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The Role of ESG in Corporate Risk Management: A Literature Review

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ABSTRACT

Environmental, Social, and Governance (ESG) has emerged as an important approach to enhancing corporate sustainability and resilience in an increasingly complex business environment. This study aims to analyze the role of ESG in corporate risk management through a literature review approach. The research employed a qualitative method by examining scientific articles and academic publications published over the last five years. The analysis process involved identifying, selecting, evaluating, and synthesizing relevant literature addressing the relationship between ESG and corporate risk. The findings indicate that ESG implementation contributes to reducing various forms of risk, including operational, reputational, regulatory, and financial risks. Furthermore, each ESG dimension demonstrates a distinct contribution to risk mitigation. The environmental dimension appears to have a more consistent influence on enhancing corporate stability compared to the social and governance dimensions. The study also identifies inconsistencies in previous research findings, mainly due to differences in ESG measurements and risk indicators. The findings suggest that ESG should not only be viewed as a sustainability instrument but also as a strategic component of corporate risk management systems that support organizational stability and long-term sustainability.

Keywords: *Corporate, ESG, Risk, Risk Management, Sustainability.*

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1. | INTRODUCTION

In recent years, the issue of sustainability has become one of the main concerns in modern business practices. Companies are no longer only required to generate economic profits, but are also expected to be able to show responsibility for the environment, society, and organizational governance. The development of the concept of Environmental, Social, and Governance (ESG) shows a paradigm shift in corporate management that emphasizes a balance between economic goals and long-term sustainability. Increasing attention of investors, regulators, and stakeholders to ESG practices has prompted companies to integrate sustainability principles into their business strategies (European Commission, 2018; Atan et al., 2018).

One of the main reasons for the increasing attention to ESG is its ability to support corporate risk management. Good ESG practices are believed to help organizations mitigate various forms of risk, including operational risk, reputational risk, market risk, and financial risk. From the perspective of Stakeholder Theory, companies that are able to meet the expectations of stakeholders tend to gain stronger legitimacy so that they have better resilience to various business uncertainties. A number of studies show that the implementation of corporate social responsibility and ESG can contribute to reducing corporate risk levels through increased investor trust and strengthening relationships with stakeholders (Albuquerque et al., 2018; Bouslah et al., 2018).

The relationship between ESG and corporate risk has become an increasingly researched topic in the academic literature. Some studies have found that companies with high ESG performance tend to have lower levels of risk than companies with low ESG performance. Gangi et al. (2019) show that better sustainability practices contribute to organizational stability and reduced risk exposure. Similar findings were also put forward by Sassen et al. (2018) who stated that ESG factors have a significant relationship with the reduction of corporate risk. However, a number of other studies have shown that the strength of these relationships is not always consistent across different industry sectors and the risk measures used.

While research on ESG and risk has progressed rapidly, there are still some research gaps that require further attention. First, the results of previous research still show inconsistencies related to the magnitude of the influence of ESG on company risk. Second, most studies use ESG scores in the aggregate so that the contribution of each environmental, social, and governance dimension is not fully understood. Third, the existing literature is still dominated by research on non-financial companies, so empirical evidence in other sectors is still relatively limited. In addition, various studies use different risk measures resulting in findings that are diverse and difficult to compare directly (Neitzert & Petras, 2022).

The article conducted by Neitzert and Petras (2022) makes an important contribution by showing that ESG has a negative relationship with risk, but the influence of each ESG dimension can vary. The study also indicates that the

environmental dimension has a relatively more consistent contribution in reducing the risk level compared to other dimensions. The findings open up an opportunity to conduct further studies on how ESG implementation contributes to organizational risk management and the factors that affect its effectiveness.

Based on this background, this study aims to analyze the relationship between ESG implementation and corporate risk management through a qualitative approach based on literature review. This research is expected to provide a more comprehensive understanding of the role of ESG in supporting organizational sustainability while enriching the literature on the relationship between sustainability and risk management. In addition, this research is also expected to be able to contribute to academics and practitioners in understanding the importance of ESG integration as part of corporate risk management strategies in the modern business era.

2. | LITERATURE REVIEW

Environmental, Social, and Governance (ESG) in a Sustainability Perspective

Environmental, Social, and Governance (ESG) is a framework used to assess the extent to which a company integrates environmental, social, and governance aspects into its operational activities and business strategies. This concept evolved in response to the increasing demands of stakeholders on business practices that are not only oriented towards financial profits, but also consider the resulting social and environmental impacts. From the perspective of Stakeholder Theory, companies that are able to accommodate the interests of various stakeholder groups tend to gain higher legitimacy and have a greater chance of maintaining long-term sustainability.

