CHAPTER 13

THE EU's SUSTAINABLE FINANCE PLATFORM: A NEW GAME PLAN IN THE QUEST FOR COMPETITIVE ADVANTAGE

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ABSTRACT

The game plan firms must navigate in the quest of competitive advantage which is changing quickly. More and more firms acknowledge that future prosperity depends on achieving the joint goals of economic, environmental and social sustainability. This understanding has resulted in both firms and actors on the financial markets enhancing their focus on environmental, social and governance dimensions in their respective decision-making processes. In this chapter, the focus is on one key component of the changing game plan, the European Union's (EU) Sustainable Finance Platform that envisions investors as a key driver of firms' sustainability transformation. Based on survey data from Swedish listed firms, we discuss implications and outcomes of the Platform. Our results show that investors play an important role in setting the rules of the gameplan for firms. However, not to the extent that it meets the ambitions of the policymakers. This suggests either that the

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Platform will fail to meet its aims or that firms should expect further significant changes to the gameplan in the future.

Keywords: Sustainable finance; transformation; CSRD (Corporate Sustainability Reporting Directive); EU Taxonomy; TCFD (Taskforce for Climate related Financial Disclosure); competitive advantage

1. INTRODUCTION

The game plan firms must navigate in the quest of competitive advantage is changing quickly (Ioannou & Serafeim, 2019; Laszlo & Zhexembayeva, 2017). More and more firms acknowledge that future prosperity depends on achieving the joint goals of economic, environmental and social sustainability (Arvidsson, 2022; European Commission, 2022). This understanding has resulted in both firms and actors on the financial markets enhancing their focus on environmental, social and governance dimensions in their respective decision-making processes (Arvidsson & Dumay, 2021). In this chapter, the focus is on one key component of the changing game plan, the EU's Sustainable Finance Platform (European Union Platform on Sustainable Finance, 2021) that envisions investors as key driver of firms' sustainability transformation. Based on survey data from Swedish listed firms, we discuss implications and outcomes of the Platform. The Platform should be viewed through the prism of the myriad of new public sustainability policies. These policies are manifested through the 17 Sustainable Development Goals set by the United Nations (UN SDGs) in 2015, the Paris Climate Agreement agreed upon in 2015, President Biden's Build Back Better plan as well as the EU's recovery plan NextGenerationEU, and its wider Green Deal programme launched in 2019. The European Green Deal focusses on environmental sustainability and combines the joint goals of climate neutrality by 2050 and the protection of biodiversity by reversing the degradation of ecosystems (European Commission, 2022b). So far, the EU has chosen an approach that can be described as climate-first, biodiversity next. Most progress has been made on the EU's climate strategy while the biodiversity strategy is still in its early development stage.

For a long time, climate change has been an important policy area for the EU with the Emissions Trading System (EU ETS) as its flagship policy. Launched in 2005, the EU ETS is the world's first international emission trading system (European Commission, 2022c). It requires polluting firms to obtain an emissions permit before they emit carbon into the atmosphere. Trading of permits among firms creates a market that puts a price on carbon. The idea behind the system is that trading permits, and pricing emission creates incentives for firms to reduce emissions by cutting waste, shifting to alternative fuels and production processes as well as innovating new low-carbon social and technological solutions (Convery, 2009). Evidence suggests that the EU ETS has contributed to the decarbonization of the economy (Löschel et al., 2019). However, the size of the actual impacts is uncertain (Texidó et al., 2019), especially, the trading system's long-term effects (Verde, 2020). Although pricing of emissions can contribute to a decarbonization its potential to lead to a complete decarbonization of the economy is questionable. Deep decarbonization of the economy requires a structural transformation involving economic, social, infrastructure and political change (Andersson & Karpestam, 2012). Such a transformation is difficult to orchestrate simply through a pricing mechanism (Andersson & Karpestam, 2013).

The EU Green Deal constitutes the next phase in the EU's climate policies. It moves beyond simply pricing emissions to focussing more on creating the right conditions for a sustainability transformation of society. The programme is built on a transition perspective recognizing that significant changes in regulations, infrastructures and behaviours are required to meet the climate target of zero net emissions by 2050. While launching the programme, the President of the Commission, Ursula von der Leyen, called it Europe's 'man on the moon moment' to illustrate the challenge, and the level of ambition, of the new climate policies. The Green Deal is a comprehensive programme that covers many different aspects of the environmental sustainability transformation, and it contains detailed plans for different sectors of the economy.

