GREEN IS THE NEW BLACK: THE VALUE OF SUSTAINABILITY IN SWEDEN

Master Thesis in Finance – HT 2015

Abstract

Being green and sustainable has never been trendier. Both financial markets and governments are currently placing increased focus on non-financial aspects. Swedish regulators, firms and investors have been at the forefront of this development and are often regarded as role models by other countries and institutions. In order to investigate the impact of sustainability, and non-financial reporting in particular, on Swedish firm performance, a limited event study on the market reaction to increased mandatory non-financial disclosure is conducted – Part I. The result from the event study as well as previous research is thereafter discussed in interviews with sustainability representatives, consultants and investors from Swedish organizations in order to further understand the net benefits or costs from non-financial aspects – Part II. Despite that the event study showed no significant cumulative abnormal returns, the interviews provide valuable findings on the relationship between sustainability and financial performance. The benefits of investing in sustainability are seen in all represented industries and relate both to direct improved business operations (including cost reductions, product innovation and increased employee satisfaction) as well as benefits from enhanced stakeholder/investor relations (including better access to capital, enhanced brand value and reduced regulatory risks).

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Hanna Grahn
21928@student.hhs.se

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1 Introduction

> ***Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs. – The Bruntland Report Our Common Future, 1987***

Being green and sustainable has never been trendier. Both the financial world and governments are currently placing increased focus on non-financial aspects. Definitions of sustainability vary greatly, but the *Bruntland Commission's* explanation above is often cited by investors, companies and the academic world. The concept of corporate sustainability has developed over the past decades to involve three types of relevant capital – environmental, social and governance ("ESG") factors (Dyllik & Hockerts, 2002). ESG are a subset of non-financial performance indicators which include sustainable, ethical and corporate governance issues. This non-financial data when used in financial markets by companies disclosing additional information and by investors evaluating companies' attractiveness as an investment (PRI, 2015; see Appendix 9.1 for further details).

Academic research has been focusing on exploring the relationship between ESG and financial performance. Companies that build sustainability into their core strategies have been proven to outperform peers with less ESG commitment (Chang & Kuo, 2008; Clacher & Hagendorff, 2012; Cohen, 2010). It is not surprising then that the share of CEOs seeing sustainability as their top priority has been increasing steadily since 2010 and today over 13% claim it to be their most important priority (McKinsey, 2014). In line with increasing corporate focus on ESG, there has been a strong growth in the number of non-financial disclosures being reported, both following voluntary and mandatory guidance.

From an investor perspective, including sustainability in investment decisions enables a more thorough understanding of the risks and opportunities that face the companies in which they invest. Consequently, financial markets are seeing an increasing demand for responsible investments ("RI") and sustainable financial vehicles. Growing numbers of investors are today choosing investments based on material non-financial criteria In 2014, $1 out of every $6 of US assets under professional management, to a total of $6.57 trillion, was invested in some form of sustainable investment, primarily in public equities (US SIF, 2015). This 76% growth is driven by a growing recognition in the financial community that effective research, analysis and evaluation of ESG issues should inform asset allocation, stock selection, portfolio construction, shareholder engagement and voting. For example, the Norwegian pension fund *Norges Bank*, with $260bn assets under management requires companies to show strategies for climate change risk mitigation and water management. It has divested from both timber and palm oil companies that don't meet their standards (CDP, 2015).

Investing in sustainability has usually met, and often exceeded, the performance of comparable traditional investments. This is on both an absolute and a risk-adjusted basis, across asset classes and over time (Morgan Stanley, 2015). As a result, leading companies across the globe are being pushed by investors to change perspective and consider sustainability as a platform for growth (Rigby, 2008).

Firms in Sweden and the Nordic region have been at the forefront of this development and are often regarded as role models by other countries and institutions. In 2007, Sweden pioneered sustainability / ESG reporting when all state-owned companies became legally required to publish sustainability reports according to the *Global Reporting Initiative ("GRI")* framework (RobecoSAM, 2015). Furthermore, Sweden is one of the top-ranked countries in the world regarding firms' disclosure of non-financial information in their annual reports. 82% report on ESG aspects compared to the international standard 56% (KPMG, 2015). Thus, it is of particular interest to investigate how Swedish companies, investors and other stakeholders react to the ESG initiatives and non-financial reporting requirements.

To further examine the impact of sustainability and non-financial reporting in particular, on Swedish firm performance, a limited event study on the market reaction to increased mandatory non-financial reporting will be conducted. The result from the event study and the by previous research proposed set of ESG net effects will later be discussed in interviews with sustainability representatives, consultants and investors from Swedish organizations to further understand the net benefits or costs from non-financial aspects.

Based on this two-phased approach, this study aims to contribute to existing research by providing an explanation to whether sustainability provides value to a company's operations and profitability. The market reaction to proposed non-financial legislation is closely related to the value firms and investors place on sustainability investments. If companies benefit from devoting resources to ESG, the market reaction should be positive as equity investors then would value non-financial information. Interviews with Swedish business representatives will further add to existing research by explaining what these benefits from sustainability are. Given that the value of sustainability on firm performance neither has been examined in a Swedish context before and that Swedish businesses and investment firms are regarded as international leaders in sustainability, this study is of additional interest for the growing research on sustainability and firm performance.

Next, a literature review of the benefits and costs associated with ESG investments will be presented followed by a description of methodology. In order to then investigate investors' and firms' view on the value of sustainability, an event study on the market reaction to increased Swedish non-financial reporting requirements will be performed – *Part I* – followed by an exploratory interview-based study – *Part II.* Finally, the thesis will conclude with a discussion of the findings and suggestions for further studies. The main aim of the study is to see if Swedish firms and investors truly value sustainable practices and to answer the question if they really walk the talk?

2 Background and literature review

2.1 Guidance and legislation

In line with the growing interest in these non-financial aspects, numerous volountary guidance and requirements have been introduced by investor organisations, stock exchanges and industry associations alike. For example, the *United Nation's Principles for Responsible Investment ("PRI")* supports signatories to incorporate ESG issues into their operations while the *Sustainable Stock Exchange Initiative ("SSE")* issued a Model Guidance on Reporting to urge stock exchanges around the globe to adopt mandatory sustainability listing requirements (PRI, 2015; SSE, 2015). Furthermore, the GRI provides metrics and methods for measuring and reporting sustainability-related impacts and performance as "…this can build stakeholders' trust in organizations, and lead to many other benefits" (GRI, 2015). Prior research on the economic effects of voluntary non-financial reporting requirements have shown that investors value the additional corporate information (Dhaliwal et al., 2011; Cheng & Serafeim, 2014).

Major accounting firms are observing an increased interest from investors in the correlation between financial performance and sustainability factors like resource scarcity, environmental performance and corporate governance when assessing a company's future risk and growth opportunities. This has created a case for mitigating financial and sustainability reporting into so called integrated reporting. In integrated reporting, companies focus on and measure both financial and non-financial indicators in the same annual report (PwC; KPMG, 2014). Research indicates that companies that practice integrated reporting have more dedicated and less transient investors (Serafeim, 2014).

In addition to these voluntary guidance, mandatory reporting requirements have been introduced by several countries and unions. In 2014, the European Union ("EU") Directive 2014/95 as regards disclosure of non-financial and diversity information by certain large undertakings and groups ("the Directive") was passed. This legislation marked a significant milestone in making the corporate world more transparent and sustainable. Under the Directive, a requirement for disclosing relevant material non-financial and diversity information in annual reports will be introduced for certain large, publicly listed undertakings and groups that meet the criteria:

i. average number of employees exceeding 500, and;
ii. exceeding either a balance sheet total of EUR 20 million or a net turnover of EUR 40 million

However, each member state has the option to impose even stricter criteria when transposing the Directive to national legislation (EU, 2014). Sweden has proposed that the Directive will be applicable to all publicly listed companies with average number of employees exceeding 250, requiring a larger number of firms to disclose non-financial data (Justitiedepartementet, 2014).

The affected companies will be required to disclose in their management report relevant and useful information on their policies, main risks and outcomes relating to at least:

i. environmental matters
ii. social and employee aspects
iii. respect for human rights
iv. anticorruption and bribery issues, and
v. diversity in their board of directors.

There is however, significant flexibility for companies to disclose relevant information, including reporting in a separate report (EU, 2014).

The main purpose is to increase European companies' transparency and performance on ESG matters and, therefore to contribute to long-term economic growth. In addition, the requirement will provide investors and other stakeholders, including employees and non-governmental organisations ("NGOs") with additional information of importance to firms' overall development, performance and position.

The European Commission ("EC") and Swedish government further emphasise the importance for companies of having in place a process to integrate social, environmental, ethical, human rights and consumer concerns into their business operations and strategies. The aim is to maximise the creation of shared value for their owners or shareholders, for their other stakeholders and for society at large. More specifically, it can bring benefits in terms of six areas – risk management, cost savings, access to capital, customer relationships, human resource management, and innovation capacity (EC, 2014).

Underlying the growth of mandatory and voluntary sustainability guidance is an increasing body of evidence that ESG factors can enhance investment value and mitigate risk. These findings will be reviewed next, to provide the company perspective on how ESG investments affect returns.

2.2 General ESG performance

The academic interest in the business case for sustainability has been growing in line with the increasing interest in ESG from investors and in the corporate sphere. Both qualitative and quantitative studies have been conducted to research the value-creation associated with ESG. While some studies have found no relationship between social responsibility and profitability (Aupperle et al., 1985; Manescu, 2011), the majority of the literature provide evidence of the value of sustainability engagements. By engaging in ESG activities, companies can generate favourable stakeholder attitudes and better support behaviours (e.g. purchase, seeking employment, investing in the company) as well as build corporate image, strengthen stakeholder relationships and enhance stakeholders' advocacy behaviours over the long run (Eccles et al., 2011).

Using a structural equation model to study firms' sustainable development in term of ESG and their financial performance, reveal that the better sustainability performers may have a tendency of positive influence on firm profitability in the same and later period. In addition, a positive reciprocal causality may exist between sustainability and profitability among the better sustainability group and that profitability affects corporate sustainability positively in both higher and lower sustainability groups (Chang & Kuo, 2008).

Other studies on sustainability effects show that companies that invest in ESG initiatives can positively increase their profitability through the improvement of two kinds of variables: (i) external, such as brand image, differentiation and customer loyalty (Du, Bhattacharya & Sen, 2010; Clacher & Hagendorff, 2012); and (ii) internal variables, related to organizational processes such as resource efficiency and employee motivation (Fenwick & Bierema, 2008; Cohen, 2010).

Business objectives, rather than ethical ones, are now the key reasons organizations implement a sustainability strategy. The most important reason for a sustainable business model is to add value to the company, according to board members and CEOs. A broad group of different stakeholders, in particular clients, employees and investors, expect companies to include ESG in their operations. Findings show that companies with strong sustainability approaches are significantly outperforming their counterparts over the longer term in the stock market and in terms of higher cash flows (EY, 2013). Other evidence also exists suggesting companies with superior performance on corporate social responsibility may be valued more highly by institutional investors (Elliott et al., 2014).

