eman ta zabal zazu

Universidad del País Vasco Euskal Herriko Unibertsitatea

EKONOMIA ETA ENPRESA FAKULTATEA
FACULTAD DE ECONOMÍA Y EMPRESA

Double degree in Business Administration and Law

2021/2022

ESG STANDARDS AND THE PARADOX OF IMPACT-DIFFUSION:

European Taxonomy and Possible Contributions

Author: Aitor Ortiz Azpiazu

Director: Leire San José Ruiz de Aguirre

Bilbao, June 24th, 2022

INDEX

GRAPHICS AND TABLES INDEX

Graphics

Tables

1. INTRODUCTION

1.1. Contextualization of the work

Although responsible investment has been done for millennia (Townsend, 2020), Socially Responsible Investing (hereafter, SRI) and the integration of Environmental, Social and Governance (ESG) factors onto investment funds and firms, the latter being born from the first as a subtype of it, has gained most track in the last decades, evolving from more simpler way into complex financial structures, together with rising concerns about social inequality or climate change among other issues that humanity is facing. This evolution in the way responsible investing is carried away has come with a switch on the perception of investors towards it. What started as a way of mainly criticizing and applying pressure on harmful sectors and activities with the consequence of losing returns on investment, is now a way to take advantage of opportunities, such as regulatory benefits and long-term returns, and to avoid social and even financial backlash.

However, as SRI and ESG begin to mature and establish as key financial points to take into consideration when investing in companies or funds, some concerns are starting to arise that are questioning the actual legitimacy of these factors. As an increasing number of companies and funds claim to respect and comply with environmental, social and governance factors, either in their day-to-day activities or in their investing strategies, rating agencies, governmental branches and some other economic actors have launched indexes and standards in order to classify and give a distinction to those companies that actually complied with what was asked by the agencies. In that regard, one of the main issues is highlighted by the Paradox of Standards (Haack & Rasche, 2021), as the struggle that sustainability standards face in order to gain major importance, while actually complying with their main purpose, which is to classify companies and firms in regards to their integration of ESG standards.

Therefore, one of the main objectives of ESG and SRI as a whole is to continue gaining importance and relevance among economic actors, while keeping the main purpose for which it came into existence, which is to highlight investment funds and companies that have high standards in regards to environmental, social and corporate governance issues, in order to boost their relative and overall importance in the world's economy.

In that regard, one of the strongest bets lately has been done by the European Union, that, along with its many initiatives, has launched the EU Taxonomy. This project, which is still being developed and integrated into the European legislation, looks to build a system to classify which activities are environmentally sustainable, and to which extent, trying to measure how responsible companies are. For that, an extensive set of financial and business data will be required from companies (listed or non-listed) to be presented together with their financial reports. As it can be seen, the main differentiating point is that, as it will be pushed through the law, companies will have to comply with what is asked by the EU, regardless of how demanding these standards may be. Also note that it is mainly focused on environmental issues, as they may be the most pressing, but there´s intention to expand it to social and governance as well.

1.2. Objectives

The main aim of this work is to suggest different actions for companies and firms to build up from, serving as the stepping stone to achieve the better information of companies regarding ESG ("**Environment, Social and Governance**"). We try, with the development of this work, to offer a set of initiatives that could be done by either big public institutions or small standard proposers, in order to obtain a way to improve their ESG criteria in an area so crucial as the impact-diffusion paradox, which could limit both the real impact achieved by the standard and the diffusion of it among economy.

Apart from the main objective of the work, we try to offer a global vision of ESG Standards, taking into account their increasing importance and the benefits that they are bringing. With this, we focus on analyzing the defects of the standard, in order to give a clear idea of where there´s room for improvement.

1.3. Methodology

The theoretical part of the work has been developed through the analytical-synthetic analysis methodology, first breaking down the idea into its different elements (analysis) and then combining them, bringing them together to achieve the desired result (synthesis) (Lopera Echavarría, Ramírez Gómez, Zuluaga Aristizábal, & Ortiz Vanegas, 2010). To this end, in the first part of the work, dedicated to theory, an exhaustive initial search was carried out on the internet, using pages such as Google Scholar or the university's virtual library, with access to different databases, as well as different articles provided by the director of the work. Once the search had been carried out and the articles of interest had been separated from those that did not offer interesting content, the information was synthesized, extracting the most important and the most appropriate references.

Once the previous phase was completed, we proceeded to the practical part of the research, for which we decided to carry out 5 interviews with 5 different professionals from the world of finance and transactions. In this way, first-hand information could be obtained from active professionals involved in activities where the subject of the work could be of major importance.

Table Nº 1: Background on interviewees

	Current position	**Years of experience**	**Company**	**Past experiences**
H1	Investment Banking Analyst	3 and a half years	Bank of America	Investment Banking Analyst at Baker Tilly Global Deal Advisory
H2	Partner of the Corporate and M&A department	Over 20 years	Canadian Corporate Finance Boutique	-
H3	Team Leader at the Corporate/M&A Team (TMT Sector)	5 years	Baker Tilly Global Deal Advisory	-

H4	Analyst at the project finance team	4 years	Moody´s	Analyst at the corporate finance team at a Venture Capital Firm
H5	Associate at the M&A and Capital Markets department at the Madrid office of the firm	6 years	Perez Llorca	Associate at the Capital Markets team at an international law firm with office in Madrid

Source: Own creation

1.4. Structure of the work

After deciding the theme of this work, although broadly as we were not sure of the direction at the beginning, the structure used to develop it is divided in four distinct sections.

The first one was dedicated to doing theoretical research about the topic in general. That is, not just focused on the impact-diffusion paradox or the EU taxonomy, but about ESG in general, in order to obtain a good amount of knowledge about the theme and to compile articles, sections of books and websites to cite later on the development of the work.

After the general research, the focus went onto the specific topics of the work, such as the paradox and problems of ESG, or specifics about the recent EU Taxonomy initiative. The first part was dedicated to researching information about them, to later be able to compare and analyze the obtained theoretical results in order to have a clear understanding for the next section, which focuses on the practical side of the work.

Once the theory was set, the next chapter focused on developing a set of recommendations that we think could help solve, or at least reduce the effects, of the paradoxes and problems found during the research.

Lastly, and in order to verify if the proposals were accurate and in terms with reality, we conducted a series of brief interviews with experts in the field to gain access to their opinions and knowledge in this regard.

Graphic Nº 1: Structure of the Work

Source: Own creation

2. ESG Criteria: concept and origin

2.1. Concept and definition

Over the last decades, ESG criteria has gained an unparalleled recognition as a global indicator of good practices in the business and finance world, growing from what it started as a derivative of SRI ("**Sustainable Responsible Investment**") in the late 1960s and early 1970s. Nowadays, compliance with ESG criteria could mean the difference between investing in a company or not, as being environmentally friendly and socially responsible is viewed as a formula to be better prepared to take advantage of opportunities arising in the future (Filbeck, Filbeck, & Zhao, 2019).

ESG factors can be defined as "environmental, social or governance characteristics that may have a positive or negative impact on the financial performance or solvency of an entity, sovereign or individual" (European Banking Authority, 2020). As it can be seen, giving a precise and specific definition of each of the three nouns would be difficult, as ESG is evolving rapidly, meaning that what today is perceived as, e.g., environmentally friendly practices, in the near future could not be regarded as that. Therefore, for the means of this work, it will be used the definition given by the EBA although specifying lightly the meanings that nowadays have Environment, Social and Governance in order to put them in the context of the time of the making of the work.

- Environment is related to the environmental footprint of the company, defined by the effect of the firms' actions in the climate. It takes into account the energy consumption, carbon emissions, use resources or waste generated among other aspects (Henisz, Koller, & Nuttall, 2019). In some cases, it could mean the opposite, as some enterprises help reduce waste or absorb carbon emissions, either as their main purpose or as effect of their activities.
- Social has to do with the relations of the firms, especially labor ones, including diversity, inclusion, gender equality etc. It also takes into account the reputation of the firm and how it is viewed by society in general, as it is a key aspect for stakeholders (Henisz, Koller, & Nuttall, 2019).
- Governance is related to the internal structure of decision making, control and any other procedure related to corporate governance of the firm (Henisz, Koller, & Nuttall, 2019). For example, in Spain there´s the Code of Good Governance for Listed Companies which includes a set of recommendations as regarding corporate governance, forcing listed companies to specify if they do not comply with some of the recommendations and why.

As it is suggested by the definitions given before, ESG criteria gives a lot of room to rating agencies, companies, media etc. to specify what their own particular interpretation is. Moreover, depending on the sector in which the enterprise operates, ESG factors could be as far apart to suggest that one of the companies cannot be compliant. Therefore, the specific definition given by the players in the economy, specially by rating agencies, as it will be seen later in the work, is crucial in order to evaluate if the company is actually taking steps in the right direction or if it´s just a marketing campaign.

2.2. Historical evolution

Although ESG and SRI have both nowadays international relevance in the business and finance world, they were not born at the same time. In fact, ESG was born out of socially responsible investment practices done throughout the late 20th century as well as early 21st century. However, even if the analysis will have its focus on practices that began on the start of last century, socially responsible investment can be traced back a couple of millennia (Townsend, 2020).

Although as it has been said, SRI started to gain major influence in the 1960s and 70s, the first fund to include SRI as part of its investment philosophy started in 1921 with the *Pioneer Group*. It was the first mutual fund in the United States to shy away from investing in certain sectors, specifically related with social issues, as at the time there was no such climate crisis as we are having nowadays. The main sectors being left out of the screening processes were tobacco, alcohol and gambling (Caplan, Griswold, & Jarvis, 2013), which at the time didn't have the reputation that nowadays have (as shown by the continuous legislation banning advertisement of those sectors, specifically tobacco and gambling).

As the century progressed, and into the 1970s, environmental issues started to arise, with social movements taking prominent role on criticizing companies which acts were harmful for the planet. Also, and more importantly, antiwar movement gained incredible support, translating into the investment world. One of the first mutual funds to be launched, PAXWX, by Pax World, did not invest in companies helping or contributing in any way to the Vietnam War. In the late 70s, and still related to the war, the *Sullivan Principles* code of conduct was developed by Reverend Leon Sullivan, in order to foster social responsibility, especially in regards to the Apartheid happening in South Africa, as a way to disincentivize companies from investing in the country in order to apply harsh economic pressure. Less than ten years later, the U.S. congressed legislated in favor of what Rev. Sullivan advocated and passed an Act banning new and further investments in South Africa.

Following on the environmental concerns, further action started to be taken. As an example, and prompted by the Exxon Valdez oil spill, the Coalition of Environmentally Responsible Economies was founded (and to this day is still active), with the main purpose of fostering sustainable business practices among businesspeople, companies and investment firms. However, SRI did not have yet global importance in finance, although major events like the Kyoto Protocol[1] continued the uphill trend. By the mid-90s, there were roughly 60 mutual funds focused on sustainable investment, with around $640 billion under management (Caplan, Griswold, & Jarvis, 2013), which, compared with data from the present, showed how marginal still it was to invest in such a way. However, data about the number of funds and the amount of money under management at that time is questionable, as according to Morningstar, the number of funds was down to 24, although with $1,9 billion under management. This difference may be explained by the difficulty to catalogue funds as responsible or not, which still remains to this day.

Finally talking about ESG, it was at the beginning of the new millennia when the term was coined, as in 2006, under the mandate of U.N. Secretary General Kofi Annan, the United Nations developed and promulgated the Principles for Responsible Investment. It can be said that these principles were a continuation of the work Rev. Sullivan started in the 1970s that was mentioned before. The main way the Principles for Responsible Investment worked was by encouraging investor to take into account ESG factors, as they could be key in order to avoid exposing themselves to misconducts, but also as a way to take advantage of new opportunities aimed directly towards socially responsible firms that could end up in different portfolios.