A key component of the Green Deal is the Sustainable Finance Platform (European Union Platform on Sustainable Finance, 2021). This Platform partially builds on the idea that more information about sustainability impacts, risks and opportunities can facilitate real change within the firm but also in the relationship between the firms and its customers/suppliers as well as between the firm and financial markets. Building on the ideas outlined in the transition finance literature (see e.g. Caldecott, 2022), one policy aim is to turn the financial sector into a key player in enabling and driving the sustainability transformation of firms. By funding new sustainable social and technological innovations, the financial sector will assist in enabling the sustainability transformation by accelerating and redirecting financial flows towards sustainable investment projects that promote the reaching of the SDGs.[1] Up to this moment, firms were too often stifled in their sustainability ambitions by the fact that there were no sustainable alternatives available to the existing less sustainability-oriented solutions. By accelerating and redirecting financial flows, new sustainable solutions are created that the firms, and households, can adopt. In addition, by incentivizing the financial sector to both fund sustainable investment projects and increase their requirements on firms to actively engage in the sustainability transformation, the financial sector is turned into an active driver of the transformation.

Thus, with the EU's Sustainable Finance Platform, firms are facing a new game plan in their quest for competitive advantage. There has been a wide range of voluntary mapping and reporting frameworks firms have been able to adopt before. These frameworks include the Taskforce on Climate-Related Financial Disclosures, the Global Reporting Initiative's sustainability reporting guidelines and the OECD Guidelines for Multinational Enterprises (on responsible business conduct). However, as voluntary frameworks, firms have been able to pick and choose which framework, and which part of a framework, that suits them the best for their individual purposes. The EU's Sustainable Finance Platform changes the game plan by requiring firms to operate on a common playing field. Being able to navigate this new field and performing well on the sustainability arenas will be a prerequisite for firms to attract low-cost capital, recruit and maintain the best employees, partners and suppliers but also to gain loyal customers granting the firm the vital licence to operate (Deegan, 2002, 2014; Demuijnck & Fasterling, 2016).

In this chapter, we discuss the key components of the Sustainable Finance Platform and discuss how it may change the playing field firms' face and its potential to achieve its aims. Here, we build on survey data from listed firms in Sweden from 2022 regarding how they work with environmental, social and economic sustainability, and the importance of the financial sector in setting and implementing the sustainability agenda.

2. THE EU's SUSTAINABLE FINANCE PLATFORM

2.1. The CSRD and the Taxonomy

The EU's Sustainable Finance Platform contains two key elements: the Corporate Sustainable Reporting Directive (CSRD) and the EU Taxonomy on Sustainable Development (Taxonomy). Information is key in any financial decision-making. While many firms have been reporting on its sustainability impacts, opportunities, risks and strategies for many years, there have been large variations in the quality and content of the reporting (Helfaya et al., 2019). The information provided in these reports have often been criticized for lacking comparability among firms (Arvidsson, 2019; Arvidsson & Dumay, 2021). Part of the problem is due to a lack of common definitions of key sustainability concepts impairing the understanding of how to map, report and incorporate sustainability into decision-making (Andersson & Arvidsson, 2022). Variations in data quality have rendered difficulties for investors to employ the information in their decision-making. One aim of the CSRD is to provide a common framework and language for how to map and report sustainability information in a comparable manner. The Directive builds on the Non-Financial Reporting Directive (NFRD), EU Directive 2014/95/EU, from 2014 that required firms with at least 500 employees to disclose information on how they operate and manage social and environmental challenges. Although the NFRD was complemented in 2017 by guidelines to assist companies to disclose social and environmental information (European Commission, 2017), it was criticized for lacking detail and for giving firms too much flexibility in their mapping and reporting processes. The CSRD framework is more stringent to provide the common ground necessary for both corporate and investor decision-making (KPMG, 2021).

The CSRD is complemented by the Taxonomy, which is a classification system that defines various activities based on their level of sustainability (European Commission, 2022d). It too provides a common language of what constitutes a sustainable activity and aims at preventing so-called green-washing where unsustainable activities are presented as green. The Taxonomy also incentivizes firms and investors to engage in the sustainability transformation[2] as they will directly or indirectly obtain a sustainability ranking. This is achieved by the Taxonomy operating as a form of marketing devise where firms' public sustainability ranking act as a marketing tool to attract not only the best employees, partners, suppliers and loyal customers but also vital capital at a low cost. Thus, a poor ranking can limit the willingness of investors to provide capital and thereby limit the firms' possibility to grow.

