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| RESEARCH ARTICLE

Why ESG Reporting is Particularly Important for the Airlines during the Covid-19 Pandemic

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| ABSTRACT
The concept of environment, society, and governance (ESG) performance is gaining momentum in all business sectors as the global economic system recognises the importance of sustainability. The airline industry has several incentives to apply ESG initiatives and report the related results. The literature has established positive links between noble ESG scores and priority access to funding, better compliance with regulatory requirements, increased customer loyalty, and employee productivity, and improved firm value and financial performance. Although adherence to ESG goals may seem contradictive to tremendous cost reduction pressures posed to airlines due to the covid-19 pandemic, literature also argues that ESG can play a vital role in the post-covid-19 world as ESG can alleviate airlines' financial risks. The aim of this short paper is to raise awareness among aviation practitioners and policymakers on the importance of ESG application and reporting as a means to strengthen business resilience and mitigate the adverse impact of the covid-19 pandemic and future crises that challenge the airline industry.

| KEYWORDS

ESG, airlines, covid-19, sustainability, performance

| ARTICLE INFORMATION

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1. Introduction

Air transportation is one of the most popular and quickly expanding businesses, providing a wide range of services and social advantages. The industry is a significant economic force for the global economy by connecting people, transferring goods, and facilitating tourism.

The airline industry, however, has a significant negative impact on the environment. Aircraft produce large amounts of carbon dioxide (CO_2), which is the principal greenhouse gas. In addition to its contribution to global climate change, aviation is also connected with aircraft noise; large consumption of energy and water to meet passenger needs; great amounts of waste produced, air, land, and water pollution, and biodiversity reduction (Paraschi and Poulaki, 2021).

The creation of long-term strategies and investments to create a sustainable airline sector have recently become increasingly important as awareness of corporate social responsibility has grown in all business sectors.

Enterprises across the world turn to the environment, society, and governance (ESG) framework, which has emerged as a crucial tenet of corporate social responsibility (CSR) for the creation of sustainable policies. Although at a very sluggish pace, airlines as well began to implement ESG efforts and report their performance. However, the amount of ESG activity engagement by the aviation sector is relatively modest. Applications of ESG in the context of travel and tourism are still in their infancy, and further research is needed (Su and Chen, 2020).

The purpose of this study is to review issues of ESG reporting in the airline industry. This study raises discussion on the drivers and the implications of ESG reporting for airlines. Subsequently, this study provides arguments about the catalytic impact of the covid-19 pandemic that featured the significance of ESG implementation and reporting to facilitate the future of air travel.

2. The ESG framework

ESG stands for Environmental, Social, and Governance, the three pillars for assessing the impact of the sustainability and ethical practices of any company.

The Environmental pillar evaluates an organization's positive or negative influence on the environment. Sub-dimensions of the Environmental performance area include Greenhouse Gas (GHG) and other air pollutants emissions, energy consumption, raw material use, waste production and management (water, solid, hazardous), water usage and recycling, impact on biodiversity, impact on ecosystems and innovation in environmentally friendly products and services. An example of an environmental factor for airlines includes aircraft carbon emissions (Li et al., 2021; Kuo et al., 2021).

The Social pillar refers to internal social policies related to internal and external stakeholders. Sub-dimensions of the Social performance area include employee rights, child labor, forced and compulsory labor, workplace health and safety, customer health and safety, discrimination, gender and diversity, equal opportunities, poverty and community impact, supply chain management, training and education, customer privacy and community impacts (Li et al., 2021; Kuo et al., 2021). An example of a social factor for an airline would include full compliance with flight crew duty and rest time requirements.

The Governance pillar refers to the implementation of sound corporate governance principles to guarantee that business decisions are made in the best interests of shareholders, such as the separation of the CEO and board chairman's responsibilities. Sub-dimensions of the Governance performance area include codes of conduct and business principles, management accountability, transparency and disclosure, executive compensation, board diversity and structure, bribery and corruption, stakeholder engagement, shareholder rights, whistle-blowing schemes and whistleblower protection, lobbying and political influence (Li et al., 2021; Kuo et al., 2021). An example of a governance factor for an airline would include dealing with regulators and authorities, such as the International Air Transport Association (IATA) and International Civil Aviation Organization (ICAO), in a transparent manner.

