# Sustainable corporate orientation in the context of risk governance

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At the 1992 Rio Conference, 27 principles for sustainable development at a macro-economic level were developed and were internationally recognised in the form of policy guidelines. The "Agenda 21" was all about linking economic, environmental and social aspects, resulting in the emergence of the three-pillar model. To further advance developments towards sustainability, in 2015 the United Nations passed the "Agenda 2030", which contains 17 targets (Sustainable Development Goals, SDGs) and 169 sub-goals for sustainable development by the year 2030. The SDGs make specific reference to the individual dimensions of the three-pillar model and also address interconnections between the different pillars.

**Establishment of sustainability in a business context**

As a counterpart to the three-pillar model at a macro-economic level, the triple bottom line method was developed as a tool for business sustainability. This adds environmental and social dimensions to the conventional "bottom line" of economic success. The triple bottom line method is designed to help companies to focus their strategy not just on financial results, but to give equal weight to all three dimensions (Elkington 1997). In terms of the economic dimension, the aim is to ensure the company's success through profit orientation, increasing business value, improved profitability and/or cost-optimised production. From an environmental standpoint, a company is successful when it imposes the least possible burden on the environment, which means continuously reducing negative environmental impacts from sites, production processes, products and services, and making a contribution to protecting the environment through appropriate investments and innovations. A company's social success manifests itself in the extent to which it meets societal, cultural and individual social requirements.

For a company, establishing the triple bottom line method means moving away from purely economic targets. Meanwhile, the shareholder theory is one of the concepts underpinning a purely economic perspective. It states that business strategy should be solely directed at the financial results for the owners (shareholders). The "stakeholder concept" differentiates itself from this approach. The term "stakeholder" refers to all groups and individuals who either have an influence on the achievement of business targets or are affected by them. It is crucial for a company to understand which interests its stakeholders are pursuing, what priorities they are setting and what resources they have to support or harm the company (Freeman 2010, p. 26).

The desire to create a management concept linking stakeholder interests with the triple bottom line method resulted in the idea of Corporate Social Responsibility (CSR), which provides a set of guidelines for businesses. There are a large number of different definitions of CSR. Most of them describe CSR as a concept in which companies incorporate the interests of their stakeholders in terms of economic, environmental and social criteria, into their business activities. If a company claims to be engaging in sustainable development, its responsibility is not limited merely to its current stakeholders, it also extends to future generations (Bassen et al 2005, p. 232-235).

In its 2001 "Green Paper on a European Framework for Corporate Social Responsibility", the European Commission took the concept of CSR and defined it as a "concept that provides companies with a basis for voluntarily integrating social issues and environmental issues into their business activity and interactions with stakeholders". This explicitly expressed the influence of stakeholders on a company's actions and the necessity for a company to consider its social and environmental responsibility when deciding on its strategy and activities.

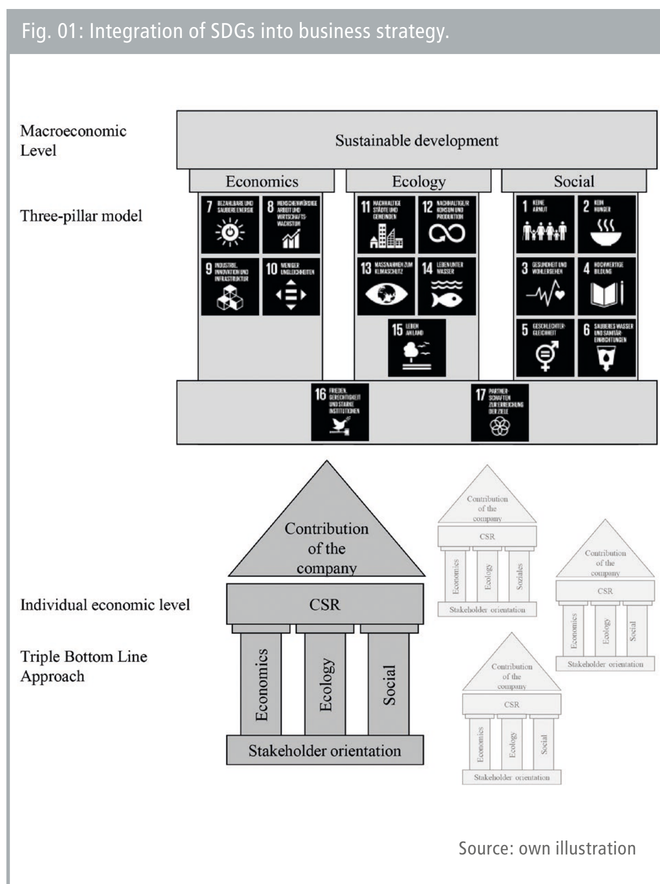
Achievement of targets can be represented and measured using the three dimensions from the triple bottom line method. A key aspect of CSR back in 2001 was its voluntary nature. The principle was that companies would recognise for themselves without compulsion that CSR can generate direct and indirect competitive advantages. The direct competitive advantages include a better working environment, increased motivation and productivity of employees, and more efficient use of natural resources. Indirectly, adopting CSR leads to growing interest from customers and investors, resulting in better market opportunities. However, the European Commission was also aware that the opposite can happen, where disclosure of CSR information can elicit criticism on the part of stakeholders, as a result of which a company's image can be negatively influenced (European Commission 2001, p. 5-8). CSR reporting can therefore have both a positive and a negative impact on a company.