At the time of writing, the development of the Sustainable Finance Platform is in its early days. Several of its key components have been announced, some in draft form, but they are not expected to be fully implemented until 2023/24. However, to maintain its competitive advantage, firms must begin to adjust to the proposals already in 2021/22.

2.2. Challenges for the EU's Sustainable Finance Platform

The EU's attempts to engage the financial sector in the sustainability transformation is not without challenges. Investors are asked to take on a new role in *enabling* and *driving* the sustainability transformation. Both investors and firms are required to engage with new types of impacts, risks and opportunities significantly different in nature and complexity compared to the risks they are familiar with. The CSRD and the Taxonomy provide assistance in developing the necessary skills to take on these challenges. However, it is likely to take time before the learning process is complete. Obviously, learning and adoption are nothing new. Some scholars even argue that modern societies should be seen as 'learning economies' in which knowledge is the crucial resource and learning is the most important process (Lundvall & Johnsson, 1994). Yet, the sustainability transformation creates a completely new environment for firms and investors in contrast to incremental changes that mainly take place within existing societal structures (Mokyr, 1994). Actors in industry, finance and policy will, individually and jointly, dramatically revise their theoretical and empirical understandings of society and their specific roles in it. Recent research explicitly suggests that this learning process will require building capacity and diffuse knowledge among and between different actors to push society (Kivimaa et al., 2019; van Mierlo & Beers, 2020) to ensure that society moves in this desired direction (Nilsson et al., 2021). The sustainability transformation is fundamentally different compared to the previous transformations that society has gone through since the first industrial revolution. Previous transformations were not guided by a specific agenda and long-term goals such as the UN SDGs. Historical transformations were shaped evolutionary by private and public actors without any clear direction of travel beyond increasing productivity and growing economic wealth. In which direction the economy grew was of minor importance. The sustainability transformation, in contrast, sets a clear direction for the development of society and actors need to adjust and learn specific knowledge and skills aligned with the roadmap set by the sustainability transformation.

The most obvious new skill that firms and investors are required to obtain is the mapping of sustainability impacts, risks and opportunities. These considerations are often of a different time scale and dimension compared to impacts, risks and opportunities that firms and investors are used to considering. For example, consider climate-related financial risks. These can be divided into two categories: physical risks and transition risks (Demaria & Rigot, 2020; Stern, 2013). Physical risks are risks related to climate and weather-related events stemming from a rise in temperatures such as a reduction in worker productivity due to higher temperatures (Kjellström et al., 2018), rising sea levels and an increased frequency of extreme weather events such as flooding or droughts (Barro, 2009, 2015). Transition risks relate to the changes in preferences (Rodriquez-Melo & Mansouri, 2011), consumer behaviours, technology and regulations due to the climate transition (Semieniuk et al., 2020). The consequences of the transition risks are exacerbated if the transition to a low carbon economy becomes a rapid and chaotic process rather than a slow steady process (Campiglo et al., 2018). For both types of risks, the potential impacts are not only direct but may also be indirect through the firms' supply chains and customer relations (Andersson, 2018, 2020).

Both the physical and transition risks are complex in nature and operate over longer time horizons compared to the horizons commonly considered by firms in their decision-making. Due to the complexity and time horizon of the climate-related impacts, risks and opportunities, mapping and reporting frameworks, such as the CSRD, recommend that firms employ scenario analysis to actively engage in strategic thinking about possible outcomes based on different future potential transformation pathways. While firms are used to forecast key financial indicators, scenario analysis is for most firms a completely new exercise (Andersson & Arvidsson, 2022) based on a different logic compared to traditional forecasting. A survey by CDSB (2018) found that even among large firms, few firms engaged in scenario analysis properly. Without the proper skills to perform, for example, scenario analysis, the mapping and reporting of climate-related risks may result in low-quality analysis and risk management that may aggravate the risks level rather than reduce risks levels. To employ scenario analysis, firms are, thus, required to obtain new knowledge and new abilities (O'Dwyer & Unerman, 2020).

