Implementation of ESG as a Strategy for Business Sustainability in a Public-Listed Tobacco Company in Indonesia

Muthiah¹, Yudo Anggoro²

¹,² School of Business Management, Institut Teknologi Bandung, Indonesia

ABSTRACT: Environmental, Social, and Governance (ESG) has been introduced to the business communities for the past two decades. It has grown in importance as a framework for measuring a company's sustainability and as a guide for investment decision-making. In Indonesia, the publicly listed companies at the Indonesia Stock Exchange (IDX) have been required to implement and report ESG practices since 2021 through a regulation issued by the Financial Services Authority (OJK) in 2017. Among those is a tobacco company operating in Indonesia, PT HM Sampoerna Tbk. (Sampoerna/The Company/IDX: HMSP) that has been an affiliate of an international tobacco company, Philip Morris International (PMI), since 2005. The tobacco industry’s ESG implementation is particularly interesting due to the adverse externalities generated by its products, which is stated by WHO as one of the biggest issues for public health. This research focuses on analyzing the company's ESG initiatives and creating improvement strategies in the context of a company operating in the tobacco industry with the objective of maximizing the role of ESG implementation to ensure business sustainability.


I. INTRODUCTION

As a widely recognized term among the business community globally, ESG has been an important factor in measuring a company’s sustainability and consideration in investment decision-making. It is beyond Corporate Social Responsibility (CSR) as ESG covers wider topics and issues of the company’s environmental, social, and governance, internally and externally. In Indonesia, the implementation and reporting of ESG have been required for public companies by the Indonesia Stock Exchange (IDX) through a regulation by the Financial Services Authority (OJK) since the full reporting year of 2021. One of these companies is PT HM Sampoerna Tbk., which operates in the tobacco industry. The industry where Sampoerna operates has often been called a sunset industry in the past few years due to decreasing demand. Some of the factors behind this situation are the increasingly strict regulations that restrict its promotional and selling activity as well as the increasing tariffs of excise taxes. The reason behind such a strict regulation would be due to the health impact caused by tobacco companies’ products, cigarettes. However, the company, in the context of this research, has done a comprehensive ESG strategy and multiple initiatives that have a role in contributing to its important stakeholders, such as employees, business partners, shareholders, adult consumers aged 18 years old and above, and the wider communities. The company’s ESG initiatives are also derived from its parent company, Philip Morris International (PMI/NYSE: PM), which was just ranked first in the 2024 Net Zero Leaders ranking by Forbes in June this year.

Sampoerna has been operating in Indonesia for 111 years in 2024. By Q1-2024, the company employs more than 90,000 employees across the country, spread in its seven owned factories, 43 production facilities owned by local cooperatives and entrepreneurs, as well as headquarters offices and 109 sales and distribution offices. Creating value and multiplier effect is important for the company in doing business. Stakeholders are at the center of the company’s sustainability strategy, with the social pillar at the core of the company's ESG material topics. These core material topics are product innovation for better alternatives, socio-economic well-being for the value chain, and a supportive working environment.

This research aims to identify how the ESG initiatives done by the company could be leveraged to ensure its business sustainability while also assessing which of the company’s strategies worked well and what improvements are needed. This research utilized several theories such as VRIO, PESTEL, Triple Bottom Line and Balanced Scorecard combination, a gap analysis, and McKinsey’s theory titled Five Ways that ESG Creates Values to identify and formulate the strategy to improve the company’s business sustainability by leveraging on ESG initiatives.
II. LITERATURE REVIEW
The term ESG was first introduced by the United Nations Environment Finance Initiative (UNEP FI) in 2005 to integrate into a firm's decision-making. This recommendation was needed in the business community at a time when companies had not considered their businesses' impact. The business communities previously only considered financial aspects and profitability, with little to zero regard for caring for their surrounding environment and community. The practices have been set into action worldwide, including in Indonesia. Beyond mere compliance with the requirements, companies can leverage ESG implementation to boost their business sustainability, as demonstrated by a case study in this research. This research used some analysis tools.

A. VRIO Analysis for Internal Organization
Jay Barney, an American professor at the University of Utah for Strategic Management, founded the VRIO analysis tool to evaluate a company's resources and capabilities. The tool comprises four elements to be identified: Value (V), Rarity (R), Imitability (I), and Organization/Organized (O). The analysis could be done for several capabilities the company has to explore, such as which of them has the potential or has already been the company's competitive advantage. The tool could help decide the resource allocation for each of these capabilities according to their impact on business.