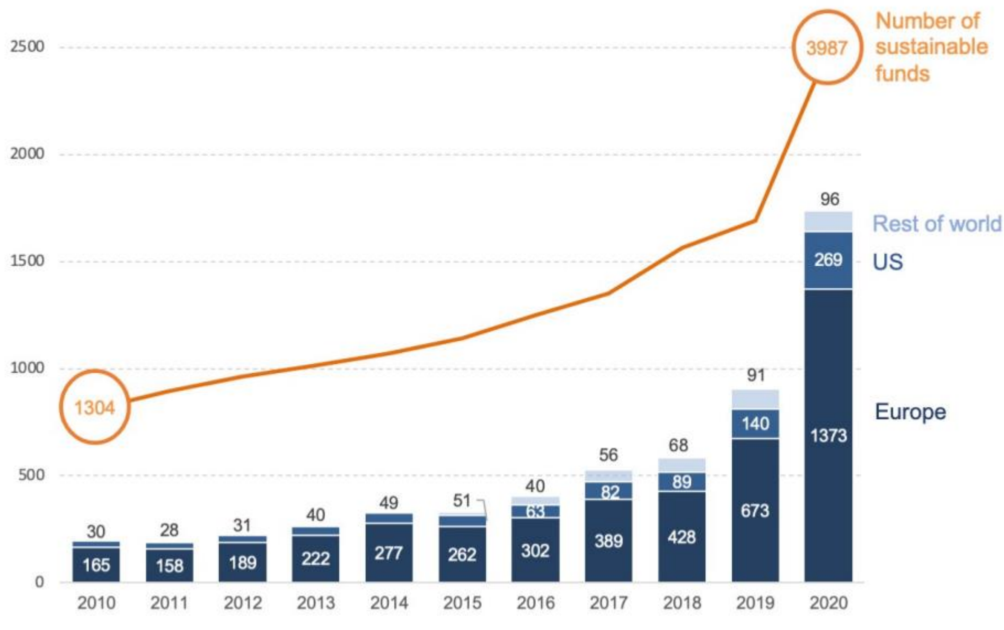
It´s interesting to take into account how socially responsible investment evolved, especially in regulatory terms (although the Principles for Responsible Investment is not legislation). What started as prohibition, with some U.S. Acts banning investing in certain sectors or even countries, as explained with Apartheid and South Africa, ended up focusing on encouraging investors by showing the benefits of SRI and ESG factors, not only the "morale" ones, but also monetary ones. As it will be shown later, this shift in criteria is part of the basis of ESG nowadays, which takes into account those factors in order to boost profitability of funds and companies alike.

[1] Interesting to include a brief description of the Kyoto protocol

By the 2010s, ESG and SRI started gaining momentum, with events like the Paris Agreement (as a follow up of the Kyoto Protocol) by the U.N. as key moments of the decade. Big players in the U.S. economy like started integrating ESG factors, with CalPERS at the forefront of it, establishing a 5-year plan to incorporate ESG into their investment processes. Larry Fink of BlackRock was also advocating for SRI, pushing companies to focus on long term profitability by incorporating environmental, social and governance aspects into their focus.

However, and as it will be analyzed in the next sections, the outlook is still doubtful, with many questions regarding ESG factors still to be resolved. However, it is important to note that SRI and ESG have become global phenomena and not just an U.S. thing, specially thanks to the European Union and their diverse set of plans and legislative packages suited to take what has been said to the next level.

Graphic Nº 2: Evolution of AUM of sustainable funds between 2010-2020



Source: UNCTAD based on Morningstar and TrackInsight data

2.3. Main types of responsible investing nowadays

As it has been stated before, responsible investment has seen an exponential growth in the last few decades, specially into the 21st century, and, with that, many new ways of investing in a responsible way have been developed and started to be used. Although this brief analysis will focus on ESG (mainly) and SRI, which could be considered the two main ways of responsible investment, there could be at least ten relevant forms (Investment Leaders Group, University of Cambridge Institute for Sustainable Leadership, 2014). Among them, some like *Best in Class (ESG) Investment* or *Impact Investing* have as much relevance as the two previous ones mentioned before.

To set things off, SRI focuses on applying a similar criteria to that used in ESG, like social or environmental, in order to evaluate companies through the scope of a defined investing guidelines. Once set, the main characteristic is the screening process (or should be said, negative screening process), which uses the information managed before with the defined guidelines in order to obtain a list of qualified companies and firms that will go on to the next phase of the investing process. Therefore, companies that do not comply with the set standards by the investor, will not *pass* the screening test and therefore will not enter into the investing scope. It must be mentioned that is not rare to see SRI combined with other responsible investing techniques, as it could improve the screening processes.

In regards to ESG investing, it differs from SRI in that it is more value driven that it. As a continuation of what was said in the definition of ESG criteria, ESG investing integrates those factors into the investment process at a fundamental level, to the extent that they are key to the return generated by the investments of the fund or investor (Investment Leaders Group, University of Cambridge Institute for Sustainable Leadership, 2014). Therefore, and as said, the main difference is that, while SRI focuses on funding activities and enterprises that fit into a certain defined set of values, ESG investing is geared towards improving performance by integrating environmental, social and governance factors into the investing process, but with the main focus of improving returns (Caplan, Griswold, & Jarvis, 2013). As it will be the theme along the work, these are not absolute definitions, as they change with the perspective of the individual, although they gave a clear criteria in order to differentiate both SRI and ESG investing.

Together with this two, Impact investing goes a step further than Socially Responsible Investment in that it focuses on a certain environmental or social objective. In other words, the investment is directed towards a certain, defined, social or environmental cause, and not just to a particular sector or group of businesses obtained through a negative screening process. It is also important to note that once the investment is done, tracking of whether the objective is being obtained or not is crucial in order to get the full potential out of Impact Investing. Lastly, and as it is well noted by the Investment Leaders Group, this is not philanthropy, as it is not a donation. Obtaining a return on investment is important, although it is not the only and most important objective for the investor.

Lastly, and in order to set the definition for later in the work, as it has been said, Best in Class ESG investing. The main difference with regards to SRI is that, normally, there´s no sector discarded by the screening, as the main focus is to invest in the best companies as far as integration of ESG factors is concerned in a certain sector, regardless of whether it is a socially or environmentally harmful sector as a whole. For example, if the tobacco sector is in the investment scope, a firm applying a Best in Class ESG investing will target the most responsible companies in relation to the environmental, social or corporate governance issues. This way of investing is key in order to better understand the controversy around ESG investing and how, as it will later be explained, investment funds and firms that are classified as ESG, may not be as responsible as they may look at first glance.

3. ENVIRONMENT, SOCIAL AND GOVERNANCE STANDARDS AND FRAMEWORK. IN DEPTH, DIFFERENT TYPES AND SITUATION NOWADAYS

Sustainability standards and frameworks have been developed as time has gone by, with some gaining important recognition while other remaining irrelevant. To better understand what standards are for the purpose of this work, they will be defined as “voluntary predefined rules, procedures, and methods to systematically assess, measure, audit and/or communicate the social and environmental behavior and/or performance of firms" (Gilbert, Rasche, & Waddock, 2015). However, as the study area of the work revolves around environmental, social and governance aspects of ESG Standards, the governance part should be added to the definition. Also, note that the starting word for the definition is "voluntary", as it will be a key characteristic later in the work, once EU Taxonomy comes into play.

With that being said, we will be dividing standards into four main categories in order to better understand them: third party principles, industry schemes, disclosure metrics and rating agency standards (Dentons, 2021).

3.1. Thirds party principles

One of the main categories, in which companies commit to a certain mix of predefined rules or principles, leading the third party to audit and report on the compliance or not with them. Usually, the third parties issuing out principles for others to comply with are well known institutions, NGOs or Governmental agencies with a revered track record as Leaders in the area.

The United Nations (UN) is one of the best examples in the category, as it is the biggest international organization, with over 190 countries being represented at the General Assembly (United Nations, 2022). Since it was created back in 1945, with the main aim of trying to guarantee global peace after the two World Wars that devastated the world, the UN has made efforts for global development, especially in the environmental and social side of things lately. The Millennium Development Goals, the 2030 agenda and, most recently, the Paris Agreement have constituted the main focus point for the organization, and have had global impact since then.

Therefore, it is no surprise that the UNs footprint extends also to the business and finance world, but with sustainability in mind, and as a result, they developed the UN Global Compat and the UN Guiding Principles on Business and Human Rights. The Global Compact focuses specifically on environment, social and governance as its main focus, with over 15.000 companies across 165 countries making it the largest corporate sustainability initiative (United Nations Global Compact, 2022). The latter it is one of the world's largest corporate responsibility initiatives which, in 2017, had over 12.000 participants from more than 170 countries (Ruggie, 2017), focusing on providing governments, corporations and stakeholders in general, practical advice on how to improve their commitment and respect for human rights on business activities (social side of things). However, and as a problem that will later be explained in-depth, the fact that they are not legally binding (as it was said, principles are voluntary), with the vision of involving as many corporations and entities as possible, makes it lack the force to make accountable of those who either comply in a poorly way, or directly go against the set principles (Jägers, 2011).

3.2. Industry schemes

As the name suggests and, in contrast with the previous type of standards, industry schemes focus on a certain sector of business in order to contribute and create initiatives for that specific industry. Therefore, although the institutions backing the frameworks may be of the size and reach of, for example, the United Nations, the number of companies complying may only be as great as the players in the industry.

For example, the OECD´s Due Dilligence Guidance for Responsible Supply Chain of Minerals from Conflict-Affected and High-Risk Areas, although being backed by one of the world's largest economic co-operation and development organizations, is only targeted at companies who source minerals from countries affected by wars and large-scale conflicts.

Another example is the Better Cotton Initiative (BCI), which revolves around the production of cotton and the environmental and social impact. This one, although not being backed by a global institution, it has large international recognition, with over 2.000 members (Better Cotton Iniative, 2022) across 21 countries. In India and Pakistan, the effects of the initiative have shown improved prices and some lower costs for farmers, although wages of workers have not been affected, although impacts depend a lot on the geographic and institutional contexts (Ghori, Lund-Thomsen, Gallemore, Singh, & Riisgaard, 2022).

3.3. Disclosure metrics

Disclosure metrics have less to do with memberships and certifications and more with the financial and non-financial reporting of companies. In this case, enterprises adopt standards and frameworks regarding the disclosure of information in order to allow investors and stakeholders in general to have in tune metrics regarding, in this case, ESG related information. As ESG has such an effect that not only financial reporting is affected, many of the metrics revolver around non-financial information.

Among disclosure metrics, the most used one (Prado Lorenzo, Gallego Álvarez, & García Sánchez, 2009) is the Global Reporting Initiative (GRI), which "provides a flexible framework for creating standalone sustainability or non-financial reports, or integrated ESG reports" (Global Reporting Initiative, 2022). However, and in line with what happened with the previous categories, the most extended standards lack real impact on stakeholders, as it happens with the responsible reporting pushed by the GRI (Alonso-Almeida, Marimon , & Llach, 2015).

It must also be noted that, in continuation with what has been explained about industry specific standards, many of the institutions that provide metric for financial and non-financial information, have different ones in regards to the specific industry of the company. For example, the Global Reporting Initiative, offers industry specific reporting programs.