Another problem firms face is the collection of new types of high-quality data necessary to map and report on sustainability impacts, risks and opportunities (de Bruin et al., 2020; van Vuuren et al., 2011). Collecting this new type of data requires firms to redirect scarce resources to develop new internal routines and processes. The CSRD may provide assistance in explaining which type of information the firm and the investor should consider and, thus, collect. However, the nature of the impacts, risks and opportunities involved requires not only simple quantitative indicators but also qualitative indicators where firms in narratives describe outcomes and strategies. Firms and investors must then find ways of combining the qualitative and the quantitative information in their respective decision-making.

None of these challenges are impossible to overcome. However, the firms' and investors' learning processes may take significant time before the EU's Sustainable Finance Platform begin to contribute significantly to the EU's sustainability transformation. Along the way, there will be unintended consequences and potential lock in effects. This calls for a continuous process of innovation, trial, learning and revision among and between the different actors in policy, industry and the financial markets.

3. MAPPING AND REPORTING OF SUSTAINABILITY RISK AMONG LISTED FIRMS AND INVESTORS IN SWEDEN

3.1. Survey Design

To illustrate the challenges of the new game plan imposed by the EU's Sustainable Finance Platform, we study how the sustainability work of large listed Swedish firms. We study to what degree the financial sector is involved designing the firms' sustainability agenda. This is a key question given the aim of the EU's Sustainable Finance Platform of turning the financial sector into a driver of the sustainability transformation. We also study to what degree the firms have begun to adjust to the upcoming requirements imposed by the CSRD and the Taxonomy. The analysis is based on survey data of firms listed on the NasdaqOMX stock exchange in Stockholm. The survey was distributed in the summer of 2022[3] and directed to the Head of Sustainability of the respective firms but also copied to the other members of the management team (e.g. CEO, CFO and Investor Manager). The survey was conducted in English as English is the main language for most of the sampled firms. In total, the survey was distributed to 134 firms with a response rate of 70.1%. Out of the responding 94 firms, 20 firms belong to the financial sector and the remaining 74 firms belong to goods producing sectors.

The survey included more than 40 questions regarding the firms' sustainability mapping, reporting and strategies for sustainability transformation. In this chapter, we focus on four questions related to whom is involved in the design and implementation of the respective firms' sustainability agenda. And, to what degree have they studied the potential impacts of the CSRD and the Taxonomy on the firm.

The population of firms, listed on the NasdaqOMX stock exchange, and the firms responding to the survey are not representative of all firms. The population consists of larger firms compared to the average, and the firms responding to the survey are more likely to have relatively higher ambitions when it comes to sustainability mapping and reporting (Andersson & Arvidsson, 2022). The firms included in the survey are, thus, at the forefront when it comes to firms' sustainability work. In addition, Swedish firms have a reputation of being front-runners when it comes to sustainability strategies (see Cahan et al., 2016; KPMG, 2015, 2019) partially due to the relatively stringent environment laws (Anderson et al., 2020; Karlsson, 2021). The results could, thus, be interpreted as representing best practice among firms globally.

3.2. Survey Results

The results are divided into two parts: firstly, we consider whom sets and implements the sustainability agenda of the firms, and then, we consider how prepared the firms are to meet the requirement of CSRD and the Taxonomy. The firms were asked to rank how important six factors were in formulating the firm's sustainability strategy: international agreements, national legislation, investors, customers, competitors and the firm's own ambition. The ranking is similar for both financial firms and goods producing firms (see Table 1). Financial firms state that their own ambitions is the most important factor followed by international agreements and customer demands. The least important factors are investor demands and the behaviour of competitors. Goods producing firms rank international agreements the highest followed by own ambitions and legislation on a joint second place. This is in line with Arvidsson and Sabelfeld (2022) who find the adaptive framing of large companies are much focussed on national and international regulations and socio-political events. As for financial firms, the least important factors are investor demands and competitors. The low ranking of investors suggests that pressures from financial markets in relation to sustainability are weak. The main driver of firms' sustainability strategies, so far, appears to be international agreements and national legislation emphasizing the important role of public policy.

When it comes to the implementation of the firms' sustainability agenda, firms were asked to rate the importance of four key groups: the board, the management team, other employees at the firm and investors (see Table 2). Again, investors come out as the least important group for both financial firms and goods producing firms. Unsurprisingly, the management team is the most important group for implementing the sustainability strategy followed by the board and other employees. The low ranking of investors in both *formulating* the sustainability strategy and *implementing* the agenda suggests that financial markets, so far, have played a limited role in driving the sustainability agenda of firms at least in Sweden. Whether the financial sector can take on its role as a key *enabler* and *driver* is a question for future research. However, our results suggest that this is a role that the actors on the financial markets are unfamiliar with and, thus, requires both learning and adjustments to succeed in their new role.

