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Advancing ESG reporting in Azerbaijan: Trends, challenges, and opportunities

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Abstract

One of the most significant trends in the development of the global economy is the integration of ESG (Environmental, Social, and Governance) principles into the operations of businesses and financial institutions. This paper aims to examine the trends and perspectives of implementing ESG principles within the Azerbaijani economy. The research methodology applies stakeholder and institutional theories to develop a conceptual framework that guides the understanding of ESG reporting in Azerbaijan, includes comparison, generalization, economic, institutional analysis. Based on the findings, it is concluded that the successful implementation of ESG principles in the Azerbaijani economy requires a thorough analysis and evaluation of current trends, key characteristics, and future opportunities within both the Azerbaijani and global economies.

Keywords: Sustainable development; ESG reporting; ESG factors; Stakeholder and Institutional theories; Emerging market

1. Introduction

Over time, natural resources are being depleted, and environmental changes are occurring more rapidly; consequently, international legal bodies and most developed nations are continuously raising questions about sustainability. In the past decade, sustainability disclosure has attracted the interest of many international organizations working toward a sustainable green economy. These organizations have developed several frameworks, such as the Global Reporting Initiative (GRI), the International Integrated Reporting Council (IIRC), the Sustainability Accounting Standards Board (SASB), the Carbon Disclosure Project, and the United Nations Global Compact that provide companies with clear guidance on reporting non-financial issues such as environmental and corporate social responsibility (CSR) disclosures (Ellili et al., 2022, Al-Hiyari et al., 2023).

Adopting ESG principles is a key factor in fostering the sustainable development of both national and global economies. The integration of ESG principles, along with the effects of organizations on the environment, society, and the economy, is increasingly becoming a central component of government policies, business norms, investment strategies, and consumer demand trends worldwide. The relevance of ESG reporting extends beyond developed economies and into emerging markets, where sustainable practices are often essential for long-term stability (Andrey, E. (2023). For Azerbaijan, an emerging market with an economy largely driven by natural resources, the adoption of ESG reporting represents a strategic opportunity. The nation's reliance on oil and gas has raised environmental concerns, such as greenhouse gas emissions and resource depletion. In addition, foreign investors, particularly those from markets where ESG disclosure is already a priority, may view ESG practices as indicative of a company's risk management and ethical standards. Therefore, adopting ESG practices can help Azerbaijani firms enhance their attractiveness to global investors, improve their operational resilience, and foster a sustainable economic model. Despite the potential benefits, the implementation of ESG reporting in Azerbaijan faces numerous challenges. The regulatory framework for ESG reporting is limited, with few formal requirements or guidelines to support companies in disclosing ESG-related information.

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Additionally, Azerbaijani firms may lack the expertise and resources necessary to conduct thorough ESG assessments, especially those companies that are smaller or have limited access to international markets. Cultural attitudes and corporate governance structures may also create resistance to transparency and ESG-focused reforms.

This paper aims to provide the trends and perspectives of implementing ESG principles within the Azerbaijani economy. The study applies stakeholder and institutional theories to evaluate and develop a conceptual framework that guides the understanding of ESG reporting in Azerbaijan. The study presents valuable insights for businesses, policymakers, and investors interested in advancing ESG practices within the country.

2. Theoretical Foundations of ESG Reporting

Environmental, social, and governance (ESG) have become everyone's primary concern in the age of seeking high-quality growth and sustainable development (Almeida & Darmansyah, 2019). From a micro-level viewpoint, corporate sustainability has emerged as a popular research topic. Devalle et al., (2017). The interest of stakeholders in ESG issues has grown quickly, including governments, investors, shareholders, and regulatory bodies (Hill, J. (2020). This trend can be attributed to various factors including increased awareness of environmental degradation, social inequality, and corporate governance failures, as well as growing investor demand for ethical and sustainable investment opportunities. The concept of ESG reporting is built on a foundation of theories that explain its importance and effectiveness. Two primary theories underpin the rationale for ESG reporting: stakeholder theory and institutional theory:

Stakeholder theory, developed by Freeman (1984), posits that companies have a responsibility to address the needs and interests of all stakeholders, not solely those of shareholders. In contrast to traditional business models focused solely on profit maximization, stakeholder theory suggests that a company's success and longevity are enhanced by addressing a broader range of interests, including those related to the environment, society, and governance. According to this theory, companies that engage in ESG reporting are better positioned to build trust with their stakeholders, mitigate risks associated with poor environmental or social practices, and enhance their reputation Stieb, J. A. (2009).