Consistent with these findings, an increasing body of academic research attests to the wide range of business benefits that a company can reap from its engagement in sustainability. The most frequently claimed effects on profitability will be presented next. The potential benefits of sustainable businesses on investors' returns are classified into the three ESG dimensions, according to the PRI framework (PRI, 2015).

3.3 Environmental performance

Climate change and carbon emissions are today a major global challenge affecting all parts of operations. Regarding the financial effects of climate change and other environmental issues, actions taken by companies to reduce their environmental impacts can give improvements to leading indicators of financial success, including sales growth, duration of sales, capital expenditure, profit margin, tax rate and cost of capital. Corporations that are actively managing climate change experience 18% higher return on investment ("ROI") as well as 50% lower volatility than companies who do not to disclose their emissions (CDP, 2014). Neglecting the organisation's carbon footprint can otherwise be costly. If companies had to pay for their environmental damages, their profit would decrease with a third (UNEP, 2012).

Many environmental improvements have effects on sustainable companies' returns through cost efficiencies, in energy and other resources. Economic benefits arise from reduced input and overhead costs, militated regulatory sanctions, hedged exposure to volatile prices and supply chain disruptions (Goldman Sachs, 2011). 70% of US companies report higher ROI on emission reductions investments than on the average business investment (CDP, 2015).

In addition, companies are today facing the challenge of limited resources which creates exceptional prices and volatile natural resource markets. This places pressure on bottom lines and planning becomes even more challenging. According to Hammer and Somers, "resource productivity must be among the top priorities—if not the top priority—of industrial manufacturers around the world" (2015). In a world with limited resources, companies will need to consider their total return not just on assets and equity but on resources. Otherwise, corporations will face price increases and volatility, regulation and social pressures and consequently lower market share and profitability (Haanaes et al., 2013).

Switching to more environmentally-friendly practices additionally has the potential of stimulating innovation. Sustainable products can give access to new markets and segments, where profit margins often are higher. For example, organic food and beverages are products with considerable sales growth, a 10 to 20% increase during the past decade (UNEP, 2012). These advances in primarily environmental issues benefits society at large and the innovator through cost reductions and creation of competitive advantages attracting more customers (Porter & Kramer, 2006).

Luo and Du investigated the relationship between sustainability engagement (as measured by an outside index) and the number of new products introduced in 128 firms in all major industry sectors from 2001 to 2004. After controlling for variables such as size, financial leverage, and market stability and performing statistical regressions to determine causality, the companies in the top third in terms of sustainability activities introduced 47 new products a year, compared to twelve brought out by the companies in the bottom third (Luo & Du, 2012). Other reports have found a causal relationship between sustainability and innovation. The probability of a company regarded as a sustainability leader also is a front-runner in innovation increases with 400% compared to companies without the same ESG focus (Deloitte, 2013).

3.4 Social performance

Another area where a company's sustainability work has financial effects is in a social dimension. Benefits are often related to a company's brand and relation to its customers. To build, maintain and improve corporate reputation is one of the top reasons for executives to address sustainability. Reputation management also provides the highest-value creation potential for the next five-year period (McKinsey, 2014). Especially consumer products companies benefit from having sustainable profiles. At least two-thirds of Canadian and American consumers participating in a study claimed that they form impressions based on a company's ethics, environmental impact and social responsibility. In another study 60% of the interviewed said "knowing a company is mindful of its impact on the environment and society makes me more likely to buy their products and services" (Rigby, 2008).

Positive environmental beliefs held by consumers are associated both with greater purchase likelihood as well as with longer-term loyalty and advocacy behaviours (Du et al., 2007). It has further been demonstrated that ESG plays a role in routine consumer behaviour, over and above economic or rational considerations such as product attributes and that sustainability initiatives have a spill over on otherwise unrelated routine consumer judgments, such as the evaluation of new products (Klein & Dawar, 2003). Sustainability positively affects both customer satisfaction and loyalty which strengthens the value associated with a brand (Chung et al., 2006). In addition, evidence to the critical role that sponsorship, CRM, and philanthropy can play in impacting consumer attitudes toward a brand has been presented (Lii et al., 2011).

Consumers are today increasingly aware of sustainability issues and demand products that are environmentally and socially responsible. In particular, an increasing consumer awareness drives demand for sustainable products in the emerging markets Brazil, India and China. In addition to the effects of sustainability initiatives on customers, other stakeholder behaviours can be enacted. A growing number of researchers are discovering the internal value of sustainability to attract and retain a qualified workforce (Sen et al., 2006; Barrena-Martinez et al., 2014). As a highly-skilled workforce is essential to good economic returns, companies need to have strategies in place to attract talent. Furthermore, as the costs of high employee turnover a large, ranging from 50% of base salary for entry level positions to 400% of specialists' base salary, retaining existing staff is economically sound (Blake, 2006).

There is growing evidence that a company's sustainable activities are a legitimate and compelling way to attract, motivate and retain talent. Both employee retention and attraction are significantly correlated with sustainability performance, leading to lowered employee turnover and the associated costs (Sprinkle & Maines, 2010). Student are increasingly regarding working for a good cause and serving their community also at work as important (Peyron, 2014). Sustainability activities can fulfil employees' needs which motivates them to identify strongly with their employers, yielding substantial returns for both employees as well as the company. In addition, ESG initiatives can differentiate the company from its competitors due to its potential to create hard-to-duplicate competitive advantage (Bhattacharya et al., 2008; Melo, 2012). Several other studies find a positive relationship between a company's sustainability climate and employee job satisfaction (Sims & Keon, 1997; Viswesvaran & Ones, 2002).

3.5 Corporate governance performance

Another aspect of ESG-strategies that can affect company performance relates to governance, which focuses on the way a company is organised, run and monitored. For investors, less risk is associated with companies that devote resources to effective governance and give shareholders influence over the operations. Firms with stronger shareholder rights have proven to have higher firm value, higher profits and higher sales growth (Gompers et al., 2003). Better access to finance can further be attributed to reduced agency costs due to enhanced stakeholder engagement as well as reduced informational asymmetry due to increased transparency. As a result of better stakeholder engagement and transparency around sustainability performance, companies engaged in ESG face significantly lower capital constraints (Cheng & Serafeim, 2014). In terms of the link between a firm's governance structure and its cost of capital, research suggests that firms that rely too much on corporate control market as a governance device are punished by costlier bank loans (Chava et al., 2008).

The ESG performance is often disclosed in sustainability reports and this transparency in financial reporting further lower cost of capital stemming from reduced uncertainty for investors (Dhaliwal et al., 2011). Research indicates that companies that practice integrated reporting have more dedicated and less transient investors. In integrated reporting, companies focus on and measure both financial and non-financial indicators in the same annual report (Serafeim, 2014). Sustainability reporting and ESG-investments might be an indicator of solid corporate governance and positive non-financial information about a firm enhances potential investors' intentions to invest in the company (Alniacik et al., 2012). The increased non-financial reporting can also be costly for companies relating to preparation, dissemination and assurance of the information. Still, the EU assessed the cost of a full mandatory reporting obligation to only range from €33,000 to €604,000, depending on the size of the company (EC, 2014).

Business ethics and reputation issues are another important aspect of governance. Including ESG factors in the operations can reduce overall risk by lowering the possibility of negative events such as child-labour scandals (Tsoutsoura, 2004). Jo and Na find when employing an extensive US sample during the 1991 to 2010 period from controversial industry firms, such as alcohol, tobacco and gambling, that ESG engagement inversely affects firm risk after controlling for various firm characteristics (2012). By initiating proactive governance projects, companies can also avoid potential carbon regulation and other market factors or governmental regulation that may force businesses to take other more costly action (Wilhelm, 2014). As mentioned above, regulatory and other developments that promise to increase investors' access to corporate ESG data and strengthen shareholders' rights have been proposed, to further increase the importance of ESG for companies.

The *CDP* Climate Action and Profitability report supports the importance of the governance risk aspect. Companies often quantify and monetize the impact of risks associated with ESG issues. The major climate risks include regulation (84%), physical impacts (83%) and reputation (77%). Global companies therefore focus on minimizing the risks from potential regulation and social pressure from investors, NGOs and media. An ESG conscious approach is a strategy often followed to identify and manage risk (2014). Research confirms that companies with superior sustainability performance enjoy lower risk of financial distress and overall idiosyncratic risks (Goss, 2009; Lee & Faff, 2009).

In summary, based on previous research the potential effects of sustainability investments and reporting are numerous for all three ESG aspects. Investors and firms may experience both positive and negative financial returns from sustainable investments, depending on their characteristics, geographies and industries. Given that the multitude of benefits seem to outnumber the costs, it is predicted ex-ante that the net effect of the transposed Swedish non-financial requirements will be positive. In the next section, more details are presented for how this will be further investigated.

3 Research design

In order to investigate the value investors and companies see in ESG investments, a combined approach with an initial event study followed by an exploratory interview-based study was followed. This joint quantitative and qualitative method was chosen given the often intangible effects of sustainability / ESG. Thus, both qualitative and quantitative data is needed to fully understand the link between ESG aspects and financial returns (Creswell, 2008).

3.1 Part I – Quantitative event study

3.1.1 Methodology

A useful method for investigating the financial impact of ESG / sustainability is event studies. This approach uses stock returns to analyze the market reaction to a certain event, in this case increased non-financial reporting. Under the efficient market hypothesis, stock prices are assumed to fully reflect publicly available information and adjust rapidly to any news (Fama, 1970). Changes in stock prices can consequently be used to determine the perceived net benefits or costs of sustainability in general and non-financial reporting in particular.

The univariate, i.e. on average, market reaction to the event will be examined. If equity investors believe the benefits from non-financial reporting will exceed the costs, a positive market reaction around the event is expected. Contrary, if investors perceive the costs to outweigh the benefits, a negative market reaction is predicted. Given the extensive body of research described above, claiming that ESG strategies created value for firms, the tested hypothesis will be that Swedish financial markets react positively to the news of mandatory non-financial disclosure.

In order to conduct an insightful event study, the recommendations by MacKinlay (1997) and McWilliams & Siegel (1997) has been followed, and will be presented in more detail below.

3.1.2 Event date and event window

As a first step, the event date needs to be defined. Several dates have influenced the likelihood of the EU adopting increased non-financial reporting requirements. In previous research, three events of particular importance have been identified on a European level. Firstly, on April 16, 2013, the EU Commission expressed a will to improve the ESG disclosure of certain companies by amending existing accounting legislature. Secondly, on February 26, 2014 the European Parliament and the European Council agreed on the proposal. Thirdly, on April 15, 2014 the European Commission adopted the Directive (EU, 2014).