The environmental dimension encompasses a wide range of companies' efforts to manage operational impacts on the environment, such as energy efficiency, emission reduction, and waste management. The social dimension relates to the relationship between the company and employees, customers, the community, and other parties affected by the organization's activities (Alsayegh et al., 2020). Meanwhile, the governance dimension emphasizes transparency, accountability, supervisory effectiveness, and the quality of decision-making in the company. These three dimensions complement each other in forming an integrated sustainability system.

Previous research has shown that effective ESG implementation can improve a company's reputation, strengthen relationships with stakeholders, and create long-term value for organizations. Atan et al. (2018) found that ESG disclosure has a positive relationship with company performance. The findings are supported by Buallay (2020) who shows that sustainability practices contribute to improving organizational performance. In addition, the European Commission (2018) emphasized that the integration of sustainability aspects into business strategies is one of the important factors in creating a more sustainable and resilient economic system.

ESG and Corporate Risk Management

Risk management is one of the important aspects in maintaining the stability and sustainability of the company. In an increasingly complex business environment, organizations are faced with various forms of risks that come from internal and external factors. Therefore, companies need to develop strategies that are able to reduce potential losses and increase adaptability to changes in the business environment. One of the approaches that is increasingly used in risk management is the integration of ESG principles into the company's decision-making process (Afanas' ev et al., 2022).

Theoretically, ESG can serve as a risk mitigation mechanism because it encourages companies to identify and manage various factors that have the potential to have negative impacts in the future. Good environmental practices can reduce regulatory and reputational risks, while strong social relationships can increase stakeholder loyalty. In addition, effective governance is able to minimize conflicts of interest and improve the quality of organizational supervision.

Various empirical studies show that there is a relationship between ESG and the level of corporate risk. Albuquerque et al. (2018) found that companies that have a high level of social responsibility tend to face lower risks than other companies. The results of the research of Sassen et al. (2018) also show that ESG factors have a significant influence on the reduction of corporate risk. Furthermore, Neitzert and Petras (2022) suggest that ESG implementation contributes to risk reduction, although the influence of each ESG dimension can vary. The findings show that ESG not only serves as a sustainability instrument, but also as an important part of modern corporate risk management strategies.

3. | RESEARCH METHOD

This study uses a qualitative approach with a literature review method to analyze the relationship between the implementation of Environmental, Social, and Governance (ESG) and corporate risk management. The qualitative approach was chosen because this research aims to gain an in-depth understanding of the concepts, developments, and empirical findings related to the role of ESG in reducing organizational risk. Through this approach, researchers can identify patterns, tendencies, and research gaps that are still present in the academic literature so as to produce a more comprehensive understanding of the phenomenon being studied.

The data sources used in this study are secondary data derived from scientific articles, reports of international institutions, and academic publications relevant to ESG and risk management topics. The literature used is focused on publications published in the last five-year period to be in line with the latest developments in the field of sustainability and corporate governance. The literature search process was carried out through various academic databases indexed by Google Scholar using keywords such as "Environmental, Social, and Governance", "ESG performance", "corporate social

responsibility", "firm risk", "bank risk", "risk management", and "sustainability". The selected literature is a publication that has direct relevance to the relationship between ESG and corporate risk and has a theoretical and empirical contribution to the research topic.

The stages of data analysis are carried out through several steps. First, the researcher identifies and selects literature that is in accordance with the research objectives. Second, the selected literature is systematically analyzed to identify the main concepts, theoretical approaches, research methods, and findings produced by each study. Third, the results of the analysis are compared and synthesized to find the pattern of the relationship between ESG implementation and corporate risk management. Furthermore, the researchers identified various research gaps that are still present in the literature, including differences in research results, variations in risk measurement, and limitations in the use of ESG dimensions in previous studies. The results of the synthesis are then used as a basis to explain the role of ESG in supporting company sustainability as well as a risk mitigation instrument.

To increase the credibility of the research, the analysis process is carried out by comparing various sources from previous research so that there can be triangulation of theories and empirical findings. Thus, the results of the research are expected to be able to provide a more comprehensive picture of the contribution of ESG to corporate risk management and enrich academic studies related to sustainability and risk management.