B. PESTEL Analysis for External Environment
Another consideration a company should consider is the external environment. One tool for this analysis would be PESTLE or PESTEL, which consists of Political, Economic, Social, Technological, Environmental, and Legal aspects that have influenced or could influence the company’s operations. This tool was first developed by an American scholar of Harvard Business School, Francis Joseph Aguilar, in the 1960s.

C. Triple Bottom Line Theory and Balanced Scorecard Combination
An entrepreneur and author on sustainable development and corporate social responsibility from the UK, John Brett Elkington, came up with the Triple Bottom Line theory in his book before UNEP FI introduced ESG. Elkington introduced the three Ps (Profit, People, Planet) as the components of his theory, which highlights the importance for companies to consider and manage their impact on social and environmental aspects as well, not only profit. The theory is not used standalone in this research. Instead, it is combined with the Balanced Scorecard, invented by Harvard Business School scholar Robert S. Kaplan and his research partner, David McMillan. The two published a paper in 2020, providing an idea to combine a Triple Bottom Line and a Balanced Scorecard (the latter was also invented by Kaplan), which will eventually be used to develop a strategy map for a company by adding vision, value for stakeholders, an updated business model, and enabler elements to the tool.

D. Congruence Model Gap Analysis
From the organization management point of view, a congruence model gap analysis introduced by David Nadler and Michael Tushman in the 1980s could help a company analyze the interaction and gaps between aspects within the organization. The interactions between work, informal and formal organization, and the people of a company could determine the organizational behavior and gaps that need to be closed to create an effectively running organization.

E. Five Ways that ESG Creates Value
ESG creates value for a company in many ways, but according to a McKinsey report published in 2019, there are five most important ones. These criteria could become a set of added value for a company by being the framework of the new ESG proposition. The framework consists of topline growth, cost reduction, regulatory and legal intervention reduction, uplifting employee productivity, and optimization of assets and investments.

III. RESEARCH METHODOLOGY
This research mainly uses qualitative methods to analyze the current ESG strategy and implementation, identify areas for improvement, and propose a new strategy to improve the company’s sustainability. The data collection is conducted through primary and secondary sources.

The primary sources consist of a structured focus group discussion (FGD) with multiple managerial members of the company and a semi-structured interview series with internal management and external stakeholders, such as micro, small, and medium
enterprises, farmers and farm workers, ESG program partners, and an ESG expert in a consulting firm. The question lists are defined by interpreting the research objectives and questions. The secondary sources include Sampoerna’s Annual and Sustainability Report 2023, Philip Morris International’s Integrated Report 2023, and other sources such as news articles and supporting reports. The research also analyzes the company’s reports based on OJK’s ESG reporting guideline for Indonesian publicly listed companies to identify the congruence and room for improvement.

IV. RESULTS AND ANALYSIS
The total number of FGD informants and interview respondents for this research is 27, consisting of eight internal middle and senior managers who are responsible and related to ESG implementation and reporting, eight internal company senior management, eight ESG program beneficiaries, two ESG program partners, and one expert in the ESG field.

A. FGD Results
The internal self-assessment pointed out that the company's ESG strategy and initiatives have been holistic and comprehensive and that the company conducted the initiatives long before authorized agencies required them. There are three strongest associations when it comes to Sampoerna’s ESG initiatives. First, these are all people—or stakeholder-focused. The company’s ESG programs have always centered on stakeholders' needs. The second and third points are on the flagship initiatives: the MSME development and product innovation on developing better alternatives, which are smoke-free products that are not burned, resulting in a significant reduction of harmful constituents compared to cigarettes. However, there is some room for improvement that the company has to consider. In terms of initiatives, the waste—particularly post-consumer waste—is the biggest issue the company hasn’t solved so far. For the operational waste, the company has set a target of zero waste to landfill by 2024 and conducted some initiatives in this area. Another room for improvement is the need for transparent and gradual progress reporting that should not be limited only when there is a major milestone. Transparency is also needed in terms of the percentage of progress against the objectives. Additionally, not all initiatives have certain targets or KPIs in place. The last suggestion for improvement from the FGD is to better define the roles and responsibilities in terms of ESG integration and to add or expand the dedicated sustainability coordinator team. Internally, there is also a challenge to alignment in such a large organization.