However, given the Swedish context of the thesis, the event of interest is the date when the Swedish government proposed the legislative changes based on the Directive. Following the adoption of the

Directive, all EU Member States should transpose the rules on non-financial reporting into national legislation by December 6, 2016. Each EU member state has the option to impose stricter non-financial requirements when transposing the Directive. The event that will be investigated is consequently December 19, 2014, when the Swedish legislative changes as result of the Directive was presented (Justitiedepartementet, 2014).

Even though this event marks the presentation, rather than adoption of the transposed Directive, it was preceded by considerable consultations and dialogues with stakeholders such as users and non-governmental organizations. Consequently, the event can be regarded as significant for the passing of stricter sustainability reporting for Swedish companies.

However, other events during or in close relation to the event date should be investigated to eliminate any confounding factors. Hence, the leading Swedish business newspaper *Dagens Industri*, daily newspaper *Svenska Dagbladet* and the European edition of *Bloomberg Business* as well as the *Financial Times*, were searched for news unrelated to non-financial reporting on the day preceding, day of and day after the event. The assessment identified one other event with potential influence on stock prices – the EU summit where European leaders discussed further sanction against Russia regarding Krim. Nonetheless, as this event would have similar effects on both the treatment and control group, its influence on the results was regarded as limited.

Next, the event window was determined. When setting the time frame, one must take the specific characteristics of the event into consideration and On the one hand, the event window must be long enough to allow for the event to have impact on stock returns. Even though, research has shown that news are incorporated into stock prices already within the first minutes after the news release, market participant might be unable to understand the full extent and therefore need time to adjust accordingly to the news (Frijins & Schotman, 2009).

On the other hand, the event window cannot be to be too wide, as it decreases the reliability of the results. The longer the event window, the more potentially confounding events will be included which can distort the relationship between the investigated event and the stock market reaction. Hence, the event window was set to days (-1, +1), where day 0 is the event date. As December 19 2015 was a Friday, the +1 day is instead December 22 2014. This is also in line with previous research on the effect of reporting legislation (Zhang, 2007; Armstrong et al., 2010; Grewal et al., 2015).

3.1.3 Data set and abnormal returns

Stock data for Swedish, public firms was collected from S&P Capital IQ. The search criteria resulted in a data set consisting of 470 firms, representing a wide range of industries – most companies operating in technology / telecom, industrials or retail. In the cases where number of employees – full-time equivalents ("FTEs") – where not listed, the data set was complemented by additional information from allabolag.se (2015). The data set could then be sorted to only include firms that would be affected by the increased Swedish legislation. Factors determining this are number of employees, turnover and / or balance sheet.

The sorted data set of 148 companies was then analyzed to see if companies that would be affected by the reporting requirements would show positive or negative abnormal returns. Thus, the *dependent variable* used is CAR_i, the cumulative three-day abnormal stock return for firm i to the event identified as impacting the probability of increased non-financial disclosures in Sweden. This is in line with prior research examining the market reaction to regulation (Zhang et al., 2010; Armstrong et al., 2010).

The abnormal return is the difference between the actual and the normal return of a security:

$$(1)\quad \widehat{AR}_{it} = R_{it} - \widehat{NR_{it}} \qquad \widehat{AR}_{it} \sim N(0, \sigma^2(\widehat{AR}_{it}))$$

$\widehat{AR}_{it}$ $\quad$ *estimated abnormal return for sequrity i in period t*

R_{it} $\quad$ *realized (actual) return for sequrity i in period t*

$\widehat{NR_{it}}$ $\quad$ *estimated normal (expected) return for sequrity i in period t*

Hence, the normal return must be calculated in order to determine if the realized returns are abnormal or not. Using the market model of calculating normal returns, follows the formula:

$$(2)\quad NR_{it} = \alpha_{it} - \beta_i R_{mt} + \varepsilon_{it}, \qquad with\ E(\varepsilon_{it} = 0)\ and\ var(\varepsilon_{it}) = \sigma^2_{\varepsilon_i}$$

NR_{it} $\quad$ *normal return for security i in period t*

R_{mt} $\quad$ *return on the market portfolio in period t*

$\alpha_i, \beta_i, \sigma^2_{\varepsilon_i}$ $\quad$ *parameters of the market model*

ε_{it} $\quad$ *zero mean disturbance term*

The OMX Nordic 40 was used as the market portfolio. To find the market effects attributable to the transposed Directive, the returns of the affected firms were compared to the returns expected by the market model. These abnormal returns for each date in the event window were then summed up for every affected firm.

To further analyse the results, the abnormal returns of the affected (treatment) group of firms was also compared to the abnormal returns of firms unaffected by the non-financial reporting requirements (control group). Lastly, the abnormal returns were tested for statistical significance using a t-test.

3.2 Part II – Qualitative study with interviews

Following the initial event study, interviews with leading Swedish companies, investors and consultants will explore and explain the registered market reaction to non-financial aspects. Rather than performing further cross-sectional analysis to determine variables that could affect equity investors' perceptions, a qualitative interview study will be used to complement the results in Part I. The interviews are also needed for investigating whether Swedish market participants attach value to sustainability in general, not only to the reporting of these factors.

The non-financial aspects of a business will be analysed using the qualitative approach that relates empirical findings to research. Hence, the literature review above on the potential value to businesses from ESG will initially define the most prominent areas of improvement in performance. These will be compared to the material gathered during interviews and related secondary sources. The findings will then be presented under each of the three ESG indicators to identify in what way sustainability strategies can influence financial returns and investor's behaviour.

3.2.1 Methodology

Qualitative studies are based on a comparison of empirical results to existing literature and theory in the subject. The approach is suitable for explaining social relations and processes. Since these studies are more focused on complex processes and in-depth knowledge, compared to quantitative studies, this method was chosen to investigate the potential value from ESG (Lundahl & Skärvad, 1999).

Interviews were used as it enables a better understanding of the respondents' views, as opposed to survey studies (Creswell, 2008). The method is particularly useful for exploring the story behind a participant's experiences and to pursue in-depth information around the topic (McNamara, 1999). Interviews can be conducted along a continuum from unstructured and closer to observation, to structured using questions similar to types of questionnaire (Cohen et al., 2007). A semi-structured approach was deemed appropriate for this study. These are generally organised around a set of predetermined open-ended questions, with other questions emerging from the dialogue between interviewer and interviewee (Miller & Crabtree, 1999).

The interview process followed the seven stages of interview investigation explained by Kvale (1996). This include initial thematising and designing the purpose and study. Next, the interviews were conducted, transcribed and analysed on the basis of the topic of investigation – the value of sustainability. Finally, the interview findings were verified regarding their generalizability, reliability, and validity and then reported in an understandable manner.

This exploratory study is set in Sweden. Data collection for the qualitative part was carried out from March 2014 through March 2015. The main data source include semi-structured interviews conducted mainly in person or by phone. The duration of the interviews ranged from 45 minutes to 2.5 hours.

The interviews revolved around open-ended questions regarding i) sustainability and its financial / quantifiable effects and ii) responsible investment and other types of financing (see Appendix 9.2 for a sample of the standard questionnaire used). The semi-structured method allowed for the respondents to elaborate freely on each question as well as it providing flexibility to follow up with additional questions for clarification or elaboration. Given the heterogeneity of the selection of participants, the questions were adapted to capture unique characteristics. Nonetheless, the majority of enquiries were the same in all interviews to ensure comparability and validity to the results.

The interview guide included questions designed to gather information about the individual respondents, the ESG initiatives at the firms, examples of profitable or successful ESG investment, their stakeholder's views on ESG and sustainability evaluation methods. These questions were not sent to interviewees in advanced, allowing for more flexibility during the interview. The questionnaire was continuously re-evaluated and slightly adapted in some cases after each interview for improvement. Still, to ensure comparability and validation of results, all respondents received the same questions.

The transcribed interviews were then coded for recurrent themes in order to identify and validate reoccurring patterns in the material, and to draw conclusions regarding the profitability of sustainability investments. The qualitative data give further detail through direct quotation and comparing descriptions.

In addition, the qualitative data obtained from interviews was complemented by different descriptive secondary data from annual reports, company web sites, financial journals and other news media. This contributed to a more accurate and encompassing discussion of the effects of investments in ESG.

3.2.3 Data set

In total, 27 corporations, 3 investors and 4 sustainability consultants were interviewed (see Appendix 9.4). To obtain a non-biased picture and a balanced and more encompassing perspective, it was natural to include investors and consultants / sustainability experts as well. The complementary interviews with ESG experts provided a valuable input to the formulation and development of the questionnaire and qualitative regression.

The Swedish corporate arena is a heterogeneous market and this should be reflected in the sample to provide an accurate analysis. Selecting in-depth interview participants is based on an iterative process that seeks to maximise the depth and richness of the data to address the research question. Sustainability is a well-established concept in all types of industries, however, variations in the importance of ESG might exist depending on type of business. In order to investigate these industry-specific differences and similarities, companies from a wide range of sectors were asked to take part in the study. The represented industries include for example healthcare, industrial production, insurance and consumer goods. With the purpose of addressing the relation between stakeholder influence and the effects of ESG, the ownership structure was also taken account of. The sample enclosed family-owned, private and public organisations.

To further represent the wide-ranging Swedish business sphere, businesses from all parts of the value chain were included, from raw-material production to recycling. The sample furthermore take account of both business-to-business (B2B) and business-to-consumer (B2C) oriented organisations. A final factor that was considered when making the sample selection was to gather the statements from companies with varying degrees of international presence. This applies to sourcing, production, distribution and other operations. Including companies with disperse characteristics allows for a more in-depth understanding of how the ESG dimensions can be linked to profitability. Given these facts, a more encompassing picture of the value ESG brings to Swedish enterprises and ultimately investors, could be investigated.

4 Part I

4.1 Results

When calculating the cumulative abnormal returns for the group of companies affected by the proposed Swedish directive on non-financial disclosure, a small positive return is obtained for the treatment group on December 19 and December 22, 2014, please reference **Table 1** below. This can be compared to the less positive CAR_i for the unaffected control group on December 19, 2014 and the negative cumulative abnormal return on December 22, 2014. Both groups exhibit negative cumulative abnormal returns on the day preceding the event, December 18 2014, slightly more negative for the affected firms.

A negative return on the day preceding the event, followed by positive cumulative abnormal returns on the event date and the following trading day, would indicate that the Swedish market reacts positively to the news of the proposed non-financial disclosure requirements. As affected firms show a stronger performance than the market index / OMX Nordic 40 and the control group, the Swedish market associates net benefits from sustainability reporting requirements. Given investors' rationality, enhanced stock prices are associated with a market belief in that the outlook for the firm's performance has improved. As the proposed Swedish legislation is the main identified event in the event window, positive returns imply that investors and other market participants see value in mandatory ESG reporting.