The next set of questions in the survey relates to how prepared the firms are to meet the challenges of the CSRD and the Taxonomy by incorporating sustainability in their decision-making processes. Firms were asked whether they had the tools and the ability to evaluate the financial effects of their sustainability agenda. Here, a minority if the firms, 15% of the financial firms and 23% of goods producing firms, said yes (see Fig. 1). The majority of firms responded that they have the tools and ability to only some extent, while between 18% (goods producing firms) and 25% (financial firms) responded they neither had the tools nor the ability. These results are not surprising considering that sustainability is a relatively new game plan for reaching competitive advantage.

Table 1. Ranking of the Most Important Factors in Formulating the Firms' Sustainability Strategy.

	International Agreements	National Legislation	Investors	Customers	Competitors	Own Ambitions
Financial	2	4	5	3	6	1
Production	1	2	5	4	6	2

Note: 1, most important actor and 6, least important actor.

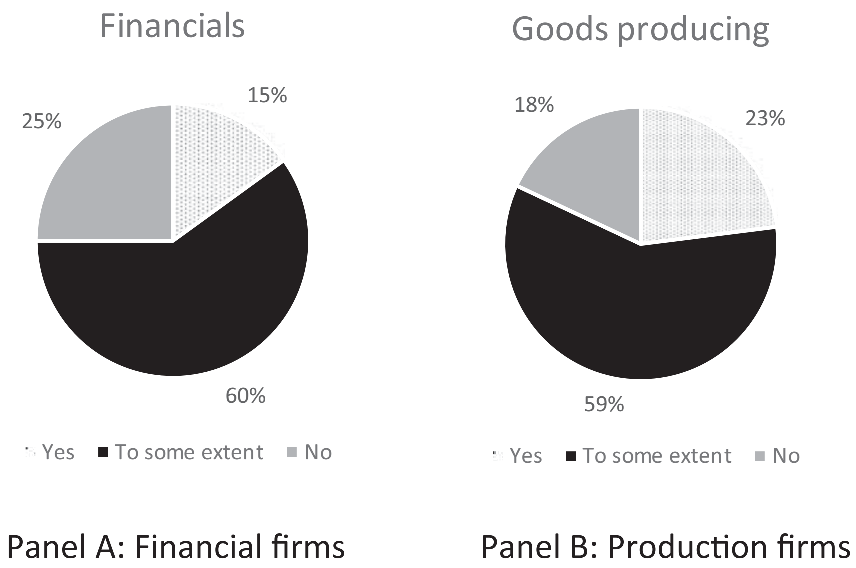

Fig. 1. Do You Have the Tools/Ability to Analyse How Your Sustainability Work Affects Your Financial Performance?

Table 2. How Involved Are the Following Actors in Implementing the Firm's Sustainability Agenda.

	Board	Management Team	Other Employees	Investors
Financial	2	1	3	4
Production	2	1	3	4

Note: 1, most important actor and 4, least important actor.

One of the purposes of the CSRD is to assist the firms in their learning and adjustment processes. Although, the first CSRD proposal was adopted in 2021 and the initial set of standards are to be implemented already in the financial year of 2023, only half of the firms (see Fig. 2) have analysed how the CSRD may affect their respective firms. One-third of all firms are working on it but have not yet completed the process. The remaining 15% of firms have not even begun the process. This result is somewhat surprising given that the CSRD builds on the previous NFRD. The CSRD is more stringent compared to the NFRD and provides additional guidelines, but firms have been required to map and report on sustainability for several years, which indicate that they should have come further in their learning and adjustment processes. The relatively modest engagement with the CSRD suggests a relatively low commitment from most firms when it comes to sustainability transformation. Somewhat surprisingly is that more firms respond that they have assessed the impacts they perceive the Taxonomy will have

