

# An Overview Of The Effects Of ESG On The Financial Performance Of Companies From Various Angles

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**Abstract.** An overview of the relationship between corporate financial performance (CFP) and environmental, social, and governance (ESG) concerns is given in this study from three angles: based on different industries, the impact of ESG dimensions, and the national development level. By reviewing and synthesizing the existing literature to examine how ESG performance affects a company's financial performance from various aspects. The analysis considers different ESG components, industry sectors, and the development of the country to provide an understanding of this relationship. The findings indicate that even though financial performance often benefits from ESG, the nature and degree of this association can vary significantly depending on the situation. This review will help the companies analyze their input cost on the ESG performance.

**Keywords:** ESG; Corporate financial performance; Review.

## 1. Introduction

Urbanization and industrialization have a negative impact on the environment [1]. Depletion of resources, harm to the environment, and the conventional model of economic development characterized by high pollution and excessive consumption are unsustainable. [2]. Enterprises need to shift to a more sustainable development mode, and relevant industries need to use resources more effectively and develop renewable resources to promote sustainable development. The concept of sustainable development is put forward in order to cope with the environmental, economic, and social challenges facing the world, and to seek a path of harmonious coexistence between man and nature and coordinated development of economy and society [3]. Sustainable development has become an international consensus global climate change is very extreme, governments and regulators have introduced several policy measures aimed at promoting companies to enhance ESG disclosure [3], including the Corporate Sustainability Reporting Directive (CSRD), which was enacted by the European Union in 2022, mandates that all major and listed firms operating in the EU make ESG disclosure mandatory starting in 2024. Data on climate-related hazards and greenhouse gas emissions would have to be disclosed by traded corporations, according to draft regulations that the U.S. Securities and Exchange Commission (SEC) proposed in 2022. The China Securities Regulatory Commission issued the "Special Self-Regulatory Rules on Corporate Governance" in 2022 to further clarify the requirements for ESG disclosure. The Environmental Risk Management Guidelines were released by the Monetary Authority of Singapore, which require banks and asset management companies to disclose environmental risk information.

An organization's CFP has a significant impact on its ability to survive and grow, as well as on the returns it generates for creditors and shareholders, fosters technological innovation, and supports the social economy's overall health. Therefore, as ESG investment concepts and practices continue to gain momentum globally, more and more investment institutions and companies are incorporating ESG factors into their decisions [4]. The central objection to ESG is that it may be a distraction from the primary role of the business [5]. This draws attention to how ESG affects the financial success of businesses. Does a business's financial success and its ESG performance correlate, positively or negatively? The existing academic results are not universal due to disparities in study approaches between ESG performance and financial performance. This paper aims to summarize the relationship

between ESG and CFP from different research perspectives and provide a reference for this complex issue.

## **2. The Relationship Between ESG Performance And CFP**

The idea of sustainable development emerges and gains traction from all sectors of society as a result of escalating global issues including resource depletion and environmental degradation. The ESG concept provides a systematic operational framework for achieving sustainable development and takes into account the impact of ESG on enterprises, which has attracted the attention of the academic community. Domestic and foreign experts use ESG as the basis for research and analyze and quantify the impact of ESG performance on CFP from multiple perspectives. Overall, the findings showed that CFP is greatly impacted by ESG disclosure practices, both directly and indirectly [6]. The majority of research has indicated a favorable correlation between an organization's financial performance and its ESG performance.

## **3. Different Aspects**

There are many aspects of the analysis of ESG's impact on finance performance. For example, industry differences, enterprise life cycles, the impact of ESG dimensions, differences in financial indicators, and the effectiveness of different ESG initiatives may also vary according to the economic development level of the country in which the company is located [7]. The following is a summary of ESG's conclusions on CFP based on the different aspects mentioned above.

### **3.1. Different Industries**

Industry-specific variations may exist in how ESG reporting influences corporate economic outcomes. Furthermore, the link between CFP and ESG disclosure procedures is complicated and may be non-linear. The main finding and general interpretation are that, at periods of both regularity and economic and financial turmoil, ESG information disclosure improves the CFP of the SP-500 index. This finding has important implications for investors, business managers, legislators, and industry regulators [6]. The effect that an industry's ESG practices have on a company's worth varies [8].