Table 1 – Cumulative abnormal returns

	Affected by increased non-financial reporting requirements	N	Mean	Std. Deviation	Std. Error Mean
CAR 18 Dec 2014	No	322	-.0219	.06609	.00368
	Yes	148	-.0228	.02770	.00228
CAR 19 Dec 2014	No	322	.0112	.06841	.00381
	Yes	148	.0154	.02075	.00171
CAR 22 Dec 2014	No	322	-.0001	.10174	.00567
	Yes	148	.0045	.02642	.00217

However, the results above are not significant on any level when conducting the Levene's test and a t-test, please reference **Table 2, Appendix 9.3**. This implies that the obtained results for the market reaction are not statistically valid and no formal conclusion regarding the market reaction can be drawn.

4.2 Improvements and next steps

Potential measures to improve the event study and its significance relate to areas including the methodology, characteristics and size of the selected data sample and the event and estimation window. Given that the treatment and control groups vary in terms of number of FTEs, net turnover and other business aspects, a potential addition could be to instead use the matched firms model to obtain the expected returns. In this model, the expected return of a firm on a given date is the return of its reference / matched firm on that date. Firms would then be matched on their size / market capitalization and their book-to-market ratios, so that the cumulative abnormal returns would be more closely linked to the event of non-financial disclosure legislation.

In addition, a longer estimation window could provide a better model for calculating expected returns. Larger samples are also useful for increasing the statistical significance, however most publicly listed Swedish companies are already included in the sample. Future studies should thus focus on exploring the market reaction with a more extensive event study on the legislation proposed in Sweden on December 19, 2014.

Given that the limited event study showed no significant cumulative abnormal returns, the following qualitative interview study in Part II will explore what net benefits or costs Swedish business representatives and investors attach to non-financial ESG aspects, and the reporting of this information.

5 Part II

The findings from the interviews is described and discussed in this section. The perceived benefits and costs associated with sustainability will be further described under the three different aspects of ESG (guided by the PRI framework, see Appendix 9.1 for a full list of sustainability topics), to find common trends and facilitate for conclusions to be made.

5.1 Environmental performance

5.1.1 Cost reductions

The most commonly cited value-creating effect of sustainability investments is cost reductions. All participating companies mentioned savings from environmental initiatives as a main source of increased profitability. The extent to which ESG projects contribute to better results are industry-independent, but a more pronounced trend was observed in organizations providing products rather than services. Companies running their own production plants see significant improvements in operating income from ESG projects. Reduced impact are often directly correlated to reduced costs, and the effects are evident after a relatively short time period (Ingemarson; Johansson; Domeij; Söderberg, 2014).

Nonetheless, cost savings could have prominent results on ROE and other financial ratios for service companies as well. For companies with human capital as their main resource, expense reductions deriving from offices and transportation are common. Service-oriented and technical companies including Tele2 and SPP have improved net income with ESG projects such as more efficient ventilation in offices and teleconferences instead of air travels (Baumgarts; Billinger, 2014).

The cost reductions associated with sustainability in Swedish enterprises can be classified into three main areas:

i. Cost of energy
ii. Cost of waste
iii. Cost of materials and water

The cost of limited resources will be presented in the next section, but first the impact of energy and waste management on profitability will be examined. Firstly, reducing energy usage can both reduce environmental problems and improve net income through lowered costs. Numerous examples of energy cost reductions from sustainability initiatives exists. SCA reduced its carbon footprint by 80 % and its costs by 50 million Swedish krona (SEK) annually by switching from fuel oil to wood power in the new lime kiln pulp mill Östrand (Strandqvist, 2014). Green Cargo replaced their diesel engines to modern version, which cut consumption of fuel by 30% (Sandström, 2014). Less energy is also used by JM as a result of their weather forecast-regulated heating system. Residential buildings are now heated at a more even level which reduces carbon dioxide (CO_2) emissions with 100 tonnes and heating expenses with 1 million SEK annually (Löfberg, 2014).

Secondly, sustainable businesses can improve their bottom-line through more efficient waste management. Handling waste in light of tightened disposal standards, growing land use pressures and rising transportation costs can be expensive (Våg; Söderberg; Stenmar, 2014). Waste reduction has the potential to reduce material and supplier costs, lower disposal fees, and generate revenues from recycling. Firms handling recycling in a responsible manner will also benefit from enhanced consumer perceptions (Linderoth, 2014). Additionally, in order to avoid being caught off guard by mandatory waste management regulation, sustainable businesses have to examine and improve their whole value chain. The effects are largest in the restaurant sector and in industrial production. Nonetheless, companies in other industries also experience the impact of sustainable waste management on returns (Mattson; Vinje, 2014).

However, environmental-friendly initiatives may also be an unprofitable investment. The purchase department of retailers such as H&M and Åhléns are often limited by tight budgets and measured on how low prices they can negotiate. The incentives to buy more expensive raw materials from certified and sustainable sources are consequently small. Anita Falkenek, Head of Sustainability at Åhléns, has noticed that the purchase department are reluctant to buy organic materials as it lowers margins. In the consumer goods market, some customers are rather price sensitive and often not willing to pay an additional premium for sustainably sourced products (2014). Other companies in the business to consumer ("B2C") market as their main target group supports this notion. Statoil, Löfberg and SJ all claim that consumers are price-sensitive and reluctant to pay the full price it takes to produce sustainable products (Nerell; Eriksson; Kronhöffer, 2014).

Cost reductions related to sustainability enhancements are reportedly more easily quantifiable than other ESG initiatives. For example, the investment in a more energy-efficient production plant can be evaluated based on the reduced energy costs over a certain period. Common financial measures and KPIs can be applied to these sustainability projects, including pay-back period and traditional discounted cash-flows. The reporting framework GRI further allows companies to present their environment achievements in a transparent way to investors and other stakeholders (Baumgarts; Larsson, 2014). Thus, environmental pioneers can be compared to their peers in the market and experience benefits from enhanced investments. Cost reductions from environmental projects can consequently be incorporated in the stock market valuation of a company (Billinger, 2014). The ability to measure the return on sustainability is viable in the cases presented next.

5.1.1.1 Vasakronan – Energy-efficiency

A case for the potential of cost reductions from sustainability projects was presented by Anna Denell, Sustainability Director at Vasakronan (2014). The real estate company made investments totalling 170 million SEK in more energy-efficient projects over a three-year period. These investments have so far resulted in 100 million SEK in annual savings, mainly from lowered energy and recycling costs. The payback period for the sustainable investment is thus less than two years. The environmental project becomes even more profitable when calculating the return on appreciation, a KPI frequently used by real estate companies. This performance indicator measures the long-term value creation and is added to the total return in financial reports. The 100 million SEK in annual savings are assumed to continue, resulting in an increased real estate value of 2 billion SEK.

5.1.1.2 McDonalds and MAX – Waste Management

The majority of the waste in fast-food restaurants comes from behind the counter. An example is the oil used to cook chips and other deep-fried foods. 100% of this oil is reused as biofuel in McDonalds' transports. This increases the percentage of renewable fuel in truck transports to 75%. The benefits on profitability are significant as both fuel-related expenses and waste handling costs decrease. Restaurants now pay 60% less for the disposal of organic waste and a biogas truck save about 10 000 litres of diesel annually.

McDonalds' investments in more environmental-friendly processes have transformed waste from a cost and operational risk to a source of income. Waste reduction initiatives strives to provide both environmental and economic benefits by reducing the chain's waste impact. Collaboration with local municipalities has increased the amount of waste that can be reused and recycled. Discarded materials are instead viewed as a valuable resource and the company are in some regards earning money on rather than paying for their waste. The investments in environmentally sound solutions are financially sustainable, explains Henrik Nerell, Environmental Manager (2014).

Pär Larshans, CSO at MAX hamburgers, confirms the benefits of responsible disposal. The fast-food chain is nowadays making a profit on separating their waste at source. MAX also compensates for all their climate impact and report the carbon dioxide emissions for every item on their menu. Starting in May 2008, Max has labelled all Sales of climate-friendly products have increased by 28% since the introduction of labelling products with their respective carbon dioxide equivalents (CO2e) in 2008. The environmental profile has been widely recognised globally, for example by Sir Paul McCartney and CNN. This sustainability work is used in MAX's communication to create a competitive advantage to McDonalds and Burger King (2014).

5.1.2 Limited resources and cost of materials

In addition to the reduced expenses from sustainable energy and waste usage, companies can improve profitability by lowering cost of materials. As current research suggests, companies face volatile resource markets and increasing prices. A large number of Swedish organisations are influenced by the concept of a circular economy. The idea is to make operations more efficient in terms of reducing resources and fossil energy consumed per unit of manufacturing output. A company following this strategy takes responsibility for their whole value chain and strives to limit waste of resources to benefit both the environment and financial results.

The importance of the limited resources aspect of sustainability is related to industry. Firms relying on production and certain inputs to that process are exposed to larger challenges. 91% of the respondents naming cost reductions from a more resource-efficient business belong to the sectors food production, consumer goods, fuel, paper / packaging and industrials. These industries are resource-dependent and raw materials constitute the main part of expenses. In the long term, these firms will face higher procurement costs or even see their business model disappear, if no action is taken regarding resources.

For instance, raw materials and other supplies constitute the majority of SCA's operating expenses, 36%. Consequently, investing in environmental projects to limit the use of excess materials can have important implications on operating results. More efficient and circular processes also decreases transportation and inventory expenses (Strandqvist, 2014). Another industrial company experiencing the importance of material costs is SKF. Ingemarson describes that sustainable strategies can lower the risks associated with fluctuating prices for steel and other raw materials. A price increase with 1% can otherwise lower operating margins with 200 million SEK (2014).

Furthermore, a trend can be noted regarding organisations with global operations. Those firms are more susceptible to resource scarcity, especially in terms of water. Production sites in Africa and other places where water and energy is in limited supply are stressing the significance of resource efficiency (Strandqvist; Grenert; Mattson; Midby, 2014).

5.1.2.1 H&M – Sustainable cotton

Catarina Midby, Head of Sustainable Fashion at H&M, explains the importance of sustainability for the company's sourcing. Cotton is an important resource in the clothing industry, but it requires large amounts of water and pesticides or other chemicals to grow. Consequently, cotton and other resources will be less available and more expensive onwards. As cotton is the most used resource in clothing production, H&M and other fashion chains have to find alternative materials to sustain their business in the future.

H&M has realised the need for more environmentally-friendly resources and has set up a goal to get all its cotton from more sustainable sources in 2020 – either organic, higher quality or recycled. The company currently buys large amounts of organic cotton at a premium price compared to less sustainably grown materials, as H&M expects the investment to be profitable in the long term. Clothing companies that do not address the issue of sustainable resources will face higher production costs and decreased margins. As the business model of fast-fashion chains are reliant on large sales and small margins, such an increase in materials could be detrimental. Companies that take environmental action proactively will benefit as they are ahead of their peers when resource scarcity turns critical. Sustainability is therefore integrated into all of the retailer's functions and countries and each department, including buying, logistics and marketing is measured against sustainability objectives called conscious (Midby, 2014).