3.4. Rating agencies

As something natural due to their activities, credit rating agencies develop distinct (or integrated) ESG ratings from the usual credit ratings that they usually give companies. In this sense, they provide investor that may care about that kind of information, comparing the business with its counterparts. Also, together with the usual agencies, there are specific ESG rating agencies which focus exclusively on this kind of information, gathering it either from public records or by private surveying. However, and as a difference from the previous categories, Rating agencies do not develop principles or a criteria to follow. Instead, they focus on collecting the information in order to measure it via certain methods, compare it with the competition and, in some cases, measure the real impact of ESG for the stakeholders of the company (Dentons, 2021).

For example, S&P Global ESG Evaluation has different indexes, including the Dow Jones Sustainability Index, which rank the sustainability of the companies in the particular index and compares it with that of the competition, in order to give investors a clear and unified set of information for him to make an informed decision. Also note that in the case of indexes, there´s a need to fulfill a certain number of criteria to be able to get into it (Dow Jones Sustainability World Index, 2022), as it would happen with a normal index such as MAB or IBEX 35.

Another example could be Sustainalytics, that, although being part of the rating agency Morningstar, has grown to have a big name in the ESG market, as it has been a global leader as far as research is concerned for over 25 years (Filbeck, Filbeck, & Zhao, 2019). Sustainalyticis focuses on analyzing and rating listed companies (as most of the rating agencies do in this regard) as far as general ESG risk is concerned, researching issues and trends that could have a potential high impact in companies. That is, it covers total exposure, manageable and unmanageable risk as well as other parameters in order to provide investors with useful information for their portfolios to be built, taking into account ESG.

3.5. Common grounds

Although being divided in four different categories, all four of them represent standards and frameworks (with the particularity of the rating agencies), with examples of the most popular in each of them. As it has been some, most of them come from, either pre-stablished supra national institutions with big reach and respect in regards to ESG or to the industry itself, or from international organizations created for the specific purpose of setting the standard or principles.

Also, as stated in the definition, all of them are not mandatory, meaning that no company has the obligation to join unless they want to be subject to the certain requirements (or they know they can meet them). As most of them are developed and enacted by international organizations but with no real power (that is, they are not supra governmental organizations with delegated sovereign power), they have limited power, not only to try and force economic players into the standard, but also to enforce any kind of penalty or punishment for a breach of what has been agreed (unless it is included in a contract with set contractual penalties).

Lastly, and being the main topic of the next part of the work, all fall into one specific problem. The standards and frameworks that have been mentioned were the most common and popular ones, with the most number of participants in each of them, which also led, as it was stated before, to having certain problems: they were not tough enough so as to translate into major effects. That means that they were so popular and extended among the globe because the requirements were not as hard as some others that were not mentioned. Therefore, a paradox arises. As a Standard tries to get to more companies and institutions, it must reduce it requirements so as most of them qualify in order to join, and therefore have the most amount of popularity. However, by doing that, impact is reduced. On the other hand, as a standard tries to have more real impact by being stricter, it gets more difficult for companies to adhere to it, which may condemn the standard to not having any kind of popularity (Haack & Rasche, 2021).

4. Problems: specifically focused on the diffusion paradox

The integration of ESG standards has been an important stepping stone towards improving business sustainability. What started decades ago as disinvestment strategies (Townsend, 2020) is nowadays a key player in business and investment decisions across the globe. Institutional support is also vital, as it represents the biggest movements and unions in this regard, with entire countries adhering to standards in order to show commitment with what sustainability represents. It is also needed, as diffusion (understood as "the spread of a practice or organizational structure within a social system" (Colyvas & Jonsson, 2011) in a global context like the one the world is immersed, requires international public organizations to be supportive and even apply social pressure for other countries and key players to join.

However, this boom in worldwide popularity in this last decades has exposed the various problems that still have to be resolved. Although the benefits of implementing ESG criteria into a business, following an structured framework and through a strong proposition, has shown that creates value for both for companies and investors (Henisz, Koller, & Nuttall, 2019),there are some inherent issues that come with it and that some must be deeply analyzed in order to obtain useful solutions to tackle and solve them, as they are key for the ultimate success.

In this work, although some of the most recurrent issues are going to be briefly explained, the focus is going to be put into the diffusion-impact paradox studied by professors Patrick Haack and Andreas Rasche. However, as mentioned, the integration paradox and greenwashing problem, are going to be mentioned in order to provide a fuller view of the issues and how they may interconnect.

4.1. Integration paradox

As something specific to fund managers and asset owners, it happens as very few investment managers have a full integration of ESG factors into their portfolios, leading to lower returns on investment than they would have if they went all in with those factors (Cappucci, 2018). As shown by the data (Eccles, Kastrapeli, & Potter, 2017), full integration of ESG factors tends to lead to returns with better risk management and longer-term value creation. That is, investment firms deal with the costs of integrating ESG factors into their investment strategies, but are not able to experience the full returns as the integration is poorly done. That low return is passed from the investment manager to the investors, as still today is hard to analyze for many investors the amount and length that the fund has gone into ESG investment, leading to worse performances even under the "ESG umbrella" (Cappucci, 2018).

4.2. Greenwashing

For context's sake we are not going to make difference between greenwashing and bluewashing as some authors do (Sailer, Wilfing, & Straus, 2022). That is, both environment and social are going to be considered under the same umbrella that is greenwashing. Using the definition that most researchers tend to gravitate towards (Vieira de Freitas Netto, Falcão Sobral, & Bezerra Ribeiro, 2020), the Oxford English Dictionary understands greenwashing as a "deliberate corporate action with the presence of misleading elements, focused on the deception of stakeholders". Bluewashing has the same definition, although instead of being focused on environmental matters, it revolves around the social side of things. Therefore, whether talking about greenwashing or bluewashing, the idea is still the same although with different topics.

On the consumer side of things, identifying greenwashing is something difficult to achieve, as the asymmetry of information makes it hard for even well-informed consumers at the time of making the acquisition (Vieira de Freitas Netto, Falcão Sobral, & Bezerra Ribeiro, 2020). For investors, the same happens, as, while they should continue investing in ESG prone firms for the sake of returns, avoiding greenwashing is also important. In order to improve and prevent such practices, more independent directors, with an increase in involved institutional investors and more influence of the public interest towards the clarity of ESG would be ideal (Pei-Yi Yu, Van Luu, & Huirong Cheng, 2020).

4.3. Paradox of diffusion

Starting from the mentioned premise that the diffusion of a standard helps brings the perception of it being widely accepted (Colyvas & Jonsson, 2011), a paradox of diffusion arises. In an area like the ESG, legitimacy is key, differentiating cognitive from moral (some authors also consider pragmatic legitimacy (Pérez Rodríguez & Basco, 2011) although it is not as relevant for the paradox). The first, cognitive legitimacy, is defined as the comprehensibility and taken-for-grantedness, considered as the more durable than the latter (Aldrich & Fiol, 1994); (Katz, 2008). Regarding the moral legitimacy, it may be defined as "a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definition" (Suchman, 1995).

Moral legitimacy, as defined before, is mainly dependent on the content of the standard. That is, as the requirements and principles set by the proposers of the standards may be tougher, impact of businesses and companies joining and complying will imply a higher results and effects (at least if the auditing of compliance is strong enough to enforce the principles in the correct way). However, take into account that, as we live in society, moral legitimacy is obtained by the positive judgement or opinion of actors with sufficient, of course, legitimacy, as certain NGOs or institutions (Haack & Rasche, 2021). Therefore, it may be easier to, either obtain higher moral legitimacy at the beginning, as the toughness of joining has not been tested yet and no adjustments have been made, or either on an advanced phase, as the number of members is big enough and stable and there´s capacity for enforcing tougher requirements.

However, for certainly new proposals that may lack the backing of international Institutions, a strong base of followers in the start and a steady growth will mean that the required diffusion may be obtained in order to gain sufficient cognitive legitimacy, so that they surpass the difficulties of the start and achieve enough status to survive and remain relevant (Haack & Rasche, 2021). For example, for global initiatives like the United Nations Global Compact, that was mentioned earlier in the work, such backing from a global institution means that since the beginning of the standard, there will be a big number of adopters. Partly, because the way of adopting such decisions requires a big consensus among the members of the international institution, continuing with the example of the UN (United Nations Global Compact).

Either way, the capacity to obtain moral legitimacy may be hurt. On the first case, of a seemingly new standard without strong backing, one way to grow and obtain cognitive legitimacy may go by reducing entry requirements. That is, a relatively lax standard entry requirement wise will be able to attract a bigger number of members, merely due to the fact that at this point not all companies will be able to comply with tough ESG preconditions. On the other hand, of a standard with support of a big international organization in which decisions are taken by consensus a majority, negotiation processes are a key part. As different actors trying to obtain the best condition for their own interest (always in the context of ESG of course) entry requisites may be reduced. Sometimes to obtain better conditions, or sometimes for something as simple as one of the proponents not being able to meet some of the requisites, which would be paradoxical on its own.

Therefore, to sum things up, the paradox is given by the following. Standards need growth and support in order to survive and stay relevant for other to adhere, and one of the ways to do that in initial phases is by having low to medium entry requirements as far as difficulty to meet is concerned. However, by doing that, the main purpose of the standards is harmed, as low entry requirements would certainly mean a reduction on the impact and an overall less important standard regarding the effectiveness and usefulness of it.

As it was said before, the focus of this work revolves around the paradox of diffusion proposed by Haack and Rasche, therefore, the next section, focused on the EU Taxonomy, will mainly focus on its effects towards the paradox, and in which areas there´s room for improvement in order to make useful propositions.

5. EU TAXONOMY: SOLUTION TO THE PARADOX?

The European Union ("EU") taxonomy is a classification system that determines which economic activities are environmentally sustainable, for the purpose of determining the degree of environmental sustainability of an investment. Accordingly, an investment that finances one or more economic activities that can be considered environmentally sustainable will qualify as such.

For that, the EU Taxonomy introduces six different environmental objectives for the regulation to revolve around: Climate change mitigation; climate change adaptation, sustainable use and protection of water and marine resources; transition to a circular economy, was prevention and recycling; pollution prevention and control and the protection of healthy ecosystems (Sustainalytics, 2022).

The EU taxonomy regime aims to: (i) play an important role in helping the EU to increase sustainable investments and implement the European green deal; and (ii) provide businesses, investors and policy makers with adequate definitions of which economic activities can be considered environmentally sustainable.

The main difference with the standards discussed above is that the European taxonomy is based in Regulations[2]. In other words, it is a regulation that the states will have to transpose into their national legislation and, therefore, it will be obligatory for all actors in the European Union. In accordance with the provisions of these regulations, an activity will be considered environmentally sustainable when this economic activity:

- Substantially contributes to one or more of the environmental objectives set out in the taxonomy regulation. Environmental objectives include, among others, the mitigation of climate change, adaptation to climate change or the sustainable use of natural and marine resources.
- It is also intended not to cause any significant detriment to environmental objectives.

