LUISS

Master's Degree in Corporate Finance

Chair of Corporate Governance

Effects of ESG and CSR on Tobacco Sector Performance

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Academic Year 2023/2024

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Summary

INTRODUCTION

Over the last decades, the idea of corporate social responsibility and environmental, social and governance have been progressively becoming more popular. It implies that companies are being measured not only by economic outcomes but also by their influence on society and nature. The given research intends to investigate the way the mentioned principles were implemented within the tobacco sector. It is possible to regard it as a central part of ethical and regulatory discussions because its items have adverse effects on the health of individuals.

The tobacco sector, despite increasing challenges, continues to be a significant part of the global economy. Tobacco companies have begun to implement CSR and ESG practices as a means to mitigate risks, enhance their public image and increase their operational sustainability. This thesis examines the effectiveness of these practices, assessing whether and how they have affected company performance in the context of a highly regulated industry under constant public scrutiny.

Firstly, the paper defines and outlines the key concepts of CSR and ESG, exploring their evolution over time and their current role in corporate governance. This is done by delving into their interconnections and related theories.

After that, we will focus specifically on the tobacco sector, analysing how these practices have been adopted by major companies in the sector and what impacts they have had on their economic performance, environmental sustainability and social relations. In addition, we will analyse the regulatory environment, which is constantly evolving and rigorous in order to better address the latest challenges.

Continuing with the work, through a methodological approach combining qualitative and quantitative analysis, this research aims to provide a deeper understanding of the dynamics between social responsibility and corporate performance. The aim is to provide an answer to the research question: "*How ESG and CSR influence performance in the Tobacco sector?*".

This will be argued using case studies of leading companies such as British American Tobacco (BAT) and Philip Morris International (PMI), the paper explores the strategies implemented and the results obtained from the research and interviews conducted with experts from the two companies. All this in an attempt to provide an overview of the challenges and opportunities associated with the adoption of CSR and ESG practices in the tobacco industry.

Ultimately, this thesis adds to the academic debate on the intersection of corporate ethics and financial performance, while also offering significant insights for policymakers, investors and business leaders engaged in navigating the complexities of this contentious but economically significant field.

CAP. 1 CSR & ESG

1.1 Corporate Social Responsibility (CSR)

1.1.1 Definition and evolution of CSR

Corporate Social Responsibility is understood as "a recent type of business self-regulation that can help on this issue, as it includes men, women and the youth in strategic plans to increase long-term companies' profits"[1].

Several organizations promoting Corporate Social Responsibility (CSR) have adopted a Triple Bottom Line (TBL) approach, such as the United Nations Industrial Development Organization (UNIDO). This approach has proven effective in balancing social and environmental objectives with the economic competitiveness of enterprises. TBL is used as a framework to assess corporate performance in economic, social and environmental terms, aligning companies with the goal of global sustainable development. With a focus on key issues such as environmental management, responsible sourcing and social equity, CSR offers competitive advantages, including improved access to capital, increased sales, operating cost savings and enhanced corporate image[2].

Before fully exploring the concept of Corporate Social Responsibility (CSR) and its contemporary applications, it is essential to retrace some fundamental stages of the debate on the need to combine business logic with ethical principles in the management of companies.

The fundamental stages of the concept of Corporate Social Responsibility (CSR) are different, the first is in the 1930s which saw the first contributions on this topic, with the jurists A.A. Berle and E.M. Dodd who expressed opposing views. Berle argued that all powers of a corporation should benefit shareholders, thus limiting Corporate Social

[1] www.sciencedirect.com. (2020). Corporate Social Responsibility - an overview | ScienceDirect Topics. [online] Available at: https://www.sciencedirect.com/topics/earth-and-planetary-sciences/corporate-social-responsibility

[2] UNIDO (2023). What Is CSR? [online] United Nations Industrial Development Organization. Available at: https://www.unido.org/our-focus/advancing-economic-competitiveness/competitive-trade-capacities-and-corporate-responsibility/corporate-social-responsibility-market-integration/what-csr

Responsibility to a narrow perspective[3]. In contrast, Dodd emphasized the service of society by businesses, underlining the fiduciary role of managers[4].

However, the concept of CSR took shape with the publication of Howard Bowen's "Social Responsibilities of the Businessman", which explored the moral obligations associated with business management. Bowen defined CSR as the obligation of business leaders to pursue policies and decisions that are desirable for society[5].

In the 1960s, Keith Davis raised crucial questions about the social responsibilities of business. From that point, interpretations of CSR became varied, with Archie Carroll's perspective identifying four levels of priorities: Economic, Legal, Ethical and Discretionary[6].

Carroll's model conceives CSR on four priority levels, guiding companies in defining objectives and daily actions (Figure 1).

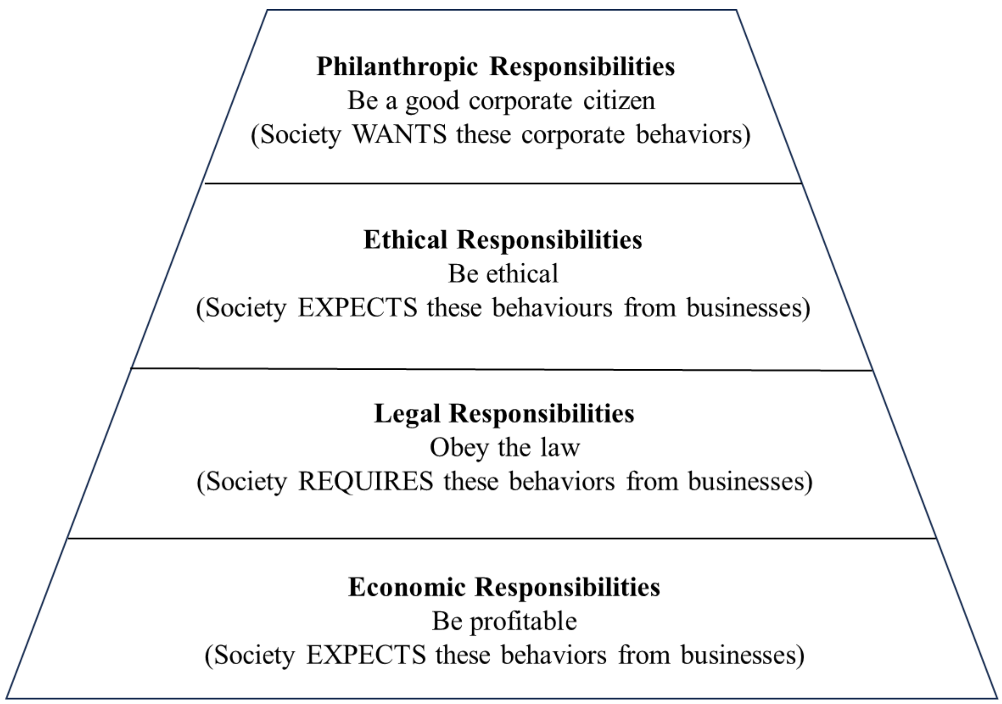

Figure 1: The four priority levels of Carroll's model

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[3] Berle, A.A. (1931). Corporate Powers as Powers in Trust. Harvard Law Review, 44(7), p.1049
[4] Dodd, E.M. (1932). For Whom Are Corporate Managers Trustees? Harvard Law Review, 45(7), p.1145
[5] Davis, K. (1960). Can Business Afford to Ignore Social Responsibilities? California Management Review, 2(3), pp.70–76
[6] Carroll, A.B. (1979). A Three-Dimensional Conceptual Model of Corporate Performance. The Academy of Management Review, 4(4), pp.497–505

Despite the proliferation of theories, interpretations and viewpoints, two opposing schools of thought emerged in the 1980s: the "Institutionalist" approach and the "Neoclassical" approach.

1.1.2 Role in Corporate Sustainability

Corporate Social Responsibility (CSR) plays a key role in corporate sustainability. It is an approach through which companies integrate social and environmental concerns into their daily operations in the interests of all stakeholders. It can be illustrated in corporate sustainability in the following ways[7]:

1. **Adapting to consumer expectations:** modern consumers are increasingly attentive to the ethical values and sustainable practices of companies. Companies that embrace CSR can respond to these expectations, gaining the trust and loyalty of customers.
2. **Reducing reputational risk:** CSR can help reduce reputational risks associated with unsustainable or socially irresponsible business practices. Companies that demonstrate a commitment to sustainability may enjoy a better reputation and greater public support.
3. **Ethical and transparent management:** companies that embrace CSR tend to adopt ethical and transparent business practices. This helps to build trust between the company and its stakeholders, including customers, employees and investors.
4. **Integration of social and environmental aspects:** CSR involves the integration of socially responsible and sustainable practices into business operations. This may include the adoption of environmental policies, the promotion of workers' rights and attention to local communities.
5. **Talent attraction and employee retention:** commitment to CSR can be an attractive factor for employees, especially younger generations who often seek out companies with shared social and environmental values. In addition, socially responsible policies can help improve employee satisfaction and loyalty.

[7] Wan-Jan, W.S. (2006). Defining corporate social responsibility. Journal of Public Affairs, [online] 6(3-4), pp.176–184: https://onlinelibrary.wiley.com/doi/abs/10.1002/pa.227

6. **Operational efficiency and resource savings:** CSR initiatives often aim to improve operational efficiency and reduce the environmental impact of business activities. This can result in resource savings, reduced energy costs and optimized supply chains.

1.2 Environmental, Social & Governance (ESG)

The growing relevance of environmental, social and governance (ESG) scores is increasingly evident in academic literature and in the corporate environment. This trend is partly attributable to the fact that the topics covered by ESG scores are designed to address several crucial social and environmental issues.

1.2.1 Definition and evolution of ESG

ESG is the acronym for environmental, social and governance areas, commonly known as the pillars in ESG contexts. These three elements constitute the main subject areas in which companies are encouraged to report. The fundamental objective of ESG is to comprehensively understand and manage all non-strictly financial risks and opportunities that arise from a company's day-to-day activities[8].

Reflecting on the historical evolution of ESG, centuries before they were named ESG, ethical and social considerations were already present in investments. Early "exclusion lists" or "codes of conduct" were based on factors such as religion, moral standards and cultural values. For example, in the 1700s, Quakers and Methodists in the US and Europe excluded investments related to slavery[9].

In the 1950s and 1960s, energy and mining workers' unions started to invest pension capital in affordable housing and health facilities.

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[8] Deloitte (2021). What is ESG? [online] Deloitte. Available at: https://www2.deloitte.com/ce/en/pages/global-business-services/articles/esg-explained-1-what-is-esg.html
[9] www.preqin.com. (2022). ESG History | Rise of ESG Investing | Preqin. [online] Available at: https://www.preqin.com/preqin-academy/lesson-5-esg/history-of-esg

In the 1960s, protests against the Vietnam War also actively involved members of the business community. Meanwhile, US companies produced Agent Orange, a chemical weapon used by the US military during the war, giving rise to lawsuits to this day.

In the 1970s, Milton Friedman introduced the Shareholder Value Theory, while the first Earth Day in 1970 led to the creation of the EPA and environmental laws in the US.

In the 1980s, attention to ESG grew, with US government action against apartheid in South Africa and the founding of CERES after a major oil accident in Alaska.

In 1990, the Domini 400 Social Index was born, and in 1992 the Earth Summit was held in Rio de Janeiro. In 1997 saw the ratification of the Kyoto Protocol and the founding of the Global Reporting Initiative (GRI) in Boston.

In 2000, the UN Global Compact was launched, followed by the "Who Cares Wins" report in 2004. In 2011, the Sustainability Accounting Standards Board (SASB) was founded to standardise sustainability accounting. In 2015 saw the birth of the Paris Agreement and the UN Sustainable Development Goals.

In 2020, the pandemic of COVID-19 highlighted economic inequalities and accelerated the importance of CSR and ESG. In 2021, Larry Fink of BlackRock emphasised the urgency of acting on ESG, pointing out that business success measured by these criteria leads to positive financial results[10].

1.2.2 Relevance in the financial and corporate sphere

Environmental, social and governance (ESG) signals are a crucial element in factor-based investment strategies, as they can be derived from the same economic rationales as general factor premiums. Considering that factors are broad and varied, constructing portfolios by jointly optimizing factor exposures together with ESG and carbon performance can generate similar historical performance as factor portfolios that do not take such considerations into account. We will illustrate how sustainable signals, which commonly involve alternative data, can be integrated into the factor definitions

[10] blog.blackbaud.com. (2021). ESG Timeline: A History of Environmental, Social & Governance Programs. [online] Available at: https://blog.blackbaud.com/esg-history/

themselves: We will provide two examples concerning green intangible value and quality of corporate culture, which respectively enhance the traditional financial value and quality factors[11].

Out of 1,000 research studies analyzed between 2015 and 2020, 58% of corporate studies showed a favourable relationship, with 13% neutral and 8% negative, between ESG and financial success. Of the investment studies, 33% showed a positive performance, 26% a neutral performance and 14% a negative performance. Among the climate change studies, 65% of the investor studies showed positive or neutral performance, compared to 57% of the corporate studies that were positive (Figure 2).

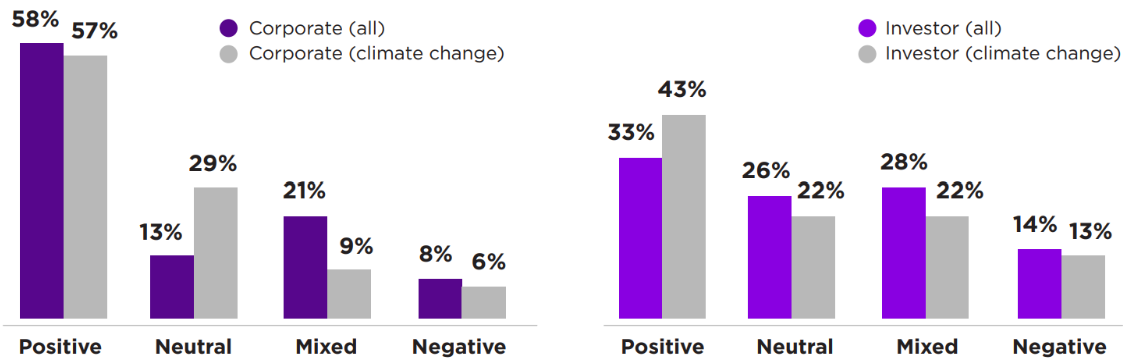

Figure 2: Results from 245 studies published between 2016 and 2020

The results were reinforced by a meta-analysis. Since 2015, 2 meta-analyses have been conducted, one on investors (107 unique studies) and 13 meta-analyses on companies (1,272 unique studies). The individual studies revealed that ESG investment returns are comparable to those of conventional investments, while the corporate studies consistently demonstrated a favourable association between ESG and financial performance. Studies that are investor-focused look at the connection between ESG and performance, focusing on benchmarks and portfolio views with themes like governance and materiality, quantified by meta-analytic effects like Hedges' g or d. Studies with a business focus, on the other hand, employ variables like risk management, innovation, and operational effectiveness as mediators to better understand how sustainability activities affect the

[11] Chan, Y., Hogan, K., Schwaiger, K. and Ang, A. (2020). ESG in Factors. The Journal of Impact and ESG Investing, 1(1), pp.26–45: https://www.pm-research.com/content/pmrjesg/1/1/26?implicit-login=true

PCP. Partial correlations obtained from regression models are called meta-analytic effects (Figure 3).

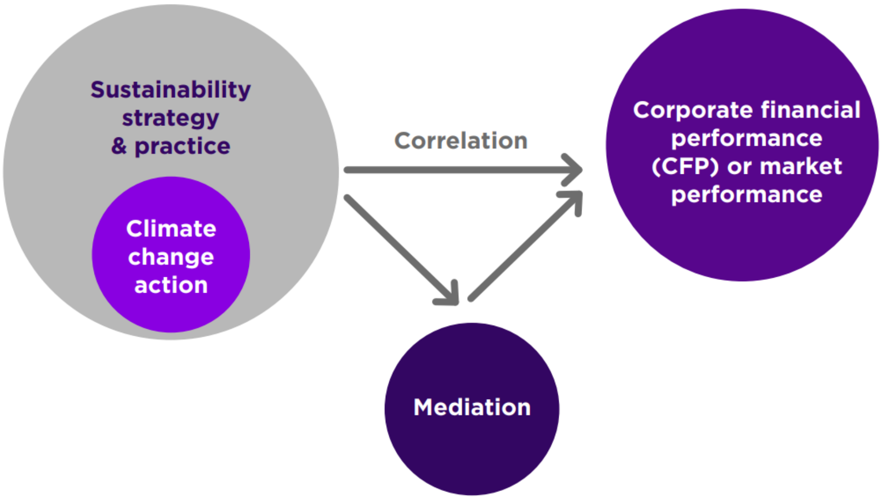

Figure 3: Conceptual Analysis of the Impact of Sustainable Investments on Financial Performance

The analysis identified consistent and robust patterns across time and locations. Stakeholder theory is the most often mentioned social science model (N=80) used by many studies to explain their findings. In 16% to 25% of the research, shared value, legitimacy theory, and the resource-based perspective were prevalent. Notably, research based on social science theories had an average odds ratio of one in two, whereas studies lacking social science ideas indicated a favourable correlation between ESG and financial performance in one out of every three situations[12].