5.1.2.2 Statoil – Renewable sources of energy

Statoil is dependent on the non-renewable resource oil for its business. Thus, the challenge of diversifying and finding alternative fuels is vital to the company's future success. As many investors already refrain from investing in fossil fuel companies, Statoil is forced to take the environment into strategic concern.

The company therefore invests heavily in research and development of new or enriched sources of energy. An example is Statoil miles diesel with 30% renewable material. An additive that reduces consumption with up to 2.0% and 2.7%, is added to the company's diesel and petrol respectively. The product is economically attractive to customers, as well as to the environment. Especially corporate clients, such as road carriers value the energy-efficient solution. By reducing Statoil's dependence on oil as their main source of business, the company will be able to continue operating and providing profitable returns in the future (Grenert, 2014).

> ***We see that our focus on sustainability related issues improves our profitability and strengthens our offer to customers. It can be difficult to place a concrete monetary value on these gains, but we can confirm that an engagement in sustainability is a prerequisite for a relatively large part of our client relationships. Simply put, without this effort it would be difficult to win contracts and attract investors. – Henrik Grenert, Quality- & Environmental Manager at Statoil***

5.1.2.3 Coca-Cola Enterprises – Smarter bottles

The PET plastic in bottles containing Coca-Cola products poses an environmental challenge to the company, according to Rønnaug Vinje, Manager Corporate Responsibility at Coca-Cola Enterprises Sweden and Norway (2014). The plastic is produced from the non-renewable sources oil and other fossil fuels. Any time the cost of packaging materials like petroleum and aluminium increases, or the supply of those materials is disrupted, it means potential harm for their business. This plastic problem further generates negative stakeholder opinions which could potentially result in unfavourable legal requirement, lower investments and decreased sales.

To handle the packaging problem, Coca-Cola has increased the amount of recycled material in their containers to 6%. The plastic corks have been shortened with one millimetre to save 560 tonnes of plastic each year. The introduction of the more resource-efficient containers help the company reduce costs as it grapple with increased prices of commodities.

The beverage producer has also designed a fully recyclable PET plastic beverage bottle made partially from plants. The new material looks and functions like traditional PET plastic, but has a lesser environmental footprint on the planet and its scarce resources. As sugarcanes are one of the key components in the PlantBottle, rather than fossil fuels, Coca-Cola's reliance on non-renewable resources further decreases.

Even though the bottle is more expensive to produce the company expects to recover the increased costs in the long term through enhanced brand value and increased sales. PlantBottle packaging has already proven to be a business success as well as an environmental one. The package reinvigorated the bottled water brand Dasani; brand loyalty among consumers has increased and sales rose with 11% in 2011, 2.4 times the growth rate of the rest in the category. In addition, the innovation has proven to have communicative potential and is often featured positively in media, which has effects on investors' views (Vinje, 2014).

5.1.3 New business opportunities and products – Innovation capacity

An environmental focus can also benefit companies in terms of product innovation. Firstly, revenues from new green products are reportedly a source of additional business in Sweden. 72% of participating companies have products or services in their portfolio related to sustainability. As previously explained, the demand for organic and certified goods are rising in Sweden and the rest of the world. The interviews confirm that their consumers are more informed and attentive to ESG concerns and take this into account when making purchasing decisions, predominantly regarding environmental aspects. Retailers such as AxFood, Åhléns and H&M are profiting from this trend by offering sustainable products (Domeij; Falkenek; Midby, 2014). Also AxFood have increased sales of their private label Garant Såklart. The sustainable product range meet the criteria set up by third-party associations such as the Nordic Swan and Tricorona Climate Partner. Third-party certifications can validate and create new business as well as open up new markets to companies seeking to expand their business. The concept is of also of relevance for companies with the public sector as their main target group. These organisations have strict ESG policies and place considerable importance on those factors in bidding processes. Suppliers are not given access to the public procurement process if not ESG demands are met (Grenert; Holm; Stenmar; Mattsson, 2014).

Secondly, environmental solutions can form the basis for entire companies. Ruben Rausing created the successful multinational Tetra Pak from an innovative solution to sustainable packaging (Linderoth, 2014). Third-party certifications are valuable also in this respect as is can give access to new markets to companies seeking to expand their business. In general, the B2B market is characterised by a need for innovation in ESG-solutions to fulfil the sustainability targets set up by companies. Products or services that solve the clients' ESG problems are, as explained in section 4.2 an attractive method to build strong customer relationships.

5.1.3.1 SEB – New financial vehicles drives business

An important investment vehicle is green bonds, which integrate fiduciary elements of fixed income products with sustainable projects, processes and technologies. This allows investors to achieve fiduciary risk/return whilst improving environmental and social performance. The concept of green bonds was introduced by SEB and the World Bank in 2008 and has since grown in popularity internationally. By 2020, SEB forecast that green bonds will account for 10 to 15% of the corporate-bond market. Head of Sustainable Products and Product Development, Fixed Income and DCM Global, Christopher Flensborg describes two ways in which SEB's green bond offering have created substantial value. Firstly, the green bonds are a profitable business for the bank and its customers. Secondly, the financial vehicle has created business for other departments at SEB. Flensborg, and his team has been able to establish contact with new clients through their unique sustainable product. Many companies are interested in green bonds and more inclined to agree to a meeting with SEB in this matter than other financial services. The majority of these customers have been so satisfied with their investment that they have continued to make business with SEB in other regards as well. In addition, being the front-runner in the financial category opens up for communicative opportunities and public interest (Flensborg, 2014).

> ***Product development plays an important role for furthering the sustainability agenda. Examples include green bonds, developed in co-operation with the World Bank, with a total market today of about USD 14 billion. We have also launched the first Swedish microfinance fund, where investments are used to fund microloans to entrepreneurs in developing countries. – Annika Falkengren, President & CEO at SEB***

5.1.3.2 JM – Environmental remediation

A sustainable business strategy can open up new opportunities and markets for companies. JM experienced this effect regarding environmental remediation. The most attractive land for properties depend on location and especially land in central parts of major cities are valuable. However, these central spots are often old industrial plants and hence the soil contains different contaminations.

JM early adopted a strategy for handling the contaminations in the ground and compare the upfront cost to potential returns. The project was risky, but the company decided to invest as it was in line with JM's sustainable strategy. The investment proved profitable as JM acquired very valuable land for a relatively low price and contributed to a better urban environment at the same time. The company also managed to obtain a strategic advantage compared to its main competitors. For JM, this business creating aspect of its sustainability efforts has been the most value-enhancing outcome (Löfgren, 2014)

5.2 Social performance

5.2.1 Strengthened brand and customer loyalty

When it comes to customer loyalty, a reputation for good knowledge in sustainability can be valuable. Several companies have managed to develop their relationships to customers by assisting them in making their value chain more sustainable (Linderoth; Eriksson; Våg; Sandström, 2014).

The effect is most profitable for business to business (B2B) sales as clients are in turn facing ESG demands from their customers. 85% of companies selling to other organisations comment on enhanced customer relationships, compared to 63% in the B2C market. If a company can help customers improve their ESG operations and simultaneously lower their expenses, customers will be interested in continued business contracts (Baumgarts, 2014). In the process, interdependencies can be formed that are hard for competitors to copy. Customer loyalty consequently increases. It is furthermore a business-smart approach to help customers lower their expenses related to materials, transportation and other inputs as it releases capital. Boosting customers' buying power through a more efficient value chain creates potential for additional sales (Wikström, 2014).

The strategy described above is mainly applicable in the B2B market. Regarding companies with end-consumers as their target group, non-financial aspects have been described to have influence on loyalty and brand image as well, but in other regards. The social dimension of ESG is the main method to earn trust and credibility (Baker, 2014). Investments in charitable projects, sponsorships and other non-profit events are part of companies' social sustainability. However, the resources devoted to social causes are seldom recovered as outcomes are difficult to quantify (Larsson; Billinger, 2014). As a result, capital spent on these causes have negative discounted cash-flows and negative KPIs. Nonetheless, 88% of Swedish organisations participate monetarily in such projects.

The main reason is that it do provide financial value, albeit it is intangible and difficult to attribute to a specific action (Larsson, 2014). Supporting charities, local communities and cultural events are a good opportunity to communicate with stakeholders. Brands associated with a non-profit organisation or sport team can profit from spill-over effects on reputation and increased awareness. Examples include SCA sponsoring an all-women team in Volvo Ocean Race and SEB being the main sponsor of the Stockholm Concert Hall, the Stockholm Royal Philharmonic Orchestra and the Swedish National Orchestra in Gothenburg (Strandqvist; Widebäck-West, 2014). Also Löfbergs has benefited from positive associations by sponsoring premium restaurants and the Swedish national chef team (Eriksson, 2014). Some companies have founded their own non-profit organisations, including H&M Conscious Foundation and Axfoundation (Midby; Domeij, 2014).

Another important aspect is that Swedish companies' ESG activities are more visible and transparent today. As a result, the ESG effects on brand and awareness are often speedier and more prominent. Thus, companies need to be aware of their sustainability profile to prevent negative customer and supplier associations (Widebäck-West; Larsson, 2014). Lists and awards such as the *Sustainable Brand Index* and *Nordic Sustainability Stars* are given considerable attention in media. Leading Swedish newspapers and NGOs moreover release their own rankings for best practise. Disclosing non-financial information in separate or integrated company reports further improves investor relations as they value the additional information on firm performance (Midby; Alestig Johanson; Larshans, 2014). This bearings stakeholders' awareness and attitudes, primarily investors, customers and employees. Companies performing well in sustainability evaluations and are highly ranked use this both in external and internal communications, such as webpages and press releases.

5.2.1.1 SCA – Helping customers become more sustainable

Having experience in ESG concerns provides an opportunity to assist clients in their sustainability works. SCA is a trusted advisor in these questions and have gained loyal customers through their extensive sustainability knowledge. Clients have their specific strategic targets to reach, and sustainability offerings can be a way of progress. SCA has managed to negotiate better agreements, premium prices and other competitive advantages based on that customers value their understanding of ESG, explains Kersti Strandqvist, Senior VP Sustainability at SCA.

The napkin dispenser Xpressnap is an example of a product that has become successful by reducing the climate impact of clients. The product feature a unique technology that ensures customers only touch and take one napkin at a time. As a result, usage can be reduced with at least 25% compared to traditional dispensers and are also more hygienic. In addition to improving customers' ESG profile, returns are enhanced through lower material costs. Providing solutions that increases profitability at lower costs to the society and environment leads to more loyal customers. SCA becomes more involved in their customers' operations which provides an effective barrier to competition. The Xpressnap is currently the best-selling napkin dispensing system in North America (2014).