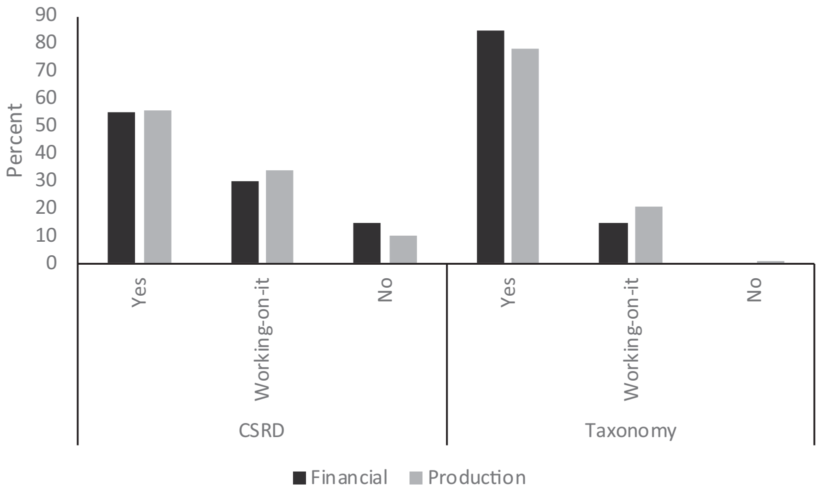

Fig. 2. Have You Analysed How CSRD/Taxonomy Will Affect Your Firm?

on the firm. About 85% of the financial firms and 78% of the goods producing (see Fig. 2) respond that they have analysed how the Taxonomy may affect their respective firms. About 15% (financial firms) and 21% (goods producing firms) of the firms are working on it but has not yet completed their assessment process. Only one, a goods producing firm, has not yet begun this process.

4. CONCLUSIONS

The requirement by the CSRD to map and report on sustainability impacts, risks and opportunities changes the gameplan for firms. It will no longer be possible to downplay sustainability considerations in the firms' decision-making processes. Furthermore, the Taxonomy, with its ranking of economic activities based on the level of sustainability, creates the necessary tools for external stakeholders to take sustainability into account in their interactions with the firms. The Taxonomy also incentivizes the financial sector to consider sustainability when making their investment decisions. Firms that do not adjust to this new gameplan will soon find it harder to attract talented employees, find new customers and attract capital.

In this chapter, we have considered how prepared large and listed firms in Sweden are to the potential changes caused by the EU's CSRD and Taxonomy. We have also considered the potential of turning the financial markets into a driver of the sustainability transformation. Our results give pause for thought. The financial sector ranks as one of the least important sectors in designing and implementing firm's sustainability agenda. Instead, the agenda is mostly formed by international agreements and national legislation (Arvidsson & Sabelfeld, 2022).

Unsurprisingly, the implementation mostly rests with the board and the management team. This may change in the future, should financial market actors take on a more leading role in demanding changes to firm's sustainability agenda. However, it is likely to take time and require financial markets to develop and learn new skills, which will delay the full effect of the EU's Sustainable Finance Platform on the economy.

Our results also show that few firms, approximately 20%, believe that they have the necessary tools to assess the impact of sustainability concerns on their financial performance. The success of incorporating sustainability into the firms' decision-making processes rests on the possibility to find a common language that can merge information on financial performance with information on sustainability impacts, risks and opportunities (Arvidsson, 2022; Arvidsson & Sabelfeld, 2022). Firms are in the process of studying the possible implications of the CSRD and the Taxonomy, which may assist firms in finding the common language (Arvidsson & Sabelfeld, 2022). However, this process is yet far from complete. Again, the full impact of the EU's Sustainable Finance Platform is potentially delayed since firms not yet are ready to respond to the changes in the gameplan that the Platform entails. A critical policy implication of our study is the need of safeguarding an alignment between policy aims and actual corporate decision-making processes.

It is worth noticing that major changes always involve a process of innovation, trial, implementation, learning and revision. The significant changes to the firm's quest for competitive advantage that the Sustainable Finance Platform implies is likely to cause a prolonged adjustment process. Whether it will become successful remains to be seen.

NOTES

1. In practice, defining sustainability is difficult. An important aim of the EU Taxonomy for sustainable activities is to guide firms and investors in classifying what constitutes a sustainable investment project.
2. Transformation includes a radical change and significant new practices and meanings (Asara et al., 2015; Blythe et al., 2018; Feola, 2015). A transformation often involves an intention to change a situation to a more beneficial state (Chapin et al., 2009), in the case of the ongoing sustainability transformation it relates to the Brundtland report emphasizing the importance of acknowledging the needs of future generations (UNWCED, 1987).
3. The survey is part of the Swedish Corporate Sustainability Ranking. The Swedish Corporate Sustainability Ranking is led by Susanne Arvidsson and joint collaboration between Lund University, and two of Sweden's leading financial newspapers *Dagens Industri* and *Aktuell Hållbarhet*.

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