All of this points to the necessity of deepening our understanding of the factors driving the connection between financial performance and environmental sustainability. In "Corporate Sustainability: A Strategy?", Ioannou and Serafeim (2019) examined the question of whether sustainability should be viewed as a common practice (a set of industry standards that give legitimacy) or as a strategic strategy that leads to a

[12] Whelan, T., Atz, U. and Clark, C. (2021). ESG AND FINANCIAL PERFORMANCE: Uncovering the Relationship by Aggregating Evidence from 1,000 Plus Studies. [online] Available at: https://sri360.com/wp-content/uploads/2022/10/NYU-RAM_ESG-Paper_2021-2.pdf

competitive advantage. They concluded that both solutions have merit and that adopting sustainability over time is a dynamic and complex process[13].

1.3 Interconnection between CSR and ESG

The intersection between corporate social responsibility (CSR) and the environmental, social and governance (ESG) framework can focus on compliance. Beyond legal obedience and associated risks, a distinct examination explores the standards or metrics that companies claiming CSR and ESG objectives aim to comply with. The landscape encompasses a dynamic mix of internal governance mechanisms, private principles, and third-party ratings, lacking standardized disclosure. Companies autonomously define their CSR or ESG goals, resulting in variability and a lack of a dependable compliance mechanism. Broadly categorized as "self-regulation" and "meta-regulation", these approaches operate voluntarily or through external measurements. In the realm of self-regulation, corporate codes of conduct, CSR board committees, business ethics units, and supply chain assurance play pivotal roles. While corporate codes vary widely, criticisms highlight their potential ineffectiveness without substantial organizational change. Internal governance mechanisms, such as CSR board committees and business ethics units, monitor principles outlined in corporate codes throughout the organizational hierarchy. Supply chain assurance extends voluntarily adopted principles into external contracts, aligning with international business norms[14].

On the meta-regulation front, institutional investors, regulators, NGOs, and other entities guide, measure, and monitor corporate conduct through third-party standards, ratings, and rankings. Frameworks like the UN Global Compact, Global Reporting Initiative, and OECD Guidelines set substantive standards for CSR and ESG. Notably, the absence of uniform reporting standards and standardized quantitative metrics poses challenges, with calls for mandatory disclosure and reform emerging globally[15].

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[13] Ioannou, I. and Serafeim, G. (2019). Corporate Sustainability: A Strategy? SSRN Electronic Journal: https://www.eticanews.it/wp-content/uploads/2019/07/SSRN-id3312191.pdf
[14] A. Gill (2008). "Corporate Governance as Social Responsibility: A Research Agenda." Berkeley Journal of International Law 26: 452–478
[15] J.E. Fisch, (2019). Making Sustainability Disclosure Sustainable. Georgetown Law Journal, [online] 107, p.923-966

As ESG investing gains traction, the role of ESG rating agencies becomes pivotal, yet challenges arise from non-standardized disclosures and conflicting methodologies[16].

From this, it can be deduced that the increase in social responsibility initiatives takes place through internal governance and meta-regulation mechanisms. However, the wide range of approaches prevents clarity on what it means for a company to comply with CSR or ESG objectives. While flexibility allows for customized approaches, the need for standardized, accurate and verified information is growing. Such information would not only help understand the relationship between CSR, ESG and financial performance, but would also contribute to the evolution of regulations and laws that impact workers, customers, communities and the environment.

1.4 Theories on how CSR and ESG influence corporate governance

By exploring the relationship between Corporate Social Responsibility (CSR), Environmental, Social, Governance (ESG) and corporate governance, it becomes essential to delve into the different theories that illustrate how CSR and ESG practices influence the decision-making structures of companies.

These theories provide help in understanding the mechanisms through which ethical, social and environmental considerations are intertwined with decision-making processes, stakeholder commitments and overall governance frameworks within organizations.

1.4.1 Agency Theory

Agency theory, a fundamental concept in the context of principal-agent relationships, is concerned with analysing the intricate dynamics that arise when one party, the principal, delegates financial decisions and transactions to an agent. This relationship, although

[16] T. Doyle (2018). THE SUBJECTIVE WORLD OF ESG RATINGS AGENCIES Vice President of Policy & General Counsel. [online] Available at: https://accfcorpgov.org/wp-content/uploads/2018/07/ACCF_RatingsESGReport.pdf

crucial, can often generate conflicts and disagreements, giving rise to the so-called "agency dilemma" or "agency problem".

In different business contexts, this theory manifests itself through various principal-agent relationships, each with its challenges and implications. For example, the relationship between shareholders and corporate executives highlights how executive decisions directly influence the value of shareholders' shares. Similarly, the investor-fund manager connection emphasizes investment performance and the investor's expectations of the manager's decisions. The causes of agency problems are manifold and range from conflict of interest between the principal and agent to insider trading and decisions made by the agent that go against the interests of the principal. These factors can lead to disagreements and tensions within the relationship. To mitigate such problems, some recommended practices arise. Transparency between the parties is crucial, ensuring that decisions and transactions are openly and fairly agreed upon. The imposition of targeted restrictions can provide security for the principal, while the introduction of bonuses can motivate the agent to make decisions aligned with the principal's interests[17].

It is essential to tailor these practices to the specific principal-agent relationship, considering each context's unique dynamics. Ultimately, the goal is to create positive and healthy relationships, mitigating potential conflicts and promoting effective cooperation between principals and agents.

1.4.2 Legitimacy Theory

Legitimacy Theory is a theoretical approach that focuses on society's perceptions of an organization's legitimacy and the organization's efforts to preserve or increase this legitimacy. In the 1990s, W. Richard Scott and Peter J. Suchman primarily created this idea, which has been used in a variety of settings, such as social reporting and corporate social responsibility (CSR). Suchman contends that an organization's legitimacy is a vital resource that affects both its long-term viability and its capacity to function well in its surroundings. Legitimacy is the general consensus that an organization's actions are

[17] CFI (2022). Agency Theory. [online] Corporate Finance Institute. Available at: https://corporatefinanceinstitute.com/resources/esg/agency-theory/

appropriate, desirable, and acceptable given the social context in which it operates. According to the legitimacy theory, companies are driven to act in ways that are regarded as socially acceptable and to comply with public standards. An organization is more likely to receive support from the public when it is seen as legitimate. This support can result in advantages including improved trust, a favourable reputation, and occasionally even financial gains.

According to Suchman, there are three different kinds of legitimacy. Normative legitimacy is the first kind, and it denotes an organization's adherence to accepted social norms and ideals. The way that society expects corporations to behave is frequently determined by cultural norms and values. The second is pragmatic legitimacy, or an organization's ability to satisfy the immediate and tangible demands of society. For instance, in order to satisfy urgent needs or adjust to new legislation, a company may adopt socially conscious operations. The last category is Cognitive Legitimacy, which describes how the organization and society share values and views. An organization's legitimacy can be shaped when it can impact societal attitudes[18].

Furthermore, the significance of the legitimacy perception for organizations is the focus of Donald Suchman's Legitimacy Theory. Maintaining this credibility over the long run depends on adhering to societal norms. Suchman suggests institutional and strategic methods for handling it.

The former claims that corporations deliberately use strategies like "symbolic isomorphism" and image management to positively control perception. In contrast, the second highlights how organizations must follow institutional standards to be considered legitimate, as determined by social institutions. Managing legitimacy becomes essential for sustainability in the socioeconomic context, affecting stakeholder cooperation, societal support, and operational capacity[19].

In conclusion, companies can manage their legitimacy in many ways, such as through public relations, participation in social responsibility initiatives, following policies and procedures, and more. Legitimacy Theory states that an organization's capacity to uphold

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[18] Burlea, A.S. and Popa, I. (2013). Legitimacy Theory. Encyclopedia of Corporate Social Responsibility, [online] pp.1579–1584: https://doi.org/10.1007/978-3-642-28036-8_471

[19] M.C. Suchman (1995). Managing Legitimacy: Strategic and Institutional Approaches. The Academy of Management Review, [online] 20(3), pp.571–610. Available at: https://www.jstor.org/stable/258788

its legitimacy is essential to its long-term viability; hence, it devises strategies to manage the perception of its legitimacy in the social environment in which it operates.

1.4.3 Stakeholder Theory

Stakeholder theory holds that organisations are composed of groups with different interests. The combination of these interests reflects the organisation's intentions. Business decisions should seek to consider and promote collaboration between these groups. However, conflict can erode these interests. When consensus cannot be reached, decisions should optimise the decision-making process by incorporating all points of view[20].

Then according to Thomas Donaldson and Lee E. Preston, Stakeholder Theory constitutes an innovative approach to corporate management. Contrary to the traditional shareholder-only perspective, this theory focuses on "stakeholders", i.e. all interested parties in the activities of an organisation. Stakeholders are not limited to shareholders, but include employees, customers, suppliers and local communities. The approach proposed by Stakeholder Theory promotes responsible management, in which the company recognises and balances the interests of all stakeholders. This ethical responsibility goes beyond the simple objective of maximising shareholder value to include broader and deeper considerations of the impacts of business decisions. Donaldson and Preston support the validity of their theory through empirical evidence and case studies. They show that stakeholder-oriented companies can achieve tangible benefits in terms of reputation, trust and long-term success. The theory proposes a more inclusive model of corporate governance, actively involving all stakeholders in business decisions. Therefore, Stakeholder Theory offers a more holistic and participatory perspective of corporate management, helping to redefine the concept of corporate social responsibility and shape new governance practices[21].

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[20] Investopedia (2019). Agency Theory vs. Stakeholder Theory: What's the Difference? [online] Investopedia. Available at: https://www.investopedia.com/ask/answers/031615/whats-difference-between-agency-theory-and-stakeholder-theory.asp

[21] T. Donaldson and L.E. Preston (1995). The Stakeholder Theory of the Corporation: Concepts, Evidence, and Implications. The Academy of Management Review, 20(1), pp.65–91. https://www.jstor.org/stable/258887?seq=1

1.4.4 Principal-agent problem

When there is a conflict of priorities between a person or organization and the representative designated to act on their behalf, the principal-agent issue occurs. This conflict can arise in any circumstance where the principle, the owner of the asset, gives the agent, another party, direct authority. The principal-agent dilemma can arise when the agent acts against the principal's best interests. Michael Jensen and William Meckling theorized this scenario in the 1970s, and it has since been extensively researched in politics and economics[22].

When a principal hires an agent, they are transferring some control and decision-making authority. This is known as separation of control. The principle is still in charge of the assets and is still liable for any losses, though. Investors of a company's shares, for instance, are principals who designate the CEO as their representative to carry out a plan in their best interests. The principals could feel deceived if the CEO chooses to use all earnings for business expansion or to give executives hefty incentives.

There are several solutions to the principal-agent problem, many of which involve clarifying expectations and monitoring results. The burden of correcting the problem generally falls on the principal. Causes of the problem include agency costs, which arise from the risk that the agent may neglect responsibilities, make wrong decisions or act contrary to the interests of the principal. Solutions involve contract design that aligns the manager's incentives with those of the shareholders, performance evaluation, and compensation tied to certain criteria. For instance, tying compensation to a performance appraisal may ensure that the agent works to the best of his or her ability. The principal-agent problem may manifest itself in various everyday situations, e.g. when a client hires a lawyer, a homeowner disapproves of the use of council funds, or a real estate buyer suspect that a real estate agent is more interested in the commission than in his needs[23].

Therefore, in order to solve the principal-agent dilemma, the principle needs to provide the agent with incentives to behave in the agent's best interests. To guarantee the finest

[22] C.M. Kopp (2021). Agency Theory: Definition, Examples of Relationships, and Disputes. [online] Investopedia. Available at: https://www.investopedia.com/terms/a/agencytheory.asp

[23] Investopedia. (2023). Principal-Agent Problem. [online] Available at: https://www.investopedia.com/terms/p/principal-agent-problem.asp#citation-1

service possible, it is critical to understand the principal-agent dilemma before entrusting someone with representation.

1.4.5 Social License to Operate

The term "social licence to operate" refers to the continued acceptance of the business practices and standard operating procedures of a company or sector by its stakeholders, employees and the general public. This idea is directly related to the concepts of triple bottom line and sustainability.

Developing trust with the community and other stakeholders is the foundation for long-term LSO development. Being a good corporate citizen means that a corporation must act properly, caring for the environment and its workers. Being quick to address issues when they arise is essential to maintaining LSO. LSO definition and measurement are challenging tasks that businesses frequently take on only after it is too late. Large-scale mishaps, like the oil leak from BP's Deepwater Horizon, jeopardize entire industries in addition to a company's social license. But even small issues, like a CEO's thoughtless remarks, can damage one's social licence and result in the firing of the offending party. The expectations placed on businesses are rising all the time. Child labor and hazardous working conditions things that were deemed typical a century ago are now forbidden in many nations. Only 25 years ago, many practices were considered acceptable. Examples include recruiting only male managers and executive directors, discriminating in hiring, and outsourcing to countries with laxer labor laws. These days, these practices are closely monitored and may be discontinued[24].

As time goes on, what were once seen to be clever business strategies like tobacco companies' child-targeted advertisements become intolerable. Companies are urged to act morally, evaluating supply chains, waste management, human resources, and other areas of their business operations to maintain and increase their social licence. Supervisors need to pose probing questions while considering potential media responses. Is purchasing from the lowest-priced vendor appropriate? What is known about how they

[24] W. Kenton, (2019). Social License to Operate (SLO). [online] Investopedia. Available at: https://www.investopedia.com/terms/s/social-license-slo.asp

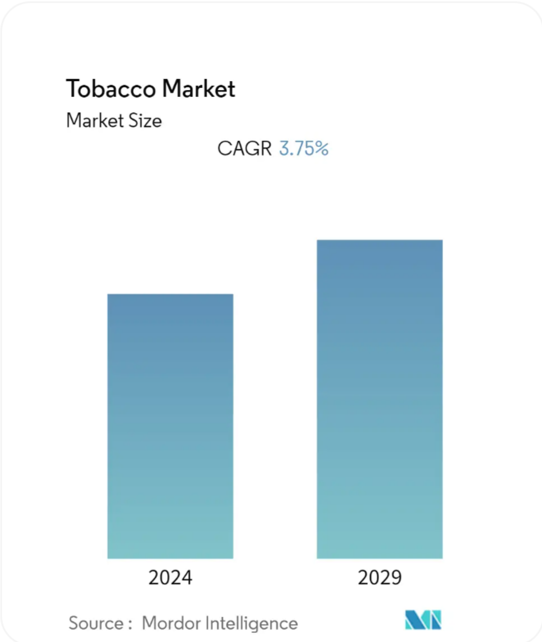
operate? Is there a chance of becoming involved in circumstances like the 2013 Bangladeshi plant collapse? Does internal staff justice rank highly?

If a company’s social licence is threatened by something that would have made sense in the short term to reduce costs a few years ago, it may end up costing it far more in the long run.

CAP. 2 Sector Overview tobacco sector

2.1 Context

The tobacco industry is currently in a period of growth, as indicated by a global market estimate of a Compound Annual Growth Rate (CAGR) of 3,75% over the next five years. The rising incidence of smoking and the consistent market for tobacco products are the primary drivers of this trend. Tobacco continues to be a significant global source of tax revenue for countries, highlighting its importance from an economic and fiscal standpoint (Figure 4).



Study Period	2018 - 2029
Base Year For Estimation	2023
CAGR	3.75 %
Fastest Growing Market	Asia Pacific
Largest Market	Middle-East and Africa
Market Concentration	High

Figure 4: Tabacco Market Size

The lax regulatory climate, which is especially noticeable in developing nations, is a major factor driving the rise of the tobacco sector. These nations are now making a major contribution to the sector's overall growth. More latitude in the law promotes economic growth and the growth of the tobacco industry. The most widely used tobacco product is cigarettes, which can be attributed to several variables including affordability, ease, and the pleasure they provide. A small number of major businesses control a sizable portion of the global market. This consolidation may impact the competitive dynamics of the industry[25].