5.2.1.2 Stena Recycling – Winning & retaining commissions

By focusing on how recycling can improve a company's sustainability profile, Stena Recycling has managed to obtain new customers and retain existing accounts. Recently, Cylinda chose Stena Recycling to handle their waste disposal. In addition to the improvements to a client's corporate image, recycling can be a profitable business. Waste used in production can be a valuable resource in other processes, turning waste disposal from a cost to an income for Cylinda and other customers. In the process, Stena Recycling becomes deeply integrated in the client's operations, increasing switching-costs and the barrier to competitors.

The food producer Findus has likewise signed a 10-year agreement with Stena Recycling and the two companies collaborate to make Findus' business more sustainable and cost-effective. The majority of Stena Recycling's customers have chosen the company based on its sustainability reputation and offerings. The company's CR-initiatives are especially important for public sector contracts and Cecilia Våg, Sustainability Manager, confirms that Stena Recycling would not have a chance of winning these contracts without their investments in sustainability (Våg, 2014).

5.2.1.3 Tetra Pak – Value-chain collaborations

Collaborations within the value chain, both upstream and downstream has been a success factor for Tetra Pak, states Erik Linderoth, Environmental Manager. The packaging industry has in recent years expanded internationally leading to that Tetra Pak's position as industry-leader no longer is unthreatened. Producers providing cheaper packaging, often based in China, are increasing their market share. The explanation to their success is the low level of differentiation among packaging producers. Hence, price becomes a major factor for customers when deciding upon supplier. Tetra Pak is a premium brand, resulting in that competing on price is a non-profitable strategy. By developing and finding solutions that makes customers' operations more sustainable without impacting their returns, the Tetra Pak has found a commercial approach.

> ***We see our environmental work as a strength and a competitive tool for us not only now, but even more so in the future. – Erik Linderoth, Environmental Director Tetra Pak***

For example, Arla has been a customer to Tetra Pak since the company was founded in 1951. Throughout the years, the two organisations have jointly found innovative solutions to the packaging of dairy products. Improvements have been made for more sustainable and cost-efficient cartons. Recently, the companies presented the world's first biodegradable plastic cork, limiting their dependence on oil. These examples and other ventures have strengthened the ties between Tetra Pak and Arla, acting as barriers to new entrants. According to Anna-Karin Modin Edman, Sustainability Manager at Arla, the partnership with Tetra Pak is a requirement for meeting the targets in Arla's sustainability strategy to 2020, especially regarding 100% recyclable containers. Tetra Pak's extensive CR understanding of packaging and Arla's sustainability strategy is thus the main reason for choosing the supplier. The sustainability profile has further helped Tetra Pak secure other business contracts, including Norrmejerier, Tine and Oatly.

Another benefit from sustainability on Tetra Pak's results is that their packages have less environmental impact than plastic, glass or other containers. By communicating the more ESG-friendly characteristics of paper cartons, the company has gained access to a new segment of clients. These customers have a profile based on sustainability and health and the packaging of their products are important to the overall brand. Tetra Pak's products hence become attractive as they provide legitimacy to their business values (Linderoth, 2014). The fresh coconut water brand Vita Coco for instance uses Tetra Pak packaging's sustainable features in their own communications. "Vita Coco produces the freshest tasting coconut water possible by packaging its beverages in Tetra Pak, an eco- and socially-responsible form of packaging based on the use of wood fibre, a sustainable source. Tetra Pak is committed to making food safer with minimum stress on the environment" (Vita Coco, 2014).

5.2.2 Employee branding and retention

The majority of the interviewed companies, 94%, confirm that their companies' sustainability profile have proven useful when attracting employees. The effect of social initiatives on a company's attractiveness as an employer applies to both students and to professionals with an existing career. During interviews, applicants are increasingly aware of corporate sustainability policies and interviewers often receive questions regarding ESG (Denell; Askfelt-Ruud; Domeij, 2014). Other Swedish companies describe similar benefits from sustainability when it comes to recruiting, both bachelor and master students (Strandqvist; Baumgarts; Holm; Ingemarson, 2014).

The importance of social initiatives increases as it will become more difficult in the future to recruit the best people. Sustainability projects can raise the number of applying candidates, which is the case for JM when participating in the student internship program *The Technical Leap*. The social project enables students to try working as an engineer for 4 months at JM, to awaken an interest in the profession. Few students are choosing technology at university today, which poses a problem for JM that depend on engineers for their business success. By taking social responsibility for students' education, JM creates a relation to future talents (Löfberg, 2014). This aspect is further exemplified in the MAX and Samhall case below.

A company known for its sustainable business attracts talented people who are interested in more values than compensation and benefits when searching for employer. Providing an applicant with these additional values can be a cost-effective strategy for organisations as it lowers the importance of high salaries. Then a company can compete for the most talented professionals and students without entering costly remuneration outbidding. Both SJ and Green Cargo receive many applications from people interested in working for them for a lower pay than competitors are offering, solely based on their ESG achievements (Kronhöffer; Sandström, 2014). For Blueberry Lifestyle, finding the right employees to convey their brand values at all cafés have been facilitated by the interest in social issues people actively seeking positions express, explains Holm (2014).

Working actively with ESG also has an impact on existing employees. ESG reportedly enhances work satisfaction and lowers employee turnover, which otherwise can signal an inadequate human capital strategy and reduce corporate profitability. Consequently, several companies offer employees opportunities to participate in various ESG related projects during working hours. All employees at Coca-Cola can work for a charitable cause two days a year, which yearly employee evaluations show have positive effects on job satisfaction (Vinje, 2014). Another example of employees involved in the company's sustainability activities is EY. The program Volunteering at Work allows staff members to work for a non-profit organisation of their choice up to 16 hours during their work time (Baker, 2014).

Allowing staff to participate in and develop the company's sustainability strategy has multiple economic impacts. Swedish companies evaluate employee satisfaction through KPIs such as sick days and staff turnover. These indicators are improved by increased sustainability attention, both internally and externally, in 45% of participating companies. No direct causality can be determined, but employees frequently cite social dimensions as major contributor to job satisfaction (Mattson; Billinger; Eriksson, 2014).

In addition, as in the case of hiring, ESG values can to various extent substitute salaries and other benefits. Moreover, the opportunities to take part in social projects or competitions for reduced climate footprint foster innovation within the organisation. For example, Statoil includes employees in the sustainability process through monthly competitions for best measure of reducing energy consumption. Grenert attests to the large interest in submitting ideas and the pride expressed by winning station workers. Hundreds of feasible suggestions have been submitted and a large part have been implemented successfully (2014).

5.2.2.1 MAX – Samhall as a solution to staff shortage and high turnover

As stated above, a strategy incorporating ESG can facilitate recruitment. MAX faced a shortage of staff and high turnover in their restaurants and could not find enough people to provide a good level of service. To solve this problem, the company started a collaboration with the organization Samhall that employs people with different disabilities such as Asperger's. All of the 80 MAX restaurant currently have at least one staff member with a disability. People hired through the program are both more engaged in their work tasks and stay longer with the company than other staff. As a result, the initially higher cost of training and introduction is offset by a longer employment. The initiative has both lowered staff turnover, absence due to illness and discrimination incidences. By creating shared value, both Samhall and MAX benefit from their collaboration and their results improved.

> ***Companies are often focusing on short term profit-maximization, but we regard this as an opportunity to earn more money. We are facing an aging population and companies that fail to understand this will face problems when recruiting in the future. This might be the most profitable measure we have taken at MAX. – Pär Larshans, Chief Sustainability Officer at MAX***

In addition to the benefits mentioned above, the cooperation with Samhall has received considerable media coverage. The attention positively affects the MAX brand and creates goodwill. For example, the former Swedish Prime Minister Fredrik Reinfeldt has shown large interest in the project and visited a MAX restaurant in Luleå to find out more. Larshans has also presented the social initiative during an EU summit in Brussels. The potential regulatory benefits and competitive advantage of such proceedings provide tangible value to MAX (2014).

5.3 Governance performance

5.3.1 Proactive risk management

> ***"Sustainability can either be value creating or value destroying. The outcome depends on whether or not firms actively engage in ESG factors and take other stakeholders than shareholders into account - Lars-Olle Larsson, Manager of ESG Affairs at Swedfund.***

This highlights the importance of integrating ESG factors in the business model in order to be aware of all opportunities and threats the company faces. As history has shown, crises can be detrimental to a company. Vera Söderberg, CR Manager at HKScan, agrees that risk management is a key aspect of their company's sustainability efforts. "The meat industry can't handle another crisis," referring to scandals concerning poor animal keeping and expired meat (2014). Corruption scandals in telecommunications is another example of the downside of neglecting governance issues (Baumgarts, 2014).

The risk associated with changes in national and EU regulation are the most frequently mentioned risk in Swedish business, 79%. The empirics for regulatory risks will therefore be presented separately in section 5.7. Other risks with large bearing on companies' performance are access to energy, water and materials (69%), brand and reputation (65%) and social scandals regarding working conditions (56%). As evident in the responses, being aware of and developing ESG factors is correlated to firm risk.

Companies are seeking early warning signs in their operations, value chains as well as the surrounding landscape in order to anticipate vulnerabilities. Sustainability takes more factors of a company's business into consideration, and its effects on all stakeholders. A thorough sustainability approach thus aids companies in discovering issues at early stages and assess where they are prone to risk (Larsson; Wilebäck-West, 2014). For private equity firms, a holding company with a well-analysed impact on its effects on the environment and society often commands a lower risk premium at exit and consequently a higher price (Askfelt-Ruud, 2014).

The risk aspect of sustainability is especially of value to Swedish companies with global operations. An international business, both in terms of sales and production, means a larger exposure to regulations as every country has its own ESG related legislation (Midby; Grenert; Mattson, 2014). To comply with all relevant demands ties up resources both in terms of time and capital. A global presence also increases the overall risk of the company as they are more susceptible to corruption, child-labour and other ESG issues compared to corporations with predominantly Swedish operations. Firms therefore recognize the need to collaborate and partner with governments, civil society, labour and the United Nations as social, political and economic challenges and opportunities in all markets increasingly affect.

5.3.1.1 Löfbergs – Certified coffee

Independent certifications can legitimise a company's sustainability strategy. Löfbergs has decreased their operational risk through working with certified coffee producers in a volatile market characterised by poor working conditions and war zones. The CR approach enables Löfbergs' to identify and handle potential crises before they seriously hurt the brand and stakeholder relations, explains Eva Eriksson, Sustainability Manager. The coffee producer invested early in certifying its products. This investment has been strategically profitable as most B2B customers today demand fair-trade or organic coffee. For example, the concert organizer Live Nation/Luger chose Löfbergs as the official partner to Swedish music festivals based on the company's sustainable coffee. Several large Swedish companies only purchase certified coffee and often communicates this to their customers to enhance their sustainable image (Larshans; Nerell; Holm; Grenert, 2014).