Institutional theory, introduced by DiMaggio and Powell (1983), explains how organizations conform to societal norms and expectations to gain legitimacy and acceptance within their operating environments (Singhania et al., (2023). This theory is particularly relevant in the context of ESG reporting, as it suggests that companies adopt ESG practices not only to meet regulatory requirements but also to align with prevailing social values and expectations. Institutional theory posits that companies face pressure from multiple sources, including regulatory bodies, industry norms, and consumer expectations, which drive them toward adopting practices like ESG reporting Helfaya et al., (2023).

2.1. ESG Reporting in Emerging Markets

Emerging markets often face unique challenges in adopting ESG reporting practices. These challenges include regulatory gaps, limited awareness of ESG benefits, resource constraints, and varying cultural attitudes toward corporate responsibility. However, despite these obstacles, the adoption of ESG reporting in emerging markets is growing, driven by factors such as international investment, reputational concerns, and domestic policy shifts (Arun, et al., (2022). In many emerging markets, regulatory frameworks for ESG reporting are underdeveloped, leaving companies without clear guidelines on what to disclose or how to report their ESG practices. This lack of regulatory support can hinder the adoption of ESG reporting, as companies may be unsure of the requirements or lack incentives to engage in such practices. In countries where regulations do exist, they may be inconsistent or poorly enforced, creating additional barriers to comprehensive ESG reporting (Tarczynska-Luniewska, et al., (2024). Resource constraints are a significant barrier for companies in emerging markets, particularly for small and medium-sized enterprises (SMEs). ESG reporting requires financial investment, skilled personnel, and technological infrastructure, which may be beyond the reach of many smaller firms (Alkathreeri, H., et al., (2023). In addition, the absence of local expertise in ESG reporting can further limit a company's ability to produce meaningful disclosures. Emerging market companies may struggle to compete with their counterparts in developed economies, where ESG reporting frameworks and resources are more readily available. Despite these challenges, there are substantial incentives for emerging market companies to adopt ESG reporting. Studies have shown that foreign investment plays a critical role in encouraging ESG adoption, as international investors often require transparency and accountability from companies in which they invest (Csordása, A., & Al-Dalameh, M. (2024); Wang et al., (2024). ESG reporting can also help companies manage risks, enhance their reputations, and improve access to capital by appealing to socially conscious investors (Kim, Y et al., (2024). In addition, countries that prioritize ESG practices may be better positioned to achieve sustainable economic growth and attract long-term investment.

3. ESG Reporting in Azerbaijan

Azerbaijan's approach to ESG reporting is relatively nascent, with limited regulatory oversight and low levels of public awareness regarding the importance of sustainable practices. The nation's economic structure, heavily reliant on oil and gas, poses both challenges and opportunities for ESG adoption. The environmental impact of Azerbaijan's primary industries has led to growing calls for improved sustainability practices, particularly as foreign investors increasingly prioritize ESG criteria in their investment decisions. In Azerbaijan, ESG reporting remains largely voluntary, with few formal requirements from the government. Regulatory bodies have yet to establish clear guidelines for ESG disclosures, leaving companies without a standardized framework to follow. This lack of regulatory support contributes to low adoption rates, as companies may perceive ESG reporting as optional or irrelevant to their operations. Moreover, Azerbaijani companies may lack the internal expertise and resources to conduct comprehensive ESG assessments, particularly smaller firms that do not have access to international markets or capital. Despite these challenges, several factors suggest that ESG reporting has the potential to gain traction in Azerbaijan. The growing influence of international investors, many of whom prioritize ESG considerations, encourages Azerbaijani companies to adopt more transparent practices. Furthermore, as global awareness of environmental issues continues to rise, local companies may increasingly view ESG reporting as a way to align with international standards, improve their reputations, and manage risks.

