Although Dasani Water refers to its chemical-laden plastic bottles as "Plant Bottles," just 30% of their components are plant-based.	The promotion of Green Dasani water was met with strong criticism.
September 2014	Despite Huggies' claims to be natural, organic, and eco-friendly, their diapers are really just a standard diaper with a tiny bit of organic cotton attached to the exterior.	In 2015, Huggies stopped making diapers in response to concerns about greenwashing.
November 2014	According to a television report, outerwear manufacturer Moncler mistreated geese during harvest.	Following a 6% decline in its market value, Moncler refuted the claims of animal

		mistreatment.
September 2015	Volkswagen modified pollution controls by installing defeat device software (EA 189) in their diesel engines. When a car is being tested, the software may detect it and modify the emissions control system appropriately. Deactivating the nitrogen oxide storage catalytic converter would result in up to forty times the allowed amount of nitrogen oxide emissions.	Volkswagen's stock price dropped sharply as a result of the scandal, falling more than 20% in a matter of days. Furthermore, a total of 6.7 billion euros were spent on the global recall of 11 million cars.
November 2015	Brazil had a disastrous dam collapse that unleashed a deadly mudflow that killed 19 people and dumped 40 million cubic meters of poisonous mud into the Rio Doce River and the Atlantic Ocean. The mining behemoth Vale and BHP Billiton are funding the dam project together.	The outcomes of both firms' investments in the mining industry have been greatly impacted by the Brazilian government's requests for compensation from Vale and BHP Billiton.
May 2021	It was discovered that Aldi's Atlantic salmon products were industrially farmed using unsustainable methods and environmentally harmful techniques, such as the use of toxic chemicals, and were not as sustainable as claimed.	Delayed.
June 2021	Johnson and Johnson omitted to reveal that the ingredient known to cause cancer, benzene, was present in its Neutrogena and Aveeno sunscreens.	On July 14, Johnson & Johnson announced a voluntary recall of a limited number of Neutrogena and Aveeno aerosol spray sunscreens.

Source: (Larwood, 2011; Saxena, 2015; Siano *et al.*, 2017; Gistri, Corciolani and Pace, 2018; Downs *et al.*, 2021; Xue *et al.*, 2023)

It should not be disregarded, given the ESG scandals that have come to light, that the majority of conflicts that arise in businesses stem from managers' self-serving actions that harm shareholders. These controversies frequently propel a social agenda, which can be positively viewed since it causes the business's social objectives to match (Ferrell *et al.*, 2019; Cole *et al.*, 2021).

The year 2021 had a rise in papers within the study sector, indicating that ESG controversies have intensified following the COVID-19 epidemic. A crisis, like a pandemic, may mark a turning point for ESG practices, as seen by the dramatic rise in scholarly papers on ESG controversies. A never-before-seen stress test for business, particularly corporate social responsibility, is the COVID-19 period (Chen *et al.,* 2022). The ESG "S" dimension addresses a number of controversies, from privacy concerns to staff safety. And the “G” dimension of ESG also includes several controversies such as corrupt practices by executives.

Research from Passas *et al.,* (2022) highlights social and governance factors as those most closely related to controversies in European markets. Gender diversity is described as an important social factor and is closely related to the ESG controversies. Women continue to be underrepresented on boards of directors, and men still make the majority of the decisions. The modern business world is typified by a corporate mentality model that includes long hours, strict physical presence requirements for employees, leadership traits akin to those of "male dominants," and opaque hiring and promotion procedures. Women are portrayed in this way as being more disadvantaged. In the financial industry, this is increasingly evident. For instance, data from European markets indicates that there are hardly any women in senior central bank roles. This demonstrates the lack of progress made in getting women into key positions where decisions are made.

Moreover, instances in which leaders disregard environmental, social, and governance concerns and become embroiled in controversies are deemed significant governance factors. Executives who act unethically for personal gain may experience this. Prioritizing their personal gains will enable them to exploit their peers unfairly and injure anyone who disagrees with their demands. But scandal might stem from more than just an executive's "personal" gains. One thing that can encourage companies to engage in unethical behavior is political corruption. Political instability leads to political corruption.

Having highlighted social and governance factors as factors most closely related to controversies in European markets. Research from Passas *et al.*, (2022) also suggests that exposure of companies in the media due to controversies may make them avoid participating in illegal practices to maintain their reputation. When a financial institution is linked to a scandal, for example, bad news can have a major impact on a company's reputation and the market. The bribery, corruption, and fraud controversies score, which takes into account a company's media exposure for illicit activities like bribery and corruption, improper lobbying, money laundering, parallel imports, or other tax fraud, supports this result. So, European companies seem intent on getting out of this illegal situation. The fewer controversies, the higher the score indicating that the company is free from all forms of illegal practices.

To mitigate and avoid controversies-related phenomena, the role of business ethics is very important (Dawson, 2021). This effect is much more pronounced in well-structured corporate cultures and well-organized, strong institutional frameworks inside businesses or nations. Applying general ethical principles to business conduct means striking a creative balance between basic behavioral patterns and relationships between businesses, shareholders and employees, consumers, and the economic and social environment in which a company operates. This is known as business ethics (Escamilla-Solano *et al.*, 2022).

In order to maintain their sustainability, companies must also review and rework their business plans and strategies whenever controversies are brought to light by the business community. Managers also have to consider the ramifications of their decisions regarding the growing ESG controversies, since these will affect how the market perceives the firm and, in turn, its worth. Consequently, it is advised that directors of numerous firms worldwide might challenge business practices linked to ESG controversies so that they can enjoy benefits, such as the assessment of the companies they manage (Passos *et al.*, 2023)

CONCLUSION

In recent years, environmental, social, and governance performance, or what is known as ESG (Environment, Social, and Governance) has become a benchmark for evaluating corporate social responsibility throughout the world. Assessing an organization's environmental, social, and governance (ESG) performance is a positive first step in understanding non-financial data. On the other hand, the business can be concealing bad, private information. A scandal can arise from any bad, sensitive internal information that is disclosed to the media. Examples of scandalous behavior, according to Utz, (2019), can be understood as details about unethical business practices such as fraud, unfavorable working conditions, mass layoffs, corruption, falsifying financial records, and ecological disasters brought on by businesses. From an investor's perspective, the ideal tool to catch detrimental business practices is ESG controversies.

ESG controversies are characterized as "corporate ESG news, such as suspicious social behavior and product defect scandals that draw investor attention and put a company in the media spotlight." Investors retaliate against companies that exhibit social irresponsibility and become embroiled in environmental and social problems. The purpose of this study is to draw attention to instances of ESG controversies that arise in businesses all around the world. Business ethics have a critical role in reducing and preventing phenomena related to controversy. The term "business ethics" describes the application of broad ethical principles to business conduct, striking a creative balance between basic business relationships and behavioral patterns, shareholders' and employees' relationships, consumers' relationships, and the economic and social environment in which a company operates.

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