In addition to risk management, the Löfbergs' focus on sustainable coffee production has improved margins. The certified coffee merchandises are sold at a premium price and more profitable than other products in the company's portfolio (Eriksson, 2014).

5.3.1.2 Sveaskog – Eco-parks and nature reserves

Also Sveaskog works with ESG proactively to secure the business in the future, states Olof Johansson, Director Environment & Sustainable Development. The forest owner assign 20% of their productive land to nature conservation in the form of eco-parks and nature reserves. This strategy is not profitable in the short-term as the land instead can be used for commercial purposes that increase revenues. However, the company has decided that the future benefits of conservation will offset the initial costs.

Sveaskog expects the investment to communicate and validate their sustainability efforts, both internally and externally. The founding of eco-parks will furthermore minimize the need for regulation in the sector which could potentially be stricter than 20% and decrease profitability to a larger extent (Johansson, 2014).

5.3.2 Regulatory pressure – pension funds, legislation & NGOs

The risk associated with changing regulation in ESG factors is a top priority for Swedish companies. Legislation has become stricter in recent years and resulted in costly changes, as described by Johansson:

> ***National and international laws are basic requirements we must adhere to. Legislation has been progressively tightened in several areas and this places considerable demands on our business. Chemicals, business ethics and consumer/product information are some areas where the law now requires more accountability and advanced compliance work. – Martin X Johansson, Lantmännen***

Decision-makers in national governments and the EU have the power to affect business in most regards – including interest rates, taxes, environmental compensation, waste management, employee conditions and terms of trade. The importance of a good reputation among legislators is thus essential for corporate performance. Swedish companies claim that their investments in sustainability have created such a favourable attitude towards a company and / or industry. 70% of the sample have managed to influence the legislative process to their benefit through investing in ESG and governance structures in particular.

By preventing scandals and actively contributing to better societies, the need for regulators to control the industry decreases. A self-regulatory market will more likely be left unregulated if it already takes ESG seriously (Larsson; Billinger, 2014). Incorporating sustainability and solid governance systems in the business strategy consequently creates long-term value as compliance-related costs are avoided. The entire business might even be at risk in some cases if sustainability is not a priority, for example the approval of new pharmaceuticals and taxes on fuel (Mattson; Grenert, 2014). The importance of regulation is as important for public companies, or even more significant according to Johansson at Sveaskog. State owned organisations have to set an example and strive to be industry-leaders in sustainability (2014).

In addition to governmental requirements, investors are organising into coalitions in order to obtain larger influence on companies they invest in. The Ethical Council is an example of such a collaborative venture between the Swedish First, Second, Third and Fourth AP Funds. The Funds can conduct preventative and follow-up work within ethical and environmental aspects and are consequently perceived as a more influential and stronger owner, which increases their possibility to influence companies to make lasting improvements (Alestig Johanson, 2015). Billinger agrees that firms with sustainable business models are more attractive investments as they mean higher net worth and a better retirement for SPP's customers (2014).

Also NGOs and other organisations can dictate terms of business for Swedish companies. These institutions are often cited in media, releases reports and sustainability rankings and influences the legislative process. Consequently, investors and NGOs can be valuable partners or powerful enemies depending on how sustainable a company is. Several Swedish enterprises have thus invested in creating relations with their stakeholders. ESG projects, including conferences and charity, are a strategic method to connect with non-profit organisations and provide societal benefit. As current research suggests, being associated with charitable causes can create goodwill that have positive impact on brand, decision-makers and profitability.

Tetra Pak collaborates with WWF among others in attempts to increase recycling in Sweden. Projects include school contests, public information and sponsorships of climate conferences and events (Linderoth, 2014). Other interviewees also regard their collaborations with NGOs as fundamental to ongoing business (Domeij; VInje; Flensborg, 2014). Swedish companies are further monitored by a third regulatory force – the media. Influential newspapers have the power to affect public opinion and subsequently firm performance. This has direct effects on sales and brand values as well as indirect effects as decision makers may be pressured to act.

5.3.2.1 Ratos & EQT – Private equity in Sweden

The private equity industry has recently been heavily criticised in Sweden. Neither the public opinion nor policymakers' regard for the industry is favourable. This has negative effects both in the short and long term for private equity firms as they find it more difficult to conduct their operations in Sweden. For instance, new regulation limiting the profit in education, private care and other related sectors has been proposed (DI, 2015). Such costly external pressure can be avoided by proactively engaging in ESG matters, and the governance aspect in particular. Two of the largest Swedish private equity firms have realised the value of adding ESG factors to their operations. Jenny Askfelt-Ruud explains that the firm is investing in projects that benefits society, displaying its sustainability commitment. Ratos has moreover started communicating with media and decision-makers actively to convey the value the company is adding through sustainable operations. Contrary to the current debate, private equity ownership is more long-term than listed firms' as they are not pressured by quarterly reporting and accordingly can devote more capital to the less tangible ESG ventures. Being a responsible owner is moreover essential for securing investments from pension funds and other investors (Billinger; Alestig Johnson, 2014).

Not only is ESG issues important for the image and investor relations of the private equity firm, but it has significance for the ongoing operations of identifying, acquiring and developing portfolio companies. The due diligence process always involve an identification and estimation of sustainability related opportunities and risks as well as a general assessment of the target company's ESG actions (Askefelt-Ruud, 2014). Therése Lennehag, Head of Responsible Investment at EQT, agrees that the private equity firm's focus on sustainability helps mitigate risk in their portfolio and also creates value. EQT reports according to the PRI to value the implications of sustainability and show how the company incorporates these issues into investment decision making and ownership practices. Sustainability is a suitable area for improvements in acquired companies and can lead to significantly increased valuation and exit prices. In other words, including sustainability in EQT's & Ratos' strategies directly affects risk and return on investments.

> ***Genuine management of ESG factors is fundamental to business success and strong investment performance. The integration and analysis of ESG factors in the investment process and during the ownership period is equally as important as managing any other material financial or non-financial aspect of a business. By having ESG as an integral part of the business model, and by aspiring to apply best practice, EQT mitigates risk and portfolio companies capture opportunities for long-term value creation and competitiveness. – EQT Annual Review 20 Years Edition***

5.3.2.2 MAX – The Angered Challenge

For MAX, risk management involves creating good relationships with regulators in municipalities across Sweden. The company actively participate in local communities and helps them solve social problems. The joint programs creates valuable connections to decision makers that have the authority to decide in issues of importance to MAX operations. Investments in ESG projects in different Swedish municipalities thus provides a proactive way of handling future regulation. An example is the Angered Challenge. MAX initiated a project in 2013 that strives to help students with a foreign background into the labour market. Favourable connections decreases the risk of unfavourable regulations. Larshans estimates the value from the Angered Challenge to be close to 1 billion SEK over a five-year period. The investment in social dimensions further mitigates risk by providing access to new employees and goodwill effects on brand and company valuation (2014).

5.3.3 Access to finance

As previously explained, Swedish and international investors are nowadays including ESG factors to financial analysis in their calculations, according to representatives from Swedish companies. Growth in RI and new financial vehicles such as green bonds, are additionally making resource-allocation to sustainability a profitable strategy. For issuers, green bonds enables closer dialogues with investors and often access to less expensive financing (Alestig Johnson, 2014). Stock exchanges and financial news sites are providing investors with transparent information on company sustainability. Examples include Bloomberg that provides detailed information on companies' ESG performance indicators and Google Finance including companies' ESG scores on its Key Stats and Ratios (Stenmar; Billing, 2014).

Investors can thus receive transparent access to responsible investments and address the increasing shareholder demand for sustainable savings and diversified risk. EY observe that investors show increased interest in the correlations between financial performance and sustainability factors like resource scarcity, environmental performance and corporate governance when assessing a company's future risk and growth opportunities. A wide variety of investors, including banks, institutional investors, fund managers and private investors, therefore request transparency in these issues before providing capital to a firm (Baker, 2014).

All companies in the sample publish sustainability reports about the economic, environmental and social impacts from company operations and the organisation's values and governance model. Failure to engage with the reporting process could consequently have a negative impact on performance, reputation and the ability to raise capital Following international guidelines for reporting, such as The Global Reporting Initiative (GRI) further attracts financing and builds stakeholder's trust in the organisation (Larsson, 2014).

A genuine sustainability profile has in Blueberry Lifestyle's case enabled the company to obtain funding from investors seeking to make their portfolios diverse and more ESG focused. Other organisations in similar situations did not have the same access to financing as they missed the uniqueness that Blueberry Lifestyle's sustainability profile rendered (Holm, 2014).

5.3.3.1 Vasakronan – Lower interest and green bonds

As previously explained, Vasakronan has experienced several advantages from their investments in sustainability. The company's CFO Christer Nerlisch explains that "…we have already obtained business benefits from our sustainability efforts in the rental and transaction market and we're pleased that this can now positively affect our financing options." The financing benefits of ESG factors are noticeable for both traditional bank loans as well as in the market for corporate bonds.

Firstly, Vasakronan has obtained lower interest rates on bank loans. As creditors are concerned with risk, solid sustainability work results in lower interest rates. The enhanced access to bank credit applies to both financing of new projects and reinvestments in existing buildings.

Secondly, the majority of Vasakronan's funding come from corporate bonds and in 2013 the corporation issued the world's first green bond. By issuing such bonds, Vasakronan has been able to further diversify its borrowings, which, over time, will result in lower borrowing costs. Moreover, green bonds attract a larger number of investors. Since shareholders are increasingly more aware of and interested in ESG factors, pension funds and other types of organizations are under pressure to find investments that meet their demands. Green bonds are an attractive investment as they can guarantee more sustainable business. Denell reports a large interest in Vasakronan's green bonds and currently the demand surpasses the supply. The effects on access to finance is already significant and today all bonds issues by Vasakronan are 100% green corporate bonds.

5.3.3.2 SCA – Green bonds

Also SCA has experienced the benefits of sustainability on financing options by issuing green bonds. The bond, which is denominated in Swedish krona (SEK), has a five-year tenor and two tranches. One tranche 1 billion floating rate note, priced at three-month STIBOR +0,68% annually and one 500 million SEK fixed rate tranche with an annual coupon of 2.5%. The green bond offer was the first made by a Swedish listed company and was quickly oversubscribed. The SCA bond was placed with approximately thirty investors and the image of SCA as a sustainable company was strengthened (Strandqvist, 2014).

"SCA's sustainability activities are based on the creation of financial, environmental and social value. Our position as the first listed company in Sweden to offer a green bond is further confirmation of how important and highly prioritized our sustainability work is," says Jan Johansson, President and CEO of SCA (Di, 2013).

