REyF Revista de Economía y Finanzas

www.reveyf.es

2024 – Vol. 2 – n.º 6 - Artículo 3

Sustainability, sustainable finance, good governance codes. A new perspective

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JEL CODES:
G38; M14

KEYWORDS:
Sustainability; Sustainable finance; Corporate governance

Abstract: The growing concern about climate change and global warming has driven greater commitment from international organizations, governments, companies, and society to take action to safeguard the planet and ensure sustainability for future generations. In this context, sustainability and finance are intertwined through the concept of sustainable finance, a key tool for channelling financial resources toward achieving sustainable development. Sustainability enables companies to identify risks and opportunities, requiring them to measure their social, environmental, and economic impact through a multi-stakeholder approach. Among the three main pillars of sustainability, corporate governance stands out, with the board of directors as its central governing body. The composition of the board, along with its oversight and monitoring roles, is essential for improving environmental, social, and governance (ESG) performance. This article develops the main concepts related to sustainability, sustainable finance and corporate governance describing the current situation of these topics and their relationship, creating a conceptual framework that allows identifying topics necessary for further empirical research and the implication of regulation in the scope of ESG issues.

CÓDIGOS JEL:
G38; M14

PALABRAS CLAVE:
Sostenibilidad; Finanzas sostenibles; Gobierno corporativo.

Resumen: La creciente preocupación por el cambio climático y el calentamiento global ha motivado un mayor compromiso por parte de organismos internacionales, gobiernos, empresas y la sociedad en general para tomar acciones que garanticen la preservación del planeta y la sostenibilidad de las generaciones futuras. En este contexto, la sostenibilidad y las finanzas se entrelazan a través del concepto de las finanzas sostenibles, un instrumento clave para canalizar recursos financieros hacia el logro de un desarrollo sostenible. La sostenibilidad permite a las empresas identificar riesgos y oportunidades, exigiéndoles medir su impacto social, ambiental y económico bajo un enfoque de múltiples actores. Entre los tres pilares principales de la sostenibilidad, destaca el gobierno corporativo, cuyo órgano principal es el consejo de administración La composición del consejo de administración, así como sus funciones de supervisión y control, son factores fundamentales para mejorar el desempeño ambiental, social y de gobernanza (ASG). Este artículo aborda los principales conceptos relacionados con la sostenibilidad, las finanzas sostenibles y el gobierno corporativo, describiendo el estado actual de estos temas y su interrelación. Además, propone un marco conceptual que identifica áreas clave para futuras investigaciones empíricas y explora el impacto de la regulación en los temas ASG.

NOTE: The authors would like to acknowledge the funding provided through the CIGE/2023/78 project, granted by Dirección General de Ciencia e Investigación, which awards grants to research groups. Generalitat Valenciana - Conselleria de Educación, Universidades y Empleo.

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https://doi.org/10.32826/reyf.v2i6.377

1. Introduction

The intersection of sustainability and finance has become a topic of attention for academics, practitioners and policymakers, driven by the global urgency to address environmental, social and governance (ESG) challenges. As financial markets evolve, the integration of ESG criteria into investment strategies, commonly referred to as sustainable finance, has been recognized as a mechanism to foster sustainable development, resulting in the development of specific sustainable investment products, ratings, and stock indices. Sustainability is a multidimensional concept that has been applied across a variety of disciplines. Defined by the World Commission on Environment and Development (1987) as meeting present needs without compromising the resources of future generations, sustainability underlines the interdependence of ecological systems and human survival. Brown et al. (1987) adds to this definition that humans depend on the proper functioning of ecological systems, therefore human activity must be aware of saving the environment where it develops and on which its survival depends.

The origins of sustainable finance can be traced to socially responsible investment (SRI), where investment decisions were guided by ethical considerations, such as avoiding sectors like tobacco or firearms. Over time, this approach evolved into a global movement supported by environmental, social, and governance (ESG) criteria (Schueth, 2003; Renneboog et al., 2008). Ethical investors now align their investments with personal and societal values, promoting sustainability while reducing portfolio risks through international diversification (Mill, 2006; Miralles-Quirós & Miralles-Quirós, 2017). As of 2020, sustainable investment assets reached $35.3 trillion globally, reflecting the rising importance of SRI in fostering sustainable development (Global Sustainable Investment Review, 2020).

Therefore, sustainable finance has emerged as a crucial avenue for ensuring corporate success while addressing international climate and sustainability commitments (Ziolo et al., 2021). This shift in financial paradigms has transformed market behavior, particularly driven by investor interest in ESG criteria (Widyawati, 2019). Consequently, sustainable investment products and transparent performance indices have gained prominence (European Commission, 2024). To support this transition, regulatory measures promoting a sustainable financial system have become essential. In the European region, the European Commission has implemented a series of regulations and directives to ensure the transition towards a more sustainable economy. Recent regulations such as Directive 2022/2464 on corporate sustainability reporting and the green taxonomy offer a regulatory framework that increases the quality of companies' non-financial information and facilitating the transition to a more sustainable economy.

Corporate governance plays a critical role in advancing sustainability. Among the three pillars of sustainability, governance focuses on the board of directors as a key mechanism for overseeing and regulating business management. It ensures the implementation of ESG practices and addresses issues such as human rights, gender equality, transparency, stakeholder protection, and shareholder rights. Corporate governance codes provide recommendations to enhance governance practices, with board composition being a central factor in promoting effective oversight and sustainable management.

This article advances the debate on sustainability by affirming its role as a transformative force shaping financial markets, corporate governance, and investment behavior. It addresses a gap in the literature by exploring the evolution and current state of sustainable finance within the European context.