#### **3.1.1. Positively Related**

According to the present research findings, there are still notable differences in the correlation between financial performance and ESG performance. Some scholars have proposed that good ESG performance has a positive role in promoting business performance. Businesses that use eco-friendly production techniques might enhance the caliber and reputation of their goods, increase the added value of products, strengthen the trust and goodwill of customers and investors, help improve the social image and reputation of businesses, and contribute positively to the financial performance of businesses. According to the study, business performance in the international hospitality sector is positively impacted by ESG standards. Adopting ESG practices can improve profitability over time by reducing waste, increasing efficiency in the utilization of resources, and lowering overhead. Incorporating ESG principles into the core strategy of the hospitality industry may enhance brand reputation, drive customer loyalty, and potentially lead to cost savings [7]. One study's primary focus was on non-financial sector businesses that were listed between 2019 and 2021 on the Indonesian Stock Exchange. Annual observations from 2,169 companies were used and STATA was used for multiple linear regression analysis. One of the key conclusions is that business financial success and ESG scores significantly positively correlate. Companies with higher ESG scores typically exhibit greater scale and higher profitability. The findings underscore that a true commitment to ESG principles not only improves a company's performance but also increases its attractiveness to investors [8]. Ren Zixian et al. connected environmental conservation with economic development and improved the indicators by combining them with information from listed businesses' annual reports in China's highly polluting industries and discovered a substantial positive correlation between the economic value added (EVA) and the enterprise's ESG performance, and businesses' economic

results improved when they performed well in ESG [9]. Using businesses in emerging economies as research subjects, Negar and Turhan (2021) demonstrate that businesses with higher ESG performance scores are more profitable [10].

### **3.1.2. Negatively Related**

Some other scholars hold the opposite view, believing that investment in ESG activities requires enterprises to pay certain costs, including capital, manpower, and time, which may exert certain pressure on the short-term business performance of enterprises and affect their financial performance [11]. In addition, other studies have shown that the operations of businesses are not much impacted by ESG performance [12]. This conclusion further intensifies the uncertainty of the academic community regarding the connection between ESG and financial success, which will inevitably affect the enterprises' active practice of the ESG concept.

Using multiple regression analysis, Shrabanti Pal looked at the connection between ESG rankings and the financial success of Indian listed automakers. Statistical analysis reveals a significant negative correlation between automotive firms' ESG ratings and their financial performance metrics. This indicates that poorer financial success is linked to higher ESG ratings [13]. More than 2,000 publications on CFP and ESG criteria were collected by Friede et al. for their study and discovered that more than 90% of the papers showed a favorable correlation between ESG and financial outcomes and expressed the opinion that, after a while, the Impact of ESG on financial outcomes would progressively grow [14].

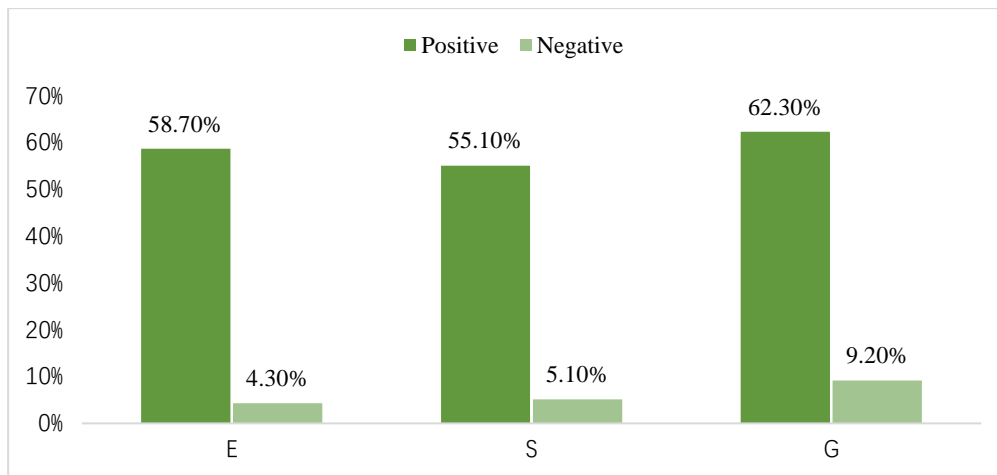
### **3.2. The Impact of ESG Dimensions**