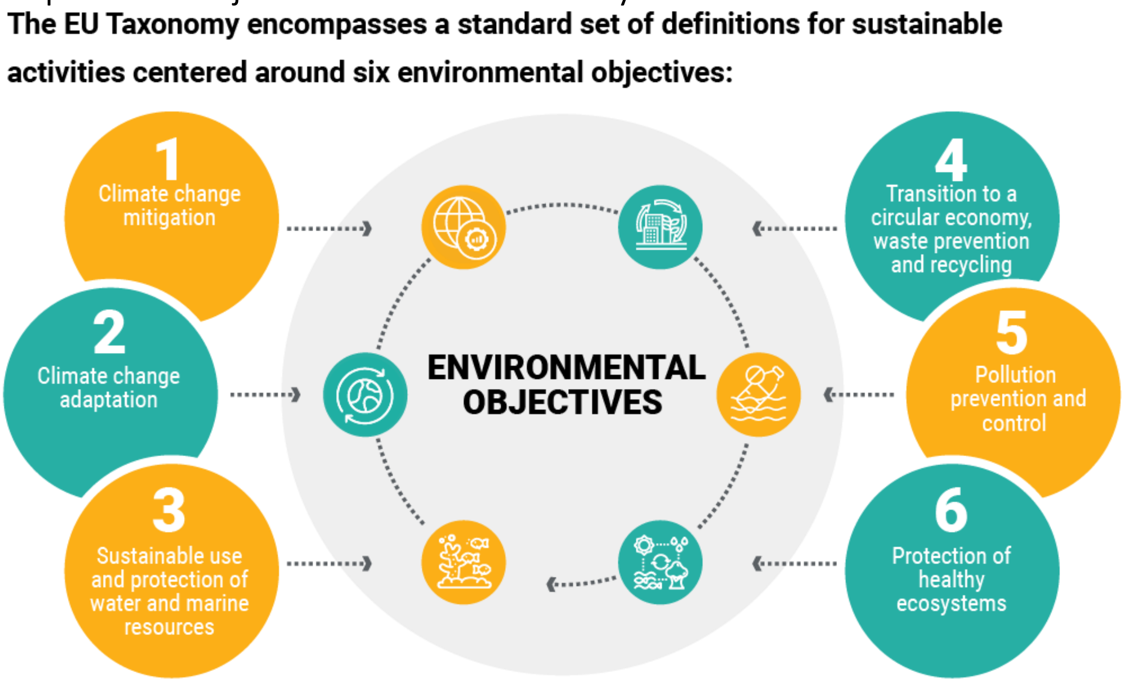
The key step, and the starting point for the above, is the obligation introduced for certain companies (to be specified below) to publish non-financial information on how and to

[2] Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088

what extent their activities are associated with economic activities that are considered environmentally sustainable.

In other words, and in line with the above-mentioned category of reporting standards, the European taxonomy will fulfil the same function, but in a standardized and mandatory way for all the companies that will be mentioned below. However, it will not be limited to just reporting, as the EU will also give the specific criteria so as to consider the activities in one the categories that the EU will provide (environmentally sustainable, harmful, neutral etc.). In the following sections of the work, options for improvement and adaptation of this type of standards will be discussed, but with the introduction of the taxonomy, and pending the actual outcome and possible modifications, they may become less important.

Graphic Nº 3: Objectives of the EU Taxonomy



Source: Sustainalytics

5.1. Information about taxonomy

Article 8 of the Taxonomy Regulation sets out taxonomy transparency obligations in the non-financial statements of companies bound by the Regulation (explained in the next section), and in particular requires them to include in their non-financial statement, whether consolidated or not, information on how and to what extent the company's activities are associated with economic activities that are considered environmentally sustainable. Specifically, obliged companies shall disclose information related to:

- the proportion of their turnover derived from products or services related to economic activities that are considered environmentally sustainable within the meaning of the Regulation and;

- the proportion of their total fixed assets and the proportion of their operating expenses related to assets or processes associated with economic activities that are considered environmentally sustainable in accordance with the provisions of the regulation

In addition to the above, there is a delegated regulation[3] which aims to further specify the content and presentation of the information foreseen in Article 8 of the Taxonomy Regulation, including the methodology to comply with it. In particular, it sets out the key performance indicators (KPIs) which are turnover, CapEX (capital expenditure) and OpEx (operational expenditure) on taxonomy, and the information to accompany those KPIs, which non-financial companies must provide in their non-financial statements, as well as the format in which they must be presented (Add such formats in an annex).

5.2. Non-financial companies subject to the obligation to publish information on their business activities are subject to the obligation to publish information on their activities.

[3] Commission Delegated Regulation (EU) 2021/2178 of 6 July 2021 supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by specifying the content and presentation of information to be disclosed by undertakings subject to Articles 19a or 29a of Directive 2013/34/EU concerning environmentally sustainable economic activities, and specifying the methodology to comply with that disclosure obligation (Text with EEA relevance)

For the time being, both the Taxonomy Regulation and the Delegated Regulation, in line with other European regulations[4], have limited the inclusion in the financial or non-financial statement of information on the manner and extent to which the company's activities are associated with economic activities that are considered environmentally sustainable to companies that comply with all the next requirements (that is, they must check all three criteria):

- Companies of public interest, meaning listed companies, credit institutions, insurance companies and those that have been designated by member states as entities of public interest, either because of their importance in relation to the activity they perform, size and number of employees.

- Large companies or parent companies of a large group, understood as those that on a consolidated basis exceed two of the following three criteria, assets exceeding 40 million euros, revenues exceeding 20 million euros or an average number of employees exceeding 250 employees.

- Companies with more than 500 employees

Without prejudice to the foregoing, a Proposal for a Directive is being processed, which aims, among other things, to amend the articles relating to the determination of the companies subject to the European Taxonomy, and which will extend the reporting obligations to all large companies, regardless of whether they are considered to be of public interest or not.

To sum things up, the EU Taxonomy is an environmentally related classification system, that proposes a clear criteria for activities to define what it means to make a substantial

[4] Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC Text with EEA relevance.

contribution and to do not significant harm. For that, mandatory disclosure obligations will be introduced for some companies (and, as said, that number is expected to grow and entail all big companies), that will require them to disclose their taxonomy related activities. That, is expected to allow for a comprehensive and comparable image of companies and their efforts, not only from a reporting side, but by a classification side.

5.3. Plans for social taxonomy

As in the environmental field, the social aspect has echoed the advances of European taxonomy and what it can offer in the current socioeconomic context. For this reason, the Platform on Sustainable Finance (Platform on Sustainable Finance, 2022) has recently proposed a structure that would be similar to that of the taxonomy in the environmental field, and which would take advantage of everything that has already been 30introduced. In other words, a categorization similar to that already introduced would be proposed, which would be based on the obligation to report non-financial information on the company's performance in the social sphere.

However, an important point that should be taken into account is that, although a large number of economic activities present a risk to society in the environmental sphere, this is not usually the case in the social sphere, since there are major benefits inherent to the activity, such as job creation, tax payments or the creation of goods and services that are beneficial to society (European Commission, 2022).

The proposal sets out, a priori, three points that will be key: offering decent and dignified work, allowing adequate living conditions and ensuring the well-being of the final recipients of the product, as well as ensuring that the activity is inclusive and respects the community in particular and society in general.

Table Nº 2: Summary of main ESG problems and the possible effects of EU Taxonomy

	Main explained problems	**How EU Taxonomy could help improve**

Integration Paradox	-Specific to investors and investment managers. - Diminished returns due to not fully integrating the ESG Standards. -Full, and not partial, integration of certain Standards would lead to improved results	-Due to the mandatory nature of the European Union Taxonomy, there won´t be the chance for companies to not fully integrate the requirements. -However, as it is not a fully developed ESG Standard (as of right now, it introduces a series of reporting criteria), fully integrating may not have the same effect as a regular ESG Standard with tough entry requirements
Greenwashing/ Bluewashing	-Common problem with ESG Standards where companies and investors (not exclusive to investors this time) claim to be complying with certain standards although lacking impact. -Can happen either by complying in an incorrect/incomplete way or by adhering to ESG Standards that have easy to access requisites, leading to low impact.	-As with the Integration Paradox, the fact that the EU Taxonomy is mandatory, would not lead to greenwashing, as every other player in the economy must also comply. It would not be adequate publicity for companies, as it is not a differentiating point. -However, in case of introducing some of the mandatory aspects of the Taxonomy in standards, it could help mitigate the effect of Greenwashing.
Paradox of Impact-Diffusion	-Standards suffer the effect of the paradox due to the fact that, in case that the Standard looks to have a big diffusion, it usually must lower the entry requirements, leading to lower impact, and vice versa. In case that the Standard looks to have a big impact, entry requirements must be toughened, leading to lower diffusion. -Difficult problem to tackle due to the voluntary nature of Standards.	-Dealt with in the following section.

Source: Own creation

6. IMPROVEMENTS ON PRESENT STANDARDS: NEW BASE LINE

The taxonomy represents a major change in the European (albeit with global impact) operation of the ESG standards. Although we started from very important advancements made in recent years ESG wise, as previously evidenced, the introduction of mandatory reporting, together with a standardized classification, changes the paradigm. In other words, if the objectives set by the European Union follow the expected course, we could move from an archipelago of voluntary and highly fragmented compliance standards to a homogenization of ESG, based on a mandatory compliance criterion for the most important players in the economy.

However, it should be noted that it does not seem plausible that the introduction of taxonomy would lead to the disappearance of the standards as a whole, as they play a very important role.

On the one hand, we consider the scope of the European taxonomy to be relevant for their non-disappearance. As it is an initiative that comes from the European power bodies, the scope is obviously limited to the 27 countries that make up the Union, leaving aside the rest of the countries that represent a majority worldwide. That is why the standards must continue to fulfill their purpose, and maintain the global scope they have (in particular those mentioned, such as those proposed by the United Nations).

On the other hand, we consider that they fulfill an important function, which is to reflect the interest of the different sectors and countries in relation to ESG criteria. While the intention of the European taxonomy is to cover as many activities as possible, the extreme diversity of economic activities inherent in society makes it impossible for a single initiative to cover the entire spectrum. For example, initiatives such as the Better Cotton Initiative or the OECD's Due Diligence Guidance for Responsible Supply Chain of Minerals from Conflict-Affected and High-Risk Areas provide additional requirements and specificity for actors in these sectors, which, although not mandatory, set a standard of compliance.

Likewise, the fact that there is a diversity of standards, each with its own particularities, criteria, principles and different requirements, is an aspect where the criteria established by bodies such as the European ones can be measured, and where the best aspects can be learned and adapted. In other words, the fact that other institutions and standards bring distinctive aspects that can sometimes be interesting to adopt is a strong reason for private standards to continue to be promoted and supported by both public and private institutions.

However, having said the above, and in order to maintain the important relevance that we believe ESG standards should have, we consider it appropriate to propose a series of improvements and adaptations.

6.1. New minimum

ESG standards are all quite different from each other, as they each have some minimum entry requirements. Some harder, some easier, every firm or company wanting to comply with the requirements, as it is obvious, will have to meet them. In this regard, the adoption of the requisites introduced by the EU Taxonomy may be a great opportunity for standards, as well as a risk in case they don´t do it.

As it was said before, Taxonomy obligations are going to be mandatory for a certain kind of companies (especially big ones, with public interests), although there are already initiatives to extend those obligations to a wider range of companies. That means that the many firms will have to comply with the criteria introduced by the Taxonomy, regardless of whether they want or not (subject to fines by the European Union). Therefore, there´s one clear aspect. Every standard with entry requirements less demanding than those proposed with the EU Taxonomy will suddenly become useless. As all companies will meet requirements tougher than the ones of the standard, there won't be any benefit from them. Firms will not contribute in more ways than they already do, as there are not any extra requirements to comply with, nor will they benefit from the public image, as it would become a great example of greenwashing or bluewashing.

On the other hand, for the standard setters or proposers, not adapting their requirements to what the EU has introduced could very much mean losing adopters and legitimacy alike. Neither companies nor the public would see any tangible benefit from adopting the standard in exchange for the effort that means doing so.