Section 2 presents the theoretical framework about the development of sustainability in finance, the role of sustainable finance in achieving sustainable development, development of sustainable finance in the financial market through socially responsible investment, rating agencies and indices sustainable stock markets. Section 3 explores the development of the principal's corporate governance code of Europe. Section 4 covers the main conclusions.

2. The evolution of sustainability in finance: origins and development

The origin of sustainability in finance is related to the appearance of ethical investment. In the mid-17th century in the United States and the United Kingdom, protestant religious groups called Methodists and Quakers excluded investing in activities related to the slave trade, war, tobacco, alcohol, and gambling (Townsend, 2017). But it is not until the 20th century that ethical investment is consolidated as an investment philosophy, the first sustainable investment funds appear, becoming an instrument to claim civil rights, against rational segregation and war. At present, the different financial and corporate scandals, climate change, the promulgation of regulations on sustainability and corporate governance, the Principles of Responsible Investment (PRI) and the Sustainable Development Objectives (SDGs) have pushed socially responsible investment as an instrument to finance sustainable development (Streimikiene et al., 2023).

The environmental, social and governance (ESG) criteria are considered an evolution of socially responsible investment (SRI), they are included for the first time by the United Nations Global Compact in 2006, through the integration of the PRI. This international initiative established a commitment for institutional investors, having to consider ESG criteria within their financial decisions and ownership policies (Motta & Uchida, 2018). Investors are increasingly concerned about ESG issues and how companies consider these criteria within their business model, preferring to select more responsible and sustainable companies (Motta & Uchida, 2018). Moreover, sustainable investment permits to reduce risks, increase profitability and improve the performance of portfolios (Broadstock et al., 2021). Another benefit of sustainable investment is generating a positive social impact, encouraging companies to be more sustainable and reorienting investment towards "green" firms and less towards "brown" firms. (Pastor et al., 2021). It should be noted that "green" firms are considered climate-friendly, produce less carbon emissions and present better environmental performance, while "Brown" firms or less climate-friendly firms are exposed to greater environmental risks (Pastor et al., 2021).

ESG criteria are indicators that measure and evaluate the sustainable practices of a company according to environmental (E), social (S) and governance (G) factors, allowing a holistic analysis of the impact of these sustainable criteria on economic and financial performance, social performance, environmental performance, and governance performance (Cek & Eyupoglu, 2020). ESG criteria are integrated into investments and business decision-making processes, allowing companies to monitor and control the impact of their activities (Arora & Sharma, 2020). In turn, ESG criteria offer qualitative and quantitative information of the corporate sustainability performance of a company, measuring the impact of its sustainable practices (Uyar et al., 2023). On the other hand, the integration of ESG criteria in the investment process allows to identified and managed risks and opportunities, considering the diversification of the investment, risk analysis and continuous evaluation (De Souza Barbosa et al.,2023).

The environmental dimension (E) indicates the ability of a company to reduce its carbon footprint and minimize its environmental impact (Lam & Lai, 2015), in turn analyzing the use and management of renewable natural resource and non-renewable natural resources (Rajesh, 2020). The Social dimension (S) refers to the company's relationships with the different stakeholders that are directly or indirectly affected, such as the community where it operates, employees, suppliers, customers, investors, regulators among others, it promotes aspects such as respect for human rights, diversity, inclusion and equal conditions (Rajesh, 2020). Regarding the governance dimension (G), consider the corporate governance structure of a company as key to achieving sustainability through its corporate governance policies, level of transparency, internal controls, shareholder rights, stakeholder protection, gender pay. gap, executive compensation, among others (Cek & Eyupoglu, 2020).

Another definition of ESG criteria is defined by Brown et al. (1987), who considers ESG criteria as a dimensions of sustainability, where the environmental dimension refers to the conservation of the proper functioning of the ecosystem and the preservation of natural resources; the social dimension seeks to guarantee basic human needs (security, food, employment, recreation, freedom, etc.); and finally, the governance dimension refers to good corporate governance practices that influence environmental and social aspects, as well as transparency, disclosure of non-financial information, and compliance with Good Corporate Governance codes.

In recent years, the demand for ESG information by investors has increased, considering non-financial performance and the inclusion of ESG criteria within their investment decisions as a tool that helps identify risks and opportunities (Limkriangkrai et al., 2017). In turn, ESG disclosure increases the quality of information (Cheng et al., 2014), reduces information asymmetry (El Ghoul et al., 2011), increase the level of transparency and encouraging investors, managers, and stakeholders to make better decisions (Cek & Eyupoglu, 2020).

The effect of ESG disclosure on firm performance is a highly researched topic in financial literature. Most of the research's affirm that exist a positive relationship between ESG disclosure and firm performance (Nisar et al., 2021), but other studies demonstrate that this relationship is negative or not exit (Atan et al., 2018; Duque-Grisales & Aguilera-Caracuel, 2019). There are two points of view of the effect of ESG practices on firm performance. From a theoretical perspective, there are two viewpoints regarding the impact of sustainable practices on ESG performance: shareholder theory and stakeholder theory. The shareholders theory argues that the main objective of a company is to maximize economic profit or shareholder value (Friedman, 1970). Shareholder value is measured through the value of dividends and the increase in share prices (O'connell & Ward, 2020). In turn, this theory considers shareholders as owners of the company, where managers and directors are the agents in charge of managing their resources to increase their profits. (Friedman, 1970; Castelo, 2013). The shareholder theory maintains that the use of resources for ESG practices could be detrimental to the main social objective of the firm that is maximizing shareholder value, considering that these socially responsible practices should be the responsibility of other purely social organizations such as the state (Castelo, 2013; O'connell & Ward, 2020). Furthermore, the shareholder theory considers that managers and directors do not have the right to act in their own interest or use company resources to obtain a social benefit that does not justify an improvement in firm performance (Castelo, 2013; O'connell & Ward, 2020). Managers motivated by personal incentives can excessively increase spending on ESG practices, exceeding the level that could benefit firm performance and therefore decrease firm performance (Barnea & Rubin, 2010). This behavior could indicate that managers, at the expense of the shareholders wealth, act in a more socially responsible way to avoid making bad decisions that harm their personal reputation, which generates agency conflict that negatively affects firm performance (Krüger, 2015).