The development of the tobacco industry is significantly fuelled by innovation in products. To increase corporate profits, manufacturers are introducing new goods to the worldwide market, which is boosting the tobacco sector's expansion. In order to satisfy the demands of the modern customer, new nicotine products also known as innovative, alternative, or unique tobacco products must be introduced. These new products are a response to the increased awareness of the negative consequences of smoking and attempt to reduce the hazards associated with tobacco usage. It should be mentioned that tobacco businesses are using tactics to sustain demand in response to the decline in tobacco consumption in industrialized and wealthy nations. One such tactic is the launch of goods that are noticeably safer than traditional goods, indicating the industry's flexibility in responding to shifting consumer demands and escalating health concerns[26].

Therefore, it is reasonable to conclude that the global tobacco market is experiencing a period of rapid expansion, driven by a blend of inventive, regulatory, and economic forces. The industry's ongoing development demonstrates its capacity to adjust to shifting global conditions and contemporary consumer demands.

2.2 Trends and recent developments

The tobacco industry is transforming rapidly due to shifting customer tastes, new laws, and an emphasis on sustainability and health. This article highlights how tobacco corporations are adjusting to a world that is changing quickly by examining trends including eco-friendly practices and alternative nicotine delivery technologies. Learn about the developments and difficulties influencing this significant sector as it adapts to changing consumer demands. Learn insightful viewpoints on the factors influencing

[25] www.mordorintelligence.com. (2023). Global Tobacco Market | 2022 - 27 | Industry Share, Size, Growth - Mordor Intelligence. [online] Available at: https://www.mordorintelligence.com/industry-reports/global-tobacco-market-industry

[26] UCSF WHO Tobacco Control Papers Title WHO report on the global tobacco epidemic, 2023: protect people from tobacco smoke. (2023). Available at: https://escholarship.org/content/qt7x18m7f9/qt7x18m7f9.pdf

transformation in this intricate sector, regardless of whether you are a stakeholder or just interested in the future of tobacco.

2.2.1 Microporous ceramics

Customers' growing health consciousness is causing the tobacco industry to adopt microporous ceramic filters as a trend. These filters are known for their ability to effectively filter out dangerous elements like nicotine and tar, making smoking a healthier experience. Microporous ceramic filters are offered as a harm reduction solution in response to tighter laws and escalating health concerns. By adding these filters, manufacturers may show that they are committed to lowering the risks related to smoking and project an image of social responsibility. Ceramic filters enhance the smoker's experience by lessening the harshness and bitterness of tobacco smoke, in addition to their health benefits. This may enhance brand loyalty. Microporous ceramic filters constitute an important trend in the tobacco industry, suggesting progress towards harm reduction and innovation in smoking products, despite high production costs and the need to address customer perception[27].

2.2.2 Eco-Friendly Vapes

The tobacco business is adopting environmentally friendly vaporizers due to growing public consciousness about environmental issues. Because they are made with recyclable materials, require less energy to produce, and produce less trash than traditional tobacco products, these vapes provide a sustainable option. Reusable parts, such as rechargeable batteries and refillable cartridges, are given priority by manufacturers to reduce their negative environmental effects. Organic components are another feature of eco-friendly vapes that appeal to health- and environmental-conscious customers. By embracing this trend, tobacco businesses appeal to a larger market by positioning themselves as pioneers in sustainability. Green vaping is becoming more and more popular, despite obstacles including consumer education and regulatory compliance. Eco-friendly vapes provide a

[27] T. GreyB, (2023). Microporous ceramic filters to enhance vaping experience. [online] Available at: https://www.greyb.com/blog/microporous-ceramic-filters/

healthier and more environmentally friendly future for the tobacco business as consumers emphasize making eco-conscious decisions[28].

2.2.3 Smart Vapes

The emergence of smart vapes has brought about a significant change in the tobacco industry. These gadgets combine cutting-edge technology to provide an interactive and customized vaping experience. Smart vapes, which collect data like puff count and nicotine consumption, give consumers the ability to monitor and regulate their usage habits with sensors and mobile apps. Through social features, users can interact with others and create unique boundaries. The trend shows that, despite worries about data privacy, the tobacco industry is becoming more and more in need of innovation and customization. With the ability to give users more control, knowledge, and connectivity in their quest for a fulfilling and responsible vaping experience, smart vapes have the potential to significantly influence the future of vaping[29].

2.2.4 Personalization

The tobacco business is moving away from its traditional mass-market strategy and toward customized products. Adults looking for a wide variety of tastes have become more and more interested in flavored tobacco products, such as smokeless alternatives and cigars. Formats, packaging, and technology are all examples of personalization; e-cigarettes and customizable packaging let customers customize their experience. Algorithm-driven recommendations on online platforms improve personalization. Despite these developments, tobacco businesses continue to face challenges in finding a balance between ethical marketing and personalization due to regulatory concerns, particularly regarding flavored products and youth appeal[30].

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[28] T. GreyB, (2023). How are companies achieving sustainability in tobacco industry? [online] Available at: https://www.greyb.com/blog/sustainability-in-tobacco-industry/
[29] T. GreyB, (2023). How Smart Vapes will look like 5 years from now? [online] Available at: https://www.greyb.com/blog/smart-vapes/
[30] T. GreyB, (2023). What Biometrics in the tobacco industry will look like. [online] Available at: https://www.greyb.com/blog/biometrics-in-tobacco-industry/

2.2.5 Age Verification

In the tobacco industry, age verification has changed throughout time in response to issues with regulatory compliance and underage smoking, especially considering the rise in internet sales. Retailers have put in place reliable age verification systems on their websites, asking users to enter their birthdate and, in certain situations, to complete extra identification verification procedures. Additionally, age verification systems on vending machines, smartphone apps, geofencing in physical retail, and third-party verification services have been used. Age verification on packaging is further improved via NFC and QR codes. Retailers and producers are being compelled to keep abreast of local legislation as governments all over the world tighten their prohibitions on tobacco sales. For increased protection, biometric techniques like fingerprint scanning and facial recognition are being investigated[31].

2.2.6 Low tar and nicotine products

Consumers in the area are concurrently adopting e-cigarettes, snuff, and low-tar goods at an increasing rate to decrease their usage of regular cigarettes. Since e-cigarettes mimic the feeling of smoking regular cigarettes, users who are eager to feed their nicotine addiction find them appealing, which propels the market. The popularity of vaping devices has led to a rise in flavouring providers who provide a large selection of e-liquids in flavours like chocolate, mint, menthol, and others, drawing in a large customer base. Furthermore, compared to traditional tobacco smoking, the use of e-cigarettes, snus, and related items resulted in lower levels of carcinogens. The market for less dangerous tobacco products is growing because of the public's search for alternatives due to the rise in cancer incidence linked to tobacco use (Figure 5)[25].

[31] T. GreyB, (2023). How Age Verification in Tobacco impacting the Industry? [online] Available at: https://www.greyb.com/blog/age-verification-in-the-tobacco-industry/

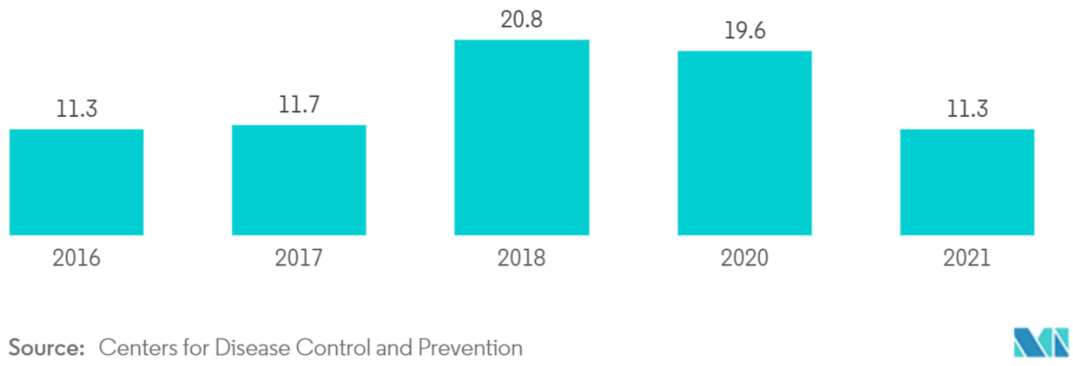

Figure 5: Tobacco Market: United States high school students using electronic cigarettes (e-cigarettes) (in %), United States, 2016 - 2021

2.3 CSR and ESG impact in the tobacco sector

Transnational firms realized that they needed to take responsibility for and address their negative effects on society, particularly on labor practices, the environment, and human rights. This led to the development of ESG practices and corporate social responsibility (CSR). Companies in the tobacco industry started to realize their connection to tobacco manufacturing and marketing as a result of the growing concerns about these issues. Consequently, they have started investigating and putting into practice Environmental, Social, and Governance (ESG) and Corporate Social Responsibility (CSR) practices. This shift indicates a growing dedication to striking a balance between corporate operations and social and environmental responsibility, tackling industry-related issues like tobacco in an ethical and long-lasting way[32].

2.3.1 Smoke-free and prevention programmes

To date, one component includes the adoption of anti-smoking and preventive programs by tobacco firms. These programs actively address smoking-related health issues to lessen the detrimental effects of tobacco use on public health. In an effort to lower tobacco use

[32] Z. Sharma, L. Song (2018), Corporate social responsibility (CSR) practices by SIN firms: Evidence from CSR activity and disclosure [online] Available at: https://www.emerald.com/insight/content/doi/10.1108/ARA-06-2017-0102/full/html

and encourage better lifestyles, tobacco firms frequently work with government agencies, health organizations, and research facilities to carry out educational and awareness-raising campaigns. This could involve tobacco cessation programs that offer assistance in quitting, informational campaigns on the negative effects of smoking, and educational materials geared toward both communities and individuals. These programs' primary goals are to lower the prevalence of smoking and raise public knowledge of the risks involved, which will help create a healthy society. It is crucial to remember that the efficacy of these programs can be questioned, and some detractors contend that tobacco firms might utilize them to deflect attention from the more serious issues related to tobacco usage. Therefore, in order to guarantee that these programs are regarded as legitimate corporate social responsibility endeavours, transparency and a sincere dedication to public health goals are vital[33].

2.3.2 Partnerships with non-profit organisations

Partnerships with non-profit organizations and government agencies are one manner in which tobacco firms more effectively address social difficulties associated to smoking and contribute to public health promotion. These collaborations can be in the shape of scientific research projects, educational initiatives, or anti-smoking campaigns. By means of these collaborations, corporations can harness the know-how and proficiency of nonprofit institutions to execute campaigns that target the prevention of tobacco consumption, assistance in quitting smoking, and management of nicotine addiction problems. Research initiatives can advance knowledge of the health and social effects of tobacco use, while educational programs can increase public awareness of the dangers of tobacco use. However, the sincerity of the companies' dedication and openness in their joint ventures determine how successful these relationships will be. Furthermore, these collaborations must be part of a long-term corporate strategy that aims to lessen the

[33] Tobacco industry tactics: smoke-free environments. (2019). Available at: https://applications.emro.who.int/docs/FS-TFI-203-2019-EN.pdf?ua=1

detrimental effects of the tobacco industry on society and the environment in order to be regarded as true CSR and ESG activities[34].

2.3.3 Transparency and reporting

Broad disclosure of corporate operations, including the social and environmental effects of tobacco production and marketing, is necessary to increase openness and public reporting. Open communication about the whole supply chain from the stages of tobacco growth to the production and distribution of final products is a goal of tobacco companies that participate in CSR and ESG initiatives. This includes a thorough explanation of the standards and regulations put in place to mitigate the environmental and social consequences of tobacco use. Thorough reporting enables all parties involved investors, non-governmental organizations, and customers to assess the company's activities and their overall effects critically. The implementation of globally acknowledged reporting guidelines contributes to bolstering the legitimacy of these endeavours. It is crucial to remember that openness runs the risk of being dismissed as a simple marketing gimmick if it is not supported by real, quantifiable activities. Tobacco firms cannot establish a reputation for sustainability and accountability that extends beyond mere adherence to regulations unless they engage in genuine and comprehensive communication, supported by quantifiable outcomes over an extended period[35].

Furthermore, Transparency International EU emphasised the need for the European Commission to strengthen control mechanisms to avoid covert influences in decision-making and lobbying, following reports that the tobacco industry has undermined the EU's efforts to tackle the illegal cigarette trade. The organisation criticised the EU's failure to take effective measures against tobacco smuggling, pointing out that this situation could have global repercussions, with governments in Asia and Africa

[34] MODEL GUIDELINES FOR NONPROFITS EVALUATING PROPOSED RELATIONSHIPS WITH OTHER ORGANIZATIONS. (2001). Available at: https://tobaccopolicycenter.org/wp-content/uploads/2017/11/177.pdf

[35] www.pmiscience.com. (2021). Can increased transparency of the tobacco companies' reporting on their business contribute to greater acceptance of their role in reducing smoking-related harm? [online] Available at: https://www.pmiscience.com/en/research/publications-library/can-increased-transparency-of-the-tobacco-companies--reporting-on-their-business-contribute-to-greater-acceptance-of-their-role-in-reducing-smoking-related-harm/

considering replicating the EU's system under pressure from tobacco companies. Transparency International EU expressed concern about the alleged involvement of EU officials in promoting an ineffective traceability system outside the EU. It emphasised the importance of making public health decisions with integrity and transparency and proposed a reform of the EU lobbying transparency rules as an urgent first step to prevent undue influence from the tobacco industry[36].

Speaking of lobbying, the lack of mandatory regulation on reporting and registration of lobbying activities in the EU has been highlighted, with voluntary and incomplete registers that do not provide detailed information on interests represented or funding. Despite more than 13 years since the European Transparency Initiative, this situation persists, with a new political exchange planned to discuss a new lobby register. However, both the European Parliament and the Council have developed legal excuses to justify the lack of access limits for lobbyists who do not comply with transparency rules. The Commission's proposal for a mandatory register in 2016 was welcomed, but recent scandals have exposed further weaknesses, including foreign interference in European elections. The current rules do not treat the activities of third country governments as lobbying, and many registered organisations would not fully disclose their activities. Transparency International EU and other associations sent a letter to the EU institutions calling for a stronger mandatory register for transparent lobbying[37].

2.3.4 Environmental Sustainability

One important area of focus for tobacco firms is environmental sustainability, which emphasizes how conscious businesses are becoming of their environmental effects. Environmental sustainability in the context of tobacco focuses on multiple aspects. Companies can implement sustainable agriculture practices, such as utilizing farming techniques that limit pesticide use and enhance biodiversity. In addition, given the substantial amount of water used in the tobacco producing process, effective water

[36] Transparency.org. (2020). Reports of undue influence by tobacco industry strengthen case for…. [online] Available at: https://www.transparency.org/en/press/undue-influence-tobacco-industry-case-for-mandatory-eu-lobby-register
[37] V. Teixeira (2018). The EU is vulnerable to secret lobbying [online] Transparency International EU. Available at: https://transparency.eu/the-eu-is-vulnerable-to-secret-lobbying/

management becomes imperative. Reducing waste through reuse and recycling techniques can help reduce the overall impact on the environment. Some businesses might even look at less harmful farming options in an effort to lessen their environmental impact. Such sustainable practices not only demonstrate a company's dedication to environmental preservation, but they can also enhance its reputation and allay growing customer worries about sustainability. But it is imperative that these efforts are backed by ongoing oversight, open communication, and a sincere dedication to tackling the particular environmental issues related to the tobacco business. Environmental sustainability methods can only make a substantial contribution to striking a balance between corporate needs and ecosystem protection in this manner[38].

2.3.5 Diversification of business

Several of these company aim to diversify to lessen their reliance on the tobacco industry financially because they recognize the serious moral and societal problems associated with tobacco use. In addition to providing chances for economic expansion, investing in industries like technology, health, or agriculture may also be a big step toward enhancing businesses' overall influence on the environment and local communities. In addition to lowering a company's exposure to tobacco-related risks, business diversification can be seen as a concrete step toward creating a portfolio of more morally and socially conscious enterprises. But rather than being viewed as merely a reputation-dampening tactic, diversification needs to be motivated by a long-term vision and a sincere commitment to addressing social and environmental challenges. Analyzing business diversification in the context of CSR and ESG necessitates closely examining the goals and tangible accomplishments of the organization in pursuit of a more comprehensive, long-term vision[39].