For that, we propose that, especially in the EU, all standards, regardless of their type, may adopt what has been introduced as mandatory by the European Union Taxonomy, in order to remain relevant and continue to contribute in a significant way to their objective, which is improving the environmental, social and governance side of things of companies.

6.1.1. Sustainable Development Goals and the introduction of EU Taxonomy

It is important to remember that the EU Taxonomy is still on its early days, with a big influence in reporting and categorizing but not in other areas, which are expected to be targeted in future updates to the norm. Therefore, the recommended way to introduce as new minimums the requirements must go through adopting the information and the way it is used. That being said, let's take for example the United Nations Sustainable Development Goals, which is used by over 40% of the world's largest corporations (Moy Hubber, Smith, & Comstock, 2018) as the reference standard.

The Sustainable Development Goals ("**SDGs**") have 5 distinct phases. First, companies must understand what SDGs are and mean, in order to define the priorities in a correct way, in order to take full advantage of all the opportunities that they bring, which is the second step. The third step means defining clear objectives, trying to align in the best way possible the main objectives of the company with those brought by the SDGs. The next step, the fourth, brings the integration to the firm. That is, in order to achieve any of the SDGs in the organization, it is key to integrate some form of sustainability, continuing with the aligning process begun in the previous step. Lastly, but also key, comes the communication and reporting done by the firm, which serves the main purpose of letting the society know about the work being done by the company as far as sustainability is concerned (United Nations Global Compact, 2020).

Having explained the key areas of the SDGs, the proposal of incorporating the minimums comes specially in the last part, in order to properly judge whether there is actually compliance with what the SDGs bring or not. Companies are not forced to disclose what they are doing, that is, they can do it voluntarily, and there´s not standardized way to do it (Lashitew, 2021).

With the incredibly global aim of the SDGs, there´s two problems of the mentioned ones that arise with that lack of standardized disclosure. The first one is the greenwashing and bluewashing, which is pretty clear. Companies may either implement a weak integration or SDGs, which obviously will not bring much sustainability to the company (and society) and still introduce in their reporting, especially the non-financial ones, that they have an SDG focused strategies and that there´s an alignment with the main objectives of the firm. That clearly happens because there´s, first, no obligation to report, which can lead to selective reporting (communicating only those aspects that may be good for the image but may not reflect nothing) and second, no standardized way to do it, that may lead, also, to companies being very selective with what they communicate. That is, firms will probably avoid those aspects that may harm the image of the firm, and publish those that will enhance it.

The second big problem revolves around one of the key areas of the work, which is the impact-diffusion paradox. As it was explained before, the aim of the SDGs was to become as global as they could and they did it. SDGs are one of the most known ESG standard, but, as it was stated before, the impact obtained by them has not been as big as expected (Lashitew, 2021). There´s no doubt that the adoption rates have been great, but the impact falls short, being a great example of what was analyzed before, ESG standards with big diffusion but not as big of a real, tangible impact.

In order to help fix those problems, introducing the EU Taxonomy may be a great contribution. However, let’s remember that the aim of both initiatives is different, as one is focused for the whole United Nations (over 190 countries) while the EU Taxonomy is focused on the European Union countries. With that being said, the example is clear enough to serve perfectly to illustrate the desired effect.

Remembering what was explained before, as it is right now, the EU taxonomy is a mandatory set of reporting rules for certain companies (especially those that may have the biggest effect in society and the environment). Therefore, there´s a clear compilation of rules for companies in order to oblige them, not only to publish the information that suits their public desires, but also the one that may harm them. Leaving aside the categorization that is so important for the taxonomy, taking advantage of the standardize set of information, specially geared towards objectives like those defined by the SDGs, can be key in order to fix the two problems explained previously, with no added cost for companies nor for the UN or any international organization or economic actor (as they would not have to develop the rules by themselves).

On the one hand, the effect of greenwashing and bluewashing could be severely reduced. Companies may still advertise and publish their commitment towards SDGs in spite of an incomplete application and integration of them. However, it could be much easier to control the degree of compliance as the information that would accompany the reporting of the company would be in an standardize way, it would be mandatory and it would be easily comparable to the one of its competitors.

Not only that, but a further implementation of the EU Taxonomy rules in the SDGs could be even more beneficial. By, for example, setting a simple sorting mechanism in which, depending of the key performance indexes that companies may have to report in accordance with the taxonomy, each company would fall into one of the categories (let´s say, 1 – weak compliance, 5 – strong compliance), investors, competitors and even the United Nations and public entities would have a much simpler and accurate way to correctly evaluate the implementation and integration of the SDGs by the company they are interested in.

In regards to the impact diffusion paradox, SDGs have the big advantage that, as things are right now, they are one of the world's most known ESG criteria (Moy Hubber, Smith, & Comstock, 2018). However, as it was said before, the fact that they are so incredibly widespread, leads to a reduction of the legitimacy (Lashitew, 2021). Therefore, the proposal of introduction of the taxonomy as a new minimum would have an effect on the SDGs that could not be easily replicable by other standards. However, it serves as an example of what could be done.

Although it is usually put into question, the European Union has taken some adequate steps over the last years to improve and solidify its moral authority and legitimacy (Bosse, 2022). The introduction of the taxonomy has continued with these steps, now focusing on ESG from a mandatory side of things. Therefore, an introduction of those reporting rules and the proposed classification would compensate the reduced moral legitimacy of SDGs. It may not fully supply the needed injection of it, but it may well be a great working point.

Also, the great benefit of such a widespread diffusion, could make companies reluctant to back off the SDGs, as it may clearly be seen as a sign of a weak compliance or greenwashing/bluewashing by the company. This would be a good way to solve (at least, stride towards) the impact diffusion paradox in cases of big diffusion but with relatively low impact, by starting to build on the latter with mandatory rules and classifications that may well force companies that follow SDGs to improve on its key performance indexes, now that they are easily comparable to the ones of other companies.

6.2. Collaboration between the EU Taxonomy and public institutions

Although less specific than the previous proposal, collaboration between the taxonomy and the different ESG standards could be a way to alleviate the impact diffusion paradox in both senses. Let's remember that, as the range of influence of the EU Taxonomy is mainly the European Union (although other countries or organizations are free to follow on the initiative), the aim of this proposal is also the European Union.

There could be many ways that collaboration may be done with the European Union, but we would like to highlight one that we think may be better suited for ESG, specially at this stage of the EU Taxonomy:

6.2.1. Bi-Directional Development

Bi-directional development, as we propose it, would happens when both entities involved in the evolution of something (in this case, an ESG Standard and a set of rules) transfer the feedback obtained in their respective area to the other. In this case, the European Union would transfer the data, information and feedback obtained to the developer of the ESG Standard and vice versa, the developer and promoter of the ESG Standard would transfer everything they get back from their experience to the European Union. This would definitely not be a first as far as collaboration is (Nikolic & Maikisch, 2006), but the introduction of it in the European Union and in the realm of ESG Standards.

The European Union is a gigantic organization, with reach over the 27 countries that compose it, which means that from the beginning of the implementation of the EU Taxonomy, the feedback and the amount of information obtained could definitely be beneficial for other parties to learn from. And the other way around, the EU could learn from smaller players how certain criteria changes may affect, and therefore anticipate some of the consequences.

This collaboration could be done via constant communication between all players involved, although it would mean a serious investment in extra resources, not only for the European Union, but for all the developers. Not only that, but this kind of collaboration is usually better suited for top executives in the private institutions, which means that some kind of training would be needed for those in the European Union side (Donahue & Zeckhauser, 2006). Therefore, periodic and not so constant meetings and publications could be a better alternative. Also, the European Union could start some sort of newsletter, that would focus on publishing the advancements made as it is a great way to reach to the public and obtain results (Guallar , Anton, Pedraza-Jiménez, & Pérez-Montoro, 2021).

6.2.2. Effects on the impact-diffusion paradox

Regarding diffusion, collaborating with such a big institution will always mean international recognition and the possibility to extend their reach across all the countries in which the European Union has influence. Not only that, but a standard (not as the one mentioned in the last example, the Sustainable Development Goals) with strict entry requirements would surely benefit from the reach of an institution like the one we are mentioning. For the standard with moral legitimacy, due to the requisites needed to comply with it, the ability to collaborate with the EU would complement perfectly, as it would give access to 27 countries as a collaborator of the institution. Also, it would be beneficial publicity and recognition for the standard setter, regardless of whether it is a public (let's say the United Nations) or a private entity, as the experience in other sectors of the economy and society have proven to be successful (Nikolic & Maikisch, 2006).

As far as moral legitimacy is concerned, we can relate to the previous proposition, as it is a clear example of what can be achieved by the collaboration between standards with a large diffusion but with not much moral legitimacy, due to what the impact diffusion paradox explains.

Once the changes needed in order to suit the standard to the requirements of the EU Taxonomy are done, having the chance to join forces with an institution like the European Union would definitely mean a boost on the legitimacy of a widespread standard. Although the European Union hasn't yet obtained enough moral authority to have full legitimacy in aspects such as the imposition of sanctions to third countries across the globe for matters as war crimes, terrorism etc. (Bosse, 2022), ESG and sustainability have been on the roadmap of the EU for the latter years (with initiatives like the 2030 Climate Target Plan), putting the Union at the forefront on this regard.

Table Nº 3: Summary of proposals made and possible effects on problems

	WHAT IS IT	IMPACT PARADOX	GREENWASHING/ BLUEWASHING	IMPACT-DIFUSSION PARADOX
General Taxonomy Implementation	**Set of mandatory reporting rules for corporations (large public companies for now).**	-	-	-
Taxonomy as a new Minimum	**Proposal for ESG Standard setter to adopt the rules introduced by taxonomy in order to establish a new minimum (and build up from that).**	**Helps with the paradox due to the fact that compliance with taxonomy has to be full. However, developers will have to push for full compliance in regards to the voluntary side.**	**Increase on the ease of monitoring green/bluewashing, due to the obligation to report information on sustainable assets and investments. Would lead to better internal control, and thus to proper auditing of compliance.**	**For standards with complicated entry requirements, being based on the European taxonomy (with which they have to comply) may facilitate the development of the standard. For those that are widely used, introducing the European taxonomy may improve the impact, due to the ease of monitoring compliance and auditing.**
Bi-Directional Development	**Proposal for the EU bodies and the standard developers to collaborate by developing the standards and the taxonomy together, with a strong bond and sharing relevant information.**	**Improvements made both in the Taxonomy and the ESG Standards that collaborate, by analysing the best solutions for and improved impact could be beneficial for the paradox**	**The flow of information on sustainable assets and investments between a public body such as the EU, with the power to monitor large companies, and the developers of the standards, can lead to better control of greenwashing and limit misleading advertising by companies.**	**Regarding diffusion, collaborating with such a big institution will always mean international recognition and the possibility to extend their reach across EU countries. The impact, as with the Impact Paradox, mutual improvements on standards and taxonomy would surely lead to better and bigger impact.**

Source: Own made

7. INTERVIEW CONCLUSSIONS

Five different interviews were conducted with five professionals in the finance and corporate transactions sector, with the aim of corroborating some of the ideas that have been raised throughout the work, as well as to see the different opinions of people who know the sector, on how the proposals made in this work could have an effect. Below is a table summarizing the data of the people interviewed.

7.1. Interview methodology

The interviews were conducted with active transaction professionals, mainly from the perspective of finance, but also with an interviewee from the world of business law. All interviewees have had contact with the ESG world, so that the answers could be as well-founded as possible. In addition to the above, professionals with a minimum of 3 years of transaction experience (although most have more) were chosen, as we considered investment experience to be key to obtaining the best possible information.

