

Moderating role of ethics between Sustainability and Environmental Social Governance

Dr. Taoufik Radouche¹

Abstract

The purpose of this paper is to examine the impact of ethical orientation on sustainability engagement and commitment to Environmental Social Governance (ESG) measures and analyze the moderating role of ethical orientation in the relationship between sustainability and ESG. The data collection method used was a survey of 178 supervisors from Saudi Arabian companies. A linear regression analysis was used to examine the direct effect of ethical orientation on sustainability engagement and ESG commitment, as well as its moderating effect. Findings indicate that ethical orientation plays a moderating role and strongly impacts sustainability engagement and ESG commitments.

Keywords: *ESG, Sustainability, Ethics, moderating relationship.*

Introduction

Sustainability is integrated into corporates' spirit and managerial acts; it refers to responsible actions taken approach in their territories. Parallel to sustainability challenge and within the context of legitimacy, the corporates are required to achieve the balance between societal paradigms and economic construct. Additionally, the corporates engaged in the corporate accountability movement are looking for social responsibility commitment, whether they carry it out themselves or are subject to the protesting social actors. In terms of sustainability, there is no objectivity, but societal and environmental choices are based on the situation at hand. As part of sustainable development, corporates are required to disclose their environmental social governance (ESG) footprint of their decisions and actions, and hence their contributions towards the sustainability goals. However, the three areas of sustainable development (economic, social, and environmental) rely on diverse and sometimes ethical dilemma situations. As far as sustainable development is concerned, there is no objectivity, but rather societal choices. Reconciliation between sustainable development is not easily achievable and requires the establishment of an order of priorities to overcome dilemma situations, and then contextualization is essential. Regarding sustainable development, the moral of manager is needed and postulate the hypothesis that development of ethical orientation is required particularly in ethical dilemma of sustainable development. Consequently, ESG has become increasingly mainstream within corporates to assess long-term sustainability of investments. Simultaneously, it is considered as a management quality measurement for designing the larger business system, promoting ethical behavior, and taking a broader view of stakeholders into account. Also, ethics has become a collective reference framework pushing toward serving interests beyond just those of financial investors (ESG goals), and thus reconciliation of sustainability goals.

¹ Department of Human Resource Management, College of Business Administration - Dar Al Uloom University, Riyadh, Saudi Arabia, taoufik@dau.edu.sa

The main objective of this paper is to examine the impact of development of ethical orientation and ESG on sustainable development, on the one hand, and the relationship between development of ethical orientation and ESG, on the other. This paper is organized as follows: A literature review of sustainable development, ESG, and ethical orientation is presented in Section 2. Section 3 presents the research model and the research methodology. A discussion of the study's findings is presented in section 4. Section 5 presents the conclusions.

Literature Review

I. The ethical matter of sustainability

In the definition of sustainability, it is emphasized that sustainability involves achieving intragenerational equity and not harming future generations (De Paula and Cavalcanti, 2000). Sustainability covers three interrelated and interdependent areas: social, economic, and ecological. According to this definition, three primary objectives of development strategies are to ensure social equity, economic efficiency, and ecological prudence. The environmental sphere must be integrated into the decision-making process of society to achieve sustainability. This will help advance social change based on ethical values previously ignored, such as solidarity, peace, and fraternity, by changing a part of society's behavior. These values form a new ethic essential to achieving sustainable development (Cavalcanti, 1996). Ethics is a set of values and normative knowledge of human acts capable of guiding our conduct and behavior. Ethical values and norms are consecrated by society and confirm the moral conduct of their members. The need for development of ethical sensibility is more important than ever because of the disconnect between human action and rationality according to ecocentric values (Chau', 1995). Furthermore, ethical values and norms perceive that harmful attitudes, dangerous conduct, and dilemma situations are permanent risks that must be controlled and limited (Depoo and Rosner, 2016).

