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ESG RISK MANAGEMENT: SOME OBSERVATIONS FROM AN ACADEMIC PERSPECTIVE

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ESG risk refers to the potential risks associated with environmental, social and governance (ESG) factors in the decision-making process. ESG refers to a set of principles that guide a sustainable and responsible approach to investing. This means that ESG factors should be taken into account in investment decisions, where social and environmental impacts should be considered alongside financial aspects.

Although the analysis of the relationship between environmental, social and governance (ESG) criteria and corporate performance, particularly in financial terms, dates back to the early 1970s (Friede, et al., 2015), the issue has become the subject of intense academic interest since rating agencies began issuing ESG risk ratings (Escrig-Olmedo, 2019; Gallucci, et al., 2022).

An ERM framework that integrates risk management with strategy and performance is recommended for effective ESG risk management. However, activity in this area is not widespread, and the literature highlights significant differences in practice, both by company structure and location. ESG risk management is common in risk management systems in Europe, Asia and Australia, but less common in Latin America. This is more characteristic of SMEs and large companies. Small companies and start-ups are more likely to overlook ESG risks (Zioło, et al., 2023). There is no doubt that integrating ESG issues into a risk management framework presents both challenges and opportunities. Key challenges highlighted by researchers include:

- lack of consensus on the benefits of incorporating ESG factors into a risk management framework (Jain & Tripathi, 2023; Pratama, et al., 2022);
- difficulties in quantifying ESG risks, which often relate to unpredictable events that can affect not only performance but also the very existence of the company (Cornell, 2021).

In contrast, the key opportunities for the organisation are identified primarily as:

- build their competitive advantage using ESG risk management as a determinant of long-term value creation for their business (Dinh, 2023);
- reduce idiosyncratic risk, which is also a driver of performance improvement (Aw, 2022);
- improve supply chain efficiency (Gündoğdu, 2023).

The current state of ESG activity is undoubtedly forcing companies to make trade-offs between ESG considerations, innovative ventures, and overall financial performance. Although there is no consensus in the academic literature on the benefits of incorporating ESG factors into a company's management processes, there is no conclusive evidence that the inclusion of ESG criteria leads to poorer performance (Aw et al. 2022). The lack of consensus on the benefits of ESG risk management can be attributed to several factors. First, there is a lack of consensus on the definition and measurement of ESG components themselves (Neto & Fontgalland, 2023). The variety of methodologies used to measure ESG over different time periods and investment areas can lead to inconsistencies in the reported results of studies in this area (Ouchen, 2021).

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The discussion of ESG risks is becoming more in-depth and covers a broader range of issues. While there is a growing body of research examining the relationship between ERM and ESG risks, the evidence suggests that ESG risks can impact a company's sustainability, financial performance and risk management processes, and that incorporating ESG factors into ERM practices can be key to effectively managing these risks. However, it should be made clear that ERM and ESG are complementary frameworks that address different aspects of risk management and corporate sustainability. As ERM focuses on integrated risk management across the organisation, while ESG encompasses environmental, social and governance factors that are increasingly recognised as important determinants of corporate performance and risk profile, their integration is critical for organisations to effectively manage risk, ensure sustainability and improve overall performance.

I believe that the articles offered to you in this issue of PMC are a contribution to building knowledge to equip managers with the skills needed in these complex and turbulent times, not least in relation to relatively new risks such as ESG risks.

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