4. | RESULTS

The results of the literature review show that Environmental, Social, and Governance (ESG) has developed into one of the important indicators in assessing the quality of a company's sustainability. Various studies published in the last five years show that there is an increasing concern about the relationship between ESG implementation and companies' ability to manage risk. This development is inseparable from the increasing demands of investors, regulators, and the public for more responsible and sustainable business practices. The European Commission (2018) emphasized that the integration of sustainability aspects into the company's activities is an important part of efforts to create long-term economic stability. In this context, ESG is no longer seen only as a non-financial reporting instrument, but also as a strategic factor that can affect an organization's level of risk.

Based on the results of a review of various previous studies, it was found that companies with good ESG performance tend to show a lower level of risk than companies with low ESG performance. Albuquerque et al. (2018) found that corporate social responsibility activities can increase customer loyalty and strengthen relationships with stakeholders so that companies have better resilience in the face of market shocks. The findings suggest that ESG can serve as a protection mechanism that helps companies mitigate the negative impact of uncertainties in the business environment.

The results of another study also show that ESG is associated with reduced reputational risk. In an increasingly open business environment, a company's reputation is one of the most important assets. Companies that fail to meet social and environmental expectations have the potential to face public criticism, decreased investor confidence, and financial losses. Bouslah et al. (2018) suggest that companies with better levels of social performance tend to have a lower risk profile because they are able to build stronger relationships with stakeholders. Thus, the social aspect in ESG can be a factor that supports organizational stability in the long term.

In addition to the social aspect, the environmental dimension also shows a significant contribution to the reduction of corporate risk. Studies have found that companies that actively manage environmental impacts are less likely to face regulatory and operational risks. Finger et al. (2018) explained that good environmental risk management can improve the company's ability to anticipate regulatory changes and reduce potential losses due to environmental problems. These findings show that attention to environmental issues not only benefits society, but also has important economic implications for companies.

In the governance dimension, the results of the study show that effective governance practices contribute to improving the quality of organizational decision-making and supervision. Good governance allows companies to reduce conflicts of interest, increase transparency, and strengthen management accountability. Cui et al. (2018) found that good social responsibility and governance practices can reduce information asymmetry between companies and investors. The decrease in information asymmetry contributes to increasing investor confidence and reducing the level of uncertainty faced by companies. Literature review also shows that the relationship between ESG and risk is not only found in non-financial companies, but also in the financial sector. In this sector, ESG is increasingly seen as part of an integrated risk management system. Torre Olmo et al. (2021) show that the application of sustainability principles in financial activities can improve operational stability and support long-term risk management. The findings show that ESG has broad relevance in different types of organizations and is not limited to specific sectors.

Furthermore, Gangi et al. (2019) found that organizations that consistently implement sustainability practices tend to have a higher level of stability than organizations that pay less attention to ESG aspects. This shows that sustainability and risk management are two interrelated concepts. Companies that are able to effectively identify and manage social, environmental, and governance risks will be better prepared to deal with the changes that occur in the business environment.

However, the results of the study also show that there are differences in findings among previous studies. Some studies have found a strong influence between ESG and risk, while others show a more moderate relationship. One of the main causes of these differences is the use of different ESG indicators. Atan et al. (2018) explained that ESG measurement is often carried out using a non-uniform approach, resulting in variations

in findings between studies. These differences in methodology are one of the factors that cause the lack of a fully strong consensus on the magnitude of the influence of ESG on company risk.

In addition, the use of different risk measures also affected the results of the study. Some studies used total risk as the main indicator, while others used idiosyncratic risk, downside risk, or default risk. These variations in measurements make it difficult to compare the results of the study directly. Sassen et al. (2018) show that the influence of ESG on risk can differ depending on the type of risk used in the analysis. Therefore, the selection of risk indicators is an important factor in understanding the relationship between ESG and corporate risk management. The results of the study also show that most studies still use ESG scores in aggregate. This approach does provide an overview of the company's level of sustainability, but it is not able to explain the contribution of each ESG dimension in more detail. Buallay (2020) states that environmental, social, and governance dimensions can have different influences on company performance and stability. Therefore, an analysis that separates each of the ESG dimensions is essential to gain a more comprehensive understanding.

The most consistent findings in the literature were found in the study of Neitzert and Petras (2022). The research shows that ESG has a negative relationship with risk so that the higher the level of ESG implementation, the lower the level of risk faced by the organization. In addition, the study found that the environmental dimension has a relatively stronger influence than the social and governance dimensions in reducing risk. These findings show that companies' efforts in managing environmental issues can provide significant benefits in supporting organizational stability and sustainability.