3.1. Current trends and perspectives of ESG principles

In the beginning of November 2024 national standard for ESG was developed at the initiative of Small and Medium Business Development Agency (KOBİA) and adopted by Azerbaijan Standardization Institute based on recommendations of the International Organization for Standardization (ISO). The state standard "AZS IWA 48:2024 "Framework for the application of environmental, social and corporate management (ESG) principles" is considered one of the first practices adopted in this field. By applying ESG principles in enterprises and organizations, the new state standard provides a framework to support sustainable development in the modern business environment and to promote social responsibility. (Small and Medium Business Development Agency of the Republic of Azerbaijan. (n.d.). The purpose of the standard which was developed on the basis of international practice, is to assist enterprises and organizations in forming and applying ESG strategies. The application of this standard will not only promote sustainable development in both the public and private sectors, but also lead to improve customer satisfaction, to reduce risks, and to enhance social responsibility. The adoption of the standard is voluntary. The standard will serve as a roadmap for businesses, providing guidance on applying ESG principles within their processes and outlining the steps needed for effective application.

Azerbaijan's focus on green development is evident in long-term plans such as the 2022-2026 Socio-Economic Development Strategy and the Azerbaijan 2030 National Priorities. Among its strategic steps, the country established an ESG subgroup under the Commission for Business Environment and International Ratings in 2022, aimed at advancing Environmental, Social, and Governance (ESG) standards within business practices. This subgroup, comprising government officials, experts, entrepreneurs, academic institutions, and civil society groups, strives to coordinate efforts and create a unified vision for ESG. A medium-term Strategic Vision document has been developed, and the Commission has ratified road maps to guide systematic ESG activities. Besides that, declaration of 2024 as the "Green World Solidarity Year," underlining the nation's strong commitment to environmental sustainability. This designation takes on added significance with Azerbaijan hosting the influential COP29 conference, a global event where countries collaborate on climate action strategies. COP29 presents Azerbaijan with a valuable chance to demonstrate its dedication to sustainable growth and to lead by example in implementing environmental initiatives. As the host of COP29, Azerbaijan will unveil a global green investment rulebook aimed at guiding sustainable investments with principles agreed upon by over 100 countries. (Small and Medium Business Development Agency of the Republic of Azerbaijan(n.d.).

4. Conclusion

This study highlights both the potential benefits and challenges of adopting ESG reporting practices in Azerbaijan. While Azerbaijan's economic structure and reliance on natural resources present unique obstacles, ESG reporting offers an opportunity for Azerbaijani companies to align with international standards, enhance transparency, and attract foreign investment. By adopting ESG practices, Azerbaijani firms can respond to growing investor expectations, build trust with stakeholders, and differentiate themselves in an increasingly sustainability-focused market.

The findings suggest that a supportive regulatory environment and incentives for early adopters would be crucial to overcoming barriers to ESG reporting. International investors' focus on sustainable business practices can act as a catalyst for Azerbaijani companies, encouraging them to adopt ESG practices to secure capital and enhance their

competitive advantage. Additionally, capacity-building initiatives, such as training programs, would help Azerbaijani companies develop the expertise needed to implement effective ESG practices. While Azerbaijan faces challenges in implementing ESG reporting, there are significant opportunities for progress. The adoption of new ESG standard can play a key role in Azerbaijan's economic development by promoting sustainable growth, reducing environmental impacts, and fostering a culture of corporate responsibility. This conceptual framework provides a foundation for policymakers, business leaders, and researchers interested in advancing ESG practices in Azerbaijan, highlighting the need for regulatory support, capacity building, and incentives to drive ESG adoption.

Compliance with ethical standards

Disclosure of conflict of interest

No conflict of interest to be disclosed.

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