Investigate how Environmental, Social, and Governance (ESG) aspects affect the financial results of businesses by dissecting each element independently. This approach allows for a detailed assessment of how individual ESG dimensions affect corporate economic performance. There is a study looked at 85 European companies in the energy sector, covering the period from 1995 to 2020, with a total of 911 company annual observations. The study used two different modeling methodologies to examine the impact of ESG issues on the financial outcomes of energy enterprises in the EU. When assessing ESG subcomponents separately, environmental responsibility was discovered to adversely impact financial performance. Conversely, corporate social responsibility and governance responsibility are positively correlated with corporate financial performance, but not significantly [15].

In the environmental dimension: utilizing the System Generalized Method of Moments (SYS-GMM) technique, the study generated a dynamic panel data model utilizing a final sample of 281 businesses and 2,829 observations from 2010 to 2019. The outcome demonstrated the significance of the environmental dimension using Tobin's Q measure [6].

In the social dimension: better corporate social performance will significantly improve company financial performance. Businesses that invest more in the environment are more profitable than those that don't care as much about the environment [16].

In the governance dimension: by analyzing data from 38 airlines around the world from 2009 to 2019, it was shown that the market value to book ratio of the firm is positively impacted by the inclusion of governance initiatives. Across the sample of 644 studies, based on vote count studies where ESG categories could be identified, all three ESG factors show a relatively even positive relationship with Corporate Financial Performance. However, when accounting for both positive and negative correlations: Governance (G) factors have the strongest positive relationship with CFP, at 62.3% of all cases, despite having both the highest positive and negative correlations. Environmental (E) factors have the second strongest positive relationship, at 58.7%. Social (S) factors at 55.1%, thus having the weakest relationship (Fig. 1) [14].



**Fig. 1** The relationship between the E, S, and G categories and CFP [14]

### 3.3. National Development Level

In advanced economies, the financial performance of healthcare organizations is positively impacted by ESG initiatives. In economies that are still developing, however, the relationship may be negative or insignificant. The findings have implications for both practitioners and policymakers. It highlights particular circumstances in which a company's financial success and its ESG activities may have a negative or negligible relationship [17].

## 4. Conclusion

It is not conceivable to summarize the relationship in general between financial success and ESG ratings. The link between CFP and ESG disclosure procedures is intricate. How ESG Affects CFP varies significantly across different industries, ESG dimensions, and national development levels, highlighting the importance of context-specific analysis. Different ESG components can have varying effects on financial metrics, with some studies showing positive impacts for all components, while others find mixed results. In terms of industry differences, observed that ESG performance positively influences CFP in sectors such as healthcare and technology, particularly in developed economies. However, in more traditional or resource-intensive industries, the relationship can be negative or insignificant, especially in developing markets. This disparity underscores the need for industry-specific ESG strategies and performance evaluations. Examining individual ESG dimensions, environmental factors generally show a positive correlation with CFP, reflecting growing market recognition of eco-friendly practices. Social factors demonstrate mixed results, with positive impacts often seen in areas like employee satisfaction and community relations. These findings have significant implications for corporate strategy, investment decisions, and policymaking. Companies should tailor their ESG strategies to their specific industry and operational context, while investors need to consider these nuances in their ESG-based investment decisions. Policymakers, especially in developing countries, should work towards creating supportive frameworks that align ESG practices with financial performance.

To further understand the long-term effects of ESG on CFP, longitudinal studies should be the main focus of future study, as well as explore the mechanisms through which ESG factors influence financial outcomes in different contexts. Additionally, developing more standardized and comprehensive ESG measurement tools could enhance the comparability and reliability of ESG-related financial analyses across different industries and countries.

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