The importance of attaching to ethical values and norms generated by culture and social norms in these situations is to ensure that the individual or group has prior objective knowledge, their action effects, and the circumstances involved, so they can distinguish between right and wrong, good and evil, responsibility and commitment consciously (Yin et al., 2018). When individuals and groups have the capacity to exercise their own conscience, responsibility, will, and freedom, the need for development of ethical orientation is accentuated more. Those who are ethically autonomous already evaluate their own capabilities, question, investigate, and critique value meanings; they are responsible for their own actions, whether positive or negative, and acknowledge that they are responsible for them; they accept responsibility for others and other things; and they refrain from violence (Boff, 1996). Since they are morally active individuals capable of developing and implementing sustainable strategies (Schaefer et al., 2020), they can succeed in sustainability. Our first hypothesis is based on these earlier findings: H1. Development of ethical orientation is positively related to sustainability.

II. The ethical matter of ESG

ESG measures refer to the environmental, social, and governance issues that influence corporate behavior and investment decisions (IFA, 2012). Among the major environmental issues are climate change and population growth and their adverse effects on the natural environment. Generally, "social" refers to corporate social responsibility (CSR) addressing issues such as climate change and population growth, as well as impacting the communities where corporates operate. Corporate governance refers primarily to the role of the board of directors in directing and controlling the corporation (Wan Masliza and Shaista, 2021). Integrating ESG into corporate investment decisions reduces investment risks, improves governance, and increases engagement with

environmental and social practices [Nelson, 2023].

As a result of committing to ESG measures, corporations gain a shared understanding of ethical behavior that drives them to make ethical decisions and thus promote ethical orientation. However, ESG scores will be lower for corporates that do not adhere to high ethical values. Developing ethics helps corporates make ethical decisions that have an impact on ESG issues (Armstrong, 2020). Ethics reasoning tools facilitate pragmatically resolving conflicts between economic and other objectives in a manner that manages effectively corporate responses to ESG. Thus, based on this argument, the following hypothesis is formulated: H2. Ethics development is positively related to ESG disclosure.

III. Relationship between sustainability and ESG

By integrating traditional economic-financial parameters with ESG factors, ESG is typically used in corporate procedures to assess long-term sustainability of investments (Van Duuren et al., 2016). Environmental issues include waste, greenhouse gas emissions, pollution, exploitation of resources, climate change, and deforestation. Social issues deal with relationships with employees, working conditions, health and safety, and diversity. A company's governance practices include its Board of Directors composition, its management compensation, audit procedures, and how its executives behave in terms of compliance with ethical, principles, law, and code of conduct. Transparency is usually associated with governance (Tamimi and Sebastianelli, 2017). Corporate sustainability performance is significantly improved by ESG ratings (Clementino and Perkins, 2021). Corporates that comply with ESG care more about the environment, have better governance, have a lower level of volatility in earnings, and can access lower-cost funds (Kumar, 2023). The third hypothesis is as follows: H3. ESG disclosure is positively associated with sustainability.

IV. The ethical dimension of the relationship between sustainability and ESG

Corporate ESG and sustainability behavior are increasingly governed by development of ethical orientation. By doing so, corporations assist stakeholders in understanding, evaluating, and managing increasingly complex, multifaceted ESG and sustainability issues (Cappucci, 2017). In contrast, by gaming ESG ratings, corporations may create a misleading impression of their true sustainability. Corporate sustainability will not necessarily improve, even if constituent scores and ratings improve, in such a scenario. ESG metrics and sustainability standards are managed as ethical initiatives. A growing trend of professional exchanges focuses on how to promote ethical orientation with ESG issues and sustainable goals. Therefore, we hypothesize as follows: H4. Development of ethical orientation positively moderates the relationship between ESG disclosure and sustainability.

Research model and Methodology

A. Research model

According to the literature review, Figure 1 presents the study's research model. Through this study, the relationship between development of ethical orientation and sustainability [H1], the relationship between development of ethical orientation and ESG [H2], the relationship between ESG and sustainability [H3], on the one hand, and the moderator role of the ethical orientation in the relationship between ESG and sustainability [H4], on the other hand were analyzed.