In contrast, the stakeholder theory (Carroll, 1991; Freeman, 2010) considers that companies as part of society have the responsibility of responding to the interests of the different agents or stakeholders with which they relate and who are affected by their activity. Freeman (2010) describes that the objective of stakeholder approach is to manage and integrate the interests of the different stakeholders to ensure the long-term success of the firm. Under the stakeholder perspective, the collaborative relationships of the companies with the different stakeholders allow value creation (Freudenreich et al.,2020). The traditional business model answers the questions of why and for whom value is created, it is based on a unidirectional process between the company and customers. On the other hand, the value creation under the stakeholder's perspective is based on a multi-directional relationship between the company and the different stakeholders, responding to the questions of with and for whom, where the stakeholders are creators and recipients of the value creation process (Freudenreich et al., 2020). This perspective considers stakeholders as partners and resources, the creation of value is mutually beneficial for the company and the different stakeholders (Freudenreich et al., 2020). In this way, stakeholders are integrated into relevant decision-making within the business.

According to stakeholder theory, the inclusion of ESG criteria within value creation depends on the effectiveness of relationships with stakeholders, because unethical behavior of the company can weaken or break the support relationships of stakeholders, impacting negatively on business operations and risk the viability of the company (Freudenreich et al., 2020). The multi-collaboration of stakeholders permits to identify and solve problems related to sustainability (Hörisch et al. 2014). Moreover, the stakeholder theory affirms that ESG performance responds to the needs of different stakeholders, minimizing costs and increasing social benefits (Freeman, 2010). Firms with better ESG performance benefit both shareholders and stakeholders, attracting long-term investors, improving external financing and sending a positive signal to the market and enhancing firm performance (Maji & Lohia, 2023).

In conclusion, ESG criteria serve as a tool for measuring sustainability, fostering the development of a more sustainable financial system, and enabling the allocation of financial resources toward sustainable development. ESG information disclosure enables monitoring of companies' sustainable performance, information that is demanded by investors and financial analysts (Barker & Eccles, 2019). The integration of ESG criteria into corporate strategies enables the reduction of environmental and social risks, and consequently a positive impact on firm performance (Hawn et al., 2018).

2.1. Sustainability and sustainable development

The concept of sustainability introduced development as a new term, which gained prominence in 1987 with the publication of Our Common Future by the World Commission on Environment and Development. In the Johannesburg World Summit on sustainable development celebrate in 2002, the United Nations secretary general describe three important pillars or dimensions about sustainable development: “economic development, social development and environmental protection” (Report of the World Summit on Sustainable Development, 2002, p.8). In this sense, sustainable development provides solutions to environmental and social problems that affect the development and sustenance of human life on the planet Earth (Millennium Ecosystem Assessment, 2005). Authors like Munashinge (2009) defines sustainable development such as the conservation of current resources by the different social actors, whose economic and productive development should not diminish the state of these resources to ensure the quality of life of present and future generations.

There are two antagonistic points of view regarding the issue of sustainability: the very strong and the very weak approach. Starting from the economic function of the capital stock, we understand that is made up of human capital, natural capital and manufactured capital. Weak sustainability posits that declines in natural capital can be offset by increases in human and manufactured capital, relying on market mechanisms to substitute depleted resources (Neumayer, 2013). This has led to models like the circular economy and green economy, promoting sustainable production and consumption (Sauvé et al., 2016). In contrast, strong sustainability considers that an increase in human capital and manufactured capital does not diminish the negative effect on natural capital. Therefore, strong sustainability requires that the irreplaceability of natural capital, requiring renewable resources to regenerate at consumption rates and waste production stay within environmental limits (Lagoarde-Segot, 2019). This approach prioritizes conserving nature in its purest state, viewing it as essential to human survival.

International agreements such as the Paris Agreement, the Convention on Biological Diversity, and the Sustainable Development Goals (SDGs) have established frameworks to promote sustainable development. In response, initiatives like the World Bank BioCarbon Fund and the Green Climate Fund have mobilized financing for sustainability efforts. According to the Global Sustainable Investment Alliance, global sustainable investment had increased 15% in the last period (2018-2020), reaching USD35.3 billion in management (Global Sustainable Investment Review, 2020). The rapid growth of responsible investment in the financial market reflects the important function of sustainable finance in sustainable development model. The global damage caused by COVID-19 has affected the global process in terms of sustainability, in turn has revealed a greater need for sustainable funds for both developed and developing economies (United Nations, 2022).

2.2. European regulation of sustainable business and finance

Sustainability regulation has become a critical tool for advancing sustainable development by fostering sustainable finance (Colaert, 2023). Sustainable finance and sustainability are interconnected through shared aspects, such as the rise of ESG criteria in investment decisions, impact investing, social responsibility, addressing climate change and human rights, and evaluating the externalities of financing. Additionally, financial institutions are increasingly aligning financial performance with social objectives (Migliorelli, 2021).

In the European context, the European Commission (2019a) introduced the European Green Deal, a strategic framework aimed at achieving climate neutrality by 2050 and facilitating the transition to a green economy. The regulation offers a development framework that allows homogenizing the criteria, concepts and improves the transparency of the financial actors and corporations (Bengo et al., 2022). Regarding the promotion of sustainability in corporate governance, the European Commission (2022) published a proposal of the Directive on corporate sustainability due diligence, with the aim of encouraging socially responsible business behavior, where companies respond to the negative impacts of their activity within and outside the European Union, considering aspects like the protection of human rights, reduction of environment impact, gender diversity on board, compensation for executive directors, sustainable reporting, among others.