That said, two interviews were conducted via calls, while the other three were conducted via a questionnaire. The most interesting information was then extracted, whether it supported the proposals made by the author of the work or was a contrary opinion, as all the responses were of great interest.

The questionnaire was developed so that practitioners could respond to the main issues raised in the work, although these issues were not posed directly, due to the specificity of the questions, and the novelty of the taxonomy and the way in which it collides with ESG standards. In relation to the live interviews, we tried to follow the rhythm of the interview, adapting to each interview and varying the questions according to the answers given previously.

7.2. Knowledge on EU Taxonomy and ESG

To begin with, it is worth highlighting the knowledge of almost all the professionals interviewed about what the European Taxonomy was, since, although of capital importance in this work and probably for the future of ESG standards in the European Union, it is a very new regulation, recently introduced and not yet fully adopted. Regarding those who did not hear of the EU Taxonomy with such frequency, they admitted that once doing a short research prior to the interview, they quickly referenced it. In regards to ESG, as it was expected, all professionals had a clear idea of the concept and the effect that the standards have.

7.3. EU Taxonomy as a complementary introduction to ESG Standards

Regarding the possible complementarity of the European Taxonomy with current ESG standards, most of the interviewees are not clear about their opinion. In general, they consider that, on the one hand, it is something complementary since the objective of both is the same, to contribute to improving the sustainability of corporations in the same area, which is the environmental area (since the taxonomy has not yet been developed in the other areas). In this sense, the fact that the objective is somewhat shared leads the interviewees to conclude that the similarities are important.

However, they also consider that there are partly differences that make the European taxonomy and the ESG standards different. In particular, the opinion of one of the interviewees (**H1**) makes it clear that until the social taxonomy is developed, the differences are too important to be considered complementary. In his opinion, “social is one of the key issues that also can back into the environment”.

Another important point mentioned by one of the interviewees (**H4)** is the fact that taxonomy should be taken as "the first step in the right direction" for improving corporate sustainability, although he considers that it is essential that "investments and efforts must make economic sense for companies". This is a key point, especially in view of problems such as the "Paradox of Integration", which led investors and managers not to fully apply ESG standards for fear of the effects, when in reality they are leaving benefits behind.

7.4. Gaps of ESG Standards

Regarding the way in which the European Taxonomy could collaborate with the current standards in order to fill the gaps that have been mentioned throughout the work, the opinions of the interviewees are again critical. They all assume that the Taxonomy could have interesting effects, and that it will be something that will help, but in general they see the contribution, as the situation stands right now, as insufficient. In fact, one of the interviewees considers that "there is still a lot of work to be done".

On the one hand, some of the interviewees consider that the ambition of the European taxonomy should be higher, in order to be able to make up for the many flaws and problems that the standards have not been able to correct so far. In this sense, they consider that a step forward of the Taxonomy is necessary, which, however, they consider (**H2**) that sooner or later it will be done, making clear that "the evolution is far from over".

On the other hand, one of the interviewees (**H1**) in particular emphasizes the fact, which has been remarked throughout the work, that at present the European Taxonomy leaves aside the social and governance part. While it is true that other initiatives exist, the fact that these are not integrated within the Taxonomy spectrum may detract from the importance of the initiative.

It should also be noted that, as a standard solution for all companies, the Taxonomy may not be sufficiently specific to meet the needs of all companies. “One size does not fit all” is an interesting term mentioned in the interviews (**H1**), and it is interesting to note that due to the generality of the European initiative, there may be sectors that do not see real benefits from its implementation.

In any case, it should be noted that everyone found interesting the idea of being able to complement the standards with the Taxonomy, either by integrating it (especially for those who valued both topics as complementary) or by helping to lay (**H5**) "the foundations" of sustainability in Europe.

Also, another point of great interest is commented by one of the interviewees (**H3**), in relation to this section, and it is that in her experience, having had the clarity that the European Taxonomy can offer when it comes to contributing to and clarifying what is considered sustainable investment would have been key. Having "had clients who wanted to invest in sustainable companies, but were not clear on what could be considered as such", the European Taxonomy would have been a highly valuable addition to be able to offer a clear answer to the investor client.

7.5. EU Taxonomy in regards to the impact and diffusion

In relation to whether taxonomy can help with the impact of ESG standards, the general response was in the affirmative, with several respondents believing that it can be key to combating important issues such as climate change, "by giving companies in the EU a scheme or system that they can use in order to engage in more environmentally friendly activities" (**H2**).

Overall, the fact that institutional activity is needed to curb climate change is strongly emphasized by interviewees as a key point for the future. Therefore, the fact that the European Union will regulate this aspect, complementing or replacing for the better the environmental aspects of the ESG criteria, is highly appreciated by most of the interviewees.

However, it was pointed out by one interviewee (**H4**) that this is only the first step and that there is still a lot of work to be done to see a real impact, so "there's room for improvement". Not just in terms of taxonomy, but in terms of the whole.

8. CONCLUSSIONS

The challenges facing the business world are linked to those facing our planet, and the success of the former will determine the success of the latter. Gone are the years when companies were concerned only with making profits without taking into account the consequences of their actions and in three key areas: the environment, society and good corporate governance.

As analyzed throughout this work, ESG criteria and standards are one of the mechanisms most widely used by companies to follow an action plan and thus comply with certain standards that help them to reduce their impact on the three aspects mentioned, and even make a contribution to improving the situation. Moreover, the number of investors that are looking to these companies to incorporate them into their investment portfolios has grown exponentially, with the aim of trying to be sustainable investors and, increasingly, to obtain long-term returns that can rival or even exceed those of those who make investments without taking ESG criteria into account, having more than tripled the number of sustainable assets under management in the last ten years.

However, as has been shown, their effects are still limited. Although assets under management, as well as the number of funds applying ESG criteria, are at record numbers, there are a number of problems that hamper the effects. Among those that can be analyzed, we have highlighted three: the impact paradox, which gives investors who apply ESG standards incompletely a lower return than they would get if they applied them fully; greenwashing or bluewashing, which means that companies use the good publicity that comes from advertising compliance with certain ESG standards, even if compliance is incomplete or the impact is very low; and finally, and most importantly for this work, the diffusion impact paradox, which exemplifies the difficulty of obtaining a high diffusion of a standard with complicated compliance criteria that would lead to a high impact, and vice versa, the impossibility of obtaining a high impact with ESG criteria that are easy to comply with, but would lead to a wide diffusion.

In this context, the European Union has introduced the European Taxonomy, as a set of mandatory reporting rules for a certain type of company (large companies and companies of significant social interest) that they will have to comply with, in order to subsequently introduce a classification system that clearly establishes whether or not an activity complies with the regulations and can therefore be considered sustainable (or its activities can be considered as such).

Having said this, the proposal made in this work is to integrate the innovations introduced by the European taxonomy in the different ESG standards in order to achieve two objectives. On the one hand, to maintain the relevance of the standards, since the introduction of a pseudo-standard such as the European taxonomy, and also being mandatory, could detract from the importance of the current common standards. And, on the other hand, to try to offer an improvement, especially in relation to the problems mentioned above and in particular to the paradox of the diffusion impact. The proposed approach involves integrating as a minimum the provisions of the taxonomy, as well as encouraging collaboration with the standards with a view to providing feedback on what each one is developing and obtaining.

While it may have some effect in relation to the impact paradox, the main effects of the proposals made focus on greenwashing and bluewashing, as well as on the diffusion impact paradox, the latter being a capital issue. The possibility of introducing a proposal such as the European taxonomy in the standards can help to solve the problem of impact and diffusion, on the one hand helping in the field of moral legitimacy, thanks to the EU as a driving force, as well as in the field of diffusion, due to the access to the 27 countries that make up the Union.

The people interviewed are positive about the impact of the taxonomy, not only because it is mandatory, but also because an institution of the caliber of the European Union has taken action on a major issue for society and has laid the foundation stone of a necessary castle. Furthermore, the possibility of collaboration between standards and taxonomy is highly valued as a point of work that can bring great benefits. Even so, not everything is clear. On the one hand, the lack of ambition in regulation has been mentioned, which may not lead to all the expected benefits (the effects are yet to be seen due to the recent introduction). Also, the fact that the taxonomy only (for now) focuses on the environmental field has produced divided opinions. On the one hand, focusing on one of the areas may lead to a better application, while on the other hand, neglecting the other two, also of paramount importance, may be a negative point.

Be that as it may, the European taxonomy is here to stay and to complement (hopefully not cannibalize) the current ESG standards, and to mark a path for the correct and complete application of the standards. It is still too early to be able to give an opinion or analyze whether it will be sufficient, but it will not take long to prove it.

9. LIMITATIONS TO THE WORK AND POSSIBLE FUTURE DEVELOPMENT

The main limitation to the work has been the lack of information, especially practical, on European taxonomy. While the ESG is a phenomenon that, as has been noted, has decades of history, the European Taxonomy was developed in the same year in which this work was carried out, so that access to studies or academic articles on the subject was very limited. Furthermore, the lack of development and therefore of empirical data on which to base the different statements has made the development of the work difficult. Also, when it came to making the different proposals and suggestions for improvement and collaboration between the standards and the taxonomy, the same lack of data conditioned the conclusions.

In relation to the impact-dissemination paradox, the research carried out in this respect is not very extensive. Beyond the articles cited above, there are no further advances, so gathering information on this issue has been difficult. However, the fact of being able to separate the paradox into the separate aspects of diffusion and impact has made it possible to carry out an in-depth analysis of the situation.

With a view to being able to continue in the future with the analysis begun in this work, it would be interesting to see the evolution of the introduction of the taxonomy and its effects in the short and medium term, as this could lead to ways of modifying and correcting any possible flaws it may have. In this sense, it would be necessary to analyze the way in which the different European companies that are subject to the taxonomy have received the new regulation and, from there, to analyze the possible achievements or failures of the taxonomy.

10. REFERENCES

Aldrich, H. E., & Fiol, C. (1994). Fool Rush in? The Institutional Context of Industry Creation . *The Academy of Management Review, 19* (4), 660-670.

Alonso-Almeida, M., Marimon , F., & Llach, J. (2015). Difusión de las memorias de sostenibilidad en Latinoamérica: análisis territorial y sectorial. *Estudios gerenciales, 31* (135), 139-149.

Better Cotton Iniative. (2022). *Better Cotton Initiative*. Retrieved from Quienes somos: https://bettercotton.org/es/

Bosse, G. (2022). Does the EU Have Moral Authority? A Communicative Action Perspective on Sanctions. *Politics and Governance, 10* (1), 22-23.

Caplan, L., Griswold, J. S., & Jarvis, W. F. (2013). *From SRI to ESG: The Changing World of Responsible Investment.* Commonfund Institute.

Cappucci, M. (2018). The ESG integration paradox. *Journal of Applied Corporate Finance, 30* (2), 22-28.

Colyvas, J., & Jonsson, S. (2011). Ubiquity and Legitimacy: Disentanglin Diffusion and Institutionalization. *Sociological Theory, 29* (1), 33-36.

Dentons. (2021). *A Guide to ESG Standards & Frameworks.* Dentons.

Donahue, J. D., & Zeckhauser, R. J. (2006). Public-private collaboration. In M. Moran, M. Rein, & R. E. Goodin, *The Oxford Handbook of Public Policy* (pp. 496-499). Oxford: Oxford University Press.