[38] Z. Sharma, L. Song (2018), Corporate social responsibility (CSR) practices by SIN firms: Evidence from CSR activity and disclosure [online] Available at: https://www.emerald.com/insight/content/doi/10.1108/ARA-06-2017-0102/full/html

[39] MarketLine (2021). Diversification among Big Tobacco is rife as players eye alternative markets. [online] Verdict. Available at: https://www.verdict.co.uk/tobacco-cannabis-investment/?cf-view

2.4 Regulation and European Directives

In the last decades, the increase in awareness of ESG and CSR issues has led to regulation and social pressure on all sectors. Specifically, the tobacco industry is the subject of controversy and debate regarding social, environmental and health impacts due to the increasing awareness of the harm caused by tobacco consumption.

2.4.1 Corporate Sustainability Reporting Directive (CSRD)

The new EU regulation known as the Corporate Sustainability Reporting Directive (CSRD) will force big, publicly traded corporations to disclose information about how they track several environmental, social, and governance (ESG) issues and their effects on the environment. More organizations will be impacted, more data will be needed, and stakeholders will be scrutinized more than ever before in what represents a major step change in reporting[40].

Furthermore, the Directive on Corporate Sustainability Reporting (CSRD), which went into effect on January 5, 2023, strengthened the requirements for the social and environmental data that businesses had to provide. Large listed firms and small and medium-sized businesses will now have to report on sustainability. The European Sustainability Reporting Standards (ESRS), which were released in the Official Journal on December 22, 2023, will be mandatory for businesses subject to CSRD. These EFRAG-developed standards support global standardization efforts and are in line with EU policy. Until the new CSRD requirements are put into effect, the regulations established by the Non-Financial Reporting Directive (NFRD) are still in effect. Public interest businesses that employ more than 500 people are required to post information on diversity, anti-corruption, social justice, environmental, and human rights problems on their boards of directors. About 11,700 sizable businesses and organizations in the EU

[40] PricewaterhouseCoopers (2023). The Corporate Sustainability Reporting Directive (CSRD). [online] PwC. Available at: https://www.pwc.co.uk/issues/esg/sustainability-reporting/corporate-sustainability-reporting-directive.html#:~:text=The%20Corporate%20Sustainability%20Reporting%20Directive%20(CSRD)%20is%20the%20new%20EU

are covered by these regulations, including listed businesses, banks, insurance providers, and other organizations that have been chosen by national authorities[41].

2.4.2 International Sustainability Standards Board (ISSB)

In response to increased market demand, the IFRS Foundation announced the creation of the International Sustainability Standards Board (ISSB) on November 3, 2021, during COP26 in Glasgow. In response to the demands of financial markets and investors, the ISSB is dedicated to creating international standards for sustainability reporting. There is an increasing need for high-quality, internationally comparable data as sustainability considerations play a bigger role in investment decisions. For businesses and investors alike, the dispersed voluntary standards landscape increases complexity and risk. With support from global organizations like the G20, G7, and IOSCO, the ISSB seeks to create standards that satisfy investors' information requirements, let businesses offer thorough disclosures on opportunities and risks related to sustainability, and make it easier for standards from different jurisdictions to work together. The goal of the ISSB is to offer affordable, market-driven standards, building on the work of previous projects like the Task Force for Climate-based Financial Disclosures (TCFD) and the Climate Disclosure Standards Board (CDSB). These standards help businesses be efficient and globally comparable while avoiding redundant reporting and satisfying jurisdictional requirements. The ultimate goal of ISSB standards is to support efficiency and transparency in international markets by offering crucial data for investor decision-making[42].

2.4.3 SASB Standards

The Sustainability Accounting Standards Board Standards, or SASB Standards, are industry-specific rules created to assist businesses in providing investors with financially

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[41] European Commission (2023). Corporate sustainability reporting. [online] European Commission. Available at: https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/company-reporting-and-auditing/company-reporting/corporate-sustainability-reporting_en

[42] IFRS (2022). International Sustainability Standards Board. [online] IFRS. Available at: https://www.ifrs.org/groups/international-sustainability-standards-board/

significant sustainability information. Within particular industries, the interaction of sustainability factors and financial performance is the subject of SASB Standards. The environmental, social, and governance (ESG) risks and opportunities that are specific to each industry's enterprises are taken into account by the industry-specific indicators provided by SASB Standards, in contrast to more general sustainability frameworks. Companies can use these criteria to determine which sustainability issues are most pertinent to their operations and financial performance, and to report on those issues. Numerous industries are covered by SASB Standards, including those in the financial, healthcare, technology and communications, and transportation sectors, among many others. SASB highlights the major sustainability challenges within each industry that are likely to have a significant effect on financial performance, such as data privacy for technology companies or carbon emissions for transportation companies. Subject matter experts, investors, and industry stakeholders participate in a rigorous process that results in the development of the SASB Standards. This guarantees that the standards are responsive to changing market demands and regulatory constraints, and they also represent current best practices. Companies can improve transparency and accountability by delivering uniform, comparable, and trustworthy sustainability information to investors by conforming to SASB Standards. This makes it easier for investors to include ESG considerations into their choices, which in turn leads to more wise capital allocation and, eventually, more long-term value generation for both investors and businesses[43].

2.4.4 GRI Standards

Organizations utilize the Global Reporting Initiative Standards, often known as the GRI Standards, as a set of worldwide sustainability reporting criteria to convey their governance, social, environmental, and economic performance. One of the primary frameworks used worldwide for sustainability reporting is represented by these standards, which were created by the Global Reporting Initiative, an international non-profit organization with its headquarters located in Amsterdam. Organizations can customize

[43] SASB CONCEPTUAL FRAMEWORK SUSTAINABILITY ACCOUNTING STANDARDS BOARD (SASB). (2017). Available at: https://www.sasb.org/wp-content/uploads/2019/05/SASB-Conceptual-Framework.pdf?source=post_page

the common and adaptable structure of the GRI Standards to suit the unique requirements of their industry, scale, and operational environment. The GRI Standards address many different subjects, such as corporate transparency, human rights, labor conditions, natural resource management, and climate change. Every standard offers comprehensive instructions on what and how organizations should report on many subjects, together with recommendations for data quality assurance and verification as well as key performance indicators. The GRI Standards stand out for their emphasis on a methodology grounded in the concepts of materiality and completeness. Organizations are urged to determine which issues are relevant to their business and its stakeholders and to disclose only those that are "material". At the same time, they should make sure that all pertinent sustainability aspects are reported thoroughly and transparently. Organizations can gain a lot from adopting the GRI Standards, such as better corporate reputation and access to new business prospects, more transparency and accountability, improved risk and opportunity management, and increased stakeholder engagement[44].

2.4.5 UN Sustainable Development Goals (SDGs)

The United Nations created the Sustainable Development Goals (SDGs), commonly referred to as the Global Goals, in 2015 with the intention of tackling environmental preservation, poverty elimination, and guaranteeing prosperity and peace for all by 2030. The 17 interconnected Sustainable Development Goals (SDGs) highlight the need to balance social, economic, and environmental sustainability while recognizing how different sectors of development are interconnected. The goal is to reduce poverty, starvation, AIDS, and gender discrimination, particularly against women and girls. To that end, they are committed to giving marginalized communities' development top priority. It will take a team effort to meet the Sustainable Development Goals, utilizing the financial, technological, creative, and skilled resources of all societal segments. To

[44] Global Reporting Initiative (2022). GRI Standards. [online] www.globalreporting.org. Available at: https://www.globalreporting.org/how-to-use-the-gri-standards/gri-standards-english-language/

achieve the lofty objectives established by the SDGs, cooperation between many settings is necessary[45] (Figure 6).

Figure 6: UN Sustainable Development Goals

1. **NO POVERTY:** despite the progress made since 1990, ending poverty is still seen as a problem worldwide. Even though many people are no longer in poverty thanks to the growth of countries like China and India. Inequalities still exist, particularly for women who have fewer job and education prospects. Moreover, 80% of people living in extreme poverty are in regions such as South Asia and sub-Saharan Africa that are experiencing gradual development. This is because there are still conflicts, climate change and food insecurity. The Sustainable Development Goals (SDGs) aim to enhance resources, support people affected by natural disasters and armed conflicts and minimize all forms of poverty by 2030[45].
2. **ZERO HUNGER:** over the past 20 years, undernourishment has decreased internationally by nearly half thanks to rapid economic expansion and increased agricultural output. Many once starving nations now provide for their citizens' nutritional needs; Latin America, the Caribbean, and Central and East Asia have made notable progress in this regard. Nevertheless, 821 million people continue

[45] United Nations Development Programme (2023). Sustainable Development Goals. [online] Sustainable Development Goals. Available at: https://www.undp.org/sustainable-development-goals

to experience chronic undernourishment, frequently as a result of drought and environmental deterioration. In Africa and South America, hunger rates are growing, and over 90 million children under five are severely underweight. By 2030, the Sustainable Development Goals (SDGs) seek to eradicate hunger and malnutrition and guarantee that everyone has year-round access to a healthy diet, particularly for children. This entails encouraging small-scale farming, helping sustainable agriculture, and guaranteeing equitable access to markets, technology, and land. To invest in infrastructure and technology for increased agricultural productivity, international cooperation is essential[45].

3. **GOOD HEALTH AND WELL-BEING:** the main causes of death and disease have seen considerable success, including decreased newborn and maternal mortality, longer life expectancies, and victories against HIV and malaria. Nonetheless, the 2030 Agenda acknowledges the intricate connection between sustainable development and health, accounting for factors like urbanization, economic disparities, infectious diseases, and developing concerns like antibiotic resistance and non-communicable diseases. In order to reduce poverty and inequality and achieve Sustainable Development Goal 3, universal health care is essential. Global health goals, however, are not being met due to unequal progress within and between nations, which has resulted in a 31-year difference in life expectancy. Though some countries have made impressive gains, a lot of people are still falling behind. In order to guarantee health equity for all, addressing inequities calls for multi-sectoral, rights-based, and gender-sensitive strategies[45].
4. **QUALITY EDUCATION:** considerable progress has been made toward the objective of universal primary education since 2000. In developing nations, 91% of children were enrolled in school by 2015, and the proportion of children who are not in school has generally declined. Particularly for women, there has been a notable surge in literacy rates. However, issues still exist in regions like West Asia and North Africa where natural catastrophes, poverty, and armed conflict have hindered schooling. Even while sub-Saharan Africa has achieved considerable strides, disparities still exist, with children from low-income households and those residing in rural areas facing more obstacles to an education. The aim of achieving inclusive and high-quality education for all by 2030 is to eliminate wealth and

gender disparities, guarantee free completion of primary and secondary education, equitable access to vocational training, and universal access to high-quality higher education. This goal acknowledges that education is a critical component of sustainable development5[45].

5. **GENDER EQUALITY:** it is important to end all forms of discrimination against women and girls, not only as a basic human right, but also to ensure a sustainable future. It is emphasized how important it is for women and girls to have more authority in order to advance economic development and growth. Even while there has been a lot of progress in the last 20 years more women are employed and more girls are enrolled in school serious inequality still exists, particularly in some areas. Sexual abuse, exploitation, unfair distribution of unpaid domestic labor, and prejudice in public office are still challenges. Furthermore, emphasis is placed on the disproportionate effects that catastrophes, migration, conflicts, and climate change have on women and children. Ensuring women have equal rights to property and land, sexual and reproductive health, and technology and the internet is crucial for achieving greater gender equality. Lastly, it is stressed how crucial it is to support more women in leadership positions in order to advance more gender equality[45].
6. **CLEAN WATER AND SANITATION:** over 40% of the world's population is impacted by growing water shortages, which is a result of warming temperatures. With more and more nations facing water scarcity, drought, and desertification, choosing drinking water suppliers is a major problem. By 2050, one in four people are predicted to face sporadic water shortages. To ensure that everyone has access to moderately priced, clean drinking water by 2030, we must invest in infrastructure, promote sanitation and hygiene, and protect and restore ecosystems associated to water. 2.3 billion people lacked basic sanitation in 2015, while 4.5 billion people lacked access to clean toilets[45].
7. **AFFORDABLE AND CLEAN ENERGY:** the proportion of people who have access to electricity rose from 78% to 90% between 2000 and 2018, while the number of individuals who do not have power dropped to 789 million. But although an economy reliant on fossil fuels is producing drastic climate change, population growth will also boost the demand for inexpensive energy. It is crucial

to make investments in renewable energy sources including solar, wind, and thermal energy, increase energy efficiency, and guarantee electricity for all if we are to meet Sustainable Development Goal 7 by 2030. Environmental protection and economic progress will result from modernizing infrastructure and boosting technologies to supply clean, efficient energy to all nations[45].

8. **DECENT WORK AND ECONOMIC GROWTH:** despite the 2008 global economic crisis, the proportion of workers living in extreme poverty has declined dramatically over the previous 25 years. The middle class today makes up over 34% of the workforce in emerging nations, nearly doubling the amount between 1991 and 2015. But when the world economy revives, growth is slowing, inequality is rising, and joblessness is growing. The International Labour Organization estimates that in 2015, there were about 204 million jobless persons. The Sustainable Development Goals (SDGs) seek to advance economic development that is steady, increased productivity, technological innovation, entrepreneurship, and job creation. Furthermore, to guarantee full, productive, and respectable work for everyone by 2030, strong action must be taken to end forced labor, slavery, and human trafficking[45].
9. **INDUSTRY, INNOVATION AND INFRASTRUCTURE:** innovation and infrastructure spending are crucial for the expansion and prosperity of the economy. Since the majority of people on the planet live in cities, the significance of renewable energy sources, information and communication technology, and public transportation is growing. In order to solve environmental and economic issues like energy efficiency and employment development, technological advancement is essential. The keys to sustainable development are encouraging sustainable industries and making investments in innovation and scientific research. Furthermore, ensuring equal access to knowledge and information, as well as fostering entrepreneurship and innovation, depend on closing the digital gap[45].
10. **REDUCED INEQUALITIES:** with the richest 10% controlling up to 40% of global revenue and the lowest 10% earning only between 2 and 7%, there is a growing disparity in income. In addition, inequality has risen by 11% in developing nations due to population growth. The Middle East has seen the

greatest increase in inequality whereas Europe has had the lowest increase in recent years. Strong policies that empower those with lower incomes and encourage economic participation for all are necessary to address these disparities. Comprehensive remedies are required, including better financial sector regulation and oversight, more foreign direct investment and development assistance going to the most underprivileged regions, and safe movement and mobility for individuals[45].

11. **SUSTAINABLE CITIES AND COMMUNITIES:** by 2050, two thirds of the world's population will reside in metropolitan areas, with over half now residing there. The design and administration of urban areas must undergo a dramatic change in order to support sustainable development. Megacities and slums have proliferated due to the fast urbanization brought on by migration and population expansion, particularly in emerging nations. Creating resilient economies and communities, as well as securing secure and affordable housing, are all necessary to make cities sustainable. Investments in public transportation, parks, and more inclusive and participatory urban design are necessary for this[45].
12. **RESPONSIBLE CONSUMPTION AND PRODUCTION:** reducing the ecological footprint through altered resource and excellent production and consumption is crucial for achieving both sustainable development and economic success. Worldwide, agriculture is the biggest user of water, accounting for around 70% of freshwater used for human consumption through irrigation. Two important objectives are properly managing natural resources and getting rid of harmful waste. It is essential to support emerging nations in implementing more sustainable consumption habits by 2030, as well as to promote recycling and waste reduction. In order to increase the effectiveness of supply chains and manufacturing, reduce the amount of food wasted per person globally at the retailer and consumer levels, and support food security and a more resource-efficient economy[45].
13. **CLIMATE ACTION:** all nations are impacted by climate change, which has resulted in a 50% increase in greenhouse gas emissions since 1990. Global warming is producing lasting climatic change with possible irreversible repercussions. With millions of deaths and injuries each year, climatic disasters

cause massive annual economic losses. By 2020, the aim is to raise USD 100 billion annually to support developing nations in their efforts to adapt to climate change. Assisting marginalized areas would help achieve Goal 13 as well as other Sustainable Development Goals. It is still feasible to keep the rise in the world average temperature to 1.5°C or 2°C, but it will take cooperation, funding, and cutting-edge technology[45].