Another legislative measure to promote and regularize corporate social responsibility activities in Europe is the Directive 2014/95/EU (non-financial information directive, NFRD), offer a regulatory framework on the disclosure of non-financial information for listed companies, banks, and insurance companies with more than 500 employees. The NFRD focuses on ESG integration, human rights, anti-corruption, and diversity in corporate policies. It also introduces the principle of double materiality, requiring companies to report both the impact of sustainability on their performance (external perspective) and their activities' effects on people and the environment (internal perspective) (European Parliament & Council, 2014; European Commission, 2021). In 2017, the European Commission released guidelines to standardize non-financial reporting under the NFRD, emphasizing usefulness, consistency, and comparability. Updates in 2019 included climate-related reporting to address gaps in environmental disclosures, ensuring companies report on climate risks, opportunities, and dependencies (European Commission, 2019b).

On these bases, the European Commission expand the scope of NFRD publishing the Corporate Sustainability Reporting Directive (CSRD) in 2020, introducing new changes such as the inclusion of small and medium-sized listed companies and increasing the credibility of the information. because the reports must be validated by an independent auditor or certifier. Companies must start the application of these standards from the year 2024, the disclosure of sustainable information must be carried out under the European Sustainability Reporting Standards (ESRS). Authors such as Couamo et al. (2022) analyzed the impact of the adoption of the NFRD on corporate social responsibility performance (CSR) of European non-financial companies in the period 2008-2018, demonstrating that after the adoption of the NFRD, improve the CSR performance and information transparency, also the companies presented lower levels of risks and cost equity.

Furthermore, in 2020 the European Commission introduced the taxonomy regulation, a classification system for environmentally sustainable economic activities. This system provides a common framework for companies and investors, encouraging sustainable investment. The taxonomy requires EU member states, financial market participants, and large public-interest entities to identify and report the sustainability of their economic activities (European Parliament & the Council, 2020).

2.3. Sustainable development goals

In 2015, the United Nations General Assembly adopted the 2030 agenda, a comprehensive action plan centered around 17 Sustainable Development Goals (SDGs) that focus on people, planet, prosperity, justice, and peace (United Nations, 2015). These goals build on the Millennium Development Goals (MDGs), which expired in 2015, and were developed through a public process involving 70 governments and civil society representatives from both developed and developing countries (Biermann et al., 2017). The SDGs represent a global governance strategy that integrates efforts from both public and private sectors towards achieving sustainable development in all nations (Stevens & Kanie, 2016).

The role of SDGs is promoting local economic development and social change in the private sector, NGOs, and public institutions (Rendtorff, 2019). In business, the SDGs provide a framework for expanding business ethics, corporate social responsibility (CSR), and corporate citizenship (Van Zanten & Van Tulder, 2018). They also aim to reduce the negative impacts of human activities, particularly focusing on social inclusiveness (e.g., SDG 1: No poverty, SDG 16: Peace, justice, and strong institutions), ecological inclusiveness (e.g., SDG 2: Zero hunger, SDG 6: Clean water and sanitation), and relational inclusiveness (e.g., SDG 3: Good health and well-being, SDG 17: Partnerships for the goals).

The SDGs represent a form of global governance that is non-legally binding, established by UN member states (Biermann et al., 2017). This non-binding nature means that countries are not required to incorporate these goals into their national legal frameworks; instead, the SDGs serve as recommendations. They provide a flexible, goal-based governance model that allows countries to adapt the objectives to their specific needs and priorities, even though they consist of 17 global goals and 169 specific objectives, have a qualitative nature that permit the implementation of the objectives to be interpreted by the countries (Biermann et. al, 2017).

The achievement of the SDGs requires significant financing, particularly through the mobilization of public and private resources. There is potential to redirect private capital toward the success of the SDGs in both developed and developing economies. However, according to the International Monetary Fund, global financial contributions to the SDGs currently amount to only $3 trillion annually, while estimates suggest an additional $2-4 trillion per year is needed until 2030 to meet the goals (SPAINSIF, 2020). The progress towards the SDGs has been impacted by recent global crises, particularly the COVID-19 pandemic and the Russia-Ukraine war, which have led to rising poverty rates, inflation, an energy crisis, and humanitarian challenges (United Nations, 2022). The realization of the SDGs also depends on geographic context, resources, and governance structures (Nilsson et al., 2018).

For businesses, the alignment with the SDGs requires considering the relationship between business activities and the SDGs. Both private companies and public institutions can address existing gaps and align their operations with the SDGs (Kremer & Biesheuvel, 2017). A progressive business model offers a solution to these gaps by combining economic profits with social and environmental sustainability (O'Higgins & Zsolnai, 2017). This model advocates for the integration of sustainability through social innovation and social entrepreneurship, allowing businesses to contribute more effectively to the achievement of the SDGs (O'Higgins & Zsolnai, 2017).

In a 2015 report, the International Monetary Fund highlighted the financing disparities between developing and low-income countries. Developing countries require approximately $2.6 billion annually for investments in health, education, infrastructure, and utilities. In contrast, low-income countries need an additional 15% of their gross domestic product to meet these needs (United Nations, 2019). Past research emphasizes the importance of considering the three dimensions of sustainable development for financing SDGs, concluding that conventional finance is inadequate for achieving these goals (Fullwiler, 2015).