B. Interview Results
Sampoerna’s priorities focus on at least two aspects: the creation of value and multiplier effect and human capital development. Both of these aspects are also integral to the company’s sustainability strategy. In terms of sustainability, the company has adopted the ESG framework since 2022. Before then, some of the currently implemented initiatives were implemented using a different framework the company developed independently.
Sampoerna’s ESG strategy adopted PMI’s framework, which divides the ESG topics into two issues: product impact, which is related to what the company produces, and operational impact, which is related to how the company produces. Both PMI and Sampoerna have done an ESG materiality assessment involving key stakeholders to define the most important materiality topics that matter to the company, which are then adjusted to where it operates. For instance, in Indonesia, the biggest issue will be socio-economic, while in European countries, environmental issues are the first priority. The company has established a Sustainability Committee that mainly oversees the governance of ESG strategy setting, implementation, and reporting. They report to the Board of Directors and have members from various departments. These practices have been in place for at least the last 1-2 years, during which time the company has started integrating ESG principles into its business operations.

From the point of view of program beneficiaries, the MSME owners, farmers, and farm workers, the ESG initiatives or specific programs that Sampoerna has done were very beneficial in changing the life quality of their families and their surrounding communities. Their most important key takeaway is that the company has been shifting the beneficiaries’ mindset for continuous learning, providing knowledge and support, and developing its capabilities. Instead of providing funding or capital, Sampoerna developed beneficiaries’ capabilities through training and assistance to increase productivity, independence, and welfare of the value chain and community in general. Their businesses and productivity grew significantly to the extent that they can now provide

Figure 1: Sampoerna’s 2023 Sustainability Strategy

Corresponding Author: Muthiah
employment for others. At the same time, they keep on adding their families’ productive assets to reach for more revenues and welfare improvements in the future.

Similarly, program partners have seen how Sampoerna’s social and environmental initiatives have changed people’s lives. At the same time, they’ve also learned so much from the governance and integrity practices the company required from its partners. They’ve experienced some challenges in terms of the company’s fast working pace and shifting the mindset of community members and MSMEs who were first expecting fresh money to help fund their capital. Over time, the MSMEs understood that knowledge and capabilities are much more worthy than one-time funding support.

Meanwhile, the ESG expert shared that an ideal ESG strategy is one that has conducted a preliminary materiality assessment to define the key material topics that matter the most for the company. Every company is different, and their initiatives should match the negative externalities and impacts. For the frequent challenges, Indonesian companies usually find it difficult to get full internal support from all employees, especially if implementing ESG will add to their workloads. Thus, the “most favorite” ESG initiatives and achievements are developing and issuing internal policies that do not necessarily create any impact without adequate programs or implementation in place. There has been a wide disparity between ESG implementation in developed countries and Indonesia in terms of awareness, understanding, prioritization, and integration into daily business operations.

C. Internal Analysis

Sampoerna has a number of ESG initiatives that have become the main aspect to be analyzed by using the VRIO framework. From the analysis below, one program in the environmental pillar, three in social, and one in governance are considered a long-term competitive advantage that could be leveraged further. In contrast, each one in environmental and social aspects is considered an unused competitive advantage that can be explored to ensure business sustainability.

One social program on disaster relief program and facility is considered a possible competitive disadvantage that the company can assess further on its effectiveness. Otherwise, a non-value-adding program can be discontinued. Maintenance is sufficient for the rest of the programs that are considered to have realized competitive parity.

<table>
<thead>
<tr>
<th>Capabilities, Resources, or Programs</th>
<th>Value</th>
<th>Rarity</th>
<th>Imitability</th>
<th>Organization</th>
<th>Results</th>
</tr>
</thead>
<tbody>
<tr>
<td>Environmental: energy efficiency, including solar panels</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>Realized competitive parity</td>
</tr>
<tr>
<td>Environmental: manufacturing waste management</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>Realized competitive parity</td>
</tr>
<tr>
<td>Environmental: water management</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>Long-term competitive advantage</td>
</tr>
<tr>
<td>Environmental: post-consumer waste</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>Unused competitive advantage</td>
</tr>
<tr>
<td>Social: youth access prevention program</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>Unused competitive advantage</td>
</tr>
<tr>
<td>Social: Innovation and R&amp;D on smoke-free product</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>Long-term competitive advantage</td>
</tr>
<tr>
<td>Social: Tobacco and Clove Farmers partnership program</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>Long-term competitive advantage</td>
</tr>
<tr>
<td>Social: Retailer MSME development program with digitalization (SRC)</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>Long-term competitive advantage</td>
</tr>
<tr>
<td>Social: General MSME development program (SETCC)</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>Realized competitive parity</td>
</tr>
<tr>
<td>Social: Sampoerna Rescue (disaster relief and preparedness program and facility)</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>Possibly a competitive disadvantage</td>
</tr>
<tr>
<td>Social: Fair Working Environment</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>Realized competitive parity</td>
</tr>
<tr>
<td>Governance: code of conduct framework</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>Realized competitive parity</td>
</tr>
<tr>
<td>Governance: responsible sourcing principle and integrity implementation</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>Long-term competitive advantage</td>
</tr>
</tbody>
</table>

*Corresponding Author: Muthiah
D. External Analysis
Some key issues may influence the company's ESG key strategy and initiatives in terms of risks or prioritization.