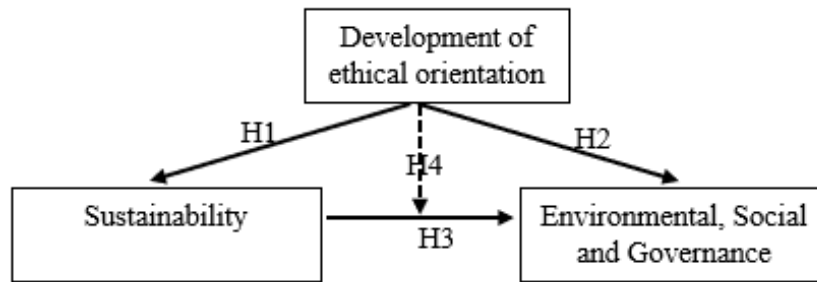


Figure 1. Research Model

B. Methodology and sampling

Saudi Arabian supervisors participated in this study. Supervisor means an employee who is responsible for a team. Only 187 of the 195 data matching survey questionnaires containing 10 items were returned. Nine of them were removed from the analysis due to substantial missing values. Thus, there were 178 valid supervisor responses, or 95% return rate. 72% of this group were men and 28% were women. A total of 65% of the respondents had a bachelor's degree. Most (70.2%) worked for the private sector, and the rest for the government. Respondents' ages ranged from 25 to 30 (33.8%), 31-40 (28%), 41-50 (16.8%) and 50+ (21.4%). Additionally, most respondents had more than 3 years' experience (73.6%) or 1-3 years (26.4%).

V. Measurement model analysis

This study used multi-measurement questionnaire items ranked on a five-point scale for each variable (see Table 2). Specifically, three measurement items were used for measuring the relationship between development of ethical orientation, sustainability, and ESG. The development of ethical orientation was measured through a total of four statements. Each sustainability and ESG is measured through three items. Our study hypotheses were tested using multiple linear regression, on the one hand, and the convergent and discriminant validity were calculated for the measurement model, on the other, using SPSS 26 (IBM, Armonk, NY, USA).

To explore the interrelation between the impact of the Development of ethical orientation (ED), on one side and Sustainability (SU) and Environmental, Social, and Governance (ESG) on other side, we used the Pearson correlation. In this study the Development of ethical orientation was moderating variables. The means and standard deviations of variables are shown in Table 1. The variables' standard deviations are close to zero indicating that the data are clustered closely around the mean (more reliable).

Table (1): Means and standard deviations of variables.

	EO	SU	ESG
Mean	3.811	3.754	3.687
Std. Deviation	0.687	0.571	0.523

The validity of the measurement model was assessed from two perspectives: convergent validity and discriminant validity. A convergence test was conducted by calculating Cronbach's alpha (α), Composite Reliability (CR), and Average Variance Extracted (AVE). Measurement of item factor loading was conducted, and discriminant validity of each variable was evaluated by taking the square root of the AVE.

Table (2): Convergent validity.

Constructs and Items	Factor Loading	α	CR	AVE
Development of ethical orientation (ED)				
As a supervisor, I frequently apply ethical values such as justice, fairness, and rightness. (ED1)	0.852	0.752	0.891	0.702
Every decision I make must be for my family, culturally, legally, and traditionally acceptable. (ED2)	0.785			
Whenever I make decisions, I strive to maximize benefits and minimize damages. (ED3)	0.760			
All decisions I make in my work must be free of unwritten rules or abusive practices. (ED4)	0.759			
Sustainability (SU)				
Our company intends to ensure social equity, economic efficiency, and ecological prudence as part of its corporate objectives. (SU1)	0.956	0.698	0.790	0.853
Environmental considerations are incorporated into decision-making. (SU2)	0.836			
The culture of our company is more focused on sustainability. (SU3)	0.582			
Environmental, Social, and Governance (ESG)				
We believe that focusing on ESG makes a business better. (ESG1)	0.749	0.733	0.753	0.773
ESG is embedded sufficiently in our business strategy. (ESG2)	0.852			
ESG will be a challenge for our company in the future. (ESG3)	0.641			

The factor loadings should exceed 0.7 to determine convergent validity (Hair et al., 2011). Table 2 shows that most factors have loadings greater than 0.7 except for SU3 and ESG3, whose loadings are near 0.7. We keep these factors because they have loadings greater than 0.4 (Chin, 2010).

According to table 3, the Cronbach's alpha values of the measurement model exceeded the threshold of 0.7 (Joseph et al., 2010) and the AVE of all latent variables exceeded 0.5 (Hair et al., 2011).