3. Drivers for ESG reporting

ESG was primarily developed as a benchmark to assess corporate conduct and potential future financial performance. As an investment concept, the three core components of ESG are the most important aspects to take into account during the investment analysis and decision-making process (Li et al., 2021). Lately, ESG has become an important tool for organizations worldwide to communicate with their stakeholders, improve their corporate image, and enhance competitive advantage (Kuo et al., 2021). As a result, the percentage of the largest multinationals that issue a sustainability report has risen from 12% in 1993 to 80% in 2020 (Howard-Grenville, 2021). In this section, the incentives that drive companies and especially airlines, to report their ESG performance are discussed.

3.1 Priority access to financing products

Governments, policymakers, and regulators are under increasing pressure to achieve their sustainability goals. Consequently, financial institutions and investors are actively seeking business opportunities with organizations and projects that promote sustainability. Third-party companies like Bloomberg and Fitch score the ESG performance of enterprises, and these scores are used by investors to compare companies regarding ESG and support their investment decision. Financiers and investors are now offering ESG financing products to companies that prioritize sustainability initiatives as measured by their ESG policy. To access these types of capital market financing, corporations must prioritize sustainability in their respective industries or undertake projects with an underlying ESG initiative. Studies by Abdi & Omri (2020), Raimo et al. (2021), and Eliwa et al. (2021) have shown that companies that are more transparent in their dissemination of ESG information benefit from better access to third-party financial resources at a lower cost of debt. Airlines may use green financing to renew their fleets or invest in newer, more fuel-efficient aircraft; the underlying ESG initiative here is to reduce the airline's carbon footprint by investing in more energy-efficient technology, such as aircraft that use sustainable fuels (SAF).

3.2 Compliance with regulations

National and international aviation authorities put increasing emphasis on the regulation of environmental issues. The International Civil Aviation Organization (ICAO), the International Air Transportation Association (IATA), the Air Transport Action Group (ATAG), the Airport Council International (ACI), the European Union Aviation Safety Agency (EASA), the European Environment Agency (EEA) and the European Organization for the Safety of Air Navigation (Eurocontrol) have developed detailed white papers, recommendations, manuals and green agendas (Paraschi et al., 2022b). As a result of the increased regulation, there will be an increase in ESG initiatives linked to projects with an environmental/climate component. For example, the Dutch government's proposed €2-4 billion support package for KLM requires the state-owned carrier to contribute to sustainability and noise-reduction initiatives, including the reduction of night flights and cutting CO2 emissions in line with CORSIA (Watts, 2021).

3.3 Customer loyalty

As conscious consumerism emerges as a new trend, airline customers are becoming more aware of social and environmental issues, turning to companies that take sustainability seriously. Therefore, customers' purchasing decisions are increasingly influenced by an airline's ESG initiatives. Hagmann et al. (2015) found that the green image of airlines influences airline selection when booking and that passengers are willing to pay more for a ticket from an airline with a green image. Han et al. (2019) concluded that an airline's environmental corporate social responsibility is a significant contributor to improving brand image, love, and respect, which build customer loyalty.

3.4 Increased employee productivity

A strong ESG proposition can assist enterprises in attracting and retaining quality employees, increasing employee motivation by instilling a sense of purpose, and increasing overall productivity (Henisz et al., 2019). On the contrary, a weaker ESG proposition can drag down productivity and trigger strikes, worker slowdowns, and other labor actions (Henisz et al., 2019). Human factors are of special importance in aviation, where poor working conditions can have safety and security implications. The study of Paraschi et al. (2022a) has shown that cost-minimizing policies adopted by the airlines (i.e., staff and wages reductions, increase in working hours and workload, work flexibility, low skills recruitment, high turnover, and faster career paths, and inadequate training) cause job insecurity, decreased job satisfaction, increased stress, and increased conflicts among coworkers. These factors can sour collaboration and communication while also increasing risk behavior and the likelihood of human error, which is the most frequent cause of aircraft accidents. Therefore, airlines' adherence to the social dimension of the ESG framework is less a matter of image and more a matter of self-survival.

3.5 Improved firm value and financial performance

Several studies support the positive correlation between the implementation of environmental, social, and governance (ESG) reporting and the firm value and financial performance of airlines. Abdi et al. (2022) demonstrated that, while ESG activities may reduce airlines' short-term financial performance, they can have a significant positive impact on their overall financial performance. Kuo et al. (2021) reached the same conclusion by analyzing 30 airline companies worldwide for five years. As a result, airlines' investments in ESG, especially in environmental and governance practices, such as re-usable resources, green innovation, reducing emissions, maximizing benefits for shareholders, and implementing a sustainability reporting strategy, may result in a higher market-to-book ratio and sustainable profitability. ESG can also significantly reduce costs. Among other benefits, effectively implementing ESG can assist in combating rising operating expenses, such as water and raw-material consumption. Energy consumption in airlines can be reduced through the use of more fuel-efficient aircraft technology and more direct flight patterns. This is of primary importance for airlines, given that fuel costs account for 25%-35% of their total operating costs, and energy savings directly lead to higher financial performance for the air carriers (Yan et al., 2016). Moreover, Ionescu et al. (2019) studied the impact of ESG factors on the market value of companies in the travel and tourism industry (including airlines). Their results support an association between ESG scores and the market value of the selected companies, regardless of the geographic region where they are located.