The global economic crisis that began in 2007 and its social consequences, along with an associated loss of trust in companies, led to an increase in public interest in the macro-economic effects of companies' activities. This brought CSR guidelines even more sharply into focus. As part of the "EU Strategy (2011-14) for Corporate Social Responsibility (CSR)" the European Commission actually changed its definition of CSR and, since then, has referred to CSR in a shorter form as "the responsibility of companies for their impacts on society."

On the one hand, this adjusts the definition to coincide with existing international frameworks. On the other, it eliminated the voluntary aspect, as it was already becoming apparent at that stage that adoption of CSR in the EU would need to be legally regulated in subsequent years. Stakeholder orientation is and remains central. A combination of voluntary measures and mandatory regulations are in place to encourage companies to develop an appropriate, flexible and individual approach for themselves (European Commission 2011, p. 5-14). The 2011 - 14 EU strategy thus contributed to a more comprehensive understanding of business success based on the triple bottom line method among the wider public.

The responsibility a company is required to demonstrate towards society and how it achieves this can be expressed using the SDGs (see ▶ Fig. 01). The SDGs also reflect the different stakeholder interests. By adopting the SDGs in their strategy and implementing them in their business model, companies can also document their contribution to macro-economic sustainable development, as ultimately it is companies whose contributions enable the targets at a macro-economic level to be achieved.

Fig. 01: Integration of SDGs into business strategy.




Source: own illustration

**Combining CSR and ESG into sustainability risks**

Alongside the "CSR" concept, the abbreviation "ESG" has also become established in the academic and public discourse surrounding sustainability. It stands for the dimensions Environment, Social and Governance. In contrast to CSR, it has no economic dimension. Instead, the governance dimension incorporates the issue of sustainable corporate governance. The ESG criteria represent the basis for corporate sustainability ratings and thus supplement the existing financial ratings, which focus on the economic dimension. In recent years, there has been a steady rise in the importance of ESG information for medium and long-term forecasts of business success. This has resulted in greater interest in ESG information in the financial market and for financial investments.

CSR and ESG developed from different directions, but it is vital not to view them as separate or isolated from one another. While the ESG criteria are intended to create a supplementary basis for evaluation of a company's initiatives and measures in terms of environmental, social and governance issues, CSR is focused on the triple bottom line and thus on the success of sustainability initiatives and measures across the three dimensions of economic, environmental and social aspects. The symbiosis between CSR and ESG provides the four dimensions of sustainable business direction: economics, environment, social and governance (Bouten/Wiedemann 2021, p. 254).

The growing importance of sustainability and appropriate reporting has also led to increased awareness of the associated risks. To address sustainability risks as part of the reporting process, comprehensive identification and assessment of all business risks is essential. Sustainability risks refer to events or conditions from the environmental, social and governance dimensions that have an actual or potential negative impact on business success. Because they focus on the ESG criteria, they are also referred to as ESG risks. As emerging sustainability risks always affect a company's financial success, they also impact performance risks. This can entail higher capital resources if more risk coverage capital has to be held. Increasing risks can also lead to rising capital costs. Correspond-

ingly, it is important to analyse the influence of sustainability risks on turnover, costs and annual profits. It is not only the influence of the risks on the company that have to be taken into account (outside-in perspective), but also the impacts that emanate from the company to its stakeholders (inside-out perspective). There are long-term interrelationships and interactions between the two risk perspectives (COSO/WBCSD 2018, p. 53).

Because they tend to have a longer-term horizon, locating sustainability risks within operational risk management makes little sense. Instead, they should be considered in the context of the business model or the business strategy. It is also important to establish appropriate governance structures. At present, we are not yet seeing systematic recording and representation in corporate governance. Changing this is the responsibility of senior executives who have to introduce the necessary processes when it comes to identification, management and monitoring of sustainability risks. In particular, early detection processes need to be established and reviewed regularly. The methods used must be consistent with the business and risk strategy and must enable appropriate management of the relevant sustainability risk (BaFin 2020, p. 18-27).

The concept of risk governance is ideally suited here (Wiedemann et al. 2022). Risk governance ensures continuous adjustment of business activity to the current risk environment and, where necessary, initiates changes in the existing strategy or a strategic realignment. At the heart of risk governance are stakeholder interests. This enables a relationship to be created between stakeholder interests and sustainability risks. Under some circumstances, it is precisely sustainability risks with their long-term effect that ultimately have a decisive influence on long-term business success (Stein/Wiedemann 2016). Risk governance means that sustainability issues are incorporated into corporate management through the stakeholder focus, thus enabling sustainable business success to be ensured and communicated to stakeholders through the external reporting system. Interweaving internal management and external reporting is effective when the indicators used internally and reported externally are closely linked to one another.