Ziolo et al. (2021) analyzed the relationship between sustainable finance and the SDGs, focusing on 23 European countries within the OECD for the year 2016. Their findings revealed that Scandinavian countries, such as Denmark, Finland, and Sweden, along with the Netherlands, ranked highest in sustainable finance. Conversely, Hungary, Lithuania, and Spain ranked lowest. The study concluded that countries with more sustainable finance models tend to achieve better results in fulfilling the SDGs.

Focusing on SDG development and achievement, disparities are evident among European Union members. Constantin et al. (2021) investigated these disparities based on research and development (R&D) and innovation factors, identifying significant gaps between countries like Denmark, Finland, Sweden (leaders in adopting sustainable development strategies) and Luxembourg, Greece, Croatia, Latvia, and Slovakia. These disparities can be explained by several factors: (i) Sweden pioneered the implementation of a national sustainable development strategy in 2002 (Ahlberg, 2009); and (ii) cultural differences, including people's preferences or aversions toward sustainable consumption, which reflect varying levels of personal responsibility (Berglund et al., 2020).

2.4. Sustainable finance

The market has driven a shift in the financial paradigm, where the traditional objective of maximizing shareholder value is becoming obsolete in the long term as it disregards the needs of other key stakeholders essential for creating sustainable wealth (Fatemi & Fooladi, 2013). Sustainable finance, or sustainable investment, extends traditional financial theory by incorporating social and environmental considerations. This integration enables proactive responses to social and environmental risks, supports the well-being of the global economy, and fosters sustainable development (Ziolo et al., 2019). Sustainable finance implementing sustainability-oriented strategies in financial and investment decision-making, places society and the environment at central aspect, adopts a long-term approach to address global sustainability challenges and employs methodologies with measurable outcomes (Widyawati, 2019; Cunha et al., 2021).

Recognizing the role of sustainable finance in advancing the sustainability agenda, numerous studies have been conducted to understand its practices and improve its outcomes. Past studies have focused on comparing the performance of socially responsible funds with traditional funds using sustainability screening methods (Cerqueti et al., 2021). These studies demonstrate that socially responsible funds often exhibit higher market-to-book ratios and higher return on assets for socially responsible investors (Dam & Scholtens, 2015) and provide opportunities to mitigate systematic risks for investors (Cerqueti et al., 2021). Others research on the relationship between ESG performance and financial performance also offers valuable insights. Velte (2017), analyzing German Prime Standard companies between 2010–2014, found that ESG performance positively impacts accounting-based performance (measured by Return on Assets) but does not influence market-based performance (measured by Tobin's Q). Additionally, governance performance was found to have the strongest impact on financial performance compared to social and environmental performance. Chen et al. (2023), studying 3,332 listed organizations worldwide from 2011–2020, revealed that ESG performance is positively correlated with financial performance, with this relationship being more pronounced for high-risk and large-scale companies. Similarly, Naeem et al. (2022) found that ESG performance positively influences the financial performance of environmentally sensitive corporations, with this relationship being stronger in developed countries than in emerging economies.

The growth of the sustainable investment market has been accompanied by the adoption of key frameworks, notably the Principles for Responsible Investment (PRI). This United Nations initiative, developed in collaboration with global institutional investors was first published in 2006, establishing to address the increasing significance of environmental, social, and governance (ESG) factors in investment practices (UN PRI, 2021). The PRI asserts that ESG issues impact investment performance and that applying these principles aligns investors with societal objectives (UN PRI, 2009). Since its launch, the PRI has gained widespread support, with over 2,200 signatories from about 50 countries by 2018, including asset managers, banks, insurance companies, and institutional investors (Peillex & Comyns, 2020). This growth underscores the central role of the PRI and its strong backing (Sievänen et al., 2013). Adopting the PRI offers signatories several benefits, including improved commitment to responsible financial practices, enhanced reputation, competitive advantage, reduced investment risks, and increased legitimacy in ESG disclosure (Peillex & Comyns, 2020).

Research highlights the benefits of adopting the Principles for Responsible Investment (PRI) in financial decision-making, as it fosters collaborative engagement between investors and companies. Peillex and Comyns (2020) find that financial companies more likely to adopt PRI tend to have fewer slack resources, higher public scrutiny, larger size, and boards with greater gender diversity and independence than non-signatory companies. In conclusion, the PRI, in partnership with the United Nations Environment Programme Finance Initiative and United Nations Global Compact, has become a global leader in responsible investment. It strives to ensure that responsible investment is understood as an integral part of the investment landscape, not an isolated concept (UN PRI, 2021).

2.4.1. Sustainability rating agencies

The increase in corporate sustainable practices has been driven by environmental and societal demands, contributing to sustainable development (Abdelkafi & Täuscher, 2016). Factors such as financial market demands, pressure from activist groups, sustainability regulations, and company competition motivate companies to improve their sustainable performance and become part of ESG ranting, given that this behavior sends positive signals to shareholders and stakeholders (Mackenzie et al.,2013). The growth of ESG rating agencies has become a significant niche in the financial market (Escrig-Olmedo et al., 2019). The rise in these agencies is driven by networks of alliances (e.g., RobecoSAM), mergers (e.g., Vigeo-EIRIS), and the involvement of financial data providers (e.g., MSCI) in the ESG rating industry (Avetisyan & Hockerts, 2017). A study by SustAinability (2019) estimated that there are over 600 ESG rating agencies and rankings globally.