14. **LIFE BELOW WATER:** because the seas affect temperature, chemistry, currents, and biodiversity, they are essential to life as we know it on Earth. Using them properly is essential to halting climate change. However, 30% of global fish supplies are overfished, and more than 3 billion people depend on their biodiversity. Ocean acidification rises by 26% as a result of the oceans absorbing 30% of carbon dioxide from humans. There is a significant amount of plastic debris in the ocean, with 13,000 pieces per square kilometer on average. Acidification, pollution control, and marine ecosystem preservation are the three main objectives of the Sustainable Development Goals. These issues can be lessened by enhancing ocean resource protection and sustainable use through international law[45].
15. **LIFE ON LAND:** the ocean and the land are necessary for human existence to exist. Plants provide 80% of the food consumed by humans, and agriculture is a major source of revenue. Forests comprise thirty percent of the world and are vital for maintaining clean air and water, a diverse range of species, and averting climate change. Still, each year we lose 13 million hectares of forest, and the 3.6 billion hectares of drylands that are turning into deserts primarily affect poor communities. Approximately 7,000 distinct species of plants and animals are traded illegally, endangering biodiversity despite the 15% of land that is protected. Immediate action is needed to reduce the loss of habitats and biodiversity in order to counteract climate change, guarantee the world's food and water supplies, and preserve peace and security[45].
16. **PEACE, JUSTICE AND STRONG INSTITUTIONS:** effective governance, human rights, peace, and stability are necessary for sustainable development. But the world is becoming more and more divided, with some areas experiencing prosperity and others being embroiled in war. While sexual assault and other

crimes are common during wars, armed violence has a detrimental effect on social and economic growth. The SDGs seek to lessen violence, advance human rights and the rule of law, and include poor nations in international organizations[45].

17. **PARTNERSHIPS FOR THE GOALS:** for the Sustainable Development Goals (SDGs) to be achieved, international collaboration and partnerships are needed. Humanitarian emergencies demand more funding, even with a consistent but below-target official development assistance of USD 147 billion in 2017. Aid is needed by many countries to promote commerce and growth. Since the globe is becoming more interconnected, expanding access to knowledge and technology is essential to promoting creativity and idea sharing. Sustainable growth requires coordinating policies to control debt and encourage investment in developing nations. In order to assist national strategies to attain the goals, the SDGs seek to deepen cooperation between the North and the South. A just and universal trading system that benefits all depends on promoting global commerce and raising exports from developing nations[45].

2.4.6 EU Green Deal

The European Green Deal is a key strategy of the European Union (EU) to achieve climate neutrality by 2050, in line with the obligations set by the Paris Agreement. Enacted in December 2019, promoting a modern and competitive economy, it aims to transform the EU into a fair, prosperous and ecological society. Specifically, it is based on a holistic, cross-sectoral approach involving policy areas such as climate, environment, energy, transport, industry, agriculture and sustainable finance.

One of the main components of the Green Deal is the “Ready for 55%” package, which aims to match EU legislation with climate targets. It also includes suggestions for a competitive and equitable transition, support for innovation, and EU leadership in the fight against climate change. Legally enforceable responsibilities to cut EU GHG emissions by at least 55% by 2030 relative to 1990 levels are imposed by EU climate legislation, together with measures to track progress and guarantee a smooth and fair transition. By 2050, the EU hopes to become more robust to climate change thanks to initiatives to strengthen data gathering, save ecosystems, and incorporate adaptation into macroeconomic plans. The Biodiversity Strategy 2030 seeks to increase funds for ecosystem restoration, decrease the use of pesticides, and expand protected areas in order to restore biodiversity in Europe. The "Producer to Consumer" policy encourages wholesome food, environmentally friendly production, and thoughtful consumption with the goal of making the entire EU food system sustainable. With policies to boost industrial competitiveness and innovation, the EU looks on the European industry to spearhead the green transition. The goal of the Circular Economy Action Plan is to encourage circular consumption and production methods while utilizing less resources. The strategy for sustainable chemicals, the management of sustainable forests, and the prevention of deforestation worldwide are further projects[46].

The EU Council and the European Council are crucial in directing and approving Green Deal policies, which aim to enact both legislative and non-legislative laws to further the EU's climatic and environmental objectives.

2.4.7 Climate-related financial disclosure regulations

The US Securities and Exchange Commission (SEC) is putting more of an emphasis on ESG (environmental, social, and governance) investing and climate-related disclosures. Given its greater commitment to solving social and environmental concerns, this is a significant signal for listed firms and the financial markets.

Climate-related information is financial information on the effects of climate change on a company's operations that investors use to assess the climate-related risks and opportunities of a company. These reports provide information on the use of natural resources, greenhouse gas emissions and climate change mitigation and adaptation techniques. ESG investing is centered on investments and ETF that take into account a company's governance, social, and environmental aspects in addition to its financial returns. A growing number of investors are realizing that these variables can affect the performance of their investments over the long run. As a result, there is an increasing need for listed firms to provide precise and comprehensible information on these areas.

[46] www.consilium.europa.eu. (2023). Green Deal europeo. [online] Available at: https://www.consilium.europa.eu/it/policies/green-deal/

In an effort to stop wrongdoing involving ESG considerations, the SEC said that task groups within the Enforcement Division will be implementing more stringent guidelines on Climate-Related Disclosures and ESG Investing. This may imply that businesses will have to give more precise and in-depth information about how they handle sustainability and climate-related challenges. This is a big step in the right direction for increased accountability and transparency in the financial sector, which may help capital be allocated to more sustainable and ethical businesses[47].

[47] www.sec.gov. (2023). SEC.gov | Climate-Related Disclosures/ESG Investing. [online] Available at: https://www.sec.gov/securities-topics/climate-esg

CAP. 3 Case study

3.1 Industry experts

The majority of the market share is held by a small number of very large businesses in the highly concentrated global tobacco market. The key to obtaining a sizable market share is also due to an increase in mergers and acquisitions, new product launches, and more industry regulation globally. The primary objective of the manufacturer is to maximise costs and increase the standard of its products in order to have a competitive advantage over other market players. The ability to expand their product variety globally is facilitated by manufacturers' extensive distribution network and manufacturing competence.

Rank	Company Name	HQ	Industry Group	Market Cap	ESG Score
1	British American Tobacco plc	GB	Food & Tobacco	LARGE	90.50
1	British American Tobacco plc	GB	Food & Tobacco	LARGE	90.50
2	Nestle (Malaysia) Bhd	MY	Food & Tobacco	MID	89.16
3	Ulker Biskuvi Sanayi AS	TR	Food & Tobacco	SMALL	88.83
4	Yihai Kerry Arawana Holdings Co Ltd	CN	Food & Tobacco	LARGE	86.97
5	Philip Morris International Inc	US	Food & Tobacco	LARGE	86.78
6	Uni-President Enterprises Corp	TW	Food & Tobacco	LARGE	85.43
7	Hershey Co	US	Food & Tobacco	LARGE	85.34
8	Danone SA	FR	Food & Tobacco	LARGE	85.29
9	Itc Ltd	IN	Food & Tobacco	LARGE	84.33
10	TCI Co Ltd	TW	Food & Tobacco	SMALL	84.31
11	Nestle India Ltd	IN	Food & Tobacco	LARGE	84.04
12	Kerry Group PLC	IE	Food & Tobacco	LARGE	83.46
13	Ajinomoto Co Inc	JP	Food & Tobacco	LARGE	82.36
14	Imperial Brands PLC	GB	Food & Tobacco	LARGE	81.04
15	British American Tobacco (Malaysia) Bhd	MY	Food & Tobacco	SMALL	80.99
16	Grupo Bimbo SAB de CV	MX	Food & Tobacco	LARGE	80.36
17	Mondelez International Inc	US	Food & Tobacco	LARGE	79.96
18	China Mengniu Dairy Co Ltd	HK	Food & Tobacco	MID	79.25
19	BRF SA	BR	Food & Tobacco	MID	79.20
20	Japan Tobacco Inc	JP	Food & Tobacco	LARGE	77.51
21	WH Group Ltd	HK	Food & Tobacco	MID	77.22
22	Herbalife Ltd	KY	Food & Tobacco	SMALL	77.09
23	Tiger Brands Ltd	ZA	Food & Tobacco	SMALL	76.89
24	First Pacific Co Ltd	HK	Food & Tobacco	SMALL	76.40
25	Fraser and Neave Ltd	SG	Food & Tobacco	SMALL	76.39
26	Archer-Daniels-Midland Co	US	Food & Tobacco	LARGE	75.58
27	Kerevitas Gida Sanayi ve Ticaret AS	TR	Food & Tobacco	SMALL	75.57
28	Barry Callebaut AG	CH	Food & Tobacco	MID	75.34
29	Fresh Del Monte Produce Inc	US	Food & Tobacco	SMALL	74.79
30	Italmobiliare SpA	IT	Food & Tobacco	SMALL	74.73
31	Tata Consumer Products Ltd	IN	Food & Tobacco	LARGE	74.52
32	Mowi ASA	NO	Food & Tobacco	LARGE	73.63
33	Hanjaya Mandala Sampoerna Tbk PT	ID	Food & Tobacco	MID	73.57
34	Standard Foods Corp	TW	Food & Tobacco	SMALL	73.46
35	Kernel Holding SA	UA	Food & Tobacco	SMALL	73.30
36	Kraft Heinz Co	US	Food & Tobacco	LARGE	72.97
37	Sime Darby Plantation Bhd	MY	Food & Tobacco	MID	72.79
38	Campbell Soup Co	US	Food & Tobacco	LARGE	72.46
39	Wilmar International Ltd	SG	Food & Tobacco	LARGE	72.00

Figure 7: Rank ESG SCORE of First 39^{th} company (Refinitiv)

Of these 39 companies shown in the figure above (Figure 7), currently, some of the main market players are[48]:

1. Philip Morris International
2. British American Tobacco
3. Altria Group
4. ITC Limited
5. Japan Tobacco Inc.

3.1.1 Philip Morris International

Philip Morris International (PMI), founded in 1847, is one of the leading tobacco companies globally. Famous for brands such as Marlboro, L&M and Chesterfield, PMI has recently focused on innovation, seeking to transform the industry towards less health-damaging options such as heated tobacco devices like IQOS. With a commitment to sustainability and social responsibility, PMI remains a major player in the global tobacco industry with a capitalization of 145.476B in USD[49].

Figure 8: PM ESG (Refinitiv)

[48] Investire.biz (2023). Tabacco: ecco le 10 aziende più capitalizzate. [online] Investire.biz. Available at: https://investire.biz/news/azioni/tabacco-classifica-aziende-piu-capitalizzate

[49] Yahoo Finance (2024). Philip Morris International Inc. (PM) [online] Available at: https://it.finance.yahoo.com/quote/pm/

3.1.2 British American Tobacco

British American Tobacco plc (BATS.L), founded in 1902, is one of the leading global tobacco companies. With iconic brands such as Lucky Strike and Dunhill, BAT is committed to the development of less health-damaging alternatives, such as heated tobacco products with a capitalization of 51,884B in USD[50].

Figure 9: BATS.L ESG (Refinitiv)

3.1.3 Altria Group

Altria Group, Inc. (MO), based in Richmond, Virginia, is a well-known US tobacco company. Founded in 1985, it is famous for brands such as Marlboro. In addition to tobacco, Altria is present in the wine and beer sectors. The company is also exploring alternative developments to tobacco with strategic diversification and has a capitalisation of 72.055B in USD[51].

[50] Yahoo Finance (2024). British American Tobacco p.l.c. (BATS.L) [online] Available at: https://it.finance.yahoo.com/quote/BATS.L?p=BATS.L&.tsrc=fin-srch

[51] Yahoo Finance (2024). Altria Group, Inc. (MO) [online] Available at: https://it.finance.yahoo.com/quote/MO?p=MO

Figure 10: MO ESG (Refinitiv)

3.1.4 ITC Limited

ITC Limited (ITC.NS) is a major Indian company founded in 1910 with headquarters in Kolkata. Originally focused on tobacco, the company has diversified into sectors such as hospitality, agribusiness and IT. With well-known brands in tobacco such as Gold Flake and Classic, ITC has also adopted a sustainable and responsible strategy in its business. It has a strong presence in the Indian market and has a capitalization of 5.822T in INR[52].

Figure 11: ITC.NS ESG (Refinitiv)

[52] Yahoo Finance (2024). ITC Limited (ITC.NS) [online] Available at: https://finance.yahoo.com/quote/ITC.NS/

3.1.5 Japan Tobacco Inc.

Japan Tobacco Inc. (JAPAF) is a renowned Japanese tobacco company, founded in 1898. With a global presence, Japan Tobacco Inc. specialises in the production and marketing of cigarettes, cigars and smokeless products. The company is committed to innovation, offering a wide range of brands adapted to market needs and oriented towards sustainable business practices. With a long history and established reputation, Japan Tobacco Inc. is a significant player in the international tobacco market with a capitalisation of 46,571B in USD[53].

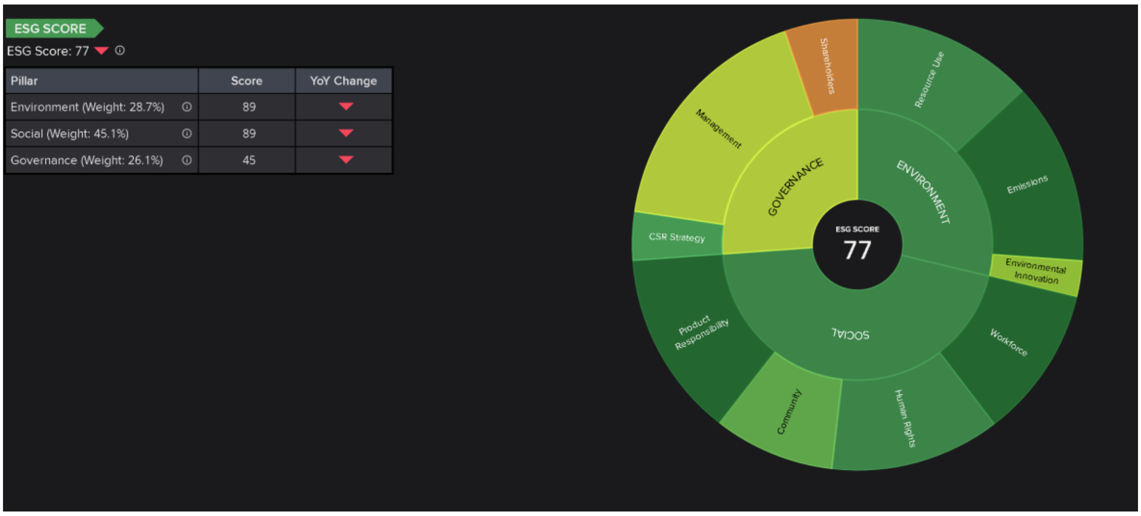

Figure 12: JAPAF.PK ESG (Refinitiv)

3.2 Research Methodology

In this section, the methodological strategy used to carry out the interviews will be examined in detail. Our analysis will encompass the methods used for participant selection, the techniques used to gather data, and the range of questions posed during the interviews.

With a firm foundation for the analysis and interpretation of the findings, this will enable us to comprehend the background and the fundamental study methodology.

[53] Yahoo Finance (2024). Japan Tobacco Inc. (JAPAF) [online] Available at: https://it.finance.yahoo.com/quote/JAPAF?p=JAPAF&.tsrc=fin-srch

3.2.1 Qualitative approach

This study uses a qualitative approach to explore perspectives on how ESG and CSR have influenced the performance of companies in the tobacco sector, and what competitive advantage the adoption of these practices has brought for companies.

After delving into the topic through specialised papers and websites, as seen in the previous chapters, participants were selected for interviews. Their selection was guided by specific criteria described in the following sections.

Interviews were conducted by sending questions and answering them via transcription, where participants were encouraged to share their opinions. The flexibility of the questions will allow for in-depth exploration of the themes that emerged during the interviews, offering a more comprehensive understanding of the phenomenon under investigation.

Subsequently, data analysis followed an inductive approach, allowing themes and patterns to emerge from participants' responses, which were analyzed to identify key concepts and relationships between them. In addition, special attention was paid to discrepancies and similarities between participants' experiences.

3.2.2 Selection of participants

After making a selection to identify industry experts, the choice to interview Philip Morris International and British American Tobacco was guided by several factors (Figure 13).