Dow Jones Sustainability World Index. (2022, June). *Dow Jones Sustainability World Index*. Retrieved from Entry requirements: https://www.spglobal.com/spdji/es/indices/esg/dow-jones-sustainability-world-index/#overview

Eccles, R. G., Kastrapeli, M. D., & Potter, S. J. (2017). How to Integrate ESG into Investment Decision-Making: Results of a Global Survey of Institutional Investors. *Journal of Applied Corporate Finance, 29* (4), 125-133.

European Banking Authority. (2020). *EBA Discussion Paper: On management and supervision of ESG risks for credit institutions and investment firms.* European Banking Authority.

European Commission. (2022, June). *Platform on Sustainable Finance*. Retrieved from https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/overview-sustainable-finance/platform-sustainable-finance_en

Filbeck, A., Filbeck, G., & Zhao, X. (2019). Performance assessment of firms following sustainalytics ESG principles. *The Journal of Investing: ESG Special Issue, 28* (2), 4-8.

Ghori, S., Lund-Thomsen, P., Gallemore, C., Singh, S., & Riisgaard, L. (2022). Compliance and cooperation in global value chains: The effects of the better cotton initiative in Pakistan and India. *Ecological Economics, 193* (3), 7.

Gilbert, D. U., Rasche, A., & Waddock, S. (2015). Accountability in a Global Economy: The Emergence of International Accountability Standards. *Business Ethics Quarterly, 21* (1), 2-4.

Global Reporting Initiative. (2022, June). *Global Reporting Initiative*. Retrieved from About GRI: https://www.globalreporting.org/

Guallar , J., Anton, L., Pedraza-Jiménez, R., & Pérez-Montoro, M. (2021). News curation by email: Analysis of the Spanish journalistic newsletters. *Revista Latina de Comunicación Social, 79*, 4.

Haack, P., & Rasche, A. (2021). The Legitimacy of Sustainability Standards: A Paradox Perspective. *Organization Theory, 2*, 4-16.

Henisz, W., Koller, T., & Nuttall, R. (2019, Noviembre). *Mckinsey Quarterly.* Retrieved from Five ways the ESG creates value: https://www.mckinsey.com/~/media/McKinsey/Business%20Functions/Strategy%20and%20Corporate%20Finance/Our%20Insights/Five%20ways%20that%20ESG%20creates%20value/Five-ways-that-ESG-creates-value.ashx

Investment Leaders Group, University of Cambridge Institute for Sustainable Leadership. (2014). *The value of responsible investment: The moral, financial and economic case for action.* Univestity of Cambridge.

Jägers, N. (2011). UN Guiding Principles on Business and Human Rights: Making Headway towards Real Corporate Accountability? *Netherlands Quarterly of Human Rights, 29* (2), 159-163.

Katz, J. A. (2008). Fully mature but not fully legitimate: A different perspective on state of entrepreneurship education. *Journal of Smaill Business, 46* (4), 550-561.

Lashitew, A. A. (2021). Corporate uptake of the Sustainable Development Goals: Mere greenwashing or an advent of institutional change? *Journal of International Business Policy, 4* (1), 4.

Lopera Echavarría, J., Ramírez Gómez, C., Zuluaga Aristizábal, M., & Ortiz Vanegas, J. (2010, January). El método analítico como método natural. *Crítica de Ciencias Sociales y Jurídicas, 25* (1), 2-4.

Moy Hubber, B., Smith, H., & Comstock, M. (2018, Octubre 4). *UN Sustainable Development Goals—The Leading ESG Framework for Large Companies.* Retrieved from https://corpgov.law.harvard.edu/2018/10/04/un-sustainable-development-goals-the-leading-esg-framework-for-large-companies/

Nikolic , I. A., & Maikisch, H. (2006). Public-Private Partnerships and Collaboration in the Health Sector. *Health, Nutrition and Population: The World Bank*, 19-21.

Pei-Yi Yu, E., Van Luu, B., & Huirong Cheng, C. (2020). Greenwashing in environmental, social and governance disclosures. *Research in International Business and Finance, 52* (5), 5-7.

Pérez Rodríguez, M., & Basco, R. (2011). The Cognitive Legitimacy of the Family Business Field. *Family Business Review, 24* (4), 336.

Prado Lorenzo, J., Gallego Álvarez, I., & García Sánchez, I. M. (2009). Stakeholder engagement and corporate social responsibility reporting: the ownership structure effect. *Corporate Social Responsibility and Environmental Management, 16* (2), 94-107.

Ruggie, G. J. (2017, Agosto). The Social Construction of the UN Guiding Principles on Business & Human Rights. *Faculty Research Working Paper Series*. Harvard Kennedy School.

Sailer, A., Wilfing, H., & Straus, E. (2022). Greenwashing and Bluewashing in Black Friday-Related Sustainable Fashion Marketing on Instagram. *Sustainability, 14* (3), 2-5.

Suchman, M. C. (1995). Managing Legitimacy: Strategic and Institutional Approaches. *Academy of Management, 20* (3), 574-576.

Sustainalytics. (2022, June). *EU Taxonomy Solution*. Retrieved from Assess companies´ alignment to the EU Taxonomy: https://www.sustainalytics.com/investor-solutions/esg-research/eu-sustainable-finance-action-plan-solutions/eu-taxonomy-solution

Townsend, B. (2020). From SRI to ESG: The Origins of Socially Responsible and Sustainable Investment. *The Journal of Impact and ESG Investing, 1* (1), 1-2.

United Nations. (2022). *United Nations*. Retrieved from Mas sobre la organización: https://www.un.org/es/

United Nations Global Compact. (2020). *SDG Compass: La guía para la acción empresarial de los ODS.*

United Nations Global Compact. (2022). *United Nations Global Compact*. Retrieved from Who we are: https://www.unglobalcompact.org/what-is-gc

Vieira de Freitas Netto, S., Falcão Sobral, M. F., & Bezerra Ribeiro, A. R. (2020). Concepts and forms of greenwashing: a systematic review. *Environmental Sciences Europe, 32* (1), 8-11.

ANNEX I. INTERVIEW TO GONZALO ALONSO DE LAS FUENTES

Gonzalo Alonso. BBA from the University of Deusto. Investment Banking Analyst at the M&A department in Bank of America, London, involved multiple cross-border mergers, acquisitions and transactions of all short during his years at the firm. Prior to the three years of experience in Bank of America, he worked for 6 months in Baker Tilly Global Deal Advisory in Bilbao, as an M&A Analyst.

Well hello Gonzalo, first this conversation is going to be recorded.

Yes, its fine thankyou

Thanks for coming, first question, could you say who you are, current position and experience in finance, and if you mind, once the TFG is published if you mind your name put in it

Yea sure, my name is Gonzalo Alonso, I studied back in Bilbao Business Management in Deusto and I work in Bank Of America, former Bank of America Merrill Lynch, in the M&A department, which stands for Mergers and Acquisitions, so my job is mainly help companies value potential targets and help them to acquire them and guide them through the process, that's mostly my day to day duties, and also involves trying to understand how future is going, mainly focused on financial institutions like banks, insurance fintech and we try to help them solve current issues and potential long term ones like decarbonization and other targets that they may have, that may not be fully financial. And of course, you can put my name

Okay, thanks Gonzalo. First official question of the questionnaire, have you ever heard about the EU Taxonomy, the recent introduction of the taxonomy, and if you have heard of it, and if yes, if you could explain shortly what you know about it.

Yes, I've been involved in a couple of discussions about it, so mainly my understanding is that this is an European initiate that is trying to push for environmental or sustainable initiatives in the corporate word, it is related to ESG, E of environmental, but in this case, it tries to limit and give limit and more clarity about how it should be approached and which initiative should be taken into account, providing more information to investors. That's what I understand

Ok, thanks, do you think that the EU Taxon is something complementary to the standards that we have right now or do you understand it as something completely different.

That's a hard question haha I believe its partially complimentary, partially the same. At the end of the day, the aim or target is the same, trying to push for a cleaner and more sustainable corporate world, trying to help investors show where to invest. The main difference, as of right now, for me, is that only affects to environment, as of right now, excluding other things that, in my opinions, should be taken into account, social and governance. Again, this is my opinion, not related to BofAs opinion, but I think that social is one of the key issues that also can back into the environment, why, because at the end of the day if you paying poorly your employees, they may end up getting those things that due to price may not consider environment. Governance, not on the strict way but in its broader definition, also takes into account leadership of companies that can help or boost this initiative so I think that even if it tries to cover the same sustainable thing, the approach is more limited, and may not cover the full spectrum that should be taken into account.

Okay, so you think that the EU taxonomy should also focus on the S and the G of ESG, right?

That's it, because that way, they will be able to get not only the companies, but also consumers to put their part into this initiative to change the mindset. It should not only be companies and investors thinking about sustainability.

Okay, so, following with the environmental side of things that taxonomy regulates, do you think that mandatory as opposed to voluntary standards, normal ones, do you

think that that’s something that could fill the gaps of the current ESG Standards, even though its only in the Environmental side of things.

Well, I don’t think so. Why, let me explain. At the end of the day, different industries have different needs, okay?

Yes

Therefore, this can have very very different impact. Let’s talk, for example, about fashion or industries, you may think that banning anything that is oil related could be the best way to reduce pollution. It´s also true that if you are able to recycle, implement circular recycling, that could leave to further reduction of contamination, maybe even more that banning oil related things. It needs to be on a case-by-case basis, there cannot be a general rule that could help all companies at the same time, because doing that is a waste of time, cause at the end the real issues are not being tackled.

So, for you, in this case, one size doesn’t fit all?

Yes, that is exactly the idea.

Okay, okay, great. For you the ideal thing for taxonomy to help with ESG, would be two things. Get involved in the S and in the G. And the other side, maybe try and be more specific regarding the different sectors.

That’s it. Being too broad doesn’t provide solutions for real companies. May give you the guidance, but won’t be able to tackle the problems of the specific industries. Some of them may need more focus for a very specific rule, but other may not even work. So, of course, it’s true that the aim is to have something standardized, but if apart from, there’s something specific to the different industries, it could leave to something with much more impact.

Okay great. Lastly, I guess from your point of view, the impact is not going to be improved. Do you think being something mandatory, and in case EU Taxonomy collaborates with some ESG Standards, could it help with the diffusion of them or not?

I think that it will help more people to get involved with ESG, and to start doing something. But it could also create arbitrage opportunities for those investors that are not willing to take a step back. They could benefit in a not very ethical way of this regulations.

Okay, great, so those were all the questions Gonzalo. Thank you very much for collaborating and coming to the interview

Thank you very much for your time, and great work!

ANNEX II. QUESTIONNARE TO (WANTED TO REMAIN ANONYMOUS)

The interviewee preferred to remain anonymous. He has more than twenty years of experience in the world of finance, being a partner of a Canadian boutique M&A and corporate finance firm. Throughout his career, he has carried out a multitude of transactions at national and international level, bringing Canadian firms and companies into the European and Spanish market.

Could you please state your name, current position and experience in the world finance?

My name is * and I am currently a Partner at a Corporate Finance boutique. Over the past 20 years, I helped numerous Canadian companies develop business networks in Europe and facilitated Spanish investment projects in Canada.

I wish my information to be kept confidentially.

Have you heard about the EU taxonomy? If so, could you please explain shortly what you know about it.

I have heard of it actually. For my understanding, the EU taxonomy is a way of classifying businesses into which can be considered sustainable, to facilitate investments.

Do you understand the EU taxonomy as a complimentary standard to the ones that we have today, or as something different?

The EU needed for a long time clear and united EU directive regarding ESG. In such a crucial matter as the environment, the EU has to work as a block in order to have a material impact.

