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Original Paper

ESG Management and Corporate Sustainability Based on Balanced Scorecard

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Abstract

The concept of sustainable development drives companies to pursue improving the efficiency and quality of ESG management. As a management tool for corporate strategy implementation, the balanced scorecard (BSC) was developed to achieve corporate profit maximization strategy, and with the globalization of sustainable development, more and more companies are trying to achieve value creation in environmental, social and governance. However, the inherent limitation of the traditional balanced scorecard - the lack of environmental and social responsibility perspectives - does not satisfy the strategic goal of companies to enhance their ESG management capabilities and ultimately achieve sustainable development. Therefore, this paper incorporates the concept of sustainable development on top of the traditional balanced scorecard to help enterprises carry out ESG management and further realize their long-term development goals.

Keywords

Balanced Scorecard, ESG Management, Sustainable Development

1. Introduction

Sustainable development was introduced 30 years ago to address the world's environmental and resource problems, particularly with regard to energy-related issues. In the last 10-15 years, the level of awareness about sustainable development has been increasing. In order to comply with the globalization trend of sustainable development, many companies try to find a balance between economics and ESG. Although, this increases their overhead and resource costs for companies, these sustainability inputs translate into future earnings for companies as society increasingly expects companies to help address issues such as environmental degradation, inequality and poverty.

In order to provide capital markets with a global benchmark for sustainability-related disclosures, on June 26, 2023, the International Sustainability Standards Board (ISSB) officially released the first final drafts of the Sustainability Disclosure Standard for International Financial Reporting (SDSIFR), which consists of two parts: the first is the "SDSIFR No. 1 - Sustainable General Requirements for Disclosure of Sustainability-Related Financial Information, which requires companies to communicate the sustainability risks and opportunities they face in the short, medium and long term, and aims to ensure that companies provide decision-relevant information to investors; and IFRS 2 - Climate-Related Disclosures, which provides specific disclosures related to The State-owned Assets Supervision and Administration Commission of the State Council (SASAC) of the People's Republic of China (PRC) issued the Reference Indicator System for ESG Reporting of Listed Companies Controlled by Central Enterprises (the "Indicator System"), which is divided into 14 types of first-level indicators, 45 second-level indicators, and 132 third-level indicators, and comprehensively measures the performance of listed companies controlled by central enterprises in terms of their green operations, fulfillment of social responsibility, and sustainability in the three major dimensions of the environment, society, and governance. It also sets two levels of disclosure: "basic disclosure" and "recommended disclosure". With the full coverage of ESG disclosure by central enterprises, the unified ESG disclosure standard in China will be mandatorily extended to all A-share listed companies.

2. Balanced Scorecard and ESG Management

ESG management is about how to improve environmental and social performance through governance, which in turn reflects on the economic value of the enterprise.The relationship between ESG and sustainable development is that the former is a strategy implementation tool used to measure corporate performance, while the latter is a broad principle covering a series of responsible business practices. The Balanced Scorecard breaks down the mission, vision and strategy into four dimensions: financial, customer, process and technology, and learning and growth, which facilitates the uploading and downloading of the strategy and ensures the efficiency of its implementation, and realizes the consistency of the strategy implementation. With the help of the balanced scorecard, corporate management can effectively evaluate ESG performance, identify deficiencies and gaps in ESG practice in a timely manner, and make sustainable development the future tone of the enterprise.

So, how to make the balanced scorecard become a tool to improve the efficiency of ESG management has become one of the topics of public concern, this paper mainly describes the following two ways as a comparison, analyze the characteristics of the two.

2.1 Adding "Social and Environmental" to the Balanced Scorecard

Since the four dimensions of the Balanced Scorecard lack the measurement of the "E" and "S" dimensions of ESG, the most direct way is to add these two dimensions directly to the "Finance, Customers, Internal Processes and Learning and Growth" as the fifth dimension. The most direct way is to add these two dimensions directly to "Finance, Customers, Internal Processes and Learning & Growth" to become the fifth dimension, as shown in Figure 1, which is also the most convenient and simplest way to combine them.