ESG rating agencies are the primary source of information for investors, providing insights into corporate sustainability and measuring companies' contributions to sustainable development (Muñoz-Torres et al., 2019). These evaluations are reflected in sustainable indices, which serve as benchmarks for socially responsible investment markets (Muñoz-Torres et al., 2019). ESG rating agencies assess corporate sustainability performance using various sources of information, including extra-financial and financial data (Avetisyan & Hockerts, 2017), questionnaires, reports, and publicly available company information (Escrig-Olmedo et al., 2019). The diversity of measurement methods is seen as a market differentiation strategy (Saadaoui & Soobaroyen, 2018) and influenced by cultural and ideological factors (Sandberg et al., 2009). According to Chatterji et al. (2016), ESG agencies generally consider three aspects:

(i) evaluating environmental, social, and governance categories with positive criteria, (ii) examining controversial practices, and (iii) assessing normalization processes for industry-specific ratings.

The sustainable investment ecosystem includes customers, corporations, and ESG rating agencies (SustainAbility, 2023). Customers, such as institutional investors and supply chain partners, use ESG data to make investment and business decisions. Corporations rely on this data to assess their sustainability performance, maintaining their reputation and commitment. Finally, the ESG rating agencies create and select the data, metrics, indicators, obtaining the information for their customers. Among the main ESG rating agencies are FTSE Russell ESG Ratings, Morgan Stanley Capital International (MSCI) ESG Research, S&P Global Ratings ESG Evaluation, Sustainalytics and Vigeo EIRIS.

FTSE Russell ESG Ratings offers a weighted average measurement model, where the most relevant ESG issues carry the greatest weight when determining companies' scores. The ESG score is made up of 300 indicator assessments and 7.200 securities in 47 Developed and Emerging markets. The ESG score focuses on the following sustainable dimensions: (i) environment integrates biodiversity, climate change, pollution and resources and water security. (ii) social issues include labor standards, human rights and community, health and safety, customer responsibility. (iii) governance issues integrated anti-corruption, corporate governance, risk management and tax transparency (FTSE Russell, 2023).

Vigeo EIRIS is one of the global leading sustainable indices in ESG research and data base, it belongs as a filial of Moody's Corporation. Through its Equitics methodology, measures and scores the ESG performance of companies, based on 38 sustainable criteria and divided into six dimensions on Environmental, Human rights, Human resources, community involvement, business behavior and corporate governance. The Vigeo EIRIS methodology analyzes risks and opportunities by sector and companies at the ESG level. Of the 38 sustainable criteria, 20 to 25 criteria allow analyzing a specific sector, a weight between 0 to 3 is assigned based on three specific areas of the sector's impact on nature, level of exposure and corporate risk (Euronext Indexes, 2021).

MSCI ESG Research evaluates a company's ESG risk and opportunity management using a rules-based methodology to categorize companies by industry performance. The assessment covers 35 key ESG issues, organized into three pillars: (i) environmental: includes climate change, natural capital, pollution and waste, and environmental opportunities. (ii) social: focuses on human capital, product liability, stakeholder opposition, and social opportunities. (iii) governance: covers corporate governance and corporate behavior. Ratings range from Leader (AAA, AA) for companies with strong ESG management, to Average (A, BBB, BB) for those with mixed performance, and Laggard (B, CCC) for companies struggling to manage ESG risks and opportunities (MSCI, 2023).

S&P Global Ratings ESG Evaluation assesses the future risk and opportunity management capabilities of businesses, including organizations, banks, and insurance firms. This evaluation is based on data provided through the S&P Global Corporate Sustainability Assessment (CSA) questionnaires, which contribute to two key components: the ESG Profile and the Preparedness Opinion. The ESG profile scores the environmental dimension with 30%, the social dimension with 30% and the governance dimension with 40%. Regarding the Preparedness opinion, it allows an evaluation of the company's ability to anticipate and adapt to changes and risks in the long term. The ESG score is then determined by combining the ESG Profile and Preparedness Opinion, using a 100-point rating scale (S&P Global Ratings, 2023).

Sustainalytics, a Morningstar company, provides ESG Risk Ratings, which assess the unmanaged ESG risks of companies and their potential impact on long-term investment returns. The ratings are based on three components: (i) Corporate governance: evaluates risks from poor governance. (ii) material ESG issues covers topics like diversity and labor relations. (iii) Idiosyncratic issues: Unique risks specific to the company. The risk score ranges from 0 to 100, with companies categorized as: Negligible (0-10), Low (10-20), Medium (20-30), High (30-40), Severe (over 40) (Sustainalytics, 2021).

ESG rating agencies are of significant interest not only to financial market participants but also to academic researchers. The principal areas of study include the role of ESG agencies in advancing sustainable objectives (Veenstra & Ellemers, 2020), the impact of ESG ratings on corporate sustainability performance (Clementino & Perkins, 2021), how ESG scores influence companies and investors (Zumente & Lace, 2021), the disclosure of ESG reports, and the disagreements among rating agencies (Kimbrough et al., 2022), among others. The rapid growth of ESG rating agencies and sustainability indices reflects the increasing demand from investors, stakeholders, and shareholders for non-financial information about companies' socially responsible behavior. ESG factors not only reflect a company's social and environmental commitments but also represent potential risks and opportunities for business performance.

Additionally, rating agencies have developed various sustainable indices that measure the performance of leading companies in sustainability. These indices serve as market benchmarks and are widely used in managing socially responsible investment portfolios (Fernández-Izquierdo & Muñoz-Torres, 2009). Sustainable indices differ from traditional financial indices by evaluating a firm's performance based on environmental, social, and governance (ESG) criteria (Miralles-Quiros et al., 2017). The literature examines the differences between the performance of sustainable indices and conventional indices. Some authors like Plastun et. Al. (2022) found no significant difference between the ESG index and conventional index of the Morgan Stanley Capital Internacional (MSCI) index family for developed and emerging countries. Other studies show lower risk and similar or better performance of ESG indices compared to conventional indices (Whelan et al., 2021). Similarly, previous studies show that under periods of crisis, sustainable funds and socially responsible investment strategies present a lower risk compared to their conventional peers (Fernández et al., 2019) and have a better performance and faster recovery (Wu et al. 2017).