Philip Morris International and British American Tobacco are two of the leading multinational tobacco companies with a significant impact on the global market. Interviewing these companies provides an opportunity to take a closer look at their strategies, policies and practices related to sustainability and social responsibility. Both companies have faced unique challenges in attempting to adopt more sustainable and responsible practices, making them relevant subjects of study for a thesis on this topic.

Furthermore, interviewing two competing companies in the tobacco industry that are similar in terms of their target markets and have a similar corporate culture. These factors make it possible to compare their ESG and CSR approaches and performance. This comparison can provide a more comprehensive perspective on the dynamics of the industry and the strategies adopted by companies to address sustainability and CSR challenges.

Figure 13: Companies participating in the interview

3.2.3 Data collection tools

The data was collected by examining numerous scientific papers and sites, providing a solid theoretical and contextual basis for the research work. In addition, this information was not only used for the research, but also to extract more detailed information from the in-depth interviews with industry hands.

This combination of approaches ensured a comprehensive and diverse collection of data, allowing for an in-depth and contextualized understanding of the phenomenon under study.

3.3.4 Key questions and themes

In this section you will find questions from interviews with Philip Morris International and British American Tobacco conducted on the topic proposed in the thesis. For further details on the answers and the complete context of the interviews, I invite you to consult the appendix at the end of the thesis (Appendix 1 is Philip Morris Internationaland Appendix 2 is British American Tobacco).

General questions:

1. *How does your company measure and monitor progress towards ESG and CSR goals? What performance indicators do you use to assess the impact of your initiatives and operations on the planet, employees and customers?*

2. *What were the main obstacles or challenges you encountered in pursuing ESG and CSR objectives within the tobacco industry and how did you address them?*

Environment:

3. *How do you think the tobacco sector can impact significantly to global sustainability goals, such as those set by the UN 2030 Agenda and the Paris Climate Agreements? How do you intend to cooperate with other sectors and stakeholders in order to pursue shared goals?*
4. *How is your group working to address environmental issues in the tobacco sector? What are the main environmental objectives you have set and how do you intend to achieve them?*
5. *How has your focus on environmental issues influenced your investment and product development decisions and how have these decisions contributed to creating value for the company and stakeholders?*

Society:

6. *What measures are you taking to diversify your product portfolio beyond traditional tobacco? How is your company coping with the transition to less harmful products, such as e-cigarettes or tobacco heating products?*
7. *How does your company manage social concerns related to tobacco use, including public health risks and addiction? What initiatives have you implemented to mitigate these negative social impacts? And how do you address challenges related to the marketing of products that may have harmful health consequences for consumers?*
8. *How do you respond to criticism and pressure from health organizations, governments and consumer advocacy groups regarding your social and environmental impacts? What concrete actions do you take to improve your reputation and ESG performance?*

Performance and governance:

9. *How have efforts to improve ESG and CSR practices affected the reputation and perception of your brand by consumers and investors?*

10. *What have been the financial effects of your ESG and CSR initiatives on the company's economic performance, including factors such as cost of capital, profitability and growth?*
11. *How has the adoption of socially responsible policies improved employee satisfaction and engagement, and how has this affected employee productivity and retention?*
12. *How has your ESG strategy influenced your relations with public authorities and what impact has it had on your ability to operate in a sustainable and responsible manner?*
13. *How has the integration of ESG practices into your business strategy helped to improve operational efficiency and risk management within the company? And how do you assess the effectiveness of your ESG and CSR initiatives and what metrics or performance indicators do you use to monitor progress and demonstrate value to investors and other stakeholders?*

Concluding Evaluations:

14. *How does your ESG strategy align with your long-term corporate vision and what are your plans to continue to improve and innovate in this area?*
15. *What have you learned from your experience in integrating ESG and CSR considerations into your operations and what advice would you offer to other companies seeking to do the same in the tobacco industry or similar sectors?*

3.3 Interview mode

The interviews were prepared according to the following procedure:

- preparation of an appropriate number of questions;
- selection and revision of the questions by the thesis supervisor and his collaborators
- sending of the selected set to the experts;
- full transcription of the answers provided (see Appendix 1 and Appendix 2);
- reflections and observations following the answers received.

The questions are divided into five groups: General Questions; Environment; Society; Performance and Governance; Concluding Assessments. The groupings of questions followed the criterion from the general to the particular, starting with general questions to better enter the context and then continuing with the three components of ESG (Environment, Social and Governance), with a greater focus on how Governance and Performance are linked; and then concluding with questions that leave a glimmer of the future and try to understand through the interviewees where their companies want to focus in the future (Figure 14).

First and last name	Company	Role	Interview mode
Austin Kennedy	PMI	Sustainability Reporting & ESG Performance Manager	Online compilation
N/A	BAT	Company	Online compilation

(Figure 14, "Summary of interviewees")

In the next section, a general overview of what emerged from the interviews will be given. Instead, a reworking of the experts' answers will be reported in the chapter to provide as detailed an overview as possible of the topics discussed and, above all, to emphasize the most relevant aspects according to the experts themselves. Furthermore, it should be noted that the full text of the interviews has been included in the appendices at the end of the document.

3.4 General analysis of interview data and hypotheses

From the interviews with British American Tobacco and Philip Morris International, several focal points emerge on how these two major tobacco companies are handling ESG and CSR challenges. Both companies strongly emphasise the adoption of sustainable and responsible practices while addressing the particular challenges of their industry, which we can divide into macro topics:

1. **Measurement and Monitoring:** Both companies use a variety of key performance indicators (KPIs) to monitor progress towards sustainability goals,

such as the reduction of greenhouse gas emissions, water management and diversification of the product portfolio towards less harmful alternatives such as e-cigarettes and tobacco heating products.

2. **Environmental Goals:** Both are committed to reducing the environmental impact of their operations. BAT aims for carbon neutrality for direct operations by 2030, while PMI develops initiatives to reduce resource consumption and manage waste effectively.
3. **Addressing Social Concerns:** Both companies address social concerns related to tobacco use, including public health risks and addiction, by promoting potentially reduced-risk products and adopting responsible marketing practices to adequately inform consumers about the associated risks.
4. **Response to Criticism:** Both seek open dialogue with stakeholders to enhance their reputation and ESG performance by increasing investment in reduced-risk products and improving transparency and reporting on their sustainable practices.
5. **Economic and Operational Impacts:** ESG and CSR initiatives have positively impacted the economic performance of both companies, contributing to lower cost of capital and improving growth and profitability through more sustainable operating practices.

Therefore, the interviews reveal a significant commitment by both companies to integrate sustainable and responsible practices into their operations, despite the unique challenges presented by the tobacco industry. These efforts aim not only to meet regulatory pressures and consumer expectations, but also to consolidate the position of BAT and PMI as leaders in innovation and sustainability in their industry. However, to achieve this goal, the two companies adopt slightly different approaches, such as slightly different measurement and monitoring strategies. BAT uses several KPIs to monitor progress towards ESG and CSR goals, focusing particularly on reducing greenhouse gas emissions, managing water resources effectively and reducing waste. In addition, BAT focuses on employee satisfaction and transparency towards consumers, which it considers essential for the success of its sustainability initiatives. On the other hand, PMI has developed its unique tools, the Business Transformation Metrics and Sustainability Index, to track progress in the company's transformation towards the elimination of cigarette production. These tools not only measure the company's progress towards its environmental and social goals, but also establish a direct link between the long-term remuneration of executives and their sustainability performance, underlining PMI’s commitment to linking sustainability results to economic benefits for its leaders.

Then they have slightly different Environmental Goals BAT is committed to achieving carbon neutrality in its direct operations by 2030, to reduce emissions throughout the value chain. The company also places special emphasis on waste reduction, with a specific focus on plastics. However, PMI has defined a strategic plan that will extend until 2025, including targets to minimise the environmental and social impact of its operations. This plan is part of an attempt to fully integrate sustainability into its business strategy, demonstrating its commitment to incorporating sustainable practices into all areas of its business.

Furthermore, how companies respond to criticism and pressure is also different, while BAT actively strives to improve transparency and increase investment in reduced-risk products, adopting sustainable practices to minimise its environmental impact. Instead, PMI constantly interacts with stakeholders to understand their expectations and adjust strategies accordingly, emphasising the value of transparency and active stakeholder involvement in its operations.

Also, on how ESG and CSR initiatives have different financial impacts on the two companies. BAT highlights how these practices have lowered the cost of capital and improved profitability by attracting investments that value sustainability. Conversely, PMI notes that these initiatives not only lowered the cost of capital, but also stimulated growth and increased profitability, with a considerable portion of revenues coming from smokeless products, showing the direct impact of sustainable practices on the company’s economic performance.

Both companies are focusing on developing innovative, lower-risk products to diversify their portfolios and reduce their health impact. While BAT is actively investing in e-cigarettes, tobacco heating products and other modern oral products, PMI has a clear strategy for 2030 to transform its business model by significantly reducing dependence on traditional combustion products and moving towards a smoke-free offering.

In conclusion, both BAT and PMI demonstrate a strong commitment to sustainability and social responsibility, although they follow slightly different strategies. BAT focuses mainly on carbon neutrality and the reduction of environmental impacts, while PMI is committed to a business transformation, aiming at the elimination of traditional cigarette production. As we will see in the next chapter, both companies recognize the need to meet stakeholder expectations and to adapt their sustainability policies to market dynamics and regulatory and social pressures.

CAP. 4 Results and Discussion

In this chapter, with the help of interviews with experts in the tobacco sector, the different topics will be analyzed in order to answer the thesis question: "*How have ESG and CSR influenced the performance of companies in the tobacco sector? And what competitive advantage has the adoption of these practices brought?*".

4.1 Comparison of company performance metrics

Before analyzing the expert interviews, it is important to look at some financial and ESG metrics of the two companies (Philip Morris International and British American Tobacco).

4.1.1 British American Tobacco 2012-2022

As we can see from the table below, we can observe a considerable difference in British American Tobacco's financial results between 2012 and 2022 [54](Figure 15).

	2022	2012
Metric	**British American Tobacco (BAT)**	**British American Tobacco (BAT)**
Financial Performance		
Net Revenues	£ 27,655	£ 15,190
COGS	£ 4,781	£ 3,445
Operating Income	£ 10,523	£ 5,372
EBIT	£ 9,324	£ 5,592
Net earnings	£ 6,846	£ 4,076

(in millions)

Figure 15: Financial Performance between 2012 and 2022 of British American *Tobacco*

[54]Refinitiv, WRDS, SEC.gov (2024)| EDGAR - Search and Access. [online] Available at: https://www.sec.gov/edgar/search-and-access ; Companies House (2023). Companies House. [online] GOV.UK. Available at: https://www.gov.uk/government/organisations/companies-house

Between 2012 and 2022, British American Tobacco's Net Revenue almost doubled from £15,190 million to £27,655 million. This figure indicates substantial growth, which could be attributed to various factors such as market expansion, product diversification, acquisitions and pricing strategies.

Cost of goods sold (COGS) also increased from £3,445 million to £4,781 million, but the increase is proportionally lower than revenue growth, indicating an improvement in gross margin. This could suggest operational efficiencies, better sourcing strategies or a shift to higher margin products.

Operating income almost doubled from £5,372 million to £10,523 million, which is a sign of operational leverage and efficiency.

EBIT increased significantly from £5,592 million to £9,324 million. This metric is crucial because it shows profits before the influence of financial structure and tax regimes, highlighting the company's operational success. The analysis could further investigate how operational decisions, independent of financial decisions, influenced profitability.

Net earnings increased from £4,076 million to £6,846 million, demonstrating not only revenue growth but also the ability to translate this into underlying profitability. Factors such as interest, taxes and exceptional items that may have influenced net profits should be examined.

4.1.2 Philip Morris International 2012-2022

As we can see from the table below, we can observe a considerable difference in Philip Morris International's financial results between 2012 and 2022[54] (Figure 16).

	2022	2012
Metric	**Philip Morris International (PMI)**	**Philip Morris International (PMI)**
Financial Performance		
Net Revenues	$ 31,762	$ 77,393
COGS	$ 11,402	$ 11,103
Operating Income	$ 12,246	$ 13,863
EBIT	$ 11,634	$ 13,004
Net earnings	$ 9,527	$ 9,154

(in millions)

Figure 16: Financial Performance between 2012 and 2022 of Philip Morris International

The figures show a sharp decline in net revenues from $77,393 million in 2012 to $31,762 million in 2022. This reduction could result from various factors, such as changes in consumer behaviour, increased regulation, market saturation or competition from alternatives such as e-cigarettes. For the thesis, it would be worth analyzing market trends, regulatory impacts and business strategies that may have influenced revenues.

Despite the decline in revenues, the Cost of goods sold (COGS) remained relatively stable, increasing only slightly from $11,103 million to $11,402 million. This could suggest that the company managed to maintain or even slightly improve its gross margin, which could be due to cost optimization strategies or price adjustments.

Operating profit and EBIT both decreased, but the decline is not as marked as that of revenue. This indicates that the PMI was able to effectively control operating and capital costs. It would be useful to examine internal efficiencies, restructuring efforts or cost reduction programmes that the company may have implemented.

Net earnings increased slightly from $9,154 million to $9,527 million. This figure is interesting considering the substantial decline in revenues and suggests that PMI may have benefited from financial or tax strategies, reduced interest expenses or gains from asset sales or other extraordinary items.

4.1.3 Comparison of financial performance in 2022

Considering the information in the table below for British American Tobacco (BAT) and Philip Morris International (PMI) for the year 2022. We may now compare the two businesses, although in this instance, all of the statistics have been reported in dollars using the conversion rate of $1,21 to £1,00 as of December 31, 2012[54] (Figure 17).

	2022		2022	
Metric	**Philip Morris International (PMI)**		**British American Tobacco (BAT)**	
Financial Performance				
Net Revenues	$	31,762	$	22,855
COGS	$	11,402	$	3,951
Operating Income	$	12,246	$	8,697
EBIT	$	11,634	$	7,706
Net earnings	$	9,527	$	5,658

(in millions)

Figure 17: Financial Performance between British American Tobacco and Philip Morris International in 2022

Philip Morris International shows higher net revenues ($31,762 million) than Philip Morris International ($22,855 million), indicating that British American Tobacco may have a larger market share, better pricing power or a wider product range.

Philip Morris International's operating costs are significantly higher ($11,402 million) than British American Tobacco's ($3,951 million). This could suggest several things: PMI might have higher production costs, less efficient operations or operate in markets where the cost of goods is naturally higher. In contrast, British American Tobacco seems to be more efficient in managing production or procurement costs than its revenue.

Philip Morris International's operating income ($12,246 million) is also higher than British American Tobacco's ($8,697 million). Although Philip Morris International has a higher COGS, its operating income is higher, which could indicate effective management and operational efficiency beyond just the cost of producing goods.

Philip Morris International's EBIT ($11,634 million) is significantly higher than that of British American Tobacco ($7,706 million). This suggests that Philip Morris International is generating higher earnings from its operations before interest and taxes are removed, perhaps indicating a stronger core business performance.

Philip Morris International has a higher net profit ($9,527 million) than British American Tobacco ($5,658 million). The larger turnover at Philip Morris International may be the cause of this, but it is also vital to take other aspects like tax efficiency, interest costs, and the existence of exceptional items into account.

4.1.4 Comparison of ESG metrics in recent years

In the following analysis, we evaluate British American Tobacco (BAT) and Philip Morris International (PMI) with a focus on key ESG (Environmental, Social, and Governance) metrics as presented in the accompanying table. This comparison aims to provide a detailed understanding of how each company aligns with ESG criteria, which is increasingly vital for informed investment decisions [55] (Figure 18).

[55] MSCI (2024). MSCI – Powering better investment decisions - MSCI. [online] Msci.com. Available at: https://www.msci.com/

Metric	Philip Morris International (PMI)	British American Tobacco (BAT)
ESG Performance		
ESG Rating 2023	BBB	A
ESG Rating 2022	BBB	BBB
ESG Score 2023	3,9	4,5
Environment	*4,7*	*4,3*
Social	*1,3*	*1,9*
Governance	*6,8*	*7,8*
ESG Score 2018	3,4	4,0
Famale directors in BoD	0,3	0,4
Corporate Governance	7,0	8,7
Corporate Behavior	7,8	6,9
Product Safety & Quality	0,9	2,1
Anticompetitive Practices	5,0	5,0
Business Ethics & Fraud	5,0	5,0
Carbon Emissions	10,0	10,0
GHG Emissions Intensity 2022	10,7	20,0

(Source MSCI)

Figure 18: ESG performance between British American Tobacco and Philip Morris International

In the current fiscal landscape, Philip Morris International (PMI) maintained its BBB rating from 2022, supported by consistent environmental, social and governance (ESG) metrics. In contrast, British American Tobacco (BAT) showed a better ESG profile, moving from a BBB rating in 2022 to A in 2023, thus outperforming PMI in terms of ESG progress.