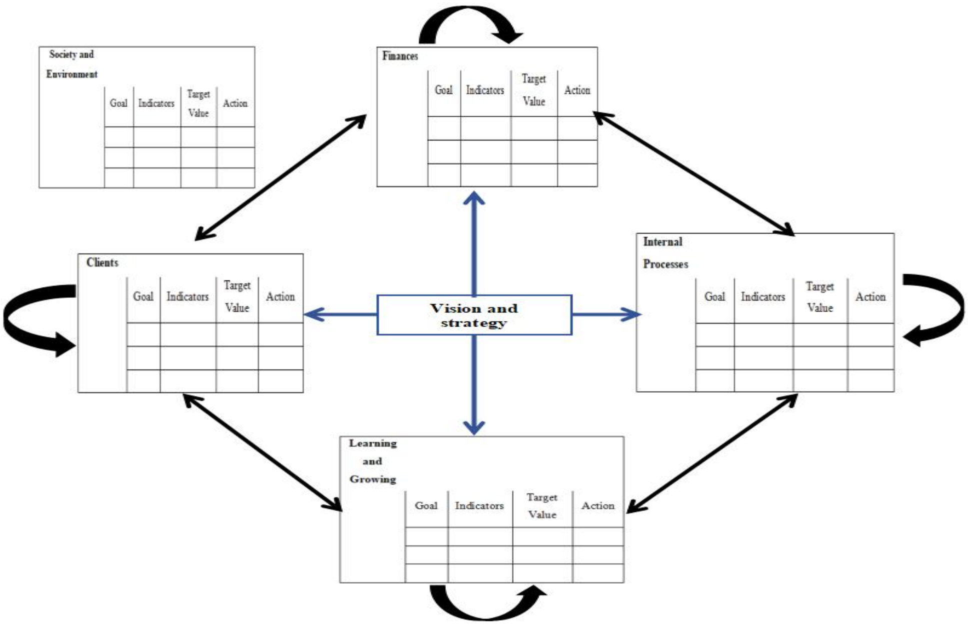

Figure 1. Addition of a "Social and Environmental" Dimension to the Balanced Scorecard

However, the obvious problem with this approach is that it separates social and environmental values from the company's strategy, lacks relevance to the company's sustainable development strategy, and is unable to effectively manage the company's ESG because this combination cannot effectively identify the relevance of the "social and environmental" dimensions to economic performance, and is prone to creating information islands and the risk of management breakdowns. It is prone to the risk of information silos and management disconnections.

2.2 Integrating ESG with the Balanced Scorecard

Another way is to nest ESG with the four dimensions of the Balanced Scorecard, and at the same time, add the original "internal process" dimension to the consideration of technical factors, so as to become "process and technology" dimension; "learning and growth" is more of a systematic enterprise development driving force, which is the most important "human resources". Learning and Growth" is more about the driving force for the development of the system enterprise, which is most importantly 'Human Resources'. Social responsibility and eco-efficiency" are also emphasized in the original four dimensions to become the fifth dimension - 'social and environmental' - to measure the health and safety of employees as well as environmental performance, based on the concept of eco-efficiency. Performance, based on the concept of eco-efficiency, reduces waste per unit of input and product and process, as shown in Figure 2. The advantage of this approach over the one shown in Figure 1 is that it does not impose the three ESG dimensions on the balanced scorecard, but rather integrates them skillfully, taking ESG performance into account from every perspective, while at the same time focusing on the performance of the "social and environmental" dimensions, and integrating sustainability factors into the balanced scorecard to strengthen ESG management. ESG management.