Another interesting finding is the increasing attention of institutional investors to ESG practices. Nofsinger et al. (2019) explained that investors are increasingly considering sustainability aspects in the investment decision-making process. This condition encourages companies to improve the quality of ESG implementation to maintain attractiveness in the eyes of investors. Thus, ESG not only serves as an instrument of internal risk management, but also as a means to increase market confidence.

The results of the study show that ESG has an important role in supporting corporate risk management. Although there are still variations in findings and measurement approaches in previous studies, most of the literature shows that good ESG implementation contributes to increasing organizational stability, reducing uncertainty, and strengthening relationships with stakeholders. These findings also confirm that ESG has developed into one of the strategic components in creating corporate sustainability in the modern business era.

5. | DISCUSSION

The results of the study show that the implementation of Environmental, Social, and Governance (ESG) has a significant contribution in supporting corporate risk management. These findings reinforce the view that ESG not only serves as a

sustainability instrument, but also as a strategic mechanism capable of increasing an organization's resilience to various business uncertainties. Through better management of environmental, social, and governance aspects, companies can reduce potential risks stemming from regulatory pressures, changes in stakeholder expectations, and increasingly complex market dynamics. These findings are in line with research by Albuquerque et al. (2018) which stated that social responsibility activities can improve a company's ability to deal with external shocks through strengthening relationships with customers and other stakeholders.

This research also shows that the relationship between ESG and corporate risk cannot be understood through an aggregate approach alone. The results of the literature synthesis indicate that each dimension of ESG has different characteristics and contributions in the risk mitigation process. The environmental dimension tends to be related to the reduction of regulatory and operational risks, while the social dimension contributes to the improvement of the company's reputation and legitimacy. Meanwhile, the governance dimension has an important role in improving transparency and quality of organizational decision-making. These findings support the argument of Neitzert and Petras (2022) who show that the influence of ESG on risk is not uniform and that the environmental dimension has a relatively stronger contribution than other dimensions.

In addition to answering the research gap regarding the use of aggregate ESG scores, the results of this study also provide support for the view that ESG can be positioned as an integral part of a company's risk management system. From a sustainability perspective, companies that are able to proactively identify and manage social, environmental, and governance risks will have better adaptability in the face of changing business environments. The findings are in line with the results of Gangi et al.'s (2019) research which emphasizes that sustainability practices contribute to increasing organizational stability in the long run.

Although most of the literature shows a negative relationship between ESG and risk, this study found that there is still variation in outcomes influenced by differences in ESG measurement methods and risk indicators used. This condition explains why some studies have obtained stronger results than others. These findings support the view of Sassen et al. (2018); Giese et al. (2019) who stated that the influence of ESG on risk is strongly influenced by the type of risk analyzed. Therefore, further research needs to consider the use of more specific indicators so that the relationship between ESG and risk can be more accurately explained.

The results show that ESG has evolved from a mere sustainability reporting instrument to a strategic factor that contributes to value creation and corporate risk reduction. In line with the European Commission (2018), the integration of sustainability principles into organizational strategies not only supports social and environmental goals, but also enhances the company's ability to maintain business stability and sustainability in the long term.

6. | CONCLUSION

This study aims to analyze the relationship between Environmental, Social, and Governance (ESG) and corporate risk management through a literature review approach. Based on the results of the analysis of various scientific publications over the past five years, it can be concluded that ESG has an important role in supporting organizational sustainability while helping companies reduce various forms of risks faced. Good ESG implementation allows companies to improve the quality of environmental management, strengthen relationships with stakeholders, and build a more transparent and accountable governance system. The results show that ESG contributes to risk reduction through various mechanisms, such as strengthening corporate reputation, increasing investor confidence, reducing operational uncertainty, and improving the quality of decision-making.

In addition, the study found that each ESG dimension has a different contribution to the risk mitigation process. Therefore, ESG evaluations should not only be carried out in aggregate, but also consider the characteristics of each dimension to gain a more comprehensive understanding. A more detailed evaluation can help companies identify specific areas that require improvement and develop more appropriate risk management strategies. Academically, this study enriched the literature on the relationship between sustainability and risk management. From a practical perspective, the results of the study imply that ESG integration needs to be part of a company's strategy in facing increasingly complex business challenges. Effective ESG integration can also strengthen corporate adaptability and support better long-term strategic planning. Thus, ESG can be seen as a strategic instrument that not only supports sustainability, but also increases the resilience and stability of companies in the long term.

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The data that support the findings of this study are available from the corresponding author upon reasonable request.

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