For the 2023 ESG ratings, PMI scored 3.9, while BAT recorded a higher score of 4,5, indicating moderate ESG effectiveness for both entities. Specifically, in the environmental dimension, PMI achieved a score of 4,7. In contrast, BAT recorded a slightly lower score of 4,3. In the social sphere, PMI's performance was particularly weak, with a score of 1,3, in contrast to BAT's 1,9, suggesting the latter's superior commitment to labour relations and community initiatives. On the governance front, PMI scored 6.8, while BAT excelled with 7.8, indicating stronger governance frameworks and compliance practices.

Looking at 2018 historical data, PMI's ESG score increased from 3,4 to 3,9, marking a growth of 14,71% in 5 years. BAT's score went from 4,0 to 4,5, an improvement of 12,50%. Regarding board diversity and governance, both companies showed limited progress in gender diversity on their boards, with PMI at 0,3 and BAT at 0,4. In addition, BAT showed gender diversity on their Boards with 41,70% women compared to 30,80% of PMI. Furthermore, BAT showed a stronger governance score of 8,7 compared to PMI's 7,0. However, PMI scored higher in corporate behaviour (7,8), indicative of higher ethical business conduct compared to BAT's 6,9.

Regarding product safety and quality metrics, PMI's low score of 0,9 contrasts with BAT's 2,1. Then both companies scored 5,0 in anti-competitive practices and business ethics, reflecting similar challenges in these governance aspects. Environmental impact assessments showed that both companies scored 10,0 for carbon emissions. In 2022, PMI's greenhouse gas (GHG) emissions intensity was noted at 10,7, while BAT's significantly higher intensity of 20.0 underlines the more substantial environmental challenges within BAT's operations.

Overall, while BAT's stronger governance and slightly superior ESG scores present it as an attractive ESG investment, its elevated GHG emissions intensity poses considerable environmental concerns. Investors with a focus on ESG considerations may find BAT's higher rating appealing, yet the environmental impact warrants careful consideration due to the substantial GHG emissions.

4.2 Implications

The interviews revealed a profound evolution in corporate management paradigms within the tobacco industry, concerning ESG and CSR practices, which give room to reflect on the current dynamics and challenges the sector is facing, opening new perspectives for analysis.

Initially, it emerged how PMI and BAT are investing significantly in the development of lower risk products, such as e-cigarettes and tobacco warming devices. This commitment not only responds to increasing regulatory pressure and market demand for safer alternatives, but also represents a strategic initiative to minimise the health impact of tobacco use. Such a transition entails a major restructuring of the company's entire value chain and raises new challenges related to market acceptance and regulatory compliance.

Furthermore, both companies emphasised the importance of continuously improving their CSR and ESG practices to enhance brand image and corporate reputation. Proactive interaction with stakeholders, which include consumers, health organisations, governments and local communities, is key to managing external pressures and aligning corporate objectives with wider social and environmental expectations.

On the environmental sustainability front, PMI and BAT are actively working to reduce the ecological impact of their operations through sustainable practices, which include reducing greenhouse gas emissions, managing water resources efficiently and minimising waste. These efforts not only improve operational efficiency but also meet global sustainability goals, such as those set out in the UN 2030 Agenda and the Paris Climate Accords.

Next is the transparent assessment and reporting of ESG and CSR-related performance, which is essential to demonstrate commitment and progress in these areas. PMI and BAT adopt a set of key performance indicators (KPIs) to monitor and report on their progress, allowing investors and other stakeholders to assess the effectiveness of their sustainable policies and practices.

Finally, the integration of sustainability initiatives has demonstrated a positive economic impact, influencing factors such as cost of capital, profitability and company growth. Investments in sustainability have also facilitated access to more favourable financing conditions, reflecting a growing market priority towards sustainability credentials.

The application of these practices in PMI and BAT not only strengthens their position in the market in terms of corporate responsibility, but also sets a benchmark for other companies in the tobacco and related sectors aspiring to integrate ESG and CSR considerations into their operations. These developments offer valuable lessons for the development of sustainable business strategies and for academic research investigating the relationship between corporate performance and sustainability.

4.3 Limitations

Through interviews with Philip Morris International and British American Tobacco, some limitations in the implementation of their ESG and CSR strategies in the tobacco sector emerged. These difficulties are mainly attributable to the inherent characteristics of their products and market expectations, outlining a number of complex challenges.

Firstly, both companies are attempting to transform their public image by distancing themselves from traditional tobacco products. However, the transition from cigarette manufacturers to pioneers of low-risk products is proving extremely difficult. Persistent negative perceptions associated with the tobacco industry can undermine efforts to renew corporate image and undermine the credibility of CSR and ESG initiatives, despite a significant commitment to greater transparency and accuracy in reporting.

Furthermore the use of KPIs to track progress towards sustainability goals presents challenges. The actual measurement of environmental and social impacts is complex and often ambiguous due to the absence of uniform standards in metrics and assessment methods. This makes it difficult for external stakeholders to accurately assess the effectiveness of company policies.

Then there is the persistent consumer dependence on traditional tobacco products. Despite efforts to offer less harmful alternatives, such as e-cigarettes and tobacco warming devices, companies face a moral and operational dilemma: they have to balance the pursuit of profit with social responsibility and risk reduction.

Finally, stringent global tobacco regulations and increasing pressure from stakeholders for more sustainable and responsible business practices can impose significant limits on business operations and influence product strategies. The need to adapt to different regulatory frameworks and to actively participate in dialogue with public authorities requires a considerable commitment of resources and may divert attention from other strategic initiatives.

These constraints underline the importance of careful management and constant efforts to overcome both internal and external obstacles. It is crucial to ensure that the evolution of business practices is consistent with the principles of sustainability and social responsibility, emphasising the need for a well-considered and proactive business strategy.

CONCLUSION

The research conducted in this thesis sought to answer the central question: "*How ESG and CSR influence performance in the Tobacco sector?*". Through a detailed analysis of ESG and CSR practices in major tobacco companies, in particular Philip Morris International (PMI) and British American Tobacco (BAT), it became clear that these practices play a crucial role in determining corporate performance.

The adoption of ESG and CSR initiatives has been shown to have a significant positive impact on the financial performance and sustainability of tobacco companies. PMI and BAT, two of the major market players, have integrated ESG and CSR practices into their operational strategies to improve efficiency, reduce risks and strengthen stakeholder relations. This was evident in their efforts to switch to lower risk products, increase transparency in their relationships and actively collaborate with healthcare organisations and regulators.

Specifically, Chapter 4 analysed the results of interviews with industry experts, revealing how PMIs and BAT measure and monitor progress towards ESG and CSR goals. Both companies use a variety of key performance indicators (KPIs) to assess the impact of their initiatives on the environment, employees and customers. For example, BAT has committed to achieving carbon neutrality in its direct operations by 2030, while PMI has developed specific tools such as Business Transformation Metrics and the Sustainability Index to monitor progress towards the elimination of traditional cigarette production.

The analysis of environmental practices showed that both companies are committed to reducing the environmental impact of their operations. BAT has placed particular emphasis on reducing greenhouse gas emissions and sustainable water management, while PMI has implemented a strategic plan until 2025 that includes specific targets to minimize the environmental and social impact of its operations.

From a social perspective, both companies have addressed concerns about tobacco use by promoting low-risk products and adopting responsible marketing practices to adequately inform consumers about the associated risks. The interviews revealed that BAT and PMI seek to maintain an open dialogue with stakeholders to improve their reputation and ESG performance, increasing investments in reduced-risk products and improving transparency in their dealings.

On the economic front, ESG and CSR initiatives have had a positive impact on companies' financial performance. The integration of sustainable practices has helped reduce the cost of capital, improve profitability and stimulate growth through more sustainable operating practices. For example, PMI highlighted how a significant portion of its revenues are derived from smoke-free products, demonstrating the direct impact of sustainable practices on financial performance.

Business diversification emerged as a key strategy to reduce dependence on traditional tobacco products and to address ethical and social concerns. BAT invested in modern products such as e-cigarettes and tobacco heating products, while PMI outlined a clear strategy to transform its business model by 2030, significantly reducing dependence on traditional combustion products.

Despite the positive results, the path towards greater sustainability is full of challenges. The tobacco industry continuously faces criticism and pressure from health organizations, governments and consumer advocacy groups. Transparency, effective commitment to public health objectives and continuous adaptation to regulatory changes are essential to maintain legitimacy and social license to operate. The study emphasized the importance of an ongoing dialogue with stakeholders and a proactive approach to addressing social and environmental concerns.

Furthermore, BAT focuses mainly on carbon neutrality and the reduction of environmental impacts, while PMI is committed to a business transformation, aiming at the elimination of traditional cigarette production.

In conclusion, the influence of ESG and CSR practices on tobacco companies' performance is profound and multifaceted. By aligning corporate strategies with sustainability and social responsibility, tobacco companies not only can improve their financial performance, but also can contribute to broader social goals. The findings of this thesis offer important insights for policymakers, investors and business leaders, highlighting the importance of ESG and CSR practices in driving sustainable growth and ethical business practices in the tobacco industry. Future research should continue to explore the evolving landscape of ESG and CSR practices, particularly to emerging trends and regulatory developments, to further understand their long-term impacts on the tobacco industry.

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APPENDIX 1

General questions

1. How does your company measure and monitor progress towards ESG and CSR goals? What performance indicators do you use to assess the impact of your initiatives and operations on the planet, employees and customers?

   Business Transformation Metrics: *To make our progress toward achieving our purpose of becoming a smoke-free business both measurable and verifiable, we developed our Business Transformation Metrics, a bespoke set of financial and nonfinancial key performance indicators (KPIs). These metrics showcase how we are allocating resources away from our legacy business as we advance toward a future in which we will no longer base our success on making or selling cigarettes. By transparently reporting periodically on these KPIs–sharing both year-on-year and cumulative progress–we enable external scrutiny and allow our stakeholders to assess the pace and scale of our transformation. For all our Business Transformation Metrics, we aim to report our historical performance, ensuring a consistent scope and calculation methodology, and we strive for external assurance. In 2023, 14 out of 15 Business Transformation Metrics were subject to external assurance by our independent auditor, PwC, confirming that our transformation is both measurable and verifiable. You can review the metrics on page 25 of PMI's Integrated Report 2023.*

   Our 2025 Roadmap: *PMI's 2025 Roadmap outlines our key goals and informs the route of our company's long-term plan. Running to the end of 2025, it comprises 11 headline goals, each connected to our eight strategies, which aim to address the priority ESG topics identified by our sustainability materiality assessment. You can learn more about this mapping exercise in our 2021 Sustainability Materiality Report. Our Roadmap offers straightforward direction to our stakeholders by clearly outlining the social and environmental impacts we aim to achieve with our strategies in relation to both our products and our operations. You can review the Roadmap on pages 28-29 of PMI's Integrated Report 2023.*

Sustainability Index: *In 2021, we developed PMI's Sustainability Index to measure objectively and communicate rigorously progress toward our aspirations, using a set of clearly defined and verifiable metrics. Our Sustainability Index comprises KPIs that are aligned with our 2025 Roadmap. In 2022, to better align with shareholder and other stakeholder expectations, the Compensation and Leadership Development Committee of PMI's Board of Directors decided to enhance the Company's practices, explicitly strengthening the link between long-term executive compensation and sustainability performance. For that purpose, our Sustainability Index was linked to part of our performance share unit (PSU) award and represents 30 percent of its total for the 2022–2024 performance cycle. You can review the Index on pages 34-35 of PMI's Integrated Report 2023.*

Aspirations: *Our complete set of sustainability-related performance indicators—alongside our respective aspirations, where applicable—can be found in the Reporting and performance section of PMI's Integrated Report 2023 and are available for download on PMI.com*

2. What were the main obstacles or challenges you encountered in pursuing ESG and CSR objectives within the tobacco industry and how did you address them?

   We discuss key challenges at the start of the "Progress in 2023" section for each of our eight impact areas in PMI's Integrated Report 2023.

Environment

3. How do you think the tobacco sector can impact significantly to global sustainability goals, such as those set by the UN 2030 Agenda and the Paris Climate Agreements? How do you intend to cooperate with other sectors and stakeholders in order to pursue shared goals?

   We considered the UN Sustainable Development Goals (SDGs) in preparing this report. They are mapped to our 2025 Roadmap and in PMI's Sustainability Materiality Assessment 2021 Report, to showcase how our *company goals seek to align with those SDGs we believe we can contribute toward.*

4. How is your group working to address environmental issues in the tobacco sector? What are the main environmental objectives you have set and how do you intend to achieve them?

   Our 2025 Roadmap discussed previously outlines our key objectives and the overarching targets we have for each area of our strategy, including those related to environmental issues. The "Reduce post-consumer waste," "Tackle climate change," and "Preserve nature" sections of our report highlight specific environmental-related aspirations, management approaches, and overviews of progress.

5. How has your focus on environmental issues influenced your investment and product development decisions and how have these decisions contributed to creating value for the company and stakeholders?

   The clearest example is with regards to eco-design, circular devices, and end-of-life take-back programs of consumables all detailed in the "Reduce post-consumer waste" section.

Society

6. What measures are you taking to diversify your product portfolio beyond traditional tobacco? How is your company coping with the transition to less harmful products, such as e-cigarettes or tobacco heating products?

   Our report extensively details the measures we are taking. Specifically, by 2030 we aspire to have 2/3 of our adjusted net revenues coming from smoke-free products. The "Maximize the benefits of smoke-free products" and "Purposefully phase out cigarettes" sections outline key measures.

   For the second question, by email, you clarified, "I mean like what are PMI's plans to switch to less 'harmful' products, for example e-cigarettes or tobacco warming products." In 2016, we were the first company to announce its smoke-free vision and commitment to phasing out cigarettes, encouraging *adults who would otherwise continue to smoke to switch completely to better alternatives. Importantly, we established Business Transformation Metrics to report progress on our transformation in a transparent manner. These metrics are described no pages 24-25 of PMI's Integrated Report 2023. Our plans are summarized in the two sections disclosed in response part a to this question.*

7. How does your company manage social concerns related to tobacco use, including public health risks and addiction? What initiatives have you implemented to mitigate these negative social impacts? And how do you address challenges related to the marketing of products that may have harmful health consequences for consumers?

   This is addressed in the "Maximize the benefits of smoke-free products" section pages 44-63 of PMI's Integrated Report 2023. Specific to marketing, please reference pages 57-61.

8. How do you respond to criticism and pressure from health organizations, governments and consumer advocacy groups regarding your social and environmental impacts? What concrete actions do you take to improve your reputation and ESG performance?

   Actively seeking open dialogue with our stakeholders allows us to understand their expectations and respond accordingly. Continuous engagement also enables us to build a shared understanding of contingency issues, proactively respond to concerns, identify potential areas of compromise, stay abreast of global trends and market expectations, and find solutions that are good for our stakeholders and business. While PMI's commitment to its transformation is unwavering, we recognize that we cannot complete the journey alone. Signed by every member of our Board of Directors, PMI's Statement of Purpose articulates our company's purpose and transparently specifies those stakeholders most critical to long-term value creation and sustainability. Our periodic sustainability materiality assessments provide valuable insights and allow us to gauge the relevance of various topics among key stakeholder groups. You can learn about why we engage, how we engage, key topics *discussed, and how we are responding to concerns all broken down by stakeholder group on our stakeholder engagement page.*

Performance and governance

9. How have efforts to improve ESG and CSR practices affected the reputation and perception of your brand by consumers and investors?

   Our effort in improving ESG and CSR practices have greatly influenced brand perception among consumers and investors. This is also thanks to the evolution of PMI's reporting, communications on the progress PMI makes to stay in line with international guidelines, which has increased transparency on the company's operations and objectives for all stakeholders. These approaches have strengthened PMI's reputation as a company committed to sustainability and social responsibility, contributing to a more positive corporate image that reflects a serious commitment to smoke-free transformation and other sustainability goals.

10. What have been the financial effects of your ESG and CSR initiatives on the company's economic performance, including factors such as cost of capital, profitability and growth?