Table 1: PESTEL analysis

<table>
<thead>
<tr>
<th>Aspect</th>
<th>Key Factors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Political</td>
<td>Highly regulated and restrictive tobacco industry and uncertainty due to regulatory changes.</td>
</tr>
<tr>
<td>Economic</td>
<td>Challenging economic conditions in Indonesia: unemployment, poverty, etc. The tobacco industry provides income to millions of Indonesians across the value chain.</td>
</tr>
<tr>
<td>Social</td>
<td>Negative perception of the public health community towards cigarettes. Smoking is a part of the culture among Indonesian adult smokers.</td>
</tr>
<tr>
<td>Technological</td>
<td>Advancement in technology as an enabler for R&amp;D and MSME digitalization.</td>
</tr>
<tr>
<td>Environmental</td>
<td>Potential issues of post-consumer waste and managing impact from manufacturing activities.</td>
</tr>
<tr>
<td>Legal</td>
<td>Permits, integrity, labor practices, and intellectual property and trademark protection.</td>
</tr>
</tbody>
</table>

E. Triple Bottom Line and Balanced Scorecard Analysis
The author selected 36 metrics for this assessment, using the triple bottom-line aspects to examine the company’s ESG performance for the full year of 2023. In terms of “Profit,” the company is going in a positive direction except for the slightly declining volume and a decrease in total investment.

![Figure 3: Triple Bottom Line – Profit](image)

In terms of “People,” the company has recorded some decreasing performances, but the one that should be paid attention to the most is the slight increase in the lost time due to work incidents.
For the “Planet” aspect, there are more notes for improvements: the increased total energy and water consumption, a slight decline in renewable energy usage and emission reduction, as well as a significant reduction of more than 99% in terms of the fleet's CO2e reduction.

**Figure 4: Triple Bottom Line – People**

**Figure 5: Triple Bottom Line – Planet**

F. Congruence Model Gap Analysis
The following analysis shows that the company can explore the deployment of technology, expert hiring, and investment allocation while allocating human resources by establishing a dedicated or expanded sustainability coordinator team and deploying a project-based team for ESG-related pilot projects.
V. CONCLUSIONS AND RECOMMENDATIONS

The research shows that Sampoerna’s ESG strategy is comprehensive and stakeholder-focused. It has been based on a materiality assessment showing different priorities with its parent company. However, Sampoerna has not implemented or created its own Sustainability or ESG Index and Roadmap, which has been done by its parent company. This is important to track reporting and ensure transparency. The Index and Roadmap could be prioritized based on the impact to the business, and subsequently tracked with a percentage of progress based on the respective objectives or KPIs.

Based on the analysis, the author will recommend the following ESG proposition with a framework derived from McKinsey’s 2019 report:

1. Topline growth: social pillar
   a) Product innovation through R&D and introducing smoke-free products as better alternatives to adult smokers.
   b) Establish and enhance partnerships with tobacco and clove farmers, as well as retail partners.

2. Regulatory, Legal Intervention: governance pillar
   To continue maintaining the highest integrity and compliance standards.

3. Uplifting Productivity: human capital development
   To increase the engagement of employees and integrate ESG implementation into business as usual.

4. Optimization of Assets and Investments: Prioritization for Strategy and Budget for Investment
   To provide an ESG Index and Roadmap to determine each focus strategy’s weighted prioritization. This will also be reflected in the reporting stage, where the progress of each objective will be transparently reported.

The following is the proposed strategy map for Sampoerna’s ESG strategy and initiative to integrate the principle to its business model, based on the Triple Bottom Line and Balanced Scorecard combination framework.

![Figure 6: Congruence Model Gap Analysis](image-url)
This research also proposes an implementation plan to be conducted in stages:
1. Materiality assessment to be conducted once every few years.
2. ESG Index and Roadmap development that will be updated along with the materiality assessment result.
3. Dedicated budget and human resource allocation.
4. Integration of ESG strategy and initiatives to the company’s business as usual daily operational activities.
5. Pilot projects for new initiatives, such as post-consumer waste programs.

Last but not least, the key enablers should also be activated to ensure the company's business sustainability improves or at least remains intact. Further research on the topic is recommended to identify areas for improvement in ESG strategy, prioritization, and implementation in other companies or industries while developing the strategy map for ESG planning.

REFERENCES