Table (3): Discriminant validity.

	ED	SU	ESG
ED	0.743		
SU	0.779	0.952	
ESG	0.741	0.844	0.912

Table 3 shows that for each latent variable the square root of the AVE is higher than all other values in the same column, which indicates that the model meets acceptable discriminant validity.

Results and discussion

Table (4): Multiple correlation Results.

Variables Relationship	Beta Value	p-Value	Hypothesis Test
ED ↔ SU	0.598	p < 0.001	Accepted H1
ED ↔ ESG	0.687	p < 0.001	Accepted H2
ESG ↔ SU	0.544	p < 0.001	Accepted H3
ESG ↔ ED ↔ SU	0.698	p < 0.001	Accepted H4

Notice: Correlation is significant at the 0.001 level. N = 178.

The relationship between model variables is shown in table 4. Sustainable engagement (SU) and Development of ethical orientation (ED) have a significant relationship ($\beta = 0.598$) with a significance level of $p < 0.001$. Consequently, as interest in Development of ethical orientation increased, interest in Sustainability also increased. Hypothesis H1 was fully supported. Similarly, the other direct relationships have a strong and positive association with $p < 0.001$: relationship between Development of ethical orientation (ED) and ESG ($\beta = 0.687$), and relationship between ESG and Sustainability (SU) ($\beta = 0.544$). Supervisors are more concerned about ESG and sustainability when the Development of ethical orientation increases. The hypotheses H2 and H3 are fully supported.

According to the results of the study, the moderating hypothesis (H4) was supported. Indeed, it appears that Ethical Orientation (ED) has a positive moderating effect that strengthens the relationship between each original variable. The direct relationship between Sustainability (SU) and ESG with (β) = 0.544 is enhanced to become (β) = 0.698 through the moderating effect of Development of ethical orientation (ED).

Environmental sustainability is concerned with initiatives that decrease environmental degradation and promote the greatest good for many people and for future generations. Thus, this field is closely linked to the development of ethical orientation. There is a rapid increase in environmental concerns, especially regarding the effects of industrial pollution. It is important for supervisors to engage in environmental sustainability in a variety of ways to preserve environmental sustainability. Sustainable environmental engagement refers to employees' ethical behavior (supervisors) through practicing direct sustainable work behavior and/or sustainable energy consumption, such as limiting energy use; recycling; adopting renewable energy and avoiding waste or any pollution-related activities, such as chemical dumping; alerting companies about unsustainable policies or operations, and so forth. According to our study, supervisor ethics are positively correlated with sustainability. Indeed, at the individual level, sustainability and ethics share the same principle of aiming to benefit as many people as possible.

Our findings also have implications for ESG. Supervisors responded to ESG issues by reflecting on, or rethinking, their values, ethical positions, or principles. Consequently, ethics-based decision-making may be highlighted and committing to ESG measures is positively associated with ethical business practices.

According to the study, commitment to ESG measures allows companies to track sustainability practices in terms of environmental, social, and governance reporting. A growing awareness of the importance of ESG issues to corporate sustainability may explain the positive relationship between ESG and sustainability.

Development of ethical orientation encompasses environmental sustainability and ESG engagement. Based on the study of the moderating role of development of ethical orientation, environmental sustainability and committing to ESG measures constitute individual moral responsibility for supervisors who believe ethical orientation is important. This encourages supervisors to protect environmental sustainability from

harm. They may not support sustainable values if they perceive their environmental engagement as going against their ethical beliefs. Therefore, supervisors who are highly ethical suppose have strong sustainable engagement and ESG.

Conclusion

Morally active corporates can develop and implement sustainable strategies. Furthermore, ethical orientation facilitates effective corporate responses to ESG. ESG-compliant corporations tend to care more for the sustainability engagement. According to a literature review, promoting ethical orientation is aligned with engagement with ESG measures and sustainable strategies. The results of the study of 178 supervisors from Saudi Arabian companies found that sustainability and ESG measures are positively associated with development of ethical orientation because they both aim to benefit as many people as possible. An analysis of the moderating role of the development of the ethical orientation between sustainability and ESG found that supervisors who are highly ethical have strong sustainable engagement and committing to ESG measures.

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