5.3.3.3 Green Cargo – Access to long-term credit

An additional example of the link between sustainability and financing is provided by Sandström at Green Cargo. When the transportation company planned to renovate and replace part of their railway engines, 1 billion SEK was needed to fund the investment. As the credit period for such loans are long, access to finance is very limited. However, the Nordic Investment bank ("NiB") was a potential creditor for such loans. NiB focuses on supporting sustainable development, thus Green Cargo's investments in reducing their climate effects was crucial for obtaining financing up to a third of the required amount (Sandström, 2014).

6 Final remarks – sustainability operations, strategy and reporting

Based on the combined findings from the event study and interviews, several conclusions can be drawn regarding the net benefits or costs of firms investing in sustainability and reporting this to other stakeholders.

Despite that the results from the event study were not significant, the indicated positive market reaction could imply that investors value non-financial information. Relating this finding to the effects of ESG investments on performance stated by participating Swedish business representatives in Part II, gives possible explanations as to why non-financial information and practices are valuable. The topic of the net benefits or costs associated with non-financial reporting is closely linked to the discussion of the value creation from sustainability in general, and will be explained further in this section.

As previously stated, ESG information is becoming more transparent and is often evaluated in Swedish companies' financial statements. This provides investors and other stakeholders with additional information on a given firm's operations and outlook. As described in Part II, sustainability investments are often more long-term in their nature and essential for maintaining operations and mitigate risks in the future. Failure to engage with the reporting process could therefore have a negative impact on stock performance, reputation and the ability to raise capital. The value to investors of knowing if and how companies incorporate ESG into their operation, can explain a positive market reaction to the Swedish legislative proposal on December 19, 2014, given that the interviews clearly prove that ESG improves returns in a number of ways, including cost reductions, employee retention and access to capital.

However, given that the positive market reaction seen in the event study was not statistically significant, non-financial activities and disclosure requirements could potentially also affect firm performance negatively. This is mainly depending on firm characteristics, as firms with poor ESG practices and reporting processes already in place, will need to devote additional time and resources to this. National or global sustainability regulation can furthermore disrupt existing ESG strategies and industry structures if companies are required to report on, incurring unnecessary costs and lost time. In addition, Swedish firms may not want to disclose all non-financial information as it could potentially be harmful to their competiveness.

One should be aware of the potential sources of error stemming from the interview method in general and the selection of interviewees and the subject in particular. As the majority of company representatives are heading or closely linked to the sustainability department, the results could be biased to include more positive attributions from sustainability investments. Nonetheless, the study provides valuable insight into why companies devote resources to ESG and that they are rewarded for this by investors and regulators alike.

7 Conclusion

To sum up, this study has investigated the market perception of how firm's investments in sustainability affect financial performance. Specifically, the equity market reaction to the presentation of mandatory non-financial reporting in Sweden has been examined. Interviews with representatives from the Swedish business community has further complemented and explained the benefits and costs associated with sustainability / ESG.

The perceived benefits from investments in sustainability are numerous and relate to all aspects of ESG. Examples of positive effects on firm performance include product innovation, cost reductions and increased employee retention. In addition, investors and other stakeholders reward Swedish companies that incorporate ESG within their businesses, with better access to capital, risk mitigation and an enhanced brand image. Having high ESG standards thus benefit companies both in terms of value created within the company as well as receiving additional financing from sustainability conscious investors.

Sustainability is no longer simply a "save the world" philosophies, Swedish firms and investors now demonstrates a belief in that ESG investments provide enhanced returns and financial benefits. Hence, despite there being no significantly positive market reaction to increased ESG reporting in Sweden, the study and interviews show that Swedish companies still seem to walk the sustainability talk. Or as Stina Billinger, Head of Sustainability at SPP puts it:

> ***Investing in sustainability is the best thing a company can do to drive long-term value creation for the business, investors and society at large.***

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8.2 Interviews

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9 Appendix

9.1 ESG factors

According to the globally recognized Principles for Responsible Investment ("PRI") framework 2015, the three ESG indicators include:

i. **Environmental**

Issues relating to the quality and functioning of the natural environment and natural systems. These include: biodiversity, product innovation, greenhouse gas (GHG) emissions, climate change, renewable energy, energy use and efficiency, water use and efficiency, resource depletion, waste management and recycling, hazardous materials and eco-efficiency ("doing more with less resources")

ii. **Social**

Issues relating to the rights, well-being and interests of people and communities. These include: customer satisfaction, diversity and equal opportunities, employee engagement, employee attraction and retention, government and community engagement, human rights, labour standards (including child labour, health and safety, forced labour and collective bargaining), supply chain management, product safety and marketing communications

iii. **Governance**:

Issues relating to the governance of companies and other investee entities. These include: accounting standards, risk management, anti-competitive behavior, board composition, business ethics, anti-corruption, transparency, executive remuneration, stakeholder dialogue, compliance, lobbying and, in general, issues dealing with the relationship between a company's management, its board, shareholders and other stakeholders.

9.2 Sample interview questionnaire

- Describe your company's sustainability strategy and focus
    - Organisatonal structure
    - History
    -
- Do you currently report non-financial information?
    - Why / why not?
    - Is this included in a separate report?
    - Do you follow any voluntary ESG disclosure standards?
- What are your thoughts on the Swedish proposed transposition of the EU Directive 2014/95?
- Describe different stakeholders' interest in and demand for sustainability achievements
    - Owners? (including family, private or government-owned companies)

- Investors?
    - Government?
    - Other influential stakeholders?
- Does ESG affect your access to financing / capital
    - Easier access?
    - Better terms?
    - Trends?
- What is your experience with investors / companies in terms of ESG?
    - Industry standard and competitors?
    - Important for operations?
    - Deal-breaker?
    - Trends?
- If, then how has improvements in ESG regards affected your company's profitability?
    - Cost reductions?
    - Increased sales?
    - Enhanced margins?
    - New markets/products?
- How do you measure return on sustainability investments?
    - Any KPIs?
    - Pay-back period?
    - What is done when ESG investments are conflicting with other projects?
- Is sustainability of value internally and for employee branding?
- Does sustainability affect you brand?
- Has sustainability contributed to profitability in any other regard?
- Other / miscellaneous

9.3 Significance tests

Table 2 – Levene's Test for Equality of Variances

	F	Sig.
CAR 18 Dec 2014	23.704	.000
CAR 19 Dec 2014	25.177	.000
CAR 22 Dec 2014	16.374	.000

Table 3 – t-test for Equality of Means

	t*	df*	Sig. (2-tailed)*	Mean Difference*	Std. Error Difference*	95% Confidence Interval of the Difference*	
						Lower	Upper
CAR 18 Dec 2014	.149	468	.882	.00084	.00565	-.01026	.01194
	.194	464.952	.846	.00084	.00433	-.00767	.00935
CAR 19 Dec 2014	-.730	468	.466	-.00419	.00574	-.01548	.00709
	-1.004	425.149	.316	-.00419	.00418	-.01240	.00402
CAR 22 Dec 2014	-.538	468	.591	-.00457	.00850	-.02127	.01212
	-.753	403.144	.452	-.00457	.00607	-.01651	.00736

9.4 Interviews

Company	Sector	Name	Position	Interview	Date
AP6	Swedish national pension fund	Margareta Alestig Johnson	Deputy Managing Director	Telephone	2014-10-07
AxFood	Food retail	Åsa Domeij	Head of Environment and Social Responsibility	Telephone	2014-11-28
Blueberry Lifestyle	Organic café chain	Ulrika Holm	Founder	Telephone	2014-04-25
Coca-Cola Enterprises	Consumer staples	Rønnaug Vinje	Senior Manager Corporate Responsibility & Sustainability	Telephone	2014-10-21
EQT	Private equity	Therése Lennehag	Head of Responsible Investment	Personal	2014-11-14
EY	Consulting & accounting	Gary Baker	Executive Director, Climate Change & Sustainability Services	Personal	2014-04-15
Folksam	Asset manager / Insurance company	Karin Stenmar	Head of Environment and Climate Department	Personal	2014-10-17
Fortum	Energy	Ulf Wikström	Sustainability Manager	Telephone	2014-11-21
Green Cargo	Transportation	Johan Sandström	Environmental Manager	Telephone	2014-10-03
H&M	Apparel retail	Catarina Midby	Head of Sustainable Fashion	Personal	2014-05-14
Hagainitiativet / 2050	Company network & consulting	Nina Ekelund	Program Director	Personal	2014-11-22
HK Scan	Food producer	Vera Söderberg	Corporate Responsibility Manager	Personal	2014-10-07
JM	Real estate management and development	Per Löfgren	Sustainability Manager	Telephone	2014-11-05
Lantmännen	Food producer	Martin X Johansson	Coordinator Sustainable Development	Telephone	2014-11-21
Löfberg	Consumer staples	Eva Eriksson	Sustainability Manager	Telephone	2014-11-03
MAX	Fast-food chain	Pär Larshans	Chief Sustainability Officer	Personal	2014-04-25
McDonalds	Fast-food chain	Henrik Nerell	Environmental Manager	Personal	2014-10-01
Pfizer	Healthcare	Bengt Mattson	Head of CSR and Sustainability	Personal	2014-05-09
Prime	Consulting & PR	Krister Nilsson	Head of Sustainable Affairs	Personal	2014-04-25
Ratos	Financials	Jenny Askfelt Ruud	Senior Investment & CR Manager	Personal	2014-05-16
SCA	Paper products	Kersti Strandqvist	SVP Corporate Sustainability	Telephone	2014-04-28
SEB	Financials	Cecilia Widebäck-West	Head of Corporate Sustainability	Personal	2014-05-22
SEB	Financials	Christopher Flensborg	Head of Sustainable Products and Product Development	Personal	2014-11-17
SJ	Transportation	Erica Kronhöffer	Director Sustainable Affairs	Personal	2014-04-17
SKF	Industrials	Helena Ingemarson	Project Manager Corporate Sustainability	Personal	2014-05-12
SPP	Asset manager / Insurance company	Stina Billinger	Head of Sustainability	Personal	2014-05-08
Statoil	Fuel & retail	Henrik Grenert	Quality- & Environmental Manager	Telephone	2014-10-28
Stena Recycling	Recycling	Cecilia Våg	Sustainability Manager	Telephone	2014-10-24
Sveaskog	Forest owner and developer	Olof Johansson	Environmental Manager	Personal	2014-10-01
Swedfund	Private equity & foreign investment / aid	Lars-Olle Larsson	Manager ESG Affairs and CEO of Integrated Reporting Sweden	Personal	2014-04-24
Tele 2	Telecommunication services	Marie Baumgarts	Head of Corporate Sustainability	Personal	2014-04-28
Tetra Pak	Packaging	Erik Lindroth	Environment Director	Personal	2014-10-09
Vasakronan	Real estate management and development	Anna Denell	Sustainability Director	Telephone	2014-11-04
Åhléns	Department stores/Retailer	Anita Falkenek	Head of Sustainability	Personal	2014-04-14