Therefore, the EU taxonomy is definitely not a complementary standard. In fact, with time, standards will develop and the EU taxonomy will be one of the pillars of the regulatory action against climate change.

Could the EU taxonomy help fill the gaps of the current ESG standards?

ESG is a new and constantly evolving aspect of the finance/business industry. As such, the EU taxonomy could be improved (the evolution is far from over).

The current ESG standards have a hard time discerning "Greenwashing" from real action. For example, some investment funds divest from polluting sectors (O&G). This will reduce the fund's carbon footprint, however it will not have any impact on the environment per say, because some other investor will come in and take over the investment (O&G will not disappear from one day to another). Instead, companies and funds should try to make those industries less polluting, so that there is a real impact on the environment.

Can the taxonomy help with the impact on ESG?

Absolutely. Climate change is a global matter which should be tackled at the widest level possible. Therefore, giving companies in the EU a scheme or system that they can use in order to engage in more environmentally friendly activities will be positive overall. However, as said previously, the Taxonomy is not the final step in the right direction, but the first one. So, there is room for improvement.

ANNEX III: INTERVIEW TO CRISTINA SALMÓN

Cristina is a team leader at Baker Tilly Global Deal Advisory in the M&A department, focused on TMT (Telecommunications, Media and Tech) sector. He leads the Purchase team, advising medium market clients throughout the financial side of the deals. He has been involved in a multitude of transactions, nationals and internationals, involving tech related clients during their investments and M&A transactions. Prior to that, she worked in the M&A department of a boutique firm, focused also on TMT clients.

Bueno, buenas tardes Cristina, gracias por venir a la entrevista, si pudieses decir tu nombre, posición actual y experiencia en el mundo de las finanzas

Mi nombre Cristina Salmón, soy responsable de analistas en Baker Tilly en el departamento de finanzas corporativas, llevo cinco años en el mundo. Empecé en una boutique especializada en el sector tech que luego fue absorbida por una gran firma como es Baker Tilly, y que el objetivo sigue siendo el mismo, seguir siendo una boutique tech enfocada en el sector de pequeña y mediana empresa.

Vale, gracias Cristina. Has oído alguna vez hablar de la taxonomía europea y, si lo has hecho, si te suena algo sobre todo en relación con los criterios ESG

Para serte sincera, había oído hablar de ello con anterioridad, pero no sabía bien lo que era, pero evidentemente he hecho research, por lo que respecto al tema y un poco lo que entiendo que es o pretende ser, un *diccionario* que permita identificar de manera clara actividades que tienen un impacto económicamente sostenibles en la sociedad.

Eso es, sí. Y crees que esa parte de ofrecer una búsqueda de lo que puede ser sostenible, sobre todo a loa hora de realizar inversiones, puede ser complementaria a los SDGs o a otros estándares, como Bloomberg, S&P, Moody´s.

Si, yo creo que si podría serlo. El que más conozco en este aspecto de inversión sostenible es el de naciones unidas, el UN Principles of Responsible Investment, y si hemos trabajado con algún fondo de inversión que está acogido a esta asociación, pero vamos, todo lo que sea un marco común, con directrices sencillas, no, de definir seis líneas como ellos hacen, y con unos criterios de no todo es ESG, que creo que es el problema actual. No hay tanta parametrización estándar de lo que es o que no deja de ser ESG y que de verdad tiene un impacto. Todo el mundo dice que hace ESG, que al final acaba siendo puro marketing y no tiene impacto.

Por tanto, centrar un poco el tema y requerimientos en que realmente haya un impacto económico, pues por un lado cualifica y por otro es necesario, tener un marco estándar que diga, sí, esta empresa hace ESG, tiene un impacto real y de esa forma lo clasifica y te da la información clara. Al final hay bastante desconcierto, hemos tenido algún inversor que nos ha dicho que quería invertir en sostenibilidad y ni él sabía bien lo que quería, pero en qué?

Si… suele pasar

Exacto, al final no sabía en cuál de las mil actividades que hay ahora como ESG quería invertir o cuales eran realmente sostenibles. Al final esto nos hubiese podido aportar esas 5/6 líneas maestras para decirle, oye, en que realmente quieres invertir. Ósea que sí, me parece super útil.

Perfecto, ósea los puntos que consideras importantes es que uno sea algo estandarizado para todos los inversores sobre todo en la UE

Si, eso es

Y, por otro lado, el hecho de que sea obligatorio cambia esa parte de lavado de imagen de las empresas de, no, nosotros hacemos, pero al final no terminan de hacer.

Exacto

Entonces, en líneas general, tu opinión es que sí, esta parte de la taxonomía podría cubrir parte de los problemas de los estándares ESG actuales.

Eso es, si yo por ejemplo hubiese sabido de esto antes, o hubiese existido antes, por ejemplo, para ese mismo proyecto, nos hubiese sido muy útil para poder identificar iniciativas.

Por último, crees que la taxonomía europea, al dejar de la parte de social y gobernanza, se está dejando de lado un punto importante en este sentido, o quizá es demasiada aspiración el trata de regular la parte social y gobernanza.

A ver, claro. Ósea yo entiendo no que, el objetivo digamos de la taxonomía es ayudar a canalizar la inversión de cara a cumplir con las agendas de la UE. Al final, si queremos cumplir esa agenda, cuanto más se canalice mejor. Al final, terminará siendo necesario para el resto de agendas de la UE relacionadas con la S y la G. Pero bueno, siendo el environment en este momento clave, ser lo más concreto posible ayudará a no diluirse, que es lo que creo que le pasa en la actualidad al ESG. Lo que te comentaba antes, tanta amplitud acaba llevando a que parezca que no hay nada real detrás. Todo lo que sea centrarse en medir va a llevar a poder un efecto real.

¡Perfecto, muchísimas gracias por todo Cristina! Agradecerte tu tiempo.

A ti Aitor por invitarme, espero que vaya bien.

ANNEX IV: QUESTIONNAIRE TO URKO GAGNON

Urko is an analyst on the Project Finance department at Moody´s in their London Office. Prior to that, he has worked at the Business Develpoment department at DBRS Morningstar in their London Office, the Canadian Credit Rating Agency, with exposure to the structured finance, sovereign, corporate finance and financial institutions markets, with multinational clients, both in London and in the European market (focused on France and Spain). He has also worked at the Investments teams at All Iron Ventures.

Could you please state your name, current position and experience in the world finance?

My name is Urko Gagnon and I am currently analyst at Moody's, the Credit Rating Agency, in their London office. During the last four years, I have been working in several sub-parts of the finance industry: Corporate Finance, Venture Capital, and more recently Credit Rating, at All Iron Ventures and DBRS Morningstar among respectively.

Have you heard about the EU taxonomy? If so, could you please explain shortly what you know about it.

Yes, in my past job at DBRS Morningstar we talked about it. Although as we are located in the London office, the impact on the EU clients has been important, so we have had talks about it. As I understand, the EU taxonomy is a reporting standard which demands from companies more clarity on ESG performance related information, and that is mandatory (or will be soon).

Do you understand the EU taxonomy as a complimentary standard to the ones that we have today, or as something different?

In my opinion, I see the EU taxonomy as the first step in the right direction. It has become evident that companies across the globe have to make more efforts to, among other things, try to reduce their carbon footprint.

For that to happen, there has to be 2 elements in place. First, a strict ESG regulation and second, investments and efforts have to make economic sense for companies to pursue. As such, the EU taxonomy will play a crucial role in the regulation part of the equation. However, as of right now, it seems to be, at least on work, insufficient on its aspirations and also lacks the social and governance side of things (although I´ve read that it is coming soon)

Could the EU taxonomy help fill the gaps of the current ESG standards?

No as much as it needs, in fact there is a lot left to be done. The data indicates that we are close to not being able to save the planet for next generations and therefore, there´s the need to set up additional pro-environment measures. These could evolve from the EU taxonomy.

There is an ever increasing investor interest for the ESG "label", but we are at the beginning of its evolution in the era that we are in . As of today, a lot of challenges remain: How to accurately track what companies do and not do in terms of ESG? Each industry has its own specificities, and therefore will have a different response to the standards.

Can the taxonomy help with the impact on ESG?

It for sure has a positive impact. Anything that helps combining the efforts of companies and countries towards reducing the carbon emissions across Europe is beneficial in terms of ESG. Just like making accounting standards converge (IFRS and USGAAP) has helped investors and users of financial statements.

Any other idea that you would like to add

One of the main challenges for companies and ESG integration is that some activities may have a positive impact on the social side, but a negative side on the environmental side. For example, a construction company may decide to build some apartment blocks for the most needy in our society. However, this may come at the expense of the environment. So the question would be how to measure both impacts and which one is the predominant one.

ANNEX V: QUESTIONNAIRE TO GABRIEL BORGOGNO

Gabriel is a lawyer in the M&A department of Perez Llorca, one of the most important law firms in Spain. He has been involved in many top level transactions, advising national and international clients in all types of matters. Prior to his current position, Gabriel was an associate in the capital markets department of Linklaters in Madrid, an international firm based in London, advising clients on IPOs and bond issuance transactions, having participated on issuance of green bonds and other financing of renewable energy projects.

Could you please state your name, current position and experience in the world M&A and corporate transactions?

My name is Gabriel Borgogno, I work as a lawyer at the M&A Department at Perez Llorca, and for the last years I´ve been involved in national and international deals, advising all sorts of clients. My focus is on mergers, acquisitions and capital markets.

Have you heard about the EU taxonomy? If so, could you please explain shortly what you know about it.

Yes, although I understand that this is a fairly recent development. What I have dealt more with is the issue of sustainable investment and ESG criteria in some of the firm's operations. From what I have discussed, the European taxonomy introduces a specific classification to differentiate between companies that could be categorized as sustainable (by reference to percentage of assets, for example).

Do you understand the EU taxonomy as a complimentary standard to the ones that we have today, or as something different?

It could be. As far as I know, I understand it more as a base, the foundation, a first step on which the rest of the standards can be developed. In that sense it could be complementary, although the fact that there are so many standards and that the market is quite fragmented could make it difficult or prevent general complementarity... at the most, perhaps, with some large and important standards.

Could the EU taxonomy help fill the gaps of the current ESG standards?

Yes of course, in the end taxonomy is mandatory, so, even though the scope of the regulation is limited, it could complement it in that sense. However, as I said, it could fill that general gap... if we go into more specific aspects, the fragmentation of the market would make it difficult again.

Can the taxonomy help with the impact or the diffusion of ESG?

I think it can especially help with impact. In the end, the dissemination of the European taxonomy will be set by the norm, while the impact is yet to be determined. In case of complementing other standards, as I said before, I don't think the diffusion will be affected... but the impact may be different. Anything that is extra, added compliance is always expected to translate into results and impact. However, it is still too early to be able to assess that

However, I think there are two necessary points. On the one hand, it should also be extended to the aspect of the S (since there are already initiatives such as the Spanish Code of Good Governance for the G), and, on the other hand, it should be somewhat more ambitious, since it may fall somewhat short in terms of solving certain problems. However, if it were tougher, it would run the risk of making compliance impossible; the line is a fine one.

INTERVIEW SCRIPTS

1. Could you please state your name, current position and experience in the world finance?

2. Have you heard about the EU taxonomy? If so, could you please explain shortly what you know about it.

3. Do you understand the EU taxonomy as a complimentary standard to the ones that we have today, or as something different?

4. Could the EU taxonomy help fill the gaps of the current ESG standards?

5. Can the taxonomy help with the impact on ESG?

6. Any other idea that you would like to add.