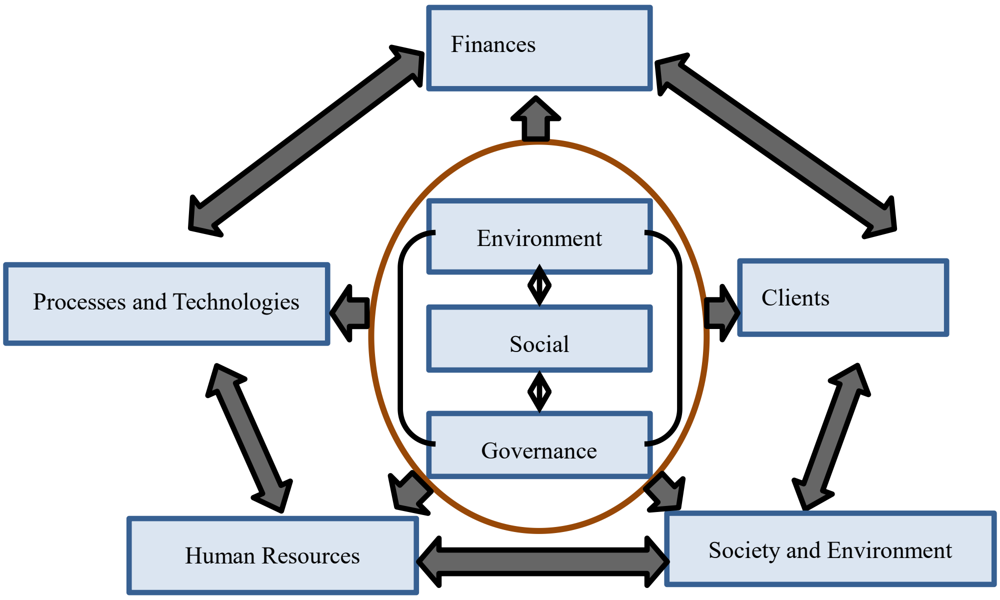

Figure 2. Integration and Splitting of ESG and Balanced Scorecard

Overall, the integration of these modules helps to support and guide the organization in achieving its sustainability goals, and the company's functional teams can do this by translating the goals in each dimension into specific action plans that detail who is to achieve what in what timeframe, and translating the qualitatively described desired outcomes into the resources that need to be allocated to achieve that goal. These actions can be revised periodically by the company's senior managers, and in-depth discussions with middle managers and front-line managers can be ensured to ensure that the plan is executable. It is also important to consider the "industry-specific" nature of these plans to achieve industry growth in a legally compliant manner.

3. Constructing a New Balanced Scorecard Evaluation Indicator System

Enterprises should build a sustainability committee under the responsibility of the board of directors to implement the ESG practice and management of the enterprise, as shown in Figure 3. The sustainable development strategy of the whole enterprise is broken down level by level through specialized functional departments.