4. ESG reporting and Covid-19 pandemic

Although the concept of sustainability is gaining popularity, there is a significant gap between theory (policy) and reality (practice). Aviation is traditionally considered the most difficult sector in which to implement sustainability initiatives (McManners, 2016). This is due to concerns about whether environmental sustainability and financial sustainability are compatible. This contradiction attracts particular importance in times of crisis, such as the covid-19 pandemic that burst in 2020. The aviation and tourism industry was hit hard by the travel restrictions imposed worldwide in spring 2020. World total passengers declined by 60%, and approximately $372 billion of gross passenger operating revenues of airlines were lost in 2020 compared to 2019 (ICAO, 2022). The high capital intensity of the sector made airlines especially vulnerable to cash burn, leading more than 86 airlines to exit the market during the last two years (Eagan, 2022). These figures would have been much worse if many governments had not provided state assistance to the airline industry. Several countries, such as Germany, France, and the Netherlands, assisted air carriers such as Air France, Lufthansa, and KLM, respectively, with billions of euros (Eagan, 2022). With airlines struggling to cut costs, how could ESG reporting facilitate their sustainability?

Literature provides evidence that ESG can play a vital role in the post-COVID-19 world as ESG mitigates companies' financial risks under the pandemic and other crises. More specifically, Broadstock et al. (2020) examined the role of ESG performance during a market-wide financial crisis triggered in response to the COVID-19 global pandemic, finding that ESG performance mitigates financial risk during the financial crisis and the role of ESG performance is weakened in 'normal' times, confirming its increased importance during a crisis. Moreover, Chen et al. (2022) analyzed the effects of COVID-19 and ESG ratings on the stock performance of the U.S. airline industry. They found that when a company has a higher ESG score, short-run stock return volatility converges to the original equilibrium level faster, implying that promoting ESG does offer a defense mechanism to airline companies and that ESG performance is suitable for integration into business operational goals. Additionally, Hartmann (2022) analyzed the ESG scores of the biggest low-cost (LCCs) and full-cost (FSCs) carriers of North America and Europe during the covid-19 pandemic. He concluded that (i) having a good ESG score does add value to the firm and (ii) that low-cost carriers are best positioned to operate in a sustainable post-Covid market environment. Finally, Mukanjari and Sterner (2020) consider the covid-19 crisis as a good opportunity for carbon-intensive industries such as the airline sector to turn to green investments and to more sustainable business models.

On top of the above, as already discussed in section 3, airlines with high ESG performance can have priority access to private financing with lower debt costs, can benefit from state financial support, can face milder regulatory pressures, can enjoy higher customer loyalty, can rely on a satisfied workforce and can achieve improved financial performance.

5. Conclusion

This short article aims to demonstrate the importance that the Environmental, Social, and Governance (ESG) performance reporting framework has for the airlines, especially during the current covid-19 crisis. Aviation is a business sector with a high negative impact on the environment; therefore, achieving and reporting high ESG performance can bring multiple benefits to the airlines. First, they can have priority access to financial products because a growing number of financial institutions and investors use ESG scores as an investment criterion, favoring sustainable firms. Second, environmental protection has become urgent by the major aviation regulatory authorities, and the airlines that achieve a satisfying ESG performance are better complied with mandatory regulations and act as best practices within the sector. Third, airlines demonstrating a green and socially-conscious profile enjoy high customer loyalty and increased employee commitment and productivity. Finally, plenty of evidence supports the positive correlation between ESG reporting and improved airlines' value and financial performance. All the above features strengthen the airlines' competitive advantage and their resilience. The current analysis shows that airlines are less sensitive to the shocks of covid-19 when they have better ESG scores reported. During unexpected crises, airlines with better ESG performance become more risk averse because the volatility of the company's equity value is lower and offers a defensive feature. Airline executives and managers should incorporate ESG strategies into their organizations to promote sustainability while maximizing shareholder wealth.

The main limitation of this study is its theoretical nature. It would be interesting to verify the academic observations described in this paper with empirical results from the industry, conducting a survey that will explore the connection between airlines' ESG performance scores and their resilience to crises.

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