    PMI's ESG and CSR initiatives have had significant financial impacts on the company's economic performance, including reducing the cost of capital and influencing growth and profitability, with PMI's share of total net/smoke-free revenues increasing to over 50 per cent in the year 2025, compared to the 2020 baseline of 23.8 per cent. These initiatives have helped position PMI's favourably in financial markets, attract sustainable investments and improve financing terms through sustainability-related instruments, aligning with the company's long-term objectives and stakeholder expectations.

11. How has the adoption of socially responsible policies improved employee satisfaction and engagement, and how has this affected employee productivity and retention?

You can learn about why we engage, how we engage, key topics discussed, and how we are responding to concerns all broken down by stakeholder group on our stakeholder engagement page.

12. How has your ESG strategy influenced your relations with public authorities and what impact has it had on your ability to operate in a sustainable and responsible manner?

    You can learn about why we engage, how we engage, key topics discussed, and how we are responding to concerns all broken down by stakeholder group on our stakeholder engagement page.

13. How has the integration of ESG practices into your business strategy helped to improve operational efficiency and risk management within the company? And how do you assess the effectiveness of your ESG and CSR initiatives and what metrics or performance indicators do you use to monitor progress and demonstrate value to investors and other stakeholders?

    We discuss improvements in the areas covered in the first question extensively throughout PMI's Integrated Report 2023.

    Clearly articulating progress against our aspirations and explaining how we measure progress is imperative. For internal and external stakeholders, this provides clarity on what we aim to achieve and visibility into the way forward, ensuring we hold ourselves accountable. Our complete set of sustainability-related performance indicators—alongside our respective aspirations, where applicable—can be found in the Reporting and performance section of PMI's Integrated Report 2023 and are available for download on PMI.com. We also consider performance in ESG ratings, rankings, and indices. At PMI, we understand the value of participating in ESG ratings: it helps us assess our sustainability performance, benchmark ourselves against our peers, and, most importantly, identify areas for improvement on which we act when they can meaningfully contribute to improving our Company's performance in line with our sustainability strategy.

Concluding Evaluations

14. How does your ESG strategy align with your long-term corporate vision and what are your plans to continue to improve and innovate in this area?

Transforming our company is not simply about substituting one product with another. It requires changing our entire value chain, as well as the way in which we engage with society. This has required a holistic review and overhaul of our entire business model and value proposition, which brings challenges and opportunities to all aspects of our business. Sustainability stands at the core of PMI's transformation. It spurs innovation, better positions the company for long-term success, and helps to address specific challenges stemming from our transition. Simultaneously managing the impacts of two value chains—the one we are moving away from (our cigarette portfolio) and the one we are moving toward (our smoke-free portfolio)—while also managing the impacts of the transition itself makes our strategy even more complex. Within PMI's Integrated Report 2023, our Business Transformation Metrics (pages 24-25) and 2025 Roadmap (pages 28-29) summarize how we plan to continue to improve and innovate.

APPENDIX 2

General questions

1. How does your company measure and monitor progress towards ESG and CSR goals? What performance indicators do you use to assess the impact of your initiatives and operations on the planet, employees and customers?

   We employ a number of key performance indicators (KPIs) to monitor and measure progress towards environmental, social and governance (ESG) and corporate social responsibility (CSR) goals. To assess the impact of our initiatives and operations on the planet, employees and customers, we use various tools and metrics as detailed in our annual reports and ESG performance book.

   a. ***Environment:*** *For environmental sustainability, we focus on KPIs such as greenhouse gas emission reduction, water management, and waste reduction. For example, we set clear targets for reducing CO2 emissions along the entire value chain and monitor water consumption efficiency in our operations.*

   b. ***Employees:*** *For our employees, we measure engagement, job security and diversity. We monitor accident frequency, employee satisfaction index and gender balance at various hierarchical levels, aiming to create an inclusive and safe working environment.*

   c. ***Customers:*** *Relative to our customers, we emphasise transparency and accountability in product information, measuring our commitment to research and development for low-risk products and compliance with market regulations. We use feedback and surveys to assess customer satisfaction and the acceptance of new product initiatives.*

   These indicators not only allow us to monitor our progress, but also to proactively respond to challenges and opportunities that arise in our industry, ensuring an ongoing commitment to responsible and sustainable business management. If you need additional information, we recommend you view the BAT Annual Report & Form 20-F 2023 *and* the BAT ESG Data Performance Book 2023.

2. What were the main obstacles or challenges you encountered in pursuing ESG and CSR objectives within the tobacco industry and how did you address them?

We have expanded on this topic in the section "Our ESG Roadmap" in the BAT Annual Report & Form 20-F 2023.

Environment

3. How do you think the tobacco sector can impact significantly to global sustainability goals, such as those set by the UN 2030 Agenda and the Paris Climate Agreements? How do you intend to cooperate with other sectors and stakeholders in order to pursue shared goals?

We recognise the importance of the tobacco industry in contributing to global sustainability goals, such as those set by the United Nations 2030 Agenda and the Paris Climate Accords. Therefore, we are committed to reducing the environmental impact of its operations and products through various strategic sustainability initiatives.

In particular, we aim to achieve carbon neutrality for its direct operations by 2030. This goal is supported by significant investments in low-carbon technologies and process optimisation to reduce energy consumption and greenhouse gas emissions. In addition, we promote sustainable agricultural practices and ensure the traceability and sustainability of its tobacco supply chain, as outlined in their BAT Annual and Sustainability Report 2023.

Regarding cooperation with other sectors and stakeholders, we work through partnerships and collaborations to amplify the impact of its sustainability initiatives. This includes continuous dialogue with suppliers to promote shared sustainability standards, engagement with local communities to support sustainable development projects, and collaboration with governments and non-governmental organisations to help shape sustainability-friendly policies. Through these actions and collaborations, we seek not only to respond to global environmental challenges, but also to actively contribute to the Sustainable Development Goals (SDGs) in a meaningful and measurable way.

4. How is your group working to address environmental issues in the tobacco sector? What are the main environmental objectives you have set and how do you intend to achieve them?

We are committed to reducing the environmental impact of the tobacco industry by addressing critical issues such as climate change, resource management and waste reduction. According to our BAT Annual Report & Form 20-F 2023*, one of the main goals is to achieve carbon neutrality in direct operations by 2030, through the adoption of renewable energy and energy efficiency, as well as to reduce carbon emissions across the entire value chain by 35% compared to 2017 levels.*

On waste, we aim to eliminate unnecessary plastic and make all its packaging recyclable by 2025, to achieve zero landfill waste from its operations. We work with suppliers and partners to promote sustainability throughout the supply chain, emphasising the importance of innovation and collaboration to the success of our environmental initiatives.

5. How has your focus on environmental issues influenced your investment and product development decisions and how have these decisions contributed to creating value for the company and stakeholders?

We are very attentive to environmental issues, which is why they deeply influence our investment strategies and product development. We aim for carbon neutrality in our operations by 2030 and invest in renewable energy and efficient technologies. These efforts reduce our environmental impact and align with global sustainability goals, adding value to our stakeholders and meeting consumer and regulatory expectations. Furthermore, we are expanding our portfolio of non-fuel products, responding to consumer demand for safer alternatives and reducing the environmental burdens associated with the production of traditional cigarettes. These initiatives strengthen our market position, attract ESG-focused investments, and contribute to long-term sustainable growth, benefiting both the company and its stakeholders.

Society

6. What measures are you taking to diversify your product portfolio beyond traditional tobacco? How is your company coping with the transition to less harmful products, such as e-cigarettes or tobacco heating products?

We are actively diversifying our product portfolio beyond traditional tobacco products to include a broader range of reduced risk products (RRPs). According to BAT Annual Report & Form 20-F 2023*, we have invested significantly in the development and marketing of products such as e-cigarettes and tobacco heating products within our "New Categories" business segment on page 20. This segment includes, among others, Vuse (our global vaping brand), Glo (our tobacco heating product) and Velo (our modern oral product).*

We are managing the transition to these less harmful products by focusing on innovation and safety. Our scientific research and product management are geared towards reducing the health impacts associated with our products, as shown on page 15. We are committed to high safety and quality standards in the development and marketing of our RRPs, seeking to ensure that they meet regulatory requirements and consumer expectations for reduced risk alternatives.

This strategy is part of our broader transformation programme to build "A better tomorrow". This includes not only reducing the health impact of our business, but also addressing the expectations of our consumers and stakeholders who are increasingly seeking safer alternatives to traditional tobacco products as explained on page 10.

7. How does your company manage social concerns related to tobacco use, including public health risks and addiction? What initiatives have you implemented to mitigate these negative social impacts? And how do you address challenges related to the marketing of products that may have harmful health consequences for consumers?

We are aware of the social concerns related to tobacco use, including public health risks and addiction. Our approach to addressing these issues is *multifaceted and focuses on harm reduction, responsible marketing and transparent communication.*

a. *Our goal is to develop and promoting a range of potentially reduced risk products (PRRPs). We aim to offer less harmful alternatives to traditional smoking by investing in vaping, tobacco heating and modern oral products that are scientifically proven to be less risky.*
b. *We follow strict marketing standards to target adults only, complying with local laws and adopting internal policies that exceed legal requirements to ensure responsible communications.*
c. *We communicate transparently, including health warnings and information on the risks of tobacco in our marketing materials and packaging to adequately inform consumers of the associated dangers.*
d. *We meet the challenges of responsible marketing with sound principles that avoid targeting non-smokers or minors. We maintain an ongoing dialogue with stakeholders, health authorities and regulators to align our marketing strategies with social expectations and harm reduction.*

As you can read more in the BAT Annual Report & Form 20-F 2023 *we are committed to reducing the social impact of tobacco use through the innovation of safer alternatives with the aim of reducing health risks.*

8. How do you respond to criticism and pressure from health organizations, governments and consumer advocacy groups regarding your social and environmental impacts? What concrete actions do you take to improve your reputation and ESG performance?

In response to criticism and pressure from health organisations, governments and consumer advocacy groups about our social and environmental impacts, British American Tobacco (BAT) takes concrete steps to improve our reputation and ESG performance. We actively engage in dialogue with all stakeholders to better understand their concerns and adapt our strategies accordingly. This is part of our broad commitment to stakeholder engagement*, as outlined in our approach to sustainability.*

To specifically address health concerns, we have intensified investment in research and development of reduced risk products to offer safer alternatives to tobacco users. This commitment is highlighted in our BAT Annual Report & Form 20-F 2023, *where we discuss progress and innovation in this area.*
Environmentally, we have implemented initiatives to reduce carbon emissions, sustainably manage water resources and reduce waste, as reported in our BAT ESG Data Performance Book 2023. *These efforts demonstrate our commitment to mitigating the environmental impact of our operations.*
In addition, we continue to work to improve our transparency and ESG reporting, ensuring that we communicate openly and honestly about our progress and the challenges we face in order to build trust and strengthen our long-term reputation.

Performance and governance

9. How have efforts to improve ESG and CSR practices affected the reputation and perception of your brand by consumers and investors?

Our robust ESG and CSR initiatives have notably enhanced our brand reputation among consumers and investors, as detailed in our 2023 reports. Consumers increasingly recognize our commitment to environmental sustainability and social responsibility, as we've implemented practices such as sustainable sourcing and reduced carbon emissions. These actions align with consumer values and have positively shifted perception towards our brand. For investors, our integration of ESG criteria into our operations, as reported in our Form 20-F 2023, has made us a more attractive investment. This is due to our focus on governance, transparency, and growth opportunities in reduced-risk products, which fosters trust and highlights our proactive approach in addressing industry challenges. Overall, our increased focus on ESG and CSR practices has significantly contributed to a more favourable reputation among both consumers and investors, as demonstrated in the BAT Annual Report & Form 20-F 2023 *and the* BAT ESG Data Performance Book 2023.

10. What have been the financial effects of your ESG and CSR initiatives on the company's economic performance, including factors such as cost of capital, profitability and growth?

We have been steadfast in integrating ESG and CSR initiatives into our business model, recognizing their profound impact on our overall economic performance. Firstly, our commitment to ESG principles has positively influenced our cost of capital. By maintaining high standards in environmental protection, social responsibility, and governance, we have bolstered our reputation and trust among investors and stakeholders. This has, in turn, facilitated better access to capital markets and often at more favorable conditions. Investors are increasingly looking to allocate capital towards companies with robust ESG credentials, and we believe our strong performance in these areas has made us an attractive investment opportunity. Regarding profitability, our ESG and CSR initiatives have also had a notable impact. By focusing on sustainable practices, such as reducing our environmental footprint and improving operational efficiencies, we have managed to lower costs over time. For example, energy efficiency measures and waste reduction have led to significant savings across our operational activities. These savings contribute directly to our bottom line, enhancing profitability. Moreover, our growth trajectory has been positively influenced by our commitment to ESG principles. Our focus on innovation, particularly in developing potentially reduced-risk products (PRRPs), aligns with growing consumer demand for alternative and less harmful products. This strategic focus not only meets consumer expectations but also opens new markets and growth opportunities for us. It is a key component in our drive towards achieving a better tomorrow, which involves transforming our business to emphasize sustainability and responsibility. In summary, our ESG and CSR initiatives are integral to our economic performance, positively affecting our cost of capital, profitability, and growth. These efforts are not just about doing the right thing; they are also about driving sustainable value for our shareholders and stakeholders alike. If you would like to explore this topic further, we refer you to the BAT ESG Data Performance Book 2023.

11. How has the adoption of socially responsible policies improved employee satisfaction and engagement, and how has this affected employee productivity and retention?

Socially responsible policies have improved employee satisfaction and commitment, increased employee motivation and productivity and strengthened employee loyalty. This is reflected in higher retention rates. Details on how we manage these dynamics can be found on our stakeholder engagement webpage.

12. How has your ESG strategy influenced your relations with public authorities and what impact has it had on your ability to operate in a sustainable and responsible manner?

Our ESG strategy has strengthened our relations with public authorities, enhancing our approach to sustainable and responsible operations. This impact is reflected in our interactions with various stakeholder groups, including details on how we engage, why we do so, and the key issues discussed. For more information on how we respond to concerns in this area, please visit our stakeholder engagement page.

13. How has the integration of ESG practices into your business strategy helped to improve operational efficiency and risk management within the company? And how do you assess the effectiveness of your ESG and CSR initiatives and what metrics or performance indicators do you use to monitor progress and demonstrate value to investors and other stakeholders?

The integration of ESG practices into our business strategy has significantly improved operational efficiency and risk management. We have taken a proactive approach to reducing our environmental footprint and improving sustainability, which has resulted in increased energy efficiency and reduced operating costs, as evidenced by the decrease in water and energy use per unit of production in the BAT Annual Report & Form 20-F 2023.

To assess the effectiveness of our ESG and CSR initiatives, we use a number of performance indicators that include reductions in CO2 emissions, occupational injury rates, and employee engagement levels. These indicators allow us not only to monitor internal progress, but also to demonstrate the value of our initiatives to investors and other stakeholders. Transparency in our results and the impact of our actions are key to building trust and sustaining long-term value for our shareholders, as explained in the BAT ESG Data Performance Book 2023.

This strategic focus on sustainability and corporate social responsibility strengthens our ability to manage risk, improves regulatory compliance and increases our competitiveness in the global marketplace, benefiting both the environment and the communities in which we operate.

Concluding Evaluations

14. How does your ESG strategy align with your long-term corporate vision and what are your plans to continue to improve and innovate in this area?

Our ESG strategy is fundamentally embedded in British American Tobacco's long-term vision of building a better, more sustainable company. We focus on environmental, social and governance impacts to support our aspiration to reduce the impact of our business and promote positive change.

As mentioned earlier, on the environmental side, we are committed to achieving carbon neutrality in our direct operations by 2030, as repopulated in the BAT Annual Report & Form 20-F 2023.

On the social front, we are working to improve the lives of farmers and the communities we interact with. This includes initiatives to ensure fair labour practices, improved living conditions and access to education in rural communities as outlined in the BAT ESG Data Performance Book 2023.

In terms of governance, we continue to strengthen our transparency and accountability, with a particular focus on adhering to the highest standards of integrity and ethical behaviour across our global operations.

To continue to improve and innovate, BAT invests significantly in research and development, particularly to develop and refine reduced-risk products, *contributing to our vision of a future where fewer people use high-risk tobacco products as explained in the* BAT Annual Report & Form 20-F 2023*. These efforts show our commitment to an ESG strategy that not only respects but anticipates the expectations of our stakeholders and the markets in which we operate.*