Sustainable investment is a rapidly growing market. By early 2020, global sustainable assets totaled USD 35.3 trillion (Global Sustainable Investment Alliance, 2020). Despite its significant economic impact, sustainable investing is relatively new. The first ESG index, the Domini 400 Social Index, was introduced in 1990 by Kinder, Lydenberg, Domini, and Co. The number of sustainable indices has since grown substantially, driven by investor and regulatory acceptance of socially responsible investing and increased corporate engagement in sustainability. Currently, there are over 170 ESG indices (Lydenberg & White, 2015). Among these indices stand out the Euronext Vigeo Eiris indices, Dow Jones Sustainability indices, FTSE4Good indices, and MSCI Sustainability indices. These indices provide benchmarks at global (e.g., Euronext Vigeo Eiris World 120), regional (e.g., Vigeo Eiris Europe 120), and country levels, and cover emerging and developing markets (e.g., Dow Jones Sustainability Emerging Markets; S&P 500).

ESG disclosure scores are another method for evaluating corporate ESG performance, based on companies' public disclosures. Among the most used is Bloomberg's ESG disclosure, it has a database of more than 15,000 companies in more than 100 countries, with more than 120 indicators to measure environmental, social and governance aspects, and obtains ESG information from companies through their ESG reports, sustainability reports and reports, information on their website, press and corporate presentations, among others (Bloomberg, 2023).

In conclusion, sustainable investment plays a key role in addressing social and environmental issues, encouraging responsible behavior in financial markets, and redirecting capital to more sustainable practices (Talan & Sharma, 2019). ESG indices and disclosure scores help monitor corporate practices, fostering greater transparency and accountability (Miralles-Quiros et al., 2017).

3. Development of corporate governance in Europe

Codes of corporate governance express the best governance practices for the companies, including themes such as board functions, board composition, nomination and remuneration members, auditing, information disclosure, typologies of directors, and relationships with shareholders. Several countries have issued one or more codes, due among other things to globalization such as financial markets, liberalization, privatization and increasing the role in the companies of institutional investors.

The Cadbury Report (1992) was the first corporate governance code in Europe, offering guidelines for board structures in UK-listed companies. It focused on the roles of boards and auditors, aiming to ensure effective governance and encourage management to prioritize shareholders' interests. Principal recommendations included separating the CEO and Chairman roles, requiring non-executive directors, establishing independent audit committees, and empowering institutional investors through voting rights. The report introduced the "comply or explain" principle, allowing companies to either follow the guidelines or explain non-compliance. This principle, a form of soft law, promotes self-regulation and transparency, encouraging sustainable governance practices over time.

The evolution of corporate governance regulation in the UK has progressed since the Cadbury Report. The Greenbury Report (1995) was followed by the Hampel Report (1998), which reviewed both the Cadbury and Greenbury Reports. Under the authority of the Financial Reporting Council and the Markets Act of 2000, the Combined Code was introduced, emphasizing shared accountability between shareholders and directors. Initially published in 1998 and updated several times, the latest version of the UK Corporate Governance Code was released in 2018. The code focuses on strengthening relationships between companies, shareholders, and stakeholders, aiming for long-term economic growth. It emphasizes gender diversity on boards and advocates for a transparent and merit-based selection process for board members. Companies are required to disclose their approach to diversity and succession planning in their annual reports.

In France, the implementation of corporate governance codes began in 1995 with the Viénot I report, followed by subsequent updates and complementary reports, including the Viénot II report (1999), the Bouton report (2002), and the French Association of Large Companies (AFEP) and the Movement of the Enterprises of France (MEDEF) code. These reports collectively established a framework for improving corporate governance practices among French listed companies. The Viénot I (1995) report outlined several recommendations, focusing on regulating multiple directorships and defining the characteristics of independent directors. Independent directors were to be selected based on their expertise and should have no dependent relationship with the company (e.g., as shareholders, investors, customers, or suppliers). The report also proposed creating specialized board sub-committees to oversee key areas such as remuneration, auditing, and nominations.

Based on these recommendations, the Viénot II (1999) report introduced the option of separating the roles of Chairman and CEO to improve power distribution and decision-making. Also, emphasized the importance of frequent board meetings, shareholder involvement, and transparency in management remuneration and disclosure of financial information. The Bouton report (2002) continued in the same direction, advocating for greater board independence, more formal governance practices, and increased transparency in board activities. The AFEP-MEDEF Code (2002) combined these recommendations and adopted the "comply or explain" principle, allowing companies to either follow the guidelines or explain non-compliance. This code became the standard for the French capital market and has been updated over time, with the latest version in 2022. The current code emphasizes social and environmental factors, advocating for their integration into executive remuneration and business strategies for sustainable, long-term value creation.

The AFEP-MEDEF Code promotes board gender diversity by requiring policies that ensure diversity and prevent discrimination, requiring at least one woman on high-level committees, including the seven-member High Committee. This commitment aligns with broader efforts to enhance inclusion in corporate leadership (Elage & Mard, 2018). In 2003, the Financial Security Law (LSF) was adopted to strengthen corporate governance by requiring transparency in board operations. The first mandatory corporate governance report was introduced in 2008 through Law 2008-649 (DDAC), which required companies listed on regulated markets to adhere to governance codes based on the "comply or explain" principle, either comply with the code or explain non-compliance (Elage & Mard, 2018).