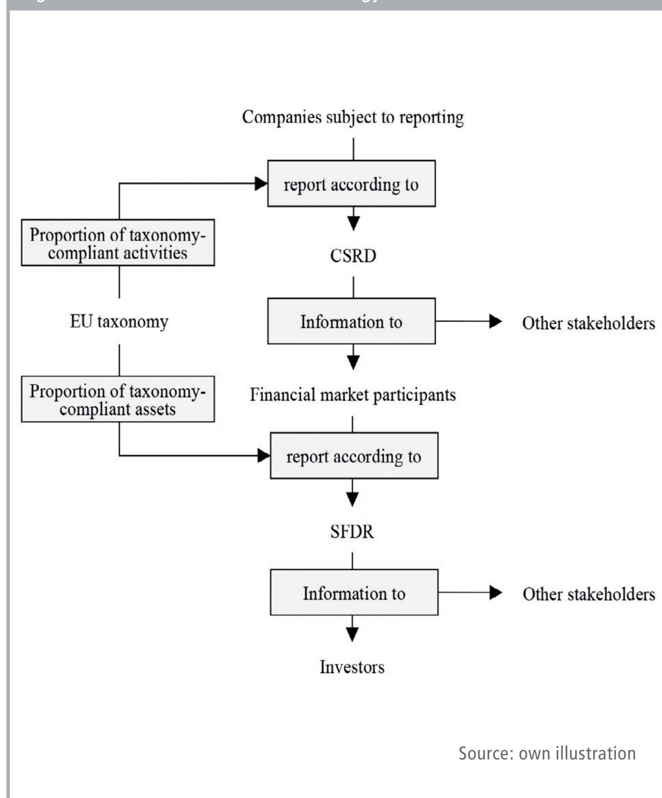
**Corporate sustainability reporting in the EU**

On 16/12/2022 the “Corporate Sustainability Reporting Directive” (CSRD) was published in the EU Official Journal. The revised directive redefines what is meant by reporting. Firstly, it no longer refers to “non-financial reporting” but specifically to “sustainability reporting”. At the same time, sustainability information is put on an equivalent footing to financial data. The CSRD is aimed not only at capital providers, but at all stakeholders. All large companies, as well as listed SMEs, are subject to the CSRD (with the exception of micro-businesses). According to the schedule, reporting for 2024 to be published during 2025 will initially only be required for companies who were previously subject to the Non-Financial Reporting Directive (NFRD, implemented in Germany as the CSR-RUG). Reporting will then become mandatory for all other large companies a year later. Listed SMEs will be subject to the CSRD for the first time in 2027 (for the 2026 fiscal year). However, they will have an opt-out until 2028. Therefore, the number of reporting companies will increase continuously in the coming years.

A key foundation of the CSRD is the principle of double materiality. Accordingly, companies’ reporting must elucidate the impacts of their business activities. It is not sufficient for the outside-in and the inside-out perspective to be included only in internal management, in future both of them will also have to be incorporated into external reporting. Furthermore, materiality in both the outside-in and the inside-out perspective was previously a prerequisite for a reporting requirement. In the future, materiality in just one perspective will impose a reporting obligation. The content of CSRD reporting will be specified in more detail by dedicated EU Sustainability Reporting Standards (ESRS). The CSRD provides for publication of the ESRS by June 2023. The standards will be developed by the European Financial Reporting Advisory Group (EFRAG) in several stages. In addition to general standards for CSRD reporting, there will also be sector-specific standards and SME standards by June 2024 (EU 2022).

In conjunction with the EU taxonomy and the Sustainable Finance Disclosure Regulation (SFDR), the CSRD makes up the EU’s “Sus-

Fig. 02: EU “Sustainable Finance” strategy.

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tainable Finance” strategy (see ▶ Fig. 02). The EU taxonomy is a classification system for the European economic area, which sets out the activities that are classed as sustainable and provides corresponding indicators such as turnover or investments to be recorded and reported for them. Companies subject to the CSRD must include particular indicators based on the EU taxonomy in their reporting. As a result, the taxonomy criteria will be reflected in the ESRS. Information from the CSRD is available to financial market agents and all other stakeholders. For their part, the SFDR imposes an obligation on finance companies to disclose information about the sustainability effects of the financial products they are selling. For example, this could be details of the greenhouse gas emissions of the investments included in the financial products. To meet their disclosure obligations, providers of these kinds of products will also require information from the CSRD reporting of companies included in their investment products. Thus, the CSRD is closely linked to the SFDR. Financial products that partially or completely follow sustainable investment goals must disclose the proportion of the investments that meet the taxonomy criteria through the SFDR to give investors guidelines for their investment decisions (European Commission 2021, p. 3-4).

**Summary**

The previous one-dimensional concept of success based solely on economic performance has been transformed into a three-dimensional concept of success, which also reflects environmental and social success (triple bottom line). Where this addresses not only current stakeholders but also includes future generations, it can be referred to as sustainable business success. Risk governance has the task of promptly drawing attention to threats to sustainable business success. If this is accompanied by a simultaneous interweaving of internal management and external reporting, risk governance not only supports compliance with the requirements of the CSRD but also contributes to a holistic business orientation.

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