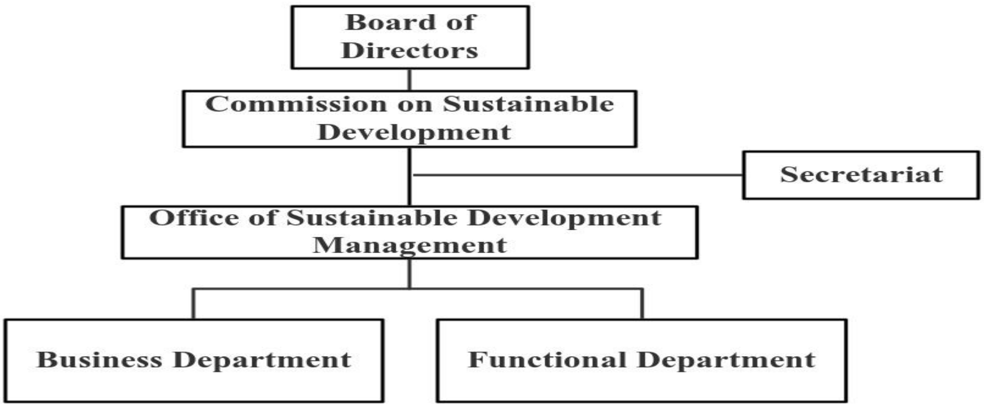

Figure 3. Organizational Structure for Sustainable Development

3.1 Preparation: Full Implementation of the 2030 United Nations Sustainable Development Goals (SDGs)

The integration of the ESG and the Balanced Scorecard constitutes a new framework for strategy implementation, and the 17 SDGs shown in Figure 4 should be taken into full consideration when selecting specific assessment indicators for each dimension. These goals are compatible with the environmental, social and governance dimensions of the ESG, for example, “13 Climate Action” corresponds to the “Environment” dimension, “8 Decent Work and Economic Growth” corresponds to the “Social Dimension”, “8 Decent Work and Economic Growth” corresponds to the “Social Dimension”, and “8 Decent Work and Economic Growth” corresponds to the “Social Dimension”. “social dimension”, and “16 Peace, justice and strong institutions” corresponds to the “governance” dimension, which is more conducive to the construction of a scientific evaluation index system.

Figure 4. 2030 United Nations Sustainable Development Goals

Moreover, when constructing the new balanced scorecard evaluation index system, it is also necessary to combine specific actions and incentives. In other words, the performance of managers is linked to rewards and penalties. Because the enterprise can achieve sustainable development depends on people rather than just information, whether it is the balanced scorecard or ESG is a tool to help the enterprise to carry out strategic practices, managers must be motivated to take action based on the new information they have obtained, and once the performance is disconnected from the rewards and punishments, the enterprise is very difficult to restrain the actions of managers.

3.2 Scientific Selection of Indicators

Relevant guideline documents have been issued for domestic and international appraisal indicator systems on sustainability disclosure and ESG. The International Sustainability Standards Board (ISSB) issued the International Financial Reporting Sustainability Disclosure Standards No. 1 and 2 in 2023, and the State-owned Assets Supervision and Administration Commission of the State Council issued the Reference Indicator System for Special Reporting on ESG of Listed Companies Controlled by Central Enterprises and the Standard Values for Evaluation of Enterprise Performance 2023. The selection of these indicators should be combined with the development characteristics of different industries, and targeted to build an adaptable, balanced scorecard as the carrier of the performance evaluation system for strategy implementation. Table 1 visualizes the changes in the balanced scorecard framework after ESG integration.

Table 1. Balanced Scorecard Framework after ESG Integration

Dimension		**Specific indicators (1 example each)**
Finances	E	Digital farming input ratio
	S	Cultural satisfaction
	G	Return on net assets
Clients	E	Green logistics
	S	Customer satisfaction
	G	Compliance System
Processes and Technologies	E	Emergency Response Plan for Environmental Emergencies
	S	Supply Chain Management Policies and Measures
	G	Governance Strategy Oversight Process
Human Resources	E	Green Office and Operations
	S	Per Employee Compensation Growth Rate
	G	Ownership Responsibilities
Society and Environment	E	Environmental Expense Investment Ratio
	S	Public Welfare Donation Rate
	G	Sustainability Management Organization and Functions

ESG management with the help of balanced scorecard can not only link corporate strategy with ESG, but also decompose responsibility, authority and responsibility to the person, and effectively carry out corporate management.

4. Summarize and Prospect

What exactly does ESG management govern? Who manages it? What is its relationship with corporate sustainable development? Due to space constraints, only a brief explanation is provided in this article. More than thirty years after its creation, the intuitive structure of the Balanced Scorecard (BSC) remains the dominant framework for corporate strategy execution and goal management systems. The original structure of the Balanced Scorecard needs to be updated as current socially conscious strategies evolve; a new capital structure may be required for rapid and steady company growth; and the company's culture needs to be stronger and more transparent in response to short-term performance pressures in pursuit of long-term sustainability and leadership. Therefore, effectively utilizing the Balanced Scorecard to provide a more efficient way to manage ESG can enable ESG to be deeply integrated with corporate strategy, and taking on social and environmental responsibility is gradually becoming an essential part of the road to sustainable development.

In the future, enterprises should pay more attention to their contribution to society and the environment while developing economically, so that “value sharing” will become the mainstream, that is to say, they should not only pay attention to their own benefits, but also consider the value creation of the stakeholders in the ecological environment, and the improvement of the environment and social performance will in turn contribute to the enterprise's comprehensive value.

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