Another European country notable for its development in corporate governance is Spain. Spain made significant strides in corporate governance with the Olivencia Report (1998), which introduced non-binding recommendations for listed companies based on the "comply or explain" principle. Principal recommendations included strengthening board supervision, approving company strategies, establishing risk policies, implementing internal controls, and evaluating executive compensation. The report also differentiated between internal and external directors, categorizing external directors as either linked to the company (e.g., major shareholders) or independent (e.g., reputable professionals representing the free float). Additionally, the Olivencia Report recommended the election of independent board members, the creation of operational committees (such as nominations, compensation, audit, and compliance committees), and a balanced approach to board members' remuneration (Fernández-Fernández, 1999).

In 2002, the Olivencia Report was updated to address the lack of transparency among Spanish listed companies, leading to the creation of the special commission for the promotion of transparency and security in the markets and listed companies. This commission published the Aldama Report (2003), which focused on transparency and loyalty, recommending the disclosure of board operations, capital ownership, and risk control systems through an annual corporate governance report. It also proposed regulating business loyalty by limiting the improper use of privileged information and company assets (Chivite & Monroy, 2009). The recommendations from the Aldama Report were incorporated into Law 26/2003 (Law on Transparency of Listed Corporations), which was later updated by Law 31/2014. This reform modified the Capital Companies Law, enhancing corporate governance and improving transparency. It introduced mandatory annual corporate governance reports under Order ECO/3722/2003 and required companies to maintain a website to provide shareholders with necessary information and disseminate relevant data (Chivite & Monroy, 2009).

In May 2006, the National Securities Market Commission (CNMV) approved the Unified Good Governance Code (UGGC). This code, based on previous corporate governance codes, was updated to align with international good governance standards and the European Commission's corporate governance recommendations. The UGGC (2006) has undergone several updates, with the most recent version in 2020. This updated code consists of 64 recommendations organized into three main sections addressing general aspects of the shareholders' meeting and the board of directors. It emphasizes the inclusion of women on boards, promotes the integration of social and environmental criteria into business policies, encourages transparency through non-financial information and sustainability reporting, highlights the importance of managing reputational and non-financial risks, and provides guidance on the remuneration of directors (Good Governance Code of Listed Companies, 2020).

In Germany, the control and transparency in business act (KonTraG) introduced legislation addressing key corporate governance issues such as risk management and strengthening supervisory board rights (Seibert, 1999). The first German Corporate Governance Code was adopted in 2002 by an expert commission appointed by the German Federal Government. This code, aimed at listed companies on the German Stock Exchange, is based on voluntary self-regulation, with a "comply or explain" principle requiring companies to disclose and explain any non-compliance. The code includes recommendations on corporate management supervision, risk and opportunity identification, and consideration of social and environmental impacts. It also emphasizes gender diversity on boards, the establishment of gender quotas, responsible management of internal control systems, and alignment with sustainability goals. Additionally, it provides guidelines on the appointment of management board members, supervisory board selection criteria, and the independence of certain members. Transparency in both external and internal reporting, including corporate responsibility reports, is also a key focus.

The German Corporate Governance Code has been revised multiple times since its introduction in 2002, with the most recent version published in 2022. The latest amendments emphasize advancing sustainability transformations, with a focus on the management board's role in promoting ecological and social sustainability within companies (Government Commission on the German Corporate Governance Code, 2022). The code reinforces the dual board structure (two-tier model) in Germany, clearly separating the roles of the CEO and Chair. The Chair oversees the management board, coordinates its members, develops strategies, identifies risks and opportunities (including social and environmental considerations), and collaborates with the supervisory board to implement these strategies. The management board's responsibilities also include promoting gender diversity in executive positions, executing internal monitoring, and ensuring effective control and risk management systems.

The Nordic corporate governance model, known for its shareholder power and low private benefits of control, has garnered attention in recent years (Ilmonen, 2015). This model is influenced by social norms and national legislation, including accounting laws, securities regulations, and European Union rules. Key features of Nordic corporate governance include strong shareholder involvement in decision-making, shares with multiple voting rights (primarily in Sweden), balanced power between major and minority shareholders, and the requirement for at least half of board members to be independent. Additionally, the model emphasizes gender diversity on boards, the presence of board sub-committees, transparency, and the board's role in risk management and internal controls (Nordic Corporate Governance, 2022).

4. Conclusions

This study examines the relationship between sustainability, sustainable finance and corporate governance. It highlights the evolution of sustainable finance, emphasizing the critical role of environmental, social and governance (ESG) criteria in fostering responsible investment and advancing sustainable development goals. Corporate governance emerges as a key mechanism, through board composition and oversight, to integrate ESG criteria into the company's corporate strategies. The study offers a conceptual framework that links theoretical knowledge and regulatory developments in Europe, providing a basis for future empirical studies.

The study underscores the evolution of sustainable finance from ethical investment practices to the comprehensive integration of ESG criteria. This process reflects a transformation in corporate behavior, where maximizing shareholder wealth is no longer the primary objective, but rather the demands and interests of a broader range of stakeholders are integrated through ESG principles, ensuring the long-term business success. This paradigm change has significantly impacted financial markets, introducing metrics and ratings that assess corporate sustainability performance, improving transparency and legitimizing business actions.

Europe has been a pioneer in implementing regulations on ESG disclosure and good governance codes, fostering the adoption of sustainable practices by companies and facilitating the transition toward a green economy aligned with sustainable development goals. However, despite these advancements, challenges remain in achieving the Sustainable Development Goals (SDGs) and making Europe climate neutral. Continued efforts are needed to drive initiatives that support companies and markets in adapting to sustainability requirements and advancing the broader sustainable development agenda.

Sustainability is not a passing trend; it is a reality that involves all economic sectors and nations. In recent decades, the rise of non-financial reporting standards, sustainability agencies and indices reflect efforts to address rapid environmental changes, combat climate change and mitigate social and environmental damage caused by industrial activities. Achieving sustainable development and effectively addressing climate change requires global action and the active participation of all social actors.

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